

SECTOR UPDATE

Banking – Singapore

Upside From Higher Terminal Interest Rates

The FOMC assessed that inflation for core services (non-housing) would take a longer time to moderate due to high labour content of 55%, elevated job vacancies and growth in wages. Core PCE inflation is expected to recede gradually to 3.5% in 2023, which remains above the Fed's long-term goal of 2.0%. We expect the Fed Funds Rate to reach a peak of 5.0% by mid-23 and remain at elevated levels in 2H23. **BUY DBS (Target: S\$46.95) and OCBC (Target: S\$18.32) for 2023 dividend yield of 4.8%. Maintain OVERWEIGHT.**

WHAT'S NEW

- Moderation in pace of rate hike.** The Federal Open Market Committee (FOMC) has raised the target for Fed Funds Rate by 50bp to 4.25% on 14 Dec 22. This is a step down from a series of four consecutive 75bp hikes.
- Too early to talk about rate cuts.** The committee needs more evidence to be confident that inflation is on a sustained downward path. Fed Chair Jerome Powell broke down inflation into three buckets: a) inflation for goods has already eased as supply chain disruptions were resolved and demand shift to services, b) inflation for housing services is expected to ease in 2023 as rents for new leases have declined, and c) inflation for core services (non-housing) is expected to take a longer time to moderate due to high labour-content of 55%, elevated job vacancies and growth in wages. The committee expects core PCE inflation to recede gradually to 3.5% in 2023 and 2.5% in 2024.
- Labour market is too tight.** Demand substantially exceeds the supply of available workers. Companies are reluctant to lay off workers because it is difficult to hire new staff. The size of the labour force is affected by accelerated retirement and slowdown in immigration. There appears to be a structural shortage of about 4m workers.
- Staying the course.** Core PCE inflation at 4.7% in Nov 22 remains above the Fed's long-term goal of 2%. Thus, there will be ongoing rate hikes to ensure that the stance of monetary policy is sufficiently restrictive to return inflation to 2% over time. The committee intends to maintain a restrictive policy for some time and cautioned against prematurely loosening monetary policy. Based on the Fed's dot plot, the Fed Funds Rate would be cut by 100bp to 4.1% in 2024.

SUMMARY OF ECONOMIC PROJECTIONS

	2022F	2023F	2024F	2025F
Real GDP Growth	0.5	0.5	1.6	1.8
Unemployment Rate	3.7	4.6	4.6	4.5
Core PCE Inflation	5.6	3.1	2.5	2.1
Fed Funds Rate	4.4	5.1	4.1	3.1

Source: Federal Reserve

ACTION

- Upside from higher terminal interest rate.** Fed chairman Jerome Powell has warned that the Fed has "some ways to go" in its efforts to tame inflation. He cautioned that the "terminal level" of interest rates (peak) could be higher than previously anticipated. Based on the Fed's dot plot, the median projection for Fed Funds Rate is 5.1% by end-23, an increase of 50bp compared to the previous survey conducted in Sep 22. We expect the Fed to hike 50bp on 1 Feb 23 and taper to a 25bp hike on 22 Mar 23. The Fed Funds Rate should reach a peak of 5.0% by mid-23 (previous: 4.5%) and remain at elevated levels in 2H23.

PEER COMPARISON

Company	Ticker	Rec	Price @ 5 Jan 22 (\$S)	Target Price (\$S)	Market Cap (US\$m)	FY	PE		P/B		P/POP		Yield		ROE	
							2023F (x)	2024F (x)	2023F (x)	2024F (x)	2023F (x)	2024F (x)	2023F (%)	2024F (%)	2023F (%)	2024F (%)
DBS	DBS SP	BUY	34.78	46.95	66,758	12/2021	9.4	8.6	1.46	1.34	7.3	6.7	4.8	5.2	15.9	15.9
OCBC	OCBC SP	BUY	12.44	18.32	41,702	12/2021	8.3	8.0	0.98	0.91	7.5	7.2	4.8	5.1	11.8	11.5
UOB*	UOB SP	NR	30.97	n.a.	38,679	12/2021	9.4	8.8	1.12	1.06	7.6	7.0	5.1	5.3	12.5	12.9
Average							9.0	8.4	1.19	1.10	7.4	7.0	4.9	5.2	13.4	13.4

* Based on consensus estimate

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

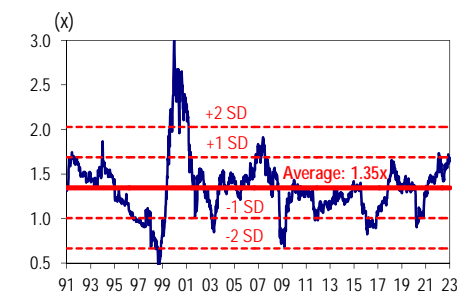
(Maintained)

