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Weekly Credit Brief Feb 14 - Feb 20

Singapore banks face test of housing, oil price slump

by Liu Hanlei

All three Singapore-listed banks announced Q4 earnings last week, missing analyst expectations but reported improved results for the whole of 2016. Our analysis of the banks' credit performance under various situations shows the banks to be resilient under adverse conditions, a conclusion similar to the Monetary Authority of Singapore's stress test last year.

During the earnings press conferences, DBS reported a 9% reduction in net profit to SGD 913mn as total allowances increased by 87% to SGD 462mn while OCBC posted an 18% drop in net profit to SGD 789mn with a 57% increase in total allowances to SGD 305mn. UOB did relatively better with a 6.2% drop in net profit and surprised the market with a 31% reduction of total allowances to SGD 131mn. All three banks had to increase allowances to cope with rising non-performing loans (NPLs) in the oil and gas sector.

OCBC painted a pessimistic outlook on the oil and gas sector. Its CEO, Samuel Tsien, commented that pressure remains in the oil and gas sector despite higher oil prices and foresees more uncertainty in the months ahead. OCBC has SGD 13.4bn of loans (6% of total loans) to the oil and gas sector with a sector NPL ratio of 10%, an increase of 6.4% from a year ago. OCBC's overall NPL ratio stands at 1.3%. UOB has SGD 11bn oil and gas industry loans (5% of total loans) and an overall NPL ratio of 1.5% while DBS had SGD 16bn of oil and gas exposure in Q3 and an overall Q4 NPL ratio of 1.4%.

To estimate the effect of the change in oil prices on the banks' default risk, we compute the CRI 1-year Probability of Default under stress (PDuS) for the three lenders from a bottom-up, reduced-form credit risk model. We define three stress scenarios to predict the corresponding change to the model's inputs, and then compute the resulting profile of the three banks. The change in 1-year PDuS will then reflect how vulnerable the target portfolio is under stress. In our base scenario, we project oil prices remain at USD 50 per barrel; our optimistic scenario assumes oil increases to USD 75 per barrel within a year and oil prices decrease to USD 25 per barrel in our pessimistic scenario. Table 1 highlights the results.

	1-year PDuS (bps) before stress scenario	1-year PDuS (bps) after stress scenario Base – USD 50	1-year PDuS (bps) after stress scenario Optimistic – USD 75	1-year PDuS (bps) after stress scenario Pessimistic – USD 25
DBS	50.03	63.72	51.07	80.31
OCBC	4.29	5.36	4.33	6.69
UOB	1.51	1.85	1.59	2.16

Table 1: Stress test scenario using WTI oil prices. *Source: Bloomberg, RMI-CRI*

The outcomes of the stress test show that the change in the 1-year PDuS is highest for DBS at 30.28bps when oil prices decline to USD 25 per barrel. Overall, the changes in oil prices do not significantly affect the credit quality of the Singapore banking sector. Lenders may have taken a prudent stance in recognizing higher allowances for bad debts in the oil and gas sector in the recent quarters. In Q4, Singapore banks collectively increased allowances by 58.7% from SGD 753mn to SGD 1195mn.

In addition to oil prices, we used the URA private residential property index as another stress variable. We selected the URA residential property index, as housing loans constitute 24.77% of total bank loans. To estimate the effect of residential prices on the banking sector's default risk, we calculate the 1-year PDuS over three scenarios – the base scenario assumes the residential price index remains at 125 within 12 months, the optimistic scenario assumes the index increases to 150 and the pessimistic scenario projects an index drop to 110.

