Economic Research, Strategic Management

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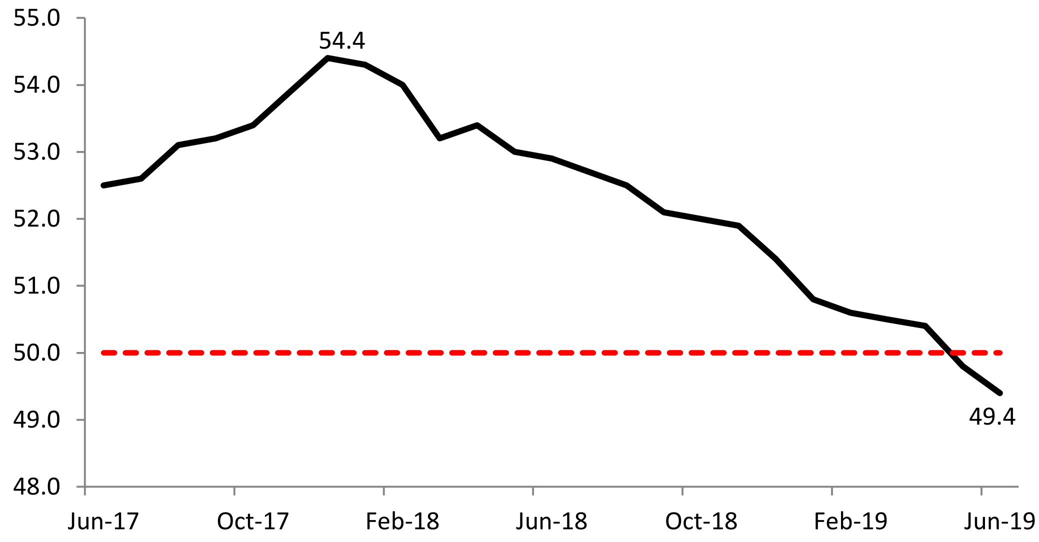
Economic outlook for 2H2019 – on high alert

Global landscape – slowing momentum

The trade conflict between the US and China has shifted into higher gear in May despite "constructive" talks seen in the prior months. On May 10, the US Trade Representative (USTR) has announced higher import tariff from 10% to 25% on approximately USD200 billion worth of Chinese imports. This has led retaliation from the Chinese government through tariff rates as high as 25% on imports from the US worth USD60 billion. In view of this, business community's sentiment was uneasy. This was reflected in the fall of JP Morgan Global Purchasing Managers Index (PMI) for manufacturing to 49.4 points in June (May: 49.8 points), the lowest reading since the data was first collected in 2012. This suggests manufacturers are very cautious on the final demand outlook as the trade tension has resulted in disruption in the supply chain as well as higher cost of doing business.

Chart 1: JP Morgan Global Purchasing Managers Index (PMI) for manufacturing



Source: Bloomberg

The UK Brexit discussion was also in the state of limbo. The Prime Minister Theresa May announces her resignation on 24 May and indicated 7 June as the day she will step aside as the Conservative Party's leader. This happened despite the Brexit dateline has been pushed forward to 31 October. The new Prime Minister, Borris Johnson is seen to be quite open to the "no-deal" option, which could be catastrophic if implemented. This could explain the fall in pound sterling (GBP) to USD1.2152 as of 30 July from USD1.2754 at the end of 2018.

The tension between the US and Iran was also in the spotlight. This followed by the removal of sanction waiver against importation of crude oil from Iran in early May. Thereafter, there has been reported attacks on oil tankers allegedly executed by the Iranian forces at the Straits of Hormuz, the choke points between Persian Gulf and Gulf of Oman. This has resulted in the sharp rise in the Brent crude prices to as high as USD74.57 per barrel on 24 April. Meanwhile, the supply of oil is expected to accelerate in 2020 especially from the non-OPEC member countries. According to International Energy Agency (IEA), the non-OPEC supply is anticipated to grow from 1.9 million barrels per day (mbpd) in 2019 to 2.3 mbpd in 2020. Gains are likely come from the US, Brazil and Norway. Therefore, it remain to be seen whether Brent crude could be sustained at such a high level. Already, Brent crude prices has corrected to around USD65.16 per barrel in late July.

Chart 2: Brent crude prices (US dollar per barrel)

Source: Bloomberg

Amidst the economic uncertainties, several central banks have responded by reducing their policy rates in order to rejuvenate the economic growth. These include Reserve Bank of Australia (RBA) and Reserve Bank of India (BOI) which both have cut their benchmark interest rates by 25 basis points to 1.25% and 5.75% respectively in early June. Philippines central bank was opting for the same route with 25 basis points reduction in the overnight reverse repurchase (RRP) facility to 4.5% on May 10. The latest US Federal Open Market Committee (FOMC) also suggests that the US Federal Reserve is likely to adopt similar measures in the 2H2019. Judging from the “dot plots”, 7 out of the 17 FOMC participants expect Federal Fund Rate (FFR) could be reduced by 50 basis points this year. Another 8 out of 17 participants anticipate FFR to be around 2.25% and 2.50%. As such, FFR is on a downward bias between July and December 2019.

All in all, the global economy is cruising on softer pace. The ongoing trade war has been the source of market instability and in so far, there is not much success for the US in bringing back more companies to operate on their soil aside from collecting more import duties. In fact, the conflict between the two countries have led talks of trade diversion which would only benefits the Asian countries.

Table 1: Quarterly gross domestic product (GDP) growth (y-o-y)

	1Q 17	2Q 17	3Q 17	4Q 17	1Q 18	2Q 18	3Q 18	4Q 18	1Q 19
US	1.9	2.1	2.3	2.5	2.6	2.9	3.0	3.0	3.2
UK	1.8	1.9	2.0	1.6	1.2	1.4	1.6	1.4	1.8
Eurozone	2.1	2.5	2.8	2.7	2.4	2.2	1.6	1.2	1.2
Japan	1.4	1.8	2.1	2.4	1.3	1.5	0.1	0.3	0.9
China	6.8	6.8	6.7	6.7	6.8	6.7	6.5	6.4	6.4
India	7.0	6.0	6.8	7.7	8.1	8.0	7.0	6.6	5.8
Thailand	3.5	4.2	4.5	4.0	5.0	4.7	3.2	3.6	2.8
Philippines	6.4	6.6	7.2	6.6	6.5	6.2	6.0	6.3	5.6
South Korea	2.9	2.8	3.8	2.8	2.8	2.8	2.0	3.1	1.8
Singapore	3.8	3.1	5.1	3.7	4.7	4.2	2.4	1.9	1.3
Indonesia	5.0	5.0	5.1	5.2	5.1	5.3	5.2	5.2	5.1
Malaysia	5.6	5.8	6.2	5.9	5.4	4.5	4.4	4.7	4.5

Source: Bloomberg

Malaysian economy – consumer spending is the savior

In view of the slowing economy, the Bank Negara Malaysia (BNM) has decided to reduce the Overnight Policy Rate (OPR) from 3.25% to 3.00% on 7 May. This happened as inflation rate was very low with the latest print showed Consumer Price Index (CPI) rises by only 0.2% y-o-y in in the first six months of this year (6M2018: 1.6%). Apart from that, economic activities in the first three months of 2019 was softening from 4.7% y-o-y in the 4Q2018 to 4.5% in the 1Q2019. This was mainly due to weak investment which fell 3.5% (4Q2018: 0.6%) as well as slower real exports to 0.1% (4Q2018: 3.1%) as external demand was not forthcoming. The unemployment rate was also gradually inching up to 3.4% in April (March: 3.4%) after remaining steady at 3.3% since September last year. Nonetheless, the jobless rate went down to 3.3% in May as the number of unemployed person fell to 519.8k (April: 523.3k) during the month. Judging from the total employment in the manufacturing sector, it continues to moderate to 1.4% y-o-y (April: 1.7%) to 1.09 million employees during May. This indicates that businesses have become increasingly wary on labour hiring as outlook for final demand is very challenging. Despite that, consumer spending has been healthy with private consumption grew 7.6% in the 1Q2019 albeit slower compared to 8.4% in the preceding quarter. Latest passenger car sales which increased by 14.3% to 232,362 units in the first five months of 2019 (5M2018: -3.4%, 203,214 units) supported the view that consumer spending has been resilient. Similarly, domestic passenger traffic at the Malaysian airports rose 7.5% to 20.5 million in the 5M2019, indicating air traveling demand has been uninterrupted by the ongoing trade war. As such, household spending has been the pillar for Malaysian economy especially when government and private firms are not willing to spend aggressively.

The federal government recorded 17.2% y-o-y increase in total revenue to RM63.7 billion in the 1Q2019. This was mainly due to higher direct tax collection of 5.1% growth to RM30.8 billion as well as a whopping 163.8% growth in interest and investment returns during the first three months of this year. Operating and net development expenditure continued to grow albeit pace of 8.3% and 5.5% to RM59.5 billion and RM11.3 billion respectively in the 1Q2019. This has led lower fiscal deficits of RM7.1 billion or 2.0% GDP in the 1Q2019 compared to RM11.3 billion or 3.0% of GDP in the same period last year.

Meanwhile, businesses have been reluctant to spend on capacity expansion as market sentiments have been very weak. In the 1Q2019, spending on machinery and equipment fell 7.4% y-o-y, the second consecutive quarter decline. Similarly, spending on structures dropped 1.3% during the 1Q2019 from 1.3% growth in the preceding quarter. Such trend was in tandem with the Malaysia's Purchasing Managers Index (PMI) which has remain below 50 points for 8 straight months. The latest PMI reading was in June where the index fell to 47.8 points from 48.8 points in the previous month. Against such backdrop, Malaysian economy in the 1H2019 has been growing at a moderate speed.

