Fitch Ratings 2020 Outlook: Asia-Pacific Developed Market Banks

Risk Appetite, Policy Settings Influencing Earnings

Fitch's Sector Outlook: Stable

Fitch's sector outlook for developed markets in Asia-Pacific (APAC) is stable, based on the number of banks, but is split between negative and stable on the number of systems covered (eight). Japan moves to negative from stable, due to rising challenges to the business model and overseas operations, which makes earnings growth difficult without taking on more risk. Most downside risk is in Australia, where larger banks face higher remediation costs, subdued economic growth, and competition dragging on earnings.

We recently affirmed our assessment of Hong Kong's operating environment, taking into account closer integration with the mainland and a weaker local economy. Banks remain exposed to downside risk stemming from a prolonged deterioration in the economy, but banks in most other markets also face downside risks from external headwinds, a low-interest-rate environment and regulation, among other factors. However, we believe any weakening of financial results in 2020 will not necessarily be significant, due partly to proactive measures being taken by policymakers.

Rating Outlook: Stable

The rating outlook is more stable than the direction of key financial metrics. Negative outlooks are concentrated mainly in Australia (and their New Zealand subsidiaries), where the Issuer Default Ratings (IDRs) are driven by their Viability Ratings (VRs). Support (institutional and sovereign) can also be a factor in APAC, meaning the outlook may reflect that of the likely support-provider.

However, most banks have at least some headroom to weather expected deterioration in financial profiles even though some VRs face downward pressure. At the same time, rising risk appetite (including higher concentrations) increases downgrade potential for the VRs, with several banking systems exposed to external challenges, including emerging markets.

Rating Transition and Distribution

Most IDRs are not likely to change. Changes in the VR-driven majority will more likely be negative if any deterioration in intrinsic profiles exceeds our tolerance at given VR levels. This could arise through the operating environment, company profiles or risk appetite becoming misaligned with loss-absorption buffers. IDR upgrades in 2019 were mainly in Taiwan (including related parties).

What to Watch

- Rising risk appetite to counter pressures on profitability
- External headwinds – trade protectionism and slower global growth
- Cyclicality of macro and macroprudential regulations to stabilise economy/system
- Exposure to higher leverage and concentrations raising downside risks



From left-to-right:

Jonathan Cornish
Head of APAC Banks

David Wong
North Asia Banks

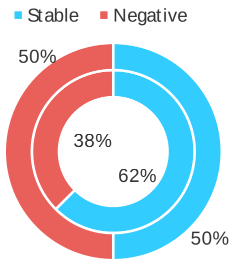
Tim Roche
Australia/New Zealand

APAC DM Banks: 2020 Outlooks

	Rating Outlook	Sector Outlook
Australia	Negative	Negative
Hong Kong	Stable	Negative
Japan	Stable	Negative
Korea	Stable	Stable
Macao	Stable	Stable
New Zealand	Negative	Stable
Singapore	Stable	Negative
Taiwan	Stable	Stable

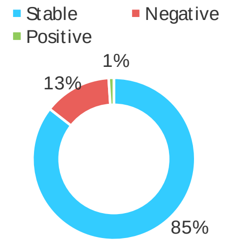
Source: Fitch Ratings

APAC DM Banks Sector Outlook



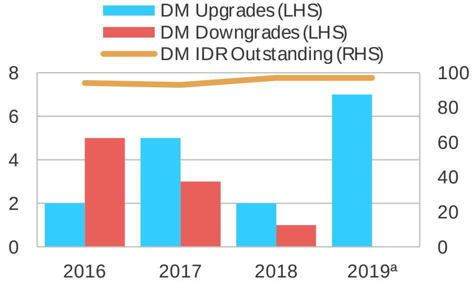
2019: Inner ring; 2020: Outer ring. Ratings outlook as of Oct-19
Source: Fitch Ratings

