Banking

How Low Can We Go?

POSITIVE (Maintain)

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HIGHLIGHTS

- **The reversal in global bond yields offers an opportunity for banks to recoup investment losses, but not the damage done to COF via more intense deposit competition – with festive season just round the corner, there is no window for alleviation.**
- **Economic indicators and the market's lackluster response suggest that there is no confidence in bond yields staying near present levels, so a reversal could happen anytime. The most glaring indicator is US inflation coming in above expected.**
- **Theoretically, as long as the Iran Conflict persists, there will be further room for banking valuations to fall further. We look at the GFC and Covid Pandemic for clues as to how far the floor is. Spoiler: We can go lower.**
- **Several factors point toward relative stability in banking share prices at least until end-CY26 – the biggest threat is if bond yields hike once more.**
- **Maintain POSITIVE call: Dividend yields are too attractive to ignore, and the reversal in bond yields imply some room to recoup earnings.**

Sector Verdict

The recent decline in bond yields make the banking sector a lot more attractive at this price point -- even though some damage has already been done. The main fear was dividend yield disappointments due to investment losses cutting into dividend yields, but now there's a chance for this to be reversed. With mid-to-large sized banks boasting ~6% yields, it's a good opportunity to accumulate. But judging how equity markets have not rallied simultaneously, be wary that the market is not confident that this signals that the worse of bond yields is over.

Core Themes

1. ▲ **Core beneficiary of emerging market inflows.** Banks serve as a proxy for the economy, and GDP is outperforming expectations. Local banks are also more defensive than regional peers, driven by geopolitical stability, high dividend yields, and superior asset quality.
2. ▲ **Dividend yields are extremely attractive.** We expect further capital release initiatives ahead, with several banks already announcing special dividends (or at least commitments to further increase payout) and prioritising subsidiary capital upshoring.
3. ▲ **Cost pressures surprisingly well maintained.** Despite initial concerns about cost inflation and high tech spend, we have been seeing extremely low OPEX inflation across the board. This is a sign that tech efficiencies are already bringing in savings.
4. ▲ **Loan growth remains strong for now.** Business loans have been on a hot streak, buoyed by the construction cycle and data-centre announcements. The latest BNM banking stats imply that this momentum should remain for now, despite drag from retail loan demand.
5. ► **Fee income is driving the topline, though non-fee income could see some weakness.** The core driver is wealth management income, which sees a surge as wealth fees are diverted from the Middle East to the ASEAN region. However, non-fee NOII outlook is gray, though the reversal in bond yields imply some room to recoup losses.
6. ► **Liquidity is still flush but expect a return to deposits.** Both CASA and FDs have seen significant growth as rising bond yields make wholesale funding less viable. We might see some turnaround, following the recent retracement in bond yields.
7. ► **Asset quality problems are confined to smaller banks.** Stress comes primarily from the retail portfolio – in residential mortgages and unsecured loans. 2HCY26's NCC should be lower, with several one-off overlays already made during this quarter. But if the Middle East conflict is prolonged past 1QCY26, we could be in for a tougher time.
8. ▼ **NIM weakness to persist.** While further steep compression is unlikely, most banks do not expect much recovery in subsequent quarters. Expect deposit competition to remain tight as high loan demand persists, with a lot of uncertainty on bond yields future trajectory. Higher asset yields from the recent surge in business loans provide the main means of offset. An OPR hike in CY27 could also provide short-term relief.

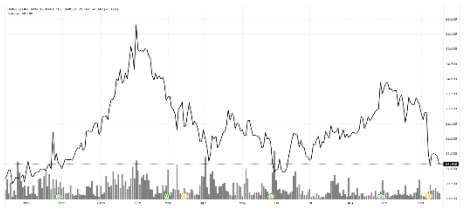
COMPANY *IN FOCUS*

HL Bank

Maintain BUY | Target Price: RM29.80
Price @ 15 October 2026: RM21.16

- Increases dividend payout yearly, with enough capital to spare.
- Defensive pick: Asset quality and provisioning remain the industry's best.
- Regional presence gives HLBK more room to grow loan growth and fee income than most

SHARE PRICE CHART

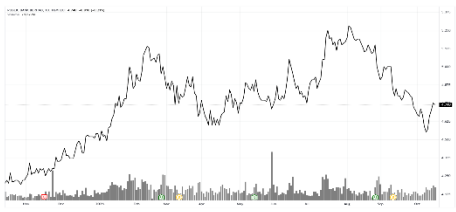


Public Bank

Maintain BUY | Target Price: RM5.53
Price @ 15 October 2026: RM4.74

- Defensive pick due to its solid asset quality and predictable quarterly earnings.
- High dividend yields, further backed by special dividends.
- In recent months, a solid loan growth trend is emerging.

