BANK ISLAM

MONTHLY ECONOMIC UPDATE

2 APRIL 2024

ECONOMIC RESEARCH

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KEY TAKEAWAYS

- **The Fed maintains its interest rate outlook for this year despite the slower-than-anticipated disinflation.** While the U.S. Federal Reserve (Fed) opted to keep its policy rate untouched for a fifth straight time at its March policy meeting, the latest Fed's dot plot still shows median expectations of three 25bp rate cuts in 2024. That said, the Fed dialled down its projections for the pace of rate cuts in 2025, looking at only three cuts compared to four in their December projections. The Fed reaffirmed its view that disinflation will continue, albeit at a more gradual pace than it had projected three months ago, with its forecast for core Personal Consumption Expenditure (PCE) inflation revising higher to 2.6% in 2024 from 2.4%. This came alongside an upgrade in growth forecast for the same year to 2.1% from 1.4%. Given the Fed's still relatively dovish stance, markets continue to expect the Fed will start its rate-cutting cycle in June.

- **BoE holds rate steady as its hawks withdraw their support for hikes.** Bank of England (BoE) acknowledged that conditions for rate cuts are unfolding with the headline inflation falling to its lowest level in more than two years, but gave little clues on the timing of the first cut. The forward guidance remained unchanged as the BoE reiterated its stance that monetary policy needs to stay sufficiently restrictive for an extended period. Markets are currently expecting three rate cuts by a total of 75 bps this year, with the first move coming as early as May or June, a timeline a BoE policymaker has, however, recently indicated as too aggressive.

- **The SNB surprises the markets by being the first major central bank to cut rate in the current cycle.** At its March policy meeting, the Swiss National Bank (SNB) opted to ease its main key rate by 25 bps to 1.50%, marking its first rate cut in nine years. Although unexpected, the rate cut is justified given Swiss inflation continues to edge lower and has been within the SNB's target range of 0.0% and 2.0% since May 2023. The SNB, in its updated projections, expecting the inflation to average 1.4%, down from 1.9% it had predicted in December 2023. The inflation forecast downgrade, in addition to the SNB's commitment to ensure inflation remains within the target range, suggested further rate cuts could follow, especially if the strength of real Swiss franc persists.

KEY TAKEAWAYS

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- **The BoJ ends its eight-year long negative interest rate policy.** The Bank of Japan's (BoJ) decision to raise its short-term interest rates to a range of 0.0% to 0.1% from -0.1% and scrap yield control curve policy came on the back of a weakening Japanese yen (JPY), as well as the strong results of wage negotiations involving major Japanese companies that bolstered the prospects of consumer demand and inflation. On the future policy path, the Summary of Opinions indicated the BoJ's preference to take a cautious approach to normalising monetary policy. This reinforced market expectations that the next rate hike would take some time, thus pressuring the JPY.

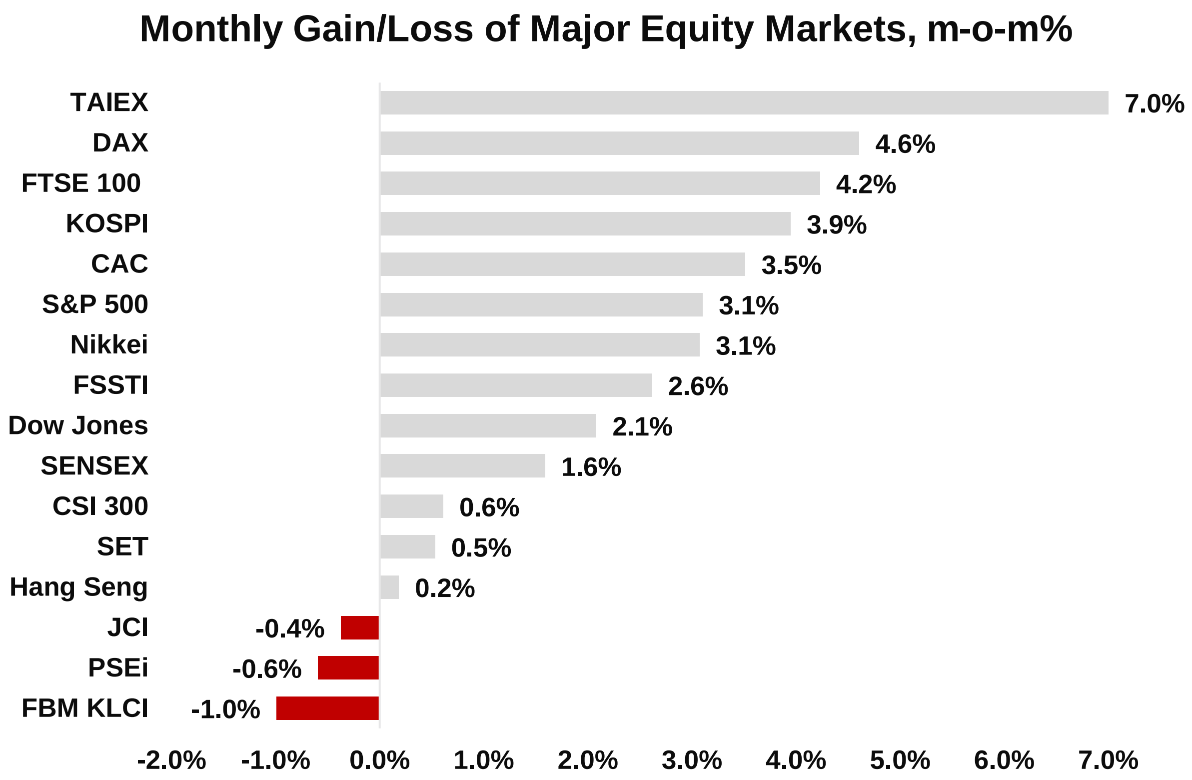
- **The Chinese government sets growth target of around 5.0% for 2024.** The growth target, which is unchanged from 2023, indicated the authorities' continued focus on dealing with economic challenges. While China's fiscal deficit-to-GDP target was kept at 3.0%, dismissing the expectations of massive stimulus, the special government bond issuance target was raised from RMB3.8 trillion to RMB3.9 trillion, and an additional RMB1.0 trillion of ultra-long central government bonds will be issued to fund projects. On the monetary front, the People's Bank of China (PBoC) reaffirmed its willingness to do more to support growth and said there was room to further cut banks' required reserve rate (RRR).

