AmInvestment Bank

Sector report
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BANKING SECTOR

BNM Financial Stability Report – 1H2020

NEUTRAL
(Maintained)

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Rationale for report: Sector update

Investment Highlights

BNM released the Financial Stability Review for 1H20 and held a briefing yesterday for analysts. Below are the key highlights:

- Despite the weaker earnings of banks in 1H20 weighed down by margin compression from consecutive OPR cuts and higher provisions for credit losses, banks maintained healthy capital and liquidity positions. Annualised credit cost rose to 56bps compared to an average of 20bps for 2010-2019. Liquidity coverage ratio (LCR) was sustained at 149.0% in June 2020 while excess capital buffers of RM121.6bil remained strong to withstand potential credit losses.
- The banking sector recorded a CET1 capital ratio of 14.6% and total capital ratio of 18.3% in June 2020 compared to 14.6% and 18.6% respectively in Dec 2019.
- Gross impaired loan ratio for the sector was at a low 1.5%. This was due to most retail and SME loans placed under the automatic blanket loan moratorium for 6 months (1st April to 30th Sept). Also, debt recovery efforts by banks have reduced the outstanding loan impairments for the sector.
- As at 25 Sept 2020, 840,000 borrowers opted out of the loan moratorium. In Aug 2020, repayments of SME and retail loan were at 69% of the levels seen in Mar 2020 (before the commencement of loan moratorium).
- Growth in household debts moderated to 4.0% in 1H20 from 5.5% in 2019 contributed by movement restrictions and decline in consumer spending with households turned more cautious. Despite the slower credit growth, household debt-to-GDP ratio rose to 87.5% in 1H20 vs. 82.9% in 2019 amid the contraction in 2Q20 GDP.
- Household continued to hold comfortable levels of financial asset as evidenced by the financial asset-to-debt and liquid financial asset-to-debt ratios of 2.2x and 1.4x, respectively.
- The unemployment rate decreased to 4.7% in July 20 vs. 5.3% in May 2020. Debt servicing ratio of households for outstanding loans was 35.0% and for newly approved household loans, it was 43.0%.
- Nevertheless, there remains stress on some households, particularly the lower income earners. Share of borrowings by borrowers with income below RM3,000 a month (vulnerable segment) to the total banking system loans ascended to 17.6% (2019: 16.7%). Leverage of these borrowers climbed to 9.5x owing to increase in borrowings for purchase of houses during the Home Ownership Campaign (HOC). Also, they continued to hold low liquidity buffers as evidenced by the low liquid asset-to-financial debt ratio of 0.7x which is below the prudent threshold of 1.0x.
- Property market in Malaysia in 1H20 was weaker attributed to decline in market activity while the oversupply conditions in the non-residential property market persist. The Malaysian House Price Index (MHPI) grew at a slower pace of 1.1%.

EXHIBIT 1: VALUATION MATRIX

			Target	Upside	Mkt Cap	EPS (sen)		PER		Net DPS		Net DivYield		BV	BV	PBV	PBV
	Rec.	14-Oct	Price	(%)	(RM Mil)	20	21	20	21	20	21	20	21	20	21	20	21
AMMB	NR	3.00	-	-	8,758	44.6	37.5	6.7	8.0	13.3	13.6	4.4	4.5	6.2	6.4	0.5	0.5
Maybank	BUY	7.22	8.40	16.3%	81,387	59.1	65.2	12.2	11.1	45.5	50.2	6.3	7.0	7.5	7.9	1.0	0.9
Public Bank	HOLD	15.70	16.00	1.9%	61,881	122.6	131.1	12.8	12.0	61.3	65.5	3.9	4.2	11.9	12.5	1.3	1.3
RHB Bank	BUY	4.57	5.70	24.7%	17,404	52.7	58.0	8.7	7.9	31.0	21.1	6.8	4.6	6.8	7.1	0.7	0.6
Hong Leong	BUY	15.04	16.80	11.7%	32,516	128.8	135.6	11.7	11.1	36.0	40.7	2.4	2.7	13.3	14.4	1.1	1.0
CIMB	HOLD	3.08	3.10	0.6%	30,265	20.9	29.6	14.7	10.4	11.2	15.8	3.6	5.1	6.0	6.2	0.5	0.5
ABMB	HOLD	2.19	2.00	-8.7%	3,437	27.4	23.8	8.0	9.2	6.0	11.4	2.7	5.2	3.9	3.9	0.6	0.6
BIMB	HOLD	3.50	3.60	2.9%	6,131	40.6	45.0	8.6	7.8	15.0	16.6	4.3	4.7	3.6	4.1	1.0	0.9
MBSB	BUY	0.51	0.78	52.9%	3,557	7.9	9.4	6.5	5.4	4.9	4.9	9.5	9.6	1.3	1.3	0.4	0.4
Average						**62.1**	**65.7**	**10.4**	**9.7**	**27.4**	**29.4**	**4.3**	**4.8**	**7.4**	**7.8**	**0.8**	**0.8**
Non-bank																	
HLFG	BUY	14.28	17.20	20.4%	16,377	174.9	179.6	8.2	8.0	38.0	41.3	2.7	2.9	18.3	20.0	0.8	0.7

Forecasts by AmInvestment Bank

Source: Bloomberg / Company / AmInvestment. Note: AMMB's estimates based on Bloomberg consensus forecasts.NR denotes Non-Rated

The number of new housing units launched in 2Q20 was only 3,911, one fifth of the quarterly average in 2019. The impacts from closure of borders, lower footfalls for shopping complexes as well as more working from home arrangements are likely to increase the risk for the non-residential property segment. Office occupancy and rental rates could be further dampened by businesses reviewing their requirements for spaces upon renewal taking into account the increase in the number of employees working from home.

