

# Singapore Banking Sector

Will a rate hike be next year's Christmas present?

SINGAPORE | FINANCIALS | UPDATE

19 December 2014

## Sector Overview

The Singapore Banking Sector provides traditional lending and depository functions, as well as other services in the areas of commercial banking, financial advisory, asset management, insurance broking and capital market services.

## Highlights

### Net Interest Margins remains key focus point

- NIM expansion of 5-6bps for DBS and OCBC in early part of the year and we suggested NIM could trend downwards (2-3bps) in later part of the year
- In 3Q14, OCBC NIM ticked down 2bps to 1.68% in 3Q14; DBS managed to bump it to 1.68%; UOB has remained largely flat
- Expect FY14 NIM for DBS and OCBC to be higher y-y whilst UOB to remain stable (DBS FY13/FY14E: 1.62%/1.67%, UOB FY13/FY14E: 1.72%/1.71%, OCBC FY13/FY14E: 1.64%/1.68%)
- **Be "Patient" for begin of normalizing the stance of monetary policy, says the FOMC.** Fed Reserve Chair Janet Yellen appeared to blow away some tendrils of the fog with regards to raising of benchmark rates which could be after April 2015. This is a big plus and we remain unchanged on our view of a gradual rate hike in 2H15 which will uplift NIMs and earnings

### Loans growth outlook appears muted

- Our Singapore banks expect moderate loan growth momentum in FY15, with y-y loan growth of high single digit at best
- We think that underlying loan growth in Singapore remains weak, with an expected drop in housing loans from lower mortgage applications. Growth is likely to be driven from regional contributions

### Regional currencies trend and impact

- We observed recent weakness in some ASEAN currencies, especially so for MYR. MYR has depreciated 4.2% against the SGD while IDR 1.7% against SGD
- Malaysia's economic outlook remains weak especially with the freefall in oil prices and declining palm oil price. These suggest possible lower loans growth and fees, higher credit costs and weakening of overseas contribution for both UOB and OCBC in 4Q14 through 1H15
- However, depreciating ASEAN currencies effect will be cushioned by a strengthening greenback and HKD

### Non-interest income is a gallimaufry of possibilities

- In 3Q14, DBS and UOB both had strong growth in their net trading income, driven by both customer treasury flows and trading gains
- USD/RMB direction has an influence on hedging activities especially for DBS
- Increased volatility in global markets suggest higher trading income in coming quarters

## Investment actions

Loans growth appear muted in FY15 but we are optimistic on improving NIMs in the medium term which will drive earnings. Fee income continues to be a staple and key drivers are trade related, wealth management and investment banking. We are positive on the probability of improving margins in the medium term. Our view and main investment theme remain unchanged: **OVERWEIGHT on banks for play on imminent US rate hike which will uplift NIM and earnings in the medium term.** DBS remains our top pick for its stable earnings growth profile and best beneficiary to higher interest rates. We have a "Buy" rating on DBS and "Accumulate" rating on OCBC and UOB based on our P/B derived valuations.

## OVERWEIGHT (Maintain)

### Singapore Banking Sector

|                    | DBS Group Holding Ltd | United Overseas Bank Ltd | Oversea-Chinese Banking Corp |
|--------------------|-----------------------|--------------------------|------------------------------|
| Rating             | Buy                   | Accumulate               | Accumulate                   |
| Price (S\$)        | 19.53                 | 23.45                    | 10.10                        |
| Target Price (S\$) | 21.60                 | 25.40                    | 11.00                        |
| Dividend Yield (%) | 3.07%                 | 3.84%                    | 3.66%                        |
| Upside (%)         | 14%                   | 12%                      | 13%                          |
| Mkt Cap (S\$ mn)   | 47,946                | 37,140                   | 40,002                       |

Source: Bloomberg, PSR est.

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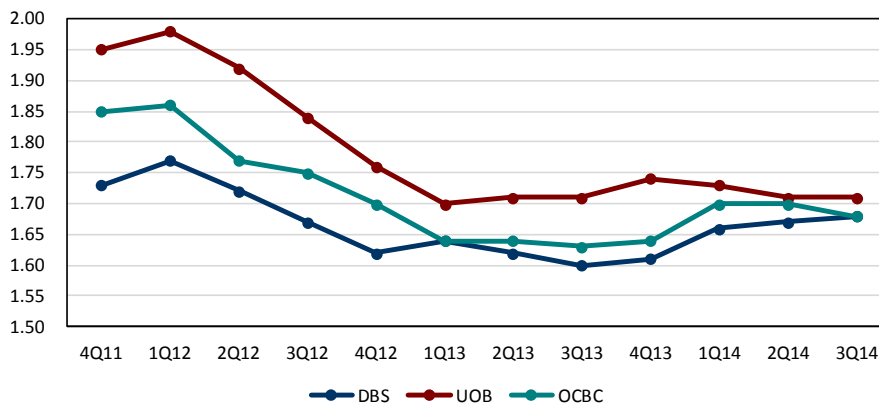
## Net Interest Margins remains key focus point

In our previous sector report in June, we noted that we had witnessed a NIM expansion of 5-6bps for DBS and OCBC in the early part of the year and suggested we could see NIM trending downwards (~2-3 bps) for the coming quarters. Indeed, OCBC's NIM was "normalized" by 2bps to 1.68% in 3Q14 but DBS has managed to bump it up even further to 1.68%, bringing their NIM to the highest seen in the last 9 quarters. UOB's NIM on the other hand has been largely flat YTD. We expect full year FY14 NIM for DBS and OCBC to be higher y-y by a few bps whilst UOB to remain stable (DBS FY13/FY14E: 1.62%/1.67%, UOB FY13/FY14E: 1.72%/1.71%, OCBC FY13/FY14E: 1.64%/1.68%).

Be "Patient" for begin of normalizing the stance of monetary policy, says the FOMC. Fed Reserve Chair Janet Yellen appeared to blow away some tendrils of the fog with regards to raising of benchmark rates which could be after April 2015. Our house view was gradual rate hike in 2H15 which would uplift NIMs and earnings and with US labor data looking increasingly healthier, we think this supports our stance for an exciting FY15 for the Singapore banks.

**Our sensitivity analysis on the 3 banks also suggest that for every 10bps of NIM improvement, EPS growth ranges between 6-7% with DBS at the highest end of the spectrum** due to their lowest cost of funding through their high CASA deposit ratio and most liquid balance sheet.

Net Interest Margin Comparison (%)



Source: Companies, PSR

## Loans growth outlook appears muted

Our Singapore banks expect moderate loan growth momentum in FY15, with y-y loan growth of high single digit at best, in effort to preserve margins. We think that underlying loan growth in Singapore remains weak, with an expected drop in housing loans from lower mortgage applications. Growth is likely to be driven from regional contributions and China seems to still be the best bet. As these suggest more downside than upside risks to FY15 loans growth, we have ascribed a 7-9% loans growth for our Singapore banks, with DBS at the higher end of the curve due to their larger China exposure.

### Regional currencies trend and impact

We observed recent weakness in some ASEAN currencies, especially so for MYR. MYR has depreciated 4.2% against the SGD while IDR 1.7% against SGD. Economic growth for Malaysia has moderated in 3Q14 as export growth fizzled. Compounding that with a more than 40% YTD freefall in oil prices and declining palm oil price (budget is based on US\$100 per barrel), it hardly raises any eyebrows for a weakening MYR. Loan balances in MYR (3Q14) for UOB and OCBC stood at ~13% and ~11% while it is insignificant for DBS. PBT for Malaysia (3Q14) for UOB and OCBC was ~17% and ~21%. These suggest possible lower loans growth and fees, higher credit costs and weakening of overseas contribution for both UOB and OCBC in 4Q14 through 1H15 as we do not yet see signs of improvement for Malaysia in the near term.

SGD/MYR



Source: OANDA, PSR

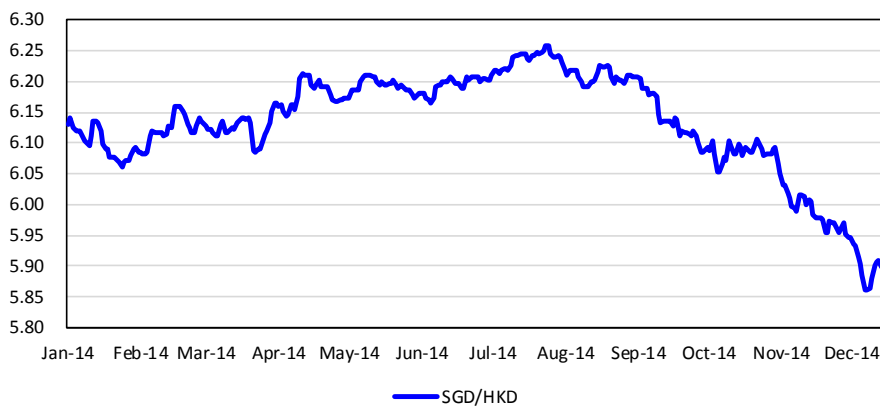
SGD/IDR



Source: OANDA, PSR

However, depreciating ASEAN currencies effect will be cushioned by strengthening greenback and HKD. USD has strengthened against the SGD by ~2.5% QTD, driven by positive economic indicators and seemingly taking on a role reversal with a slowing China. This should continue into FY15 which supports our house view of a US gradual rate hike. Our Singapore Banks have significant USD loan exposures (3Q14 DBS: 34% UOB: 16% OCBC: 27%) suggesting positive impact on loans growth from the continued appreciation of USD. HKD has also strengthened ~2.6% QTD against the SGD, which would benefit both DBS and OCBC to a lower extent (WHB consolidation started in 3Q14). 3Q14 HKD loans for DBS and OCBC were ~12% while PBT were 22% and <11% respectively. UOB's exposure is not material.

SGD/HKD



Source: OANDA, PSR

USD/SGD



Source: OANDA, PSR

## Non-interest income is a gallimaufry of possibilities

In 3Q14, DBS and UOB both had strong growth in their net trading income, driven by both customer treasury flows and trading gains. For DBS especially, hedging activities from customers are affected by the movements of the USD/CNY currency pair. RMB depreciation is usually reflected in lower hedging activities as a portion of trade finance activities are USD denominated. QTD, CNY has been largely flat, appreciating only 0.5%. With China's slowing growth outlook in the coming FY15, stimulus measures for economic growth (e.g. PBOC cutting benchmark 1-year deposit rates by 25 bps and 1-year lending rate by 40 bps) and RMB internationalization could see the RMB appreciating in the medium term. Increasing volatility in global markets also suggest higher trading income in the coming quarters.

