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Banking

BNM 1HCY24 FSR: Smooth Sails Expected

By Clement Chua | clement.chua@kenanga.com.my

OVERWEIGHT



BNM has released its Financial Stability Review (FSR) report for 1HCY24. The banking sector has produced sequential improvements since the last review on the back of supportive economic macro. For now, BNM's stance to keep OPR decisions isolated from regional monetary policies continues to bode well for markets. Previous concerns on forex driven inflationary pressures look to subside following the recent spike in MYR's strength, albeit we reckon hedges may delay its full impact into CY25 only.

Maintain OVERWEIGHT on the sector in lieu of valuations to be driven further, spurred by a return of foreign investors back into Malaysian banks. For our top picks, we find opportunities in the laggards, albeit high-quality names being: (i) PBBANK (OP, TP: RM5.10), (ii) HLBANK (OP, TP: RM27.40), and (iii) RHBANK (OP, TP: RM7.55) which holds strong regard as a dividend pick (c.7% yield), especially with asset quality issues resolved.

Tailwinds outweigh headwinds. 1HCY24 was well-supported with GDP growth of 5.0% lending support to income and employment prospects. This should spill onto 2HCY24 with thanks to infrastructure projects and foreign investments into the country. We view the appreciation of the MYR from RM4.70/USD in June 2024 to RM4.20/USD in Oct 2024 favourably with the cheapening of imports costs and foreign-denominated lending. That said, we received no indication that BNM will fine tune its headline inflation target of 2.0%-3.5%, perhaps as fundamental improvements may require it to pan out in a longer-term.

Sector still held high. Thanks to the above, the demand for loans is expected to remain bouyant with liquidity still appearing ample as at June 2024 LCR of 166% (Dec 2023: 161%). Credit risks are also a waning concern as we saw industry GIL hovering at a historical low of 1.6% (Dec 2023: 1.7%, Jun 2023: 1.7%) with signs of further improvement as repayments and debt servicing appearing in good shape. Meanwhile, 1HFY24 credit cost of 13 bps is below a 14 bps pre-pandemic average, suggesting that conditions have normalised.

With regards to monetary policy, BNM will likely continue to make OPR decisions independent from regional markets due to differing inflationary pressures and economic trajectory. We take the view of OPR remaining stable at 3% throughout CY25 with considerations for changes to require data-driven findings to quell higher-than-expected inflation from the spillover of targeted fuel subsidies and input costs remaining floaty.

Households in good shape. Jun 2024's debt-to-GDP ratio came in at 83.8% (Dec 2023: 84.2%, Jun 2023: 81.9%) and reflects sustained appetite of loans which is supported by higher income. Residential properties remain the lion's share of total debt (61.0%) and would be largely collateralised, providing buffers to the financial system in the event of unsavory downturns. We gathered that there is a bigger proportion of debtors operating in the higher income group of >RM10k per month at 39.1% of total financing (Dec 2023: 37.6%) which further supports repayability. We opine the banks are applying better confidence in the household space, evident by the increase in housing loan approval rates to 76.9% (Dec 2023: 75.7%).

Businesses meanwhile still have concerns. We view operating conditions to be fully back to normalcy, as we observed fewer firms-at-risk within the hospitality, mining and construction sectors. That said, there appears to be pain points experienced by wholesale and retail accounts, possibly due to higher import costs which we believe will taper down albeit more meaningfully into CY25. On a brighter note, an increase in industry interest coverage ratio of 6.2x (Dec 2023: 5.8x; Jun 2023: 5.7x) paints lower repayment risks for businesses, particularly with past hikes in interest costs put behind us.

With regards to the implementation of Basel III's Standardised Approach, BNM believes its adoption could lead to a reduction in credit RWA for the banks of up to 1.45%. Through our qualitative assessments, the freed up capital could translate to higher dividends paid out in the tune of <1% additional yield.

