

# Malaysia Banking

# POSITIVE

[Unchanged]

## The effect of rising interest rates

### Rising rates generally positive on earnings

Rate hikes should generally benefit banks' earnings and positively, the ROEs of most banks could return to over 10% in FY23 as a result. Additionally, we think that current MGS yields seem to already reflect future rate increases and thus future MTM losses are likely to be contained, if any at all. Moreover, we believe banks have sufficient provisions to buffer against potential asset quality issues arising from higher borrowing costs. We maintain a POSITIVE on the sector with BUYs on HLBK, RHB, AMMB, ABMB and HLFG.

### ROEs of most banks could rise above 10% in FY23

Our Economics Team expects BNM to hike the domestic Overnight Policy Rate (OPR) by 50bps in 2H22, taking the total rate hike to 75bps in 2022, with a further 50bps increase in 2023 to 3%. Our forecasts currently factor in just one 25bp rate hike in 2022. Our sensitivity analysis (Fig 4) imputes a further 25bp rate hike in 2H22 and a 50bp increase in FY23. On average, this is expected to result in a 1-3% increase in earnings this year and 2-5% earnings increase in 2023, with ABMB, AMMB and RHB being the key beneficiaries. ROEs are expected to expand by 0.2%-pts in FY22 and 0.3%-pts in FY23. Positively, most banks should see ROEs return to over 10% in FY23 as a result. Our forecasts are maintained for now.

### Rate hikes already reflected in MGS yields?

Marked-to-market (MTM) investment losses featured in 1Q22 and we expect them to feature in 2Q22 as well, as bond yields have continued to rise. For instance, the 3-year MGS yield currently averages 3.59% or 41bps higher QoQ while the 10-year MGS yield is 47bps higher at 4.34%. However, current MGS yields appear to have largely reflected the total OPR hikes that we are projecting of 75bps this year (including the rate hike in May) and 50bps in 2023. For instance, from 2018 to 2020, the 3-year MGS yields were on average 25bps higher than the OPR. This has since widened to about 140bps currently (Fig 5), as compared to the cumulative 125bps OPR hike that our Economics Team is forecasting into 2023. This would be positive for banks in that any MTM losses are likely to be minimal moving forward, if any at all.

### Sufficient provisions to buffer asset quality issues

We remain wary of a possible deterioration in asset quality as a result of the rise in borrowing costs. However, based on our sensitivity analysis (Fig 6), we find that current pre-emptive provisions and regulatory reserve levels are sufficient to cover up to a 20% default on current repayment assistance (RA) loans, when current defaults are less than 5%. As such, there is still much room for provisions to buffer against further asset quality deterioration arising from higher interest rates, if the need arises.

#### Banking Sector - Peer Valuation Summary

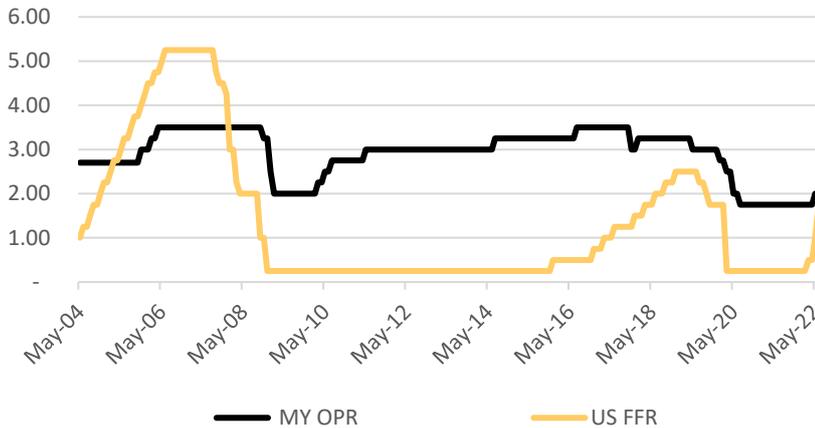
Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	PER (x) CY 22E	PER (x) CY 23E	P/B (x) CY 22E	P/B (x) CY 23E	ROAE (%) CY 22E	ROAE (%) CY 23E	Net yield CY 22E	Net yield CY 23E
Maybank *	NR	8.62	106,174	NR	13.3	11.4	1.2	1.2	8.9	10.2	6.5	7.5
Public Bank	HOLD	4.46	89,483	4.80	15.7	13.0	1.7	1.6	11.2	12.7	3.4	4.0
CIMB	HOLD	4.92	54,152	5.70	9.3	7.9	0.8	0.8	8.7	9.8	5.1	5.9
HL Bank	BUY	20.62	45,739	24.70	12.3	11.2	1.3	1.2	10.8	11.2	3.1	3.4
RHB Bank	BUY	5.71	23,822	7.10	9.6	8.1	0.8	0.8	8.6	9.8	5.2	6.2
HLFG	BUY	18.40	22,836	22.10	8.4	8.0	0.8	0.8	10.2	10.0	2.9	3.1
AMMB	BUY	3.81	12,395	4.37	8.6	7.9	0.6	0.6	8.4	8.0	3.1	3.8
BIMB	HOLD	2.68	6,293	3.00	12.2	10.1	0.9	0.8	7.2	8.3	3.3	3.9
ABMB	BUY	3.32	5,496	4.30	8.2	7.4	0.8	0.7	9.5	9.9	6.1	6.7
Simple avg			366,390		10.8	9.4	1.0	0.9	9.3	10.0	4.3	5.0
MC-wtd					12.4	10.6	1.2	1.1	9.7	10.7	4.6	5.4

