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BANKING SECTOR

BNM Financial Stability Review for 2H2020

OVERWEIGHT

(Maintained)

Rationale for report: Sector update

Investment Highlights

BNM released the Financial Stability Review for 2H20 and held a briefing for analyst. Below are the key highlights:

- The Malaysian economy will rebound to 6–7% in 2021 from -5.6% in 2020. This will be supported by an improvement in external demand from the global technology upcycle, improving private consumption from less strict movement restrictions as well as the vaccine rollout. Also, 2021 will see a gradual improvement in labour market conditions with unemployment rate of between 4% and 5% and continued policy support for households and businesses.
- 9.7% of the total business loan accounts were under debt repayment assistance as at end-December 2020. By value, this was 17.0% of the total business loans.
- 2H20 saw some recovery in the operating environment of businesses. However, the recovery has been uneven across business sectors. The manufacturing sector experienced improvements but tourism-related industries continued to face challenges. Nevertheless, the share of loan exposure to tourism-related industries remained small at 2.5% of the total banking system loans. Meanwhile, the share of loan exposure to consumer-related sectors (including wholesale, retail trade, hotels and restaurants) stood at 7.5% of total loans.
- Despite weaker earnings, the debt servicing capacity of businesses has been preserved with operating margin and interest coverage ratio (ICR) of 4.7% and 4.1x in 3Q20 vs. 5.0% and 3.9x respectively in 2Q20. Meanwhile, cash-to-short-term debt ratio and debt-to-equity ratio were 1.1x and 23.4% respectively in 3Q20 (2Q20: 1.0x and 24.2%).
- The ratio of stage 2 loans to the total business loans rose to 15.7% in December 2020 vs. 14.1% in June 2020, thus reflecting banks' cautious outlook on credit risk.
- For household loans, 8.9% of the total accounts or 11.1% in value terms were under the debt repayment assistance as at December 2020. 56.0% of these borrowers have income of below RM5,000 a month. On household loan borrowers that are earning less than RM3,000 a month, their leverage and liquid financial asset-to-debt ratios were 10x and 0.7x in December 2020 respectively (June 2020: 9.5x and 0.7x). These segments must remain closely watched.
- A total of 1.5mil R&R applications have been received to date with 95.0% approval rate. On a comforting note, repayment assistance applications are declining.
- The household debt-to-GDP ratio climbed to 93.3% in December 2020 (June 2020: 87.5%) largely attributed to the lower GDP. Credit risk to the household sector remains manageable based on the financial-asset-to-debt ratio of 2.2x, liquid financial asset-to-debt of 1.5x and debt servicing ratio (DSR) for outstanding loans and newly-approved loans of 35.0% and 43.0% respectively.
- In December 2020, after the automatic moratorium, loan repayments reached more than 90.0% of the level seen in 1Q20 (pre-Covid levels) (SME: 116.0% and households: 93.0%).

EXHIBIT 1: VALUATION MATRIX

			Target	EPS (sen)		PER		Net DPS		Net DivYield		BV	BV	PBV	PBV
	Rec.	31-Mar	Price	20	21	20	21	20	21	20	21	20	21	20	21
AMMB	NR	2.93	-	44.6	-25.7	6.6	-11.4	13.3	5.9	4.5	2.0	6.2	5.6	0.5	0.5
Maybank	BUY	8.25	9.80	59.2	69.9	13.9	11.8	52.0	54.5	6.3	6.6	7.5	7.6	1.1	1.1
Public Bank	HOLD	4.20	4.40	26.6	28.9	15.8	14.5	13.0	14.7	3.1	3.5	2.4	2.6	1.7	1.6
RHB Bank	BUY	5.37	6.80	54.5	65.1	9.9	8.2	17.0	26.0	3.2	4.8	6.7	7.1	0.8	0.8
Hong Leong	BUY	18.70	20.30	128.8	141.2	14.5	13.2	36.0	42.4	1.9	2.3	13.3	14.4	1.4	1.3
CIMB	BUY	4.34	5.50	12.9	43.8	33.6	9.9	4.8	21.9	1.1	5.0	5.7	5.9	0.8	0.7
ABMB	BUY	2.65	2.95	27.4	18.6	9.7	14.2	6.0	7.4	2.3	2.8	3.9	3.9	0.7	0.7
BIMB	BUY	4.23	4.70	40.3	55.1	10.5	7.7	12.6	15.3	3.0	3.6	3.6	4.1	1.2	1.0
MBSB	BUY	0.66	1.10	9.6	12.0	6.9	5.5	4.8	4.8	7.3	7.3	1.3	1.3	0.5	0.5
Average				**49.3**	**49.6**	**14.3**	**8.5**	**19.3**	**23.5**	**3.2**	**3.8**	**6.2**	**6.4**	**1.0**	**1.0**
Non-bank															
HLFG	BUY	17.42	20.60	174.9	175.8	10.0	9.9	38.0	40.4	2.2	2.3	18.3	20.0	1.0	0.9

Forecasts by AmInvestment Bank

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

- The portion of stage 2 retail loans to total household loans rose to 7.3% in December 2020 from 5.6% in June 2020.
- In 2020, banks' earnings were impacted by provisions leading to a higher credit cost of 78bps and lower ROE of 9.2% compared to 8bps and 13.0% respectively in 2019. Provisions rose by 40.6% YoY in the form of management overlays and changes to the ECL (expected credit loss) model. In 2H20, allowances for potential credit losses increased by RM6.1bil to RM30.9bil in December 2020.
- Total capital ratio for the banking system remained robust at 18.5% with excess capital buffer of RM127bil to absorb losses. Meanwhile, liquidity coverage ratio (LCR) stood at 148.2%.
- Gross impaired loan (GIL) ratio for the sector was higher at 1.6% in December 2020 vs. 1.4% in June 2020. GIL ratio for household and business loans rose slightly to 1.1x and 2.6x respectively in December 2020 (June 2020: 0.9x and 2.5x).
- BNM updated its macro simulation stress test with 2 adverse scenarios. This included a hypothetical adverse scenario with GDP in the negative and remaining below pre-pandemic levels even by end-2022, assumptions of unemployment rate to increase further and staying elevated, weaker commodity prices and lower house price growth in 2021 and 2022. Based on the stress test, the banking system's capital ratios under adverse scenarios 1 & 2 stayed above the minimum regulatory requirement at 17.0% and 16.8% respectively.
- **Retain our OVERWEIGHT stance on the sector with our top BUYs on Hong Leong Bank (fair value RM20.30/share), RHB Bank (FV RM6.80/share), Maybank (FV RM9.80/share) and CIMB Group (RM5.50/share).** We favour the larger systematic banks (Maybank and CIMB) to ride on the economy recovery in 2021 and banks with undemanding valuations trading at attractive P/BVs (RHB Bank). Also, we like Hong Leong Bank with a strong topline growth, robust profit contribution from associates and resilient asset quality.

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