Singapore Banking and Finance

How is the Singapore Loans Market Shaping Up in 2017?

SINGAPORE | BANKING & FINANCE | UPDATE

A visit to Sing Investment & Finance Limited ("SIF").
We visited the SIF to discuss the changes to Finance Company Regulations announced by MAS on the 14th February 2017. We believe, finance companies are finally unshackled to finance and service better the SMEs in Singapore.

But lacklustre business expectations forecast for next 6 months may crimp SME loans growth.
General Business Expectations released by Singapore Economic Development Board showed a generally muted outlook for the period January – June 2017. For the Manufacturing Sector, 96% manufacturing establishments responded to the survey. The result was a net weighted balance of 2% of the respondents anticipate a favourable business situation. And for the Services Sector, c.1,500 enterprises were surveyed. The result was a net weighted balance of 14% of the enterprises anticipate a deteriorating business situation for the period January – June 2017.

Elevated leverage of households could deter the lifting of Total Debt Servicing Ratio ("TDSR") policy in the near term.
Household ability to service mortgages remain at record low levels. The ratio of *Private Property Mortgage Loans to Total Annual Income from Work by Households in Private Properties* over a 16-year period from 2000 to 2016 has reached beyond +1 standard deviation since 2012. Not only had the growth rate of *Average Monthly Income from Work by Households in Private Properties* been declining since 2010 but the growth rate had also fallen below the private property mortgage loans growth rate; even though private property mortgage loans growth had declined sharply after the implementation of TDSR in June 2013.

The three local banks have been boosting Singapore housing loans growth by increasing market share.
We estimate that the three local banks' market share of Singapore housing loans at c.47% by end of 2016 compared to c.43% by end of 2014. In 2016, the Singapore housing loans growth for each of the local banks have outpaced the system loans growth of 4%. We estimate Singapore housing loans grew c.10% for OCBC, c.8% for UOB and c.12% for DBS. In the report, we explain why this trend is expected to continue in 2017.

INVESTMENT ACTIONS

UNDERWEIGHT on Singapore Banking Sector – We are cautious on the Singapore Banking Sector. The weak Singapore economic outlook offsets some positive progress the Singapore banks are making in supporting network clients such as large conglomerates in Singapore expand overseas. Though the Singapore banks may continue to grow Singapore mortgage loans in 2017, we believe the volume growth will be offset by weaker margins. Owing to the operating headwinds we presented in this report, we are Underweight the Singapore Banking Sector. We maintain our Reduce rating on UOB, DBS and OCBC. We do not have a market weight on the Singapore Finance Companies because currently we do not have coverage on Singapore Finance Companies.

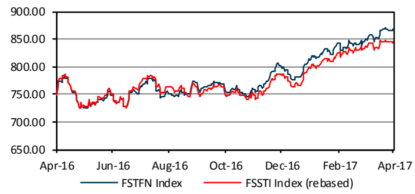
21 April 2017

UNDERWEIGHT

INDEX PERFORMANCE (%)

	1 MTH	3 MTH	1 YR
FSTFN RETURN	2.7	7.2	21.1
STI RETURN	1.5	6.3	17.6

FSTFN VS. STI



Source: Bloomberg, PSR

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MCI (P) 118/10/2015
Ref. No.: SG2017_0070

HOW DO WE VIEW THIS?

Regulatory changes to enhance finance companies' ability to finance SMEs.

The regulatory changes are still preliminary but from our visit to SIF, we saw a couple of straightforward opportunities for finance companies to enhance SME lending:

