Malaysia Banking

NEUTRAL *[Unchanged]*

Managing risks in the economy

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Risk management remains a priority

The focus of BNM's 2015 Financial Stability and Payment Systems report very much mirrors that of 2014, with emphasis on managing household (HH), business, property market, financial market volatility and external exposure risks. Generally, some of the financial indicators have seen some weakness due to ongoing domestic and external volatility, but the banking system remains well prepared to weather through. We remain NEUTRAL with a BUY on AFG, HL Bank and HLFG, SELL AMMB.

Household debt higher but coverage still decent

HH debt rose at a more moderate pace of 7.3% in 2015 (+9.4% in 2014) to MYR1.03t, but HH debt/GDP was a higher 89.1% end-2015 from 86.8% end-2014. Positively though, the aggregate HH liquid financial assets/HH debt ratio remained comfortable at 142% while the HH impaired loans ratio continued to trend lower to just 1.1% end-2015. BNM's stress test of HHs in 2015 employed more stringent criteria, the result of which being an estimated loss of MYR65.4b to the banking system. Even so, this would still be comfortably absorbed at just 56% of banks' excess capital buffers (above the regulatory minimum.

Commercial property risk exposure still low

Lending to borrowers with at least three outstanding housing loans increased by 3.1% in 2015 (+2.9% in 2014) but accounted for just 3% of total housing loan borrowers. About 84% of housing loan borrowers have only one outstanding housing loan, of which 88% are first-time buyers. There is higher risk in the office space, shopping complex and hotel segments, but lending to these segments remains small at just 3.3% of total bank loans.

Exposure to individual sectors manageable

Total bank credit exposure to the CPO and O&G segments accounted for a manageable 4% and 2% of total credit exposures as at end-2015, while the transport sector accounted for 3.9% of total bank credit exposures. Bank exposure to business sectors that are more exposed to demand from China accounted for 16% of total credit exposures, but with decent median interest coverage ratio of between 4.4x and 26.5x.

Banking Sector – Peer Valuation Summary

Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	PER (x) CY16E	PER (x) CY17E	P/B (x) CY16E	P/B (x) CY17E	ROAE (%) CY16E	ROAE (%) CY17E	Net yield CY16E	Net yield CY17E
AFG	BUY	3.86	5,886	4.20	10.8	10.5	1.2	1.1	11.1	10.8	4.4	4.5
AMMB	SELL	4.57	13,775	4.10	10.4	10.2	0.9	0.8	8.5	8.3	4.1	4.2
CIMB	HOLD	4.87	41,528	4.40	10.6	10.0	1.0	0.9	9.3	9.4	3.9	4.3
HL Bank	BUY	13.26	27,212	14.40	12.3	12.3	1.3	1.2	10.2	10.2	2.6	2.7
Maybank *	NR	8.94	87,270	NR	13.2	13.4	1.4	1.3	10.7	10.3	6.1	6.0
Public Bank	HOLD	18.80	72,596	19.60	14.0	13.5	2.1	1.9	15.7	14.7	3.1	3.2
RHB Cap	HOLD	5.86	18,018	5.85	10.2	9.9	1.1	1.0	8.9	10.5	2.4	2.6
Simple avg			**266,284**		**11.7**	**11.4**	**1.3**	**1.2**	**10.6**	**10.6**	**3.8**	**3.9**
MC-wtd					**12.5**	**12.3**	**1.5**	**1.4**	**11.6**	**11.3**	**4.2**	**4.3**
BIMB	HOLD	3.80	6,037	3.90	12.0	11.6	1.6	1.4	13.7	12.8	2.4	2.4
HLFG	BUY	15.08	17,270	16.30	9.7	9.2	1.1	1.1	11.2	10.7	2.2	2.3

** Consensus estimates Source: Maybank KE*

Banks

Malaysia

Managing risks

Key priorities for the central bank in 2015 were little changed from the priorities in 2014. BNM continued to focus on:

- Managing risks arising from household indebtedness
- Managing developments in the domestic property market
- Managing credit risk exposures to businesses
- Managing risks from financial market volatility
- Managing contagion risk from external exposures and overseas operations.

