ECONOMICS and BANKING SECTOR (*Maintain* POSITIVE)

Likely muted impact from another (almost certain) OPR cut

KEY INVESTMENT HIGHLIGHTS

- **Another OPR cut in 1Q20 is almost a certainty**
- **But there will likely be only one rate cut due to keeping a cautionary stance and given a GDP growth of above 4% can still be considered solid**
- **Net interest margin compression in the short term is a given. However, normalisation could be quick as was the case after the May-19 OPR cut**
- **Banks could have already anticipated the rate cuts and would have likely maneuovered early. This is suggested by the rebound in NIM in one quarter and tepid growth in fixed deposits**
- **Another OPR cut would have already been priced in but banks remains undervalued**
- **We maintain our POSITIVE stance in the banking sector**

MALAYSIA'S MONETARY POLICY – OPR CUT in 2020 A CERTAINTY?

Setting the scene; Malaysia's GDP growth on a moderating trend. Malaysia's GDP growth expanded by +4.4%yoy in 3Q19. While it matched market expectations, it was the slowest GDP expansion since 3Q18. All sectors' growth moderated when compared against 2Q19. From expenditure side, private consumption growth slowed to 6-quarter low while those of public improved slightly in 3Q19. Investment remains weak for both private and public side while trade war continues to weigh on external trade performances.

Record-high trade surplus despite weakening trade flows. In Oct-19, Malaysia's trade surplus registered at RM17.3b, the highest monthly surplus ever recorded. This came in despite a -6.7%yoy fall in export during the month with import declining at harder pace of -8.7%yoy. Export marked third consecutive month of contraction due to weak performance in all major sectors. For the first ten months of the year, exports growth averaged at -1.8%yoy. In term of absolute value, monthly average of 2019 so far recorded at RM81.9b which is still lower than RM83.7b in 2018. Looking ahead to the 4Q19, exports performance is expected to be quite vulnerable. Faltering of global trade derive from rising protectionism, loss of momentum in some major economies and uncertainty over trade tensions will be a key factor.

Continued external headwinds in 2020. Similar to external trade, we had observed a slowdown in industrial production and manufacturing sales performances so far in 2019 as compared to 2018. Year-to-date industrial production and manufacturing sales grew at softer pace of +2.7%yoy and +5.6%yoy (2018: +3%yoy and +7.7%yoy) respectively. We expect the external headwinds to continue into 2020 amid unresolved US-China trade tensions, slowing global economy and geopolitical crisis, capping the expected recovery in exports.

COMPANY IN FOCUS

Malayan Banking Bhd

Maintain **BUY |** Unchanged Target price: RM10.30

Price @ 10th December 2019: RM8.54

- Earnings started to improve in 3QFY19
- Low exposure to floating rate which should moderate OPR cut impact
- It has scale and size
- Attractive dividend yield of circa 6%

Share price chart

CIMB Group Holdings Bhd

Maintain **BUY |** Unchanged Target price: RM6.30

Price @ 10th December 2019: RM5.14

- Earning recovery in Indonesia and Thailand
- Net interest margin recovered
- Robust net income
- Relatively undemanding valuation
- Decent dividend yield of circa 5%

Share price chart

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GDP growth in 2020 is expected to moderate further. We expect the Malaysian economy to further moderate next year to +4.5%yoy (2019e: +4.6%yoy) as domestic demand is likely to ease following a number of factors including increasing inflationary pressure. We anticipate inflationary pressure to surge in 2020 as the targeted fuel subsidy will kicks off in Jan-20, causing the price of RON95 to be floated. Inflationary pressure from transportation and fuel-related items is likely to increase in line with our forecast of Brent crude oil price at USD65pb in 2020, higher than USD63pb estimated for this year. In addition, floating RON95 price will have a spillover effects to food component. Food and transport component, besides housing & utilities have the highest weightage in overall CPI basket. Hence, any price movement will carry significant impact to the overall headline figure.

Another OPR cut in 1Q20 looks an overwhelming certainty. We believe that another 25bp OPR cut in 2020 is almost a certainty. Weak exports on top of easing domestic demand will also affect the manufacturing sector and this could also weigh on employment opportunities. Manufacturing sector has the second biggest share of total employment in the country at almost 20% after services sector (60%). Therefore, another rate cut might be needed to boost private investment and support domestic demand. We do expect inflation to trend higher next year but we view that any rise in the fuel prices is expected to be gradual to prevent shocks. Taking this into consideration, we opine that BNM might want to get a rate cut in 1Q20 while the environment is still conducive as cutting rates generally increase inflation.