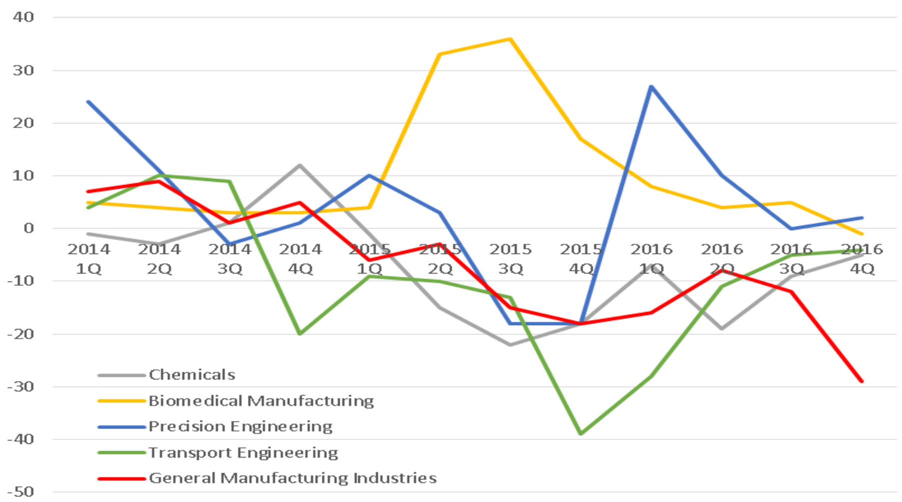
a) **Changes to uncollateralised lending.** Currently, the limit on uncollateralised business loans to a single borrower is S$5,000 but the S$5,000 limit created no market demand as it was not meaningful for SMEs in general. Therefore the original limit for a finance company's aggregate uncollateralised business loans to 10% of its capital funds had never been close to being hit. Now, the new limit to a single borrower is raised up to 0.5% of the finance company's capital funds. Based on SIF's FY2016 Share Capital and Equity Reserves of S$320mn, SIF's uncollateralised business loan exposure to a single borrower could go as high as S$1.6mn. The limit on aggregate uncollateralised business loans will also raised from 10% to 25% of its capital funds thus potentially raising its aggregate uncollateralised business loans limit from S$32mn to S$80mn.

b) **Current account and chequing services capabilities.** SIF's major source of funds had been Fixed Deposits ("FD") but FDs are long term funding with higher costs. But with the ability to open Current Accounts and offer transactions services, finance companies like SIF can capture short term funding and lower their cost of funds. At the same time, finance companies will be able better match their assets to liabilities as they will be able to grow deposits to match the growth in loans.

To estimate the potential net interest income contribution to SIF from uncollateralised business lending, we assume spread on SIF's uncollateralised loans to be an average of 3% per annum for an aggregate uncollateralised business loan size of c.S$60mn. This will yield S$1.8mn in net interest income ("NII") which will potentially add 4.7% to SIF's FY16 NII and hiring charges of S$38.6mn. In addition, we believe there will be positive knock-on effects from increased activity in uncollateralised business lending. Finance companies can start building relationships with fledgling SMEs through uncollaterised lending and when these SMEs expand, there will be better opportunities to extend collateralised business loans by way of a stronger relationship. We opine that the new regulation presents a sweet spot for finance companies to engage and nurture fledgling SMEs that would otherwise be paid less attention by larger banking entities.

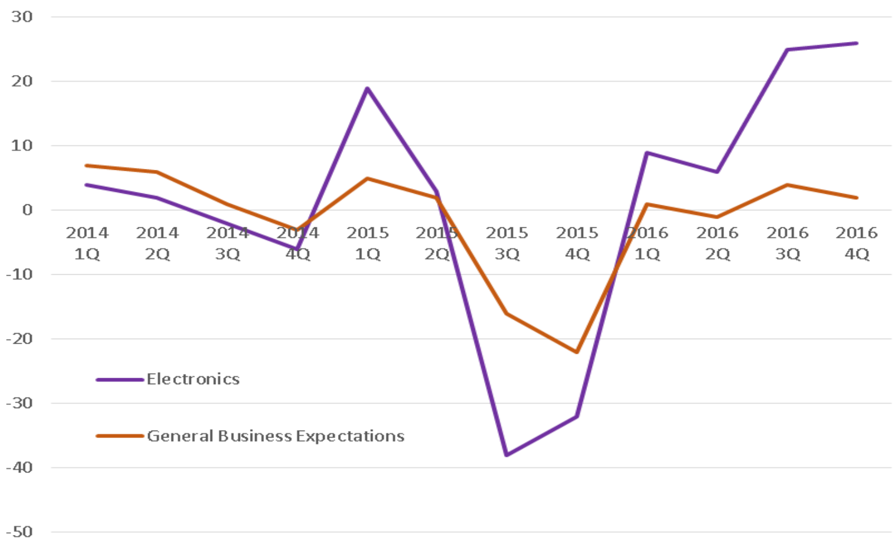
Marginally positive General Business Expectations from January 2017 to June 2017 was supported only by the electronics sector.

Fig 1. All indicators show either a negative or a marginally positive net weighted balance.



