Maybank Investment Bank

Banks

Malaysia

Malaysia Banking

2H21 Financial Stability Review

POSITIVE *[Unchanged]*

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Sector fundamentals intact

The banking system remains stable and resilient, especially amid economic recovery. BNM nevertheless highlights that the recovery is uneven and a few sectors continued to warrant monitoring. It also highlights the risk of higher mark-to-market losses on investments should bond yields rise. This, however, is not unexpected and has somewhat been factored into our forecasts. We maintain sector POSITIVE with BUYs on HLBK, AMMB, RHB, ABMB, HLFG and BIMB.

Some sectors remain a concern

While businesses have begun seeing a recovery with the opening up of the economy and financial ratios are improving, BNM highlights an uneven recovery with concerns still over certain sectors such as the hotel and commercial real estate segments. The SME sector has nevertheless, seen a tapering off of repayment assistance applications, while corporates remain sound. Household (HH) debt grew at a slower pace of 4.1% (June 2021: 5.5%) YoY end-Dec 2021 and the ratio of HH debt-to-GDP declined to 89% from 93.2% in 2020, on the back of stronger nominal GDP growth.

Manageable exposure to CRE

Rising oversupply in the commercial real estate (CRE) sector remains a concern but BNM points out that financial stability risks are manageable in that a) there is limited direct linkages to financial institutions whereby credit exposure to CRE is 7.8% of total banking system assets, b) there is sound quality of bank lending whereby the impairment ratio is low at 1.5%, and c) outstanding bank loans (excluding end-financing) that are secured by commercial properties are just 4.5% of total banking system loans.

Risk of higher MTM losses

While the banking system remains sound, BNM cautions that domestic bond yields are likely to experience further upward pressure amid monetary policy normalization in the US. This could lead to outflows from emerging market economies such as Malaysia, as well as an expected pick-up in deposit competition. We have factored this into our forecasts to some extent, in that we project aggregate non-interest income to contract marginally this year.

Banking Sector - Peer Valuation Summary

Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	PER (x) CY22E	PER (x) CY23E	P/B (x) CY22E	P/B (x) CY23E	ROAE (%) CY22E	ROAE (%) CY23E	Net yield CY22E	Net yield CY23E
Maybank *	NR	8.92	106,907	NR	13.7	11.8	1.2	1.2	8.9	10.2	6.3	7.3
Public Bank	HOLD	4.65	85,795	4.80	16.3	13.6	1.8	1.7	11.2	12.7	3.3	3.9
CIMB	HOLD	5.31	54,685	5.60	11.9	9.9	0.9	0.9	7.4	8.5	4.0	4.7
HL Bank	BUY	20.18	44,221	24.70	12.0	10.9	1.3	1.2	10.8	11.2	3.1	3.5
RHB Bank	BUY	5.95	24,236	6.60	10.1	8.4	0.8	0.8	8.6	9.8	5.0	5.9
HLFG	BUY	19.48	22,721	22.10	9.2	8.4	0.9	0.8	9.8	10.0	2.8	3.1
AMMB	BUY	3.67	10,771	4.05	9.6	8.7	0.7	0.7	7.8	7.8	3.0	3.5
BIMB	BUY	2.92	6,466	3.40	11.2	9.0	0.9	0.9	8.6	10.0	3.4	4.2
ABMB	BUY	3.66	5,558	4.00	9.0	8.3	0.8	0.8	9.4	9.7	4.4	4.8
Simple avg			**361,360**		**11.5**	**9.9**	**1.0**	**1.0**	**9.2**	**10.0**	**3.9**	**4.5**
MC-wtd					**13.1**	**11.2**	**1.2**	**1.2**	**9.5**	**10.5**	**4.3**	**5.1**

** Consensus estimates   Source: Maybank IBG Research*

PP16832/01/2013 (031128)

Market risk – risk of higher MTM losses

Domestic institutional investors turned net sellers of domestic equities (-MYR12b in 2021) for the first time in 3 years, cushioned by purchases by domestic retail investors and some non-resident investors.

Retail investor activity increased to account for 35% of total value traded in the equity markets (34% in 2020), this being well above the 3-year average share of 24%.

