Banking

BNM 2HCY23 FSR: Eyeing Better Conditions

OVERWEIGHT

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BNM has released its Financial Stability Review (FSR) report for 2HCY23. Tying into its CY24 GDP target of 4.0%-5.0% and headline inflation target of 2.0%-3.5%, we find that BNM is overall optimistic that our domestic financial system will likely remain highly stable. Key threats that could stem from prolonged and extended weakness of the MYR (leading to higher pass-through inflation) and lower-than-expected economic performance, are reflected in an updated stress test and still cushioned by high capital buffers. With regards to the OPR, BNM's stand is that any changes are back by data-driven findings but we opine it may mirror changes in US Fed rates.

Maintain OVERWEIGHT on the sector with a new eye on certain industry laggards which we believe are due to see better appreciation from the sector's resilience and sustained growth prospects. We like: (i) PBBANK (OP; TP: RM5.10) with a highest perceived resilience against headwinds with brighter expectations for write-backs, (ii) RHBBANK (OP; TP: RM7.25) as the new dividend leader while supported by a sizeable CET-1 balance, and (iii) ABMB (OP; TP: RM4.30) for its leading yet sustainable fundamentals which outpace certain larger-cap names, despite being the smallest listed bank.

Big picture, solid frame. Through its findings in the 2HCY23 FSR, BNM pointed that Malaysia did miss the expectations of several indicators (i.e. GDP growth +3.7%) as global trade was being crimped (CY23: +0.4%) as well. Moving forward, the wider economy could see bright sparks from: (i) a turnaround in exports from a recovery in global semiconductor sales, (ii) rejuvenation in hospitality sectors, and (iii) influx of investments into multi-year projects - all of which would stimulate household income growth and improve unemployment rates.

A large underlying concern comes from a stubborn weakness in the MYR, which BNM had attributed to regional monetary policies being more hawkish and rendering domestic financial instruments less attractive. That said, BNM believes that appreciation for the MYR is forthcoming given the abovementioned strengthening fundamentals. On the other hand, closer engagement with large corporates and institutions with heavy foreign currency holdings are ongoing to encourage greater utilisation of proceeds and conversion back to support local exchange rates.

Managing the MYR would be key in keeping inflation in check, with BNM eyeing headline inflation to range between 2.0%-3.5% and core inflation at 2.0%-3.0%, which had already accounted for a higher implemented SST and low value goods tax. Assuming the above sustains, BNM is hopeful to strike a GDP growth of 4.0%-5.0% in CY23, which is within our in-house expectation of 4.7%.

Banks' resilience uncontested. In the same review, the banking sector continued to exhibit sustainable performance while still supporting a greater demand for loans. Industry liquidity coverage remains flushed at 161% (Jun 2023: 154%) while loan loss cover was sufficient, hovering above 100% at 119% (Jun 2023: 116%). We note that credit cost charges of 16 bps is above a pre-pandemic average of 14 bps, but we gathered that CY23 could see a slightly higher uptick to readings with the expiry of assistance programs. Overall, we continue to opine asset quality risks are behind us with industry GIL of 1.6% (Jun 2023: 1.7%) marking a reversion back to pre-pandemic levels.

While BNM did not offer explicit guidance on monetary policies, we believe they are more likely to maintain OPR at 3% throughout CY24. Considerations for changes require to be supported by data-driven findings, which we reckon could be to quell higher-than-expected inflation from the spillover of targeted fuel subsidies, and MYR hampering import costs. On the flipside, BNM appears to hold expectations for US Fed Rates in line with street estimates at three 25 bps cuts for the year. Given its wider spread relative to our OPR, should BNM follow suit, we believe we may end up seeing on 25 bps cut on our end.

