Maybank

Macro | FX Research and Strategy

Global

FX Insight

MYR - Poised for Greater Stability

Analysts

Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

MYR Forecast on Hold This Year but Upgrade Beyond 2018

We maintain our out-of-consensus USDMYR forecasts for this year at 3.85, 3.70 and 3.65 for 2Q, 3Q and 4Q, respectively. Current level of Ringgit remains fundamentally undervalued relative to our updated fair value estimates of 3.56 for USDMYR and we expect this misalignment to correct further in the longer term. MYR fundamentals remain well anchored by sustained current account surplus, rising FX reserves to retained imports & short-term debt, sustained growth pick-up backed by consumption, investment and exports as well as higher oil prices. We lowered USDMYR forecasts beyond 2018 on efforts taken by the new government to improve governance, transparency and accountability. We now project USDMYR at 3.20, 3.00 and 2.80 for 2019, 2020 and 2021 (vs. old forecasts of 3.60, 3.50 and 3.50, respectively).

Next 100 Days or So a Crucial and Closely Scrutinized Period

We believe the 100-day promises made by PH in its manifesto will be a "scorecard" for investors to check if PH and its team of Eminent Persons fulfilled their objectives, in terms of execution and implementation. Swift execution of its objectives and clear communication to address government finances will demonstrate the new government's capability; dispel uncertainty associated with government policies and restore investors' confidence within the next 100 days. This could manifest into further gains for the Ringgit. Meantime we do not rule out bouts of volatility as investors await results. To add there will be **briefing by Council of Eminent Persons to market analysts and fund managers today at 11am (SG/KL time).** While sentiment may have stabilised for now and we continue to maintain a bullish bias on the Ringgit, FX is never one way and is also driven by externalities including global monetary policies, financing conditions, USD direction, pace of UST yield upmove, geopolitical events (such as tensions in middle east that may affect oil prices, US mid-term elections), ongoing trade tensions, etc..

Reversal Risks for USDMYR; Bias to Fade SGDMYR

USDMYR was last seen at 3.9505 levels. Bullish momentum on daily chart remains intact but shows tentative signs of waning while stochastics is showing signs of turning lower from near-overbought conditions. Reversal risks not ruled out. Support at 3.9440 (38.2% fibo retracement of 2018 high to low), 3.91 levels (23.6% fibo) and 3.8530 (2018 low). Resistance seen at 3.9720 (50% fibo) before 4.00 (61.8% fibo). SGDMYR was last seen at 2.9640 levels. Daily momentum and stochastics indicators are mild bullish. Next resistance at 2.9880 (50% fibo), 3.0020 (61.8% fibo retracement of 2018 high to low). Support at 2.95 (21 DMA), 2.93 levels. Interim upside risks seen but bias to lean against strength. Mild downward sloping trend channel remains intact.

SEE PAGE 9 FOR IMPORTANT DISCLOSURES

There were some investors' concerns on policy uncertainty associated with the change in government. But **on the ground development saw a smooth and orderly transition of powers** to Pakatan Harapan (PH) from Barisan Nasional (BN).

In particular, (1) the **swift appointments of 3 key ministers to the cabinet** including, **Lim Guan Eng**, the Secretary General of Democratic Action Party (DAP) as **Finance Minister, Tan Sri Muhyiddin Yassin**, the President of Parti Pribumi Bersatu Malaysia (Bersatu) as **Home Afairs Minister** and **Mohamad Sabu**, the President of Parti Amanah Negara (Amanah) as **Defence Minister**; (2) identification of **10 core Ministries to the Government** (Finance, Home Affairs, Defence, Education, Rural Development, Economy, Public Works, Transport, Multimedia Science and Technology, and Foreign Affairs) and (3) the setting up of **5-member team of Eminent persons** with extensive experience in government, institutions, corporate and academia to advise the government on economic and financial matters.

In addition, newly elected Prime Minister Mahathir said that his government will focus on country's finances and economic management and intend to build the economy with the help of investors from inside and outside the country. He also promised to set out a good government to ensure the constitution is upheld and laws of the country are what will guide them in their administration.

7 more core Ministers will be unveiled this week and the full cabinet of 25 members will be made known in the next 2 – 3 weeks. For further details, please refer to our Economists' update on recent development (see here and here).

