Banking

OVERWEIGHT

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BNM 2HCY22 FSR: In Solid Command

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BNM has released its Financial Stability Review (FSR) report for 2HCY22. Further OPR hikes are put under a "conditional pause" as the central bank evaluates the impact of its cumulative +100 bps decision since May 2022 and to allow borrowers to adjust against external pressures. With the current optics, BNM deems inflation manageable with economic conditions to spur domestic demand and income opportunities, translating to an expected GDP growth of 4%-5% for CY23. This should support loan serviceability and overall asset quality concerns among lenders. With regards to the fallout of global financial institutions, exposure is highly limited as local banks are not pinned by similar concentration and reputation risks. Their operational soundness is also carried by total capital ratios (18%), far exceeding minimum requirements (8%), with stress testing projecting a capital consumption of 2%. Regarding safety of deposits, it is indicated that 96% of overall depositors qualify under PIDM's RM250k deposit protection. While BNM's confidence could uplift sentiment, nervous investors may still be on the lookout for further developments that may spell a meltdown. With that, we lean towards banks with wider safety nets, such as: (i) PBBANK (OP; TP: RM4.90) for its stellar asset quality and highly collateralised loans portfolio, a fair trade-off for lower-than-industry loans growth, and (ii) RHBBANK (OP; TP: RM7.10) for its leading CET-1 and refreshed dividend potential (c.7% yield) serving as a high-yield alternative. Maintain OVERWEIGHT for the sector.

Well-founded resiliency. We found BNM to be optimistic with the overall standing of the Malaysian economy and financial system, which is mostly supported by better containment of inflationary pressures against domestic activity. **In the household sector,** we studied that loan impairment has flattened albeit with delinquencies progressively rising (possibly as a function of lapses in repayment assistance programs). However, we are seeing debt composition to be made up of more residential properties (c.60%) which are collateralised in the banks' books. The health of overall household accounts are slated to improve as unemployment rates are projected to improve, targeted at 3.5% in CY23 (from projected 3.9% in CY22 and 4.6% in CY21). Based on current readings, a debt-service ratio for outstanding household loans stand at 37% (Jun 2022: 35%) is considered far from excessive.

This would be made possible by **supportive business activity projections** with CY23 GDP growth targeted at 4%-5%. While this is materially softer than CY22's 8.7%, BNM views the rate as normalising levels with higher input costs holding back expansionary potentials. That said, they opine that Malaysia could perform better than expected on more vibrant labour market conditions, tourism and larger scale implementation of government projects.

Capital and liquidity highly sound. As opposed to certain developed countries which practice deregularised ovesight, BNM continues to keep a tight watch across all licensed institutions by imposing consistent capital requirements. As of Dec 2022, industry CET-1 capital ratio was maintained at slightly above 15% (Dec 2021: 15.5%) with total capital ratios sitting at 18.8%. Recall that BNM imposed an 8% minimum capital requirement buffer to cushion the banks from unexpected capital spillage. Meanwhile, a commendable liquidity coverage ratio of 154% is an indication that banks can continue to lend without falling short from obligations unlike headline global banks as seen recently. With regards to the safety of depositors, PIDM's honoured RM250k deposit coverage is expected to be highly sufficient on a local context, as BNM indicates that 96% of overall deposit accounts fall within the insured amount.

Prepared for a severely stress-tested gross impaired loans (GIL) ratio of 7.7%. Amidst possible deterioration of global macros, BNM drew a 3-year horizon (to end-CY25) in its recent stress test, with the worse case scenarios reflecting: (i) heightened geopolitical tension; (ii) tighter credit conditions; and (iii) spillover from highly contracted local and global economies. In its case studies, BNM anticipates protacted economic slowdown that could drag GIL to 7.7% in Dec 2025 (from Dec 2022's 2.1%). However, should this materialise, its translates to a dip in CET-1 ratio to 12.8% in Dec 2025 (-1.9ppts from Dec 2022). Additionally, a cumulative credit loss of RM58.5b in this scenario (from CY23-CY25) would only make up 2.9% of CY22 system loans of RM2.02t. This is demonstrative of the resiliency of our banking system against severe widescale shocks.

