Malaysia Banking

NEUTRAL *[Unchanged]*

Is liquidity an issue?

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NIM compression into 2016

Liquidity is adequate, in our view, as borne out by the system's high LCR and surplus liquidity at BNM. Funding cost pressures, however, are unlike to abate and we expect NIMs to compress further in 2016. Neutral on the sector; no change in earnings forecasts and TPs – BUY AFG, BIMB, HL Bank and HLFG.

Liquidity is adequate...

The industry's loan/deposit ratio (LDR) has been on a climb (91% end-Nov 2015), due mainly to the moderation in deposit growth, which expanded at an annualized rate of 2.5% as at end-Nov 2015. Possible reasons for this, in our view, include domestic and foreign capital outflows as well as the reclassification of Islamic deposits as Investment Accounts (IA).

Undoubtedly, the volatility in the MYR has played a part and the slowdown in deposit growth will have to be closely monitored. Nevertheless, interbank rates would indicate that any tightness in supply is mild at this stage, and that current liquidity is adequate, judging from the system's comfortable liquidity coverage ratios (LCRs) and surplus liquidity at Bank Negara (BNM).

...but funding cost pressures to persist

Domestic LDRs of the local banks are still comfortable at 90% or less, the outliers being RHB and AMMB. Even so, these two banks are the least reliant on expensive money market deposits, which could easily be remedied if they chose to pay up. Including debt, the modified LDR for most of the banks would trend within a tight range of 84-87%, with the exception of HL Bank at 76%.

That said, funding cost pressure is unlikely to ease anytime soon, not for the lack of liquidity, but for reasons such as ongoing deposit competition from Islamic banks that have moved to IA and other NBFIs, as well as the need to: (i) still beef up LCRs; (ii) rebalance deposit portfolios; (iii) meet internal LDR targets; and (iv) comply with PIDM's requirements. As such, we do expect NIM pressure to persist and we have imputed a further 7bps compression in average NIMs in 2016, versus 12bps in 2015.

Banking Sector – Peer Valuation Summary

Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	PER (x) CY15E	PER (x) CY16E	PER (x) CY17E	P/B (x) CY15E	P/B (x) CY16E	ROAE (%) CY15E	ROAE (%) CY16E	Net yield CY15E	Net yield CY16E
AFG	BUY	3.48	5,307	4.20	9.9	9.8	9.5	1.1	1.1	11.7	11.1	4.7	4.8
AMMB	HOLD	4.50	13,564	4.90	9.4	9.5	9.2	0.9	0.9	10.2	9.2	4.8	4.5
CIMB	HOLD	4.42	37,691	4.90	11.0	9.3	8.7	1.0	0.9	7.5	10.0	3.6	4.3
HL Bank	BUY	13.06	28,310	14.60	10.9	11.9	11.8	1.3	1.3	12.8	11.0	2.9	2.7
Maybank *	NR	8.20	80,046	NR	11.8	12.2	12.4	1.3	1.3	12.0	10.7	6.8	6.4
Public Bank	HOLD	18.28	70,588	19.60	14.7	13.9	13.3	2.4	2.2	16.9	16.6	3.1	3.3
RHB Cap	HOLD	5.57	17,126	5.85	9.6	9.1	8.8	0.7	0.7	8.0	8.0	1.1	1.1
Simple avg			**252,632**		**11.0**	**10.8**	**10.5**	**1.3**	**1.2**	**11.3**	**11.0**	**3.9**	**3.9**
MC-wtd					**12.1**	**11.8**	**11.5**	**1.5**	**1.4**	**12.4**	**12.0**	**4.3**	**4.3**
BIMB	BUY	3.81	5,876	4.50	11.2	10.9	10.6	1.7	1.5	16.3	14.9	3.2	3.2
HLFG	BUY	13.80	15,807	16.20	8.9	8.8	8.5	1.1	1.0	12.4	11.2	2.5	2.4

** Consensus estimates   Source: Maybank KE*

PP16832/01/2013 (031128)

The issue at hand – slowing deposit growth

The adequacy of liquidity in the banking system is an issue that has been much discussed of late, and this matter has been brought to the forefront, principally because of the sustained rise in the banking system's loan/deposit ratio (LDR) as well as the intense competition for retail deposits, that seems to be shaping up into a seasonal affair at the end of each year.

Undeniably, liquidity in the banking system has tightened over the past year or two, but it is our view that liquidity remains adequate, as borne out by the high liquidity coverage ratios (LCRs) at banks and surplus liquidity at Bank Negara Malaysia (BNM).

The moderation in deposit growth is a trend to be wary of, especially if prolonged. What bears closer scrutiny at this stage, however, would be the factors that have given rise to the aggressive pursuit of retail deposits, which in turn, is translating into higher funding costs and further NIM compression.

The LDR has been on a steady climb…

The industry's gross LDR has been climbing steadily, and from a trough of 69.5% end-Jan 2007, the ratio has since hit a new post-GFC high of 91.0% end-Nov 2015. Taking the ratio back to Dec 1996, the highest this ratio has been was 95.9% back in Oct 1998.

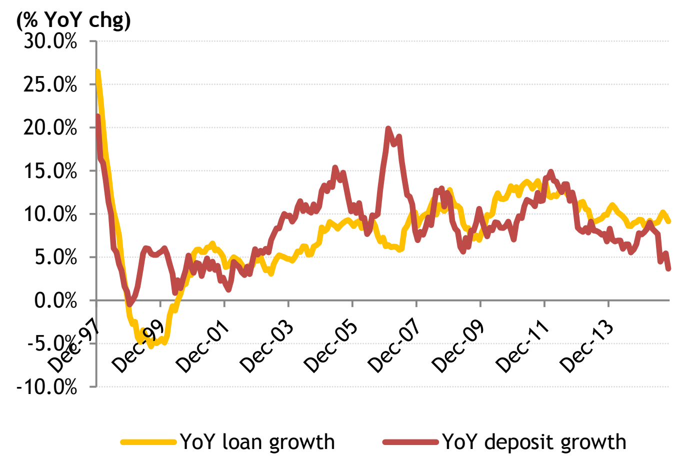
Banking system's LDR: Dec 1996 – Nov 2015

