Fitch downgrades Malaysia's sovereign rating

On 4 December 2020, Fitch downgraded its sovereign credit rating for Malaysia by one notch from A- rating with a negative outlook to BBB+ with stable outlook.

The downgrade was driven by:

- The depth and duration of the COVID-19 crisis which have weakened Malaysia's economic growth and fiscal burden.
- Lingering political uncertainty following the change in government in March 2020 weighs on policy outlook as well as prospects for further improvement in governance standards.

Following this downgrade, Malaysia currently has 'split ratings' by the major rating agencies as shown in Table 1.

Table 1: Malaysia's sovereign rating by major international rating agencies

S&P	Moody's	Fitch
A-/negative	A3/stable	BBB+/stable

Source: S&P, Moody's, Fitch Ratings.

Investors have known that there was a risk of Fitch downgrading Malaysia's sovereign rating since Fitch has revised Malaysia's sovereign rating outlook to 'negative' prior to this. However, the timing of the downgrade was unexpected since the revision to 'negative' outlook was done only recently in April 2020. Overall, the downgrade is likely to have a negative impact on the domestic financial markets.

Market Implications – Fixed Income

Given that 2 out of 3 rating agencies still rate Malaysia sovereign at A, and BBB+ is still an investment grade rating, we expect muted response from foreign index or passive funds manager. Local investors also have no pressing reasons to trim their Malaysia government bond holdings, though they typically take cue from the overall market sentiment, which in turn, could be led by funds flow from foreign active fund managers.

Headwinds against the local bond market has been building up over the past couple of weeks, considering the expected additional outflow from Malaysia's largest pension fund under the i-Sinar programme and renewed optimism in global growth recovery as vaccine rollout plans were announced. This sovereign rating downgrade by Fitch adds to the headwinds.

We expect knee jerk price pressure on the Malaysian Government Securities (MGS) curve and Malaysia's USD bonds following Friday's downgrade though we do not expect a major bond selloff like the one in March 2020. Thereafter, we expect buy-on-dip demand to return and stabilise the market.

The bond market is still supported by expectations of a prolonged low interest rate environment, healthy domestic liquidity and compelling real yields. The expansionary budget suggested less urgency for monetary easing, though rate cut may still be in the cards in 2021, depending on whether Gross Domestic Product (GDP) growth in 2021 undershoots target.

On the other hand, upward pressure on bond yields persists due to the deluge of bond supplies in the market and uncertainties related to Malaysia's political development.

Market Implications – Equity

The negative sentiment created by the downgrade could result in a similar knee-jerk selling action by foreign investors. Nonetheless, we expect the market impact to be mild as:

a) The low foreign shareholding levels of Bursa Malaysia – The foreign shareholding level of 20.8% as of end-November 2020[1] was close to the lowest point experienced during the Global Financial Crisis;

[1] CGS-CIMB Securities, 8 December 2020

b) Market support from retail investors, whose participation rate has been strong at 34.4% year-to-date November 2020. In comparison, the average retail participation rate over the past 10 years was 24%[2].

c) Market support from the traditional “window dressing” in December. KLCI ended higher month-on-month in December in 9 out of the past 10 years[3].

We view weakness in equity markets as buying opportunities in view of the vaccine-led economic recovery in 2021. The availability of vaccine is a game changer and signals a change in both investors and consumers’ sentiment.

[2] HLIB Research, Newsbreak 7 December 2020, “Fitch Downgrades Malaysia to BBB+”
[3] Bloomberg

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