Edited transcript for DBS first-quarter 2023 results conference call for buy and sell sides, 2 May 2023

Michael Sia Welcome everyone to our first-quarter results briefing for the buy and sell sides.

Jayden Vantarakis (Macquarie) What is the sustainable level of Treasury Markets income? I heard during the media briefing it was $275 million per quarter but I wanted to know how much is from client flows and how much from trading its own book.

Piyush Gupta The $275 million per quarter or $1.1 billion a year is only for trading and does not include client flows. It used to be $1 billion a year and we increased it to $1.1 billion due to business model improvements and the use of digital capabilities. It is obviously volatile but we have the view that $275 million a quarter is a good number to work with. Treasury customer income shows up in IBG and CBG.

Chng Sok Hui The other non-interest income line for the Commercial book is mainly treasury customer income, which is $432 million this quarter. It is separate from the trading income for Treasury Markets, which is $269 million.

Jayden Vantarakis My next question is on the potential impact of the recent digital banking disruption. Do you think it will lead to additional penalties on the CET-1 beyond the 40 basis points that was imposed for the first outage, and is there an impact on how you view dividends?

Piyush Gupta The decision is obviously not in our hands. The regulator is going to take a view after it gets the full report. But in terms of the capacity to pay dividends, we have surplus capital even before the impact of the Basel IV adjustments, which give us another two-percentage-point headroom in the CET-1. Therefore, it is unlikely that any penalty is going to have a material bearing on our ability to pay out.

Aakash Rawat (UBS) What are your assumptions for Fed rate hikes this year? You mentioned at the media briefing that there are another $30 billion-40 billion of deposits that have yet to be repriced. Could you elaborate on that in the context of system trends, which suggest that Casa outflows are stabilising.

Piyush Gupta We are assuming that Fed rate hikes are pretty much done after one more hike tomorrow, but we are not expecting any cuts this year. We use analytical models to determine the amount of deposits that need to be repriced and it crept up in the past few quarters because of higher outflows to T-bills. But the outflows are slowing as customers recycle money from maturing T-bills into new issuances. Based on the modelling, we are 75-80% through the repricing of deposits.

Chng Sok Hui Our modelling also includes Casa accounts switching to fixed deposits, which are included in the $30 billion.

Aakash Rawat On asset quality, what are your thoughts on the credit cycle? In the past few decades, there have been boom and bust cycles led by careless lending in specific sectors. This time it looks a bit trickier. If I were to ask, what sectors do you think the risk could come from this time for Singapore banks like yourself?

Piyush Gupta I have been saying for two to three years that the biggest risk was in the SME book. Because when inflation goes up, the cost of goods goes up, interest rates go up, leaving SMEs with less pricing power than large corporates. It is a surprise to me that for 12-18 months now we are not seeing any stress at all. I can only attribute it to the three or four prior years when SMEs were hammered by Covid and in Hong Kong by China-US tensions. Therefore we have had a lot of culling in the portfolio and the SMEs themselves have built up a degree of resiliency.

In addition, the bulk of our portfolio is secured with LTVs that are not high. Even so, if something were to happen, that is the book you have to watch. One reason we continue to be cautious and build up general allowances is you never know when the SME book starts getting worse.

A second portfolio to watch is the unsecured consumer exposure. It is not a large book for us, just shy of $10 billion. Again, we are not seeing any stress so far. Credit card interest rates are by and large capped around the region, so higher rates have not resulted in higher pricing. Nevertheless, there are some early signs of a pick-up in delinquencies in Hong Kong and China. Outside of that we are not seeing stress in our portfolio.

We have also done a lot of sectorial reviews based on high interest rates, energy prices, inflation and so on. We are not picking up systemic risk in any sector.

Aakash Rawat The second level of risks would come from contagion from developed markets, such as in commercial real estate, either through exposures directly or some sort of squeeze in money markets. How would you rate the risk of that and is there something you can do to hedge against them?

Piyush Gupta One of the hedges we took is through the $99 million of general allowances this quarter. We now have $2.1 billion of general allowance reserves, which a lot of cushion for potential losses.

We also look at liquidity risk, which is when there is an exodus of US dollars from the system. While it is possible, there is just so much liquidity in the system. I think the fact that the Fed balance sheet has gone up means no matter what it says, there is a lot of money sloshing around. Therefore our access to commercial paper and repo lines is very strong. Having said that, after the recent bank runs, we have become even more cautious. We continue to hold a lot of high-quality liquid assets.

While contagion risks from developed markets are possible, it is not clear to me that they are going to be very consequential to the Asian banking system or certainly to DBS in the coming year.

Aakash Rawat How much of your commercial real estate exposure is to office buildings in developed markets?

Piyush Gupta Let me get somebody to check the exposure. [Post-briefing note: developed market office exposure accounts for around 4% of the total commercial real estate portfolio.]