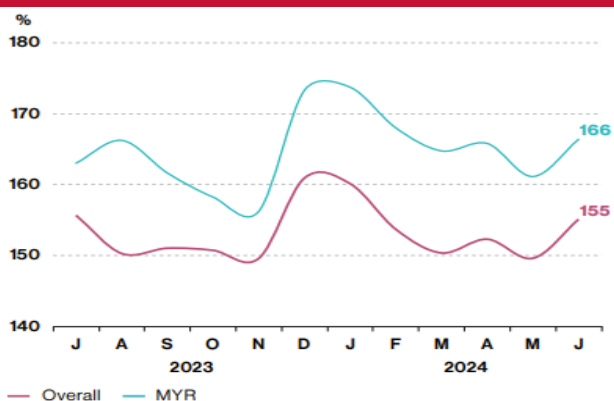
Overall, **our review of 1HFY24 FSR upholds the resiliency of our banking space.** These factors above will support banking corporates with regards to credit risks, leaving them more room to optimise NIMs and cost efficiency. Most banks have progressively written back their pandemic provision and narrowed their macro buffers, implying that we may see fewer extraordinary asset risks. While BNM did not provide a refresh to its stress test parameters, its inputs could appear as even more far-reaching given our stronger fundamentals. Despite this, assuming the worst is to materialise, we still take comfort that our highly capitalised banking system could sufficiently absorb shocks from the market (*refer to 2HCY23's Stress Test Exercise*). Separately, banks are also on the lookout for climate-related risks (i.e. flooding) and have applied management overlays. On that note, we have previously explored the flood risk in our ESG report on 23 Sep 2024 titled: "UrbanMetry: Understanding Floods Through Big Data".

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 challenges to the sector's resiliency. For our top picks, we continue to believe that laggards could see the greatest appreciation, being: (i) **PBBANK**, (ii) **HLBANK**, and (iii) **RHBBANK**. Commonly, these banks reflect foreign shareholding levels firmly below recent peak (see Exhibit 4). With regards to **PBBANK** and **HLBANK**, their leading asset quality (GIL <1.0%) offer firm cushion against the potential degradation in the industry as risk appetite expands with better economic prospects. Meanwhile, **RHBBANK** offers leading dividend yields (c.7%) which could attract yield seekers in spite of modest loans growth targets (4%-5%), suggesting the possibility of greater upside should they be able to leverage on the same wider economic growth.

Appendix

Snapshots on Banking System

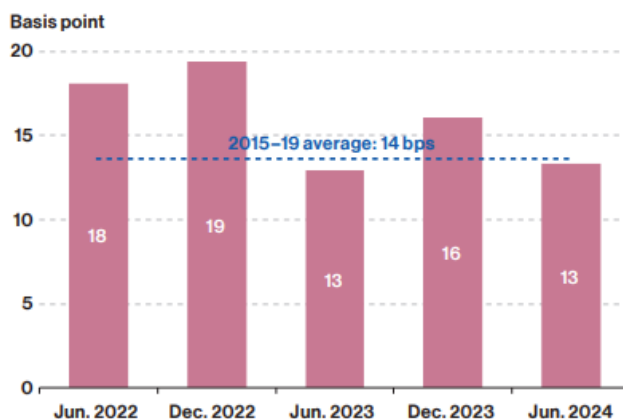
Liquidity Coverage Ratio



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.

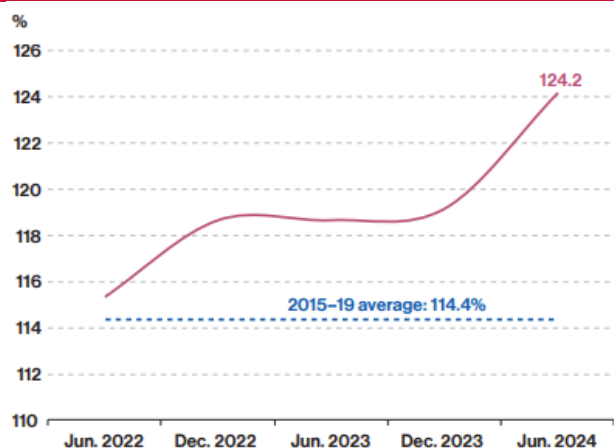
Source: BNM

Annualised Credit Cost Ratio



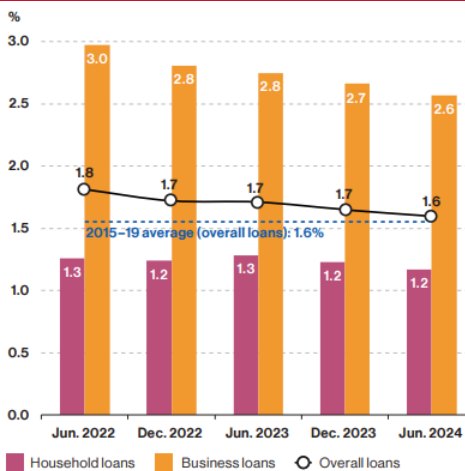
Source: BNM

Loan Loss Coverage (including Regulatory Reserves)