USD/CNY



Source: OANDA, PSR

## Valuations

Maintain **OVERWEIGHT** on Singapore Banking Sector - We are positive on the probability of improving margins in the medium term. Our view and main investment theme remain unchanged: **OVERWEIGHT on banks for play on imminent US rate hike which will uplift NIM and earnings in the medium term**. DBS remains our top pick for its stable earnings growth profile and best beneficiary to higher interest rates. We have a "Buy" rating on DBS and "Accumulate" rating on OCBC and UOB based on our P/B derived valuations.

## Key risks for the Sector

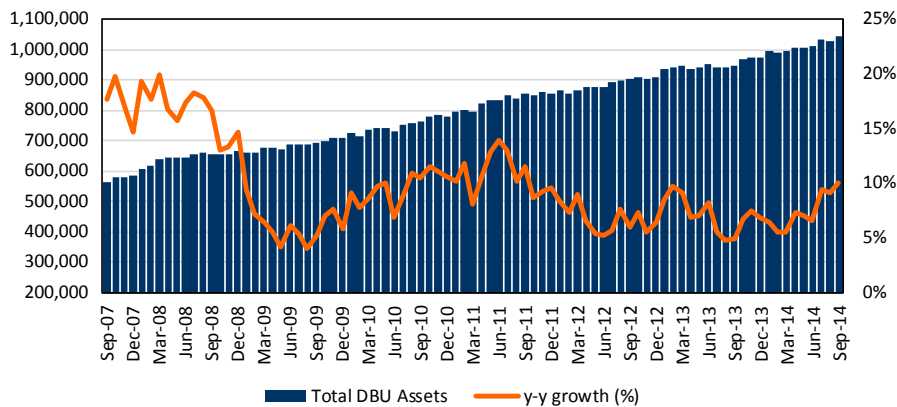
A worsening global economy may result in rise of NPLs and credit costs, as affected customers, especially SMEs and unsecured consumer loans, default on loan repayments. This may negatively impact our bottomline.

Unfavourable government policies and regulatory measures, both in Singapore and in the key overseas markets, may also impact the banks negatively.

Irrational pricing of loans and deposits, especially in the foreign markets, would also lead to further NIMs compression or loss of market share.

## System assets

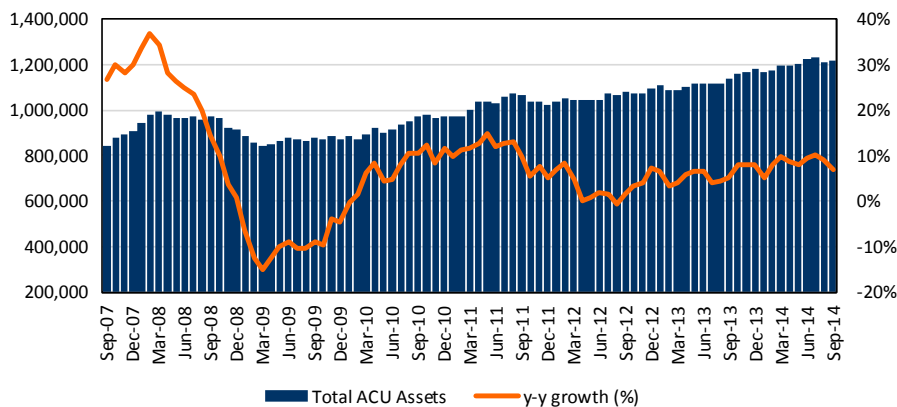
Total DBU Assets (\$\$ mn)(LHS) and y-y growth %(RHS)



DBU Assets grew by 10% y-y

Source: MAS, PSR

Total ACU Assets (\$\$ mn)(LHS) and y-y growth %(RHS)

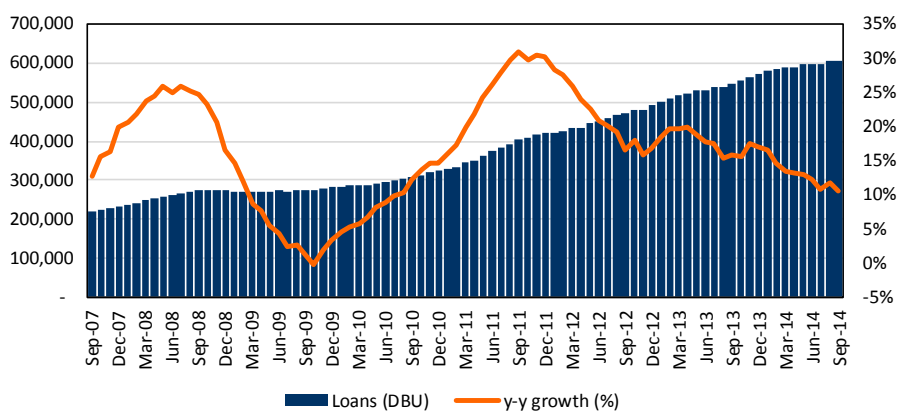


ACU Assets grew by 7% y-y

Source: MAS, PSR

## System Loans

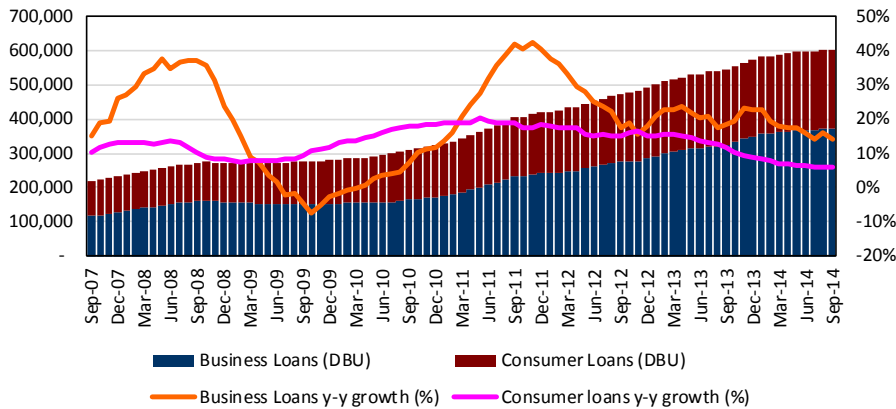
Total DBU Loans (\$\$ mn)(LHS) and y-y growth %(RHS)



DBU Loans grew by 11% y-y

Source: MAS, PSR

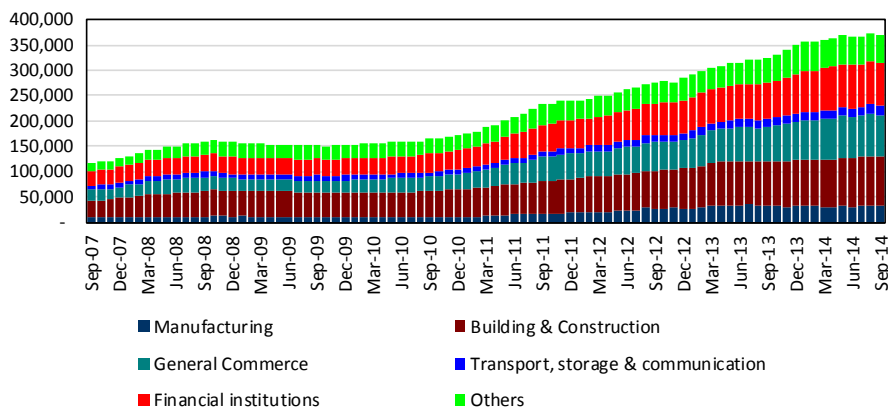
**Business Loans vs. Consumer Loans (DBU)(\$\$ mn)(LHS) and y-y growth (%)(RHS)**



Business Loans grew by 14% y-y but consumer loans growth has slowed down to 6% y-y

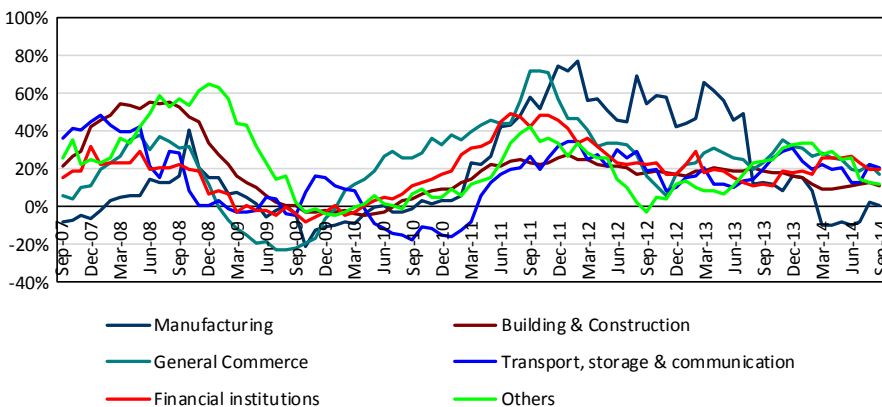
Source: MAS, PSR

**Business Loans Breakdown (DBU)(\$\$ mn)**



Source: MAS, PSR

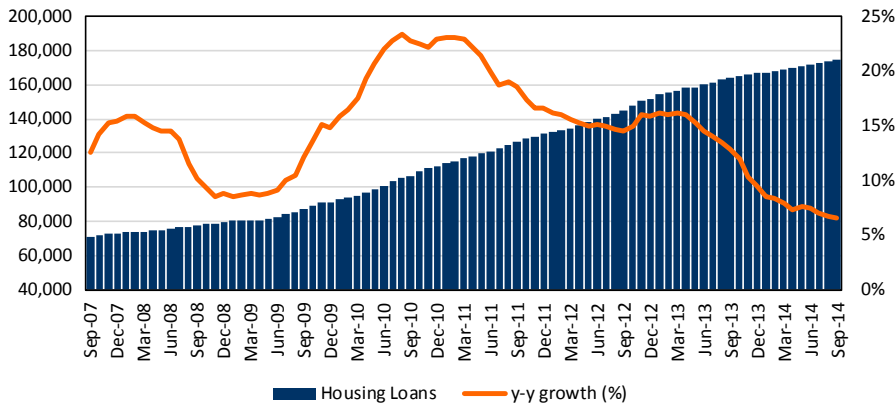
**Business Loans Breakdown y-y momentum (DBU)(%)**