	Housing sector NPL ratio (%)	1-year PDuS (bps) before stress scenario	1-year PDuS (bps) after stress scenario Base – 125	1-year PDuS (bps) after stress scenario Optimistic – 150	1-year PDuS (bps) after stress scenario Pessimistic – 110
DBS	0.2	50.03	78.37	53.11	100.20
OCBC	0.7	4.29	6.89	4.68	8.77
UOB	1	1.51	2.32	1.67	2.85

Table 2: Stress test scenario using URA Residential Property Index. *Source: Bloomberg, RMI-CRI*

As shown in Table 2, DBS shows the largest change in 1-year PDuS at 50.17bps when the URA private residential property index decreases to 110. Overall, the outcomes show that the residential prices have a stronger impact than oil prices on the credit profiles of Singapore banks. This could be due to a large amount of housing loans in the banks' books and a small NPL ratio. Due to the banks' exposure to the property market, the credit profiles of banks could be adversely affected when the property price index declines to 110, similar to the 2008-2009 housing situation.

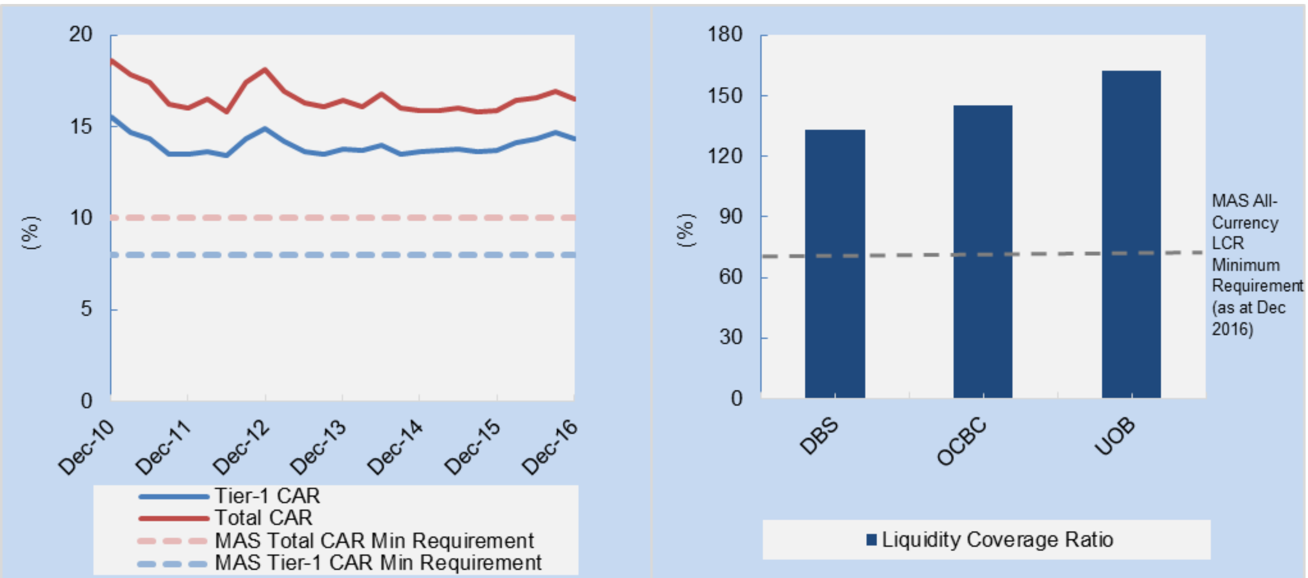

Figure 1. Tier-1 Capital Adequacy Ratio (CAR), total CAR (left panel) and Liquidity Coverage Ratio (LCR) (right panel) and MAS requirements for Singapore banks as of Q3 2016. Source: MAS

In the Monetary Authority of Singapore's Financial Stability Review report, the central bank performed a stress test on the Singapore banking system with similar scenarios such as a 50% drop in oil and property prices over 3 years. The assessment concluded that the Singapore banking system exhibits resilience even in the severe shock scenarios. The capital and liquidity of the Singapore banking sector remains healthy as it meets both the minimum requirement of the capital adequacy and liquidity coverage ratios.

