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Covid-19 and Malaysia Banking Industry

Covid-19 and Oil price war

The spread of the highly contagious Covid-19 has sent financial markets into a tailspin and thus creating fears of a global recession. The impact of the virus has now extended beyond China and to the rest of the World. Globally, the number of Covid-19 cases has surpassed 700,000 with more than 34,000 deaths. Many countries are imposing lockdown measures to contain the virus including Malaysia. In Malaysia, although movement control order has been extended to 15 April, no one knows when the virus will be contained. To make things worse, oil price has fallen more than 60% year-to-date due to the price war initiated by Saudi Arabia and Russia. Countries' central banks have decided to interfere and help to stabilize the economy.

Federal Reserve revives quantitative easing programme

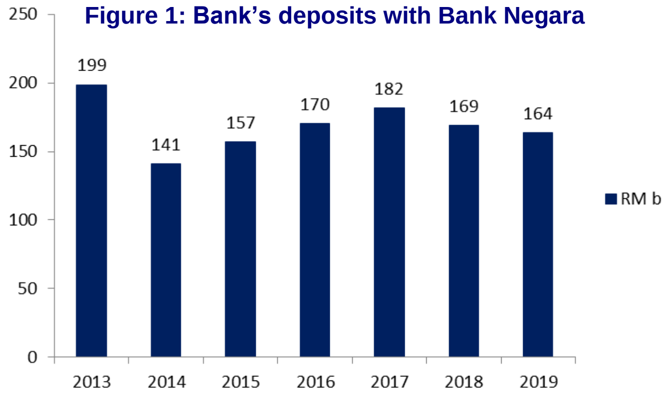
Federal Reserve cuts interest rates and the new benchmark interest rates range between 0% and 0.25%. Furthermore, Federal Reserve will purchase treasury securities and agency mortgage-backed securities in the amount needed (previously announced to purchase at least $500b of treasury securities and $200b of mortgage-backed securities). The agency mortgage-backed security is including the agency commercial mortgage-backed securities. Other than monetary policy, the Senate approved $2 trillion stimulus package to support the U.S economy.

Bank Negara Malaysia (BNM) measures to combat Covid-19

Key measures announced include:
i. 6-month moratorium on all SMEs and consumer loans starting 1 April, providing the loan not been in arrears for more than 90 days.
ii. Convert credit card outstanding balances into a 3-year term loan with interest cap at 13%.
iii. Banks will facilitate requests by corporations to defer or restructure their loans/financing repayments
iv. Regulatory reserve will be set to zero.
v. Banks may drawdown on the capital conservation buffer of 2.5% and operate below minimum liquidity coverage ratio (LCR) of 100%.
vi. NSFR minimum requirements reduced from 100% to 80%.
vii. Banks should take into consideration the nature of Covid-19 when formulating expected credit loss.

Back home, BNM has announced different measures to support the economy and this can be seen that they are focusing on ensuring stable asset quality and providing liquidity to support the economy. Other than that, government has announced RM250b worth of economic stimulus package that focus on public welfare and businesses including SMEs. Out of RM250b, RM100b has been allocated for the 6-month loan moratorium.

Figure 1: Bank's deposits with Bank Negara



Impact to Malaysia's banks

The measures are seen as a stabiliser rather than a positive uplift. 6-month moratorium and corporate loans that undergoing rescheduling and restructuring are exempted to classify as impaired could help to prevent deterioration in asset quality and ease provision trends until 3Q20. Regulatory reserves set at zero will help to increase banks' CET1 ratios but BNM stated banks should gradually rebuild the buffers once economic conditions improve.