Source: BNM

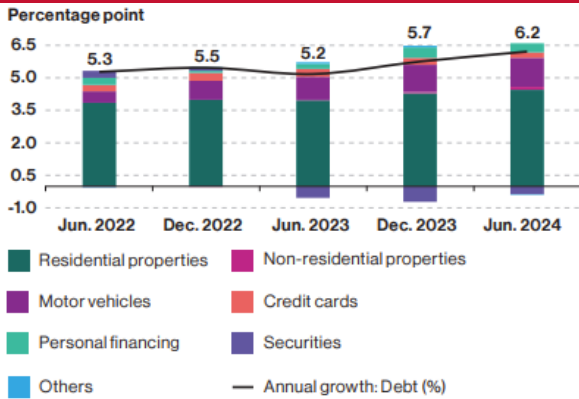
Gross Impaired Loans Ratio



Source: BNM

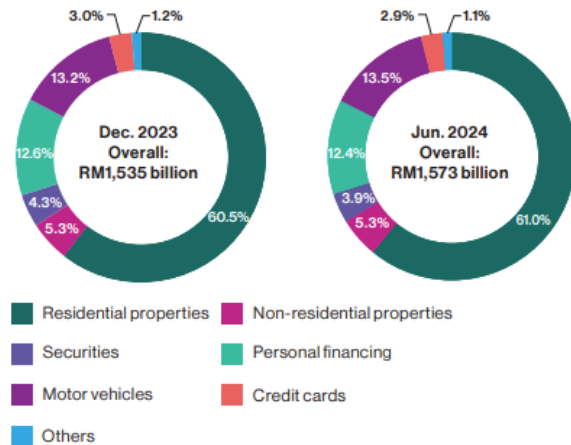
Snapshots on Household Sector

Household Debt Growth



Source: BNM

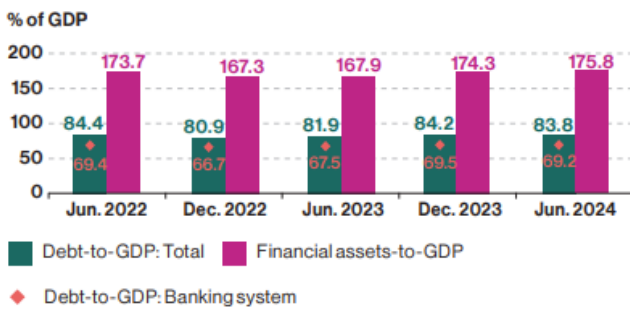
Composition of Debt by Purpose



Note: Figures may not add up due to rounding.

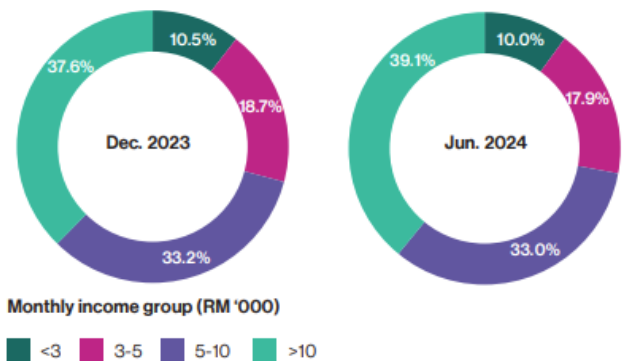
Source: BNM

Household Sectors – Key Ratios



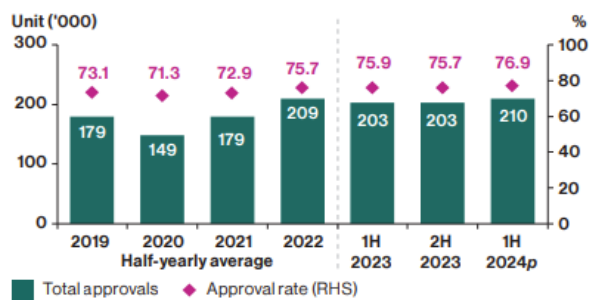
Source: BNM, Bursa Malaysia, DOSM, EPF and Securities Commission Malaysia

