BANK ISLAM

MONTHLY ECONOMIC UPDATE

3 MAY 2024

ECONOMIC RESEARCH

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KEY TAKEAWAYS

- **The Fed signals that interest rates will stay elevated for a longer period.** In line with broad consensus, the U.S. Federal Reserve (Fed) has opted to maintain the Fed funds rate (FFR) target range at 5.25%-5.50% at the conclusion of its May meeting as inflation continues to run hot. Fed Chair Jerome Powell has said that it will take longer than previously expected for policymakers to gain confidence that inflation will return sustainably to the 2.0% target, implying that rate cuts would be deferred. For record, Fed policymakers had expected to cut interest rates three times this year. While giving little clues about the timing of the first rate cut, the Fed has ruled out any further rate hikes to counter the recent uptick in inflation. Fed fund futures showed the market is currently pricing in two rate cuts this year, with a roughly 60.0% chance the first cut would take place in September.

- **The ECB signals rate cut is coming.** The European Central Bank (ECB), as widely expected, held its interest rates steady at record highs for a fifth consecutive meeting in April. However, there was a dovish tweak to the policy statement in which it flagged a possible rate cut for the first time amid signs of stable inflation. ECB President Christine Lagarde also revealed that a few policymakers had already expressed support for a rate cut, leading to a market perception that the policy meeting overall was paving the way for a rate cut at the next meeting in June. Nevertheless, the ECB’s scope for further rate cuts could be constrained given the risks of inflation reaccelerating alongside the U.S. despite Lagarde pushing back the idea that the ECB plans to keep rate cuts in line with the Fed.

- **China’s 1Q2024 GDP growth beat expectations.** China’s economy grew 5.3% in the 1Q2024, faster than the 5.2% expansion in 4Q2023 and above consensus expectations of 4.6%. Growth was in part driven by the strong fixed asset investment, which recorded a growth of 4.5% in the said quarter (January-February: 4.2%) amid increased fiscal investments toward infrastructures. The unexpected pick-up in GDP growth puts the economy on path to achieve its 5.0% growth target for this year and offers relief to the policymakers as they seek to support the economic growth in the face of a protracted property downturn and mounting local government debt. Indeed, the People’s Bank of China (PBoC) has left its interest rates unchanged following the encouraging GDP report.

KEY TAKEAWAYS

- **The BI steps up efforts to stem currency weakness via a rate hike.** The hike, which was Bank Indonesia's (BI) first since October 2023, raised the benchmark seven-day reverse repo rate by 25 basis points to 6.25%, marking its highest level since the instrument became the main policy rate in 2016. The rate hike decision came as no surprise as BI has been intervening to support the Indonesian Rupiah, which has slid past 16,000 per USD – the weakest level since 2020. Rupiah weakness was driven by risk-off sentiment as Fed rate cut expectations receded and as President-elect Prabowo Subianto's populist policies raised concerns about the country's fiscal deficit. However, the rate hike is unlikely to be the start of another prolonged rate tightening cycle given the slowing growth.

- **The Malaysian economy got off to a strong start in 2024.** Advance estimate by the Department of Statistics Malaysia (DOSM) showed Malaysia's GDP expanded by 3.9% in 1Q2024, improving from 3.0% in 4Q2023. All main sectors registered positive growth in the said quarter, led by a 4.4% increase in the services sector, reflecting a robust domestic demand. In the meantime, the latest trade data showed Malaysia's exports rebounded by 2.2% in 1Q2024 (4Q2023: -6.9%) after recording three consecutive quarters of contraction, suggesting that the drag from net trade on overall growth is fading. Malaysia's GDP growth will likely pick up pace in the quarters ahead, aided by sustained public sector infrastructure investments, the recovery in electrical and electronics products (E&E) exports, higher tourist arrivals, domestic demand resilience underpinned by stronger investment growth, as well as the onset of low-base effect. Still, Malaysia will have to contend with potential inflationary impact of the winding back of fuel subsidies, as well as global uncertainties surrounding the geopolitical tensions in Middle East, for instance. While Malaysia's trade and tourism incomes have relatively low exposure to the Middle East economies, slower global GDP growth and trade could impact Malaysia's external demand and investment income.

SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: HONG KONG STOCKS OUTPERFORMED ALL OTHER GLOBAL STOCKS INDICES IN APRIL

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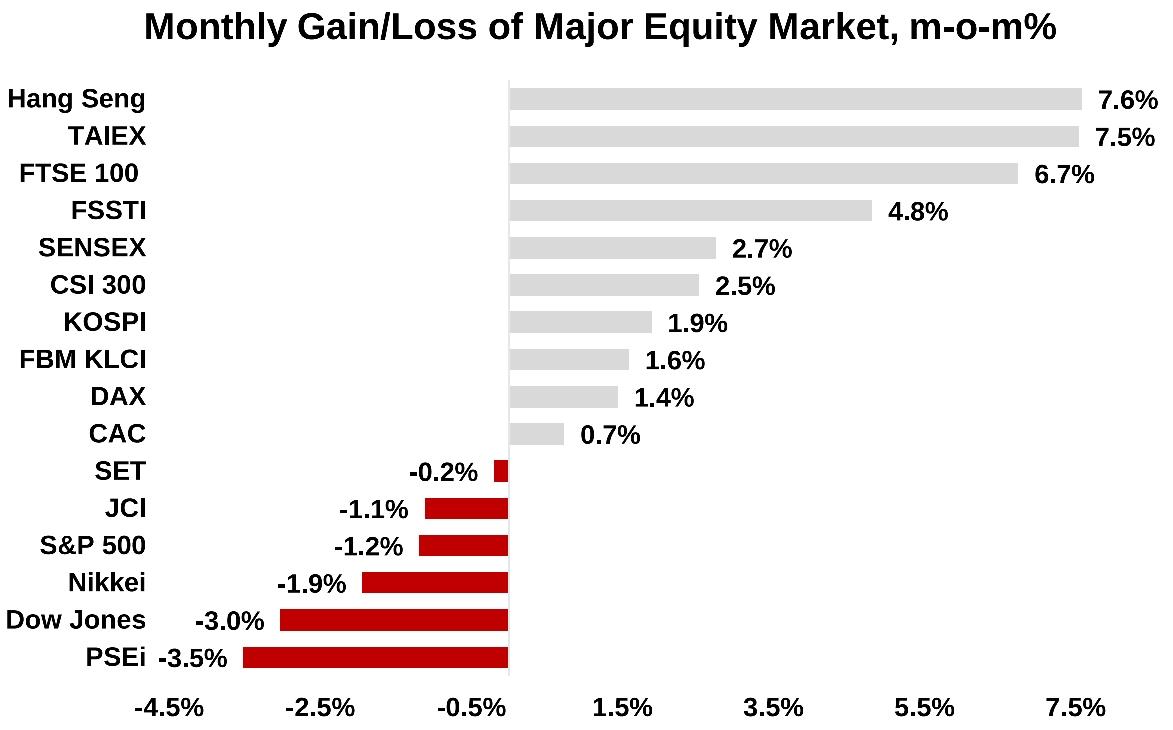

