

17 June 2020

Financial Services | Banks

Banks

Neutral (Maintained)

Prolonged NIM Squeeze From FFR Weakness

Stocks Covered: 3
 Rating (Buy/Neutral/Sell): 0 / 3 / 0
 Last 12m Earnings Revision Trend: Downgrade

- Remain NEUTRAL on a prolonged low interest rate period.** The US Federal Reserve guided last week for the federal fund rate (FFR) to remain near zero till 2022. This translates into the SIBOR staying soft – banks' NIMs are expected to be narrow in FY20-21. Asset quality remains a key negative for banks' earnings, notwithstanding Singapore moving into a Phase 2 re-opening later this week. Within the sector, we prefer Oversea-Chinese Banking Corp (OCBC) the most, as it has a stronger capital ratio and high exposure to a likely faster recovering Greater China.
- US Fed's 10 Jun guidance points to a NIM squeeze through early 2022.** The US central banking system cut the FFR twice (150bps in total) to the current upper bound 0.25%. The 3-month SIBOR is now at 0.54% vs 1Q20's 1.55% average. The 10 Jun guidance from the US Fed was for the FFR to remain near zero till 2022, which should translate into a soft 3-month SIBOR for the duration and, hence, narrow banks' NIMs. The 1Q20 average NIM of these banks stood at 1.78%, and we forecast an FY20 average of 1.69% vs FY19's 1.81% (Figure 1). We estimate average FY21 NIM to be even lower: 1.65%.
- Yet to see the worst of asset quality.** As of March, all three banks we cover (SG Banks) recorded NPL ratios of 1.5-1.6%. LLC was a high 88-92%. With the Government guiding for a 2020 GDP contraction of 4-7%, we forecast a 2.2% average NPL ratio by end 2020 (Figure 4) – provisions will stay high, in our view. Although Singapore is moving into a Phase 2 re-opening this week, it remains to be seen how the small & medium enterprises will fare over the next few months.
- OCBC has the highest CET1 capital adequacy ratio (CAR) amongst peers.** OCBC's 1Q20 CET1 CAR stood at 14.3% – higher than DBS and United Overseas Bank's (UOB) 13.9% and 14.1% (Figure 6). This is a big positive for OCBC, given the current tough economic circumstances.
- Collapse for FY20F earnings.** We forecast SG Banks to record 2020 net profit falls of between 26% and 36% YoY. These declines are primarily due to higher loan loss provisioning and narrower NIMs.
- Short-term share price weakness is likely.** SG Banks' gave investors YTD total returns of between -18% and -15% (Figure 8). Whilst the re-opening of the Singapore economy is a positive, the extent of the asset quality damage remains to be seen. We believe such uncertainties will lead to further short-term share price downsides, but – on a 12-month timeframe – we are NEUTRAL on SG Banks.
- We have a GGM-derived SGD8.70 TP on our preferred pick, OCBC,** based on 0.81x 2020F P/NBV. We are NEUTRAL on the bank, factoring in a sustainable 8.3% ROE assumption vs 1Q20's 6%. Capital strength is vital, and OCBC has the highest CET1 CAR. In addition, its high 25% loan share to Greater China is a positive, as this region is likely ahead of ASEAN in resuming economic activities post the COVID-19 shutdowns.

Top Picks

Oversea-Chinese Banking Corp (OCBC SP) – NEUTRAL

Target Price

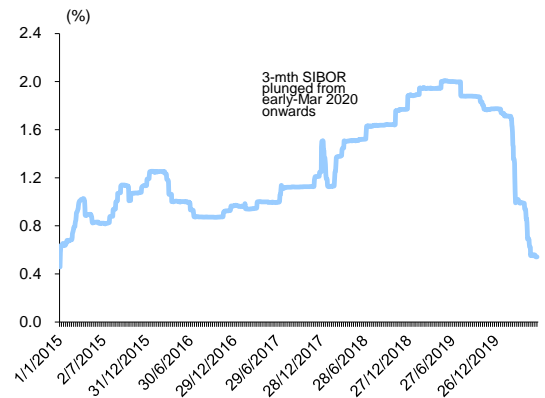
SGD8.70

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SIBOR will stay soft going forward



Source: Bloomberg

Company Name	Rating	Target Price(SGD)	% Upside (Downside)	P/E (x) Dec-20F	P/B (x) Dec-20F	Yield (%) Dec-20F
DBS	NEUTRAL	SGD18.70	(13.7)	11.7	1.0	4.6
Oversea-Chinese Banking Corp	NEUTRAL	SGD8.70	(5.0)	12.8	0.8	3.9
United Overseas Bank	NEUTRAL	SGD19.40	(8.1)	11.5	0.9	4.3

Source: Company data, RHB

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Figure 1: NIMs to stay narrow till early 2022

NIM	DBS	OCBC	UOB
FY17	1.75%	1.65%	1.77%
FY18	1.85%	1.70%	1.82%
1Q19	1.88%	1.76%	1.79%
2Q19	1.91%	1.79%	1.81%
3Q19	1.90%	1.77%	1.77%
4Q19	1.86%	1.77%	1.76%
FY19	1.89%	1.77%	1.78%
1Q20	1.86%	1.76%	1.71%
FY20F	1.75%	1.67%	1.66%
FY21F	1.71%	1.63%	1.62%
FY22F	1.76%	1.69%	1.68%

