27 September 2018 | Sector Update

BANKING

***Maintain* POSITIVE**

Passed the test so far

INVESTMENT HIGHLIGHTS

- **Banks remain resilient and are expected to be able to withstand shocks**
- **Household debt level remains on sustainable trend**
- **Macroprudential measures is judged to remain relevant**
- **Demand for housing remains firm especially affordable segment**
- **Strong capitalisation and sustained profitability of banks**
- **We maintain our POSITIVE stance in the banking sector**

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

- Banks remains resilient in the event of stress to its assets.
- Demand in affordable residential properties remains solid.
- Financing to business sector continue to be supportive for investment growth.
- Ample liquidity in the banking system.
- Banks are well capitalised and profitability sustained.

Existing macroprudential measures remain relevant at current juncture. For the period until 1HCY18, the trend of household debt accumulation has been more sustainable. The household debt level to GDP has gone down from 89% as at CY15 to 83.8% as at 1HCY18. Meanwhile, the household financial asset to total household debt ratio (household debt coverage) increased to 210.9% as at 1HCY18 from 205.7% as at CY15, which indicate that there is sufficient coverage for the given household debt level. The sustainable trend of household debt accumulation is the result of the macroprudential measures that BNM implemented since CY10. In view of this, we had observed that there were calls to loosen the macroprudential measures to facilitate lending for the affordable housing segment. However, BNM judges that the existing macroprudential measures remain relevant, given the elevated level of household indebtedness, coupled with pockets of financial stress observed in certain segments.

We opine that banks may not even take advantage of any loosening of measures. In our opinion, any loosening of the macroprudential measures, while might spur loans growth further, may pose a risk to banks' asset quality. Furthermore, we opine that banks' might not even take advantage of the loosening measures, as it may want to remain prudent given the uncertain external environment that stems from the trade spat between the US and China, and monetary tightening policy in the US. To assist in improving house ownership in the affordable segment, we understand BNM is in discussions with the Ministry of Housing and Local Government to formulate alternative schemes.

Even under stressed scenarios, banks are able to withstand potential losses from household sector. BNM had performed a stress testing simulation on the health of the banking sector. In an unlikely event of simultaneous default incidents, it had observed that the potential losses to the banking system are estimated to be RM65.1b. This far exceeds the excess capital buffers (which are above the regulatory minimum of 8%) of RM138.5b held by banks as at end June 2018. Potential losses attributable to households

in the lower income segments (earning less than RM5,000 per month) account for 40% of total potential losses (or RM14.5b). We understand that the parameters for the stress test includes 40% loss in property value, 100% in loss given default for all borrowings except mortgages and an OPR hike of 150bps.

Build up in capital affected ROE but decreased risk as well. We opine that this is evidence that banks continue to be resilient and shows that banks' capital remains sufficiently buffered for any potential shocks. The build-up of banks' capital over the years may have lead to a downtrend in ROE but we opine that the consequence was the reduction of risk relating to the solvency of the banks. Hence, we believe that banks' share prices performance in general have not moved in tandem with the lowered ROE. We believe that the only event in which could put a stress to banks' capital will be an economic shocks that affected employment, which currently remains unlikely.

Imbalances in the property market persisted, but no imminent risks to financial stability. As at end-June 2018, total exposures of Malaysian financial institutions to the domestic property market grew by 6.8% (vs. 7.2% in CY17) to RM878.9b. This led to a higher share of total assets (28% vs. 27.4% as at CY17). Banks remained the largest lender to the domestic property market, representing approximately 97% (RM852.2b) of total financial institutions' exposures to the property market. Of this, circa 90% were end-financing for the purchase of residential and non-residential properties. However, there is still mismatch between housing demand and supply, particularly in the affordable segment, which continued to exert upward pressure on house prices. Despite this, BNM views that risks from a significant correction in house prices to remain low.

Demand for housing remains firm…especially in the affordable segment. Outstanding financing extended to first-time buyers of houses priced below RM500,000 accounting for about 71% of total residential property loan borrowers. Meanwhile, houses priced below RM250,000 accounts for 54%. The approval rates for residential property loan applications remained above 70%, thus supporting continued access to house financing for eligible borrowers. This is in line with our view that the demand for affordable housing is driving loans growth for the banking sector. In fact, we understand that banks have been focusing its lending to this segment.

In our opinion, banks will still be able to lend to the affordable housing segment. We are comforted by the fact that the banks are able to withstand the impact of an event of a fall in house prices, as evident by the stress test done by BNM. This could mean that banks will be able to continue to lend to the affordable housing segment, which are still in high demand. As such, we believe that this segment could continue to lend support to loans growth into CY19.