Table 2: Federal government fiscal position

RM Million	1Q 18	2Q 18	3Q 18	4Q 18	1Q 19
Revenue	54,324	52,470	58,920	67,169	63,688
Q-o-Q%	*-15.9%*	*-3.4%*	*12.3%*	*14.0%*	*-5.2%*
Y-o-Y%	*16.5%*	*4.0%*	*0.3%*	*4.0%*	*17.2%*
Operating expenditure	54,906	62,903	55,051	58,099	59,454
Q-o-Q%	*-5.9%*	*14.6%*	*-12.5%*	*5.5%*	*2.3%*
Y-o-Y%	*-4.6%*	*17.5%*	*14.1%*	*-0.4%*	*8.3%*
Current balance	(583)	(10,433)	3,868	9,069	4,234
Gross development expenditure	10,918	9,167	7,634	28,381	11,524
Q-o-Q%	*-28.4%*	*-16.0%*	*-16.7%*	*271.8%*	*-59.4%*
Y-o-Y%	*15.5%*	*-14.9%*	*-19.0%*	*86.2%*	*5.6%*
Less: Loan recoveries	167	99	143	380	177
Net development expenditure	10,751	9,068	7,492	28,001	11,346
Q-o-Q%	*-19.9%*	*-15.7%*	*-17.4%*	*273.8%*	*-59.5%*
Y-o-Y%	*15.5%*	*-14.8%*	*-22.4%*	*108.7%*	*5.5%*
Overall balance	**(11,333)**	**(19,501)**	**(3,623)**	**(18,932)**	**(7,112)**
Overall balance % of GDP	**-3.3%**	**-5.5%**	**-1.0%**	**-5.0%**	**-2.0%**

Source: CEIC

2H2019 Outlook – heightened uncertainties

The uncertainties surrounding the trade conflict between the US and China will continue to hog the limelight for the remainder of the year. Notwithstanding, the recent indication following the G20 Summit which was held in Osaka, Japan on 28 and 29 June has shed hope that the two nations would find some amicable solution. In the interim, the US government will halt its plan to raise additional tariff on USD300 billion worth of China's import. Additionally, the US technology companies are allowed to continue their dealings with Huawei which can be beneficial to the semiconductor industries which has been in a doldrums in the past four months. In return, China has promised to buy more agricultural products from the US. While such development has been positive, the situation would remain fluid as there is no definitive agreements. As a precautions, businesses would find their ways to readjust to the new ecosystem. However, this would require time in order to familiarize with the new suppliers and to gain the economies of scale.

On a brighter note, Malaysia is seen to be the main beneficiaries from the trade diversion especially in areas relating to semiconductor and natural gas. Already, total approved manufacturing investments in the 1Q2019 has gone up to RM20.2 billion in the 1Q2019, representing 102.8% jump over the same period last year. However, businesses would be generally mindful on their capital expenditure as well as their production activities. This is to avoid potential build-up in the inventory level following the ongoing economic uncertainty and therefore, the actualization of approved investments could stall.

Against such backdrop, we are still maintaining our 2019 GDP growth forecast of 4.5%. We believe the GDP growth would accelerate in the 2H2019 to around 4.7% from an estimated growth of 4.3% in 1H2019. The recent announcement of infrastructure projects revival such as East Coast Rail Link (ECRL) and Bandar Malaysia would propel domestic-oriented industries such as construction, manufacturing and services sector. Apart from that, consumer spending will continue to provide the needed support to growth albeit moderate pace in view of higher of cost of living and volatility in the financial markets. In this regards, the announcement by FTSE Russell on their review of World Government Bond Index (WGBI) in September, whether Malaysian govvies remain part of the benchmark index, will be closely watched.

On OPR, we believe the BNM would be inclined to maintain the prevailing rate at 3.00% but we also reckoned that the possibility of 25 bps cut should not be totally ruled out. This in light of the softening in the global growth, benign outlook on inflation rate and the potential FFR reduction by the US Federal Reserve. All this would translate into more policy space to the BNM which can be used during heightened uncertainties.

Table 3: Macroeconomic variable forecast

Macroeconomic variable	2018	2019F
GDP	**4.7%**	**4.5%**
CPI	**1.0%**	**0.7%**
OPR	**3.25%**	**3.00%**
USDMYR (end period)	**4.18**	**4.21**
CPO	**RM2,316 per MT**	**RM1,900 per MT**
Brent	**USD76.7 per barrel**	**USD63 per barrel**

Source: Economic Research, Strategic Management

Sectoral outlook – remain cautious

Our sectoral outlook are mostly neutral as moderate economic growth would undermine demand for goods and services as households would be mindful in their spending patterns. Apart from that, higher cost of doing business following higher raw material prices, labour cost, weak exchange rates as well as intense competition in the market place would lead to lower profit margins. Some industries such as Rubber Gloves and Semiconductor have been actively expanding their productive capacity in the last two to three years. While this is good for long term as it will improve the economies of scale, however, the outlook for final demand in the immediate term has been murky. This is due to the ongoing trade war between the US and China which has led to cautious sentiments among the private firms globally. This could result in an unused capacity to be prevalent which can be a costly affair to businesses. Apart from that, the transition towards Industrial Revolution 4.0 (IR 4.0) would force companies to allocate more funds to upgrade their existing production capacity in order to stay competitive and relevant in the industries.

Despite that, there are some silver linings that is worth considering. First, higher asset utilization rate for Oil Services companies suggests that economic activities in the Oil & Gas upstream sector has been forthcoming. For instance, asset utilization for Perdana Petroleum Berhad and Velesto Energy Berhad have gone up from 27.0% and 65.0% in 1Q2018 to 36.0% and 66.0% in 1Q2019 respectively. Similarly, the order books for Sapura Energy Berhad stood at RM17.2 billion as of 31 January 2019 from RM16.9 billion on 31 July 2018. Higher crude oil prices albeit at gradual pace has been a boon to the sector. Nonetheless, we are still maintaining our Neutral call for the sector in view of the supply glut in the industries which would limit the upside potential for prevailing crude oil prices.

Apart from that, the government announcement to revive the East Coast Rail Link (ECRL) and Bandar Malaysia in April this year suggests that the Construction players would be able to benefits from the contract awards. As for ECRL, there will be 40% works will be allocated to the local contractors and in so far, more than 1,300 companies have submitted their bids during the Pre-Qualification stage on 29 and 30 May. There was also favourable trend emerging from the Automotive sector when the Total Industry Volume (TIV) increased by 12.7% y-o-y to 253,808 units for the first five months 2019. This was due to 14.3% expansion in the Passenger Vehicles to 232,362 units which makes up 91.6% of total TIV. Nonetheless, Commercial Vehicle sales was down by 2.2% to 21,446 units in the 5M2019, suggesting business are not keen to incur capital expenditure. As such, we maintained our Neutral call for the sector.

All in all, we are cautious on the impact to the businesses following the potential slowdown in the economy. Already, we have seen the Gross Impaired Financing Ratio (GIFR) for the banking sector rose to 1.52% in May from 1.46% in December last year. Higher GIFR was more pronounced for the non-household sector which expanded from 2.1% in December 2018 to 2.2% in May 2019. Fortunately, GIFR for household sector has been low to 0.98% in May 2019 from 0.99% in December 2018. This indicates finances among household has been resilient despite having to contend with rising cost of living.

Table 4: Sector ratings

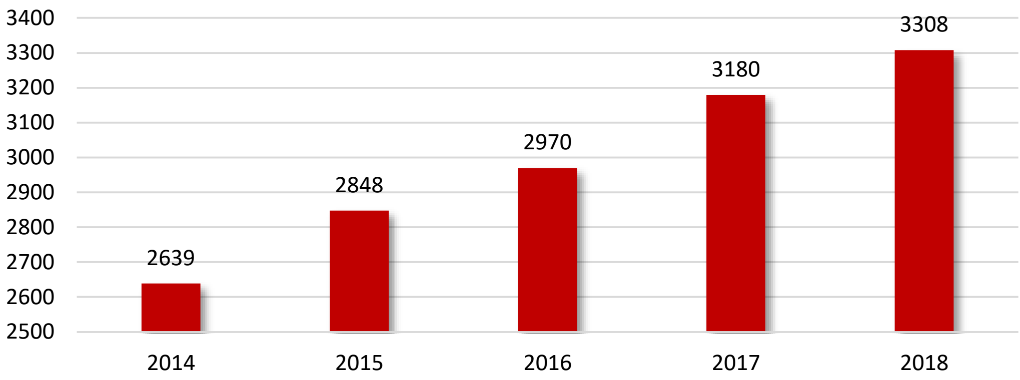
Sector	Rating	Remarks
1. Healthcare	+ve	Steady demand from NCD patient & medical tourism
2. Manufacturing – Rubber Gloves	+ve	Better economies of scale & strong demand
3. Manufacturing - Semiconductor	+ve	Establishment of 5G network will be key catalyst
4. Construction	Neutral	Higher DE and possible pump priming by the govt.
5. Automotive	Neutral	New model launches & weak ringgit (lower cost)
6. Power	Neutral	Higher coal and gas prices.
7. Plantation	Neutral	Trade war and backlash from European countries
8. Telecommunication	Neutral	Higher capex for 5G network. Lower profits ahead
9. Education	Neutral	Higher allocation from govt. but lack of policy clarity.
10. Property - Residential	Neutral	Rising overhang units and lack of purchasing power
11. Banking	Neutral	Lower rates and intense deposit competition
12. Oil & Gas	Neutral	Excess capacity is still prevalent but project awards up
13. Property – Shop units	-ve	Overhang gradually declining.
14. Textile	Neutral	Competitive exchange rates
15. Trading / Retail	Avoid	Excess floor space & proliferation of e-commerce
16. Steel	-ve	Improving steel prices but overcapacity remains

Source: Economic Research, Strategic Management
*NCD = Non Communicable Disease

Healthcare – positive

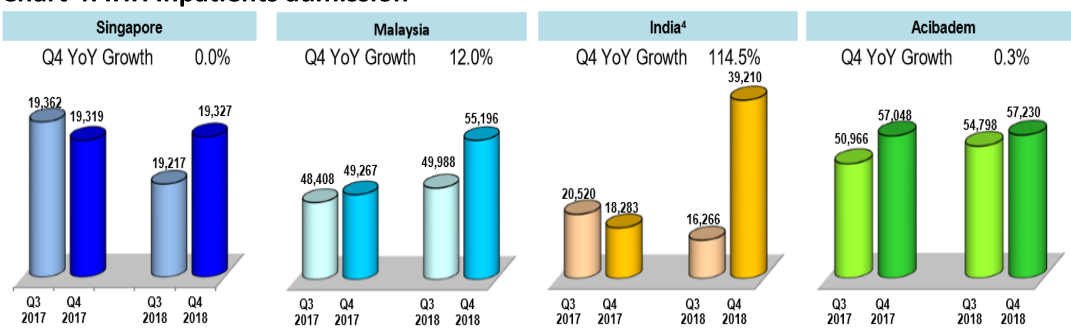
The financial performance of medical services provider has been decent in the recent years. For example, KPJ Healthcare Berhad (KPJ) has recorded total revenue of RM3.3 billion for financial year ending 2018 from RM3.2 billion in the previous period. Similarly, the IHH Healthcare (IHH) Berhad has reported a total revenue of RM11.5 billion in 2018 compared to RM11.1 billion in the preceding financial period. The medical services providers have been increasing their capacity in order to cater for the robust demand. To this end, IHH has set aside approximately RM2.0 billion for capital expenditure for financial year 2019 of which RM458.6 million will be allocated for its Malaysian operations. Similarly, KPJ has envisioned 5 new hospitals over the next 3 years while at the same time, adding more capacity to the existing hospitals whenever possible. Such endevour is in tandem with the rising number of patients admission. Total inpatients for IHH in the 4QFY18 rose 12.0% year-on-year to 55,196 (Malaysian operation) while KPJ recorded 299,780 inpatients (Malaysia operation) in the final quarter of 2018, representing 4.6% growth. The noncommunicable diseases (NCD) such as cardiovascular, cancer and diabetes alongside with ageing population will continue to support demand for medical services. Additionally, diversified portfolio across geographical location among the medical service providers are expected to mitigate demand risk. Overall, we maintained our positive call for the sector.