Household Sectors – Composition by Income Group



Source: BNM

Volume and Approval Rate for Housing Loans

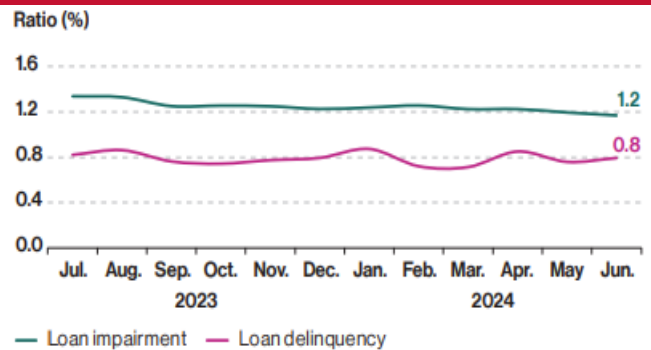


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Note: Approval rate calculated based on volume of approvals.

Source: BNM

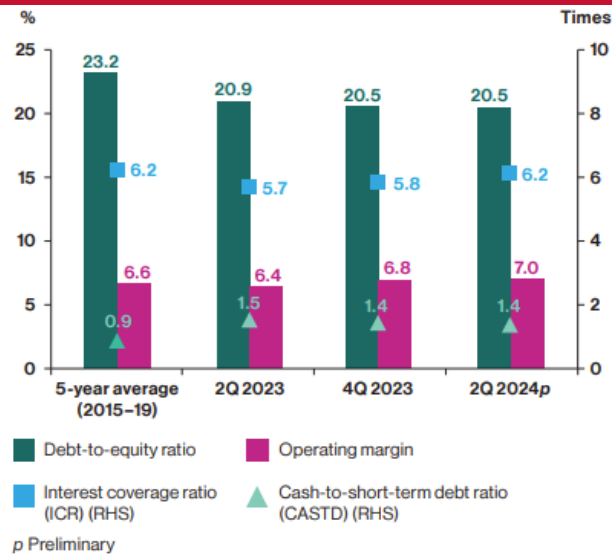
Loan Impairment and Delinquency Ratio



Source: BNM

Snapshots on Business Sector

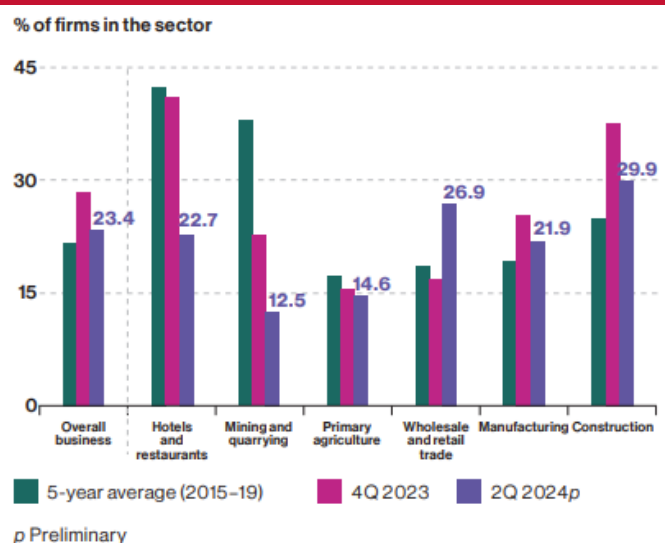
Business Sector – Key Ratios



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



Source: S&P Capital IQ, BNM

2HCY23's Stress Test Exercise

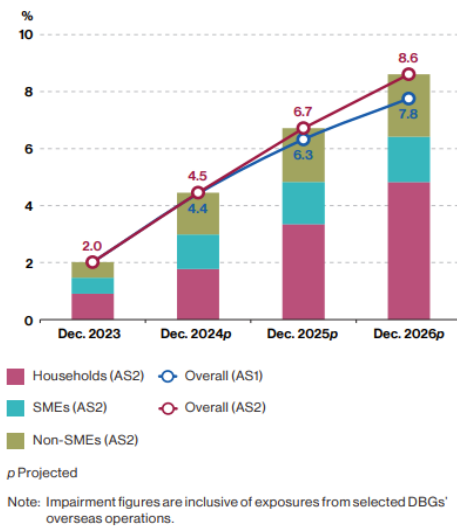
Stress Test Key Assumptions and Shock Parameters

