MARC

Malaysian Rating Corporation Berhad
199501035601 (364803-V)

SECTOR OUTLOOK

BANKING INDUSTRY

Contacts:

Farhan Darham
+603-2717 2945
farhan@marc.com.my

Haziq Najmuddin
+603-2717 2965
haziq@marc.com.my

Mohd Izazee Ismail
+603-2717 2947
izazee@marc.com.my

December 2021

Summary

- MARC maintains a stable outlook on the Malaysian banking sector. Despite the challenges posed by the COVID-19 pandemic, the domestic banking industry was shielded from severe financial distress, having entered the pandemic with a strong position.

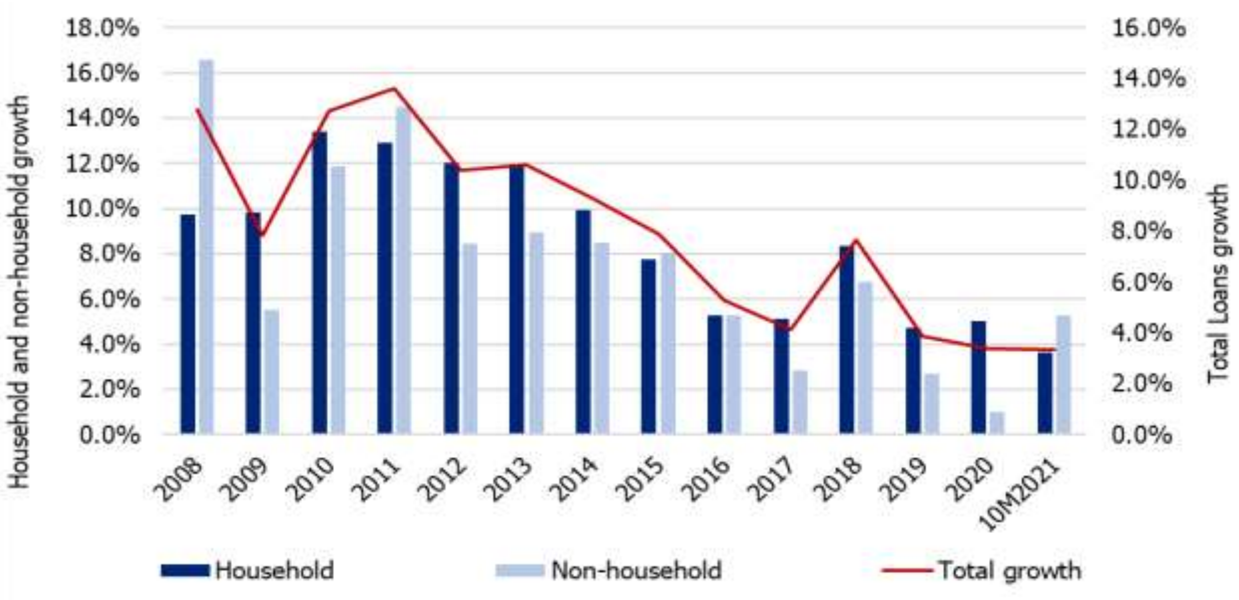
- Overall impaired loans and delinquencies have not spiked, supported by loan moratorium and relief measures. Profitability is starting to pick up after a series of large pre-emptive provisions as well as modification losses made in the previous year had put a dent on the banks' bottom line, particularly in 2020.

- Impairments will increase when loan moratorium and support measures end. The pre-emptive provisions made since 2020 in anticipation of eventual slippages in asset quality will mitigate the overall impact on banks' balance sheet, as reflected by the loan loss coverage of 124% as at end-October 2021. The banking system's Common Equity Tier 1 (CET1) and total capital ratios of 14.3% and 18.0% also provide ample buffers against unexpected risks.

- With the gradual reopening of all economic sectors and lifting of restrictions, we expect the banking industry to gain growth momentum and chart higher loan growth in 2022. Nonetheless, any change in the pace of recovery as a result of the impact of the new COVID-19 variant could result in a setback to growth.

