Singapore Banking Monthly

Relief to tide through challenging times

SINGAPORE | BANKING & FINANCE | UPDATE

13 April 2020

Overweight (Maintained)

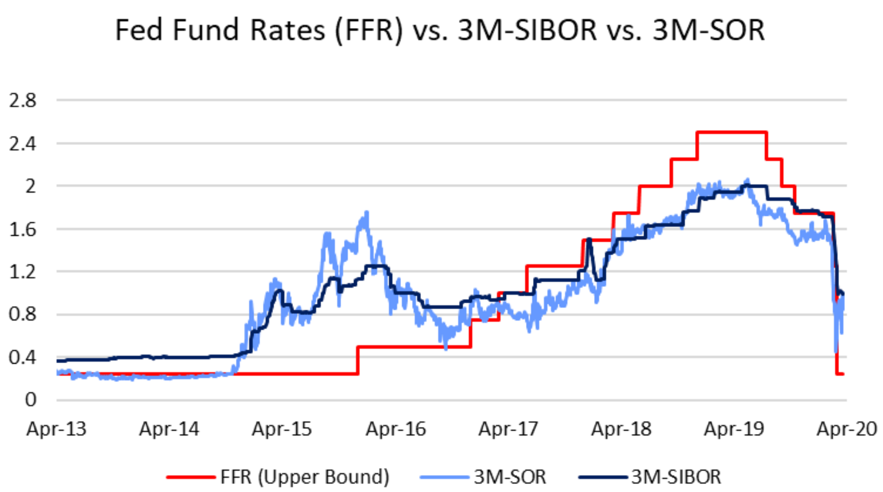
- Despite the rate cut by the Federal Reserve totalling 150 bps in March, local interest rates are showing short-term resilience. NIMs may compress by mid-teens level for the full year, less than previously expected.
- February loans growth was stable at 3.05% YoY. Loans will likely sustain at current levels of growth with various government measures to encourage lending amidst liquidity crunch faced by businesses as the COVID-19 pandemic ensues.
- Derivatives volume rose 34% YoY in March as volatility is at their highest monthly levels since the 2008 Global Financial Crisis.
- **Maintain Singapore Banking Sector at Overweight.** Local banks will benefit from the slew of measures introduced by the government to reduce the strain on the financial system through risk-sharing and provision of low-cost funding.

Reprieve in local lending rates

Despite the surprise double rate cuts of 150 bps by the Federal Reserve in March, we have observed local interest rates showing signs of resistance to the drop. 3M-SIBOR fell by 73 bps while 3M-SOR fell more than 120 bps from February peaks before rebounding roughly 50 bps to current levels. The stabilisation in lending rates will determine how well local banks will be able to resist NIM compression pressures.

The lag effect of NIM compression means the full impact of the drop in interest rates should only be experienced in 2H20. As such, we expect full-year NIM across the three local banks to fall by mid-teens level, lower than previously expected of beyond 20 bps.

Figure 1: 3M-SIBOR and SOR holding out despite 150 bps rate cut in March



Source: Bloomberg, PSR

Figure 2: Lending rates showing signs of resilience

	3M-SIBOR (%)	3M-SOR (%)
Current	0.99 (-73 bps)	0.95 (-74 bps)
March Low	0.99 (-73 bps)	0.46 (-123 bps)
February Peak	1.72	1.69

DBS Group Holdings

ACCUMULATE (Maintained)

BLOOMBERG CODE	DBS SP
LAST TRADED PRICE	SGD 19.14
FORECAST DIV	SGD 1.32
TARGET PRICE	SGD 27.30
TOTAL RETURN	49.53%

Oversea-Chinese Banking Corp

ACCUMULATE (Maintained)

BLOOMBERG CODE	OCBC SP
LAST TRADED PRICE	SGD 8.95
FORECAST DIV	SGD 0.56
TARGET PRICE	SGD 12.10
TOTAL RETURN	41.45%

United Overseas Bank Limited

ACCUMULATE (Maintained)

