Singapore Industry Focus

Singapore Banks

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DBS Group Research . Equity

20 Jul 2023

What lies ahead as earnings peak?

- 2Q23 NIM expected to continue q-o-q decline across most banks even as fixed deposit rates start to decline
- Loan growth and fee income largely weak in a risk-off environment
- Asset quality remains benign, expect q-o-q 2Q23 net profit decline for OCBC and UOB
- Maintain HOLD ratings on OCBC and UOB as high dividend yields support share prices as earnings peak; Prefer Indonesia Banks as expected strong loan growth continues to support net interest income and earnings

2Q23 NIM expected to continue q-o-q decline across most banks even as fixed deposit rates start to decline. We believe further rate hikes will limit loan yields upside as DBS Group Research expects a final 25bps rate hike to take place in July, with competition for high quality loans on the rise. While fixed deposit rates had started to decline during 2Q23, the higher rates locked in will continue to weigh on 2Q23 NIMs.

Loan growth and fee income largely weak in a risk-off environment. With system loans in Singapore remaining flattish in the months since end-March 2023, we continue to expect muted loan growth from the Singapore Banks during 2Q23. We expect non-interest income to be mixed across banks as fee income may continue to see a drag from weak market sentiment, though strong customer-related treasury income should buffer overall non-interest income.

Asset quality benign in meantime, expect q-o-q 2Q23 net profit decline for OCBC and UOB. Asset quality across Singapore Banks remains benign in the meantime, and we remain comfortable with average LTVs of 40-60% for the banks' commercial real estate exposure. While credit costs and expenses are likely manageable for 2Q23, we expect q-o-q 1Q23 net profit decline for OCBC and UOB with weaker net interest income and mixed non-interest income

Maintain HOLD on OCBC and UOB as high dividend yields support share prices as earnings peak; Prefer Indonesia Banks as expected strong loan growth continues to support net interest income and earnings. We do not see any immediate catalysts on the horizon for Singapore Banks, although valuations of OCBC and UOB remain undemanding at c.0.95x FY24F P/BV. High dividend yields of c.5.8%, and strong provisions buffer continue to support share prices, limiting downside in the near term.

STI : 3,275.24

Analyst
Rui Wen LIM +65 66823720
ruiwenlim@dbs.com
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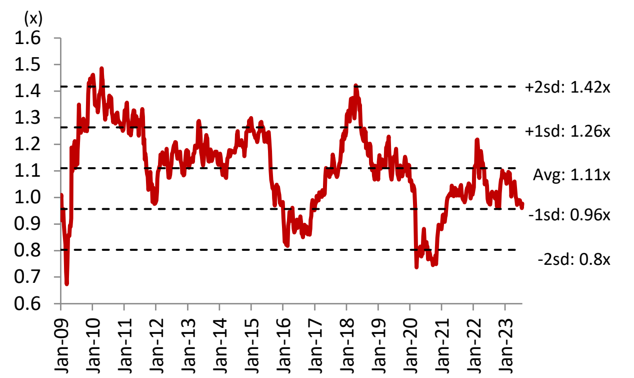
STOCKS

	Price	Mkt Cap	12-mth Target Price	Performance (%)		Rating
	S$	US$m	S$	3 mth	12 mth	
DBS	32.74	63,724	n.a	(0.6)	9.3	NR
OCBC Bank	12.67	42,971	13.00	(1.7)	11.7	HOLD
UOB	28.64	36,211	30.30	(4.9)	8.4	HOLD

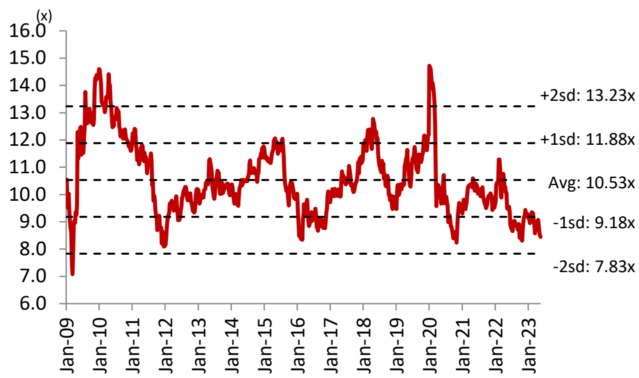
Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 19 Jul 2023