TOP BUYS

Company	Rec	Share Price (\$S)	Target Price (\$S)
DBS	BUY	34.78	46.95
OCBC	BUY	12.44	18.32

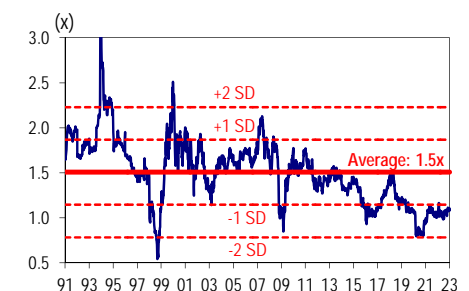
Source: UOB Kay Hian

P/B – DBS



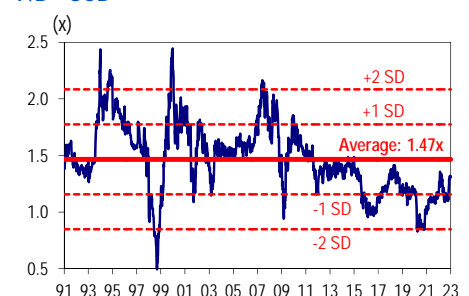
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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POLICY RATES

	Dec 22	1Q23F	2Q23F	3Q23F	4Q23F
SGD 3M SIBOR	4.17	4.45	4.55	4.55	4.55
SGD 3M Compounded SORA	2.92	3.99	4.31	4.31	4.31
USD Fed Funds Rate	4.00	5.00	5.00	5.00	5.00

Source: UOB Global Economics & Markets Research

- Benefitting from reorientation of supply chain towards ASEAN countries.** ASEAN countries have a large population of 680m and accounts for about 8% of global exports. Many multinational companies have adopted the China + 1 strategy and have plans to set up alternative production facilities within the ASEAN region. Malaysia, Thailand and Vietnam saw growth in inflow of FDI for manufacturing. Indonesia is receiving FDI for the processing of its mineral resources. OCBC and UOB benefits from reorientation of supply chain towards ASEAN countries.
- Maintain OVERWEIGHT.** Banks benefit from the ongoing hikes in interest rates and NIM expansion on a full-year basis in 2023 with DBS most sensitive to higher interest rates. Shareholders would be rewarded with higher dividends in tandem with the strong growth in earnings. We expect DBS and OCBC to increase DPS by 17% and 7% respectively to S\$1.68 (42 S cents per quarter) and S\$0.60 (30 S cents each for 1H23 and 2H23) in 2023. BUY DBS (Target: S\$46.95) and OCBC (Target: S\$18.32) for 2023 dividend yield of 4.8%.

PROJECTED DPS AND DIVIDEND PAYOUT RATIOS

Price (S\$)	DBS			OCBC			UOB*		
	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F
Year to 31 Mar									
Price (S\$)	34.78			12.44			30.97		
EPS (S ¢)	307	371	406	133	149	156	277	330	354
DPS (S ¢)	144	168	180	56	60	64	133	157	165
Payout Ratio (%)	47.0	45.3	44.3	42.1	40.3	41.1	48.1	47.5	46.7
Dividend Yield (%)	4.1	4.8	5.2	4.5	4.8	5.1	4.3	5.1	5.3

* Based on consensus estimate
Source: UOB Kay Hian

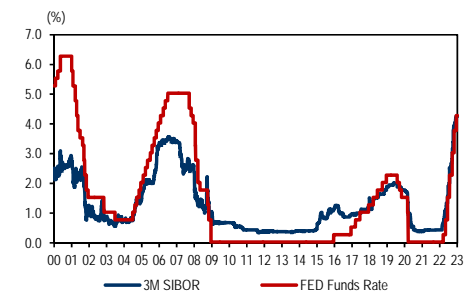
- DBS (DBS SP/BUY/S\$34.78/Target: S\$46.95)**
- We expect NIM to expand by 56bp to 2.33% in 2023 (previous: 47bp) and 5bp to 2.38% in 2024 (previous: 1bp). We forecast earnings growth of 21% in 2023 (previous: 17%) and 9% in 2024 (previous: 8%).
- We expect DPS of S\$1.68 in 2023 and S\$1.80 in 2024, which represents dividend payout ratio of 45% and 44% respectively. DBS provides dividend yield of 4.8% for 2023 and 5.2% for 2024.
- We raised our target price from S\$45.00 to S\$46.95 based on 1.98x 2023F P/B, derived from Gordon Growth model (ROE: 16.3%, COE: 8.5%, Growth: 0.5%).