Harsh Modi (JPM) I think you guided for the likelihood of special dividends at mid-year. Given the strong profits and positive other comprehensive income, should we assume a special dividend at mid-year?

Piyush Gupta I have never guided for special dividend at mid-year.

Harsh Modi But there was some indication that you could do more capital management.

Piyush Gupta The mid-year special dividend I have never guided to. What I did say was that we have a lot of capital so, yes, we can do more capital management. It is something that we are working through with the board.

Harsh Modi On net interest margin, the behavioural duration of your deposits is long. With interest rates where they are now, are you trying to lengthen, let's say, your fixed-rate owner-occupied mortgages to five or 10 years? Is there demand for that product? How do you think about locking in duration even if it means giving up some NIM benefit now?

Piyush Gupta The specific answer to your question is there is no demand for five-year fixed-rate housing loans. We currently offer two- and three-year fixed-rate housing loans, and the bulk of the demand is for two years. The longer-tenor loans tend to be large-corporate loans. However, not many customers are not taking them up right now. Everybody is taking a view that rate cuts will come, so it is difficult to get them to bite at a five-year fixed-rate loan.

The other thing we do is swap some floating-rate loans to fixed rates, which results in duration. When we do it, we take into account the overall interest rate risk in the banking book. The overall duration of the book is low, under three years.

Harsh Modi If the Sing dollar weakens meaningfully, is there a risk to funding costs and NIM?

Piyush Gupta It does not show up as a major variable in our modelling at this time. Even with competition, we have been holding up pricing on loans and dropping rates on fixed deposits.

Chng Sok Hui Our model assumes exchange rates are going to be quite stable. And with Sing-dollar weakness, the pass-through from US interest rates to Sing-dollar interest rates becomes better.

Harsh Modi I was worried about system liquidity outflows, do they then start impacting your deposit betas more than now when liquidity is ample?

Piyush Gupta Remember the bulk of deposits are low cost and stable, so if there is a system outflow and liquidity tightness, if anything it gives us an opportunity to increase lending rates.

Harsh Modi Of the couple of segments more at risk – SME, unsecured consumer, parts of commercial real estate – can you quantify the increase in probability of default, even if it is still low.

Piyush Gupta Our GP model looks at the macroeconomic variables and the quality of the portfolio, and in recent quarters it has indicated the portfolio is getting better. In the previous quarter, the model indicated a GP write-back of around $100 million and it was the same this quarter. We took $200 million in overlays this quarter because I did not want to reduce GP reserves given the uncertain outlook. We have stress tested property – obviously commercial property – banks, TMT and so on, and are not seeing any material signs of risk in any of the sectors at this point in time based on our client positions. I am not seeing a pick-up in PD across any sector at this stage.

Chng Sok Hui When an exposure becomes an NPL, the GP is reversed and becomes part of specific allowances. Because we set aside a substantial amount of GP when an exposure is identified as a weak or red watchlist case, about half of the SP required when it becomes an NPL is from the GP. This means our entire stack of GP and SP reserves is resilient to future problematic cases.

Tan Yong Hong (Citi) Will fourth-quarter NIM come in below 2% given the revised guidance that first-quarter NIM of 2.12% is the peak and there is further deposit repricing?

Chng Sok Hui Based on our models, NIM will still be above 2% in the fourth quarter. That is why we say the NIM decline is going to be gradual.

Tan Yong Hong On asset quality, your Hong Kong mortgage book is not big, but how are you thinking about property valuations given higher interest rates.

Piyush Gupta I think property valuations depend on the sector. The residential markets in Singapore and Hong Kong are very robust. I think the real challenge is commercial property, in the US and UK principally because people are not coming back to work, which is putting some pressure on prices. In most parts of Asia, most people are coming back to work, so I am not seeing a glut. Sebastian, what is the outlook for Hong Kong?

Sebastian Paredes I think Hong Kong office space that came in 2022 is stressed. Rental yields have probably declined by 30-40% in the past three years. But with the border re-opening, the stress will probably start reversing. Retail is also a bit stressed because of Covid, but we expect that to normalise as mainland tourists come back to Hong Kong. Residential prices have stabilised, with properties priced below HK$10 million not a problem at all while high-end prices have been reduced by about 15%. Our portfolio is still robust. We are focused on large conglomerates and top- and mid-tier real estate investment companies.

Piyush Gupta I was just checking, our LTV on secured commercial real estate in Hong Kong is only 44%.

Tan Yong Hong On fees, how is April tracking relative to the first quarter?

Piyush Gupta It has been slightly softer than March. I think the strains from the US financial sector are having some impact on animal spirits in Asia. Capital markets were strong in January and came off for both ECM and DCM over the following two to three months. While we do not have a large investment bank, ECM is material for us at the margin.