SHARE PRICE CHART



1. FALLING BOND YIELDS OFFER RESPITE – BUT NOT ALL IS REVERSIBLE

The recent fall off in global (and local) bond yields is good for banking fundamentals… but some damage has already been done. After spiking up to nearly 4.2% in the last month, 10Y MGS yields have come down last week to a more manageable 3.8%. Global bond yields have moved in a similar direction. This provides some relief to investment income worries: If positioned correctly, local banks can benefit from a reversal in investment income returns in 4QCY26 after the disastrous yield hike in 3QCY26. The fall in bond yields also make wholesale funding methods more viable once again, which provides COF optimisation opportunities.

But its not a one-for-one reversal. The hike in bond yields has already led to further intensification of deposit competition in the last couple of months, as wholesale funding methods becomes less viable and corporate deposit rates go through the roof. Couple this with the higher-than-normal loan demand seen in previous quarters. Even with the reversal in bond yields, the elevated deposit rates are unlikely to dissipate to former levels as we enter the period for seasonal promotion. Hence, while investment losses have a chance to be reversed in 4QCY26, the impact on COF remains.

For bond yields, is the worst over? The market does not think so – there is no proper equity rally. Unfortunately, equity markets did not rally simultaneously as bond yields fell (which is usually the case). This implies that the market still fears the possibility of weak corporate earnings and the threat of further global interest rate hikes. Our banking stocks are still trading well below pre-bond-yield-hike valuation levels. Some elements of this may be due to equities lagging the bond rally. But at the same time, the fears are very valid: With the latest data suggesting that US CPI is rising more than expected in September, there's always a possibility that bond yields may go up again given the higher likelihood of an interest rate hike.

FIG 1: 10Y MGS Yields came off from the peak some weeks ago



Source: Investing.com, MBSBR

2. SOME STABILITY IN THE SHORT-TERM… AND IS IT TIME TO ACCUMULATE?

We should see relative share price stability until the end of the year – unless bond yields hike again. Some notes:

1. **3QCY26's results is expected to be weak, but 4QCY26 should provide some offset.** Fears of a weaker 3QCY26 have likely been priced in. The recent fall in bond yields imply a stronger 4QCY26 earnings-wise, even with deposit competition. This allows banks to recoup investment losses, as well as increasing the viability of wholesale funding methods. The prospect of a stronger 4QCY26 provides a bit more certainty in the short-term.
2. **The biggest threat to share price stability is bond yields hiking up once again.** Which could happen, as the latest US inflation came in higher than expected. This erases all positive things to look forward to in 4QCY26.
3. **No dividend surprises/disappointments for now.** It is not a dividend quarter, so expect limited announcements. For banks issuing dividends, **ABMB** and **AMMB** should not see any surprises. The only bank to be wary of is **CIMB,** as expectations of a special dividend in 3QFY26 are very high.
4. **3QCY26's guidance is unlikely to be overly negative.** Apart from the negative bond yield impact (which the market has already priced in), most of banks' previous guidance should have already factored in prolonged conflict and cost inflation until at least end-CY26 (which has yet to come). Previous guidance, which was only minorly negative on asset quality, should still hold.
5. **End-CY26 is also too early to tell whether the Middle East conflict will be prolonged past 1QCY26 – so limited room for disappointments on this front.** A Republican victory is extremely unlikely. Even if Democrats win the mid-terms by a landslide, they will need time to apply enough political pressure on the Trump administration to deescalate – a process that may require a few months at the very least. The markets should be factoring in this lag period before pricing in further developments.

Dividend check: Are yields still attractive at the current price point? Yes, Big-to-mid-sized banks' yields are currently hovering at ~6% (above the usual ~5%). We think previous fears of dividend disappointment due to missed earnings are overblown, especially since the reversal in bond yields offer an opportunity to recoup investment losses in CY26. And with extra capital loosened from Basel implementation, there may be a small opportunity for upside in 4QCY26 results.

FIG 2: Current Dividend Yields Are Attractive

Banks	Relevant Dividend Yields (%)
MAY	6.5
CIMB	6.5
PBK	6.2
RHB	6.4
HLBK	5.8
AMMB	6.1
BIMB	6.9
AFFIN	4.8
ABMB	5.1

Source: Banks, MBSBR

Reiterating our stance: We remain POSITIVE on the Banking sector. Dividend yields are now too attractive to ignore, especially since the reversal in bond yields offers added certainty. The reversal in bond yields offer an opportunity for banks to recoup their losses. Share prices could see at least relative stability in the near term (reasons mentioned above). Business loan and fee income growth prospects remain solid for now, while asset quality (according to latest result season guidance, which should still be relevant) is not too big of an issue.

