16 October 2014 | Sector update

Maintain NEUTRAL

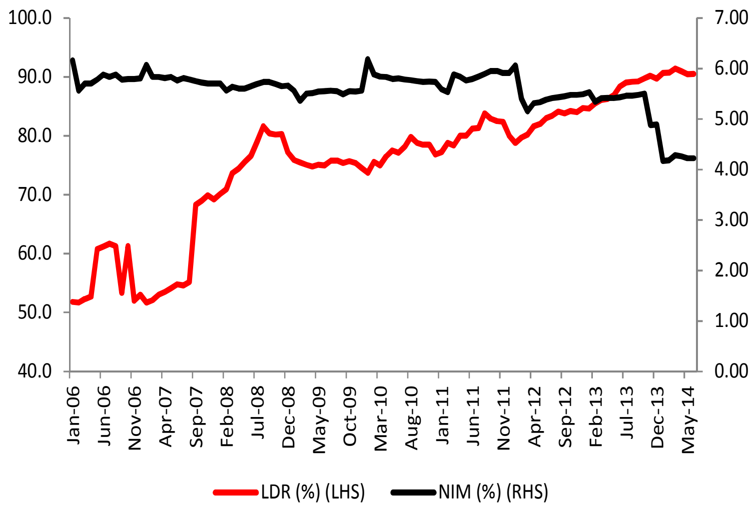
BANKING - Some reprieve to NIM pressures in Indonesia

OJK imposed maximum capping on time deposit rates effective 1st October 2014

- In Indonesia, deposit competition has been stiff. This was due to the tight liquidity situation in the banking sector with Loan-to-Deposit ratio (LDR) rising as seen in Chart 1.
- Interest rates on time deposits (TD) surged beyond reasonable levels as large depositors were able to pressure banks to offer them higher rates.
- Large depositors with TDs of more than IDR2b have been offered higher interest rates. This has resulted in even banks without liquidity issues to follow the trend and raise their TD rates. Subsequently, this has caused cost of funds (COF) in the banking sector in Indonesia to rise and NIM to decline (see Chart 1).
- TD rate rose significantly to an average of 11.0% for banks categorised under BUKU III and IV as compared to 7.97% in January 2014. Corresponding to increase in TD rates, credit interest rates for corporate loans rose to 11.25-13.3% while that of micro credit increased to 16.0-23.0% in July 2014.
- On 30 September 2014, Financial Services Authority (OJK) exercised its supervision over deposits gathering and addressed the banking liquidity situation in Indonesia by imposing maximum caps on TD rates.

  We expect rationality in TD pricing to return as a result of these regulations. Also, NIM pressures on banks in Indonesia are likely to abate with the implementation of the new rulings. The new measures will likely ease pressure on banks' COFs which have earlier risen significantly.

Chart 1: Trend of NIM and LDR of banks in Indonesia



Source: BI

- Table 2 shows the different BUKU categories of banks are based on their core capitals. Summary of the maximum interest rates set on TDs by OJK effective 1st October 2014 are as follows:

Table 1: Summary of the new regulations of OJK

BUKU classification for banks	Maximum rates for large TDs of above IDR2b
BUKU I & II	No maximum rate has been set but OJK will monitor and conduct supervisory action over banks in this category to support efforts to lower deposit rates. Banks in this category are likely to follow rates of major banks in Indonesia.
BUKU III	Maximum of 2.25% above benchmark interest (BI) rate or currently at 9.75% based on BI rate of 7.5%.
BUKU IV	Maximum of 2.00% above benchmark interest (BI) rate or currently at 9.50% based on BI rate of 7.5%.

