Singapore Banks

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DBS Group Research . Equity

22 Jul 2019

Earnings likely to be supported in 2Q

- Loan repricing continues into 2Q19; likely to still see marginal NIM improvement
- Apr-May'19 saw strong industry loan growth numbers amid slowing economy; 2Q19 loan drawdowns likely to be on track with guidance
- Overall market sentiment remains resilient, supporting wealth management income
- Singapore banks due to declare interim dividends; UOB remains preferred pick

Loan repricing continues into 2Q19; likely to still see marginal NIM improvement. According to our channel checks, repricing of loan book as well as mortgages are still ongoing in 2Q19 following that in 1Q19. While we are likely to still see marginal NIM improvement across the Singapore banks, we believe that OCBC's NIM improvement in 2Q19 is unlikely to be as strong as that in 1Q19 (+4bps q-o-q) where the bulk of loan repricing was done. We believe that UOB is also likely to let go of some excess funds which have been weighing on its NIM in the last few quarters, and hence is likely to reverse the trend of NIM decline.

Apr-May'19 saw strong industry loan growth numbers amid slowing economy; 2Q19 loan drawdowns for Singapore banks likely to be on track with guidance. In May'19, MAS's latest statistics continued to point to strong loan growth momentum. Industry loans grew 1.3% m-o-m in May'19, atop of Apr's +1.0% m-o-m growth. While the figures for Jun'19 remain to be seen, we believe that Singapore banks continue to be on track for decent 2Q19 loan drawdowns and are likely to meet their full-year loan growth guidance of low-to-mid single digit.

Overall market sentiment remains resilient, to support wealth management income in 2Q19. The broader market has been relatively resilient through 2Q19, despite a market correction seen in May'19. We believe that wealth management income through 2Q19 remains to be relatively supported, post 1Q19's recovery from 4Q18's lows.

Due to declare interim dividends; UOB remains preferred pick. Singapore banks are due to declare interim dividends alongside 2Q19 results (DBS: 29 Jul 2019, OCBC and UOB: 2 Aug 2019). We believe that with the existing macroeconomic conditions alongside some market uncertainty, there is unlikely to be any upside surprises on dividends as banks would prefer to maintain their existing dividend levels and preserve more capital. UOB remains our preferred pick in the sector (BUY, TP S$29.20) as a defensive pick for its high dividend yield of c.4.7%.

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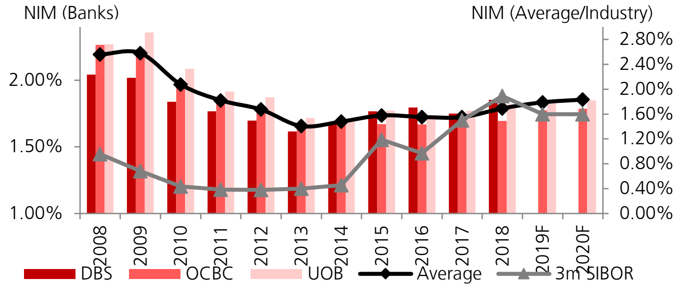
STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
DBS	26.50	49,777	n.a.	(2.9)	2.9	NR
OCBC Bank	11.64	36,360	11.50	(1.1)	4.4	HOLD
UOB	26.80	32,866	29.20	0.5	4.1	BUY

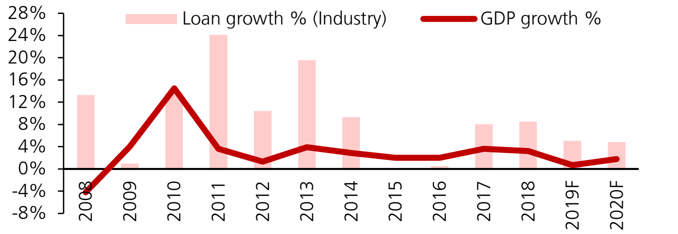
Source: DBS Bank, Bloomberg Finance L.P. Closing price as of 22 Jul 2019