APAC DM Banks Rating Outlook



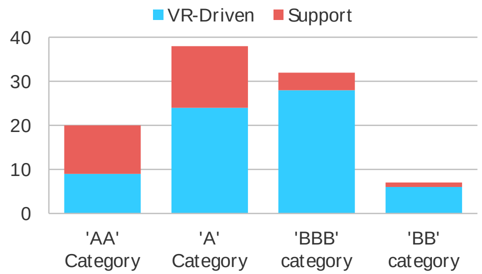
Note: All individual bank outlooks (not system)

APAC DM Banks: IDR Changes



[a] YTD Oct 2019
Source: Fitch Ratings, Fitch Solutions

APAC DM Banks: Support
Distribution of IDRs at October 2019



Source: Fitch Ratings, Fitch Solutions

Rising Risk Appetite to Counter Pressures on Profitability

The most striking trend in recent years has been the banks' incremental rise in risk appetite to fend off threats to profitability coming from lower interest rates, softer growth prospects and tougher competition. Higher prudential or macroprudential standards have also pressured profitability, but in some cases the latter has been wound back in the face of cyclical headwinds. Many banks are selectively increasing their appetite for risk to support profitability despite the intention of regulation to make banks safer.

We perceive banks to be taking on additional risk via various channels. Most obvious is expansion into riskier markets (eg emerging), which could affect our assessment of the operating environment. Other channels include higher concentration of exposure (eg property, SME), M&A (including non-banks, as in the case of Korean and Taiwanese holding companies), or holding higher-yielding investments.

Banks also face challenges from an evolving landscape, responding by way of investing further in their businesses and/or acquiring digital licences/players. Risk-pricing has also become more aggressive under a low-interest-rate environment, with asset growth potentially coming through selective relaxation of underwriting standards (in part, sanctioned indirectly by regulators).

Additional risk-taking may not be obvious to many market observers due to the relatively benign – albeit still challenging – operating environment, and may only become apparent in a less benign environment. We see only modest scope for further strengthening of loss-absorption buffers (exceptions being higher prudential standards for Australian banks and their New Zealand subsidiaries), meaning the potential for greater downside risk over time.

External Headwinds – Trade Protectionism and Slower Global Growth

Fitch's forecasts for nominal GDP growth in 2020 reflect the lower bases in 2019, but the outlook is for economic growth to remain subdued relative to longer-term averages. However, external headwinds loom large across the region, in particular Singapore, greater China and north Asia, which are most exposed to slower global capital flows and slower trade, among other factors.

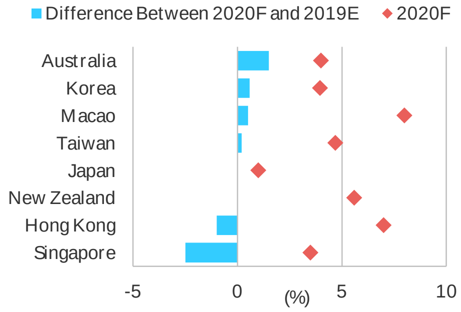
Fitch assesses these markets as the most likely to be affected (mainly in asset quality and earnings) by a faster-than-expected slowdown in China's growth, due mainly to direct credit exposure or their local economies being hit. We see lower growth as challenging for most banks – particularly where credit risks have increased in recent years and leverage has risen the most or remains high – such as Australia and New Zealand, but also Singapore, Korea and Taiwan.

Cyclicality of Macro and Macroprudential Regulations to Stabilise Economy/System

Five of eight developed markets covered by Fitch have cut their policy rates in 2019, while low interest rates are likely to be sustained. This is negative for bank net interest margins (NIMs), but potentially a mitigating factor for asset quality as impaired-loan rates come off multi-year lows, albeit low interest rates are likely to spur a further rise in leverage.