Source: OJK

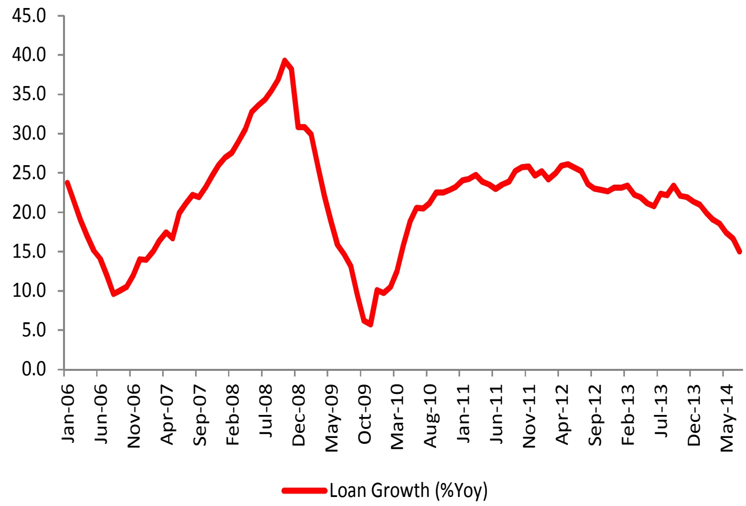
- The maximum rates on BUKU III and BUKU IV banks TDs of above IDR2b will be 9.75% and 9.50% respectively. This will be applicable on new TDs and TDs that have matured.
- For smaller deposits of up until IDR2b, the maximum ceiling rate on TDs will be 7.75%, similar to the current Deposit Insurance Corporation (LPS)'s interest rate.

Table 2: Size of core capital & required lending to productive sectors by BUKU categorisation of banks in Indonesia

Classification	Size of Core Capital & required lending to productive sectors	Banks in this category
BUKU I	▪ Core Capital of below IDR1t. ▪ A minimum of 55% of the bank's total credit or financing to be extended to finance productive sectors	▪ Bank Sinar Harapan Bali ▪ Bank Kesejahteraan Ekonomi ▪ Bank Bumi Arta
BUKU II	▪ Core Capital of between IDR1t and IDR5t. ▪ A minimum of 60% of the bank's total credit or financing to be extended to finance productive sectors	▪ Bank Nobu Optimis
BUKU III	▪ Core Capital of between IDR5t and IDR30t. ▪ A minimum of 65% of the bank's total credit or financing to be extended to finance productive sectors	▪ CIMB Niaga (Niaga) ▪ Bank Internasional Indonesia (BII) ▪ Danamon ▪ Permata ▪ Bank Tabungan Pensiunan Nasional (BTPN) ▪ OCBC-NISP ▪ UOB ▪ Citibank ▪ Tokyo-Mitsubishi and Sumitomo
BUKU IV	▪ Core Capital of at least IDR30t. ▪ A minimum of 70% of the bank's total credit or financing to be extended to finance productive sectors	▪ Bank Mandiri ▪ Bank Rakyat Indonesia BRI) (BRI) ▪ Bank Negara Indonesia (BNI) ▪ Bank Central Asia (BCA)