Households to remain stable. Dec 2023's debt-to-GDP stood at 84.2% (Jun 2023: 82.0%, Dec 2022: 81.0%) and is rising albeit still within historical levels of c.86%, with the recent increase likely attributed to higher financing costs catching up. That said, residential and non-residential properties still make up the majority of total debt (c.65%) and are hence collateralised. Meanwhile, c.70% of borrowers appear to be categorised as lower-M40 and above, where we hold the view that repayment capacity could continue to remain strong. In relation to this, we noted that housing approval rates are moderately improving with Dec 2023 reporting at 76.4% (Jun 2023: 76.0%, Dec 2022: 75.7%).

Businesses could experience some prosperity. The 2HCY23 FSR found that the proportions of firms-at-risk within hospitality and construction sectors are still largely above pre-pandemic readings. However, the abovementioned factors for GDP growth could finally turn around these spaces with the former likely to benefit from a stronger tourists draw from the weak MYR. A slightly diminished interest coverage ratio of 5.7x (Jun 2023: 5.6x, Dec 2022: 7.1x) could be a result of the same higher average interest cost amidst past rate hikes. That said, given steady state expectations for OPR and better overall output, there could be better hopes for repayment capacity to increase in the near-to-medium term.

Overall, **we are encouraged by the findings in the 2HFY23 FSR to attest to the resiliency of our local banking landscape.** We gathered that several corporates may hold a more modest tone for CY24 on the back of forex-related headwinds and uncontained inflation. However, we believe the worst may have already passed us with the banks having faced its biggest challenge when navigating against tightening funding costs in CY23. On a brighter note, most banks hold confidence in maintaining asset quality with risks (albeit minor relative to overall books) stemming from the remaining balance of their respective repayment assistance accounts.

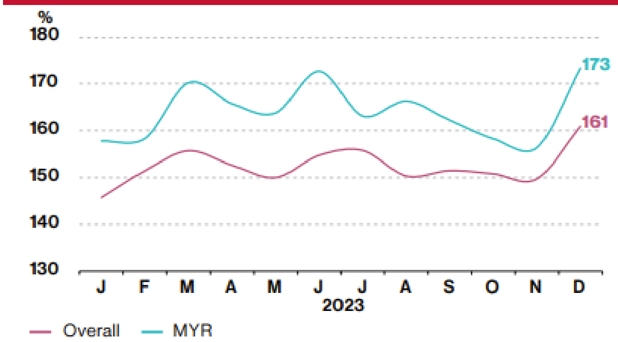
Looking at the refreshed stress test parameters by BNM, we see such severe circumstances to be highly unlikely (i.e. GDP degrowth of 3.5%-6.0%, unemployement rate of 5.6%-6.0%, OPR +100 bps, continued depreciation of the MYR) baring an unexpected recessionary fallout in the wider global economy, only attributed to unfavourable escalation of global geopolitics.

Maintain OVERWEIGHT on the banking sector. Market tailwinds (i.e. persistent loans growth and GDP, better margin retention) are expected to continue outweighing industry headwinds (i.e. inflationary pressures, weaker MYR), which we believe may lead to fewer tests to the sector's resiliency. The sector should be of interest with dividend yields still appearing attractive (6%-7%) on most names on top of lower embedded sector volatility as compared to other industries. We had seen meaningful moves in share prices with the inflow of foreign investors looking to accumulate sector heavyweights. In that regard, we find opportunities in the likes of: (i) **PBBANK (OP; TP: RM5.10)** with a highest perceived resilience with leading GIL reporting (0.4%) brighter expectations for write-backs, (ii) **RHBBANK (OP; TP: RM7.25)** as the new dividend leader (c.7%-8%) while supported by a sizeable CET-1 balance, and (iii) **ABMB (OP; TP: RM4.30)** for its leading yet sustainable fundamentals (ROE: 11%, dividend yield c.7%) which outpace certain larger-cap names, despite being the smallest listed bank.