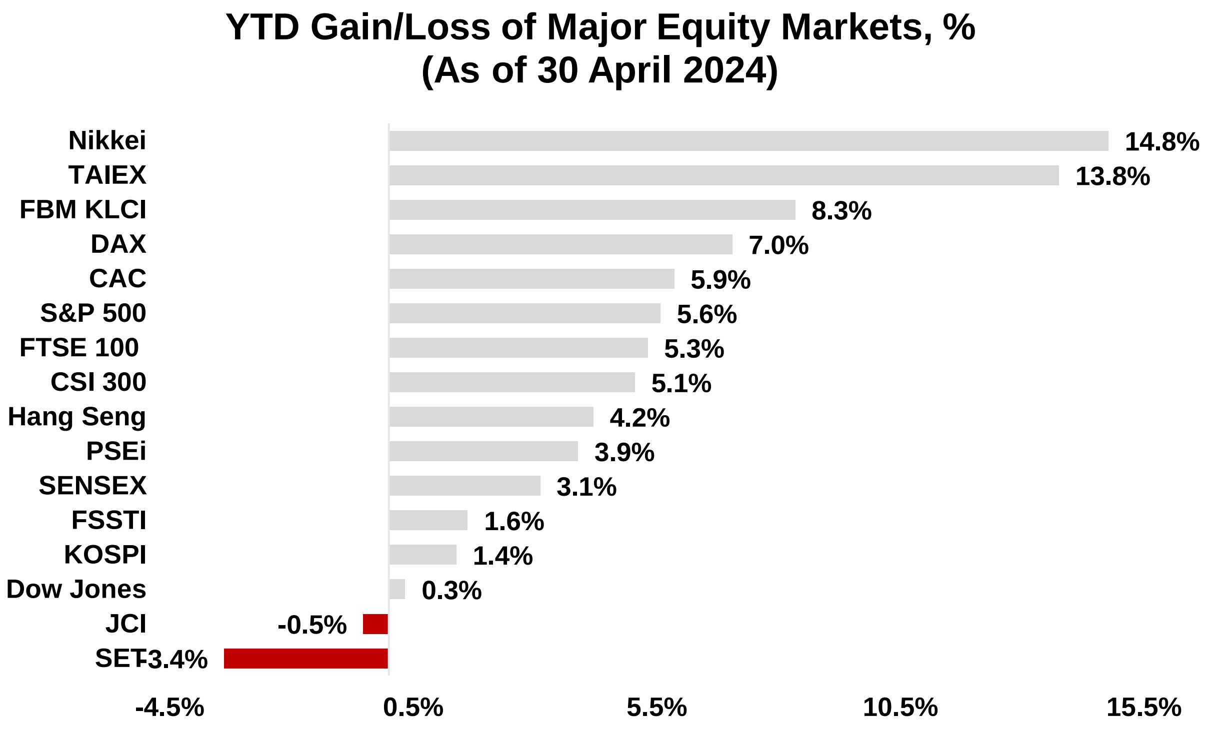

Sources: Bursa, CEIC data

- Hong Kong's Hang Seng (+7.6%) emerged as the top performer among major global indices in April, buoyed by strong earnings from leading Chinese companies and recent supportive government measures. In addition, a stronger-than-anticipated 1Q2024 GDP performance for China's economy helped propel the investor sentiment further.
- Meanwhile, U.S. stocks – Dow Jones (-3.0%) and S&P 500 (-1.2%) slumped as markets wrestled with economic data presenting both rising labour costs and falling consumer confidence with the Fed interest rate decision looming.
- For the first four months of the year, Japan's Nikkei was the top performer, leading with a 14.8% gain as the weakness in Japanese yen buoyed the outlook for corporate profit.

FIXED INCOME: YIELDS ELEVATED AMID HIGHER-FOR-LONGER RATES EXPECTATIONS

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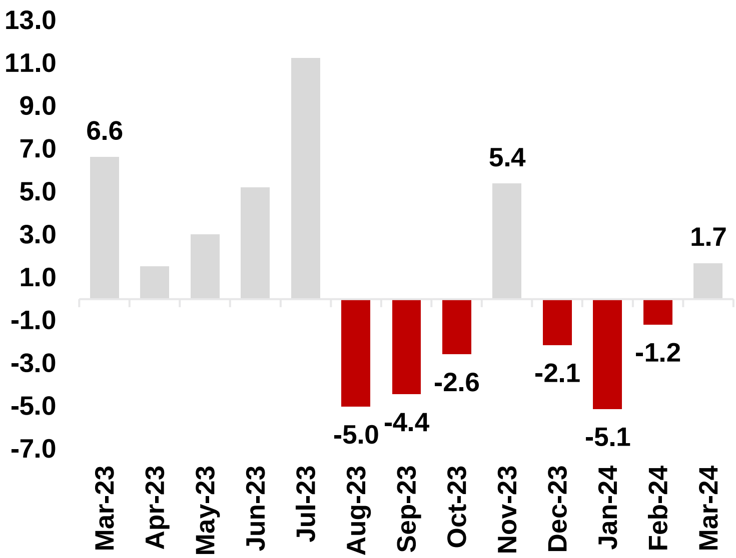
Monthly changes, basis points (bps)

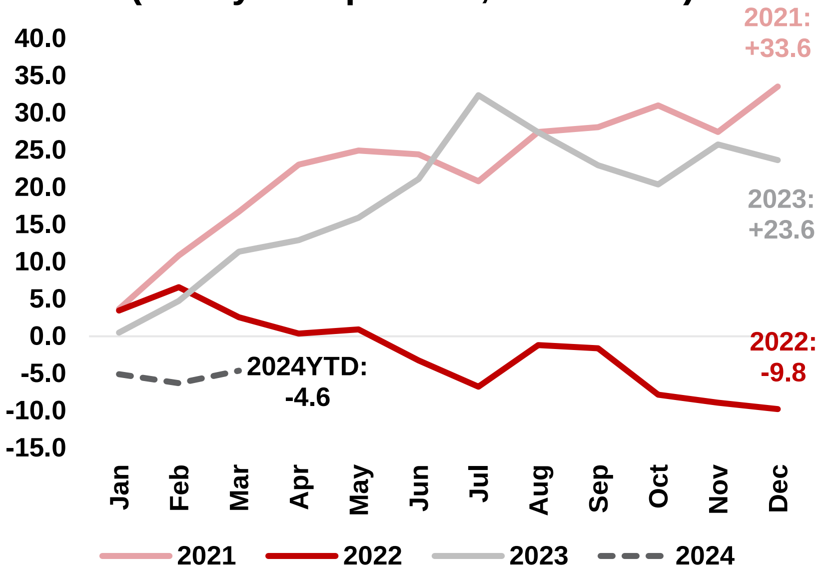
UST	Yields (%) 28-Mar-24	Yields (%) 30-Apr-24	Change (bps)
3-Y UST	4.40	4.87	47
5-Y UST	4.21	4.72	51
7-Y UST	4.20	4.71	51
10-Y UST	4.20	4.69	49
MGS	**Yields (%) 29-Mar-24**	**Yields (%) 30-Apr-24**	**Change (bps)**
3-Y MGS	3.49	3.61	12
5-Y MGS	3.63	3.79	15
7-Y MGS	3.77	3.90	13
10-Y MGS	3.86	3.98	13
GII	**Yields (%) 29-Mar-24**	**Yields (%) 30-Apr-24**	**Change (bps)**
3-Y GII	3.46	3.60	14
5-Y GII	3.61	3.79	18
7-Y GII	3.75	3.89	14
10-Y GII	3.87	3.99	12

Sources: Bank Negara Malaysia (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) yields edged upwards in the range of 47bps and 51bps as stronger-than-anticipated U.S. labour cost data fuelled expectations that the Fed will maintain higher interest rates for a prolonged period.
- Malaysian Government Securities (MGS) and Government Investment Issues (GII) yields ticked higher between 12bps and 18bps, tracking the gains in UST yields, although at a slower momentum.
- Foreign fund flows in the local bond market rebounded into the positive territory with a net foreign inflow of RM1.7 billion in March (February: -RM1.2 billion). Local govvies' foreign shareholdings to total outstanding decreased slightly to 21.4% in March (February : 21.5%).
- For the first three months of this year, the local bond market recorded the cumulative net foreign outflows of RM4.6 billion, significantly lower than the inflows of RM11.6 billion in the same period in the previous year.