Managing risks arising from household (HH) indebtedness

HH debt expanded by 7.3% in 2015 (+9.4% in 2014) to MYR1.03t. Growth has continued to moderate but as a percentage of GDP, HH debt rose to 89.1% end-2015 from 86.8% end-2014.

HH balance sheets remained firm with the financial assets/HH debt ratio at 205% end-2015, and a HH liquid financial assets/HH debt ratio of 142%. These percentages remain comfortable, but the ratios have continued to trend lower.

Positively:

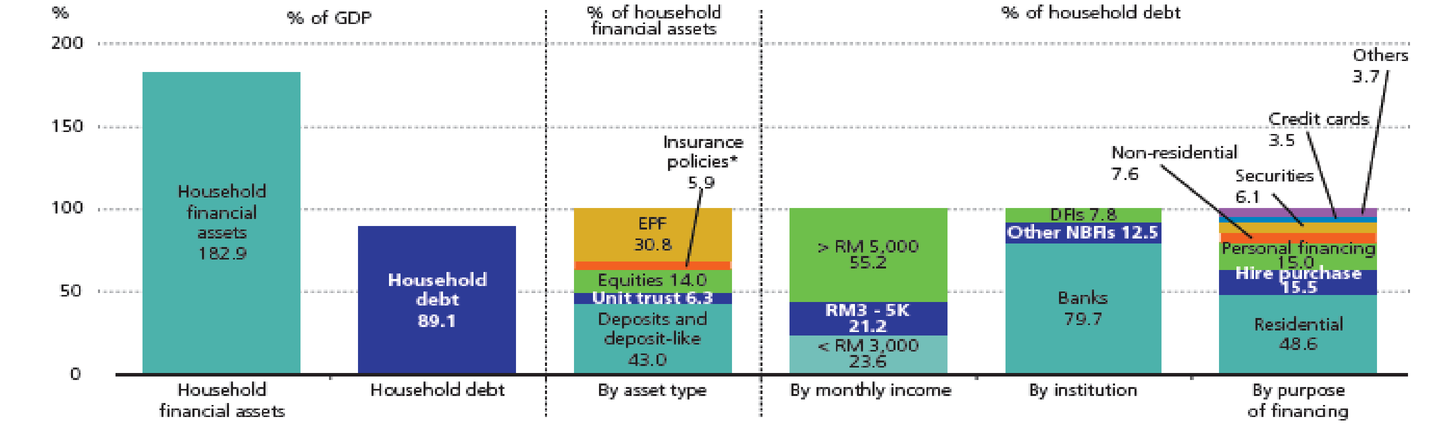
- The HH impaired loans ratio has continued to trend lower to just 1.1% end-2015, which is very healthy.
- The quality of loans to the more vulnerable income class earning MYR3k per month and below also improved as the share of debt from this segment declined to 23.6% of total HH debt from 24.3% in 2014 and 28.4% in 2013. Such loans made up 20.4% of total banking system financing (2014: 20.9%, 2013: 25.1%).
- Personal financing granted by non-bank financial institutions (NBFIs) increased by just MYR3b in 2015 vs MYR4.4b in 2014 and MYR10.2b in 2013. The average financing size also declined to just MYR22k per facility from as high as MYR68k.

Household debt ratios (%)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015p
HH debt (MYR'b)	395.5	422.9	465.2	510.8	594.2	694.2	782.3	877.6	960.2	1030.6
Chg in HH debt		*6.9%*	*10.0%*	*9.8%*	*16.3%*	*16.8%*	*12.7%*	*12.2%*	*9.4%*	*7.3%*
HH fin assets (MYR'b)	978	1160	1068	1226	1,400	1,520	1,712	1,905	2,018	2,116
HH debt/GDP	68.8	65.9	60.4	72.4	74.5	76.1	80.5	86.1	86.8	89.1
HH fin assets/HH debt	247.4	274.3	229.6	240.5	235.5	218.9	218.9	217.1	210.2	205.3
HH liquid fin assets/HH debt	151.7	175.3	141.5	168.1	166.9	154.7	156.3	155.7	147.9	142.0
Impaired loans ratio	7.1	5.3	4.1	3.1	2.3	1.8	1.5	1.3	1.2	1.1

Source: BNM Financial Stability & Payment Systems Report 2015

Household sector: Profile of borrowings & financial assets



Source: BNM Financial Stability & Payment Systems Report 2015

In stress testing the banking system's resilience to the HH sector, BNM this year has employed more stringent criteria and increased the stressed probability of default (PD) rates to up to 18% compared to 15.8% in 2014. The comparison between the 2015 and 2014 scenarios are laid out below.