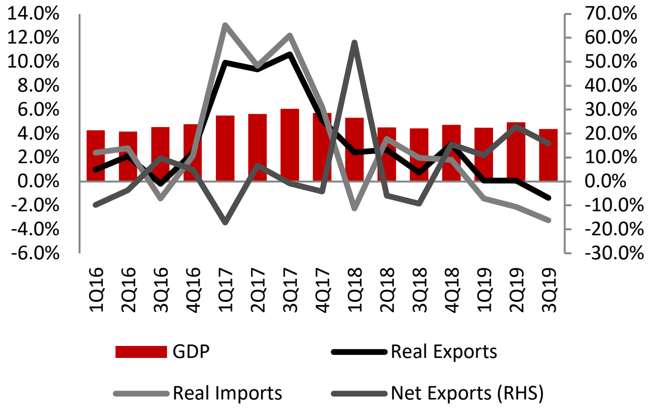
Historically, OPR cut came after weak exports and GDP moderation. During the key interest rate cut in July-16 (the fourth MPC meeting of 2016), export performance was weak as it just recorded tepid growth of +2.1%yoy in the 1H16, extending the slowdown in 2015 (+1.5%yoy). The downside risks on the external front affected growth as reflected in the +4.1%yoy GDP growth in 1Q16, moderated sharply from +4.7%yoy in the previous quarter.

Limited room for rate cuts. Despite more challenges ahead, we only foresee a single rate cut for the full year of 2020. In response to the 2008/09 global financial crisis (GFC), BNM engaged in a series of rate cuts during the period of Nov-08 to Feb-09. The total reduction was 150bp with the largest one time cut was 75bp in Jan-09. The lowest OPR on record was reached in the following month at 2%. Therefore, at current OPR level of 3%, we believe that BNM has relatively limited room for rate cuts in the event of any crisis. Besides this, during the GFC, government also had used of fiscal policy significantly to stimulate the economy along with monetary policy, resulting in a fiscal deficit of -6.7% in 2009, the largest deficit since 1987. In comparison, fiscal deficit recorded at -3.8% in 2018 and government projected lower deficit moving forward (2019: 3.4%; 2020: 3.2%). Sizeable national debt level will somehow restrain government from spending generously in the nearest future. Hence we opine there will be a cautionary stance on monetary policy tools.

Growth at above 4% is still solid. As we mentioned, we expect GDP growth to come in at +4.5%yoy in 2020. This will only be a slight moderation from our +4.6%yoy expected for this year. In our opinion, growth of above 4% can still be considered solid. Consequently, we do not foresee the need of a vigorous expansionary policy, just yet.

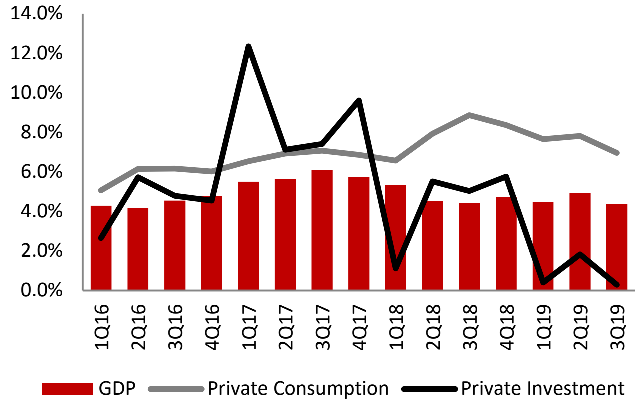
More aggressive OPR cut might cause significant Ringgit's depreciation. As of Oct-19, Ringgit averaged at RM4.14, higher than 2018's average of RM4.03. Lower interest rates tend to be unattractive for foreign investment, reducing the demand for and relative value of the currency. In addition, the decision of Norway's sovereign wealth fund (SWF) to retain Malaysia on its Fixed Income Watch List until further update after the interim review in Mar-20 would pose some pressure on Ringgit as it raises the risk of capital flight. Furthermore, moving towards the end of next year, the US Presidential election scheduled in Nov-20 would boost the greenback and expected to appreciate further assuming Trump's victory in the election. In turn, Ringgit would depreciate. Given that other factors determining the value of Ringgit such as domestic policy stability are still in a flux, we believe that trimming the rate more than once might not be the right move at this juncture as it will result in high depreciation of Ringgit.

