

Malaysian Banking Sector Outlook

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MALAYSIAN RATING CORPORATION BERHAD

Clarity and Integrity

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Presentation Outline



- Macroeconomic environment
- Industry performance trends and outlook
- Trigger events
 - Positive triggers
 - Challenges
 - Opportunities
- MARC's financial institutions portfolio
- Concluding remarks

- **International Environment**
 - Sovereign debt woes and geo-political uncertainties.
 - Commodity price volatilities and spillover effect into the real economy.
 - Weak international trade conditions.

- **Policy Environment**
 - Inflation and 'pre-mature' monetary policy tightening.
 - Increased regulatory scrutiny.

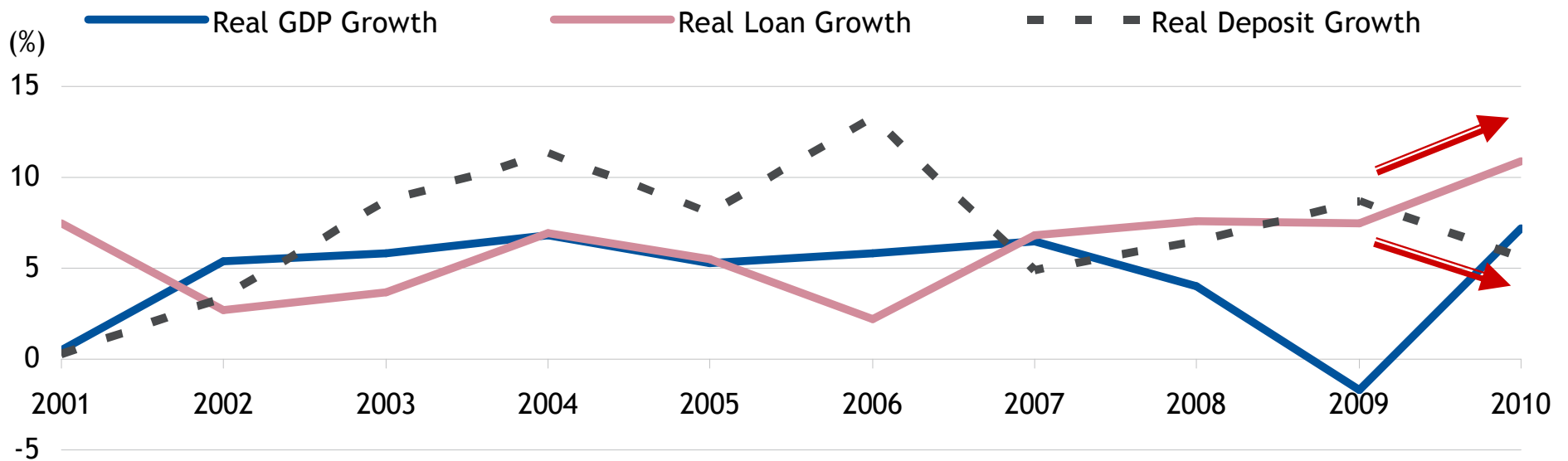
- **Domestic Operating Environment**
 - Saturating domestic market and intensifying competition.
 - Escalating household sector debt.
 - Improved corporate performance; however, uncertainties linger.

Industry Performance Trends and Outlook

Rebounding Balance Sheet Growth



Growth Trends: GDP, Loans and Deposits



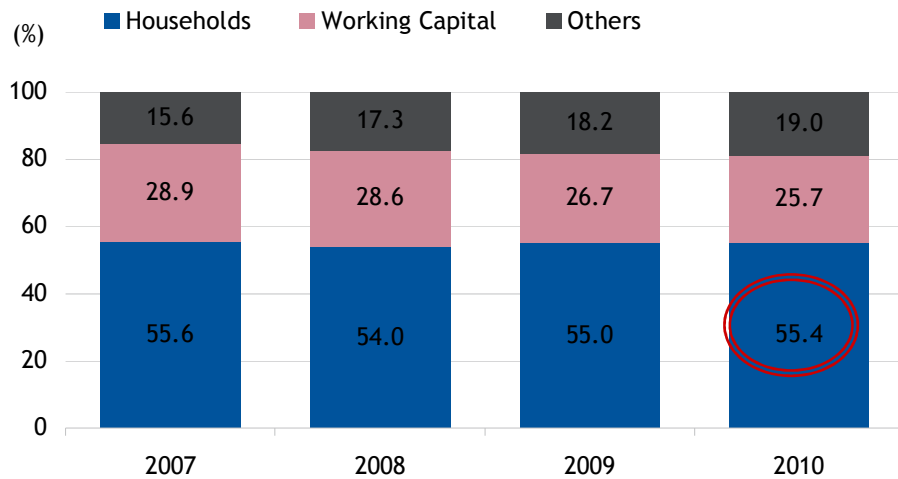
Source: CEIC, MARC

- Real loan growth trending above real GDP growth.
- Deposit growth has fallen below loan growth.
- Nominal loan growth of 12%-15% expected in 2011.