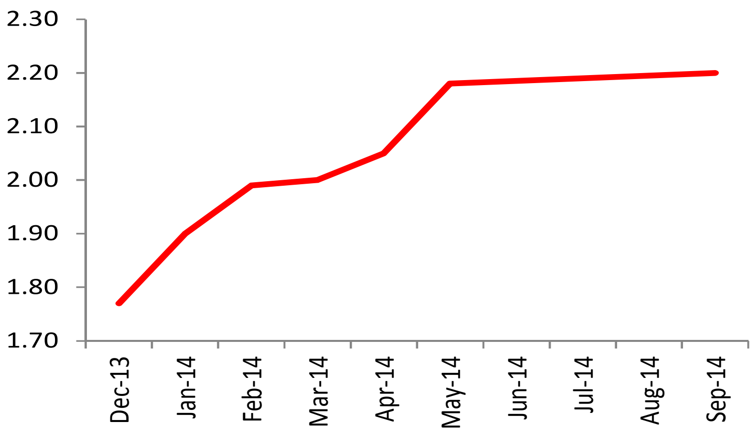
- Table 2 above shows the 4 different BUKU categories of banks in Indonesia based on the size of core capital. Of 119 commercial banks in Indonesia, 53 banks have been classified under BUKU I while 45, 17 and 4 banks have been classified as BUKU II, III and IV respectively.
- BII and Niaga, the respective subsidiaries of Maybank and CIMB Group, have been categorised as BUKU III banks due to their core capitals of between IDR5t and IDR30t. As of 30 June 2014, on consolidated basis, Niaga and BII's core capital was IDR26.2t and IDR10.6t correspondingly. Hence, both these banks will be subjected to OJK's new regulations which will cap the maximum rate for TD of up to IDR2b at 7.75%. Meanwhile, the maximum ceiling rate for larger deposits (TDs of above IDR2b) for Niaga and BII will be 9.75%.
- In line with the implementation of the new regulations, OJK requires banks in Indonesia to:
  i. Make efforts to lower credit interest rate immediately after the implementation of maximum deposit rate. Banks need to report on its realization to OJK at first opportunity available on this;
  ii. Include commitment to lower credit interest rate in banks' business plans for 2015. These plans need to be submitted to OJK latest by end of November 2014, together with assessment of impacts on financial performances of banks, and
  iii. Expand credit according to targets of business plan by considering availability in source of fund and referring to prudential principles.

Chart 2: Loan growth of the Banking Sector in Indonesia



Source: OJK

Chart 3: Trend of the asset quality of the Banking Sector in Indonesia (NPL ratio %)



Source: OJK

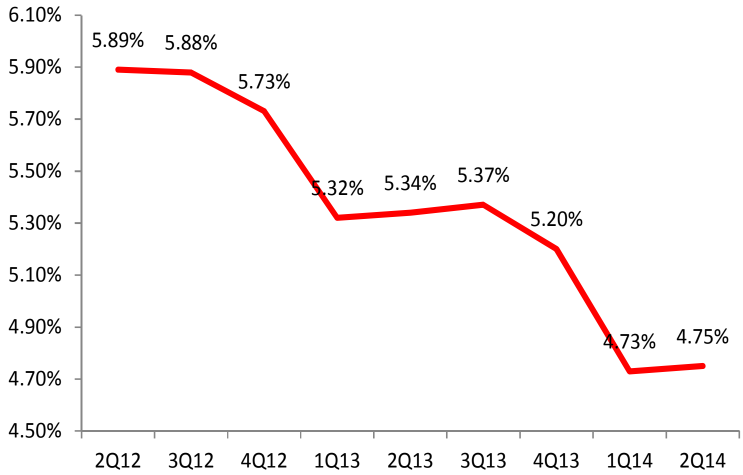
OUR VIEWS ON THE NEW REGULATIONS OF OJK

- The tight liquidity situation experienced in the banking industry has led to increasing COFs which impacted banks' NIMs. Chart 4 and 5 showed that decline in BII and Niaga's NIM due to higher COFs.

  OJK' capping of banks' TD rate is seen as a positive move to address the irrational pricing in TD rates as well as to address the liquidity tightness in Indonesia's banking system. We view this as an essential step to prevent NIM of banks from further declining. The new regulations will eventually lower banks' COF, particularly banks which have earlier offered higher rates to customers for large TDs. Banks with high LD ratios can now be more aggressive in deposit growth to support loan expansion.

