THEMATIC REPORT

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Coronavirus, China & Malaysia

KEY INVESTMENT HIGHLIGHTS

- **Temporary economic impact**
- **China is expected to expand at a slower rate in the 1Q20 but not solely due to the 2019-nCoV epidemic. First quarter is usually off-peak period for semiconductor industry**
- **Global output to contract -0.56%. The impact of coronavirus and other viruses will be reflected by weaken household expenditure**
- **In a worst case scenario, ceteris paribus, GDP of China could fall by -2.67% while other countries like Taiwan, New Zealand, Vietnam and Malaysia are expected to experience slight downfall due to geographical and trade factors**
- **E&E and food products are among impacted sectors in Malaysia.**
- **Coronavirus attack adds another reason for the PBOC and the Chinese government to pursue both expansionary monetary and fiscal policies in 2020**

2019-Ncov: SHORT TERM ECONOMIC IMPACT

More infectious but less deadly. The 2019-nCoV is a virus that caused an outbreak of respiratory illness, first reported in Wuhan, China. According to Centres for Disease Control and Prevention (CDC), genetic analyses suggest this virus emerged from a virus related to SARS. Currently (6th February 2020), a total of 28,280 cases have been confirmed and among that, 565 were dead. The 2019-nCoV outbreak spreads faster than SARS as the latter took eight months to record about 8,000 cases while the current outbreak hit the number in a couple of weeks. However, the fatality rate is much lower compared to SARS (2% vs 9.6%).

Table 1: Brief Comparison of SARS and 2019-nCoV

	SARS	2019-nCoV
Year Identified	2003	2020
Cases	8,098	28,280
Deaths	774	565
Fatality Rate	9.6%	2.0%
Incubation Time	2-7 days	2-14 days
Number of Countries	29	28

Source: CDC, WHO, Johns Hopkins University

Temporary economic impact. We believe the economic impact of the virus is likely to be temporary based on previous experience. During the peak of SARS outbreak which was in 2Q03, the economic growth slowed to 9.1%yoy from 11.1%yoy in 1Q03. All three industries: primary, secondary and tertiary expanded at a softer pace. Among the tertiary sub-industries, transport, storage & post showed sharp slowdown (2.3%yoy vs 7.7%yoy in 1Q03). However, the economic growth quickly recovered to 10%yoy in the following quarter.

Chinese economy to slow in 1Q20. We expect China to expand at a slower rate in the 1Q20 but not solely due to the 2019-nCoV epidemic. The outbreak coincides with Chinese New Year festival where factories and businesses shut down for at least two weeks. However, the holiday could disrupt production up to two months as employees travel back to rural villages for the celebration. In addition, first quarter is usually off-peak period for the semiconductor industry.

China's current stage could influence the degree of economic impact. Based on 2015 global value chain model, China is the world's second largest economy, holding about 18.9% of global output. For comparison, China only accounted for 6% of global output in 2005. China made the significant improvement from ranked 4th in 2005 to 2nd in 2015. In line with the patterns in global output, China is rising strongly. Its global demand share rose from 4.5% to 14.2% over a decade. As China is more significant to the world now as compared to back in 2003, the momentum of the outbreak and impact to the economy could be greater. However, the Chinese government swift actions in locking down a number of cities, restricting travel and building a new hospital are likely to contain the virus. In addition, Chinese central bank has been rapidly placing several measures aiming at stabilizing the economy amid the outbreak. The latest measure announced was to inject USD173bn of liquidity into the financial system and cut short-term rates. All these pooled together could limit the impact.

