4QCY23 Outlook

Fed to finally hit the pause button

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EXECUTIVE SUMMARY

- **We observed performance of developing markets started to improve in 3QCY23 from growing expectation that the US Fed will finally pause its rate hike. FBM KLCI climbed from its trough for the year, to post a +3.4%qoq rise in 3QCY23.**
- **The year 2023 has been identified as the year of slowdown, with the IMF projecting the world economic growth to moderate to +3.0% (2022: +3.5%). For next year, the IMF forecasted global growth to remain at +3.0%.**
- **While Malaysia recorded almost 2-year low GDP growth in 2QCY23, we foresee a stronger recovery in the final lap of 2023, harping on the better recovery in China, elevated commodity prices and steady domestic demand. We expect Malaysia's GDP growth to moderate to +4.2% in 2023. As for 2024, we view the GDP growth at +4.7%, lower than the government's target +5.0~5.5% for 2024-2025.**
- **The prevailing bias of FOMC is for an additional rate hike this year but the interest rate futures market is betting for no hike in the remaining FOMC meetings. At MIDF Research, we also believe there will be no further hike by the US Fed. Domestically, we also expect the BNM to not raise the OPR.**
- **We expect the Ringgit to strengthen against the US Dollar in 4QCY23 with a year-end target of RM4.30. Moreover, the Ringgit is fundamentally in a good position to strengthen due to (i) the domestic economy remains on an upbeat momentum, and (ii) improving terms of trade from the elevated global commodity prices (of crude petroleum, LNG, and palm oil).**
- **At PER23 of 14.3x, the FBM KLCI is trading at a depressed valuation (vis-à-vis its historical range of 16.0x to 17.0x). However, we expect its valuation to improve in 4QCY23 predicated on (i) recovery of Ringgit vs. US Dollar, (ii) inflow of international funds into the local equity market, and (iii) healthy macro as well as corporate earnings outlook into next year. Hence, we maintain our FBM KLCI end-2023 target at 1,540 points or PER23 of 15.4x.**
- **We also expect the market valuation of FBM70 to remain buoyant going forward, mainly underpinned by the prospect of robust corporate earnings growth. We therefore maintain our FBM70 end-2023 target at 14,500 points or PER23 of 19.2x.**
- **For 2024, we expect the valuation of FBM KLCI to remain relatively subdue as its key Financial Services constituents continue to grapple with challenges in the elevated interest rates environment. Based on the prevailing earnings forecast, we introduce our preliminary FBM KLCI end-2024 target at 1,650 points or PER24 of 15.0x. We also introduce our preliminary FBM70 end-2024 target at 16,600 points or PER24 of 17.0x.**

A. 3QCY23 PERFORMANCE – Some Resiliency Despite No Definitive Pause

Better performance in developing markets. We observed performance of developing markets started to improve in 3QCY23 from growing expectation that the US Fed will finally pause its rate hike. This was strengthened by the skip in June-23 and later on in Sept-23. FBM KLCI climbed from its trough for the year, to post a +3.4%qoq rise in 3QCY23. Other markets such as Jakarta Composite Index and Singapore STI also registered a +4.2%qoq and +0.4%qoq respectively. Nevertheless, FBM KLCI still closed the quarter in negative territory on a year-to-date basis.

Still no definitive indication that the US Fed will hit the pause button. We should note however, equities market has not taken off as expected, and most seems to be trading range bound. We postulate that investors are looking for a definitive indication from the US Fed that it will be finally hitting the pause button. This has yet to come as US FOMC dot plot suggest one more rate hike. Nevertheless, the fed fund rate futures market is suggesting otherwise, betting on no more rate hikes. We expect that the equities market will continue to trade range bound until we get a more definitive language from the US Fed.

Table 1: Performance of Indices (as at 29 September 2023)

Indices	YTD performance as at end 29/9/2023	Quarter-on-quarter performance		
		1QCY23	2QCY23	3QCY23
NASDAQ	26.3%	16.8%	12.8%	-4.1%
Nikkei	22.1%	7.5%	18.4%	-4.0%
S&P500	11.7%	7.0%	8.3%	-3.6%
DAX	10.5%	12.2%	3.3%	-4.7%
S.Korea	10.2%	10.8%	3.5%	-3.9%
CAC	10.2%	13.1%	1.1%	-3.6%
FTSE	2.1%	2.4%	-1.3%	1.0%
Jakarta	1.3%	-0.7%	-2.1%	4.2%
Dow Jones	1.1%	0.4%	3.4%	-2.6%
Shanghai	0.7%	5.9%	-2.2%	-2.9%
Singapore	-1.0%	0.2%	-1.6%	0.4%
Philippines	-3.7%	-1.0%	-0.5%	-2.3%
FBMKLCI	**-4.8%**	**-4.9%**	**-3.2%**	**3.4%**
HK Han Seng	-10.0%	3.1%	-7.3%	-5.9%
Thailand	-11.8%	-3.6%	-6.6%	-2.1%

Source: Bloomberg, MIDFR

FBM70 continue to outshine. Having said that, we saw that the mid-caps have performed well in thus far in CY23. FBM70 closed at its year high in 3QCY23 and registered +9.1%ytd rise. This is in line with our expectation and recommendation earlier this year. This is especially we saw the impact the banking turmoil in US and Europe was having on sentiments to global banking stocks. This part explains the lacklustre performance of the FBM KLCI given the high weightage of banks in the index.

Property, utilities, construction and energy have been clear winners. Amongst the sectors that saw strong performance this year have been Property, Utilities, Construction and Energy sector. These sectors recorded double digit rise on a year-to-date basis. Meanwhile, those sectors that lagged behind were Finance, Healthcare, Industrial and Consumer. Based on this, it is not surprising that FBM KLCI have underperformed given the underperformance of its constituent sector while FBM70 have outperformed.

Table 2: Performance of Bursa Malaysia Sectoral Indices (as at 29 September 2023)

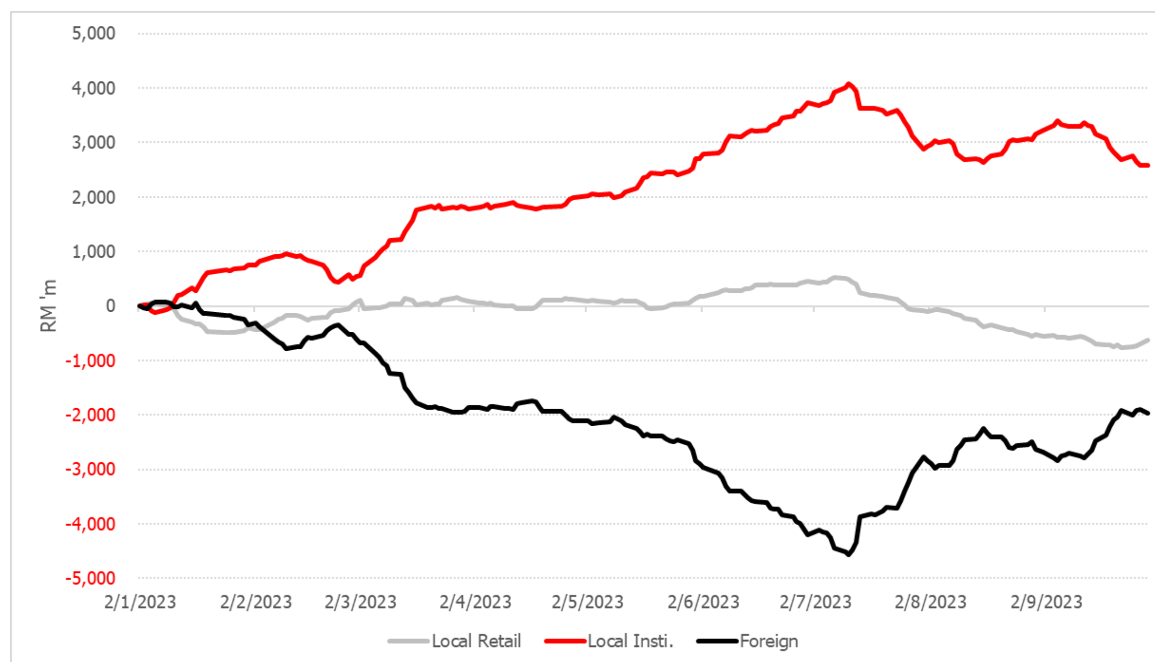
Indices	YTD performance as at end of- 29/9/2023	Quarter-on-quarter performance		
		1QCY23	2QCY23	3QCY23
FBMKLCI	**-4.8%**	**-4.9%**	**-3.2%**	**3.4%**
FBM70	9.1%	3.8%	-0.9%	6.0%
FBM Small Caps	8.5%	2.2%	-2.7%	9.0%
Property	36.5%	7.3%	0.2%	26.9%

Indices	YTD performance as at end of-	Quarter-on-quarter performance		
	29/9/2023	1QCY23	2QCY23	3QCY23
Utilities	29.0%	4.0%	8.1%	14.8%
Construction	21.0%	4.8%	1.4%	13.8%
Energy	15.1%	7.8%	-7.5%	15.5%
Transportation	7.1%	4.4%	0.8%	1.9%
REITs	0.4%	3.4%	-2.8%	-0.1%
Tech	-0.9%	-1.3%	-2.8%	3.3%
Telco	-2.8%	1.3%	-3.2%	-0.8%
Plantation	-2.9%	-4.8%	-0.6%	2.7%
Finance	-3.5%	-4.8%	-2.4%	3.8%
Healthcare	-4.2%	1.3%	-6.2%	0.8%
Industrial	-5.7%	-5.9%	-8.3%	9.3%
Consumer	-5.8%	-2.6%	-4.1%	0.9%

Source: Bloomberg, MIDFR

Foreign flows saw persistent net inflow despite no definitive pause. We can deduce that foreign funds have changed its stance in 3QCY23 despite no definitive indication of a US rate pause. This is based on the net inflow amounting to RM2.23b in 3QCY23, a reversal of the net outflows of -RM1.87b and -RM2.33b in 1QCY23 and 2QCY23 respectively. We also observed that the net inflow started in mid July-23 which coincided with the recovery in FBM KLCI. We view this positively as this suggest that foreign investors are confident of an eventual pause in US rate hikes and are positioning early to take advantage of the expected rally in equities market after the pause.

Chart 1: Cumulative Fund Flow in Bursa Malaysia (as at 29 September 2023)



Source: Bursa Malaysia, MIDFR

B. ECONOMIC OUTLOOK FOR 4QCY23

GLOBAL ECONOMY: GROWTH TO REMAIN MODERATE AS POLICY TIGHTENING NEARING ITS END

Moderate global growth to continue. The year 2023 has been identified as the year of slowdown as the pace of growth for many economies is projected to moderate after the robust 2-year post-pandemic recovery, with the IMF projecting the world economic growth to moderate to +3.0% (2022: +3.5%). While supply condition improved, spending activities normalised after the unsustainable surge in the past years, partly due to the revenge spending following economic reopening. Broadly, the global policy tightening by monetary authorities to contain inflation is also expected to bring about a more moderate growth this year, particularly in the advanced economies as interest rates were raised to more restrictive levels. Given the slowing growth, international trade and global production activities have also been subdued. We foresee the moderate growth prospects to continue in 4QCY23. However, we anticipate a possible pick-up in external demand for manufactured goods particularly E&E products. As we noticed no further worsening in the recent months, we expect the weakness in global manufacturing activities could reverse benefiting from the expected improvement in overseas demand. For next year, the IMF forecasted global growth to remain at +3.0%, still below the pre-pandemic average (2011-2019: +3.5%). The softer growth in advanced economies will continue while the pace of growth for emerging and developing economies will be more or less the same as before.

Table 3: Central Bank Policy Rate by Selected Economies (%)

	2021	2022	2023f	2024f
World Economy	**6.3**	**3.5**	**3.0**	**3.0**
Advanced Economies	5.4	2.7	1.5	1.4
USA	5.9	2.1	1.8	1.0
Euro area	5.4	3.5	0.9	1.5
UK	7.6	4.1	0.4	1.0
Japan	2.1	1.0	1.4	1.0
Developing Economies	6.6	4.0	4.0	4.1
China	8.4	3.0	5.2	4.5
India	9.1	7.2	6.1	6.3
Indonesia	3.7	5.3	5.0	5.0
Philippines	5.7	7.6	6.2	5.5
Thailand	1.6	2.6	3.4	3.6
Vietnam	2.6	8.0	5.8	6.9

Source: IMF, MIDFR

Growth prospects not as initially anticipated but still on moderating trend. Comparing the growth between regions, the slowdown in advanced economies did not occur as sharp as anticipated. Given the resilience in job market and consumer spending, the US growth projection has been upgraded, with less concerns over recession risk. Meanwhile, the adverse effect from energy crisis on European economies was not as significant as feared. In contrast, growth prospects in the emerging markets are broadly expected to moderate towards more normal levels. For China, although the country's growth was expected to support global growth this year, the post-reopening recovery thus far has been below market expectations. With this year's growth having been driven mainly by recovery in consumption activity, concerns over slowing growth momentum intensified as data in Jul-23 pointed towards slower growth in domestic spending. Going into 4QCY23, we expect the differing narratives to continue since the advanced economies are approaching the end of its tightening cycle while keeping rates at high levels to push inflation lower and developing countries like China, in contrast, are expected to be more focused on sustaining growth which may require more policy supports.

Global inflation eased. Price pressures in many countries subsided following improvement in supply conditions and the effect of softer global demand. In many countries, headline inflation has eased from multi-year high levels, while underlying demand pressures have also reduced as shown by the deceleration in core inflation. Going into the final quarter of the year, we expect the soft price pressures will continue as demand condition would pose less pressure on price

outlook, taking into account the expected moderation in aggregate demand as a result of high interest rates and tighter credit. Going forward, while inflation continues to be moderate, any disruptions to supply stability (e.g. supply cuts, shortages and even policy uncertainty) will be the key reason that will keep price outlook elevated. The price pressures could also come from rising energy and commodity prices, with our in-house views projecting crude oil and CPO prices to average higher next year.

Reduced concerns over inflation require no further hikes. For most economies, central banks have mostly starting to keep its benchmark interest rates unchanged after raising rates in the previous years and early part of this year. This was underpinned by easing inflation and policymakers paying greater attention towards supporting growth. Major central banks like the ECB and BOE also recently signalled the end of policy tightening and no more hikes will be necessary as inflation eased, with growth especially for European economies to be subdued by the previous tightening. However, high interest rates may be kept for a longer period as inflation remained above targets. Although we argue for no more hike, we opine market volatility in 4QCY23 will continue as sentiment will be influenced by decisions by the US Fed despite the still hawkish stance after the Sep-23 FOMC meeting.

Table 4: Central Bank Policy Rate by Selected Economies (%)

	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23
Malaysia	2.75	2.75	2.75	2.75	3.00	3.00	3.00	3.00	3.00
Indonesia	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Philippines	5.50	6.00	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Thailand	1.50	1.50	1.75	1.75	2.00	2.00	2.00	2.25	2.25
Vietnam	6.00	6.00	6.00	5.50	5.00	4.50	4.50	4.50	4.50
South Korea	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
India	6.25	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	3.50	4.00	4.25	4.25	4.50	5.00	5.00	5.25	5.25
Euro area	2.50	3.00	3.50	3.50	3.75	4.00	4.25	4.25	4.50
USA	4.25-4.50	4.50-4.75	4.75-5.00	4.75-5.00	5.00-5.25	5.00-5.25	5.25-5.50	5.25-5.50	5.25-5.50

Source: Macrobond, MIDFR

Downside risks remain. The recent rise in oil prices cast doubt that the inflation outlook will remain moderate. The higher bills for energy and fuel charges could result in higher utility and transport costs, and this could affect cost pressures for various industries. While we do not expect another hike later this year, we believe the focus and attention in the financial markets will continue to be impacted by decisions by the US Fed. We also expect fluctuations in the financial market will continue to be influenced by changes in central banks' policy decisions, subject to the future growth and inflation outlook. A sharp deterioration in the job market (and then final demand) will also lead to significantly weaker growth as the high interest rates may be maintained for longer period. In addition, changes to geo-political relations (e.g. between the US and China) and economic policy (e.g. India's ban on exports of non-basmati white rice) will also influence growth and price movement beyond borders.

US: GROWTH PROSPECTS MORE RESILIENT DESPITE EXPECTED SLOWDOWN

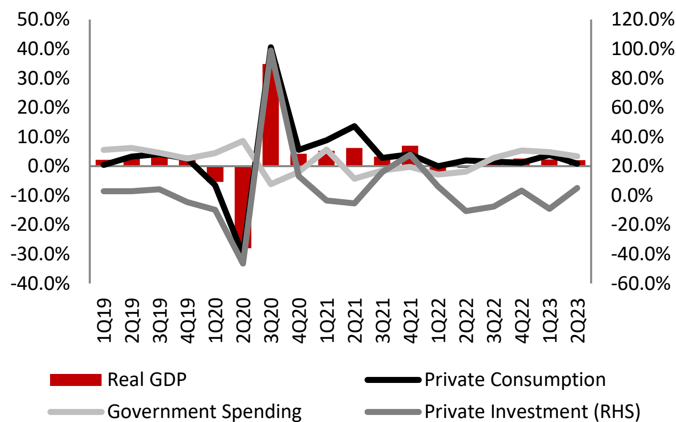
The economy is more resilient than expected. Despite the aggressive tightening with the Fed having raised the fed funds rate by +525bps since Mar-22, the US economy continued to show resilience and ability to adapt to the high borrowing costs. In 2HCY23, the US GDP grew further in 2QCY23 at +2.1%qoq on annualised basis (1QCY23: +2.2%qoq), underpinned by the stronger non-residential investments, increased government spending and sustained expansion in consumer spending albeit at slower annualised growth of +0.8%qoq (1QCY23: +3.8%qoq). On year-on-year basis, the US economy grew faster at +2.1%yoy in 1HCY23 (2HCY22: +1.2%yoy). As inflation expectations reduced, the sustained growth in consumer spending was supported by the strength in the job market and positive wage growth. In view of the economic resilience, this has led the FOMC to upgrade its growth projection for the US economy to grow at +2.1% this

year (previous forecast: +1.0%). We estimate even if the US economy were to experience no growth in 2HCY23, the economy can still grow at +1.1% for the full-year 2023. For next year, the IMF projected the US economic growth will moderate further, which can be dragged down by the effects of previous policy hikes.

Recession concerns may reappear as growth slows further. Although the US is in a good position to avoid going into recession this year, we expect the slowing growth to be more visible in the coming period. First of all, the effect from previous policy tightening will translate into weaker aggregate demand as the Fed is engineering a demand-led slowdown to push inflation lower. The job market is expected to deteriorate further, even though recent data only showed there was a reduction in labour demand while overall condition in the US labour market remained robust. On that note, we believe there will be renewed concerns that a sharper slowdown in the US economy will revive discussion about the recession risk. In addition, apart from stubbornly elevated inflation which could lead the Fed to keep restrictive interest rates for too long, other factors could also weigh down on the US growth outlook. This includes adverse impacts from long labour strikes, congressional standoffs and therefore fiscal pressures (affecting the government operations), and high energy prices. On another note, the inversion of the US treasury yield curve since 2HCY22 continues to signal possibility of the economy going into recession which typically takes place 12 to 24 months after the yield curve started to invert.

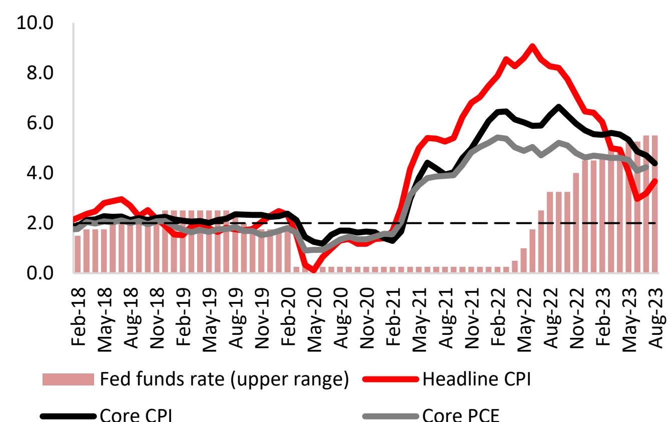
Hawkish Fed keep its fight to contain inflation. On the policy setting by the Fed, we expect there will be no further hikes in the fed funds rate given the moderation in the US inflation and the success in anchoring inflation expectations. Although demand could increase as consumers benefit from the moderate inflation, we believe the high borrowing costs will cause consumers to be more cautious in their spending plans. The tightness in the job market will ease, and labour demand could weaken further if demand continues to remain weak. In other words, firms will likely be cautious in terms of hiring and production if demand is expected to slow. Despite the recent rise in energy prices, we view the increase was driven mainly by supply cuts, but the upside will likely be limited by subdued demand growth. Ultimately, with the core PCE inflation easing further to +3.9%yoy which was the lowest since Sep-21, we foresee less need for further tightening as the current high interest rate is already at restrictive levels. Going into next year, as growth is expected to slow further and inflation moving closer to the Fed's 2% target, we expect the Fed may consider cutting rates to reduce the level of restrictiveness of monetary policy on the economy.

