

## MY Elections: Are there concerns that we should be aware of?

Wednesday, May 02, 2018

### Highlights

- Financial markets currently look relatively unaffected by the upcoming elections.
- MYR-denominated asset markets are generally following broader USD themes.
- Malaysia's economic fundamentals remain strong.

Back in 2008, many political analysts were predicting a “boring” election for Malaysia. That said, with the loss of a two-third majority, the FBM KLCI lost 10% within two days after the results were announced and the yield on the 10 years Malaysian government securities (MGS) shot up 10bps to 3.820%. The MYR depreciated against the USD to 3.200 from 3.168 after two days. For the 2013 election, market players went in slightly more cautious only for status quo to be maintained, albeit the popular vote was lost. Financial markets also largely recovered two months after the event risk. Now, financial markets appear very much unaffected by impending elections. Nomination day on 28 April saw only 30 of the 222 districts as two-sided contests, with the rest having up to four candidates, and even one having six candidates contesting, according to the Election Commission website.

### **What are the possible scenarios?**

Polling surveys could not predict Trump's victory in 2016. The same uncertainty can be said for Malaysian elections. There are four plausible scenarios that could emerge:

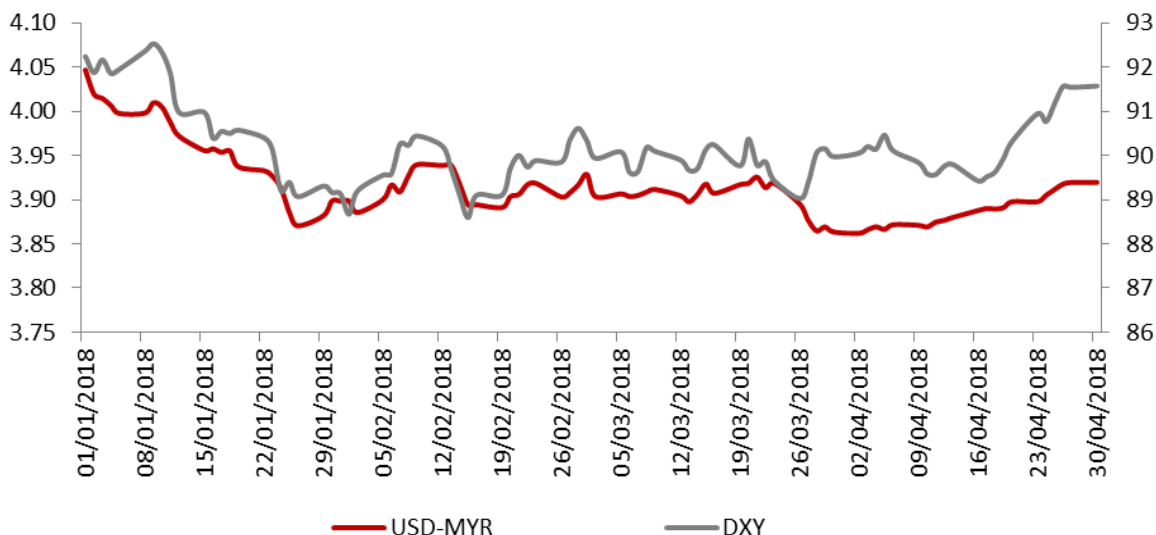
- **Barisan Nasional (BN) wins more than two-third of the seats:** In this scenario, the details would be extremely important. It would strongly depend upon where most of the support comes from for BN to win this two-thirds majority. Not surprisingly, government policy would depend upon who their constituents are. There is a possibility that there could still be a more muted knee-jerk market reaction.
- **BN wins by roughly the same margin and the status quo is maintained:** Financial markets could continue to tread their current trajectory.
- **A hung parliament:** The details of this scenario is really what matters. It would depend upon the number of seats that BN, Pakatan Harapan (PH) and PAS each wins. This would affect the nature and strength of the government that would be formed regardless of whether it is a BN or PH led government. Obviously, PAS would probably only be an influential kingmaker at the federal level if it held a substantial number of seats but if it didn't, its influence may only be limited to the areas of the country where it has won the most seats. Again, there would probably be a knee-jerk market reaction.

