SECTOR UPDATE

Banking – Singapore

Step-up In Intensity Of Hawkishness

FOMC minutes and recent comments by Fed officials indicate that interest rate hikes are likely to be frontloaded in 2022, and quantitative tightening should commence in May 22. We expect the next two rate hikes to be 50bp each. The resilient labour market will help the US economy weather the tightened monetary policy and higher interest rates, which are positive for banks. BUY DBS (Target: S$39.55) and OCBC (Target: S$15.50) for their 2022 dividend yields of 4.1% and 4.6% respectively. Maintain OVERWEIGHT.

WHAT'S NEW

- **Fed officials clamouring for 50bp hikes.** Many Fed officials have voiced support for 50bp hikes during upcoming FOMC meetings as well as frontloading interest rate hikes in 2022. Vice Chair Lael Brainard has recently stressed that the Fed is prepared to take stronger action in raising interest rates as controlling inflation is of paramount importance. Mary Daly, President of San Francisco Fed, said that the case for a 50bp hike has grown. James Bullard, President of St Louis Fed, is the most hawkish and advocates moving the Fed Funds Rate above 3% by end-22.
- **Series of 50bp hikes in the making.** Many FOMC participants judged that it is appropriate to move monetary policy towards a neutral posture expeditiously, which could entail raising the Fed Funds Rate to about 2.5% by end-22. This implies successive hikes of 50bp during upcoming FOMC meetings on 3-4 May and 14-15 June.
- **The next step is quantitative tightening (QT).** The Fed will unveil its plan to reduce the size of its bloated balance sheet (that currently stands at US$9t) during the next FOMC meeting on 3-4 May 22. It would allow Treasury securities and agency mortgage-backed securities to mature and run-off naturally. FOMC participants have agreed to a monthly cap of US$95b, comprising US$60b for treasury securities and US$35b for mortgage-backed securities. The pace of QT is much faster compared to the monthly cap of US$50b for the last QT conducted in 2017-19. QT would drain liquidity from the financial system.
- **Mortgage refinancing already hit by tighter monetary policy.** The Fed will consider prioritising downsizing its holding of mortgage-backed securities of US$2.6t at an even faster pace, which could be achieved by outright sale. In future, the Fed's balance sheet would comprise primarily of treasury securities. Thus, interest rates for 30-year fixed mortgages have hit the highest level in three year at 4.8% recently.

ACTION

- **Acclimatising to heightened geopolitical tension.** Russia's invasion of Ukraine has been bogged down by tactical blunders, inaccurate intelligence, faulty equipment and overstretched supply lines. The Ukrainians have posed stiff resistance and are continuously resupplied with ammunition from Western countries. The attack on Kyiv has stalled and the risk of Ukraine's capital Kyiv being seized by Russians has abated. Russian forces have regrouped to concentrate on the breakaway Donbas region. The conflict could degenerate into a protracted stalemate as Russians deploy siege tactics in the new battleground of Eastern Ukraine.

OVERWEIGHT

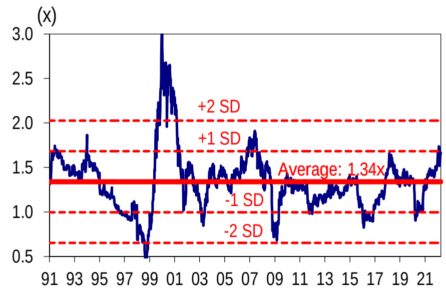
(Maintained)

TOP BUYS

Company	Rec	Share Price (S$)	Target Price (S$)
DBS	BUY	35.33	39.55
OCBC	BUY	12.26	15.50