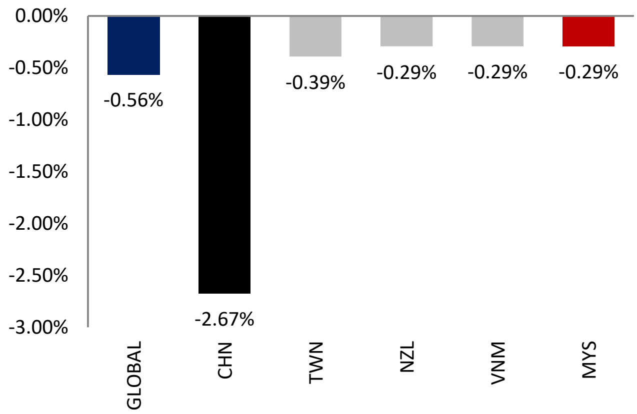
We maintain GDP growth forecast for Malaysia at 4.5%yoy in 2020. The 2019-nCoV will not directly impact Malaysian economy but indirectly through the external trade and investment medium. China is Malaysia's largest trading partner, accounting for approximately 17% of our total trade. However, at current stage we do not foresee any significant impact of the outbreak to Malaysian economy as we believe the threat is only temporary and will be contained. Hence, we maintain our full year GDP, export and import forecast at 4.5%yoy, 1.5%yoy and 0.8%yoy respectively.

SIMULATING WEAK HOUSEHOLD EXPENDITURE IN CHINA

Global output to contract at -0.56%. The impact of the coronavirus and other virus outbreak will be reflected by weaken household expenditure. Assuming 10% drop in China's household expenditure, global output is predicted to shrink by -0.56% with presuming all other factors remains constant. In this worst case scenario, GDP of China could fall by -2.67% while other countries like Taiwan, New Zealand, Vietnam and Malaysia are expected to experience slight downfall due to geographical and trade factors. Developed countries like EU27 and USA are less impacted in the event of weakening household expenditure in China. Please refer to Table 2 in Appendices section for details list of countries impacted.

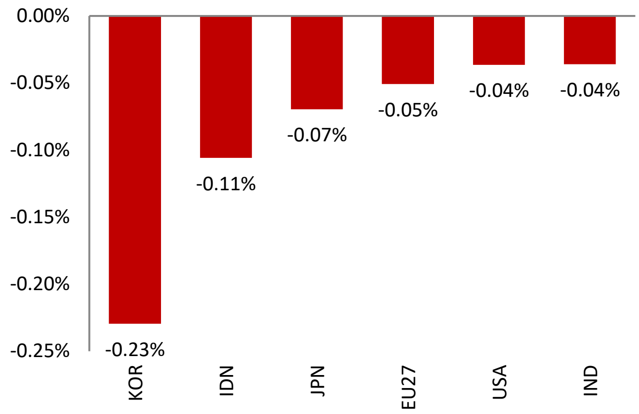
E&E and food products are among impacted sectors in Malaysia. Malaysia is among the main country to experience significant slowdown in the event of weakening household expenditure in China. Malaysia's main exports products to China like E&E, Food & Beverages, Chemicals and Agriculture products to be affected if the virus attacks continue to intensify in the world's second largest economy. Please refer to Table 3 & 4 in Appendices section for details of sectoral impacts in China and Malaysia.

Chart 1: Global Output Change, Top 5 (%)



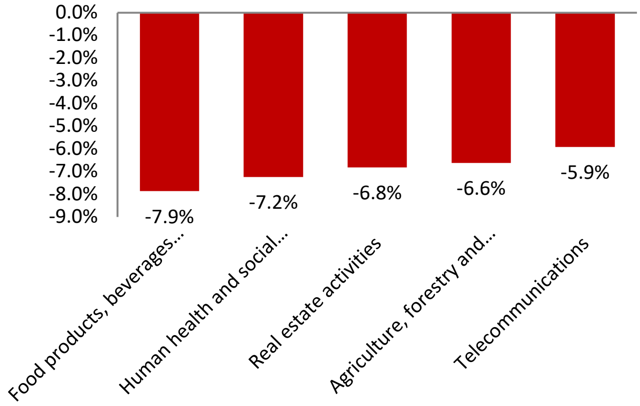
Source: OECD, MIDFR

Chart 2: Global Output Change, Major Economies (%)