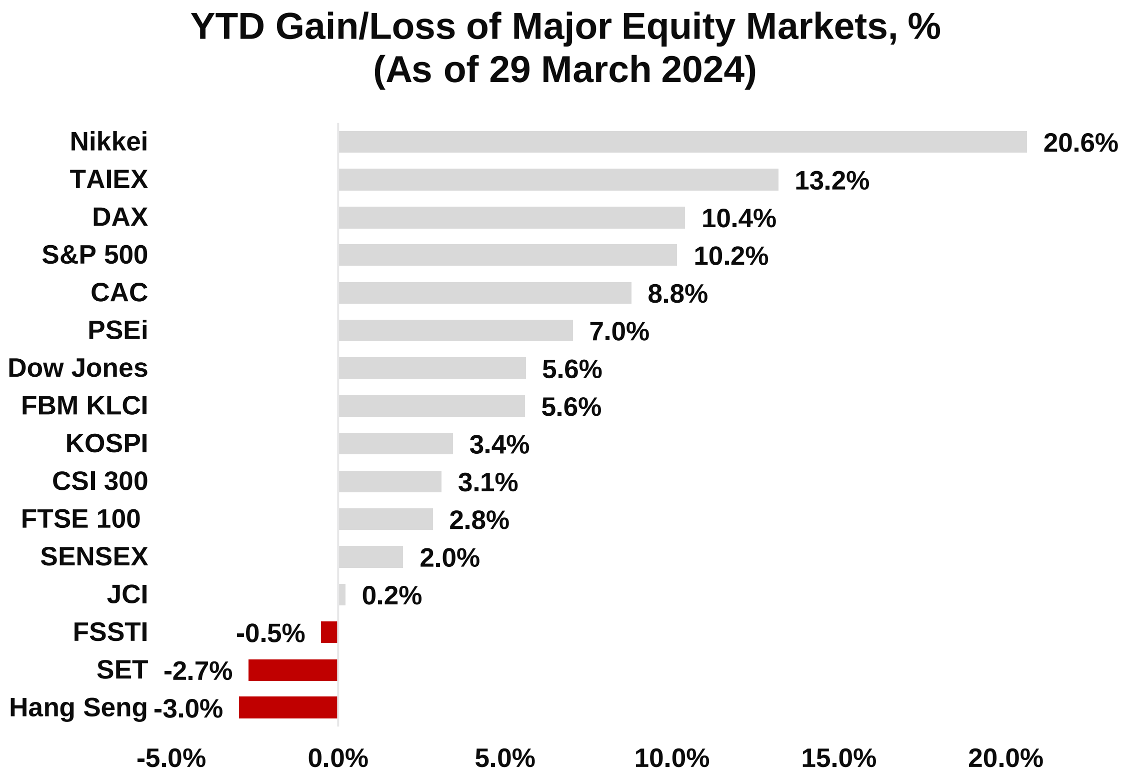
- **BNM held the OPR steady at 3.00%.** Bank Negara Malaysia (BNM) opted for rate pause for the fifth consecutive meeting on March 7 as policymakers contend with a weaker currency amid looming inflation and economic growth risks. We maintain our view that the BNM will keep Overnight Policy Rate (OPR) unchanged at least through to the end of 2024 on the back of robust economic backdrop with both headline and core inflation remaining modest. In its recently published Economic Monetary Review 2023, BNM expects the Malaysia's GDP growth to pick up to between 4.0% and 5.0% in 2024 (2023: 3.7%), in line with the government's projection. Our growth forecast of 4.7% is within the official projection range, and we concur with BNM's view that growth will be underpinned by continued expansion in domestic demand as well as improvement in external demand. Meanwhile, on inflation outlook, BNM stated that its wider inflation forecast of between 2.0% and 3.5% (Bank Islam: 2.7%) has taken into account of potential upside from the implementation of fuel subsidy rationalisation.

SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: TAIWAN STOCKS LED THE GAINERS IN MARCH





Sources: Bursa, CEIC data

- Taiwan's TAIEX led the gainers, rising by 7.0% in March, buoyed by the technology stocks related to artificial intelligence (A.I.) development and as investors cheered on the dovish tone by the Fed during the March's Federal Open Market Committee (FOMC) meeting.
- Germany's DAX and U.K's FTSE 100 rose by 4.6% and 4.2%, respectively, as sentiment buoyed by positive economic news, but gains were capped as a wait-and-see approach prevailed ahead of key European inflation figures.
- YTD, Japan's Nikkei continued to spearhead the winners with a total gain of 20.6% as investors overlooked concerns about potential currency intervention. The weaker JPY boosted the outlook for corporate profits and fuelled investor appetite for Japanese stocks particularly exporters.
- In contrast, FBM KLCI (-1.0%), Philippines' PSEi (-0.6%) and Indonesia's JCI (-0.4%) were among the major losers in March.

DOMESTIC EQUITY: THE FBM KLCI EASED ON SELLING OF BLUE CHIPS

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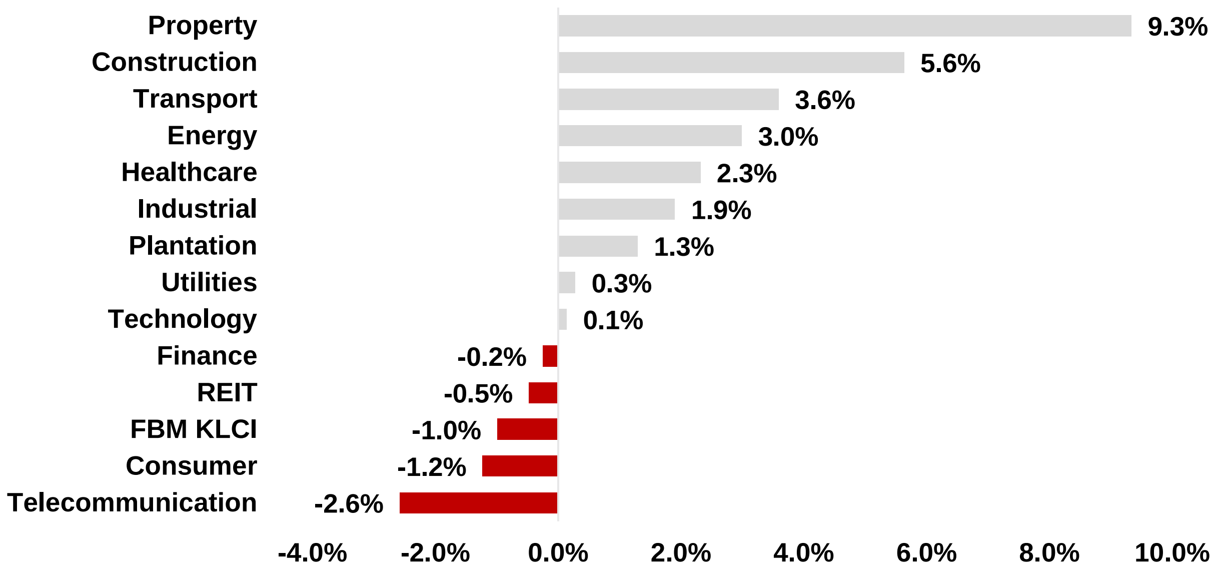

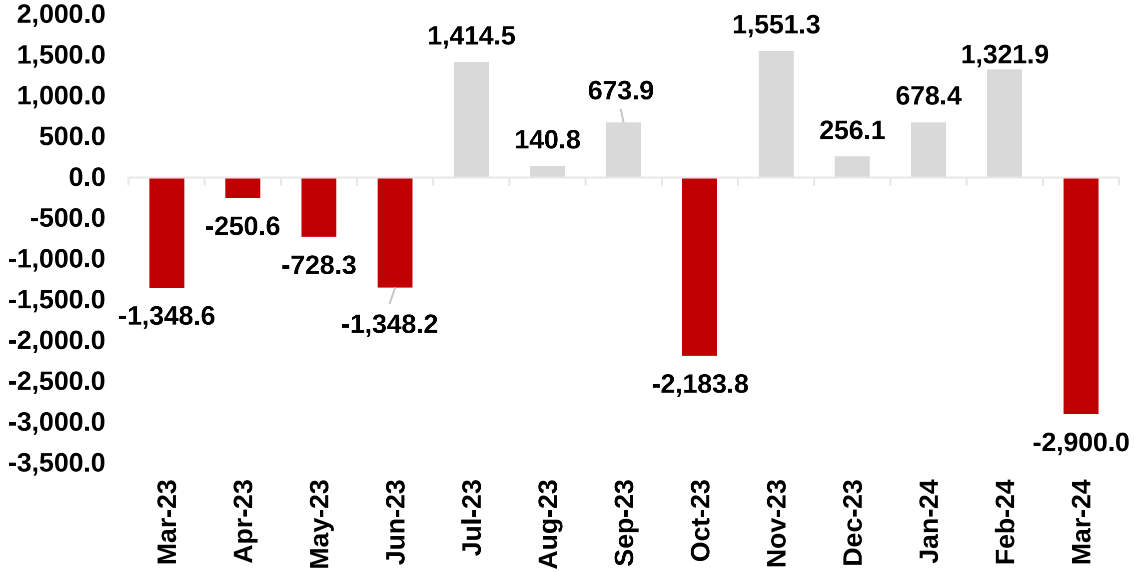

Sources: Bursa, BNM, CEIC data

- The FBM KLCI ended the month of March in the red with a 1.0% decline amid cautious regional sentiment as investors assessed path ahead of Fed rate cuts.
- However, Bursa sectoral indices were mostly positive with 9 gainers to 4 losers. The Property index led gains with a 9.3% rise, followed by Construction (+5.6%), reflecting investors' optimism about the prospects on both sectors with several development projects in the pipeline.
- Meanwhile, losses were led by the Telecommunication (-2.6%) and Consumer indices (-1.2%), the top gainers in the previous month, on profit-taking activities.
- Foreign investors turned net seller for the first time after four consecutive months of net buying. They had net sold RM2.9 billion worth of equities from a buying position of RM1.3 billion in February.
- Trading in local stocks will remain influenced by Fed rate cut expectations and China's economic outlook.