Chart 2: US GDP Growth (Annualised QoQ%)



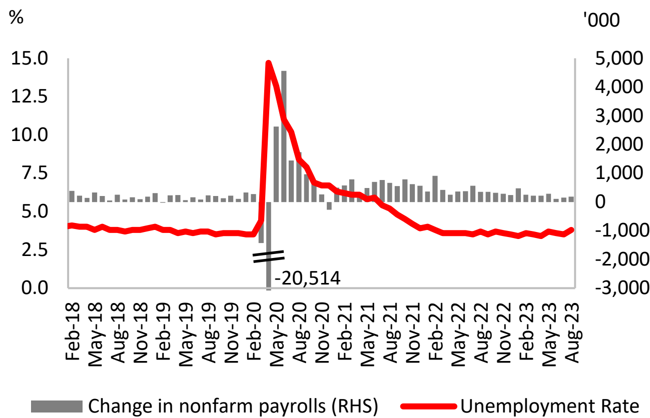
Source: Macrobond, MIDFR

Chart 3: Fed funds rate (%) vs. US Inflation (YoY%)



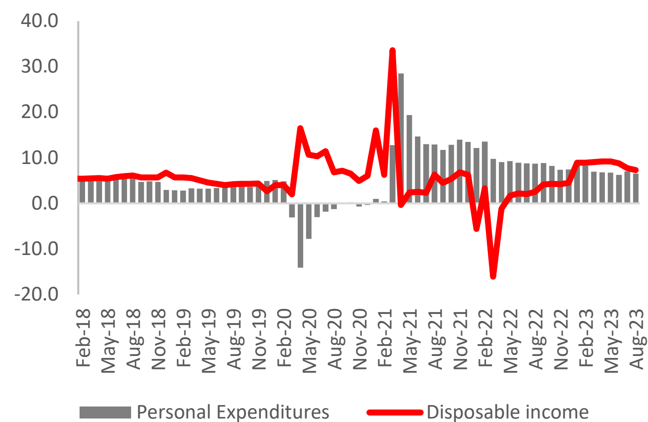
Source: Macrobond, MIDFR

Chart 4: Unemployment Rate (%) vs. Change in US Nonfarm Payrolls ('000)



Source: Macrobond, MIDFR

Chart 5: US Personal Outlays vs. Disposable Income (YoY%)



Source: Macrobond, MIDFR

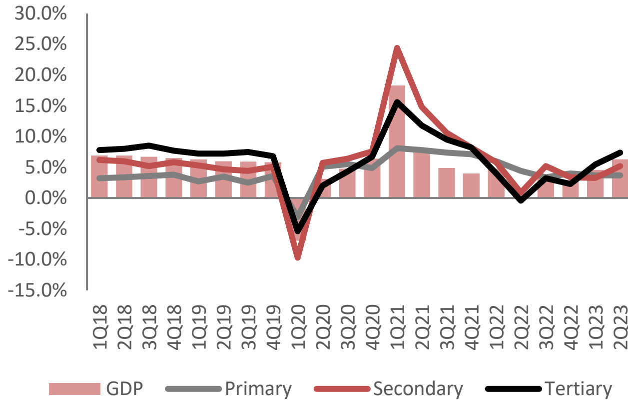
CHINA: PROPERTY MARKET REMAINED KEY CONCERN AS MORE POLICY SUPPORTS NEEDED

Post-reopening recovery has been below expectations. Although the economic reopening led to China's economy growing faster at +6.3%yoy in 2QCY23 (1QCY23: +4.5%yoy), the growth performance thus far has been below expectations. The recovery has been led mainly be rising consumption, and the highlight about slowing consumer spending caused the government to worry about the slowing growth momentum. On the other hand, the prospect of growth in the industrial output and manufacturing activities was less encouraging, which was also impacted by the weakness on the external front. With the government keeping its push to further strengthen domestic consumption, the policy measures in the past 2 months also geared towards encouraging consumer spending including purchases of cars and electronics, apart from measures to ease pressures on banks, SMEs and the property market. Although we remain cautious on the drag from property market, we foresee the official 5% growth target set by the government for this year is still feasible as we anticipate China's growth to continue growing in the final 3 months of 2023. For next year, China's economy is projected to moderate towards +4.5%, according to the IMF's projection.

More policy supports to sustain growth momentum. We opine more policy supports may be introduced to ensure a more vibrant and sustainable recovery. Although the People's Bank of China (PBOC) decided to keep the 1-year and 5-year Loan Prime Rates (LPRs) unchanged at 3.45% and 4.20% after the Sep-23 meeting. The need for further policy easing decreased as growth momentum seen improving as shown by the stronger-than-expected growth in retail sales and industrial output in Aug-23. However, with property being one of the major assets held by the people, it is understandable that sentiment will be swayed by the negative news related to the property market and the negative wealth effect could affect future spending plans. As we expect problems in the real estate market will continue into next year, we opine more policy actions by the government will be needed to minimize the adverse impacts to the broader economy.

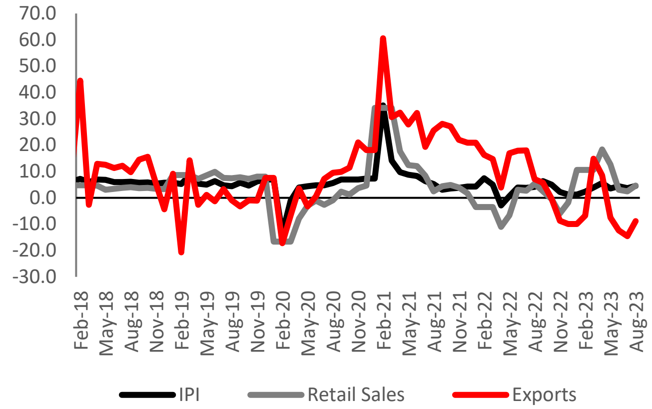
Property market remains the major downside risks. From time to time, the troubles in the property market will resurface and cause concerns about the stability of China's growth outlook. While the weakness in the property market already translated into slower growth in the fixed asset investment in the real estate market, the struggles faced by China's property developers to fulfil its financial obligations led to jitters in the financial markets. We foresee this uncertainty will continue to affect sentiment in the country. We believe the government is also trying to balance between minimizing the negative impacts vis-à-vis avoiding unnecessary rise in speculative activities. Apart from the challenges in the property market, we opine China will need time to be a more sustainably domestic demand-driven economy. Hence, we foresee the moderate global growth and expected slowdown in final demand in the advanced economies will continue to affect China from the external front. China is also facing heightened geopolitical and trade tensions with the US, which adds downside risks to China's trade and manufacturing sector's outlook.

Chart 6: China GDP by Industry (YoY%)



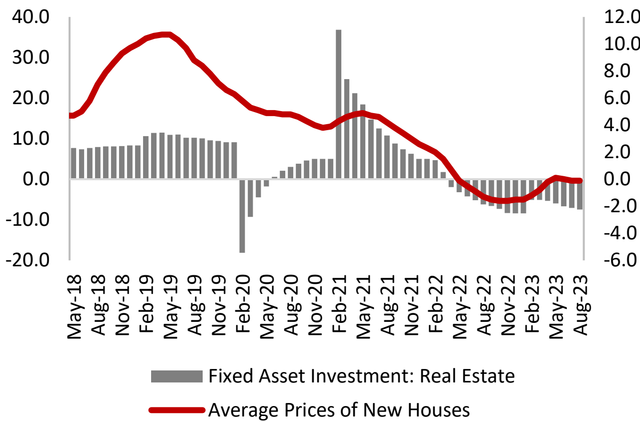
Source: Macrobond, MIDFR

Chart 7: China Retail Sales, IPI and Exports (YoY%)



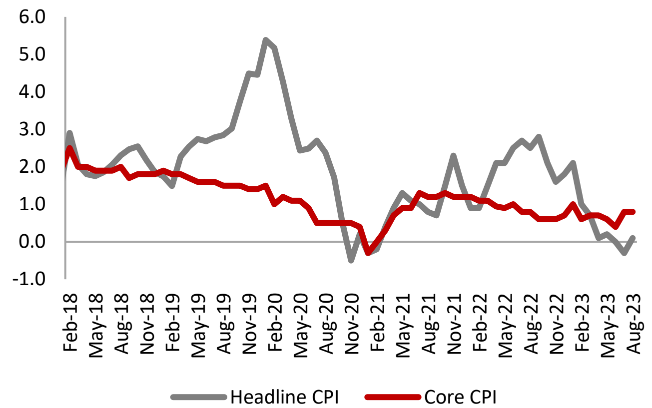
Source: Macrobond, MIDFR

Chart 8: China Fixed Asset Investment in Real Estate YTD vs. Average Prices of New Houses (YoY%)



Source: Macrobond, MIDFR

Chart 9: China Headline vs Core CPI Inflation (YoY%)



Source: Macrobond, MIDFR

MALAYSIA: RESILIENT DOMESTIC DEMAND WITH A GLIMPSE OF HOPE ON EXTERNAL FRONT

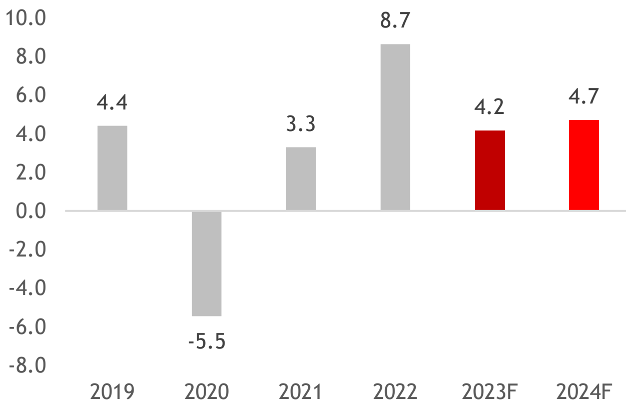
Rebound in 4QCY23. After recording almost 2-year low GDP growth in 2QCY23, Malaysia's economy is forecasted to grow slower at +2.2%yoy in 3QCY2 due to high-base effects and external slowdown. Nevertheless, we foresee a stronger recovery in the final lap of 2023, harping on the better recovery in China, elevated commodity prices and steady domestic demand. Malaysia's GDP growth is forecasted to moderate to +4.2% in 2023. The softening growth is mainly due to contraction of external trade performances as global demand is anticipated to be slower than the previous year. Negative effects of tightening monetary policy in major economies, weaker-than-expected China's economic recovery and normalisation of commodity prices are among the downside pressures to global demand in 2023. However, Malaysia's external trade will continue to benefit from increased global demand for commodities especially palm oil, crude petroleum and LNG as the prices of CPO and Brent crude oil are projected to stay elevated at RM3,800 per tonne and USD83pb for 2023. Moving into 2024, we expect bright prospects for external trade as well as primary sectors given that our in-house forecast for both commodities are RM4,200 per tonne and USD85pbd for 2024. Malaysia's agriculture and mining sectors are projected to grow by +1.5% and +2.6% respectively for next year. Manufacturing sector growth to register a faster pace of +4.0% for 2024, among others supported by NIMP 2030 initiatives. As for 2024, we view the GDP growth at +4.7%, lower than the government's target +5.0~5.5% for 2024-2025.

Domestic demand still the main anchor. Domestic economy to be anchored by continuous upbeat consumer spending, busier tourism-related activities and revival of infrastructure projects. Job market remains in good shape as reflected in continuous positive growth in employment, decline in unemployment and lower jobless rate. Thanks to easing of global tight supply chain and normalised commodity prices, overall inflationary pressure is trending lower than in 2022. However, food inflation seems still stubborn as compared to non-food inflation. Private consumption and services are

expected to grow by +5.3% and +6.0% respectively in 2023. As for next year, we foresee slight moderation for domestic demand especially if targeted-fuel subsidy is roll-out. Surge in fuel inflation will lead to a higher headline inflation to above +3.0%. We expect consumer spending power to be marginally dragged despite fiscal cash-assistance to certain targeted groups. We forecast private consumption and services sector to increase by +5.2% and +5.6% respectively for 2024.

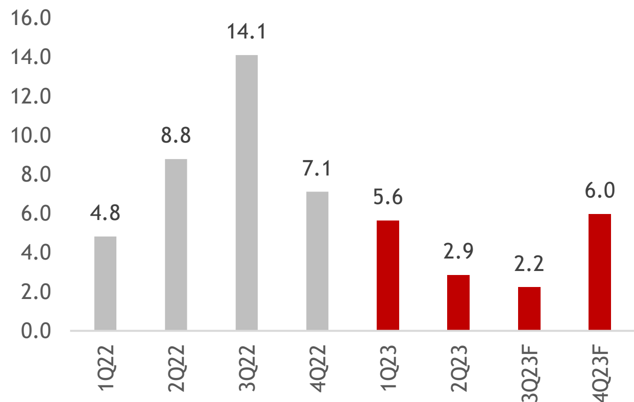
Stronger growth for construction sector. Referring to construction work done data, Malaysia's building output grew at solid pace of +8.7%yoy in 1HCY23 (2022: +8.8%). Across four components, civil engineering which contributes 37.4% of the works grew stronger by +13.7%yoy in 1HCY23 against +2.7% in 2022. Private-led projects are growing at double-digit pace +13.9%yoy (2022: +17.6%) while government-led output growth improved to +3.1%yoy (2022: +2.2%). Public Corporation-led projects lagged behind, still in contractionary form -1.3%yoy (2022: -7.1%) amid non-residential activities. Looking ahead, we expect construction sector to record a higher growth in 2HCY23 underpin by expansionary fiscal policy and better-than-expected private investment. Budget 2023 allocated development expenditure (DEVEX) of RM99b and we expect another RM90b allocation for Budget 2024 as guided by the recent midterm review of 12th Malaysia Plan. Public investment is projected to continue growing above +7.3% for 2023 and +3.4% for 2024, among others attributable to the public infrastructure projects such as KVDT Phase 2, Pan-Borneo Highway, ECRL, LRT3 and RTS Link. In addition, increase of residential, non-residential buildings and facilities will further boost investment spending as well as construction sector. Meanwhile, the 5G roll-out will boost growth in the civil engineering sub-sector. Also, we foresee construction sector to benefit expanding by +7.5% for this year and +5.2% for 2024.

Chart 10: GDP Growth Forecast (YoY%)



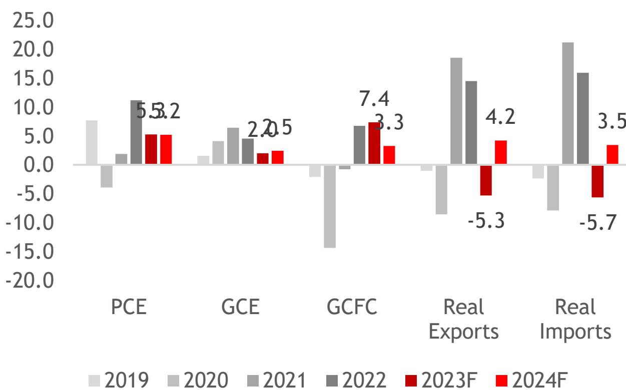
Source: Macrobond, MIDFR

Chart 11: GDP Growth Quarterly Forecast (YoY%)



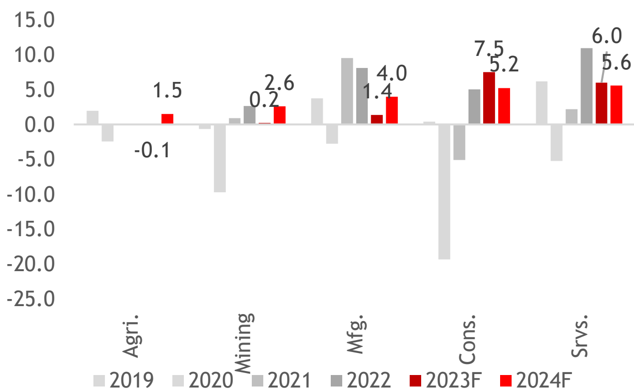
Source: Macrobond, MIDFR

Chart 12: 2023 GDP Growth by Expenditure (YoY%)



Source: Macrobond, MIDFR

Chart 13: 2023 GDP Growth by Supply (YoY%)



Source: Macrobond, MIDFR

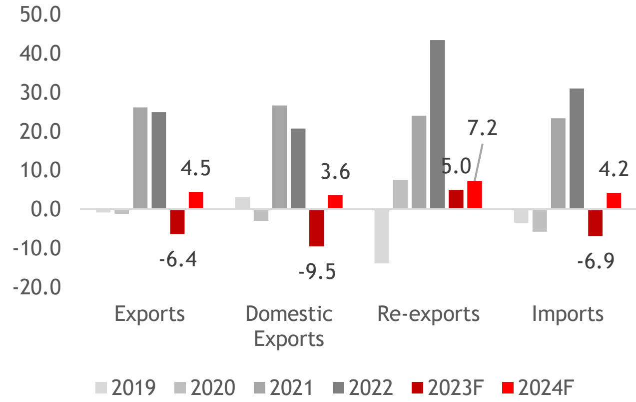
Larger exports contraction forecast at -6.4% for 2023. Considering the recent weaknesses in trade numbers so far, we slash lower our initial forecast exports and imports to fall by -6.4% (-3.4%) and -6.9% (-1.9%) respectively for this year. Below expectations China's recovery, negative effects of tightening monetary policy in major economies and normalisation of global commodity prices are among key downward pressures on Malaysia's external trade performances at

least for 8MCY23. Exports to China reduced by -8.6% in 8MCY23 (2022: +9.4%), USA -2.7% (2022: +17.6%) and Europe -10.2% (2022: +21.5%). By sector, outbound shipments of agriculture fell by -25.8% (2022: +23.2%), manufacturing -6% (2022: +22.2%) and mining -9.2% (2022: +69.2%). Nevertheless, we foresee Malaysia's external trade to stabilise and regain its momentum in 4QCY23 onwards. We expect both exports and imports growth to return to positive rate territory in 4QCY23 amid stronger recovery in China, positive sentiments over loosening monetary policy in major economies and persistent elevated commodity prices. We believe the external trade momentum to turn better in 2024, predicting exports and imports to expand by +4.5% and +4.2% respectively.

Chart 14: External Trade Performances (YoY%)

Source: Macrobond, MIDFR

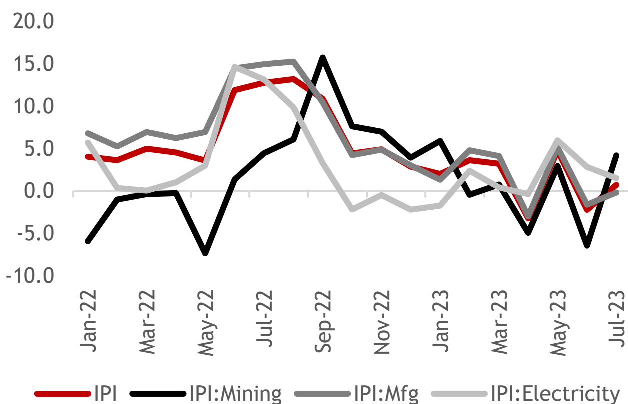
Chart 15: External Trade Forecasts (YoY%)



Source: Macrobond, MIDFR

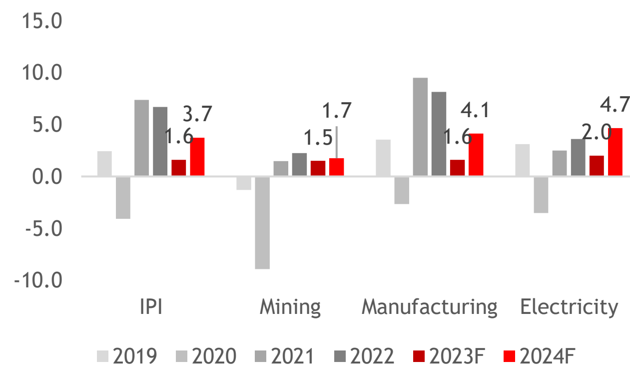
Brighter prospects for mining production. Mining output is expected to recovery strongly underpin by elevated global energy prices. Brent crude oil prices for instance returned to above USD90pbd in Sep-23, the highest since Oct-22. The completion of new pipeline projects in Sarawak and resumption of Sabah's oilfields operation are seen to benefit and able to uplift mining output in 2023. Mining output growth to stay on expansionary, +1.5% for 2023 and +1.7%yoy for 2024. In line with external slowdown, factory output growth is forecasted lower at +1.6%. Electricity output, which is closely associated with factory performance, to record marginal gain of +2.0% for 2023. Nevertheless, the outlook for electricity output is optimistic as driven by the National Energy Transition Roadmap projects. Overall IPI is predicted to expand by +1.6% in 2023, much lower than initial projection of +2.2%. As for 2024, we predict a stronger IPI growth of +3.7% which supported by rebound in regional demand and higher output growth from manufacturing sector in particular.

