Edited transcript for DBS second quarter 2019 results media briefing, 29 July 2019

Edna Koh Good morning, everyone, and welcome to our second-quarter results briefing.

Chng Sok Hui Good morning, everyone.

Overview. First-half net profit rose 12% to a record $3.25 billion as total income increased 11% to a new high of $7.26 billion. The broad-based growth was driven by corporate loan growth, higher net interest margin, record fee income and a recovery in trading income from a low year-ago base. The cost-income ratio improved one percentage point to 42%. Return on equity increased from 12.5% a year ago to 13.7%.

Net profit for the second quarter rose 17% from a year ago to $1.60 billion. Total income reached a new quarterly high, rising 16% from a year ago and 4% from the previous quarter to $3.71 billion. Business momentum was sustained as loans grew 1% from the previous quarter and fee income rose to a quarterly high. Net interest margin increased three basis points to 1.91%. The strong income growth, together with a positive jaw, resulted in profit before allowances reaching a new high of $2.16 billion.

Asset quality was healthy. The NPL rate was stable from the previous quarter at 1.5% as new NPA formation remained low. Specific allowances for the second quarter were at 22 basis points of loans, in line with expectations.

The balance sheet was strong, with CET-1, NSFR and LCR all comfortably above regulatory requirements.

First-half performance. First-half total income grew 11% to $7.26 billion.

Net interest income rose 9% or $387 million to $4.74 billion. Net interest margin rose six basis points to 1.90% from higher interest rates in Singapore and Hong Kong. Loans grew 5% or $15 billion in constant-currency terms to $350 billion.

Net fee income increased 3% or $47 million. Growth was broad-based but moderated by a high year-ago base for wealth management and brokerage due to unusually buoyant sentiment in first-quarter 2018.

Other non-interest income grew 35% or $263 million as trading income and gains from investment securities were higher.

Expenses rose less quickly than income, by 8% or $228 million to $3.04 billion. The positive jaw resulted in a one-percentage-point improvement in the cost-income ratio to 42%. Profit before allowances increased 13% to $4.22 billion.

Total allowances were 22% or $58 million higher at $327 million, with specific allowances at 18 basis points.

Second quarter compared to year ago. For the second quarter, net profit rose 17% from a year ago to $1.60 billion. Total income increased 16% to a new high of $3.71 billion.

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Net interest income rose 9% or $205 million to $2.43 billion. Net interest margin was six basis points higher at 1.91% while loans grew 5% or $15 billion in constant-currency terms.

Net fee income increased 9% or $61 million to $767 million. Growth was broad-based and led by wealth management, cards and investment banking.

Other non-interest income rose 88% or $240 million to $513 million. Trading income recovered from a weak year-ago performance and gains on investment securities increased from a low base.

Expenses rose 9% or $128 million to $1.55 billion, resulting in a two-percentage-point improvement in the cost-income ratio to 42%. Profit before allowances increased 21% to $2.16 billion.

Total allowances more than doubled to $251 million. There had been a specific allowance write-back of $65 million a year ago due to a recovery for an oil and gas support service exposure. In addition, general allowances of $58 million were taken this quarter compared to $7 million a year ago.

Second quarter compared to previous quarter. Second-quarter total income was 4% higher compared to the previous quarter from corporate loan growth, net interest margin progression and higher fee income.

Net interest income rose 5% or $119 million. Loans grew 1% or $4 billion from trade and non-trade corporate loan growth. Net interest margin rose three basis points.

Net fee income was 5% or $37 million higher as investment banking, wealth management and card fees grew.

Other non-interest income was stable as a decline in trading income from a strong first quarter was offset by higher gains on investment securities.

Expenses were 3% or $48 million higher. Profit before allowances rose 5% or $110 million.

Total allowances were higher due to a general allowance write-back of $100 million in first-quarter 2019, compared with a charge of $58 million in the second quarter.

Net interest income. Net interest income rose 5% from the previous quarter to $2.43 billion.

Net interest margin rose three basis points from the previous quarter to 1.91% as loans were repriced in line with higher interest rates in Singapore and Hong Kong.

We expect the impact of US interest rate cuts in the second half to be modest. We are maintaining our full-year guidance of a mid-single-digit basis point increase in NIM from the 1.85% for full-year 2018.

