5 April 2016

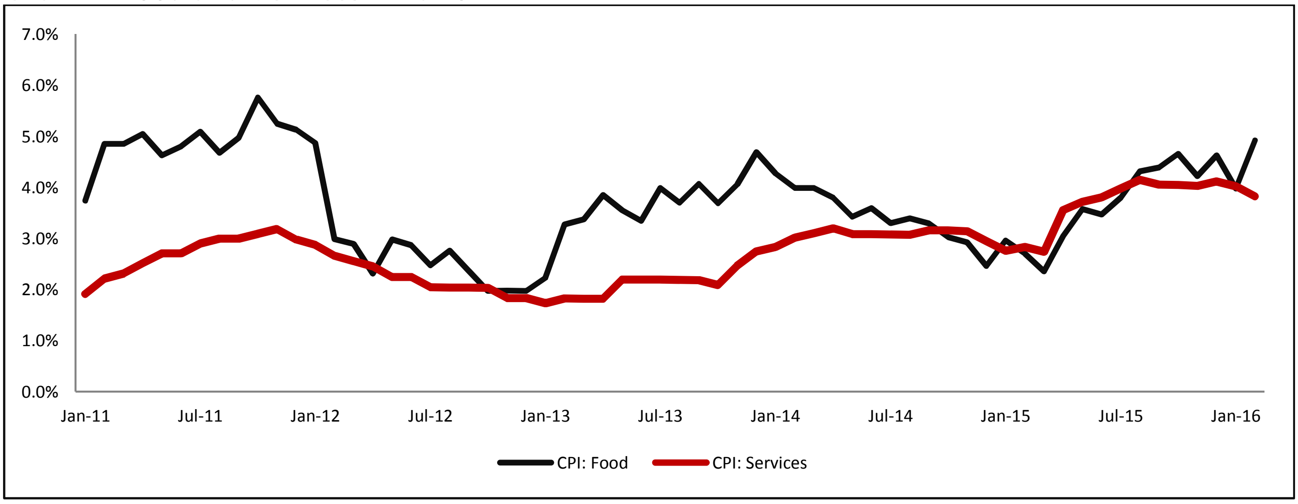
MONTHLY ECONOMIC REVIEW | March 2016

Ringgit Getting Closer to Its Fair Value

- *The 3-month average of leading indicator was still in negative territory after January's reading. Malaysia's official leading indicator entered into negative territory for the first time in the third quarter of last year and had dive deeper into the red in 4Q15. We maintain GDP growth expectation at 4.2% for 1Q16 and 4.4% for the whole of 2016.*
- *Highest inflation in 7 years at 4.2% year-on-year basis as gap of pump price in February narrows. Inflation in February reached 4.2%, the highest level in 7 years and in line with our forecast. We expect inflation to come in at 2.7% in March while keeping our forecast for the whole year at 2.6%*
- *At this juncture, we are expecting Fed will conduct an interest rate hike once this year in June by 25 bps, while OPR to be cut by 25 bps in 2H16. We are revising our Ringgit forecast from average RM4.175 to RM4.000 FY16, while upgrading year-end forecast from RM4.00 to RM3.85. We are not expecting negative sentiment on Ringgit to totally diminish, hence we do not perceive for Ringgit to return to its fair value (RM3.70) for now.*

Highest inflation in 7 years at 4.2% year-on-year basis as gap of pump price in February narrows. Inflation in February reached 4.2%, the highest level seen in 7 years. The number was in line with our forecast and slightly higher compared to the consensus at 4.1%. Most of the increase was due to the low pump price in February last year at RM1.70, which was much closer to the February 2016 pump price at RM1.75. On the other hand, core CPI increased by 3.6%yoy, similar to the previous month. On month-on-month basis, headline CPI maintained at the same level, though core CPI rose by 0.4%. Inflation ex-fuel rose to 4.4%. As an addition, food and non-alcoholic beverages price index rose by 0.7%mom in February, the most in 7 months, leading to 4.8% inflation on yearly basis, highest in 49 months.