Chart 16: IPI Performances (YoY%)



Source: Macrobond, MIDFR

Chart 17: IPI Forecast (YoY%)

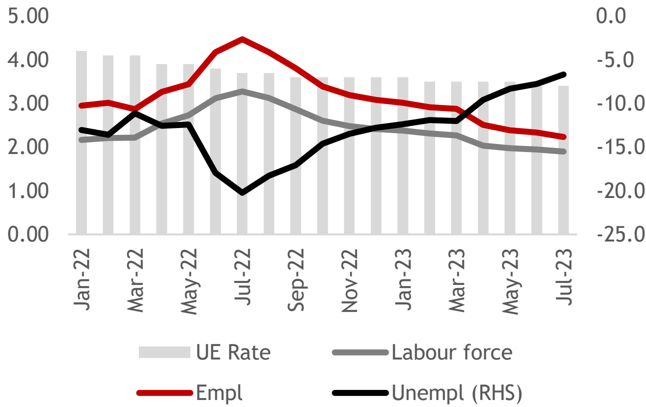


Source: Macrobond, MIDFR

Steady job market. The labour market in Malaysia is predicted to strengthen further in 2023 and 2024, backed by encouraging momentum in the domestic economy. Malaysia's unemployment rate is expected to decline further to 3.5% in

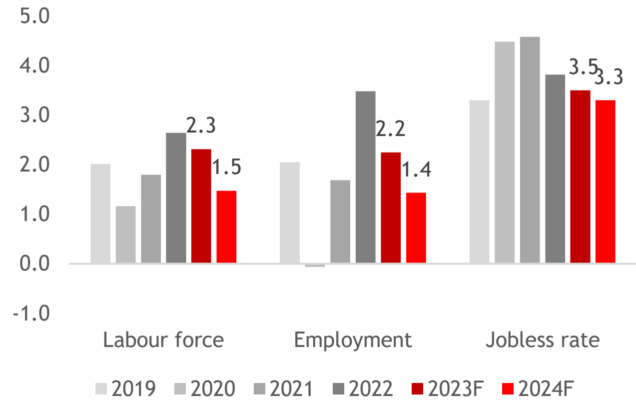
2023 and return to pre-pandemic levels at 3.3% in 2024. The return of non-citizens workers is expected to boost overall employment and reduce the jobless rate. As of 2QCY23, non-citizens' employment is almost -2.7% (1QCY23: -4.4%) lower than pre-pandemic levels. As of 7MCY23, employment grew by +2.6%yoy while unemployment reduced by -9.9%yoy (2022: -14.8%) and jobless rate averaged at 3.5%. The downside risks to Malaysia's labour market among others is continous weakening in external trade.

Chart 18: Labour Market Performances (%)



Source: Macrobond, MIDFR

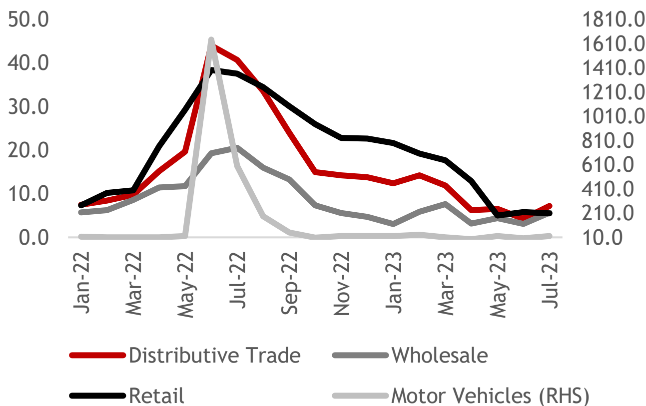
Chart 19: Labour Market Forecasts (YoY%)



Source: Macrobond, MIDFR

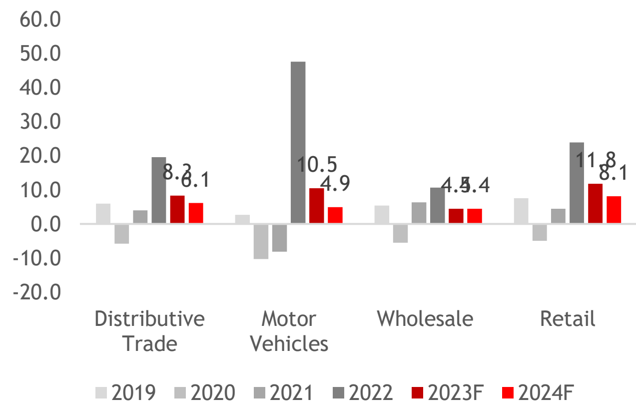
Solid consumer demand. Malaysia's distributive trade sales remained firm, expanding by +8.8%yoy in 7MCY23. All components particularly sales of motor vehicles and retail trade improved by +12.1%yoy and +13.7%yoy while wholesale trade inched up by +4.7%yoy. Consumer demand remains solid as inflation pressure moderated and stable job market. Excluding price effects, seasonally adjusted volume of distributive trade growth touched +6.5%yoy (2022: +15.3%), mainly supported by motor vehicles, wholesale trade and retail trade by +9.5%yoy (2022: +220.0%), +4.4%yoy (2022: +3.8%) and +6.5%yoy (2022: +21.9%) respectively in 7MCY23. Looking ahead, the upbeat momentum of domestic demand to continue in 2023 and 2024 underpin by resilient labour market, easing inflationary pressure, pick-up in tourism activities and supportive economic policies. During the pre-pandemic, 50.7% of Malaysia's airports passenger traffic was contributed by international travels, 25.0% by ASEAN and 25.7% by non-ASEAN destinations. As of Jul-23, travellers for domestic destinations accounted for 52.4% (2022: 71.7%) vis-à-vis international destinations at 47.6% (2022: 28.1%), whereby 22.2% were non-ASEAN and 24.6% ASEAN.

Chart 20: Distributive Trade Sales, DT (YoY%)



Source: Macrobond, MIDFR

Chart 21: Distributive Trade Sales Forecasts (YoY%)

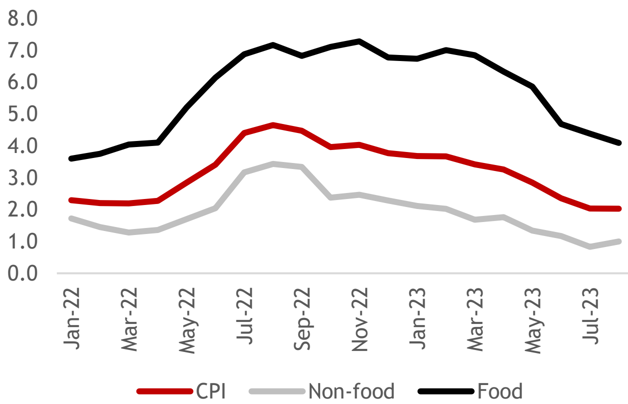


Source: Macrobond, MIDFR

Elevated food prices to lead average headline inflation rate at +3.0% for 2023. As of 8MCY23, average food inflation registered at +5.7%yoy, equivalent to previous year's +5.7%. We estimate food inflation to remain at range of

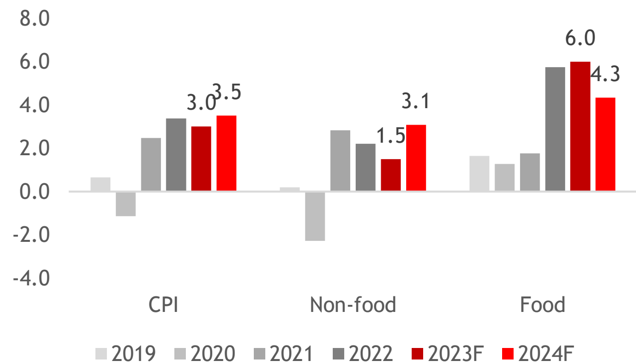
+5.5~6.0% in 2HCY23 due to externally challenging environment especially for global agriculture output. Plus, prolong depreciated MYR among others will lead to higher imported inflation particularly via food prices as Malaysia is a net importer for most food products. As for non-food inflation, we are confident the government will keep retail fuel prices status quo at least until the end of this year. Non-food inflation is expected to average at +1.5% (8MCY23: +1.5%yoy). Considering both CPI components, we foresee Malaysia's headline inflation rate to average at +3.0% for 2023. Looking into next year, we foresee higher inflation rate at +3.5% with the assumption that the government will roll-out the fuel-targeted subsidy. We foresee the government to introduce managed-float mechanism which RON95 price to be set higher at RM2.30 per litre and cash-handouts to those eligible as guided by the PADU database. Non-food inflation rate to rise by +3.1% while food inflation rate to moderate at +4.3%.

Chart 22: Food-led Inflationary Pressure (YoY%)



Source: Macrobond, MIDFR

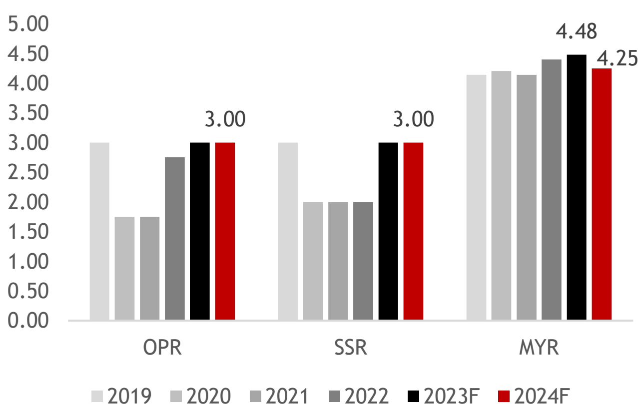
Chart 23: Inflation Forecast (YoY%)



Source: Macrobond, MIDFR

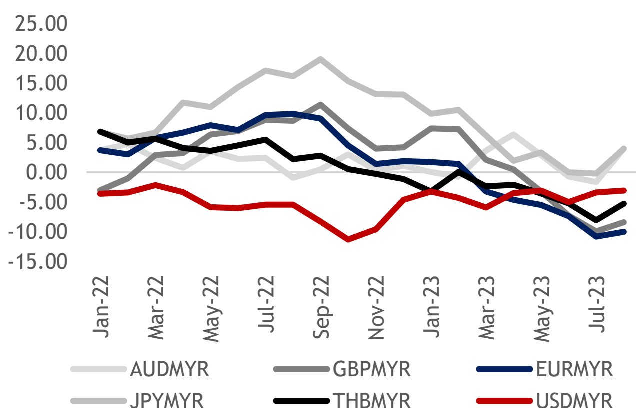
OPR to remain status quo until year-end following external demand weakness. The current focus of BNM's monetary policy setting is to ensure a sustainable growth momentum of Malaysia's economy. Even though core inflation still sticky, weakening external trade performances is seen as dragging factor on overall GDP growth. For the last MPC meeting in Nov-23, we foresee BNM to keep OPR status quo at least until the end of this year. The decision will be subjected to the stability of economic growth, the pace of price increases and further improvement in macroeconomic conditions, particularly a continued recovery in the labour market and growing domestic demand. From a medium-term perspective, the policy rate normalization is needed to avert risks that could destabilize the future economic outlook such as persistently high inflation and a further rise in household indebtedness.

Chart 24: Monetary Policy & USDMYR Forecast (%)



Source: Macrobond, MIDFR

Chart 25: MYR against Major Currencies (YoY%)



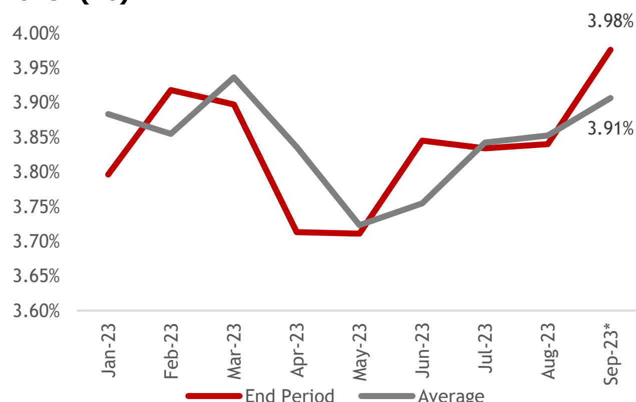
Source: Macrobond, MIDFR

MYR to appreciate in 4QCY23. Strong US dollar has been the main factor for the depreciation of most currencies since early 2022 due to the aggressive interest rate hikes by the Fed. MYR stays on depreciation path as the Fed keep on

delaying its interest rate pause. Also, weaker-than-expected China's performances indirectly disappoint MYR given that exports to China (12.8% of total exports) fell by -8.6%yoy in 8MCY23 (2022: +9.4%). For 2023, we revise lower MYR average to RM4.48 per USD1 and year-end at RM4.30. Fundamentally, ringgit is in a good position to strengthen as the domestic economy stays on upbeat momentum and as a net commodity exporter (of crude petroleum, LNG and palm oil), Ringgit stands to gain from the elevated global commodity prices and sustained trade surplus. However, we believe the strengthening of MYR will return and regain once the fed hit the pause button and the earliest is in 4QCY23.

Bond market to remain volatile ahead of Fed's pause. The first 2-month period of the 3QCY23 saw relative stability of the benchmark MGS 10-year yield. The MGS 10-year yield reached 3.98% on 26th Sep-23, the highest level since Mar-23 and registered the second-highest monthly average for the year after the Fed maintained a hawkish tone following the latest FOMC meeting. The domestic bond market is expected to remain volatile ahead of the Fed's rate trajectory. The delay in the Fed's pause is also expected to increase the demand for the safety of the dollar, hence foreign holdings of a government bond are likely to see a decline until the much-awaited pause is confirmed. Nevertheless, we foresee the MGS 10-year yield to move lower, ending the year at 3.77%, aligned with our view that the Fed is set to keep FFR status quo for the rest of the year. As the Fed is expected to start cutting the interest rate in the 2HCY24, we opine MGS 10-year yield to edge lower in 2024.

Chart 26: 10y MGS Yield, Monthly Average and End-Month (%)



Source: Bloomberg, MIDFR
*as of 28th September

Chart 27: Foreign Holdings of Government Bonds (RM million) and Percentage Over Total Outstanding

Source: Macrobond, MIDFR

Table 5: MIDF Research Macroeconomic Forecast Figures for 2023 & 2024 (%)

(YoY%) Unless Stated Otherwise	2020	2021	2022	2023f	2024f
Real GDP	(5.5)	3.3	8.7	4.2	4.7
Govt. Consumption	4.1	6.4	4.5	2.0	2.5
Private Consumption	(3.9)	1.9	11.2	5.3	5.2
Gross Fixed Capital Formation	(14.4)	(0.8)	6.8	7.4	3.3
Govt. Investment	(21.2)	(11.1)	5.3	7.6	2.8
Private Investment	(11.9)	2.7	7.2	7.3	3.4
Exports of goods & services;	(8.6)	18.5	14.5	(5.3)	4.2
Goods Exports	(0.7)	21.4	11.1	(11.8)	3.4
Services Exports	(47.8)	(8.2)	56.8	52.7	8.6
Imports of goods & services;	(7.9)	21.2	15.9	(5.7)	3.5
Goods Imports	(3.6)	23.8	14.6	(10.2)	2.8
Services Imports	(25.3)	7.7	23.9	19.5	6.3
Net Exports	(13.7)	(4.0)	(1.0)	(1.2)	13.5
Agriculture etc.	(2.4)	(0.1)	0.1	(0.1)	1.5
Mining & Quarrying	(9.7)	0.9	2.6	0.2	2.6
Manufacturing	(2.7)	9.5	8.1	1.4	4.0
Construction	(19.3)	(5.1)	5.0	7.5	5.2

(YoY%) Unless Stated Otherwise	2020	2021	2022	2023f	2024f
Services	(5.2)	2.2	10.9	6.0	5.6
Exports of Goods (f.o.b)	(1.1)	26.1	24.9	(6.4)	5.9
Imports of Goods (c.i.f)	(5.8)	23.3	31.0	(6.9)	4.2
	2020	**2021**	**2022**	**2023f**	**2024f**
Unemployment Rate (%)	4.48	4.58	3.82	3.50	3.30
Headline CPI Inflation (%)	(1.1)	2.5	3.4	3.0	3.5
Non-Food Inflation (%)	(2.3)	2.8	2.2	1.5	3.1
Food Inflation (%)	1.3	1.8	5.7	6.0	4.3
Brent Crude Oil (Avg, USD per barrel	41.6	71.5	102.0	83.0	85.0
Crude Palm Oil (Avg), MYR per tonne	2,775	4,486	5,262	3,800	4,200
USD/MYR (Avg)	4.20	4.14	4.40	4.48	4.25
USD/MYR (End-period)	4.02	4.17	4.35	4.30	4.10
MGS 10-Yr Yield (Avg)	2.84	3.23	4.07	3.80	3.70
MGS 10-Yr Yield (End-period)	2.65	3.59	4.04	3.77	3.60
Overnight Policy Rate (%)	1.75	1.75	2.75	3.00	3.00

Source: Macrobond, Bloomberg, MIDFR

C. MARKET OUTLOOK FOR 4QCY23

Equity market disappointed by lack of definitive US Fed pause signal. The European Central Bank (ECB), on 14 September, stated that its policy rate shall likely be "maintained for a sufficiently long duration". The ECB statement essentially signalled a pause to its series of interest rate hikes. Likewise, the market was arguably hopeful for a similarly conclusive statement from the US Fed during its recent 20 September FOMC meeting. Unfortunately, the US Fed did not signal a definite pause but instead reiterated its bias for (with 12 out of 19 FOMC members in favour of) an additional rate hike this year. Thus, negative equity market reaction ensued.

Expect the risk-off reaction to be short-lived… Nonetheless, we expect the negative knee-jerk equity market reaction to a key outcome of the US Fed September meeting to be short-lived. Going forward, we believe investors will look beyond the possibility of a final hike this year and shall begin to take heed of other important outcomes of the meeting. Namely, the favourable growth and inflation outlook into next year.

…due to favourable fundamental outlook. In regard to the above, it must be highlighted that the US Fed revised upward its GDP growth projections for 2023 and 2024 to 2.1% (from 1.0%) and 1.5% (from 1.1%) respectively. Moreover, its inflation (Core PCE) projections for 2023 and 2024 were revised down to 3.7% (from 3.9%) and maintained at 2.6% respectively. It must also be noted that downward revision to the expected number of rate cuts in 2024 to two times (from four times) was due to [as clarified during the US Fed Chair press conference] optimism about economic growth rather than concerns about stubborn inflation.

Additionally, the interest rate futures market is betting on no more rate hike. As earlier stated, the prevailing bias of FOMC (12 of 19 members, or 63%) is for an additional rate hike this year. However, on the contrary, the interest rate futures market is betting in the opposition with 80% and 66% probabilities (as of writing) of no hike in the upcoming November and December FOMC meetings respectively. At MIDF Research, we also believe there will be no further hike by the US Fed hence a terminal rate of 5.50%. Domestically, we also expect the BNM to not raise the OPR from its current level of 3.00%.

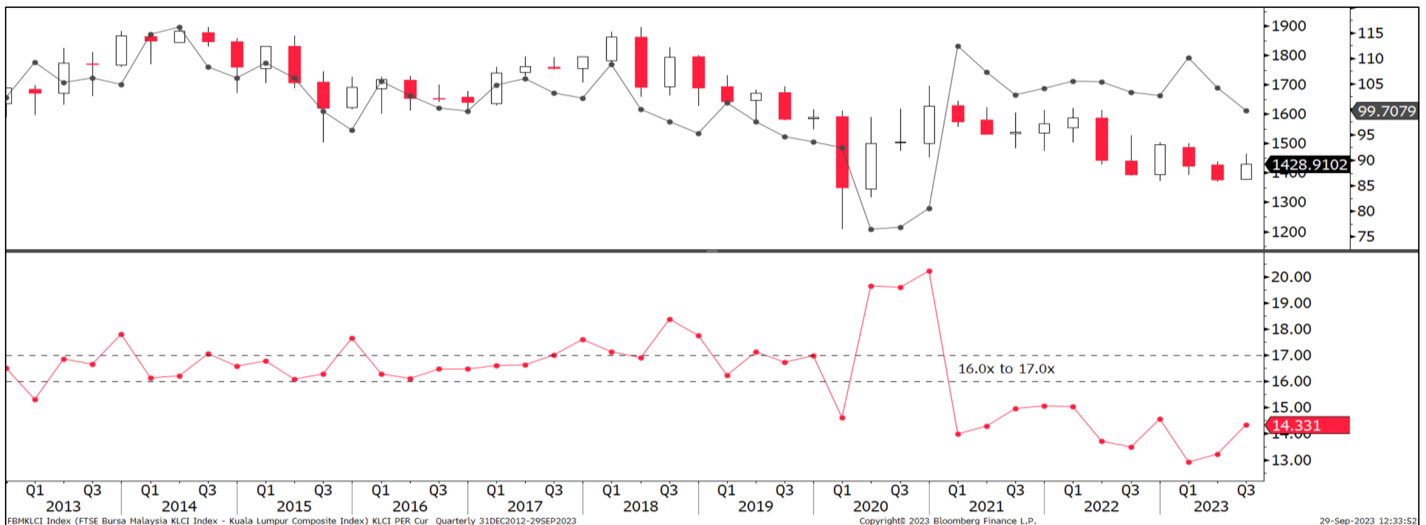
Expect stronger Ringgit in 4QCY23… The hitherto strong US Dollar has been principally due to the highly aggressive interest rate hikes by the US Fed. It must however be noted that the burgeoning policy rate differential between the US Dollar and Ringgit is likely to (if not already) reach its peak in the final quarter this year, either with or without another US Fed rate hike. Hence, we expect the Ringgit to strengthen against the US Dollar in 4QCY23 with a year-end target of RM4.30. Moreover, the Ringgit is fundamentally in a good position to strengthen due to (i) the domestic economy remains on an upbeat momentum, and (ii) improving terms of trade from the elevated global commodity prices (of crude petroleum, LNG, and palm oil).

