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Rate Pause As Expected

Overnight Policy Rate left unchanged. The Monetary Policy Committee (MPC) of BNM left the Overnight Policy Rate (OPR) unchanged at 3.5%, as predicted by all economists polled by Bloomberg. This rate pause was the fourth consecutive time that BNM is holding the rate steady after the last 25bps hike in April 2006.

Inflation no longer a threat. BNM expects inflation to decelerate further from the current level, particularly with the recent softening in global oil prices and the expected mild moderation in global growth. However, BNM expects inflation to tick up slightly in the coming months due to seasonal factors but "the broad trend towards easing price pressures" should continue. With inflation no longer a threat to the economy, we believe in the near term, BNM will leave interest rates at the current level to ensure sustainability of growth momentum.

Summary: Monetary Policy Decisions

Date	OPR	Change
24 August 2005	2.70%	-
30 November 2005	3.00%	+0.30%
20 January 2006	3.00%	-
17 February 2006	3.25%	+0.25%
25 April 2006	3.50%	+0.25%
22 May 2006	3.50%	-
28 July 2006	3.50%	-
25 August 2006	3.50%	-
26 September 2006	3.50%	-

Source: Bank Negara Malaysia

Rate cut next year? We think unlikely. With another pause in rate hike, economists have spiced up the guessing game again on the timing of a possible reduction in the OPR. At this instance, we believe the current level of interest rate is likely to be maintained for a fairly long period of time, probably until end 2007, based on the following arguments:

- (i) **Current monetary stance still expansionary.** Our previous estimation showed that the "neutral rate" for Malaysia is around 4%, which means that the current level of OPR (3.5%) is still "theoretically" supportive of growth. We believe that demand for financing (exemplified by both loan applications and approvals) will start kicking in again once consumers and businesses finish adjusting their spending and investment behaviour. We would like to stress that easing inflation rate alone is NOT sufficient to justify for a rate cut. Nonetheless, with inflation out of picture, BNM will make the rate decision based on the assessment the near-term economic forecast.

- (ii) **External sector moderating, not melting.** Talking about the growth outlook, a lot of downside risks for Malaysia's economic growth have been emphasised on the slowing US economy. In this regard, we believe that the ongoing correction in the US housing sector is not going to result in major slowdown in consumption spending. The IMF recently pointed out that the equity extraction from the housing market only accounted for 7.5% of US households' total disposable income. Bulk of the household income still remains steady, with healthy employment outlook and resilient corporate profitability.
- (iii) **Boost from Government spending in 2007.** As the Government is expected to significantly enhance spending in 2007, there is no real need to "artificially" boost domestic demand growth by lowering interest rates. We believe BNM is mindful of the possible distortion in resource allocation if interest rates are set too low from the neutral level, which will encourage channelling of funds into unproductive sectors and weaken the fundamentals of the economy.

Expect steady rates ahead. With inflation no longer an issue for the policymaker and the relatively stable macroeconomic outlook, we can expect interest rates to be kept steady at the current level as **frequent adjustments to the interest rate direction will create unnecessary confusion for economic agents** (i.e. consumers and businesses), hence resulting in holding back of spending and investment decision. Going forward, we believe keeping interest rates stable is crucial to brush away uncertainty and allow economic agents to resume their roles in supporting economic growth.

OSK Research Guide to Investment Ratings

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Trading Buy: Total return of the stock may exceed 10% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Total return of the stock may fall within the range of +/- 10% (inclusive) over the next 12 months OR is not expected to outperform or underperform the relevant benchmark index by the same quantum over the same period

Take Profit: Target price has been attained. Look to accumulate at lower levels.

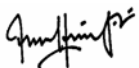
Sell: Total return of the stock may fall more than 10% OR underperform the underlying benchmark index over the next 12 months

* Total Return (capital gain + dividend yield)

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