Singapore Banks: Forward P/BV



Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

Singapore Banks: Forward P/E



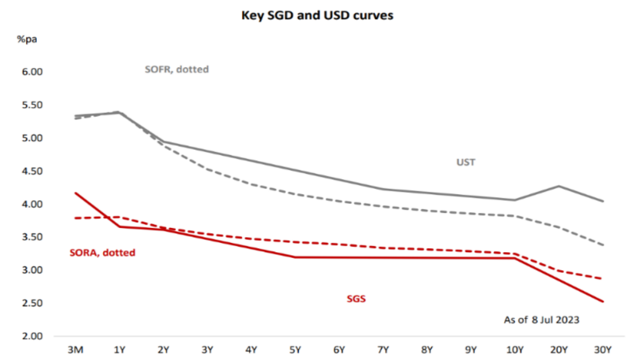
Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

ed: JS/ sa: DT, PY, CS

Further smaller rate hikes limit loan yields upside. As NIM started to decline during 1Q23, DBS/OCBC/UOB saw NIM movements of +7/-1/-8bps during 1Q23, compared to +15/+25/+27bps during 4Q22 to 2.12%/2.30%/2.14%. We believe further rate hikes will limit upside to loan yields as competition for high quality loans starts to rise, with Fed continuing to deliver smaller 25bps rate hikes during March and May 2023. DBS Group Research expects a further 25bps hike in July, taking the Fed Funds Rate to 5.25-5.50%, before signalling the end of the rate hike cycle.

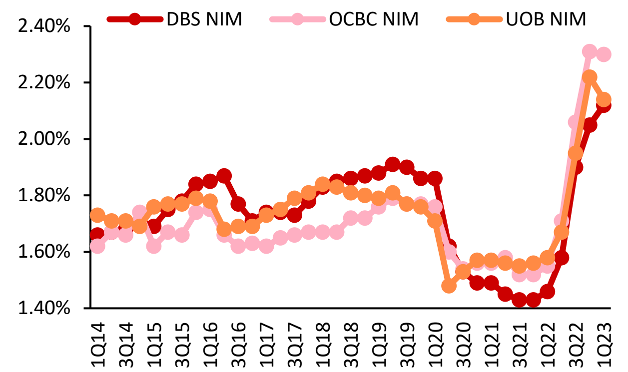
Cost of deposits to continue weighing on NIM even as fixed deposit rates start to decline. OCBC and UOB saw improvements in loan yields being offset by a larger magnitude of increase in deposit costs during 1Q23. We continue to expect a similar trend during 2Q23 even as fixed deposit rates have already peaked and are on a sequential decline as it takes time for the expensive fixed deposits to be flushed out. Hence, we expect 2Q23 NIM to continue to decline q-o-q across most banks, as the NIM expansion cycle ends.

Key interest rate curves



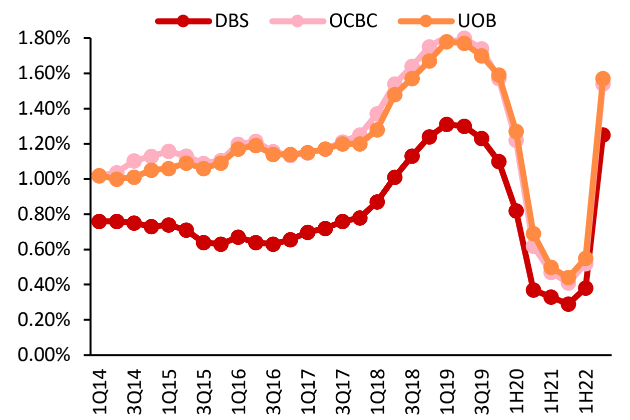
Source: Bloomberg Finance L.P., DBS Bank

Singapore Banks: Net interest margins



Source: Companies, DBS Bank

Singapore Banks: Cost of funds



Source: Companies, DBS Bank

Singapore Banks: Fixed deposit rates

2022	Dec	Jan 2023	Feb	Mar	Apr	May	Jun
DBS	3.20% (12mth)	3.20% (12mth)	4.88% (3mth)	3.20% (12mth)	3.20% (12mth	3.20% (12mth)	3.20% (12mth)
OCBC	3.40% (12mth)	3.88% (8mth)	4.08% (8mth)	3.55% (5mth)	3.40% (6mth)	3.30% (6mth)	2.70% (6 mth)
UOB	3.85% (6mth)	3.85% (6mth)	3.55% (6mth)	3.55% (6mth)	3.55% (6mth)	3.20% (6mth)	2.90% (6mth)