Chart 28: FBM KLCI versus USD/MYR*

Source: MIDFR, Bloomberg (G660), * Invert scale

...to attract foreign funds and engender positive momentum on the local market. The prospect of a stronger Ringgit against the US Dollar in 4QCY23 is expected to attract inflows of foreign money into the local financial system and its equity market in particular. We reckon it would engender positive momentum on the local equity market in 4QCY23 due to the positive correlation between the performance of Ringgit (against US Dollar) and the FBM KLCI.

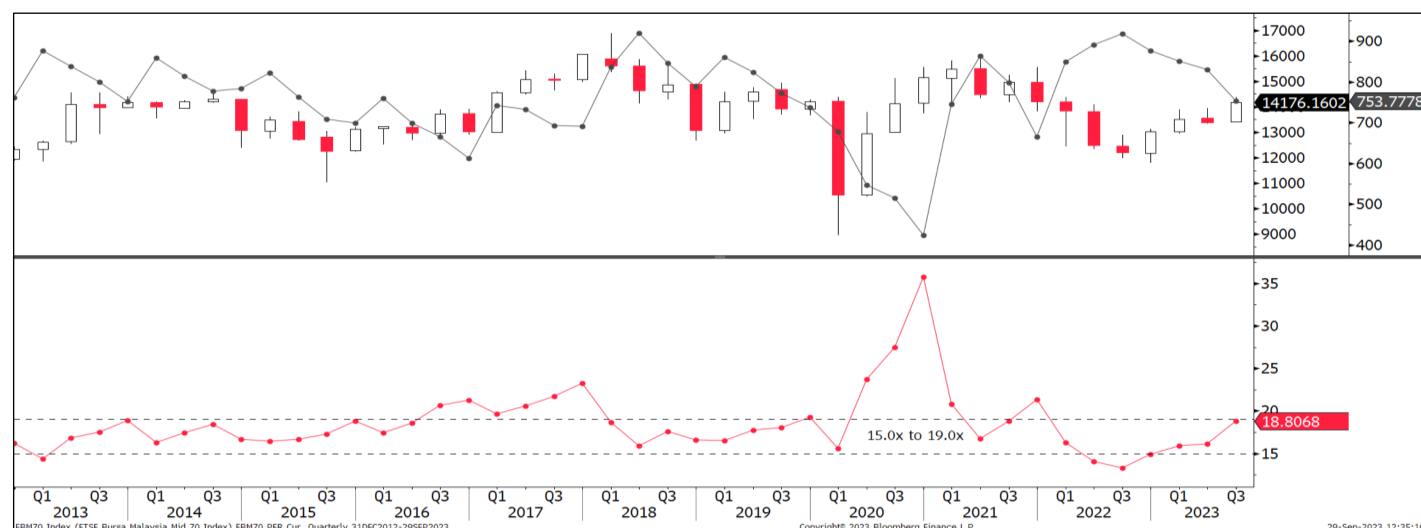
Chart 29: FBM KLCI: Price, Earnings and PER valuation



Source: MIDFR, Bloomberg (G658)

Maintain FBM KLCI end-2023 target at 1,540 points. At PER23 of 14.3x, the FBM KLCI is trading at a depressed valuation (vis-à-vis its historical range of 16.0x to 17.0x) which is partly attributable to the underperformance of its key Financial Services constituents. However, we expect its valuation to improve during the final quarter this year predicated on (i) recovery of Ringgit vis-à-vis US Dollar, (ii) inflow of international funds into the local equity market, and (iii) healthy macro as well as corporate earnings outlook into next year. Hence, we maintain our **FBM KLCI end-2023 target at 1,540** points or PER23 of 15.4x.

Chart 30: FBM70: Price, Earnings and PER valuation



Source: MIDFR, Bloomberg (G715)

Maintain FBM70 end-2023 target at 14,500 points. At PER23 of 18.8x, the FBM70 index (which represents mid-cap stocks) is currently trading at the upper end of its historical valuation range (of 15.0x to 19.0x). We expect the market valuation of FBM70 to remain buoyant going forward, mainly underpinned by the prospect of robust corporate earnings growth. We therefore maintain our **FBM70 end-2023 target at 14,500 points** or PER23 of 19.2x.

C.1 PRELIMINARY 2024 TARGETS

Going into 2024, we expect Malaysia's macro recovery to remain on track. Our preliminary forecast suggests Malaysia's GDP growth to accelerate (from estimated 4.2% in 2023) to 4.7% in 2024. Along with the expectation of buoyant macro performance, market consensus is forecasting the FBM KLCI to register a healthy +10.6%yoy earnings growth in 2024. Furthermore, the FBM70 is projected to register a robust +29.7%yoy earnings growth next year.

Table 6: FBM KLCI: Consensus Forward Earnings

Calendar Year	Earnings (Points)	YoY (%change)
CY2024 (F)	110.26	10.58

Source: Bloomberg, MIDFR

Preliminary FBM KLCI end-2024 target at 1,650 points or PER24 of 15.0x. Despite the expectation of buoyant macro performance along with healthy earnings growth next year, we expect the valuation of FBM KLCI to remain relatively subdue as its key Financial Services constituents continue to grapple with challenges in the elevated interest rates environment. Based on the prevailing earnings forecast, we introduce our **preliminary FBM KLCI end-2024 target at 1,650 points** or PER24 of 15.0x.

Table 7: FBM70: Consensus Forward Earnings

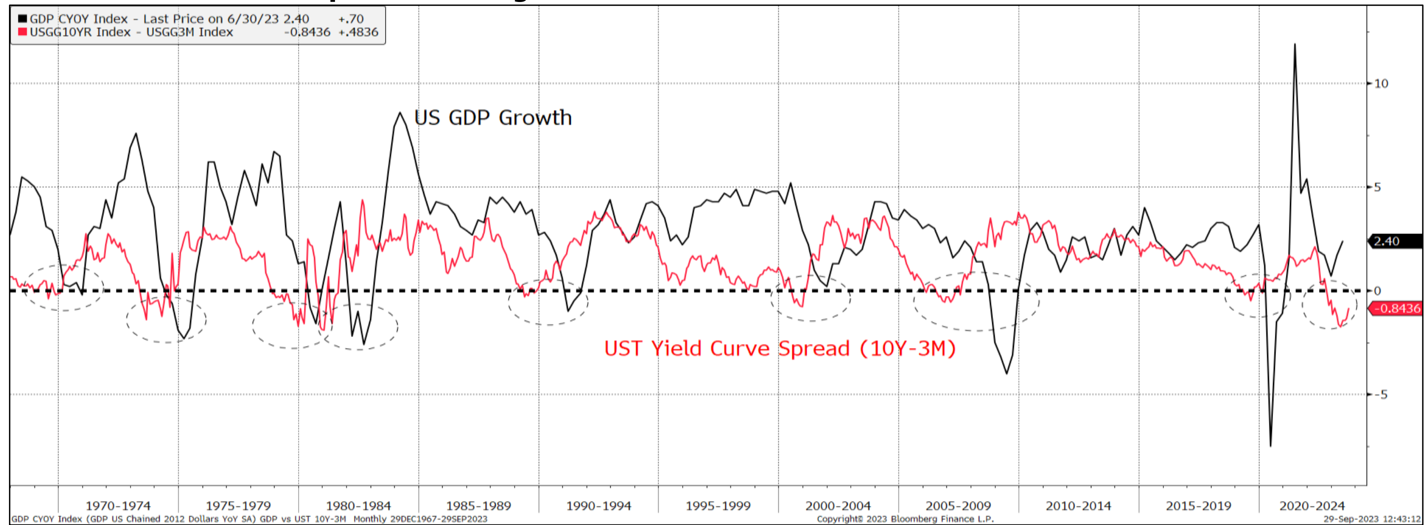
Calendar Year	Earnings (Points)	YoY (%change)
CY2024 (F)	977.45	29.67

Source: Bloomberg, MIDFR

Preliminary FBM70 end-2024 target at 16,600 points or PER24 of 17.0x. The outperformance of FBM70 index (both its valuation level as well as price return) thus far in 2023 may be attributable to the buoyant earnings growth prospect into next year. Nonetheless, going into 2024, we expect its valuation to gradually revert back toward the middle valuation range from the current upper level as earnings growth beyond 2024 normalizes. Hence, based on the prevailing earnings forecast, we introduce our **preliminary FBM70 end-2024 target at 16,600 points** or PER24 of 17.0x.

Caution ahead… While the prevailing projections for next year are positive both at the macro and corporate earnings levels, we would like to be mindful of potential downside risk to the 2024 outlook based on a time-tested signal which is coming out of the US Treasury market.

Chart 31: UST 10Y-3M Spread: Harbinger of Recession



Source: MIDFR, Bloomberg (G705)

…as the bond market is foretelling a US recession by second half of 2024? The aggressiveness of the US Fed in raising the short-term policy rate has invariably resulted in a complete inversion of bond yield curve. Looking at various long versus short maturity spreads of the US Treasury (UST), the last to invert was the 10-year against 3-month (10Y-3M) in late October 2022. It should be highlighted that the inversion of 10Y-3M spread serves as a potent signal of an impending economic recession, empirically within the ensuing 1 to 2 years. Most notably, it correctly predicted all US recessions since at least the early 1970s. Presently, the bond market is tacitly predicting the US economy to fall into a recession possibly by the second half of 2024.

D. STOCK SELECTION

Cautiously optimistic. Despite no definitive indication from the US Fed of the pausing of its rate hikes, we are still cautiously optimistic. We remain sanguine on the continued recovery of the economy, albeit at a normalised level. Meanwhile, we expect valuation of our equity market will recover once the US Fed finally hits the pause button.

New economic catalyst in the horizon. We are very positive on the launching of the National Energy Transition Roadmap as we believe that this could lead to a new economic catalyst. The clear and firm policy layout on the energy transition under NETR, we opine should drive a sector re-rating on improved growth and ESG profile. We expect key beneficiary in the asset ownership space from both RE capacity expansion and grid upgrade investments while the RE EPCC sub-sector is also a big beneficiary of NETR given massive potential for orderbook expansion.

Construction sector will be a beneficiary from continued high DEVEX. In our opinion, the 12MP Mid Term Review (12MP-MTR) have given more prominence to the construction sector given that the planned development expenditure has been increased by RM15b and the government is expected to spend circa RM90b per year on development expenditure for the remainder of the 12MP period. This could entail more infrastructure works and we can expect the upcoming rollout of

large rail projects such as the MRT3, Penang LRT and the proposed revival of the KL-Singapore High Speed Rail (HSR) to provide a boost to order books of construction companies.

Property and Oil & Gas sector is another one to look at for 4QCY23 onwards. We are positive on the improving outlook for property sector amid downtrend in property overhang and inventory level of property companies. Besides, unchanged OPR is positive to property companies as that supports recovery in demand for property. In view of the improving outlook for the property developers, we are narrowing our RNAV discount and target prices for property companies under our coverage. Meanwhile, the uptrend in oil prices will continue to benefit the oil & gas sector.

One changes to sector calls. We make one change to our sector calls in which we upgraded Transportation sector to POSITIVE (from NEUTRAL). We had also recently upgraded the Utilities (Power) sector and Property sector to POSITIVE, but downgraded the Automotive sector to NEUTRAL (from POSITIVE). The summary of our sector calls are as follows;

POSITIVE : Banking, Construction, Consumer, Healthcare, Power, Property, Oil & Gas, REITs, Transportation

NEUTRAL : Automotive, Plantations, Technology, Telecommunication

NEGATIVE : Gloves

Top ten picks reflect our view. We make changes to our top ten stock picks given the new sector themes in 4QCY23 onwards. Hence, our top ten stock picks are as follows:

Table 8: Top Stock Picks (Rank by total return)

	Rec.	Price (RM) @ 29/9	Target Price	Price Return	Dividend Yield	Total Returns	FBM ESG Rating	FTSE4Good?
Dialog Group	BUY	2.12	3.28	54.7%	0.1%	54.8%	3	N
Ranhill Utilities	BUY	0.65	0.80	23.1%	3.8%	26.8%	4	Y
Samaiden	BUY	1.23	1.54	25.2%	0.0%	25.2%	NR	N
Gamuda	BUY	4.43	5.38	21.4%	2.2%	23.7%	2	N
S P Setia	BUY	1.03	1.25	21.4%	1.3%	22.6%	3	Y
IJM Corp	BUY	1.86	2.11	13.4%	3.8%	17.2%	4	N
Mah Sing	BUY	0.90	1.01	12.2%	3.4%	15.6%	4	Y
MISC	BUY	7.08	8.16	15.3%	0.0%	15.3%	4	Y
Tenaga Nasional	BUY	9.99	11.00	10.1%	3.8%	13.9%	3	Y
Sunway Construction	BUY	1.90	2.09	10.0%	2.9%	12.9%	NR	N

Source: Companies, Bursa Malaysia, FTSE, Bloomberg, MIDFR

E. SECTOR OUTLOOK

AUTOMOTIVE *(Analyst: Hafriz Hezry)*

Backlog Growth Peaking……………………………………………………………………………Maintain NEUTRAL

TIV still holding up. The latest August 2023 total industry volume (TIV) was the second strongest this year at 71,745 units (+6.1%yoy) driven by: (1) National Day promotion campaigns, (2) Deliveries of backlog orders, (3) Improved supply chains. Cumulatively, TIV as at August 2023 stood at 501,552 units (+11.6%yoy), making up 70%/69% of our/MAA's full year forecast of 713K/725K units. Among the key players, Proton TIV was up +23.3% YTD, Perodua's TIV was up +18.9% YTD, Toyota TIV was up +8.8% YTD while Mazda TIV saw a +34.1% YTD increase. This was partly offset by Honda and Nissan however, which saw TIV contraction of -10.4% and -33.5% YTD respectively.

Strong revenue visibility in the near-term. We believe there is room for 2023 TIV to outperform our projection, while near-term revenue visibility is solid given the existing order backlog. However, the recent round of management briefings/engagements suggest that backlog order growth has started to flatten out with initial signs of receding compared to March-June levels. This follows a pickup in production to address the long waiting list previously. While we believe TIV momentum is close to peaking (after record breaking TIV in 2022 and potentially another new record this year), we do not expect a drastic fall at this juncture as demand could remain supported by improvement in unemployment rate and income conditions, while a moderating inflation trend also lends support. A potential risk however, is retargeting of fuel subsidies which could impact the cost of living and ultimately, spending propensity on big ticket items.

Some headwinds from a weak Ringgit. The Ringgit (vs. USD) has remained persistently weak year-to-date (negative for UMW Holdings and Tan Chong Motor given USD-denominated cost exposure), averaging at USD:RM4.51. The impact however, is to a large extent offset by upward price revisions by the non-national players (between +1.8% to +12% depending on marque and models) since early this year. Given large order backlogs, we reckon the 2QCY23 earnings season only partially reflected the impact of these price increases. Nevertheless, our economics team is projecting the Ringgit to end the year at USD:RM4.30, suggesting an upward trajectory for the Ringgit in 4QCY23. In contrast to the USD, the JPY remains weak and this is beneficial to BAuto which is exposed to JPY-denominated CBU imports.

Recommendation. Despite the strong backlog orders and potentially another record TIV this year, we believe this has largely played out among selective stocks under our coverage and as such, we keep our **NEUTRAL** call on the auto sector. Our top sector picks are **BAuto (TP: RM3.36)** and **MBMR (TP: RM4.70)** as these stocks remain sector laggards trading at ~30% discount to mean PER. BAuto is our tactical favorite riding on the weak JPY and its CKD model expansion, while dividend yield of 9.2% is attractive. We also like MBMR (5.9x FY24F PER) as a cheap proxy to Perodua which has: (1) High model localization rate with minimal forex risk (2) Strongest backlog bookings among the major players stretching up to 6 months. Dividend yield is attractive at 8.5%.

Chart 32: Annual TIV trend

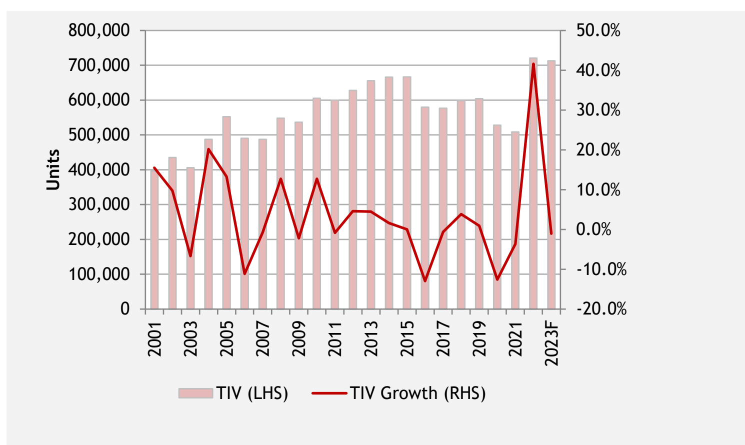
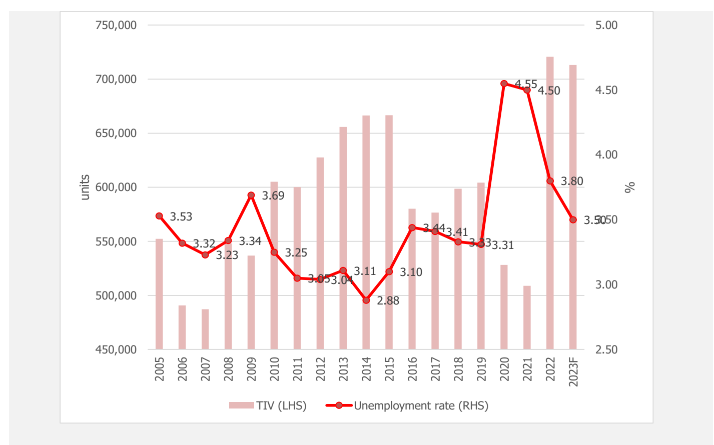


Chart 33: TIV vs. Unemployment Rate Trends



Source: MAA, BNM, MIDFR

BANKING *(Analyst: Samuel Woo Choong Yi)*

A More Muted 4QCY23 Expected...Maintain POSITIVE

Net profit sees no major upside probability. While NOII should continue to pull through in 2HCY23, we aren't too optimistic about NIM outlook (given the year-end deposit competition). NCC should be more normalised, and some banks are guiding for a more moderate OPEX outlook. No convincing or reliable earnings drivers in near term.

Downside bias to NIM, while NOII should perform decently. Although banks are guiding for stable-to-slightly-improved NIMs in 2HCY23, we urge investors to be cautious of potential downside stemming from year-end deposit competition – a repeat of last year could easily happen, given that we still are not entirely sure if deposit competition is driven by structural factors.

2QCY23 was a bumper quarter for NOII, with several companies surprising on the non-fee income side. While fee income might see some level of pickup, we are unsure if banks will be able to achieve treasury gains of a similar scale.

Better cost control expected. Personnel costs should be more normalised, given that the brunt of Collective Agreement adjustments have been finalised in 1HCY23. Tech spends is a bit harder to determine, but we aren't expecting any drastic ramp-ups (apart from BIMB or Affin). Several banks are guiding for relatively muted OPEX growth closer to the middle-single-digit range. Maybank indicates possible upside – but HLBK could see elevated costs as it potentially heads towards a transformation plan.

Banks vying for a strong 2H loan pipeline. Despite a weak 1HCY23, most banks are maintaining initial loan growth guidance (though some of them are conservative), gunning for a strong 2HCY23 post-election corporate pipeline. Liquidity issues are not expected to hold back the banks too much. Do note weaker retail leading indicators in 1HCY23, which could manifest in 2HCY23.

Deposits growth should pick up once more. CASA attrition did see some temporary relief following the non-renewal of pricier long-tenured FDs, but this shouldn't stop the overarching trend downward. We should see deposits begin to pick up, as several banks have guided that FD paring exercises should not continue in the following quarter.

The market has been saturated with liquidity for quite some time. Next quarter should finally see this go down, as we see higher loan growth and shorter-tenured FDs take centre stage.

Smaller banks are more vulnerable to negative asset quality issues. Banks which have been managing their asset quality well should see a further non-concerning uptick, continuations of current RA-related residential mortgage and SME GIL trends. But we are more concerned about smaller banks with riskier assets, which are more vulnerable to the May-23 OPR hike – especially when related arrears will finally be officially classified as impairments.

Provisioning outlook more mixed. This is going to vary between banks. We aren't expecting too many positive surprises, though there may be some writebacks that lessen the load – we think it's mostly going to range from average to heavy levels.

Dividend outlook still good. While BNM doesn't seem likely to exercise any form of leniency on capital requirements anytime soon, several banks have grown satisfied with their current capital position and are guiding for full cash dividends and payouts skewed towards the higher end – continuing the trend from previous quarters.