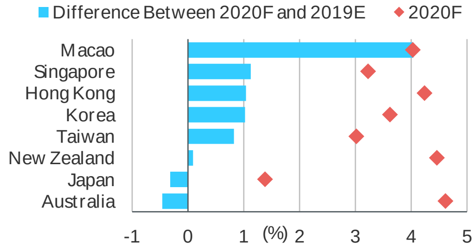
Downside rate risk exists in the near term, but longer-term we see a shift to normalisation of rates. However, monetary policy is not the only booster for economic growth – increased investment in infrastructure stands to be another policy tool that governments can leverage to support the local

APAC DM Banks: Loan Growth (%)



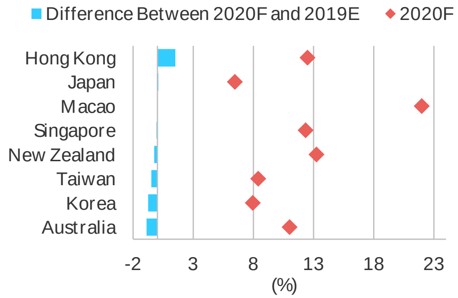
Source: Fitch Ratings, Fitch Solutions

APAC DM Banks: Nominal GDP growth (%)



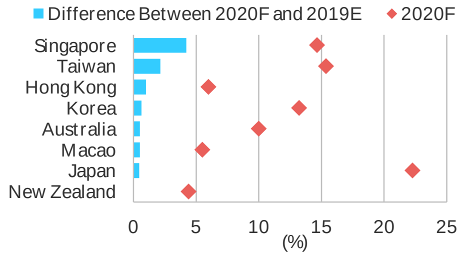
Data per Fitch Sovereign's estimation as of Sep-19.
Source: Fitch Ratings, Fitch Solutions

APAC DM Banks: ROE (%)



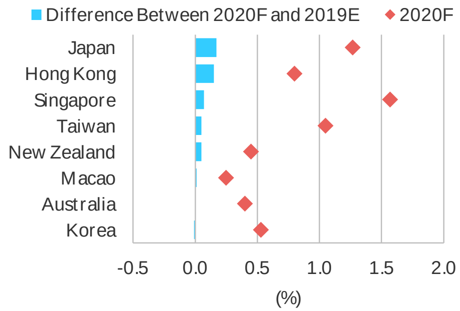
Source: Fitch Ratings, Fitch Solutions

APAC DM Banks Credit Cost/Pre-Provision Operating Profit (%)



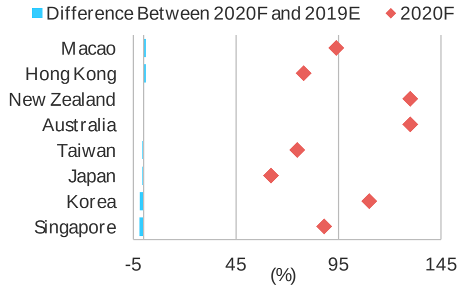
Source: Fitch Ratings, Fitch Solutions

APAC DM Banks: NPL Ratio (%)



Source: Fitch Ratings, Fitch Solutions

APAC DM Banks Loan-to-deposit ratio (%)



Source: Fitch Ratings, Fitch Solutions

economy and, indirectly, the banking system. We see more potential for that in Australia, Japan and Korea.

APAC arguably has implemented more macroprudential policies over the past few years than any other region. We believe that reflects the generally proactive nature of policymakers and extent of risk that has built up in most economies. The counter-cyclicality of regulations means the authorities have room to unwind them in the event that sectors (where macroprudential rules are in place) come under pressure. This has already been the case for property in Australia, New Zealand and Taiwan, with more recent measures in Hong Kong to support mortgage affordability.

We see policy refinement as remaining flexible to suit the situation at hand, including relaxation in markets most under pressure – which would ultimately be supportive for bank credit profiles in the short term, but increase risk in the longer term should leverage build further as a consequence.

Exposure to Higher Leverage and Concentrations Increasing Downside Risks

Fitch views the general economic outlook as challenging, but stable. However, any downside to our growth expectations could render banking systems more vulnerable to asset-quality deterioration than in the past decade – no developed market in APAC has experienced stress over this period. However, we see a combination of higher leverage and asset concentration as likely to hasten deterioration in asset quality more than in the past, should the environment weaken.