FIs grew 20% y-y and General Commerce grew 17% y-y

Source: MAS, PSR

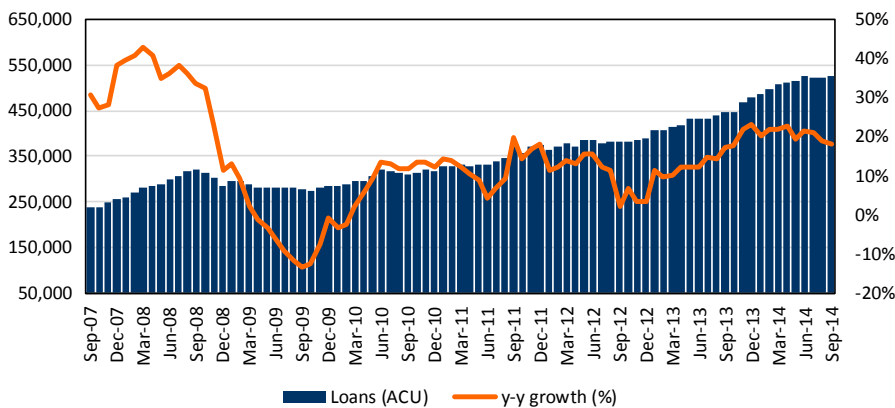
Housing Loans Growth (DBU)(\$\$ mn)(LHS) and y-y growth %(RHS)



Housing loans growth is slowing down, expect this to stutter more in FY15 with less mortgage applications

Source: MAS, PSR

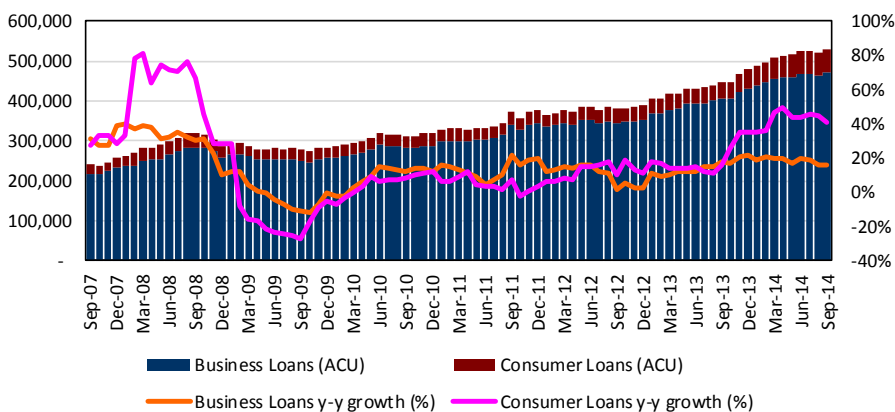
Total ACU Loans (\$\$ mn)(LHS) and y-y growth %(RHS)



ACU Loans grew by 18% y-y

Source: MAS, PSR

Business Loans vs. Consumer Loans (ACU) (\$\$ mn)(LHS) and y-y growth %(RHS)

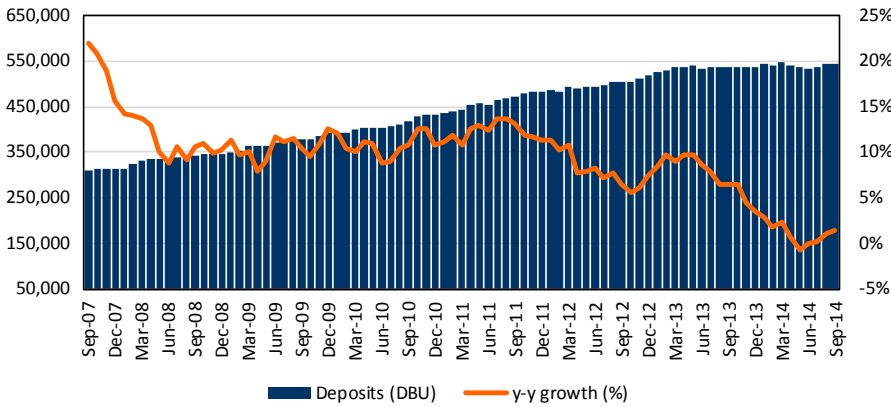


Source: MAS, PSR



### System Deposits

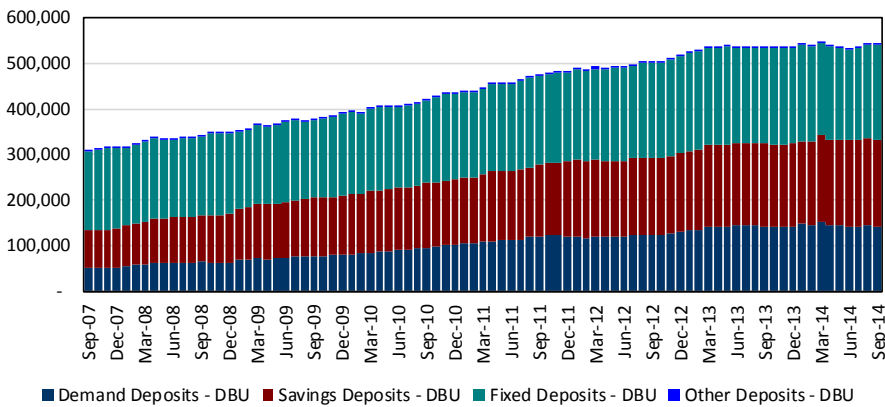
Total DBU Deposits (\$\$ mn)(LHS) and y-y growth (%)(RHS)



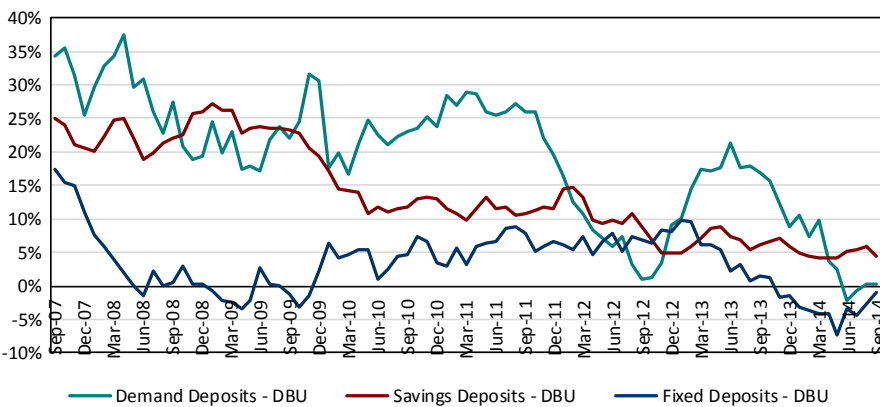
DBU Deposits growth has been sluggish, dropping to nil in Jun but started picking up in Sep by 1.5% y-y

Source: MAS, PSR

Deposits Breakdown (DBU)(\$\$ mn)



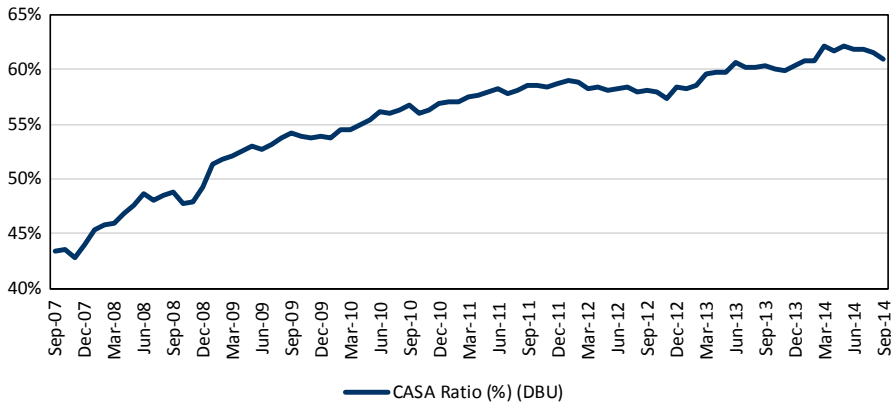
Deposits Breakdown y-y momentum (DBU)(%)



Savings deposits have grown 4.5% y-y

Source: MAS, PSR

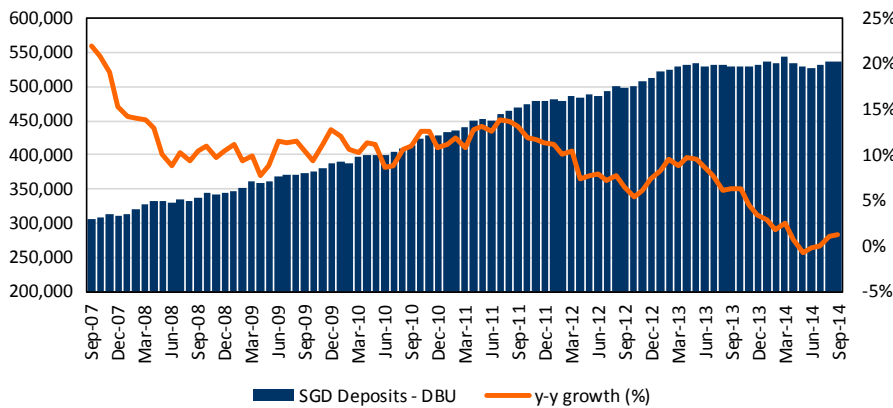
CASA Ratio (DBU)(%)



CASA ratio largely flat for past few months (Sep 14: 61.0%)

Source: MAS, PSR

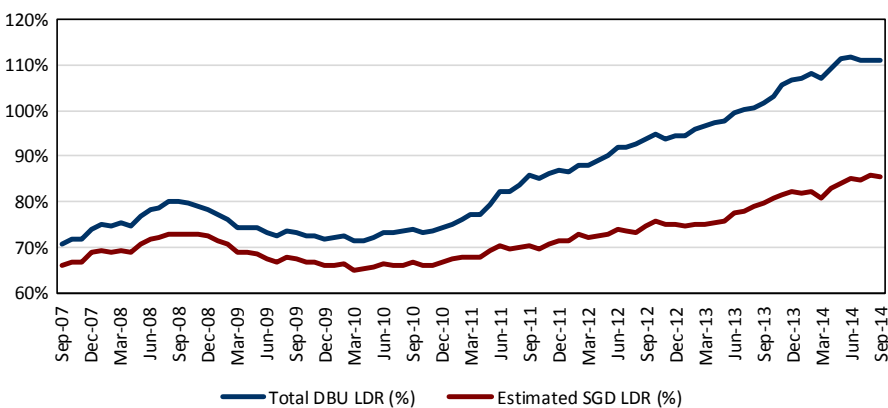
SGD Deposits (DBU)(S\$ mn)(LHS) and y-y growth (%)(RHS)