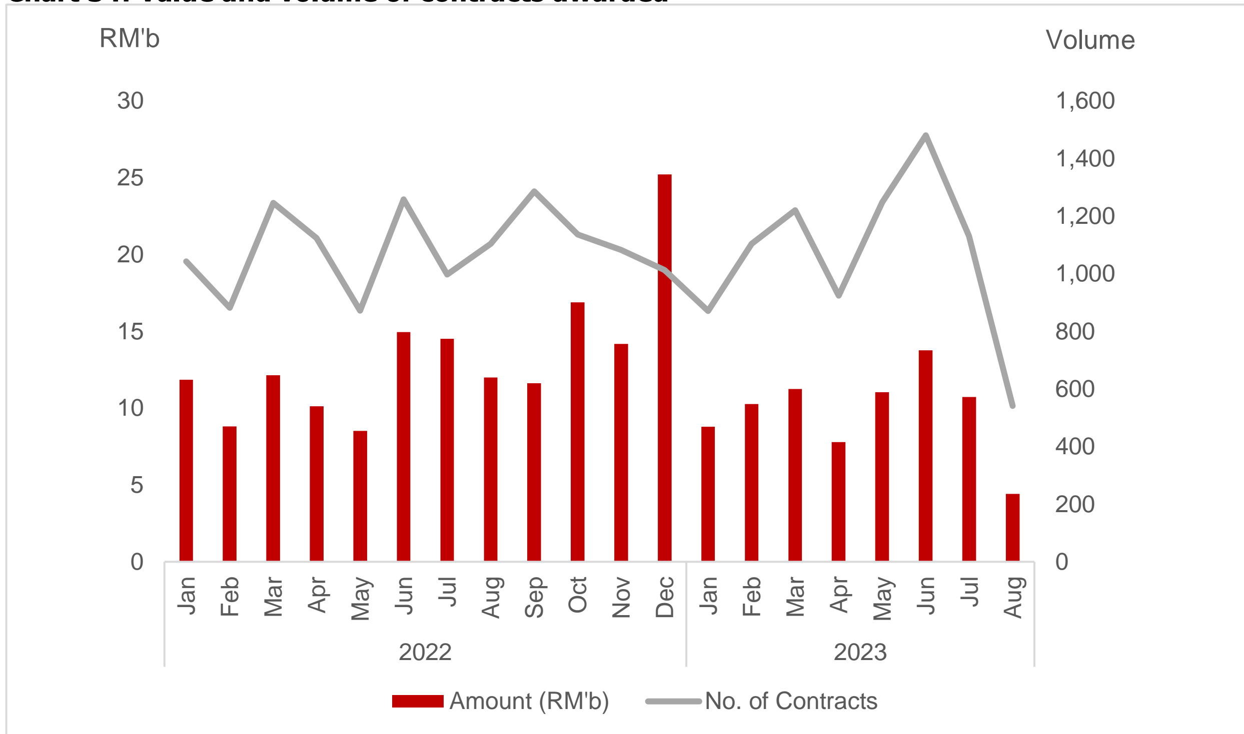
CONSTRUCTION *(Analyst: Royce Tan Seng Hooi)*

Looking at 2024..Maintain POSITIVE

Improving slowly, but steadily. Despite the slower pace of project rollouts in Malaysia this year, the value of construction work done has been consistently picking up pace, just slightly below pre-pandemic levels and this forms the basis of our macroeconomics team's projection of a +7.5% growth in 2023, followed by a +5.2% growth in 2024. In 2QCY23, the value of work done rose +8.1%yoy to RM32.35b, bringing the 1HCY23 value to RM64.57b (+8.8%yoy). On a quarterly basis, this has been the seventh consecutive month of increase in activities. Construction activities for the first half of the year were driven by the construction of buildings at RM34.08b (52.8%), roads and railways at RM12.32b

(19.1%) and utility projects at RM8.41b (13.0%), among others. In terms of projects awarded, a total of 8,517 contracts (-0.1%) were awarded from Jan-23 to Aug-23, with a total value of RM78.04b (-16.0%). We do not expect 4QCY23 to be any much different in terms of work done and project rollouts and we pin our hopes on 2024 for large projects such as the MRT3, Penang LRT and Pan Borneo to drive the sector. The recent mid-term review of the 12th Malaysia Plan has set the tone for the construction sector for the next two years and the execution of such projects will come from the development expenditure allocation of RM99b on Budget 2023 and expectations of about RM90b in Budget 2024.

Chart 34: Value and volume of contracts awarded



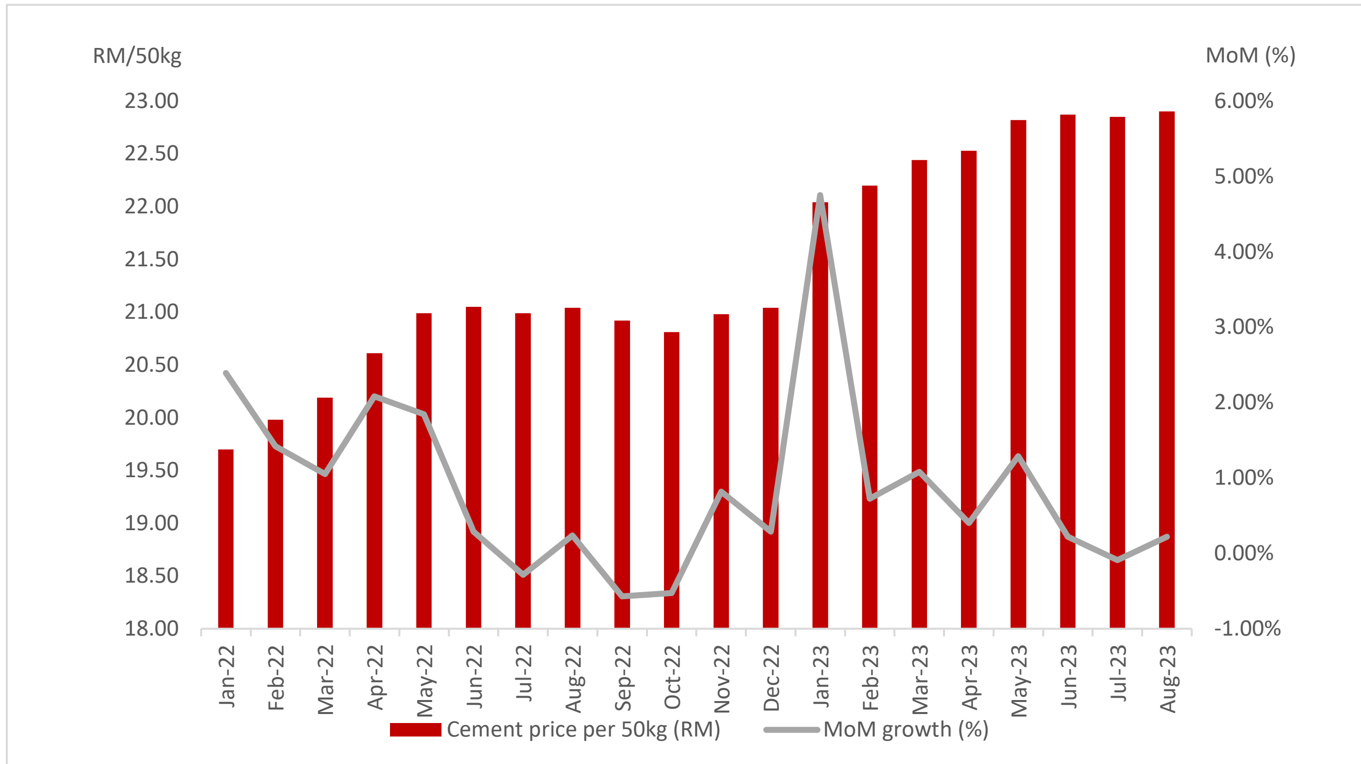
Source: CIDB, MIDFR

Looking forward to 2024. As mentioned in our previous outlook report, we do not expect any mega scale projects to be rolled out this year. MRT Corp has recently extended the tender validity period for the MRT3 packages until end-2023, where among front-runners include Gamuda, IJM Corp and MRCB. The tender awards have been delayed since Dec-22 due to a cost review by the government, to bring down the price tag by 10% from RM50b to RM45b of which about RM8b to RM10b would be for land acquisitions. We reiterate our view that the MRT3 mega rail project remains a crucial development to give the construction sector a jolt and we expect it to be rolled out by 1QCY24. Smaller construction firms will be able to benefit from second-tier jobs. As for the Penang LRT project, the timeline is still unclear at the moment. Recall that MRT Corp, which is also the lead agency for the project, has proposed that the initial line be extended by 6km to Tanjung Bungah, for certain parts of the alignment to go underground in George Town and an undersea alignment connecting the island to the mainland. Delays can be expected due to feasibility studies involved and a reconsideration of the cost by the Federal Government is likely as the new proposals may potentially triple the initial amount of RM10b. Other than these, contractors remain upbeat on future prospects, with job flows expected from data centres, logistic warehouses and semiconductor plants.

Building material costs remain elevated. The prices of building materials remain elevated, although prices of steel bars have come off slightly, but cement prices remain stubborn. The average price of steel bars stood at RM3,641.02 per tonne in Aug-23, easing for four consecutive months. Meanwhile, cement prices rose +0.22%mom in Aug-23 to an average of RM22.90 per 50kg bag, after briefly declining by -0.1% in Jul-23. Before that, prices have risen every month from Nov-22 to Jun-23. Prices would remain roughly similar over the next quarter, and we do not expect this to have a

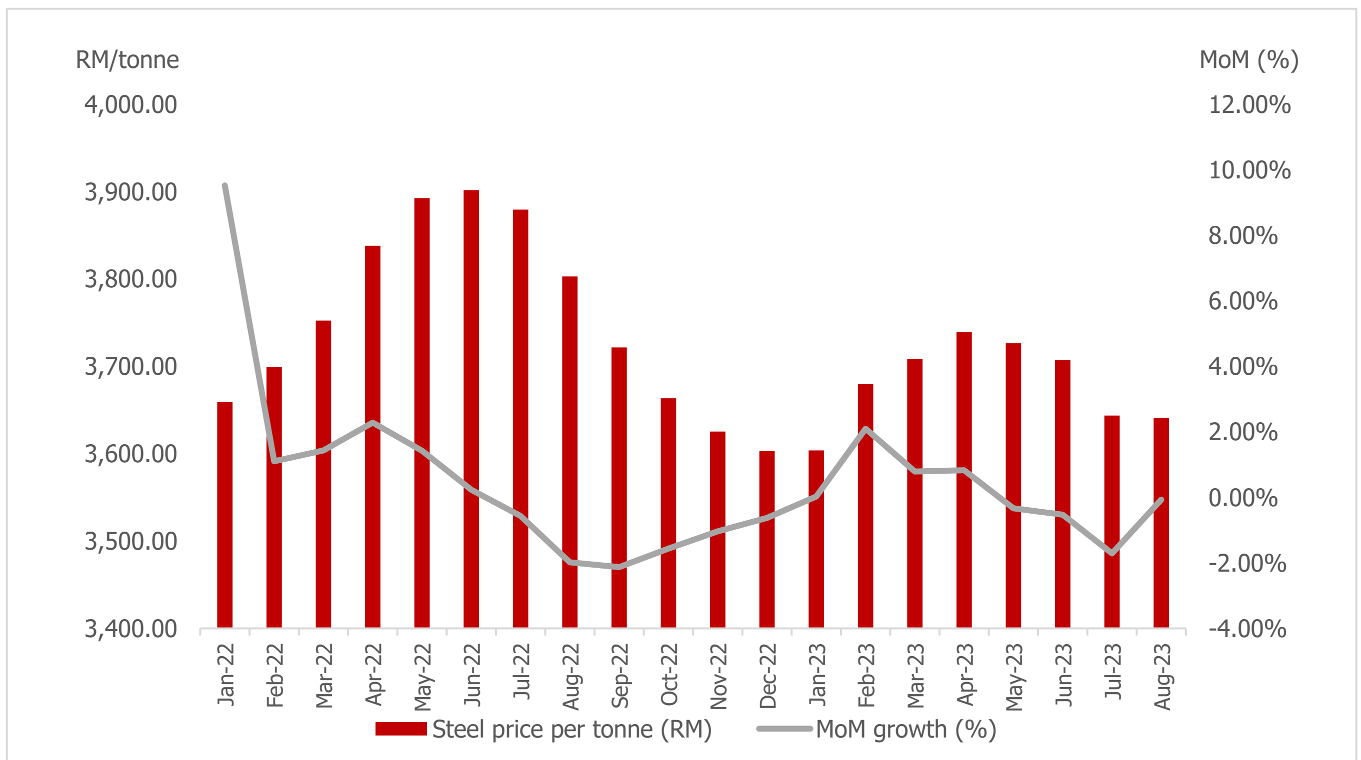
significant impact on most contractors as they would have factored in costs at these levels in their contracts or made prior arrangements to have their clients absorb certain price spikes.

Chart 35: Portland cement average price/50kg



Source: DOSM, MIDFR

Chart 36: Steel bars average price/tonne



Source: DOSM, MIDFR

Maintain POSITIVE. We reiterate our **POSITIVE** view on the construction sector, on the back of the expected improvement in job flows, driven by the initiatives in Budget 2023 and the upcoming Budget 2024. With elections out of the way following the state elections in Aug-23, we can expect more commitment from policymakers in terms of project rollouts, especially crucial infrastructure projects like roads and flood mitigation projects. We are also keeping a close eye on developments in Sarawak, which is set to benefit from developments to improve its connectivity, which is vital as it is one of the main gateways to Nusantara. Our top pick for the sector is **Gamuda (BUY, TP: RM5.38)** for its strong balance sheet and order book and also its successful regionalisation plan, especially in Australia. Other beneficiaries of infrastructure project rollouts are **IJM Corp (BUY, TP: RM2.11)** and **Sunway Construction (BUY, TP: RM2.09)**. We also recommend **Malayan Cement, (BUY, TP: RM4.50)**, being the direct beneficiary of a strong construction sector.

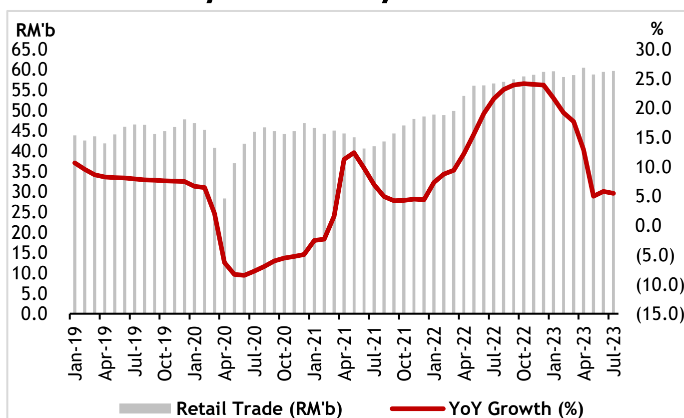
CONSUMER

(Analyst: Genevieve Ng Pei Fen)

Stabilization of Raw Material Costs ....Maintain POSITIVE

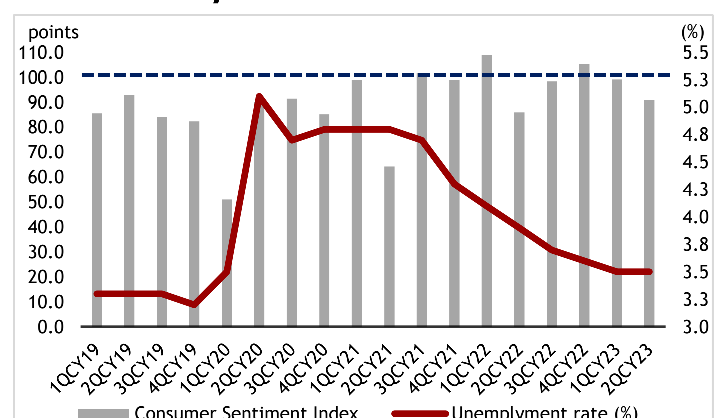
Resilient retail sales outlook for non-specialised and F&B stores. Based on the department of Statistics Malaysia ("DOSM"), retail trade in May, June, and July 2023 continued its single-digit growth, partly attributed to a high base from the previous year. Cumulatively, retail sales surged by +12.1%yoy, reaching RM414.8b in 7MCY23. This was primarily fuelled by consistent double-digit expansions in non-specialised stores, F&B, tobacco, automotive fuel, other goods, and stalls & markets. Looking ahead, we anticipate the resilience of retail trade sales in 4QCY23, with a focus on non-specialised stores and the F&B and tobacco sectors. This was mainly driven by sustained demand for essential products as well as stable job market (unemployment rate remained low at 3.4%). Additionally, we expect the Budget 2024 to continue providing cash assistance and other supportive policies that could enhance the disposable income of the B40 income group, thereby maintaining demand. Moreover, the resurgence of out-of-home consumption and the gradual recovery of tourism activities are expected to further boost retail sales in shopping and F&B. Consequently, non-specialised retailers like **Aeon Co (BUY, TP: RM1.40)** and Family Mart within **QL Resources (BUY, TP: RM6.75)** are poised to benefit from this upward trend. Furthermore, **Padini (BUY, TP: RM4.60)** is also well-positioned to capitalize on the favourable retail trade outlook due to its competitively priced products.

Chart 37: Malaysia's Monthly Retail Trade



Sources: DOSM, MIDFR

Chart 38: Malaysia's Consumer Sentiment Index

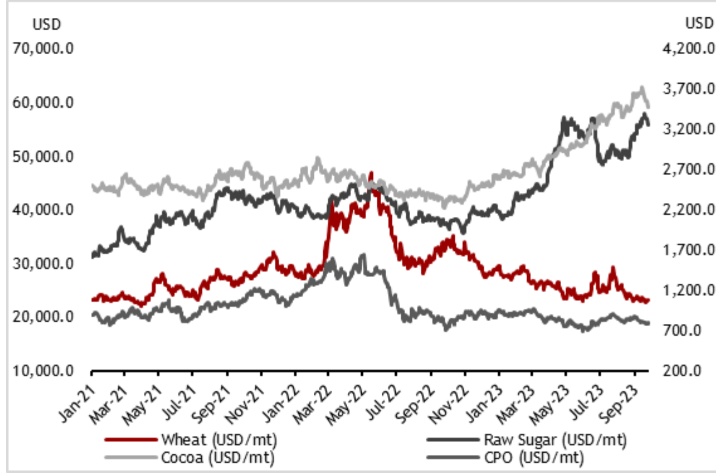


Sources: DOSM, MIER, MIDFR

Downward trend in F&B commodities prices. As of September 26, 2023, the 3-month futures prices for global F&B commodities have predominantly shown a downward trend compared to the end of the previous year. Notably, the prices of wheat (-17.6%ytd), Whole Milk powder (-15.4%ytd), Arabica (-11.1%ytd), CPO (-10.9%ytd), Skimmed Milk Powder (-10.8%ytd), and pet resin (-3.3%ytd) have all experienced declines. Looking ahead, we anticipate a reduction in raw material costs for all F&B products in 4QCY23, driven by the continued decline in most global commodities futures prices. On the other hand, the 3-month future prices for Cocoa (+40%ytd), Raw Sugar (+40.5%ytd), Robusta (+24.9%ytd), and White Sugar (+10.9%ytd) have remained elevated. This can be attributed to the anticipation of limited global supply due to extreme weather conditions in major exporting countries. However, we think that the impact is manageable, given the

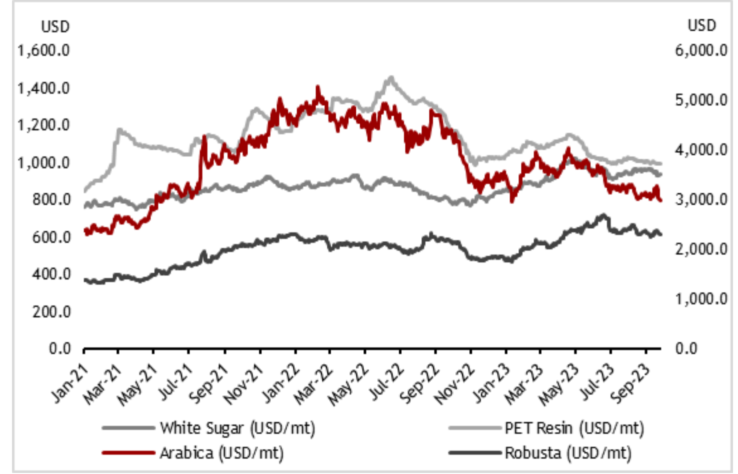
overall downward trend in most commodities prices. Moreover, considering the robust demand for F&B products and their strong household brand recognition, we believe that market players can pass on the increased cost.