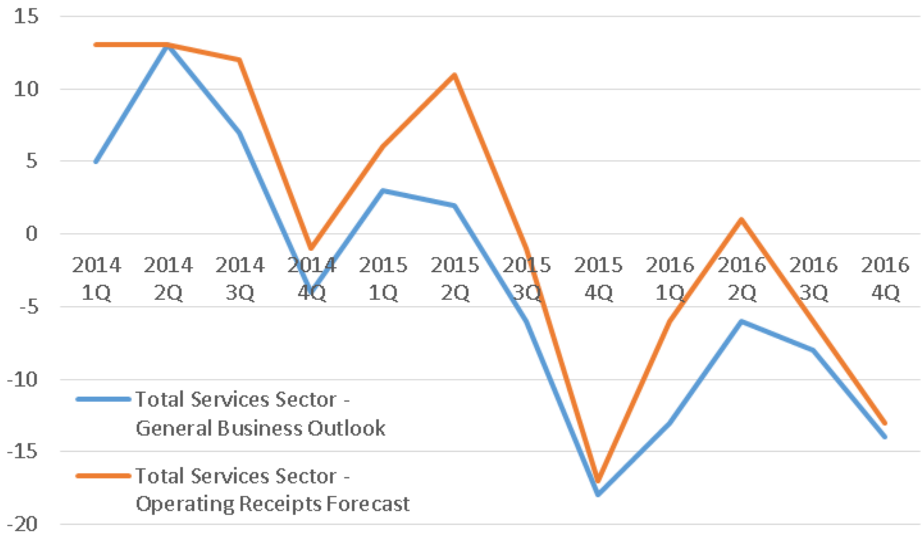
Source: Singstat, PSR estimates

Fig 2. Except for the Electronics Sector but expectations in this sector are very volatile.



Source: Singstat, PSR estimates

Fig 3. Services Sector Expectations are also weaker.

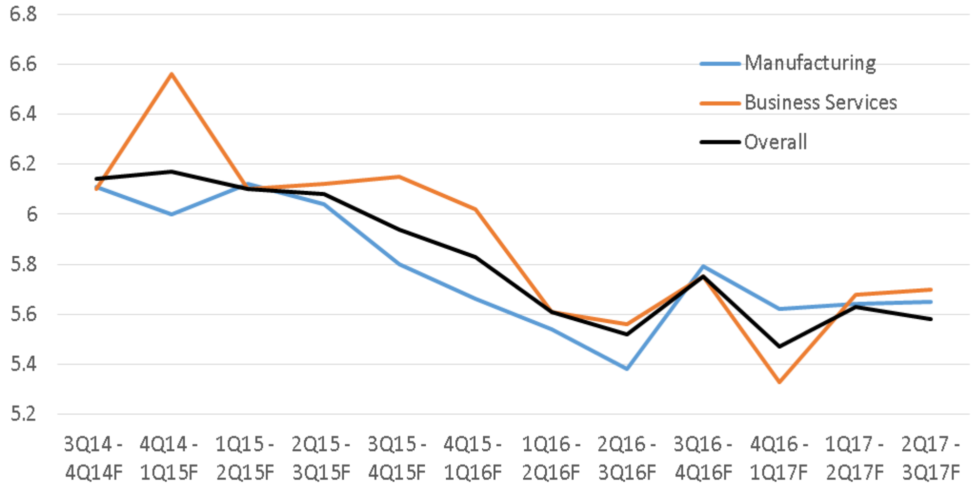


Source: Singstat, PSR estimates

How do the weak business expectations affect SME borrowing?

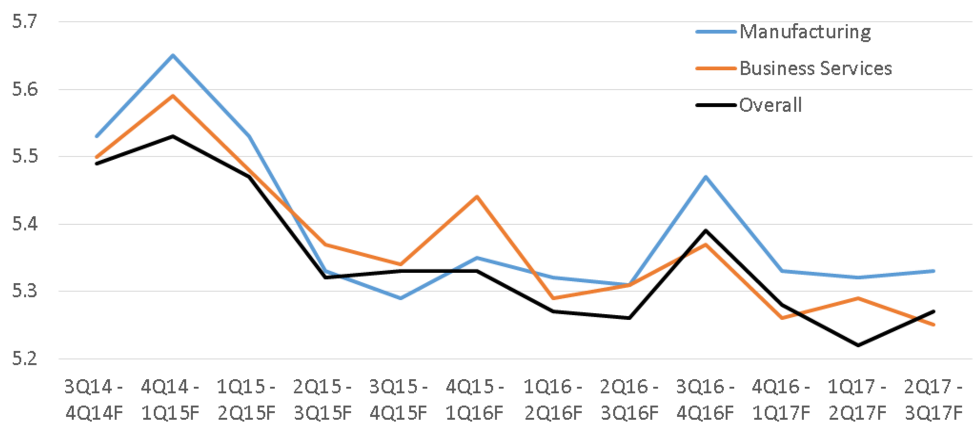
The weak business expectations have affected SMEs' appetite for expansion and capital investments. Therefore, we expect capital goods financing and working capital financing for SMEs to be weak for the next 6 months.