- PH wins the election:** A new government with new policies. Immediate business uncertainty over PH's campaign promises, especially those involving abolishing GST and major policy shifts, will likely weigh on interim market confidence.

**But as mentioned, financial markets currently look relatively unaffected by the upcoming elections...**

Building up to May 9th, we can't sense any election impact to the market. The USD-MYR is generally driven more by the USD movement (see Chart 1). Since about the end of January, the USD-MYR value has hovered in the range of about 3.86 to 3.95.

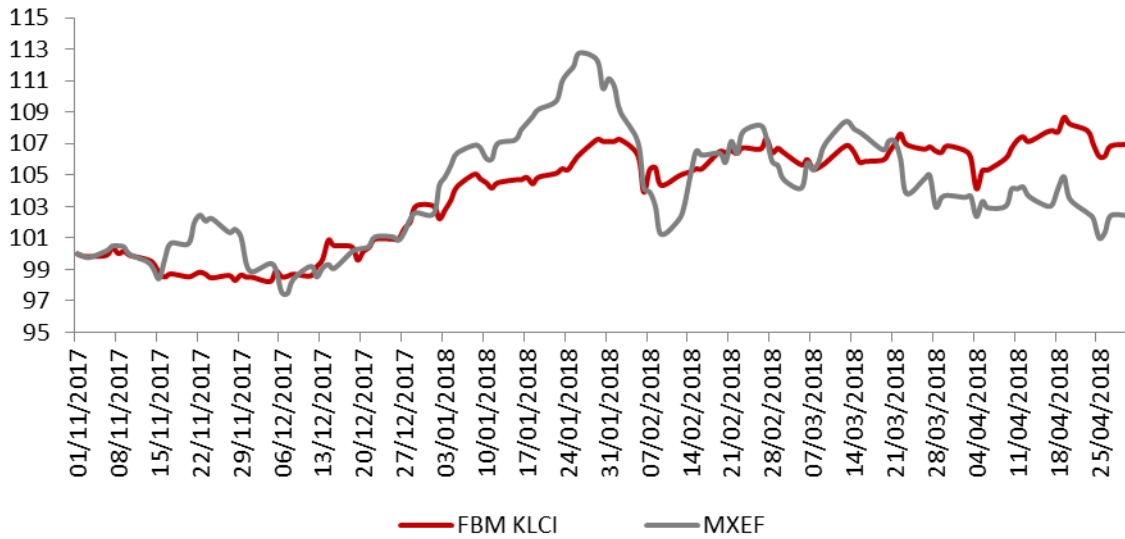
**Chart 1: USD – MYR (LHS) and DXY (RHS)**