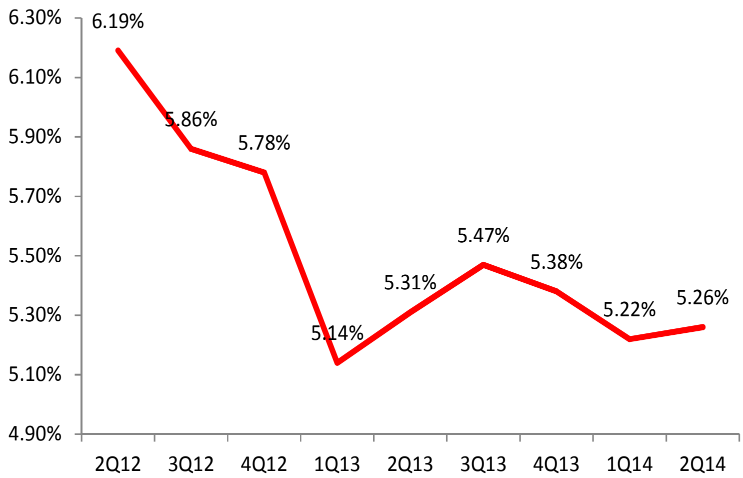
  The new regulations will benefit Niaga and BII as we expect these banks' COFs to be lower moving forward. Adjustments in TD rates as the deposits mature and renewed at lower rates are likely to lower banks COF. Also, new TDs will be offered at lower rates.

Chart 4: NIM trend of BII



Source: Company

Chart 5: NIM trend of Niaga



Source: Company

- In addition to the need to address the irrational TD pricing, the intention of OJK is also to boost lending growth in Indonesia. As seen in Chart 2, loan growth in Indonesia has been declining. We believe that this has been contributed by tighter measures on consumer lending, inflation pressures as well as weaker economic conditions impacting corporate loan growth.

  Moving forward, OJK will be monitoring banks in Indonesia to ensure that these banks' adjust their credit rates lower after the implementation of maximum ceiling rates on TDs.

- We opine that even though OJK has not imposed on smaller banks (banks under BUKU I & II) ceiling rates on TDs of more than IDR2b, these banks will be under pressure to follow the TD rates of larger banks under BUKU III & IV. Rationale for this is that depositors of banks under BUKU I & II will likely shift their TDs to the other banks under BUKU III & IV if lower rates have been offered.

- Based on the maximum ceiling rates of 9.75% for BUKU III banks and 9.50% for BUKU IV banks for deposits of more than IDR2b, there will be a difference of 25bp on the cap rates between the two categories of banks. We believe that this will provide a slight advantage to BUKU IV's banks' COF. This together with the greater operational flexibility for BUKU IV banks are likely to encourage banks with capitals close to the core capital requirement for BUKU IV such as Niaga to move into that category. We will not be surprised if Niaga moves into BUKU IV category eventually with a higher core capital position.

- While the regulations are likely to ease off NIM pressure, we are still concerned on the asset quality of banks in Indonesia. As seen from Chart 3, NPL ratio for commercial banks in Indonesia has been rising. This is in view of the weaker economic growth in Indonesia with its trade balance still weak shrinking into deficit based on the latest numbers in Aug'14.

  The slower economic growth coupled with the likelihood of a weaker IDR ahead with the potential further foreign fund outflow from Indonesia as US moves towards ending Q3 taper and the possibility of a start in rate tightening by US Fed are likely to put further pressure on the asset quality of banks. Market expectation and statements by the Fed officials suggest that rate tightening cycle could start in late 2nd quarter or 3rd quarter of 2015.

  We maintain our earnings forecast as of now with a BUY call on Maybank at unchanged TP of RM11.50 (FY15 P/BV of 1.9x) and NEUTRAL call on CIMB with a lower TP of RM7.70 from RM8.00 previously (FY15 P/BV of 1.6x) in view of a weaker market sentiment. As highlighted in our earlier report, we have yet to revise our TP for CIMB fully to RM7.27 which is the price valued for the stock in the proposed the three way merger of RHB-CIMB-MBSB's deal. This is pending further clarity of the regulatory approvals, particularly with regard to Bursa approval on the right of the key shareholders to vote on the deal. Our NEUTRAL stance is still maintained on the banking sector.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.