

SECTOR UPDATE

Banking – Singapore

Monetary Policy Under The Fog Of War

Systemic risk is elevated but below the levels seen during past crises as Russia is not well integrated into the global financial system. Singapore banks' exposures to Europe and Russia are minimal. The Fed is expected to kick-start the interest rate upcycle with a hike of 25bp next week. We see strong support for DBS at S\$30.00 and for OCBC at S\$11.00. BUY DBS (Target: S\$35.80) and OCBC (Target: S\$15.10) for 2022 dividend yield of 4.5% and 4.9% respectively. Maintain OVERWEIGHT.

WHAT'S NEW

- Russia shocked the world by invading Ukraine.** Russian forces launched a full-scale invasion of Ukraine by land, air and sea on 24 Feb 22. Facing stiff resistance from Ukrainian forces, Russia has put its nuclear forces on special alert, risking an escalation to unconventional nuclear weapons. Western countries have imposed sanctions by freezing the assets of major Russian banks and its central bank and cutting selected Russian banks off from the SWIFT messaging system.
- Liquidity crisis contained within Russia.** Sanctions had a crippling impact on Russia's financial system with the Rouble losing 43% of its value ytd against the US Dollar. The Bank of Russia was forced to hike its key interest rate from 9.5% to 20% to defend the Rouble. The picture is vastly different outside of Russia. FRA-OIS spread, a measure of dollar funding stress, inched higher by 27bp ytd to 34bp. The deterioration is modest compared to previous crises, such as Europe's Sovereign Debt Crisis (peaked at 59bp in Dec 11) and the COVID-19 pandemic (peaked at 79bp in Mar 20). Financial markets are under stress but remain functional.
- Systemic risks under control.** Russia is not well integrated into the global financial system. Financial linkages with other countries have been reduced since the European Union first imposed sanctions after Russia annexed Crimea and Sevastopol in 2014. Foreign central banks have not tapped on swap lines and repo facilities established by the Fed, indicating most countries didn't experience dislocation in their financial systems.
- US an oasis far away from ongoing crisis.** The US economy created a substantial 678,000 jobs in Feb 22. The unemployment rate has improved 2.4ppt yoy to 3.8%, which is near pre-pandemic levels (troughed at 3.5% in Jan 20). We observed that labour force participation rate for those aged 55 and above has improved 0.9ppt yoy to 39.3%. Core PCE inflation remains elevated and reached 6.1% in Jan 22, the highest in four decades, even before accounting for the recent surge in energy prices caused by Russia's invasion of Ukraine. Implied inflation based on five-year Treasury Inflation-Protected Securities (TIPS) has deteriorated 0.6ppt ytd to 3.5% in Mar 22.
- The US is self-sufficient and would not be affected by the embargo on imports of crude oil and liquefied natural gas from Russia.**
- Monetary policy under the fog of war.** With conditions in the labour market having improved and higher inflation remaining a threat, the Fed is expected to kick-start the interest rate upcycle with a hike of 25bp during the upcoming FOMC meeting on 15-16 March. We expect a series of four hikes with the Fed Funds Rate reaching 1.0% by end-2022 (unchanged). We expect no hikes in 2023 (previous: four hikes).

PEER COMPARISON

Company	Ticker	Rec	Price @ 9 Mar 22 (S\$)	Target Price (S\$)	Market Cap (US\$m)	FY	PE		P/B		P/POP		Yield		ROE	
							2022F (x)	2023F (x)	2022F (x)	2023F (x)	2022F (x)	2023F (x)	2022F (%)	2023F (%)	2022F (%)	2023F (%)
DBS	DBS SP	BUY	32.26	35.80	60,925	12/2021	12.3	11.9	1.43	1.35	10.3	9.2	4.5	4.6	11.6	11.4
OCBC	OCBC SP	BUY	11.48	15.10	37,850	12/2021	10.4	9.5	0.96	0.91	9.2	8.5	4.9	5.2	9.2	9.7
UOB	UOB SP	NR	29.31	n.a.	35,966	12/2021	10.9	9.2	1.12	1.05	8.3	7.0	4.6	5.3	10.6	12.0
Average							11.2	10.2	1.17	1.11	9.3	8.2	4.6	5.0	10.5	11.0

* Based on consensus estimate

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

(Maintained)

TOP BUYS

Company	Rec	Share Price (S\$)	Target Price (S\$)
DBS	BUY	32.26	35.80
OCBC	BUY	11.48	15.10

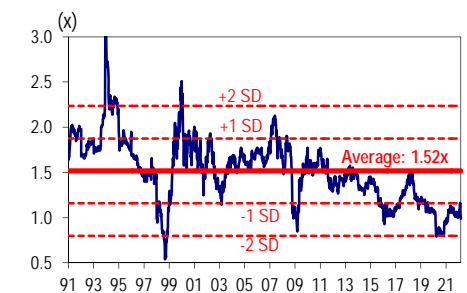
Source: UOB Kay Hian

P/B – DBS



Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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ACTION

- Europe not a core market.** Singapore banks' core markets are within Asia. They have established branches in London to serve their networks customers in Europe. They do not have branches in continental Europe, such as Paris and Frankfurt. Europe is a small part of the banks' operations. Singapore's three listed banks classify exposure to Europe under the "Rest of the World" category, which also includes their exposures to Australia, Canada, Japan and the US.
- Minimal direct exposure to Russia.** The authorities have banned financial institutions from entering into transactions or establishing business relationships with four Russian banks, namely VTB Bank, Vnesheconombank, Promsvyazbank and Bank Rossiya. Singapore banks are restricted from issuing letters of credit to finance trade in crude oil and liquefied natural gas from Russia. They have minimal direct exposure to Russia.