Chart 1: GDP vs External Trade (YoY%)



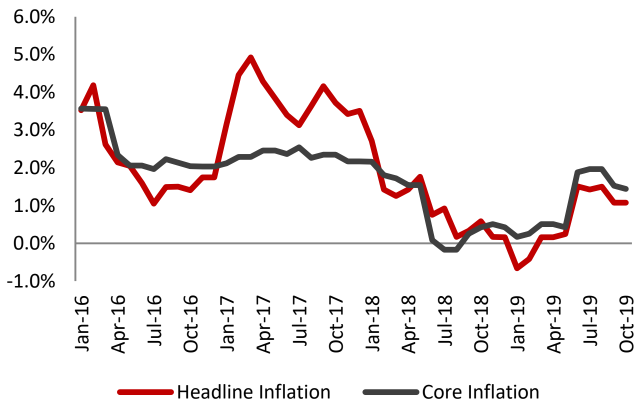
Source: CEIC, MIDFR

Chart 2: GDP vs Private Sector (YoY%)



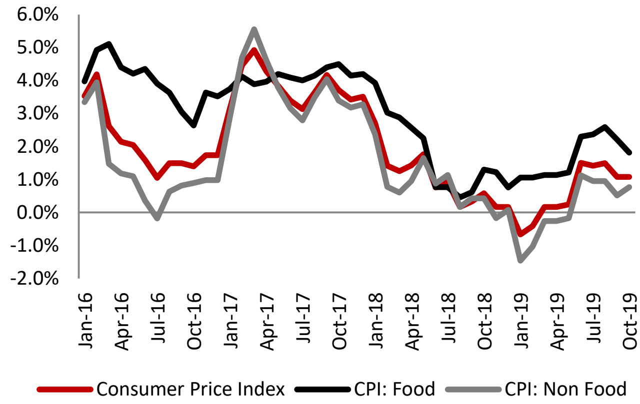
Source: CEIC, MIDFR

Chart 3: Headline vs Core (YoY%)



Source: CEIC, MIDFR

Chart 4: CPI: Headline vs Food & Non-food (YoY%)



Source: CEIC, MIDFR

IMPACT TO THE BANKING SECTOR MAYBE MUTED THIS TIME

Margin compression is expected in the short term. Theoretically, an OPR cut will have a negative impact to banks' earnings from downward pressure in net interest income due to net interest margin (NIM) compression. This is due to the fact that there will be a near-immediate downward adjustment to loans and financing which has a floating rate, while term deposits (such as fixed deposits) are repriced after maturity. The floating rate loans, on average, contributed circa 78.9% of total loans book of banks under our coverage as at end September 2019.

Table 1: Banks' Percentage of Floating Rate Loans & Casa Ratio as at end September 2019

Banks	Percentage of floating rate loans	CASA ratio
Maybank	72.2%	33.7%
Public	78.2%	25.4%
CIMB	84.2%	34.9%
Hong Leong Bank	81.6%	25.6%
RHB	88.0%	25.4%
AMMB	75.2%	22.8%
BIMB	92.0%	30.2%
Alliance Bank	82.9%	37.4%
Affin	69.5%	14.6%
Average	***78.9%***	***29.7%***

Source: Company, MIDFR

But normalisation could be surprisingly fast. Under normal circumstances, we would expect it will take 2 to 3 quarters for the NIM to normalise due to cost of fund decreasing, in particular from adjustment to the fixed deposit rates which had been contracted before the OPR cut. Even so, we observed that NIM normalisation was much faster than we had first anticipated during the review of 3QCY19 results of banks under our coverage. We noted that NIM declined on average -5bp qoq in 2QCY19, when BNM cut OPR by 25bp in May-19. However, NIM rebounded on average by +4bp qoq in 3QCY19 with some banks reporting much better NIM in that quarter.

Table 2: Banks Reported Net Interest Margins (NIM) and Sequential Quarter Comparison

Banks	2QCY19 NIM (%)	+ / - bp QoQ	3QCY19 NIM (%)	+ / - bp QoQ
Maybank	2.19	-11	2.32	13
Public	2.12	-7	2.12	0
CIMB	2.37	-11	2.53	16
Hong Leong Bank	1.89	-11	2.03	14
RHB	2.09	-7	2.13	4
AMMB	1.87	9	1.91	4
BIMB	2.56	-3	2.53	-3
Alliance Bank	2.40	-10	2.34	-6
Affin	1.65	4	1.61	-4
Average	*2.13*	*-5*	*2.17*	*4*

Source: Company, MIDFR

Expectation led to early manoeuvres. We believe that the surprising fast rebound in NIM was due to the fact the OPR cut in May-19 was partly expected. As such, banks' management could have already planned for such an event and manoeuvred accordingly. We posit that banks were careful in taking term deposits which allowed the deposits to be released much earlier. For example, aggregate non-CASA deposits of banks under our coverage increased only +0.6%qoq to RM1.32t and declined -0.4%qoq to RM1.31t as at 3QCY19 and 2QCY19 respectively.