SGD Deposits growth has been declining but picked up 1.3% y-y in Sep 14

Source: MAS, PSR

Total DBU Loans-to-Deposits Ratio vs SGD Loans-to-Deposits Ratio (%)

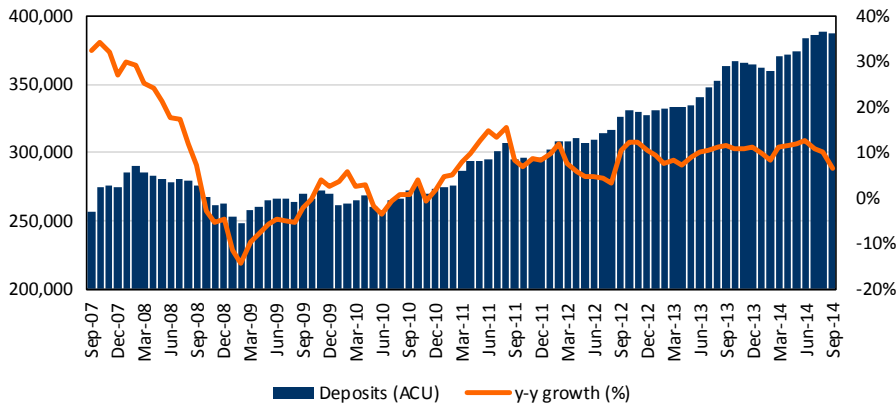


System liquidity appears tight with LDR of 111%...

... SGD LDR appears to remain comfortable at 85.6% by our estimation

Source: MAS, PSR estimates

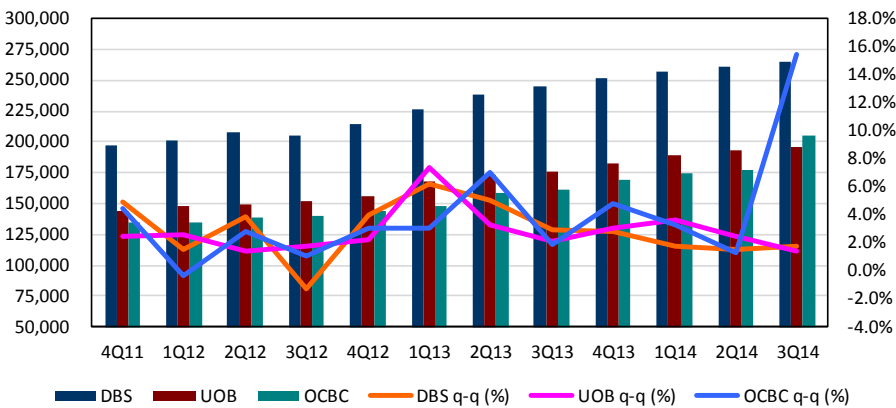
Total Deposits (ACU)(\$\$ mn) (LHS) and y-y growth (%) (RHS)



Source: MAS, PSR

### Bank Level Loans

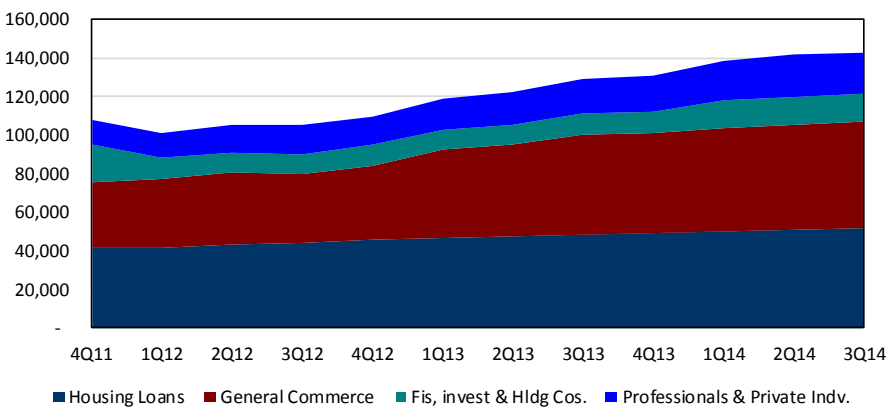
Loans Growth Momentum (\$\$ mn)(LHS) and y-y growth (%) (RHS)



Slowing loans growth (OCBC includes WHB)

Source: Companies, PSR

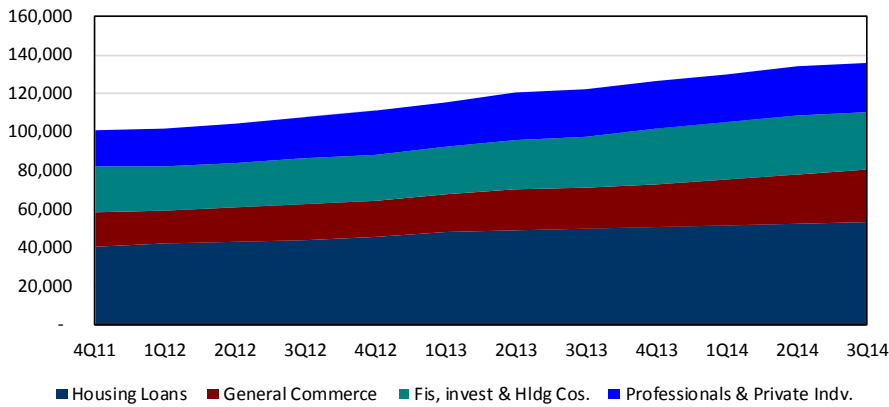
Loans Breakdown for DBS (\$\$ mn)(selected items)



General commerce loans continue to be the largest proportion

Source: Company, PSR

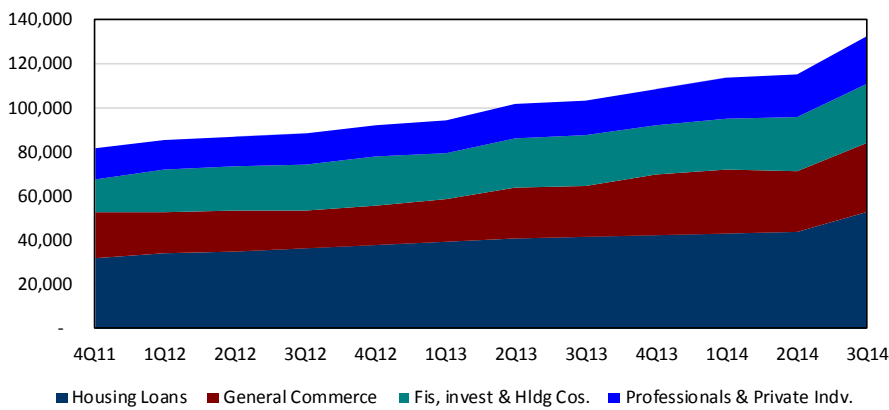
Loans Breakdown for UOB (\$\$ mn)(selected items)



UOB appears to be most vulnerable to Singapore housing sector

Source: Company, PSR

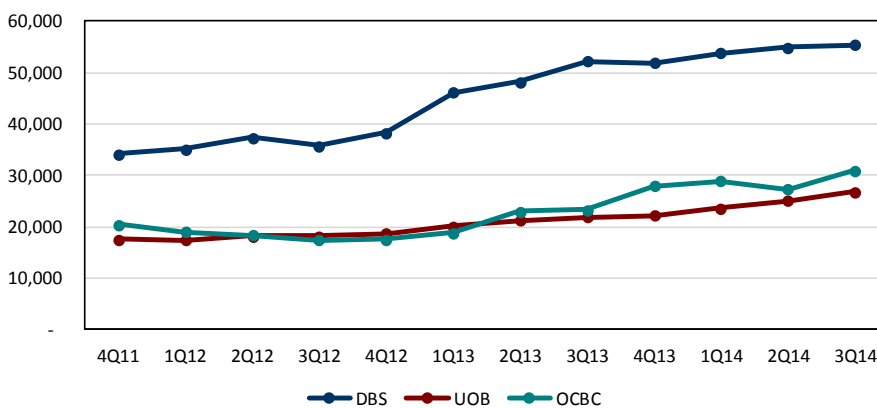
Loans Breakdown for OCBC (\$\$ mn)(selected items)



OCBC loan books boosted by WHB acquisition

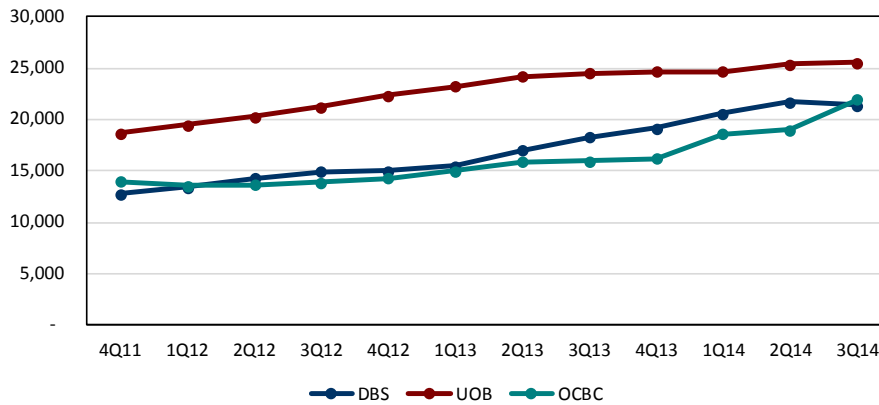
Source: Company, PSR

General Commerce Comparison (\$\$ mn)