Appendix

Snapshots on Banking System

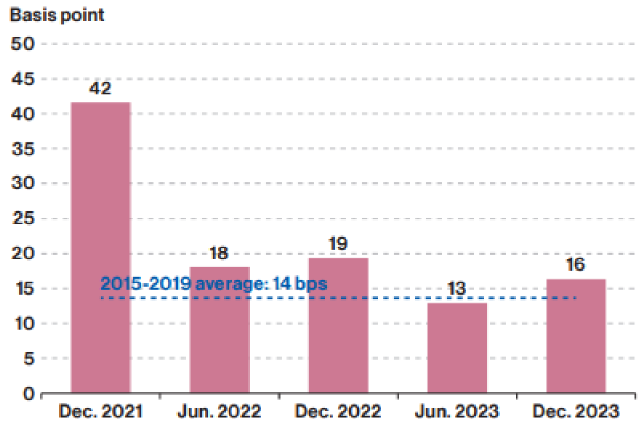
Liquidity Coverage Ratio



Note: 1. MYR LCR is calculated based on HQLA and expected net cash outflows denominated in ringgit.
2. Overall LCR is calculated based on HQLA and expected net cash outflows denominated in all currencies.

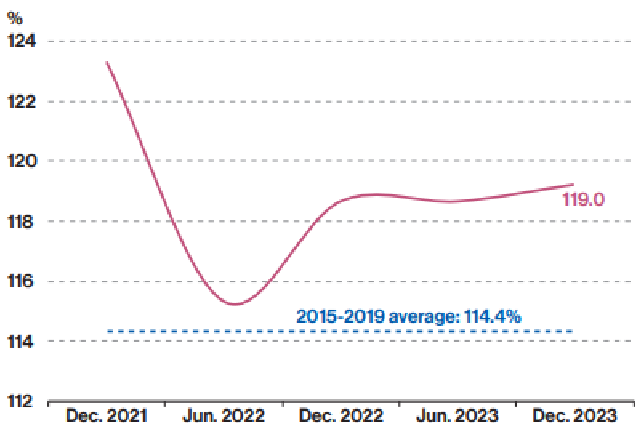
Source: BNM

Annualised Credit Cost Ratio



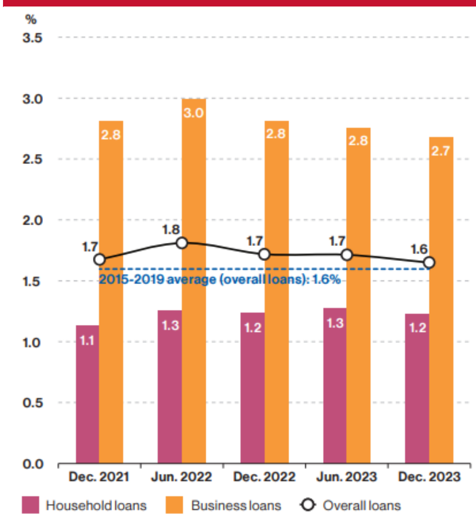
Source: BNM

Loan Loss Coverage (including Regulatory Reserves)



Source: BNM

Gross Impaired Loans Ratio



Source: BNM

2HCY23's Stress Test Exercise

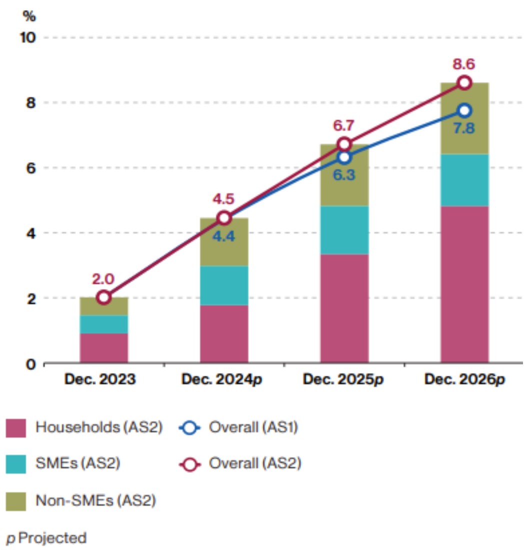
Stress Test Key Assumptions and Shock Parameters