Source: Bloomberg

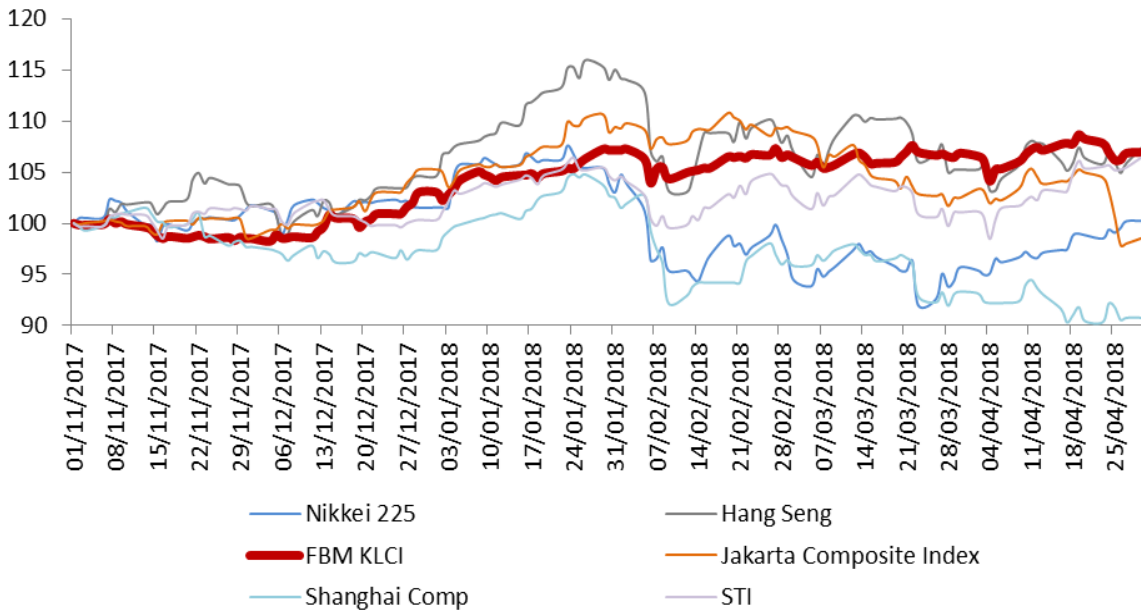
As for the FBM KLCI, it is in fact having a strong period right now having hit a high close of 1,895.18 on 19th April 2018 and has retraced slightly to 1870.37 at the end of Monday 30th April 2018. The FBM KLCI has also outperformed the MSCI Emerging Markets Index (MXEF) with the FBM KLCI having been on an upward trend since the start of the year whilst the MXEF has not gained much during the same period (see Chart 2). Compared to the other major Asian stock indices, the FBM KLCI has generally been on a consistent less volatile climb since early November last year (see chart 3). The FBM KLCI is also among the best performing among the major Asian stock indices to date. To note, Malaysian equity flows have been positive so far throughout 2018 (see chart 4), indicating that foreign sentiment towards Malaysian equities is still strong.