SINGAPORE BANKS' EXPOSURE TO "REST OR THE WORLD", WHICH INCLUDE EUROPE

	Total Income from "Rest of the World" (\$m)	% of Total Income	Total Assets from "Rest of the World" (\$m)	% of Total Assets
DBS	515	3.6	39,406	5.7
OCBC	367	3.5	30,083	5.5
UOB	903	9.2	45,919	10.0

Source: Respective Banks

- Heightened uncertainties but peace talks offer potential for rebound.** The average P/B in the month that P/B troughed during the past eight crises is tabulated below. Using the past three crises (Europe's Sovereign Debt Crisis, Crash in Oil & Gas and COVID-19 pandemic) as a gauge, the potential downside is 30-42% for DBS, 1-13% for OCBC and 15-22% for UOB. Direction for share prices of banks depends on the progress of peace talks to end the Russia-Ukraine war. We see opportunities for bargain hunting in current weakness. Technically, we see strong support for DBS at S\$30.00 and for OCBC at S\$11.00.

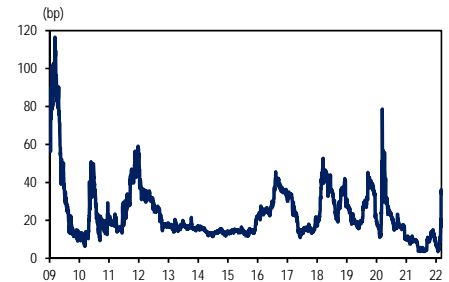
TROUGH P/B* DURING THE PAST EIGHT CRISES

Past Crises	DBS		OCBC		UOB	
	Trough P/B* (x)	Upside/Downside (%)	Trough P/B* (x)	Upside/Downside (%)	Trough P/B* (x)	Upside/Downside (%)
Sep-98 Asian Financial Crisis (AFC)	0.38	-73	0.57	-40	0.55	-51
May-00 Dotcom Crash	2.30	61	1.67	74	1.71	53
Sep-01 911 Terrorist Attack	1.24	-13	1.44	49	1.25	11
Apr-03 SARS Outbreak	0.91	-36	1.37	42	1.27	14
Mar-09 Global Financial Crisis (GFC)	0.75	-47	0.92	-5	0.99	-11
Oct-11 Europe's Sovereign Debt Crisis	1.00	-30	1.32	38	1.19	6
Feb-16 Crash In Oil & Gas	0.82	-42	0.95	-1	0.96	-15
Apr-20 COVID-19 Pandemic	0.96	-33	0.83	-13	0.88	-22
9-Mar-22 Current P/B	1.43	n.a.	0.96	n.a.	1.12	n.a.

Source: Bloomberg *Average for the month when P/B hit trough.

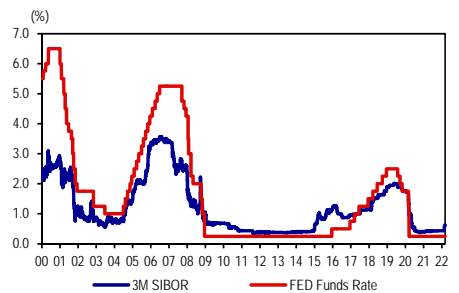
- Maintain OVERWEIGHT.** Russia's invasion of Ukraine is shocking. The ramifications for the global economy and outlook are immense and severe. The situation is still unfolding and it is uncertain if the ongoing peace talks would come to fruition.

FRA-OIS SPREAD



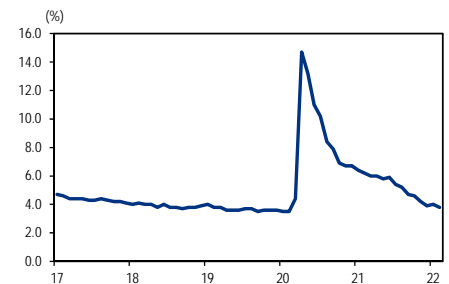
Source: Bloomberg

FED FUNDS RATE VS 3-MONTH SIBOR



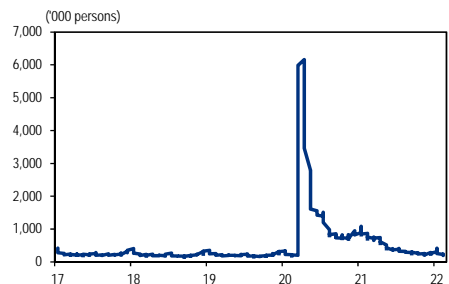
Source: Bloomberg

US UNEMPLOYMENT RATE



Source: CEIC

US WEEKLY JOBLESS CLAIMS: INITIAL



Source: CEIC

DBS (DBS SP/BUY/S\$32.26/Target: S\$35.80)