FIXED INCOME: YIELDS LITTLE CHANGED ALBEIT DOVISH TONE BY THE FED

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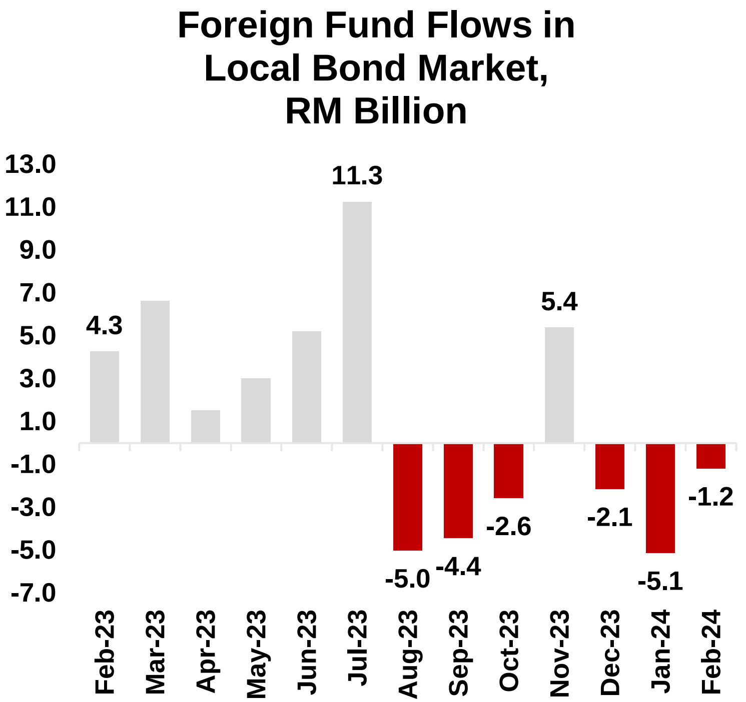
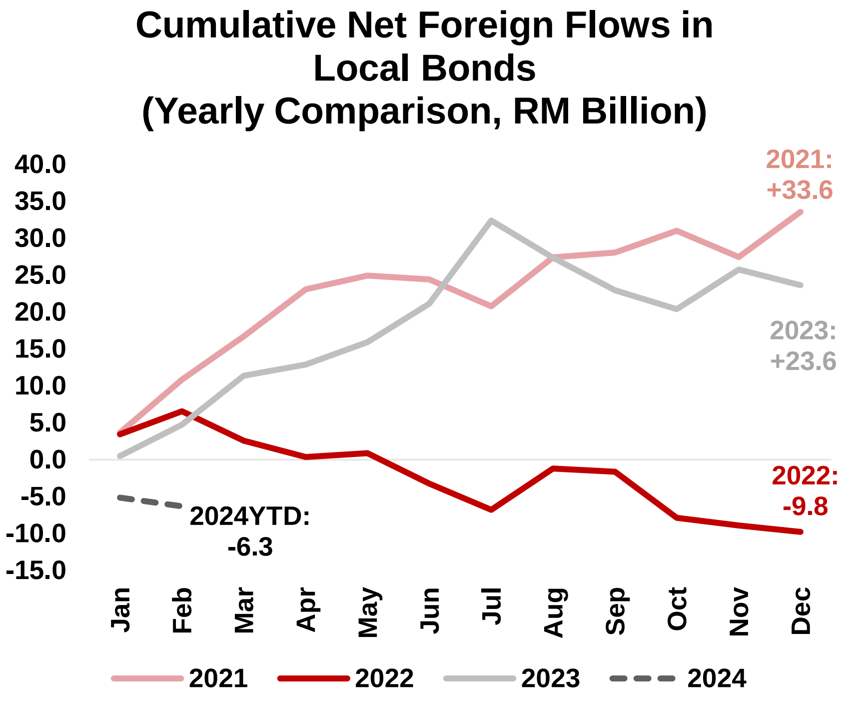
Monthly changes, basis points (bps)			
UST	Yields (%) 29-Feb-24	Yields (%) 28-Mar-24	Change (bps)
3-Y UST	4.43	4.40	-3
5-Y UST	4.26	4.21	-5
7-Y UST	4.28	4.20	-8
10-Y UST	4.25	4.20	-5
MGS	Yields (%) 29-Feb-24	Yields (%) 29-Mar-24	Change (bps)
3-Y MGS	3.50	3.49	-1
5-Y MGS	3.59	3.63	4
7-Y MGS	3.78	3.77	-1
10-Y MGS	3.86	3.86	0
GII	Yields (%) 29-Feb-24	Yields (%) 29-Mar-24	Change (bps)
3-Y GII	3.48	3.46	-2
5-Y GII	3.61	3.61	0
7-Y GII	3.78	3.75	-3
10-Y GII	3.88	3.87	-1





Sources: BNM, Federal Reserve Board

- The U.S. Treasury (UST) yields inched marginally lower in the range of 3bps and 8bps as investors reassessed future interest rate path after dovish note by the Fed.
- Malaysian Government Securities (MGS) yields mostly ended little changed with the exception of 5-Y MGS, which saw its yield rising 4bps. On the other hand, Government Investment Issues (GII) yields mostly ended stronger, with yields edging lower between 1bp and 3bps. Meanwhile, 10-Y MGS and 5-Y GII yields plateaued at 3.86% and 3.61%, respectively.
- Foreign fund flows in the local bond market remained sluggish in the negative territory with a net foreign outflow of RM1.2 billion in February (January: -RM5.1 billion). Local govvies' foreign shareholdings to total outstanding slid to 21.5% in February (January : 21.8%).
- For the first two months of this year, the local bond market recorded the cumulative net foreign outflows RM6.3 billion, significantly lower than the inflows of RM4.8 billion in the same period in the previous year.