Households Dominate Loan Book

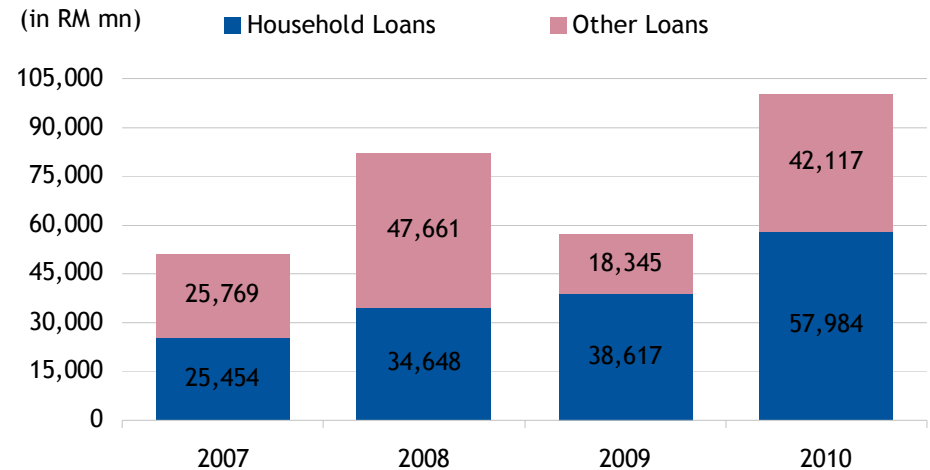


Loan Book Mix of Malaysian Banks



Source: BNM, MARC

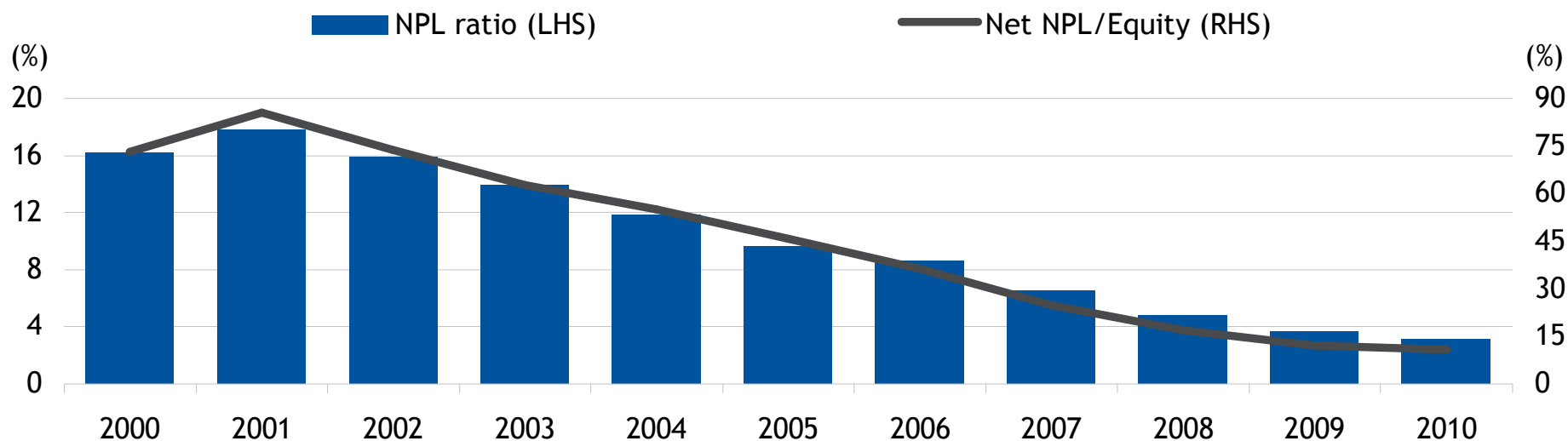
Incremental Loan Growth (y-o-y)



Source: BNM, MARC

- Household loans continue their dominance, while working capital financing remains significant.
- Long-term project financing exposures and credit appraisal competencies of Malaysian banks remain fairly untested.
- Is this a cause for concern?