For FX - The Next 100 Days Will Be Closely Watched

We believe the 100-day promises made by PH in its manifesto will be a "scorecard" for investors to check if PH and its team of Eminent Persons fulfilled their objectives, in terms of execution and implementation. Achieving those objectives will demonstrate the new government's capability; dispel uncertainty associated with government policies and restore investors' confidence within the next 100 days. This could manifest into further gains for the Ringgit.

The 5-member team of Eminent Persons comprising of (1) **former Finance Minister Tun Daim Zainuddin as the Council's Head**, (2) **former Bank Negara Governor Tan Sri Dr. Zeti Akhtar Aziz**, (3) **former President and CEO of PETRONAS Tan Sri Hassan Merican**, (4) **Hong Kong-based Malaysian tycoon Robert Kouk**, and (5) **prominent economist Prof. Dr. Jomo Kwame Sundaram** with extensive experience in government, institutions, corporate and academia will hold daily meetings for the next 100 days to cover issues relating to overall management of the fiscal position including governance process and how decisions were made and level of transparency and disclosure, currency, GST, current economic situation, fuel subsidies amongst others and will make recommendations to the government whom will then decide.

We believe such a set-up adds another layer of booster to investor confidence and enhances the probability of fulfilling the 100-day promises. Some of these 100-day promises are:

- Abolish Goods & Services Tax (GST) and re-instate Sales and Services Taxes (SST);
- Re-instate fuel price stabilization/subsidy;
- Review of mega projects;
- Raise and equalize minimum wage between Peninsula Malaysia and Sabah, Sarawak & Labuan;
- Defer repayments of student loans for those earnings below MYR4,000 per month;
- Address FELDA issues;
- Set up Royal Commissions to investigate 1MDB, FELDA, MARA and Tabung Haji;
- A Special Cabinet Committee on Malaysia Agreement 1963 with regards to Sabah and Sarawak.

Fiscal Concerns Likely to be Limited

While the planned removal of GST, reinstatement of fuel price subsidy and raising minimum wage were meant to alleviate living costs for the nation, the measures are expected to have repercussions on government finances. Most importantly, will these measures result in increased burden for the government in terms of borrowings and will the fiscal discipline or sovereign credit rating be compromised?

Our Economists estimated that GST removal entails a revenue loss of MYR44bn (based on Budget 2018 projection). **Replacing GST with the previous Sales and Services Tax (SST) which last earned a full-year revenue of MYR17b in 2014, there is a prospective net tax revenue loss of MYR27b.** Malaysia's budget deficit to GDP ratio will arithmetically increase by as much as 1.9 percentage points, just on this basis alone, assuming no offsetting reduction in expenditures or revenues from oil or more efficient collection of taxes. However this is only a simplistic assumption for preliminary illustration. **Former BNM Governor Zeti (currently a member of the Eminent Persons) recently said that Malaysia can meet its revenue requirements after shelving the GST by prioritising its projects, increasing the efficiency of the public sector, avoiding wastages and exploring new sources of revenue.**

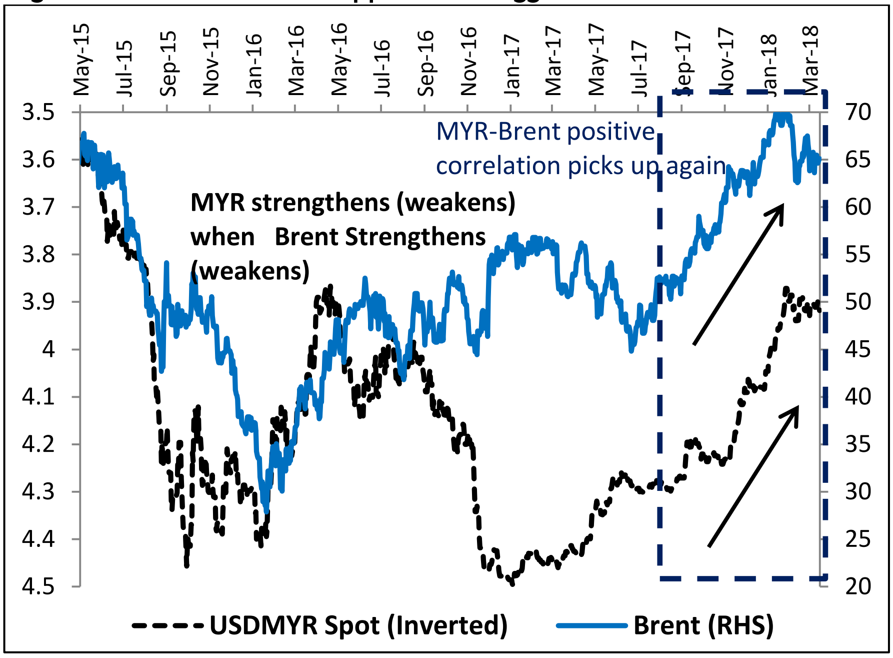
Our Economists also noted that PH's Alternative Budget 2018 argues there is scope for operation expenditure rationalisation such as lowering the Prime Minister's Department budget to MYR8.4bn from MYR20.8bn.