Chart 1: Food and Services Inflation



Source: DoS, CEIC, MIDF Research

The 3-month average of leading indicator was still in negative territory after January's reading. Malaysia's official leading indicator entered into negative territory for the first time in the third quarter of last year and had dive deeper into the red in 4Q15. The trend is likely to continue in the first quarter of this year due to panic in the global financial market which has thus far seems to affect global trade as observed from regional trading peers. Malaysia's leading indicator has performed well in predicting the economy two quarters ahead. The past two quarters have been in negative while the latest reading in January registered 0.9% year-on-year decline. This means the reading is in line with our forecast of moderating economic growth in the first half of 2016.

IPI grew by 3.26%yoy, higher than consensus at 2.18%. The rebound was due to a better than expected figure in the mining index. On the other hand, manufacturing index continues to moderate. On a seasonally adjusted basis, IPI moderated to 0.49%mom, as the buying momentum in December slowed down. All of the three sub-indices registered positive growth in January, the first time in 4 months. Mining, manufacturing and electricity index expanded by 0.63%, 3.97% and 7.74% respectively on year-on-year basis.

Slowdown in January IPI is a world-wide phenomenon. The slowdown in the IPI data for January is not only observable in Malaysia, but could also be observed in various parts of the world. Among the 5 Asean economy, Thailand slowed down the most with 3.3% contraction, followed by Singapore and Indonesia with -0.5% and 2.9% respectively. On the other hand, among the major economies, Japan slowed down the most with 3.8%yoy contraction, US shrunk by 0.7%yoy and China growing by 5.4%. Overall, major economies are being hit the most, which we expect due to slowing demand from emerging market economies.

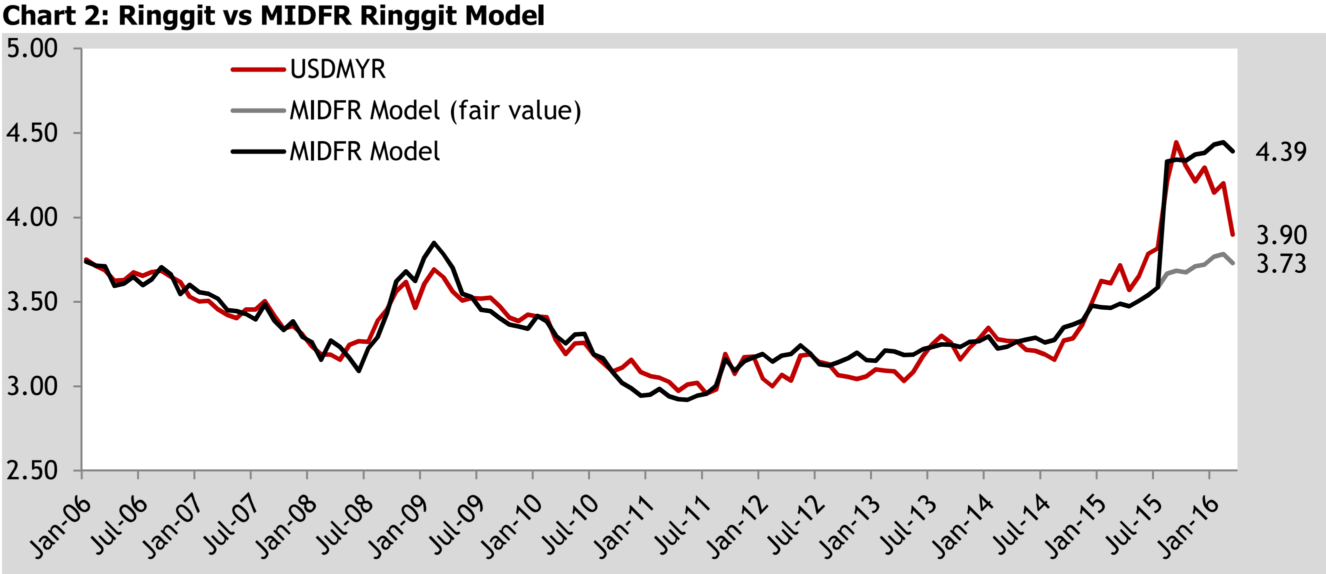
The Fed details out what 'data dependence' means. Despite the fact that Yellen has been stressing that they are being data dependent, it was becoming more clearer as she revealed that the 'data' was not only about the US economy, let alone the core PCE and unemployment rate. The 'data' includes;

i. global economy and financial market,
ii. stabilisation of Dollar,
iii. commodity prices stabilising,
iv. US housing sector performance
v. and inflation rate target

