

SECTOR UPDATE

Banking – Singapore

Rate Cuts Coming But Not Too Much

We anticipate one rate cut in 4Q24 (previous: three rate cuts) and four rate cuts in 2025 (unchanged), bringing the Fed Funds Rate to 4.00% by end-25. Rate cuts are less pronounced due to sticky inflation. The last mile for the deceleration of inflation is drawn-out due to tight labour markets. Maintain OVERWEIGHT. We raise our 2025 earnings forecasts for DBS by 1.5% and OCBC by 1.3%. DBS and OCBC provide 2025 dividend yields of 6.7% and 6.2% respectively. BUY OCBC (Target: S\$18.35), followed by DBS (Target: S\$41.40).

WHAT'S NEW

- The front-runners in cutting rates.** Swiss National Bank cut its main policy rate by 25bp to 1.5% in Mar 24. Bank of Canada lowered its overnight rate by 25bp to 4.75% in Jun 24, the first G-7 country to cut interest rates. European Central Bank cut the interest rate on its main refinancing operations by 25bp to 4.25% in Jun 24. Unfortunately, the Fed is not able to follow suit in the near term.
- The Fed adopting wait-and-see approach for rate cuts.** The Fed paused rate hikes for the seventh consecutive FOMC meeting on 12 Jun 24. The median projected path for Fed funds rate is 5.1% by end-24 and 4.1% by end-25, indicating rate cuts of 25bp in 2H24 (previous: 75bp) and 100bp in 2025 (previous: 75bp). We expect the Fed to commence rate cuts in 4Q24. The Fed can afford to be patient before making the first decisive rate cut given the current resilient economic growth and strong labour market.
- Inflation has "stabilised".** US core PCE inflation peaked at 5.6% in Feb 22, the fastest pace in 30 years. Core PCE inflation eased 2.1ppt yoy to 2.8% in May 24 but remains above the target of 2%. Sequential momentum moderated to 0.4% mom. Inflation for housing and utilities & public transportation remains elevated. Inflation is expected to moderate at a slow and gradual pace in 2H24.
- US labour market remains too tight.** The US economy added 272,000 jobs and unemployment rate was low at 4.0% in May 24. Labour force participation rate for those aged 25 to 54 improved 0.3ppt yoy to 83.6% in May 24, remaining above pre-pandemic levels. Average hourly earnings eased slightly to 4.0% yoy in May 24.
- Higher for potentially longer time frame.** Ben Bernanke & Oliver Blanchard published a paper entitled "An Analysis of Pandemic-Era Inflation in 11 Economies" in May 24. They observed that labour market tightness has become a more important source of inflation during the last mile to get inflation under control. The Fed may need to loosen labour market conditions to achieve its inflation target. They suggested that vacancy-employment ratio needs to fall below 1.2x to get inflation down to 2%.
- The Fed began tapering the pace of Quantitative Tightening.** The Fed is tapering the pace of reduction for its holdings of Treasury securities from US\$60b to US\$25b per month with effect from Jun 24. The pace of reduction for agency mortgage-backed securities remains unchanged at US\$35b per month. The move could reduce volatility in treasury markets. The Fed has already reduced the size of its balance sheet by US\$1.5t as of Mar 24.

PEER COMPARISON

Company	Ticker	Rec	Price @	Target	Market	FY	PE		P/B		P/POP		Yield		ROE	
			26 Jun 24	Price	Cap		2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
			(\$)	(\$)	(US\$m)		(x)	(x)	(x)	(x)	(x)	(x)	(%)	(%)	(%)	(%)
DBS	DBS SP	BUY	35.69	41.40	74,861	12/2023	9.4	9.7	1.61	1.52	8.0	8.1	6.2	6.7	16.8	15.5
OCBC	OCBC SP	BUY	14.40	18.35	47,731	12/2023	8.9	9.0	1.15	1.08	7.7	7.8	6.0	6.2	13.2	12.3
UOB#	UOB SP	NR	31.03	n.a.	38,304	12/2023	8.7	8.5	1.10	1.03	6.5	6.3	5.8	5.9	12.9	12.6
Average							9.0	9.1	1.28	1.21	7.4	7.4	6.0	6.3	14.3	13.5