**Chart 2: FBM KLCI and MXEF, 1st November 2017 = 100**



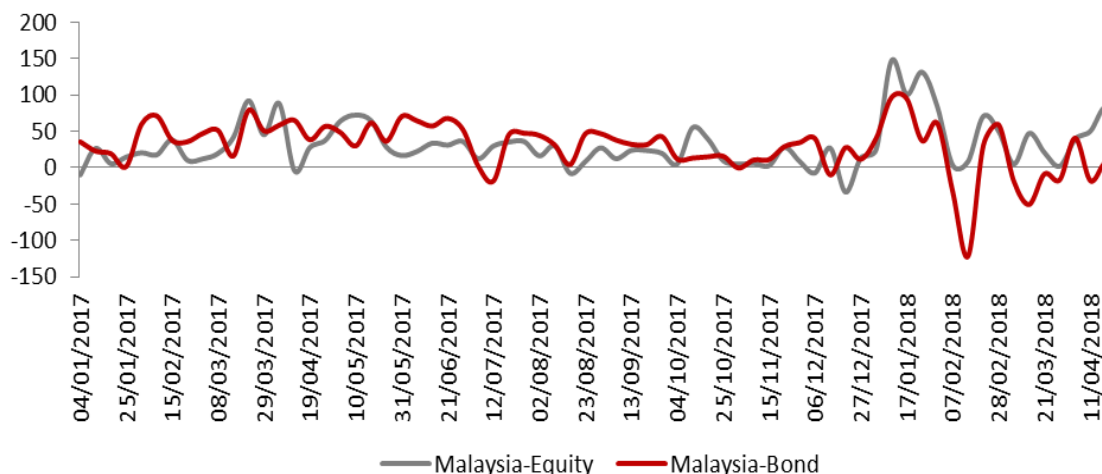
Source: Bloomberg, OCBC

**Chart 3: Performance of major Asian stock indices, 1st November 2017 = 100**



Source: Bloomberg

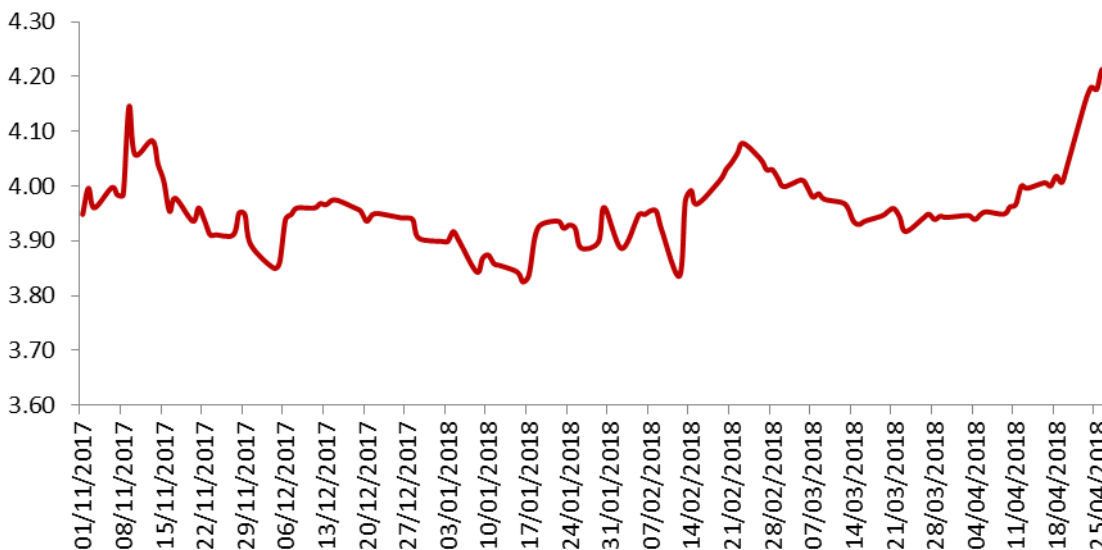
**Chart 4: EPFR Equity and Bond Flows for Malaysia, USD mn**



Source: EPFR

10Y MGS yields have also been fairly stable since November last year (see chart 5) although there was a 14 basis points increase over the last two weeks.

**Chart 5: 10Y MGS Yield**



Source: Bloomberg

**Previous elections showed that the results did not appear to have any impact on long term trends**

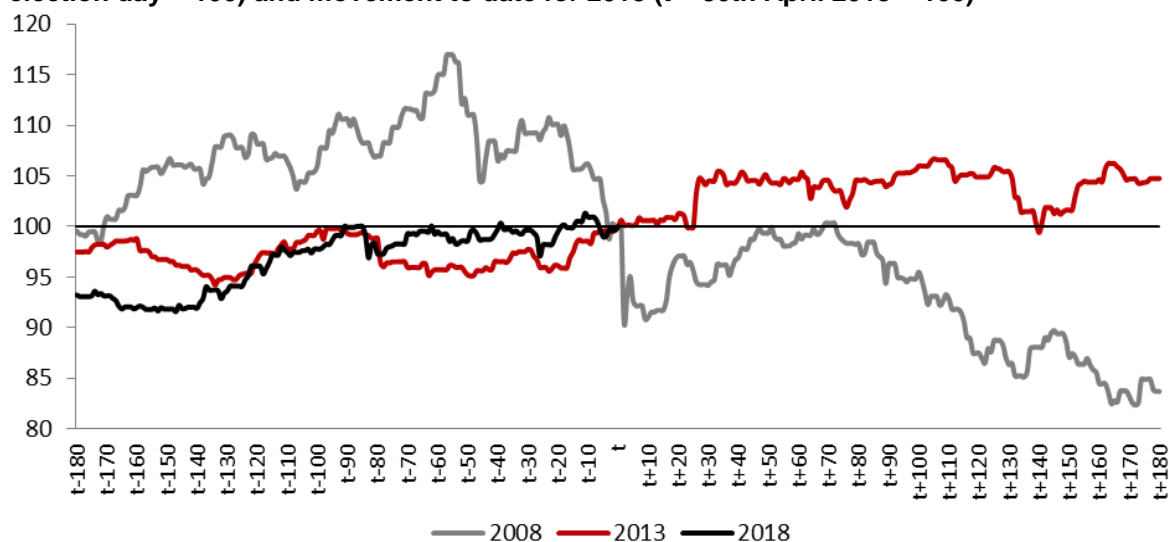
If we look back at 2008, after an initial period of uncertainty, the market once again started to be more heavily driven by external factors. The FBM KLCI reverted to its election day value after about two months. The USD-MYR experienced some small initial depreciation but it was quick to rebound back to the election day level. For the 10Y MGS, yields were at the election day level after about a week. This suggests that the election results did not have a sustained or permanent effect.

