3 October 2014 | Strategy

Syed Muhammed Kifni | smkifni@midf.com.my

Fuel hike

Commitment to PFR and market valuation

KLCI: 1,837.68

(2014 Year-end Target: 1,900 points)

FUEL HIKE: A COMMITMENT TO PFR

- The government's attempt to public finance reform (PFR) is a question of commitment and fiscal discipline. The commitment is demonstrated by the recent 20 sen/liter hikes in RON95 gasoline and diesel prices beginning 2 October. Likewise, the fiscal discipline is attested by Malaysia's budget deficit for the first half of this year which narrowed to 3.7% of GDP as compared with deficit of 4.1% of GDP during the corresponding period last year. At this rate, the government is deemed on track to meet 2014 deficit spending target at 3.5% of GDP.
- Despite its good intention, the fuel price hikes shall invariably nudge up inflation rate via primary price adjustments and, to a certain degree, secondary knock-on effects. It should be noted that cost push inflation, as opposed to demand pull, has the tendency to exert downward pressure on business margins. On the consumer side, potentially reduced purchasing power may in turn affect consumption demand of goods and services. The headwind may be duly felt by the broad consumer sector. The consequent reactions may then collude to clip the growth rate of corporate earnings.
- Notwithstanding the above, strong government finances is of strategic importance to the nation's well-being particularly with regard to (i) Malaysia's sovereign rating stability, (ii) global investor confidence, and (iii) continued ability of the government to provide adequate backstops during an economic downturn. Therefore, we cannot understate the urgency of putting the government's fiscal position on a stronger footing.

PFR COMMITMENT AND THE MARKET

- Fundamentally, the underlying price trend of an equity market is reinforced principally by the underlying growth rate of its corporate earnings. Thus potential headwind from the fiscal action would, at least in the short-term, bring forth a moderating effect on the underlying price trend of the local equity market.
- Nonetheless, we believe the secular trajectory of equity price trend would not in any way be jeopardized by the fiscal action as it is recognized that equity pricing is essentially the questions of not only earnings but also that of valuation. And equity valuation, by extension, involves considerations with regard to the measure of risks and its attendant required return.
- Hence we believe the underlying price trend of the stock market, while moderated, would remain upward sloping as the somewhat suppressed earnings growth shall be counteracted by a more liberal market valuation. In our view, lessening sovereign and economic risks which attract a lower required return would customarily drive market valuation higher. These valuation drivers will be propelled by improved sovereign rating stability, higher investor confidence and stronger government finances which in turn are engendered by the nation's improving fiscal underpinnings.
- In respect of the above, it is noteworthy that Malaysian Ringgit led gains among Asian currencies yesterday as it rose by the most in nearly two months. The currency gain was arguably in reaction to the government's decision to raise fuel prices for the first time in 13 months in order to improve the nation's fiscal position. Furthermore, the local equity market retreated by less than 0.5% yesterday as compared to between 1-3% decline among other major regional bourses in reaction to a selloff on Wall Street.

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.

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	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.