

Interest rate and global policy risks to emerge in 2025

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Over the past year, few major market events occurred in line with expectations. In particular, US interest rates, which were initially expected to be cut in the first half of 2024, were eased only in September. The second major event that followed was the victory of US president-elect Donald Trump and his control of Congress, both the House of Representatives and the Senate, following the November 2024 elections. Both events would have the effect of raising bond yields, given that persistent US inflation has dampened expectations of aggressive US interest rate cuts, and fiscal spending would expand given the comprehensive political support in Trump's Congress.

The reverberations of both interest rate and geopolitical risks continue to be felt in emerging markets. The ringgit, alongside other regional currencies, has depreciated in recent weeks. Forecasters initially expecting the ringgit to appreciate below 4.00 to the US dollar are quickly reversing estimates. Not only have US interest rate cut expectations been dampened, but global trade as a contributor to economic growth faces challenges. In Malaysia's case, the currency can be said to have performed well, having not breached previous dollar-ringgit highs despite the confluence of both interest rate and global trade policy risks.

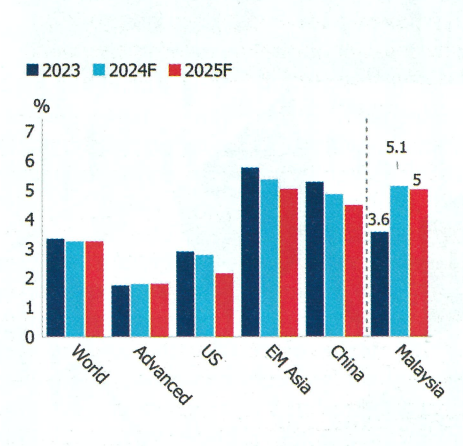
What anchors the ringgit

Through these lenses, it is important to dissect and remain anchored by the strengths of Malaysia's situation within emergent risk narratives. First, Malaysia has yet to cut interest rates despite the commencement of monetary easing by the US and other economies. This improves the Malaysia-US rate differential factor in Malaysia's favour, which will help attract portfolio inflows. Malaysia's interest rates are unlikely to change for now, as it supports already robust economic growth amid manageable inflation. Second, Malaysia is likely to prosper from trade diversion, since the arrow of US protectionism remains mainly focused on China. Previously, when Trump was US president from January 2017 to January 2021, Malaysia's trade with the US continued to grow, while Asean countries benefited from a higher trade surplus due to rising exports to the US. Nonetheless, it should be noted that the reduction in China's trade caused by tariffs then was not fully diverted to Asean exporters. This scenario presents evidence that trade protectionism leads to lost opportunities in total economic value-add even if some countries benefit from trade diversion, it is a suboptimal outcome.

Trade protectionism: two sides of the coin

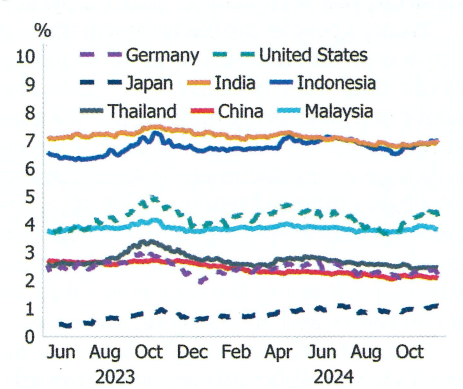
While the net impact of trade protectionism can be said to be negative, intervening factors may dilute its final impact on economic growth and markets remain uncertain. The complexity of trade policies is sometimes described as a "spaghetti bowl" by economists, evoking images of messy and complex networks. For example, a Malaysian company might be able to export products to the US with fewer tariffs than China, but that may then make the company less eligible for preferential policies in trade with China. There is also the complex issue of tariffs based on country of origin and import content policies. Such issues lead to other entanglements such as regional trade blocs, joint ventures, friend-shoring and the like. The irony of convulsion

Chart 1: GDP growth in 2025 is expected to remain resilient



Note: Malaysia's 2024 and 2025 are in-house forecasts. Sources: IMF, Macrobond, MARC Ratings

Chart 3: Asian bond yields have been relatively stable compared to G3 bond yields



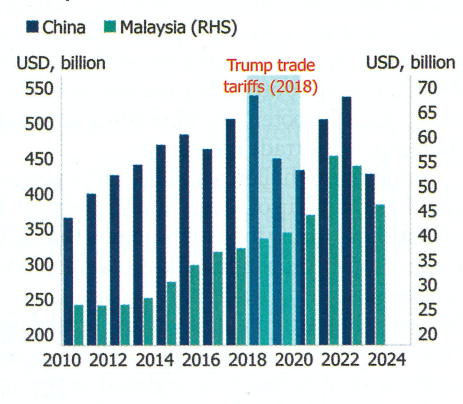
Sources: Macrobond, MARC Ratings.

in such arrangements is that it prevents the financial markets from being able to price trade policy risk premiums effectively, leading to shallow and non-persistent effects. Evidentially, the correlation between current account balances and foreign exchange effects remains unclear, despite the theory, at least in Malaysia's case. Trade tariffs aside, non-tariff measures such as US Treasury policy to limit depreciation in emerging currency markets can be undertaken, such as the labelling of countries as currency manipulators, a possible stance given Trump's preference for a weaker US dollar. For now, the appointment of industry technocrats such as Scott Bessent as US Treasury Secretary provides hints that Trump's policy choices are not designed to roil financial markets. Consequently, while currency markets will likely remain volatile with trading opportunities, it would be unreasonable pessimistic to expect emerging market currencies to depreciate persistently and singularly due to rising trade protectionism.