Source: CEIC, BNM

…due largely to slowing deposit growth

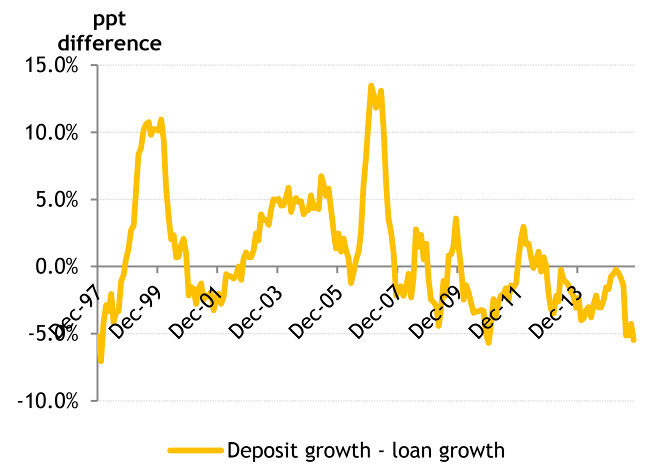
System deposit growth has been slowing, expanding at a pace of just 3.2% YoY end-Nov 2015 versus loan growth of 8.4% YoY. On an annualized basis, the disparity is just as pronounced, with deposits expanding just 2.5% versus loan growth of 7.5%. As the RHS chart on the following page shows, deposit growth has been trailing loan growth on a consecutive basis since Dec 2012.

Loan growth vs deposit growth (Dec 1997 - Nov 2015)



Source: CEIC, Maybank KE

Deposit growth minus loan growth (ppt difference)

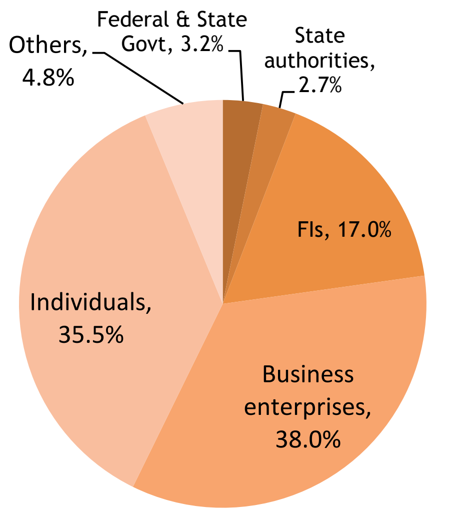


Source: Maybank KE

...stemming mainly from FIs and business enterprises

As at the end of Nov 2015, business enterprises and individuals accounted for 38% and 36% of total deposits respectively, with financial institutions making up another 17%.

Banking system deposits by account holder, end-Nov 2015

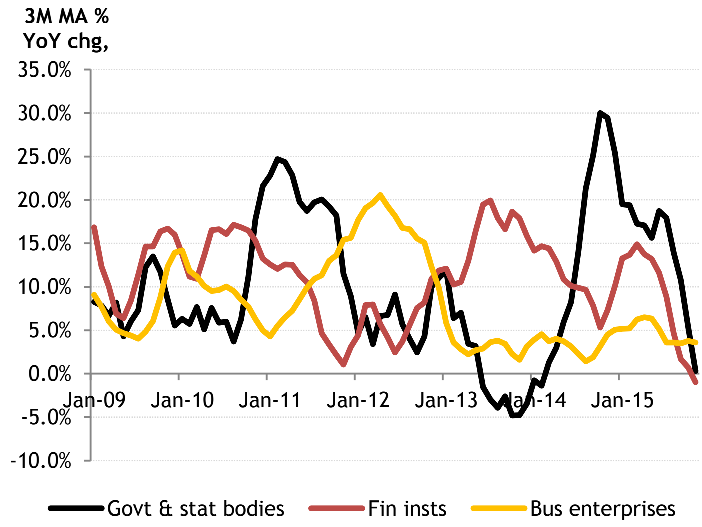


Source: BNM

In breaking down the growth in deposits by account holder, we find that deposits from government (federal & state) & statutory bodies, financial institutions and business enterprises have slowed considerably. As the 3-month moving average (3M MA) charts overleaf would indicate, there has been a marked slowdown especially in business enterprise deposits from a double-digit growth pace between Jul 2011 to Nov 2012, to just 3.6% (3M MA) end-Nov 2015. Deposits from government bodies grew just 0.3% on a 3M MA basis while deposits from financial institutions contracted 1% (3M MA) end-Nov 2015.

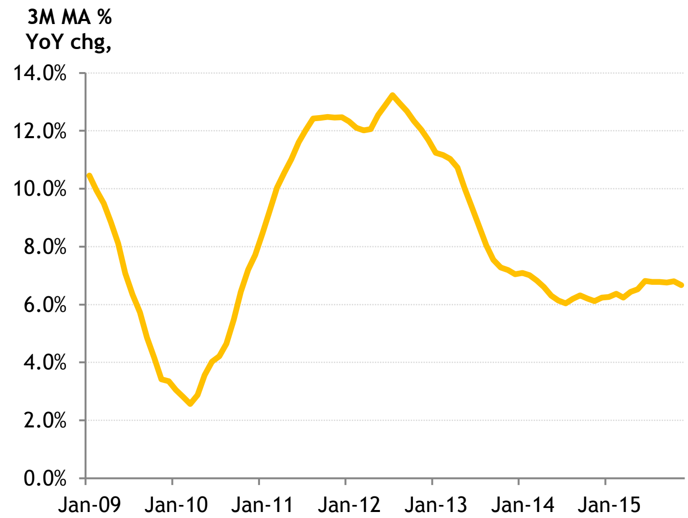
Deposits from individuals have also moderated in growth, but the pace has nevertheless held steady at between 6-8% since Aug 2013 (+6.7% on a 3M MA basis end-Nov 2015), which is a positive.

