21 November 2016

ECONOMIC REPORT | Ringgit Update

Ringgit Under Pressure as Fed December Rate Hike Seems Imminent

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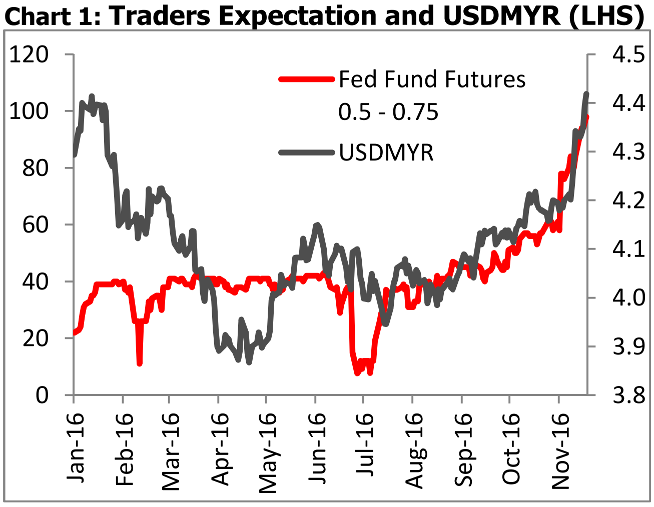
- *Despite the huge sell off this month, Ringgit could be repeating last year's post Fed rate hike rally*
- *We are revising our ringgit 2016 year-end forecast to RM4.35 – RM4.40 from RM4.10*

As December rate hike seems imminent, Dollar draws strength. The market is anticipating Trump's stimulus pledge estimated at more than USD550b to spark inflation, higher growth and eventually forcing the Fed to raise interest rates at faster pace than earlier anticipated. Traders are pricing in a 98% probability for 25bps December rate hike on 18 November, up against 84% the week before. Dollar also draws strength with the dollar index moved past the 100 points for the first time in 2016 while Ringgit along with other EM currencies took hit. Ringgit closed at 4.4183 on the same day, down by 4.9% since 8 November.

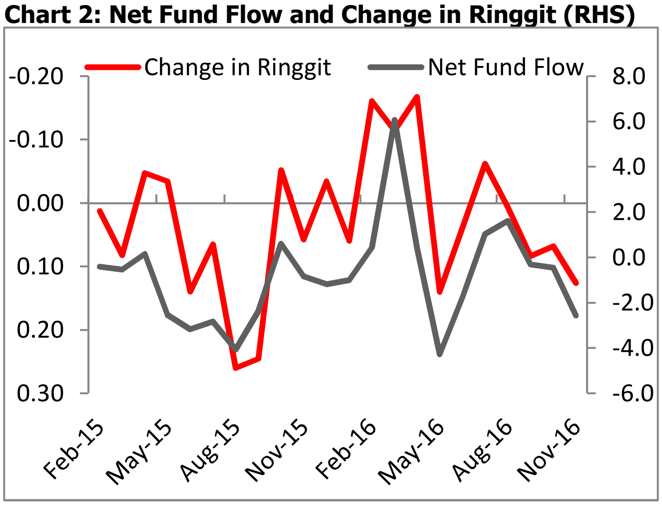
Despite the huge sell off this month, Ringgit could be repeating last year's post Fed rate hike rally. As of 18 November, net foreign outflow from the equity market for this month was at RM2.57b. This was the biggest outflow since May this year. Despite the huge sell off this month, Ringgit could be repeating last year's post Fed rate hike rally. Recall that foreign funds returns to EM markets including Malaysia early this year as Fed turned dovish as US economic data was worse than expected. The planned four rate hike did not materialise and at some point market lose confidence in Fed will do anymore rate hike this year. We think similar situation could happen in 1H17. Leading indicators are pointing towards further moderation in the US economic growth. Private investments have been in the negative for third consecutive quarters while corporate earnings are set to register the six successive decline in earnings.

Chart 1: Traders Expectation and USDMYR (LHS)



Source: Bloomberg, MIDF Research

Chart 2: Net Fund Flow and Change in Ringgit (RHS)

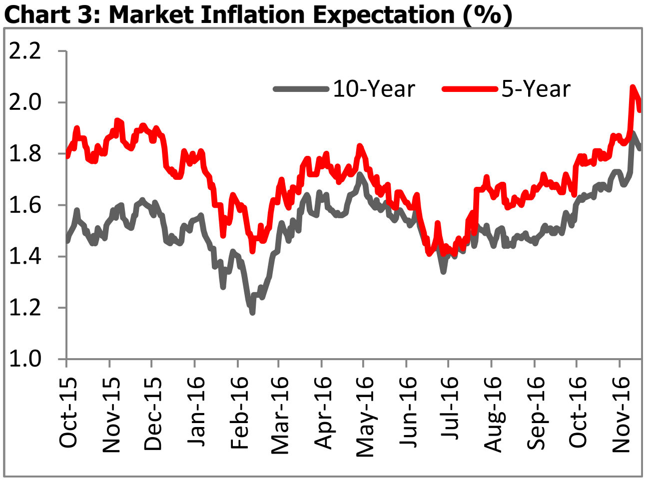


Source: EIA ; MIDF Research

Trump's pledged stimulus may not be forthcoming, fiscal constraint is the issue. It is rather questionable whether the US government will have the money to pursue Trump's fiscal policy manifesto (cutting taxes, spending on infrastructure etc). Note that the federal debt limit will be reinstated on March 2017, and with US current debt level close to USD20 trillion, it is yet to be known whether president-elect Trump will be able to follow through with his economic plan. However, we would expect that the current high yield and flow of funds into the US economy will continue until the Fed conducted the widely expected rate hike in December 2016. Until then, Ringgit is likely to remain under pressure. The situation could turn for the better after Trump enters the office on 20th January 2017. Clarity on the much anticipated policies directions in regard to stimulus packages, trades and foreign engagements will provide bearing on Ringgit performance for the rest of 2017.