FX MARKET: RINGGIT REMAINED PRESSURED AGAINST THE USD

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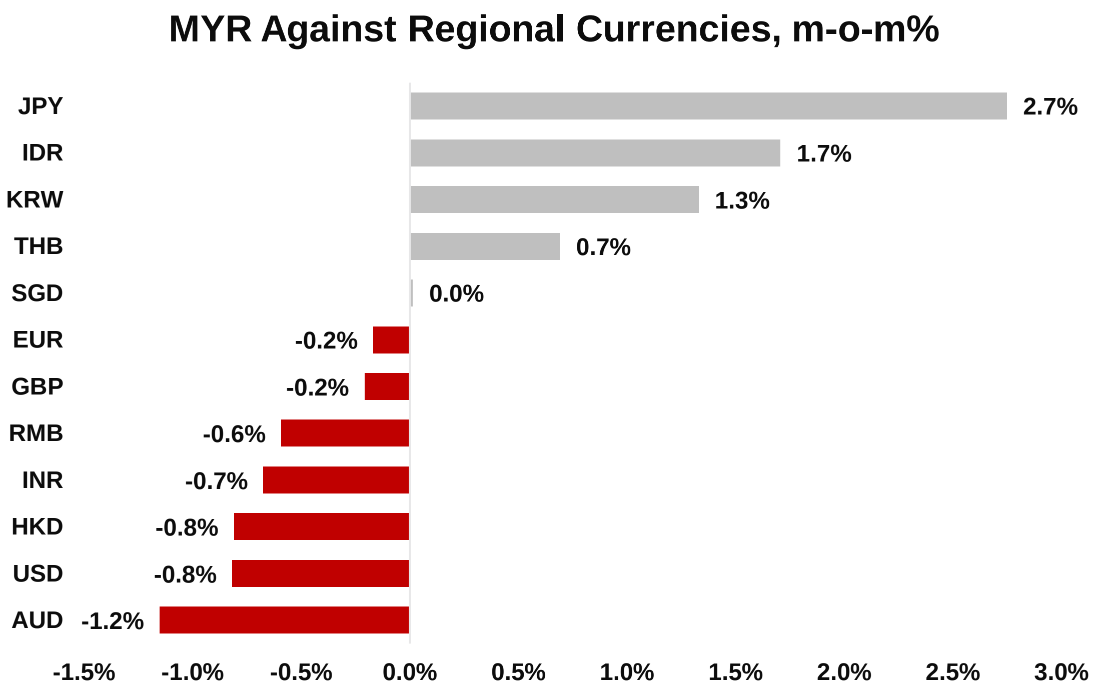
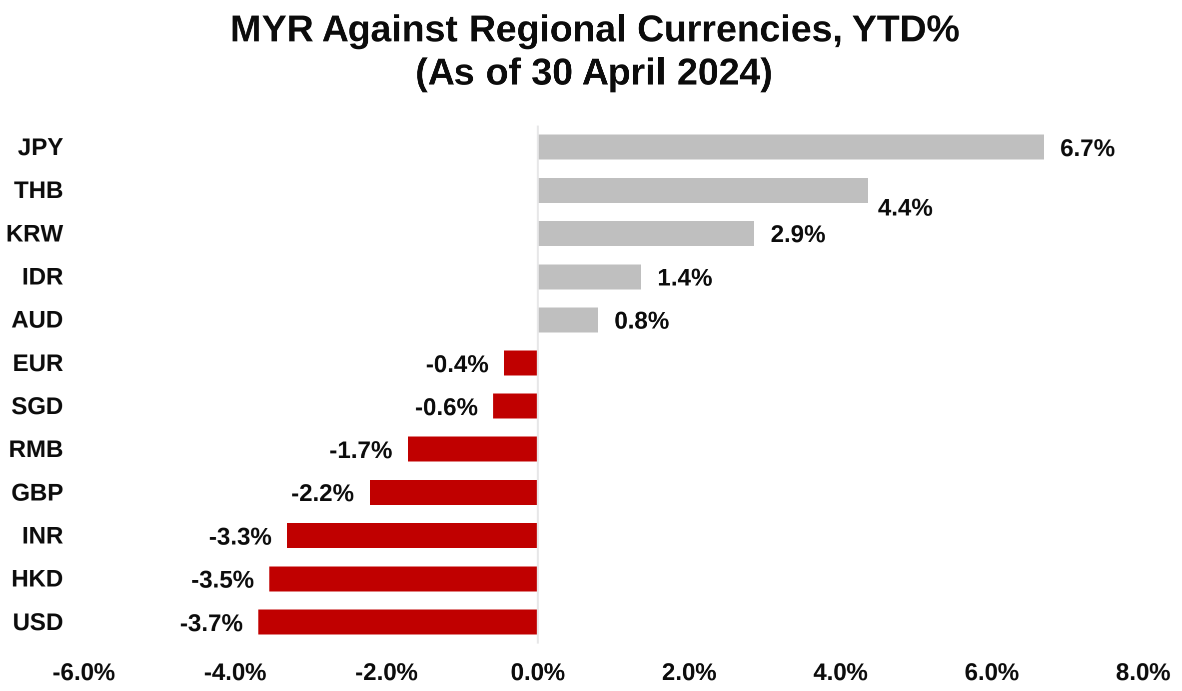




Source: BNM

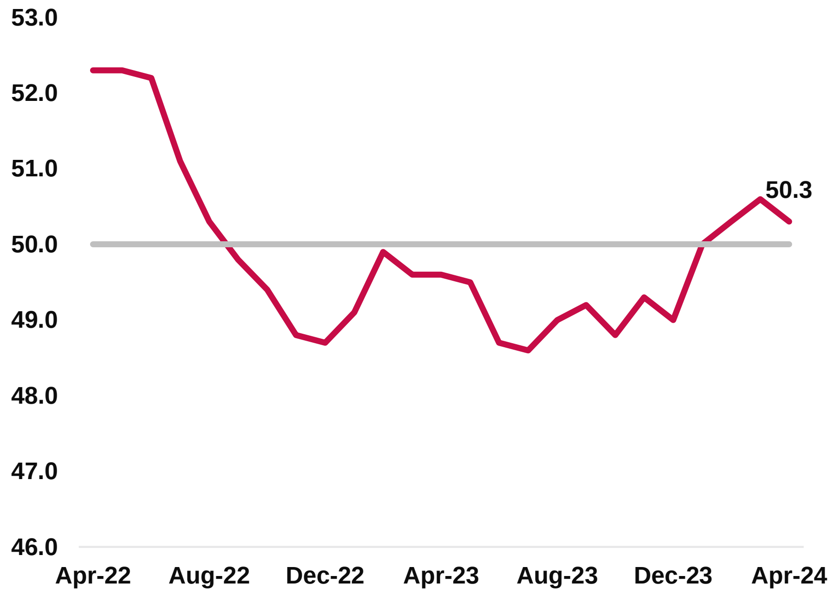
- The current trend of the Ringgit had to do with the external factors such as geopolitical tensions in Middle East, as well as higher-for-longer FFR narrative from the Fed.
- Latest, the U.S. central bank kept the FFR unchanged during its May meeting for the sixth straight time in view of ongoing inflationary pressure and a tight labour market. This could have spurred capital outflows from emerging countries including Malaysia into the U.S. considering the returns are much higher.
- However, the outlook of the Ringgit does not reflect the underlying fundamentals in the Malaysian economy as it is anticipated to have grown by 3.9% in 1Q2024, according to an advanced estimate released by the DOSM (Bank Islam's estimate: 4.0%) – faster than the 3.0% expansion in 4Q2023.
- Meanwhile, BNM has reiterated its commitment to stabilise the local note and ready to deploy the tools to ensure Malaysian financial market remains orderly and continue functioning properly.