Asset Quality of Malaysian Banks



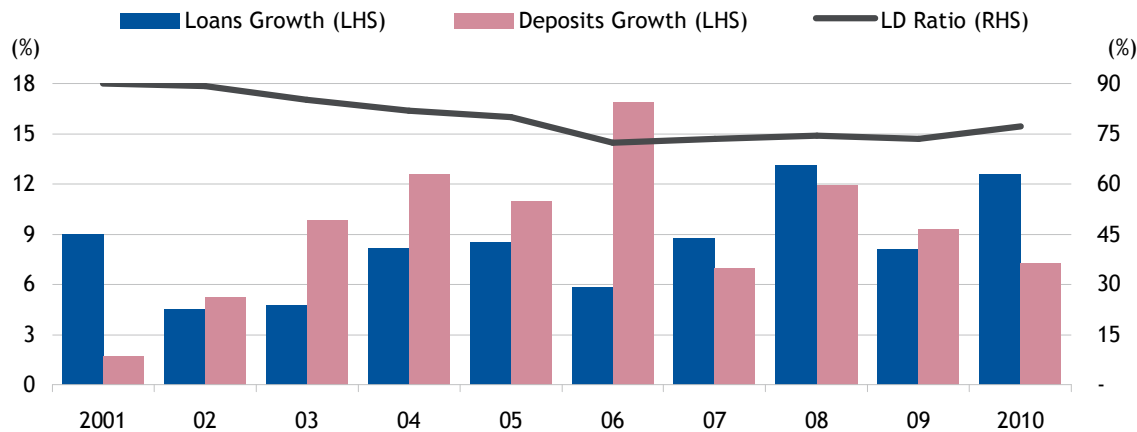
Source: BNM, MARC

- Asset quality remains strong, while impact of unreserved NPLs on equity at a decade low.
- Further improvement in asset quality is likely to be minimal as NPLs are already at a fairly low level.

Deposits: Is it a Concern?



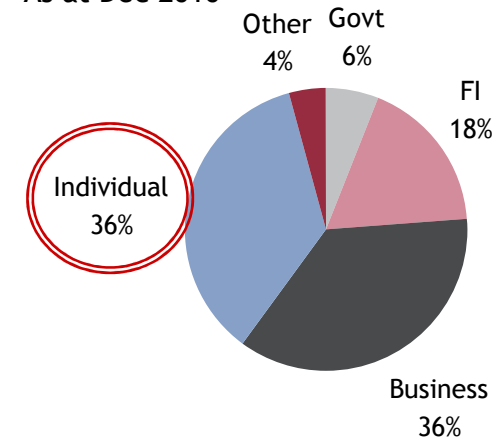
Loans-to-Deposit Ratio



Source: BNM, MARC

Deposits by Holders

As at Dec 2010



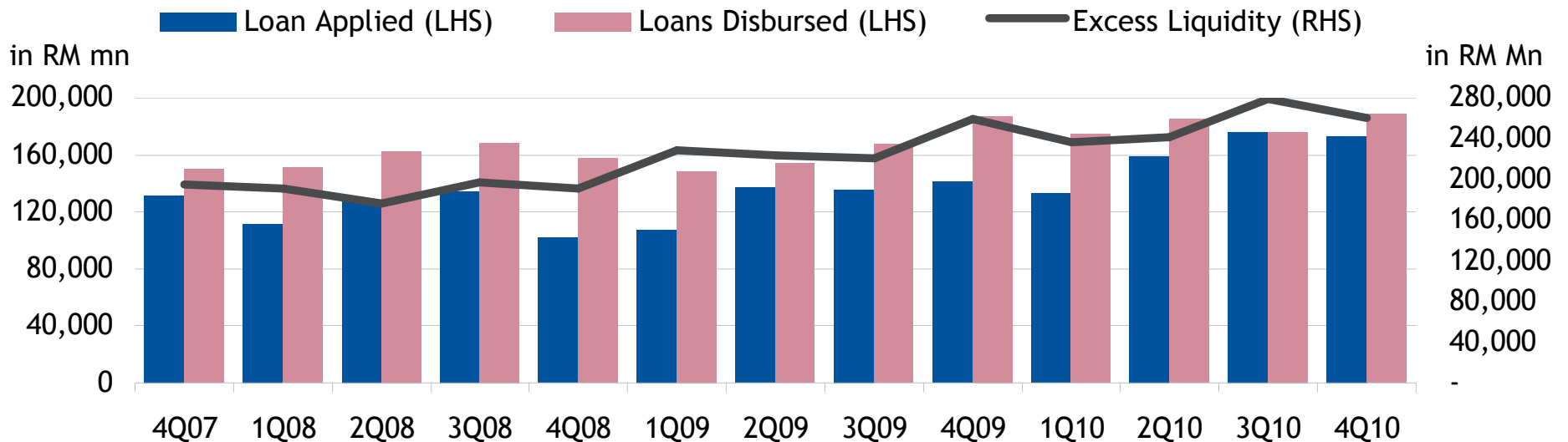
Source: BNM, MARC

- Deposits growth is trending lower and the loans-to-deposits ratio is trending higher.
- Individual deposits account for only 36% of total deposits.

