SECTOR UPDATE

# Banking – Singapore

The First Strike At High And Persistent Inflation

**The Fed's dot plot indicates six hikes totalling 175bp for the remainder of this year, including one hike of 50bp. The plan to downsize the Fed's balance sheet will be unveiled during the next FOMC meeting on 3-4 May 22. Tighter monetary policy and higher interest rates are positive for banks. However, the outcome of the Russia-Ukraine war remains uncertain. BUY DBS (Target: S$38.15) and OCBC (Target: S$15.00) for 2022 dividend yield of 4.1% and 4.7% respectively. Maintain OVERWEIGHT.**

## WHAT'S NEW

- **Interest rate hikes front loaded in 2022.** The Federal Open market Committee (FOMC) has hiked the Fed Funds Rate by 25bp, bringing the target range to 0.25-0.5%. Based on projections submitted by FOMC participants, the Fed Funds Rate is expected to reach 1.9% by end-22 and 2.8% by end-23. This translates to about six hikes totalling 175bp in 2022 (one of the hike could be 50bp). The monetary tightening will tone down to just three hikes totalling 75bp in 2023. The Fed Funds Rate is projected to peak at 2.8%, which is much higher than previous expectations of 2.1%.

- **The next step is quantitative tightening.** The FOMC reaffirmed its intention to begin reducing its holdings of Treasury securities and agency mortgage-backed securities currently at US$9t. The Fed could allow Treasury securities and mortgage-backed securities to mature and run-off naturally. The move would drain liquidity from the financial system and could push long-term interest rates higher. The Fed could prioritise downsizing for its holding of mortgage-backed securities of US$2.6t at a faster pace, which could be achieved by selling them.

- The plan to reduce the size of the Fed's balance sheet is being finalised and will be announced during the next FOMC meeting on 3-4 May 22.

- **Priority on restoring price stability.** The Fed has adopted a more hawkish stance:

  a) The Fed does not want current elevated inflation to become entrenched. Core personal consumption expenditures (PCE) inflation has hit a 38-year high of 5.2% in Jan 22. FOMC participants expect Core PCE inflation to average 4.3% in 2022 as inflation is expected to moderate in 2H22 due to slower demand and easing of capacity constraints in supply chains and labour markets.

  b) The FOMC is confident of the resiliency of the US economy. GDP growth of 5.5% in 2021 was accompanied by massive fiscal stimulus. FOMC participants projected GDP growth of 2.8% in 2022, which is still fairly robust.

## ACTION

- **Systemic risks under control.** FRA-OIS spread, a measure of dollar funding stress, inched higher by 15bp ytd to 22bp. The deterioration is modest compared with 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). 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. Financial markets are under stress but remain functional.

## OVERWEIGHT

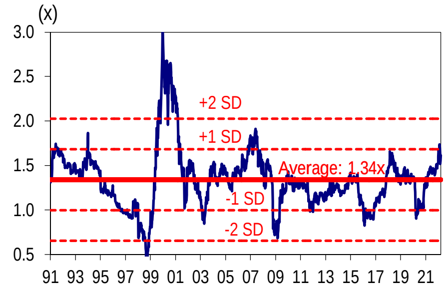
(Maintained)

### TOP BUYS

| Company | Rec | Share Price (S$) | Target Price (S$) |
|---|---|---|---|
| DBS | BUY | 34.76 | 38.15 |
| OCBC | BUY | 12.03 | 15.00 |

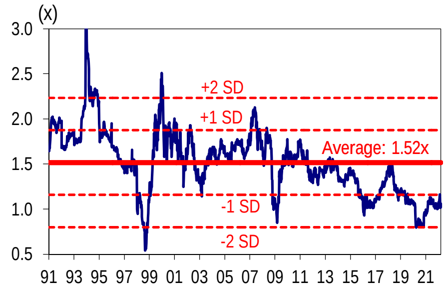
*Source: UOB Kay Hian*

### P/B – DBS



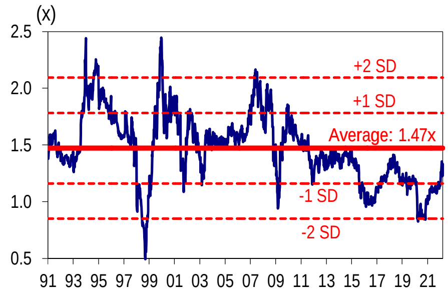

*Source: UOB Kay Hian*

### P/B – OCBC




*Source: UOB Kay Hian*

### P/B – UOB




*Source: UOB Kay Hian*

ANALYST(S)

