SECTOR UPDATE

Banking – Malaysia

1H22 Financial Stability Report: Optimistic Of A Recovery

BNM has released its 1H22 financial stability report. Despite inflationary pressure on businesses and households, BNM remains optimistic that banks are still expected to register improving profitability trends. Even in a simulated severe shock scenario, the banking system's CET1 ratio remains well above the minimum requirements. Maintain OVERWEIGHT given attractive valuations and earnings recovery.

WHAT'S NEW

- **BNM remains optimistic of banking sector recovery despite headwinds.** Despite pockets of macroeconomic headwinds on businesses (rising input costs and labour shortages) and households (higher cost of living and rising interest rates), Bank Negara Malaysia (BNM) indicated that businesses, including SMEs, have continued to display improving asset quality trends while households have shown strong resilience, partly underpinned by banks' prudent underwriting standards. As such, BNM remains optimistic of a continued improvement in the provision trend. In addition, BNM indicated that banks have set aside sufficient pre-emptive provisions for borrowers who require further extension of repayment assistance into 2023.

- **Modest potential increase in GIL ratio from higher interest rates and cost of living.** While higher interest rates and costs of living could result in higher loan defaults for some borrowers, BNM believes that any potential increase in overall impairments is expected to be modest given normalisation of economic activities and improving labour market.

- **BNM's stressed scenario GIL ratio of 5.8%.** In BNM's severe shock scenario, the banking system's GIL ratio is only expected to increase from the current 1.84% to 5.80% (household GIL ratio: 5.7%, Non-SME: 7.0% and SME: 6.9%). Key assumptions include MGS yields rising to a two-decade high and a USD/MYR exchange rate that is even worse than during the peak of the Asian Financial Crisis (AFC). However, such a scenario is unlikely to occur and our base case assumption is for system GIL ratio to potentially peak at 2.0%-2.2% while we estimate that banks have on average set aside pre-emptive provision to cover potential peak system GIL ratio of 2.6%-2.8%.

ACTION

- **Maintain OVERWEIGHT.** We remain positive on the sector. This is premised on: a) sector valuation of -1.0SD nearing average crisis trough of -1.5SD, b) earnings resilience sustained by potential positive NIM surprise as we remain at the early to mid-stages of the overnight policy rate (OPR) hike cycle, c) comfortable pre-emptive provisions provides some buffer against any deterioration in asset quality on inflationary pressures, and d) attractive 2022/23 dividend yields of 4.8%/5.4%.

- **Top picks.** In the larger-cap space, we like Public Bank given its high provision buffers which provide earnings resilience and potential scope for provision write-backs in 2023. In the smaller-cap space, we like Alliance Bank given its attractive valuations and it being the prime beneficiary of an interest rate hike cycle.

OVERWEIGHT

(Maintained)

TOP SECTOR PICKS

Company	Rec	Target Price (RM)	Share Price (RM)
Public Bank	BUY	4.85	4.25
Alliance Bank	BUY	4.50	3.62

Source: UOB Kay Hian

KLFIN INDEX OUTPEFORMED FBMKLCI IN RATE HIKE CYCLE

Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US$m)	PE (x) 2021	PE (x) 2022F	PE (x) 2023F	ROE 2022F (%)	P/B 2022F (x)	Div 2022F (sen)	Div Yield (%)
Maybank	MAY MK	BUY	8.70	9.45	22,503	12.1	11.9	10.2	9.5	1.1	55.0	6.3
Public Bank	PBK MK	BUY	4.25	4.85	17,817	13.4	14.4	12.1	11.9	1.6	14.7	3.5
CIMB Group	CIMB MK	BUY	5.26	6.30	11,899	12.3	10.2	8.1	8.1	0.8	25.9	4.9
HL Bank	HLBK MK	BUY	20.70	24.00	9,691	13.1	11.1	10.4	10.9	1.3	65.2	3.1
RHB Bank	RHBBANK MK	BUY	5.70	6.60	5,185	8.0	8.9	7.4	9.5	0.8	35.1	6.2
HLFG	HLFG MK	BUY	18.58	21.70	4,596	8.7	7.6	7.2	10.4	0.8	47.5	2.6
Alliance	ABMB MK	BUY	3.62	4.50	1,210	9.9	8.1	7.6	9.0	0.8	22.3	6.2
AMMB	AMM MK	HOLD	3.98	3.70	2,847	7.9	8.2	7.6	9.6	0.7	18.6	4.7
Bank Islam	BIMB MK	HOLD	2.60	2.45	1,210	9.3	11.9	10.2	8.4	0.8	9.8	3.8
Affin	ABANK MK	HOLD	2.04	1.90	975	7.4	7.7	6.5	5.4	0.4	7.9	3.9

