

SECTOR UPDATE

Banking – Singapore

The Interest Rate Cycle Has Reversed Course

Based on the dot plot, the Fed Funds Rate is expected to ease 75bp in 2024 and 100bp in 2025. The interest rate downcycle is facilitated by a decline in inflation as supply-side distortions are normalised. The interest rate downcycle has negative impact on Singapore banks' NIM and net interest income. Downgrade to **MARKET WEIGHT**. Our top **BUY** is OCBC (Target: S\$16.85) for its new dividend policy with payout ratio at 50%, focus on ASEAN and defensively low P/B of 1.06x.

WHAT'S NEW

- **The interest rate cycle has reversed course.** The Fed paused rate hike for the third consecutive FOMC meeting on 13 Dec 23. We expect the Fed to commence rate cuts in 2H24. Based on the dot plot, the median projected path for Fed Funds Rate is 4.6% by end-24 (previous: 5.1%) and 3.6% by end-25 (previous: 3.9%), indicating rate cuts of 75bp in 2024 and 100bp in 2025. The dovish bias can be seen from the downward shift in the dot plot by 50bp in 2004 and 30bp in 2025.
- **Not if but when.** The FOMC has started to deliberate on the appropriate timing for rate cuts. Fed officials do not want to cause unintended harm to the economy by keeping interest rates too high for too long when inflation is falling. All three categories, namely manufactured goods, housing services and core services, are contributing to lower inflation. Chair Jerome Powell also confirmed that the Fed would not wait until PCE inflation returns to 2% before cutting interest rates.
- **Inflation has turned the corner.** US core PCE inflation peaked at 5.6% in Feb 22, the fastest pace in 30 years. Core PCE inflation eased 1.9ppt yoy to 3.2% in Nov 23. Sequential momentum has also moderated to 0.1% mom. Based on economic projections provided by FOMC members as of Dec 23, the US economy is expected to expand by 1.4% and core PCE inflation to recede to 2.4% in 2024, which reflect continued economic expansion and a likely soft landing.
- **COVID-19-induced supply-side distortions have normalised.** The Global Supply Chain Pressure Index devised by the Federal Reserve Bank of New York indicates that supply chains have fully normalised to pre-pandemic efficiency since 1Q23, which coincide with China's reopening after abandoning the zero-COVID policy. Overheated US labour market has started to cool. US labour force participation rate for those aged 25 to 54 has improved 1.0ppt ytd to 83.5% in Nov 23, moving above pre-pandemic levels. Thus, average hourly earnings eased slightly to 4.0% yoy in Nov 23 (peak: 6.3%).
- **Asset quality - withstood test from COVID-19 pandemic.** The three Singapore banks have weathered the COVID-19 pandemic with NPL ratio deteriorating on average by just 0.1ppt. DBS' and OCBC's NPL ratios have slipped 0.2ppt to a similar 1.1% over the past three quarters. Banks have ample management overlays for general provisions amounting to about S\$2,200m for DBS, S\$1,000m for OCBC and S\$1,000m for UOB.
- **Capital adequacy - among the safest in the world.** OCBC has the highest CET-1 CAR at 15.9% as of Mar 23, followed by DBS at 14.4%, far exceeding the minimum requirement of 9%. DBS is ranked 12th safest on a worldwide basis by Global Finance, followed by OCBC at 13th. Within Asia, the three Singapore banks are recognised as the top 3 safest ahead of banks in South Korea, Taiwan and Hong Kong.

PEER COMPARISON

Company	Ticker	Rec	Price @	Target	Market	FY	PE		P/B		P/POP		Yield		ROE	
			29 Dec 23	Price	Cap		2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
			(S\$)	(S\$)	(US\$m)		(x)	(x)	(x)	(x)	(x)	(x)	(%)	(%)	(%)	(%)
DBS	DBS SP	BUY	33.41	41.65	65,275	12/2022	8.6	9.1	1.35	1.26	7.2	7.6	5.7	5.7	15.6	13.8
OCBC	OCBC SP	BUY	13.00	16.85	44,258	12/2022	8.4	8.8	1.06	1.00	7.3	7.6	6.2	6.2	12.7	11.5
UOB#	UOB SP	NR	28.45	n.a.	36,043	12/2022	8.1	7.9	1.01	0.95	6.0	5.8	6.3	6.4	12.9	12.5
Average							8.4	8.6	1.14	1.07	6.8	7.0	6.1	6.1	13.7	12.6