This is particularly so where household leverage is highest, such as Australia (debt to disposable income is 191%) or Korea (184%), or where corporate leverage is high – again in Korea (private sector credit/GDP: 148%) and Taiwan (183%). Leverage remains high in Hong Kong and Singapore, but these are international financial centres where debt is also raised for use in other geographies.

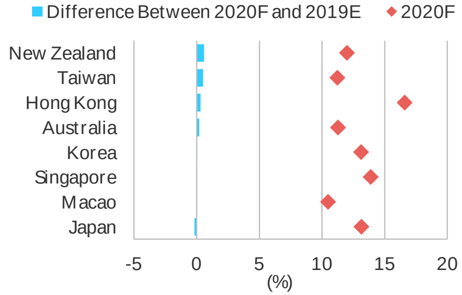
Reflecting higher risk appetite, banks in many systems have relied on a rising rate of growth from where asset concentrations are already significant – emerging markets and property, and to a lesser extent SMEs. Growth in mortgages is still likely to be pursued for the higher risk-adjusted returns, but competition remains acute and stands to trim risk buffers through lower pricing or higher average loan-to-value ratios (LTVs).

Evolution of Fintech

The year 2019 has marked the offering of digital licences (or the intention to offer digital licences) in Hong Kong and Singapore, while Korea is looking at expanding the number of internet banks beyond the current two. Meanwhile, Australia is providing more freedom for digital disruptors to the incumbent banks.

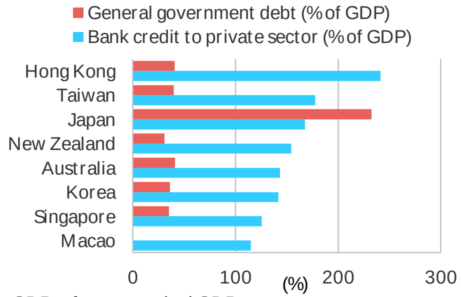
That said, while the Korean experience suggests that new entrants can make a rapid impact, we believe that incumbents are still well-positioned to fend off new challengers – at least in the near term. Indeed, Singapore's regulator is focused mainly on licensees bringing about innovation and healthy competition, rather than risk unhealthy damage to the major banks' business profiles.

APAC DM Banks: CET1 (%)



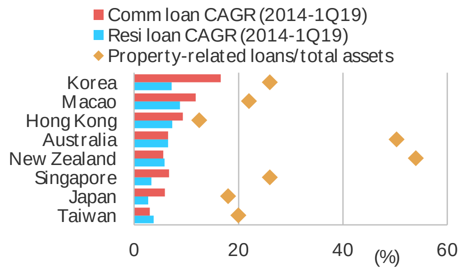
Data for Macao was T1 ratio
Source: Fitch Ratings, Fitch Solutions

APAC DM Debt/Credit to GDP Ratio



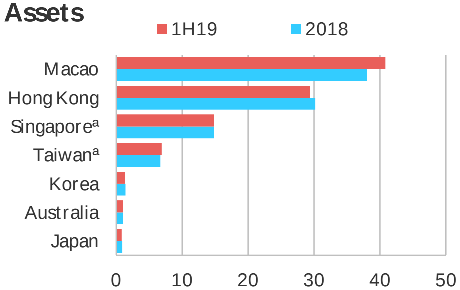
GDP refers to nominal GDP
Source: Fitch Ratings, Fitch Solutions