Chart 3: KPJ's total revenue in RM million



Source: KPJ's analyst briefing deck

Chart 4: IHH inpatients admission



Source: IHH's analyst briefing deck

Manufacturing (rubber gloves) – positive

Sales for rubber gloves have been very encouraging despite facing the external uncertainties, intense competition as well as rising cost of doing business. Total sales for the first five months of 2019 stood at RM6.6 billion, representing 15.0% growth compared to the same period last year (5M2018: 10.9%, RM5.7 billion). On the same note, production activities have been growing at a faster pace of 4.6% in the 5M2019 from 0.8% in 5M2018. Apart from that, the main industry players have been expanding their production capacity in order to cater for high product demand. For instance, Top Glove Corporation Berhad is expected to increase its existing lines and capacity from 648 lines and 60.5 billion pieces per annum to 872 lines and 83.3 billion pieces per annum by the year 2020. Similarly, Hartalega Holdings Berhad's Next Generation Integrated Glove Manufacturing Complex (NGC) which will substantially boost their annual production capacity from 14.0 billion to 44.6 billion pieces annually has been progressing well. For instance, Plant 5 of NGC facility has commissioned 10 out of 12 lines with remaining production lines to come on-stream progressively. Construction of Plant 6 structure has started and the supporting facilities to follow in second half of calendar year 2019. Plant 5 and Plant 6 will each have annual installed capacity of 4.7 billion pieces. A new plant – Plant 7 is also in the expansion pipeline catering to small orders focusing more on specialty products. Plant 7 will have an annual installed capacity of 2.6 billion pieces. Against such backdrop, we maintained our positive call for this sector.

Manufacturing (semiconductor) – positive

The industry is expected to experience some headwinds in the immediate terms following the ongoing trade war especially between the US and China. The trade conflict has evolved to a new dimension and the technology sector appears to be the main target given the recent sanction levied against technology giant such as Huawei in May this year. Although the recent G20 meeting in June has partly removed some of the fears over further escalation of the trade friction, it remain to be seen whether there could be tangible solution. Already, the semiconductor industries are undergoing periods of correction after experiencing a robust growth in the past two years. The recent forecast by the World Semiconductor Trade Statistics (WSTS) has revised down the 2019 growth forecast for the industries from 2.6% (2018: 13.7%), which was made in November last year, to a contraction of 12.1% that was announced in June 2019. Despite that, we maintained our positive rating for the sector in view of its wide range of application to other industries such as automotive and healthcare. Apart from that, the potential rollout of 5G network at some point in 2020 would be the key catalyst for growth as new electronic products launches including smartphones would be prevalent. To some degree, Malaysia is seen to be the main beneficiaries of the current trade war as semiconductor and technology companies are relocating their production hub away from China. Therefore, capital expenditure from the semiconductor companies are expected to be healthy although demand remain weak at the moment.

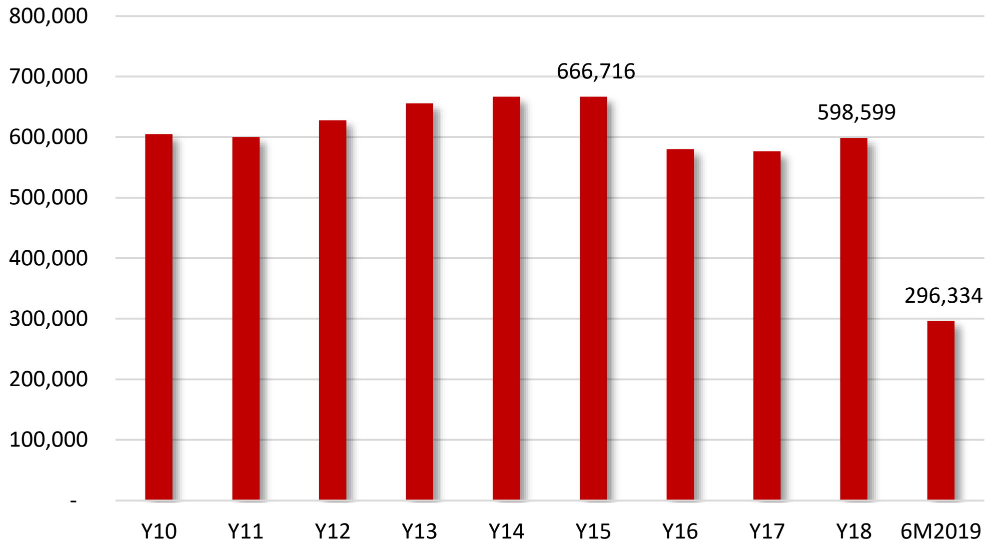
Construction – neutral

The excess supply in the property markets have taken a serious toll on the sector with residential and non-residential property construction declined by 7.4% y-o-y (4Q2018: 9.2%) and 4.4% (4Q2018: 2.5%) in 1Q2019 respectively. As for the residential property construction, which accounted for 24.0% of total construction work done, has declining for five quarters straight amidst no signs of easing in the overhang units. Nonetheless, the recent decision by the Federal government to revive the key infrastructure projects such as the East Coast Rail Link (ECRL) has sparked interest in the sector. The pre-qualification exercise has been done at the end of May 2019 with more 1,300 local contractors have submitted their bids for the project. The ECRL project value has been scaled down from RM65.5 billion to RM44.0 billion with 40% of total works will be allocated to the local contractors. The project is expected to be completed by 2026 and one of salient points of the project is the land bridges that connects the two main ports i.e. Port Kuantan and Port Klang. The nexus between these two ports would facilitate the international trade between China and the rest of world and therefore, there will be an urgent to upgrade the existing capacity of the ports. As such, we placed neutral call for the sector as there will be more infrastructure to be rolled by the government as a means to resuscitate the sluggish economic growth.

Automotive – neutral

The Total Industry Volume (TIV) increased by 2.3% year-on-year (y-o-y) in the first six months of 2019 to 296,334 units after recording 1.8% expansion in the same period last year (6M2018: 289,599 units). Passenger Vehicles (PV), which accounted for 91.4% of total TIV, was the main driver, growing by 3.8% to 270,875 units (6M2018: 2.0%, 260,923 units). This was underpinned by the stellar performance in sales of 4 Wheel Drive (4WD) and Sports Utility Vehicle (SUV). Judging from the first five months of 2019, TIV for the segment has risen from 28,563 units in the 5M2018 to 58,378 units in 5M2019. This represents 104.4% growth from a year ago. Apart from that, sales of Window Van rebounded forcefully by 30.0% in 5M2018 to 1,410 units after 17.9% plunge in the 5M2018 (1,084 units). Upon further scrutiny, sales for BMW (5M2019: 5.1% vs. 5M2018: 1.8%), Mini (5M2019: 20.9% vs. 5M2018: 16.4%) and Volvo (5M2019: 93.6% vs. 5M2018: 21.2%) were higher, suggesting robust demand from the mass affluent customer. On the same note, sales of Kia (5M2019: 7.1% vs. 5M2018: -4.5%), Nissan (5M2019: 7.9% vs. 5M2018: -20.5%), Proton (5M2019: 71.5% vs. 5M2018: -34.9%), Renault (5M2019: 30.4% vs. 5M2018: -0.8%) and Toyota (5M2019: 45.0% vs. 5M2018: -32.3%) rebounded to positive territory in May respectively.

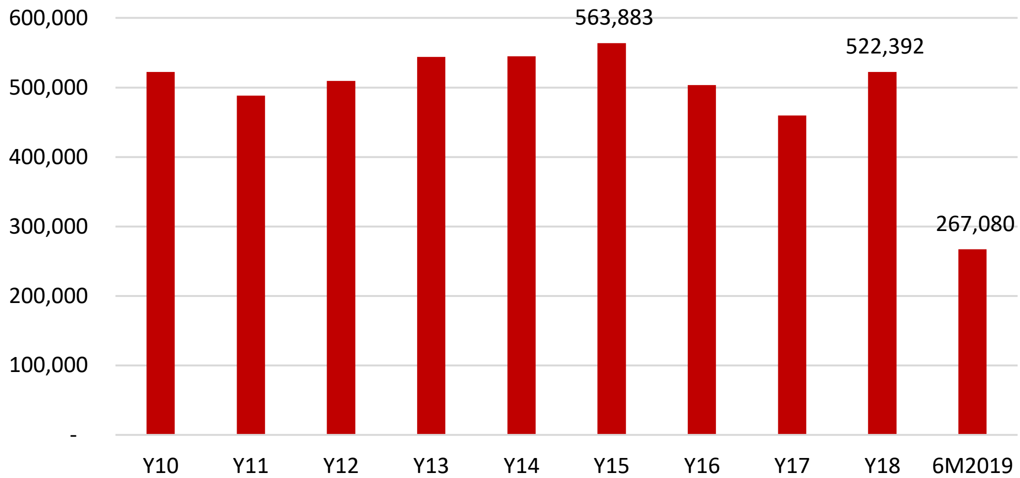
Chart 5: Total Industry Volume (TIV)



Source: CEIC, Malaysia Automotive Association (MAA)

Meanwhile, Total Industry Production (TIP) moderated by 2.2% in the first six months of 2019 to 267,080 units from 10.5% growth in 6M2018 (261,324 units). On monthly basis, the production declined by 28.3% y-o-y in June from -0.5% in the previous month. This suggests the growth momentum for the sector is somewhat inconsistent.

Chart 6: Total Industry Production (TIP)



Source: CEIC, Malaysia Automotive Association (MAA)

There has been series of new model launches from the national cars. The new Proton Iriz and Persona which were officially launched on 23 April this year. On 28 May 2019, Proton also launched the Exora RC, a seven-seat MPV which has received running changes for the 2019 model. The changes include styling revisions, component improvements to raise product quality as well as first-in-class smart features, setting it apart from its competitors. Following the convention set by the Proton X70, 2019 Persona and Iriz, Exora uses "Intelligence That Moves" to signify not only its intelligent features but also the class leading performance. Additionally, the wider space it offers for up to seven adult occupants have also been the main selling points. On the same note, Perodua was also off to a good start in 2019 with 20,124 vehicles sold in the first month of the year, of which the compact car registered 1,025 units of its recently launched SUV, the Perodua Aruz on the 31 January 2019. For the 5M2019, Proton and Perodua recorded a TIV of 35,903 units (+71.5%) and 105,745 units (+8.5%) respectively.