Fig 4. SBF-DP SME Index for Business Expansion Expectations for the next 6 months are on a weak trend.



Source: Singapore Business Federation and DP Information Group, PSR estimates

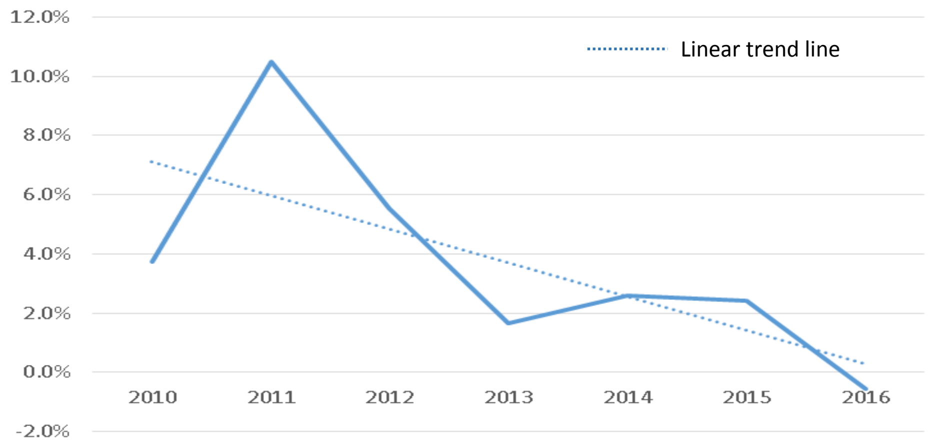
Fig 5. SBF-DP SME Index for Capital Investment Expectations for the next 6 months are also weak.



Source: Singapore Business Federation and DP Information Group, PSR estimates

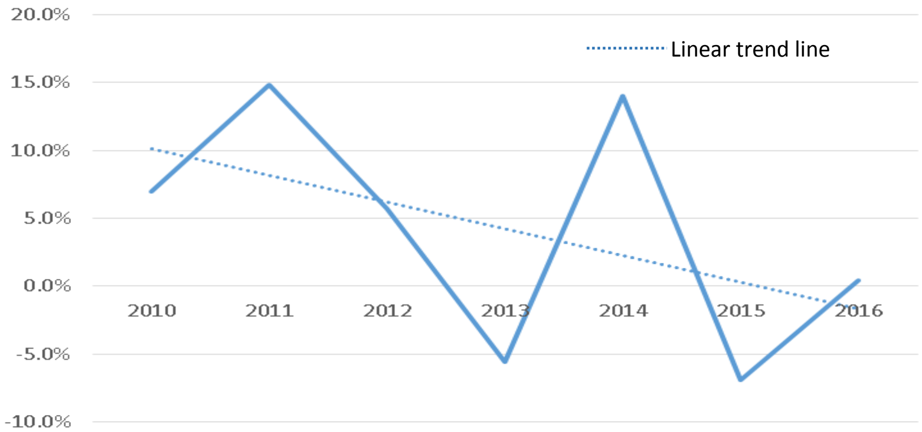
Monthly income of home owners on declining trend.

Fig 6. Growth rate of average monthly income from work by resident households in condominiums and other apartments.