APAC DM Property Loan Growth



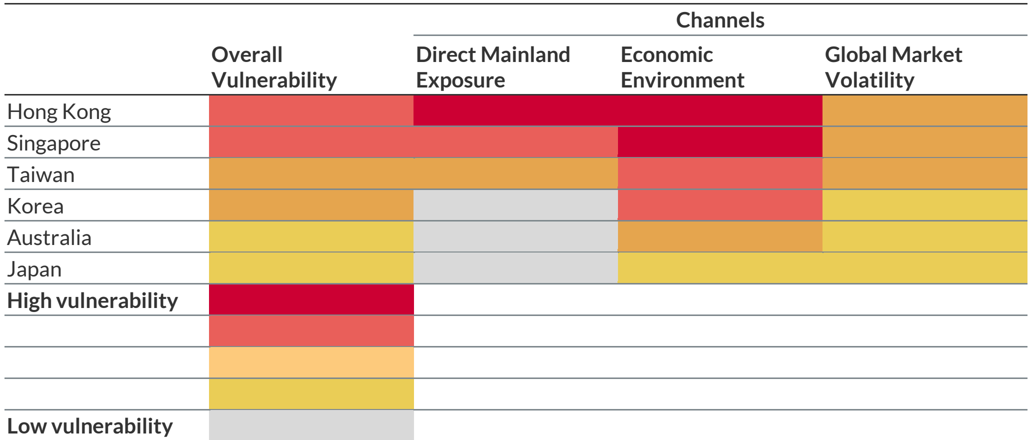
End-2014 to end-18 CAGR for Korea. End-16 to 1Q19 CAGR for New Zealand
Source: Fitch Ratings, banks, central banks

Selected APAC DMs' MCE/System Assets



[a] Estimated
Source: Fitch Ratings, regulators, banks

Relative Vulnerabilities to a Severe China Slowdown



Source: Fitch Ratings

Australia

Fitch's Sector Outlook: Negative

Fitch maintains a negative sector outlook on Australian banks due to a number of headwinds which continue to weigh on performance. These include the easing interest-rate cycle, subdued credit growth, intense competition, and ongoing remediation and compliance costs associated with inquiries into the financial sector. These factors are likely to squeeze NIM and act as a drag on operating efficiency and overall profitability.

Rating Outlook: Negative

The ratings outlook has been revised to negative from stable, to reflect Fitch's view on the four major banks which account for around 79% of total system loans. The banks maintain sound financial profiles, while their focus on remediating operational and compliance-risk issues increase the prospect of resources being diverted away from key aspects of their operations – and result in a weakening of the franchise or earnings.

What to Watch

Robust Capital Positions

Fitch believes the system capital will remain sturdy following the finalisation of "unquestionably strong" capital targets set by the regulator in 2020. Capital positions of the major banks will be strengthened further by the issuance of at least 3pp of risk-weighted assets in Tier 2 instruments to meet the Australian Prudential Regulation Authority's (APRA) minimum loss-absorbing-capacity requirements, which will take effect from 1 January 2024.

In our view, APRA's decision not to require the major banks to issue senior non-preferred debt means that support for domestic systemically-important banks has not diminished.

Remediation and Compliance

APRA identified deficiencies within the management of operational and compliance risks at the major banks and, to a lesser extent, some regional banks. Fitch expects further costs to arise in 2020 as banks continue to work through their respective remediation programmes and in dealing with other potential charges which reportedly could be made against them.

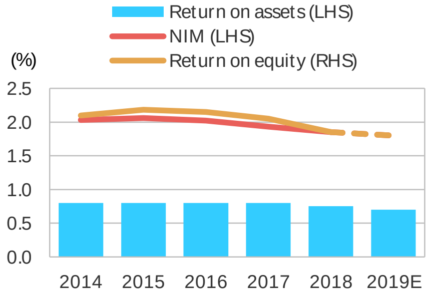
Pressure on Households

Asset quality will be supported by low interest rates, however loan-impairment charges and bad debt are unlikely to remain at historically low levels – reflecting a general weakening in household finances following a long period of tepid wage growth. Nevertheless, any deterioration should be manageable for the banks.

Acceleration in Housing Prices

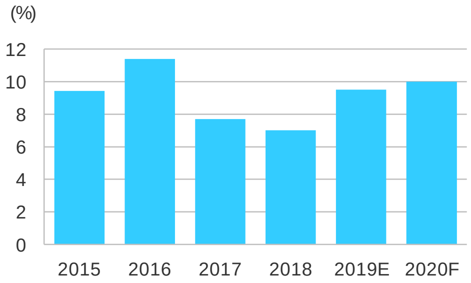
The low- and falling-interest-rate environment could lead to significant growth in house prices in Australia's major property markets, and raise risk for the system, although this is not Fitch's base case. Underwriting standards remain tighter than during the previous housing upswing, and the banks have reduced their appetite for higher risk loans such as investor and interest-only loans.