**Jonathan Koh, CFA**
+65 6590 6620
jonathankoh@uobkayhian.com

### PEER COMPARISON

| | | | Price @ | Target | Market | | -------- PE -------- | | -------- P/B -------- | | ----- P/PPOP ----- | | ------- Yield ------- | | --------- ROE --------- | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | 18 Mar 22 | Price | Cap | | 2022F | 2023F | 2022F | 2023F | 2022F | 2023F | 2022F | 2023F | 2022F | 2023F |
| Company | Ticker | Rec | (S$) | (S$) | (US$m) | FY | (x) | (x) | (x) | (x) | (x) | (x) | (%) | (%) | (%) | (%) |
| DBS | DBS SP | BUY | 34.76 | 38.15 | 65,968 | 12/2021 | 13.0 | 11.8 | 1.53 | 1.44 | 10.9 | 9.2 | 4.1 | 4.3 | 11.8 | 12.3 |
| OCBC | OCBC SP | BUY | 12.03 | 15.00 | 39,853 | 12/2021 | 10.8 | 9.7 | 1.00 | 0.95 | 9.6 | 8.7 | 4.7 | 5.0 | 9.3 | 9.9 |
| UOB | UOB SP | NR | 32.07 | n.a. | 39,545 | 12/2021 | 11.9 | 9.9 | 1.23 | 1.15 | 9.3 | 7.8 | 4.2 | 4.8 | 10.6 | 12.0 |
| Average | | | | | | | 11.9 | 10.5 | 1.26 | 1.18 | 9.9 | 8.6 | 4.3 | 4.7 | 10.6 | 11.4 |

** Based on consensus estimate*

*Source: Bloomberg, UOB Kay Hian*

- **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 Singapore government has imposed sanctions on Russia. Financial institutions are banned 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 INCLUDES EUROPE

| | Total Income from "Rest of the World" (S$m) | % of Total Income | Total Assets from "Rest of the World" (S$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*

- **Russia-Ukraine war creates heightened uncertainties.** The Russia-Ukraine war poses a threat to economic recovery and exacerbates higher inflation. 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 35-46% for DBS, 5-17% for OCBC and 3-29% for UOB. The 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 Trough P/B* (x) | DBS Upside/ Downside (%) | OCBC Trough P/B* (x) | OCBC Upside/ Downside (%) | UOB Trough P/B* (x) | UOB Upside/ Downside (%) |
|---|---|---|---|---|---|---|---|
| Sep-98 | Asian Financial Crisis (AFC) | 0.38 | -75 | 0.57 | -43 | 0.55 | -56 |
| May-00 | Dotcom Crash | 2.30 | 50 | 1.67 | 67 | 1.71 | 39 |
| Sep-01 | 911 Terrorist Attack | 1.24 | -19 | 1.44 | 44 | 1.25 | 2 |
| Apr-03 | SARS Outbreak | 0.91 | -41 | 1.37 | 37 | 1.27 | 4 |
| Mar-09 | Global Financial Crisis (GFC) | 0.75 | -51 | 0.92 | -8 | 0.99 | -19 |
| Oct-11 | Europe's Sovereign Debt Crisis | 1.00 | -35 | 1.32 | 32 | 1.19 | -3 |
| Feb-16 | Crash In Oil & Gas | 0.82 | -46 | 0.95 | -5 | 0.96 | -22 |
| Apr-20 | COVID-19 Pandemic | 0.96 | -37 | 0.83 | -17 | 0.88 | -29 |
| 18-Mar-22 | Current P/B | 1.53 | n.a. | 1.00 | n.a. | 1.23 | n.a. |

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

- **Maintain OVERWEIGHT.** Tighter monetary policy and higher interest rates are positive for banks. We have factored in a series of seven hikes with the Fed Funds Rate reaching 2.0% by end-22 (previous: 1.0%). We did not factor in any hikes in 2023 (unchanged). BUY DBS (Target: S$38.15) and OCBC (Target: S$15.00) for 2022 dividend yield of 4.2% and 4.7% respectively.