Singapore Banks: NIM trend



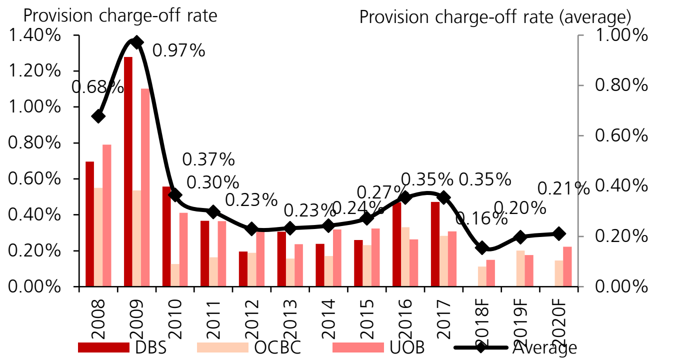
Source: Companies, DBS Bank

Singapore: Loan growth (Industry)



Source: MAS, DBS Bank

Singapore Banks: Credit costs

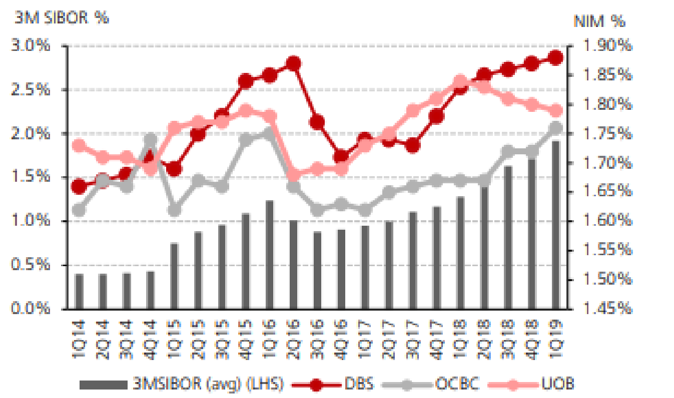


Source: Companies, DBS Bank

DBS
Live more, Bank less

Continue to see marginal NIM improvement in 2Q19 results; bulk of NIM improvement likely to occur in 1H19. We are forecasting NIM to improve by 1-7bps through FY19, with most of the impact to be felt in 1H19. Overall, we expect Singapore banks to continue seeing marginal NIM improvement in 2Q19 results as repricing of loan book as well as mortgages continue to take place in 2Q19. As 3MSIBOR pushes past 2% in 2Q19 amid an easing environment, average 3MSIBOR in 2Q19 increased c.6bps over the previous quarter (1Q19: c.21bps), which should support NIM. Regionally, we believe that NIMs may continue to stay flattish. We believe that OCBC's NIM improvement in 2Q19 is unlikely to be as strong as that in 1Q19 (+4bps q-o-q) where the bulk of loan repricing was done. We believe that UOB is also likely to let go of some excess funds which have been weighing on its NIM in the last four quarters, and hence is likely to reverse the trend of NIM decline.

Singapore Banks: NIM (quarterly)