Still Sufficient Liquidity



Loans Applied, Disbursed and Excess Liquidity



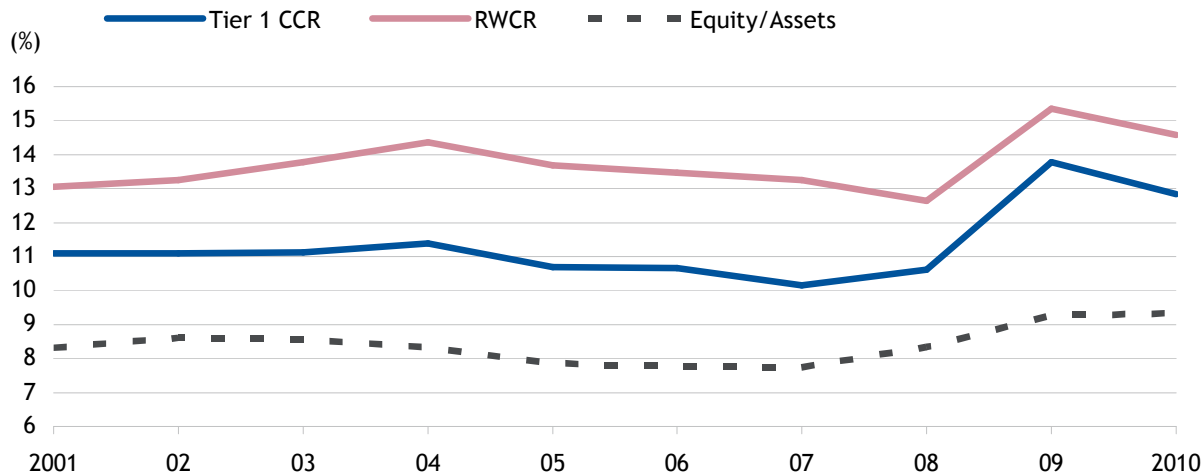
Source: BNM, MARC

- Excess liquidity in the banking system sufficient to absorb additional credit disbursements.
- Recent SRR hike unlikely to create a significant impact on lending.

Adequate Capitalisation

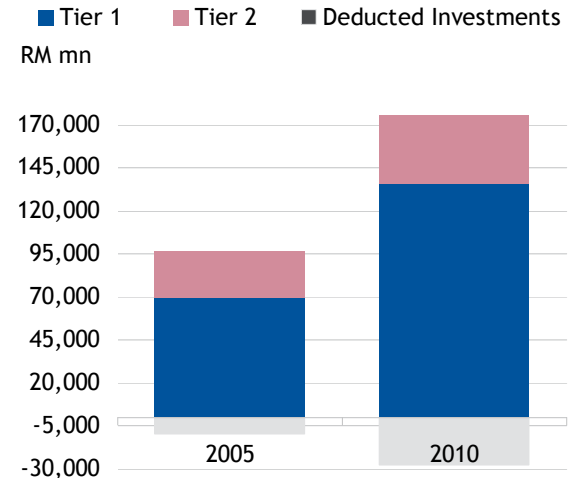


Capital Ratios of Malaysian Banks



Source: BNM, MARC

Capital Composition



Source: BNM, MARC

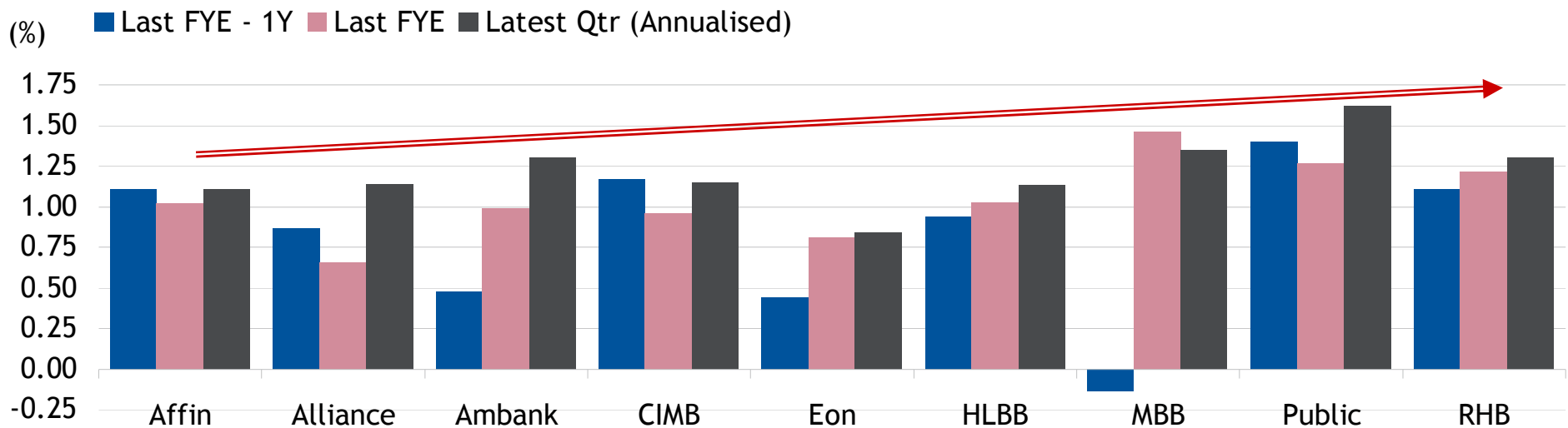
- Capitalisation remains adequate with comfortable loss absorption ability.
- RWCR of 14.6% is well above regulatory minimum of 8% and reasonably above the market implied minimum of 12%.

