Singapore banks' credit health recovers fastest among banks in ASEAN-6 with strong earnings and expectation on lower credit costs

by Lin Yuxi & Wang Anyi

- **Singapore Banks demonstrate the fastest recovery in credit profile among its ASEAN-6 peers**
- **As economic recovery and vaccination efforts strengthen in Singapore, potentially lower credit cost and NPLs signal improving credit outlook, as demonstrated by the NUS-CRI Agg Forward PD time series**

Since the start of 2021, Singapore domiciled banks (Singapore banks) have witnessed strong earnings and lower NPL ratios. Singapore's listed banks, DBS, OCBC, and UOB, remain among the least affected ASEAN lenders in terms of bad debt and saw their net profits in Q1 2021 increase by 18% (UOB), 72% (DBS), and 115% (OCBC) YoY. In contrast, most banks domiciled in ASEAN-6[1] have been relatively less optimistic in their outlook for economic recovery amid the resurgence of COVID-19 cases. The NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) in Figure 1a below shows the divergence in credit quality between Singapore and ASEAN-6 (excluding Singapore) banks since the start of this year, with Singapore banks' credit risk decreasing the most (see Figure 1b).

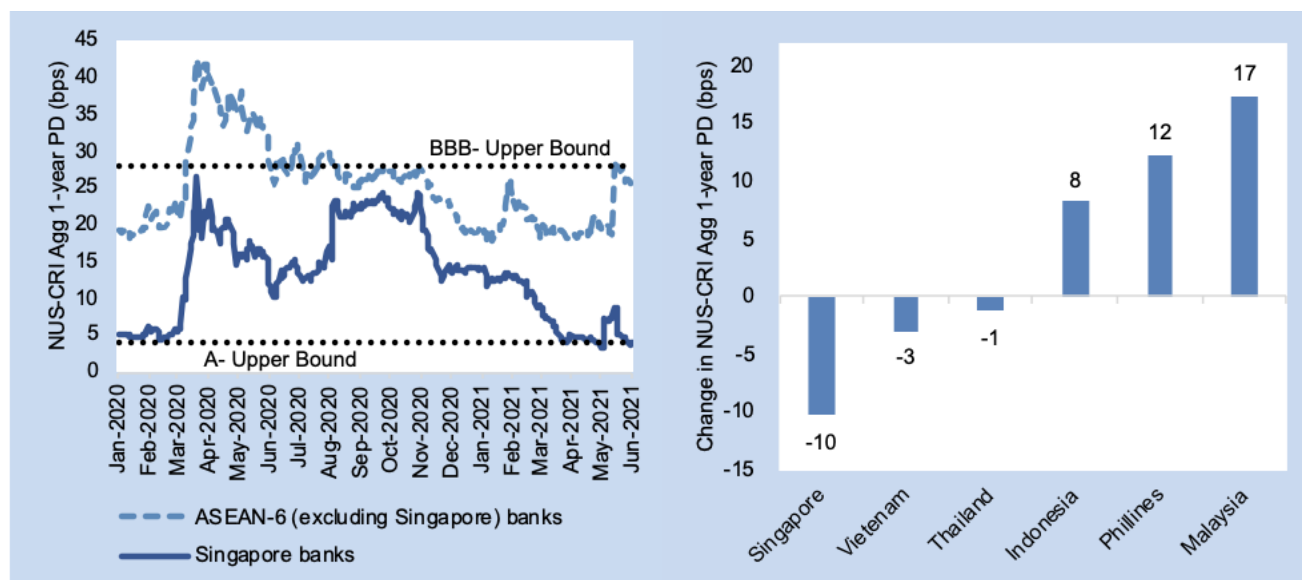

Figure 1a (LHS): NUS-CRI Aggregate 1-year PD for Singapore and other ASEAN-6 (median) banks with PDiR2.0 bounds[2]. Figure 1b (RHS): Change in NUS-CRI Aggregate 1-year PD for ASEAN-6 (median) banks from Jan-2021 to Jun-2021. *Source: NUS-CRI*

