30 January 2014

MALAYSIA

BNM stands pat but hinted possibility of OPR to be hiked up

OPR left unchanged at 3.00% for the 33rd consecutive month even as the headline inflation had continued to creep up. That matched the consensus and our expectation of no change in the Overnight Policy Rate (OPR) by Bank Negara (BNM) at its first Monetary Policy Committee (MPC) meeting for the year held on January 28-29. At this juncture, BNM perceived the risks between growth and inflation remained in balance even as the headline inflation, the Consumer Price Index (CPI) had continued to edge up in December following ths surge in September (2.6% YoY from 1.9% YoY in August) when the fuel prices were raised by 20 sen per litre. The hike in tobacco duties in October as well as the abolishment of subsidy in sugar (34sen hike) compounded the cost-push effect on the general price level of the economy.

Risks on growth and inflation remained in balance... While the economy is set to benefit from the recovery in the US and other developed countries, the contribution coming from the developed markets is smaller than that of in the past indicating bigger weight from the EM countries. With the Fed to taper its QE programme this year, the likely portfolio shift and capital outflows may result in output loss in many EM countries, and that will have negative impact on our economy. As noted in the MPC statement, BNM highlighted that "..global economic and financial conditions remain vulnerable to shifts in sentiments and heightened volatility in the international financial markets." The central bank believes that domestic demand, is expected to moderate, citing the ongoing public sector consolidation and a slower growth in private consumption as the main factors contributing to the slowdown. On inflation, the central bank believed disruptions in supply following adverse weather conditions and higher domestic costs contributed to the rising inflation but well contained thus far.

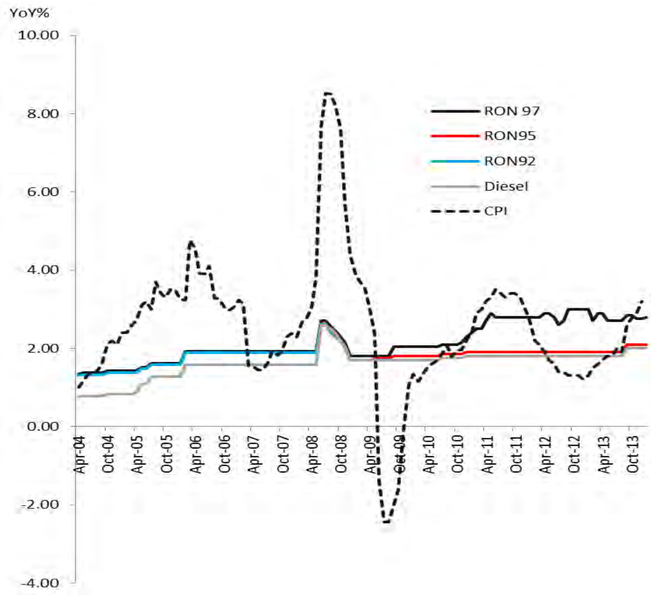
..but not for long. We think that the second round effects of the adjustment in prices of those administered items is working on its way to the broader economy. The continued MoM rise in the CPI is an indication that the one-off cost push effect may not have died away as instantly as it should. Businesses may have foreseen structurally, the economy will face much higher prices of inputs going forward amidst sustained strong domestic demand. That may lead to rising inflation expectations. As BNM noted "Going forward, inflation is expected to average higher largely due to domestic cost factors..", although the central bank remained confident that the rise will be tempered by "..the subdued external price pressures and moderate domestic demand conditions.."

We do not think any decision to hike up the OPR to be triggered by the need to prevent capital flight following the US Fed taper moves this year. Rather, the domestc factors of anchoring inflation expectation and curbing domestic debt although in that process, credibility of the central bank would be boosted and help to prevent further sharp depreciation in the currency. At present, our real interest rate stood at -0.2%. We are among the few in EM Asia with Our FX reserves is big enough to cushion any likely capital outflows and other external funding requirements. At the same time, Ringgit has room to tolerate further weakness, although we do think BNM may have some floor level to the Ringgit at which it feels is fair and non-threatening to the stability of domestic financial markets.