\* Consensus estimates Source: Maybank IBG Research

## Further rate hikes ahead...

With the Federal Reserve (Fed) having raised the US Federal Funds Rate (FFR) by 75bps to 1.5-1.75% on 15 Jun 2022, the interest rate differential between Malaysia's Overnight Policy Rate (OPR), which currently stands at 2%, has narrowed to just 25bps, from as wide as 300bps in 2014/15.

**Fig 1: US Federal Funds Rate (FFR) versus Overnight Policy Rate (OPR)**



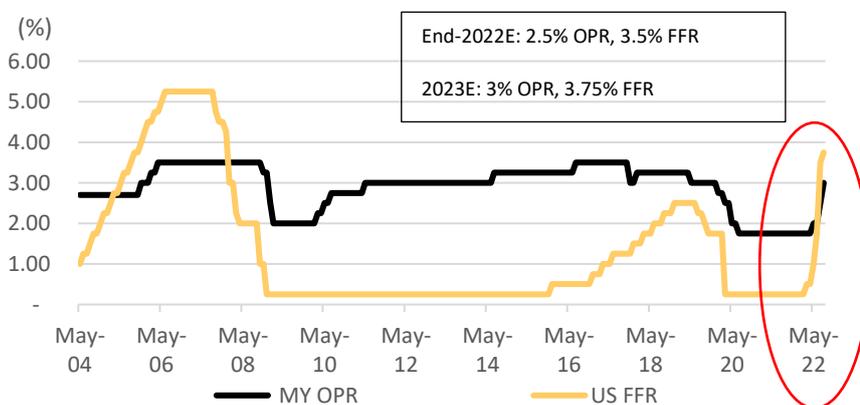
Source: Bloomberg, BNM

The Fed's latest "dot plot" signals another +175bps hikes over the remaining four FOMC meetings this year, with expectations that the current rate hike cycle ends in early 2023 at 3.75%. This implies a total of 200bps rate hikes between now and early 2023.

With this latest aggressive Fed move, our Economics Team now expects Bank Negara to hike the domestic Overnight Policy Rate (OPR) by another 25bps at the next Monetary Policy Committee (MPC) meeting on 5-6 July, with the prospect of another +25bps by end-2022. This would raise the OPR to 2.5% by end-2022 from 1.75% at the beginning of the year (taking into account the recent 25bp hike in May), this representing a cumulative 75bp rate hike in 2022. Our Economics Team projects a further 50bps OPR hike in 2023 to 3%.

What our internal projections would imply is that the FFR could be higher than the OPR by about 75bps in 2023. This would not be entirely out of the norm, for as Figure 2 shows, the FFR was higher than the OPR from Mar 2005 to Dec 2007, and by as much as 175bps for a period of time (Jun 2006 - Aug 2007).

**Fig 2: US Federal Funds Rate (FFR) versus Overnight Policy Rate (OPR)**



Source: Bloomberg, BNM, Maybank IBG Research

## Generally positive for banks' margins

Rate hikes generally have a positive short-term impact on banks' net interest margins (NIMs) through higher loan yields on variable rate loans and higher bond yields. Funding costs take, on average, about 3-6 months to normalize, this being the common duration of fixed deposits in the system.