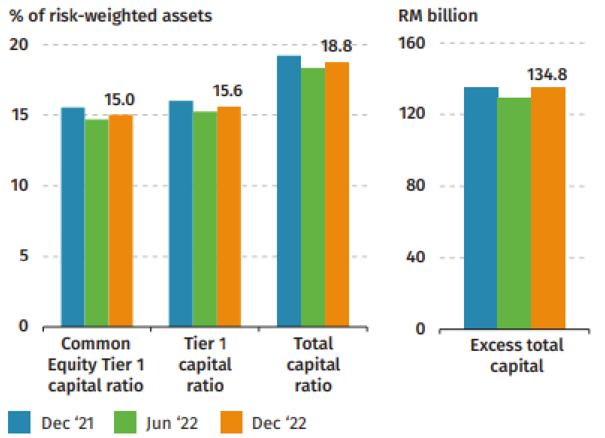
Coming out of the BNM's hosted briefing, **we echo BNM's confidence in the domestic financial system, assured by the sector's strength, resilience and overall stellar management.** We also take comfort on BNM's statements with regards to complex asset structures and it will respect key attributes with regards to stake holder hierarchy, in the sense that the write-off in AT1 bonds would not be replicated here, albeit with few such products existing in our markets.

Maintain OVERWEIGHT on the banking sector. We continue to believe that the fundamentals of the banking sector is well grounded and is not likely to experience any pressures which gravitates anything close to what is happening abroad. That said, it is understandable if investors prefer to stay on the side line as global sentiment for the financial sectors has tumbled. While this could present numerous buying opportunities across our coverage calls, we opine to selectively promote names which offer greater safety nets amongst its peers. We also avoid banks with a higher non-interest income exposure as investors may also view this space with greater caution. With that, for 2QCY23, we opt to promote **(i) PBBANK** as it is the leading bank in terms GIL reading at 0.4% (vs. peer average: 1.5%) backed by a highly collateralised loans book thanks to a substantial mortgage portion (41% of total books). Meanwhile, its recent shares sell-down owing to uncertainties of its shareholder and ownership structure may see an inversion when clarity on the matter unfolds. We also like **(ii) RHBBANK** as we believe the relevancy of strong capital safety will be in the limelight once more. RHBBANK continues to lead its peers with its CET-1 buffers (17% vs peer average: 14%). On the other hand, RHBBANK's dividend prospects have become more promising with targeted payouts of c.55% looking to generate yields of 7%-8%. Also, developments on its upcoming digital bank with Boost could support interest.

Appendix

Snapshots on Banking System

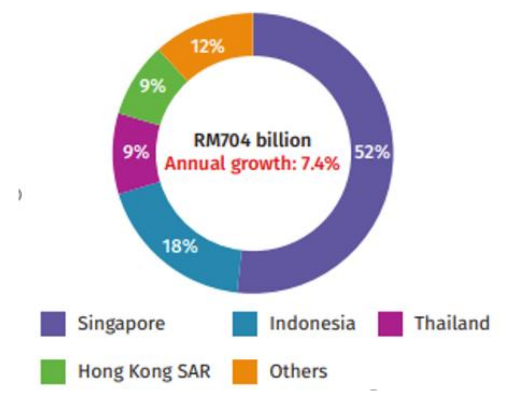
Total Capitalisation



Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement of 2.5% and bank-specific higher minimum requirements.

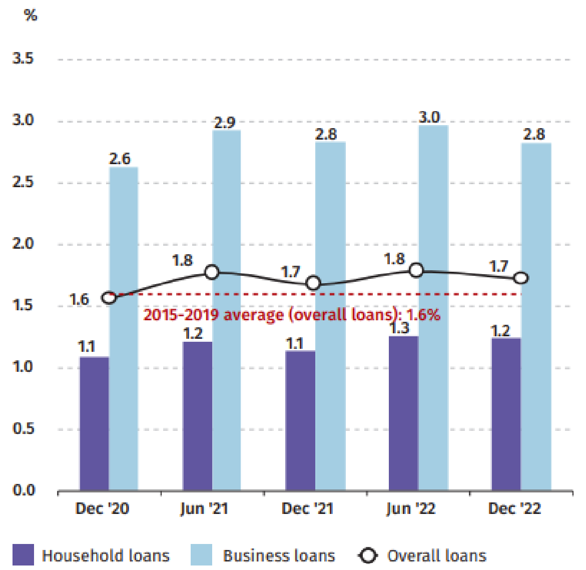
Source: BNM

Asset Profile of Major Overseas Operations



Source: BNM

Gross Impaired Loans Ratio



Note: The loan/financing data from 2021 onwards are based on updated statistical reporting requirements to reflect more accurate data definition and reporting methodology.

