BANKING

Maintain POSITIVE

Facing headwinds in a position of strength

KEY INVESTMENT HIGHLIGHTS

- **Release of Financial Stability Review for 2HCY19 by BNM**
- **Situation have changed significantly since then, but it is important to view banks condition then as a base for assessing impact of Covid-19 pandemic to the sector**
- **Banks facing the headwinds in a position of strength**
- **Household sector debts have sufficient coverage for now**
- **Stress test shows that banks will remain resilient**
- **Cognizant of the impact of Covid-19, BNM measures and MCO. However, we maintain our POSITIVE stance in the banking sector as the banks will be able to withstand the impending shocks and BNM measures provides breathing space for everyone**

Release of BNM Financial Stability Review. Bank Negara Malaysia (BNM) released its financial stability review (FSR) for 2HCY19 last Friday. We are cognizant that the period in which the latest FSR was conducted was during more optimistic times. While global financial vulnerabilities remained elevated in 2HCY19, there were improvements in the outlook for global growth as we end of 2019 and headed into 2020 following the Phase 1 trade deal between the US and China. However, all the optimism has since given way to widespread concerns over public health and the economic impact of the COVID-19 pandemic.

Looking behind as a base to look ahead. We believe that it is still worthwhile to evaluate the situation in the banking sector despite the many recent developments. This provides a base on which to assess the possible impact of the COVID-19 pandemic to the banking sector.

Banks ended the year on solid footing. We noted the banking system profitability was sustained in 2HCY19, with ROE at 13.0%, above the estimated average cost of capital of 9%. This was despite weakness in net interest income as loans growth was tepid and NIM contraction. Pre-tax profits of the banking system recorded a growth of 15.4%yoy, supported by strong growth in non-interest income as banks took advantage of falling yields in government bonds and sukuks.

More importantly, capital position remains strong. Meanwhile, total capital ratio in the banking system improved further to 18.3%. Its CET1 and Tier 1 capital ratios were 14.3% and 14.8% respectively as at end CY19. Although previously this accumulation of capital had led to lower ROEs than when compared in the past. Nevertheless, in our report, There's more than just downtrend in ROE, we have argued that lower ROE was not necessarily bad, and that this had led to lowering of risk. In current precarious situation, we underscore our consistent opinion that banks made the right decision to build up its capital buffers.

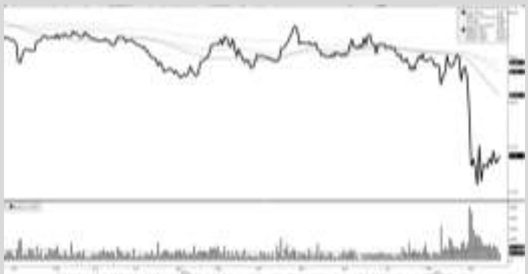
Facing headwinds in a position of strength. It is without any doubt that banks will be impacted by the twin headwinds of low oil prices and the Covid-19 pandemic. We expect asset quality and credit cost will be impacted by rise in delinquencies as economic activities slows especially during the Movement Control Order (MCO). However, we believe that the banks are facing these headwinds in a position of strength. Excess capital buffer, which is capital above the regulatory requirements, stood at RM119b as at end CY19. Furthermore, the continued profitability has further strengthening banks' solvency positions.

COMPANY IN FOCUS

Malayan Banking Bhd
Maintain **BUY** | Unchanged Target price: RM9.55
Price @ 3rd April 2020: RM7.40

- Likelihood of stable asset quality and credit cost
- Scale and size
- D-SIB bank means support
- Attractive dividend yield of circa above 7%

Share price chart



CIMB Group Holdings Bhd
Maintain **BUY** | Unchanged Target price: RM5.70
Price @ 3rd April 2020: RM3.50

- Likelihood of stable asset quality and credit cost
- Scale and size
- D-SIB bank means support
- Relatively undemanding valuation as it is trading below 1x PBV
- Decent dividend yield of circa above 7%

Share price chart

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Household debt driven by mortgages. For the 2HCY19 period, household debt expansion was primarily driven by loans for the purchase of residential properties. The Home Ownership Campaign launched by the Government had bolstered Demand for residential property loans. We understand that personal financing and credit card loans also recorded higher growth, largely attributed to lending by development financial institutions to civil servants. As a result, the ratio of overall household debt-to-GDP edged higher to 82.7% as at end-CY19 from 82.2% as at end 1HCY19.

Household sector debt has sufficient coverage for now. While the household debt remains elevated, overall debt-servicing capacity of households continues to be supported by income growth and adequate financial buffers. Both outstanding household financial assets and liquid financial assets remained broadly stable at 2.2 times and 1.4 times of debt respectively. Also, household financial assets continued to outpace the growth in debt for the third consecutive year.