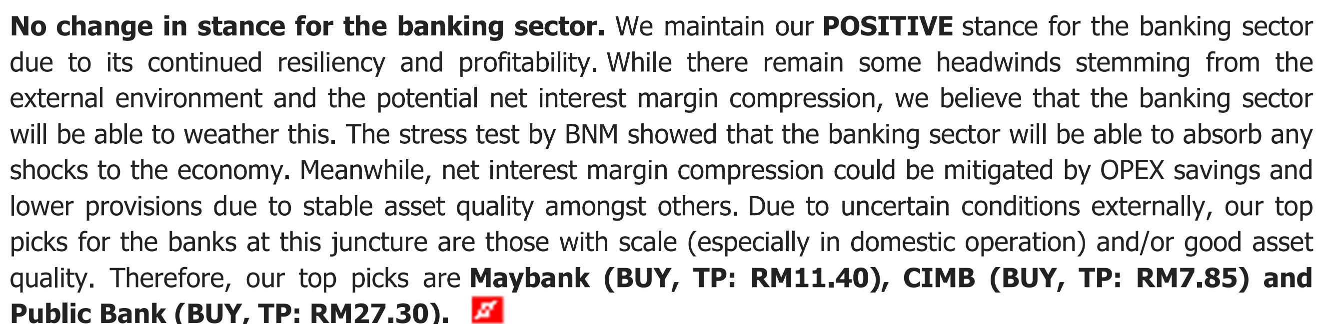
Risk is in the commercial properties segment. The report highlighted the risk stemming from the non-residential properties, specifically the commercial and office space, where there is an oversupply. However, we understand that banking sector exposure in these segments remains limited. Accordingly, banks' exposures to these segments in the form of loans (including end-financing and financing for construction and development) and holding of corporate bonds and sukuk accounted for just 5% of banks' total outstanding loans and 6.7% respectively.

Financing to business sector remains supportive of investment growth. As at end June CY18, aggregate non-financial corporate (NFC) debt grew at an annual rate of 7.2% to RM1.47t. This was largely contributed by the growth in domestic borrowings of 6.7%, which represented 73.6% of total NFC debt. Outstanding bonds and sukuk expanded by 14.1%, accounting for 30% of total NFC debt. Loans from banks and Development Financial Institutions also grew higher by 2.2% (vs. December CY17: 1.3%), mainly from the expansion in loans to SMEs, by 4.6%. There were no signs of broad-based credit tightening among banks. Overall business loan rejection rates remained stable at 16.3%. To put into context, the 5-year average of business loans rejection rates is 16%. We believe that this is in line with our understanding of the stable risk appetite of the banking sector for business loans. We understand that the delay is in the drawdown of approved loans. This is due to the fact that corporate and businesses are adopting a "wait-and-see" approach in order to get further clarity on the Government economic policies. Demand for SME loans and lending appetite from banks for this segment remains solid. Only weakness in the SME segment is relating to property development and oil & gas sector.

Corporate external debt manageable. Total outstanding corporate external debt increased by 8.7% as at end-June 2018 (December 2017: -4.4%), driven mainly by new borrowings in the manufacturing sector. The bulk of which was for a specific petrochemical project with a natural hedge of foreign currency export proceeds. Total corporate external debt accounted for 26.4% of total business debt.

Banking system maintained sufficient liquidity to meet demanding needs. The funding structure of the banking system remained unchanged, with deposits constituting 69% of total bank equity and liabilities. The growth of bank deposits continued to trend upwards. It grew 5.1% as June CY18 as compared to 4.1% as at December CY17. This was partly driven by deposits from individuals which grew at a higher rate of 5.4% (vs. 3.9% as at December CY17). While liquidity remains ample, we believe that the competition for deposits have been on an increasing trend. This is evident by the funding cost creeping up, based on our observation of the banks' 1HCY18 results. However, this was also partly due to repricing of deposits following the OPR hike. As such, this had put some pressure on net interest margins, and we foresee margin compression to be prevalent in 2HCY18. Part of the contribution to the funding cost increase was the rise in individual fixed deposits. However, we do not view too negatively to this as individual FDs are more stable. Nevertheless, we do not expect margin compression to be severe as to significantly impact banks' earnings.

Strong capitalisation and sustained profitability of banks. BNM noted that the banking system recorded sound profitability as margins improved due to continued efficiency gains and improved asset quality. In 1HCY18, PBT grew by +12%yoy to RM19.3b. Annual returns on assets and equity were mostly unchanged at 1.5% and 13.3%, respectively. While higher provisioning under MFRS 9 was expected to reduce banks' earnings, the magnitude of the impact has remained manageable, as the increase in provisions was partly absorbed by regulatory reserves already maintained by banks.