As a result, the potential loss to the banking system is now estimated to be a larger MYR65.4b as opposed to MYR39.1b in 2014 and this would be represent about 56% of the excess capital buffers (above the regulatory minimum) of MYR117.3b held by banks end-2015, as opposed to 40% of the excess capital buffers of MYR97.4b end-2014. The buffers remain comfortable.

Household sector: Potential losses based on severe assumptions of PD and LGD in 2015

		Housing loan	Motor vehicle hire purchase	Personal financing	Credit cards	Total[1]
Stressed PD (%) (Baseline PD, %)		12.3 (4.1)	14.4 (4.8)	13.2 (4.4)	18.0 (6.0)	
Stressed LGD (%) (Baseline LGD, %)		40.0 (22.5)	75.0 (55.8)	95.0 (84.7)	95.0 (85.5)	
Potential losses (RM bil)	All borrowers – Borrowers earning ≤ RM3,000 per month – Borrowers earning ≤ RM5,000 per month	20.2 2.5 6.2	15.8 5.0 9.4	7.9 2.6 4.3	6.1 1.1 2.6	65.4 15.3 28.2

[1] Includes other household loans such as financing for the purchase of non-residential properties and consumer durables

Source: BNM Financial Stability & Payment Systems Report 2015

Household sector: Potential losses based on severe assumptions of PD and LGD in 2014

		Housing loan	Motor vehicle hire purchase	Personal financing	Credit cards	Total[1]
Stressed PD (%) (Baseline PD, %)		8.4 (4.2)	10.0 (5.0)	8.8 (4.4)	15.8 (7.9)	
Stressed LGD (%) (Baseline LGD, %)		40.0 (25.6)	75.0 (48.0)	95.0 (84.1)	95.0 (85.2)	
Potential losses (RM bil)	All borrowers - Borrowers earning RM3,000 or less per month - Borrowers earning RM5,000 or less per month	12.4 2.0 4.4	10.7 3.9 6.8	5.0 1.8 2.9	5.3 1.0 2.3	39.1 10.2 19.2

[1] Includes other household loans such as financing for the purchase of non-residential properties and consumer durables

Source: BNM Financial Stability & Payment Systems Report 2014

Managing developments in the domestic property market

Macro prudential measures implemented in recent years have generally been successful in curbing speculative property purchases and are contributing to a moderation in property price increases. These measures include the 70% cap on the loan-to-value ratio for third property loans, higher property gains taxes and the prohibition of developer interest bearing schemes (DIBS).

Lending to borrowers with at least three outstanding housing loans increased by 3.1% in 2015 (2.9% in 2014, 5.3% in 2013 and 15.8% in 2010), and accounted for just 3% of total housing loan borrowers.

Financing to houses priced below MYR500k accounted for 85% of total outstanding house financing. About 84% of housing loan borrowers have only one outstanding housing loan, of which 88% are first-time buyers.

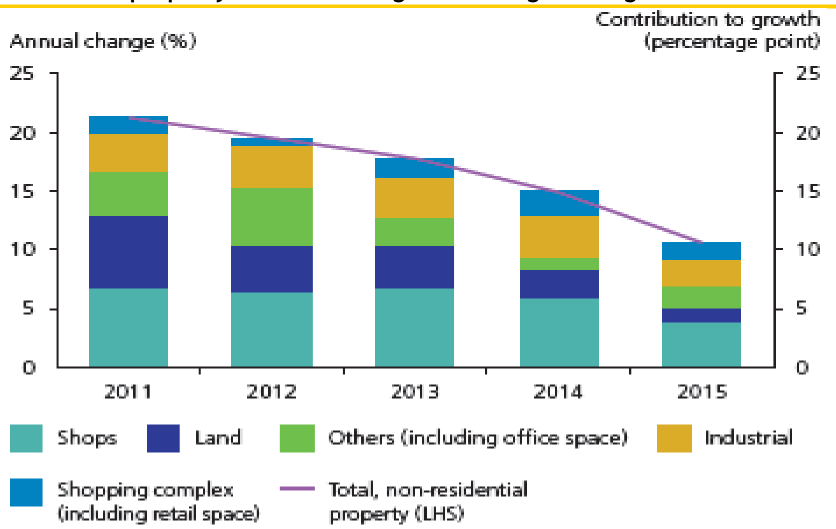
The stress test on the previous page assumes a probability of default (PD) of up to 12% for housing loan and a severe 40% correction in house prices. Under such a scenario, it has been assessed that the excess capital buffers of banks were comfortably about 6x the estimated loss.