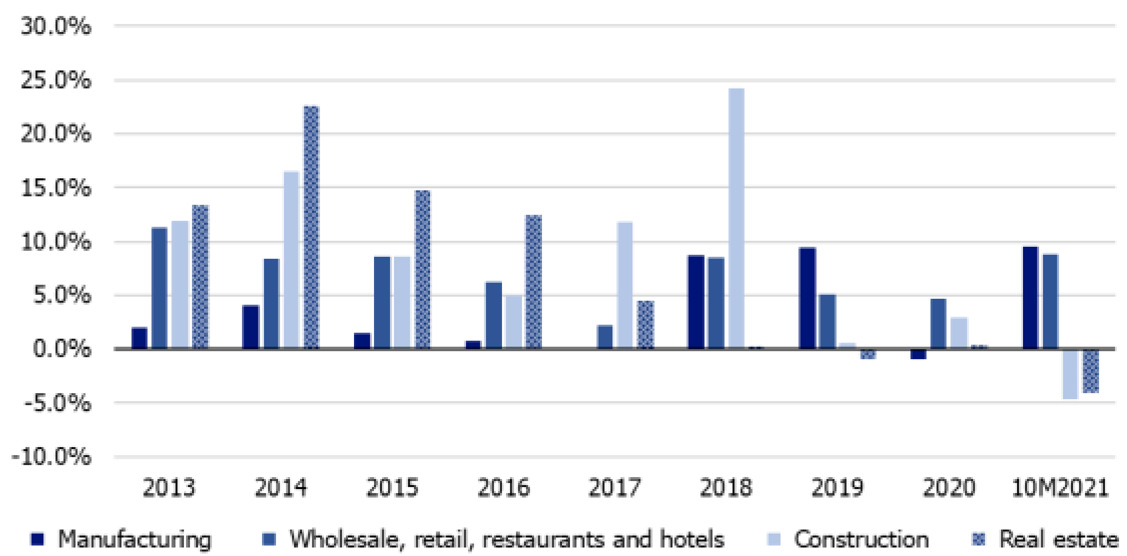
Loan growth on recovery mode

Exhibit 1: Banking industry's loan growth



Sources: Bank Negara Malaysia (BNM), MARC

Exhibit 2: Loan growth by sector



Sources: BNM, MARC

- Loan growth for 2020 and 2021 were affected by business disruptions caused by shutdowns and movement restrictions imposed to contain the COVID-19 risk. For 10M2021, loan growth was largely unchanged at 3.3% y-o-y (2020: 3.4%). We view that loan growth during the period affected by the pandemic may not be reflective of actual credit demand as the growth was also boosted by the loans under moratorium and relief measures.

- As evident from exhibit 1, the banking industry's loan growth was at a declining trend due to uncertainties in the economy even before the onset of the pandemic. Similarly, the reduced visibility in relation to how asset quality will fare post-moratorium may significantly curb banks' appetite in undertaking new loans.

- Business loan growth has improved to 2.9% in 10M2021 compared to 1.0% in 2020. The manufacturing and wholesale trade sectors were the main beneficiaries of the easing of restrictions while the construction and real estate sectors have remained sluggish. We are also expecting business loans to make some grounds going forward.

- The household sector saw a lower growth of 2.5% in 10M2021 compared to 5% in 2020. This was largely due to slower growth from residential lending, which registered a 4.6% growth in 10M2021 compared to 7.1% in 2020. Residential lending forms the bulk of the household portfolio at 61%.

- With stronger growth expected for 4Q2021, loan growth is projected to close at 3%-3.5% for 2021. For 2022, we expect the banking industry to chart a higher loan growth of 4%-5%, supported by the increase in economic activities. Nonetheless, any change in the pace of recovery as a result of the impact of the new COVID-19 variant could result in a setback to growth.

Understated impairment numbers

Exhibit 3: Banking industry's gross impaired loans trend

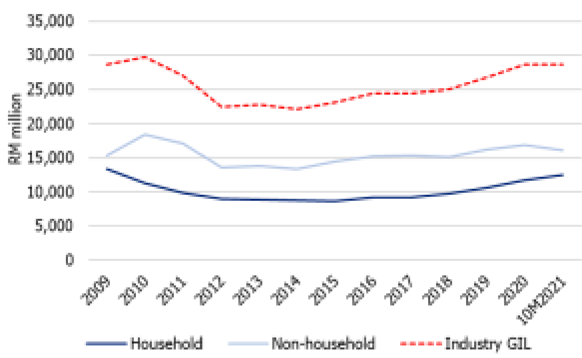
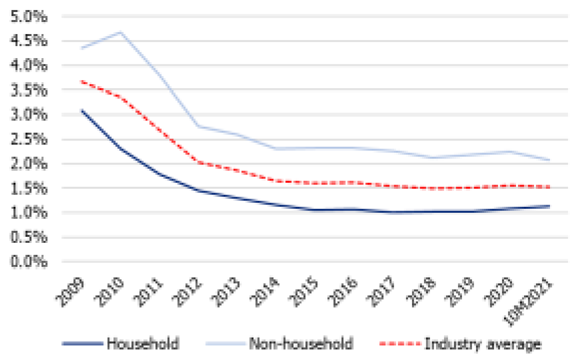


