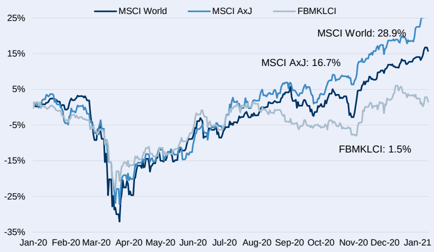
"Malaysia has been in 4 state of emergency in the past – however this emergency is very different"

KLCI vs MSCI World, MSCI AxJ



Source: Bloomberg, Affin Hwang

Key market statistics

	2020E	2021E
GDP growth (%)	(5.0)	6.0
KLCI EPS growth (%)	(12.8)	30.3

Source: Affin Hwang forecasts

Top calls for 2021

Ticker	Stock	Rating	Price (RM)	TP (RM)
TNB MK	TENAGA	BUY	10.12	12.80
HART MK	HARTALEGA	BUY	13.14	18.90
PMAH MK	PRESS METAL	BUY	8.27	9.66
T MK	TELEKOM	BUY	5.60	6.20
QLG MK	QL RESOURCES	BUY	6.00	7.11
INRI MK	INARI	BUY	2.67	3.33
SCI MK	SCIENTEX	BUY	12.40	13.20
VSI MK	VS INDUSTRY	BUY	2.50	3.20
ACSM MK	AEON CREDIT	BUY	10.90	13.50
MTAG MK	MTAG	BUY	0.73	0.98

Source: Affin Hwang, share prices as of 12 January 2021

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Malaysia Strategy

NEUTRAL (maintain)
Up/Downside: +7.3%

2021 KLCI Target: 1,730
Previous Target: 1,730

Entering an economic emergency

- **In the previous day, the government announced MCO 2.0 which impacts Malaysia's key economic states. Based on our estimates, for every 2-week lockdown, this could shave off 0.8ppts of our 2021E GDP growth forecast of 6%**
- **Early yesterday morning, the Agong announced that Malaysia would be in a state of emergency until August 1, 2021 to contain the spread of Covid-19. In our view, there are prospects of further fiscal stimulus measures, but this could possibly come at the expense of sovereign ratings**
- **No changes to our GDP forecast and corporate earnings growth although there is increasingly downside bias. Maintain Neutral on the KLCI**

Background on past emergency

In Malaysia, the Emergency Ordinance is used and enacted following a Proclamation of Emergency that has been issued by the Agong under Article 50 of the Constitution. There are 3 facets to an emergency consisting of security, economy and public order. Malaysia has been in a state of emergency four times. Both in 1964 and 1969, these were due to security reasons. In 1966 and 1977, the states of Sarawak and Kelantan fell into an emergency due to political chaos and instability.

An economic emergency, nothing else

In our view, given that this state of emergency is one that is not sparked by security or public order, there will not be any mobilisation of military personnel, and hence reducing any unnecessary fear. We understand that PM Tan Sri Muhyiddin is merely seeking an economic emergency, to ensure that the government's spending in the recent months to lift the economy during the current pandemic, is not jeopardised by political developments.

KLCI retraced 1.6%, before recovering most losses by end of the day

There was a knee jerk reaction on the KLCI, declining as much as 1.6% earlier in the day, as the market reacted to the unanticipated turn of events. Although foreign shareholdings is already at a 10-year low, we expect foreigners to take this opportunity to further Underweight their positions in Malaysia (Fig 5). Foreigners have been net sellers on Malaysia for six of the last seven years.

KLCI typically recovers after any indiscriminate sell down

However, in the past, the KLCI has always recovered from such indiscriminate selling. In the last 2 significant political events in Malaysia, being the surprising win by the opposition party in the 2018 General Elections and the change in government in February 2020, the KLCI declined by 10% and 18% respectively over a short period of time. It took the KLCI a period of 3 months to recover its losses both in 2018 and in 2020 (Fig 6).