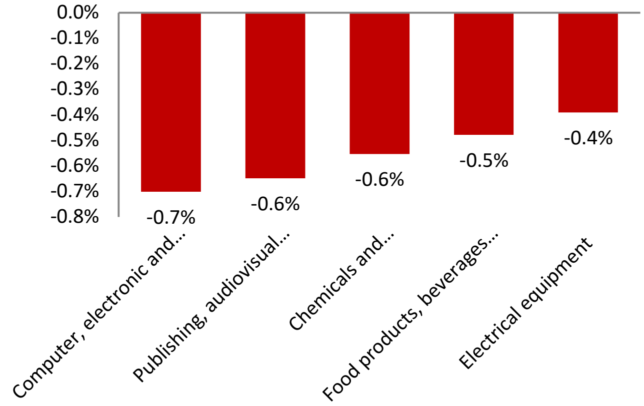
Source: OECD, MIDFR

Chart 3: Top 5 Sectoral Impact in China (%)



Source: OECD, MIDFR

Chart 4: Top 5 Sectoral Impact in Malaysia (%)



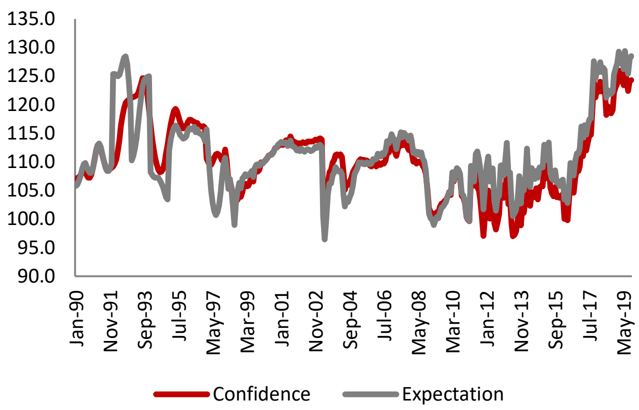
Source: OECD, MIDFR

CHINA: MODERATE GROWTH ALLOWS COUNTERCYCLICAL MOVES

China growth momentum continues at moderate pace. China's economy is projected to keep expanding at moderate pace as the economy is still surrounded by downside risks such as escalating trade tension, rising inflationary pressure and volatility in commodity prices. On a flip side, we expect its growth to maintain above 6.0% amid firm domestic demand and government spending. At the current juncture, the economy is operating at full-employment condition and consumer sentiment is at super high level. In addition, the Chinese government has room to spend and invest given that its government debt to GDP is only at circa 50.5%.

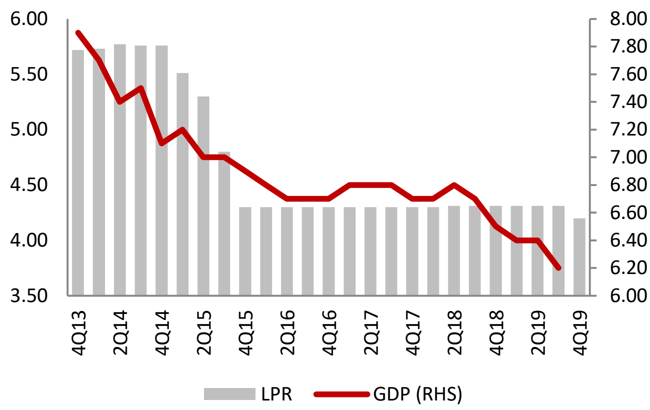
China has extra bullets. On monetary side, People's Bank of China (PBOC) has not aggressively cutting interest rate in 2019. The central bank had slashed only 15bps with the current rate at 4.15%. As China's economy is anticipated to continue growing at a moderate pace this year, we expect PBOC to adopt a more expansionary monetary policy. On top of that, we view the coronavirus attack adds another reason for the central bank and government to pursue both expansionary monetary and fiscal policies in 2020. Further cuts would strengthen Chinese domestic demand especially household spending and business investment. Judging from 2015 precedent, we opine PBOC may cut its loan prime rate to as low as 3.00% in 2020.