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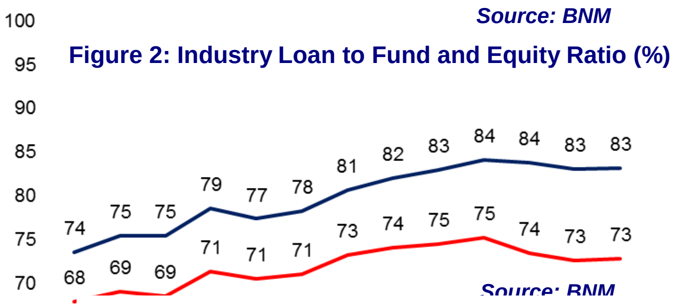


Figure 2: Industry Loan to Fund and Equity Ratio (%)

Possibility of liquidity crunch

Bank Negara Malaysia (BNM) will publish on the industry and their own statistics on their website on a monthly basis. The deposits of financial institutions in BNM are one of the indications of liquidity available as BNM can release this if they feel there is a need to. BNM has RM145b of deposits from financial institutions as of January2020 **(Figure 1)**. Furthermore, industry loan to fund ratio and loan to fund and equity ratio stood at 83.4% and 72.6% respectively as of January2020 **(Figure 2)**. RM337b of the funds are not lend out **(Appendix 1)**. Industry's liquidity coverage ratio stood comfortably at 151% as of January2020 as compared to minimum requirement of 100% **(Figure 3)**. Moreover, BNM can utilise Statutory Reserve Requirement (SRR) ratio to maintain liquidity in the financial system. They have lowered SRR from 3% to 2% effective March2020 and the lowest that it had ever gone to was 1%. Hence, it can be seen that there is ample liquidity in the banking system. However, since the moratorium will affect bank cash flow, we should not rule out that the banks may liquidate some of their bonds holdings to meet cashflow needs in near term.