But at the same time, tailwinds will not persist in the long term – business loans could drop off toward the end of CY27, while retail loan growth sees no reason to buck its negative trajectory. Bond yields could easily reverse at any given time. And the banking sector outlook will turn incrementally negative the longer the Iran war is prolonged – our base case assumes resolution by 1QCY26.

3. FORECASTING THE BOTTOM – THEORETICALLY, HOW LOW CAN OUR VALUATIONS GO?

Theoretically, if the Iran War persists, there will always be a lower floor to share prices. As long as the war goes on, there will always be further threat of resultant rampant inflation and global bond yield/interest rate hikes. We are more optimistic: Our base case assumes that the US mid-term elections signify a turning point in the war, if the Democrats win a huge majority and apply enough political pressure for the Trump administration to cave – hopefully ending the war in 1QCY27.

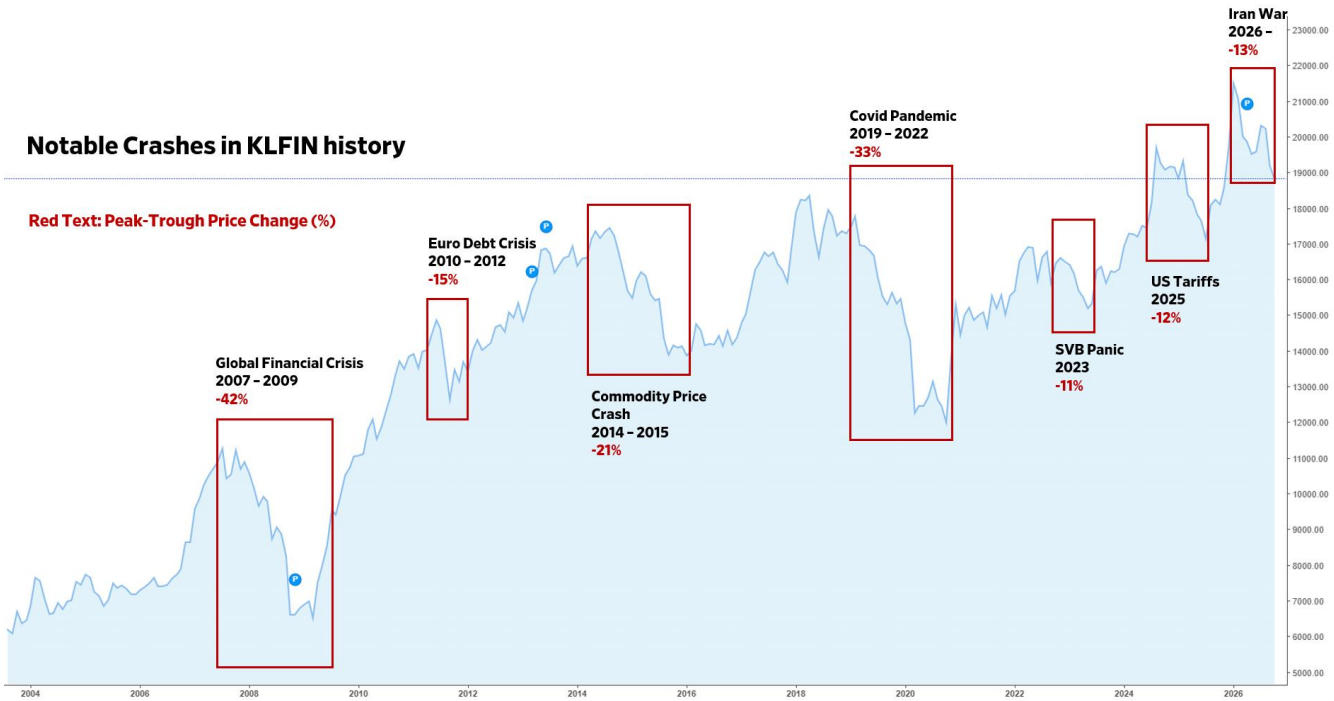
But realistically, it is not that simple, as the threat of escalation in these few months is significant. Iran has taken to sinking ships, while Trump and Netanyahu may attempt for one last grab for power if they fail in their coming respective elections. Hence, the threat of prolonged conflict well into CY27 is very real.