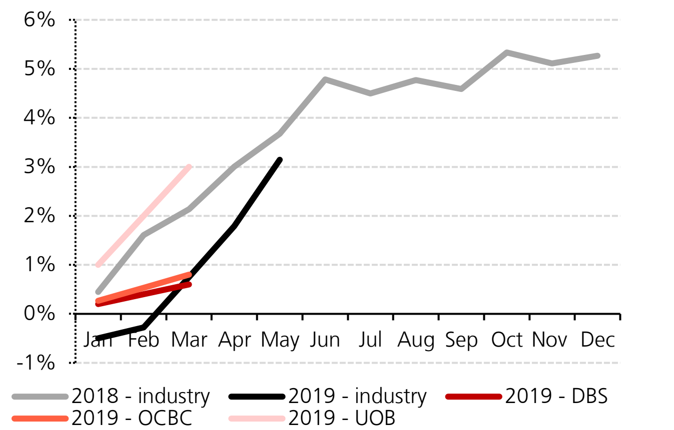


Source: Companies, DBS Bank

Cost of funding unlikely to come down significantly so soon, though banks start to take advantage of lower interest rate environment to reprice outstanding bonds. Our channel checks across various banks indicate that SGD fixed deposits are still highly sought after by both local and foreign banks, with competitive interest rates offered and decent interest from recent issues of Singapore Savings Bonds, though the short-end rate of the latest Singapore Savings Bonds issue has come off by c.25bps in a lower interest rate environment. More recently, UOB issued 3.58% S$750m perpetuals which will replace its 4.75% S$500m perpetuals due in Nov 2019.

Growing loan book in a slowing environment. 1Q19's loan growth varied among Singapore banks, where DBS/OCBC/UOB saw +0.6%/+0.8%/+3.0% q-o-q growth. Particularly, UOB saw strong loan growth supported by pipeline built prior to property cooling measures. MAS's latest statistics continued to point to strong loan growth momentum in Apr and May'19. As Singapore's 2Q19 advance GDP estimates surprised on the downside, DBS Group Research has lowered its full-year GDP forecast for 2019 to 0.7% (previous: 2.1%). However, we note that banks are also capitalising on the slower growth environment to capture more regional flows, and believe that our full-year loan growth estimate for FY19F of c.5% is intact. We believe Singapore banks are on track to meet their full year loan growth guidance (DBS, UOB: mid-single digit, OCBC: low-to-mid single digit), with support from ongoing pipeline from enbloc and infrastructure projects. We believe it remains early to revise down our FY20F loan growth forecast of c.4%.

Singapore Banks: Loan growth YTD (%)

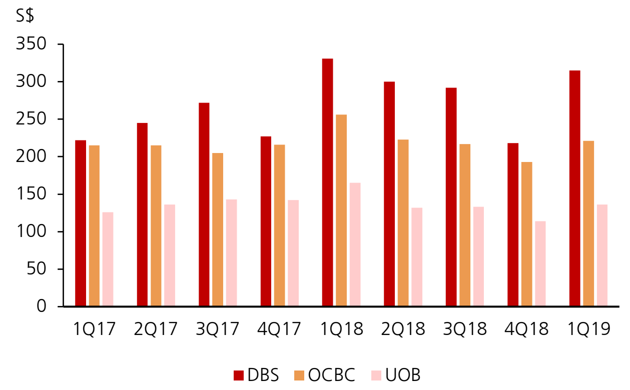


Source: Companies, DBS Bank

Mortgages largely flat in May'19; limited growth upside expected for now. In May'19, mortgage book across Singapore was largely flat (-0.1% m-o-m; YTD -0.9%). As of 1Q19, mortgages represented 24% of Singapore banks' total loan book. While DBS Group Research does not expect the mortgage book to contract severely, unless there is an accelerated slowdown in the economy with massive unemployment, we believe that recovery in secondary sales transactions is needed to catalyse growth in mortgages, amidst a flattish primary sales environment.

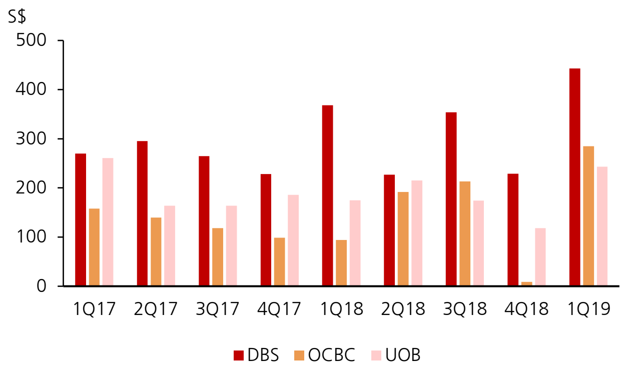
Overall market sentiment remains resilient, to support wealth management income in 2Q19. In 1Q19, Singapore banks' non-interest income recovered from the lows in 4Q18 which was largely affected by market volatility as well as unrealised market-to-market (MTM) losses. Particularly, wealth management fees in 1Q19 were still -5 to -18% y-o-y lower than 1Q18's peak. We believe that in 2Q19, despite a market correction seen in May'19, the overall market sentiment remains resilient which should support wealth management income in 2Q19 as investors cautiously seek to navigate the markets.