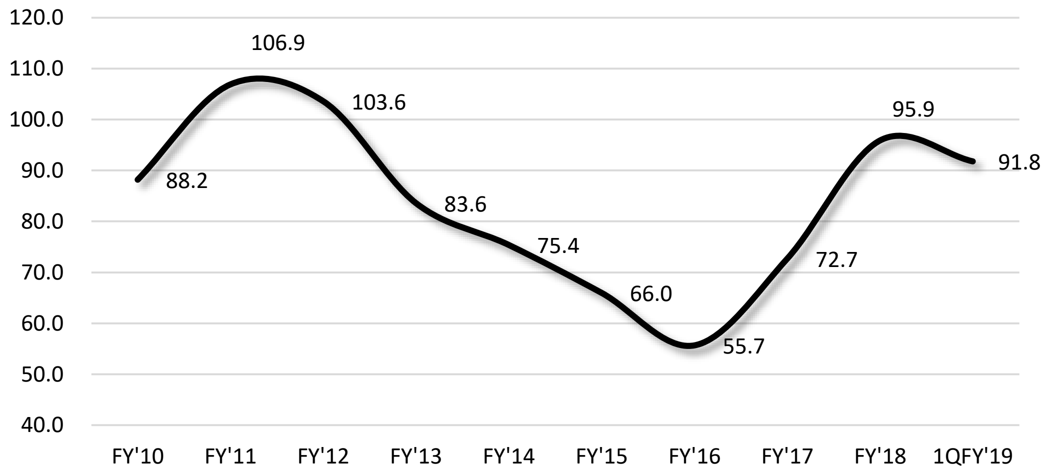
All in all, we opine that the demand for passenger vehicle is expected to record a healthy sales in 2019. The recent move by Bank Negara Malaysia (BNM) to cut the Overnight Policy Rate (OPR) by 25 basis points to 3.0% in May should to entice consumers to purchase new cars following the attractive financing rates. Moreover, a slew of new models launched in the 2H2019 would also add more colour to the industry. These include Mazda 3 Hatchback 2019, Subaru Forester 2019 and Renault Megane RS 2019 slated to be launched in July, August and September this year. Stronger ringgit against the US dollar could also help to reduce the cost of importation for parts and this would help to improve the profit margin among the industry players. Nonetheless, we remain neutral on the sector as uncertainties over growth prospect could easily shift the consumer sentiments. This, in turn, could affect TIV performance in the 2H2019. Thus far, the Malaysian Automotive Association (MAA) has maintained its conservative TIV growth forecast of 0.2% to 599,893 units for 2019. If materialise, this would be the fourth consecutive years TIV of below 600,000 units.

Power – neutral

Demand for electricity has been quite decent especially from the industrial sector. As of April 2019, total electricity consumption stood at 12,660 gigawatt hour (Gwh), representing 3.0% growth (March: 3.9%) compared to the same period of last year. Out of this amount, demand from industrial sector rose 4.1% to 10,058 Gwh in April which accounted for 79.4% of total electricity demand. While the remaining balance is accrued to domestic users which fell by 1.0% to 2,602 Gwh. While demand has been forthcoming, the generation cost especially coal prices have remained at elevated levels.

According to Tenaga Nasional Berhad (TNB), higher generation cost between 1 July until 31 December 2018, amounting to RM1.82 billion was mainly due to the increase in average coal price to USD97.835 per metric tonne (MT). Such level was higher relative to the forecasted coal price set in the Base Tariff for Regulatory Period 2 (RP2) from 2018 to 2020, which is at USD75.0 per MT. Following this, the additional generation cost of RM1.82 billion will be passed to customers via the Imbalance Cost Pass Through (ICPT) mechanism with the bulk of it will be borne by the Non-Domestic customers (RM948.0 million). Therefore, power industries are insulated from the rise in generation cost. Despite that, the government is contemplating to liberalized the sector with customers would have more choice to choose the supplier of electricity. On 3 July 2019, the Energy, Science, Technology, Environment and Climate Change Ministry's in parliamentary written reply, indicated that that the government is conducting a study on whether to allow new energy suppliers to come into the market, with the results to be made known soon. As such, we maintained our neutral call for the sector pending further information on the latest development.

Chart 7: Coal prices in USD per MT



Source: Tenaga Nasional Berhad

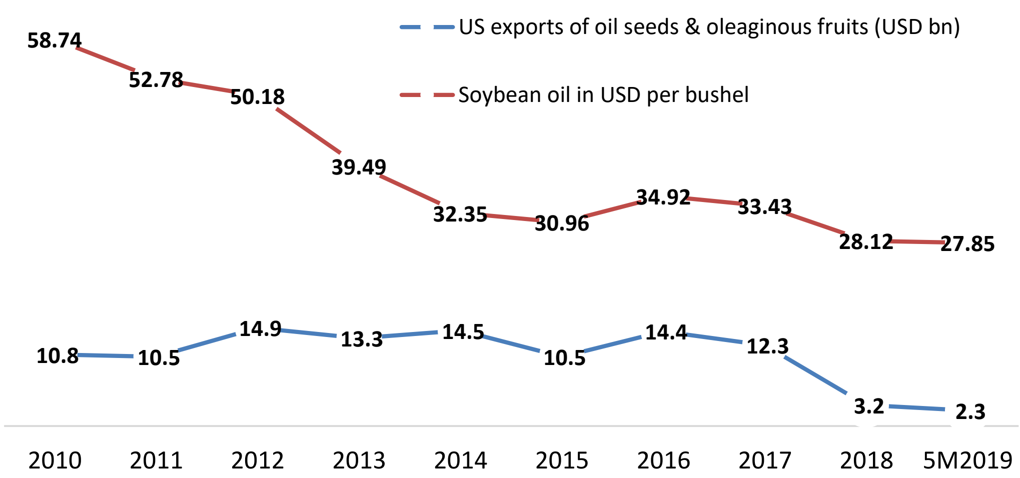
Plantation – neutral

Crude Palm Oil (CPO) prices have been low this year despite inventory level coming off from its multiyear highs in December 2018. As of June 2019, total inventory stood at 2.42 million metric tonne (MT), significantly lower from 3.22 million MT at the end of 2018. Higher exports as well as consumption were able to reduce the level of inventory. As such, the main factor for lower CPO prices was none other than Soybean oil prices which currently hovering at USD28.6 per bushel against 2018 last year's average of USD30.3 per bushel. This is given the fact that the strong positive relationship between CPO and Soybean oil at 90.0%.

The trade war has led China reducing their imports of Soybean from the US as a form of retaliation. This was reflected in the sharp fall of US exports in Oil Seeds and Oleaginous Fruits from USD12.3 billion in 2017 to USD3.2 billion in 2018, representing 74.2% decline. While the CPO prices have been low, the government has been quite proactive to improve the industries resiliencies. This include the phase in of B10 program which came to full force in February 2019. The initiatives would result 761,000 tonnes of palm oil consumption annually.

Apart from that, the government offor more Malaysia Sustainable Palm Oil (MSPO) certification whereby planters could fetch premium prices at the international markets. According to the Ministry of Primary Industries, MSPO certification accounted for 42.0% of total 5.849 million hector of palm oil plantation while aiming for a full MSPO certification by end of 2019. We ascribe neutral rating for the sector as the CPO prices are expected to remain under pressure in view of the ongoing trade war between the US and China which has significant impact on Soybean oil. However, palm oil industry is deemed to be an important sector for the country in view of its potential in renewable energy space. Apart from that, the complexity of the downstream sector such as oleo-derivatives could also be the key catalyst for higher value added manufacturing activities.

Chart 8: US exports of oil seeds & oleaginous fruits in USD billion and Soybean oil price



Source: CEIC

Table 5: Crude palm oil (CPO) statistics

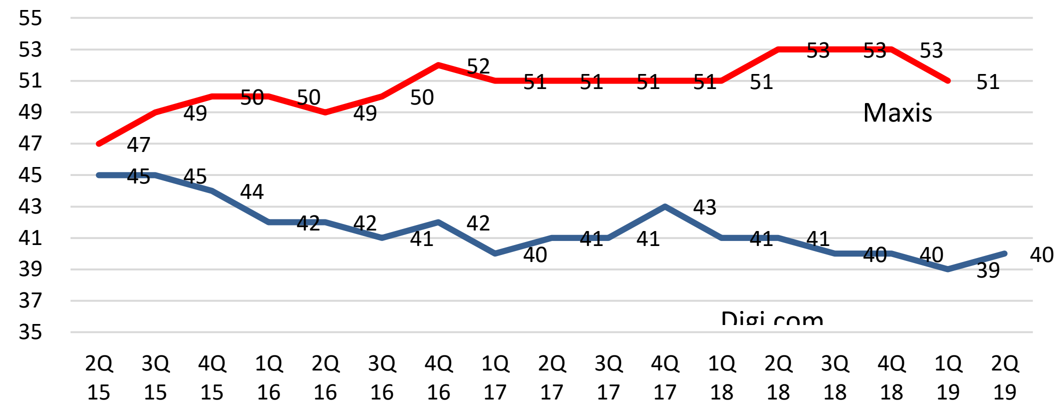
000 metric tonne	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
Opening stocks	**3,216**	**3,005**	**3,059**	**2,923**	**2,730**	**2,447**
Production	**1,737**	**1,545**	**1,672**	**1,649**	**1,671**	**1,518**
Y-o-Y	9.5%	15.0%	6.2%	5.8%	9.6%	13.9%
M-o-M	-3.9%	-11.1%	8.3%	-1.4%	1.3%	-9.2%
Exports	**1,681**	**1,325**	**1,620**	**1,654**	**1,715**	**1,383**
Y-o-Y	14.1%	6.6%	3.4%	8.1%	32.7%	22.4%
M-o-M	21.5%	-21.2%	22.2%	2.1%	3.7%	-19.4%
Imports	**81**	**94**	**131**	**62**	**62**	**101**
Y-o-Y	134.0%	40.4%	231.2%	74.4%	91.5%	17.9%
M-o-M	-25.0%	15.7%	39.2%	-52.7%	-0.5%	63.9%
Consumption	**349**	**260**	**320**	**251**	**301**	**260**
Y-o-Y	5.2%	8.8%	74.0%	19.5%	12.8%	-6.4%
M-o-M	7.8%	-25.7%	23.4%	-21.7%	20.1%	-13.5%
Closing stocks	**3,005**	**3,059**	**2,923**	**2,730**	**2,447**	**2,424**
Y-o-Y	17.9%	23.5%	24.9%	24.4%	11.6%	10.0%
M-o-M	-6.6%	1.8%	-4.5%	-6.6%	-10.3%	-1.0%
Stock-to-usage	**8.6**	**11.8**	**9.1**	**10.9**	**8.1**	**9.3**