Australia: Key Performance Trends
Profitability



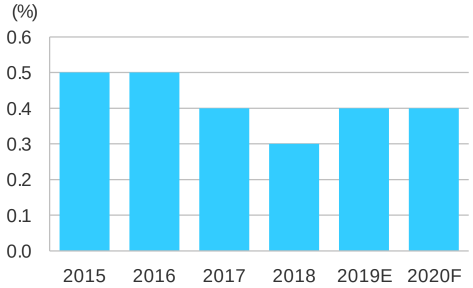
Source: Fitch Ratings, APRA

Australia: Key Performance Trends
Credit costs as % of pre-provision operating profit



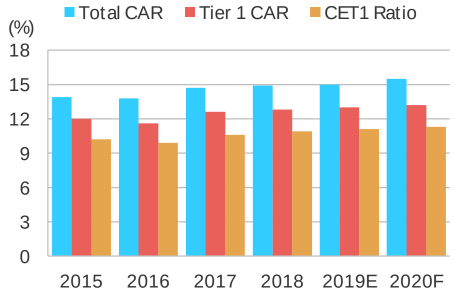
Source: Fitch Ratings, APRA

Australia: Key Performance Trends
Impaired loan ratio



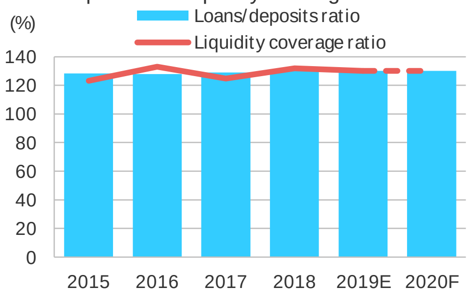
Source: Fitch Ratings, APRA

Australia: Key Performance Trends
Capital ratios



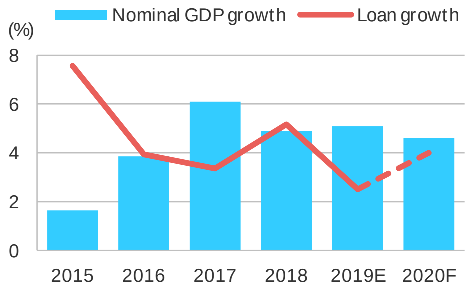
Source: Fitch Ratings, APRA

Australia: Key Performance Trends
Loans/deposits and liquidity coverage ratio



Source: Fitch Ratings, APRA

Australia: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, APRA

Hong Kong

Fitch's Sector Outlook: Negative

Fitch's negative sector outlook reflects rising headwinds from economic slowdown. Ongoing social disruptions in Hong Kong as well as US-China trade tensions are adding to pressures over business sentiment, leading to softer property markets and slower loan demand. These near-term uncertainties should reduce banks' risk appetite in their expansion strategies. Profitability is likely to weaken slightly due to moderate loan growth, lower fee contribution and higher credit costs, but a lower-interest-rate environment should alleviate pressure on funding costs.

Rating Outlook: Stable

The ratings outlook is stable, reflecting either the outlook on parent IDRs (for those banks whose IDRs are underpinned by institutional support) or sufficient buffers (at current VR levels) within their intrinsic financial profiles to withstand rising operating challenges. We expect key financial metrics to stay largely inside tolerance levels, aided by resilient revenue contribution, continued cost discipline and strong reserves.

We also expect little change in banks' funding and liquidity profiles, with no significant deterioration in the territory's liquidity position and sufficient resources to maintain the Hong Kong dollar/US dollar peg.

