FUNDAMENTAL FLASH

Gradual Recovery for Malaysia

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Nearing Pandemic Peak?

Amidst tentative signs of the coronavirus infection starting to stabilise and stimulus optimism, global equity market gauges have staged a mild rebound. The MSCI World Index declined -31.7% as at mid-March and has recovered to -15.8% as at 10 April, delivering a recovery of +15.9%. The rally was also fuelled by additional stimulus measures from the US Federal Reserve that unleashed a US$2.3 trillion package.

In Asia, the MSCI Asia ex Japan Index fell -27.0% as at mid-March and has recovered to -15.2% as at 10 April, recouping back +11.8% in gains. In Malaysia, the FBM KLCI lost -22.6% as at mid-March and has recovered to -13.2% as at 10 April, eking a recovery of +9.4%.

Spain reported the fewest number of new coronavirus deaths in more than two weeks. Italy which was one of the hardest hit countries in Europe is starting to see signs of the pandemic ebbing. In the US, the daily rate of infection went below its daily average of 7.9% in the past week.

Locally, there are signs of the infection curve starting to flatten with an impressive recovery rate. The government has decided to extend the Movement Control Order (MCO) to April 28. It is hoped that a prolonged MCO would help flatten the curve and slow down the infection rate.

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Enough Policy Room for Malaysia

The Malaysia government has announced a volley of stimulus measures to help cushion the economy from the fallout of the coronavirus. These include the RM250 billion economic stimulus package called 'Pakej Rangsangan Ekonomi Prihatin Rakyat' (Prihatin), followed by a supplementary RM10 billion relief package for SMEs.

More pertinently, the wage subsidy programme was expanded to RM13.8 billion in total, from RM5.9 billion, with additional measures for all SME sizes (from under 75 employees to over 200 employees). The measure is critical to help buoy SMEs in this period particularly in terms of cashflow and job preservation. With SMEs making up about 38% of GDP and contributing two-third of employment in the country, it is critical that they are provided the assistance they need.

The country's **fiscal deficit is expected to widen to 4.7%** under the new stimulus package. The government will have to tap into the country's coffers including relying on dividend payments from GLCs like Petronas to help fund the package. However, this also comes on the back of depressed oil prices that may put additional fiscal constraints.

At a recent meeting between OPEC countries and its allies last week, the oil cartel collectively known as OPEC+ had agreed to production cuts of over 9.7 million barrels per day following multiple discussions after Mexico initially balked at a deal. However, it came below market expectations as the coronavirus pandemic eroded demand.

According to estimates, the pandemic has sapped demand by as much as 25 – 30 million barrels per day. Thus, the production cut is unlikely to be sufficient to help prop oil prices back to its previous highs. At most, the production cuts would be enough to provide a floor for oil prices to range between US$30-40 per barrel this year.

With most businesses remain shuttered due to the extension of the MCO order, economic forecasts and consumption figures have been significantly toned down for 2020. It will take time for consumption pattern to normalise and return to full scale. There may also be a drag on demand especially with social distancing measures becoming the new normal.

We believe there is still enough policy room for the government to stimulate/stabilise the economy if the situation worsens and the MCO continues to be extended. In the aftermath of the GFC, the country's fiscal deficit went as high as 6.6% in 2009. A stronger fiscal discipline and the lack of any high foreign currency debt, unlike during the 1997 Asian financial crisis also puts Malaysia in a better position today to weather through this crisis.

From a monetary policy standpoint, Bank Negara Malaysia (BNM) is expected to cut the overnight policy rate (OPR) by another 50 bps this year to shore up liquidity.

Swoosh-Shaped Recovery

Our base-case is for a gradual economic recovery with the market **staging a tick-shape or a 'Nike-swoosh' rebound.** We expect a very gradual recovery with a flatter upturn as economic activities pick-up and containment measures are slowly relaxed.

In the longer-term, given low foreign positioning and ample amounts of liquidity on the side-lines, any positive incremental change can spark a turn in the market once Covid-19 has been arrested.

It will be critical to monitor leading indicators including the peak of infection rates as well as development of a drug/vaccine to treat COVID-19. Whilst there are tentative signs of success regarding the use of re-purposed drugs, there is still little visibility on its timeline treatment.

The market has yet to also factor-in any risk of a second wave or re-acceleration in infection rates especially countries that has passed its peak like Korea, Taiwan, China and Japan. There could be further volatility if the above developments deteriorate or is prolonged from our base-case.

On portfolio positioning, we remain cautious on outlook and continue to stay prudent. We entered into this correction with ample liquidity and raised cash. As market conditions start to normalise following massive stimulus measures by global central banks like the Fed, we started to nibble back in and build back our position.

As a defensive measure, we continue to stick with low gearing names and focus on business models with higher chances to withstand the market shock. We also favour names with deep value.