Chart 39: Raw Material Price Trend for Wheat, Raw Sugar, Cocoa, CPO



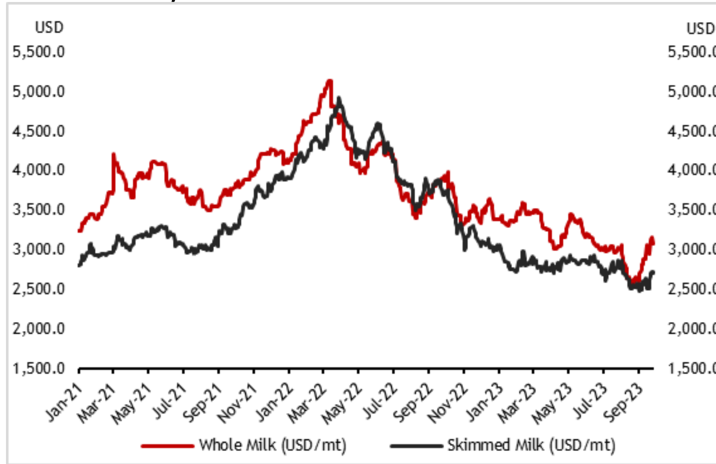
Sources: Bloomberg, MIDFR

Chart 40: Raw Material Price Trend for White Sugar, Pet Resin, Arabica, Robusta



Sources: Bloomberg, MIDFR

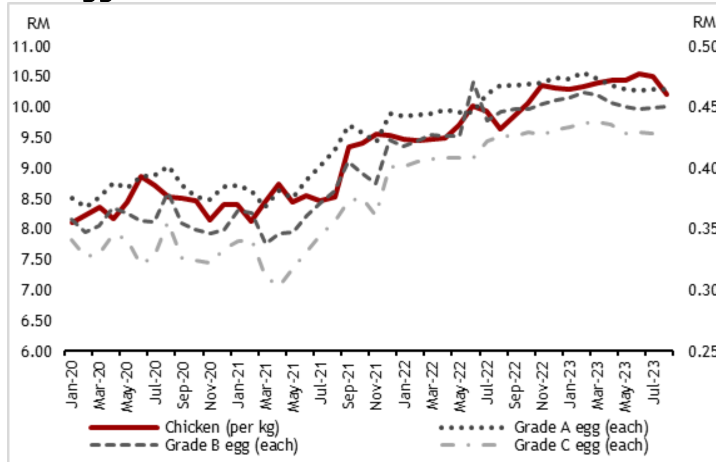
Chart 41: Raw Material Price Trend for Skimmed Milk Powder, Whole Milk Powder



Sources: Bloomberg, MIDFR

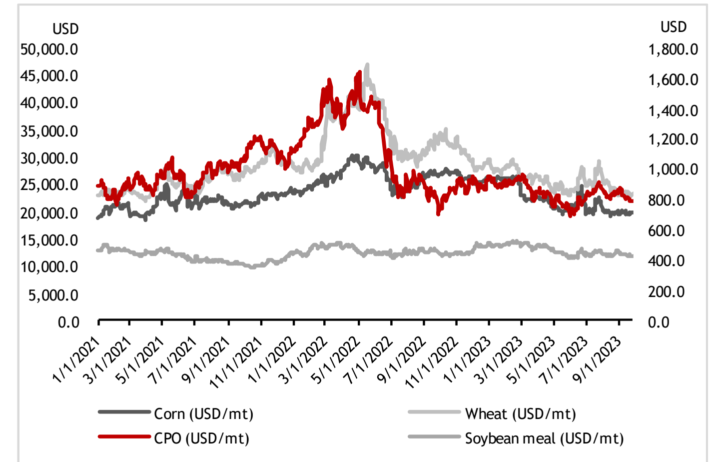
Favourable margin prospects for poultry players. Malaysia's average chicken prices for Aug 2023 stood at RM10.21 per kg, with Grade A, B, and C eggs priced at 0.47sen, 0.45sen, and 0.43sen per egg, respectively. These prices exceeded the government-mandated price ceilings of RM9.40 for chicken and RM0.45 for Grade A eggs, RM0.43 for Grade B eggs, and RM0.41 for Grade C eggs. Based on our channel check, the supply of chicken and eggs in Malaysia has been deemed sufficient due to the import of Grade B eggs from other countries. However, the main factors driving higher average prices for these products are distribution issues leading to inadequate supply in certain states. Additionally, the limited availability of high-quality GPS stock has constrained growth in the industry. On a positive note, the 3-month futures average prices for key chicken feed raw materials, such as corn (-22.5%ytd), soybean meal (-14.5%ytd), CPO (-10.9%ytd), and wheat (-17.6%ytd), have all exhibited a downward trend as of 26 Sept 2023, compared to the end of 2022. Going forward, we are positive that the declining raw material costs for chicken feed, coupled with government subsidies, are expected to bolster profit margins in 4QCY23 despite ongoing price ceilings for chicken and eggs. This positive outlook should particularly benefit companies like **QL Resources (BUY, TP: RM6.75)** and **Leong Hup International (NEUTRAL, TP: RM0.50).**

Chart 42: Malaysia's Average Price Trend for Chicken and Egg



Sources: Bloomberg, MIDFR

Chart 43: Raw Material Price Trend for Chicken Feed



Sources: Bloomberg, MIDFR

Normalization of global commodities prices offset the stronger USD. On 26 September 2023, the USD/MYR stood at RM4.6895 as compared to RM4.4045/USD on 30 December 2022. The stronger USD poses a risk to all F&B and poultry players who source commodities in USD. Nevertheless, we believe the impact will be manageable, considering the recent normalization of global commodity prices for key raw materials. Going forward, our economists anticipate a stronger MYR, with an average exchange rate of USD 1.00: RM 4.48 for 2023, projected to reach USD 1.00: RM 4.30 by the end of the year. Consequently, a stronger MYR is expected to benefit consumer-staple companies, including both F&B and poultry players, as it has the potential to lower their raw material costs. Conversely, export-oriented companies such as **Asia File (Sell, TP: RM 1.50)** and **Rhong Khen International (Neutral, TP: RM 1.35)** may experience lower sales, as a significant portion of its revenue is received in USD.

Favourable outlook for CY24 with slight neutral bias. Moving in CY24, we anticipate a positive outlook consumer staple mainly supported by: (1) resilient demand for necessities, (2) stable job market with consistently low unemployment rate, and (3) positive private consumption forecast by our in-house economists. Nevertheless, we saw the normalization of most commodities for F&B and poultry player which could sustain the margin ahead. However, the potential downside risk for the sector would be the (1) ongoing retail price ceilings for chicken and eggs; (2) potential reversal in global commodities prices due to lower-than-expected production from major exporting countries; (3) potential inclusion of targeted subsidies for petrol in the upcoming Budget 2024, which could raise certain M40 household expenditures, thus possibly reduce retail spending.

Maintain POSITIVE on the consumer sector. Overall, we remain positive about the outlook for consumer sector underpinned by: (1) a defensive play due to the resilient demand for staple-related products, (2) solid domestic consumption backed by stable labour market, robust retail trade, and increased tourism activities, and (3) better profit margins for F&B producers driven by declining global commodities prices and previous price hikes, offsetting other cost pressures. Additionally, the normalizing soybean meal and corn futures prices suggest lower raw material costs for poultry players, further supporting their profit margins. Our top picks continue to be consumer staple-related companies that exhibit resilient demand, such as **QL Resources (BUY, TP: RM6.75),** and **F&N (BUY, TP: RM33.50).** We favour QL Resources, which is supported by consistent demand for marine and livestocks products. We also like F&N because the company is likely to benefit from the rising demand for ready-to-drink beverages, which is being fueled by an increase in tourist traffic.

GLOVE

(Analyst: Genevieve Ng Pei Fen)

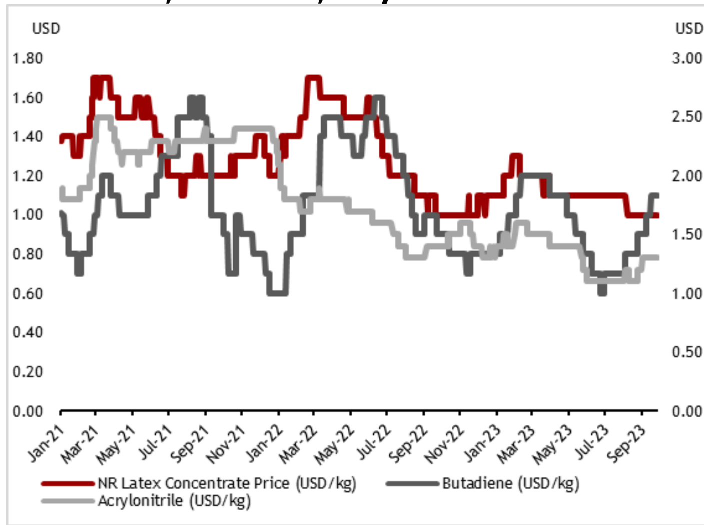
Ongoing Intense Competition and Normalizing Glove Demand.......................................Maintain NEGATIVE

Mixed raw material cost outlook. As of 26 September 2023, the 3-month futures average prices for key glove raw materials, including NR Latex Concentrate (-1.8%ytd), Acrylonitrile (-2.1%ytd), and Butadiene (+26.3%ytd), show a varied

price trend compared to the end of 2022. Note that NR Latex Concentrate is the core raw material for natural rubber gloves, while acrylonitrile and butadiene are the key component for nitrile gloves. Moving forward, we expect price of NR Latex Concentrate to trend downward due to improved supply post the wintering season. Conversely, Acrylonitrile and Butadiene prices may remain volatile due to elevated crude oil prices, potentially leading to higher production costs. Note that Acrylonitrile is derived from crude oil refining, while Butadiene typically comes from the cracking of hydrocarbons in crude oil or natural gas. Therefore, we anticipate slightly higher raw material costs for nitrile gloves in the near term, while natural rubber gloves could potentially benefit from lower NR Latex Concentrate prices.

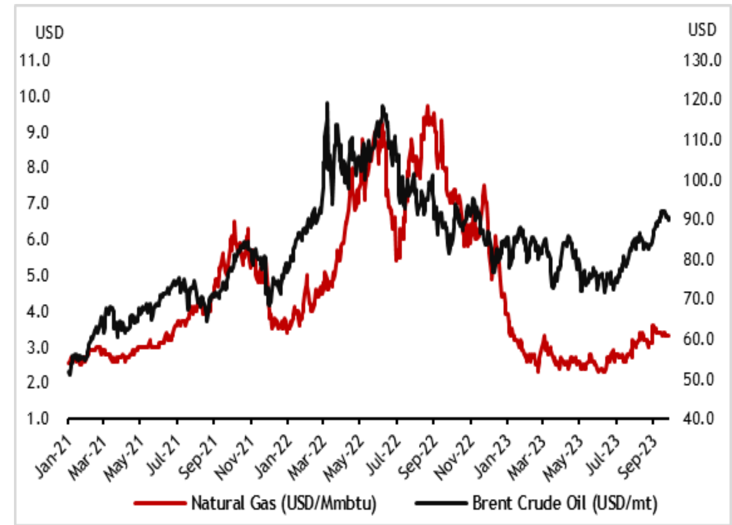
Elevated USD may offset lower natural gas price. The global natural gas futures prices have decreased significantly by -40.9%ytd, reaching USD3.3/mmbtu as of 26 September 2023, compared to the end of 2022. This decrease suggests a potential reduction in natural gas tariffs for 1QCY24, given the usual six-month lag in reflecting lower global natural gas futures prices. However, this expected lower natural gas tariff may be counteracted by the strengthening USD/MYR exchange rate. Note that local natural gas tariffs are determined by a combination of global natural gas prices, currency exchange rates, and other associated expenses. Moving forward, we anticipate an upward trajectory in global natural gas prices, considering the positive correlation between natural gas prices and crude oil, and with global crude oil prices remaining elevated at above USD80 per barrel. As such, we remain cautious about the near-term production costs for gloves due to the higher USD/MYR exchange rate and the expectation of elevated natural gas prices, given the surge in global crude oil prices. This impact could be significant since natural gas accounts for approximately 20-25% of operational costs.

Chart 44: Raw Material Price Trend for NR Latex concentrate, Butadiene, Acrylonitrile



Sources: Bloomberg, MIDFR

Chart 45: Price Trend for Natural Gas, and Brent Crude Oil



Sources: Bloomberg, MIDFR

Global glove demand remains lacklustre in 4QCY23. Based on our channel checks, buyers continue to place smaller orders for gloves, attributed to short delivery times and excess stock accumulated during the pandemic period. Looking ahead, we anticipate this trend to persist in 4QCY23 as customers continue ordering conservatively amidst the normalization of glove demand, driven by most countries transitioning into the endemic phase post-border reopening, which could further limit demand. While we expect a gradual resurgence in customer orders starting in 1QCY24 following the depletion or expiration of some old inventory purchased during the pandemic period, we remain cautious about the ability of local glovemakers to capture sufficient orders to break even. This caution arises from the intense competition posed by China's glovemakers, who have a cost advantage and offer significantly lower average selling prices (ASPs) to capture market share. Recall that China's glovemakers maintain an average utilization rate of over 90%, while Malaysian glovemakers' utilization rate remains below 40%.

ASP compression and market dynamic. We gather that several Malaysian glovemakers attempted to increase ASP as part of its cost-passing efforts, but these attempts were unsuccessful, leading to a substantial drop in sales volume. This

decline in sales volume is evident in the utilization rates, with Chinese glovemakers achieving rates of more than 90%, while the industry average in Malaysia remains below 40%. However, Chinese glovemakers' intense competition, characterized by offering significantly lower ASPs to secure market share, will continue to exert pressure on local players to carefully consider passing on increased costs. Nonetheless, the expectation of lower natural gas tariffs for 4QCY23 could signal some relief in production costs. Therefore, we view that local players should prioritize cost efficiency over increasing ASPs to narrow the price gap with China's glovemakers and secure orders from customers.

Benefiting from stronger MYR. The recent appreciation of the USD/MYR exchange rate signals a stronger USD, and our economists project an average USD/MYR rate of USD1.00: RM4.48 for CY23. This boost in the USD is set to favour all glovemakers within our coverage, given that its revenues are denominated in USD. However, this gain will be partially mitigated by the increasing costs of raw materials and natural gas, which are purchased in USD.

Subdued outlook for 2024. In 2024, we maintain a cautious stance on glove sector with a slight neutral bias. We foresee a gradual recovery in global glove demand following the depletion or expiration of inventory purchased during the pandemic. However, we are wary of local glovemakers' ability to secure orders from Chinese glovemakers, given the aggressive pricing strategies of the China's manufacturers. This, along with local glovemakers' attempt to raise ASP to cover rising costs, may widen the price gap with competitors, causing customers to switch to cheaper suppliers. Additionally, we foresee an upward trend in natural gas tariffs and raw material costs for nitrile gloves in 2024, driven by elevated crude oil prices.

Maintain NEGATIVE on the sector. We remain cautious about the outlook in 4QCY23 due to ongoing intense competition and normalizing glove demand, leading to a continuous surplus. As such, we are now expecting companies to experience losses for the next 2 quarters before reaching a break-even point due to the continuous margin compression and oversupply situation. Thus, we maintain **NEGATIVE** on gloves sector in the near term.

OIL & GAS

(Analyst: MIDF Research Team)

Crude Oil Price Gaining Traction Again Amidst Tighter Supply.. Maintain POSITIVE

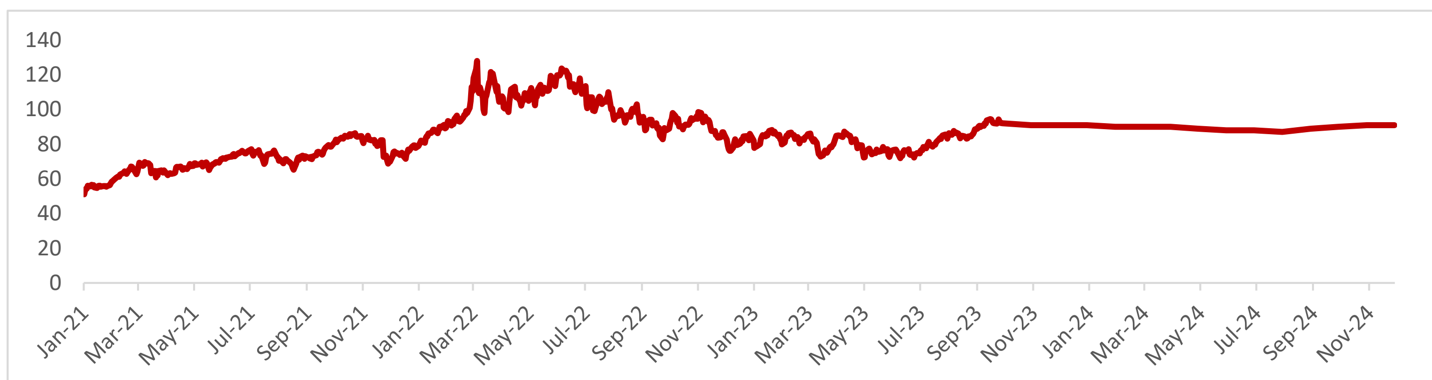
Brent Crude rising again, average expected USD92pb in 4QCY23. Saudi Arabia's recent announcement to continue its voluntary crude oil production cut of 1 mbpd to the end of the CY23, as well as Russia's production cut of 300,000bpd in a similar timeline. Additionally, Russia recently banned its export of gasoline and diesel in a bid to stabilize its domestic pump prices. However, this may prove to only affect the price temporarily. Global inventories are expected to fall by approximately 200,000bpd to 250,000bpd in 4QCY23 based on the extension of this production cut. We expect the Brent crude oil price to average at USD92pb in 4QCY23, and average at USD83-86pb in CY23. As of writing, YTD average for Brent crude is USD84pb.

But China's slow recovery and El Nino may put a lid on oil prices. Aside from the Saudi Arabia production cuts and Russian export bans, a possible factor that we believe could put a lid on the crude prices is the continuously slow recovery of China's oil demand in CY23. We believe China's Another significant factor is an El Nino winter. El Nino has a profound impact on the weather in the Northern Hemisphere, causing a warmer winter which could decrease demand for petroleum products for the usage of heat generation. However, El Nino is also known for its influence on frequent storms in winter, and this would affect shipping routes and offshore exploration activities, and subsequently tighten the oil and gas supply further.

LNG regional stocks on a high in preparation for winter, lowering near-term demand. Despite El Nino's impact on a possibly warmer winter, regional LNG stocks are expected to rise, especially in East Asia, in preparation for the season after stocks plunged due to the prolonged heat in CY23's summer. Spot cargoes had been bought to secure fuel for heat and power generation, making near future demands to be on a slight decline. Additionally, global LNG supply is expected to remain tight until CY25, on the basis of Russia's continued sanctions and green energy policies in Europe. This is in spite of the growing LNG import facilities mushrooming in Europe and Asia. In 4QCY23, we expect that LNG trade to remain overall robust, but demand may not climb any quicker after the surge in gas prices earlier this year still stemmed worries in LNG price volatility, as well as China's slow demand for LNG in 1HCY23 that could further dampen gas demand in the

near future. As of writing, regional LNG has averaged at YTD of USD14pMMBtu, lower by -59% from CY22's yearly average.

Chart 46: Brent Crude Oil (4QCY23 Forecast)



Source: Bloomberg, MIDFR

We opine that this twist of events for the last leg of CY23 will slightly change our outlook for the sector in our local front, especially with the launching of the National Energy Transition Roadmap (NETR) and New Industrial Masterplan (NIMP) 2030 in 3QCY23, for 4QCY23 and ultimately for CY24. Below are our views on what to expect in 4QCY23:

UPSTREAM

Continuous nurture of OGSE services. With Brent crude price going above USD90pb and the expected incline in natural gas prices, we believe the upstream would remain robust. Oil and Gas Services and Equipment (OGSE) companies are expected to benefit on exploration and production (E&P) projects, of both older projects and those in the discovery stages. With PETRONAS's recent discovery of 6 potential gas fields, as well as the Carbon Capture and Storage (CCS) projects in Kasawari, Lang Lebah and BIGST fields, we opine that the upstream division will continue to see more activities in the upcoming quarter. With energy transition on its forefront, we anticipate more investments in the upstream, for not only to add in revenue for energy transition, but also to increase the discoveries of better and more efficient technology to fulfil aspirations of a net-zero carbon future. However, do note that E&P projects lasted at a minimum of 2-3 years, hence investments in this division would only be feasible on a longer term.

MIDSTREAM

A surge incoming for tanker rates? Baltic Tanker Rates for both crude oil (dirty) and petroleum products (clean) had been volatile since early this year, due to Brent crude prices going as low as USD72pb as well as a poor petroleum product demand especially from China in 1HCY23. However, with crude price's uptrend, and the gradual increase in demand for petroleum products due to customer sentiments and replenishment of stock inventories, tanker rates might just be poised for an increase as well. For 4QCY23, we are expecting an upward pressure in demand for tanker shipping, as producers and traders will seek to transport more to take advantage of the higher prices. In addition, the recent banning of Russian petroleum products export in Europe would fuel for more tankers in the affected region, consequently pushing the shipping rates further.

For our local front, we opine that companies in the tanker business would benefit from the higher shipping rates. Market sentiment could shift among traders to secure tankers and tanker capacity faster, as the sense of urgency to lock in the transportation cost and capacity mounted. Nevertheless, we don't expect the rates to overshoot in 4QCY23, in consideration of the slow economic conditions, continuous geopolitical tensions, and weather-related disruptions. Additionally, the upcoming winter season would also increase demand for more movement in oil and gas transportation, but dockyard operators for maintenances and retrofits may see a decline in docking rates as carriers and tankers would most likely dock in their destination ports during this season.