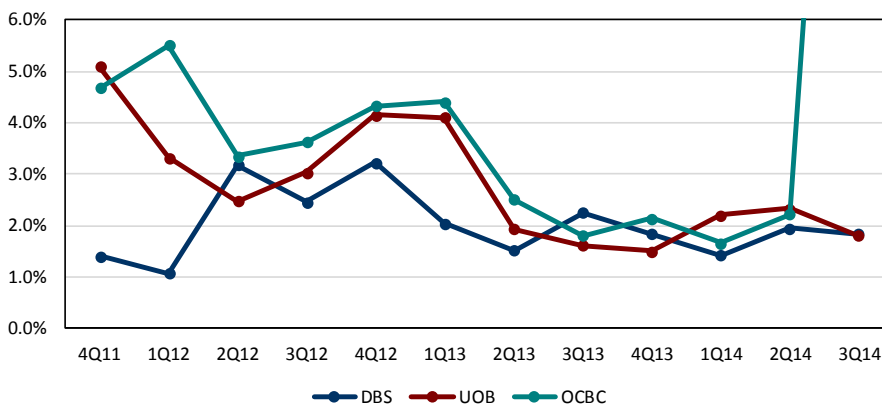
Source: Companies, PSR

Professionals & private individuals Comparison (\$\$ mn)



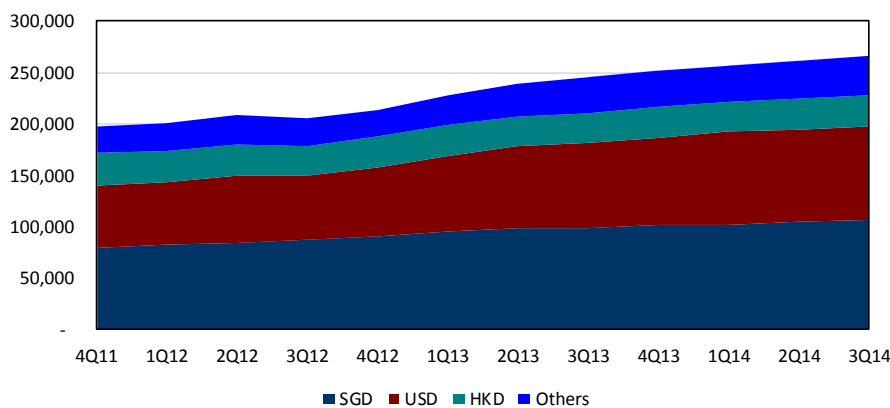
Source: Companies, PSR

Housing Loans q-q Momentum (%)



Source: Companies, PSR

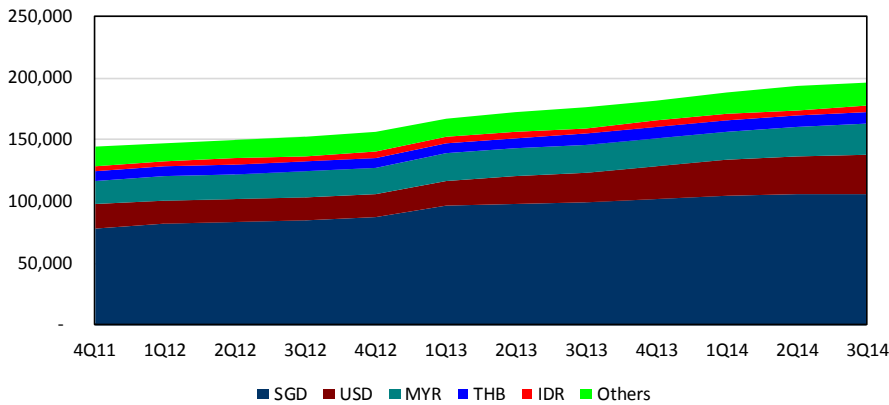
Loans Breakdown for DBS (\$\$ mn)(By Currencies)



Source: Company, PSR

Loans growth could benefit from strengthening USD and HKD

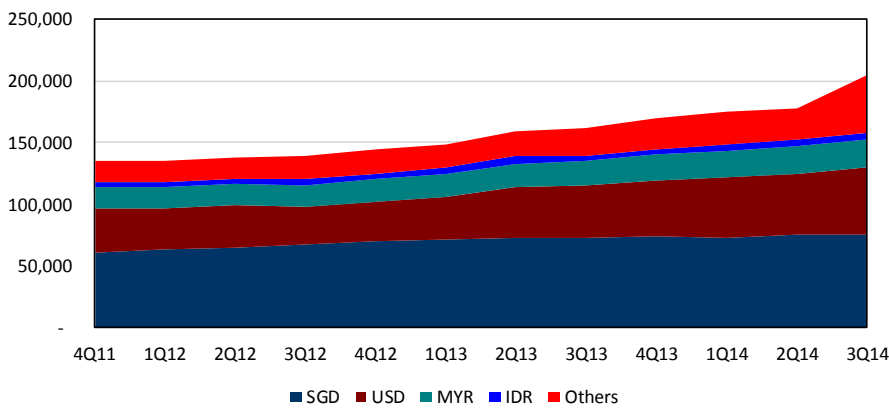
Loans Breakdown for UOB (\$\$ mn)(By Currencies)



Depreciation of MYR could be a drag but might be mitigated by USD strengthening

Source: Company, PSR

Loans Breakdown for OCBC (\$\$ mn)(By Currencies)

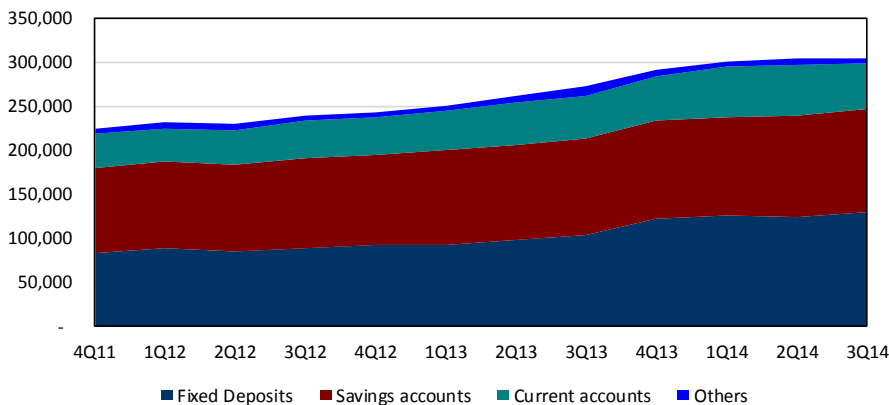


Depreciation of MYR could be a drag but might be mitigated by USD strengthening

Source: Company, PSR

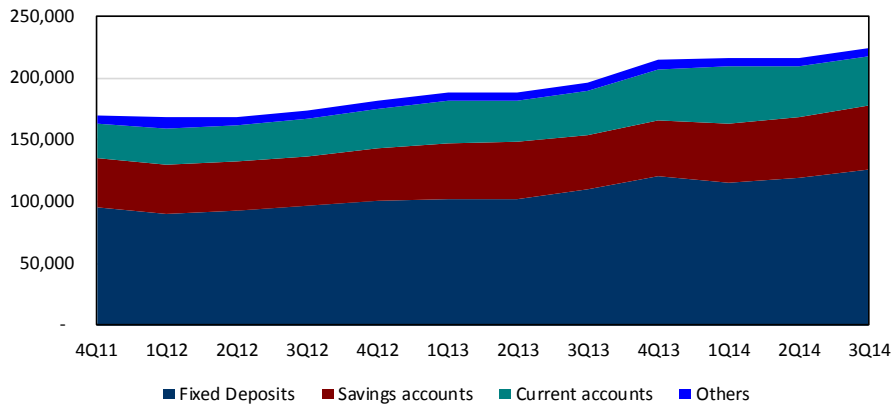
## Bank Level Deposits

Deposits Breakdown for DBS (\$\$ mn)(By Types)



Source: Company, PSR

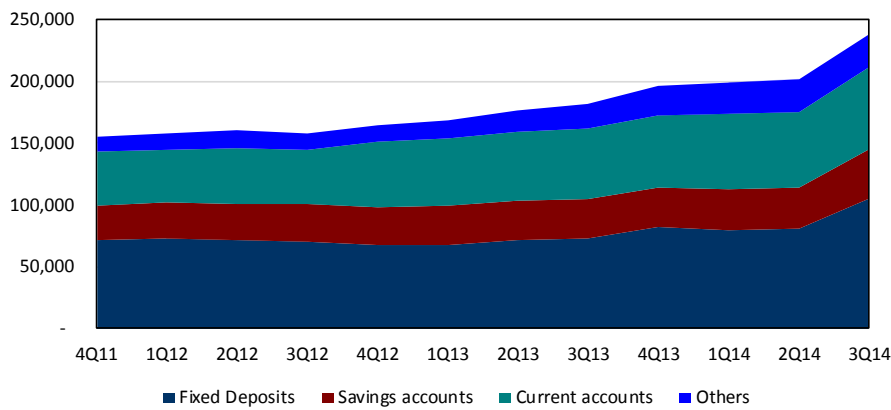
Deposits Breakdown for UOB (\$\$ mn)(By Types)



UOB managed to grow their CASA balances in the last quarter

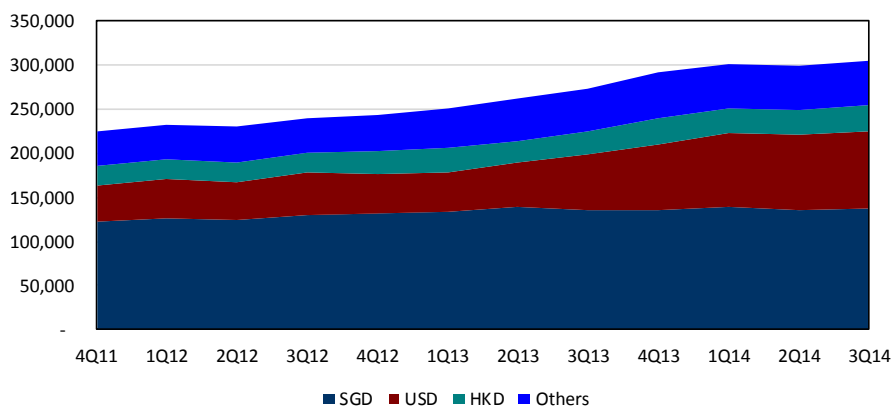
Source: Company, PSR

Deposits Breakdown for OCBC (\$\$ mn)(By Types)