No change in stance for the banking sector. We maintain our **POSITIVE** stance for the banking sector due to its continued resiliency and profitability. While there remain some headwinds stemming from the external environment and the potential net interest margin compression, we believe that the banking sector will be able to weather this. The stress test by BNM showed that the banking sector will be able to absorb any shocks to the economy. Meanwhile, net interest margin compression could be mitigated by OPEX savings and lower provisions due to stable asset quality amongst others. Due to uncertain conditions externally, our top picks for the banks at this juncture are those with scale (especially in domestic operation) and/or good asset quality. Therefore, our top picks are **Maybank (BUY, TP: RM11.40), CIMB (BUY, TP: RM7.85) and Public Bank (BUY, TP: RM27.30).**

FIGURE 1: PEER COMPARISON FOR MALAYSIAN BANKING STOCKS

	Rec.	Price @ 26/9 (RM)	TP (RM)	EPS (sen)		PER (x)		Net DPS (sen)		Net Div Yield (%)		BV (RM)		PBV (x)	
				17	18	17	18	17	18	17	18	17	18	17	18
Maybank	BUY	9.78	11.40	72.0	74.1	13.6	13.2	55.0	58.0	5.6	5.9	6.8	6.9	1.4	1.4
Public Bank	BUY	25.00	27.30	141.7	149.9	17.6	16.7	61.0	63.0	2.4	2.5	9.7	10.7	2.6	2.3
CIMB	BUY	6.04	7.85	50.0	61.0	12.1	9.9	25.0	22.0	4.1	3.6	5.2	5.5	1.2	1.1
RHB Bank	T. BUY	5.39	6.00	48.6	54.2	11.1	9.9	15.0	15.0	2.8	2.8	5.8	6.0	0.9	0.9
Hong Leong	NEUTRAL	20.58	18.85	128.2	135.8	16.1	15.2	45.0	48.0	2.2	2.3	11.7	12.6	1.8	1.6
AMMB	NEUTRAL	4.07	4.10	42.8	45.3	9.5	9.0	15.0	15.0	3.7	3.7	5.5	5.7	0.7	0.7
Affin	BUY	2.39	2.70	24.0	30.0	10.0	8.0	2.3	11.0	1.0	4.6	4.3	4.5	0.6	0.5
Alliance	BUY	4.19	4.75	35.7	39.0	11.7	10.7	15.3	17.0	3.7	4.4	3.5	3.7	1.2	1.1
BIMB	BUY	3.91	5.15	37.9	42.2	10.3	9.3	14.0	15.0	3.6	3.8	2.8	3.0	1.4	1.3
Average				**64.5**	**70.2**	**12.4**	**11.3**	**27.5**	**29.3**	**3.2**	**3.7**	**6.1**	**6.5**	**1.3**	**1.2**

Imran Yassin Yusof
imran.yassin@midf.com.my / 03-2173 8395

APPENDIX: DIRECTION OF RISKS THAT IMPACT DOMESTIC FINANCIAL STABILITY

			Direction of risks (1H2018 vs 2017)
Credit risk	Household	• Debt servicing capacity of households remained broadly intact • Households maintained aggregate financial assets at more than two times of debt • Banks are resilient to shocks from households, with potential losses from the lower income segment accounting for less than one-fifth of excess capital buffers	Stable
	Property market	• Continued mismatch in the demand and supply for affordable houses • Oversupply situation persists in the office space and shopping complex segments with banks exposures to these segments accounting for 5% of total loans • Banks are resilient against potential shocks arising from the property market and related sector developments	Stable
	Non-financial corporations	• Overall asset quality remained intact, despite weaker debt servicing capacity of borrowers in oil & gas and real estate sectors • Banks' exposures to oil & gas related sectors accounted for 6% of total business exposures • Majority of large borrower groups able to support debt repayments even under stressed scenarios • Risks to financial stability arising from external debt are largely mitigated given 30% are intercompany loans, with the remainder largely hedged with foreign currency revenue and/or financial derivatives	Stable
Market risk		• Domestic financial markets remained orderly despite increased market stress • Market risk exposures of financial institutions are stable	Increased
Liquidity and funding risk		• Ample liquidity in the banking system to meet liquidity needs • Funding structure of banks remained healthy; predominantly funded by deposits • Banks maintained liquidity coverage ratios well in excess of the regulatory minimum, mitigating short-term liquidity risk	Stable
Contagion risk	Interlinkages with NBFIs	• No material change in the nature and magnitude of risk transmission from nonbank financial institutions (NBFIs) • Slight reduction of NBFIs' interlinkages with the financial system following merger of an NBFI with a licensed bank	Stable

			Direction of risks (1H2018 vs 2017)
	External exposures	• Widening of net external liability position as banks reinforce foreign currency (FCY) liquidity buffers • More than two-thirds (68%) of external FCY interbank borrowings are from related counterparties, which are less likely to be subjected to sudden withdrawal shocks • Banks continued to be predominantly funded by ringgit-denominated domestic funding sources with little sign of undue reliance on external and cross-currency funding • Banks remained prudent in managing maturity and currency mismatches; banks hold substantial liquid FCY assets that could be drawn upon to meet their external obligations	Increased
	Banks' overseas operations	• Risks arising from overseas operations are assessed to be low as these operations are supported by strong capital and liquidity buffers as well as sound asset quality	Stable

Source: BNM

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.

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.