Exhibit 4: Banking industry's gross impaired loans ratio trend



Sources: BNM, MARC

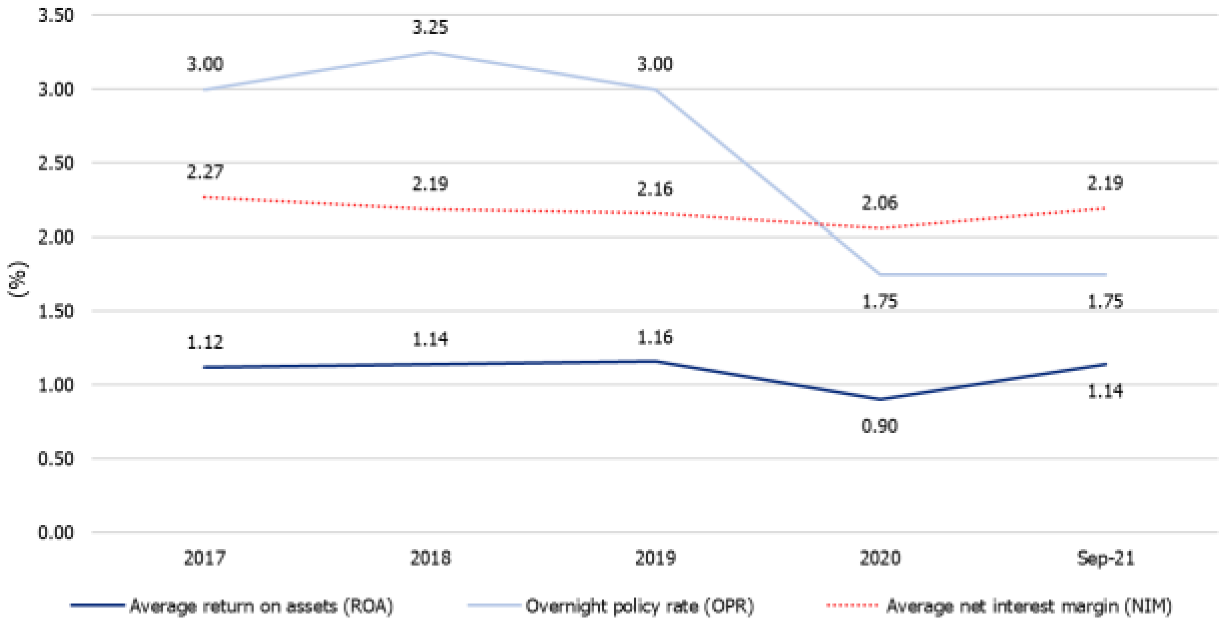
- The banking system's gross impaired loans (GIL) ratio stood at 1.52% as at end-October 2021, compared to 1.56% as at end-December 2020. The impairment numbers may be understated by the moratorium and relief measures granted during the pandemic.

- Latest numbers for loans under relief as at end-October 2021 from the larger domestic banks ranged from 21%-32% of total loans, increasing from 8%-17% in May 2021. The increase followed the expanded scope of relief measures after the reimposition of nationwide lockdown in June 2021. With the relief measures and expected continued stance of the government in aiding troubled borrowers, we do not expect impairment numbers to deteriorate significantly over the near term.

- Loan defaults are expected to rise over the next few years after the gradual expiration of the relief measures. While GIL ratio is expected to remain below 2.0% for 2021, the ratio may climb to the 2.0%-2.5% levels in 2022.

Profitability on the mend

Exhibit 5: Profitability matrix



Sources: BNM and selected bank's financial statements

- Profitability numbers in 2020 were dragged down by hefty provisions, modification losses as well as the lower net interest margin (NIM) following multiple overnight policy rate (OPR) cuts during the period. However, the profitability numbers reported by the six largest Malaysian banks for the period up to September 2021 indicate that banks are on track to register better full year profits compared to the 2020 levels. The average ROA and NIM improved to 2.19% and 1.14% in 9M2021 from 2.06% and 0.90% in 2020.

- We expect further earnings upside for 2022 on the back of continued economic recovery and lower impairment charges with the pandemic-related provision cycle to end soon. A possible increase in the OPR in the second half of 2022 would give a further boost to the banks' profit. Although banks' earnings performance is expected to improve, the recently announced Cukai Makmur (prosperity tax) will put some dent on the banks' retained earnings. Under the Cukai Makmur, companies with pre-tax profit of more than RM100 million will be taxed at a higher rate of 33% (compared to 24% currently).