Earnings Trending Up



Return on Assets

Last FYE varies among the banks; Dec 2010, Jun 2010 or Mar 2010



Source: Bank financials, MARC

- Earnings and return on assets maintain upward trend.
- ROA supported by lower loss allowances and improving net interest income and non-interest income sources.

- **Positive Triggers**

- The economic transformation programme (ETP) impetus

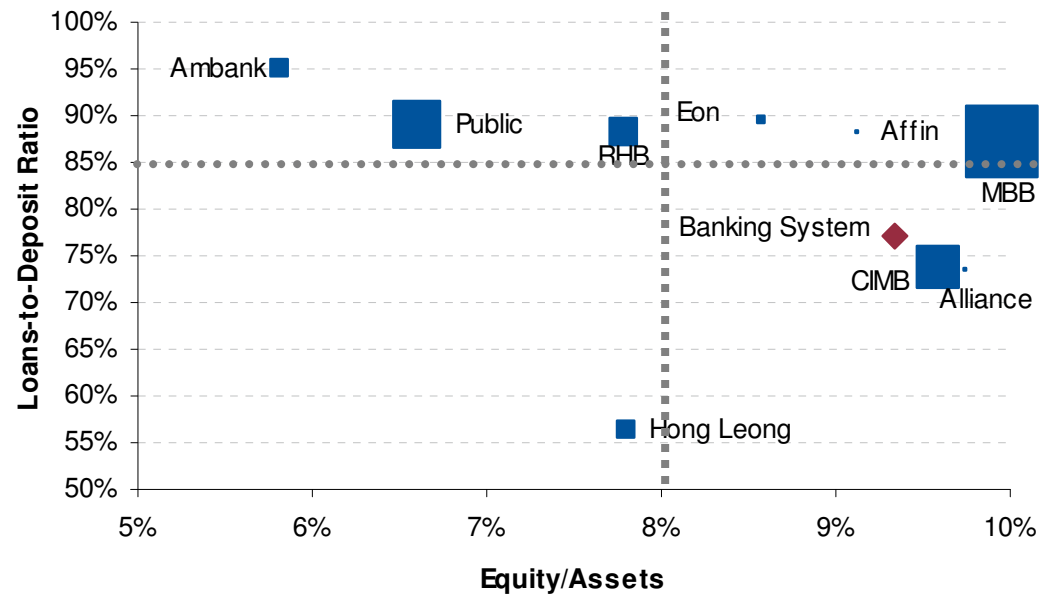
- **Challenges**

- Funding trends
- Household sector debt
- Increased regulatory intervention

- **Opportunities**

- Regional expansion
- Consolidation

The ETP Impetus

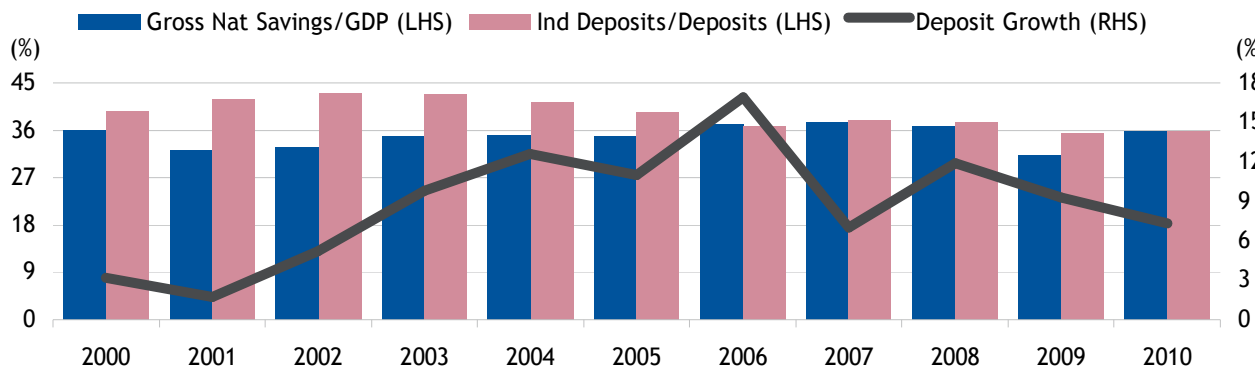


- Good opportunity for banks to expand their corporate loan books, especially for foreign banks with proven expertise in project and infrastructure financing.
- Possible challenges:
 - Limited project and infrastructure financing expertise.