Singapore Banks: Wealth management income (S$)



Source: Companies, DBS Bank

Singapore Banks: Net trading income (S$)



Source: Companies, DBS Bank

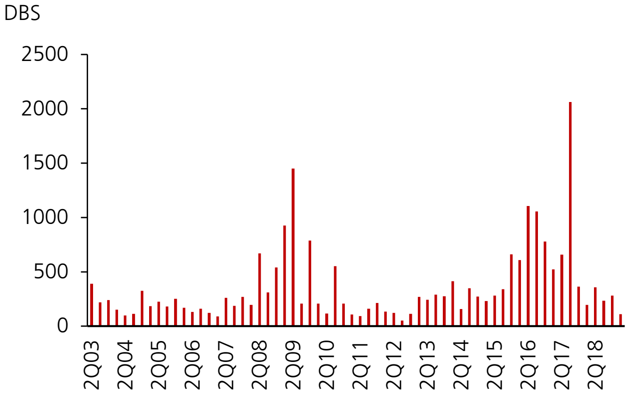
Credit costs should continue to normalise; watchful for downside risks. Against a slower global growth backdrop, we continue to expect credit costs to normalise towards historical levels. Specifically for OCBC, there remains concerns post its one-off oil and gas provisions taken in 1Q19, the second consecutive quarter where higher provisions were taken. As a result of 1Q19's one-off oil and gas provisions, OCBC is likely to see higher provisions nearer 22bps for FY19F, compared to its previous guidance of c.12-15bps. We continue to be watchful for downside risks amidst a slowing economy. Accordingly, pockets of stress experienced by banks' customers remain non-geographic and non-sector specific.

Singapore Banks: Asset quality (1Q19)

	DBS	OCBC	UOB
NPL ratio	1.5%	1.5%	1.5%
Provisions charged to P&L (S$m)	76	249	93
Total credit costs (bps)	9	39	14
NPL coverage ratio	90%	61%	78%
NPA coverage ratio	92%	78%	87%

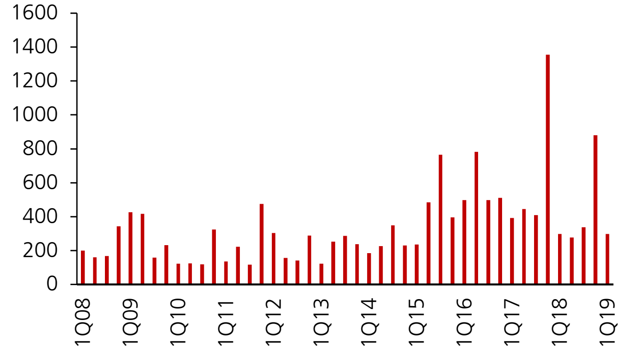
Source: Companies, DBS Bank

Singapore Banks: New non-performing asset formation (S$m)



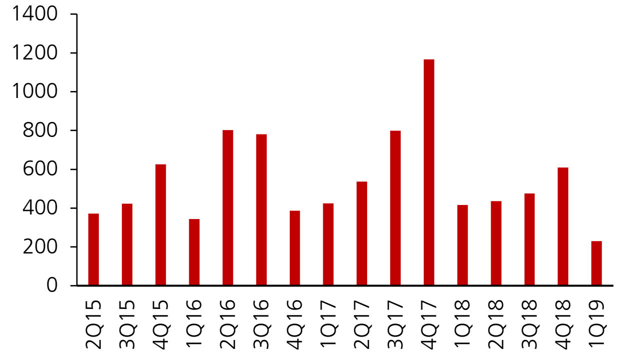
Source: Companies, DBS Bank

OCBC



Source: Companies, DBS Bank

UOB



Source: Companies, DBS Bank

Watching the digital space. The Monetary Authority of Singapore (MAS) has most recently announced that it will issue up to five digital bank licenses. In the meantime, the incumbent local banks continue to be focused on their digital agenda both locally and within Asia, which is believed to be the key growth driver going forward. DBS has since launched its digibank in India and Indonesia and will apply lessons from India and Indonesia when it rolls out in Vietnam. OCBC NISP has launched its ONE Mobile app in Indonesia while UOB launched its mobile-only digital bank TMRW in Thailand with further launch plans in ASEAN countries.