In the non-residential property space, the bulk of the loan exposure is to shops (39% of total loans) and land (19.7%), followed by industrial buildings (17%), shopping complexes (9.7%) and other non-residential properties including office space and hotels. The growth in lending to the non-residential property market moderated to 10.6% in 2015 (14.9% in 2014, 17.8% in 2013).

Average transaction values for shophouses increased at a slower pace of 4.5% in 2015 (2014: +6.5%) while land prices have remained strong. BNM however sees heightened risks in the office space and shopping complex segments where in the case of the former, the vacancy rates in the Klang Valley rose to 20.4% from 18.6% in 2014. As for shopping complexes, more than 50 shopping complexes are being built across major employment centres, which gives rise to over-supply concerns.

Nevertheless, banks' exposure to the office space, shopping complex and hotel segments remains small at just 3.3% of total bank loans.

Non-residential property market: Loan growth & segmental growth contributors



Source: BNM Financial Stability & Payment Systems Report 2015

Managing credit risk exposures to businesses

Business sector debt jumped about 16-17% to MYR1.21t end-2015 from MYR1.04t end-2014, and accounted for 104.8% of GDP versus just 96.9% end-2014. This has been attributed in large part to the weaker MYR, with exchange rate valuations accounting for about 75% of the increase in corporate external debt.

Positively, the average debt/equity ratio of 160 firms listed on Bursa Malaysia (80% of total market cap excluding financial institutions) was still decent at 46.8% end-2015 (41.5% end-2014). Interest cover meanwhile, declined to 5.3x from 7.3x in 2014, but is still comfortably above the prudential minimum of 2x. BNM also highlights that the median cash-to-short-term debt was decent at 1.2x end-2015.

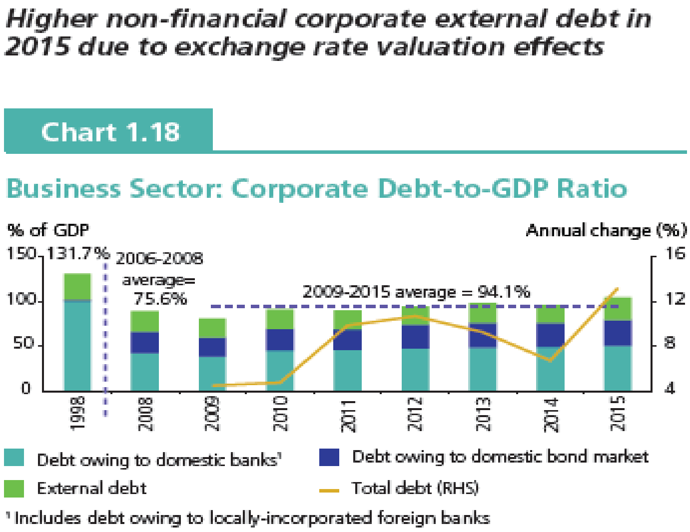
About 76% of outstanding corporate debt continues to be funded domestically. Of external debt, 73% had a maturity period of over a year, thus mitigating short-term rollover risks, while trade credits and non-resident holdings of MYR-denominated PDS and sukuk, which pose limited currency risks, made up 22% of total corporate external debt.