 - Single obligor concentration and industry concentration limits.

Funding Trends



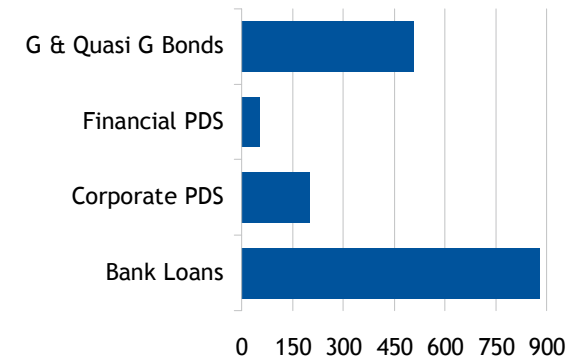
Trends in National Savings and Deposits



Source: BNM, CEIC, MARC Note: Gross National Savings/GDP for 2010 is MARC FI Analyst Forecast

Financing Trends

in RM bn as of Dec 2010



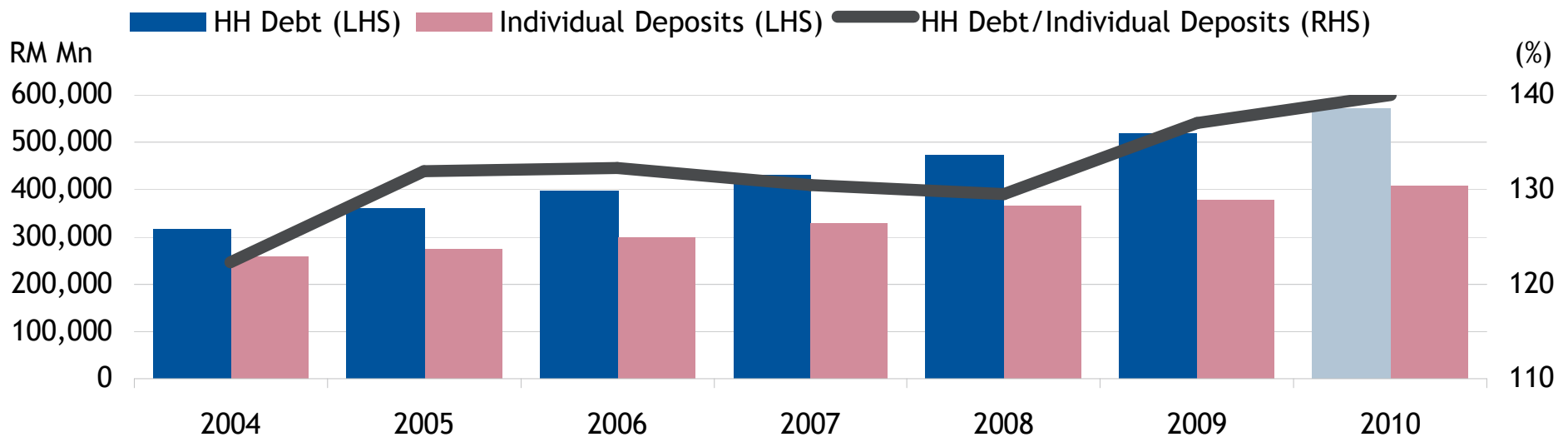
Source: BNM, MARC

- Gross national savings remain low, while individual deposits have remained relatively flat as a proportion of total deposits.
- Can the Malaysian economy fund its ambitious projects?

Household Sector Debt



Household Debts and Deposits



Source: BNN, MARC

Note: 2010 HH Debt is MARC FI analyst forecast figure

- Household sector debt inches up as households remain a net debtor to the banking sector.
- Can evolve into a significant risk in the future.