Figure 3 below sets out the estimated impact to banks' NIMs from a 25bps OPR hike. Generally, it would result in an average 1-4bps improvement in NIMs, which in turn translates to roughly a 2-3% enhancement in earnings for every 25bps increase (Fig 4).

**Fig 3: Estimated positive impact to NIM from a 25bps OPR hike (bps chg)**

	bps		bps
ABMB	3-4	HL Bank	3-4
AMMB	2-3	Maybank	1-2
BIMB	2-3	Public Bank	2-3
CIMB	2-3	RHB	2-3

Source: Banks, Maybank IBG Research

## Impact to earnings

Given the expected staggered nature of hikes to the OPR throughout the year, coupled with the eventual upward adjustment to funding costs, we do not expect NIMs to increase in full to reflect the expected 75bp rate hike this year and 50bps in 2023.

Our present forecasts already impute the rate hike in May. Our sensitivity analysis below imputes a further 25bp rate hike in 2H22 and a 50bp increase in FY23. On average, this is expected to result in a 1-3% increase in earnings this year and 2-5% earnings increase in 2023. With ABMB, AMMB and RHB being the key beneficiaries. ROEs are expected to expand by 0.2%-pts in FY22 and 0.3%-pts in FY23. Positively, most banks should see ROEs of more than 10% in FY23 as a result of the expansion in NIM.

**Fig 4: Estimated impact of the OPR hikes on earnings**

	NIM chg		Net profit (before)		Net profit (after)		Net profit change		ROAE (before)		ROAE (after)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
ABMB <sup>^</sup>	0.04%	0.08%	645	707	662	742	3%	5%	9.7%	9.9%	9.9%	10.4%
AMMB <sup>^</sup>	0.03%	0.06%	1,393	1,485	1,431	1,562	3%	5%	8.0%	8.0%	8.2%	8.4%
BIMB	0.02%	0.04%	481	599	497	623	3%	4%	7.2%	8.3%	7.5%	8.6%
CIMB	0.02%	0.04%	5,278	6,271	5,368	6,472	2%	3%	8.7%	9.8%	8.9%	10.1%
HLBK#	0.04%	0.08%	3,690	3,858	3,751	4,002	2%	4%	11.3%	11.1%	11.5%	11.4%
MAY	0.02%	0.04%	7,820	9,350	7,912	9,612	1%	3%	8.9%	10.2%	9.1%	10.5%
PBK	0.02%	0.04%	5,532	6,659	5,599	6,817	1%	2%	11.2%	12.7%	11.3%	13.0%
RHB	0.03%	0.06%	2,452	2,919	2,507	3,073	2%	5%	8.6%	9.8%	8.8%	10.3%
	<b>0.03%</b>	<b>0.05%</b>	<b>27,290</b>	<b>31,849</b>	<b>27,727</b>	<b>32,903</b>	<b>2%</b>	<b>3%</b>	<b>9.2%</b>	<b>10.0%</b>	<b>9.4%</b>	<b>10.3%</b>

Source: Maybank IBG Research <sup>^</sup> FYE3/23 and FYE3/24 respectively

# FYE6/23 and FYE6/24 respectively

## Rate hikes already reflected in MGS yields?

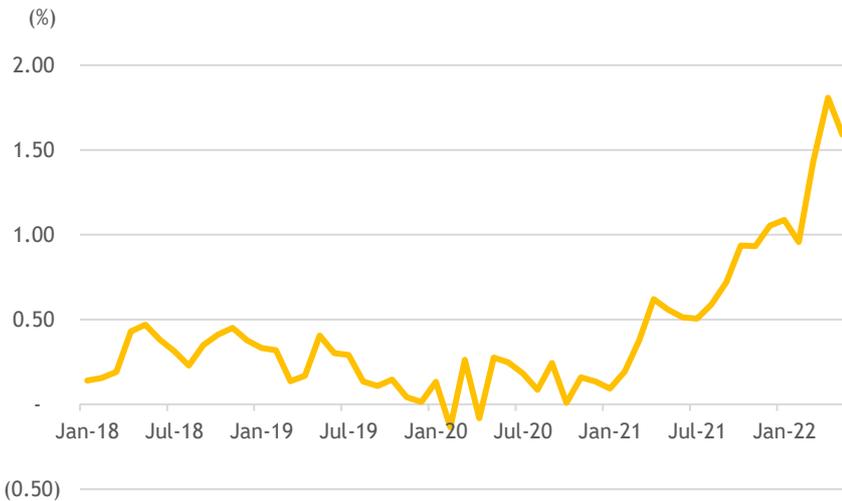
One concern that we have had this year is that of marked-to-market (MTM) losses arising from the marking to market of FVTPL (fair value to P&L) investments. This was one of the setbacks to earnings in 1Q22 as bond yields rose. For instance, the 3-year MGS yield averaged 38bps higher in March 2022 at 3.18% versus 2.8% in Dec 2021, while the 10-year MGS yield was 30bps higher.