Source: Company data, RHB

Figure 2: More Greater China exposure is a positive, as these economies are recovering from COVID-19 ahead of ASEAN

FY19 loans breakdown by geography (%)	DBS	OCBC	UOB
Singapore	46.5%	41.2%	51.6%
South and South-East Asia	8.1%	N/A	N/A
South-East Asia	N/A	N/A	N/A
- Malaysia	N/A	10.8%	11.0%
- Thailand	N/A	N/A	7.3%
- Indonesia	N/A	7.4%	4.3%
Greater China	29.8%	24.7%	15.4%
- Hong Kong	15.2%	13.2%	N/A
Others	15.5%	15.9%	10.4%
Total	100.0%	100.0%	100.0%

Source: Company data

Figure 3: NPL ratios were in high single-digits during 2003's SARS

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY02	6.1%	8.1%	9.0%
FY03	5.2%	6.9%	8.1%
FY04	2.5%	5.0%	8.0%
FY05	2.1%	4.1%	5.6%

Source: Company data

Figure 4: NPL ratios will trend up

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY19	1.5%	1.5%	1.5%
1Q20	1.6%	1.5%	1.6%
FY20F	2.0%	2.6%	2.0%
FY21F	1.9%	2.4%	1.9%
FY22F	1.7%	1.7%	1.8%

Note: Working to further raise NPL expectations above the levels shown above

Source: Company data, RHB

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Figure 5: Credit costs to spike up

SP credit cost (bps)	DBS	OCBC	UOB
FY16	38	23	45
FY17	72	62	61
FY18	19	14	15
FY19	20	34	17
1Q20	35	36	31
FY20F	66	71	52
FY21F	48	61	46
FY22F	25	25	27

Source: Company data, RHB

Figure 6: OCBC has the highest CET1 CAR

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY19 CET1 CAR	14.1%	14.9%	14.3%
FY19 Tier 1 CAR	15.0%	15.6%	15.4%
1Q20 CET1 CAR	13.9%	14.3%	14.1%

Source: Company data

Figure 7: Consolidated financials for SG Banks

(SGDm)	2018	2019	2020F	2021F	2022F
NII	21,065	22,518	22,103	22,079	22,954
NII growth (%)	12.4	6.9	(1.8)	(0.1)	4.0
Loan growth (%)	8.5	3.1	2.7	2.6	4.5
NIM (%)	1.80	1.82	1.71	1.66	1.72
Fee income	6,778	7,207	6,963	7,485	8,005
Other income	4,157	5,719	4,972	5,756	6,294
Non-II	10,935	12,926	11,935	13,241	14,299
Non-II growth (%)	(5.9)	18.2	(7.7)	10.9	8.0
Total operating income	32,000	35,444	34,038	35,320	37,253
Operating income growth (%)	5.4	10.8	(4.0)	3.8	5.5
Non-II/total income (%)	34.2	36.5	35.1	37.5	38.4
Operating costs	(14,031)	(15,374)	(15,536)	(16,247)	(17,035)
Operating cost growth (%)	8.04	9.57	1.05	4.58	4.85
CIR (%)	43.8	43.4	45.6	46.0	45.7
PIOP	17,969	20,070	18,502	19,073	20,218
PIOP growth (%)	3.4	11.7	(7.8)	3.1	6.0
Loan impairments	(1,391)	(2,028)	(5,655)	(4,698)	(2,426)
Other impairments					
Total impairment charges	(1,391)	(2,028)	(5,655)	(4,698)	(2,426)
Credit costs (bps)	17	23	62	50	25
NPL ratio (%)	1.6	1.6	2.2	2.1	1.8
Loan loss coverage (%)	84.0	79.3	73.7	85.1	91.9
Associates & others	459	514	436	470	492
Pre-tax profit	17,037	18,556	13,283	14,845	18,284
Taxation	(2,688)	(2,745)	(2,127)	(2,438)	(3,023)
Minority interests	(272)	(209)	(218)	(233)	(253)
Net profit	14,077	15,602	10,938	12,174	15,008
Net profit growth (%)	19.2	10.8	(29.9)	11.3	23.3

Source: Company data, RHB

Figure 8: Banks recorded sharp YTD price falls, and weakness may persist

Name		DBS	OCBC	UOB
Price @	16-Jun-20	21.66	9.16	21.12
Market cap	(SGDm)	54,996	40,351	35,259
P/E (x)	Historical	9.4	6.3	8.6
	Currency	11.2	11.1	11.6
	Forward	10.6	10.4	10.9
P/BV	(x)	1.02	0.84	0.95
ROE	(%)	11.3	9.5	11.9
ROA	(%)	1.0	0.9	1.0
Yield	(%)	5.8	5.8	5.2
YTD TR	(%)	(14.9)	(15.9)	(18.3)
1-month TR	(%)	12.1	5.8	11.2
3-month TR	(%)	13.8	1.8	7.1
6-month TR	(%)	(14.7)	(15.8)	(18.2)
1-year TR	(%)	(9.2)	(12.3)	(11.8)

Note: P/E ratio forecasts are based on consensus expectations

Note 2: TR means "total return"

Source: Bloomberg

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