- We expect NIM to expand by 11bp to 1.55% in 2023 (previous: 1.61%). We cut our earnings forecast by 6% to S\$7,058m in 2023.
- We expect DPS of S\$1.44 in 2022 and S\$1.48 in 2023, which represent dividend payout ratios of 54.8% and 54.7% respectively. DBS provides dividend yield of 4.5% for 2022 and 4.6% for 2023.
- Our target price of S\$35.80 is based on 1.50x 2023F P/B, derived from Gordon Growth model (ROE: 11.6%, COE: 8.25% (previous: 8.0%), Growth: 1.5%).

KEY ASSUMPTIONS – DBS

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	4.2	9.9	4.5	8.9	6.6
NIM (%)	1.63	1.45	1.44	1.55	1.57
Fees, % Chg	0.2	15.2	4.5	14.5	9.3
NPL Ratio (%)	1.60	1.27	1.31	1.28	1.30
Credit Costs (bp)	79.7	1.3	5.3	20.4	20.2
Net Profit (S\$m)	4,721	6,805	6,860	7,058	7,817
% Chg	(26.1)	44.1	0.8	2.9	10.8

Source: UOB Kay Hian

OCBC (OCBC SP/BUY/S\$11.48/Target: S\$15.10)

- We expect NIM to expand by 9bp to 1.63% in 2023 (previous: 1.65%). We cut our earnings forecast by 2% to S\$5,460m in 2023.
- We expect DPS of S\$0.56 in 2022 and S\$0.60 in 2023, which represents dividend payout ratio of 50.6% and 49.4% respectively. OCBC provides dividend yield of 4.9% for 2022 and 5.2% for 2023.
- Our target price of S\$15.10 is based on 1.20x 2023F P/B, derived from the Gordon Growth model (ROE: 9.8%, COE: 8.25% (previous: 8.0%), Growth: 0.5%).

KEY ASSUMPTIONS – OCBC

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	0.6	8.6	4.4	6.3	6.8
NIM (%)	1.62	1.55	1.54	1.63	1.65
Fees, % Chg	(5.6)	12.0	3.4	8.3	8.3
NPL Ratio (%)	1.47	1.45	1.49	1.47	1.44
Credit Costs (bp)	76.7	31.3	23.1	23.2	23.7
Net Profit (S\$m)	3,588	4,858	4,981	5,460	5,828
% Chg	(26.3)	35.4	2.5	9.6	6.7

Source: UOB Kay Hian

SECTOR CATALYSTS

- The easing of COVID-19 restrictions and recovery in 2H22 after the economy has weathered the Omicron variant wave.
- Banks paying more dividends as risks emanating from COVID-19 pandemic recede.

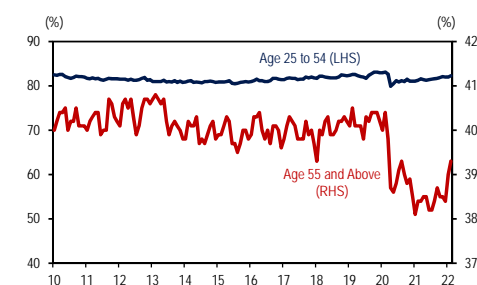
ASSUMPTION CHANGES

- As mentioned above.

RISKS

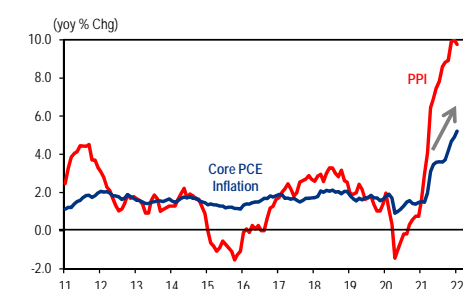
- Escalation of the Russia-Ukraine War beyond Ukraine.
- Geopolitical tensions and trade conflicts between the US, China and Russia.

US LABOUR FORCE PARTICIPATION RATE



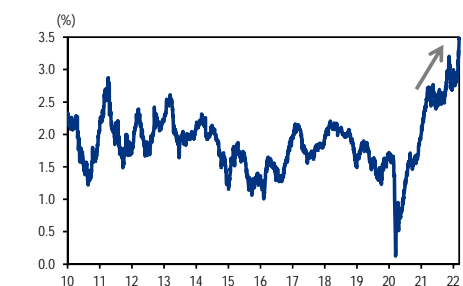
Source: CEIC

US CORE PCE INFLATION VS PPI



Source: CEIC

IMPLIED INFLATION BASED ON YIELD FOR 5-YEAR TIPS



Source: CEIC

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