FX MARKET: RINGGIT REBOUNDED AGAINST THE USD ON A MONTHLY BASIS

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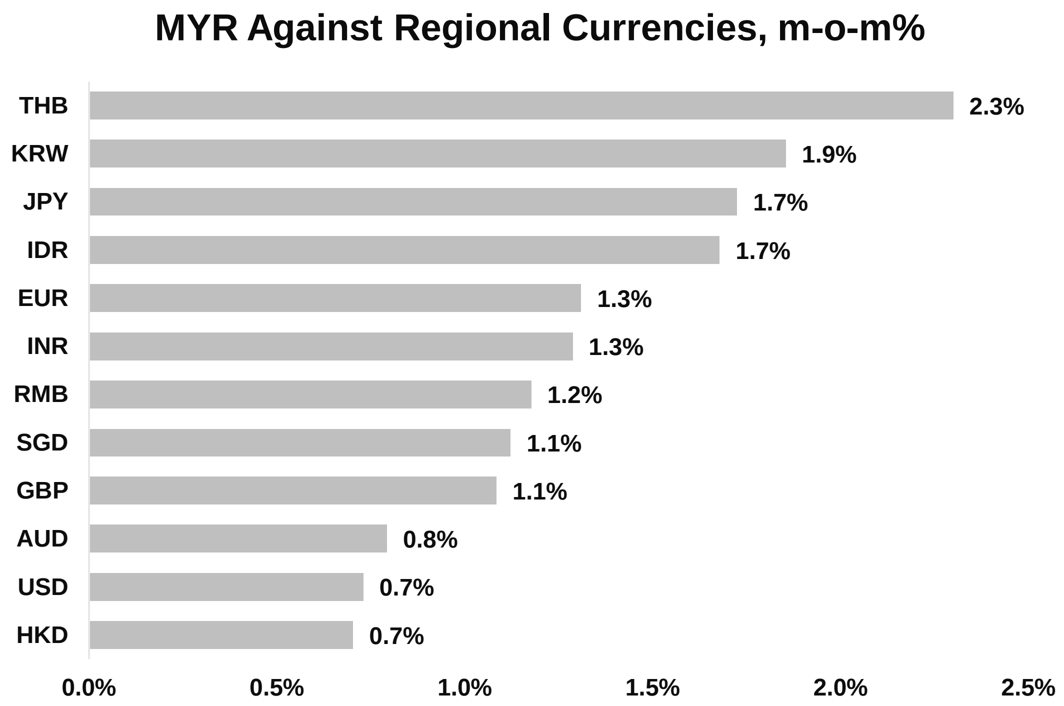
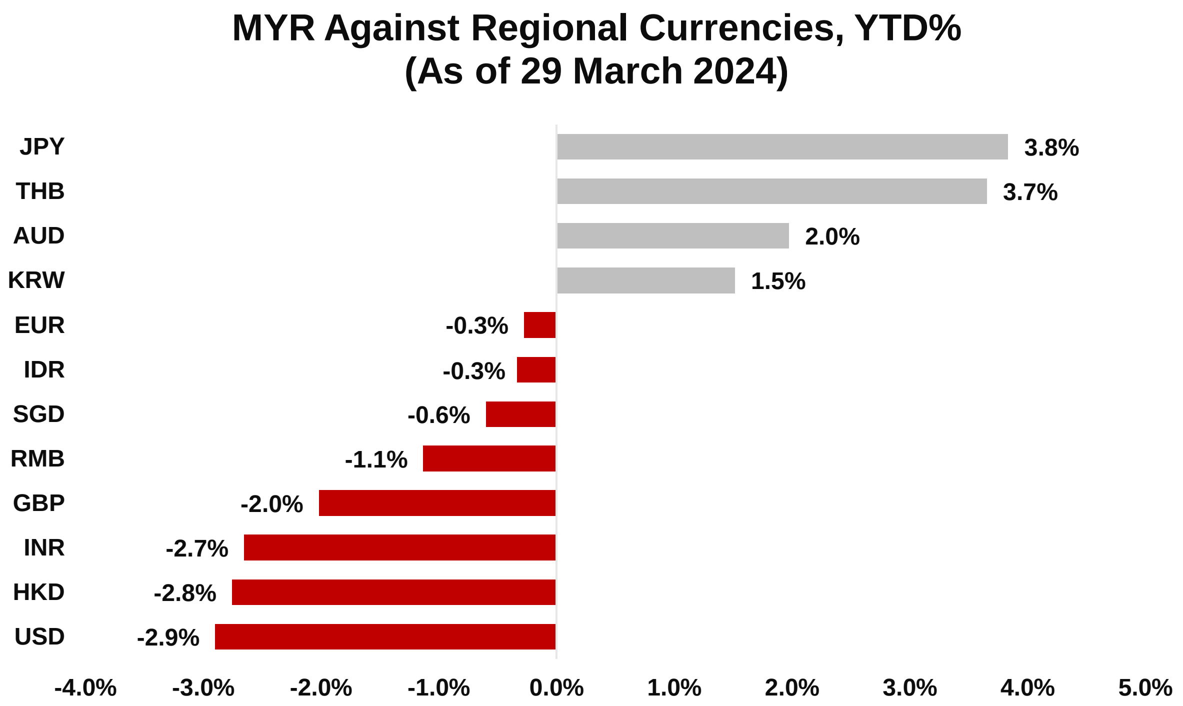




Source: BNM

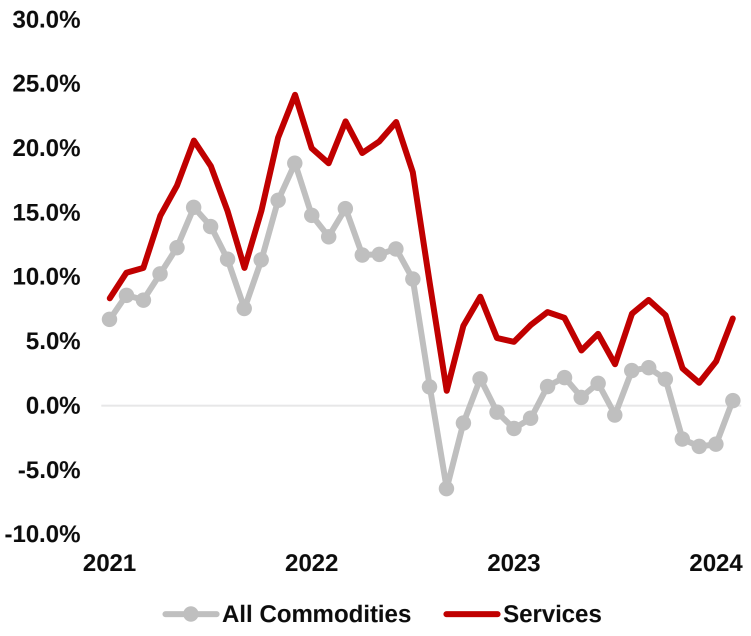
- YTD, the Ringgit recovered slightly, paring back some of the losses from the first two months of 2024 (-3.6%) to close down against the USD by just 2.9%.
- We posit the People's Bank of China's (PBoC) reinforced its support for the under-pressured Yuan could have helped its currency to rebound, thus stabilise the Ringgit's outlook given their strong positive correlation.
- Nevertheless, the Ringgit is still hovering around RM4.70 threshold as the USD index could have been bolstered by the S&P's reaffirmation of the U.S. AA+ rating, pointing to economic resilience. Previously, Fitch also reaffirmed U.S.' long-term foreign currency sovereign credit rating at AA+ with a stable outlook.
- Additionally, the Fed Governor Christopher Waller still sees no rush to rate cuts following sticky inflation data. Based on the latest projection, the policymakers continues to pencil three rate cuts this year, with markets expecting the first cut in June.

SECTION 2

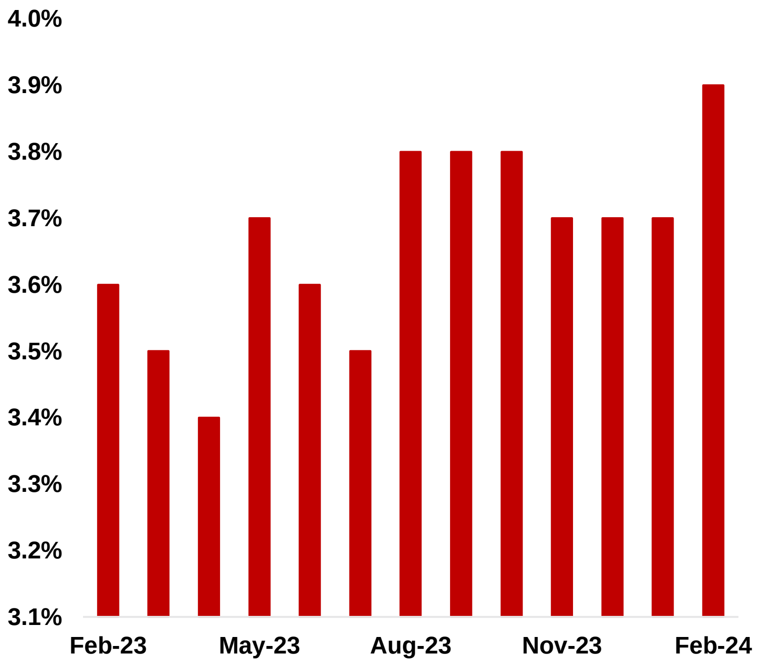
The Global Economy

WILL THERE BE MORE RATE CUT DELAYS FOR THE U.S.?