Loans. We had loan growth of $4 billion or 1% in constant-currency terms during the quarter.

Non-trade corporate loans rose 1% or $2 billion. The increase was smaller than previous quarters as some of the expected drawdowns of the loan pipeline did not materialise or were delayed due to uncertainties in the external environment.

Trade loans grew 4% or $2 billion as new bookings with acceptable pricing exceeded run-offs.

Consumer loans were little changed. While non-housing loans grew, the impact was offset by a $0.5 billion decline in housing loans.

We are maintaining our guidance of mid-single-digit percent loan growth for the full year from increases in non-trade corporate loans and housing loans.

Deposits. Deposits fell 1% or $3 billion in constant-currency terms during the quarter to $391 billion. We let go of higher-cost fixed deposits and replaced them with less expensive commercial paper, which rose $6 billion during the quarter.

Our liquidity coverage ratio at 137% and the net stable funding ratio at 109% were above regulatory requirements.

Fee income. Gross fee income rose 10% from a year ago and 5% from the previous quarter to $896 million.

Compared to a year ago, the growth was broad-based. Wealth management fees increased 11% to $332 million from higher investment product sales. Card fees grew 16% to $198 million from higher activities across the region. Investment banking fees rose 44% to $56 million from higher debt and equity capital market income.

Compared to the previous quarter, gross fee income rose 5% as fees from investment banking, wealth management and cards were higher.

For the first half, gross fee income increased 5% to $1.75 billion, with all of the growth occurring in the second quarter. Gross fees were unchanged in the first quarter compared to last year because of a high base for wealth management and brokerage income.

Consumer Banking and Wealth Management. Consumer Banking and Wealth Management's first-half total income rose 15% from a year ago to a new high of $3.17 billion.

Loan and deposit income grew 24% to $1.88 billion as net interest margin improved with higher interest rates. Card income grew 6% to $400 million from higher transactions across the region. Investment product sales income rose 3% to $853 million led by higher insurance sales.

Income for the wealth management customer segment rose 17% to a new high of $1.56 billion as assets under management expanded 8% to $234 billion.

Income from the retail customer segment increased 13% to $1.61 billion. Our market shares for both Singapore-dollar savings deposits and Singapore housing loans as at May were maintained from the previous quarter at 52% and 31%.

Expenses rose 12% to $1.61 billion. The positive jaw resulted in a one-percentage-point improvement in the cost-income ratio to 51%.

Institutional Banking. Institutional Banking's first-half total income rose 9% to $3.04 billion.

The growth was due largely to cash management, which grew 35% to $1.01 billion. Cash management deposits fell 3% to $132 billion as some high-cost deposits had been managed out in the previous quarter and replaced with other sources of funding. Cash management deposits were stable in the second quarter.

Loan income rose 2% to $1.33 billion from growth in non-trade loans.

Assets rose 4% to $270 billion as non-trade loan growth was partially offset by a decline in trade assets.

Treasury Markets. Treasury Markets' first-half interest and non-interest trading income rose 39% from a year ago to $495 million. The increase was broad-based including interest rate activities. The second-quarter income of $202 million was in line with the average quarterly run-rate and double the weak performance in second-quarter 2018.

Treasury customer income for CBG / WM and IBG for the first half rose slightly to $644 million.

Expenses. First-half expenses rose 8% to $3.04 billion. The increase was lower than the 11% growth in total income. The positive jaw resulted in a one-percentage-point improvement in the cost-income ratio to 42%.

We are maintaining our cost-income ratio guidance of 43% for the full year.

Hong Kong. Hong Kong had recorded a property gain of $86 million in first quarter 2018. This chart excludes the property gain to show the underlying performance.

Hong Kong's first-half net profit rose 13% in constant-currency terms to a record $755 million. The results were underpinned by an 11% increase in total income to $1.46 billion, which was also a new high.

Net interest income rose 16% or $152 million to $994 million. Loans grew 6%, led by non-trade corporate loans. Net interest margin increased 18 basis points to 2.10% as loans were repriced with higher interest rates.