Overall, we took the MPC statement as giving guidance of the possible hikes in OPR in subsequent meetings. The combination factor of improving growth performance, narrowing real interest rate (Malaysia is the very few EM countries with negative real interest rates), rising inflation and inflation expectations, persistently high household debt, and the likely further capital outflows would all culminate to signal that the risk of faster inflation would outweigh the risk of growth slowdown.

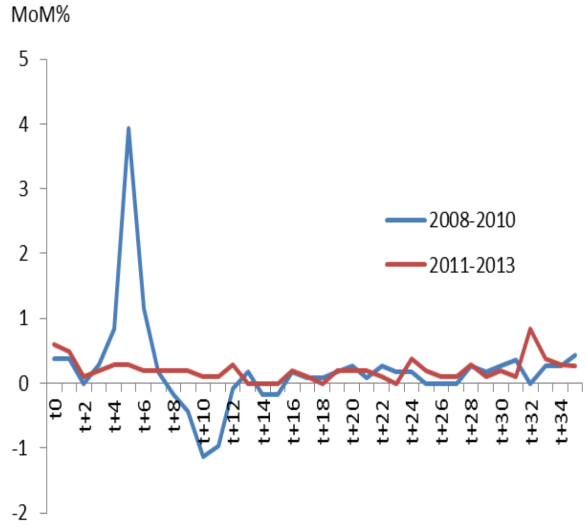
More economists concurring with us in expecting more than 26bps hike in the OPR. The point of argument supporting the case for a hike in the OPR also indicates that in such event, a 25bps hike may not be sufficient. We continue to expect BNM to hike up by 25bps in the 2Q 14 and another in late 3Q or early 4Q 14.

Chart 1: The history of inflation and fuel price hikes



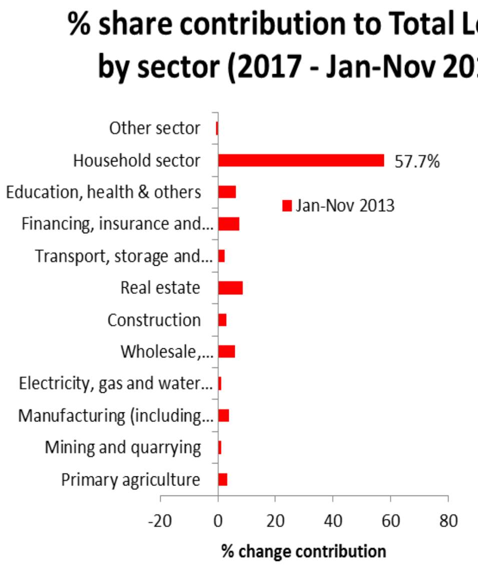
Source: DoS, BNM.

Chart 2: MoM changes did not instantly die off after the one-off effects in prices of adisnitered items



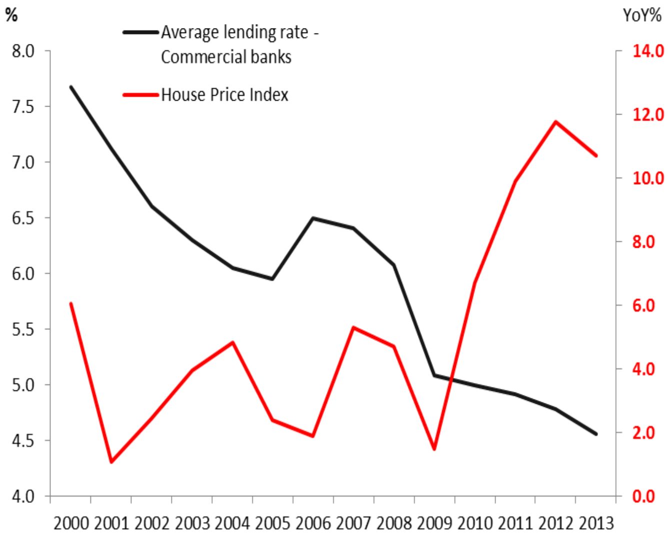
Source: DoS, BNM.