Household loans to purchase quoted shares remains small and stable at just 0.5% of total banking system loans.

Non-resident participation in the equity market fell further to 20.1% (from a 3-year average of 22.8%) of Bursa Malaysia's market capitalization.

The domestic government bond market recorded non-resident net inflows of MYR17.4b between July 2021 and Feb 2022. As such, the share of non-resident holdings in the government bond market increased to 25.3% from a 5-year average of 24.4%.

For the rest of 2022, BNM estimates that domestic bond yields are likely to experience further upward pressure amid monetary policy normalization in the US, coupled with the anticipated higher incoming government bond supply. This could lead to higher borrowing costs for financial institutions, businesses and the Government.

Banks could therefor see increased risk of higher mark-to-market (MTM) losses from their investment portfolios.

Credit risk (businesses) – some sectors remain a concern

Businesses began seeing recovery towards end-2021 with the opening up of the economy.

The median interest coverage ratio (ICR) and operating margin of businesses improved to 7.5x and 7.6% respectively from 6.7x and 7.2% in 2Q21 (2015-2019 average: 6.2x, 6.6%).

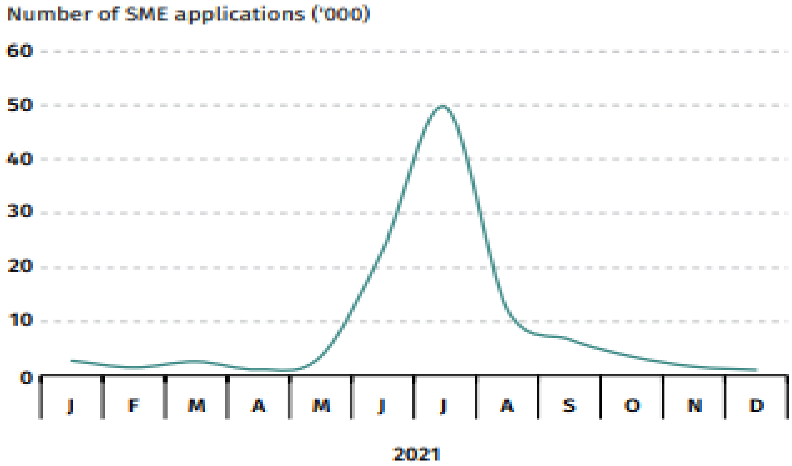
The aggregate cash-to-short-term debt ratio (CASTD) of businesses was 1.4x against a 2015-2019 average of 0.9x and debt-to-equity was 21.8% (2015-2019 average: 23.2%).

The percentage of firms-at-risk (listed non-financial corporates with an ICR<2x) declined to 20.9% in 4Q21 from a peak of 31.9% in 3Q20 and compares against a 2015-2019 average of 21.4%.

However, the recovery was uneven and BNM points out concerns over the hotel sector (weak tourism activity) and commercial real estate (oversupply and weaker demand from work-from-home arrangements).

The SME sector was hard hit in 2021 and SME loans under repayment assistance remained high at 36.5% of total SME loans (5.7% of total banking system loans) in 4Q21. Positively though, monthly restructured and rescheduled (R&R) applications have tapered off since.

Fig 1: SME sector: Monthly R&R applications



Source: BNM Financial Stability Report 2H21

Corporates continued to tap the bond market for funds (corporate bonds rose 4.2% YoY in 2021 vs 6.6% in 2020). External debt expanded at a faster pace of 15.3% in 2021 versus 5.2% in 2020 (5-year average: 7.5%) as companies raised external funding to support their overseas operations and intercompany borrowings of MNCs in Malaysia. However, external debt-at-risk remained low at 6.6% (6.9% in 2020).