Aakash Rawat Thank you for taking a follow-up question. On the GP model, I think it will help investors' confidence if you could share some details on the data that go into the models.

Piyush Gupta We start with macroeconomic variables – GDP, inflation and so on. But what really drives the model is our own portfolio quality. We categorise our portfolio into amber, red and weak. We proactively move accounts into and across these categories depending on forward-looking and backward-looking indicators – the usual financial ratio analysis and the forward-looking view on sectors. We use PD and LGD assumptions based on our historical losses according to the category. We then recalibrate our GP assumptions. The process is quite robust – it takes a top-down view that is then reinforced with the bottoms-up view of the portfolio.

Chng Sok Hui An improvement in portfolio quality can come from a few areas. When there is a reduction in exposures to weak cases, or a reduction in their maturity, we have to write back GP.

Sometimes cases get upgraded, for example from amber to green. Transfers to NPL also result in GP write-backs, but downgrades within the watchlist would increase GP. In addition, we do stress tests to see potential pockets of concern, which results in the GP overlay.

Theo Hadiwidjaja (JP Morgan Asset Management) You mentioned that the adoption of Basel IV will improve the Tier-1 CAR ratio by two percentage points. Can I clarify whether the CET-1 ratio will also improve? What are the drivers of this improvement? Do you have CET-1, LCR and NSFR targets?

Chng Sok Hui Our CET-1 operating range is 12.5-13.5%. We are currently above that level. We expect the implementation date for Basel IV to be announced in July this year. The implementation could be early 2024, mid-2024 or even 2025. The bigger movers of the reduction in RWA are lower LGDs and the removal of a 1.06 multiplier.

There is also the interaction with the capital floor that starts kicking in at 50% on the standardised model, which then rises all the way to 72.5%. Over a five-year period, we expect the RWAs from internal models and from the standardised model with the capital floor to converge. But in the interim, we will benefit from a higher transitional CET-1 ratio compared to the phased-in final ratio. We will report both ratios. But it means that in the transitional period, the additional buffer would help us to offset the need to refinance AT-1 instruments since the CET-1 will do double duty during the period.

Piyush Gupta In other words, you will see the benefit in CET-1, not just total capital.

Theo Hadiwidjaja Would you also have the same CET-1 target of 12.5-13.5% under Basel IV?

Chng Sok Hui Yes, and we will calibrate both the transitional and final CET-1 ratios around that target. On the LCR and NSFR, we tend keep a comfortable buffer above the regulatory requirement of 100%.

Weldon Sng (HSBC) Have you done any analysis comparing your NIM with peers'? Your NIM is not higher, which I thought should be the case since you have the highest Casa ratio. I had assumed it was due to a lag in asset repricing, but is there anything structurally different this cycle? Has the securities business grown significantly and caused a NIM drag compared to peers? Or do you think that eventually your NIM will still become the highest?

Piyush Gupta The answer is a bit of both. First, our Treasury Markets is about 19% of our assets and is bigger than our competitors. It has a balance sheet of more than $100 billion that is showing a negative net interest income. Our Commercial book NIM is up 104 basis points over the past year and is a better reflection of our franchise. The NIM and net interest income drag from Treasury Markets is noise because it is made up in non-interest income.

Second, our assets reprice more slowly than competitors, who price some assets on one-month Sora, while ours are on the three-month rate. The one-month spikes quickly, giving immediate benefit, but then comes off. In addition, we still have $113 billion or 22% of our Commercial book still yet to be repriced. As the repricing goes through, it will provide a higher degree of stability in our NIM compared to the market.

Chng Sok Hui We started disclosing the Commercial book to eliminate the noise from Treasury Markets. The Commercial book NIM moved up 104 basis points over the past year whereas the group NIM moved up 66 basis points. Besides NIM, the Commercial book gives a better view of the fee income as well as the treasury customer income. The larger US banks do a similar disclosure.

Weldon Sng If there were rate cuts, would your group NIM not drop as much as well?

Piyush Gupta It is possible, but Treasury Markets will not make as much on non-interest income either. Seventy to eighty percent of the Treasury Markets net interest income impact shows up in non-interest income. Therefore the way to think about Treasury Markets is on a consolidated net interest income and non-interest income basis of $275 million a quarter.

Weldon Sng What is the reason your LDR of 80% is lower than the 85% in 2019?

Piyush Gupta It is because we benefit from deposit inflows. Our deposit market share has continued to creep up. We are not finding enough opportunities to put the money to work and instead have lent $30 billion to MAS.

Weldon Sng Will your capital return initiatives be more likely to be special or ordinary dividends?

Piyush Gupta It could be a mix of both. We are currently engaging the board on the method and timing.

Michael Sia Thank you for joining us today.