

Key Developments in the First Half of 2024

MARKET RISK

Domestic financial markets remained orderly and resilient

Throughout the year, many major central banks have begun monetary policy easing as inflation continued to trend downwards, with the US Federal Reserve Board (Fed) the latest to follow suit. Global financial markets continued to experience heightened volatility through the second and third quarters of 2024, which peaked in early August amid fears of a 'hard landing' triggered by the release of weaker-than-expected US labour market data.¹ Since then, market expectations for earlier and more substantial rate cuts by the Fed² have improved investors' appetite for assets of emerging markets, including Malaysia. Nevertheless, uncertainties remain as investors stay vigilant ahead of the US presidential election and ongoing geopolitical risks.

Domestic financial markets have continued to remain orderly. Overall domestic market stress, as measured by the Financial Market Stress Index (FMSI), rose briefly in early August following a temporary sell-off in global equities on US recession fears, but has since stabilised below 10% (Chart 1.1). Throughout the period,³ market volatility was driven mainly by the foreign exchange (FX) markets amid the appreciation of the ringgit exchange rate against the US dollar as investors' appetite for Malaysian assets improved. Financial asset mispricing risks from a higher-for-longer interest rate environment have receded somewhat given clearer signals from major central banks on the path to unwinding tight monetary policy as well as stronger-than-expected economic outturns supporting a positive outlook for the domestic economy.

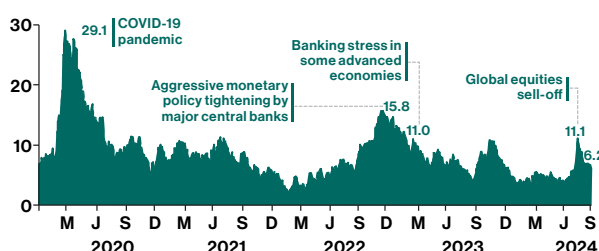
¹ The continued unwinding of Japanese yen carry trades since end-July amid the strengthening of the Japanese yen has further amplified market volatility. A carry trade is an investment strategy where investors borrow a low-interest rate currency and then use that to purchase a higher yielding currency to gain from the interest rate differential, usually with a view that the funding currency will continue to depreciate.

² Following a 50-bps rate cut by the Fed on 18 September 2024, market participants priced in another 75-bps cut for the rest of the year, higher than the Fed officials' median forecast of another 50-bps cut.

³ All data and assessments in the Market Risk section are as at 20 September 2024, unless stated otherwise.

Chart 1.1: Financial Market – Financial Market Stress Index (FMSI)

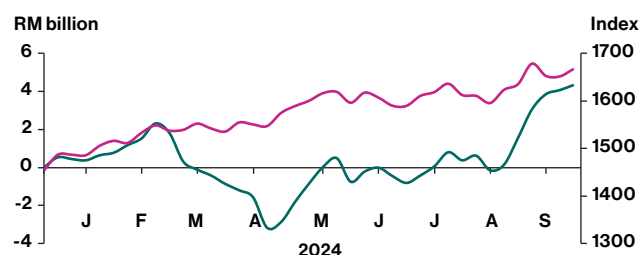
Stress level, % (Minimum=0, Maximum=100)



Source: Bloomberg, Reuters and Bank Negara Malaysia estimates

The domestic equity market has staged a strong recovery since the start of this year, with the benchmark FBM KLCI gaining 7.6% since the last Review in March. This has been supported by non-resident net inflows of RM4.3 billion for the year-to-date, reflecting positive investor sentiment on domestic growth prospects (Chart 1.2). The construction, utilities and property sectors benefitted significantly from investments in data centres and the continued implementation of mega infrastructure projects and national master plans. Financial stocks also gained on sustained earnings. Domestic institutional investors (DIIs)⁴ continued to provide firm support to domestic equities with a net purchase of equities amounting to RM3.0 billion between March and September 2024 (March-20 September 2023: RM2.3 billion, 2015-19 annual average: RM8.2 billion).