Fee income was stable at $323 million. Growth in cash management, insurance and loan-related fees was offset by declines in wealth management investment sales due to high year-ago base and in trade finance. Other non-interest income increased 15% or $20 million to $142 million from an improved trading performance.

Expenses rose less than income, by 6% or $41 million to $528 million, and the positive jaw resulted in a 14% increase in profit before allowances to $931 million.

Total allowances rose from $13 million a year ago to $23 million as higher specific allowances were partially offset by a general allowance write-back.

Non-performing loans. Non-performing assets rose 3% from the previous quarter to $5.8 billion. New NPA formation of $277 million was in line with recent quarters. The NPL rate was stable from the past two quarters at 1.5%.

Specific allowances. Specific allowances amounted to $193 million, in line with recent quarters and with guidance.

General allowances. During the course of the quarter, the ECL for Stage 1 and 2 – or general allowances – rose $57 million to $2.53 billion. Additional general allowances were set aside in view of heightened economic uncertainty and geopolitical tensions.

Capital. Our capital ratios remained strong. The Common Equity Tier-1 ratio declined from 14.1% in the previous quarter to 13.6% due to the payment of the final 2018 and first-quarter 2019 dividends in May.

Our leverage ratio of 6.9% was more than twice the regulatory minimum of 3%.

Dividends. The Board declared a second-quarter dividend of 30 cents a share, unchanged from the previous quarter. Based on yesterday's closing share price, the dividend yield was 4.5%.

In summary. We achieved record earnings in the first half despite macroeconomic uncertainty and geopolitical tensions.

Return on equity for the first half of 13.7% reflects the improved structural profitability of our franchise from a shift towards higher-return businesses, digitalisation and nimble execution.

Business momentum from the first quarter was sustained into the second quarter as total income rose to a record. The performance reflects the strength of a broad-based franchise that is well placed to navigate market volatility and capture market opportunities across the region.

Piyush Gupta Thanks, Sok Hui. The first observation is that the second quarter had increased headwinds, partly because of the trade dispute and Huawei-related issues. Economic activity in April and May basically softened. Expected loan drawdowns were deferred as business confidence was impacted. We also saw two consecutive quarters of decline in trade, while PMIs were below the 50 level. Interestingly, we've started seeing some pick-up in June towards the tail-end of the quarter, particularly after the G20 truce.

My general view is that the global synchronised slowdown is happening. I don't think the rest of the year will be as bad as the second quarter; you should still expect some lift. But if you were to compare the growth for the rest of the quarters to that of the first quarter or to that of last year, I think you will see a slowdown.

Despite the challenging macroeconomic environment, we're very pleased with the numbers. We had 11% growth in income in the first half. If we exclude the property sale in Hong Kong last year, we had 12% growth. That's a strong set of results, which was obviously helped by Treasury Markets.

I said earlier that our Treasury Markets business is expected to contribute about $200 million a quarter. We had $500 million for the first half as income was very strong in the first quarter. We had $200 million for the second quarter, which was on track.

We also benefitted from NIM, which was stronger than we expected partly because Hibor held up through parts of the quarter. Also, the loan pricing increases that we pushed through in the first quarter of the year into April benefitted NIM as well.

Our underlying fee income was strong, led by investment banking, credit cards, wealth management and cash management. Growth in fee income was quite broad-based.

Our expenses were well managed. Our overall cost-income ratio of 42% is obviously flattered by the strong income. Even if you were to back out the unusual Treasury Markets income in the first quarter, we still wind up with 42.5% cost-income ratio. Overall costs have been relatively well-contained.

As our first half has been strong, we're confident about being able to maintain our full-year guidance for 2019.

We are maintaining our guidance of mid-single-digit loan growth. Our first-half loan growth has been a tad lower – around 2%. The mortgage book was the major headwind as it declined by almost $1 billion in the first half of the year. Fortunately, bookings in the second quarter increased 60% from the first quarter, which will flow through in the second half of the year. We'll probably get about $1 billion to $1.5 billion of mortgage loan growth in second half of the year. For the full year, mortgage loan growth will be flat to up $0.5 billion. The $2 billion shift in the mortgage growth between the first and second halves will help overall loan growth in the second half.

Trade loans are looking alright – second-quarter trade loans grew by $2 billion. We anticipate some seasonality effect in the third quarter as businesses start stocking up inventory for Christmas. Our open account trading business is also doing well. We think that there is some upside in trade loans in the back-end of the year.