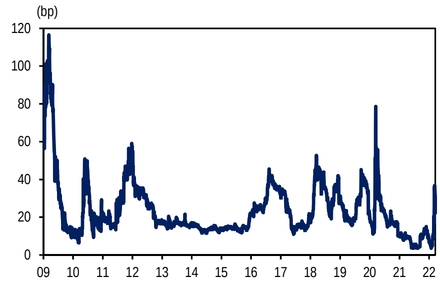
- **Russians persist with hostilities.** Russia's invasion of Ukraine has bogged down due to poor planning, inaccurate intelligence, faulty equipment and overstretched supply lines. The Ukrainians have posed stiff resistance and are continuously resupplied with ammunition from Western countries. The Russian also has to contend with crippling sanctions imposed by Western countries. Half of Russia's reserves of US$630b held at central banks around the world have been frozen. The Russian economy will suffer painful increases in unemployment and runaway inflation. Nevertheless, the Russians have regrouped for an assault on Kyiv.

- The situation is still unfolding and it is uncertain if the ongoing peace talk would come to fruition.

**DBS (DBS SP/BUY/S$34.76/Target: S$38.15)**

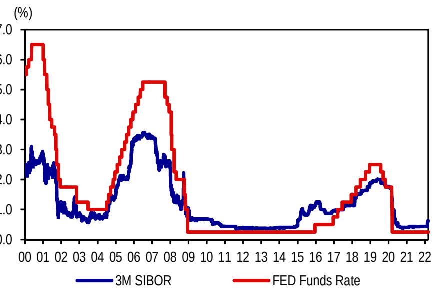
- We expect NIM to expand by 4bp to 1.49% in 2022 (previous: 1.44%) and 25bp to 1.73% in 2023 (previous: 1.55%). We raised our earnings forecast by 2% to S$6,996m for 2022 and by 9% to S$7,670m for 2023.

FRA-OIS SPREAD



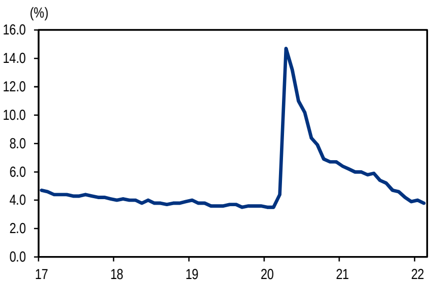

*Source: Bloomberg*

FED FUNDS RATE VS 3-MONTH SIBOR



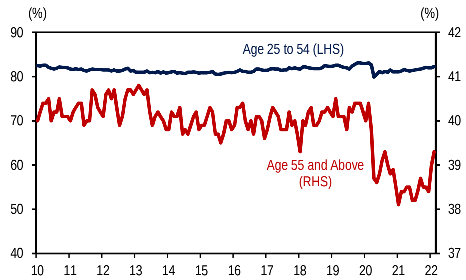

*Source: Bloomberg*

US UNEMPLOYMENT RATE



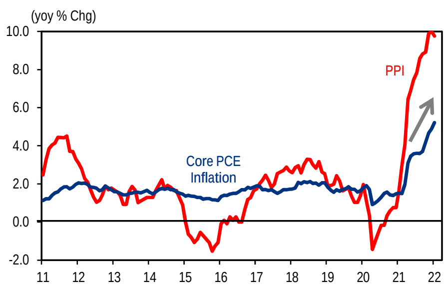

*Source: CEIC*

US LABOUR FORCE PARTICIPATION RATE




*Source: CEIC*

US CORE PCE INFLATION VS PPI




*Source: CEIC*

- We expect DPS of S$1.44 in 2022 and S$1.48 in 2023, which represents dividend payout ratio of 53.7% and 50.3% respectively. DBS provides dividend yield of 4.1% for 2022 and 4.3% for 2023.

