

MONDAY FEBRUARY 9, 1998

FEB 3 - 6, 1998	1 YEAR AGO	1 MONTH AGO	LAST WEEK
Market Cap (RM bil)	854.2	330.2	454.5
— Main Board	789.0	311.3	428.8
— Second Board	65.2	18.9	25.7
KLCI (pts)	1,241.95	525.74	728.19
SBI (pts)	616.92	143.52	189.46
3-mth Klibor	7.315	9.180	10.050
RM/US\$	2.5365	4.2400	3.8350

#### WEEKLY VOLUME LEADERS

<i>counter</i>	<i>Close</i> <i>(RM)</i>	<i>High</i> <i>(RM)</i>	<i>Low</i> <i>(RM)</i>	<i>+/-</i> <i>(RM)</i>	<i>+/-</i> <i>(%)</i>	<i>Vol</i> <i>(m)</i>
Renong	1.590	1.660	0.725	0.860	117.81	173.8
UEM	4.600	4.600	2.100	2.510	120.10	131.0
Intria	0.950	1.020	0.350	0.585	160.27	105.7
Ekran	1.390	1.650	0.830	0.565	68.48	89.8
MRCB	2.310	2.500	0.920	1.430	162.50	72.8

#### WEEKLY TOP GAINERS

<i>counter</i>	<i>Close</i> <i>(RM)</i>	<i>High</i> <i>(RM)</i>	<i>Low</i> <i>(RM)</i>	<i>+/-</i> <i>(RM)</i>	<i>+/-</i> <i>(%)</i>	<i>Vol</i> <i>(m)</i>
Apex-W	0.570	0.570	0.100	0.490	612.50	0.4
Commerce-T	0.325	0.325	0.065	0.265	441.67	0.9
Kim Hin-W	0.240	0.240	0.060	0.190	380.00	1.0
F&N-W	1.400	1.610	0.350	1.100	366.67	0.4
Kelanamas-W	0.310	0.310	0.070	0.240	342.86	0.7

#### WEEKLY TOP LOSERS

<i>counter</i>	<i>Close</i> <i>(RM)</i>	<i>High</i> <i>(RM)</i>	<i>Low</i> <i>(RM)</i>	<i>+/-</i> <i>(RM)</i>	<i>+/-</i> <i>(%)</i>	<i>Vol</i> <i>(m)</i>
Uniphoenix	3.340	4.980	2.500	-1.640	-32.93	36.105
PWE Industries	8.900	15.600	6.750	-3.100	-25.83	0.602
Actacorp-W	7.800	10.500	7.350	-2.700	-25.71	0.005
Gadek-U	0.650	0.840	0.650	-0.190	-22.62	0.002
Berjaya Land-U	0.810	0.830	0.770	-0.090	-10.00	0.258

#### WHAT'S INSIDE

Economics & Strategy  
 Market shifts into higher gear, Bank  
 Negara injects liquidity ..... 2

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## ECONOMICS &amp; STRATEGY

Market shifts into higher gear, Bank Negara injects liquidity

**Sustained run-up last week:** Despite minor profit-taking and Moody's outdated downgrade on Friday, the market amply absorbed such pressure to close on the positive note. Strong buying support was seen from foreign hedge and pension funds from the US and Europe. The US added 358,000 jobs last month, above expectations though average hourly earnings, a measure of labour costs increased just 0.3% - suggesting that inflation is well under control. The report boosted US stocks on Friday with the DJIA rising 72 points to 8189, the closest it has come to re-testing its Aug 6 record of 8259 pts.

The currency market has also demonstrated renewed strength almost across the board — the ringgit settled well at RM3.80 level while the rupiah recovered from 16,000 to 9,500 to the dollar. The South Korean crisis has probably seen its worst; indeed, the MSCI Emerging Market Index boosted confidence by increasing its weighting on the market last week.

Like a freight train rolling downhill, banking merger news is now more likely to gain momentum than slow down - as small or medium-sized banks start considering potential partners to compete with larger and more aggressive rivals. This week will probably be another memorable one as the market digests banking developments and a new set of economic statistics.