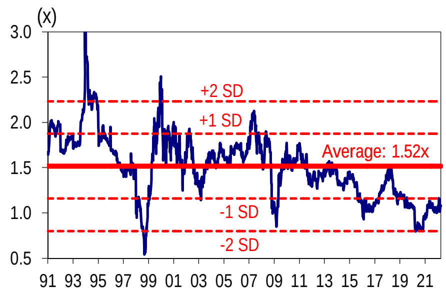
Source: UOB Kay Hian

P/B – DBS



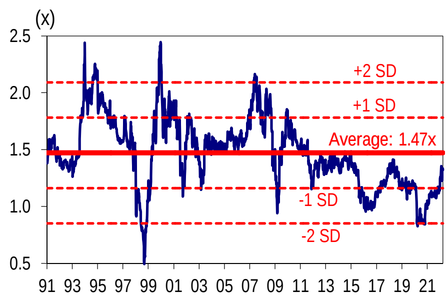
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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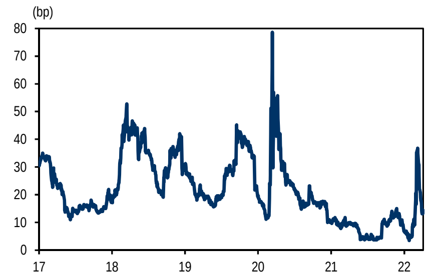
PEER COMPARISON

Company	Ticker	Rec	Price @ 6 Apr 22 (S$)	Target Price (S$)	Market Cap (US$m)	FY	-------- PE -------- 2022F (x)	2023F (x)	-------- P/B -------- 2022F (x)	2023F (x)	----- P/PPOP ----- 2022F (x)	2023F (x)	------- Yield ------- 2022F (%)	2023F (%)	--------- ROE --------- 2022F (%)	2023F (%)
DBS	DBS SP	BUY	35.33	39.55	66,807	12/2021	13.2	12.0	1.56	1.47	11.1	9.4	4.1	4.2	11.8	12.3
OCBC	OCBC SP	BUY	12.26	15.50	40,465	12/2021	11.0	9.8	1.02	0.97	9.8	8.8	4.6	4.9	9.3	9.9
UOB	UOB SP	NR	31.75	n.a.	39,007	12/2021	11.8	9.9	1.22	1.14	9.0	7.6	4.2	4.9	10.6	11.9
Average							12.0	10.6	1.27	1.19	10.0	8.6	4.3	4.7	10.6	11.4

** Based on consensus estimate*
Source: Bloomberg, UOB Kay Hian

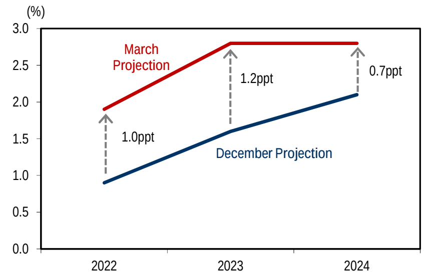
- **Systemic risk has eased.** FRA-OIS spread, a measure of dollar funding stress, hit a peak of 37bp in mid-March but has since subsided to the current 14bp. The level of systemic risk is modest compared with previous crises, such as Europe's Sovereign Debt Crisis (peaked at 59bp in Dec 11) and the 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. Russia and Ukraine accounted for just 2% of global GDP in aggregate in 2021. Thus, financial markets are under some stress but remain functional.
- **US labour market remains resilient.** The US economy added 431,000 jobs in Mar 22 as hotels, restaurants, retailers and manufacturers hired more workers. The unemployment rate dropped from 3.8% to 3.6%, which is near pre-pandemic levels and 50-year low of 3.5% in Feb 20. Increase in average hourly earnings remains robust at 5.5% yoy. Chairman Jerome Powell commented that the labour market is tight to an unhealthy extent.
- **The resilient labour market supports growth in domestic consumption.** It will help the economy to weather the series of interest rate hikes and generate sustained recovery.
- **Maintain OVERWEIGHT.** Tighter monetary policy and higher interest rates are positive for banks. The Russia-Ukraine war exacerbates higher inflation, which keeps bond yield higher for longer. BUY DBS (Target: S$39.55) and OCBC (Target: S$15.50) for their 2022 dividend yields of 4.1% and 4.6% respectively.