On non-trade corporate loans, second quarter slowed as some deals got pushed back. We expect to be able to get a $4 billion to $5 billion growth in the non-trade corporate loan book in the second half. Putting all of these together, we think mid-single-digit overall loan growth is possible for the year.

On NIM, it is quite clear that the Fed will cut rates tomorrow, followed by another rate cut in September or October, which will put some pressure on our NIM. We've been prepared for this scenario and built up our securities book in the four- to five-year tenor. These measures will cushion some of the headwinds from the rate cuts.

Also, the mortgage rate increases in the past few quarters are still flowing through. This lagged impact contributed to the pick-up in the second quarter's NIM to 1.91%. This lagged impact will continue to be sustained into the second half as two-year fixed-rate loans get repriced, even when interest rates start coming down.

Overall, we anticipate a drop in NIM in the third and fourth quarters as our NIM cycle has peaked. On a full-year basis, we will still get the mid-single-digit NIM increase that we have guided for.

We think we can achieve high-single-digit income growth for the full year, consistent with our previous guidance. Our cost-income ratio will be slightly worse in the second half due to seasonal effects as it tends to be higher in the fourth quarter. We should be able to get 43% for the full year.

Our allowances have been coming in lower than we guided. We have been very prudent in our allowances including in the second quarter. We built up some general allowances in light of the overall uncertainties in the macroeconomic environment. As we go forward, we have some opportunities to sharpen overall allowances. We might have some recoveries on previously-taken allowances. Looking at the end of 2019 and in 2020 and 2021, that is one line that might provide some upside.

Overall, we've given guidance of ROE approaching 13%. We achieved 13.7% in the first half. Even with some weakness in the second half, we should still be able to deliver ROE consistent with our guidance.

To conclude, we're the only bank that has ever held on to all three best-banking awards concurrently from both sides of the Atlantic – from Global Finance, The Banker, and Euromoney. For both the management and the Board, it's something that we're quite pleased about. The fact that we have received recognition from various publications adds credibility to our transformed franchise and company, both in digital capabilities and corporate culture.

Chin Yong Chang (Bloomberg) I have three points that I'd like to seek clarification. First, why do you expect the overall growth outlook to remain positive in spite of slowing economy and trade war? Second, do you see any significant shifts in wealth assets in the second quarter coming from Hong Kong and, if not, do you expect to see this shift going forward? Lastly, what's your outlook on Singapore's mortgage books for the second half of the year?

Piyush Gupta For the first question, I said last year that we expected slower global growth, but the reality is that a slowing Asia is still one that is growing between 4.5% to 5%. This will translate into overall growth in the financial system. A deep recession is not our base-case assumption. The IMF's most recent prediction on global GDP growth was between 3.2% to 3.3%, so you're seeing a world which is growing rather than shrinking. That is the view on Singapore as well. Singapore's economy slowed in the second quarter, but there should be some pick-up in the third and fourth quarters.

On Hong Kong wealth assets, we are not seeing any significant flow of money to Singapore thus far, even though there have been some inquiries from customers. But even if there is uncertainty in Hong Kong, the shifts may not happen immediately. Hong Kong is a very credible financial centre and it is not clear an outflow of wealth assets will happen.

On the mortgage market, because of the tightening measures in July last year, we've had three quarters of subdued growth. But we've seen bookings recover – second quarter bookings were up about 60% from the first quarter. You will see the flow-through in the third and fourth quarters. But it will be much slower than it used to be. In a good year, we would grow our mortgage book by about $4 billion. For the second half of this year, I think our book will probably grow by $1 billion.

Goola Warden (The Edge) Could I ask for an update on digibank and what the MAS virtual banking licenses could bring to Singapore in terms of services that you haven't provided? My second question is on the outlook of the credit costs. Are there any sectors, companies or any idiosyncratic issues in your book?

Piyush Gupta Both India's and Indonesia's digibanks are doing well. We are tracking between 80% and 90% of our model expectations. We've been able to tweak our customer acquisition methodology and we're getting customers with better profiles but with slower customer growth. We also started unsecured lending and other products, which are growing reasonably well. As previously indicated, these businesses are still loss-making; they will continue to be loss-making for another two to three years as we invest in them. But the revenue trajectory is tracking to what we were hoping for. We are quite confident that both digibanks will hit our two- to three-year projections.