Valuation and Recommendation

Fed cuts likely to pose downside earnings risks for banks in FY20F. With the Fed's dovish shift, our sensitivity analysis shows that every 25-bp cut in interest rates may have 1-3bps impact on NIM for FY20F: every 10-bp change in NIM has 5-7% earnings impact on banks' FY20F bottom line.

Valuations supported by strong capital levels and decent dividend yields in the meantime, amid benign credit environment. Singapore banks are now trading at c.1.1-1.3x FY20F BV. We believe that Singapore banks may be a beneficiary should liquidity flow into Asia. Valuations would also be supported by strong capital levels and decent dividend yields in view of heightened uncertainties arising from the trade war and investors search for yields.

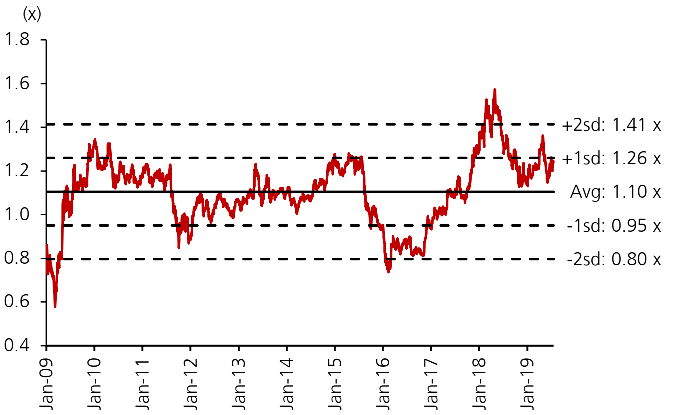
UOB our preferred pick. We continue to like UOB (BUY, TP S$29.20) as a defensive pick for (1) its attractive dividend yield of c.4.7%, (2) smaller exposure to China among the local banks and a more defensive wealth management franchise as UOB continues to navigate cautiously in a moderating growth environment. We believe current valuations at c.1.1x FY20F BV remain inexpensive, below its 10-year historical average. We currently have a HOLD call on OCBC (TP S$11.50) in the absence of catalysts for its share price. As OCBC's dividend payout ratio has lagged peers', we believe any increase will be welcomed by investors.

Key risks

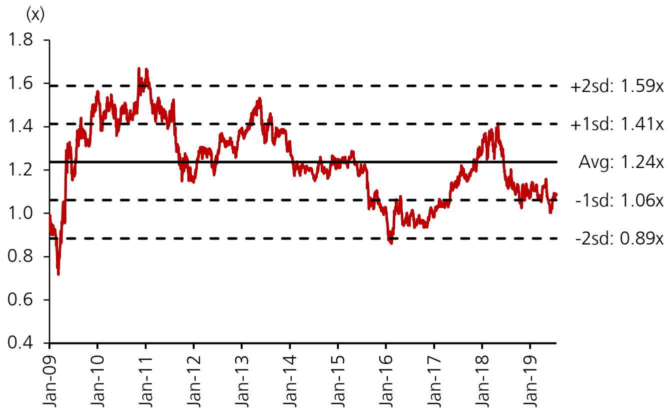
Asset quality trend reversal. It is largely expected that oil-and-gas-related provisions and NPLs have been dealt with. A larger-than-expected NPL arising from the oil and gas sector, or generic sectors could indicate risks of a faster-than-expected slowing economy, and unwind expectations of credit cost and NPL declines, thus posing risks to earnings. Based on our sensitivity analysis, every 5-bp uptick in credit costs may impact sector earnings by c.2.5%.