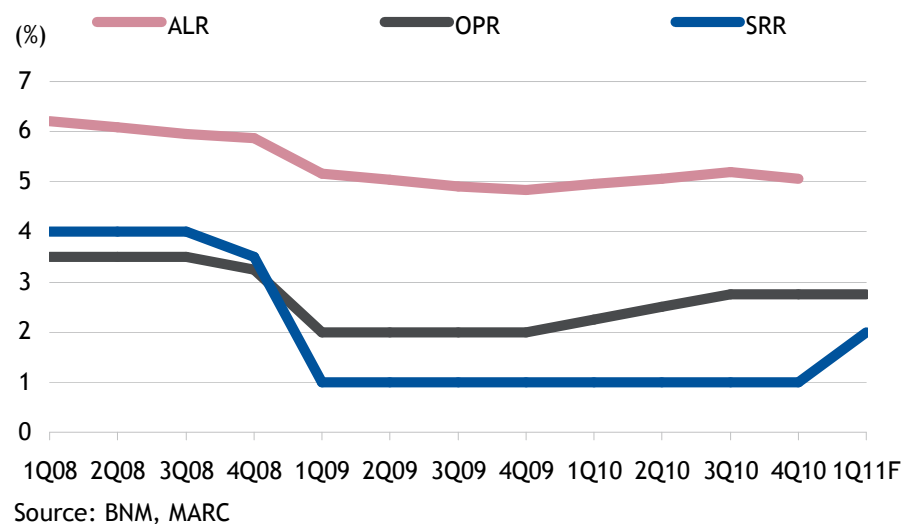
Recent regulatory moves

- Policy normalisation.
- Lower loan-to-value for third property purchase.
- Higher risk-weighted assets for property loans.
- Prudential regulations governing credit card issuance.

Possible regulatory moves

- Further policy normalisation moves involving OPR and SRR.
- More targeted prudential regulations, especially for household lending.
- Increased moral suasion.
- Basel III-related preliminary developments.

Macro Interest Rate and SRR Movements

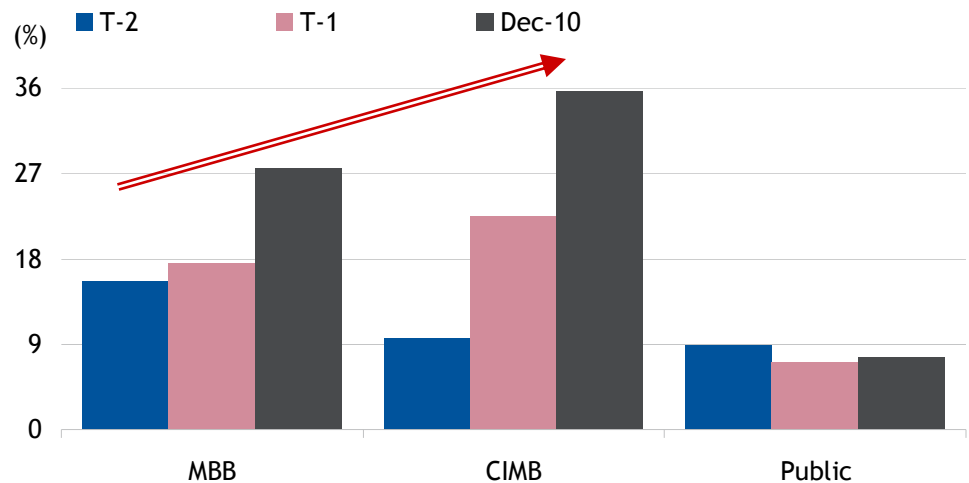


Managing Regional Expansion



- Regional ventures fraught with complex regulatory, legal, political and socio-economic challenges.
- Limited expertise of Malaysian banks and low brand recognition in international markets.
- Heavy financial and human capital investments required for value extraction.
- However, regional expansion is also proving to be rewarding for Malaysian banks.
- Will there be a credit rating impact?