Credit News

European bond investors seek havens as political risks increase

Feb 19. A muddier outlook for Europe resulting from political and economic developments led investors to shift their holdings towards safe haven assets last Friday. A potential single presidency between France's centre-left Socialist Party candidate Benoit Hamon and far-left candidate Jean-Luc Melenchon increased France's political instability, as both are seen as market-unfriendly candidates. German bunds led the gain among core euro-region securities, while Austrian and Dutch securities followed suit. Italy 10-year bonds and UK 10-year gilt yields slid, resulting from a deepening split in the Italian ruling Democratic party and a fall in UK retail sales respectively. UK gilts are at its lowest level since November 9, a day after the US presidential election. (Bloomberg)

IMF reaches staff level agreement with Mongolia

Feb 19. The IMF will provide an Extended Fund Facility (EFF) to the amount of SDR 314.505mn (USD 440mn) to the Mongolian government, after the two parties reached a staff-level agreement in a series of meetings in Ulaanbaatar which concluded today. The Asian Development Bank (ADB), World bank and other bilateral partners will also provide up to USD 3bn in budget and project support, while China's central bank is expected to extend an RMB 15bn swap line with the Bank of Mongolia for at least another 3 years. The total financing package is valued around USD 5.5bn, and is aimed to support the government's Economic Stabilization Program, after a sharp decline in commodity prices and a collapse in Foreign Direct Investment slowed the country's growth. (IMF)

Toshiba falls after credit rating comes under pressure

Feb 17. Shares of Japanese conglomerate Toshiba plunged again on Friday after it emerged that the company will increase the size of its controlling stake in its troubled US nuclear subsidiary Westinghouse. The company has an 87% stake in the US business, which will further increase to 90% after Japanese machinery maker IHI exercises its option to dispose its 3% stake back to Toshiba. Kazatomprom – the Kazakh nuclear operator which owns 10% of Westinghouse, has the right to sell its stake back to Toshiba from October 1 2017. The credit rating agency Standard & Poor's issued a downgrade possibility if the company receives a debt restructuring deal as part of financial support from its creditors – which further impacted the outlook on the Japanese company. The company is planning to book a USD 6.3bn write-down on Westinghouse and a net loss of JPY 390bn for the year to March 31. (FT)

Hanjin Shipping is declared bankrupt

Feb 16. A court order was issued, declaring the bankruptcy of Hanjin Shipping Co. and ordering the remaining assets of the company to be liquidated. The former Shipping incumbent led South Korea's shipping industry for the past four decades and has been selling ships, stakes in seaport terminals and other assets since filing for receivership in August last year. The court stated that liquidation would bring greater value to creditors and following the court ruling, Hanjin's stock will be delisted. (WSJ)

Distressed retail debt will not be back in vogue soon (FT)

US delinquent car loans at 8-year peak, but this will not cause another crash (Forbes)

Regulatory Updates

Bangko Sentral Pilipinas eases liquidity rules for big banks

Feb 20. The Bangko Sentral ng Pilipinas (BSP) has relaxed the liquidity rules for big banks following the decision by the central bank's Monetary Board to set aside previous liquidity-related guidelines to ensure that big banks would have the necessary assets on hand to weather short-term liquidity disruptions. According to the Central bank, previous guidelines such as the requirement of universal and commercial banks to maintain liquid assets equivalent to at least half of government deposits and liabilities, and the requirements of big banks to maintain foreign currency denominated liquid assets equivalent to 30% of foreign currency deposit unit (FCDU) liabilities and foreign currency denominated assets equivalent to 70% of FCDU liabilities in the same currency as the liability could be lifted. (Philippine Star)

MAS loosens rules for finance companies to help SMEs raise funds

Feb 14. To aid SMEs procure more funding from finance companies, the Monetary Authority of Singapore (MAS) has relaxed some of its rules to strengthen the resilience of finance companies. The policy prohibiting a foreign takeover of a finance company was also liberalized. According to the MAS, "this will accord finance companies greater flexibility to explore strategic partnerships and innovative business models that can strength their SME financing business." (Business Times)

China regulator warn that 90 percent of peer-to-peer lenders could fail in 2017 (SCMP)

Bank bad debt provisions to become more volatile (AFR)

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