On your question relating to digital banks in Singapore, many of their value propositions are related to payments, which are already well covered in Singapore. Some of the fintechs also provide wealth management or lending services. In general, Singapore banks are quite competitive in digital wealth offerings and lending. In markets where the incumbent banks are less able to digitise and create compelling value propositions, the impact of digital players is likely to be more meaningful. In markets like Singapore, where the banks have spent three to four years changing their own digital capabilities and value propositions, it is not immediately obvious where the gaps are.

On your question relating to allowances, we're not seeing any idiosyncratic or industry segments which are giving us sleepless nights. We were conservative in the second quarter as we took the opportunity of a strong Treasury Markets quarter to buffer up our allowances. There are some areas that we've been quite conservative in provisioning in the past that we might even see some upside.

We've done a lot of stress testing on our portfolio, in light of the technology and trade disputes. We have also stressed tested our portfolio, assuming China's economic slowdown continues to deteriorate. There are no immediate risks to our portfolio.

Hu Yuanwen (Lianhe Zaobao) For the 60% increase in booking for mortgage in the second quarter, how much was the increase?

Piyush Gupta About $2.5 billion.

Hu Yuanwen Just as a follow-up on the Hong Kong situation, do you see that having an impact on your corporate business and the loan business?

Piyush Gupta We are not seeing it but if the uncertainty is prolonged and affects consumer and business investment confidence, there may be some impact on our business.

Lee Yen Nee (CNBC) You said you expect the Fed to cut interest rates tomorrow. Are you expecting a series of cuts or do you see this as a temporary cut and that the Fed would resume hiking rates again sometime in the future?

Piyush Gupta The current macroeconomic data do not necessarily support a rate cut. Even though US's second-quarter GDP slowed, the underlying consumption, retail sales and payrolls are holding up. While business investment was down, it is not alarming. You could make a case that if you had to take a pure view on US domestic data, the Fed might not even need a rate cut. I think the Fed is cutting partly for insurance because firstly, it is mindful of a global slowdown, and secondly, it has been monitoring the easing monetary policies in Europe and

Japan. Lastly, the Fed is also concerned about driving inflation up as wage growth has not been coming through.

The markets are anticipating two cuts this year and I think it will happen, based on the Fed's rhetoric. The Fed will monitor the data after that. A lot of people think these two cuts precede a series of cuts next year. I'm not convinced.

Takashi Nakano (Nikkei) First, are you planning to expand digibank to other countries in addition to India and Indonesia? Second, Singapore's GDP growth and exports have fallen sharply. But your income and net profit are at a record, your NPL hasn't increased. How can we interpret this gap? Is it due to the diversification of your business, or it's just because you have managed the bank very well?

Piyush Gupta Towards the later part of this year, we are going to rebrand, refresh and upscale our digibank offering in Hong Kong. We think that there's an opportunity to really change the game over there. We may also have the opportunity to take digibank into other markets, such as Taiwan and Vietnam.

In Singapore, we have already rebranded our mobile offering as digibank. We are confident about taking on new competition as digibank in Singapore is complete. It addresses almost every market segment and every product category. It fulfils everything instantly, such as money transfers and payments. We also offer financial planning and budgeting tools, wealth management, as well as instant loan and credit card approval. We have a very competitive product compared to any digital bank in the world.

On Singapore's GDP, first, about 40% of our business is outside of Singapore. And our Singapore franchise includes local customers' overseas business activities. A large part of our loan growth has been contributed by Singapore property developers who are developing in the UK and Australia. Therefore, Singapore's GDP doesn't necessarily reflect the condition of our business.

Tay Peck Gek (Business Times) You mentioned that you will see some drop in NIM because of the impending rate cuts. Where do you see NIM for the second half of the year? Second, when the digital banking licenses are awarded in Singapore, how do you see competition for deposits affecting NIM?

Piyush Gupta If the Fed does a 25-basis-point rate cut tomorrow, our second-quarter NIM of 1.91% might be reduced by about one basis point. If the Fed does another rate cut after that, we expect another one to two-basis-point reduction in the fourth quarter. If there are two cuts in 2019, second half NIM will end up at 1.88-1.89%. Our full-year NIM will still be close to 1.89-1.90%, which gives us an increase of about five basis points for the full year. If the Fed does more than two cuts, our NIM may be reduced further. One of the uncertainties is how US rate cuts will translate into Sibor and Hibor movements. We generally assume some pass-through to Sibor and Hibor, but the actual impact could vary.

On your second question, the two full licenses for digital banking are constrained by the deposit cap of $50 million, which is not consequential for incumbent banks. For the longer term, it is important to note that both HKMA and MAS have put into their respective guidelines that the new players' business models have to be profitable. This is extremely important as the regulators are keen on ensuring that the banking industry does not end up like the e-commerce industry in which businesses that are driven by monopolistic behaviour endlessly burn cash with a limited profitability objective in sight. As long as new competitors have an objective of making an acceptable return on equity, we can compete against them.

Chanyaporn Chanjaroen Will you be looking to trim any expenses as a precaution for the global synchronised economic slowdown that you are expecting? Second, are there any market sectors in Singapore that you see as underbanked, such as unsecured personal loans and SMEs? Do you see businesses like Grab entering such sectors?

Piyush Gupta We believe in running the bank for the long term. While we have some flexibility in tightening expenses when there are headwinds, we don’t want to end up doing what a lot of global investment banks do with mass retrenchments and deep restructurings. We’ve been able to run the bank quite sensibly for the past decade by being very thoughtful about how we invest while producing decent returns. We don’t foresee major expense cuts in the short term.

MAS has a very tight guidelines on unsecured lending, which limits how much an individual can borrow. Hence the unsecured lending market is not huge. It is possible that the new digital banks can build a value proposition to compete with money lenders, serving the lower-income segment. It’s a high-risk segment; a lot of the credit models that other countries have used for this segment don’t necessarily work. If you look at some of the companies in Europe and the US, delinquency record in recent quarters have been through the roof.

On the SME segment, most of the surveys done by agencies such as SPRING indicate that the availability of credit to SMEs in Singapore is extraordinarily high. It is possible to build a business serving the micro-SMEs, the mom-and-pop stores for instance. Since Singapore is not a big country, these business segments do not offer a lot of room for growth.

Leslie Shaffer (Shenton Wire) The performance summary states that specific allowances for South and Southeast Asia doubled. What was that related to?

Chng Sok Hui It’s due to a couple of cases that were mainly in Indonesia.

Leslie Shaffer You’ve also mentioned that the duration of the mortgage book was extended by four to five years? How much of your mortgage book has been repriced?

Piyush Gupta For the question on duration, it’s not in the mortgage book. We hold overlay positions in securities, which are high-quality liquid assets. We have increased our securities holdings in the four- to five-year duration bucket due to our view that interest rates would come off. If rates do come off, this will cushion the impact of lower rates.

For the fixed-deposit-rate mortgages, we repriced it once in January and another round in March. We also have fixed-rate mortgages that reprice slowly; they form about 25% of the mortgage book.

Anshuman Daga (Reuters) It seems like DBS is in a strong spot. What are the big challenges for DBS for the next two years? Where do you see growth to sustain the business?

Piyush Gupta In a slowing global economy, we won't be able to sustain our double-digit income growth. Assuming it halves from the 11% we achieved, we will have to evaluate investment and spending plans. Apart from flexibility in expenses, I indicated that our we do not see any stress in the portfolio and our conservative provisioning in the past could provide some support to future earnings.

Vivien Shiao (Business Times) First, what would you consider to be the biggest downside risk for your bank's earnings for the rest of this year? Second, what's your forecast for business momentum for the rest of the year?

Piyush Gupta Business momentum in the back-end of the year will generally be better than that of the second quarter, but not as good as the first quarter or last year. The major downside risk is if we have more than two rate cuts, or if the rate cuts are more severe. If the Fed cuts 50 basis points tomorrow instead of 25 basis points, that certainly deviates from our base case assumption, which will be a major headwind to us.

Edna Koh If there are no further questions, thank you for coming today. We'll see you next quarter.