Impact from another rate cut could be muted. Taking into consideration the previous trend that we had observed, we opine that the impact of another OPR cut in 1QCY20 will likely be muted to banks' full year net income and earnings. In our view, it will probably be less than our previous estimate of an average decline of -3% to our earnings forecast. While we do not discount a short term compression to NIM but it will likely be only for a quarter and will recover rather quickly.

In addition, deposits competition not as intense as before. The requirement to meet the Net Stable Funding Ratio (NSFR) as prescribed by BNM played a key factor in banks accumulating deposits in CY18 and CY19. We understand that all the banks under our coverage have complied with the NSFR requirement. Consequently, we expect deposits competition will normalize in CY20 leading to a moderation in deposits growth.

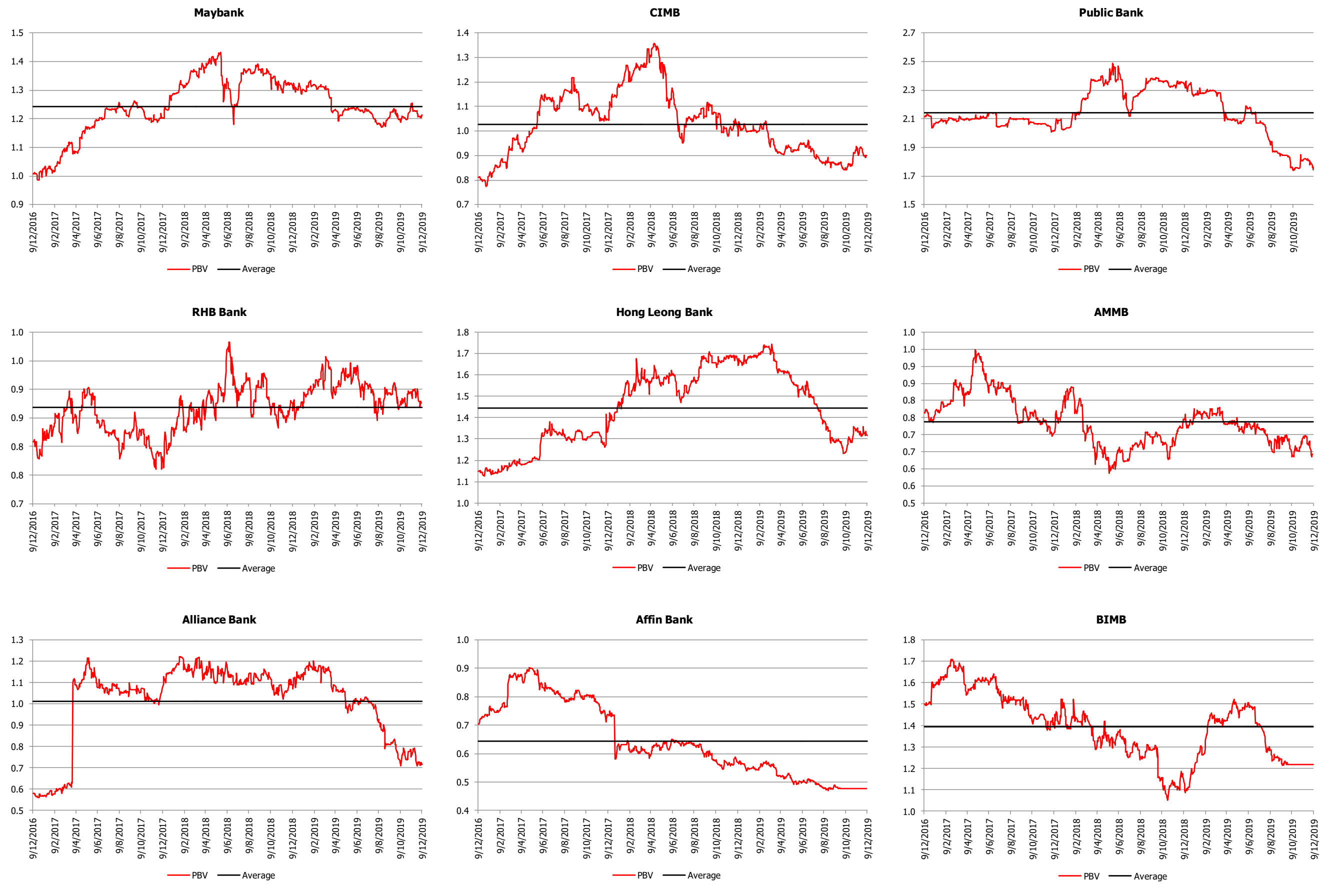
Pressure on margin will be manageable. We expect that NIM compression will be manageable in CY20. We opine that banks will be less keen to fight aggressively for deposits with NSFR requirement already being met. Furthermore, banks will not have to lock-in pre-OPR fixed deposits due to the absence of that need, and will manage its rates given there is already an expectation of another OPR cut.