Source: Singstat, PSR estimates

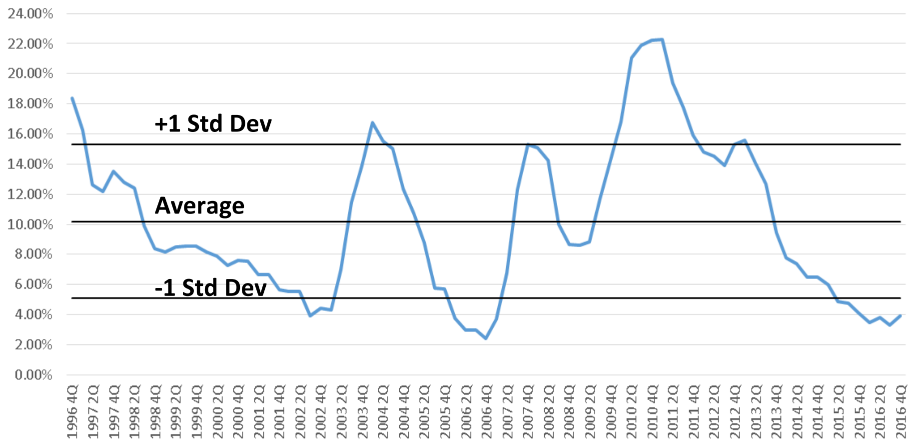
Fig 7. Growth rate of average monthly income from work by resident households in landed properties.



Source: Singstat, PSR estimates

Despite steep decline in the growth rate of mortgages post TDSR implementation in June 2013 to c.4% y-o-y in the beginning of 2016, it remains higher than the growth rate of average monthly household income of c.0%.

Fig 8. Singapore Private Property Mortgage year-on-year ("y-o-y") growth rate.

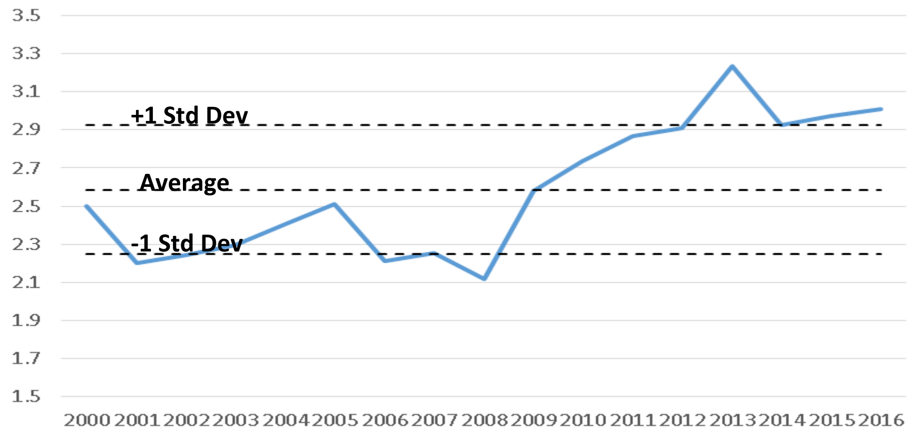


Source: Singstat, PSR estimates

Ratio of Private Property Mortgage to Income is at an all-time high.

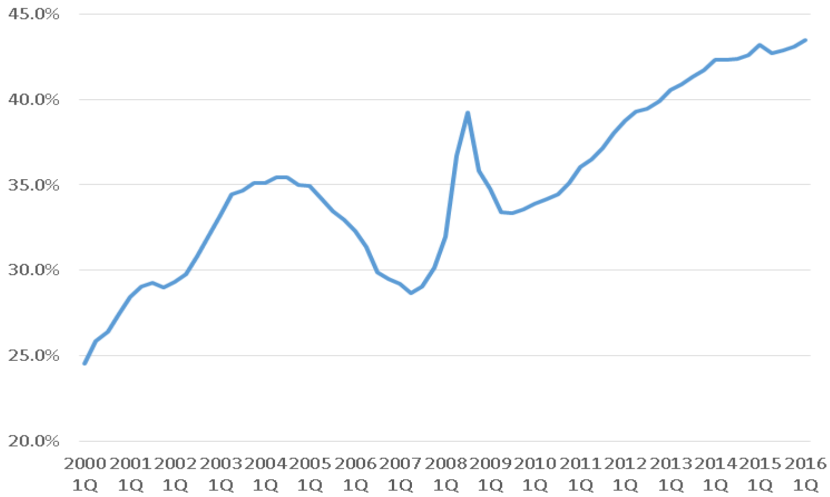
As of 2016, 84.1% of condominiums and other apartments and 92.8% of landed properties are owner-occupied. Owing to the high home ownership of private properties in Singapore, we think it is reasonable to measure the total annual income from household residing in private property against private property mortgage loans in the household balance sheet to give an overall picture on household leverage (Fig 9). The ratio is currently at +1 standard deviation over a 16-year period while the declining average monthly household income growth rate is now below the mortgage loans growth rate. This means we will not expect the ratio to improve unless there is strong and sustained growth in household income of more than 4%. In addition, the mortgage loan to value shown in Fig 10 is at an all-time high surpassing the last peak in 2008.