Fig 2: Business sector ratios (%)

	2H19	1H20	2H20	1H21	2H21p
Return on assets	1.6	0.9	1.1	2.1	2.4
Return on equity	3.2	1.6	2.2	4.0	4.1
Debt-to-equity Ratio	25.8	24.1	22.6	22.2	21.8
Interest cover (x)	4.8	4.0	5.1	6.7	7.5
Operating margin	5.7	5.1	5.5	7.2	7.6
Impaired loans ratio	2.5	2.5	2.6	2.7	2.4

Source: BNM Financial Stability Report 2H21

BNM highlights rising oversupply in the commercial real estate (CRE) sector whereby vacancy rates for office space in the Klang Valley rose further to 28.9% in 4Q21 from 26.7% in 2020 while the vacancy rate for retail space was higher at 27.9% from 25.5% in 2020. Nevertheless, it also points out that financial stability risks remain limited in that:

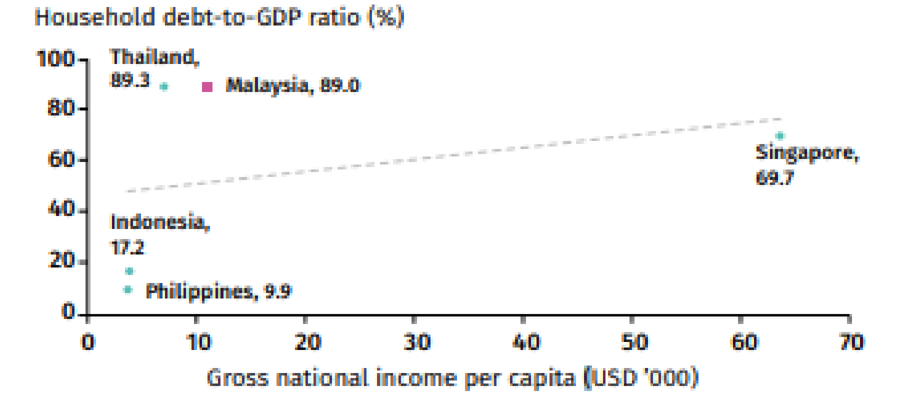
- There is limited direct linkages to financial institutions whereby credit exposure to CRE is 7.8% of total banking system assets.
- There is sound quality of bank lending to the sector. Although there is a higher share of Stage 2 loans to the sector at 12%, but the impairment ratio is low at 1.5%.
- Outstanding bank loans (excluding end-financing) that are secured by commercial properties are just 4.5% of total banking system loans.

Credit risk (households)

Household (HH) debt grew at a slower pace of 4.1% (June 2021: 5.5%) YoY end-Dec 2021 and was driven primarily by housing loans, aided by incentives under the Home Ownership Campaign that ended on 31 Dec 2021.

The ratio of HH debt-to-GDP declined to 89% from 93.2% in 2020, on the back of stronger nominal GDP growth.

Fig 3: Household sector: Regional debt/GDP ratios



Source: BNM Financial Stability Report 2H21

HH loan growth was 4.3% YoY and 71% of new disbursements were to borrowers earning more than MYR5k per month. Median debt service ratios (DSRs) of newly-approved and outstanding HH loans were unchanged from their Jun 2021 positions, at 44% and 35% respectively.

Borrowers with DSRs exceeding 60% was stable at 25% of total HH borrowers – 67% of which was held by borrowers earning >MYR5k/month.

As at end-2021, the median loan-to-value ratio of outstanding housing loans was 65.2% (Mar 2020: 66.5%).

As at end-2021, 73.6% of house financing to first-time home buyers have LTV ratios exceeding 90%.

The growth in housing loans taken up by owner-occupiers of 7.4%, outstripped that by HH loan investors (+5.7%). 75% of HH investors are earning >MYR5k per month.

Loans under repayment assistance (RA) rose to 30% of HH loan accounts or 35.7% of outstanding HH loan exposures in Dec 2021, from 12.8% and 16% respectively in June 2021.

Borrowers earning <MYR5k/month accounted for 60% of new accounts under RA.

Positively though, borrowers under repeat repayment assistance accounted for just 0.7% of total HH borrowers and 1.7% of total banking system loans.

HH financial assets grew at a more moderate pace of 2.4% versus 5.3% end-June 2021 due to the weaker equity market and sizeable drawdowns of retirement savings.

Stress tests indicate that under adverse scenarios of income and employment shocks, about 3.8-4% of banking system loans could be at risk of default by end-2024 due to insufficient financial buffers. 63.5% of these at-risk borrowers earn less than MYR5k/month.