BLOOMBERG CODE	UOB SP
LAST TRADED PRICE	SGD 20.17
FORECAST DIV	SGD 1.30
TARGET PRICE	SGD 27.80
TOTAL RETURN	44.27%

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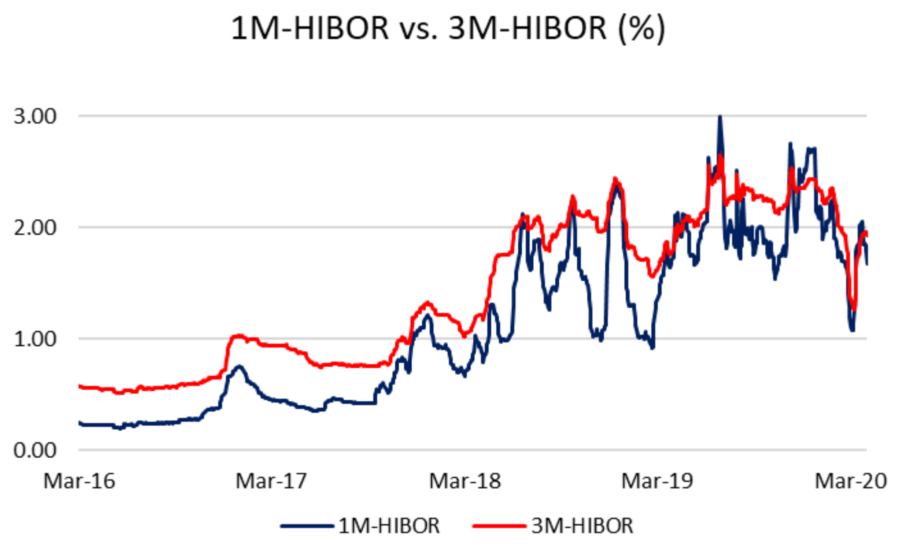
List of Abbreviations:
WM – Wealth Management
CASA – Current and Savings Account
NII – Net Interest Income
NIM – Net Interest Margin
NPL – Non-performing Loans
PPOP – Pre-Provision Operating Profit
WACC – Weighted Average Cost of Capital
ROIC – Return on Invested Capital
FHR – Fixed Deposit Home Loan Rate
EV – Economic Value
SME – Small to Medium Enterprises
LDR – Loan to Deposit Ratio
CIR – Cost-to-income ratio
ROE – Return on Equity
ECL - Expected Credit Losses
B&C – Building and Construction
CPO – Crude Palm Oil
SP – Specific Provisions
GP – General Provisions

HIBOR rebounds from lows

Similar to the resilience shown in SIBOR, both 1M and 3M-HIBOR also rebounded from lows after the double rate cuts in March to slightly under 2%, less than 20 bps below-average levels observed in February.

Figure 4: HIBOR adds pressure on banks' margins



Source: Bloomberg, PSR

Figure 3: HIBOR

	1M-HIBOR	3M-HIBOR
Current	1.68%	1.92%
Mar Low	1.07%	1.26%
Feb Average	1.82%	2.08%