FRA-OIS SPREAD



Source: Bloomberg

FED'S DOT PLOT (MAR 22 VS DEC 21)



Source: Federal Reserve

DBS (DBS SP/BUY/S$35.33/Target: S$39.55)

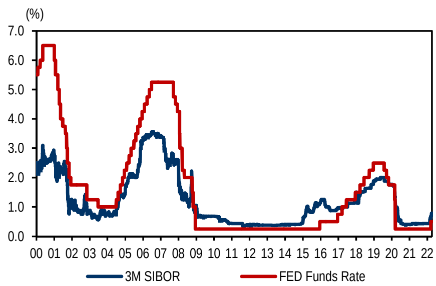
- We expect NIM to expand by 4bp to 1.49% in 2022 and 25bp to 1.73% in 2023. We forecast earnings growth of 9.6% in 2023 and 10.8% in 2024.
- We expect DPS of S$1.44 in 2022 and S$1.48 in 2023, which represents dividend payout ratios of 53.7% and 50.3% respectively. DBS provides dividend yield of 4.1% for 2022 and 4.2% for 2023.
- Our target price of S$39.55 is based on 1.64x 2023F P/B, derived from Gordon Growth model (ROE: 12.6%, COE: 8.25% (previous: 8.5%), 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

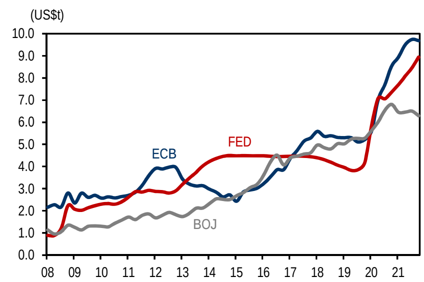
Source: UOB Kay Hian

FED FUNDS RATE VS 3-MONTH SIBOR



Source: Bloomberg

SIZE OF THE FED'S BALANCE SHEET

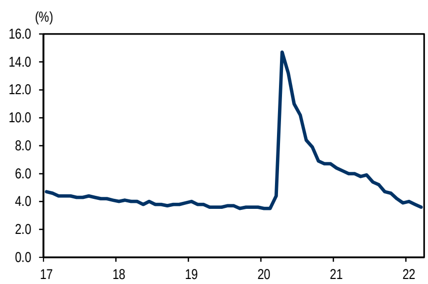


Source: CEIC

OCBC (OCBC SP/BUY/S$12.26/Target: S$15.50)

- We expect NIM to be unchanged at 1.55% in 2022 and expand 15bp to 1.70% in 2023. We forecast earnings growth of 11.7% in 2023 and 6.9% in 2024.
- 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 4.6% for 2022 and 4.9% for 2023.
- Our target price of S$15.50 is based on 1.22x 2023F P/B, derived from the Gordon growth model (ROE: 10.0%, COE: 8.25% (previous: 8.5%), growth: 0.5%).

US UNEMPLOYMENT RATE



Source: CEIC

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

- Economic recovery driven by reopening and easing of COVID-19 restrictions.
- Banks pay more dividends as risks emanating from COVID-19 pandemic recede.

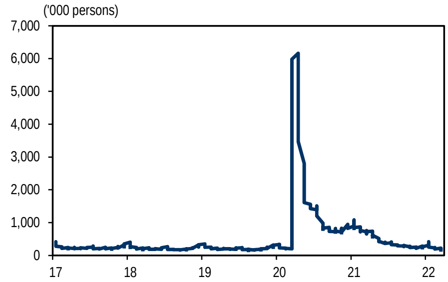
ASSUMPTION CHANGES

- As per mentioned above.

RISKS

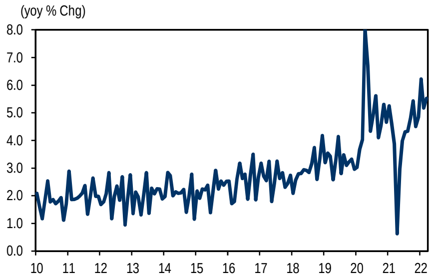
- Escalation of the Russia-Ukraine war beyond Ukraine.
- Geopolitical tension and trade conflict between the US, China and Russia.

US WEEKLY JOBLESS CLAIMS: INITIAL



Source: CEIC

US AVERAGE HOURLY EARNINGS, YOY % CHANGE



Source: CEIC

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