Sources: MPOB & CEIC

Telecommunication – neutral

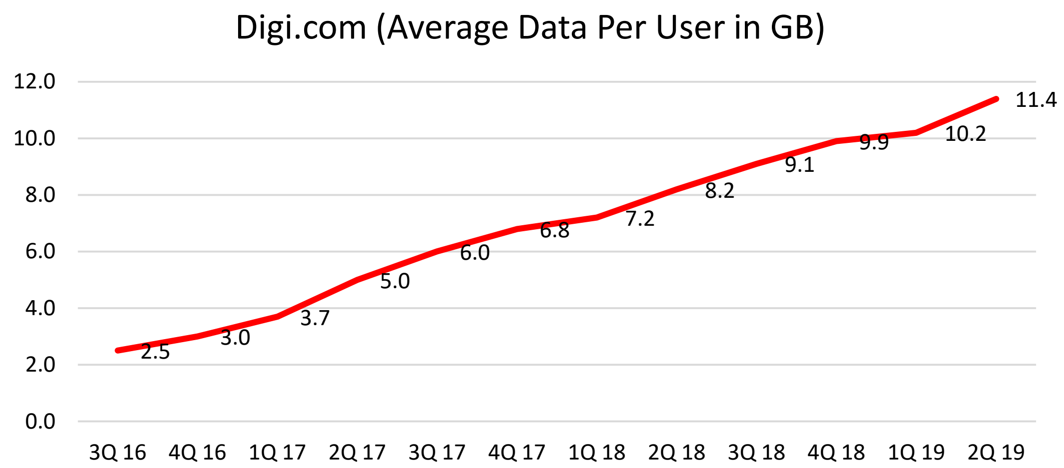
The main industry players were generally recorded weaker results in the 1QFY19. Net profits for Maxis, Digi and Axiata and were down by 22.0%, 12.0% and 33.0% (core basis) respectively during the first three months of financial year 2019. The Average Revenue Per Users (ARPU) were also not gaining traction, suggesting intense competition from the Mobile Virtual Network Operators (MVNO). While demand for data remain robust, the need to shift into the fifth generation (5G) network have become more pressing. In particular, policy makers are preparing the country to embrace the fourth Industrial Revolution (IR4.0) that will enable other industries to fully exploit the power of artificial intelligence, robotics, big data, virtual reality and software engineering. As such, the players are expected to incur massive capital expenditure in order to prepare the right infrastructure as well as acquisition of telco spectrum. Against such backdrop, mergers and acquisitions appears to be compelling option in order to stay ahead of the curve. Already, Axiata Group Berhad and Telenor ASA are currently in discussion to establish a new merged entity that will operate in ASEAN and South Asia markets. The proposed transaction was announced on 6 May and if materialise, Celcom under Axiata would be merged with its rival, Digi.Com Berhad. In light of this, we are maintaining our neutral call for the sector as the competitive forces are expected to be more intense while pricing power among the players are likely to be affected by the government aspiration to offer high speed data with competitive pricing.

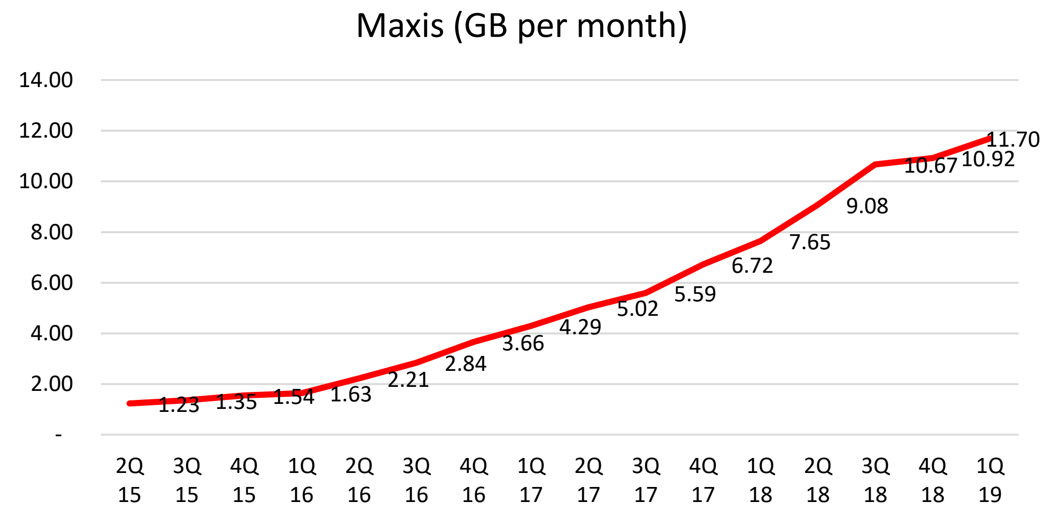
Chart 9: Average Revenue Per User (ARPU) in RM – Blended



Sources: Maxis & Digi.com

Chart 10: Data usage





Sources: Maxis & Digi.com
*GB=Giga byte

Education – neutral

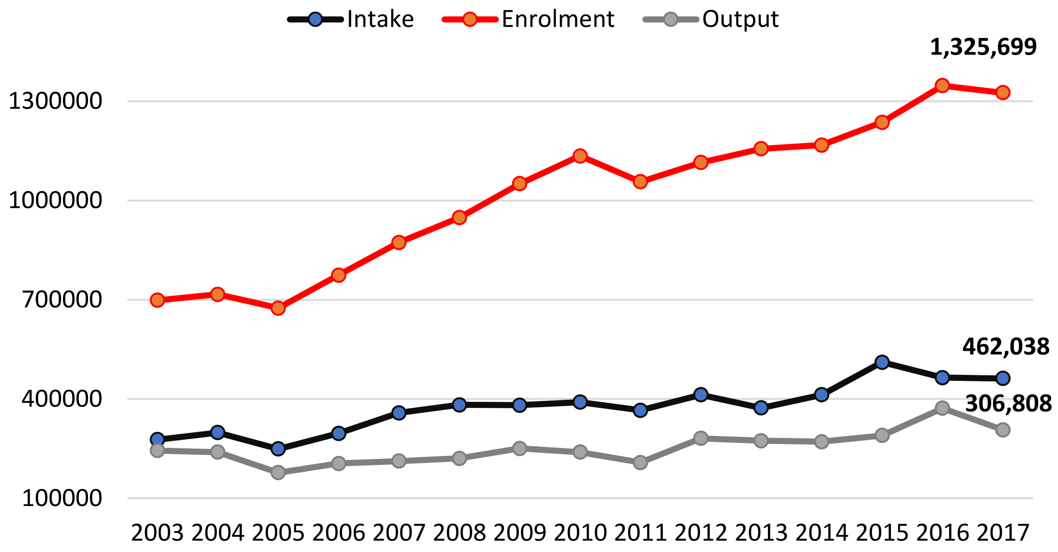
One of the key areas under Malaysian Budget 2019 is to ensure the socio-economic well-being of Malaysians via proper education. As such, the Ministry of Education (MOE) has been the largest recipients with total allocation of RM60.2 billion or 19.1% of the total Budget 2019. From this, a total RM30.0 million is specifically set aside for the Training and Vocational Education and Training (TVET) Prestige Fund, which aimed to bring the quality of education to a greater height. At the same time, there will also be an additional allocation of RM20.0 million to raise youth competency through a TVET sponsored Bootcamp. These indirectly will boost our youngsters' confidence and to be more competitive in the job market. Our government has recognised TVET as one of the key priorities in order to be a developed nation. As such, the government decision to lessen the admission requirement for Indigenous People into public TVET institutions was seen as positive steps as it helps to empower the community and more towards inclusive society.

Judging from the Department of Statistics Malaysia (DOSM) data, the majority of employees in Malaysia has secondary education, totaling 8.22 million from the total labour force of 15.01 million in the 1Q2019. However, the percentage share from this group has decreased by 1.0%, from 55.8% in 4Q2018 to 54.8% in 1Q2019. Meanwhile, employees with tertiary education increased by 0.9% to 29.6% in 1Q2019 (4Q2018: 28.7%). This indicates employer's preference towards labour who are highly skilled and has better educational background. Therefore, demand for higher education is expected to be healthy in light of the potential upward mobility.

While the number of students graduated from colleges or universities were declining from 371,935 in 2016 to 306,808 in 2017, however, the number of students' intake by educational institutions remained steady at 462,038. Additionally, the inflation rate for tertiary education fees has flattened to 0.4% year-on-year (y-o-y) in May from 1.1% in December last year (Average 2018: 2.8%). This suggests that the costs of education is still fairly bearable and should not inhibit the average Malaysians to pursue their studies to a higher level. This could also attract foreign students in view of weaker ringgit which would make the total cost to study in Malaysia very competitive.

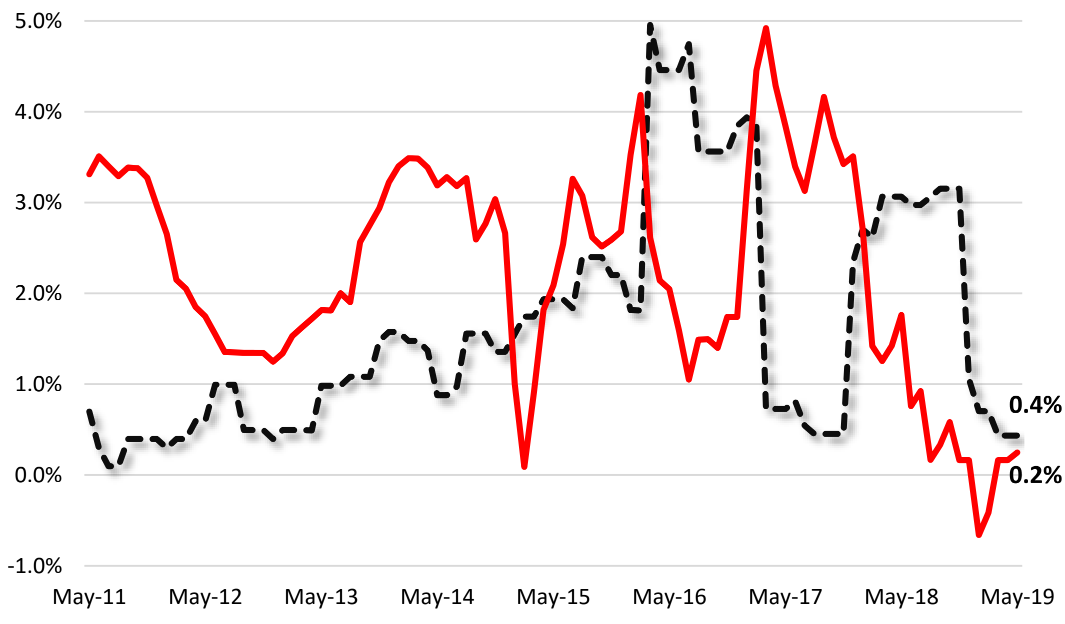
All in all, the sector's neutral call is maintained premise on rising cost amidst intense competition between the public and private universities. Additionally, limited fiscal space would mean the public universities would need to find ways and means to improve its revenue collection.