MTM losses are expected to feature in 2Q22 as well, as bond yields have continued to rise. The 3-year MGS yield currently averages 3.59% or 41bps higher QoQ while the 10-year MGS yield is 47bps higher at 4.34%.

However, our Fixed Income analysts are of the view that current MGS yields largely reflect the OPR hikes that we are projecting of 75bps this year and 50bps in 2023. As such, they are cautiously bullish on bonds at this stage, with expectations that yields will move down from current levels in 2H22. This would be positive for banks in that any MTM losses are likely to be minimal moving forward, if any at all.

Figure 5 below depicts that differential between the 3-year MGS yield and the OPR. From 2018 to 2020, the 3-year MGS yields were on average 25bps higher than the OPR. This has since widened to about 140bps currently, which would largely reflect the cumulative 125bps OPR hike that our Economics Team is forecasting into 2023.

**Fig 5: Differential between 3-year MGS yield and the OPR (Jan 18 - Jun 22)**



Source: BNM, Maybank IBG Research

## Possible deterioration in asset quality?

Amid domestic inflationary pressures and a volatile external environment, the rise in interest rates could serve to further crimp domestic consumption, as borrowing costs rise. We remain wary therefore of a possible deterioration in asset quality as a result.

However, with banks having set aside pre-emptive provisions over the past two years, we believe that banks have set aside sufficient provisions to buffer against such an eventuality.

Based on our sensitivity analysis, we find that current pre-emptive provisions and regulatory reserve levels are sufficient to cover up to a 20% default on current repayment assistance (RA) loans, when current defaults are less than 5%. As such, there is still much room for provisions to buffer against further asset quality deterioration arising from higher interest rates, if the need arises.

Our sensitivity analysis below assumes:

- That total pre-emptive provisions set aside to date and remaining balances in regulatory reserves, go towards covering potential defaults on repayment assistance (RA) loans.
- A default rate of 20% and a loss given default (LGD) rate of 30%. We think a default rate of 20% on the entire RA book is reasonably prudent at this stage, in light of the re-opening of the economy. We also think that an LGD of 30% is comfortable, given that anecdotal evidence suggests it averages about 20% for consumer loans (bulk of such loans comprise mortgages) and about 40% for SME loans. These percentages will vary from bank to bank.

From the table below, it would appear that current provision levels are comfortable, especially since the percentage of loans under RA is likely to trend down further in the coming months. Loan loss coverage on potential RA defaults range from 102% for Maybank to 391% for HL Bank.

**Fig 6: Sensitivity analysis on the sufficiency of pre-emptive provisions**

(MYR'm)	ABMB	AMMB	CIMB	HLBK	MAY	PBK	RHB
Pre-emptive provisions	487	394	2,200	873	2,896	1,747	908
Regulatory reserves	48	103	301	560	1,667	177	363
<b>Total pre-emptive provisions</b>	<b>534</b>	<b>497</b>	<b>2,501</b>	<b>1,433</b>	<b>4,563</b>	<b>1,924</b>	<b>1,271</b>
Total RA loans	6,280	6,600	19,235	6,100	74,900	20,100	9,200
Total loans	46,189	119,993	384,721	162,494	562,047	362,732	201,348
% RA loans	14%	6%	5%	4%	13%	6%	5%
Assumed LGD	30%	30%	30%	30%	30%	30%	30%
Assumed default rate	20%	20%	20%	20%	20%	20%	20%
Loss on default	377	396	1,154	366	4,494	1,206	552
Loan loss coverage	142%	125%	217%	391%	102%	160%	230%

Source: Maybank IBG Research

## Historical trends in monetary policy

The table below summarizes the policy changes to the OPR and statutory reserve requirement (SRR) since 2005.