Source: Companies, DBS Bank

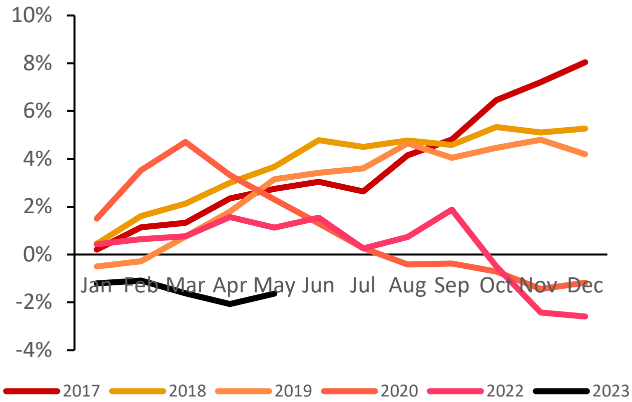
Singapore Banks: CASA ratio

	1Q23	4Q22	3Q22	2Q22	1Q22
DBS	57.1%	60.3%	65.7%	72.3%	75.5%
OCBC	47.1%	51.8%	56.1%	60.9%	62.7%
UOB	47.9%	47.5%	49.8%	54.7%	55.9%

Source: Companies, DBS Bank

Loan growth continues to be muted across the industry. As of 1Q23, DBS/OCBC/UOB recorded loan growth of +1%/flat/-1% q-o-q. Year-to-date (end-May 2023) since end-Dec 2022, loans in Singapore had declined by 1.6%, while being flat in the two months after end-Mar 2023. Given the ongoing macroeconomic uncertainty and loan repayments being made amidst high interest rates, we believe loan growth will continue to be muted across Singapore Banks. Banks had started to downgrade loan growth guidance during 1Q23 (DBS loan growth guidance downgraded to 3-5% from mid-single digit, OCBC and UOB downgraded to low-to-mid single digit from mid-single digit).

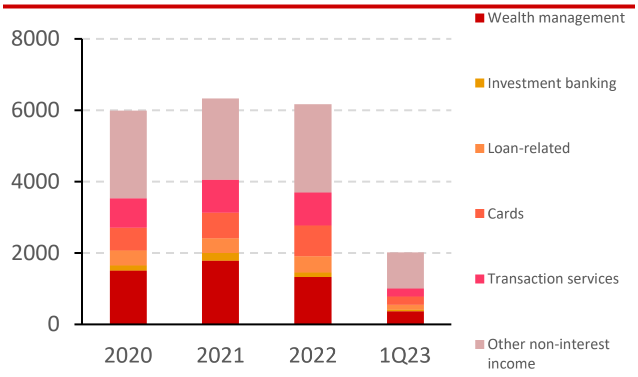
Singapore Banks: Loan growth y-o-y



Source: MAS, DBS Bank

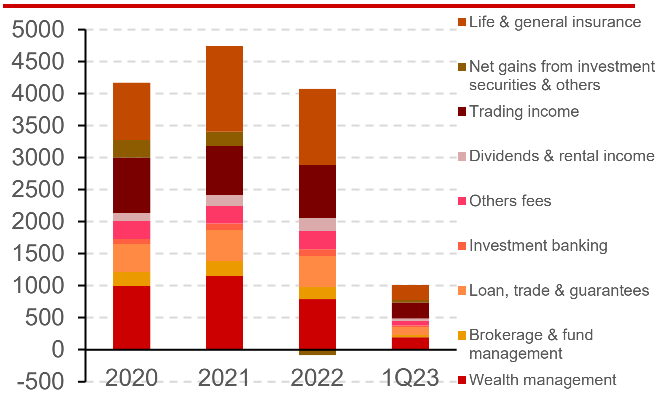
Non-interest income likely mixed across banks. We expect non-interest income to be mixed across banks as fee income may continue to see a drag from weak market sentiment, though strong customer-related treasury income should buffer overall non-interest income. During 1Q23, fee income across DBS/OCBC/UOB saw broad-based growth of +21/+14/+14% q-o-q from 4Q22's seasonal low, largely driven by stronger wealth fees but still short from pre-COVID levels (-1/-13/-3% y-o-y). We believe the uncertainty in market outlook and Fed trajectory continues to limit improvements for wealth activities.