Source: MAS, PSR

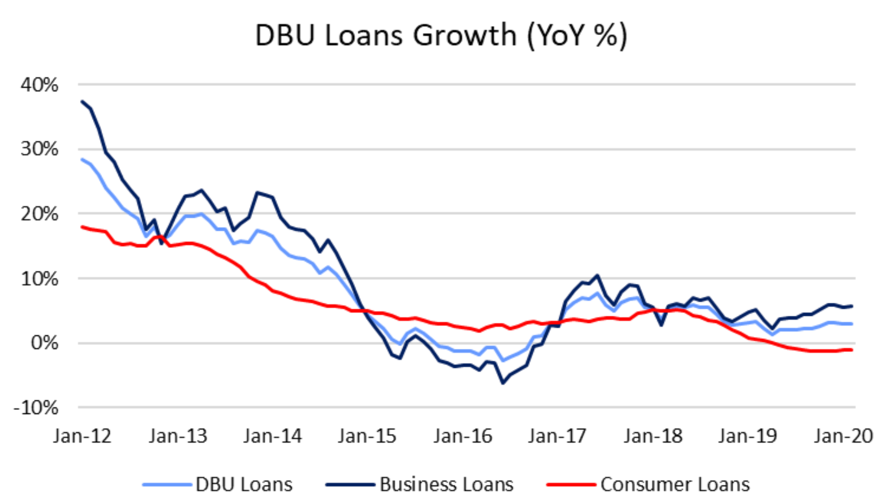
Loans growth hold steady

Domestic loans grew 3.05% YoY in February, holding YoY growth rates steady since November 2019. With a series of regulatory and supervisory adjustments by MAS to encourage and support lending activities by financial institutions as the economy faces headwinds from the COVID-19 pandemic, loans growth may be bolstered and come in at the higher end of our 2 – 3% forecast for the full year.

Nevertheless, an industry-wide loan restructuring is expected – including the extension in loan tenures and lowering of interest rates. The restructuring will not affect allowances, but deferment to interest payments may see reduced cash flow for the banks in the short-term.

For more information on the series of MAS announcements to support lending activities by financial institutions, please refer to Annex A and Annex B.

Figure 6: Domestic loans growth



Source: MAS, PSR

Figure 5: Past 5 months loans growth

	Loans growth (YoY %)
February 2020	3.05
January 2020	2.97
December 2019	3.08
November 2019	3.10
October 2019	2.63

Source: MAS, PSR

Derviative volumes set to benefit from heightened volatility

The VIX index recorded a monthly average of 82.06 points in March, the highest level since the 2008 GFC. SGX's DDAV jumped 34% YoY in March, derivatives volume for SGX 3Q20 recorded 23%, 11% and 34% respectively across each of the three months.

The market sell-down led by the spike in volatility also saw massive fund flow in the equity market. SDAV more than doubled in March (+114% YoY), also reaching record levels since the 2008 GFC. SDAV for March quarter is up 114% YoY.

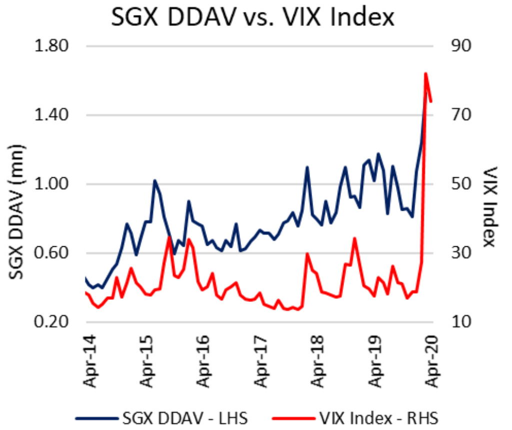
The improvement to SDAV and DDAV will likely see earnings beat our estimations by 25% for the quarter ending March.

Figure 6: 3Q20 SDAV and DDAV performance

	SDAV ($mn)	YoY	DDAV (mn)	YoY
March	2,193	+114%	1.53	+34%
February	1,377	+30%	1.24	+11%
January	1,219	+24%	1.07	+23%

Source: SGX, PSR

Figure 5: Correlation of DDAV and VIX Index



Source: MAS, Bloomberg, PSR

Investment Action

Maintain the Singapore Banking Sector at Overweight. With the MAS stepping in with monetary policies to reduce the impact of the COVID-19 pandemic on the economy, local banks will be partially relieved of their burden placed on the financial system. Short-term liquidity may be impacted as loan repayments are deferred, but risk sharing by the government will allow banks to mitigate risks to asset quality, while availability of low-cost funds by the government will allow banks to have the ability to support loans income over the long term once the pandemic comes to pass.

Annex A: MAS and Financial Industry to Support Individuals and SMEs Affected by the COVID-19 Pandemic

(Dated 31 March 2020)