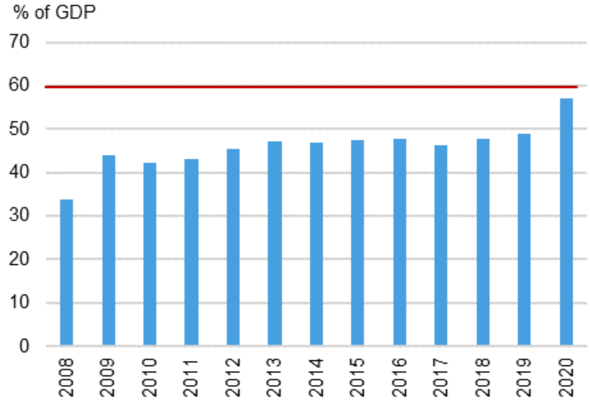
Maintain Neutral on KLCI with year-end target of 1,730

While the call for an emergency may signal the loss of support for the Perikatan Nasional government and further exacerbating the political instability in Malaysia, we think that any pullback on the KLCI will be an opportune time to build onto selective apolitical sectors and on selective stocks. Our stock focus remains on leaders in their respective sectors and those that continue to execute and perform well regardless of the macro environment challenges. Our sector Overweights are in the EMS, Rubber Products, Building Materials, Technology and Utilities. For stock selection, our Top Buys include quality picks such as Hartalega, QL Resources Scientex, Recovery plays like Tenaga, Aeon Credit and Press Metal, Thematic 5G plays including Inari and TM and finally Thematic trade diversion plays like VS and MTAG.

Prospects of additional fiscal stimulus is likely

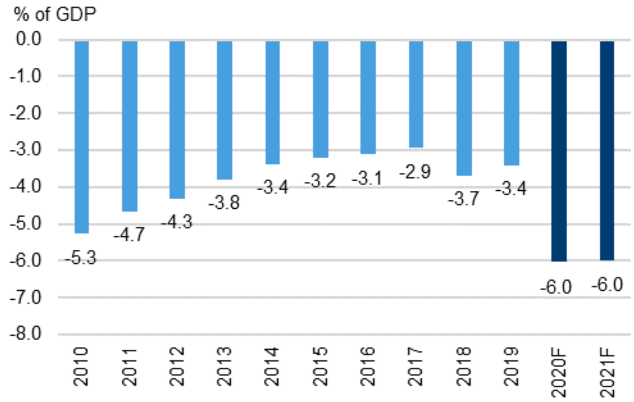
In our view, there is high likelihood that the Government will announce further fiscal stimulus measures to mitigate the negative impact of the current MCO, and any increase in the statutory debt ceiling will be manageable. With the potential for higher expenditure, based on our estimate, if necessary, Malaysia's 2021 fiscal deficit target may likely rise by another 0.6 percentage points to 6.0% of GDP in 2021 compared with our earlier projected deficit of -5.4% of GDP (-6.0% of GDP in 2020).

Fig 1: Domestic debt



Source: MOF
2020 = End-September 2020

Fig 2: Fiscal deficit



Source: MOF, Affin Hwang estimates

..but possibly at the expense of sovereign ratings

In terms of sovereign ratings, although the persistent budget deficit since 1998 continues to be a weak link to the country's sovereign credit rating profile, we are of the view that in light of the pandemic, it is understandable that the Government needs to implement large fiscal spending plans in order to boost the country's recovery. We believe that the current account surplus will continue to be the feature of economic fundamentals in Malaysia. In early December 2020, Fitch Ratings downgraded Malaysia's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'BBB+' from 'A-'. Fitch revised Malaysia's ratings outlook from negative to stable after the downgrade to BBB+, signalling current sovereign rating will likely remain in the immediate term. Both Standard & Poor's Ratings Services (S&P) and Moody's Investors Service (Moody's) have maintained the country's long-term foreign currency issuer default rating at A- and A3 respectively. However, S&P assigned Malaysia's outlook long-term foreign currency issuer default rating from stable to negative on 26 June 2020. The Malaysian banking system is still on sound capital footing, and with improving economic prospects, sustainable current account surpluses, steady foreign exchange reserves and given the country's manageable external debt, we believe agencies like Standard and Poor's and Moody's will unlikely follow suit to revise the country's sovereign rating.