On oil prices, our Economists shared that every US$10/bbl increase in annual average crude oil prices will boost government revenues by MYR7-8bn via oil related revenues.

Last year's average crude oil price averaged US$54/bbl, up from US$44/bbl in 2016. And YTD 2018, crude oil price averaged about US$69. Theoretically the US$15 increase in crude prices from 2017 works out to a potential increase in government revenues by MYR10.5bn - 12bn.

Potentially higher government revenues from increase in oil prices could partially buffer against revenue losses from removal of GST and re-instatement of fuel subsidy.

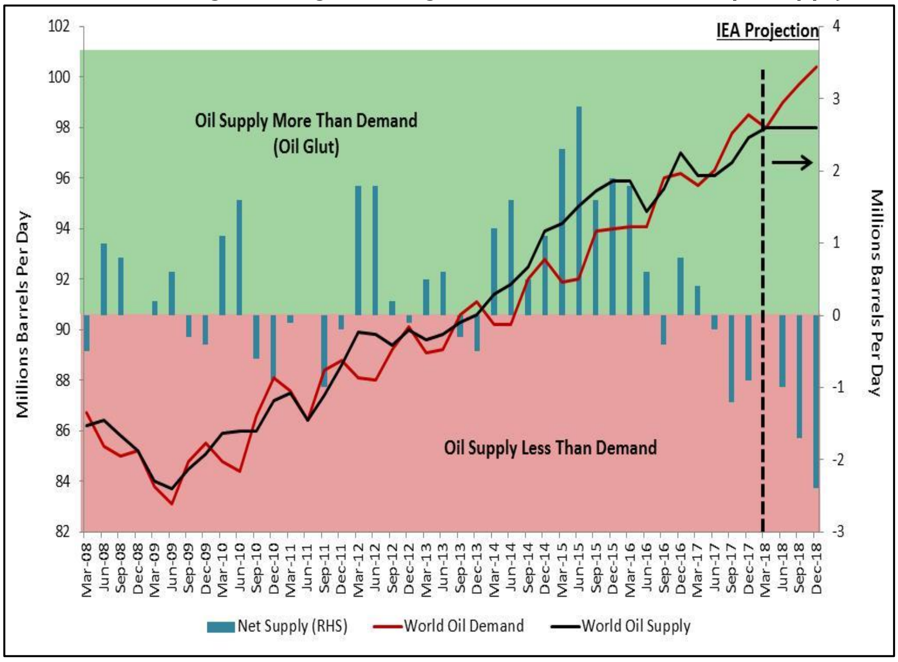
Higher Oil Prices to Lend Support for Ringgit