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

OVERWEIGHT

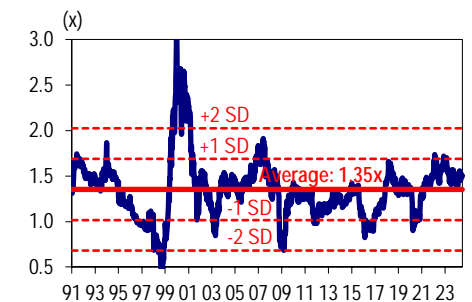
(Maintained)

SECTOR PICKS

Company	Rec	Share Price (\$)	Target Price (\$)
DBS	BUY	35.69	41.40
OCBC	BUY	14.40	18.35

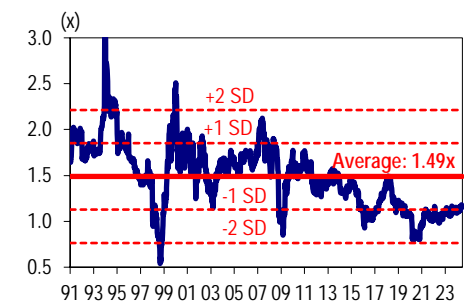
Source: UOB Kay Hian

P/B – DBS



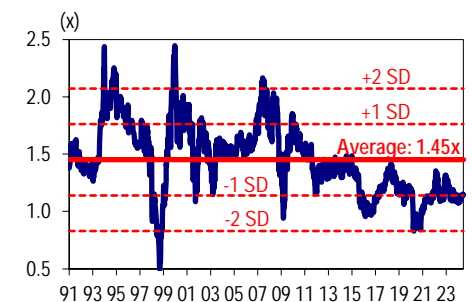
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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ESSENTIALS

• **Maintain OVERWEIGHT.** Banks provide attractive value with low P/B of 1.21x and high dividend yield of 6.3% for 2025. Our top BUY pick is OCBC (Target: S\$18.35) for its commitment to maintaining dividend payout ratio at 50%, focus on trade and investment flows within ASEAN and defensively low 2025F P/B of 1.08x. We also like DBS (Target: S\$41.40) due to its excellence in execution and consistency in delivering good results. Management will continue to review DBS' capital structure in view of returning more surplus capital to investors.

**DBS Group Holdings (BUY/Target: S\$41.40).**

• **High payout ratio supported by high ROE.** 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 will continue to review its capital structure to return surplus capital to shareholders. We expect DBS to raise quarterly DPS by 6 S cents to 60 S cents in 4Q24, representing an increase of 11%. The elevated payout ratio of 65% for 2025 is supported by its high ROE of 15.9%.

• **Maintaining high ROE.** CEO Piyush Gupta has voiced confidence that DBS could achieve ROE of 15-17% over the next 3-5 years assuming Fed funds rate recedes to a new normal of 3%. Management expects growth to be driven by wealth management and global transaction services regionally. DBS has obtained regulatory approvals to increase its stake in Shenzhen Rural Commercial Bank from 13.0% to 16.7% in Dec 23. Management will also allocate S\$300m-500m to expand the consumer and SME businesses in India.

• **Maintain BUY.** Our target price for DBS of S\$41.40 (previous: S\$40.70) is based on 1.77x 2025F P/B, derived from the Gordon Growth Model (ROE: 15.9%, COE: 9.0%, Growth: 0.0%).