**Fig 7: Historical OPR and SRR changes**

<b>2005-06</b>	<b>OPR hike</b>	<b>OPR hike</b>	<b>OPR hike</b>	<b>Total impact</b>
	<b>(30 Nov '05)</b>	<b>(22 Feb '06)</b>	<b>(26 Apr '06)</b>	
OPR	3.00% (+30bps)	3.25% (+25bps)	3.50% (+25bps)	+80bps
SRR	4.00% (no chg)	4.00% (no chg)	4.00% (no chg)	no chg
<b>2008-09</b>	<b>OPR/SRR cut</b>	<b>OPR/SRR cut</b>	<b>OPR/SRR cut</b>	<b>Total impact</b>
	<b>(24 Nov '08)</b>	<b>(21 Jan '09)</b>	<b>(24 Feb '09)</b>	
OPR	3.25% (-25bps)	2.50% (-75bps)	2.00% (-50bps)	-150bps
SRR	3.50% (-50bps)	2.00% (-150bps)	1.00% (-100bps)	-300bps
<b>2010</b>	<b>OPR hike</b>	<b>OPR hike</b>	<b>OPR hike</b>	<b>Total impact</b>
	<b>(4 Mar '10)</b>	<b>(13 May '10)</b>	<b>(8 Jul '10)</b>	
OPR	2.25% (+25bps)	2.50% (+25bps)	2.75% (+25bps)	+75bps
SRR	1.00% (no chg)	1.00% (no chg)	1.00% (no chg)	no chg
<b>2011</b>	<b>SRR hike</b>	<b>OPR/SRR hike</b>	<b>SRR hike</b>	<b>Total impact</b>
	<b>(1 Apr '11)</b>	<b>(16 May '11)</b>	<b>(7 July '11)</b>	
OPR	2.75% (no chg)	3.00% (+25bps)	3.00% (no chg)	+25bps
SRR	2.00% (+100bps)	3.00% (+100bps)	4.00% (100bps)	+300bps
<b>2014-16</b>	<b>OPR hike</b>	<b>SRR cut</b>	<b>OPR cut</b>	<b>Total impact</b>
	<b>(10 Jul '14)</b>	<b>(21 Jan '16)</b>	<b>(13 Jul '16)</b>	
OPR	3.25% (+25bps)	3.25% (no chg)	3.00% (-25bps)	0 bps
SRR	4.00% (no chg)	3.50% (-50bps)	3.50% (no chg)	-50bps
<b>2018-19</b>	<b>OPR hike</b>	<b>OPR cut</b>	<b>SRR cut</b>	<b>Total impact</b>
	<b>(25 Jan '18)</b>	<b>(7 May '19)</b>	<b>(10 Nov '19)</b>	
OPR	3.25% (+25bps)	3.00% (-25bps)	3.00% (no chg)	-25bps
SRR	3.50% (no chg)	3.50% (no chg)	3.00% (-50 bps)	-50bps
<b>2020</b>	<b>OPR cut</b>	<b>OPR cut</b>	<b>SRR cut</b>	<b>Total impact</b>
	<b>(22 Jan '20)</b>	<b>(3 Mar '20)</b>	<b>(19 Mar '20)</b>	
OPR	2.75% (-25bps)	2.50% (-25bps)	2.50% (no chg)	-50bps
SRR	3.00% (no chg)	3.00% (no chg)	2.00% (-100bps)	-100bps
<b>2020-22</b>	<b>OPR cut</b>	<b>OPR cut</b>	<b>OPR hike</b>	<b>Total impact</b>
	<b>(5 May '20)</b>	<b>(7 Jul '20)</b>	<b>(11 May '22)</b>	
OPR	2.00% (-50bps)	1.75% (-25bps)	2.00% (+25bps)	-50bps
SRR	2.00% (no chg)	2.00% (no chg)	2.00% (no chg)	0 bps

Source: BNM, Maybank IBG Research

## Risk statement

**Upside risks:** (i) Stronger-than-expected GDP growth, which would contribute to stronger loan growth and lower credit risks; as well as (ii) improved liquidity, which would help to sustain interest margins.

**Downside risks:** (i) Weaker-than-expected GDP growth, which could lead to slower loan growth and asset- quality issues; (ii) potential interest rate cuts that could negatively impact interest margins in the short term; and (iii) a slowdown in CASA growth, which could exacerbate deposit competition.

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