Chart 5: Consumer Confidence (Points)



Source: CEIC, MIDFR

Chart 6: Loan Prime Rate vs GDP Growth (%)



Source: CEIC, MIDFR

STRATEGY

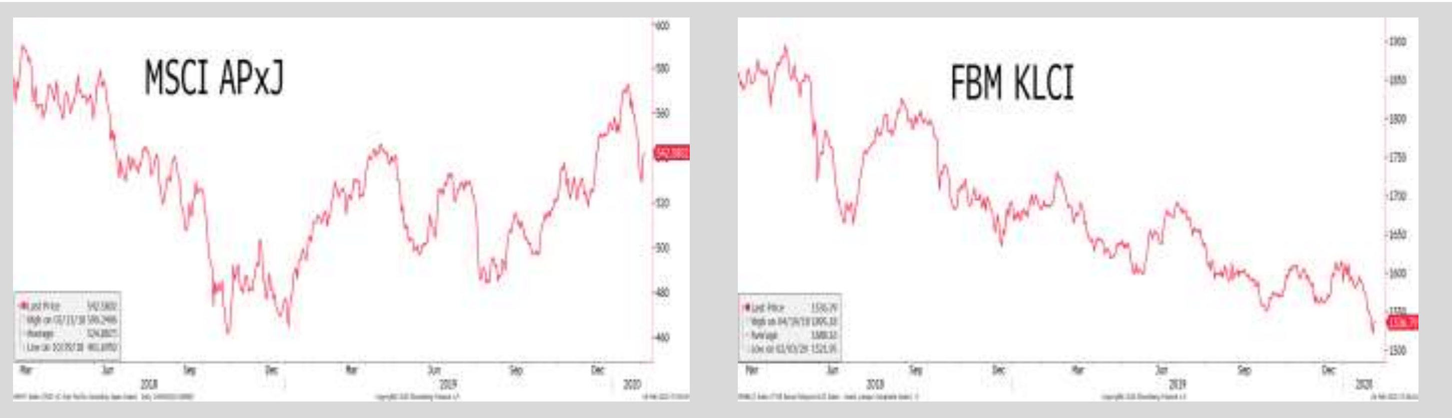
In our earlier Strategy report dated 31 December 2019, we lamented over the comparatively muted response by East Asian monetary authorities to the prevailing economic slowdown. In China, despite its GDP growing at multi-decades low, the PBOC has been especially measured in its monetary policy reaction. The China central bank has thus far (since the onset of US-China trade spat in March 2018) decided to cut its LPR policy rate by a relatively miniscule 15bps (from 4.30% to 4.15%) in total.

In the US, despite its hitherto buoyant economic performance, the US Fed decided on multiple rate cuts totalling 75bps in 2019. Whereas in Europe, the ECB reacted to the economic slowdown by postponing an earlier planned timeline of rate hikes and instead announced the resumption of liquidity injections via TLTRO III program.

In regards of the above, it is notable that while key European economies, namely France and Germany, were teetering on the brink of technical recession (i.e. France 4Q19 GDP contracted -0.1%; Germany 2Q19 GDP contracted -0.2%), the Euro region STOXX600 index began to rally off a cyclical low in the first quarter of last year and eventually achieved a new all-time high in mid-January 2020.

Source: Bloomberg, MIDFR

The apparent disconnect between prevailing fundamentals and price performance can be ascribed to liquidity-induced valuation expansion in European equities during the past year. Stateside, the S&P500 and other key Wall Street indices also made new all-time highs on multiple occasions until as recent as this week.