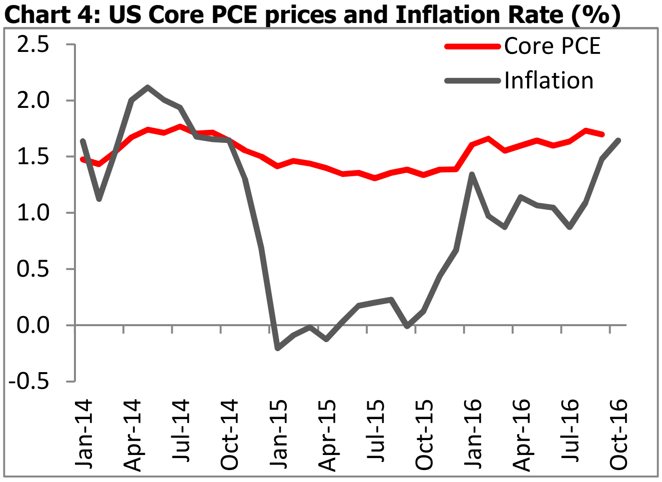
We are revising our ringgit 2016 year-end forecast to RM4.35/USD from RM4.10/USD. The market takes an interesting twist post-election. Trump's acceptance speech 'soothed' the market plus seemingly able to inject higher inflation expectation via anticipated stimulus pledges. We think greater expectation of inflationary pressure is transmitted and revealed in the current conditions of bond market. Regardless, the higher expectation has probably given what Yellen needs, a greenlight to proceed with the 25bps rate hike in the last of 2016 FOMC meeting come this 14 December. We forecast Ringgit to remain under pressure, trading range bound of between RM4.35/USD –RM4.45/USD throughout year-end. In 2017, we expect Ringgit to gain especially in the 1H17 on the presumption that commodity prices to stabilise at higher prices and the US economics growth to continue to underperform, recording below 2% year-on-year growth.

Chart 3: Market Inflation Expectation (%)



Source: Federal Reserve St Louis; MIDF Research

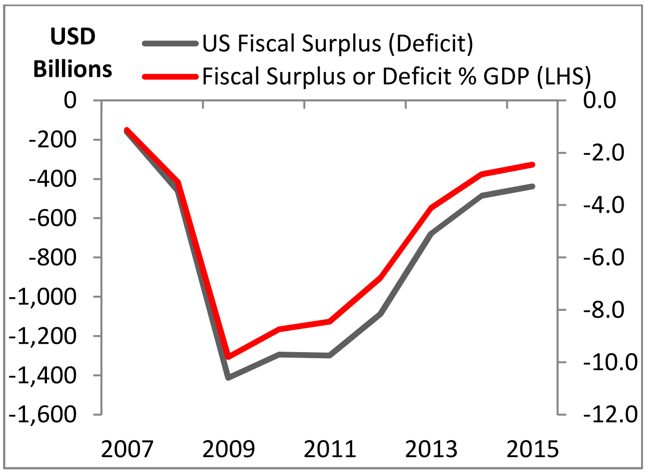
Chart 4: US Core PCE prices and Inflation Rate (%)



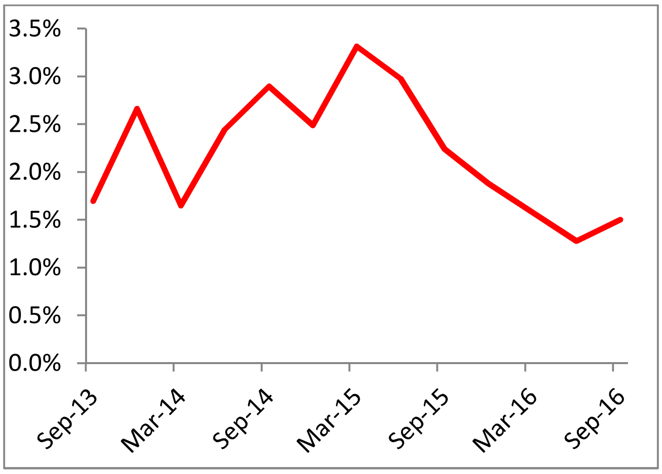
Source: US Bureau of Economic Analysis, MIDF Research

Chart 5: US Fiscal Deficit and Deficit To GDP Ratio

Chart 6: US GDP Growth (YoY)



Source: US Office of Management and Budget; MIDF Research



Source: US Bureau of Economic Analysis; MIDF Research

As for OPR, we opine that there will be at least another rate cut in 2017. However, as we are in the view that the moderation in Malaysia economy has yet to recede, we are keeping our stance that there will be at least another rate cut next year, leading the benchmark interest rate to settle at 2.75% by end of 2017. This is because despite our expectation of a better trade performance next year, the lagged impact of slow trade activity this year will only start to prevail in the first half of 2017, leading to a relatively weak domestic economy in 1H17. As such, we expect that BNM will intervene to stimulate domestic economy, despite slight recovery from the external front. As for the last MPC meeting on 23 November, we maintained our forecast of BNM to keep the OPR at the current rate of 3.00%.

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