KEY ASSUMPTIONS - DBS

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	4.2	9.9	5.8	6.7	4.9
NIM (%)	1.63	1.45	1.77	2.33	2.38
Fees, % Chg	0.2	15.2	(8.8)	13.8	8.8
NPL Ratio (%)	1.60	1.27	1.20	1.41	1.45
Credit Costs (bp)	79.7	1.3	10.6	27.5	27.2
Net Profit (S\$m)	4,721	6,805	7,989	9,666	10,572
% Chg	(26.1)	44.1	17.4	21.0	9.4

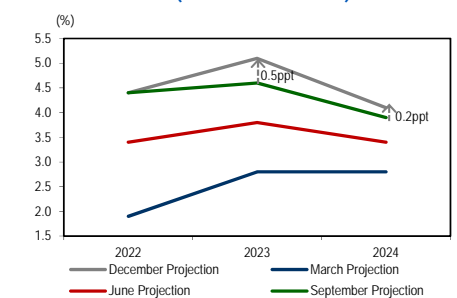
Source: UOB Kay Hian

FED FUNDS RATE VS 3-MONTH SIBOR



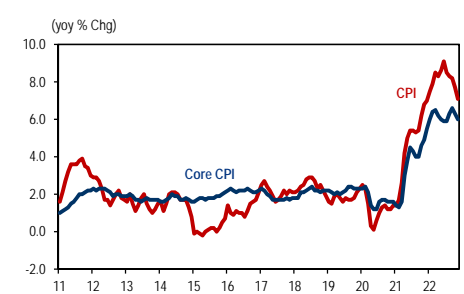
Source: Bloomberg

FED'S DOT PLOT (DEC 22 VS SEP 22)



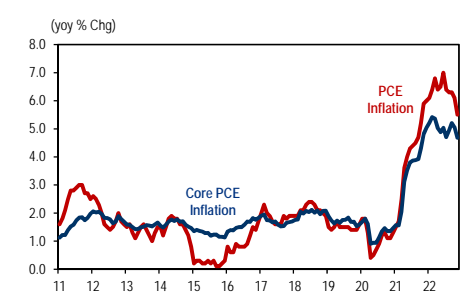
Source: Federal Reserve

US CPI AND CORE CPI



Source: CEIC

US PCE INFLATION AND CORE PCE INFLATION



Source: CEIC

• OCBC (OCBC SP/BUY/S\$12.44/Target: S\$18.32)

- We expect NIM to expand by 34bp to 2.23% in 2023 (previous: 33bp) and remain stable at 2.22% in 2024 (previous: 1bp). We forecast earnings growth of 12% in 2023 (previous: 12%) and 4% in 2024 (previous: 5%).
- We expect DPS of S\$0.60 in 2023 and S\$0.64 in 2024, which represents dividend payout ratio of 40% and 41% respectively. OCBC provides dividend yield of 4.8% for 2023 and 5.1% for 2024.
- We raised our target price from S\$18.28 to S\$18.32 based on 1.44x 2023F P/B, derived from the Gordon growth model (ROE: 12.0%, COE: 8.5%, Growth: 0.5%).

KEY ASSUMPTIONS – OCBC

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	0.6	8.6	4.5	4.0	4.8
NIM (%)	1.62	1.55	1.89	2.23	2.22
Fees, % Chg	(5.6)	12.0	(14.8)	0.7	6.1
NPL Ratio (%)	1.47	1.45	1.19	1.46	1.45
Credit Costs (bp)	76.7	31.3	14.2	27.1	27.7
Net Profit (S\$m)	3,588	4,858	5,969	6,689	6,980
% Chg	(26.3)	35.4	22.9	12.1	4.4

Source: UOB Kay Hian

SECTOR CATALYSTS

- NIM expansion in 2023 driven by upcycle in interest rates.
- Economic recovery driven by the reopening and easing of COVID-19 restrictions.
- Banks pay more dividends as risks emanating from COVID-19 pandemic recede.

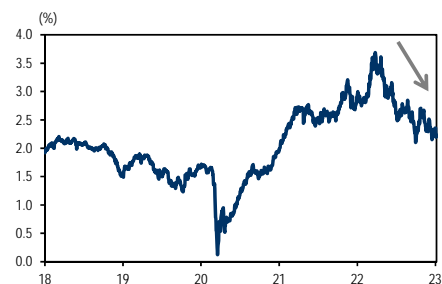
ASSUMPTION CHANGES

- As per mentioned above.

RISKS

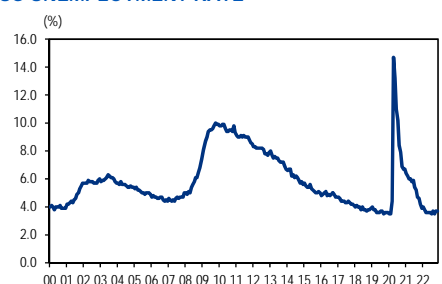
- Escalation of the Russia-Ukraine War beyond Ukraine.
- Geopolitical tension and trade conflict between the US, China and Russia.

IMPLIED INFLATION BASED ON YIELD FOR 5Y TIPS



Source: CEIC

US UNEMPLOYMENT RATE



Source: CEIC

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