Deposit growth by holder on a 3M MA basis



Source: BNM, Maybank KE

Individuals deposit growth on a 3M MA basis



Source: BNM, Maybank KE

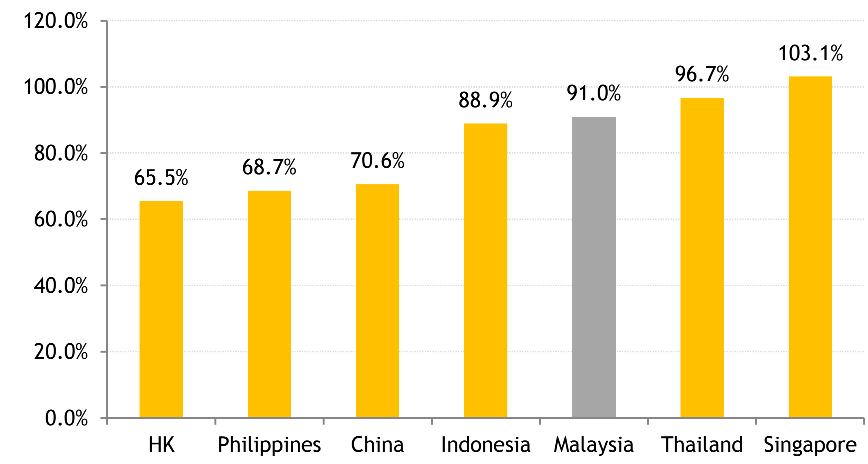
LDR about in line with ASEAN peers

Despite the concerns, Malaysia's banking system LDR, on a relative basis, is about in line with that of its regional ASEAN peers – higher than that of the Philippines and Indonesia, but lower than Thailand's and Singapore's.

Two points to note about the ratios below:

- Singapore's SGD LDR was just 85.1% as at end-Sep 2015, but its foreign currency LDR was a higher 105.7%.
- Thailand's LDR of 96.7% does not include Bills of Exchange in the denominator.

Regional gross loan/deposit ratios



Source: Various, Maybank KE

Possible reasons for slower growth in deposits

In our opinion, some of the reasons for the slower growth in deposits include:

- Domestic outflows from the system;
- Foreign capital outflows from both the equity and bond markets;
- The reclassification of deposits as Investment Accounts.

Domestic outflows from the system

In the post-GFC period, it has been the case that local GLCs, GLIFs and corporates have increasingly been investing abroad, be it in property, equities or other forms of investments. As of Sep 2015, Malaysia was a net exporter of capital, with investments made by Malaysian companies overseas amounting to MYR602b against foreign direct investment of MYR500b.

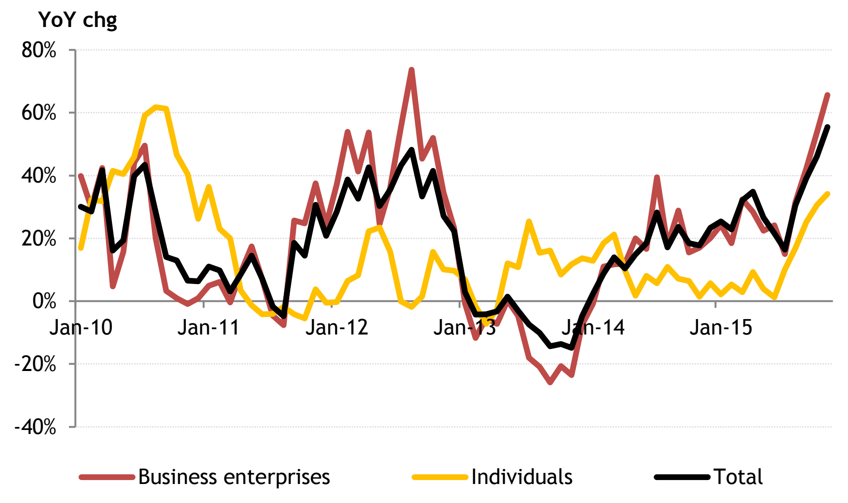
The EPF, for instance, has about 27% of its total assets of MYR668b as at Sep 2015 invested overseas, be it in equities, bonds or real estate. As reported in the press, the EPF has invested more than GBP1b in the UK and more than EUR1b in France and Germany since 2008/2009. KWAP has also been venturing overseas, but is committed to investing 89% of its funds domestically.

Anecdotal evidence would suggest that local companies have also been keeping their foreign receipts abroad, to take advantage of the strengthening USD, while even individuals have been converting their MYR into other currencies for the same reason. While the quantum cannot be readily ascertained, the pace of this conversion can be illustrated from the conversion of onshore foreign currency accounts.

Onshore foreign currency deposits (FCDs) accounted for 8.0% of total system deposits as at end-Nov 2015, as compared to just 2.6% as at end-Dec 2007. Of the total FCDs, business enterprises made up 68% of total as at end-Nov 2015, while individuals accounted for 13%.

Since the weakening of the MYR, the pace of conversion has picked up pace and total FCDs has expanded at a double-digit rate since Mar 2014 and rose 55% YoY end-Nov 2015. Business enterprise FCDs surged 66% YoY while individual FCDs jumped by 34% YoY.

Growth in onshore foreign currency deposits by depositor (Jan 10 - Nov 15)



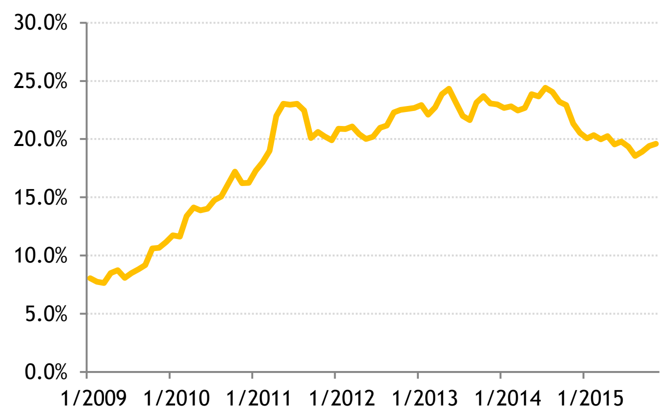
Source: BNM

Foreign capital outflows from the equity and bond markets

One of the more recent phenomena is the outflow of foreign liquidity from the equity and bond markets. Foreign holdings in Malaysian bonds have declined from a peak of 24.4% end-Jul 2014 to 19.6% end-Nov 2015. In absolute terms, the decline has been about MYR43.6b over this period.