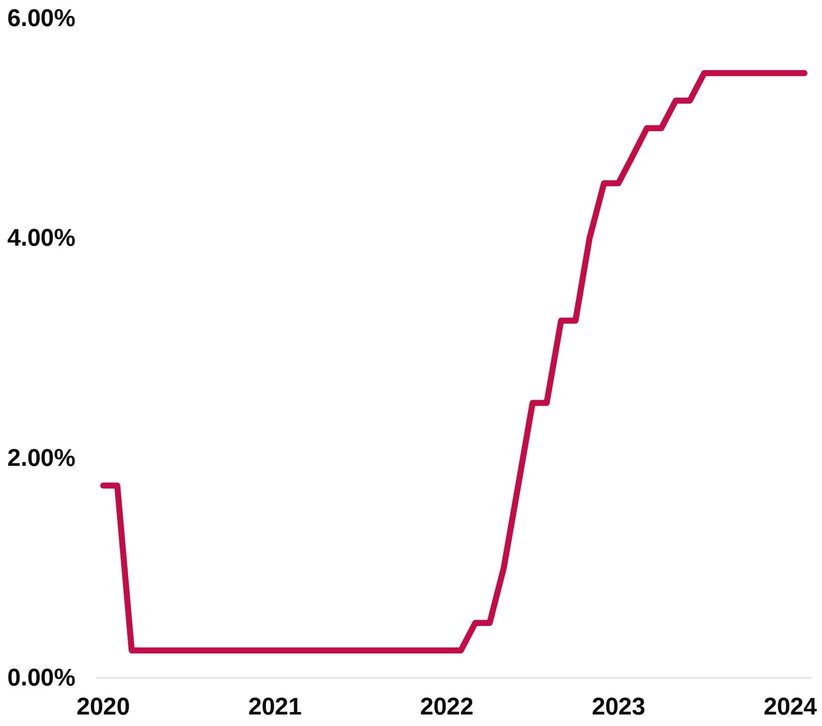
U.S. Consumer Price Inflation, 2021-2024 percent change over three months, annualised



Unemployment Rate, %



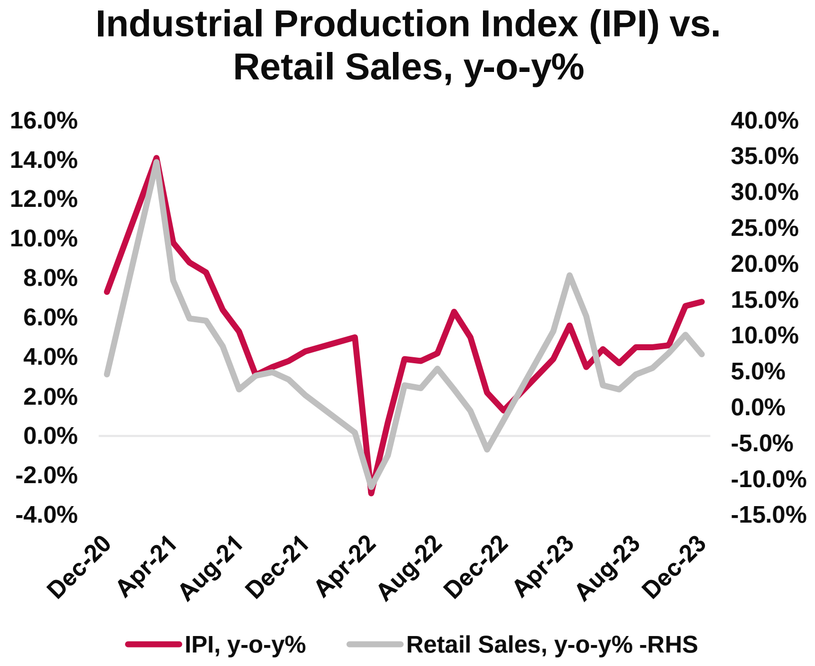
Federal Fund Rate (FFR), %

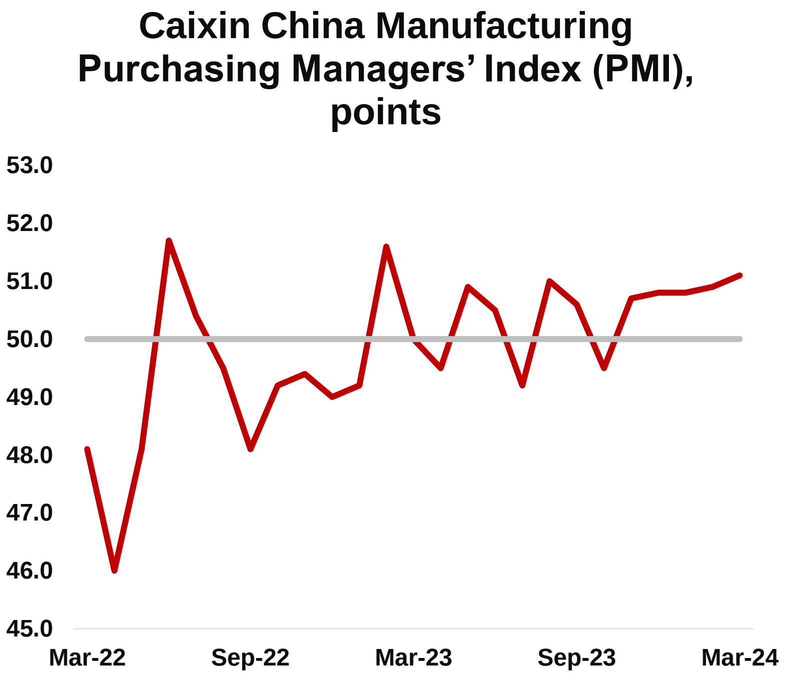


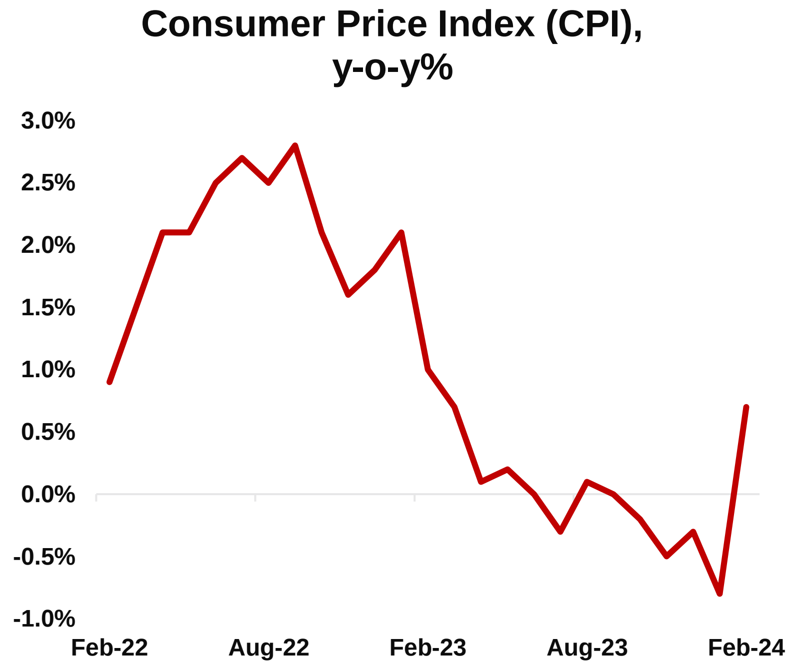
Sources: U.S. Bureau of Labor Statistics, Federal Reserve Board

- The three-month annualised figures for service sector inflation have moved up. That is not a welcome news considering the service sector dominates the economy and that suggests U.S. inflation may remain sticky.
- Recent inflation readings have prompted one of the Fed policymakers to view that it is prudent to hold steady the rate at its current restrictive stance for longer than previously thought to help the price pressures on a sustainable trajectory toward 2.0%.
- However, rate cuts this year are not off the table as it is highly anticipated to begin in June. While it could take a few months of easing inflation data to gain such confidence, until then, a strong economic performance could give the Fed some space to navigate how the economy is performing.