Chart 3: Monetary policy too loose? Rising household Debt



Source: DoS, BNM

Chart 3: Monetary policy too loose? Lending rates vs House Price Index



Source: BNM, NAPIC

Table 1: EM current inflation and policy rates

	Benchmark policy rate (%)	CPI YoY% - Dec 2013	Real rate (%)
Argentina	11.50	10.90	0.60
Brazil	10.50	5.91	4.59
Chile	4.50	3.01	1.49
Hungary	3.00	0.40	2.60
Poland	2.50	0.70	1.80
Russia	5.50	6.50	-1.00
Turkey	10.00	7.40	2.60
South Africa	5.00	5.40	-0.40
Indonesia	7.50	8.38	-0.88
India	8.00	6.20	1.80
Philippines	3.50	4.10	-0.60
Malaysia	3.00	3.20	-0.20
China	6.00	2.50	3.50
Thailand	2.25	1.67	0.58
S Korea	2.50	1.10	1.40

Source: Bloomberg, official statistics, MIDF Research estimates.

US

Fed sticking to measured taper, paving way for Yellen to better communicate Fedspeak

Further QE cutback by US$10 billion beginning February. The Fed made the decision at its FOMC meeting held on January 28-29, 2014. That followed the first taper move of equal quantum beginning this month which would see the Fed trimming its bond purchase to US$65bn per month from US$75bn per month of which US$30bn is allocated for the purchase of motgage-backed securities and the rest for longer term US Treasuries. The move was widely expected by consensus despite a slew of economic indicators recently showing signs of the US economic recovery pace was faling short of expectation.

The Fed believes that while economic performance was mixed, the remaining QE in place should continue to be supportive of economic activity and brings the unemployment rate and the inflation rate closer to the Fed's longer term target at which could mark the stage where the economy may no longer need the zero interest rate policy (ZIRP). The statement issued for the meeting clearly reflected the fact that Fed is set to stick to its measured pace of QE taper as it is confident that the economic recovery will gather pace - "The Committee continues to see the improvement in economic activity and labor market conditions over that period as consistent with growing underlying strength in the broader economy.." . and the economy is making "..cumulative progress toward maximum employment.."

For now, the ZIRP will stay in place and the Fed now seeing the complexity of its twin objectives. The Fed had been having the twin objectives of the unemployment rate to fall to 6 – 6.5% and inflation rate at 2% before considering to end its ZIRP. Nonetheless, in recent months, the unemployment rate has continued to trend lower and stood at 6.7% at the end of 2013, a decline of 2-3 percentage points in the preceding two months, made possible by the fast decline in labour participation rate. If the pace continues, we will be hitting the 6.5% unemployment rate soon enough. Nonetheless, inflation has continued to trend lower and hovered around 1% for most of 2013 (2012: 1.8%). That led the Fed to revise its view on when it thinks the economy is strong enough to face the ened of ZIRP. It stated that it "..continues to anticipate, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6.5%, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal."

The Fed is putting in more clarity and further emphasis on its forward guidance policy. By announcing further QE taper in February and clarifying on its longer-term objectives in deciding on the beginning of normalization of its monetary policy, the Fed is paving way for the Yellen who would be replacing Bernanke end of this month to face the market that is already prepared for taper steps and the path towards monetary policy normalization. Yellen had no experience in dealing with Fedspeak and its impact on the global financial markets. With monetary policy objectives set out clearly ahead, that would ease her job in communicating Fed's stance to the market.

But measured QE pace not cast in stone. Just as the Fed warned that asset purchase is on a preset course when it started announcing the taper moves to start in January this year, ahead of the consensus expectation for it to start in March, the Fed is now stating that while the second taper move to begin right after the first one this month, and it will likely reduce the pace of asset purchases in further measured steps at future meetings, further moves would be conditioned on the economic performance. It reiterated the preset course statement " asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases."

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.