In hindsight, many argued that there wasn't a change in government in 2008 so this wasn't a major shock. However, BN had lost its two-third majority and it was now facing a much enlarged opposition in parliament. Furthermore, within Peninsular Malaysia itself, the government had only won five more seats than the opposition. The major economic states of Penang and Selangor also fell to the opposition. Overnight, the market was suddenly dealing with a higher level of political noise from the norm.

In 2013, the markets went in more cautiously but the end result and the argument here would be on the flipside. If the market was cautious and expecting a change, then there should be a stronger sustained increase if it was a status quo outcome. Again, this was not the case and no sustained increase in values post-election can be seen.

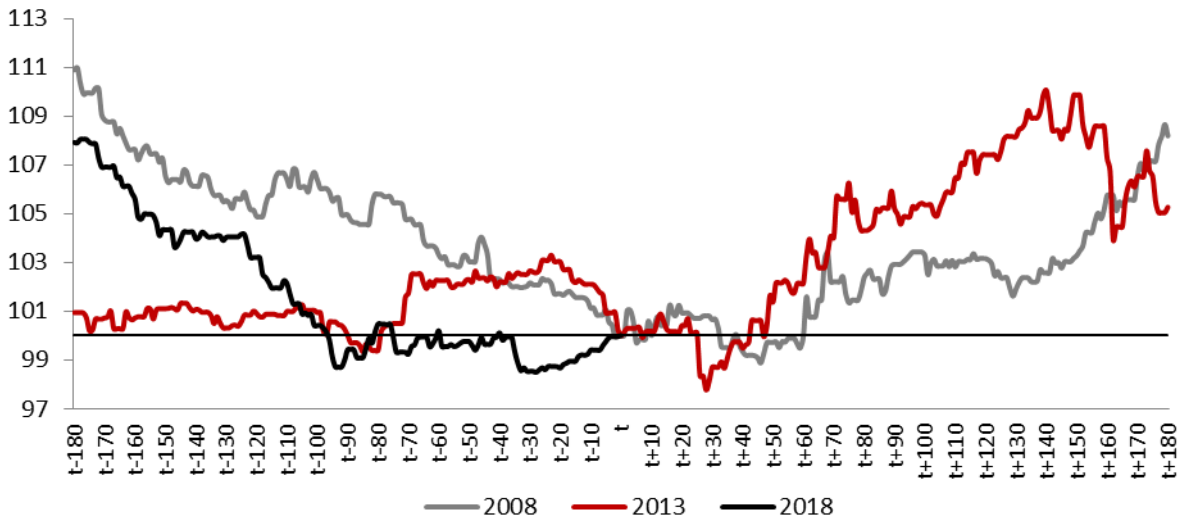
This brings us to the point that financial markets may be fairly adaptable and resilient to political noise in Malaysia. Initial uncertainty immediately preceding and post-elections may cause some jitteriness. However, over time, markets refocus on external and/or economic drivers. It is also very possible that financial markets may be less concerned about elections as the current economic climate is bustling and businesses have accepted the currently heightened political noise as a new norm. At the end of the day, Malaysia's economic fundamentals remain strong to still effectively drive the economy in the long run. The country has a thriving private sector. There may be a positive output gap but the OPR has been raised pre-emptively to manage this and ensure a smooth landing for the economy. Inflation is also moderate and unemployment is low. Overall, singular events such as elections may have a short term impact on the market but in the medium term, investors would still focus on the economic fundamentals of a nation. Case in point, Trump's election was a singular event that led to some initial concerns but developments regarding America's economy in the medium term would depend upon Trump being able to implement his campaign promises. For over a year now, it has been difficult for him to implement many of his said promises.