CHINA'S ECONOMY IS ON TRACK FOR STRONG MARCH PERFORMANCE







Sources: National Bureau of Statistics, S&P Global

- The country's retail sales recorded steady growth in the first two months of the year, up by 5.5%, topping market consensus of 5.2%, but slower than 7.4% increase recorded in December 2023. Despite a modest growth, the latest figure was the thirteenth straight month rise in the retail trade, offering some relief to policymakers despite the persisting weakness in the property sector that has undermined consumer confident.
- At the same time, the industrial output rose by 7.0% during January-February 2024, above market expectations of 5.0% and faster than 6.8% growth recorded in December last year.
- Meanwhile, China's factory activity in March expanded by its strongest pace since February 2023 at 51.1 (February: 50.9), suggesting signs of stabilising growth in the world's second largest economy.
- Though some are of the view that the China's growth target of 5.0% this year seems quite ambitious, it is achievable should the country is able to escape the deflationary spiral. For now, it might be too soon to celebrate the news as the latest CPI number is largely supported by the Lunar New Year holiday – a boom spending that has helped to lift the prices.

UNITED KINGDOM (U.K.)'S INFLATION AT THE LOWEST POINT SINCE SEPTEMBER 2021 – ALL EYES ON BOE'S NEXT MOVE

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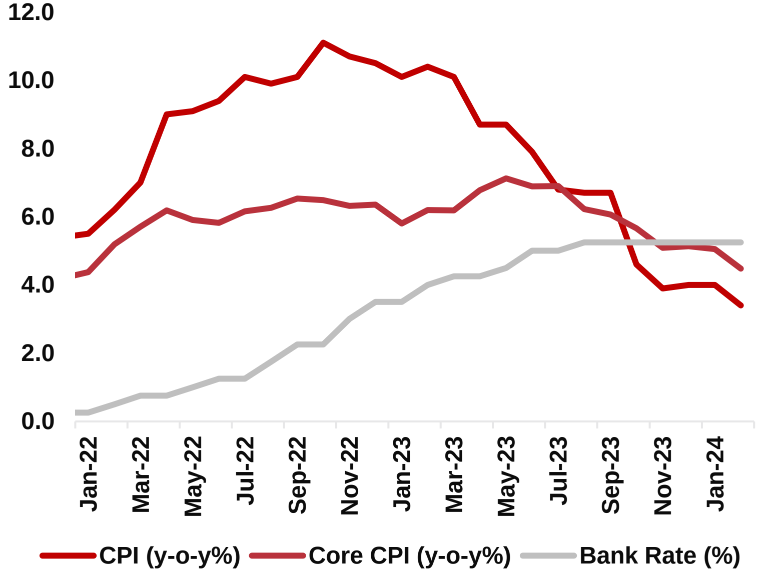
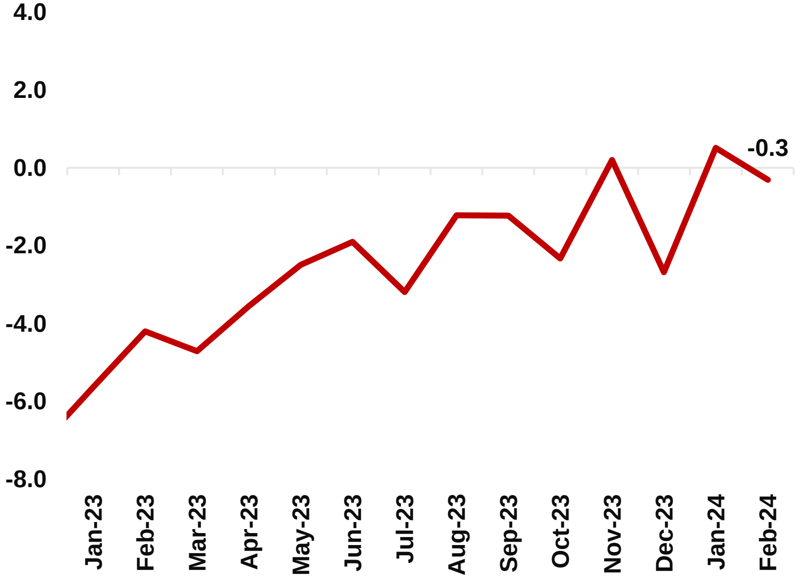
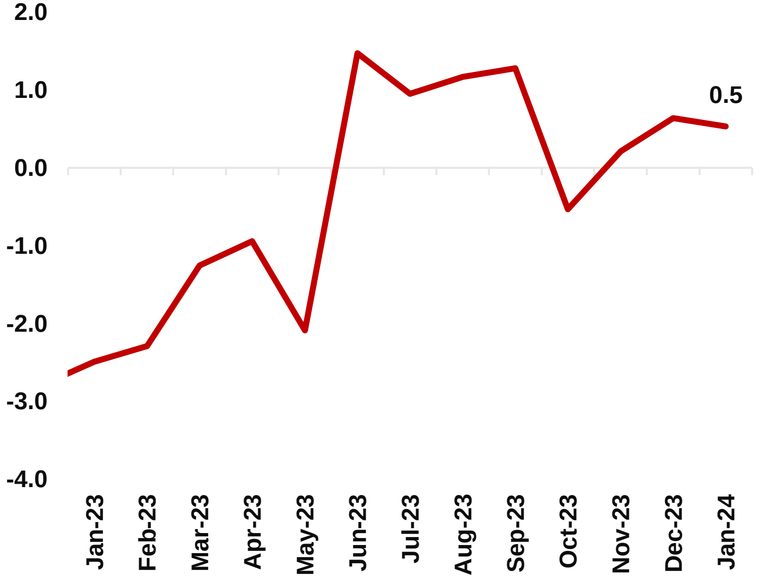
CPI vs. Core CPI vs. Bank Rate, %



Retail Sales inc. Fuel sa, y-o-y%



Index of Production sa, y-o-y%



Sources: Office for National Statistics (ONS), BoE

- Since BoE's last rate hike in August 2023 which brought the Bank Rate to the current 5.25% level, markets have been placing bets on when the rate cuts will begin, which is heightened by BoE's dovish shift in its latest policy meeting in March.
- Recent disinflationary trend sheds a more optimistic light on the timing of the rate cuts as the latest inflation print rose lower-than-expected at 3.4% in February (consensus estimate: 3.5%), dropping from January's 4.0%.
- Additionally, core inflation moderated to 4.5% in the same month (January: 5.1%) albeit persisting at more than double of the targeted 2.0%.
- On the job market front, the unemployment rate ticked up to 3.9% in January (December 2023: 3.8%) while the number of employed persons fell by 21K in January (December 2023: +72K).
- Coupled with the slowdown in wage growth for both private and public, households are feeling the pinch which resulted in a contraction of 0.3% in February's retail sales (January: 0.5%).
- As such, the Index of Production missed market expectations, rising by a mere 0.5% in January (Est: 0.7%).