Source: Bloomberg, Maybank FX Research & Strategy

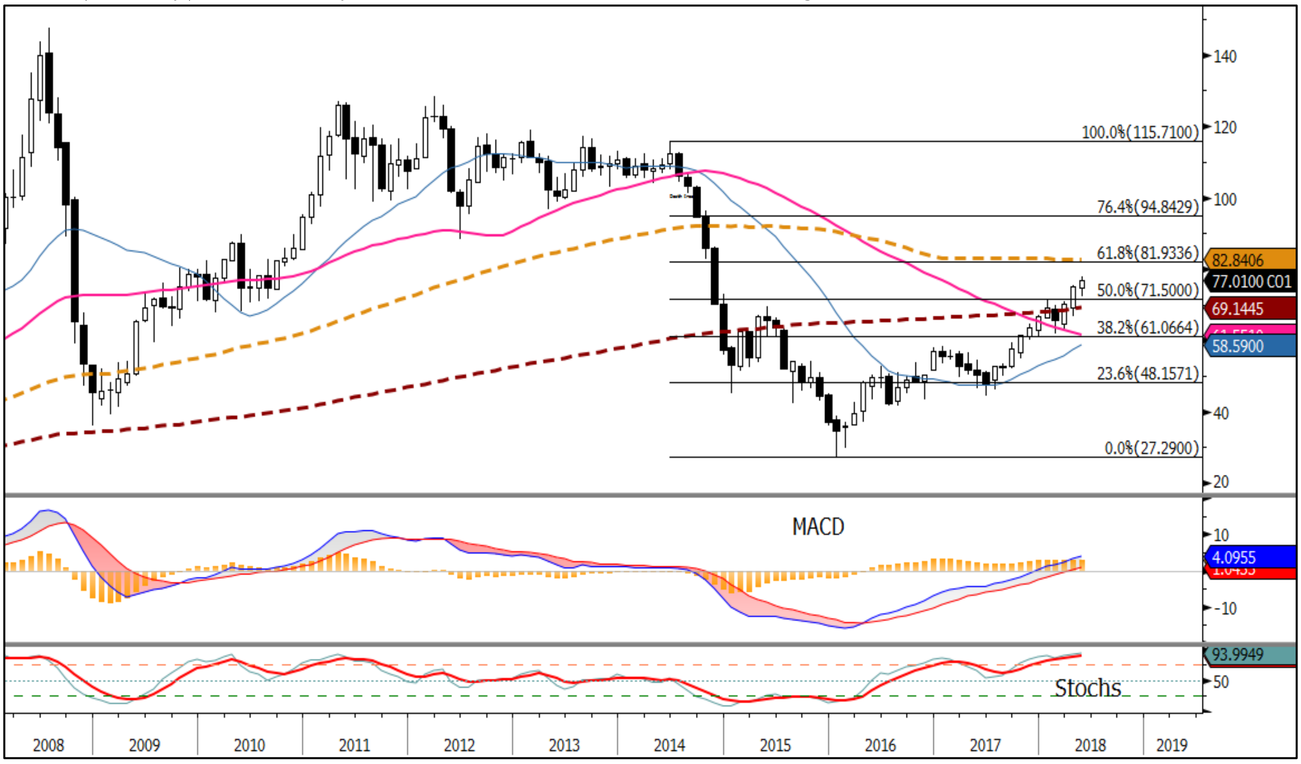
Oil supply-demand projections from IEA somewhat suggests that oil demand is projected to marginally exceed oil supply (i.e. tight supply) amid OPEC's continued policy to restrain production. This could subject oil prices to some upside risks. Contrast the current environment with 2014 where there was an oil glut (oil demand less than supply) resulting in downward pressure on oil prices.

Oil Prices Shifting into Higher Range as Oil Demand Outstrips Supply



Note: Supply Projection assumed unchanged from 1Q output; units in millions of barrels per day
Source: IEA, CEIC, Maybank FX Research & Strategy