**Oversea-Chinese Banking Corp (BUY/Target: S\$18.35).**

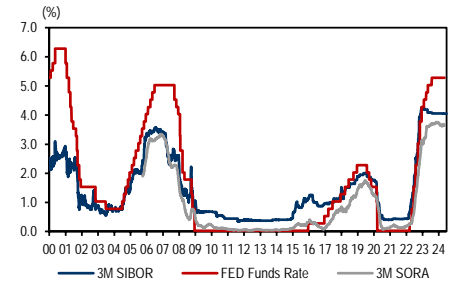
• **Strategic initiatives to deliver incremental S\$3b revenue.** Management aims to deliver incremental revenue of S\$3b cumulatively over 2023-25, driven by four growth pillars: a) Asian wealth, b) trade and investment flows, c) new economy, and d) sustainable financing. Management aims to deliver ROE of 12-13% with additional contribution of 1ppt from the incremental revenue of S\$3b. OCBC has the highest CET-1 CAR of 16.2% and lowest NPL ratio of 1.0% as of Mar 24.

• **Potential upside from higher regular dividend.** We expect OCBC to raise final dividend by 2 S cents to 44 S cents in 2H24, representing an increase of 5%.

• **Potential redevelopment of OCBC Centre.** OCBC has engaged a consultant to identify potential partners to execute the redevelopment of its properties at Chulia Street, comprising OCBC Centre (50 storeys), OCBC Centre South (seven storeys) and OCBC Centre East (15 storeys). The three properties sit on 120,000sf of prime land at Raffles Place with quadruple frontages on Chulia Street/South Canal Road, Synagogue Street, Church Street and Phillip Street. According to Business Times, the properties could be redeveloped into an integrated development with retail, office and hospitality components and could qualify for the Strategic Development Incentive scheme.

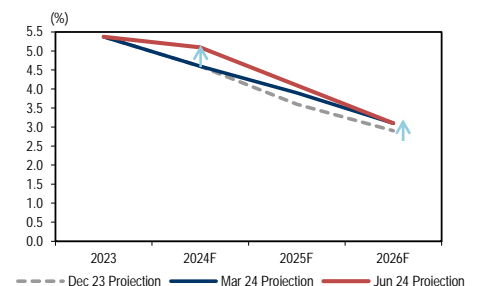
• **Maintain BUY.** Our target price for OCBC of S\$18.35 (previous: S\$18.10) is based on 1.38x 2025F P/B, derived from the Gordon Growth Model (ROE: 12.4%, COE: 9.0%, growth: 0.0%).

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



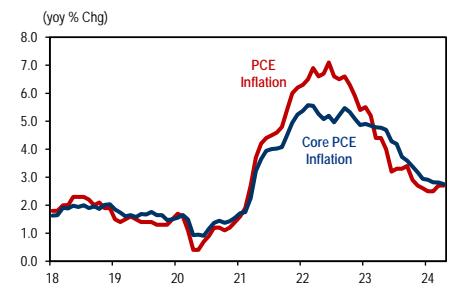
Source: Bloomberg

FED'S DOT PLOT



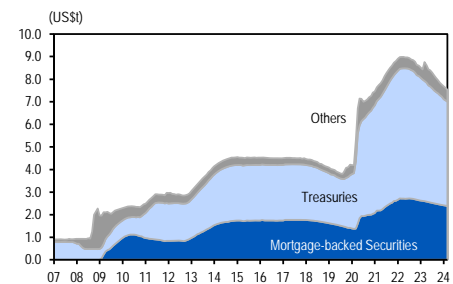
Source: Bloomberg

PCE AND CORE PCE INFLATION



Source: CEIC

SIZE OF FED'S BALANCE SHEET



Source: Federal Reserve

### PROJECTED DPS AND DIVIDEND PAYOUT RATIOS

	DBS			OCBC			UOB#		
	FY23	FY24F	FY25F	FY23	FY24F	FY25F	FY23	FY24F	FY25F
Price (S\$)	35.69			14.40			31.03		
Year to 31 Dec									
EPS (S c)	399	380	369	155	163	162	334	357	367
DPS (S c)	192	222	240	82	86	89	170	179	184
Payout Ratio (%)	48.1	58.5	65.1	53.0	52.7	55.1	50.9	50.1	50.2
Div Yield (%)	5.4	6.2	6.7	5.7	6.0	6.2	5.5	5.8	5.9