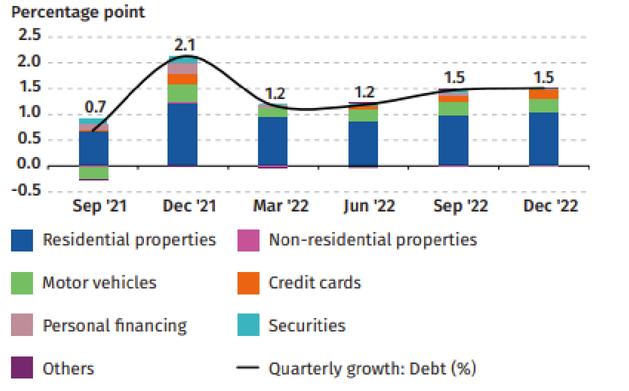
Source: BNM

Annualised Credit Cost Ratio

Source: BNM

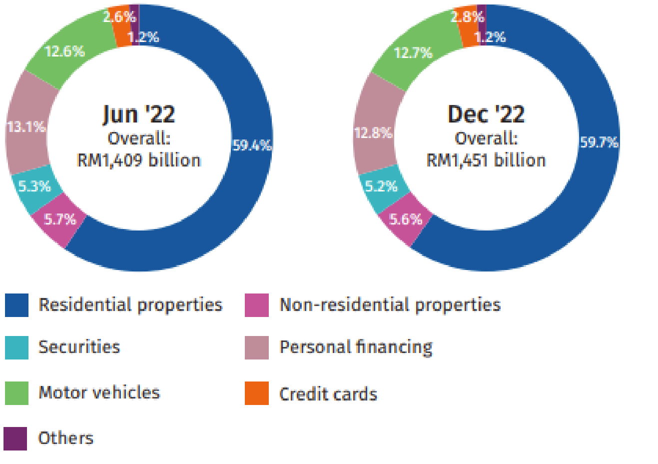
Snapshots on Household Sector

Quarterly Debt Growth



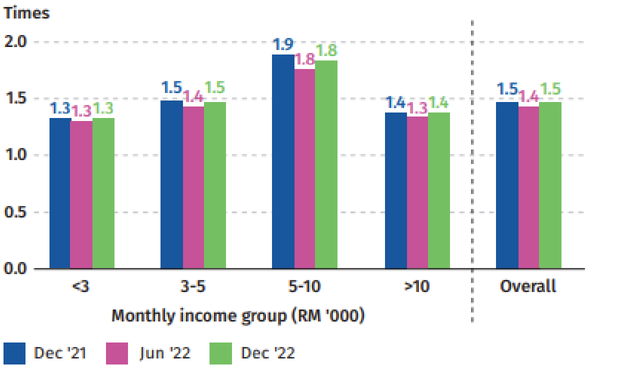
Source: BNM

Composition of Debt by Purpose



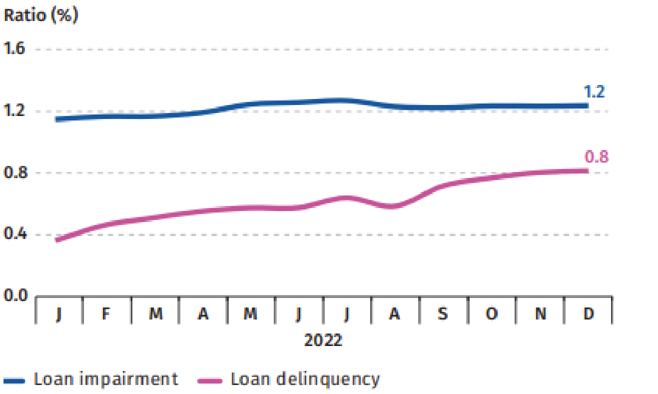
Note: Figures may not add up due to rounding.
Source: BNM