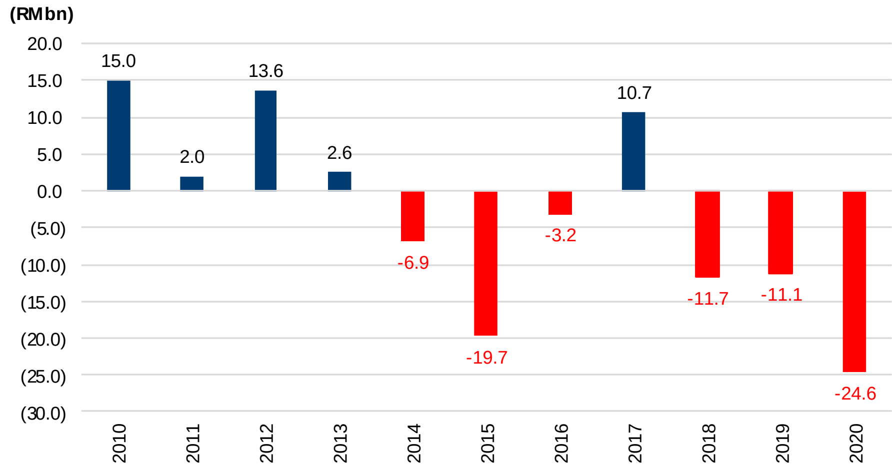
Government debt level manageable

The Federal Government debt stood at RM874.3bn or 60.7% of GDP as at end-September 2020. In terms of the statutory limit applied to MGS, MGII and MITB, the debt to GDP ratio was 56.6% of GDP as at end-September 2020, which is below the statutory limit of 60% of GDP under the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020. The debt limit will allow the Government to fund stimulus packages and implement economic recovery measures. The country's government debt ceiling rate was increased to 60% of GDP recently (from 55% of GDP previously), starting February 2020 and enforced until 31 December 2022 to finance economic stimulus packages to mitigate the impact of the pandemic on the domestic economy.

A rating downgrade would nevertheless result in further outflows

While we are hopeful that the sovereign rating agencies would be more forgiving of a more stretched fiscal position given current circumstances, we are nevertheless of the view that any sovereign rating downgrade will result in further portfolio outflows. That said, judging from the sharp outflow of funds over the past 10 years (Fig 3), we believe that any hot money flows exiting the country would also likely be limited.

Fig 3: Malaysia equities flows – Annual flows 2010 – YTD 2020



Source: Bloomberg

Five states and federal territories to be placed under MCO from 13 January

Recently, the Government announced the reimplementation of the Movement Control Order (MCO) from 13 January to 26 January 2020, covering the states of Kuala Lumpur, Selangor, Putrajaya, Labuan, Penang, Melaka, Johor and Sabah. These states placed under MCO accounted for 66.4% of Malaysia's total GDP, which includes the two biggest contributors (Selangor and KL). The Ministry of International Trade and Industry (MITI) came up with Standard Operating Procedures (SOPs) to ensure the smoothness of Business Continuity Plan during the duration of renewed MCO. As announced, the five essential economic sectors are allowed to operate to ensure business sustainability, maintaining economic recovery process, avoiding a spike in unemployment rates and allowing access to basic and critical necessities. These are manufacturing, services, trade and distribution, plantation and commodities (*refer to Appendix 1 for list of businesses deemed essential*).