Chart 11: Number of students' intake, enrolment and output (graduates)



Source: MOHE

Chart 12: CPI for tertiary education: Diploma and above y-o-y%

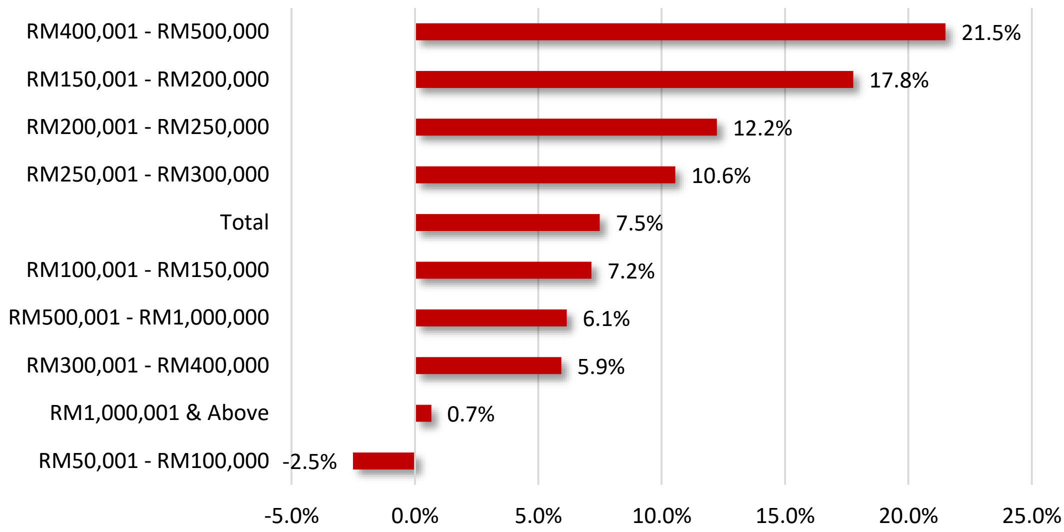


Source: CEIC

Property (residential) – neutral

Total property transaction stood at 84,424 units valued at RM36.97 billion in the first quarter of 2019. This is higher compared to 79,480 units (RM35.17 billion) recorded in the same period last year, representing 6.2% growth. Of this amount, residential properties accounted for 61.8% with total property transaction stood at 52,212 units (RM18.26 billion), higher by 7.5% from the same period last year. Property prices between RM400,001 – RM500,000 recorded the highest transaction growth of 21.5% followed by prices between RM150,001-RM200,000 (+17.8%), RM200,001-RM250,000 (12.2%) and RM250,001-RM300,000 (+10.6%). The House Ownership Campaign (HOC) is likely to be the key catalyst for the higher sales growth during the first three months and it is expected to do so in the remainder of the year following the extension of HOC until 31 December 2019. Lending to residential properties is also growing with loans application grew by 36.6% year-on-year in May from 12.2% in the preceding month. Similarly, total loans approval for the residential properties increased by 32.4% in May from 13.3% previously.

Chart 13: Residential property transaction growth in 1Q2019 (y-o-y)



Sources: NAPIC

Despite that, the number of unsold units for completed residential properties continue to grow at a rapid pace of 30.7% y-o-y to 32,936 units in the 1Q2019. Home prices between RM200,000 to RM400,000 accounted the largest share of unsold units in the first three months this year with total share of 39.4%. This followed by property prices between RM400,000 to RM600,000 with total share of 16.8%.

Table 6: Unsold units for completed residential properties

House prices	Unsold units	Proportion
RM0 - RM100,000	2,142	6.5%
RM100,001 - RM200,000	2,425	7.4%
RM200,001 - RM300,000	7,506	22.8%
RM300,001 - RM400,000	5,485	16.7%
RM400,001 - RM500,000	2,852	8.7%
RM500,001 - RM600,000	2,697	8.2%
RM600,001 - RM700,000	2,175	6.6%
RM700,001 - RM800,000	1,173	3.6%
RM800,001 - RM900,000	1,666	5.1%
RM900,001 - RM1,000,000	484	1.5%
More than RM1,000,000	4,331	13.1%
Total	**32,936**	**100.0%**

Source: NAPIC

On the same note, House Price Index (HPI) has been moderating to 1.3% y-o-y in the 1Q2019 from 2.6% in the preceding quarter. HPI for Semi Detached houses recorded 0.9% decline during the 1Q2019 while High Rise Unit and Detached House recorded 0.2% (4Q2018: -1.0%) and 0.3% (4Q2018: -1.4%) increases in the first three months of this year. As for Terraced House, its HPI moderated from 2.6% in the 4Q2018 to 1.3% in the 1Q2019.

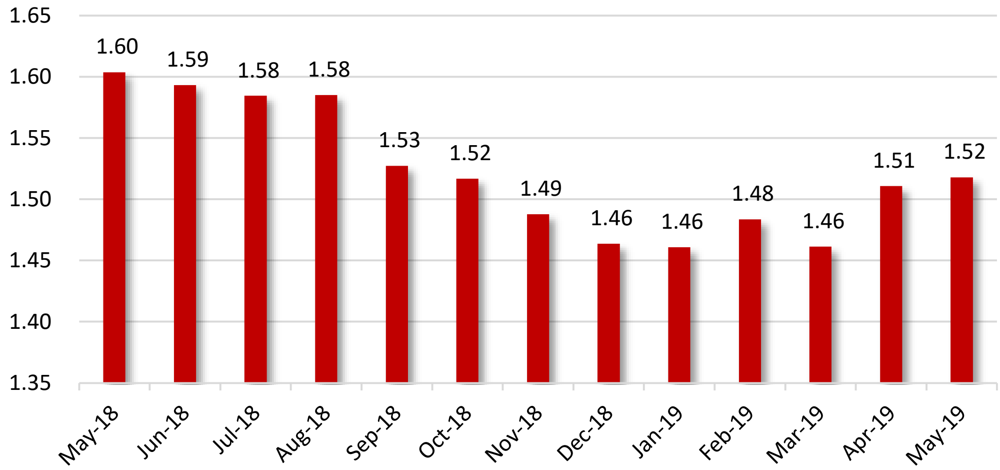
In a nutshell, property markets have been very soft as prices are mostly beyond reach for average Malaysians. Addressing the access to financing is only part of the equation. More importantly is how the government would stabiles the housing prices and to allow household income to grow more sustainably. In that sense, a change in mindset is urgently required among the Malaysians as government is currently experiencing limited financial resources. Perhaps, renting a house may not be such a bad idea as this will allow households or individuals to be nimble in managing their finances. The good thing about renting is that it gives you the flexibility to shift to a different house should he or she found a good deal at a different location. Or perhaps the individual would get better job offer at different location or geographical area and therefore, decision to move would not be too hassle.

Banking – neutral

There are multiple challenges ahead facing the industries. For one, weaker economic growth would mean asset quality to experience some deterioration. Gross Impaired Ratio (GIR) increased from 1.46% at the end of 2018 to 1.52% in May this year. GIR for Working Capital (0.22% to 2.04%) and Construction (0.19% to 6.77%) saw sizeable increases while for households, there was a slight decline in GIR from 0.99% in December 2018 to 0.98% in May 2019. As such, businesses may have difficulties to service their debt obligation in view of weaker sales and higher cost of doing business.

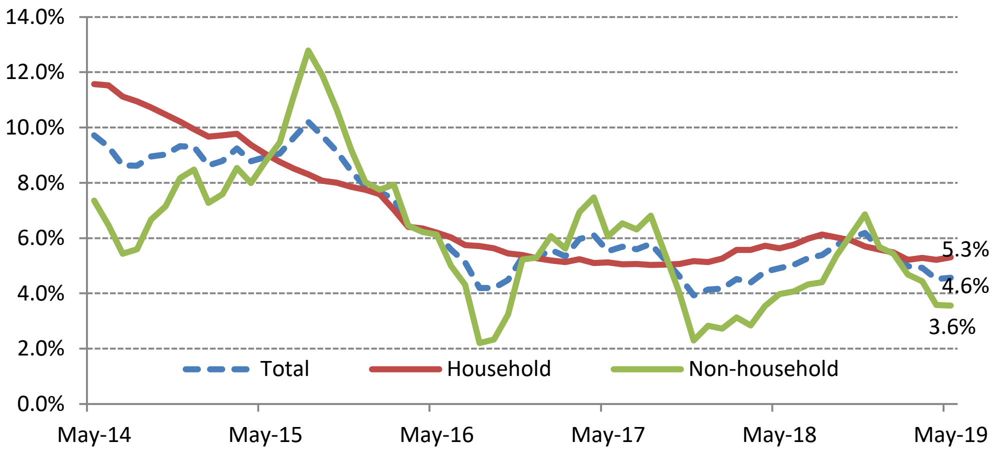
The other challenges experienced by the banks is the competition for deposits in order to meet the regulatory parameters such as the Net Stable Funding Ratio (NSFR) which will be implemented in January 2020. While the liquidity condition in the financial system remain ample, the outflow of capitals from the capital markets would, to some degree, exert upward pressure on the market rates. This situation could, in some ways, affect the deposit rates. Notwithstanding that, the banking institution is firmly sound with capital in excess of 8.0% minimum requirement is estimated at around RM153.0 billion in May 2019. Therefore, banks can always increase its financing activities without compromising their level of capital adequacy. At the moment, Common Equity Tier 1 (CET1) ratio, Tier 1 Capital Ratio and Total Capital Ratio (TCR) stood at 13.36%, 14.05% and 17.46% respectively as of May 2019. In view of the difficulties in the operating environment, we foresee banks would step up their efforts to boost fee based income, investing in technologies as a means to improve the economies of scale as well as going for Small and Medium Enterprises (SMEs) segment to increase their asset yield. All in all, the sector is accorded with neutral rating in light of the economic uncertainties.