- **Exposure to Mainland China.** DBS China currently has a network of 12 branches and 23 sub-branches in Mainland China. It has also invested Rmb5.3b (S$1.1b) to acquire a 13% stake and became the largest shareholder in Shenzhen Rural Commercial Bank (SZRCB) in Apr 21. Greater China (including Taiwan but excluding Hong Kong) accounted for 8.6% of total income in 2021 and 14.3% of total loans as of Dec 21. Loans denominated in Chinese Yuan accounted for 4.6% of total loans as of Dec 21.

- Our target price of S$38.15 is based on 1.58x 2023F P/B, derived from the Gordon Growth Model (ROE: 12.6%, COE: 8.5% (previous: 8.25%), 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 | 1.49 | 1.73 | 1.75 |
| 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 | 6,996 | 7,670 | 8,500 |
| % Chg | (26.1) | 44.1 | 2.8 | 9.6 | 10.8 |

*Source: UOB Kay Hian*

**OCBC (OCBC SP/BUY/S$12.03/Target: S$15.00)**

- We expect NIM to be unchanged at 1.55% in 2022 (previous: 1.54%) and expand 15bp to 1.70% in 2023 (previous: 1.63%). We raised our earnings forecast by 1% to S$5,011m for 2022 and by 3% to S$5,598m for 2023.

- We expect DPS of S$0.56 in 2022 and S$0.60 in 2023, which represents dividend payout ratio of 50.3% and 48.2% respectively. OCBC provides dividend yield of 4.7% for 2022 and 5.0% for 2023.

- **Exposure to Mainland China.** OCBC Wing Hang China currently has a network of 18 branches and sub-branches across 13 cities across Mainland China. It has a 20% stake in Bank of Ningbo worth S$9.7b in market value. Mainland China accounted for 11% of total loans (onshore: 2.4%, offshore: 8.6%) as of Dec 21. Loans denominated in Chinese Yuan accounted for 2.3% of total loans as of Dec 21.

- Our target price of S$15.00 is based on 1.19x 2023F P/B, derived from the Gordon Growth Model (ROE: 10.0%, COE: 8.5% (previous: 8.25%), 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 | 1.55 | 1.70 | 1.72 |
| 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 | 5,011 | 5,598 | 5,986 |
| % Chg | (26.3) | 35.4 | 3.2 | 11.7 | 6.9 |

*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 pay more dividends as risks emanating from the COVID-19 pandemic recede.

## ASSUMPTION CHANGES

- As per mentioned above.

## RISKS

- Escalation of the Russian-Ukraine war beyond Ukraine.

- Geopolitical tension and trade conflict between the US, China and Russia.

Disclosures/Disclaimers

This report is prepared by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser in Singapore.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

**This report is prepared for general circulation.** It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKH. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKH may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKH and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by UOBKH to be reliable. However, UOBKH makes no representation as to the accuracy or completeness of such sources or the Information and UOBKH accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKH and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKH and its connected persons are subject to change without notice. UOBKH reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKH, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKH, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKH may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business"); and (4) UOBKH may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

**IMPORTANT DISCLOSURES FOR U.S. PERSONS**

This research report was prepared by UOBKH, a company authorized, as noted above, to engage in securities activities in Singapore. UOBKH is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKH (whether directly or through its US registered broker dealer affiliate named below) to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). All US persons that receive this document by way of distribution from or which they regard as being from UOBKH by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc ("UOBKHUS"), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKH.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

**Analyst Certification/Regulation AC**

Each research analyst of UOBKH who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKH or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKH's total revenues, a portion of which are generated from UOBKH's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

| | |
|---|---|
| General | This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation. |
| Hong Kong | This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note:<br>(i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and<br>(ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law. |
| Indonesia | This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia ("OJK"). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report. |
| Malaysia | Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia. |
| Singapore | This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore.Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note:<br>(i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and<br>(ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law. |
| Thailand | This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand. |
| United Kingdom | This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients. |
| United States of America ('U.S.') | This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly. |



http://research.uobkayhian.com

RCB Regn. No. 197000447W