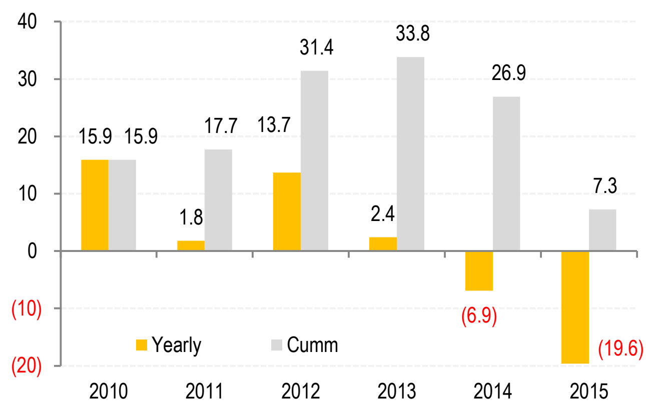
In the equities market as well, foreign selling heightened in 2015, with cumulative net outflows of MYR19.6b as at end-Dec 2015, versus cumulative outflows of MYR6.9b in 2014. Foreign shareholding in Malaysia equities tapered to 22.6% as at 20 Nov 2015 (last available data) from 23.8% end-2014. At 22.6%, this is 2+ppts above the GFC/post-GFC lows of 20+% over Jan 2009-Jul 2010 (lowest was 20.3% in Feb 2010), 2.6-ppts below a recent high of 25.2% at May 2013, after the 13th General Election, before the US QE taper tantrum.

Foreign holdings in Malaysian bonds (Jan 2009 - Nov 2015)



Source: CEIC

Malaysian equities: Yearly & cumulative foreign net buy/(sell) (MYR'b)



Source: Bursa Malaysia, Maybank KE

The reclassification of deposits as Investment Accounts

This is a fairly new development which took effect from July 2015. Some of the Islamic banks such as Maybank Islamic Bank and Bank Islam, have started to convert some of their Mudarabah deposit accounts into Investment Accounts (IA), which are no longer classified as deposits but "other liabilities". This has, as such, artificially deflated the total deposits number.

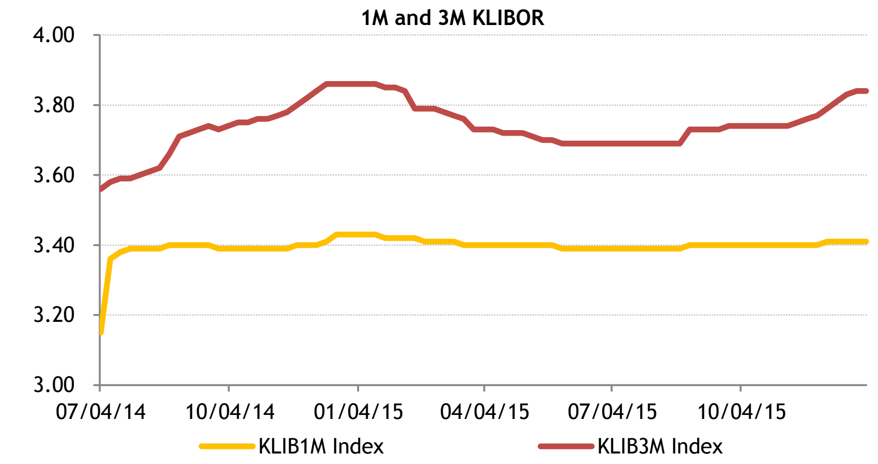
As at end-Sep 2015, the total amount in the IA of the domestic banks was about MYR4.3b, by our estimates, with Maybank accounting for MYR3.5b. The growth of IA has been rapid for Maybank, which expects to secure MYR13b of such accounts by end-2015. As such, one would expect total banking system deposits to continue declining as IA continue to build, but purely due to reclassification.

Is there a shortage of liquidity?

In our view, liquidity is tighter, but adequate in supply. This observation is borne out by the fact that interbank rates have remained relatively stable since July 2014 (which was when the overnight policy rate (OPR) was last raised by 25bps to 3.25%).

We saw the 3M KLIBOR climb by about 30bps between Jul 2014 to Jan 2015 amid the foreign selldown on the bond market during that period, but the rate started to ease thereafter. Lately, the 3M KLIBOR has started ticking up again, which would suggest some tightening of liquidity in the market. Nevertheless, the uptick from the 2015 low of 3.69% has been just about 15bps, which would suggest that the situation is manageable thus far.

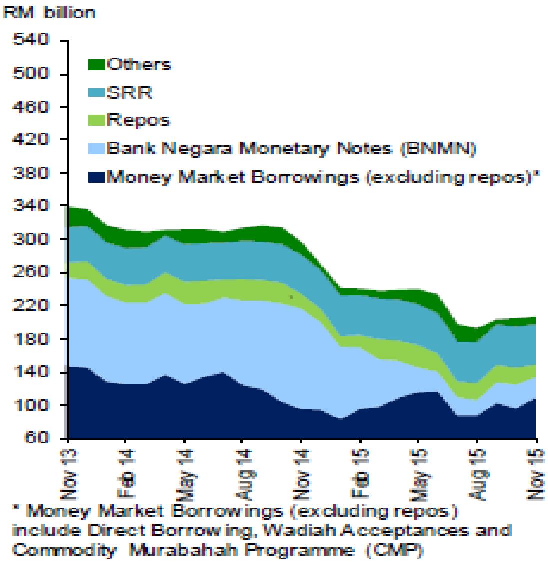
1M and 3M KLIBOR (Jul 2014 - Present)



Source: Bloomberg

Furthermore, as the chart overleaf would indicate, there is outstanding liquidity placed with the central bank, to the tune of just over MYR200b. Stripping out the SRR reserves of about MYR49b, there is still about MYR150b of liquidity, representing about 9% of total deposits, that banks could possibly tap into if need be.

Outstanding liquidity placed with BNM (MYR'b)



Source: BNM

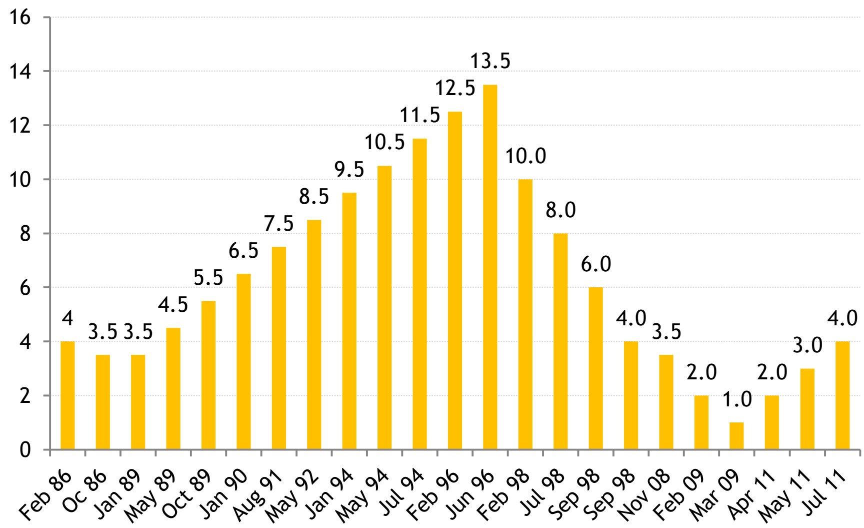
Would releasing the SRR help?