Real GDP growth projected at 6% but subject to revision if MCO is extended

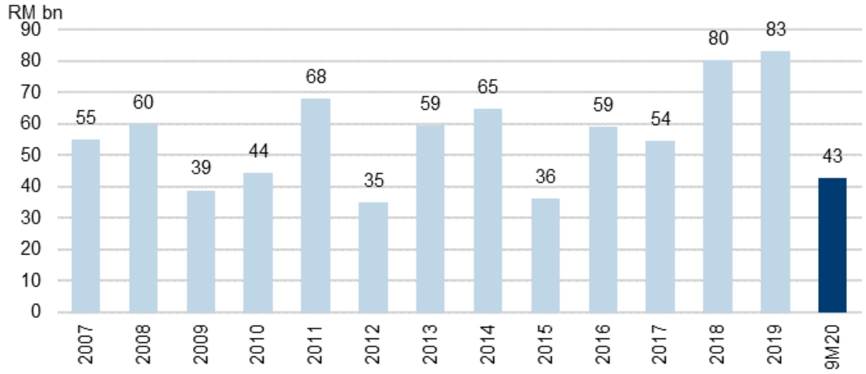
We are maintaining our full year 2021 GDP growth forecast of +6% in 2021, as compared to -5.0% estimated for 2020 (+4.3% in 2019). The current account surplus is projected to narrow slightly to 3.4% of GDP in 2021, from a surplus of 3.6% of GDP in 2020. We believe BNM will maintain an accommodative monetary policy, keeping its OPR unchanged at 1.75% throughout 2021.

Based on our estimate, the current two-week MCO could result in economic losses of roughly around RM0.8bn to RM1bn per day, compared with losses of RM2bn per day in previous year's MCO. As a result, we believe the country's real GDP growth will likely be dragged by between 0.8 percentage point during this MCO period. We will revisit our forecast where it will be likely revised downwards subject to the duration of the current MCO as well as the fiscal stimulus response by the Government in view of the uncertainty surrounding the resurgence of domestic Covid-19 cases.

Private investment will continue to recover in the short term

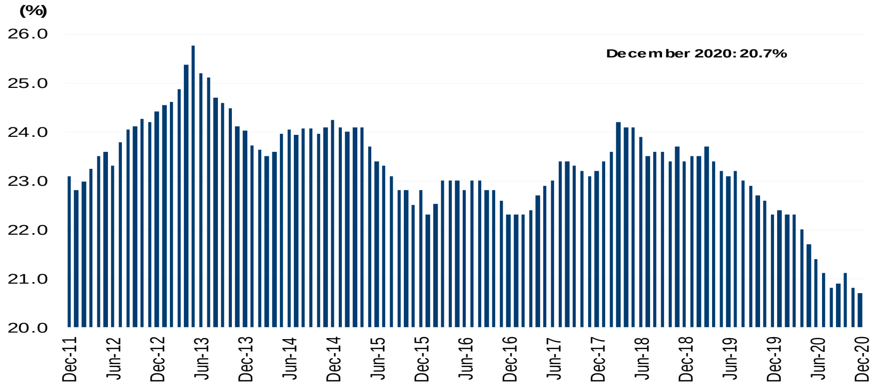
The country's domestic demand is expected to recover going into 2021. The risk of a sharp slowdown in private investment is small and unlikely. Despite a challenging backdrop in 2020, Malaysia has continued to attract FDIs where in the first nine months of 2020, approved foreign direct investment remained positive amounting to RM43bn (RM65.4bn in 9M19). We believe that as soon as the political development stabilises, the upward trend in private investment growth will recover, especially when business sentiment improves in a relative low interest rate environment.