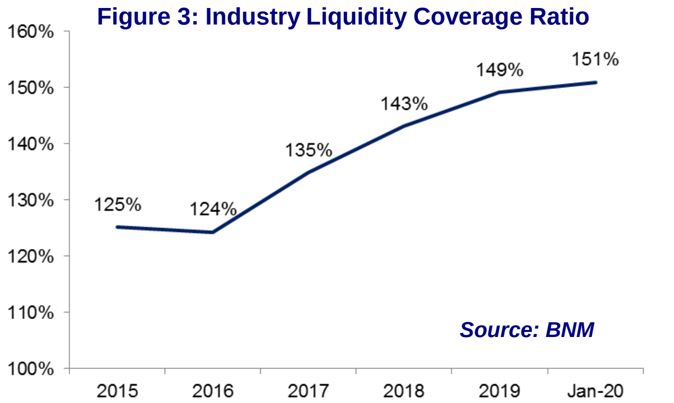


Figure 3: Industry Liquidity Coverage Ratio

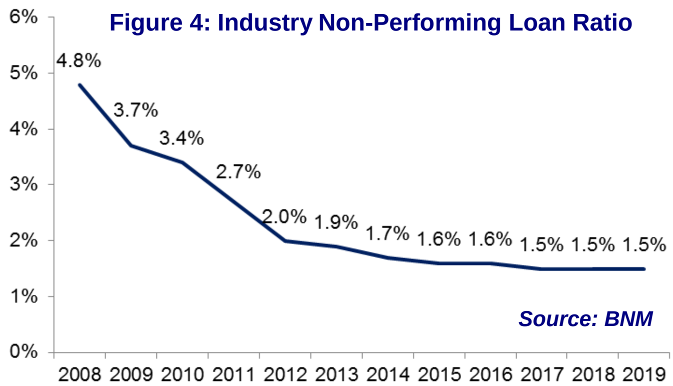


Figure 4: Industry Non-Performing Loan Ratio

Asset Quality

Industry NPL ratio is manageable at 1.5% **(Figure 4)** and average net credit costs was at 21 basis point in 2019 **(Figure 5)**. Covid-19 is a black swan event but it is inappropriate to label it as financial crisis at this point of time. We should only consider if the credit costs will rise to 2008-2009 level should the Covid-19 prolong to more than 6 months and caused severe supply chain disruption. Given the uncertainty in credit costs due to the difficulty in forecasting the impact of each banks, it is easier to study the types of customers **(Appendix 2)** and purposes of loans **(Appendix 3)** given out by the banks. Individual accounts for 74% of BIMB's customers profile as their main focus is on personal financing. 32% of Maybank's loans (RM168b) are lend out as working capital while SMEs and corporates account for 10% and 25% of their customer profile respectively. Public Bank has the highest market share in SMEs but they have the lowest NPL ratio among the peers at 0.5%. HLB, Public Bank and BIMB have the highest loan loss coverage ratio **(Figure 6)**. On the other hand, oil and gas sector accounts only 2-3% of banks' total loans. We would prefer to pick banks with defensive qualities at this point of time and HLB seems to top the chart among the peers with NPL ratio at 0.8% and LLC at 182%.

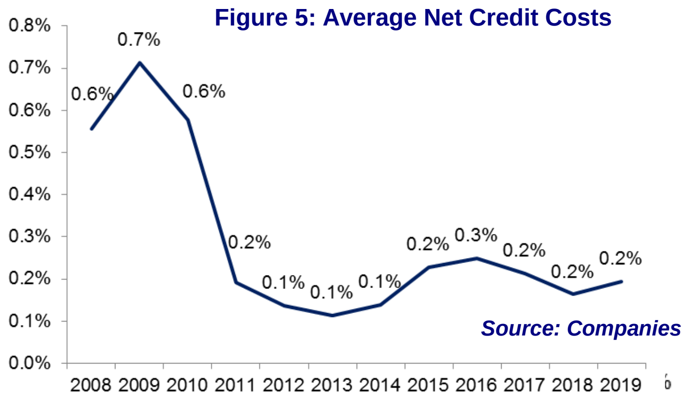


Figure 5: Average Net Credit Costs

Figure 6: Loan Loss Coverage Ratio

Conclusion

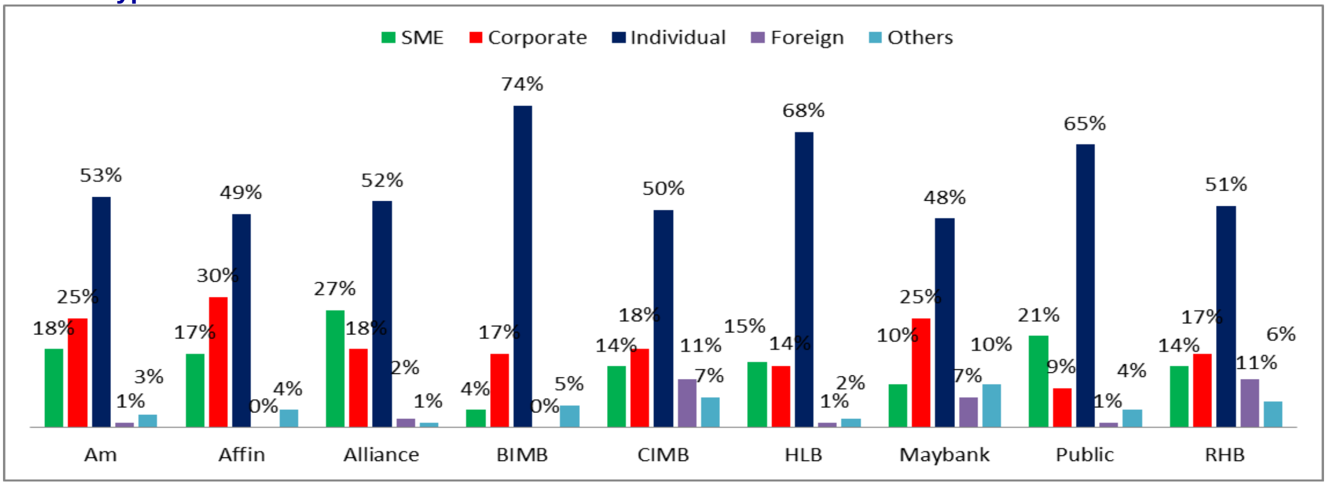
The government and BNM's measures are neutral or slightly positive to the banks in 1H20. The real challenges lie after the moratorium. However, we believe Covid-19 will be contained within the next few months.

