Trump and the Malaysian economy

Donald Trump, a personality who never fails to grab the attention of financial, economic and global news reporters, continues to fuel intense debate across the globe. His unorthodox policies — be they on foreign relations, economic growth or international trade — have indeed triggered vastly different responses worldwide and spurred volatility in the financial markets in recent months.

In the wake of Trump's nationalistic rhetoric, which sparked a strong rally in the greenback, emerging market (EM) currencies went on a roller-coaster ride, while bond markets succumbed to selling pressure in many parts of the world as yields spiked. Meanwhile, trade-dependent countries were shocked by his decision to remove the US from the Trans-Pacific Partnership agreement, a trade partnership effort championed by his predecessor.

Economists are paying close attention to the possible impact of his policies on Asia. Of particular interest is the trade relationship between the US and China, the world's second largest economy and also Malaysia's single largest trading partner in the past few years. To some extent, China has always been a special country to Malaysia in economic terms. The cordial ties between the two countries that started back in the 1970s play an important role in the way Malaysia views its largest trading partner today.

China's rapid development and ascent to become a global economic power, as well as its strength in facing economic challenges — for example, the Asian financial crisis (AFC) in 1998 and global financial crisis (GFC) in 2008 — serve as inspiration to many economies in the region. Its relatively closed capital account drew special attention during the AFC as it prevented capital outflows from disrupting its economy.

Trump's laser-like focus on the US' trade relationship with China sparks concerns that any potential trade friction between the two countries would lead to several possible responses by the Chinese authorities. Possibly the most cited response by economists is the way the

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renminbi will be manoeuvred should the US curtail its imports of Chinese goods through higher tariffs. Even now, the renminbi has depreciated by 12% against the greenback since end-2015.

Trend-wise, the Chinese currency has broken the upper range of one standard deviation above its mean since the fourth quarter of last year, suggesting that the currency will remain weak in the near term. If, for some reason, China decides to further weaken its currency against the greenback in response to increasing trade pressure from the US, then Asian economies will likely be the ones to suffer the repercussions.

Why? Because a weaker renminbi means China will reduce its imports from other Asian nations. Being largely dependent on China's market, Malaysia would be affected by such an event. In addition, indirect trade links via other Asean countries would mean slower Malaysian exports to those countries as well.

Trade is not the only concern among EM economies. Trump's proposed plans for higher fiscal expenditure, while likely to provide a boost to the economy during the initial stages, would also lead to higher interest rates in the future. Higher expenditure means higher budget deficits, which would have to be financed in the next few years, and this would entail higher borrowing costs.

On the monetary side, steady economic growth, coupled with a relatively tight labour market, would mean that the US Federal Reserve will continue on its normalisation path. Combining expansionary fiscal policy with tighter monetary policy would lead, again, to higher interest rates. If this happens, it would have significant ramifications for the greenback. The experience in the 1980s, during the first half of the Reagan Administration, showed that the rapid appreciation of the US dollar finally had to be dealt with through the combined efforts of global central banks via the Plaza Accord in September 1985.

As for EM economies, a strong US dollar means a problem of capital outflows. Flush with liquidity as a result of advanced countries' quantitative easing policies, portfolio capital is looking for excuses to revert to US dollar-denominated assets. Hence, the prospect of a further strengthening of the greenback presents a strong case for asset managers to continue relocating their funds. Notwithstanding this, for Malaysia, the issue of possible capital outflows may not be as bad as some foresee. During the recent bond market correction, foreign ownership of Malaysian securities fell by only RM31 billion from its peak in August to December last year. This is in stark contrast with the situation in 2008, when foreign bondholders withdrew about RM84 billion during the GFC.

Still, it is worth paying attention to the bond market when it comes to assessing the impact of Trump's policies. Many global bond market indices are now looking toppish or have retreated from their peaks. For instance, Barclay's global aggregate bond index is now below its 100 and 200-day moving averages, down about 7.5% from its peak. Similarly, the US Treasury Bond Index has retreated 5% from its peak, while China's Treasury bond index has slipped 4% from its recent peak.

Another risk is looming on the horizon. The rise of Trump on the US political scene has been followed by similar political developments in Europe. Specifically, in France, the populist presidential candidate leading the polls is known for her desire to revert to using the franc, France's own currency, rather than continue using the euro. The redenomination of France's public debt, if this materialises, would have significant ramifications for the country's sovereign rating and may rattle the global bond markets, including those of Malaysia and Asia.

Trump's proposed policy to boost the US fossil fuel industry will also have an impact on oil-dependent countries. His intention of encouraging drilling activity and creating more jobs in the industry would lead to higher US oil production as drilling activity increases. This

may eventually cap the upside of global crude oil prices, which are now ascending towards US$60 per barrel.

The US produced 8.5 million to 9.5 million barrels per day in 2015 and 2016, compared with about six million to eight million bpd between 2012 and 2013, according to the US Energy Information Administration. The recent increase in US crude oil inventories to a record high in the first week of February is a sign that higher US production will continue to fill the gap left by the Organization of the Petroleum Exporting Countries' (Opec) production cut, implemented since last November, and will limit the upside of crude oil prices.

At the same time, the fate of Opec's production-cut agreement after June remains unknown. This is probably why crude oil prices have yet to breach US$60 per barrel. Being dependent on oil and oil-related revenue, the Malaysian economy — and by extension, government revenue — will likely be affected by the movements in crude oil prices.

Not all is gloomy, however. Malaysia can still bank on its domestic economy, which has evidently continued to support its headline GDP growth in past years. Of particular importance is its consumer spending strength, which contributed 65% to 75% to headline growth in recent years. Investments are also not doing too badly, and may in fact strengthen this year on the back of large infrastructure projects such as the Klang Valley Mass Rapid Transit Line 2 and Light Rail Transit Line 3.

Stable corporate bond issuances in the past few years at around RM85 billion per annum show that investments are still coming in at a decent pace. Meanwhile, exports in US-dollar terms are also bottoming out, and net exports will not likely drag growth down. As such, there is still a likelihood of the economy registering decent headline growth this year.

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