Potential booster for loans growth. One of the possible upside from any OPR cut will be a boost to loans growth due to higher loans demand. This could be due to borrowers taking advantage of the better rates. However, we do not believe that the steep upswing in loans demand as loan affordability will continue to be a determinant.

Banks continue to be undervalued. In our opinion, the impact of another OPR cut have been fully priced in earlier as half of the consensus expected the second cut in the Nov-19 MPC meeting. Nevertheless, we view that banking stocks in general are relatively undervalued. This include taking into consideration of another rate cut which we have imputed into our CY20 earnings forecast. Majority of the banks are trading below its 3-year historical average. We opine that this is unjustified given that in our view, banks have managed to navigate the headwinds the sector faced this year. In addition, we have yet to observe any significant negative earnings surprise nor are we expecting it in the short terms.

Monitoring asset quality but so far it had been isolated incidence. One metrics that could be affecting banks' valuation is asset quality. We have noted banks reporting few corporate accounts turned non-performing this year. We opine that this could be due to the external headwinds. Also, with the slowing economic growth, banks would have to make some judgmental provisioning. Yet, we believe that it does not yet constitute a trend at current juncture. With our economics team expecting CY20 to see an improvement in trade, higher government investment (and the related spillover effect) and most importantly stable labour market, we expect that asset quality will be kept in check in CY20.

Chart 5: Banks Price to Book Value (PBV) and 3 years historical average



Source: Bloomberg, MIDFR

Cautiously optimistic, maintain POSITIVE. Based on the ability of banks in general to navigate the headwinds it faced this year, we opine that banking stocks are undeservedly undervalued currently. Hence, we cautiously optimistic and maintain our POSITIVE stance at the moment. However, we are cognizant of the potential headwinds next year and the risk it pose to asset quality. Not to mention the increase volatility of share price performance. Therefore, our top picks for this sector will banks with scale and size or the potential to maintain its earnings momentum. These are **Maybank (BUY, TP: RM10.30), CIMB (BUY, TP: RM6.30)** and **RHB Bank (BUY, TP: RM6.35)**. Good dividends yields will be an added bonus.

PEER COMPARISON TABLE

	FYE	Rec.	Price @ 10/12/19	Target Price	EPS (sen)		PER		Net DPS		Net Div Yield		BV		PBV	
					19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21
Maybank	Dec	BUY	8.54	10.30	74.1	73.9	11.5	11.6	58.0	58.0	6.8	6.8	7.1	7.4	1.2	1.2
Public Bank	Dec	BUY	18.96	24.00	145.6	148.7	13.0	12.8	72.0	73.0	3.8	3.9	11.3	12.0	1.7	1.6
CIMB	Dec	BUY	5.14	6.30	50.0	49.0	10.3	10.5	26.0	26.0	5.1	5.1	5.6	5.7	0.9	0.9
RHB Bank	Dec	BUY	5.61	6.35	62.4	67.7	9.0	8.3	25.0	27.0	4.5	4.8	6.3	6.5	0.9	0.9
Hong Leong	Jun	NEUTRAL	16.80	17.70	130.0	143.1	12.9	11.7	50.0	50.0	3.0	3.0	12.5	13.0	1.3	1.3
AMMB	Mar	T. BUY	3.87	4.20	50.0	46.6	7.7	8.3	20.0	20.0	5.2	5.2	5.9	6.1	0.7	0.6
Affin	Dec	NEUTRAL	1.89	2.10	29.0	29.0	6.5	6.5	5.0	7.0	2.6	3.7	4.7	4.7	0.4	0.4
Alliance	Mar	T. BUY	2.64	3.35	34.7	32.6	7.6	8.1	16.7	14.5	6.3	5.5	3.7	3.7	0.7	0.7
BIMB	Dec	BUY	4.30	5.05	43.7	44.0	9.8	9.8	16.0	18.0	3.7	4.2	3.2	3.5	1.3	1.2
Average					**68.8**	**70.5**	**9.8**	**9.7**	**32.1**	**32.6**	**4.5**	**4.7**	**6.7**	**7.0**	**1.0**	**1.0**

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.