Figure 1a shows that the Singapore banking sector's Agg PD has been lower than its ASEAN-6 counterparts throughout the pandemic. To support individual and business borrowers through COVID-19, the Singapore government had announced four stimulus packages amounting to SGD 90.5bn. In addition, the Monetary Authority of Singapore (MAS) reduced the overnight rate at the end of February 2020 and implemented a

[1] ASEAN-6 includes Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

[2] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

moratorium to ease domestic liquidity pressures. These measures have boosted the country's economic recovery by stimulating loan growth and reducing short-term liquidity concerns faced by borrowers. With a 1.3% YoY economic growth for Singapore in Q1 2021, Singapore banks have benefited from decreased NPL pressure and impairment charges as borrowers benefit from renewed economic activity. Singapore is expected to keep its growth at 4-6% this year, which should bode well for the short-term credit outlook for the domestic banking industry with a further potential reduction on credit and impairment costs, especially as the industry has built up greater capital reserves than their exposures to loans under moratoriums over the past year.

On the other hand, the majority of Singapore banks' ASEAN-6 peers have been grappling with spikes in COVID-19 cases. Hit by the new pandemic wave in South Asia, the IMF has lowered growth estimates for the majority of the countries in the ASEAN-6. Economic slowdown brought on by pandemic-induced lockdowns has also placed pressure on corporate borrowers' repayment ability. Consequently, aside from Indonesia, ASEAN-6 (excluding Singapore) banks have witnessed an increase in their NPL ratios since the end of 2020 (see Figure 2b). The ability of ASEAN banks to roll back NPLs will depend on each nation's progress in vaccinating their population and the speed of economic reopening.

Singapore banks' ability to weather future shocks in NPLs bodes well for the industry's credit risk outlook. As seen from the NUS-CRI Agg Forward 1-year PD time series in Figure 2a, the outlook for the credit health of the industry in Dec 2021 has been improving. As seen in Figure 2b, Singapore banks have consistently maintained one of the lowest NPL ratios of 1.50-1.60% throughout the pandemic compared to their peers. Furthermore, stress tests conducted by MAS in their latest Financial Stability Report suggest that the industry has sufficient capital (CET1 ratio of 14.1% compared to the minimum requirement of 6.5%) to weather exogenous shocks on asset quality. Comparatively, the outlook for the remainder of ASEAN-6 banks remains relatively stable, possibly signaling that the credit outlook is not expected to change in the short term unless further measures are taken to curb the spread of the virus and its impact on economic recovery and corporate credit health in the region.