SECTION 3

Domestic Landscape & Banking Sector Update

FIRM DOMESTIC AND EXTERNAL DEMAND HAS LED THE MANUFACTURING SECTOR THROUGH THE MUCH-ANTICIPATED REBOUND

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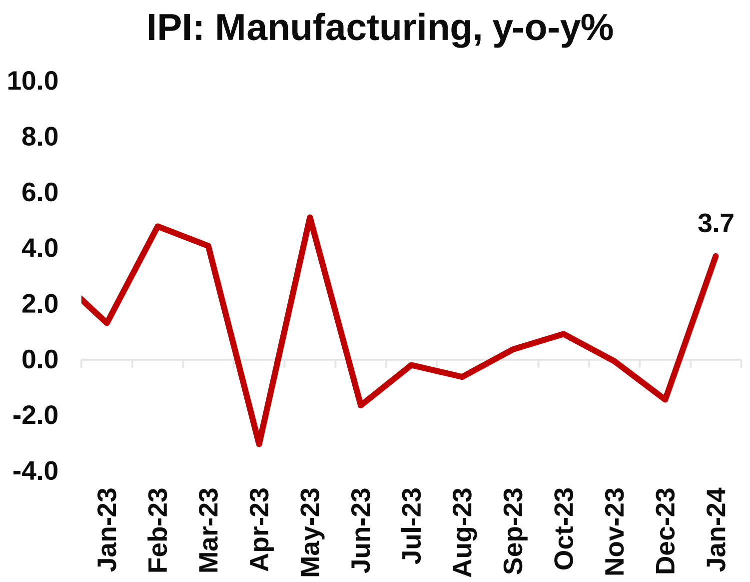
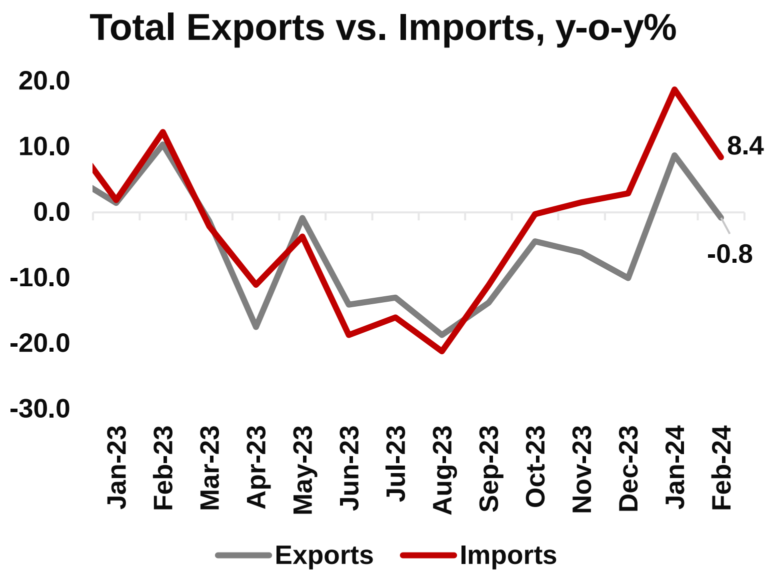
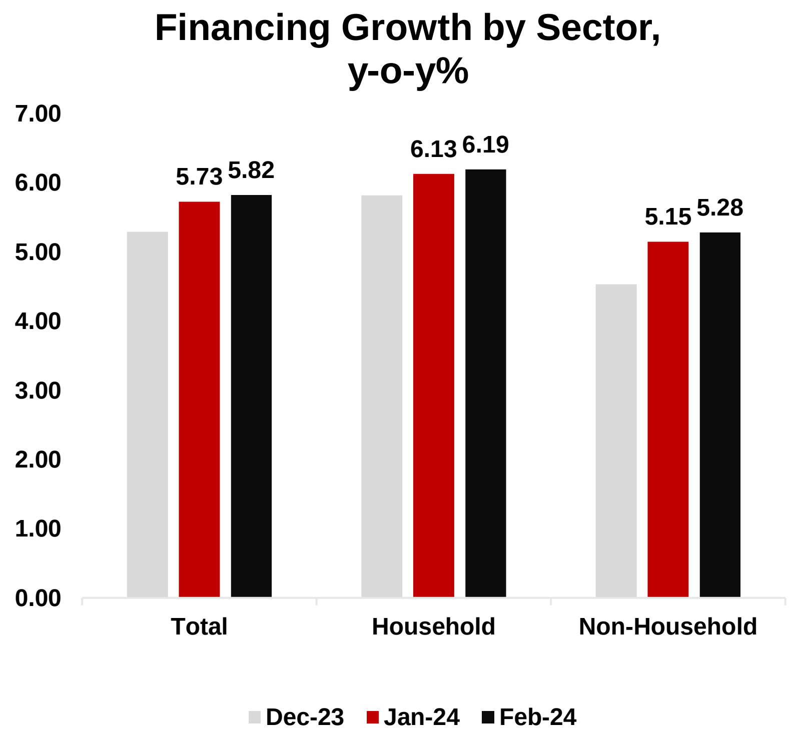


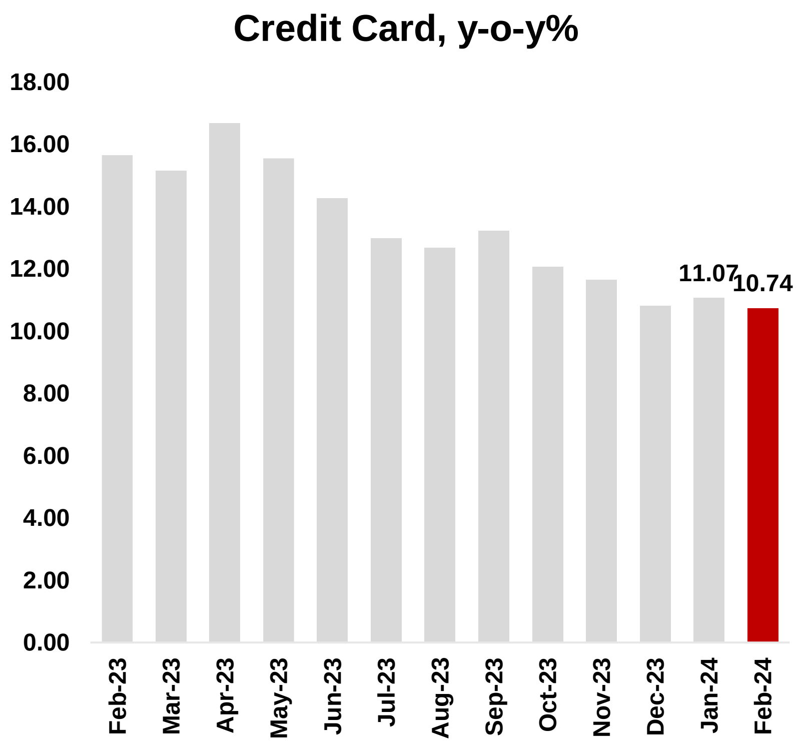


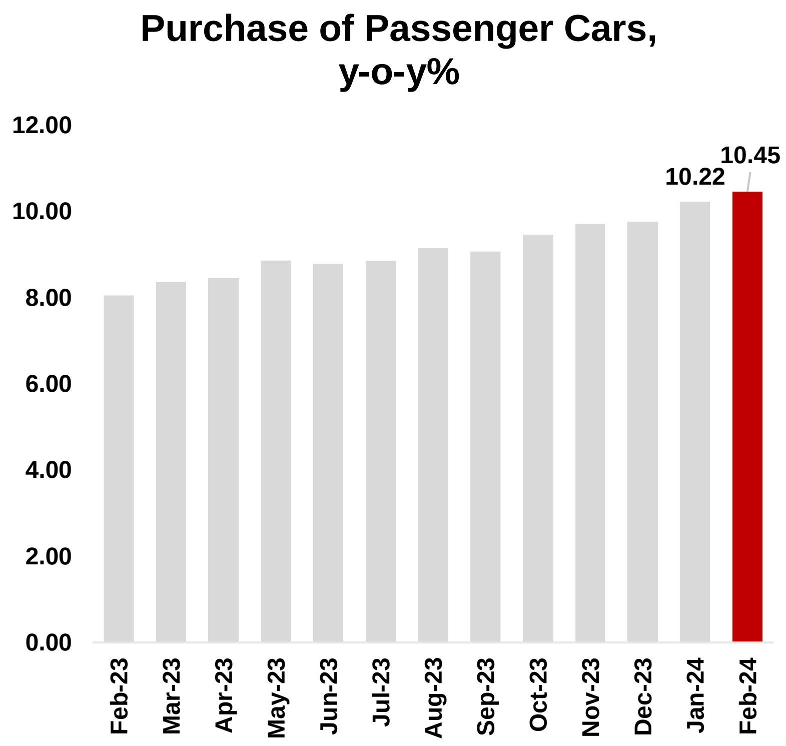
Sources: Department of Statistics Malaysia (DOSM), BNM

- Malaysia's IPI kicked off the year on a great start as it jumped by 4.3%, the highest in eight months, following December's stagnant performance, propelled by the revival of the manufacturing sector (January 2024: 3.7% vs. December 2023: -1.4%).
- Breaking down the key drivers for the sector, growth in factory activities encompassing domestic-oriented industries had accelerated by 8.0% in January from 4.2% in the previous month.
- At the same time, the output of export-oriented industries expanded by 1.6% (December: -4.1%), reflecting the uptick in external demand.
- However, the delicate recovery hangs on a thin thread as the latest trade figures shows that exports slipped by 0.8% in February (January: 8.7%) while imports rose at a relatively slower pace (February: 8.4% vs. January: 18.7%).
- Domestic demand remained a stable force in driving growth with Wholesale & Retail Trade expanded by 5.4% in January (December 2023: 4.8%), supported by a broad-based expansion in all sub-sectors. Of note, sales value of Motor Vehicles surged by 16.0%, in line with a 12.1% increase in Manufacture of motor vehicles, trailers and semi-trailers.