Brent (Monthly): Technically Oil Prices Can Continue to Climb Higher



Source: Bloomberg, Maybank FX Research & Strategy

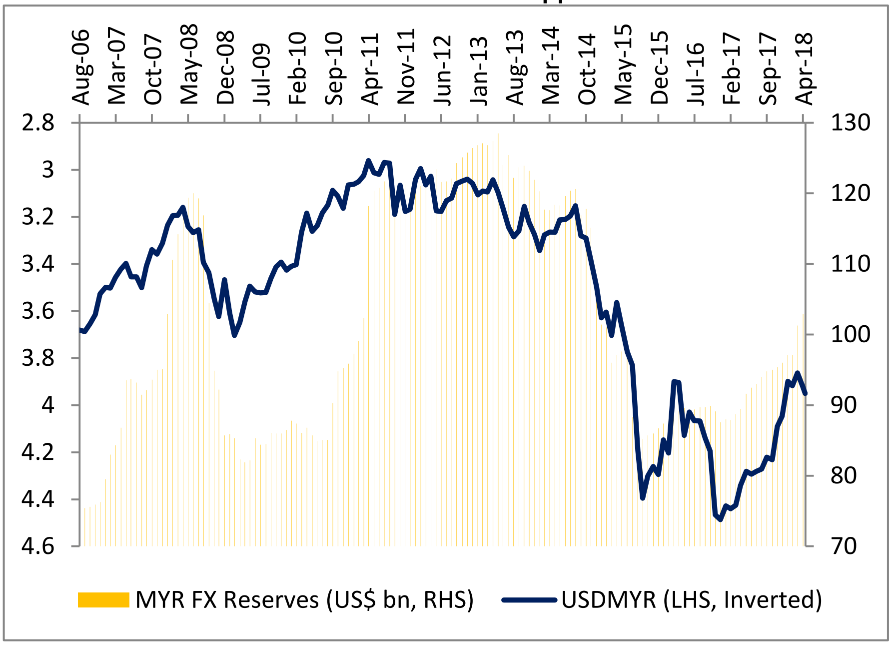
We had previously shared that brent could be poised for further upside, with next objective seen at $82 (61.8% fibo retracement of 2014 peak to 2016 trough). Support levels seen at $71.50, $61 levels. Upside risks to oil prices suggest room for positive surprise as government budget assumption (Budget 2018) for oil prices was conservative at $52/bbl.

Ringgit Peg Not Expected as MYR is Undervalued, FX Reserves Rising

> *"We will try to make the ringgit as steady as possible," he added, saying there should be no cause for the devaluation of the ringgit.*
>
> - Prime Minister Mahathir at press conference after being sworn in as 7th Prime Minister, 10th May 2018

We do not expect the Ringgit peg to be re-visited. Unlike the Asian Financial crisis in 1997, the current environment saw a build-up of FX reserves to its highest level in Mar 2015 (US$109.5bn as of end-Apr 2018). This is equivalent to 7.5months of retained imports and 1.1 times of short term external debt. Both trade and investment flows have also remain supportive of external reserves via repatriation of net export earnings and oil & gas sector following Saudi Aramco's purchase of stake in Petronas' Refinery and Petrochemical industry Development project (RAPID), respectively. Rising FX reserves tend to support the MYR.

Further Increase in FX Reserves to Lend Support to MYR



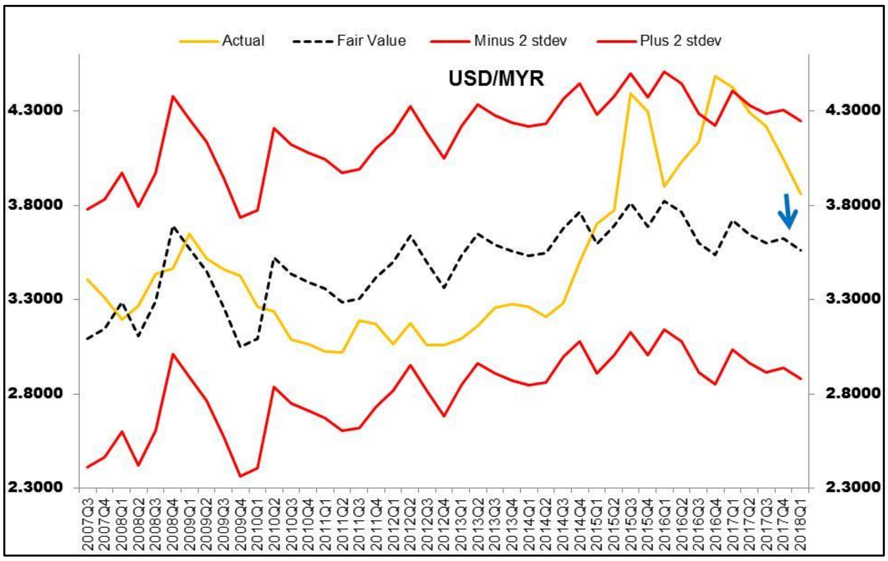
Source: Bloomberg, Maybank FX Research & Strategy

In addition the current level of Ringgit remains fundamentally undervalued by about 10% and this suggests room for MYR to correct towards its fair value estimate.

