Fitch downgraded Malaysia's rating to BBB+

Fitch Ratings has downgraded Malaysia to BBB+ from A-, with a stable outlook on 4 December 2020. The rating downgrade was attributed to weakening of several key credit metrics due to the depth and duration of the COVID-19 pandemic. Malaysia's credit metrics were already weaker than A-rated sovereigns even before COVID-19, but tolerated by Fitch given the country's fiscal consolidation before the crisis. The pandemic has necessitated substantial stimulus spending and Malaysia's fiscal deterioration is unlikely to improve meaningfully in the middle term. That said, Fitch deems Malaysia's projected debt and deficit ratios in 2020-2021 to be achievable. Political instability may further weigh on Malaysia's governance indicators, which have recently shown deterioration in World Bank's governance score (below A-rated sovereigns). Fitch will likely maintain Malaysia at BBB level for a foreseeable future since meaningful improvement in fiscal performance and governance is unlikely in the near term. There is also risk of further downgrade by S&P (currently rates Malaysia at A-/Negative) considering Malaysia's weakened fiscal prospects and growing political uncertainties.

We expect some knee-jerk reactions in the local capital market as the rating downgrade was not anticipated. There is risk of a sell-off on government securities especially coming from foreign investors as foreign share of government securities (MGS+GII) remained high at 24% as at end of October 2020. However, we believe any price correction would be modest and temporary as the market is likely to be supported by the attractive yield spread offered by the domestic market. With the global central banks reducing rate to near zero and record amount of global government bonds in negative real yield, Malaysian government securities are still offering relatively high positive real yields. In addition, the impact to our portfolios is further cushioned by our overweight position in corporate debts. Foreign ownership in this space is light with relatively lower risk of experiencing a sell-off. We do not have any exposure in MGS/GII for United Income Plus Fund and United Best & Equity Strategic Trust while United Conservative Bond Fund has about 1.3% as at 3 December 2020. Meanwhile on Ringgit, we don't expect Ringgit to weaken substantially against the Dollar due to the rating downgrade. If there is any correction on Ringgit, it will be temporary in our view. US dollar weakness trend is likely to continue given the risk on sentiments. We expect Ringgit to trade within 4.05-4.10 in the near term and could strengthen closer to 4.00 by 1H21.

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