SECTION 2

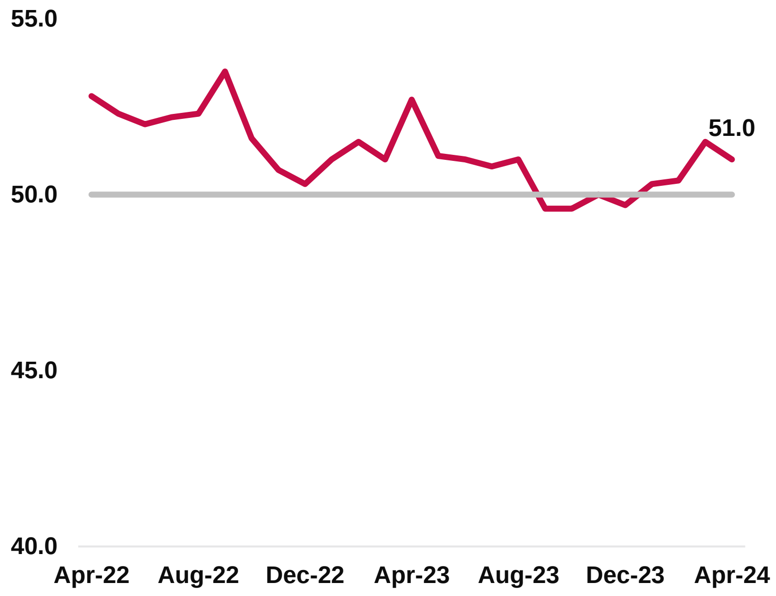
The Global Economy

GLOBAL MANUFACTURING ACTIVITY CONTINUED TO SHOW EXPANSION IN APRIL AMID RISING IN OUTPUT AND NEW ORDERS

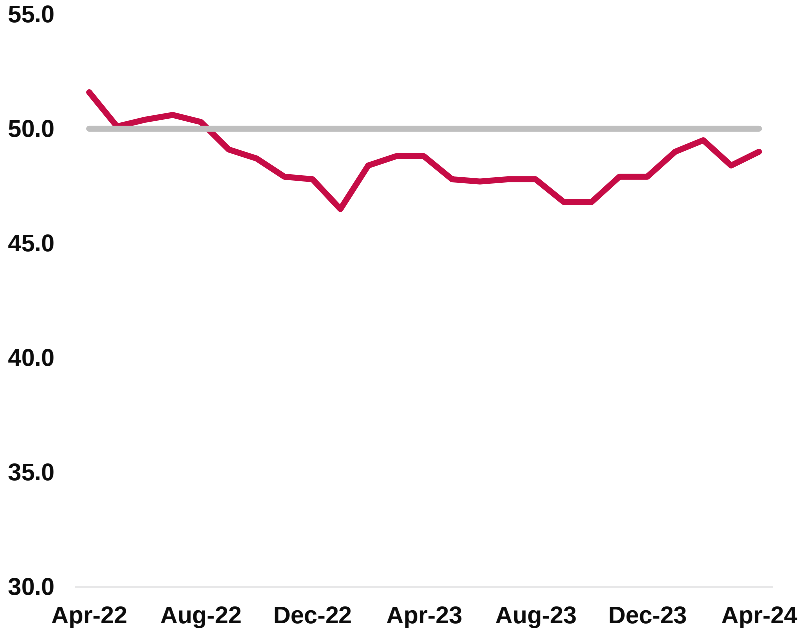
J.P. Morgan Global Manufacturing PMI, points