Appendix

1. Industry fund, equity and loan size

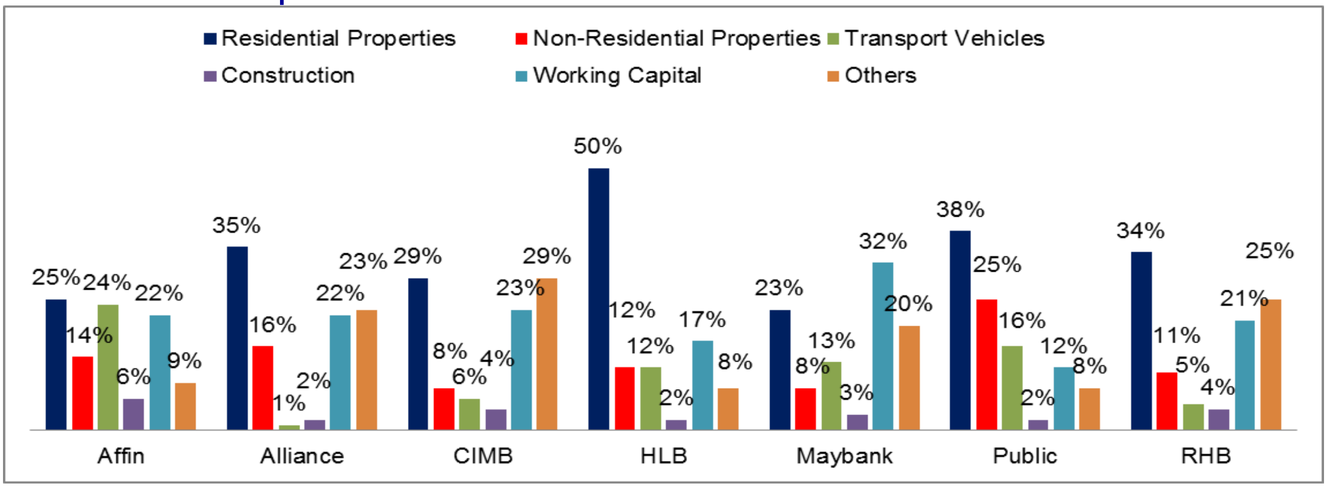
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund	852	945	1,030	1,114	1,286	1,403	1,506	1,618	1,674	1,709	1,783	1,936	2,013
Equity	71	87	102	112	124	142	151	173	188	203	251	278	286
Loan	627	713	777	876	995	1,099	1,215	1,328	1,389	1,438	1,495	1,609	1,676

2. Types of Customers in FY19



Source: Companies

3. Economic Purposes of Gross Loans in FY19



#AmBank and BIMB doesn't show the purposes of gross loans in their quarterly report

Source: Companies

4. Peers Comparison

	Share Price 31-Mar	P/E		P/B		Dividend Yield (%)		ROE (%)	
		FY20E	FY21F	FY20E	FY21F	FY20E	FY21F	FY20E	FY21F
Am	3.00	6.4	7.1	0.5	0.5	7.0	6.6	7.8	7.0
Affin	1.44	6.0	5.8	0.3	0.3	4.6	5.0	5.2	5.2
Alliance	1.90	6.6	6.3	0.5	0.5	7.4	7.5	7.6	8.0
BIMB	3.25	7.3	6.8	1.0	0.9	5.0	5.2	13.4	12.9
CIMB	3.60	7.9	6.9	0.6	0.6	7.2	7.8	8.3	8.6
HLB	13.46	10.6	10.2	1.0	1.0	3.8	4.0	10.0	9.9
Maybank	7.45	10.8	10.5	1.0	1.0	7.2	7.5	9.4	9.5
Public	15.90	11.6	11.1	1.3	1.3	4.5	4.7	11.8	11.6
RHB	4.69	8.0	7.6	0.7	0.7	6.4	6.7	9.1	9.3

Source: Bloomberg Consensus