As of 4 Mar 2022, 5,657 individuals have enrolled into URUS with total loan exposures of MYR2.7b. Around half of the borrowers (MYR1.4b) had experienced job losses.

6.1 million EPF members currently have retirement savings of <MYR10k in their accounts, of which 3.6 million have less than MYR1k.

Fig 4: Household debt ratios (%)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021p
HH debt (MYR'b)	694.2	782.3	877.4	952.7	1,023.2	1,080.5	1,133.8	1,186.7	1,251.8	1,320.6	1,374.7
Chg in HH debt	*16.8%*	*12.7%*	*12.2%*	*8.6%*	*7.4%*	*5.6%*	*4.9%*	*4.7%*	*5.5%*	*5.5%*	*4.1%*
HH fin assets (MYR'b)	1,520	1,712	1,905	2,015	2,119	2,232	2,421	2,544	2,709	2,904	2,972
HH debt/GDP	76.1	80.5	86.1	86.1	88.4	87.8	83.8	82.0	82.9	93.2	89.0
HH fin assets/HH debt	218.9	218.9	217.1	211.5	207.1	206.6	213.5	214.3	216.4	219.7	216.2
HH liquid fin assets/HH debt	154.7	156.3	155.7	148.7	143.4	141.4	145.7	143.4	143.2	145.2	144.2
Impaired loans ratio	na	na	2.2	1.7	1.5	1.5	1.4	1.2	1.2	1.1	0.7

Source: BNM Financial Stability Report 2H21

Soundness of the banking sector

Funding sources remain stable and the aggregate Net Stable Funding Ratio (NSFR) of the banks stood at 116.2% end-Dec 2021, with all banks already meeting the minimum 100% requirement.

Deposits grew at a faster pace of 6.3% end-Dec 2021 from 3.9% end-June 2021, due to a recovery in business deposits. 36% of deposits were in the form of current and savings accounts (CASA) deposits.

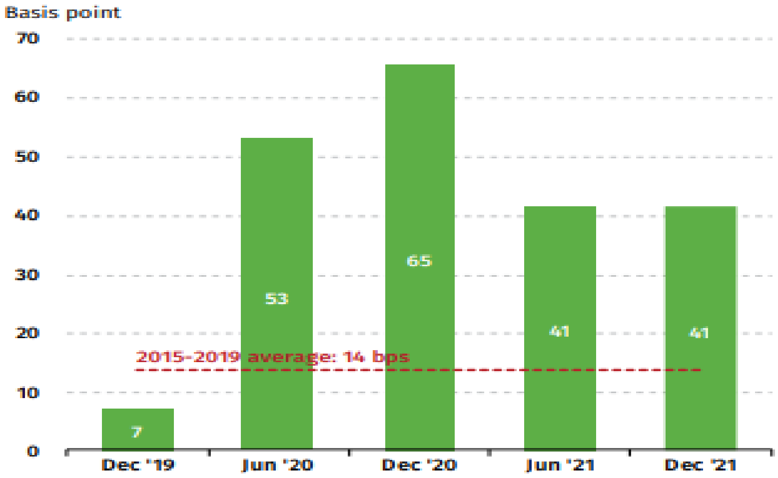
The Liquidity Coverage Ratio (LCR) of banks remained high at 154% (in MYR) and 162% (including all currencies) respectively.

External debt risk is low as banks continue to hold sizeable foreign currency (FCY) liquid assets. FCY liquid assets are sufficient to cover 3.5x FCY external debt-at-risk.

Into 2022, BNM expects banks to face some tightening in funding conditions. Monetary policy normalization in advanced economies could lead to outflows from emerging market economies such as Malaysia, and raise funding costs. Moreover, competition for deposits is expected to pick up as well as the increased preference for higher-yielding fixed deposits. These developments are expected to contribute to upward pressure on funding costs.

Banks remain cautious over credit risk and have built up sizeable provisions over time. Credit costs remained elevated at 41bps in 2021 versus 65bps in 2020. Management overlays represented 27.7% of total provisions as at 31 Dec 2021. The aggregate loan loss coverage ratio (including regulatory reserves) remained high at 142.5%.