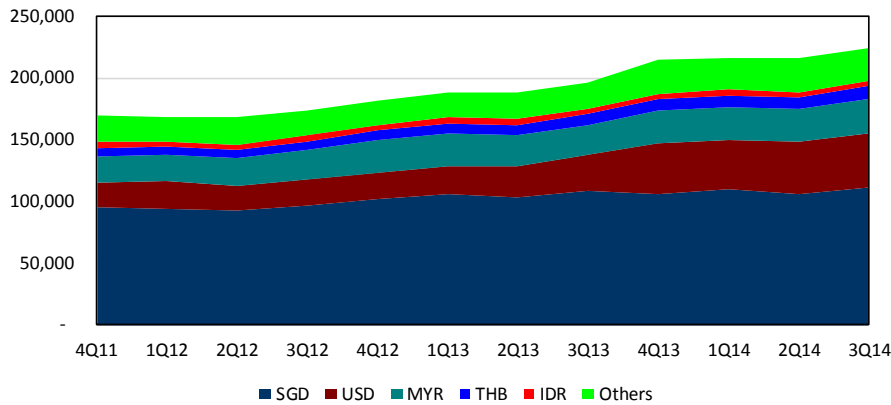
Source: Company, PSR

Deposits Breakdown for DBS (\$\$ mn)(By Currencies)



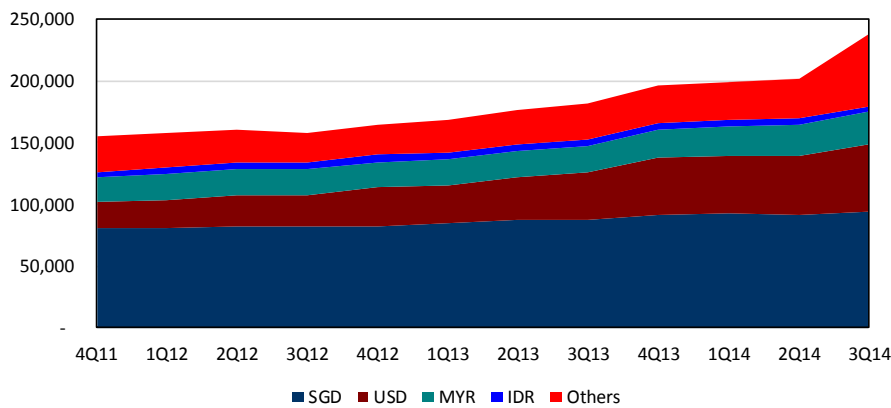
Source: Company, PSR

Deposits Breakdown for UOB (\$\$ mn)(By Currencies)



Source: Company, PSR

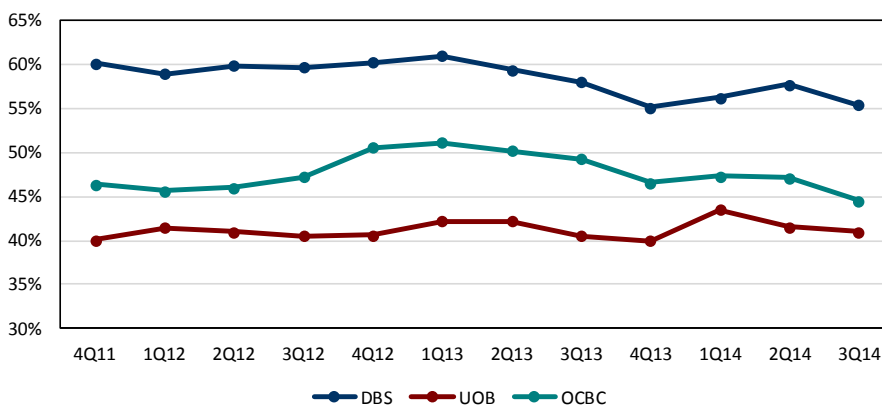
Deposits Breakdown for OCBC (\$\$ mn)(By Currencies)



Source: Company, PSR

## Key Ratio Comparisons

CASA Ratio Comparison (%)

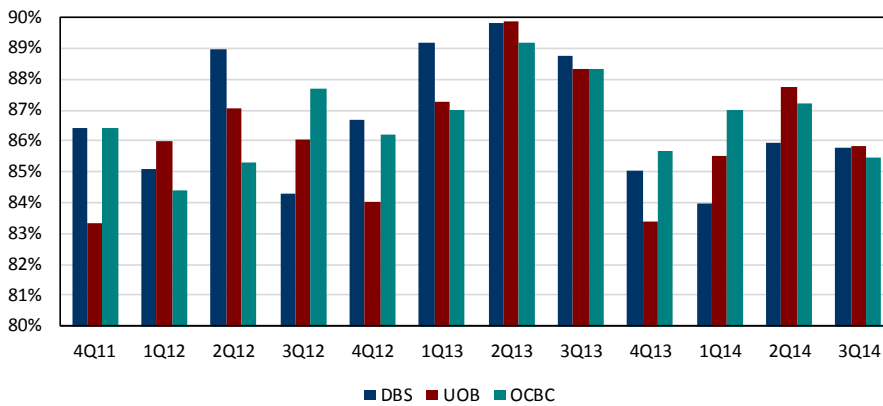


Source: Companies, PSR

CASA ratio DBS still the highest at 55.4%, positioning itself to benefit the most from rate hikes

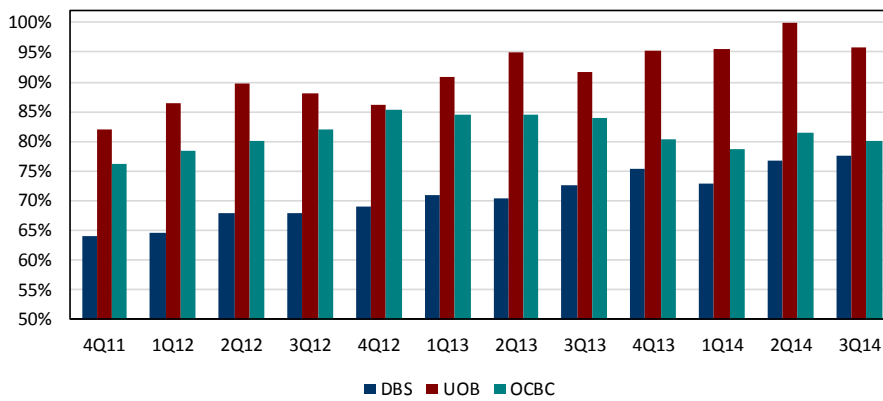


Overall Loan-to-Deposit Ratio Comparison (%)



Source: Companies, PSR

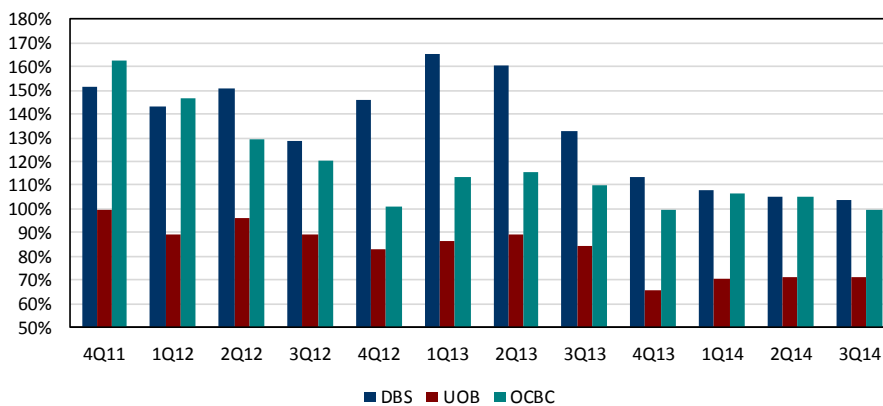
Estimated SGD LDR Comparison (%)



DBS with the most liquid SGD balance sheet

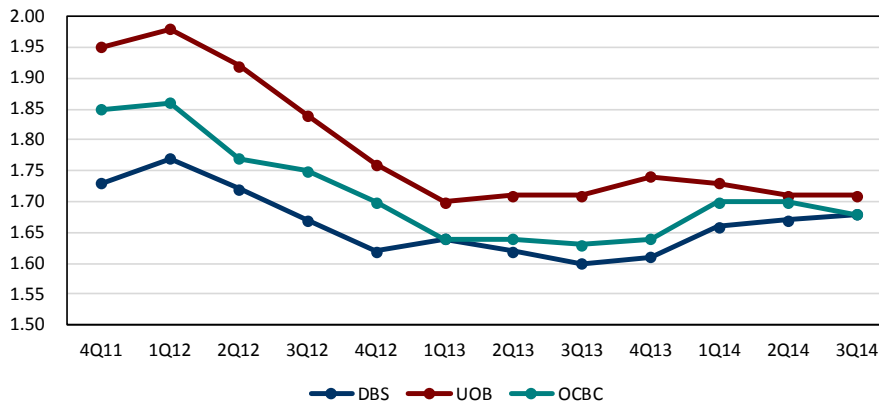
Source: Companies, PSR

Estimated USD LDR Comparison (%)



Source: Companies, PSR

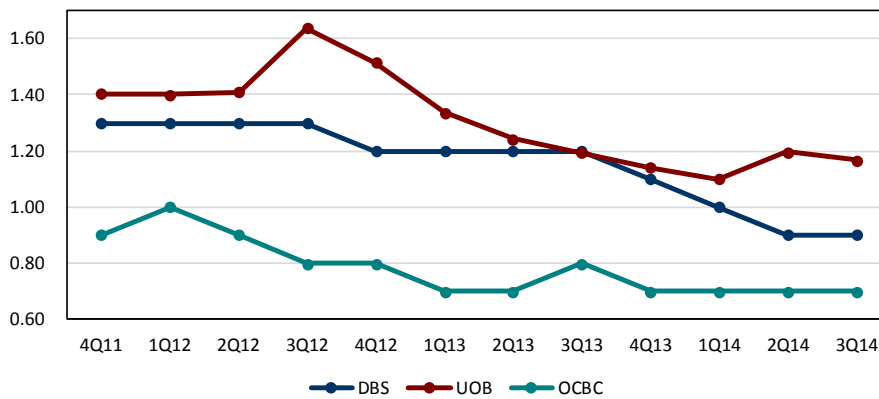
Net Interest Margin Comparison (%)