Malaysia's statutory reserve requirement (SRR) ratio hit a peak of 13.5% of total eligible liabilities in June 1996 and trended down to a post-GFC low of 1% in Mar 2009, before it was restored to 4% in Jul 2011.

As at end-Nov 2015, the banking system's total SRR amounted to MYR48.5b, representing about 3% of total system deposits. As such, even if we assumed that the SRR ratio was brought down to 0%, the impact to total system deposits would be quite negligible.

Moreover, since the SRR currently counts towards the LCR computations of the banks, the freeing up of the SRR could potentially negatively impact the ratios if the surplus funds are not invested in high quality liquid assets.

Statutory reserve requirement ratio (Feb 1986 to present)

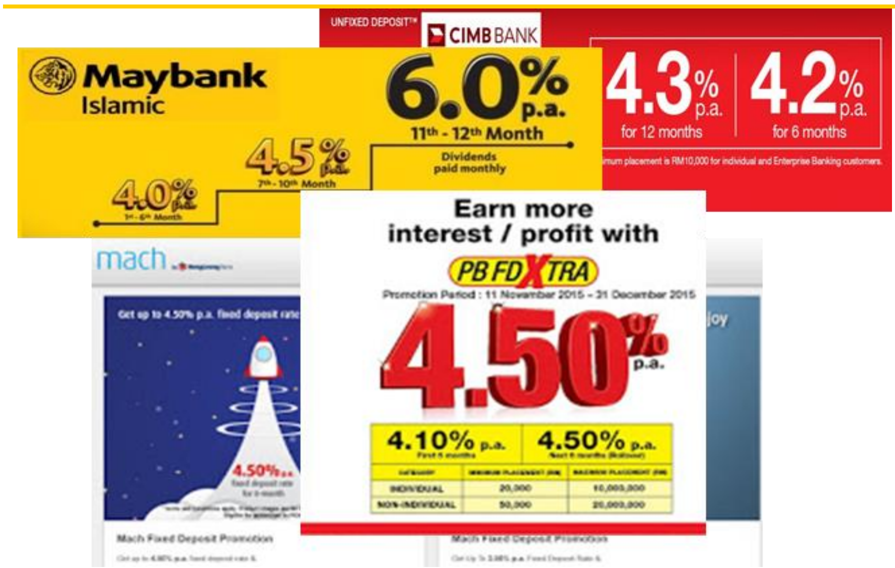


Source: BNM

Why then are commercial banks competing so aggressively for funds?

Retail deposit rates, which were fairly stable throughout much of last year, picked up with a vengeance in Nov/Dec 2015. Against board rates of about 3.2-3.3% for 12-month deposits, promotional rates jumped to as high as 4.7% and some of these campaigns are still ongoing.

Selected fixed deposit campaigns in Nov/Dec 2015



Source: Companies

So if liquidity is not a major issue, why then are banks vying so aggressively for funds, especially retail deposits? We would suggest that there are several reasons for this:

- The need to still beef up liquidity coverage ratios;
- The rebalancing of the deposit mix;
- Meeting internal LDR targets;
- Meeting PIDM's requirements;
- Competition from Islamic banks that have moved to IA and non-bank financial institutions (NBFIs) for funds.

The need to still beef up LCRs

The essence of the liquidity coverage ratio (LCR) is that banks have to hold sufficient high-quality liquid assets (HQLA) to withstand an acute liquidity stress scenario over a 30-day horizon and this is measured in the form of the ratio below:

- LCR = Stock of HQLA / Net cash outflow over the next 30 calendar days.

The ratio that banks have to meet is set out in the deadline below i.e. a minimum LCR of 70% by Jan 2016, building up to 100% by Jan 2019.

Deadline for LCR compliance

	1.6.15	1.1.16	1.1.17	1.1.18	1.1.19
Min LCR	60%	70%	80%	90%	100%

Source: BNM

In Jan 2015, BNM moved to ease the LCR requirements with several revisions, one of which being the recognition of Statutory Reserve Requirement (SRR) balances as Level 1 high-quality liquid assets. A point to note, however, is that this leeway is only temporary in nature and will eventually be phased out by 2019.

The banking system's average LCR stood at 121% as at end-Oct 2015 and we wondered what the ratios would look like if we stripped out the SRR balances. The table below shows the results with still fairly healthy ratios of 108% for the banking system, 112% for the commercial banks.

Stripping out the SRR, the LCR for Islamic banks would decline to 94% from 111% but this would still be comfortable, given that banks need only comply with the 100% ratio by end-2018.

Nevertheless, it is the case that the LCRs of some banks are still below 100% such as RHB (about 90%) and Bank Islam (about 80%). While adequate, there is a need to continue beefing up LCRs ahead of the 2019 deadline, we believe.

Liquidity coverage ratio end-Oct 2015, with & without SRR

	Bkg system	Comm bks	Islamic bks	Inv'mt bks
Stock of HQLA	447,271	336,594	89,773	20,904
Less: SRR	(49,253)	(34,487)	(13,842)	(925)
Net stock of HQLA	398,018	302,107	75,931	19,980
Net cash outflows	368,935	269,973	80,821	18,140
LCR including SRR	121%	125%	111%	115%
LCR excluding SRR	108%	112%	94%	110%

Source: BNM, Maybank KE

The rebalancing of the deposit mix

Banks have generally attempted to restructure their deposit portfolios by garnering more stable/sticky individual deposits, not just for the purposes of the LCR but as a means towards (i) reducing reliance on expensive money market deposits (thus improving NIMs), while (ii) extending the duration of their funding profile, which would assist in meeting net stable funding ratios (NSFR).

As the trends below would indicate, Maybank and AFG have seen their share of retail deposits slip over time, while the gains have been at CIMB and HL Bank. Public Bank and HL Bank arguably have the most stable deposit base among their peers today, with individual deposits accounting for about 49% of total deposits, versus a sector average of 42%.