Fig 5: Banking sector: Annualized credit costs



Source: BNM Financial Stability Report 2H21

Capitalization remained high for the banks, with an aggregate CET1 ratio of 15.2% end-Dec 2021.

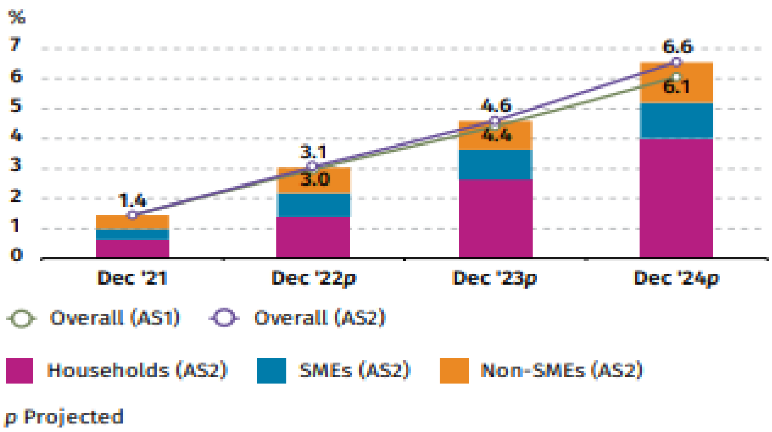
Stress testing the banking sector

In stress testing the banking system, BNM has assumed two adverse scenarios (AS).

AS1 – sharp contraction in GDP growth in the first year of stress with a magnitude close to 3 standard deviations below the average growth over the past two decades. The unemployment rate climbs to a peak of 6.9% in 2022. GDP growth makes a strong V-shaped recovery in 2023 and normalizes thereafter.

AS2 – sluggish and L-shaped economic recovery. GDP growth is negative in 2022 and 2023 with a cumulative decline of close to 3 standard deviations from the long-term average growth, before a subdued recovery begins in 2024. The unemployment rate peaks at 7.6% in 2023 and remains elevated throughout the stress test horizon, given severe scarring effects from the pandemic. Moreover, under both scenarios, bond yields are expected to remain elevated amid sovereign rating downgrades, with MGS yields assumed to rise by up to 120bps relative to pre-stress levels.

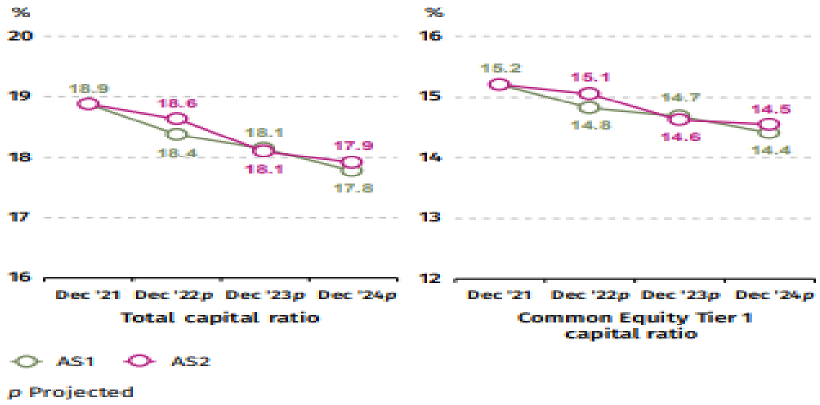
Fig 6: Macro stress test – impaired loans ratio under Adverse Scenarios 1 and 2



Source: BNM Financial Stability Report 2H21

The results show that the gross impaired loans ratio of the banking system would rise to 6.1% and 6.6% of total loans respectively under AS1 and AS2, with projected credit costs over the 3-year horizon amounting to MYR38.4b and MYR41.7b, or 1.8% and 2% of total loans, under AS1 and AS2 respectively. Aggregate banking system profits could decline by more than one third, driven by higher credit costs and lower net interest income as funding costs rise, coupled with revaluation losses on bond holdings. Nevertheless, capital ratios would remain comfortable, with CET1 ratios of 14.4% and 14.5% under AS1 and AS2 respectively, by 2024.

Fig 7: Macro stress test – impaired loans ratio under Adverse Scenarios 1 and 2



Source: BNM Financial Stability Report 2H21

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