Source: Bloomberg, MIDFR

On the other hand, most East Asian indices are struggling even to return to the March 2018 (being the starting point of the ongoing trade spat and ensuing macro slowdown) levels. Meanwhile, earlier this week, the local benchmark FBM KLCI briefly fell into bear territory (i.e. decline of more than 20% from the peak, or approximately 1,518 points).

In this regard, we can argue that the underperformance of East Asian equities benchmark MSCI Asia-Pacific ex-Japan (MXAPJ) vis-à-vis US (S&P500) and European (STOXX600) counterparts during the past year can be partly attributed to the relative lack of aggressiveness in monetary policy reaction by the PBOC (being the most dominant central bank in East Asia) to the prevailing economic slowdown.

We earlier reckon, without a more accommodative monetary stance, the East Asian region may continue to be beset by the relative lack of liquidity-induced macro reflationary prospects.

However, unexpectedly, the forward push for a more aggressive monetary easing [by the PBOC in particular] may have been recently triggered by a deadly virus.

MORE LIQUIDITY ON THE HORIZON

The coronavirus epidemic is still evolving. Up until now, hundreds of people have died with more than twenty thousand reported cases. These numbers, mostly China-based, are expected to rise.

While the immediate fallout from the outbreak on China's economy (i.e. travel bans, flight cancellations, value-chain disruptions, business/consumer sentiments) is inevitable, we expect the monetary/fiscal authorities to duly react to mitigate any medium to longer term economic implications.

We opine there is now a **higher likelihood for the PBOC to take a more accommodative monetary stance** in order to provide a backstop to the impending economic fallout from the coronavirus epidemic. Hence we would not be surprised to see more meaningful cuts in the key LPR policy rate going forward. In addition, depending on the severity of the virus outbreak, other regional central banks may also react in tandem.

Having said the above, our baseline scenario is for the coronavirus outbreak to be brought under control within the next six months, i.e. similar to the duration taken to contain the 2002/3 SARS epidemic.

FBM KLCI: Market reaction to SARS epidemic in 2002/3

Source: Bloomberg, MIDFR

Thus, as in year 2002/3, we envisage that the equity market would be trapped in a cautious mood during the next 3 to 5 months. However, the additional region-wide financial liquidity (from further rate cuts by PBOC in particular) may help to lend downside support. As the total number of infected cases begins to dwindle, the market shall thereafter regain upward momentum and recover to levels prior to the onset of the outbreak.

Looking further forward into the second half of this year, we reckon the additional financial liquidity would continue to propel the regional equity markets higher with the local benchmark FBM KLCI scaling towards our 2020 baseline target.

At this juncture, pending further insights over the coronavirus epidemic, we reiterate our year-end 2020 baseline target for the **FBM KLCI at 1,680 points**.

Appendices

Table 2: Global Output Change by Country (%)

Countries	Code	Output Change
China	CHN	-2.67%
Taiwan	TWN	-0.39%
New Zealand	NZL	-0.29%
Vietnam	VNM	-0.29%
Malaysia	MYS	-0.29%
Thailand	THA	-0.24%
Singapore	SGP	-0.24%
South Korea	KOR	-0.23%
Cambodia	KHM	-0.16%
Chile	CHL	-0.15%
Saudi	SAU	-0.14%
Hong Kong	HKG	-0.14%
Peru	PER	-0.13%
Australia	AUS	-0.13%
Brazil	BRA	-0.12%
Philippines	PHL	-0.11%
Indonesia	IDN	-0.11%
Brunei	BRN	-0.10%
Rest of World	ROW	-0.10%
Kazakhstan	KAZ	-0.09%
Russia	RUS	-0.09%
South Africa	ZAF	-0.09%
Argentina	ARG	-0.07%
Japan	JPN	-0.07%
Switzerland	CHE	-0.06%
Iceland	ISL	-0.06%
Canada	CAN	-0.06%
European Union	EU27	-0.05%
Costa Rica	CRI	-0.05%
Norway	NOR	-0.05%
Israel	ISR	-0.04%
Colombia	COL	-0.04%
USA	USA	-0.04%
India	IND	-0.04%
UK	GBR	-0.03%
Morocco	MAR	-0.03%
Tunisia	TUN	-0.03%
Mexico	MEX	-0.03%
Turkey	TUR	-0.02%