Individual deposits as % of total deposits

	2010	2011	2012	2013	2014	End-Sep15
Maybank	49.8%	42.7%	43.7%	41.1%	41.0%	41.2%
CIMB	35.1%	37.9%	37.5%	35.2%	39.6%	40.5%
Public Bk	49.0%	45.7%	45.3%	44.6%	45.2%	48.5%
AMMB	39.6%	39.7%	39.9%	38.9%	38.7%	39.8%
HL Bank	38.0%	46.5%	50.9%	52.3%	50.6%	49.2%
RHB Cap	29.1%	26.9%	23.7%	27.9%	27.3%	27.4%
AFG	56.4%	50.0%	46.0%	44.8%	41.3%	40.3%
Average	42.4%	41.4%	41.0%	40.7%	40.5%	**41.7%**

Source: Companies, Maybank KE

Negotiable instruments of deposits (NIDs) and money market deposits (MMDs) are typically more expensive forms of deposits, and banks have been attempting to shed these in favour of higher CASA and/or retail deposits. Banks with the lowest reliance on NIDs/MMDs include Maybank, AMMB and RHB. AFG, for one, has expressed a desire to move its gross LDR (ex NIDs, MMDs) to less than 100% over the longer term, from about 107% as at end-Sep 2015 by our computation, by focusing more on retail deposits and CASA growth.

Gross LDRs with and without NIDs, MMDs

	NIDs, MMDs as % of deposits	Gross LDR	Gross LDR ex NIDs, MMDs
Maybank	3%	96.6%	100.0%
CIMB	21%	95.7%	121.9%
Public Bk	20%	90.5%	112.8%
AMMB	0%	97.2%	97.2%
HL Bank	18%	80.9%	98.6%
RHB Cap	0%	94.1%	94.1%
AFG	20%	86.2%	107.3%

Source: Companies, Maybank KE *MMD = money market deposits*

Meeting internal LDR targets

Banks have generally been arguing that investors and analysts should not focus on the LDR, given that there are other measures that safeguard against liquidity risks such as the LCR.

We certainly do agree that the LCR is a more appropriate measure of liquidity risk. The LDR however, in our view, is pertinent in assessing the business cost to and profitability of a bank, since other forms of funding (borrowings, equity) are more expensive in nature relative to deposits. Moreover, without proper LCR disclosures at this stage, comparing this ratio across the board is quite difficult at this stage. And much as banks argue that the LDR is no longer as important an indicator, quite a few do have implicit/explicit LDR targets that they strive to meet.

Loan growth/deposit growth targets for FY15/FY16

Bank	Comments
Maybank	FY15: Loan growth 12-13%; deposit growth 10-11%
CIMB	FY15: Loan growth 10%; deposit growth NA
Public Bk	FY15: Loan growth 9-10%; deposit growth 9-10%
AMMB	FY16: Loan growth 2%; deposit growth NA
HL Bank	FY16: Loan growth 8-9%; LDR of 80-82%
RHB Cap	FY15: Loan growth: 6-7%; deposit growth NA
AFG	FY16: loan growth 7-8%; deposit growth NA; internal LDR (ex NIDs) of 95% over longer term.

Source: Companies, Maybank KE

Meeting PIDM's requirements

Perbadanan Insurans Deposit Malaysia (PIDM) or the Malaysian Insurance Deposit System, is a system which protects depositors against the loss of their insured deposits should a member bank fail. Under this system, the bank deposits of all depositors, be they businesses or individuals, are covered up to MYR250,000 per depositor per member bank.

PIDM employs a Differential Premium System (DPS) framework, in assessing the premium that each bank has to pay for its services, the objective of which is to differentiate the banks according to their risk profiles and as an incentive to banks to adopt sound risk management practices.

Indicators of financial performance

Criteria	Indicators	Max score
Profitability	Return on RWA ratio	15
	Mean adjusted return volatility	10
Asset profile	Total impaired loan/financing ratio	15
	Loan/financing loss reserves ratio	10
	Loan/financing concentration profile	10
	RWA to total assets ratio & total asset growth ratio	15
Funding profile	Loans/financing to deposits ratio	15
	Composition of individual depositors	10
Total		**100**

Source: PIDM

One will note from the preceding page that a bank's funding profile carries a total weightage of 25%, which is fairly significant. Breaking the criteria down further, PIDM rewards banks that have more liquid balance sheets and one will note that a zero score is accorded to banks with a LDR of more than 100%. Moreover, PIDM also rewards banks that have a higher composition of individual deposits to total deposits, which works in favor of the retail banks. The operational costs of a bank would thus be lower if they had higher ratings with PIDM.

Score range for loans/financing to deposits ratio

Criteria	Max score
Loan/financing to deposits ratio <=80%	15
80% < loans/financing to deposits ratio <=90%	10
90% < loans/financing to deposits ratio <=100%	5
Loans/financing to deposits ratio >100%	0

Source: PIDM

Score range for composition of individual depositors

Criteria	Max score
Composition of individual depositors =>30%	10
15% <= composition of individual depositors <30%	5
Composition of individual depositors <15%	0

Source: PIDM

Competition with some Islamic banks and NBFIs for funding

One of the reasons why retail deposit rates have been so high is because commercial banks have had to vie just as aggressively with Islamic banks and non-bank financial institutions (NBFIs) for funding.

NBFIs such as Bank Rakyat were offering promotion 12-month fixed deposit rates of 4.3% up to end-Dec 2015 while Malaysia Building Society was offering 4.5% for 18-month tenures. Bank Simpanan Nasional's current promotional rate is 4.5% for a 12-month deposit. A point to note is that these institutions enjoy higher loan yields and better NIMs (eg MBSB's NIM is about 3.4% versus the banking industry's 2.3%). They can, as such, offer more competitive deposit rates.

Anecdotal evidence would suggest that banks have also had to vie with Lembaga Tabung Haji (LTH), or the Pilgrim's Fund, whose attractive dividend rate of 6% in 2014 has attracted depositors in search of higher yields. Understandably, this does not cause a drain in system liquidity, but it does encourage retail deposits to flow to LTH, which in turn would likely place some of the funds back in the banking system as more expensive money market deposits.