ASEAN Manufacturing PMI, points



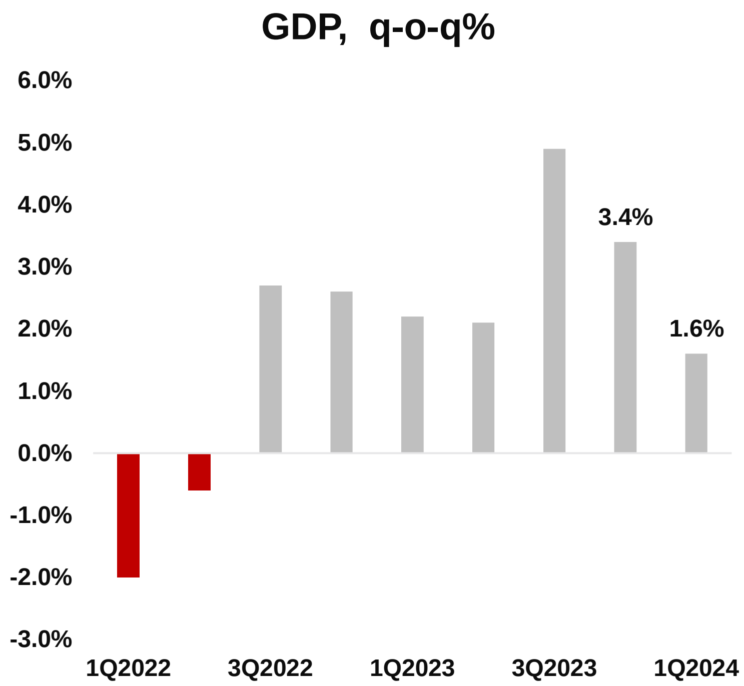
Malaysia Manufacturing PMI, points

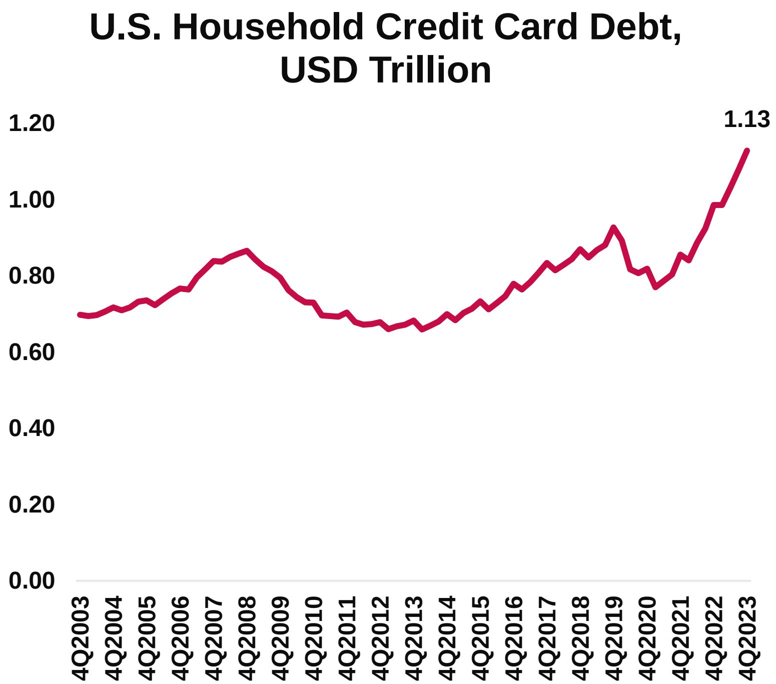


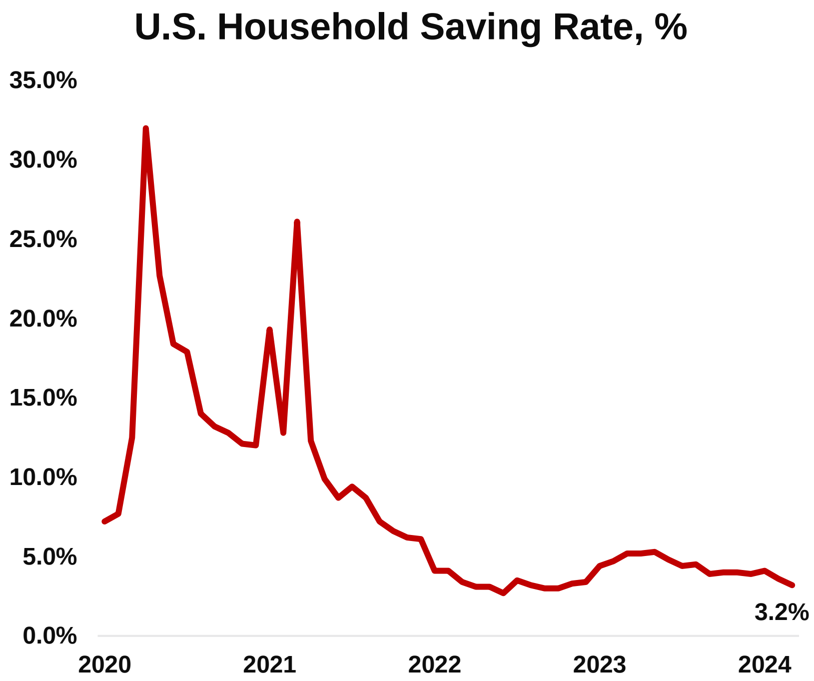
Source: S&P Global

- Although the latest reading took a step back (April: 50.3 points vs. March: 50.6 points), global manufacturing Purchasing Managers' Index (PMI) is still above the neutral 50.0-mark for the third straight month.
- Likewise, the headline S&P Global ASEAN PMI posted above the neutral 50.0-mark for the fourth straight month albeit at a softer pace (April: 51.0 points vs. March: 51.5 points). Elsewhere, job shredding in the manufacturing employment was first seen since October last year despite capacity pressures continuing to build, with backlogs rising at a quicker pace.
- On the domestic front, while the latest data (April: 49.0 points vs. 48.4 points) seemed to point a muted manufacturing demand, the outlook towards output over the coming year remained positive in April with stable employment level reported after three consecutive monthly falls.

U.S. ECONOMY GREW SLOWER IN THE FIRST QUARTER OF THE YEAR







Sources: Bureau of Economic Analysis, Federal Reserve Bank of New York

- The latest GDP reading of 1.6% q-o-q is a steep slowdown from the 4Q2023's 3.4% and also below the market's estimate of 2.5%. Consumer spending also weighed on the economy q-o-q (1Q2024: 2.5% vs. 4Q2023: 3.3%) but remained a growth driver in the first quarter amid a robust labour market.
- Additionally, the credit card debt by the U.S. household rose to USD1.13 trillion in 4Q2023 (3Q2023: USD1.08 trillion), a 4.6% q-o-q increase, suggesting consumers were still willing and able to spend even in the face of high interest rate environment.
- This could have explained the downward trend seen in the personal saving rate when the latest data showed that the rate declined to 3.2% in March (February: 3.6%). It was the lowest level since October 2022, implying a sign that some are bullish about spending.
- Given the mixed economic indicators, the forthcoming second GDP estimate which is due in late May will be vital to confirm the trends and adjusting forecasts accordingly.

CHINA'S 1Q2024 GDP PERFORMANCE CAME IN BETTER-THAN-EXPECTED

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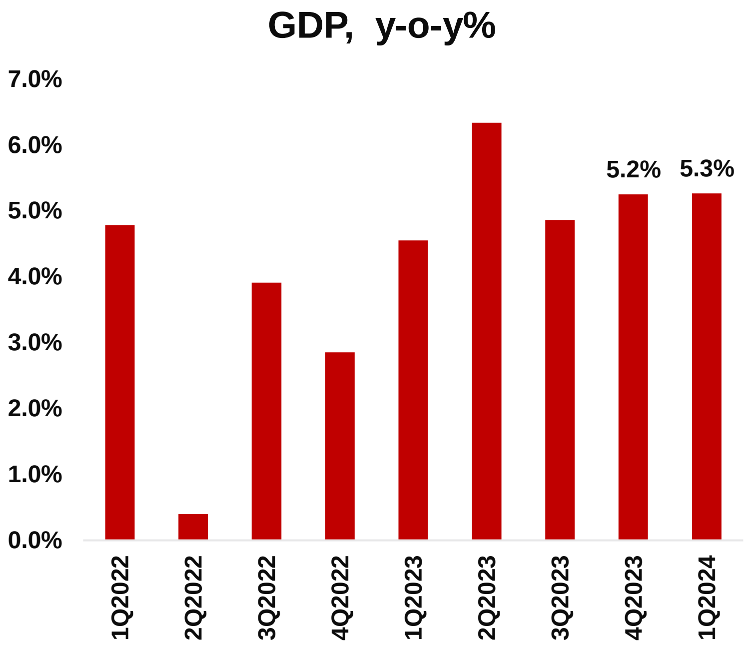

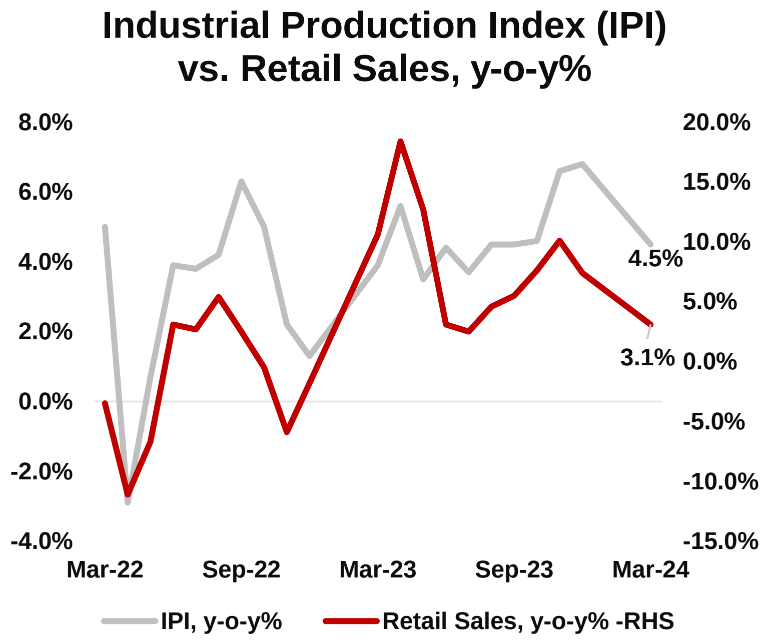

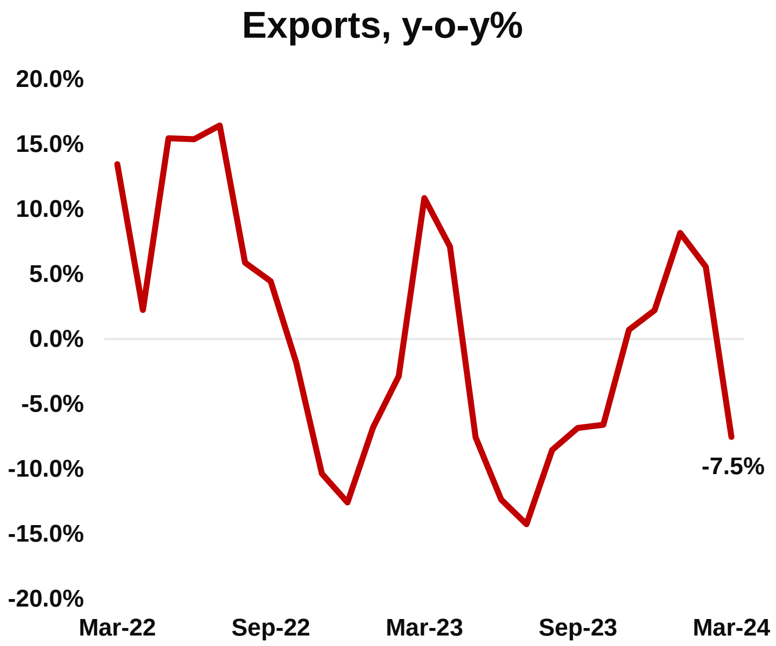

Sources: National Bureau of Statistics, General Administration of Customs

- Despite the solid 1Q2024 GDP growth (Act: 5.3% vs. Est: 5.0%) following a 5.2% expansion in the previous quarter, a slew of economic indicators for March such as retail sales (March: 3.1% vs. February: 7.4%) and industrial output (March: 4.5% vs. February: 6.8%) pointed to a moderating domestic demand.
- At the same time, exports from the country dropped by 7.5% in March, reversing a 5.5% gain in the previous month, raising some doubts that global demand would continue to help drive growth in the world's second-largest economy. However, it should be noted that the number came with a higher base effect in March last year when the country recorded a robust growth of about more than 10.0%.
- Meanwhile, a housing market crunch continues to loom as China seeks to emerge from its post-pandemic economic malaise. The 1Q2024 report showed that investment in real estate development went down by 9.5% (February: 9.0%) since the same period last year. It seems that there is a lot more work to do as risk-averse policymakers have so far not moved to lend a helping hand to indebted real state giants and local governments.