Fig 9. The ratio has exceeded +1 standard deviation since 2012 over a 16 year period from 2000 to 2016.



Source: Singstat, PSR estimates

Fig 10. Private Property Mortgage Loan to Value at a 16 year high, surpassing the level before the Great Financial Crisis in 2008

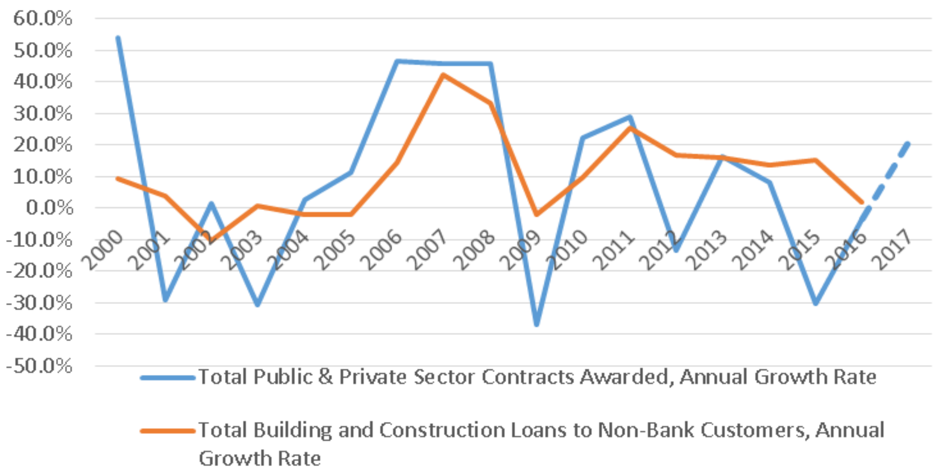


Source: Singstat, PSR estimates

We expect Building and Construction Loans to rise c.20% by end of 2017 in tandem with the expected c.20% growth in Building and Construction Contracts awarded.

Historically, the growth rate of Domestic Banking Unit ("DBU") Building and Construction Loans closely matched the growth rate of contracts awarded. However, the lower downside volatility associated with loans growth is may be due to loans carried forward into the following year(s) as multi-year contracts progress. On contrary, awarded contracts growth recognizes contracts only in the year they were awarded.

Fig 11. Building and Construction Loans are strongly correlated to Building and Construction Contracts awarded.

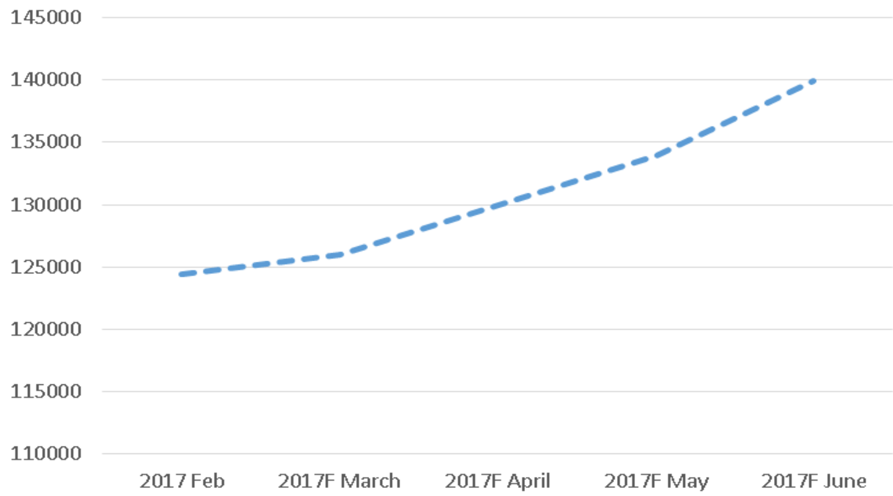


Source: BCA, MAS, PSR estimates

We could see the bulk of the Public Sector Building and Construction Loans added in 2Q17.