The other competitor to conventional banks would be some of the Islamic banks, that have begun converting their Mudarabah deposits to Investment Accounts (IA). One has to bear in mind that there are two major incentives attached to IA, as offered by BNM:

- the assets to which the funds are tagged need not count towards risk-weighted asset computations. As such, the higher the IA balance, the greater the improvement in the bank's capital ratios. It has been estimated that every MYR1b of IA contributes to a 6 bps improvement in capital ratios.
- the IA funds need not count towards the computation of the SRR, and banks therefore do not need to place 4% of such funds with BNM, interest free.

With these savings, Islamic banks are willing to sacrifice some of their NIM, in particular for savings on capital.

We reiterate that the flows above do not cause a drain in liquidity from the banking system, but what they do highlight is the disintermediation of funds flows which has contributed to higher funding costs for the banking system.

Current liquidity positions still manageable

Current gross LDRs of the individual banks, while higher than before, are still manageable for most banks, in our view. Maybank's gross LDR of about 97% end-Sep 2015 was skewed upward by higher ratios of 96% for Singapore and 103% for Indonesia while domestically, its LDR was just 89%. The same applies to CIMB, whose domestic LDR end-Sep 2015 was just about 85%, but its group LDR was skewed higher to 95.7% by higher ratios in Indonesia and Thailand.

Public Bank's gross LDR of 90.5% is just about within management's target while AFG and HL Bank's ratios of 86% and 81% respectively are comfortable.

At the high end is AMMB's ratio of 97%, but we think that this will be kept in check by the group's muted loan growth target of just 2-3% for FY16. RHB, meanwhile, has scaled back its loan growth target for FY15 to just about 6-7% from 17% in FY14, and will likely have to scale back more if its LDR is to be capped.

Gross loans/customer deposits

	3Q14	4Q14	1Q15	2Q15	3Q15
Maybank	92.1%	93.2%	93.5%	95.4%	96.6%
CIMB	94.7%	93.8%	91.1%	94.9%	95.7%
Public Bk	88.5%	88.6%	88.7%	87.6%	90.5%
AMMB	101.4%	97.2%	95.3%	95.3%	97.3%
HL Bank	80.3%	81.3%	81.0%	80.9%	81.0%
RHB Cap	91.8%	90.7%	90.5%	92.1%	94.1%
AFG	84.5%	86.0%	82.8%	85.1%	86.2%
Average	**91.1%**	**91.1%**	**90.4%**	**91.7%**	**93.2%**

Source: Companies, Maybank KE

Furthermore, as the table overleaf would indicate, one of the reasons why AMMB and RHB's LDRs are high is because of the banks' attempts to shed their reliance on more expensive NIDs and MMDs. Excluding these more expensive deposit types, AMMB and RHB's LDRs would in fact be among the lowest in the industry. For these two banks, lowering their LDRs by paying up for more expensive wholesale deposits should not be too difficult, but there is of course a higher cost attached.

Gross LDRs with and without NIDs, MMDs as at end-Sep 2015

	NIDs, MMDs as % of deposits	Gross LDR	Gross LDR ex NIDs, MMDs
Maybank	3%	96.6%	100.0%
CIMB	21%	95.7%	121.9%
Public Bk	20%	90.5%	112.8%
AMMB	0%	97.2%	97.2%
HL Bank	18%	80.9%	98.6%
RHB Cap	0%	94.1%	94.1%
AFG	20%	86.2%	107.3%

Source: Companies, Maybank KE *MMD = money market deposits*

Taking into account longer term funding

As we have pointed out, current liquidity positions are manageable from a LDR perspective. Another point to bear in mind is the fact that Malaysia's bond market has more depth and breadth relative to that of most other ASEAN countries. This will prove increasingly more important once the net stable funding ratio (NSFR) comes into play, for banks would be more compelled to improve funding gaps by matching asset-liability durations. The downside to this is that it will come at a higher cost to the banks, given that it would be more costly to issue debt.

Interestingly, if we were to calculate a modified LDR which included debt, the ratios for most of the banks would trend within a tight range of 84-87%, with HL Bank being the exception at just 76%.

Modified LDR: Gross loans/(customer deposits plus debt)

	Cust deps	Debt	Total	Gross LDR	Modifed LDR
Maybank	480,979	52,119	533,097	96.6%	87.1%
CIMB	311,008	35,188	346,196	95.8%	86.0%
Public Bk	296,339	13,874	310,213	90.5%	86.4%
AMMB	89,304	13,874	103,178	97.2%	84.2%
HL Bank	143,710	8,553	152,264	80.9%	76.4%
RHB Cap	158,968	12,925	171,893	94.1%	87.0%
AFG	44,055	614	44,669	86.2%	85.0%

Source: Companies, Maybank KE

NIMs will, however, continue to compress

We reiterate our view that liquidity positions are tighter than before but not excessively so, and that the LDRs of the domestic banks are still manageable at this stage.

Regardless, however, funding cost pressures are unlikely to abate anytime soon, and we do expect deposit competition to persist. As such, we estimate a further 7bps compression in average NIMs in 2016, versus 12bps in 2015.

NIM estimates (annualised)

	2013	2014	2015	2016F	2017F
Maybank	2.43%	2.31%	2.30%	2.26%	2.23%
CIMB	2.85%	2.81%	2.63%	2.53%	2.43%
Public Bk	2.35%	2.24%	2.13%	2.06%	2.01%
AMMB	2.69%	2.49%	2.17%	2.05%	2.00%
HL Bank	2.11%	2.07%	2.02%	1.97%	1.97%
RHB Cap	2.33%	2.29%	2.15%	2.08%	2.04%
AFG	2.24%	2.14%	2.15%	2.14%	2.10%
Average	**2.43%**	**2.34%**	**2.22%**	**2.15%**	**2.11%**

Source: Companies, Maybank KE

That we expect the NIM compression to be of a smaller magnitude in 2016 is premised on the fact that:

- The mortgage substitution effect (replacement of older higher yielding mortgages with newer lower yielding ones) is beginning to wear off and should be less pronounced moving forward.
- What we have seen of late is the upward repricing of new mortgages and auto loans by some of the banks, to counter the pressure on NIMs.
- Several banks have begun giving greater emphasis to risk adjusted returns and returns on risk weighted assets, which implies the prioritization of higher yielding loan segments eg SMEs, personal loans, credit cards etc, as well as increased cross-selling activity.
- Loan growth is being scaled back and this should ease funding needs. We expect overall loan growth for the seven banks to ease to 8.1% in 2016 from 9.3% in 2015, while domestic loan growth is forecast to moderate to 6.8% in 2016 from 7.3% in 2015. Risk is to the downside if deposit growth continues to moderate.