Capital position provides buffer against shocks

Exhibit 6: Banking industry's capital ratios

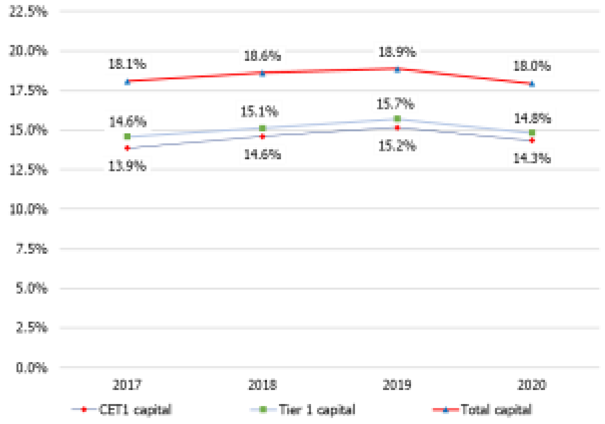
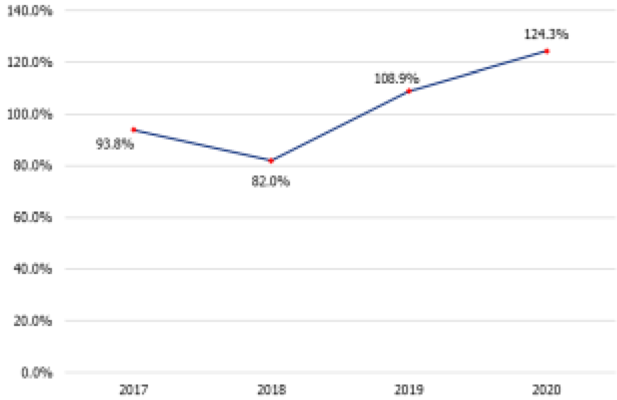


Exhibit 7: Banking industry's loan loss coverage



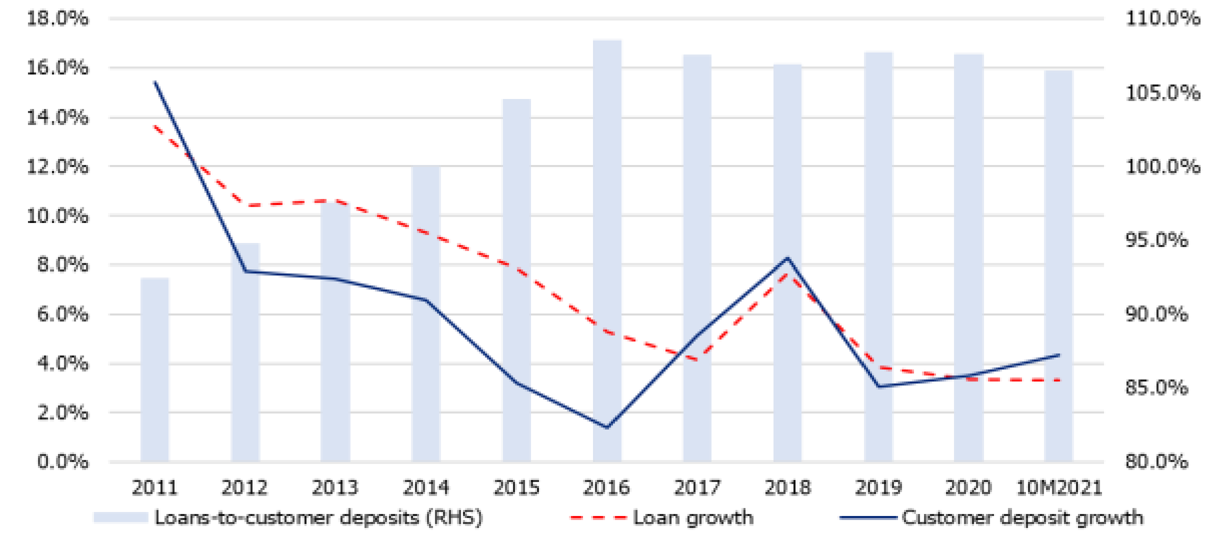
Sources: BNM, MARC

- The banking sector remains well capitalised with sizeable liquidity buffers in place. The CET1 and total capital adequacy ratios stood robust at 14.3% and 18.0% as at end-October 2021. With excess capital buffers of about RM125.0 billion, banks are in a good position to withstand any severe macroeconomic and financial shocks.

- Banks have also been setting aside higher buffers to absorb the likely rise in credit losses. Total provisions as at end-October 2021 were about 62% higher than the pre-pandemic level at the end 2019. The majority of banks have applied management overlays to bolster provisions given the uncertainties faced in the business environment that may affect borrowers' repayment capabilities. Total loan loss coverage of the banking system (excluding regulatory reserves) as at end-October 2021 accounted to 124% of impaired loans, compared to 82% prior to the pandemic.