EUROZONE RECORDED HIGHEST GROWTH SINCE 3Q2022 AS ITS DISINFLATION TREND CONTINUED, FUELLING BETS OF A JUNE RATE CUT

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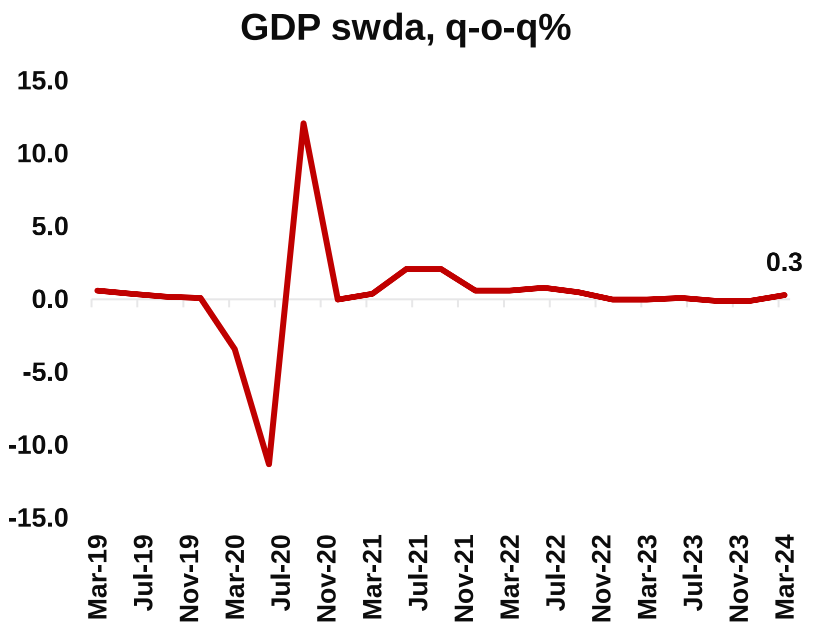
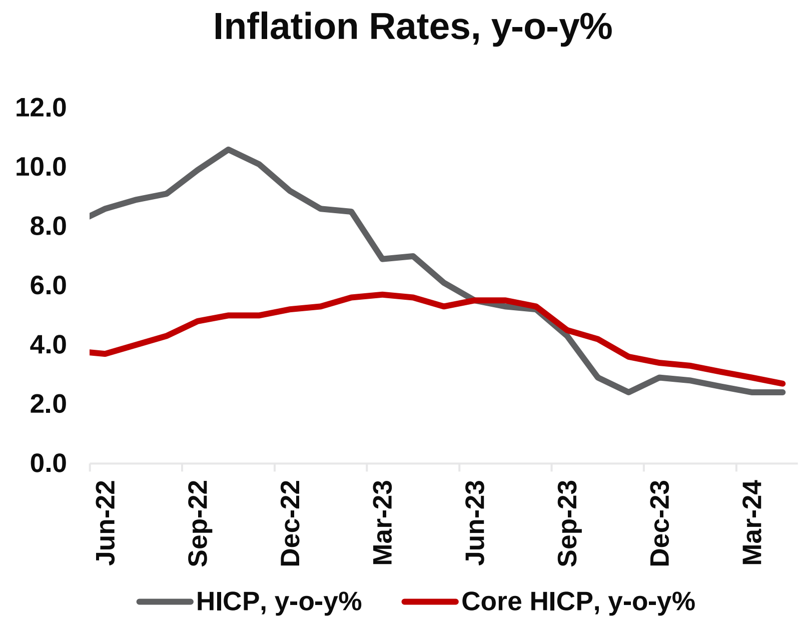
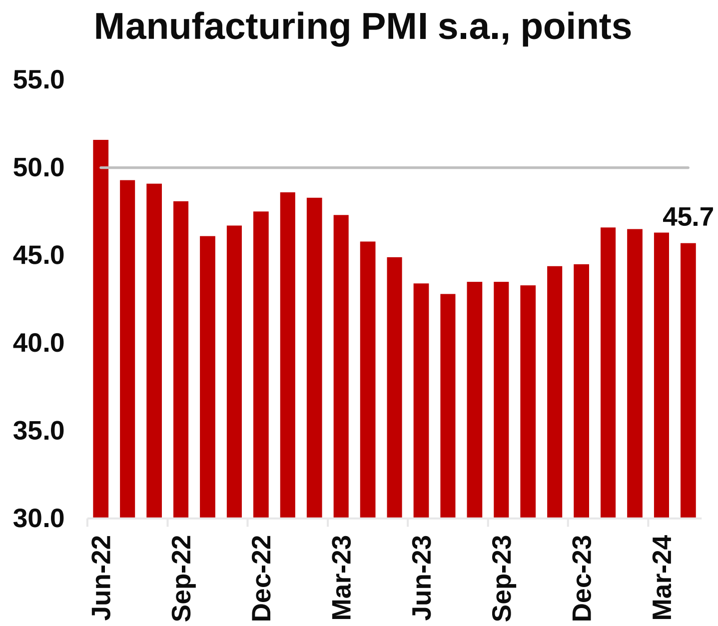






