**Malaysia**

**Improved Macro Conditions**
Despite the fragile external environment, Malaysia’s economic growth has held above 4% against potential GDP growth of 4.5-5.0%. Economic indicators have improved since November last year with exports rebounding to double-digit growth, resilient manufacturing output over 4% buoyed by higher export orders, and the Nikkei manufacturing PMI rising to its highest level in 21 months in February signaling improving manufacturer confidence. Recent loan indicators signal stable loan growth momentum of ~5% in the coming months, which is supportive of further economic growth in 1H 2017.

Private consumption will be held up by positive wage adjustments for minimum wages, civil servant salaries and higher government cash-handouts for 6.3 million low-income applicants totaling MYR5.41bn this year. There has been a raft of domestic support measures including big ticket infrastructure spending to spur growth in the short and medium term. Positive news on Malaysia and China signing of MYR144bn worth of agreements and the Saudi Aramco and Petronas US$7bn deal in developing RAPID has been eye-catching in lifting sentiment. The weaker Ringgit has made Malaysia a compelling investment destination.

Oil prices have averaged US$55/bbl through most of first quarter against the government’s oil price assumption of US$45/bbl under Budget 2017 implying some fiscal buffer. The current account surplus as a percentage of GDP widened to 3.7% in 4Q 2016, bringing the full year surplus to 2.0% (3.0% in 2015) which helps to allay initial fears of a current account deficit. Our estimations show every 1% rise in average Brent crude oil price increases the current account by 0.4%.

**Interest Rates On Hold**
Bank Negara Malaysia (BNM) has kept the Overnight Policy Rate (OPR) unchanged in the first two meetings this year and signaled no rate change for now. The pressure to ease rates has abated amid stabilizing growth. While inflation has trended upwards since January, price pressures are largely cost-driven on the back of reversal in energy prices. Headline inflation is expected to average 4% in 1H 2017 assuming global oil prices between US$50-55/bbl. But we do not see prospects of negative real interest rates prompting BNM to tighten policy given that the upshift in inflation is expected to be temporary on the back of normalizing oil prices, signs of moderate domestic demand, and caution on lingering external risks. On balance, we think BNM is likely to keep OPR unchanged through the year.

**Ringgit Flat lines**
Post US elections, USD/MYR gapped up above the 4.00-4.20 range to end last year at 4.48. The pair has since steadied within 4.40-4.46 since February. The Ringgit remains undervalued on a real effective exchange rate basis despite more encouraging macro conditions, suggesting that factors weighing on Ringgit are beyond fundamentals. Amid prospects of higher US interest rates and stronger dollar, BNM continues to juggle an arduous task of managing pressure on the local currency and ensuring stable financial markets. Foreign reserves has held steady at US$95bn since end-January. Following the introduction of new FX measures and intensified actions to clamp down offshore Ringgit non-deliverable forwards (NDFs), investors raised concern on reportedly low levels of liquidity in the onshore ringgit market that prevents a more effective pricing for the ringgit. BNM noted that the onshore FX market is still undergoing adjustments and the central bank has been supplying liquidity in addressing demand and supply mismatches. Meanwhile volumes have been sustained by the conversion of export proceeds that has helped to shore up liquidity of foreign currency in the onshore market. To assure investors, BNM has clarified that capital markets remain open. BNM introduced the dynamic hedging framework to facilitate investor needs and more hedging instruments to improve market liquidity are in the pipeline.

We think there is genuine interest in Malaysian assets judging by its compelling valuations. Prospects for further FDI are strong given mega infrastructure plans like the High-Speed Rail and East Coast Rail Link, regional integration efforts, and China’s One Belt One Road initiative. However key risks to watch are MYR47.5bn worth of government bond maturities between June and November. Timed together with expectations of another two Fed rate hikes this year (UOB: 25bps in June and 25bps in September) and Trump policy announcements. As such until foreign selling of bonds recedes, market liquidity normalizes, and sentiment improves, USD/MYR is expected to trade within 4.40-4.50 assuming moderate dollar strength.

**FX & Rates**

<table>
<thead>
<tr>
<th>2017F</th>
<th>2018F</th>
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</thead>
<tbody>
<tr>
<td>MYR/USD</td>
<td>4.46-4.52</td>
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**Economic Indicators**

<table>
<thead>
<tr>
<th>2015</th>
<th>2016</th>
<th>2017F</th>
<th>2018F</th>
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<tbody>
<tr>
<td>GDP</td>
<td>5.0</td>
<td>4.2</td>
<td>4.5</td>
</tr>
<tr>
<td>CPI</td>
<td>2.1</td>
<td>2.1</td>
<td>3.6</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>3.1</td>
<td>3.5</td>
<td>3.6</td>
</tr>
<tr>
<td>Current account (% of GDP)</td>
<td>3.0</td>
<td>2.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Fiscal balance (% of GDP)</td>
<td>-3.2</td>
<td>-3.1</td>
<td>-3.0</td>
</tr>
</tbody>
</table>

**Source:** Bloomberg, UOB Global Economics & Markets Research

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**Ringgit Stabilises Post BNM Measures**

**Index (2 Nov 2016 = 100)**

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