



FUNDAMENTAL FLASH

Newsflash | Fitch Downgrades Malaysia's Sovereign Rating

7 DECEMBER 2020

Prepared by Affin Hwang Asset Management

Fiscal and Political Concerns

Fitch ratings has downgraded Malaysia's sovereign rating to BBB+ with a stable outlook from A-/Negative on 4 December 2020. Fitch had previously revised Malaysia's sovereign outlook to Negative from Stable in April 2020. Malaysia has been rated A- since 2004.

According to Fitch, the prolonged COVID-19 crisis has resulted in a weakening of Malaysia's key credit metrics such as the elevated government debt to GDP and revenue vs "A" and "BBB" rating countries medians.

Meanwhile, lingering political uncertainty which impacts policy outlook in addition to governance standards was also cited as a key factor. Government debt including government guarantees is expected to jump to 76% of GDP in 2020 from 65.2% in 2019.

Fitch expects GDP to contract 6.1% this year before rebounding to 6.7% in 2021. Malaysia's 2021 budget deficit to GDP target of 5.4% and an average deficit of 4.5% over the next few years is considered achievable.

Flashpoints

- Fitch ratings has downgraded Malaysia's sovereign rating to BBB+ with a stable outlook from A-/Negative.
- Although the timing is unexpected, the downgrade did not come as a surprise.
- We have seen many sovereign downgrades and negative watch by rating agencies since March.
- We could see a knee-jerk sell-off in government bond yields in the near term.
- However, we do not expect the correction to be sustainable.
- Any sharp sell off presents a good buying opportunity as we expect portfolio inflows to EM bonds to continue into 2021 given stronger Asian FX outlook and search for higher yields.

#GrowWithUs



Fitch also sees room for further easing by Bank Negara (BNM) with another 25bps cut in 2021 with inflation at 1.5%. Malaysia's rating remains supported by continued current account surplus (although expected to narrow), low level of foreign currency denominated debt and a deep and developed domestic bond market among others.

Although the timing is unexpected, the downgrade has not come as a surprise. We have seen many sovereign downgrades and negative watch by rating agencies since March as central banks and governments take unprecedented monetary and fiscal measures to protect lives and livelihood.

Market Impact

Malaysia's could still be under downgrade rating pressure over the next 1-2 years but we do not expect any immediate downgrade by other rating agencies. Standard & Poor ("S&P") currently rates Malaysia at A- on negative watch since June 2020. After the Budget 2021 announcement in November, S&P noted that it saw no material impact on Malaysia's key credit factors currently though it acknowledged fiscal risks are more pronounced.

On 1 December 2020, Moody's has maintained Malaysia's rating at A3 on stable outlook in its regular update, implying that no further changes are likely in the coming months. Overall, S&P and Moody's have a less negative view on Malaysia's fiscal position. Both rating agencies are factoring in lower level of contingent liabilities in their assessment of government debt and a more optimistic outlook on the country's growth. S&P is also sounding more positive on Malaysia's external position, although less positive on the political development in the country.

We do expect the local bond market to react cautiously to the downgrade especially on the heels of the final government bond auction on 7 December 2020. We could see a knee-jerk sell-off in government bond yields by 10-20 basis points in the near term. We also expect the Ringgit to weaken and underperform regional currencies in the coming days.

However, we do not expect the correction to be sustainable. Any sharp sell off presents a good buying opportunity as we expect portfolio inflows to EM bonds to continue into 2021 given stronger Asian FX outlook and search for higher yields.

Disclaimer

This article has been prepared by Affin Hwang Asset Management Berhad (hereinafter referred to as "Affin Hwang AM") specific for its use, a specific target audience, and for discussion purposes only. All information contained within this presentation belongs to Affin Hwang AM and may not be copied, distributed or otherwise disseminated in whole or in part without written consent of Affin Hwang AM. The information contained in this presentation may include, but is not limited to opinions, analysis, forecasts, projections and expectations (collectively referred to as "Opinions"). Such information has been obtained from various sources including those in the public domain, are merely expressions of belief. Although this presentation has been prepared on the basis of information and/or Opinions that are believed to be correct at the time the presentation was prepared, Affin Hwang AM makes no expressed or implied warranty as to the accuracy and completeness of any such information and/or Opinions. As with any forms of financial products, the financial product mentioned herein (if any) carries with it various risks. Although attempts have been made to disclose all possible risks involved, the financial product may still be subject to inherent risk that may arise beyond our reasonable contemplation. The financial product may be wholly unsuited for you, if you are adverse to the risk arising out of and/or in connection with the financial product. Affin Hwang AM is not acting as an advisor or agent to any person to whom this presentation is directed. Such persons must make their own independent assessments of the contents of this presentation, should not treat such content as advice relating to legal, accounting, taxation or investment matters and should consult their own advisers. Affin Hwang AM and its affiliates may act as a principal and agent in any transaction contemplated by this presentation, or any other transaction connected with any such transaction, and may as a result earn brokerage, commission or other income. Nothing in this presentation is intended to be, or should be construed as an offer to buy or sell, or invitation to subscribe for, any securities. Neither Affin Hwang AM nor any of its directors, employees or representatives are to have any liability (including liability to any person by reason of negligence or negligent misstatement) from any statement, opinion, information or matter (expressed or implied) arising out of, contained in or derived from or any omission from this presentation, except liability under statute that cannot be excluded.