Fig 4: Approved FDIs into Malaysia



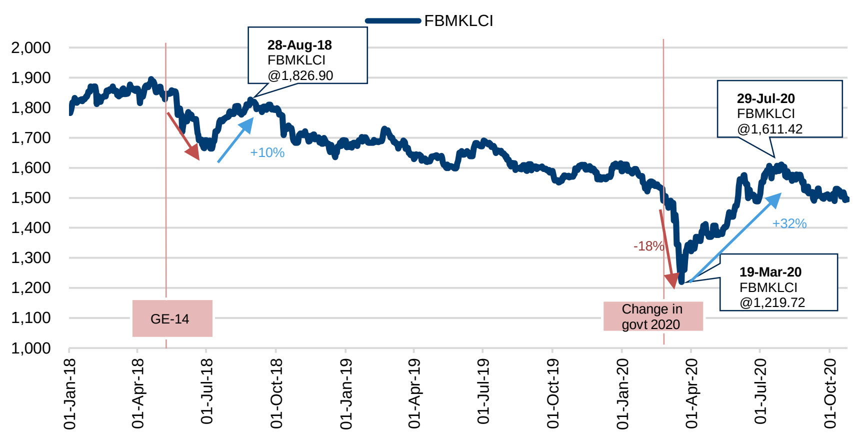
Source: MIDA

Fig 5: Foreign shareholdings at 10-year low



Source: Bursa

Fig 6: Stock Behavioural pattern during last 2 significant political events in Malaysia



Source: Affin Hwang, Bloomberg

Appendix I: MITI's list of essential businesses

Factories and manufacturing

- Aerospace including MRO (maintenance, repair and overhaul)
- Automotive manufacturing and after-sales services
- Food, beverages and its chain
- Packaging and printing
- Household products, self-care goods (FMCG — fast-moving consumer goods — soap and others) and detergents including its chain
- Healthcare and medicine including dietary supplements
- Personal protective equipment (PPE) and fire safety equipment
- Components for medical tools
- Electrical and electronics
- Oil and gas
- Petrochemicals and petrochemical products
- Chemical products
- Machines and tools
- Ceramics (ceramics as moulds for glove manufacturing)
- Iron and steel
- Textile (involving PPE production)
- Furniture sector
- Manufacturing, distillation, storage, supply and distribution of fuel and lubricants

Construction

- Maintenance and critical repair works
- Main works to build public infrastructure
- Building construction works that provide complete worker accommodations at the construction site or workers placed at Centralised Labour Quarters (CLQ)

Services

- Financial services and its chain
    - Financial institutions (Banking, insurance, takaful and other entities that are licenced, approved or registered by Bank Negara Malaysia)
    - Capital market entities that are licenced, registered or supervised by the Securities Commission Malaysia
- Local government and municipal services
    - Pawning services (pajak gadai)/community credit (registered money-lender companies)
    - Solid waste management / sewerage
    - Public cleaning
    - Cleaning of premises and sanitisation
- Telecommunications and digital infrastructure including ICT services and global business services (GBS)
- E-commerce and its chain including e-marketplace services, digital payments and local e-dagang internet centres
- Hotel and accommodation
- Agriculture, aquaculture and livestock sector including veterinary services:
- Management of farms/ swallow farms/ horses/ animal processing plants/ slaughter houses/ livestock/ factories for livestock feed/ supplies such as vaccines/ livestock management/ pet stores (operations to shift livestock is at night)
- Disease control and supervision of production of livestock, livestock input and products related to the livestock industry (including export and import) and
- Health management, diagnosis of illness and treatment of animals
- Utilities (water and electricity)
- Professional services (including accountants/ lawyers/ auditors/ engineers/ architects), scientific (including R&D) and technical (including maintenance)
- Security services
- Security and defence
- Land, water and air transportation
- Services and operating of ports, shipyards, airports, including the moving of cargo, storage or bulk commodities

Distribution business (Perdagangan pengedaran)

- Warehousing and logistics
- Services/Sales/Distribution of Food and Beverages
- Retail/ distribution/ wholesale

Plantations and commodities

- Agriculture, aquaculture and livestock and its chain
- Plantation and commodities and its chain

Others

- Any services, works, industries and businesses as determined by the health minister after discussions with the authorities supervising that service, work, industry and business.

Source: MITI

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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