Looking at valuations, the closest point of comparison is the Covid pandemic. The KLFIN has seen multiple shocks since 2004. But the closest comparisons to our current situation are the GFC and Covid Pandemic, given the scale of the economic strain on the everyday consumer. Other, smaller crashes are usually panic induced with serious repercussions in other countries… but not Malaysia. This time, the KLFIN has already gone down by -13% from its peak – already comparable to the price tumble seen in some smaller shocks.

It is tempting to assume that the GFC is the most accurate point of comparison. But MY banks in that era were a lot less secure, with lower capital and liquidity safeguards. And a fair amount panic came from the collapse of the Lehman Brothers – tighter regulation imply similar incidents will not happen this time around. Also, we do not have data for all the banks during the GFC, so we are going to use Covid Pandemic valuations instead.

Admittedly, things are still nowhere as dramatic compared to the Covid pandemic – there is no widespread lockdown, and logistical issues are not as severe. But in some ways, we are on much less secure ground this time: the population is not as financially secure as it once was, having already depleted savings during the pandemic – and wages have not kept pace. And the reality is that conflict will drag on for a fair few months (at the very least), as the window to stop the war has not yet arrived – and even if the war stops, it will take even more time for logistical disruptions and cost pressures to normalise.

FIG 3: KLFIN Shocks



Source: Investing.com, MBSBR

We used valuations from the Covid Pandemic to gauge a possible bottom. Unfortunately, we soon learnt that this study is not viable! We did not want to derive target prices by using only trough PBV values from previous crashes. They did not factor in changes in ROE. Instead, to better reflect changes in present ROE, we used Covid's PBV / 1Y Forward ROE ratio to get a better sense of the appropriate PBV values for our estimations. However, our study is heavily flawed (and unusable) due to the presence of several limitations:

1. **Dividend payouts back then were much lower – there's been a drastic increase in recent years.** We could not really find out a way to incorporate these changes into our calculation. This is a huge discrepancy for banks such as **CIMB, RHB, AMMB** and **HLBK,** which have amped up their dividend payouts significantly. Their implied PBV / ROE ratio was a lot lower during the pandemic as a result.
2. **The study also does not incorporate of the removal/addition of overhang.** This includes **HLBK's** partial sale of BOCD, **AMMB's** previous regulatory penalties, and drastic asset quality clean-ups seen in banks such as **ABMB** and **CIMB** (or in the case of **BIMB**, more marked deterioration).

FIG 4: Gauging a Possible Bottom to Valuations and Share Prices (with the Covid Pandemic as a reference point). But study is unusable due to heavy flaws!

Banks	Lowest PBV during Covid (x)	1Y Forward ROE during the period (%)	Implied PBV / ROE x100 (x)	1Y Forward ROE now – our forecasts (%)	Implied PBV (using Covid's PBV / ROE x 100 values) (x)	PBV used in our current TP valuation (x)	Implied Target Price (RM)	Difference from present share price (%)
MAY	0.94	9.5	9.9	11.1	1.10	1.48	9.19	-8%
CIMB	0.53	8.1	6.5	10.9	0.71	1.33	4.91	-34%
PBK	1.25	11.9	10.5	12.1	1.27	1.68	4.18	-12%
RHB	0.62	10.2	6.1	9.4	0.57	1.12	4.84	-34%
HLBK	0.98	10.1	9.7	11.0	1.07	1.39	22.94	+8%
AMMB	0.44	9.6	4.6	9.4	0.43	1.15	3.02	-53%
BIMB	0.83	8.4	9.9	6.6	0.65	0.59	2.33	+16%
AFFIN	0.29	4.5	6.4	4.7	0.30	0.45	1.52	-21%
ABMB	0.44	6.9	7.5	9.7	0.72	1.06	4.15	-10%

Source: Banks, MBSBR

Conclusion: For the sake of simplicity, refer to the KLFIN's previous peak-trough prices changes during crashes. The current peak-trough price decline of -13% seems relatively small compared to the two most relevant crashes: the GFC and the Covid Pandemic. This implies there is a lot more room for further share price decline. But as mentioned earlier, we could at very least see some share price stability until end-CY26 – unless bond yields hike upwards once again.

Maintain POSITIVE call. (Our comprehensive list of sector drivers is on the first page).
Top downside risks include:

1. Disruptions to economic growth, which could lead to slower asset growth and asset quality issues.
2. An exacerbation in deposit competition, which will compress NIMs.
3. Further asset quality flare-ups and instances of higher provisioning, especially if cost inflation persists.