DBS and OCBC have seen NIM upticks this year while UOB has been largely flat

Source: Companies, PSR

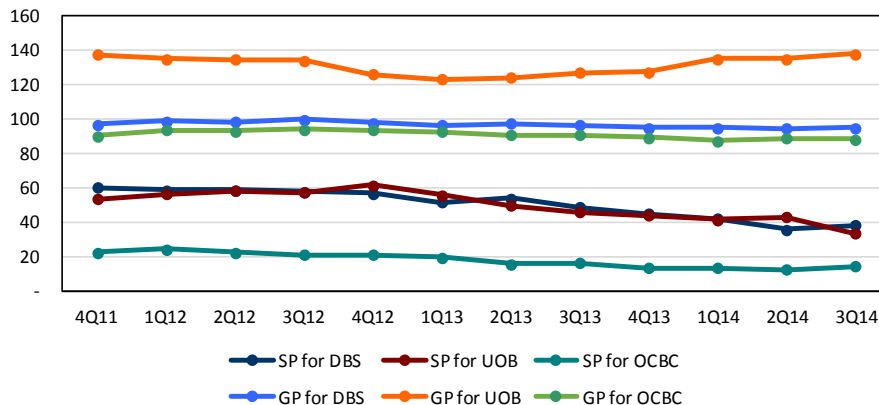
Non-Performing Loans Ratio Comparison (%)



NPLs have been rock bottom low, expect to see upticks in FY15

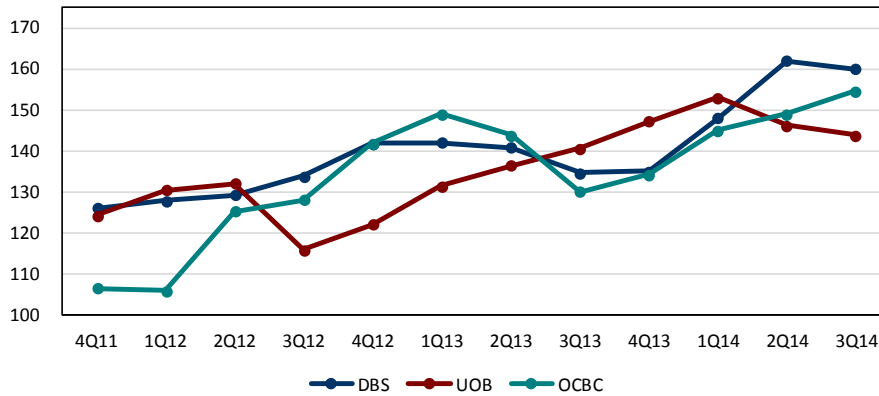
Source: Companies, PSR

Loan Provisioning as a % of Gross Loans (bps)



Source: Companies, PSR

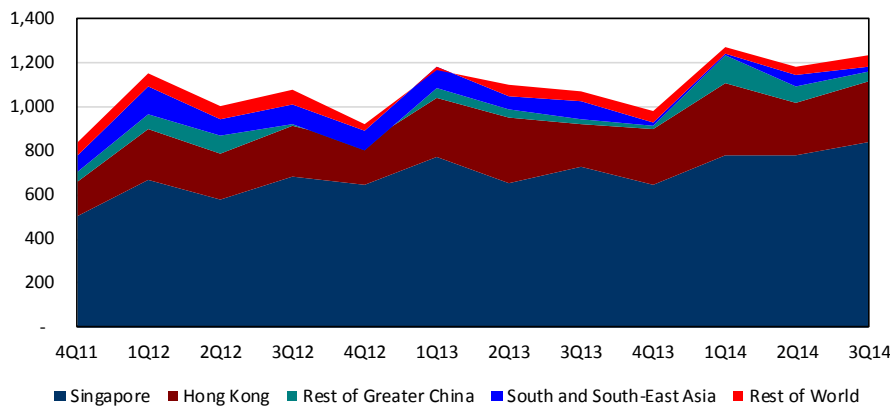
Total Allowances for NPA/Total NPA (%)



Source: Companies, PSR

### P&L Items

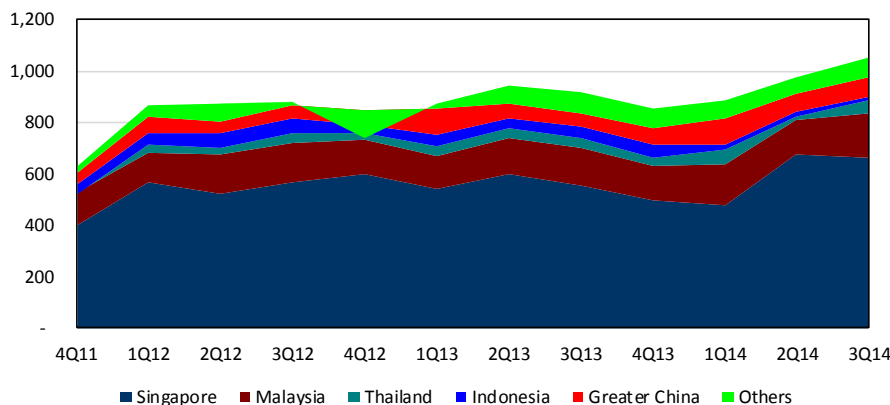
PBT by Geography for DBS (\$\$ mn)



DBS shielded more from weakening of regional currencies

Source: Company, PSR

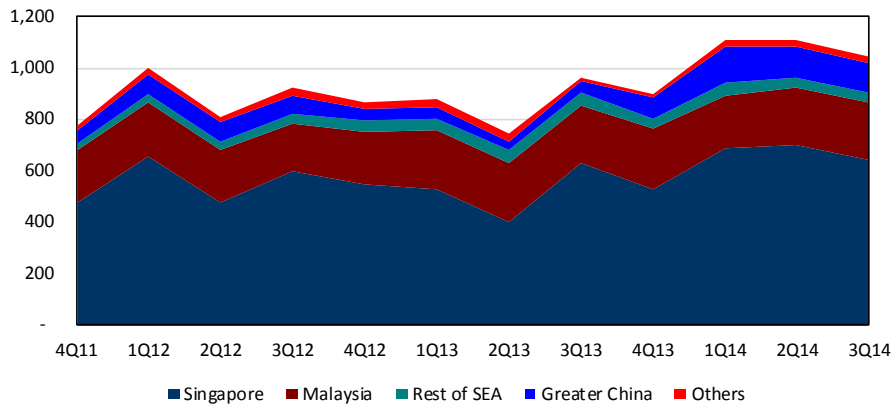
PBT by Geography for UOB (\$\$ mn)



PBT from Malaysia could be negatively affected

Source: Company, PSR

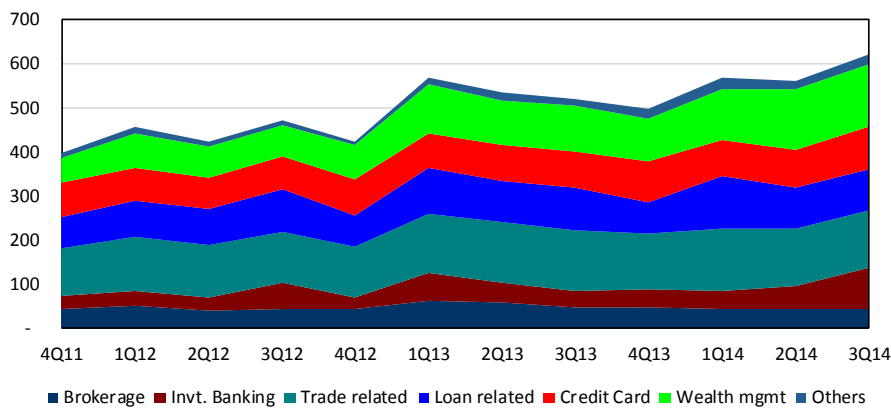
**PBT by Geography for OCBC (S\$ mn)**



PBT from Malaysia could be negatively affected

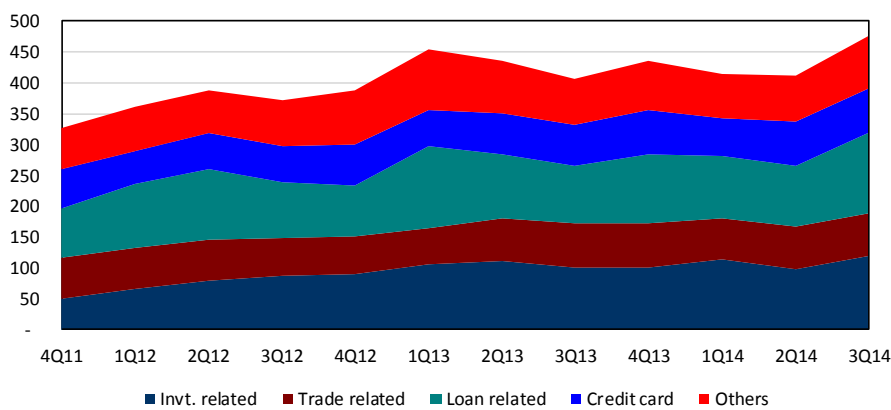
Source: Company, PSR

**Fees and commission for DBS (S\$ mn)**



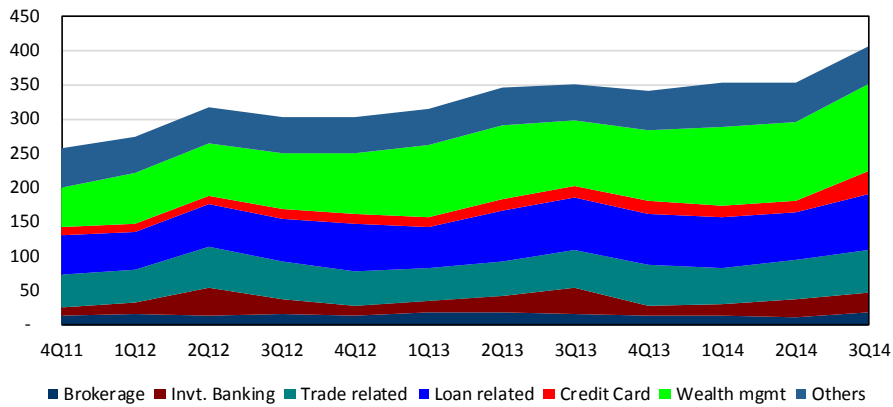
Source: Company, PSR

**Fees and commission for UOB (S\$ mn)**



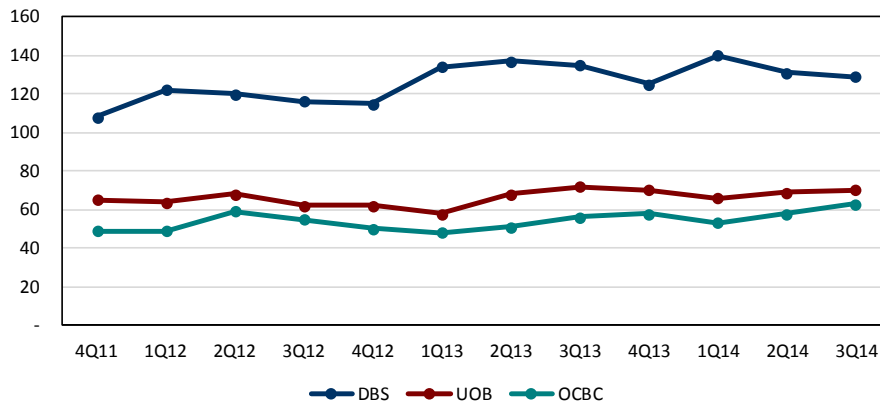
Source: Company, PSR

Fees and commission for OCBC (\$\$ mn)