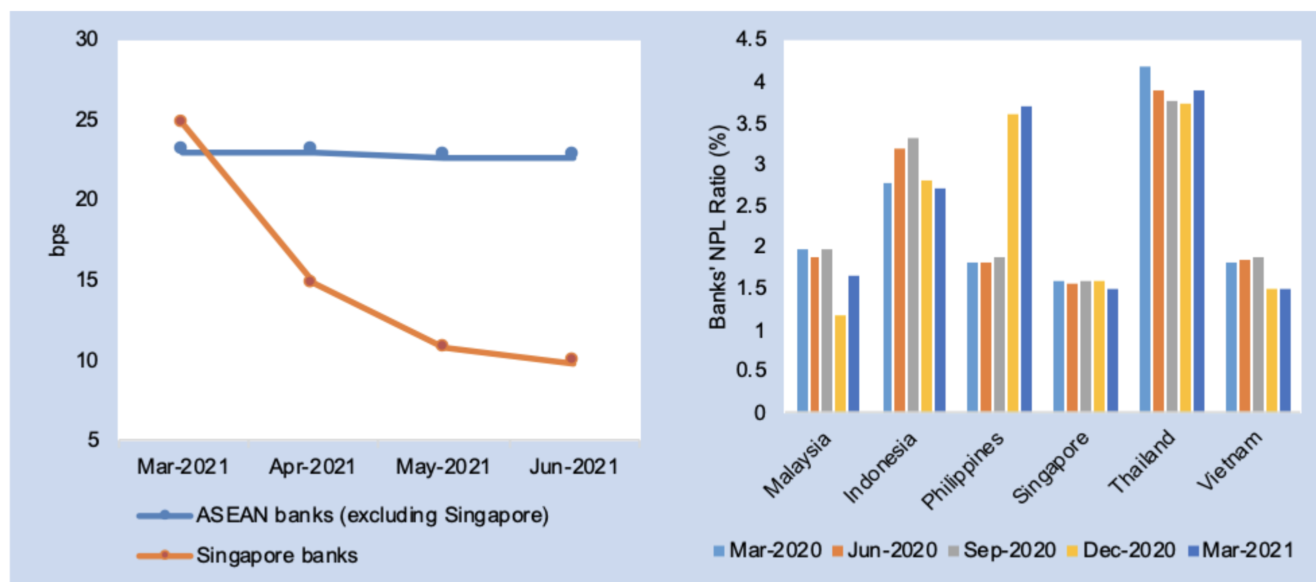

Figure 2a (LHS): NUS-CRI Agg Forward 1-year PD[3] (median) time series for Singapore and other ASEAN-6 banks from Mar-2021 to Jun-2021 looking to Dec-2021. Figure 2b (RHS): ASEAN-6 banks' quarterly NPL ratios (median). *Source: NUS-CRI, Bloomberg*

As Singapore continues to expand its vaccination efforts faster than its ASEAN-6 counterparts, prospects of an accelerated economic recovery help in mitigating NPL pressure felt by Singapore banks. It won't be surprising to, therefore, see a further divergence between ASEAN-6 (excluding Singapore) and Singapore Banks' Agg PD levels moving forward. However, should Singapore face a resurgence in its own COVID-19 infections, it would be likely that further restrictive measures will take place, harming the economic recovery and limiting corporates' repayment capabilities.

[3] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months, conditional on the firm's survival in the next 6 months.

Credit News

Long rally in high-yield debt stutters as investors take more cautious approach

June 1. As inflation worries rise, the US junk bond market has begun shuttering, with its long rally possibly coming to an end. Investors piled into the high-yield bond market this year, partly due to central bank stimulus and prospects of higher economic growth. Spreads have declined dramatically from the peak of near 11% in March 2020. However, junk bonds are now losing momentum as investor appetite dwindles due to fears of a sharp increase in inflation, prompting the Fed to withdraw the supports. Consequently, investors have pulled USD 5.6bn over the past six weeks from mutual and exchange-traded funds that invest in US high-yield bonds. However, the robust junk bond issuance suggests the concern has not spread throughout the market. The US dollar high-yield bond issued this year is over USD270bn, exceeding the record-breaking issuance seen in H1 2020. (FT)

'Greenium' shrinks as climate bond sales swell

June 3. 'Greenium', which is the premium commanded by green bonds over conventional bonds, has been steadily declining. An increase in green bond issuances seems to be the major driver of the declining premium demanded by such bonds. As per Refinitiv, USD 193bn has been raised via green bonds in the first half of 2021, amounting to almost 3 times the amount raised for the same period in 2020. Lower premiums are favored by investment funds looking to increase their ESG quotient, but unfavorable for issuers as they lose the advantage of raising additional funds through a green issuance. However, in corporate sectors where green issuances are rare, a 'Greenium' persists. Such scarcity premium enjoyed by green bonds is now increasingly seen in social & sustainability bonds. (Business Times)