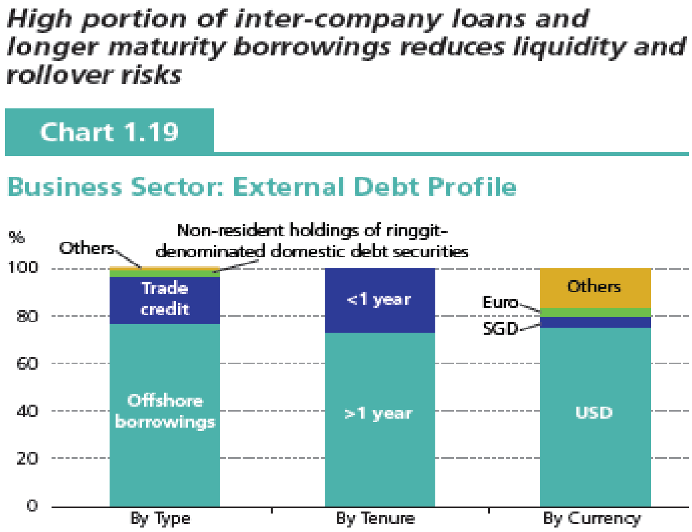
Business sector ratios (%)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015p
ROA	5.1	5.8	4.6	5.4	5.4	5.5	5.1	4.9	4.7	3.9
ROE	10.0	11.5	8.2	9.5	10.0	10.2	9.0	9.3	8.1	6.8
Debt/equity ratio	50.3	47.9	46.3	42.6	39.2	45.5	42.5	40.0	41.5	46.8
Interest coverage ratio	4.6	5.5	4.5	6.6	8.0	6.9	5.4	7.6	7.3	5.3
Operating margin	10.9	10.9	9.9	12.5	12.6	13.2	12.2	12.9	11.8	13.4
Impaired loans ratio	10.2	8.0	6.0	4.7	5.2	4.1	3.0	2.8	2.6	2.5

Source: BNM Financial Stability & Payment Systems 2015

Corporate sector: External debt





Source: BNM Financial Stability & Payment Systems Report 2015

In terms of sector exposures, bank credit exposure to the CPO segment accounted for 4% of total credit exposures as at end-2015. Sector exposure to the O&G industry, meanwhile, was lower at 2.2%, while the transport sector accounted for 3.9% of total bank credit exposures.

As for bank exposure to business sectors that are more exposed to demand from China - electrical and electronics, petroleum and chemical products, commodities (CPO, O&G, metals, and rubber and rubber products) - accounted for 16% of total credit exposures, with a median interest coverage ratio of between 4.4x and 26.5x.

Corporate sector: Potential losses based on severe assumptions of probability of default (PD) and loss given default (LGD)

	ICR (Times)	Stressed PD (%)	Stressed LGD (%)	Potential losses (RM billion)	% of banking system capital
Real estate activities	5.3	11.3	55.0	6.5	2.7
Palm oil	5.2	11.6	55.6	1.6	0.7
Metal	1.0	10.9	54.3	1.6	0.6
Rubber products	26.5	8.3	48.7	0.7	0.3
Oil and gas	4.4	8.3	48.7	0.6	0.2
Electrical and electronics	13.3	8.3	48.7	0.4	0.2
Chemical- and petroleum-related products	11.3	8.3	48.7	0.3	0.1
Total				**11.7**	**4.8**

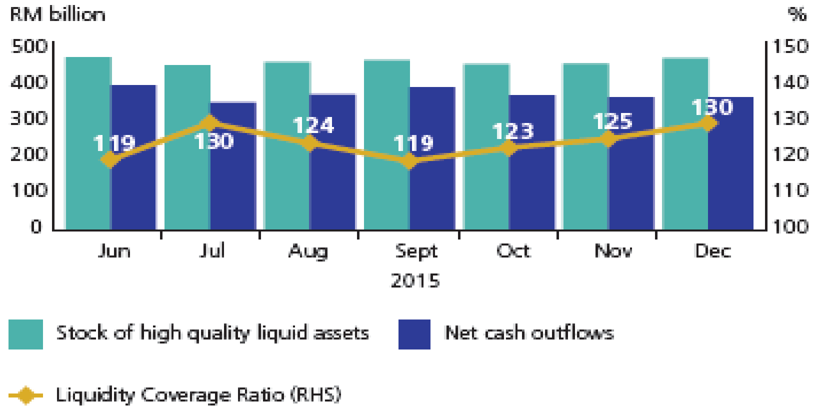
Source: BNM Financial Stability & Payment Systems Report 2015

Managing risks from financial market volatility

The overall forex risk exposures of financial institutions increased to 6.1% of total capital in 2015 from 4.7% in 2014, which remains at levels consistent with prudent internal value-at-risk and loss limits.