Achieving all of the conditions is an uphill task due to portfolio rebalancing effect. If the Fed decides to increase its interest rate target, capital inflow to the US economy will push the greenback to raise higher and pushing commodity prices lower. Otherwise, leaving the rates unchanged will send cue to the market that the Fed is not confident with the strength of US economy which in turns creates volatility in the financial market. The Fed seems to reach a difficult juncture and a gridlock in their future decision making.

Ringgit is getting closer to its fair value. Recent developments from both domestic and external factors are causing Ringgit to strengthen closer to its fair value. Recent developments at external and internal front such as Fed being more dovish than it was previously, 1MDB debt settlements news among other contributed to Ringgit getting closer to its fair value. However, we do not perceive that the negative sentiment will be able to be totally write-off, hence for Ringgit to reach its real 'fair value' would be difficult. As such, we are not revising our Ringgit average forecast from RM4.175/USD to RM4.000/USD while revising our year-end forecast from RM4.00/USD to RM3.85/USD.

Chart 2: Ringgit vs MIDFR Ringgit Model



Source: Bloomberg, MIDFR

(YoY%) unless stated otherwise	2014	2015	2016f	1Q16	2Q16f	3Q16f	4Q16
Real GDP	6	5.0	4.4	4.2	4.2	4.7	4.7
Private consumption expenditure	7.1	5.5	4.9	4.3	5.4	5.7	4.2
Government expenditure	4.4	4.7	2.7	1.7	1.7	2.6	4.9
Gross fixed capital formation	4.8	3.4	4.2	1.4	9.0	4.7	1.7
Exports of goods and services	5.1	0.6	2.2	2.0	5.8	1.0	0.0
Imports of goods and services	4.2	1.2	2.0	2.3	6.4	0.5	-1.3
Net exports	12.8	-3.3	3.8	-0.3	1.2	4.4	9.8
Nominal GDP	8.6	4.5	4.1	4.7	4.5	3.8	3.5
Exports of Goods (f.o.b)	6.3	1.9	3.9	2.2	5.9	6.2	1.6
Imports of Goods (c.i.f)	5.3	0.4	3.2	2.3	5.3	3.7	1.8
Trade Balance – RMb	82.5	94.3	102.9	21.7	22.7	27.9	30.6
Consumer price index	3.2	2.2	2.6	3.5	2.0	2.5	2.9
Current account – RMb	47.3	34.0	25.0	-	-	-	
Current account - % of GNI	4.8	2.8	2.5	-	-	-	
Fiscal balance - % of GDP	-3.5	-3.2	-3.1	-	-	-	
Federal government debt - % of GDP	52.7	54.3	53.8	-	-	-	
	2014	**2015**	**2016f**	**1Q16**	**2Q16f**	**3Q16f**	**4Q16**
Brent Crude Oil (Avg)	99.4	53.6	40.0	-	-	-	
Crude Palm Oil (Avg)	2,415	2,168	2,450	-	-	-	
USD/MYR (Avg)	3.273	3.907	4.000	-	-	-	
EUR/MYR (Avg)	4.347	4.336	4.400	-	-	-	
JPY/MYR (Avg)	3.096	3.228	3.350	-	-	-	
SGD/MYR (Avg)	2.583	2.840	2.800	-	-	-	
Brent Crude Oil (End of)	57.3	37.3	40.0	39.0	40.0	40.0	40.0
Crude Palm Oil (End of)	2,297	2,200	2,250	2,600	2,800	2,250	2,250
USD/MYR (End of)	3.497	4.294	3.850	3.900	4.000	3.950	3.850
EUR/MYR (End of)	4.251	4.691	4.350	4.446	4.500	4.450	4.300
JPY/MYR (End of)	2.922	3.572	3.150	3.464	3.300	3.200	3.150
SGD/MYR (End of)	2.647	3.040	2.850	2.895	2.950	2.850	2.850
Yield on generic 10-year MGS (%)	4.15	4.19	3.65	3.77	3.85	3.70	3.65
3-month KLIBOR (%)	3.86	3.84	3.40	3.71	3.65	3.40	3.40
Overnight policy rate (%)	3.25	3.25	3.00	3.25	3.25	3.00	3.00