Top Picks: HL Bank (BUY, TP: RM29.80) and **Public Bank (BUY, TP: RM5.53).**

PEER COMPARISON

Bank	Call	Share P	Target P	Upside	Mkt Cap	FY Basis	P/B	ROE	LTG	COE	P/E (x)		P/B (x)		ROE (%)		Div Yield (%)	
	^Top Pick	(RM)	(RM)	(%)	(RM b)		(x)	(%)	(%)	(%)	FY26	FY27	FY26	FY27	FY26	FY27	FY26	FY27
MAY	BUY	10.08	12.36	22.6	121.9	FY27F	1.48	11.1	3.0	8.5	11.3	11.0	1.25	1.21	11.3	11.1	6.4	6.5
CIMB	BUY	7.48	9.20	23.0	80.8	FY27F	1.33	10.9	4.0	9.2	10.4	10.0	1.11	1.08	10.8	10.9	6.2	6.5
PBK	^BUY	4.74	5.53	16.7	92.0	FY27F	1.68	12.1	3.5	8.6	12.9	12.1	1.49	1.44	11.7	12.1	5.8	6.2
RHB	BUY	7.28	9.51	30.6	32.0	FY27F	1.12	9.4	4.0	8.8	9.5	9.3	0.90	0.86	9.6	9.4	6.3	6.4
HLBK	^BUY	21.16	29.80	40.8	43.4	FY27F	1.39	11.0	4.0	9.0	9.2	8.6	0.99	0.94	11.0	11.1	5.8	6.6
AMMB	BUY	6.42	8.09	26.0	21.2	FY28F	1.15	9.4	4.0	8.7	10.1	9.9	0.95	0.91	9.5	9.4	5.9	6.1
BIMB	NEUTRAL	2.01	2.12	5.5	4.5	FY27F	0.59	6.6	4.0	8.5	9.2	8.6	0.58	0.56	6.2	6.6	6.5	6.9
AFFIN	NEUTRAL	1.93	2.28	18.1	5.0	FY27F	0.45	4.7	3.0	6.8	9.7	8.2	0.39	0.38	4.1	4.7	4.1	4.8
ABMB	BUY	4.60	6.10	32.7	8.0	FY28F	1.06	9.7	5.0	9.4	8.9	8.5	0.85	0.80	9.8	9.7	4.6	5.1
Total Weighted avg											**11.0**	**10.5**	**1.18**	**1.14**	**10.9**	**10.9**	**6.1**	**6.4**
Large-Cap	**MAY, CIMB, PBK**										**11.6**	**11.1**	**1.29**	**1.25**	**11.3**	**11.4**	**6.2**	**6.4**
Mid-Cap	**RHB, HLBK, AMMB**										**9.5**	**9.1**	**0.95**	**0.91**	**10.2**	**10.2**	**6.0**	**6.4**
Small-Cap	**BIMB, AFFIN, ABMB**										**9.2**	**8.4**	**0.65**	**0.62**	**7.3**	**7.5**	**5.0**	**5.5**

**Closing prices from 15 Oct 2026.*
**HLBK, AMMB and ABMB use FY27F/28F values.* **HL Bank & HL FG uses FY23F/24F values.*

Near-term Pecking Order: [HLBK & PBK] > [RHB & AMMB & ABMB] > [MAY & CIMB] > [AFFIN & BIMB]

Source: MBSBR

Income Statement	Balance Sheet	Valuations & Sector
Core NP – Core Net Profit	LCR – Liquidity Coverage ratio	ROE – Return on Equity
PPOP – Pre-Provisioning Operating Profit	L/D ratio – Loan/Deposit ratio	GGM – Gordon Growth Model
	CASA – Current & Savings accounts	P/BV – Price to Book Value
NII – Net Interest Income	FD – Fixed Deposits	BVPS – Book Value per Share
NIM – Net Interest Margin	GIL – Gross Impaired Loans	BNM – Bank Negara Malaysia
COF – Cost of Funds	NIL – Net Impaired Loans	OPR – Overnight Policy Rate
NOII – Non-Interest Income	LLC – Loan Loss Coverage	SRR – Statutory Reserve Requirement
MTM – Mark to Market	NCC – Net Credit Costs	SBR – Standardised Base Rate
CIR – Cost to Income Ratio	GCC – Gross Credit Costs	ALR – Average Lending Rate
OPEX – Operational Expenses	CET 1 – Common Equity Tier 1	

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	The stock price is expected to rise by >10% within 3 months after a Trading Buy rating has been assigned due to positive news flow.
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	The stock price is expected to fall by >10% within 3 months after a Trading Sell rating has been assigned due to negative news flow.

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