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 ⁽¹⁾	Up to 100 basis points	Up to 100 basis points
MYR depreciation against USD	Up to 31%	Up to 22%

Note: ⁽¹⁾ The assumption of an OPR hike may not, in certain circumstances, be consistent with the broader macroeconomic scenarios but is assumed by design to account for potential downside risks.

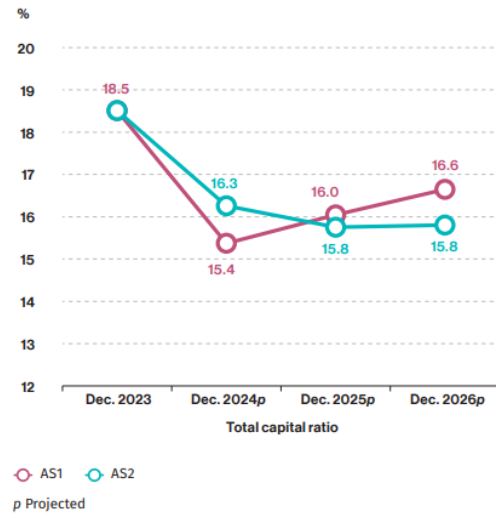
Source: BNM

Sensitivity Analysis: Impaired Loans Ratio



Source: BNM

Sensitivity Analysis: Post-shock Total Capital Ratio



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																	
AFFIN BANK BHD	UP	2.84	2.20	-22.5%	6,817.4	N	12/2024	20.6	26.9	18.4%	30.2%	13.8	10.6	0.6	4.2%	8.0	2.8%
ALLIANCE BANK MALAYSIA BHD	OP	4.31	5.00	16.0%	6,672.3	N	03/2025	49.0	52.9	9.8%	8.0%	8.8	8.2	0.9	10.3%	25.0	5.8%
AMMB HOLDINGS BHD	OP	4.99	5.85	17.2%	16,519.2	N	03/2025	57.2	59.1	21.6%	3.3%	8.7	8.4	0.8	9.6%	22.0	4.4%
BANK ISLAM MALAYSIA BHD	UP	2.73	2.35	-13.9%	6,187.5	Y	12/2024	25.2	29.0	3.3%	14.9%	10.8	9.4	0.8	7.6%	17.0	6.2%
CIMB GROUP HOLDINGS BHD	MP	7.99	7.60	-4.9%	85,608.2	N	12/2024	69.4	73.8	6.0%	6.4%	11.5	10.8	1.2	10.6%	49.0	6.1%
HONG LEONG BANK BHD	OP	21.30	27.40	28.6%	46,172.4	N	06/2025	212.9	223.4	4.0%	4.9%	10.0	9.5	1.1	11.3%	71.0	3.3%
MALAYAN BANKING BHD	OP	10.54	11.95	13.4%	127,185.7	N	12/2024	80.6	91.0	4.0%	12.8%	13.1	11.6	1.3	10.2%	62.0	5.9%
MALAYSIA BUILDING SOCIETY BHD	UP	0.770	0.590	-23.4%	6,331.2	Y	12/2024	4.0	6.4	109.0%	58.7%	19.2	12.1	0.6	2.9%	2.0	2.6%
PUBLIC BANK BHD	OP	4.57	5.10	11.6%	88,706.9	N	12/2024	37.5	39.2	9.5%	4.6%	12.2	11.7	1.5	12.9%	21.0	4.6%
RHB BANK BHD	OP	6.15	7.55	22.8%	26,810.9	N	12/2024	69.8	72.7	6.8%	4.2%	8.8	8.5	0.8	9.5%	42.5	6.9%
SECTOR AGGREGATE					417,012					7.3%	8.1%	11.7	10.8	1.2	10.1%		4.9%

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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KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia

Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my