Overseas Profit Contribution as a % of Total



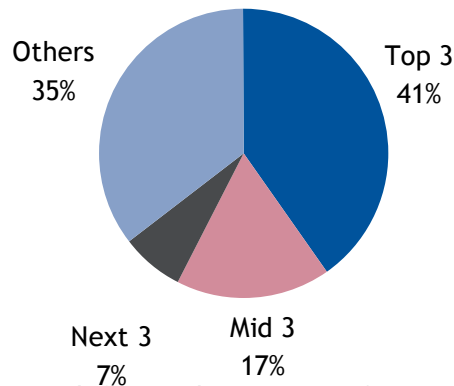
Source: Bank financials, MARC

The Case for Consolidation



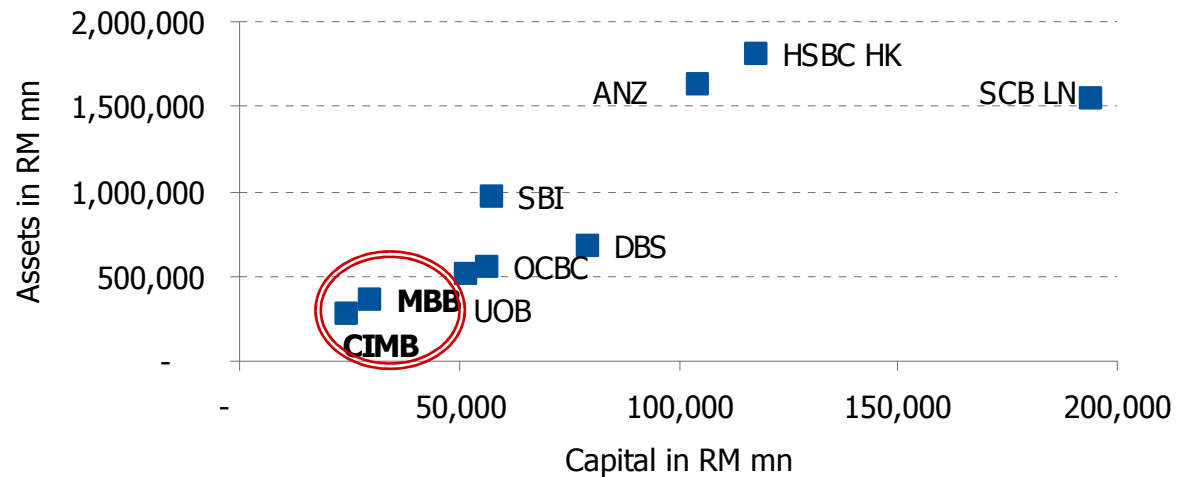
Market Share by Assets

As of 30 Sep 2010



Source: Bank financials, BNM, MARC

Selected Regional Banks: Capital & Assets



- Consolidation can create meaningful economies of scale for smaller banks.
- Going forward, interest in consolidation is likely to be renewed, especially by interested foreign parties.

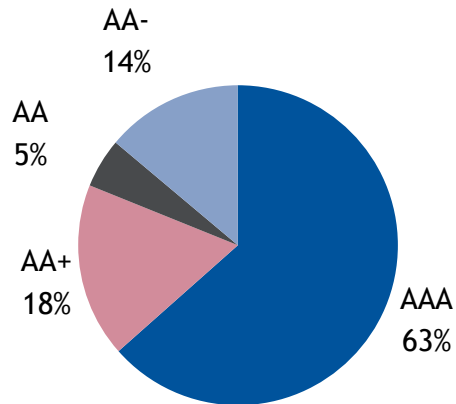
MARC's Financial Institutions Portfolio

MARC's FI Rating Universe



MARC's FI Rating Universe

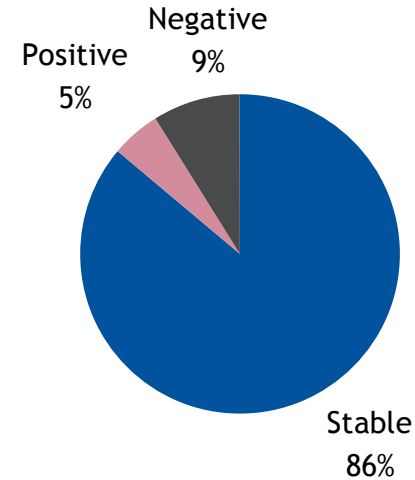
As of 21 March 2011



Source: MARC

FI Rating Outlooks

As of 21 March 2011



Source: MARC

- Highly rated and stable rating universe, reflecting underlying credit strength and expected resilience of the banking sector.

External Support in Credit Ratings



- MARC's ratings of financial institutions incorporate support from the government, regulatory authorities or, where applicable, from the parent entity.

- MARC will ascertain expected support on a case by case basis, considering among others:
 - The size and the resulting systemic importance of an institution.
 - Substitutability of an institution and its strategic importance to the economy and/or the government.
 - An institution's interconnectedness with the broader financial system.
 - Past precedence of support and its forms.
 - Availability of explicit and legally binding support commitments.

- To uphold greater transparency, MARC will indicate the level of support factored into a rating in its rating rationale.

Concluding Remarks



- Malaysian banks have performed well during the crisis and the recovery phase.
- The regulators have performed commendably well to ensure the stability of the financial sector.
- Rating stability of the Malaysian banking sector is underpinned by adequate capitalisation, good asset quality and decent earnings streams.
- Key rating risks include overzealous growth and acquisitions as well as event-related risks, including possible escalation in household sector defaults.
- Overall, MARC maintains a stable outlook on the Malaysian banking sector.



Thank You