Liquidity, meanwhile, remained ample, with aggregate surplus liquidity placed at BNM at MYR205.1b end-2015. Non-resident deposits account for just 4.1% of total deposits, while foreign currency (FCY) funding of the banks remained small at 16.3% of total liabilities. Of this amount, FCY denominated deposits accounted for just 8.4% of total deposits. Meanwhile, liquidity coverage ratios (LCR) remain comfortable at 130% end-2015 against the minimum requirement of 60%.

Banking system: Basel III Liquidity Coverage Ratio



Source: BNM Financial Stability & Payment Systems Report 2015

Managing contagion risk from external exposures and overseas operations

Claims by Malaysian banks on all external counterparties rose 11.1% YoY to MYR254.1b in 2015 (2014: +19.3%), while claims by external counterparties on Malaysian banks grew at a slower pace of 9.2% to MYR392.8b (2014: +21.8%). This basically reflects the more moderate expansion of banks' external debt, which makes up three quarters of external liabilities.

The net external liabilities position largely reflects the net exposures of locally incorporated foreign banks (LIFBs) that have a long-established presence in Malaysia. These external claims comprise mainly (i) capital investments in the form of equity and retained earnings (28%), securities held under custody (24%) and interbank placements by parents and sister companies (19%). Other deposit placements from non-residents account for 21% of LIFB's external liabilities. Domestic banking groups meanwhile continued to report a net external assets position of MYR7.9b, largely reflecting their capital investments in overseas subsidiaries.

Banking system: Income & Expenditure

(MYR'm)	2008	2009	2010	2011	2012	2013	2014	2015p
Interest income	63,147	56,365	65,682	73,681	83,760	83,079	89,417	96,797
Less: interest expense	(34,058)	(26,558)	(31,331)	(38,918)	(46,293)	(43,621)	(47,912)	(54,626)
Net interest income	29,089	29,807	34,351	34,763	37,467	39,458	41,505	42,172
Fee based income	7,386	7,857	8,563	8,952	9,126	9,618	10,103	9,667
Other income	7,034	4,911	8,089	9,910	10,605	10,055	9,593	10,455
Operating income	43,508	42,574	51,002	53,624	57,198	59,130	61,202	62,294
Less: Operating costs								
Staff costs	(9,343)	(9,839)	(11,467)	(12,842)	(13,810)	(13,562)	(13,629)	(15,206)
Overheads	(10,826)	(10,841)	(12,209)	(11,751)	(12,667)	(13,384)	(14,172)	(15,216)
Operating profit	23,340	21,895	27,326	29,031	30,721	32,185	33,401	31,871
Less: provisions	(4,170)	(4,904)	(4,367)	(2,836)	(1,502)	(2,427)	(1,472)	(2,851)
Pretax profit	19,170	16,991	22,959	26,196	29,219	29,758	31,929	29,020
Pretax profit/average assets (%)	1.5	1.2	1.5	1.6	1.6	1.5	1.5	1.3
Pretax profit/avg shrs funds (%)	18.6	13.9	16.6	17.4	17.4	15.9	15.2	12.4
Pretax profit/avg employee (MYR'000)	169.5	148.5	193.5	213.3	231.9	236.2	255.0	237.4
Cost per MYR of revenue (sen)	46.4	48.6	46.4	45.9	463.0	45.6	45.4	48.8
Cost per MYR of net int income (sen)	69.3	69.4	68.9	70.7	70.7	68.3	67.0	72.1
Overheads to staff cost (%)	115.9	110.2	106.5	91.5	91.7	98.7	104.0	100.1
Staff cost/employee (MYR'000)	82.6	86.0	96.6	102.7	108.8	108.4	108.8	127.6
Growth rates (%)								
Net interest income	10.7	2.5	15.2	1.2	7.8	5.3	5.2	1.6
Operating income	16.0	(2.1)	19.8	5.1	6.7	3.4	3.5	1.8
Operating profit	10.2	(6.2)	24.8	6.2	5.8	4.8	3.8	(4.6)
Pretax profit	22.4	(11.4)	35.1	14.1	11.5	1.8	7.3	(9.1)

Source: BNM Financial Stability & Payment Systems Reports

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