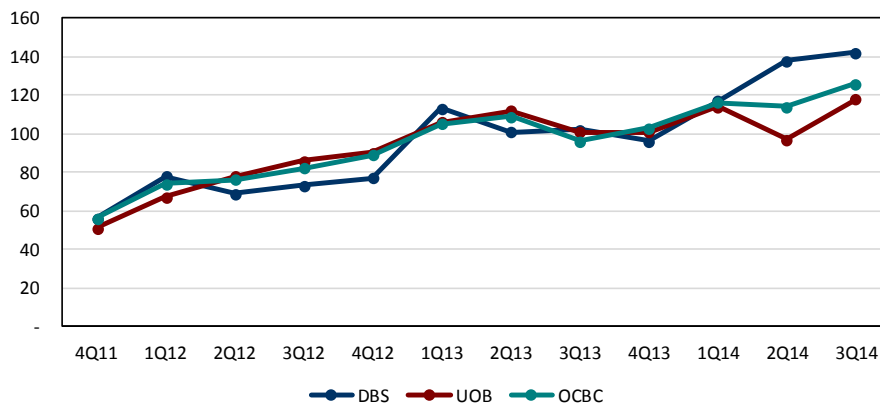
Source: Company, PSR

Trade related fees comparison (\$\$ mn)



Source: Companies, PSR

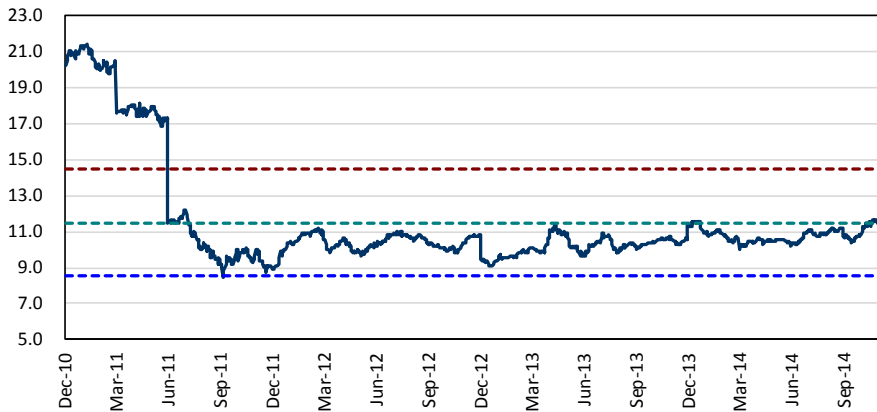
Wealth management fees comparison (\$\$ mn)



Source: Companies, PSR

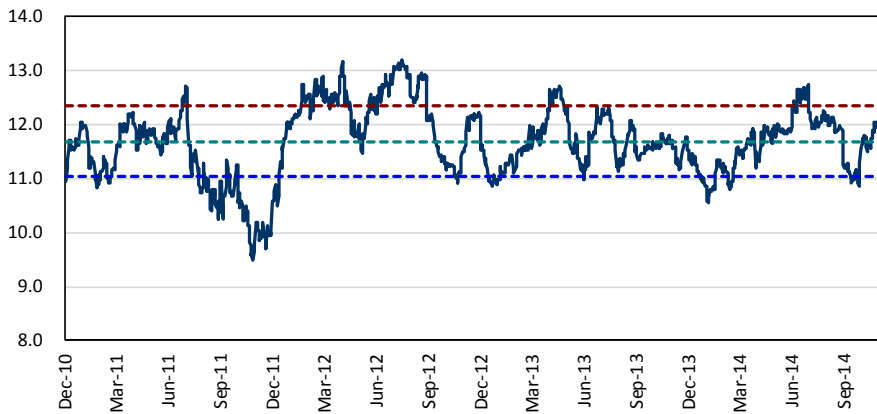
## Valuation multiples

**3Y PER (X) DBS**



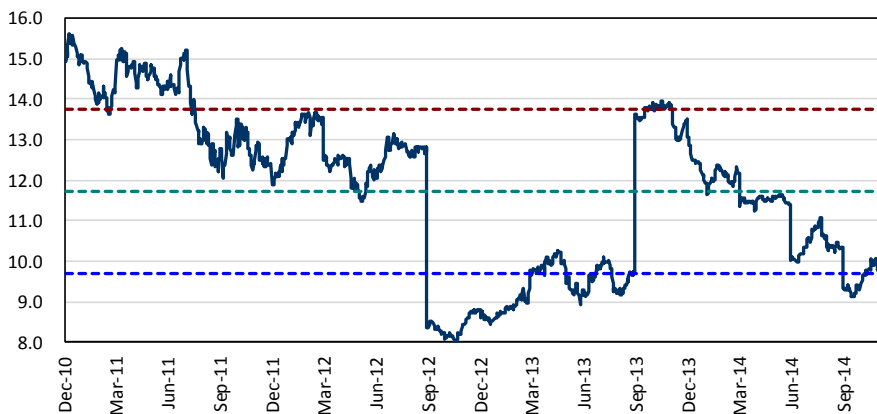
Source: Bloomberg, PSR

**3Y PER (X) UOB**



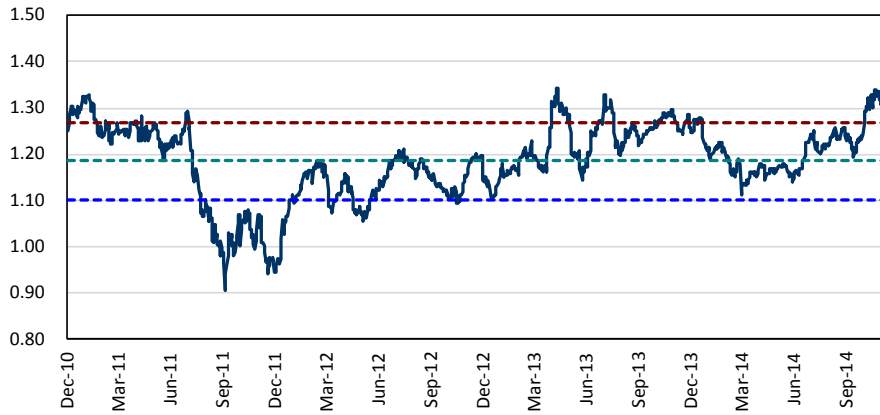
Source: Bloomberg, PSR

**3Y PER (X) OCBC**



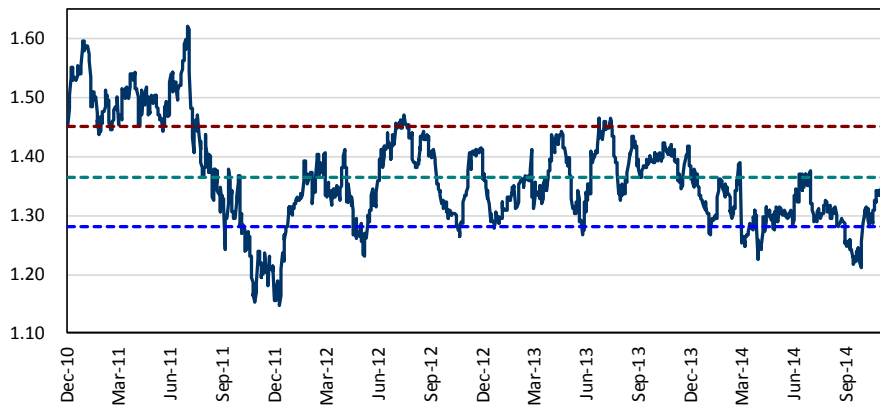
Source: Bloomberg, PSR

**3Y PBV (X) DBS**



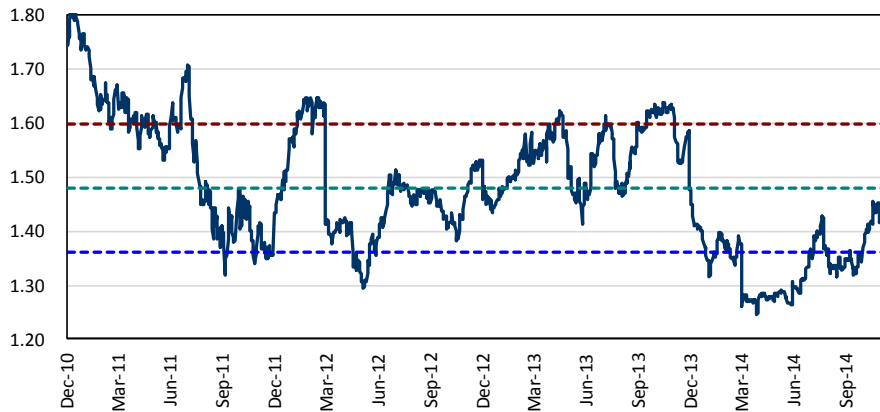
Source: Bloomberg, PSR

**3Y PBV (X) UOB**



Source: Bloomberg, PSR

**3Y PBV (X) OCBC**



Source: Bloomberg, PSR

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