Median Debt-to-Income Ratio by Income Group



Source: BNM

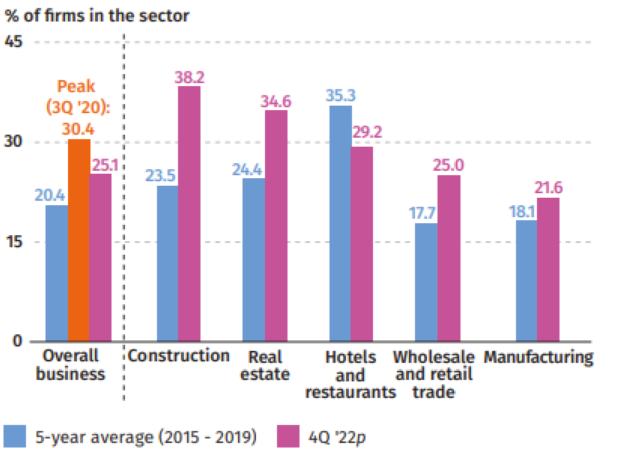
Loan Impairment and Delinquency Ratio



Source: BNM

Snapshots on Business Sector

Firms-at-risk for selected sectors



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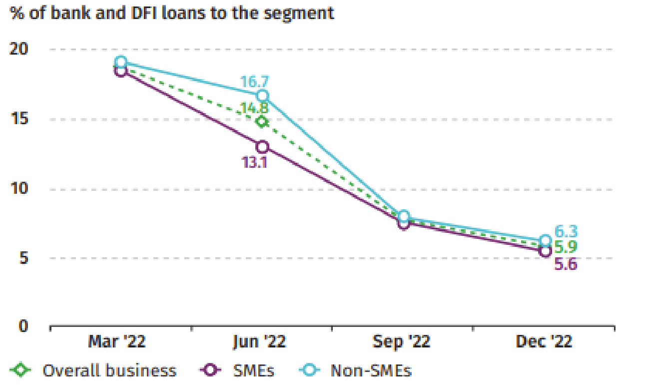
Source: S&P Capital IQ, BNM

Share of R&R Loans by Segment



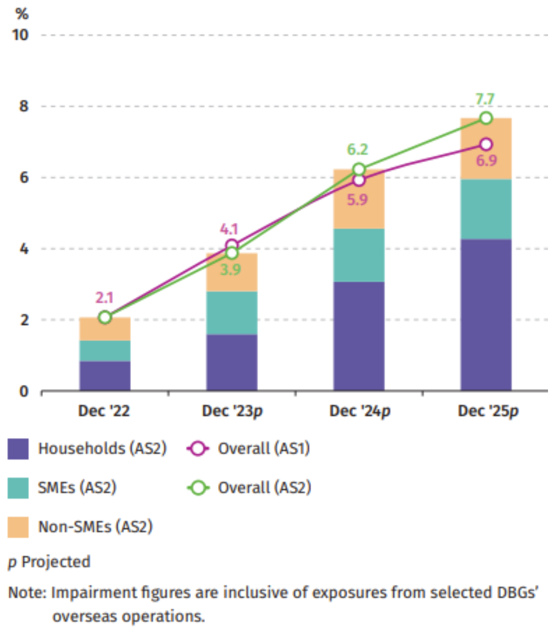
Source: BNM

Snapshots on Stress Testing

Capital Ratios Under Adverse Scenarios 1 (AS1) and 2 (AS2)

