MARC RATINGS BERHAD

P R E S S A N N O U N C E M E N T

MONTHLY REVIEW: MONETARY POLICIES IN TRANSITION COULD LEAD TO BOND MARKET VOLATILITIES

Malaysia's latest exports in June fell by 14.1% (May: -0.9%), as exports to the US and EU slumped by double-digits of 19.0% and 21.8%. The weaker external sector performance in 2Q2023 reinforced our views of weaker domestic gross domestic product (GDP) growth for the quarter. A sustained trade moderation coupled with higher interest rates in the advanced economies could reinforce a global economic slowdown in the coming months. However, domestic demand softened mildly, as the seasonally adjusted volume index of wholesale and retail trade eased for the third month to 4.6% in May (Apr: 4.8%).

On the bond market, the spread between the 10-year Malaysian Government Securities (MGS) and US Treasury (UST) yields narrowed significantly, due to the aggressive US rate tightening over the past two years. The sizeable positive spread of MGS over UST of 123 bps a year ago, has turned negative in July. While the local government securities continued to attract foreign demand with positive foreign flows of RM5.2 billion in June, the negative yield differentials with the UST could lead to volatility in the coming months.

The MGS yield curve in July has shown a noticeable flattening pattern when compared to three months and one year ago. Over the past year, the three-year yield fell by 15 bps to 3.39% while the 30-year yield declined as much as 62 bps to 4.18% (21 July 2022: 3.55% and 4.79%). The flattening of the yield curve partly reflects Bank Negara Malaysia's (BNM) policy actions over the past year, as well as market expectations for easing domestic inflation over time.

Inflationary pressures have similarly eased across emerging economies as central banks responded with rate tightening over the past year. A potential interest rate pause by the US Federal Reserve by year-end and softer inflation could prompt central banks in emerging economies to consider rate cuts. Consequently, the advanced and emerging economies' mixed stances on monetary policy could lead to capital flow fluctuations and increased volatility in bond markets.

Globally, concerns over inflation have alleviated, although central banks remain watchful. We maintain our 2023 inflation forecast at 2.8%, with the easing inflation trend anticipated to be sustained well into 2024 at 2.5%. In view of this, BNM is expected to maintain the overnight policy rate at 3.00% for the rest of the year. Overall, tighter monetary conditions and a challenging external environment could constrain domestic growth going forward, with the initial indications likely to be seen in the 2Q2023 GDP data due to be released in August. For now, we maintain our forecast for full-year 2023 GDP growth at 4.2% (2022: 8.7%).

The full report can be accessed here.

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