DOWNSTREAM

Petrochemical on a solemn uptrend, but fears remain on pump prices. Petrochemical had been performing on a slower pace in 1HCY23, partially due to the lower Brent crude oil, as well as lower than expected demand over business-as-usual supply that tipped the supply-demand balance. With Brent crude oil now ranging USD90-95pb, petrochemical firms are expected We also observe several drivers that could trend in 4QCY23, which includes the growing consumption of plastic and increased in manufacturing activities and infrastructure development. Nevertheless, key challenges remain, such as the volatile macroeconomic environment, independency of imported feedstock, higher input costs and low investments in specialty chemicals. As for petroleum products, such as gasoline, diesel and jet fuel, we anticipate that the demand for such would increase in tandem with the increase in land transport frequency and travelling activities post-pandemic. However, prior to the tabling of Budget 2024, the risk of a targeted fuel subsidy from the effects of a higher Brent crude oil price remain in the decks.

ADDITIONAL: Energy Transition

Baby steps to fulfil NETR aspirations. Energy transition had been a hot topic within the oil and gas sector in the global scene since the oil crisis in 1973. With the launching of the National Energy Transition Roadmap (NETR), Malaysia is set to introduce several policies and projects for the future of energy security and the reduction of carbon emissions by 2050. From the oil and gas perspective, decarbonization has been the key initiative under NETR, and through the expertise of the oil and gas players, the sector will be stewarding CCS projects. Meanwhile, for energy security, hydrogen had become a sought-after alternative fuel as the governments around the world had initiated subsidies for hydrogen, which, as of current, amounted up to USD280m in CY23. However, it should be noted that energy transition still posed challenges in terms of: (i) high infrastructure and operational cost, (ii) basic regulatory framework, and (iii) small talent and skilled pool. While NETR had detailed most of its initiatives for energy transition in Malaysia, many are still on the regulation and partnership stages. Nonetheless, we believe the risks can be mitigated and we also expect the challenges are addressed and solutions are identified within 4QCY23.

CY24 OUTLOOK

Brent Crude to stay elevated despite demand uncertainty. With Saudi Arabia and Russia cutting production until the end of the year, Brent crude oil price is expected to remain elevated in CY24. Tight supply amid higher demand recovery expected would continue to keep prices above USD90pb in CY24. However, we are also expecting global oil inventories to gain at least in 2HCY24, and geopolitical tensions in Europe to ease. Hence our expected average Brent price remained in the range of USD84-86pb in CY24. For the upstream, OGSE are expected to perform, most notably in FPSOs as production is expected to gain momentum in South America and in SE Asia. Similarly, tanker rates are expected to increase in consideration of replenishing crude inventories and Russia's continuous sanctions on its petroleum products. Conversely, fuel oil and gas are faced with the risk of higher prices and higher refinery cost, coupled with inflationary pressures, which could affect the government's fuel subsidy policy, and subsequently the end consumers. Nevertheless, we are expecting petrochemicals to see improvements in CY24, on the strength of a more stable demand-supply balance, as well as the increasing prominence of specialty chemicals for other critical industries such as agriculture, food and beverages, animal feed and pharmaceuticals.

Maintain POSITIVE with caution on demand. All in all, we reiterate our positive stance with the oil and gas sector. However, we maintain cautious on the demand for crude oil and petroleum products. While supply will continue on its tightening streak, the major trend to look out for in 4QCY23-CY24 is the volatility of demand. Key drivers to the upside of demand include, but not limited to: (i) robust economic growth, (ii) improvement in tanker fleet technology, (iii) increased industrial activities, (iv) stable geopolitics and strong government policies, (v) growing of energy intensive industries, and (vi) undisrupted supply chain.

Our **TOP PICKS** for the sector in 4QCY23 are **MISC (BUY, TP:RM8.16)** and **Dialog (BUY, TP:RM3.28).** We like MISC for its involvement in the Kasawari CCUS Project in offshore Sarawak, through its subsidiary Malaysia Marine and Heavy Engineering (MMHE). Additionally, MISC has the capacity to be involved in the transportation of both hydrogen and CO2, given its expertise in marine and transportation subsectors. These could not only aid in the realization of the NETR goals, but also to ensure a continuous revenue stream for OGSE companies out of the usual upstream activities. We also like

Dialog for its diverse portfolio and resilient balance sheet, across all divisions of the sector. Its recent involvement in specialty chemicals showcase its initiatives to not only add in more value into their operations, but also to ensure a safer and sustainable petrochemical industry.

HEALTHCARE

(Analyst: MIDF Research Team)

To See Boost in Demand……………………………………………………………………………… Maintain POSITIVE

Healthcare Providers to see a boost in service demands. The healthcare sector had seen more stability since the diminished effect of Covid-19 on the system, globally and locally. Since the end of the pandemic, demand for healthcare services for non-communicable diseases (NCDs) and rare diseases had been on the rise, placing bed occupancy rate and inpatient visits back to pre-pandemic levels, if not more. Additionally, the reopening of borders for travelers had increase the potentiality of medical tourism to take proper flight within the regional and local healthcare scene. The inclining demand is in line with the growing aging population, which, according to the World Health Organization, will consist of 22% of the world's population by 2050. The pace of aging population had been growing faster than pre-pandemic times, with 80% of older people are expected to belong from the low- and middle-income groups. All things considered, we believe our healthcare service providers, both public and private, are on the right trajectory in 4QCY23. However, risks remain on worker shortages and higher operational costs for certain treatments and surgeries.

Pharmaceuticals and medical devices on higher cost risk. While we are positive that the sector will continue to see a strong influx of patients in the upcoming quarter, pharmaceuticals and medical equipment may see a risk in higher production cost. With Covid-19 no longer a threat, vaccines had been lowering in demand and pharmaceutical companies are not able to profit from vaccine distribution. Additionally, the manufacturing of medicinal products faced inflationary pressure from rising median prices of feedstock for new drugs as well as increasing prices of existing drugs. Additionally, many feedstock chemicals are still imported, adding to the cost of manufacturing. Meanwhile, medical devices may see issues production-wise in the near term, due to the strict competition for semiconductors and electronic components, for the production of new devices and the maintenance of existing equipment. Nevertheless, the government had been actively improving the pharmaceutical and medical equipment subindustries, with emphasis on affordability and access to the products. We believe with the help of the Ministry of Health, along with the private healthcare sector, the risk of higher operational and manufacturing cost can be mitigated.

FY24 OUTLOOK

Ahead of the tabling of Budget 2024, we believe healthcare would be one of the main focus by the government under the initiatives for the betterment of the Malaysian people. As such, we are expecting an elevated capital expenditure for the healthcare sector, most notably for NCDs, geriatrics and rare diseases care. With the increasing demand expected in tandem with the uptrend of aging population, we are expecting more hospitals to be build and more existing facilities and equipment to be maintained. For pharmaceuticals, Covid-19 vaccines are expected to be redundant and companies still keeping stock of the vaccine are expected to deplete its supply by the end of the year. In the uptrend of AI technology and big data, medical devices are expected to be the centrepoint in pivoting healthcare services for the better in CY24. Nevertheless, challenges still remain on medical worker shortages, lack of maintenance on equipment and facilities, and poor access to healthcare providers and healthcare financing.

Maintain POSITIVE. Healthcare had been a stable sector, despite being in the rough post-pandemic due to the lack of inpatient visits for NCDs and the utilization of facilities for Covid-19 patients. However, as domestic and international borders are now open, patient influx into hospitals and clinics had increased in tandem to the increase in the rate of comorbid diseases as well as the growing awareness for healthcare services post-pandemic. However, the cost of services, medication and maintenance of equipment remain the key issue within the sector; one that we believe can be mitigated through public-private partnerships and government incentives and subsidies.

Our **TOP PICK** remain to be **IHH HEALTHCARE (BUY, TP:RM7.12).** We like IHH for its vast network of hospitals and medical experts that ranged across several countries. IHH's facilities are well equipped to cater for the aging population and the demand for services from local and international patients.

PLANTATION *(Analyst: MIDF Research Team)*

Demand Has Reached Pre-Pandemic Level………………………………………………………………Maintain NEUTRAL

CPO price to be stagnant in the remaining of the month. Jumping into 4QCY23, we anticipate that Indonesia's supply distortion (due to El-Nino environments) would contain the CPO price movement, to an average of USD800-900/tonnes in October to December for the major producer country. In Malaysia, the volatility behind CPO price will likely persist, in confluence of rebound in local output, higher closing stocks, continued demand from major importing countries as well as strengthening ringgit, bringing the CPO price to average of RM4,061 (+9.8%qoq), in our view. On the external front, we've seen the CPO price traded in reversal mode against Soybean, lowered by USD17.7/Mt to USD860.8/Mt, with discount vis-à-vis SBO price widened to USD265.7/Mt (+3.3%mom) in August, however year-to-date price have weaken to USD204.5/Mt (-25.3%Ytd) following formidable market share competition against soybean oil, due volatility of US soybean supply particularly, where lower soybean yields were seen in Illinois, Nebraska, Kansas, Minnesota, Louisiana, and Wisconsin, partially offset by forecasts for higher yields in Ohio, Kentucky, and South Dakota. Nonetheless, the Brazil export remains steadfast, well supported by the large 2023 crop development.

Production recovery continues. Based on MPOB data, we have seen Malaysia production recovery is on track, as August data showed that production improved to 1.75m tonnes (+8.9%mom; +1.6%yoy; -1.1%Ytd) versus 1.73m tonnes in prior year supported by contribution from most of the states except for Kedah (-13.9%yoy), Pahang (-6.4%yoy) and Negeri Sembilan (-4.7%yoy), due to incompetency of newly hired foreign workers. Additionally, the nation's average FFB yield inched by +3.4%yoy to 1.5 tonnes/ha in line with steady production levels eastern states which roughly ups by +4.5%yoy, while OER remained supportive at 19.92% due to better evacuation activities in the said month. We anticipate production to be volatile for the 4QCY23 on combination end of high peak crop months coupled with better estate activities starting in October as there will be fewer wet days and most states in Peninsular Malaysia are expected to receive rainfall at an average level which is from 150mm to 400mm (end of Southwest monsoon), according to MET Malaysia.

Subdued import from major importing countries. On year-to-date basis, total PO export volume to major importing countries were slower to 5.7m tonnes (-6.3%Ytd), while value wise tumbled by -37.6%yoy to RM21.77b due significant weaker demand from India c. RM6.94b (-38.8%yoy), China c. RM2.88b (-33.7%yoy) and Turkiye c. RM2.42b (-28.3%yoy) respectively, on the back of price effects (Table 2). The closing stocks level on the other hand, remained robust, grew by double digit growth for India (+102.8%ytd), China (+139.2%ytd) and Pakistan (+62.1%ytd) respectively. When compared to 2018, India and China's closing stocks have now risen to pre-pandemic levels of 4.2m tonnes and 5.8m tonnes, respectively, while Pakistan's stocks have increased to 2.7m tonnes. Moving to the next quarter, we anticipate demand to pick up in the selected four-season nations that hold some weight (based on CY22 total trade), such as Turkiye (8.4%), Pakistan (5.8%) Japan (5.8%) and China (29,6%), from mid-October as consumers prepare for Winter and the CNY festival.

Table 9: Export to major importing countries by volume (Mt)

Country	8MCY2023	8MCY2022	Chg (%)
India	1,809,125	1,885,648	-4.1%
China	847,682	748,825	13.2%
Turkiye	601,237	595,760	0.9%
Kenya	566,220	521,968	8.5%
Japan	367,471	358,542	2.5%
Netherlands	341,932	555,452	-38.4%
Pakistan	328,838	324,796	1.2%
South Korea	319,905	283,410	12.9%
Philippines	270,762	475,607	-43.1%
Saudi Arabia	265,205	352,310	-24.7%
Total	**5,718,377**	**6,102,318**	**-6.3%**

Source: MPOB, MIDFR

Table 10: Export to major importing countries by value (RM'm)

Country	8MCY2023	8MCY2022	Chg (%)
India	6,944	11,344	-38.8%
China	2,877	4,343	-33.7%
Turkiye	2,417	3,368	-28.3%
Kenya	2,109	2,929	-28.0%
Japan	1,599	1,951	-18.1%
Netherlands	1,374	2,937	-53.2%
Pakistan	1,324	1,790	-26.0%
South Korea	978	1,216	-19.6%
Philippines	1,093	2,886	-62.1%
Saudi Arabia	1,058	2,110	-49.8%
Total	**21,772**	**34,872**	**-37.6%**

Source: MPOB, MIDFR

Fertiliser prices normalizing. We are seeing the energy crisis across European have dissipated, as the fall in natural gas prices decelerated to the average of USD13.2/mmbtu (-66. 5%Ytd) in 8MCY23, following the import of LNG replaced some supplies in last 2HCY2022, signalling the end of the energy crisis in Europe. This is significant since natural gas traditionally accounts 50-60% of fertilisers cost of production. We think that this would successfully shift the reliance on Russia to a long-term basis and reduce the risk for chemical companies in European nations in Bulgaria, Slovakia, Germany, Italy, and Poland, where the percentage of their imports from Russia used to be 77%, 70%, 49%, 46%, and 40%, respectively.

As a result, the price of NPK fertiliser may soon return to normal since fertilisers price index have fallen to 157.6 pts (-31.4%yoy) and its input costs including urea, DAP (18% Nitrogen & 46% Phosphorus), and potassium chloride have stabilised, to USD345.6/Mt (-53.7%Ytd), USD554.8/Mt (-31.7%Ytd), and USD407.6/Mt (-58.9%Ytd) respectively. Therefore, most of the planters will incur pretty much lower operational expenses started in 2HCY23 and ahead, as the typical industry practise is for fertiliser stocks to be locked in 6-12 months in advance. As to-date, we observe average planter's production cost approximately RM2,800-RM3,200Mt, in which there still some margin that can be fetch in our view.

Maintain NEUTRAL. We opine sector's top-line to continue consolidate in the 4QCY23 as opposed prior year in-line with average CPO price assumptions of RM3,800/Mt. However, margin will be taper by the downstream segment caused by lower demand in palm oil-based products in view of tight spending environments. We keep our **NEUTRAL** call as it seems EL-Nino affects were mitigated by the uneven monsoon seasons; hence, we recommend investors to be more selective on stock selection and frontload stock's fundamental facing the volatility in this 4QCY23. We prefer **KLK (BUY, TP: RM24.60)** and **IOI Corp (BUY, TP: RM4.45)**.

POWER *(Analyst: Hafriz Hezry)*

Riding On the Energy Transition……………………………………………………………………………Maintain POSITIVE

Driven by strong policy support. A firm policy layout to drive an energy transition under the National Energy Transition Roadmap (NETR) is expected to provide a strong, multi-year catalyst for the power utilities sector. One of the overarching goals of NETR is a 70% RE capacity mix target by 2050, a significant increase from 23% in 2020. An average 2.2GW per annum RE capacity addition is required between 2025 till 2050, a significant jump from the estimated 0.5GW per annum RE build-up rate currently. Ultimately, some 68GW RE capacity is targeted to be installed by 2050 where solar PV will be a key driver accounting for 83% of the targeted 2050 RE capacity. The RE ambitions under NETR is already kickstarted with several flagship RE projects namely: (1) A 1GW hybrid solar plant with an integrated RRE industrial park spearheaded by UEM Group and Itramas Corporation, (2) Five centralized large scale solar (LSS) parks totaling 500MW capacity spearheaded by Tenaga (3) A 2.5GW hybrid hydro floating solar project also spearheaded by Tenaga utilizing its Kenyir and Sungai Perak hydro facilities (4) A 4.5MW residential rooftop solar project spearheaded by Sime Darby Properties. Importantly, significant grid investment is required to accommodate the higher variable RE penetration, which will see Tenaga's grid capex doubling to RM90b in 2025-30 from RM45b between 2018-2024. A third-party access (TPA) to the grid is also in the works, which we believe will drive growth of market-driven corporate PPAs.

Expecting further measures to drive rooftop solar adoption. In an effort to drive rooftop solar adoption, the government had in July relaxed conditions for the Net Energy Metering (NEM) and Self-Consumption (SELCO) for solar PV programs by: (1) Increasing allowable capacity to 85% of consumption from 75% previously for both NEM and SELCO, (2) Allowing participation of high voltage consumers in the SELCO program. We believe these, coupled with the electricity subsidy rollback for non-domestic and high-consumption domestic consumers, will encourage further solar PV adoption in order to reduce electricity cost. We anticipate further supportive policies to drive rooftop solar adoption, which includes a rooftop leasing mechanism to incentivize property owners to lease out their rooftop space for utilisation by independent solar developers for power generation. We also anticipate renewal of the current NEM program which is reaching expiry by end-2023. Some 1.05GW quota was allocated for the NEM program between 2021-2023 of which almost 70% has been taken up.

Capitalising on regional demand. Another potential sector catalyst is RE exports, which will allow domestic players to capitalize on regional demand at premium tariffs, especially from Singapore which is looking to import up to 4GW of clean

electricity by 2035. An RE exchange and the related regulations are expected to be established by year-end to enable cross-border RE trading. The exchange will be operated by a single market aggregator and will essentially function as a wholesale RE market. Players are expected to sell RE generation to this exchange, which in turn will manage the export to neighbouring countries, allowing monetization of excess power through bi- or multi-lateral power trading arrangements and providing an efficient price discovery mechanism. It is envisioned that this RE exchange will eventually function as regional energy exchange hub, taking advantage of Malaysia's location in the centre of ASEAN. The cross-border RE trading might also necessitate new or upgrade of existing interconnections with neighbouring countries.

Easing fuel prices. Separately, coal price has now eased to around USD157/MT, less than half of peak levels of USD464/MT seen in 3QCY22, albeit still well higher than pre-pandemic levels and RP3 projected coal price of USD79/MT - coal makes up 56% of Malaysia's generation mix. The lower coal price is positive for Tenaga, as it should reduce the group's fuel cost under-recovery, which had been an overhang as the previously elevated fuel prices drove significant under-recovery leading to starkly higher working capital requirement and interest cost. Additionally, the recent ICPT decision in December 2022 and June 2023 was positive, with the government allowing an ICPT pass-through of the entire ICPT receivables at Tenaga via a mix of government subsidy and a sharp increase in ICPT surcharge for medium-to-high voltage non-domestic consumers. In line with the higher ICPT collection and easing fuel prices, we expect both Tenaga's ICPT receivables and underlying fuel cost under-recovery in the 1HFY23 period to ease, reducing the strain on cash flows and allowing retirement of some short-term debt undertaken previously to fund the elevated fuel cost.

Recommendation. We remain **POSITIVE** on the power utilities sector on the back of a clear and firm policy layout on the energy transition under NETR, which we believe should drive a sector re-rating on improved growth and ESG profile. **Tenaga (BUY, TP: RM11.00)** is a key beneficiary in the asset ownership space from both RE capacity expansion and grid upgrade investments. We believe the big movers in the immediate-term will come from its upcoming 500MW solar park project and 2.5GW hybrid hydro-floating solar projects under NETR Phase 1. Meanwhile, the upcoming RP4 review should underpin the expansion in Tenaga's grid capex and RAB, in our opinion. Other potential beneficiaries of NETR in the asset ownership space are **YTL Power (BUY, TP: RM2.45)** and **Ranhill Utilities (BUY, TP: RM0.80)**. The RE EPCC sub-sector is also a big beneficiary of NETR given massive potential for orderbook expansion – our picks in this space are **Samaiden (BUY, TP: RM1.54)**, **Sunview (BUY, TP: RM1.48)** and **Pekat (BUY, TP: RM0.63)**

PROPERTY

(Analyst: Jessica Low Jze Tieng)

Better Outlook Ahead...Maintain POSITIVE

Residential overhang at lowest level since 2Q2018. According to data released by National Property Information Centre (NAPIC), residential overhang declined to 26,286 units in 2QCY23 from 26,872 units in 1QCY23. Note that residential overhang surged to peak of 36,863 units in 4QCY21 due to Covid-19 pandemic and started to decline since 1QCY22. Residential overhang declined for sixth consecutive quarters in 2QCY23 and is at lowest level since 2QCY18. The residential overhang in 2QCY23 is below 3-year average of 31,000 units. The decline in residential overhang was due to renewed buying interest on property after reopening of Malaysia's international borders.

Improving residential overhang in Johor. Residential overhang in Johor declined for fourth consecutive quarter in 2QCY23 to 4,717 units from 4,759 units in 1QCY23 and 6,040 units in 2QCY22. Note that residential overhang spiked to above 7,000 units in 4QCY20 due to Covid-19 pandemic and that sparked the concern of residential oversupply in Johor. Residential overhang in Johor is improving as total overhang units of 4,717 units in 2QCY23 is well below 3-year average of 5,947 units. Johor Bahru in Johor contributed to the highest number of residential overhangs at 3,597 units which were largely made up by condominium/apartment.

Lower inventory level of property companies. The declining residential overhang in Malaysia is in line with the lower inventory level of property companies as property companies had been actively monetize inventories in the past few years. The inventory monetization is to generate cash flows amid challenging operating environment due to Covid-19 pandemic. Notably, inventories of Eco World Development fell significantly by 58% in 2QCY23 since 2019. Similarly, Mah Sing Group, S P Setia and Glomac saw double digit decline in inventory. We think that the declining inventory level of property

companies would improve financial position of property companies and give better pricing power to property companies in term of new launches going forward.