Chart 14: Gross Impaired Ratio (GIR)



Source: CEIC

Chart 15: Loans growth y-o-y%

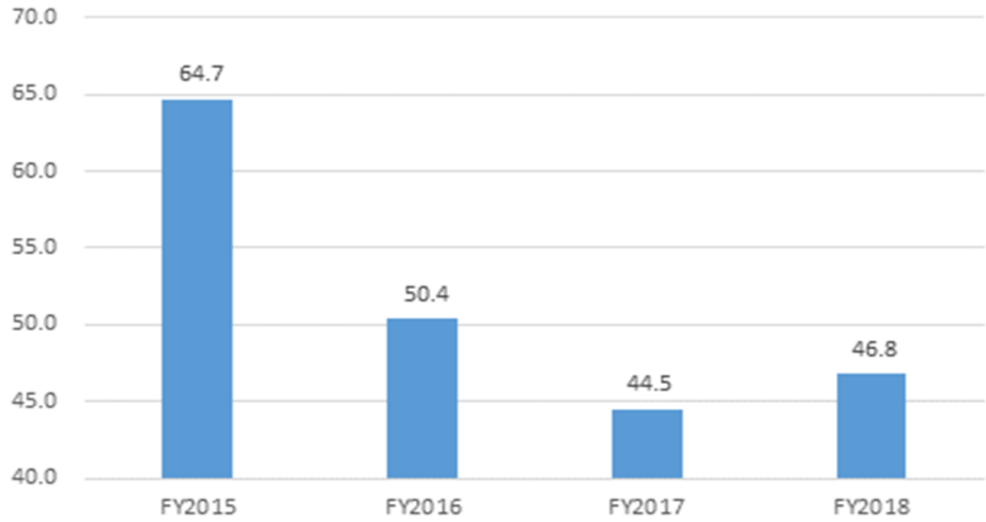


Source: CEIC

Oil & gas – neutral

We remained neutral on the Oil & Gas sector as oil crude oil prices are expected to remain tepid in view of excess supply in the industries. Our Brent crude oil prices forecast for this year is USD63.0 per barrel which is very much in line with BNM's range forecast of USD60.0 to USD70.0 per barrel for 2019. Having said that, the upstream players have been getting contracts with duration from 1 to 5 years. This has resulted higher asset utilization which helped improve their profitability in the near term. In a nutshell, there are pockets of opportunities for the sector in view of wide application of the products such as petrochemical industries. As such, the oil majors such as Petronas would need to carefully plan their Exploration and Production (E&P) activities in order to ensure steady supply of oil in the future. In FY2018, Petronas capital investment stood at RM46.8 billion, higher from RM44.5 billion in the preceding year. For FY2019, Petronas is expected to ramp up capital investment to above RM50 billion, suggesting further normalization of capital expenditure.

Chart 16: Petronas Capital Investment in RM billion



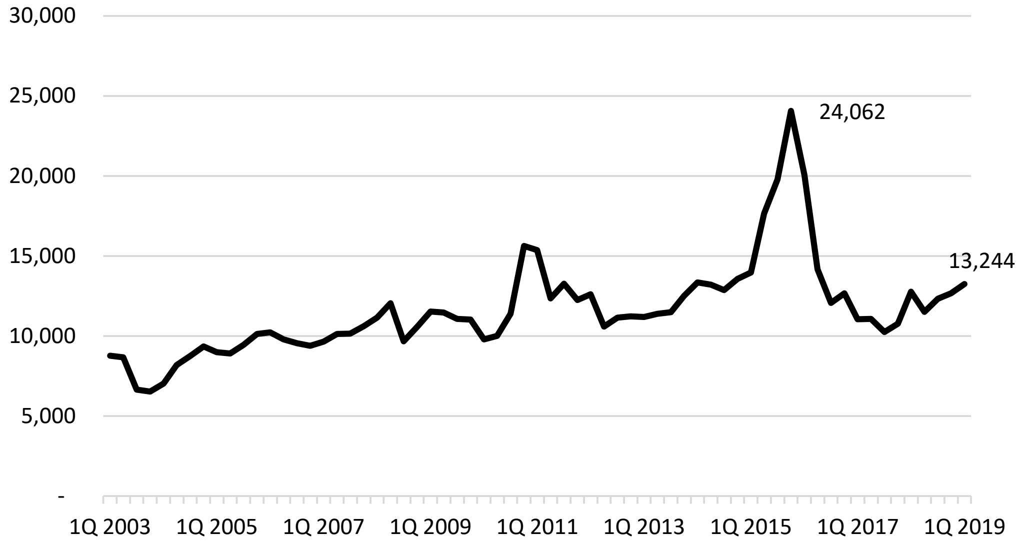
Source: Petronas

Property (shop units) – negative

Total unsold units for the commercial property (shop) gradually rising from 10,241 units in the 3Q2017 to 13,244 units in the 1Q2019. Such trend happens as total unsold units hitting its historical high of 24,062 units in the 4Q2015. Higher unsold commercial property were mostly contributed by the completed units which grew 37.8% y-o-y to 5,472 units in the 1Q2019. Meanwhile, under construction and not yet constructed unsold units were down by 9.5% and 34.3% to 7,276 units and 496 units respectively during the first three months of 2019. Based on property type, overhang units lingering around 1 to 1.5 storey (297 units), 2 to 2.5 storey (2,530 units), 3 to 3.5 storey (1,396 units) and stratified (1,143 units).

By states, total unsold units were concentrated in Selangor (3,069 units), Johor (3,017 units), Sabah (1,059 units), Perak (1,023 units) and Pahang (894 units). Although the extent of overhang was not too severe, we maintained the negative call for the sector on account of weak property transaction for the commercial segment which has fallen by 25.9% y-o-y to RM6.5 billion in the 1Q2019. Apart from that, the emergence of online shopping can have an impact to demand for shop houses. The usual mantra “location, location, location” will continue to be the main key consideration before investing in a shop houses.

Chart 17: Total unsold units for commercial property



Source: CEIC

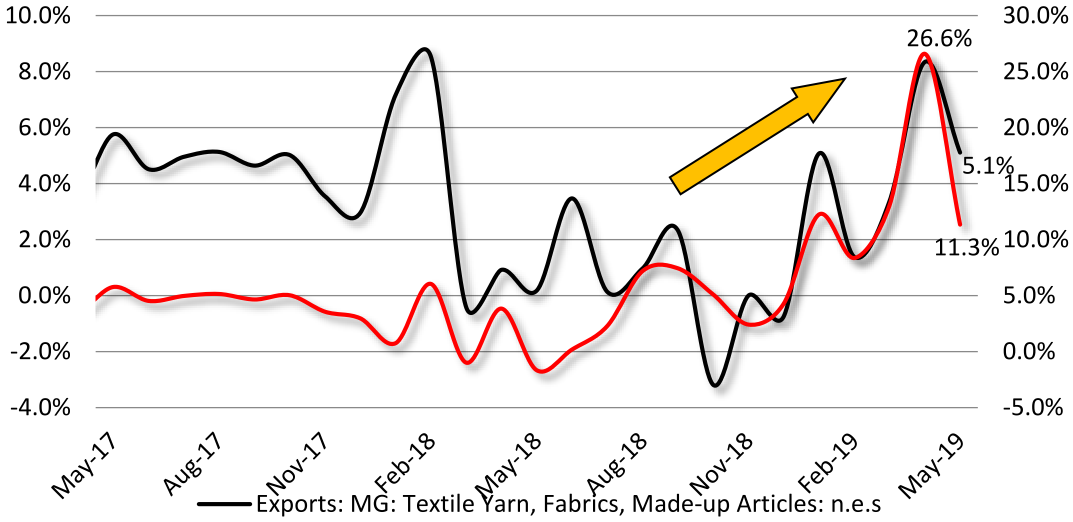
Textile – neutral

Export growth for Textile Yarn, Fabrics, Made-up Articles grew by 2.3% in the first five months of 2019 from 1.2% in the same period last year. Production activities in the sector are also improving during 5M2019. The Industrial Production Index (IPI) for textile related industries expanded by 4.6% in 5M2019 as compared to 3.7% in 5M2018. Overall, textile industries appear to have gained its importance premised on its share to total exports which has risen from 1.5% in 4M2018 to 1.6% in 4M2019. According to Department of Statistics Malaysia (DOSM), the sales value of own manufactured products related to textiles, wearing apparel, leather products & footwear recorded sharp rose by 6.4% in the first five months of 2019 (5M 2018: 0.6%).

Based on the Malaysia Investment Performance Report (MIPR) 2018, US held on to its position as the top trading partner for Malaysia’s exported textile products. The US has purchased a total amount of RM1.6 billion (13.0%) of the industry’s total exports during 2018. Against such backdrop, Malaysian government has been supportive via industrial policies such as the extension of grant under the Domestic Investment Strategic Fund (DISF) and Automation Capital Allowance (ACA) in order to increase industry players’ efficiency, as well as to improve quality of the products.

Under the ACA, textiles industry is deemed to be high labour intensive industries which is fell under the First Category. Therefore, ACA will be granted of 200% on the first RM4 million expenditure incurred within 3 year of assessment from 2015 to 2020. Notwithstanding that, the ongoing trade war is expected to have material impact to global demand. Given that, the neutral rating is maintained.

Chart 18: Textiles Exports vs. Production



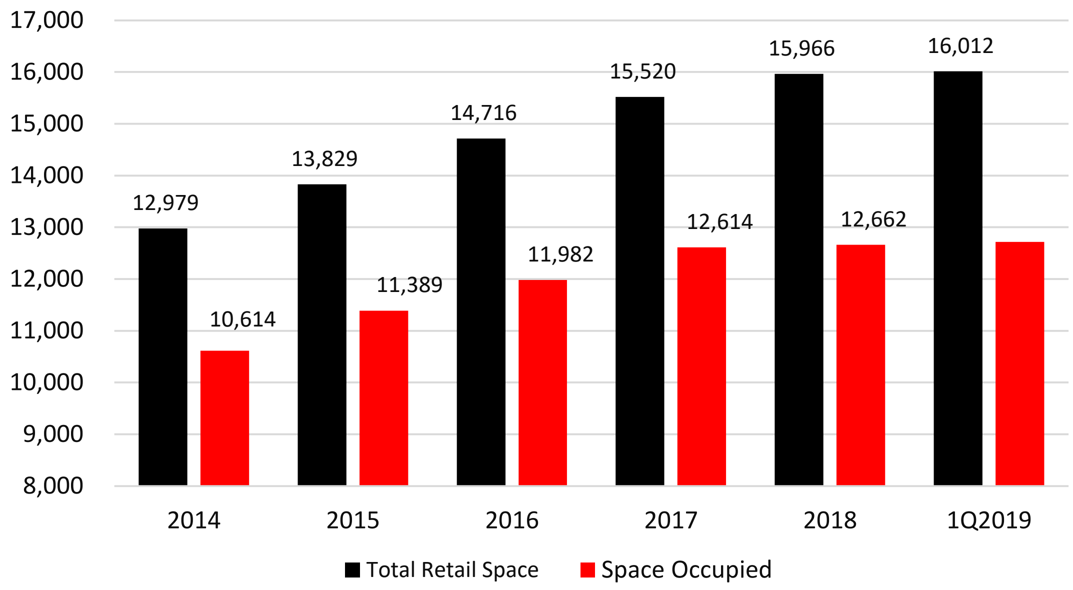
Source: CEIC

Trading / retail – avoid

Total retail space for shopping complexes in Malaysia expanded to 16,012k square meter (sqm) in 1Q2019 from 15,966k in 2018. Similarly, space occupied increased by 0.4% to 12,717k sqm in 1Q2019 from 12,662k last year. As such, occupancy rate edged up to 79.4% in 1Q2019 from 79.3% at the end of 2018. Key states such as Kuala Lumpur and Johor recorded higher occupancy rate of 83.1% (2018: 82.8%) and 77.9% (2018: 71.7%) in 1Q2019 respectively. This indicates there is still strong demand from the tenants for the malls that are located at the strategic place with easy access to public transportations. According to CBRE – WTW Real Estate Market Outlook 2019, 11.3 million sqm retail space would enter the market by 2020 which may press the occupancy rate lower. The incoming supply will be contributed by the mega malls such as Empire City Mall, Tropicana Garden Mall, TRX Lifestyle Quarters and Pavilion Bukit Jalil.