Yield decline in bonds to support financial markets

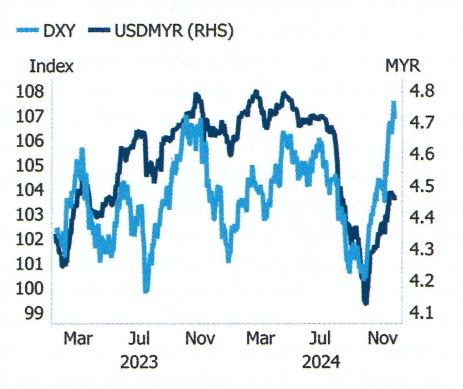
While the attractiveness of the bond market has receded due to a reduction of rate cut expectations in the US, the bond market should remain moderately constructive on lower interest rates. This attractiveness is reinforced in Malaysia, with accelerating GDP growth projected above 5% in 2024 and 2025. Higher GDP growth provides flexibility for Malaysia's central bank to maintain stable interest rates, improving sentiment for ringgit-denominated bonds relative to developed market bonds. Corporate credit spreads have remained narrow, reflecting favourable supply dynamics, cash redeployment, robust economic conditions and few negative credit

Chart 2: Malaysia's exports to US continued to grow despite trade tariffs in the past



Note: As at 9M2024. Sources: Macrobond, MARC Ratings

Chart 4: Ringgit depreciation was mild, relative to recently sharp strength in the dollar index



Sources: Macrobond, MARC Ratings

events. Consequently, the interest rate and credit market conditions in Malaysia remain optimal amid improving economic growth. Given the anticipated decline in global interest rates, flush liquidity will benefit financial markets.

Well-contained domestic risks

In Malaysia, there are rising inflation expectations linked to the ongoing reduction of fuel and other subsidies for certain foodstuffs and electricity. Nonetheless, Malaysia's inflation is likely to remain close to 3% in 2024 and 2025, which is highly manageable. The subsidy rationalisation exercises in Malaysia were gradually implemented alongside extensive public consultations by the gov-

ernment. Therefore, even if inflation were to rise, it would be temporary, with market participants likely focusing on growth outcomes as subsidies are retargeted for welfare needs. Nonetheless, it is important for fiscal consolidation in Malaysia to be more ambitious while maintaining social spending needs and a target GDP growth of above 5% in 2025. Malaysia's debt management goals will remain on track, although the litmus test is in reaching a 3% deficit-to-GDP target expeditiously. Furthermore, fiscal consolidation should occur not only with expenditure reduction but also with increases in tax revenue. Reforms of Malaysia's tax system remain an ongoing and oft-repeated theme, spanning the need for a broad-based consumption tax and e-invoicing systems to reduce leakages. The implementation of tax revenue-raising measures remains a long-drawn challenge although the vision remains intact and in the right direction. As such, the government has been able to address fiscal consolidation partly through quickly implemented measures such as the reduction of expenditure and by raising private sector participation in public sector projects. As such, redevelopment investment expenditure is being reallocated to the private sector. Additionally, public-private partnerships are valuable as they promote private sector involvement and, in theory, reduce administrative costs and duplication of efforts by government agencies in facilitating these projects.

Hope for better market outcomes in 2025

Next year remains fraught with potential challenges, particularly with the likelihood that US trade and interest rate policies have just begun to evolve from a relative period of stability. While US rate cut expectations have been pared down, slower growth and labour market conditions could prompt a stronger interest rate response in 2025. Financial markets have just experienced the US interest rate peak in 2024, and the post-interest rate peak economic conditions will take time to fully unfold over the next 12 to 24 months, providing hope for better market outcomes. In response to the preponderance of US policy risks, 2025 is likely to witness the formation of new alliances, as many economies and private sector corporations prioritise growth-oriented, open trade relations, fostering beneficial durability in global trade diversification.

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Banks to drive Maybank IB's target

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Theme 4: Investment realisation

Malaysia's record-high approved direct investments since 2023 should start to be realised from as early as 2025. The focus will be back on industrial properties, which have seen heavy activity.

Theme 5: Corporate restructuring

We expect corporate restructuring to excite the market, supported by the introduction and execution of strategies to reinvigorate some underperforming companies.

FBM KLCI target at 1,740 for year-end 2025

With the above supporting factors set

to buoy the market, our year-end 2025 FBM KLCI target is 1,740, or 15 times 2026E price-earnings ratio (PER), on the back of 8% earnings growth. In a bear scenario, assuming earnings growth drops to 5% and a moderation in terms of applicable PER to 14 times, the FBM KLCI could be as low as 1,580. Positively, in a bull scenario, at 16 times PER and 8% earnings growth, the index could surge as high as 1,850.

The sector driver to achieve our FBM KLCI target is the banks, which is a key overweight alongside consumer and healthcare, particularly hospitals. We are also selectively positive on construction (data centre plays), oil and gas (floating production storage and offloading vessels) and technology (software and EMS).