Based on the Building and Construction Authority's pipeline of Public Sector Consultancy and Construction Tenders, we estimate that c.50% of 2017 tenders are out by 1Q17. We estimate c.S$16bn worth of Building and Construction contracts awarded in 1Q17 are ready to commence by end of 2Q17. Therefore we estimate Building and Construction DBU loans may grow c.15% from S$121bn in Dec 2016 to c.S$140bn by June 2017 because of the commencement of the new contracts plus backlog of older projects.

Fig 12. Our estimated Building and Construction DBU Loans from Feb 2017 to June 2017.



Source: MAS, PSR estimates

For the three Singapore banks, housing loans growth is likely to continue to come from increasing market share but would also imply weaker margins amid stiffer competition.
Fig 13a shows that by end of 2016, the three Singapore banks were implied to have gained market share in the Singapore mortgage loans compared to 2015 at the expense of other competitors. We expect the Singapore banks to continue gaining more share in 2017 and their growth rates are also expected to be faster than the overall mortgage system's growth of c.4% as shown in Fig 8.

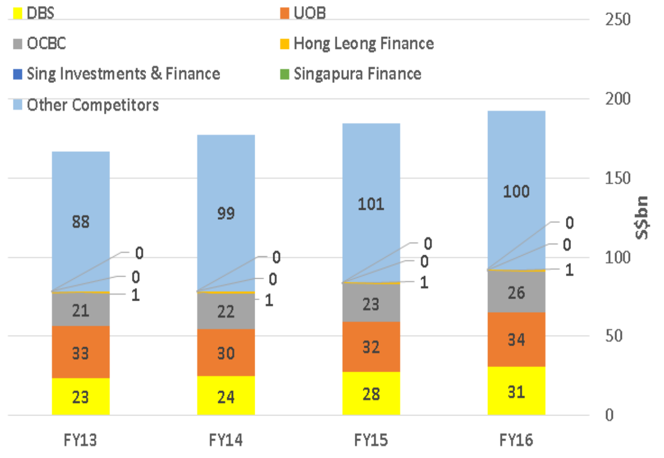
The reasons for gaining more market share are:

a) Compliance to the Net Stable Funding Ratio ("NSFR") whereby banks are required to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. Given this circumstance, the foreign banks may have to reduce their mortgage business, if long term funding is more constrained, to better match the tenure of loans with the tenure of funding.

b) Singapore banks having faced loans quality deterioration in the commodities, and oil and gas space are seeking to secure more high quality loans in consumer mortgage loans. As a result, competition for high quality loans within the Singapore mortgage loans space heats up and margins become low. Foreign banks with higher costs of funding (compliance to NSFR may also result in higher cost of funding because banks are required to add more costly long tenure funding and be less reliant on cheaper short-term wholesale funding) will then be discouraged to compete and therefore reduce their market share.

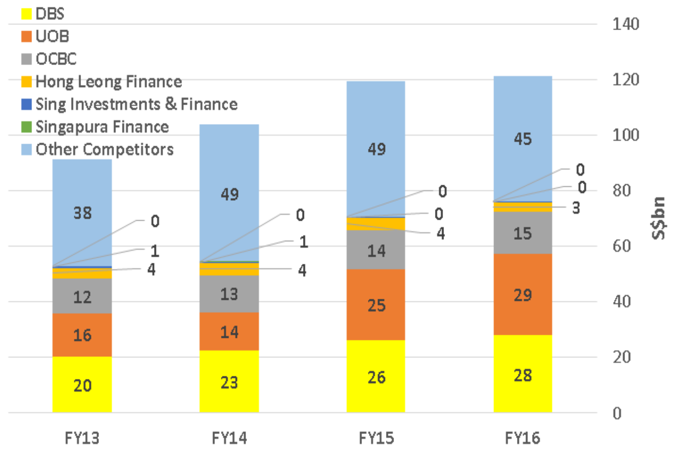
However in the Singapore Building and Construction sector, UOB appears to be leading..
Fig 13b shows that by end of 2016, UOB is implied to have taken a lion's share of other competitors' share in the Singapore Building and Construction loans market, well ahead of DBS and OCBC. We believe UOB's market leadership in the Singapore Building and Construction loans market and its efforts ramp up market share in 2016 would provide it momentum to ride on the growth of public sector projects in 2017.