March Key Economic Events

2 Mar 2016: China credit outlook cut to negative. Moody's cut China's credit outlook from stable to negative, as the massive capital outflow and slowing economy could eventually hit its fiscal position. On 31st March 2016, S&P followed Moody's to cut China's outlook from stable to negative. Currently, both Moody's and S&P are rating China's credit rating outlook at the lowest level of high investment grade, at Aa3 and AA- respectively. On the other hand, Fitch is still keeping China's rating outlook a band lower at A+ with stable outlook

10 Mar 2016: ECB Cuts Main Rates, Expands Asset Purchases. ECB made further cuts for major deposit and refinancing rates. Deposit rate was lowered to -0.4% from -0.3% previously while the main interest rate was pushed down by 0.5% to 0.0%. ECB also intends to increase its bond purchasing plan from €60 billion per annum to €80 billion per annum – a 33% increase, which will continue until the end of March 2017. In addition, the ECB will extend its bond purchases to include highly rated corporate bonds as well giving cheap four-year loans to banks.

16 Mar 2016: Fed Revised Its Interest Rate Projection. Fed decided to maintain the benchmark interest rate in March at 0.50% level while revising their target for fed fund rate at 1.00% FY16, down 1.50% from earlier forecast. The US economic growth was also revised downward by 0.2% to 2.2% for 2016 and 0.1% to 2.1% in 2017. Expectation on unemployment rate and core PCE inflation remained at 4.7% and 1.6% respectively.

17 Mar 2016: Bank Indonesia Rate Lowered 25bps to 6.75%. Bank Indonesia cut its interest rate for the third time this year by 25bps to 6.75%, its third consecutive cut since earlier this year. Bank Indonesia has mentioned that it "will be more careful in determining further monetary easing," reflecting that it is likely that the BI rate will be capped at the current level for a while.

24 Mar 2016: Taiwan Cuts Rate for Third Straight Meeting. The central bank lowered the benchmark discount rate by 12.5 basis points to 1.5 percent. The cut means this is the third consecutive quarters that the central bank cut the interest rates. Taiwanese economic output has shrank for two consecutive quarters, contracting by 0.8% and 0.5% in third and fourth quarter of 2015 while exports contracted by 6.6% in 2015. The first months of 2016 were still trending down with double digit contraction on year-on-year basis.

29 Mar 2016: Bank of England Raises Countercyclical Capital Buffer Rate. The Bank of England has previously mentioned the intention to gradually increase its countercyclical capital buffer rate from 0% to 1% although the impact should be mitigated by lower other capital buffers. At the same time, BOE instructed to have a tighter credit check on buy to let activities, including a stress test scenario where the mortgage rate rises up to 5.5%. Overall, the new rules are expected to reduce lending to landlords by up to 20%.

30 Mar 2016: Asian Development Bank Forecasts China Growth at 6.5% This Year. The central bank lowered the benchmark discount rate by 12.5 basis points to 1.5%. ADB's forecast was in line with economists' consensus at 6.5%. China's effort to shift its economy has not been showing signs of success. There was no sign that its imports volume has declined, its wage growth has been slowing down and its private consumption and services is yet to play a more significant role to its overall economy.

30 Mar 2016: Yellen Points Out 5 Conditions for Rate Hike. Fed's chairman revealed that being data dependence means the Fed is not only watching the core PCE and unemployment but also includes a multitude of other factors as follows; global economy and financial market condition must stabilize, Dollar must not appreciate further, commodity prices stabilizing, US housing sector to make larger contribution to the output and inflation reaching its 2% target in the mid-long term period

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER