

## FUNDAMENTAL FLASH

# Malaysia Declares State of Emergency

12 JANUARY 2021



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### State of Emergency

*The Yang di-Pertuan Agong (YDPA) has consented to declaring a state of emergency until the 1 August 2021 following a meeting with Prime Minister (PM) Tan Sri Muhyiddin. This follows an announcement by the PM that the government would also be reinstating the movement control order (MCO) in various states for a two-week period to contain the spread of COVID-19.*

*We discuss the implications of these recent events and how it could impact both the local equity and bond market.*

### Pushed to Emergency

The declaration of a state of emergency to curb the spread of COVID-19 has come as a surprise to market participants. Recall, PM Muhyiddin had earlier suggested to the YDPA to declare a state of emergency back in October 2020. However, the YDPA had said at the time that there was no need to so.

The declaration of emergency until 1 August 2021 (or earlier depending on the state of COVID-19 infections) also comes right after the announcement of stricter movement restrictions for several states which will last for two (2) weeks starting from 13 January.

### Flashpoints

- The YDPA has consented to declaring a state of emergency. This also follows the reinstatement of MCO 2.0.
- The emergency declaration reduces the risk of political instability in the short-term as the government focuses on tackling COVID-19.
- Though, if left unchecked and prolonged it can be harmful to the country's democratic process.
- Snap elections are unlikely to solve the political impasse possibly leading to a hung parliament and even worsen the pandemic.
- We expect some kneejerk selloff in the in both the equity and fixed income space.

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Under the emergency, the national parliament and state legislatures would be suspended and any elections or by-elections would not be allowed. Nonetheless, the PM has assured that the emergency does not involve a military coup and curfews will not be enforced.

The civil service and government apparatus will continue to function while all economic activities will proceed as usual with the usual movement control order (MCO) SOPs in place.

However, critics have opposed the move as it is seen as an attempt by Muhyiddin to hold on to power against the backdrop of internal fighting within his Pakatan Nasional (PN) coalition partners and to remove parliamentary oversight.

### **Market Impact – Equity & Fixed Income**

The Malaysian market is reacting to both MCO 2.0 and the state of emergency declaration. Reopening plays like banks and the broad market is generally weaker as the lockdown will slow economic activity temporarily.

In our view, we think the much expected lockdown event has mostly been factored-in by the market already, with correction prior to and post announcement.

However, the declaration of a state of emergency was a surprise to the market.

We believe the emergency declaration has removed the risk of political instability for now while the government focuses on tackling COVID-19 situation. Ultimately, we think it is positive as it temporarily removes political overhang.

The focus should now shift towards containing the spread of COVID-19. There will no doubt be concerns raised from various government parties, which were eyeing a breakdown of the weak coalition as a route to power.

We think the market will come to appreciate this event after a typical knee-jerk sell off. The alternative is an election during a health crisis, with the likely result of a hung parliament and even accelerating the spread of COVID-19.

Weak coalition makes for weak policy making due to political compromises. Some of the things that we need to watch out for are foreign investor reaction, currency impact and potential rating changes.

If the COVID-19 situation worsens, the government has emergency powers to take over private healthcare for public use. Our unit trust funds do not have large exposure to such names. Bottomline, we don't think equity markets will see a severe sell-down.

Political stability is the better alternative. Whether there will be upside will depend on new government policy to drive growth, which is not known at this point in time.



From a fixed income perspective, we believe this will also be positive for the local bond market as investors can focus more on economic fundamentals in their investment decisions.

We do expect a mild kneejerk reaction in the near term from foreign investors which could see some weakness in government bond yields and MYR.

Other implications include negative impact to sovereign ratings due to perceived erosion of governance standards by rating agencies as implementation of long term and reform policies would likely be on hold.

Nonetheless, we expect the market will be supported by rising prospect of another rate cut amidst heightened downside risks from prolonged COVID-19 containment measures. Seasonal factors in the 1Q'2021 is also expected to support the market in the near term as investors position for the new year.

In addition, foreign inflows remain positive despite various negative headlines news in the past.

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