- The Covid-19 could pose a risk of broad decline in property prices with the deterioration in income and demand. However, this risk will be mitigated by measures to support the housing market which included the reintroduction of HOC, lower financing cost with OPR cuts and the automatic loan moratorium and targeted repayment assistance. In addition, more than 80% of mortgage loans are for purchase of owner-occupied houses while most borrowers of housing loans for investment purposes are in the higher income category. Risk is also mitigated with most housing loans in the positive equity.

- The pandemic has resulted in challenging business conditions for the non-financial corporates (NFC). The business sector's operating margin fell to 4.8% in 1H20 compared to 5.6% in 2H19. Interest coverage ratio (ICR) slipped to 3.7x while the number of listed firms with ICR < 2% increased to 32.1%. Nevertheless, liquidity position was sustained with a cash-to-short-term debt ratio of 1.0x and current ratio of 2.0x.

- Total non-financial corporate (NFC) debts expanded by 3.8% in 1H20 representing 108.1% of GDP. This was contributed by lower repayments due to the loan moratorium and increase in loans for working capital.

- Even though businesses have recovered from the gradual relaxation of the MCO restrictions, the recovery has been uneven with the service and tourism industries experiencing slower recovery. The vulnerable sectors of tourism-related, real estate, wholesale and retail, oil & gas, construction and SMEs made up 7%, 17.7%, 18.1%, 1.1%, 14.5% and 43.7% respectively of banks' business loans. The risks of these vulnerable sectors to banks are mitigated by: i) relief measures and continued assess to financing which included the total allocation of RM18.1bil funding for SMEs, ii) collaterals and guarantees from the government and agencies such as CGC, iii) diversified revenue streams of larger borrowers and iv) intensified risk monitoring and proactive restructuring and rescheduling (R&R) of borrower's loans. As at 25 Sept 2020, 514,300 R&R applications from retail and SME borrowers have been received with a 98% approval rate. We gather that 40% of these applications have requested for deferment of repayments while the balance 60% have applied to lower their repayment amounts. On the R&R applications for corporates received, it was 3,400 with 3,000 approved.

- Risk of domestic banking group's overseas operations from weaker economic conditions remained low despite the weaker regional economic growth. ROE for overseas' operations of banks fell to -4.2% in 1H20 with an increase in GIL ratio to 4.2% in June 2020 vs. 3.6% in Dec 2019. Total capital ratio of the overseas operations of domestic banking group remained healthy at 19.1% with a low share of loans extended to vulnerable sectors of 0.1% to 5.3%. Also, the internal stress test of the foreign subsidiaries indicated the ability to withstand economic shocks.

- The domestically systematic important banks buffers (D-SIBs) for the three largest banks remained unchanged (Maybank and CIMB: 1% and Public Bank: 0.5 %).

- Based on BNM's macro simulation stress test with defaults driven by businesses in the affected sectors and households with higher leverage, banks are still comfortably able to withstand shocks of up 8 times their historical average default rates with the aggregate CET1 ratio slipping by 3.1ppts.

- We retain our **NEUTRAL rating** on the sector. While the pressure on interest margins is subsiding with expectations of no further cuts for the remainder of 2020, concerns on asset quality continues to cloud the sector with the Covid-19 infections rising again, thus affecting global demand. The transition from automatic loan moratorium to targeted repayment assistance provides a better visibility on loan performance. However, should the elevated Covid-19 cases and CMCO be prolonged, it will further impact earnings of businesses and slowdown the economic recovery. Coming out of the automatic loan moratorium, it remains to seen if the higher overall provisions of RM2.7bil (RM1.7bil for stage 2 provisions) set aside by banks on pre-emptive basis including management overlays in 1H20 are adequate. **Our top picks are Maybank (FV: RM8.40/share) and RHB Bank (FV: RM5.70/share). Also, we like Hong Leong Bank with a FV of RM16.80/share.**

EXHIBIT 2: FINANCING FACILITIES FOR SMES

Financing Facilities for SMEs^

(% of fund utilised as at 2 Oct 2020)

Total allocation: RM18.1 bil

SRF
RM10 bil
(100%)
Alleviate short term cash flow

ADF
RM300 mil
(21%)
Incentivise automation and digitalisation

AES
RM5 bil
(86%)
Enhance access to financing

AF
RM1.5 bil
(64%)
Increase food production

PTF
RM1 bil
(2%)
Aid SMEs in the tourism sector

MEF
RM300 mil
(67%)
Collateral free financing for micro-enterprises

^ Special Relief Facility (SRF); All Economic Sector (AES); PENJANA Tourism Financing (PTF); Automation and Digitalisation Facility (ADF); Agrofood Facility (AF); Micro Enterprise Fund (MEF)

Source: BNM

EXHIBIT 3: KEY INDICATORS FOR VULNERABLE SECTORS

	Tourism-related	Wholesale and retail	Construction	Real estate	Oil and gas
ICR (times)	3.7	4.9	2.3	2.6	3.1
CASTD (times)	1.0	1.2	0.5	0.5	0.8
CR (times)	2.0	2.4	1.8	1.6	1.3
DE (%)	23.8	27.4	36.8	39.1	36.1
% of bank loans to businesses	7.0	18.1	14.5	17.7	1.1
Impairment ratio (%)	2.2	1.6	2.6	2.0	3.6

Source: BNM

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