Gross loan growth estimates (annualised)

	2013	2014	2015F	2016F	2017F
Maybank	13.7%	13.3%	10.2%	8.5%	7.2%
CIMB	12.6%	12.8%	11.4%	9.8%	8.8%
Public Bk	11.8%	10.8%	10.8%	9.1%	8.0%
AMMB	6.2%	0.0%	1.1%	2.0%	2.0%
HL Bank	7.2%	8.0%	8.6%	7.7%	7.2%
RHB Cap	9.2%	17.0%	6.5%	5.9%	5.3%
AFG	13.8%	14.5%	7.7%	5.4%	5.1%
Average	**11.5%**	**11.7%**	**9.3%**	**8.1%**	**7.1%**

Source: Companies, Maybank KE

Gross domestic loan growth estimates (annualised)

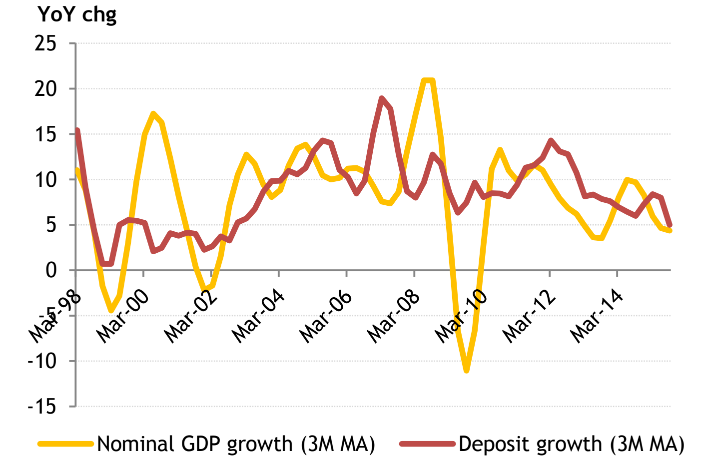
	2013	2014	2015F	2016F	2017F
Maybank	11.5%	8.8%	7.0%	6.0%	5.0%
CIMB	12.0%	8.1%	8.1%	7.7%	7.4%
Public Bk	12.0%	10.5%	9.8%	9.2%	8.1%
AMMB	6.2%	0.0%	1.1%	2.0%	2.0%
HL Bank	6.8%	7.6%	8.1%	7.5%	7.0%
RHB Cap	5.1%	14.3%	6.0%	5.5%	5.3%
AFG	13.8%	14.5%	7.7%	5.4%	5.1%
Average	**9.9%**	**9.0%**	**7.3%**	**6.8%**	**6.2%**

Source: Companies, Maybank KE

Keeping tabs on deposit growth

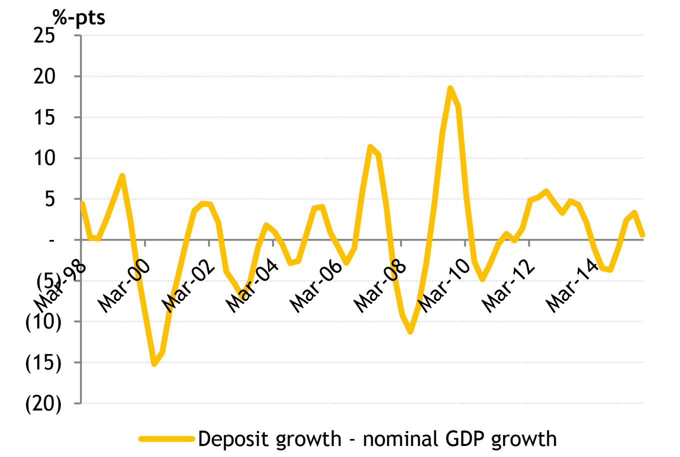
While we take the view that liquidity in the banking system is adequate, we are nevertheless keeping close watch over deposit growth trends, which up to Sep 2015, was still trending above nominal GDP growth – deposit growth was 5.4% versus nominal GDP growth of 4.9%. While the correlation between both data is weak (+0.4x), one would generally hope for deposit growth to outpace economic growth.

Nominal GDP growth vs deposit growth (3M moving average) Mar 1998 – Sep 2015



Source: BNM, CEIC, Maybank KE

Deposit growth less nominal GDP growth (%-pts)

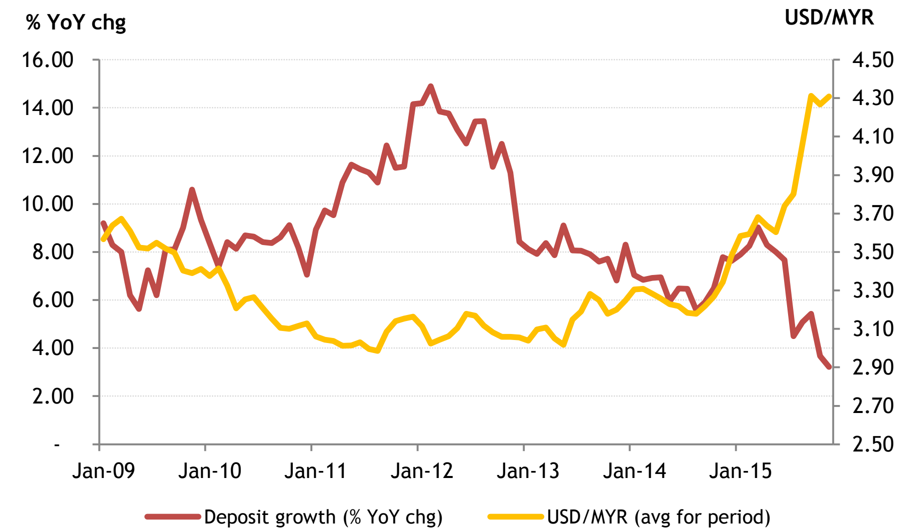


Source: BNM, CEIC, Maybank KE

Currency trends are an important determinant

Much of the liquidity issues has stemmed from the volatility of the MYR, which has contributed in part to the capital outflows. Undoubtedly stability on the currency front would aid in stemming such outflows, while encouraging the repatriation of funds.

Deposit growth vs USD/MYR movement (Jan 2009 – Nov 2015)



Source: BNM, CEIC, Maybank KE

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