DBS: Non-interest income (1Q23)



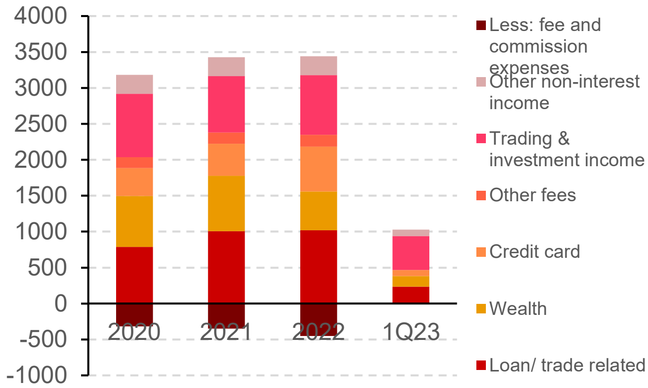
Source: DBS Bank

OCBC: Non-interest income (1Q23)



Source: Company, DBS Bank

UOB: Non-interest income (1Q23)



Source: Company, DBS Bank

Concerns over asset quality risks abound; asset quality benign in the meantime. As of 2Q23, DBS' exposure to offices in developed markets accounted for c.4% of its total commercial real estate portfolio. For OCBC, the exposure was c.10% of its real estate loan book/3% of total loan book, but mainly for network customers. For UOB, ex-SG and HK book developed markets accounted for c.7% of real estate book/2% of total loan book. There continues to be concerns over asset quality risks of Singapore Banks, particularly for Commercial Real Estate segment, though average LTV across the banks remains healthy at 40-60%. We look towards a normalization in overall credit costs in FY23F: OCBC guided for 15-20bps (FY22A: 16bps), UOB increased guidance from 20bps during 4Q22 to 20-25bps during 1Q23.

Singapore Banks: Asset quality (1Q23)

	DBS	OCBC	UOB
NPL ratio	1.1% (4Q22: 1.1%)	1.1% (4Q22: 1.2%)	1.6% (4Q22: 1.6%)
Allowances on loans charged to P&L (S$m)	161	110	192
Total credit costs (bps)	16	12	25
(Total allowances + RLAR)/NPA	127%	121%	96%

Source: Companies, DBS Bank

Singapore Banks: Peer comparison

	Mkt cap (US$m)	Price (S$/s)	12-mth TP (S$/s)	Rating	PE (x) FY22A	FY23F	FY24F	CAGR^ (%)	PBV (x) FY22A	FY23F	FY24F	ROE (%) FY23F	Net div (%) FY23F
DBS	63,724	32.74	NA	NR	10.3x	8.7x	8.7x	20%	1.5x	1.4x	1.3x	16.8%	5.3%
OCBC	42,971	12.67	13.00	HOLD	9.7x	8.6x	8.4x	15%	1.1x	1.0x	0.9x	11.9%	5.9%
UOB	36,211	28.64	30.30	HOLD	10.2x	8.6x	8.2x	15%	1.1x	1.0x	1.0x	12.2%	5.8%
Simple average					10.1x	8.6x	8.4x		1.2x	1.1x	1.1x	13.6%	5.7%
Weighted average					10.1x	8.6x	8.5x		1.2x	1.2x	1.1x	14.2%	5.6%

*^ Refers to 2-year EPS CAGR for FY21-23F *Based on Bloomberg consensus*
**Based on Bloomberg consensus*

Source: Companies, Bloomberg Finance L.P., DBS Bank

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**Share price appreciation + dividends*

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DBS Regional Research Offices

HONG KONG
DBS (Hong Kong) Ltd
Contact: Dennis Lam
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

SINGAPORE
DBS Bank Ltd
Contact: Paul Yong
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
e-mail: groupresearch@dbs.com
Company Regn. No. 196800306E

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: indonesiaresearch@dbs.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
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