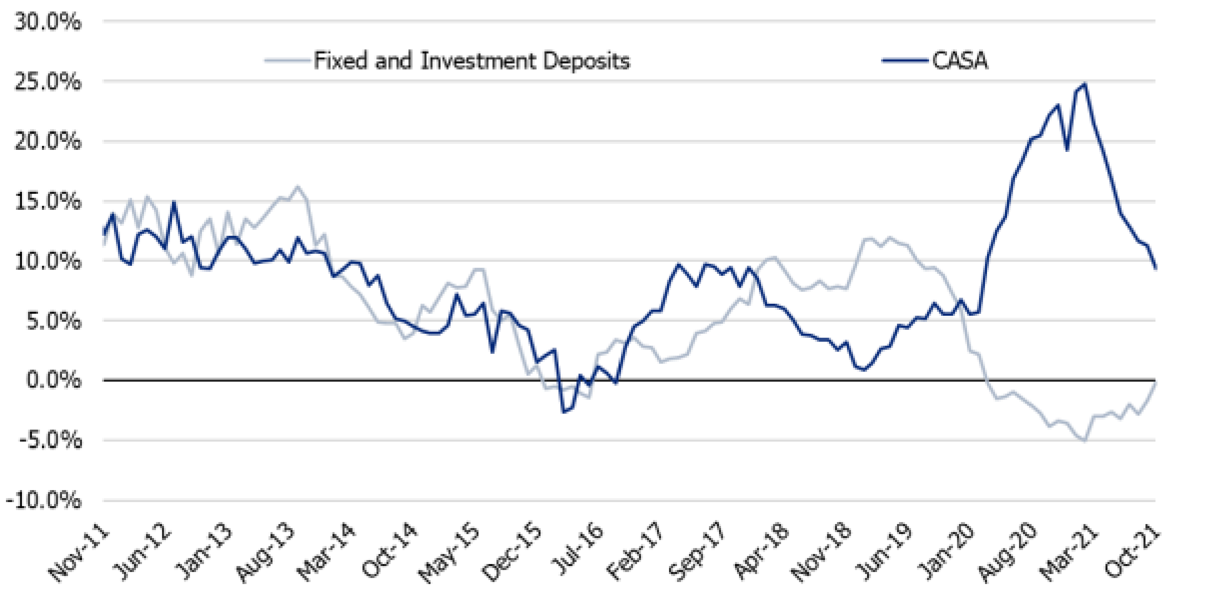
Funding and liquidity profile remained healthy

Exhibit 8: Banking industry's loan and deposit growth



Sources: BNM, MARC

Exhibit 9: Deposit growth by type



Sources: BNM, MARC

- The liquidity coverage ratio (LCR) of the banking system stood at 153% as at end-October 2021, well above the regulatory minimum. Total deposits grew by 4.4% y-o-y, outpacing loan growth of 3.3% y-o-y, supported by high current and savings account (CASA) deposits growth, which peaked at close to 25% y-o-y in the early part of 2021 before tapering to 9.4% in October 2021. Meanwhile, with low interest rates, the appetite for fixed deposit placements was muted as reflected by the marginal contraction of 0.2% y-o-y over the same period.

Sustainability a key growth driver going forward

- Sustainability is becoming a competitive imperative with a growing awareness and acceptance among businesses that growth opportunities lie in solving key sustainability challenges. More and more businesses are stepping up to manage their total impact as an enterprise across the triple bottom line of profit, people and planet. The emergence of sustainable banking provides new growth opportunities for banks and helps address slowing growth rates.

Digital banking making good progress

- MARC continues to see positive developments in Malaysia's digital banking journey. The financial services industry rapidly transformed in 2020 as COVID-19 accelerated the growth of fintech and the adoption of digital banking services. This pace of adoption is expected to pick up when BNM grants five digital banking licences in the first quarter of 2022. BNM announced that it has received 29 applicants for digital banking license when the application period ended in June 2021. With fintech fast becoming a central part of the country's financial services sector, we expect that banks will continue in pursuit of digital transformation and product innovation to strengthen long-term business growth.

Published by:

MALAYSIAN RATING CORPORATION BERHAD 199501035601 (364803-V)
19-07, Level 19, Q Sentral, 2A Jalan Stesen Sentral 2, Kuala Lumpur Sentral, 50470 KUALA LUMPUR
Tel: [603] 2717 2900 Fax: [603] 2717 2920
Email: marc@marc.com.my   Website: www.marc.com.my