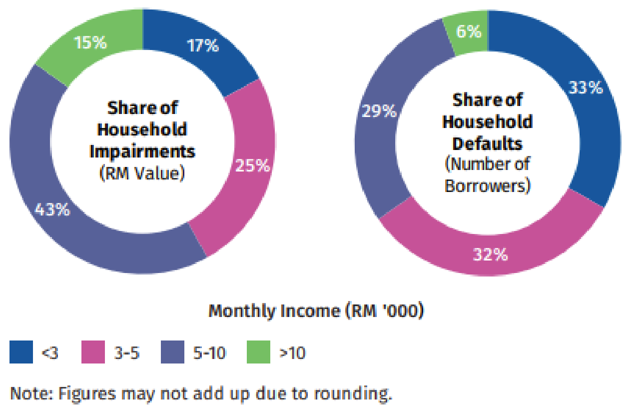
Source: BNM

Impaired Loans Ratio Under AS1 and AS2



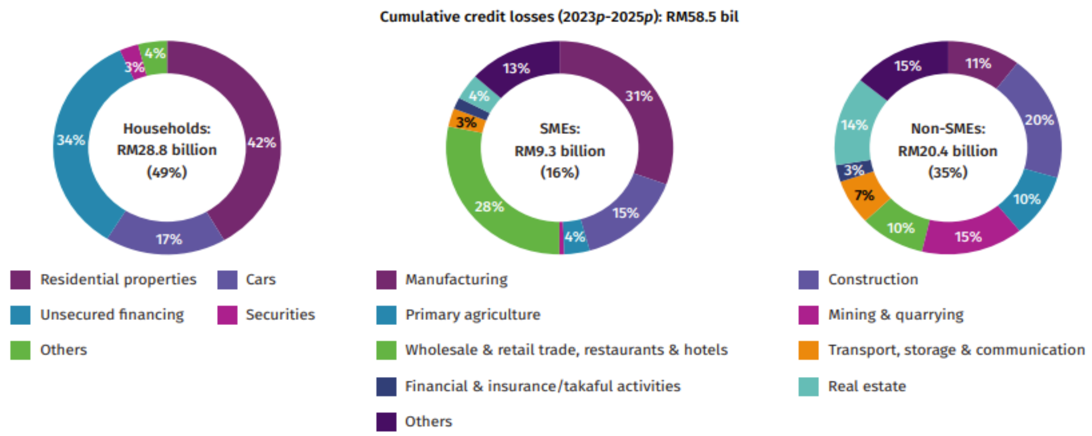
Source: BNM

Household Sector Impairment Profile Under AS2



Source: BNM

Drivers of Cumulative Credit Losses Under AS2



Source: BNM

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE	Net. Div. (sen)	Net Div Yld
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
ALLIANCE BANK MALAYSIA BHD	OP	3.34	4.40	31.7%	5,171	N	03/2023	44.7	49.4	20.9%	10.4%	7.5	6.8	0.8	10.5%	22.0	6.6%
AMMB HOLDINGS BHD	OP	3.73	5.00	34.0%	12,336	N	03/2023	51.0	54.8	12.0%	7.4%	7.3	6.8	0.7	9.7%	16.0	4.3%
BANK ISLAM MALAYSIA BHD	MP	2.17	2.30	6.0%	4,869	Y	12/2023	26.2	27.2	14.4%	4.2%	8.3	8.0	0.7	8.1%	15.5	7.1%
CIMB GROUP HOLDINGS BHD	OP	5.31	6.55	23.4%	56,632	N	12/2023	59.7	68.4	14.3%	14.7%	8.9	7.8	0.8	9.7%	30.0	5.6%
HONG LEONG BANK BHD	OP	20.24	23.35	15.4%	43,875	N	06/2023	197.0	199.7	22.7%	1.4%	10.3	10.1	1.2	12.5%	70.0	3.5%
MALAYAN BANKING BHD	OP	8.56	10.10	18.0%	103,183	N	12/2023	79.6	79.3	15.7%	-0.3%	10.8	10.8	1.2	11.0%	68.0	7.9%
PUBLIC BANK BHD	OP	3.96	4.90	23.7%	76,866	N	12/2023	35.9	37.0	13.8%	3.2%	11.0	10.7	1.4	13.4%	18.0	4.5%
RHB BANK BHD	OP	5.54	7.10	28.2%	23,530	N	12/2023	77.4	77.6	15.8%	0.2%	7.2	7.1	0.7	10.7%	43.0	7.8%
Sector Aggregate					**326,462**					**12.4%**	**4.9%**	**9.8**	**9.3**	**1.0**	**10.5%**		**5.8%**

Source: Kenanga Research

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Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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