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

MARKET WEIGHT

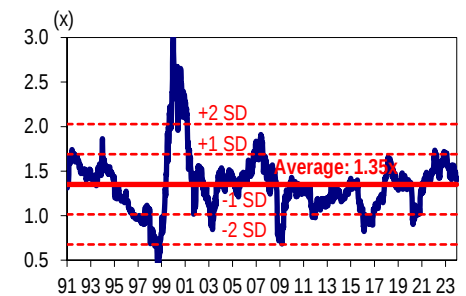
(Downgraded)

TOP BUYS

Company	Rec	Share Price (S\$)	Target Price (S\$)
DBS	BUY	33.41	41.65
OCBC	BUY	13.00	16.85

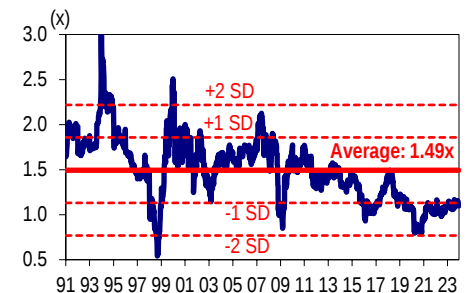
Source: UOB Kay Hian

P/B – DBS



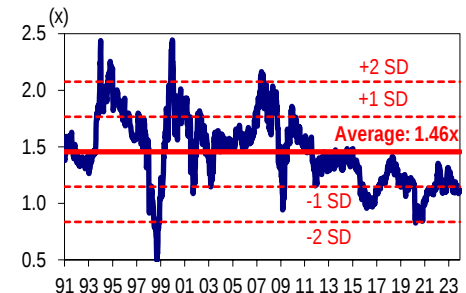
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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ACTION

- **Downgrade to MARKET WEIGHT.** The anticipated interest rate down-cycle has a negative impact on Singapore banks. Rate cuts are expected to result in NIM compression and lower net interest income in 2H24 and 2025. Valuations are undemanding with Singapore banks trading at low P/B of 1.14x, low PE of 8.4x and attractive dividend yield of 6.1% for 2024.

Oversea-Chinese Banking Corp (BUY/Target: S\$16.85).

- Out top pick is OCBC due to its commitment to maintain dividend payout ratio at 50%, consistency in delivering growth in quarterly earnings, focus on trade and investment flows within ASEAN and defensively low 2024F P/B of 1.06x. It has the highest CET-1 CAR of 14.8% and lowest NPL ratio of 1.0% as of Sep 23.

DBS Group Holdings (BUY/Target: S\$41.65).

- We also like DBS for its excellence in execution and consistently delivering good results. Management estimated surplus capital at S\$3b or S\$1.20 per share based on optimal operating range for CET-1 CAR of 12.5-13.5%. DBS could consider potential capital management exercise to return surplus capital to shareholders over three years given that Final Basel III Reforms are already finalised and would be implemented starting 1 Jul 24.

PROJECTED DPS AND DIVIDEND PAYOUT RATIOS

	DBS			OCBC			UOB#		
Price (S\$)	33.41			13.00			28.45		
Year to 31 Dec	FY23	FY24F	FY25F	FY23	FY24F	FY25F	FY23	FY24F	FY25F
EPS (S ¢)	397	387	366	155	154	148	342	352	361
DPS (S ¢)	186	192	192	80	80	80	172	179	181
Payout Ratio (%)	46.9	49.7	52.4	51.7	51.9	54.1	50.4	50.9	50.1
Dividend Yield (%)	5.6	5.7	5.7	6.2	6.2	6.2	6.1	6.3	6.4

Based on consensus estimate

Source: UOB Kay Hian

ASSUMPTION CHANGES

- We forecast DBS' NIM to narrow 8bp in 2024 and 25bp in 2025. We expect net interest income to increase 1.8% in 2024 but decline 8.0% in 2025. We forecast earnings decline of 5.2% in 2025. The interest rate down-cycle reduces 2025 ROE by 3.7ppt to 14.2% compared with its recent peak (2023: 17.9%).