Slower-than-expected loan growth. A technical recession in Singapore, breakdown in US-China trade talks, disappointing macro indicators and a less firm macroeconomic outlook going forward could temper our loan growth expectations, though we argue that several large infrastructure projects in the pipeline would support loan growth. Although loan growth is less sensitive to earnings, any deceleration as a result of weaker sentiment would dent top-line prospects. A sharper-than-expected slowdown in the Singapore property market will cause mortgage books to shrink faster.

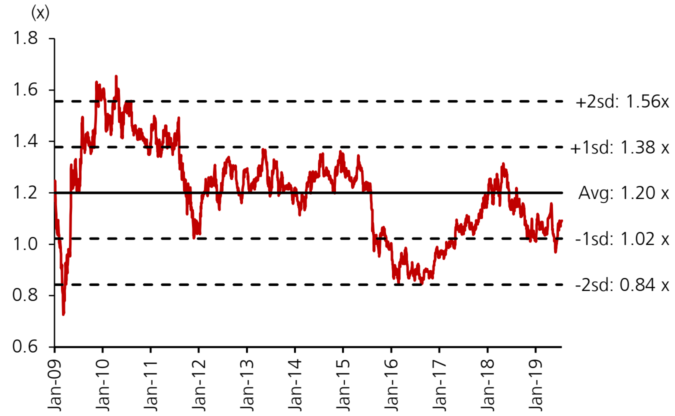
DBS: Rolling forward P/BV band



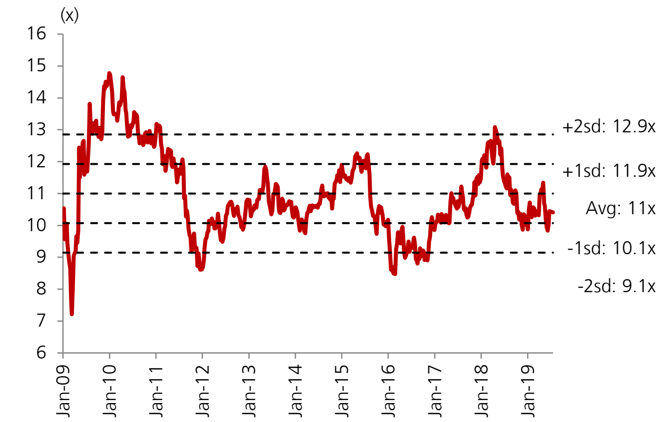
OCBC: Rolling forward P/BV band



UOB: Rolling forward P/BV band



Singapore Banks: Rolling forward P/E band



Source: Companies, Thomson Reuters Datastream, DBS Bank (Closing price as of 19 Jul 2019

Singapore Banks: Peer Valuations

	Market cap	Price	Target Price	Rating	PE (x)		CAGR^ (%)	PBV (x)			ROE (%)	Net div (%)
	(US$m)	(S$/s)	(S$/s)		FY18A	FY19F		FY18A	FY19F	FY20F	FY19F	FY19F
DBS*	49,777	26.50	NA	NR	12.2x	11.0x	16%	1.4x	1.4x	1.3x	12.5%	4.6%
OCBC	36,360	11.64	11.50	HOLD	11.2x	10.7x	5%	1.2x	1.2x	1.1x	10.9%	4.0%
UOB	32,866	26.80	29.20	BUY	11.4x	10.9x	9%	1.2x	1.2x	1.1x	10.6%	4.7%
Simple average					11.6x	10.9x		1.2x	1.2x	1.1x	11.3%	4.4%
Weighted average					11.7x	10.9x		1.3x	1.2x	1.1x	11.4%	4.4%

^ Refers to 2-year EPS CAGR for FY17-19F ** Based on Bloomberg consensus*
Source: Companies, Bloomberg Finance L.P., DBS Bank (Closing price as of 22 Jul 2019)

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS Bank unless otherwise specified.

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