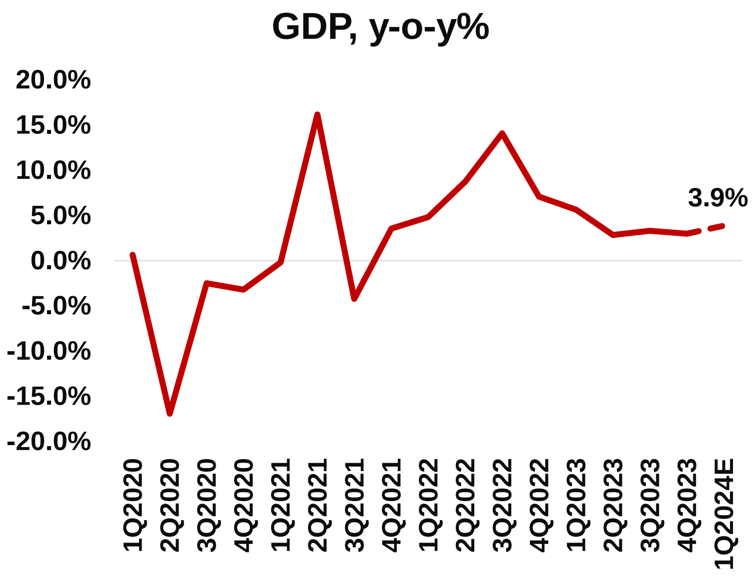
Sources: ECB, Eurostat, S&P Global

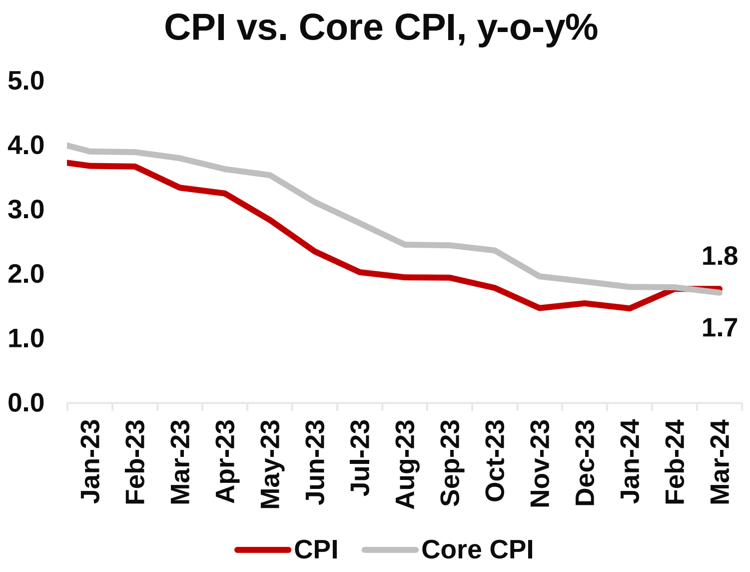
- Eurozone's economy expanded more-than-expected at 0.3% in 1Q2024 (Est: 0.1%), recording the fastest growth since 3Q2022 following two straight quarters of contraction. Such performance was supported by a rebound in the region's largest economy, Germany, which grew by 0.2% in the same period (4Q2023: -0.5%).
- Thus far, consumer spending in the region has remained supportive, backed by a resilient labour market and moderating inflation. With the ECB expecting to start easing its monetary policy soon, the less restrictive financial conditions will be supportive to growth moving forward. International Monetary Fund (IMF), in its April outlook, forecasted a 0.8% growth for the region in 2024 (2023: 0.5%).
- Albeit a hiccup when the latest March inflation print remained steady at 2.4%, ECB policymakers has signalled their confidence in inflation easing towards the targeted 2.0%, fuelling market expectations of a rate cut during their June meeting. Core inflation also draws weight on the bets as it slowed to 2.7% in March from 2.9% in the previous month.
- However, Eurozone's manufacturing PMI stayed in the contraction zone for 22 consecutive months as the volume of new orders declined, leading factories to reduce their purchases of capital and intermediate goods at an accelerated rate.

SECTION 3

Domestic Landscape & Banking Sector Update

SMOOTH SAILING OR ROUGH WATERS? – 2H2024 DEVELOPMENTS TO DETERMINE THE TRAJECTORY OF THE ECONOMY

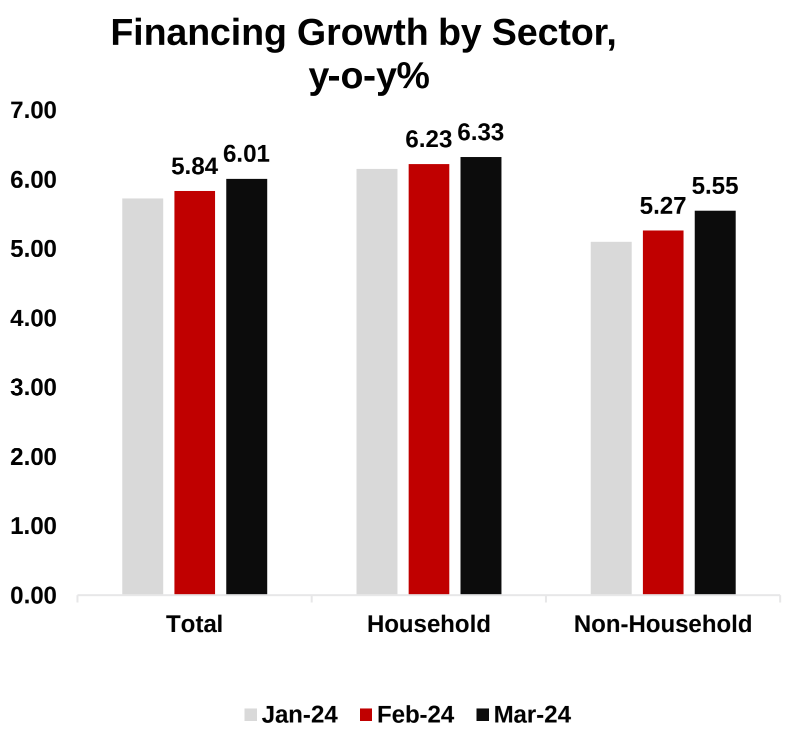


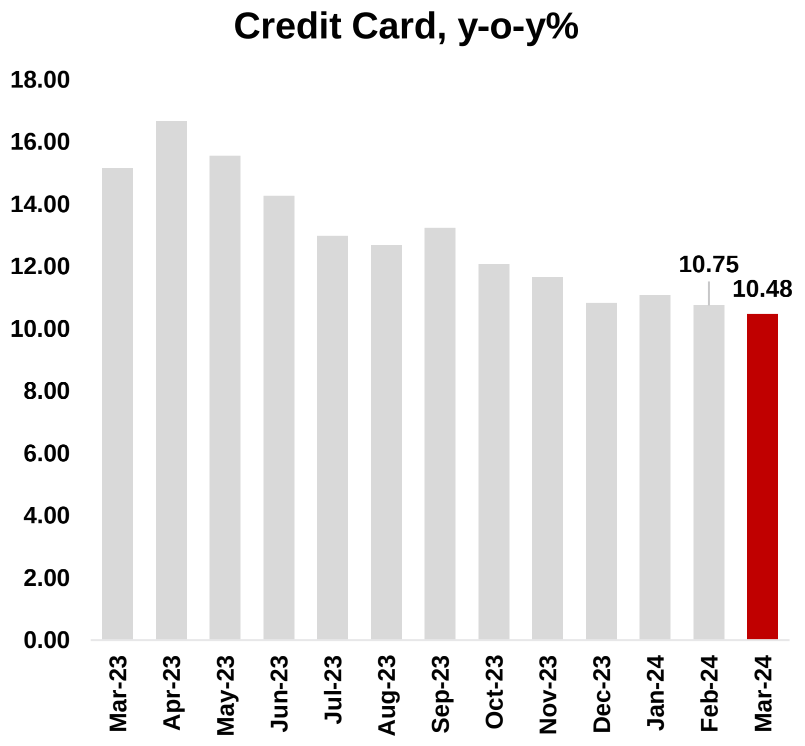


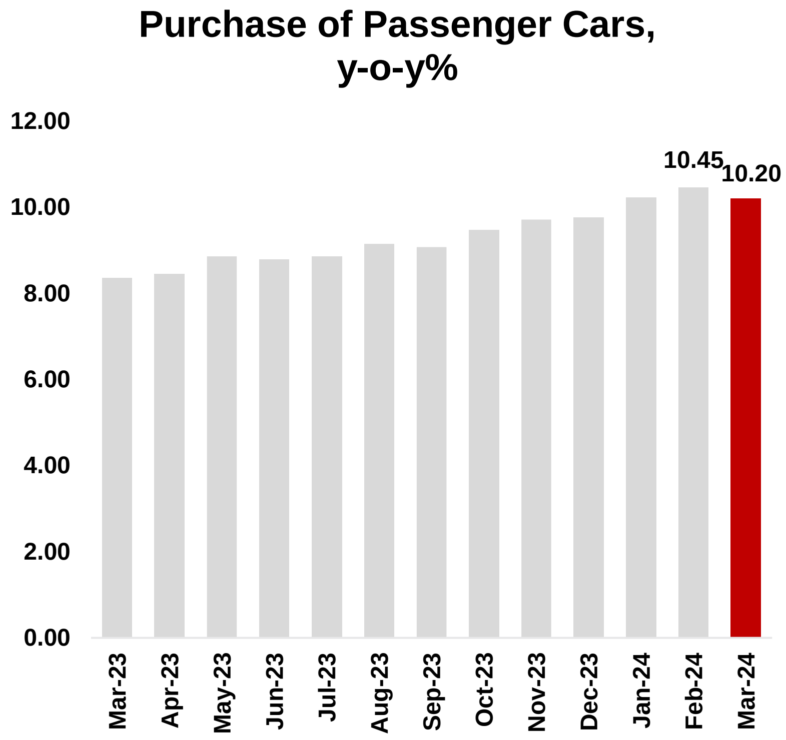
Sources: DOSM, BNM

- Advanced official estimates anticipates the economy to have grown by 3.9% in 1Q2024, improving from 3.0% in the previous quarter, propelled by the services sector (1Q2024: 4.4% vs. 4Q2023: 4.2%).
- Malaysia's inflation remained steady at 1.8% in March with a slower rise in food & beverages inflation (March: 1.7% vs. February: 1.9%) despite both housing and utilities as well as restaurant and accommodation services inflation ticking up to 3.0%. We foresee price pressures to flare up in 2H2024 with the implementation of subsidy rationalisation as the Economic Minister recently reiterated the government's commitment to reduce RON95 subsidies with the details to be announced in the coming weeks.
- Meanwhile, exports in 1Q2024 rebounded by 2.2% (4Q2023: -6.9%), marking the first expansion in a year, while imports surged by 13.1% (4Q2023: 1.3%). Catalysts for trade are the better-than-expected growth of China's economy and the much-anticipated lift from the semiconductor upcycle. Of note, E&E exports had recorded the smallest contraction in eight months (March: -1.5% vs. February: -9.7%).
- However, risks to the trade outlook remain from the possible escalation of the conflict in the Middle East and prolonged high interest rate environment, most notably the U.S..