**This week:** We believe the last two weeks represented a major trend reversal, as the KL Composite Index surged 170 points to 728 pts. That uptrend was well-supported by volume in the 700-1,000m units, unseen in the past 10 months, never mind if investors were caught underweight in the market. It is normal that some corrections will probably punctuate this uptrend; we would advise buy/accumulation on dips, hold positions and sell if the market runs out of steam. We would be willing sellers when the KLCI approaches 800 points. We weigh our positive (buy) strategy on a few significant developments but chiefly trade statistics and the implications of the 3.5 percentage point reduction in statutory reserves requirement (from 13.5 to 10%) — a drastic unwinding by any measure — that will inject RM14b of liquidity into the system effective Feb 16.

**Some cheers on the economic front:** Malaysia registered a trade surplus of RM400m in 1997 after posting a deficit for three consecutive years, according to the Statistics Department. The surplus in the merchandise balance (which excludes cost, insurance and freight) would have been much larger at more than RM10b. Exports grew at a rate of 12.4% to RM221.4b compared with 1996, while imports grew by slightly slower 12% to RM221b. The manufacturing sector, once again was the main impetus driven by the weaker ringgit while the primary commodities sector showed a mixed performance. Electrical and electronic products, Malaysia's largest export earner, brought in RM112.3b, 16% higher than 1996.

**Statutory reserves requirement:** It would be premature to assume that the central bank is flooding the system with fresh liquidity without considering the other neutralising factor. Bank Negara wants to sterilise the expansionary effect of the SRR cutback by reining in an equivalent amount of cash via its direct intervention in the interbank market and possibly through contractionary open market operations. But there is certainly a lag effect in between, which suggests it is a mildly expansionary policy.

Beneath the latest policy rationale, we view the true objective of the weekend's intervention as an attempt to influence/rectify the term structure of interbank and lending rates. The shorter end interbank rates tend to reflect the exceptionally tight liquidity situation of a small number of banks. Thus, short-term lending rates tend to be based on cost-plus basis, giving tremendous financial strain to businesses that rely on trade financing and revolving credit facilities.

The SRR reduction aims to improve the flow of liquidity in the system, which should be welcomed by the banking community. But this is not easy and cheap money: a hike in Bank Negara's 3-month intervention rate from present 10% to 11% means weighted BLRs in future months would still be maintained at current high levels of 12-13%. Weighted 3-month money and SRR are two determinants of BLR-setting formula.

$$\text{BLR}_t = \text{Weighted 3-month Klibor}_{t-1} \times 0.8 + 2.5\text{-point} \\ \text{(1-SRR ratio)}$$

The intended effect is to resolve the liquidity crunch of net inter-bank borrowers. Bottomlines will be a shade brighter in months ahead because RM14b of interest-free deposits will be recouped and redistributed as income-generating resources. The banking system made some RM8.7b in pre-tax profits in FY96; assuming a margin spread of 5%-point, industry-wide pre-tax profits would be enhanced by more than RM500m.

To cynics, it's a case of Bank Negara backpedalling, almost certain to compromise on its monetary targeting policy of late-1997. It hopes to cap loans growth at 20% in 1Q98 and 15% by end-1998, from 25.9% recorded at end-1997. To other less critical minds, it's corrective surgery. On the balance, we think it is a crucial and positive move.

**Some concerns on the international front:** Two potential red flags are worth reminding. The US-Iraq conflict and the China's yuan factor. While regional developments take centrestage, we believe that potential political conflict in the Gulf could dampen investor sentiment in the weeks to come. US officials yesterday rebuffed an Iraqi proposal for weapon inspections mandated by the United Nations and reiterated that a military strike aimed at forcing full compliance is "weeks" away.

In China, the state-controlled Xinhua news agency quoted Foreign Trade and Economic Cooperation Minister Wu Yi as saying that China faces "stark challenges" in trade and investment prospects. She added that the impact of the regional turmoil should "on no account" be underestimated. China's basic export principle is based on the premise of seeking economic results. It would aim to maintain "stable increases in exports, and raising imports to an appropriate level." Although China has time and again said that it will not devalue the yuan to boost exports, we interpret this as a subtle warning not to take its present stance for granted. Yuan devaluation has the potential of upsetting currency stability and regional trade competition. **[David Yong 466-3929/Chris Leow, CFA 2531-626]**