Source: OECD; MIDFR

Table 3: Sectoral Impact in China (%)

Type of Product	Output Change
Food products, beverages and tobacco	-7.9%
Human health and social work	-7.2%
Real estate activities	-6.8%
Agriculture, forestry and fishing	-6.6%
Telecommunications	-5.9%
Accommodation and food services	-4.9%
Publishing, audiovisual and broadcasting activities	-4.3%
Financial and insurance activities	-4.1%
Transportation and storage	-3.2%
Electricity, gas, water supply, sewerage, waste and remediation services	-3.1%
Wholesale and retail trade; repair of motor vehicles	-3.0%
Arts, entertainment, recreation and other service activities	-2.9%
Textiles, wearing apparel, leather and related products	-2.6%
Coke and refined petroleum products	-2.6%
Paper products and printing	-2.4%
Education	-2.4%
Other business sector services	-2.4%
Chemicals and pharmaceutical products	-2.3%
Mining support service activities	-2.2%
Mining and extraction of energy producing products	-2.2%
Motor vehicles, trailers and semi-trailers	-1.6%
Other manufacturing; repair and installation of machinery and equipment	-1.5%
Rubber and plastic products	-1.5%
Wood and products of wood and cork	-1.2%
Electrical equipment	-1.1%
IT and other information services	-1.1%
Computer, electronic and optical products	-1.0%
Mining and quarrying of non-energy producing products	-0.9%
Fabricated metal products	-0.8%
Basic metals	-0.7%
Other non-metallic mineral products	-0.7%
Other transport equipment	-0.5%
Machinery and equipment, nec	-0.4%
Public admin. and defense; compulsory social security	-0.2%
Construction	-0.1%
Private households with employed persons	0.0%

Source: OECD; MIDFR

Table 4: Sectoral Impact in Malaysia (%)

Type of Product	Output Change
Computer, electronic and optical products	-0.7%
Publishing, audiovisual and broadcasting activities	-0.6%
Chemicals and pharmaceutical products	-0.6%
Food products, beverages and tobacco	-0.5%
Electrical equipment	-0.4%
Agriculture, forestry and fishing	-0.4%
Mining and quarrying of non-energy producing products	-0.4%
Wholesale and retail trade; repair of motor vehicles	-0.3%
Other non-metallic mineral products	-0.3%
Rubber and plastic products	-0.3%
Wood and products of wood and cork	-0.3%
Transportation and storage	-0.3%
Mining support service activities	-0.2%
Mining and extraction of energy producing products	-0.2%
Coke and refined petroleum products	-0.2%
Basic metals	-0.2%
Other manufacturing; repair and installation of machinery and equipment	-0.2%
Fabricated metal products	-0.2%
Paper products and printing	-0.2%
Textiles, wearing apparel, leather and related products	-0.2%
Other business sector services	-0.2%
Machinery and equipment, nec	-0.2%
IT and other information services	-0.2%
Electricity, gas, water supply, sewerage, waste and remediation services	-0.2%
Financial and insurance activities	-0.1%
Other transport equipment	-0.1%
Telecommunications	-0.1%
Motor vehicles, trailers and semi-trailers	-0.1%
Arts, entertainment, recreation and other service activities	0.0%
Accommodation and food services	0.0%
Real estate activities	0.0%
Human health and social work	0.0%
Construction	0.0%
Education	0.0%
Public admin. and defense; compulsory social security	0.0%
Private households with employed persons	0.0%

Source: OECD; MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.