Key Assumptions	AS1	AS2
Annual domestic real GDP growth	Up to -6.0%	Up to -3.5%
Annual unemployment rate	Up to 5.4%	Up to 6.0%
Market risk shocks - Increase in 10Y MGS yield - Increase in 10Y AAA corporate bond yield - Decline in FBM KLCI	 Up to 296 basis points Up to 422 basis points Up to 32%	 Up to 266 basis points Up to 369 basis points Up to 31%
OPR hike[i]	Up to 100 basis points	Up to 100 basis points
MYR depreciation against USD	Up to 31%	Up to 22%

Note: [i] The assumption of an OPR hike may not, in certain circumtances, be consistent with the broader macroeconomic scenarios but is assumed by design to account for potential downside risks.

Source: BNM

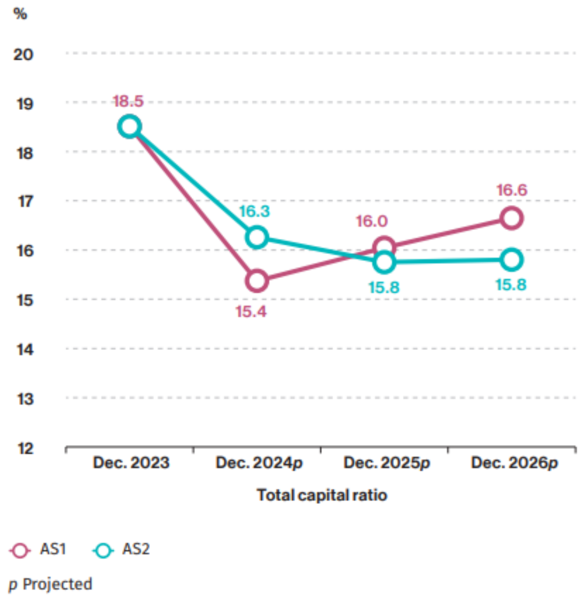
Sensitivity Analysis: Impaired Loans Ratio



Note: Impairment figures are inclusive of exposures from selected DBGs' overseas operations.

Source: BNM

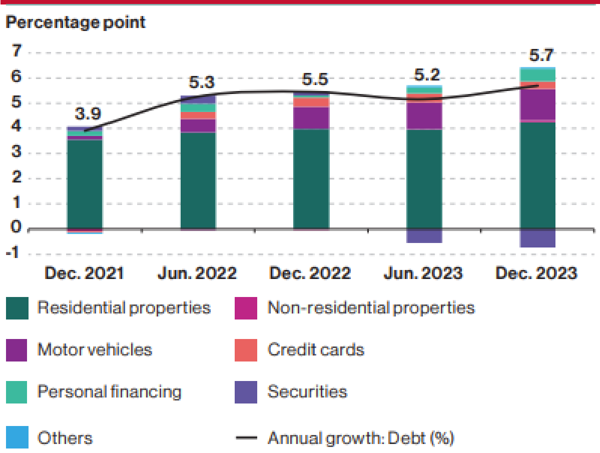
Sensitivity Analysis: Post-shock Total Capital Ratio