BANKING SECTOR: FEBRUARY MAINTAINED AN OVERALL IMPROVEMENT IN FINANCING GROWTH



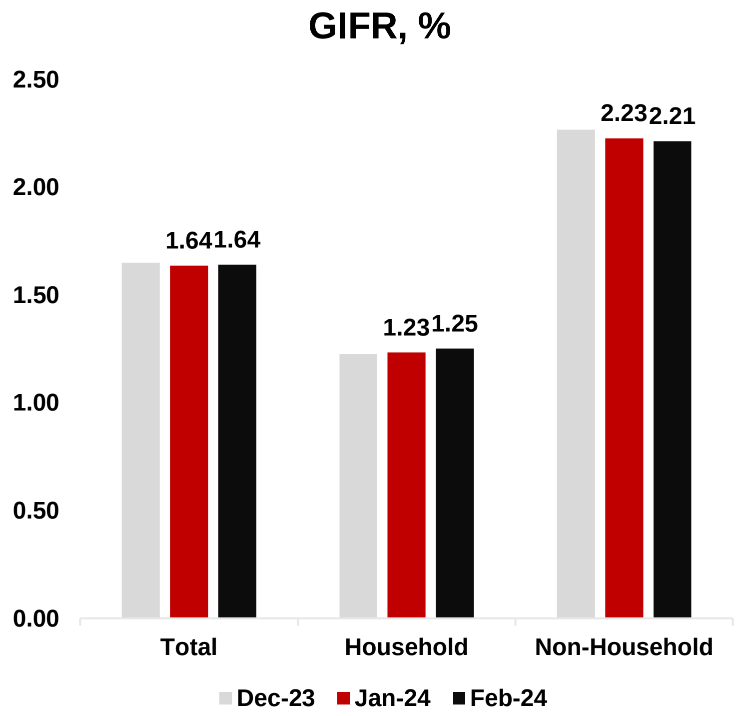


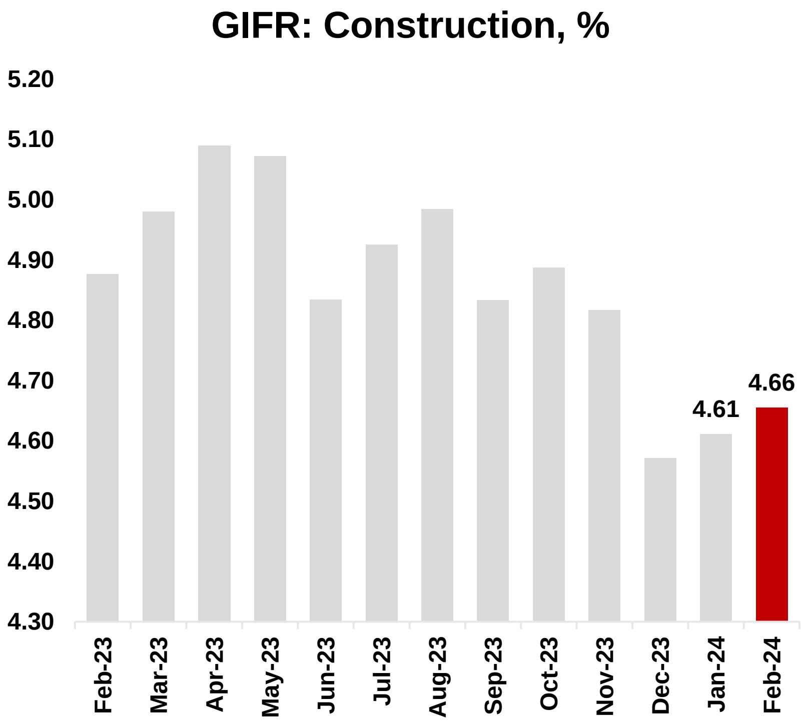


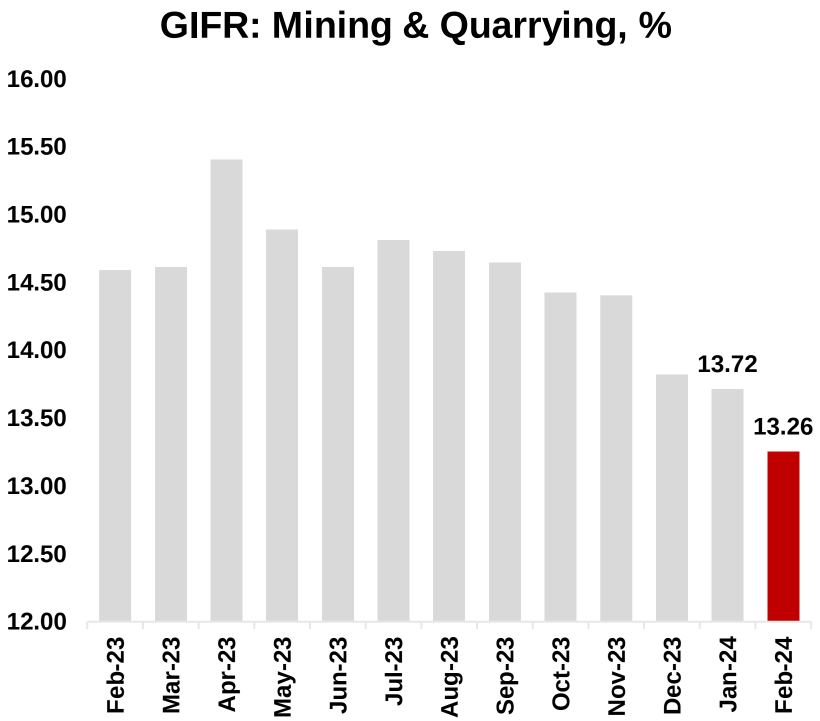
Source: BNM

- Financing activities grew by 5.82% in February from 5.73% registered in January. The non-household segment's financing growth rose slightly to 5.28% in February (January: 5.15%). Similarly, the growth rate in the household sector saw a slight uptick, rising to 6.19% in February from 6.13% in January.
- The credit growth in the purchase of passenger cars segment grew moderately to 10.45% in February (January: 10.22%). Conversely, the financing growth within credit card segment decreased slightly to 10.74% in February compared to 11.07% in January. Moreover, financing activities related to the purchase of residential property saw a slight increase, reaching 7.49% in February (January: 7.43%).

BANKING SECTOR: ASSET QUALITY REMAINED STEADY IN FEBRUARY







Source: BNM

- Total gross impaired financing ratio (GIFR) in the banking sector held steady at 1.64% in February (January: 1.64%). The GIFR in the household segment inched up to 1.25% in February (January: 1.23%). Furthermore, the impairment within the non-household sector down to 2.21% in February (January: 2.23%).
- The impairment within the construction segment expanded moderately to 4.66% in February from 4.61% in January. The asset quality in the Mining and Quarrying industry declined to 13.26% in February (January: 13.72%).

THANK YOU