BANKING

Maintain **POSITIVE**

Remains resilient

KEY INVESTMENT HIGHLIGHTS

- **Operating environment globally has become more challenging over six month**
- **Banks continue remains resilient in the event of stress to its assets**
- **Household debt remains elevated but sufficient coverage.**
- **Household holdings of financial assets continue to expand faster than debt**
- **Risks from corporates are contained**
- **Banks are well capitalised and profitability sustained**
- **We maintain our POSITIVE stance in the banking sector**

Release of Financial Stability Review for 1HCY18. Bank Negara Malaysia (BNM) had released the mid-year review of the financial stability of the banking and insurance sector. Amongst the key take away we gathered from the report were:

- Operating environment globally has become more challenging over six month
- Banks continue remains resilient in the event of stress to its assets
- Household debt level remains elevated but households continue to be able to comfortably service their debt and holdings of financial assets continue to expand faster than debt
- Financial performance of businesses weakened slightly on lower earnings but overall debt-servicing capacity remains reasonably healthy
- Banks are well capitalised and profitability sustained

Household debt remains elevated but sufficient coverage. Household debt grew at a faster rate of 5.1%yoy in 1HCY19. As such, the household debt-to-GDP edged higher to 82.2% as at end June CY19 from 82% as at end CY18. However, loans for the purchase of residential properties remained the key driver while there was also strong demand for loans for the purchase of securities. In contrast, growth in household loans for consumption has remained modest. Despite the elevated level of household debt, there was sufficient coverage as the total household assets exceeded debt by 4.1x. If housing wealth were excluded, household financial assets stood at 2.2x of debt.

Exposure to vulnerable segment declined… Exposures of banks and non-bank financial institutions to the more vulnerable segment (borrowers earning less than RM3,000 per month) have continued to decline. As at 1HCY19, it was 18.5% from 19.3% as at end CY18 and 19.9% as at end CY17. We believe that this reduces the risk of asset quality deterioration as the vulnerable segment is most susceptible to shocks.

COMPANY IN FOCUS

Malayan Banking Bhd

Maintain **BUY |** Unchanged Target price: RM10.30

Price @ 20th September 2019: RM8.73

- Earnings expected to be stable
- Earnings expected to improve in 2HFY19
- Low exposure to floating rate which should moderate OPR cut impact
- Attractive dividend yield of circa 6%

Share price chart

CIMB Group Holdings Bhd

Maintain **BUY |** Unchanged Target price: RM6.30

Price @ 20th September 2019: RM5.02

- Earning recovery in Indonesia and Thailand
- Net interest margin compression will lessen
- Relatively undemanding valuation as it is trading below 1x PBV
- Decent dividend yield of circa 5%

Share price chart

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...providing cover against borrowers facing financial stress. The leverage of households earning less than RM3,000 per month has continued to rise (1H 2019: 8.9x; 2018: 8.8x; 2015: 7.7x) due to housing loans made more accessible under various loan assistance schemes introduced recently. Default incidents by housing loan borrowers have also increased, indicating that more households may be experiencing financial stress. However, we noted that this is not broad based and more prevalent among borrowers that either; (i) obtained housing loans for properties priced above RM500,000 and/or (ii) experience greater variability in monthly income. Nevertheless, risks to the financial system remain low as exposures at risk of these borrowers accounted for only 6.2% of total household lending with only 0.9% of such loans being classified as impaired as at end June CY19.

Sensitivity analysis shows that banks can absorb potential shocks. BNM had enhanced the financial margin (FM) framework which uses individual-level income and credit information to identify and assess risks to financial stability from the household sector. Recall, FM is calculated by deducting monthly debt obligations and expenditure on basic necessities to personal disposable income and liquid financial assets. The enhancement now includes deduction on communication services. With this, BNM had performed a sensitivity analysis on the FM (table 1). It shows that the banking system could absorb the potential losses as the bank's excess capital buffers stood at RM146.1b as at end June CY19.

Scenarios	Baseline	50bp increase in borrowing cost	20% increase in living cost	10% decrease in income
Share of borrowers with negative FM	8.3%	9.0%	12.2%	14.4%
Potential losses to the banking system (RM b)	43.9	67.5	85.5	106

Demand for affordable housing remains strong. Some signs of market recovery were observed in the 1QCY19 as housing transactions both in terms of volume and value saw sharp increases. Housing transactions were largely driven by houses priced below RM300,000, reflecting continued demand for affordable housing. Demand for housing was also boosted by various public and private sector initiatives to lower housing costs. Nevertheless, there continue to be mismatch between supply and demand for housing. This is expected to persist in the near to medium term. Housing units priced above RM300,000 continued to form the bulk of new launches, adding to the supply and demand mismatch. In terms of banks' exposures to property developers with unsold housing units, it remained small at 2.0% of total banking system loans and 2.9% of holdings of corporate bonds and sukuk, while impaired loans remain insignificant at 0.1% of total banking system loans.

Risks from property sector contained. The loan impairment ratio for the purchase of residential and non-residential properties remained low at 1.1% and 1.4% respectively as at June CY19 (CY18: 1.1% and 1.4% respectively). Of note, a significant share (83%) of residential property loans is extended to owner-occupiers. This is in line with our anecdotal evidence based on our discussions with banks under our coverage. We believe that this reduces the risk of delinquencies and financial stability should there be a generalized downward correction in house prices as owner-occupiers have stronger incentive to maintain loan repayments. Furthermore, 69% of outstanding housing loans have a loan-to-value ratio of less than 80%, providing a buffer against potential losses from defaults.