Source: BNM

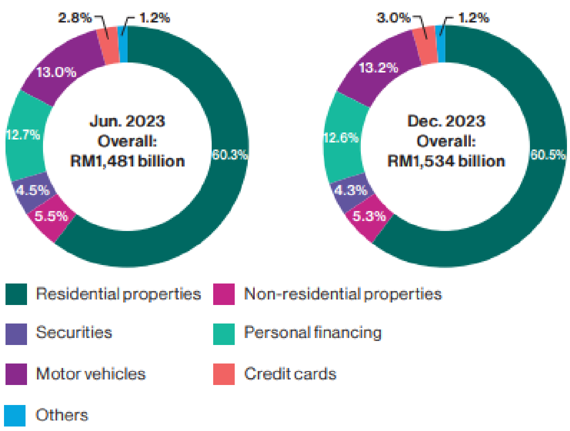
Snapshots on Household Sector

Household Debt Growth



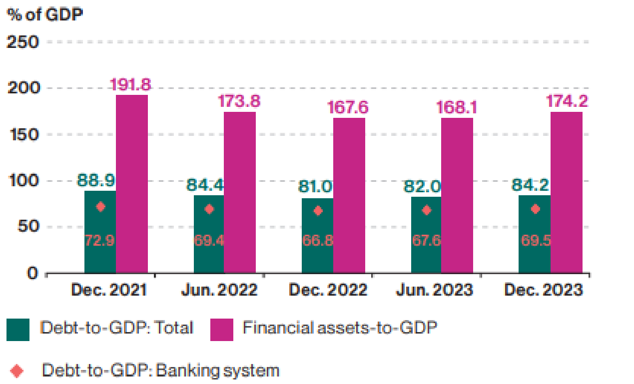
Source: BNM

Composition of Debt by Purpose



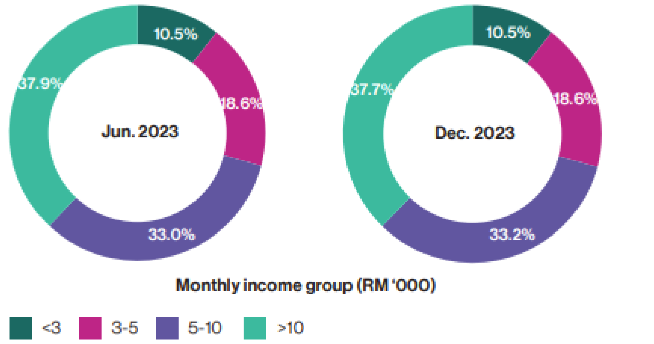
Source: BNM

Household Sectors – Key Ratios



Source: BNM, Bursa Malaysia, DOSM, EPF and Securities Commission Malaysia

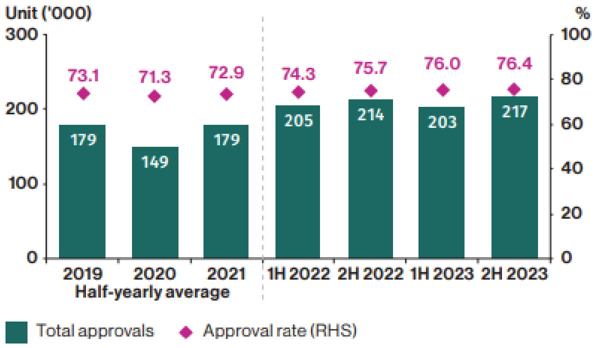
Household Sectors – Composition by Income Group



Note: 1. Figures exclude loan accounts with incomplete income information.
2. Figures may not add up due to rounding.

Source: BNM

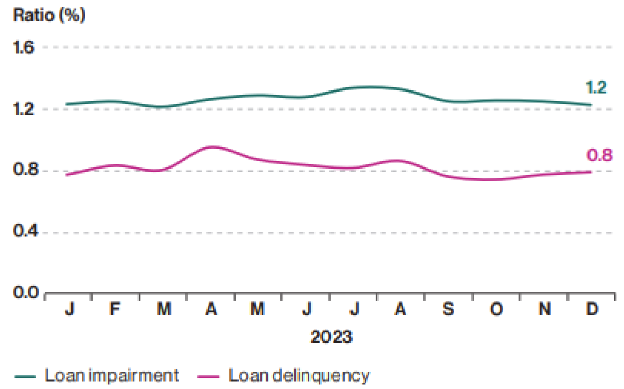
Volume and Approval Rate for Housing Loans



Note: Approval rate calculated based on volume of approvals.