China is leading global surge in green bond financing this year

June 3. Propelled by China's economic recovery and commitment to achieve carbon neutrality by 2060, green bond issuances in China have surged to USD 26.1bn. However, 72% of the issuances were onshore and unavailable to foreign investors. China's green bond market remains closed mainly due to relaxed rules around the use of proceeds from green issuances. Chinese regulations allow domestic businesses to use up to 50% of the proceeds towards bank loans or working capital requirements, as compared to 5% stipulated by international standards. Due to increased interest by global investors in Chinese debt and with China's bond market opening to foreign investors, China seeks to match international green bond issuance standards. From July 2021, clean coal usage and oil & gas extraction projects will no longer qualify to raise funds through green bonds. Additionally, China and the EU have partnered to establish a classification system for further green finance projects moving forward. (SCMP)

'Draghi put' holds Italy's bond markets in thrall

June 3. During Draghi's eight year tenure as the president of the European Central Bank, he is credited with reining in the borrowing cost for governments and taming the eurozone debt crisis. Investors believe he could do the same in Italy. When he swore in as Italy's prime minister, Italian bond prices climbed up, driving down the borrowing cost. Investors have expressed their support for his plans to overhaul Italy's bureaucracy while spending EUR 205bn of the EU recovery fund. Some believe that the stability brought by Draghi provides an ideal backdrop for the reform to streamline bureaucracy and speed up infrastructure development. However, the "Draghi effect" may disguise Italy's substantial public debt of over 160% of GDP, which may be too optimistic. Furthermore, the plans may reignite old political conflicts and may be vulnerable to markets' sensitive reaction to an early tapering. (FT)

China Limits Issuance in $63 Billion Mortgage-Backed Debt Market

June 1. To stem surging home prices, China has started to curb the issuance of residential mortgage-backed securities (RMBS). Although the size of the RMBS market declined to USD 63bn last year, it still accounted for the largest portion of asset-backed securities in China. Since April, the central bank has started controlling the size and pace of RMBS issuance by lenders and is considering the inclusion of such securities in its assessment of property-related loan exposure for domestic banks. Commercial banks considered to be overly exposed to the property sector have also received guidance from regulators that their RMBS investments be part of the assessment of overall real-estate exposure. Simultaneously, China's policy makers have signaled possible introduction of a national property tax, with aims to curb the risk present in its domestic financial sector. (Bloomberg Quint))

Fed Is Among the Biggest Winners From Its Foray Into Credit ETFs (Bloomberg)

Dubai Reit faces fight ahead of Islamic bond restructuring vote (FT)

U.S. High-Grade Sales, Large LBOs to Ramp Up (Bloomberg)

Regulatory Updates

Fed says it will start unwinding its corporate bond holdings

June 3. The Federal Reserve (Fed) announced that it would begin to unwind its corporate bond holdings acquired last year during the height of the pandemic. While doing so, the Fed would also factor in daily liquidity and trading conditions for exchange-traded funds and corporate bonds to minimize the potential effects on markets. The two corporate credit facilities launched by the Fed were little used in the end but were supposedly successful in signaling the markets that the Fed was prepared to provide a backstop to corporate credit markets. The Fed will start selling its ETFs soon and corporate bond holdings in the summer, intending to sell its full portfolio by the end of this year.(Reuters)

India Central Bank Expands QE as Growth Seen Faltering

June 4. The Reserve Bank of India (RBI) has expanded on its quantitative easing (QE) measures as economic growth forecasts worsen amidst the world's worst COVID-19 wave. RBI plans to buy INR 1.2tn of bonds in Q2 2021 under the Government securities acquisition program 2.0. Simultaneously, expectations for GDP growth reduced from 10.5% to 9.5% in the current fiscal year, while the benchmark rate was held steady at 4%. The QE measures aim to support the administration's borrowing plan, while the governor of RBI also indicated several new programs for financial institutions and other stakeholders, specifically, the amount of debt that banks can restructure for small borrowers up to INR 500mn under the new second set of debt-resolution plans. (Bloomberg)

ECB Seen Pushing Ahead With Faster Bond Buying Until September (Bloomberg)

BOJ Calls for Faster Progress on Libor as Clock Ticks on Expiry (Bloomberg Quint)

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Contributing Editors: Emir Hrnjic, Anthony Prayugo, Raghav Mathur