

An insurance policy

We view the OPR cut as a positive surprise and should be well received by the market. Although a small reduction, we are hopeful that it can help support GDP growth but without causing financial imbalances in Malaysia. The BNM has this flexibility due to Malaysia's strong macro fundamentals with its positive savings-investment gap, high excess liquidity in the financial system and high foreign currency reserves.

A surprise to us

Bank Negara Malaysia (BNM) cut the overnight policy rate (OPR) by 25bps to 3% on 13 July 2016. In the same Monetary Policy Committee (MPC) meeting, it guided down its inflation projection to 2-3% for 2016 from 2.5-3.5% range previously, and expect inflation to remain stable in 2017. The price stability was attributed to energy and commodity price levels as well as low global inflation. Meanwhile, the effects of the Goods and Services Tax (GST) introduced on 1 April 2015 has dissipated. However, the statutory reserve requirement (SRR) remains at 3.5% subsequent to the 50bps cut in January 2016.

Insurance policy

We see two general possibilities for the cut. The first is if preliminary numbers show 2Q16 real GDP slowing sharply from the 4.2% in 1Q16 thus warrant easing monetary conditions. This may be the case as the MPC policy statement said that looking ahead growth momentum is moderating in the major economies and also pointed to increased downside risks post Brexit. Also, we note that 1Q16 GDP saw a large build-up in inventories that added 2ppts to GDP growth thus 2Q16 will most likely see this benefit lapse. The second reason is if it is purely a pre-emptive measure given the flexibility accorded to BNM due to lower inflation expectation. This is plausible as well, given that the MPC statement acknowledged the domestic economy remains strong with private consumption and investment being cornerstone to growth though uncertainties in the global environment could weigh on Malaysia. We are hopeful that the decision is based more on the latter, which is good for the equity market.

One concern

Financial markets especially in the current environment are attracted to easy monetary conditions hence BNM's decision would be positive for the KLCI especially if it is due to scenario two described above. Nonetheless, we note that global markets are flooded with liquidity due to the extended years of quantitative easing by major central banks. Its side effects could be seen in record low bond yields (and some dipping into negative territory) as well as rapid asset price inflation over the past few years. In Malaysia's case, the excess liquidity has caused some financial imbalances requiring BNM to introduce macro prudential measures especially targeted at the property segment. The interest rate cut could perpetuate this further although we find comfort in the MPC statement that risk of destabilising financial imbalances have receded.

Sector implications

Lower interest rate is generally negative for banks, putting further pressure on net interest margin. However, key positive is property due to lower interest service and higher affordability. Construction sector should benefit as well due to their exposure to property while project financing and working capital could be cheaper for new projects. It is also positive for consumption due to higher disposal income. High yielding sectors such as REIT and companies with high local debt are beneficiaries too.

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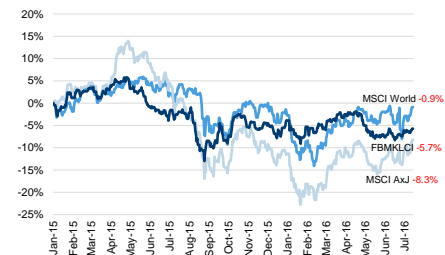
Malaysia Strategy

KLCI 1,660
@ 13 July 2016

POSITIVE (maintain)

KLCI Target: 1,746
 Previous target: 1,746

KLCI vs MSCI World vs MSCI AxJ (since 2015)



Source: Bloomberg

Key market statistics

	2015	2016E
GDP growth (%)	+5.0	+4.5*
KLCI EPS growth (%)	-4.4	+3.0

Source: BNM, Affin Hwang estimates and forecasts
 *will be revisited

Top calls for 2016

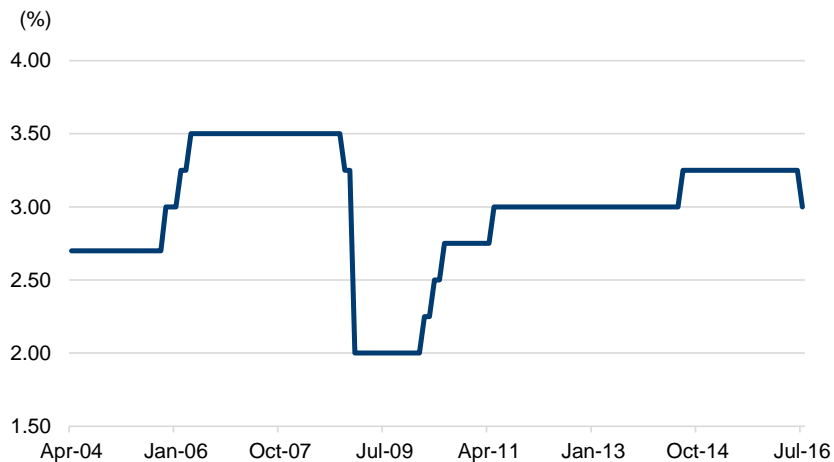
Stock	Rating	Price (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)
Top Buys					
AEON CREDIT	BUY	13.30	14.80	11.3	1,915.2
AFG	BUY	4.13	4.50	9.0	6,392.4
CARLSBERG	BUY	14.62	14.40	(1.5)	4,531.5
CIMB	BUY	4.32	5.00	15.7	37,708.7
GAMUDA	BUY	4.89	5.70	16.6	11,817.3
GENTING MALAYSIA	BUY	4.36	5.00	14.7	25,887.7
INARI	BUY	2.97	3.54	19.2	2,840.9
JAKS RESOURCES	BUY	0.96	1.60	67.5	418.6
KPJ	BUY	4.33	5.01	15.7	4,587.0
PUBLIC BANK	BUY	19.40	21.80	12.4	75,313.5
PETRA ENERGY	BUY	1.23	1.48	20.3	395.8
PAVILION REIT	BUY	1.84	1.90	3.3	5,556.4
SUNWAY CONSTRUCTION	BUY	1.65	1.98	20.0	2,133.3
SCICOM	BUY	2.28	2.62	14.9	810.4
SUNWAY	BUY	2.97	3.90	31.3	6,032.6
TA ANN	BUY	3.31	4.42	33.5	1,472.6
TENAGA	BUY	14.32	16.50	15.2	80,816.5
TOP GLOVE	BUY	4.49	6.30	40.3	5,653.8
UOA DEVELOPMENT	BUY	2.49	2.64	6.0	3,786.7
WCT	BUY	1.53	2.02	32.0	1,922.3
Top Sells					
MAHB	SELL	6.20	5.50	(11.3)	10,287.0
MCL	SELL	0.72	0.55	(23.6)	1,214.8
MEDIA PRIMA	SELL	1.39	1.21	(12.9)	1,541.8
STAR	SELL	2.64	2.07	(21.6)	1,949.8
UMW-OG	SELL	0.93	0.73	(21.1)	1,999.9
UNISEM	SELL	2.51	1.76	(29.9)	1,841.9

Source: Affin Hwang forecasts, pricing as of 13 July 2016

Chue Kwok-Yan
 (603) 2146 7618

www.affinhwang.com

Fig 1: Overnight policy rate in Malaysia



Source: BNM

Fig 2: Sector positioning

Overweight	Neutral	Underweight
Banks & Financials	Auto & Autoparts	Oil & Gas
Construction & Infrastructure	Building Materials	
Gaming	Consumer	
Healthcare	Media	
MREIT	Plantation	
Property	Rubber Products	
Timber	Technology	
Utilities	Telecoms	
	Transport & Logistics	

Source: Company, Affin Hwang

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