Source: UOB Kay Hian

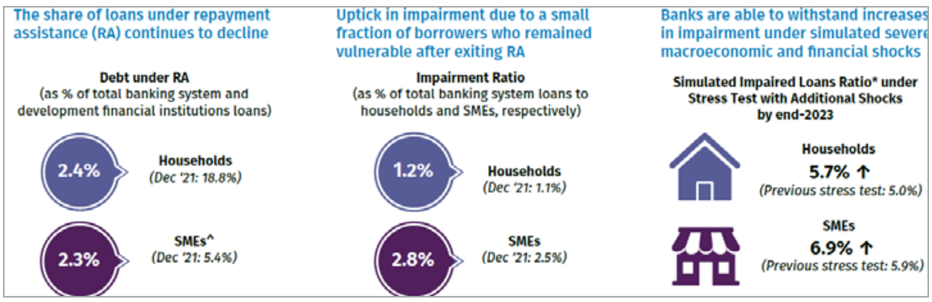
ESSENTIALS

- **Business in a stronger position vs pre-COVID-19 period.** Based on BNM data, the median interest coverage ratio (ICR) and operating margin of overall business stood at 7.1x and 7.3% in 1H22 (vs 2015-19 average: 6.2x and 6.6%). Essentially, this implies that overall business financial position has strengthened vs pre-COVID-19 levels. This has resulted in GIL ratio for businesses edging up only slightly to 1.1% as at end-Jun 22 (vs Dec 21: 1.0% and 2015-19: 1.0%) while providing comfort that any increase will be well contained.

- **SMEs facing more challenges but vulnerable segments remain within manageable levels.** Unsurprisingly, SMEs are facing greater challenges in their debt servicing obligations vs larger corporates given their smaller buffers. Nevertheless, SME loans under repayment assistance has declined by 50% to 13.1% as at end-Jun 22 while the proportion of SME loans that exited the repayment assistance that had turned non-performing only represented 0.3% of total system SME loans base.

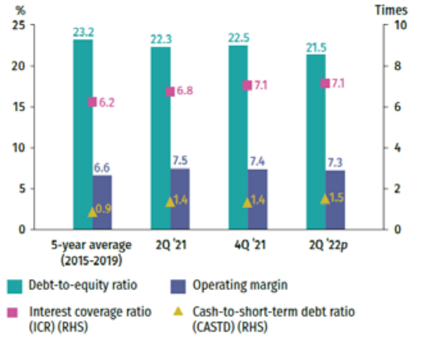
- **Only a marginal uptick in household GIL ratio.** The unwinding of the repayment assistance has only led to a small portion of household borrowers continuing to face challenges in repaying their loans, leading to a marginal increase in overall household GIL ratio to 1.2% as at end-Jun 22 from the pre-COVID-19 average of 1.0%. Meanwhile, the share of household debt under repayment assistance declined significantly in the first half of 2022 to 2.4% (Dec 21: 18.8%) of outstanding banking system and development financial institutions (DFIs) loans. The share of household loans classified by banks as exhibiting higher credit risk (Stage 2 loans) correspondingly declined further to 7.9% (Dec 21: 8.5%) and is expected to decline further in 2H22.

- **Prudent household lending standards intact.** Household debt servicing capacity remained prudent. The median debt service ratios (DSR) of newly approved and outstanding household loans stood at 43% and 35% respectively, preserving healthy buffers to support loan servicing. The share of more-risky borrowers with a DSR above 60% has also been stable at 24% of total household borrowers. Most (67%) of this debt is associated with borrowers earning more than RM5,000 monthly, with a low GIL ratio of 1.3% (Dec 21: 1.2%). Household debt to GDP has also declined over the past two years to 84.5% as at Jun 22.



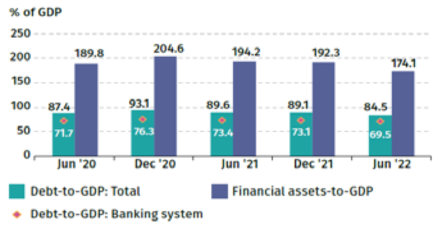
Source: BNM

BUSINESS IN STRONGER FINANCIAL POSITION



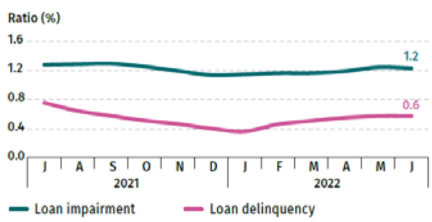
Source: BNM

DECLINING HOUSEHOLD DEBT TO GDP



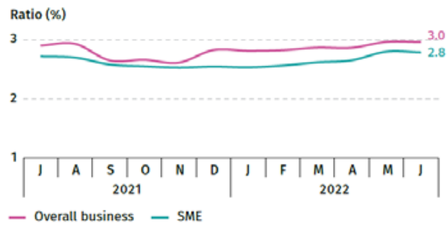
Source: BNM

HOUSEHOLD LOAN IMPAIRMENT TREND



Source: BNM

BUSINESS LOAN IMPAIRMENT TREND



Source: BN

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