Fig 13a. Our estimation of Singapore Housing and Bridging Loans Market Share breakdown.



Source: MAS, Company Annual Reports, PSR estimates

Fig 13b. Our estimation of Singapore Building and Construction Loans Market Share breakdown.



Source: MAS, Company Annual Reports, PSR estimates

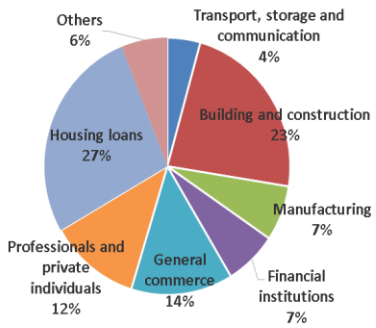
PEER COMPARISON AND LOANS BREAKDOWN BY INDUSTRY

Name	Ticker	Market Cap (S$mn)	Price	P/E	P/B	ROE (%)	Total Return YTD (%)	Div Yield (%)
DBS GROUP HOLDINGS LTD	DBS SP Equity	48,946	19.25	11.4	1.09	9.97	11.02	3.12
OVERSEA-CHINESE BANKING CORP	OCBC SP Equity	40,572	9.70	11.8	1.13	9.96	8.74	3.72
UNITED OVERSEAS BANK LTD	UOB SP Equity	36,061	22.04	11.9	1.17	10.21	8.04	3.18
HONG LEONG FINANCE LTD	HLF SP Equity	1,241	2.79	23.3	0.73	3.14	30.37	3.23
SING INVESTMENTS & FINANCE	SIF SP Equity	242	1.54	17.4	0.76	4.39	30.64	3.25
SINGAPURA FINANCE LTD	SBD SP Equity	172	1.09	21.9	0.69	0.79	26.16	1.84

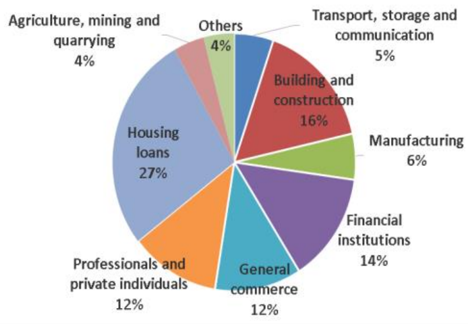
Source: Bloomberg, PSR estimates

4Q16 DBS Loans by Industry

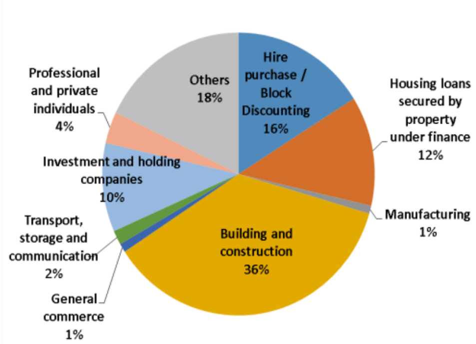
4Q16 UOB Loans by Industry



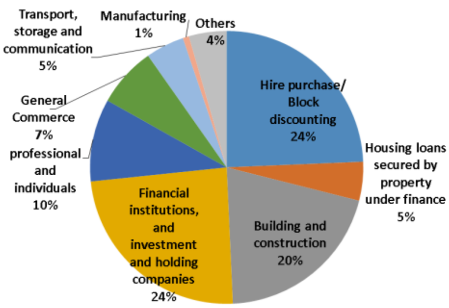
4Q16 OCBC Loans by Industry



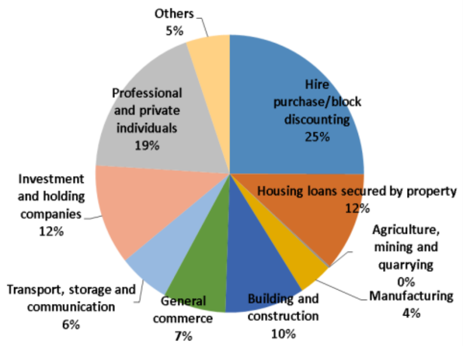
4Q16 Hong Leong Finance Loans by Industry



4Q16 Sing Investments & Finance Loans by Industry



4Q16 Singapura Finance Loans by Industry



Source: Company Annual Reports, PSR estimates

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