SMEs	Summary	Impact
i. Secured SME Loans	▪ Defer principal payments up to 31 December 2020 ▪ Opt-in basis ▪ Interest will continue accruing ▪ Ability to extend tenure by up to corresponding principal deferment period ▪ Must not have payments past 90 days due as of 6 April 2020	▪ SMEs who opt in for extension in loan repayment will need to consider additional interest accrued ▪ Banks will have lesser cash flow from deferred interest payments ▪ No impact on earnings as interests continue accruing ▪ Restructuring of loans by extending tenure will not be recording as NPLs
ii. New loans	Banks and finance companies may apply for low-cost funding through a new MAS SGD Facility under Enterprise Singapore: i) SME Working Capital Loan Scheme and ii) Temporary Bridging Loan Programme Savings in funding cost must be passed to SME borrowers	▪ Banks will be encouraged to extend more loans due to lower funding costs under the new scheme ▪ Loans volume will improve, but lower interests on loans may have limited impact on earnings
iii. Insurance Premium Payment	Allow SMEs to apply for changes to instalment payment plans; paying premiums in smaller amounts instead of lump sum premium for policy period at the start of the period	-
Individuals	**Summary**	**Impact**
i. Residential Property Loans	▪ Defer either (i) principal payment or (ii) both principal and interest payments up to 31 December 2020 ▪ Opt-in basis ▪ Interest will accrue only on deferred principal payment and not on deferred interest payments ▪ Must not have payments past 90 days due as of 6 April 2020	▪ Individuals who opt in for extension in loan repayment will need to consider additional interest accrued ▪ Banks will have lesser cash flow from deferred interest payments ▪ No impact on earnings as interests continue accruing ▪ Restructuring of loans by extending tenure will not be recording as NPLs
ii. Personal Unsecured Credit	▪ May apply to convert outstanding balances to term loans at a reduced rate of interest, capped at 8% ▪ Term of loan converted can be up to five years ▪ Available for individuals who suffered loss of 25% or more of monthly income after 1 February 2020 ▪ Application period between 6 April till 31 December 2020	▪ Reduced NII from lower interest rates on credit card ▪ Conversion to term loan may accrue more interest over time ▪ Banks will have lesser cash flow from deferred interest payments
iii. Life and Health Insurance	▪ May apply to defer premium payments for up to six months ▪ Available for all individual life and health insurance policies with policy renewal or premium due date between 1 April and 30 September 2020	-
iv. General Insurance	▪ Allow individuals to apply for changes to instalment payment plans; paying premiums in smaller amounts instead of lump sum premium for policy period at the start of the period	-

Source: MAS, PSR

Annex B: MAS Takes Regulatory and Supervisory Measures to Help Financial Institutions Focus on Supporting Customers

(Dated 7 April 2020)

<table>
<tr><th>Measures</th><th>Impact</th></tr>
<tr><td>Adjusting Capital and Liquidity Requirements for Banks

▪ Allow full recognition of regulatory loss allowance reserves (RLAR) as Tier 2 Capital, which are currently only granted limited recognition as Tier 2 Capital</td><td>Easing of regulations will encourage local banks to utilise greater portion of capital set aside for RLAR as loans:

i) Spurs lending to viable businesses without violations to regulations

Loans growth will be held up which will help to boost NII of local banks</td></tr>
<tr><td>Setting Accounting Loan Loss Allowances

▪ Allow Financial Institutions to consider extraordinary measures taken by government to bolster economic resilience</td><td>Impact of forward-looking Expected Credit Loss (ECL) on credit costs and allowances to be mitigated.

MAS' increase to risk share of loans to 90% reduces risk faced by banks, encouraging banks to continue lending activities. Risks undertaken also diminishes over time.

Illustration:
For every $1 of loans defaulted under the MAS scheme, the banks will be compensated $0.90 by the MAS.

If default occurs after 50% of loan principle has been paid up, MAS will compensate banks 90% of the remaining outstanding principle (i.e. 45% of original loan amount), resulting in lower loss on the banks (5% compared to 10% if there was a complete default.

However, banks are to maintain similar levels of risk management in its decision to approve loans.</td></tr>
<tr><td>Deferring Implementation of Regulatory Reforms</td><td rowspan="3">Reduce operational costs for banks to comply with additional standards slated to be put in place.

Implementation of various requirements deferred till September 2021 and beyond to reduce burden placed on financial institutions.</td></tr>
<tr><td>Extending Reporting Timelines and Deferring Industry Projects</td></tr>
<tr><td>Suspending On-site Inspections and Supervisory Visits</td></tr>
</table>

Source: MAS, PSR

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