BANKING SECTOR: MARCH SAW A SLIGHT UPTICK IN FINANCING GROWTH



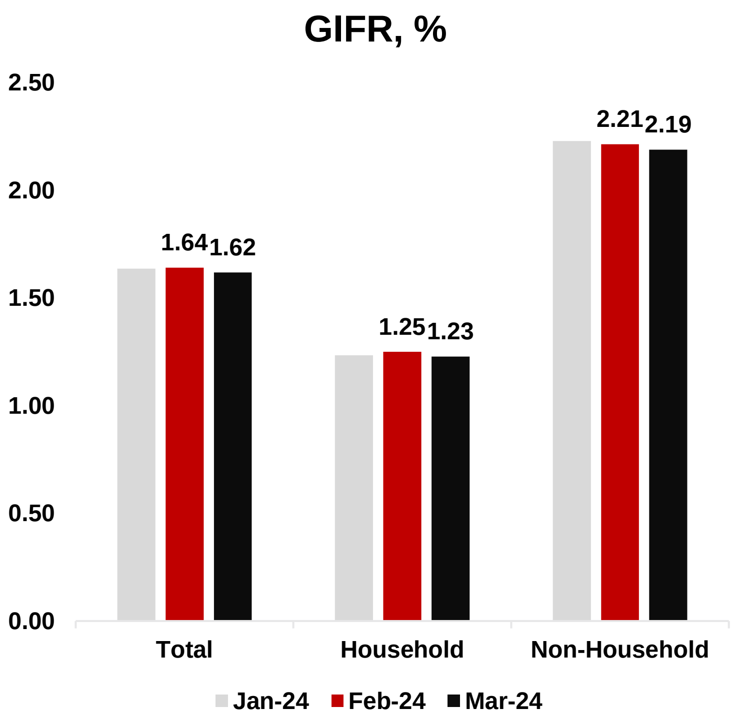


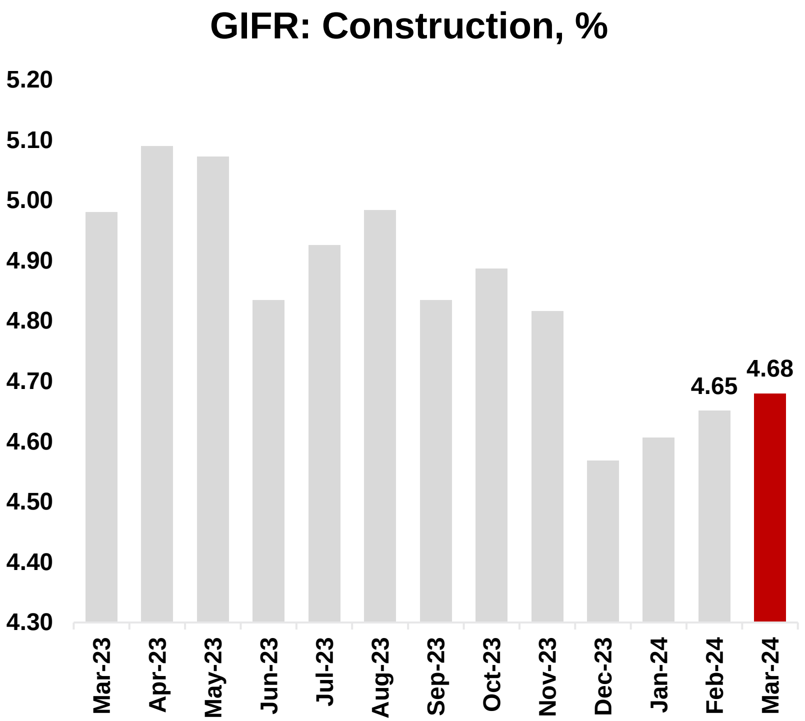


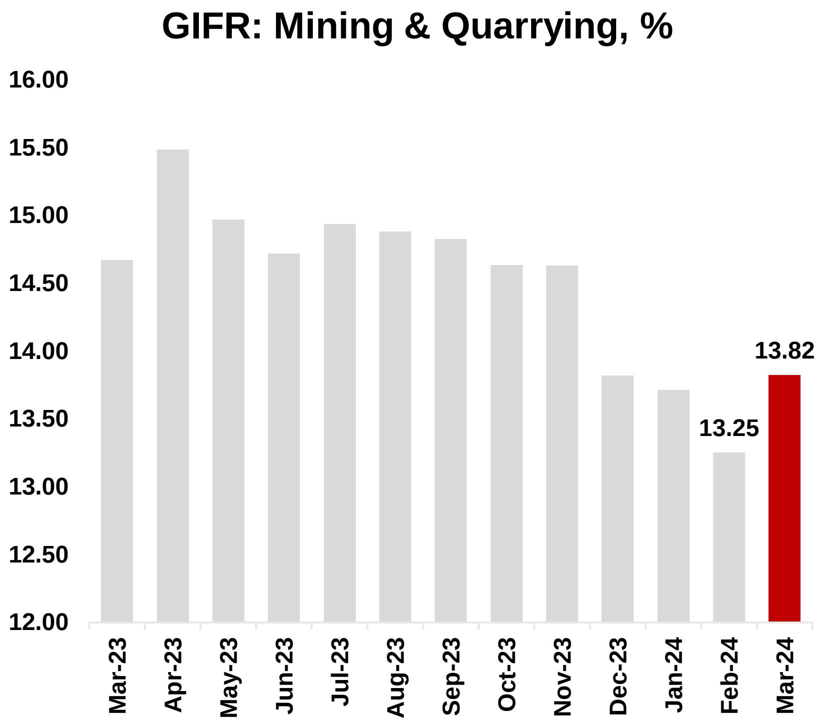
Source: BNM

- Financing activities grew by 6.01% in March from 5.84% recorded in February. The non-household segment's financing growth inched up to 5.55% in March (February: 5.27). Similarly, the growth rate in the household sector saw a slight uptick, rising to 6.33% in March from 6.23% in February.
- The credit growth in the purchase of passenger cars segment dipped slightly to 10.20% in March (February: 10.45%). Similarly, the financing growth within credit card segment decreased to 10.48% in March compared to 10.75% in February. Moreover, financing activities related to the purchase of residential property declined slightly to 7.43% in March (February: 7.49%).

BANKING SECTOR: ASSET QUALITY REMAINED SOUND IN MARCH







Source: BNM

- Total gross impaired financing ratio (GIFR) in the banking sector remained stable at 1.62% in March (February: 1.64%). The GIFR in the household segment registered a moderate decline to 1.23% in March (February: 1.25%). Furthermore, the impairment within the non-household sector drop to 2.19% in March (February: 2.21%).
- The impairment within the construction segment grew moderately to 4.68% in March from 4.65% in February. The asset quality in the Mining and Quarrying industry surged to 13.82% in March (February: 13.25%).

THANK YOU