Flexibility to adjust discretionary expenditure. The median debt service ratios (DSR) for outstanding and newly-approved loans were at 37% and 43% respectively. This seems that it remained within prudent levels. However, we understand that share of newly-approved loans to borrowers with DSR exceeding 60% have increased in the past few years, suggesting that some easing in underwriting standards. However, close to two-thirds of these loans were extended to borrowers earning more than RM5,000 per month and about half were credit card and personal financing facilities. This suggest that borrowers have larger residual income and greater flexibility to adjust discretionary expenditures under adverse circumstances. Therefore, the risk of defaulting on their loan repayments is likely to remain low.

Impairments remained low. Aggregate impairment and delinquency ratios remained low and stable at 1.2% and 1.1% of total outstanding household debt respectively. Borrowers with variable income accounted for the bulk of the recent increase in housing loan impairments. However, risks to financial stability remain contained as exposures-at-risk associated with these borrowers account for only 2% of total banking system loans. Moreover, household asset quality was further supported by the lower average loan-to-value ratio (LTV) of outstanding housing loans from the banking system, which declined to 57% in 2019 (vs. 59% in 2018).

Stress test shows that banks still resilient. A potential impact of the Covid-19 pandemic could be a drop in household income and potentially shock in the housing market. A steep house price decline can potentially weaken household resilience, in turn leading to stress in the banking system. BNM had ran simulations to test the resilience of households and banks in the face of a hypothetical housing market correction. The simulations shows that banks will be able to withstand an impending stress to the system. In the event of house prices declining by 50%, the potential losses to the banking system is RM58b which is above the excess capital buffers. Another simulation is where house prices decline 20% and household income falls 10%. In this scenario, potential losses to the banking system is RM38.6b.

Table 1: Stress testing of house price correction by BNM

	Scenario			
	Baseline	**House prices falls 20%**	**House prices falls 50%**	**House prices falls 20% and income falls 10%**
Borrowers-at-Risk Share of borrowers with both negative financial margin and negative equity to total borrowers	0.1%	2.0%	3.4%	3.4%
Debt-at-Risk Share of debt held by borrowers-at-risk to total household debt	0.1%	2.1%	5.4%	3.8%
Potential losses to the banking system	RM0.5b	RM21.8b	RM58b	RM38.6b
As a share of banks' excess capital buffers	0.3%	13%	36%	24%

Source: BNM

Maintain POSITIVE at current juncture. We are cognizant of the impact that Covid-19, the loan moratorium and MCO will have on banks profitability and asset quality. However, we believe that the banks are facing these headwinds in a position of strength due to build up of capital buffer. Furthermore, we opine that the moratorium and other measures announced by BNM recently are positive for the banking sector as it addresses the issue of asset quality and liquidity, and to certain extent cost of fund. It provides much breathing space for the banks. Therefore, we maintain our **POSITIVE** stance on the sector. Our top picks are the three D-SIB banks due to its solid fundamental, scale and size. Also, being systematically important banks will ensure support should there be any stress to asset quality. Hence, we favour **Maybank (BUY, TP: RM9.55)**, **CIMB (BUY, TP: RM5.70)** and **Public Bank (TRADING BUY, TP: RM19.00)**. Additionally, attractive dividend yield will also cushion any downside risk.

PEER COMPARISON TABLE

	FYE	Rec.	Price @	Target	EPS (sen)		PER		Net DPS		Net Div Yield		BV (RM)		PBV	
			3-Apr	Price	20	21	20	21	20	21	20	21	20	21	20	21
Maybank	Dec	BUY	7.40	9.55	71.6	71.2	10.3	10.4	56.0	56.0	7.6	7.6	7.34	7.55	1.0	1.0
Public Bank	Dec	T. BUY	15.70	19.00	144.3	146.5	10.9	10.7	73.0	73.0	4.6	4.6	11.92	12.51	1.3	1.3
CIMB	Dec	BUY	3.50	5.70	51.0	52.0	6.9	6.7	26.0	26.0	7.4	7.4	5.70	5.85	0.6	0.6
RHB Bank	Dec	BUY	4.56	6.30	66.1	69.8	6.9	6.5	31.0	31.0	6.8	6.8	6.45	6.60	0.7	0.7
Hong Leong Bank	Jun	BUY	13.14	17.00	136.6	143.9	9.6	9.1	52.0	54.0	4.0	4.1	12.94	13.20	1.0	1.0
AMMB	Mar	T. BUY	2.92	4.20	46.6	48.5	6.3	6.0	22.0	24.0	7.5	8.2	6.04	6.14	0.5	0.5
Affin Bank	Dec	NEUTRAL	1.42	1.87	27.0	27.0	5.3	5.3	7.0	8.0	4.9	5.6	4.71	4.79	0.3	0.3
Alliance	Mar	T. BUY	1.84	2.70	28.6	34.3	6.4	5.4	14.5	17.0	7.9	9.2	3.85	3.92	0.5	0.5
BIMB	Dec	BUY	3.23	5.05	50.5	51.3	6.4	6.3	18.0	18.0	5.6	5.6	3.62	3.96	0.9	0.8
Average					**69.1**	**71.6**	**7.7**	**7.4**	**33.3**	**34.1**	**6.3**	**6.6**	**6.95**	**7.17**	**0.8**	**0.7**

DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.