Source: BNM

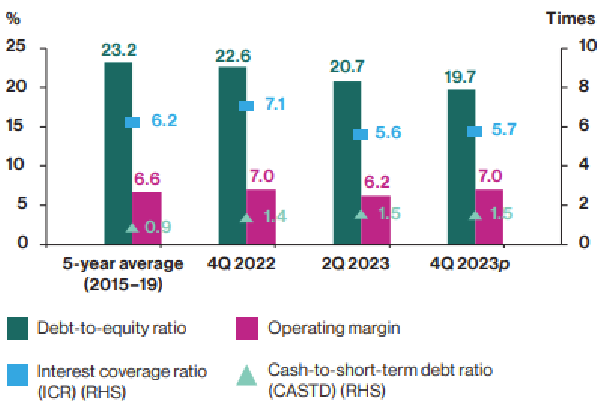
Loan Impairment and Delinquency Ratio



Source: BNM

Snapshots on Business Sector

Business Sector – Key Ratios



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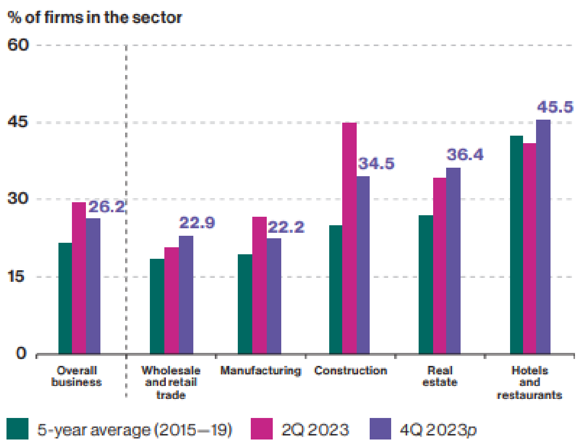
Note: Prudent thresholds for ICR and CASTD are two times and one time respectively.

Source: S&P Capital IQ, BNM

Firms-at-risk for selected sectors



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Source: S&P Capital IQ, 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																	
AFFIN BANK BHD	UP	2.51	1.80	-28.3%	5,889.7	N	12/2024	21.2	27.8	21.4%	31.6%	11.9	9.0	0.5	4.3%	8.0	3.2%
ALLIANCE BANK MALAYSIA BHD	OP	3.52	4.30	22.2%	5,449.3	N	03/2024	45.5	50.9	4.0%	11.8%	7.7	6.9	0.8	10.2%	24.5	7.0%
AMMB HOLDINGS BHD	OP	4.08	4.80	17.6%	13,491.9	N	03/2024	43.6	51.1	-16.9%	17.3%	9.4	8.0	0.7	9.4%	19.0	4.7%
BANK ISLAM MALAYSIA BHD	MP	2.54	2.25	-11.4%	5,756.8	Y	12/2024	25.6	29.3	5.1%	14.1%	9.9	8.7	0.8	7.8%	17.0	6.7%
CIMB GROUP HOLDINGS BHD	MP	6.48	6.60	1.9%	69,109.9	N	12/2024	67.1	69.8	2.6%	3.9%	9.7	9.3	1.0	10.3%	44.0	6.8%
HONG LEONG BANK BHD	OP	19.32	24.20	25.3%	41,880.3	N	06/2024	196.0	213.1	5.2%	8.7%	9.9	9.1	1.1	11.3%	60.0	3.1%
MALAYAN BANKING BHD	OP	9.57	11.00	14.9%	115,480.7	N	12/2024	80.7	82.9	4.1%	2.8%	11.9	11.5	1.2	10.2%	62.0	6.5%
MALAYSIA BUILDING SOCIETY	UP	0.780	0.590	-24.4%	6,413.4	Y	12/2024	3.4	6.3	79.3%	82.1%	22.7	12.5	0.6	2.5%	2.0	2.6%
PUBLIC BANK BHD	OP	4.24	5.10	20.3%	82,301.3	N	12/2024	37.8	39.6	10.3%	4.8%	11.2	10.7	1.4	13.0%	21.0	5.0%
RHB BANK BHD	OP	5.64	7.25	28.5%	24,175.0	N	12/2024	72.8	76.4	11.5%	4.8%	7.7	7.4	0.8	9.9%	44.0	7.8%
SECTOR AGGREGATE					**369,948**					**5.2%**	**6.2%**	**10.6**	**10.0**	**1.1**	**10.0%**		**5.3%**

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.***

Published by:

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