Our fair value model which takes into account the relative differentials in interest rates, inflation, current account and a reflation proxy variable (defined as the change in the ratio of MSCI World index to JPM Global Aggregate Bond Index) estimates USDMYR at 3.56 levels. This is lower than our previous estimate of 3.70 and represents a reflection of improvement in fundamentals.

We had previously said that Ringgit weakness in 2014-16 was temporary and was not a reflection of underlying fundamentals. We believe stability and strength is gradually returning to Ringgit as contingent liability risk subsides, oil prices continue to stabilize and efforts are undertaken to improve governance, transparency and accountability in the system.

More Room for MYR to Correct Towards its Fair Value Estimate



Source: Eviews, CEIC, Bloomberg, Maybank FX Research & Strategy

MYR Strength Likely to Accelerate in the Medium Term

We expect MYR strength to accelerate in the medium term. MYR fundamentals remain well anchored by sustained current account surplus, rising FX reserves to retained imports & short-term debt, sustained growth pick-up backed by consumption, investment and exports as well as higher oil prices. Change in government has so far given the impression that efforts will be taken to improve governance, accountability and transparency. We believe investors' confidence will more than return if the government and its team of Eminent Persons managed to fulfil its 100-day objectives, and that would manifest into further gains in the MYR, especially in the longer run (beyond 2018).

We maintained our forecast for 2018 but revised forecasts beyond 2018 to reflect our bullish bias.

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019	End-2019	End-2020	End-2021
USDMYR	3.85 (--)	3.70 (--)	3.65 (--)	3.55 (3.65)	3.20 (3.60)	3.00 (3.50)	2.80 (3.50)
SGDMYR	2.96	2.89	2.87	2.82	2.56	2.48	2.33

Previous Forecasts in Parenthesis

USDMYR Relatively Well Behaved but No One Way Moves

Onshore markets reopened yesterday after a 3-day holiday last Wed-Fri due to polling day and post-elections holiday. MYR opened nearly 1% weaker at 3.9848 (vs. USD) relative to Tue close of 3.9497. As of market close yesterday, MYR has totally reversed its losses (vs. the USD) and was last seen at 3.9505 levels.

While sentiment may have stabilised for now and we continue to maintain a bullish bias on the Ringgit, FX is never one way and is also driven by externalities including global monetary policies, financing conditions, USD direction, pace of UST yield upmove, geopolitical events (such as tensions in middle east that may affect oil prices, US mid-term elections), ongoing trade tensions, etc. We stress that domestically, the next 100 days or so is of great importance. Swift execution of its promises and clear communication to address government finances will add to the list of catalysts for the MYR.

USDMYR May Face More Downside on Break Below 3.9440

USDMYR was last seen at 3.9505 levels. Bullish momentum on daily chart remains intact but shows tentative signs of waning while stochastics is showing signs of turning lower from near-overbought conditions. Reversal risks not ruled out. Support at 3.9440 (38.2% fibo retracement of 2018 high to low), 3.91 levels (23.6% fibo) and 3.8530 (2018 low). Resistance seen at 3.9720 (50% fibo) before 4.00 (61.8% fibo).

USDMYR (Daily Chart): Bullish Momentum Shows Signs of Waning

Source: Bloomberg, Maybank FX Research & Strategy

SGDMYR - Interim Upside Risks but Bias to Fade

SGDMYR was last seen at 2.9640 levels. Daily momentum and stochastics indicators are mild bullish. Next resistance at 2.9880 (50% fibo), 3.0020 (61.8% fibo retracement of 2018 high to low). Support at 2.95 (21 DMA), 2.93 levels. Interim upside risks seen but bias to lean against strength. Mild downward sloping trend channel remains intact.

SGDMYR (Daily Chart): Bias to Lean against Strength

Source: Bloomberg, Maybank FX Research & Strategy

DISCLAIMER

Published by:

Malayan Banking Berhad
(Incorporated in Malaysia)

Saktiandi Supaat	Christopher Wong	Fiona Lim	Leslie Tang
Head, FX Research	Senior FX Strategist	Senior FX Strategist	Senior FX Strategist
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378