Chart 1.2: Financial Market – Cumulative Non-resident Equity Flows and Performance of the Domestic Equity Market



— Cumulative non-resident equity flows — FBM KLCI (RHS)

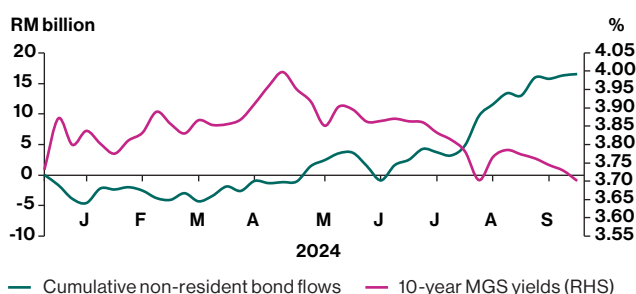
Source: Bloomberg

⁴ Domestic institutional investors include banks, non-bank financial institutions (NBFIs) and insurers and takaful operators (ITOs).

Non-resident flows in the government bond market continued to be largely influenced by external factors

The 10-year Malaysian Government Securities (MGS) yields peaked in April before trending downwards, tracking broad declines in global bond yields. The 10-year MGS yields traded at 3.71%, remaining broadly unchanged compared to its level at the beginning of the year. Non-residents recorded inflows into sovereign bonds amounting to RM20.6 billion from March to September 2024 (September 2023 to February 2024: -RM2.7 billion), reflecting investor expectations of more attractive relative returns of emerging market bonds in anticipation of lower US Treasury yields (Chart 1.3). During this period, yield differentials between 10-year MGS and 10-year US Treasuries (UST) narrowed to -4 basis points (bps) (end-February 2024: -38.6 bps). Importantly, the share of bond holdings by non-resident investors typically regarded as more stable has remained broadly unchanged. This will continue to mitigate excessive volatility in market conditions. Market liquidity remained healthy, with sustained demand for government bonds in the primary market as evidenced by the healthy weighted average bid-to-cover ratio of 2.4 times. This is further supported by Dlls' continued active participation in both the primary and secondary markets.

Chart 1.3: Financial Market – Cumulative Non-resident Government Bond Flows and Performance of the Domestic Government Bond Market



Source: Bank Negara Malaysia and Bloomberg

Funding conditions in the corporate bond market remained healthy. The yields for 10-year AAA-rated corporate bonds declined by 19 bps between January and September, enabling corporates to tap the bond market for funding at a more attractive level. Total gross issuances amounted to RM56.9 billion between March and July 2024 (March-July 2023: RM56.8 billion), mostly in government-guaranteed (GG) and AAA-rated papers. Overall, credit quality of outstanding corporate bonds remains high, with GG and AAA-rated papers accounting for more than half of the outstanding size.

Movements in the ringgit remained largely driven by global developments, including the changing expectations on the timing and magnitude of reduction in the US Federal Funds Rate (FFR) and geopolitical concerns that continued to drive the US dollar strength. Between January and end-September, the ringgit strengthened by 11.41% against the US dollar to 4.1235. This was mainly driven by the greater clarity surrounding the trajectory of the US FFR reduction. Firm improvements in the performance of the domestic economy and the positive impact from the implementation of domestic structural reforms, such as the New Industrial Master Plan (NIMP) and National Energy Transition Roadmap (NETR), also provided support for the ringgit. While ringgit volatility has increased to 6.44%⁵ following the strong appreciation of the currency, it remains manageable and remains close to the 10-year average of 5.76%. FX turnover volume has also improved, reflecting more balanced flows, with the year-to-date daily average volume increasing to USD17.6 billion (2023 daily average: USD15.5 billion).

Global financial market conditions in the remainder of the year remain susceptible to continued uncertainty over the pace of the Fed's monetary policy easing and slower growth momentum in major economies. The escalation of geopolitical and trade tensions, and materialisation of risks arising from country-specific vulnerabilities could renew heightened volatility in global and domestic financial markets. Notwithstanding this, Malaysia's strong banking system, deep financial markets and diversified investor base will continue to support orderly domestic market conditions.

⁵ Implied volatility based on USDMYR 1-month at-the-money options as at 30 September 2024.