# Based on consensus estimate

Source: UOB Kay Hian

### ASSUMPTION CHANGES

- We anticipate one rate cut in 4Q24 (previous: three cuts) and four rate cuts in 2025 (unchanged), bringing the Fed Funds rate to 4.00% by end-25.
- We forecast DBS' NIM to narrow 8bp and net interest income to increase 0.8% in 2025. We forecast earnings to decrease 3.0% in 2025. The lower interest rates would reduce 2025 ROE by 1.8ppt to 15.9% compared with its recent peak (2023: 17.7%). We raise 2025 earnings forecast for DBS by 1.5%.

### KEY ASSUMPTIONS – DBS

	2022	2023	2024F	2025F	2026F
Loan Growth (%)	1.3	0.4	5.6	4.9	4.9
NIM (%)	1.75	2.15	2.13	2.05	2.03
Fees, % Chg	(12.3)	9.5	17.1	5.6	7.7
NPL Ratio (%)	1.13	1.11	1.17	1.20	1.21
Credit Costs (bp)	5.4	13.7	18.3	20.1	20.1
Net Profit (S\$m)	8,196	10,062	10,683	10,357	10,724
% Chg	20.5	22.8	6.2	(3.0)	3.5

Source: UOB Kay Hian

- We forecast OCBC's NIM to narrow 6bp and net interest income to increase 1.6% in 2025. We forecast earnings to decrease 1.2% in 2025. The lower interest rates would reduce 2025 ROE by 0.9ppt to 12.4% compared with its recent peak (2023: 13.3%). We raise 2025 earnings forecast for OCBC by 1.3%.

### KEY ASSUMPTIONS – OCBC

	2022	2023	2024F	2025F	2026F
Loan Growth (%)	1.8	0.4	3.4	4.9	4.9
NIM (%)	1.91	2.28	2.25	2.19	2.17
Fees, % Chg	(17.6)	(2.5)	12.4	7.4	7.4
NPL Ratio (%)	1.15	0.95	1.00	1.02	1.03
Credit Costs (bp)	20.0	24.8	22.2	22.1	22.1
Net Profit (S\$m)	5,748	7,021	7,371	7,283	7,568
% Chg	18.3	22.2	5.0	(1.2)	3.9

Source: UOB Kay Hian

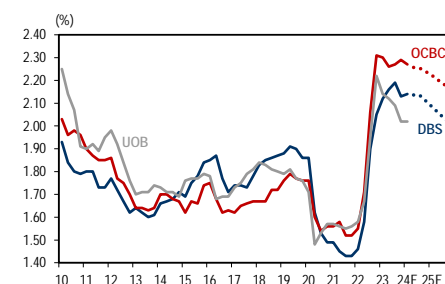
### SECTOR CATALYSTS

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

### RISKS

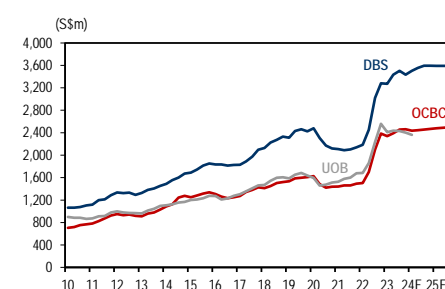
- Escalation of the Russia-Ukraine war and Israel-Hamas war.
- Geopolitical tensions and trade conflicts between the US, EU and China.

### NET INTEREST MARGIN (NIM)



Source: Respective banks, UOB Kay Hian

### NET INTEREST INCOME



Source: Respective banks, UOB Kay Hian

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