Despite more challenging business conditions, risks from corporates are contained. Non-financial corporate debt expanded at a more moderate +3.6%yoy to RM1,508.8b. This reflected higher business loan repayments amid more uncertain economic conditions and lower bond issuances following the rationalisation of public infrastructure projects by the Government. Meanwhile, financing growth was underpinned by sustained business activity in the construction, manufacturing, and wholesale and retail trade sectors.

Slower business loans demand amid global economic uncertainties. Growth of total business loan repayments outpaced loans disbursement, +2.6%yoy to RM393.6b vs. +0.3%yoy to RM391.1b. The slower growth in loans disbursed also reflected lower demand for financing corroborated by the lower applications received, including from SMEs. This is in line with the trend we have observed for the past couple of months. We believe that the lower demand for business loans was partly due to uncertainties rising from external events such as escalation of US-China trade tensions. Recent quarters also saw modest tightening of credit conditions, but this has been not been broad based and mostly limited to sectors with relatively weak credit risk outlook, such as the real estate and O&G sectors.

Stress from corporates was firm specific. Financial position of corporates weakened slightly during 1HCy19 coming from more challenging business conditions. Financial indicators of business health saw some deterioration, partly due to adjustments under new financial reporting standards i.e. MFRS 16. The impaired loans ratio of the overall business sector increased marginally but within five-year average of circa 2.65%. However, this was from specific firms in the manufacturing and palm oil sectors and was not broad-based. Some signs of improvement have recently emerged for firms in the O&G-related, construction and real estate sectors that continued to face headwinds.

Banks profitability sustained... We like the fact that banking system profitability continues to be healthy which were supported by financing activities. Meanwhile, earnings were bolstered by dividend income from subsidiaries and lower loan loss provisions. This is due to the fact that banks continued to refine its credit risk estimations under MFRS 9. Sustained improvements in cost efficiency also moderate the impact of net interest margins compression following OPR cut in May.

..and are well capitalised. Banks maintained strong capitalisation levels throughout 1HCY19. We noted that 77% of banks' capital continued to be held in the form of high-quality loss-absorbing capital comprising paid up capital, retained earnings and reserves. The resilience of banks' capital and profits continued to be underpinned by sound asset quality, supported by the sustained debt-servicing capacity of the household sector. Banks also continued to maintain strong buffers against potential future losses despite slightly higher impairments from business loans given challenges in selected sectors.

Increased risk from global uncertainties. While domestically, banks' displayed resiliency, external risk have increased. Concerns of slower global growth and rising geopolitical tensions have led global financial vulnerabilities to remain elevated in 1HCY19. Escalating trade tensions between the US and China have also weighed on growth prospects. We observed that this had led to heighten cautiousness amongst businesses in Malaysia, as evident by the slower business loans growth.

Turning cautious but maintain POSITIVE for now. Due to increased risk from external factors, we have turned cautious on the banking sector. However, we noted that Malaysia's banks remain resilient despite potential stresses. In addition domestic demand especially private consumption remains robust and this will continue to support loans growth. On the impact of the OPR cut, we believe it will normalise. Besides, we believe that there are still positives for banks such as sustained profitability supported by the low credit cost as highlighted by BNM's report. This should be able to alleviate any weakness in income. Furthermore, we opine that banking stocks in general are currently undervalued given its fundamentals remains intact. Hence, we maintain our POSITIVE stance at current juncture. Given the current uncertainties and market conditions, our top picks for this sector are **Maybank (BUY, TP: RM10.30)**, **CIMB (BUY, TP: RM6.30)** and **Public Bank (BUY, TP: RM24.00).**

PEER COMPARISON TABLE

	FYE	Rec.	Price @	Target Price	EPS (sen)		PER		Net DPS		Net Div Yield		BV		PBV	
			20/9/19		19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21
Maybank	Dec	BUY	8.73	10.30	74.1	73.9	11.8	11.8	58.0	58.0	6.6	6.6	7.1	7.4	1.2	1.2
Public Bank	Dec	BUY	20.16	24.00	145.6	148.7	13.8	13.6	72.0	73.0	3.6	3.6	11.3	12.0	1.8	1.7
CIMB	Dec	BUY	5.02	6.30	50.0	49.0	10.0	10.2	26.0	26.0	5.2	5.2	5.6	5.7	0.9	0.9
RHB Bank	Dec	BUY	5.64	6.35	62.4	67.7	9.0	8.3	25.0	27.0	4.4	4.8	6.3	6.5	0.9	0.9
Hong Leong	Jun	NEUTRAL	16.38	17.00	130.0	143.1	12.6	11.4	50.0	50.0	3.1	3.1	12.5	13.0	1.3	1.3
AMMB	Mar	NEUTRAL	4.21	4.20	50.0	46.6	8.4	9.0	20.0	20.0	4.8	4.8	5.9	6.1	0.7	0.7
Affin	Dec	NEUTRAL	1.98	2.10	29.0	29.0	6.8	6.8	5.0	7.0	2.5	3.5	4.7	4.7	0.4	0.4
Alliance	Mar	T. BUY	3.07	3.50	34.7	32.6	8.8	9.4	16.7	14.5	5.4	4.7	3.7	3.7	0.8	0.8
BIMB	Dec	BUY	4.00	5.05	43.7	44.0	9.2	9.1	16.0	18.0	4.0	4.5	3.2	3.5	1.2	1.1
Average					**68.8**	**70.5**	**10.1**	**10.0**	**32.1**	**32.6**	**4.4**	**4.5**	**6.7**	**7.0**	**1.0**	**1.0**

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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.