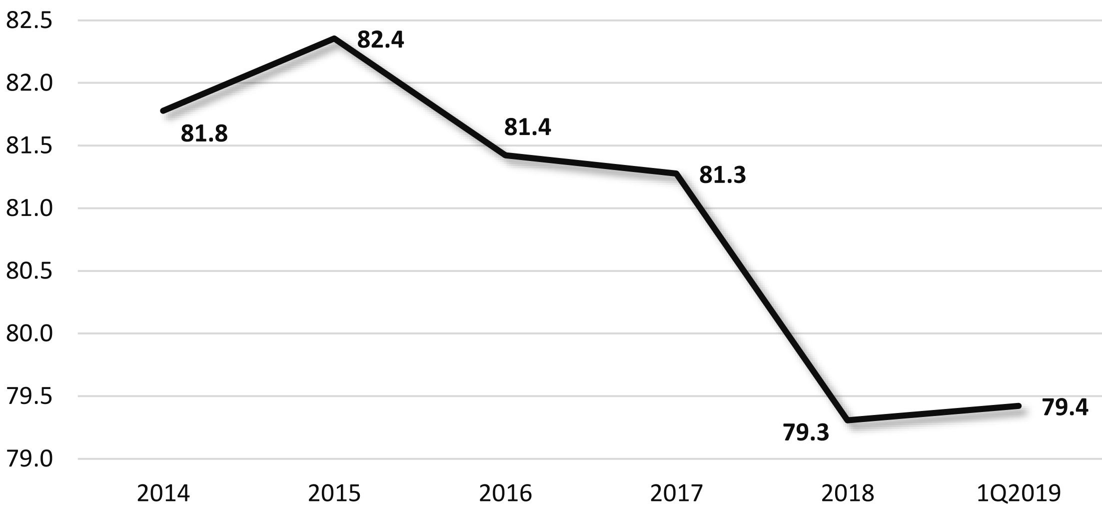
Be that as it may, we foresee a big challenge for shopping complex property as the fast growing of e-commerce can affect retail space demand. Apart from that, changing lifestyles of the new generations who are preferring online shopping can also give an impact to the number of patrons to the shopping malls. Consequently, it will affect the tenant's revenue streams as well as lower occupancy rate and rental rates for the landlords. Therefore, traditional retailers need to tailor-made its value proposition in order to attract interests of the prospective visitors. Hence, we are maintaining our avoid stance on the sector, after considering the evolving of technologies and lifestyle of the millennial.

Chart 19: Total Retail Space & Space Occupied in Shopping Complexes ('000 sqm)



Source: NAPIC

Chart 20: Occupancy Rate in Shopping Complexes, %



Source: NAPIC

Table 7: Occupancy Rate in Shopping Complexes, %

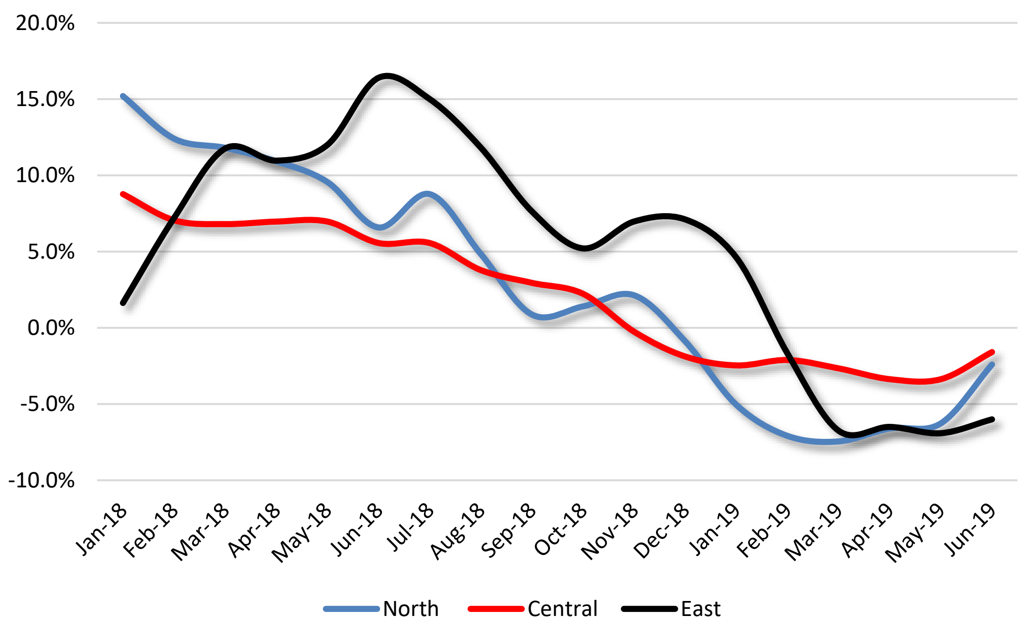
States	Occupancy Rates		
	2018	1Q2019	Change
W.P. Kuala Lumpur	82.8	83.1	0.3
W.P. Putrajaya	82.6	82.6	0.0
W.P. Labuan	95.9	95.9	0.0
Selangor	84.3	81.8	-2.5
Johor	71.7	77.9	6.2
Pulau Pinang	73.1	72.2	-0.9
Perak	83.9	84.0	0.1
Negeri Sembilan	70.7	72.0	1.3
Melaka	70.2	70.2	0.0
Kedah	79.1	78.1	-1.0
Pahang	67.0	66.2	-0.8
Terengganu	72.8	74.1	1.3
Kelantan	91.4	91.4	0.0
Perlis	100.0	100.0	0.0
Sabah	81.9	81.9	0.0
Sarawak	82.3	79.6	-2.7

Source: NAPIC

Steel - negative

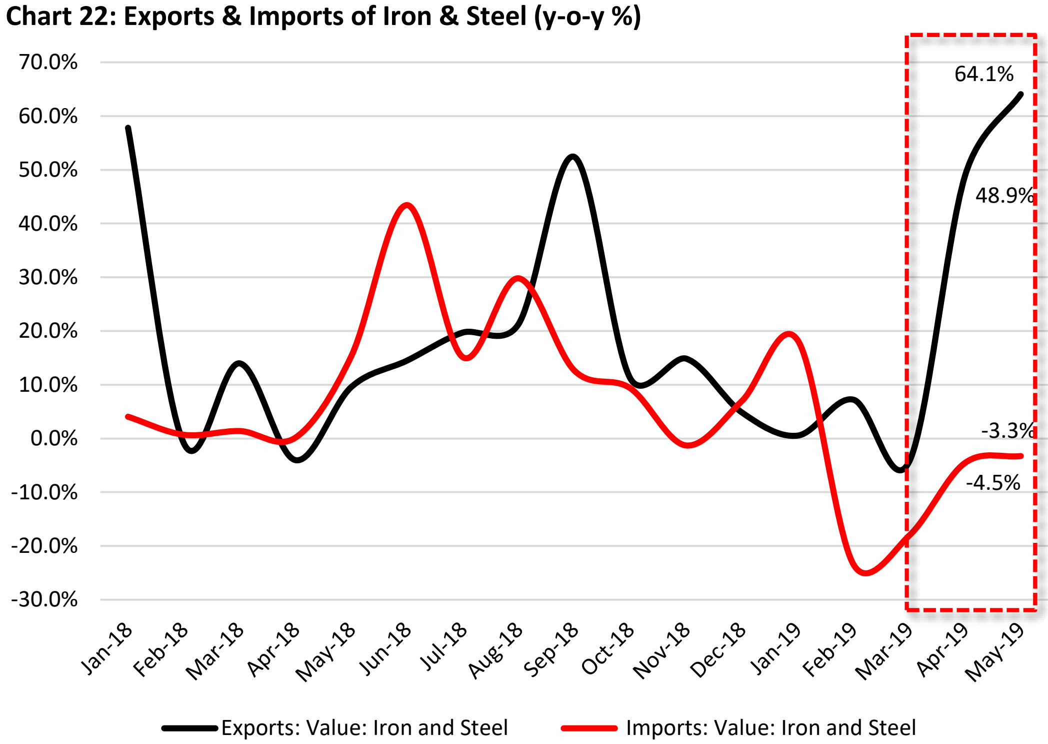
Forecasted demand for steel is expected to be positive this year with world steel demand is anticipated to rise to 1.63 billion tonnes against 1.59 billion tonnes in 2017, according to Malaysian Iron and Steel Industry (MISIF). Apart from that, Malaysia's Apparent Steel Consumption (ASC) is projected to grow from 9.4 million tonnes in 2017 to 12.4 million tonnes in 2025, giving 3.5% compound annual growth rate (CAGR). However, the industry is still plagued with excess capacity with capacity utilization rates are well below the 80% benchmark. At the current juncture, production capacity for Malaysian iron and crude steel stood at 5.1 million tonnes and 12.4 million tonnes respectively in 2017. The situation was clearly manifested in the low selling prices for steel. Prices for Mild Steel Round Bar 10 mm (North) has been declining for seven consecutive months, falling from RM2,657.15 per Metric Ton (MT) in December 2018 to RM2,597.78 per MT in June 2019. However, exports of iron & steel shot up by 64.1% in May (April: 48.9%, May 2018: 9.6%) amidst lackluster domestic demand as weakening Ringgit against the US dollar has resulted in better competitive pricing at the international markets. The government announcement on the reinstatement of selected mega infrastructure projects such as East Cost Rail Link (ECRL) and Bandar Malaysia is clearly positive for the sector as this will improve plant utilization rates among the players. However, we retained our negative call for the sector in view of the excess capacity in the industries which remain prevalent. Already, the key players such as Ann Joo Resources Berhad (1QFY2019: -111.0%), Press Metal Berhad (1QFY2019: -24%), Amalgamated Indsutrial Steel Berhad (1QFY2019: -42%) and Lion Industries Corporation Berhad (3QFY2019: - 219.0%) have recorded a massive decline in their net profits.

Chart 21: Steel prices – Mild Steel Round Bars 10 mm (RM per MT)



Source: CEIC

Chart 22: Exports & Imports of Iron & Steel (y-o-y %)



Source: CEIC