**Chart 6: FBM KLCI 180 days movement before and after elections for 2008 and 2013 (t = election day = 100) and movement to date for 2018 (t = 30th April 2018 = 100)**



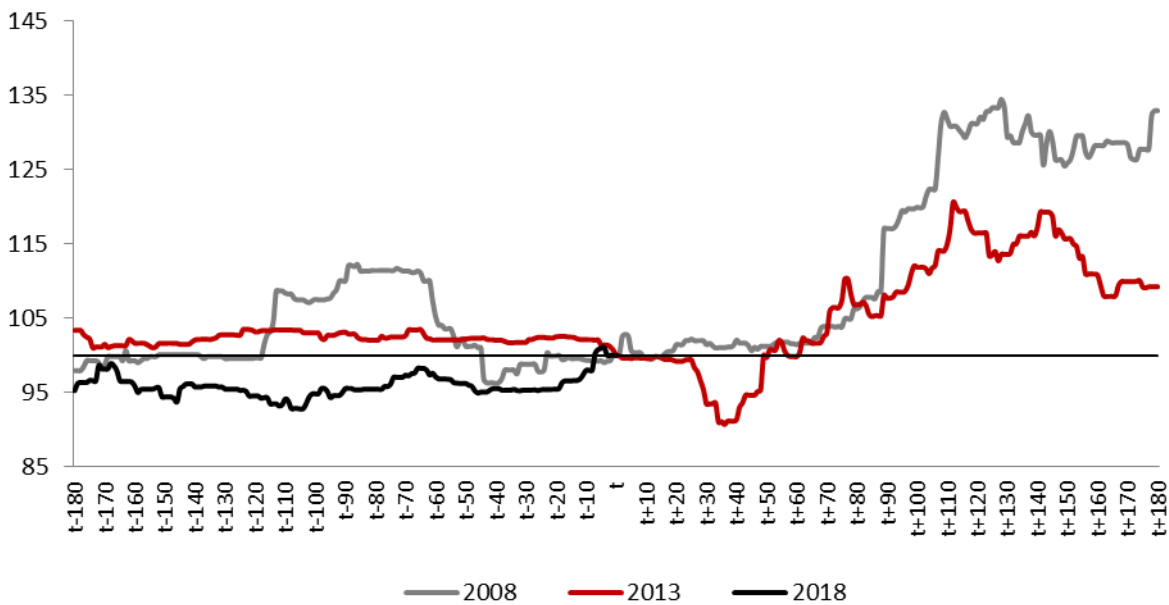
Source: Bloomberg, OCBC

**Chart 7: USD – MYR 180 days movement before and after elections for 2008 and 2013 (t = election day = 100) and movement to date for 2018 (t = 30th April 2018 = 100)**



Source: Bloomberg, OCBC

**Chart 8: 10Y MGS yield 180 days movement before and after elections for 2008 and 2013 (t = election day = 100) and movement to date for 2018 (t = 30th April 2018 = 100)**



Source: Bloomberg, OCBC

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