Unchanged OPR a boon to sector. Bank Negara Malaysia (BNM) kept OPR unchanged at 3% in July and September 2023 meeting. Unchanged OPR is positive to the sector as that will keep buying interest on property supported. Recall that property market was hit by four consecutive OPR hikes in 2022 which dampened buying sentiment on properties. We estimate that every 25bps increase in interest rate to increase monthly instalment by RM60-RM70 for house loan of RM500k. Looking ahead, our in-house economist forecasts that OPR to remain unchanged for the rest of this year which is positive to property sector. We think that the unchanged OPR should bode well for recovery in demand for property for the rest of 2023 and 2024.

Maintain POSITIVE on property sector. We maintain our **POSITIVE** stance on property sector due to improving outlook for property sector amid downtrend in property overhang and inventory level of property companies. Besides, unchanged OPR is positive to property companies as that supports recovery in demand for property. Our top picks for the sector are **Mah Sing Group (BUY, TP: RM1.01) and Matrix Concepts (BUY, TP: RM1.86)** as we remain sanguine on property developers that focus on mid-market and affordable segment amid resilient demand for affordable homes. We also like **S P Setia (BUY, TP: RM1.25), Glomac Berhad (BUY, TP: RM0.47) and IOI Properties Group (BUY, TP: RM1.94)** as their valuation remains undemanding.

REITS

(Analyst: Jessica Low Jze Tieng)

Stable and Defensive .... Maintain POSITIVE

MGS yield remains favourable to REIT. The 10-year Malaysian Government Securities (MGS) yields hovered below 4% in September 2023. This follows Bank Negara Malaysia's (BNM) decision to keep OPR unchanged at 3% in July 2023 and September 2023. The low MGS yield is favourable to REIT as spread between 10-year MGS yield and REIT remains wide at around 140bps and makes REIT remains attractive for investors who seek for yield.

Year-end shopping spree to spur retail REIT. Most of the retail REIT reported higher earnings in 1HCY23 due to positive rental reversion and higher shopper footfall. Looking forward, we see that shopper footfall and tenant sales to be stronger in 4QCY23 due to year-end shopping spree. Besides, we see that shopper footfall to be supported by higher tourist arrival. In a nutshell, we see that retail REIT with malls in prime location namely IGB REIT, Pavilion REIT, KLCCP Stapled Group and Sunway REIT to see stronger earnings contribution from retail division in 4QCY23.

Year-end holiday season bodes well for recovery of hotel industry. Hotel industry is expected to perform better in 4QCY23 due to year-end holiday season. Average room rate and occupancy rates are expected to trend upwards towards the fourth quarter as people travels and as Malaysia sees higher tourist arrivals. Besides, revenue from F&B will also support recovery of hotel industry. In a nutshell, tourist arrivals particularly from China should on uptrend from fourth quarter onwards and further drive the recovery of hotel industry. REIT with exposure to hotel industry namely Sunway REIT and KLCCP Stapled Group will continue to see better earnings contribution from hotel division.

Outlook to normalise in 2024. Moving into 2024, we see that outlook for REIT to normalize and remain stable after the recovery years in 2022 and 2023. Retail REIT is expected to return to moderate earnings growth going forward, driven by organic growth of positive rental reversion. In this context, we expect rental reversion for malls to be in positive territory as tenant sales recovered. For industrial REIT, earnings outlook is also expected to remain stable, driven by healthy demand for industrial space. As for office subsector, outlook should remain subdue due to oversupply of office space.

Maintain POSITIVE on REIT. We continue to see stable earnings prospect for REIT in 4QCY23 as consumer spending at malls remains robust while higher tourist arrivals would further support recovery of retail and hotel industries. Meanwhile, performance of REIT with exposure to industrial properties is expected to remain stable going forward as demand for industrial properties remains healthy. In a nutshell, we maintain **POSITIVE** on REIT with top picks are **IGB REIT (BUY, TP: RM1.86) and Sunway REIT (BUY, TP: RM1.70)**. Average yield of REIT is attractive at 5.5%.

TELECOMMUNICATION *(Analyst: Martin Foo Chuan Loong)*

Awaiting Better Clarity...Maintain NEUTRAL

We are maintaining our **NEUTRAL** recommendation on the telecommunication sector. 4QCY23 should see the commencement of Jendela phase 2 once the hurdles surrounding 5G have been cleared. We should also have more details on the second 5G network provider. On another note, YB Minister Fahmi Fadzil mentioned that prices of broadband to be notably cheaper in 4QCY23 once the negotiations concluded by the end of September 2023 post the revision in MSAP. We view that Telekom Malaysia's earnings could be impacted the most as compared to its peers as the former is the main wholesale provider. All things considered, CelcomDigi Bhd is our preferred telco for the sector as it unlocks its synergistic benefits.

Imminent take off for Jendela Phase 2. The Jendela phase 1 was concluded with its targets being exceeded. This includes 7.74m premises with fibre connections, 96.92% 4G population coverage and average mobile network speeds of more than 116.0Mbps. These achievements have set a good foundation for Jendela Phase 2. However, to this date, the phase 2 has yet commenced. Based on MCMC guidance, the phase 2 should commence in 4QCY23. Target for phase 2 would generally include 9m premises passed, 100% internet coverage and 100Mbps mobile speed. Nonetheless, the main focus area for phase 2 would be on expanding the 5G coverage. While Jendela phase 2 has officially commence, we view that it is in the interest of the telcos to continue to pursue to the above targets as they translate into better quality of service for the users. We view that **CelcomDigi Bhd (BUY, TP: RM4.97)** would stand in a better position to benefit given their bigger market share in the industry.

Shift in 5G infrastructure. The delay in phase 2 was mainly due to the introduction of dual wholesale network once 5G coverage hit 80% towards the end of this year. This would involve making the necessary changes to the Reference Access Offering (RAO). For context, as of 31st August 2023, there are 5,724 sites developed by Digital Nasional Bhd (DNB) which comprises of 68.8% coverage. On another note, Prime Minister Anwar Ibrahim stated that the dual 5G network can allow participate of China's Huawei for a more balanced technology approach. To recall, previously DNB and Ericssson entered into a 10-year partnership to drive deployment of 5G. We view that the above development is in the right direction as it would provide better clarity to the telcos on the local landscape. This would enable them to solidify their respective 5G plan, moving into 2024.

Fortifying DNB. According to YB Minister Fahmi Fadzil, five telcos, namely CelcomDigi, Maxis, Telekom Malaysia, U Mobile and YTL Communications, are in the midst of finalising their new share subscript agreements with DNB. This should be concluded soon with all the five telcos have equal stakes in DNB. In conjunction with this milestone, we can also expect the announcement of new DNB CEO. According to newswire, Datuk Azman Ismail, former managing director and chief executive officer of PLUS Malaysia Bhd is tipped as one of the main contenders. We opine that having the necessary shareholders and leadership would greatly enable DNB to hit the remainder 11.2% 5G coverage of populated areas.

Cheaper broadband in the offing? YB Minister Fahmi Fadzil mentioned that prices of broadband could be seen to be getting much more competitive, potentially starting 4QCY23. This is in-tandem with the revision in MSAP (Mandatory Standard on Access Pricing (MSAP) which took effect on 1st March 2023. MCMC clarified that most access providers have or are in the process of publishing RAO and the negotiations of access agreements will commence based on the published RAO.

At this juncture, we understand that all the telcos have published their respective RAO, with Telekom Malaysia being the last. These negotiations are expected to be concluded by the end of September 2023. Hence, we can assume that there would revision to the existing broadband offering earliest by October 2023. We anticipate that earnings of **Telekom Malaysia Bhd (NEUTRAL, TP:RM5.22)** would be at risk as compared to its peers as the former is the main wholesale broadband provider.

TECHNOLOGY

(Analyst: Martin Foo Chuan Loong)

Doesn't Point Towards a Strong Rebound in 4QCY23...Maintain NEUTRAL

We are maintaining our **NEUTRAL** view on the sector moving into 4QCY23. While the worst may be over, we view that the pace of recovery may remain tepid. This is seen in the slow pace of recovery for GSS as well as end market such as smartphone sales. Meanwhile, we expect the local semiconductor companies to record better sequential earnings performance in 4QCY23. On another note, we view that semiconductor companies with dual manufacturing presence in both Malaysia and China will continue to benefit from "China plus one" strategy as the trade war between US and China does not show any sign of abating.

Expecting continued recovery in 4QCY23. The latest global semiconductor sales (GSS) for the month of July 2023 of USD43.2b indicated that worldwide chip sales remain down (-11.8%yoy) as compared to last year. Nonetheless, this was the slowest pace of decline seen since the beginning of the year. Moreover, July 2023 represents the fourth consecutive months of sequential growth. We expect the slow but steady momentum of recovery to sustain into 4QCY23.

On another note, we view that Malaysia's export of semiconductor goods has historically outperform that of GSS. For context, July 2023 export of semiconductor products expanded at a higher pace of +16.1%yoy. This represents the second consecutive months of growth. We do not discount the possibility that the better export performance was partially boosted by a higher number of semiconductor companies. Nonetheless, we expect the positive momentum to continue to be seen in 4QCY23. Premised on this, we view that semiconductor companies under our coverage should recorded better earnings on a sequential basis.

Slower rate of decline in smartphone sales. According to IDC, the worldwide smartphone shipments declined by -6.8%yoy to 268m units in 2QCY23. In tandem with trend seen in GSS, it is noteworthy that the rate of decline is slowing compared to the previous quarters of (-14.6%yoy). Further improvement should be seen in 3QCY23 as excess inventory clear up. This could potentially turn positive by the end of the year and into 2024 with release of new model smartphone such as the iPhone 15 announced in September 2023.

Rebound in iPhone interest in China sustainable? Following the debut of iPhone 15, there seems to be resurgence in demand which outpace that of iPhone 14 in China. Referring to JD.com the first two hours of launch saw a 253% uptick as compared to last year. Interestingly, order from customers in lower-tier cities jumped six times which indicate iPhone adoption is spreading outside of major Chinese cities.

However, there are differentiating opinion whereby the positive demand for iPhone 15 was due to insufficient supply of Huawei Mate 60, the group first 5G phone in nearly three years. Note that previously Huawei depended on TSMC to manufacture the HiSIlicon chipsets. However, this partnership was severed due to the trade wars. In view of this, Huawei has partnered with SMIC who used a 7nm process to fabricate the new Kirin 9000s with 5G support.

It is also noteworthy that Chinse manufacturer Transsion which makes smartphones under the TECNO, Infinix and itel brands has garner a lot of market share in recent times. This signals that the smartphone market remains competitive.

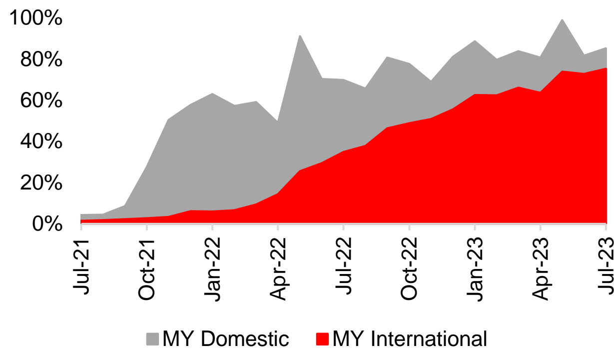
US-China trade remains intense. In July 2023, China announced restriction on the export of eight gallium and six germanium products starting 1st August 2023. This revolves around access to materials used in making high-tech microchips. Under the new rules, exporters of germanium and gallium products now need to obtain an export licence for dual-use items and technologies, meaning those with potential military and civilian applications. This signals that the tension between US and China will not abate anytime soon. In this regard, we expect local semiconductor companies to continue to benefit from the "China plus one" strategy which are currently ongoing. This is especially so for companies with manufacturing presence in both Malaysia and China such as Unisem, MPI and Inari.

TRANSPORTATION *(Analyst: MIDF Research Team)*

Overcoming Adversity...Upgrade to POSITIVE

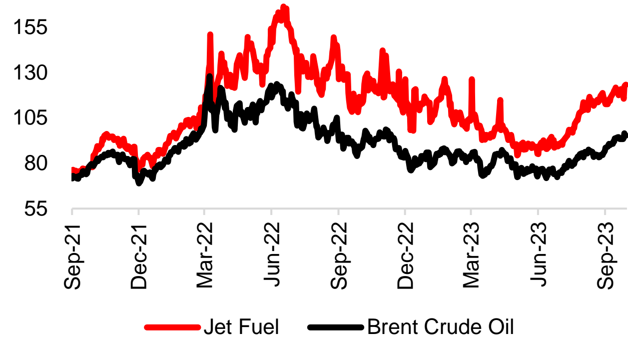
Aviation

Chart 47: Malaysia's Passenger Recovery (%)



Source: MAHB, MIDFR

Chart 48: Brent Crude Oil vs. Jet Fuel (USD/barrel)



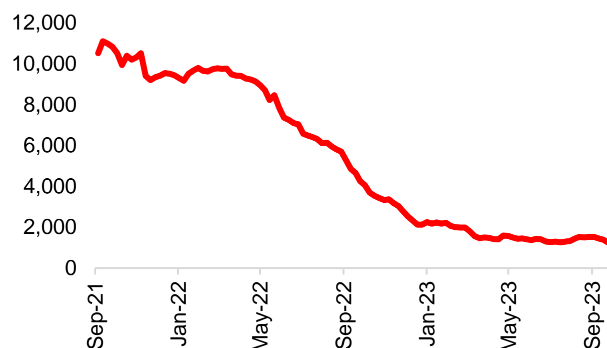
Source: Bloomberg, MIDFR

Positive trends in passenger numbers. Malaysia's passenger numbers have shown a promising recovery trajectory, and we anticipate this trend to continue going into 4QCY23. By end-7MCY23, the traffic has achieved 77% (domestic: 85%, international: 68%) of pre-pandemic passenger levels. The non-ASEAN sector holds significant growth potential but is hindered by capacity constraints, while the Chinese market has only recovered to 40% of its pre-Covid passenger volumes as of Jun-23. The filed capacity for this sector currently stands at 56% of 2019 level, with forecasts suggesting it will reach 63% by end-CY23. Our passenger traffic assumptions remain unchanged, with a projected traffic recovery of 85% in CY23 (domestic: 90%, international: 80%). Looking ahead, domestic traffic will be boosted by Malaysia AirAsia's (MAA) full fleet reactivation in Dec-23 (following 65% operation in 2QCY23), while international traffic will benefit from the return of foreign airlines. As of Aug-23, 67 airlines (91% of 2019 levels) are operational in Malaysia, and this is expected to grow by +8.0% over the next two years, driven by key airlines like British Airways, Qantas and Lufthansa reintroducing or launching services, with some starting as early as next year.

Navigating short-term obstacles. In the short-term, the prevailing high USDMYR exchange rate could present obstacles for local airlines, given their significant USD-denominated expenses (close to 60%-70%). Nevertheless, our economists expect the MYR to potentially strengthen to USDMYR4.24 by year-end, driven by capital flow reversals into riskier markets. Furthermore, airlines may find support in the high-yield airfare environment created by dynamic pricing strategies, alongside the continued application of fuel surcharges to navigate fluctuations in crude oil prices. We remain cautious about seat capacity constraints due to the ongoing MRO challenges, including reported delays in aircraft servicing due to component shortages and cabin furnishing issues. Potential upsides to our traffic numbers are: (i) local airlines rebuilding its fleet and (ii) faster-than-expected return of Chinese tourists. The key anticipation lies in the upcoming finalisation of the new operating agreement (OA) in 4QCY23, which is expected to provide insights into MAHB's earnings prospects.

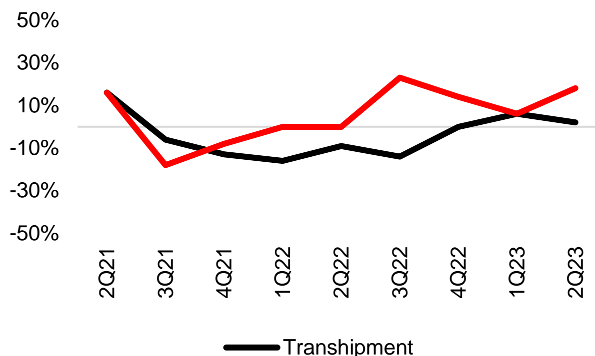
Port & Logistics

Chart 49: Freightos Baltic Index (USD/FEU)



Source: Bloomberg, MIDFR

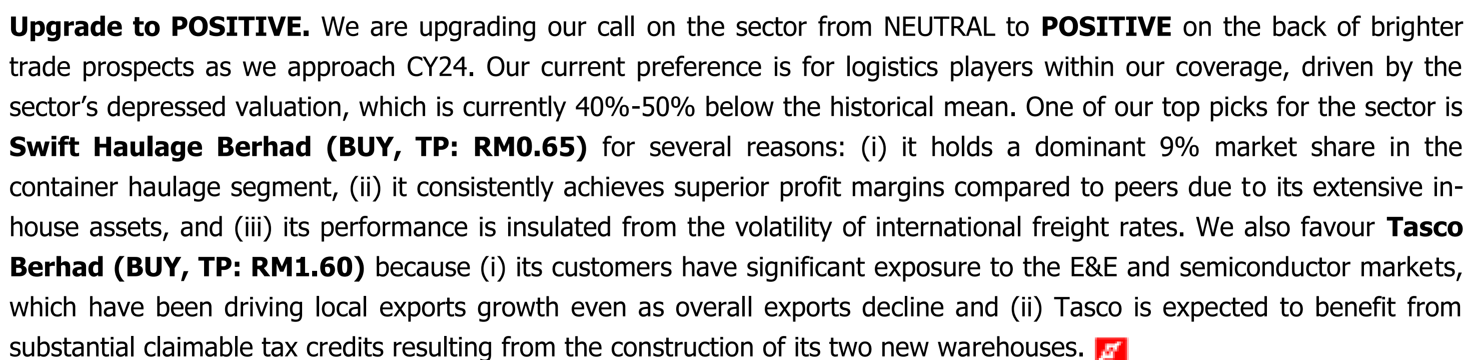
Chart 50: Westports' Container Volumes (YoY %)



Source: Westports, MIDFR

Favourable trade expectations. Heightened inflation and rising interest rates in the Western region have led to reduced goods consumption, adversely affecting port operators like **Westports Holdings Berhad (BUY, TP: RM3.90)**, which have seen year-on-year declines in quarterly container volumes (excluding empties) due to decreased interregional movements. Nonetheless, there is an improvement in the situation as global trade volumes are anticipated to increase moderately in 3QCY23, continuing the positive trend observed after two quarters of decline, according to the World Trade Organisation (WTO). The WTO's periodic goods barometer rose to 99.1 from the previous reading of 95.6 in May-23, as reported in its Aug-23 publication. Looking ahead, the WTO mentioned that its projected trade growth of +1.7% for CY23 (CY22: +2.7%) remains achievable if trade picks up as expected in 2HCY23. As for gateway operations, according to our macroeconomic forecasts, Malaysia's external trade is set to stabilise and pick up momentum in 4QCY23. This is due to the anticipation of both exports and imports returning to growth, driven by a stronger recovery in China, optimistic outlook linked to the steady monetary policies in major economies, and sustained high commodity prices. The external trade outlook for CY24 appears to be more promising, with exports and imports projected to grow by +4.5% and +4.2% respectively, rebounding from declines of -6.4% and -6.9% in CY23.

Logistics players to remain resilient. The logistics companies under our coverage that are engaged in freight forwarding have seen substantial drops in revenue from this segment. This decline is attributed to the normalisation of ocean and air freight rates, driven by slowing demand, resolved congestion, and the delivery of new vessels. As rates stabilise, better earnings visibility is anticipated among the freight forwarders. This is attributed to their capability to secure freight rates with customers and leverage their strong negotiating position with shipping lines. This stands in contrast to the previous period characterised by elevated freight rates, where most rates were negotiated on a short-term basis. Furthermore, the demand for warehouse space is projected to sustain its growth, although industry players acknowledge that rental rates may undergo a slight moderation with the introduction of millions of square feet of additional warehouse capacities over the next two years, especially in key areas like Shah Alam. However, this trend poses greater challenges for smaller warehouse operators, as multinational corporations (MNCs) increasingly favour logistics providers capable of accommodating consolidation requirements and delivering tailor-made warehouse solutions.



Upgrade to POSITIVE. We are upgrading our call on the sector from NEUTRAL to **POSITIVE** on the back of brighter trade prospects as we approach CY24. Our current preference is for logistics players within our coverage, driven by the sector's depressed valuation, which is currently 40%-50% below the historical mean. One of our top picks for the sector is **Swift Haulage Berhad (BUY, TP: RM0.65)** for several reasons: (i) it holds a dominant 9% market share in the container haulage segment, (ii) it consistently achieves superior profit margins compared to peers due to its extensive in-house assets, and (iii) its performance is insulated from the volatility of international freight rates. We also favour **Tasco Berhad (BUY, TP: RM1.60)** because (i) its customers have significant exposure to the E&E and semiconductor markets, which have been driving local exports growth even as overall exports decline and (ii) Tasco is expected to benefit from substantial claimable tax credits resulting from the construction of its two new warehouses.

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology