Edited transcript for DBS third-quarter 2019 results conference call for buy and sell sides, 11 November 2019

Michael Sia Welcome to our third-quarter session for the buy and sell sides.

Robert Kong (Citi) First, could you provide details on your Hong Kong loan book? Second, on your NIM guidance where you assume another US Fed rate cut next year, do you have a number where you think Sibor and Sor would go? Third, your regional growth over the past five to six years has been driven by Hong Kong and China. Is it the right time to think about finding another growth engine in the region?

Piyush Gupta We have a relatively small consumer loan book in Hong Kong. The bulk of it is from large China and Hong Kong corporates and it is very solid. For our SME book, the LTV ratios are very low and it is also well secured against properties.

Sebastian Paredes Our loan book is close to HK$400 billion, of which residential mortgages comprise HK$25 billion. The low LTVs of our mortgages are in line with the overall market. Hence, we are fine even if there is a material decline in real estate prices. Our loan portfolio comprises mainly Hong Kong conglomerates and Chinese SOEs and the US-China trade tensions as well as the ongoing protests in Hong Kong have not affected our loan book. For our SME book, the majority relates to manufacturing and it is exposed to the Chinese export market rather than the Hong Kong domestic market. In Hong Kong, the industries affected are mainly related to tourism and retail as well as hospitality. Most of these customers are not borrowers but depositors. Hence, it is the deposit levels on those industries which are most impacted.

Piyush Gupta On NIM, we model a 60% pass-through from US rates to Singdollar rates. On our regional growth, the bulk of it is attributed to China. The question is whether you expect China to stop being an engine of growth, and that is certainly not our base case. It is growing at a decent rate of 5.5 to 6%, and we think that this will continue. A lot of this growth leads to cross-border investments into the region, which we benefit from. These activities are mostly booked in Hong Kong and so our performance will continue to be quite robust. In the short term, we continue to see China as a key driver of growth, particularly in the Greater Bay Area. Our Hong Kong business remains resilient and I’m not counting Hong Kong out as it has an uncanny knack of bouncing back from short-term headwinds. In the medium term, our view is that the integration of Hong Kong into the Greater Bay Area region is going to have a material impact on our business. For the longer term, we are investing in countries such as India and Indonesia to grow organically. But there are long lead times as we build up the digital capabilities in both markets.

Harsh Modi (JP Morgan) First, although your Hong Kong SME book is mostly secured, will firms with weak cash flows impact the ECL model and lead to increased credit costs, and has that been incorporated into your guidance? Second, NPL formation was elevated at $367 million this quarter with write-offs of $226 million. RLAR has also come off to the lowest level in five quarters. What are the drivers for the third quarter and are these related? Third, dividends this quarter remain at $0.30 while CET-1 has increased to 13.8%, above your targeted CET-1 ceiling of 13.5%. Should we take the lack of a dividend increase as indication of a potential acquisition?

Piyush Gupta Our SME book in Hong Kong is resilient from a cash flow standpoint. We did a bottoms-up review by sector and found a few names which we flagged out to look for signs of weakness. The stress-testing suggests that it won't have a material impact on our allowances next year. Nevertheless, we took precautionary general allowances for Hong Kong. On NPL formation, it's one idiosyncratic case in the transport sector. It's well secured and we took some allowances against that. Outside of that, the portfolio is holding up well.

Our dividend policy of distributing a progressive and sustainable dividend over time has not changed. We don't look at the dividend pay-out every quarter, but that is something that we would revisit at the end of the year.

Chng Sok Hui The RLAR declined by around $170 million this quarter because MAS rules allow us to deduct against property collateral.

Conrad Werner (Macquarie) What is the guidance on NIM for the fourth quarter? What is your updated outlook on full-year loan growth for 2019, especially for the mortgages segment?

Piyush Gupta We guided that full-year NIM will be around five basis points higher than last year's 1.85%. We now expect a three basis point lift for the year. Our commercial book NIM is already coming down although we're getting some relief on the treasury side.

I had expected housing loans to start growing again in the third quarter but they shrank by another half a billion dollars. However, housing loans should stabilise in the fourth quarter. Primary market transactions have recovered but loan drawdowns will only flow through gradually over the next few years. Our resale market portfolio continued to shrink in line with the market. We are looking at a growth of about $1 billion for housing loans next year. Putting everything together, overall loan growth will probably be around 4% this year.

Marcus Chua (HSBC) First, it was mentioned previously that normalised Treasury income would be at around $200 million per quarter. This year has been very strong. What is driving this and what is the proportion of client flows and pure trading activities? Second, the cost-income ratio remains relatively low. How sustainable is this, and is management looking to bring it down further ?

Piyush Gupta Treasury income in the second and fourth quarters of 2018 were particularly poor, and I gave guidance of around $200 million a quarter. It has been much stronger this year and we had better FICC performance than many US and European banks. There was some pick up in the longer end of the yield curve, which presented gapping opportunities. I think that $225 million a quarter is realistic going forward.

Our cost income ratio for the year to date is 42% but it will go up in the fourth quarter due to seasonality. The ratio will also likely be higher next year because we expect to see low-single-digit income growth. Although we will manage expenses efficiently, we will not compromise on long-term investments.

Melissa Kuang (Goldman Sachs) First, on the China-related SME manufacturing exposure that you have in Hong Kong, is it being affected by the ongoing trade tensions? Second, are you still on track to deliver the ROE target of 13% next year? Third, you have guided that credit costs next year will be similar to this year. In terms of the ECL model in a subdued environment, are you still able to deliver what you've guided?

Piyush Gupta We have stress-tested our portfolio and scaled down on some exposures in the past and haven't seen much stress or delinquency. There is some shift in the supply chain out of southern China which has been happening for a period of time, but we've been able to follow our customers as they shift.

On ROE, we're delivering substantially ahead of our guidance. We said ROE would approach 13% this year and for nine months, we are at 13.6%. It will be a bit challenging next year given earnings growth of low-single digits. Towards year-end we will look at the appropriate level of capital and if we can make its usage more efficient, it will help in the ROE.

Sebastian Paredes While there has been a slowdown in trade, what we've witnessed is the movement of the technology-driven supply chain to Southeast Asia and we have been following our customers to support their financial needs.

Chng Sok Hui Our ECL Stage 1 and 2 reserves are currently at $2.6 billion with a total general reserve; including the RLAR, general allowances are at $2.9 billion. We have done our benchmarking against banks that have released their results. We believe that we have been prudent in the amounts of general allowances taken. If the macroeconomic situation worsens, the GP will enable us to absorb potential losses; if things improve, we should be looking to release some GP.

Piyush Gupta In addition to the model-based ECL, we have been quite cautious in using management overlays to account for the global synchronised slowdown and the situation in Hong Kong. This will help us cushion any portfolio deterioration that might happen.

Melissa Kuang Your peers have reported downward RWA migration as some loans have not performed well. Is the increase in your RWA due to the same reasons or has your loan mix changed?

Piyush Gupta We had some downward migration but we had a similar number of upgrades as well. On a net basis, the RWA change didn't come from any portfolio migration. Some of it is from currency translation.

Andrea Choong (CIMB) First, wealth management income has been coming up strongly this year. Is this a realistic run rate to expect going forward, and can you give some colour on where the net new money is coming from? Second, on the seven basis point NIM reduction expected in 2020, should we be looking at this from the exit NIM at the end of fourth quarter or is this on a year-on-year basis?

Piyush Gupta AUM growth has been 9%. The growth has been broad-based and we continue to attract money in the ultra-high net worth and mid-tier segments. It is also quite diverse geographically with new money coming from across the region. We are confident that it is sustainable given the strong momentum we've seen in this segment. On NIM, the seven-basis-point reduction is on a full-year basis.

Robert Kong Could you give colour on the recent digital offering you launched in Hong Kong?

Piyush Gupta We launched a digital add-on to our offering in Hong Kong to support our physical presence. We had strong digital capabilities but were lacking the ability to onboard customers digitally which was what we recently included. We've also brought together our other digital assets under one roof. That allows us to create a more complete offering and as competitive as any digital-only bank could offer.

Sebastian Paredes The onboarding capability and placing all digital assets into one single environment is a massive change. We are the only bank in Hong Kong that can onboard investment and wealth management accounts. Also, considering the situation in Hong Kong today and that we only have 32 branches, this capacity to remotely onboard will be a critical differentiator in the ability of DBS Hong Kong to capture a much larger market share in the affluent segment.

Conrad Werner The CEO observations slides presented in the media briefing lists a potential US-China trade deal as a positive. Is this outcome baked into your 2020 outlook?

Piyush Gupta The 2020 outlook assumes the status quo. If there is a trade deal which improves market sentiment, then that would be a positive to the outlook.

Diksha Gera (Bloomberg) Could you reflect on the impact of the digitalisation of the yuan on your business and how it will move the needle in terms of the yuan being used as a trade settlement currency? Could you also reflect on the IBOR transition and what it could mean in terms of bank margins from a structural basis?

Piyush Gupta About 95-96% of all currency in the world today is digital. The money supply for institutional activity, whether it's capital markets or trade finance, is already digital. The question is whether you can digitise the remaining 4-5% for settlement processes and last-mile payments. However, I don't see it dislocating the process of institutional fund flows and leading to a wider adoption of the yuan as a trade currency. I think China will continue to advocate the use of the renminbi as a settlement currency for oil, but it remains a small fraction of global trade.

The transition from IBOR for the institutional market such as for derivatives and fixed income is relatively straightforward. For the commercial book, where customers pay the prevailing IBOR rate, it is more tricky and there is no consensus on the direction. Hong Kong has decided to stick with Hibor while Singapore has decided to use Sibor-plus as a way to transition. In other markets, there is a notion that it will be based on derivatives. One issue is that such a rate would be a risk-free rate whereas benchmark rates such as Libor have a credit spread built into them. The question then is whether credit spreads increase to make up for the difference. There are currently debates on whether another risk-adjusted market-driven reference rate should be created.

Three things can happen. First, the markets come out with a risk-adjusted reference rate, and the credit spreads that banks currently charge remain unchanged. Second, there is a risk-free market rate and credit spreads rise from current levels to fully reflect credit risk. Third, we stick to existing reference rates such as Sibor or Hibor. From my conversations with regulators, nobody expects margins to narrow.

Diksha Gera Is there network inefficiency which prevents the renminbi from becoming more widely used for trade settlement, or is it purely related to the fact that it is not a reserve currency?

Piyush Gupta Obviously, it's the reserve currency issue. There is massive inertia in adopting a new reserve currency. While the US overtook the UK as the largest economy in the world in the 1880s, the US dollar only supplanted the sterling after the World War II. Even today, about 70-80% of global trade is USD-denominated despite the existence of other major currencies such as the Euro and the Yen.

Harsh Modi On the guidance for credit cost, what's the underlying assumption on the Hong Kong economy?

Piyush Gupta Our base case assumption is that the current turmoil runs through into the first half of the year, and then things settle down. So, at the back end of the year, we expect to see normalisation.

Harsh Modi So you are assuming that economic growth for the next six months stays at around the current levels and will not deteriorate?

Sebastian Paredes Yes, we are assuming a very mild recovery in economic activity after the second quarter next year. That is the main assumption that we've have built into our planning for next year.

Piyush Gupta The reason we bumped up GP for Hong Kong is to incorporate tail events. The situation could worsen and we decided to take some allowances as a precaution.

Michael Sia Thanks for calling in. See you next quarter.