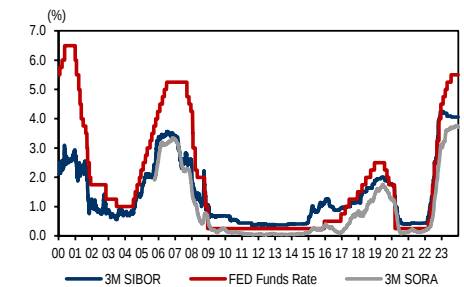
KEY ASSUMPTIONS - DBS

	2021	2022	2023F	2024F	2025F
Loan Growth (%)	9.9	1.3	2.4	4.9	4.9
NIM (%)	1.45	1.75	2.16	2.08	1.83
Fees, % Chg	15.2	(12.3)	11.4	16.2	7.7
NPL Ratio (%)	1.27	1.13	1.18	1.24	1.26
Credit Costs (bp)	0.6	5.4	14.6	20.1	20.1
Net Profit (S\$m)	6,802	8,196	10,124	9,942	9,421
% Chg	44.1	20.5	23.5	(1.8)	(5.2)

Source: UOB Kay Hian

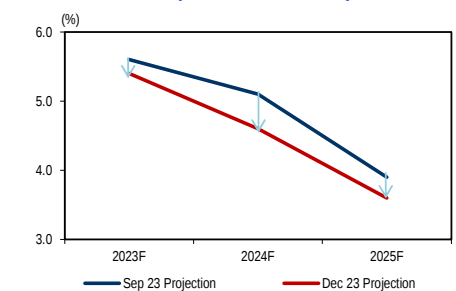
- We forecast OCBC's to NIM narrow 8bp in 2024 and 22bp in 2025. We expect net interest income to increase 0.5% in 2024 but decline 5.9% in 2025. We forecast earnings decline of 4.1% in 2025. The interest rate down-cycle reduces 2025 ROE by 1.7ppt to 11.7% compared with its recent peak (2023: 13.5%).

US FED FUNDS RATE VS 3M SIBOR AND 3M SORA



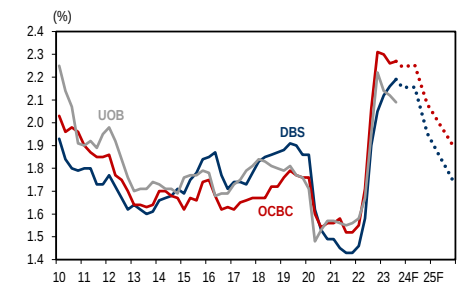
Source: Bloomberg

FED'S DOT PLOT (DEC 23 VS SEP 23)



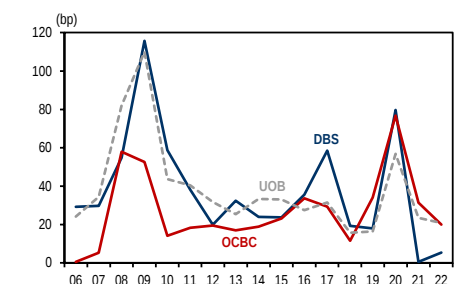
Source: Bloomberg

NET INTEREST MARGIN (NIM)



Source: Respective banks

CREDIT COSTS



Source: Respective banks

KEY ASSUMPTIONS – OCBC

	2021	2022	2023F	2024F	2025F
Loan Growth (%)	8.6	1.8	1.5	3.4	4.9
NIM (%)	1.55	1.91	2.27	2.19	1.97
Fees, % Chg	12.0	(17.6)	(0.5)	13.7	7.6
NPL Ratio (%)	1.45	1.15	1.03	1.07	1.09
Credit Costs (bp)	31.3	20.0	23.9	22.3	23.3
Net Profit (\$m)	4,858	5,748	7,020	6,998	6,712
% Chg	35.4	18.3	22.1	(0.3)	(4.1)

Source: UOB Kay Hian

SECTOR CATALYSTS

- Soft landing paving the way for continued economic growth.
- Banks reviewing their dividend policy and capital management.

RISKS

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

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