What to Watch

Capital Flow Trend: a Mixed Bag

Prolonged social disruptions may change perceptions of Hong Kong's business environment and may lead to more systemic capital outflows, thus eroding bank liquidity. Weaker deposit growth has driven the Hong Kong dollar LDR to exceed 90% – highest since 2008's global financial crisis.

Relaxation Measures to Support Property Prices

Fitch expects the relaxation in mortgage down-payment by the Hong Kong Monetary Authority (HKMA) in October 2019, together with the low-interest-rate environment, to reduce downside risks to property prices and collateral for banks in the near term. Nevertheless, we expect banks to set aside more provisions under HKFRS 9 in 2020 as local economic conditions weaken.

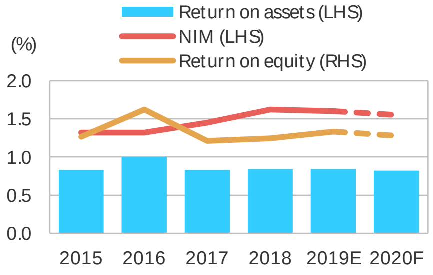
China-Related Lending to Slow but Exceed Hong Kong

China-related lending remains a core earnings driver, though the weakening economy (both locally and in China) and renminbi depreciation may lead to slower cross-border loan demand and wealth-management activities. The pace of growth in China-related lending hinges on the economic outlook and credit conditions in mainland China, but we expect China-related lending to support the sector's overall growth, thus offsetting the negative domestic momentum.

Virtual Bank Competition Likely to be Gradual

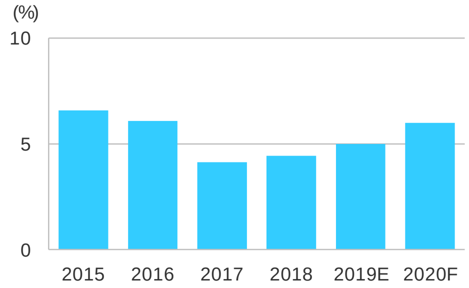
Weaker economic conditions in Hong Kong could delay the official launch of the 'virtual banks', while new entrants are likely to be more circumspect in a less benign credit environment. Competition for the incumbent banks is likely to be gradual, but we expect the incumbents will boost their fintech investments to keep pace with the competition.

Hong Kong: Key Performance Trends
Profitability



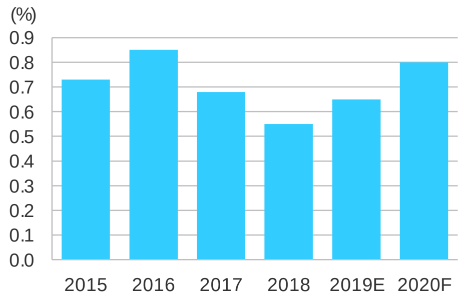
Source: Fitch Ratings, Fitch Solutions, HKMA

Hong Kong: Key Performance Trends
Credit costs as % of pre-provision operating profit



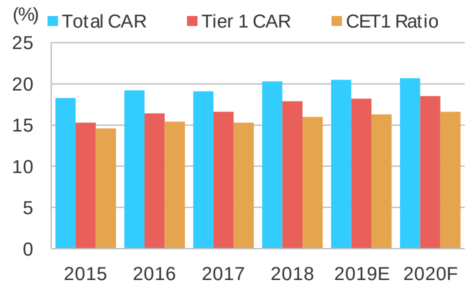
Source: Fitch Ratings, Fitch Solutions, Banks

Hong Kong: Key Performance Trends
Impaired loan ratio



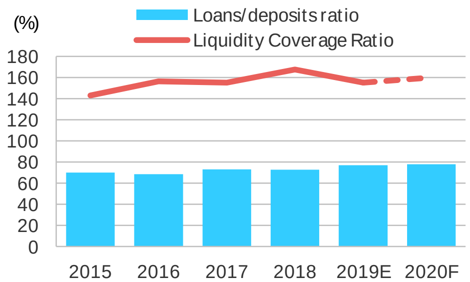
Source: Fitch Ratings, Fitch Solutions, HKMA

Hong Kong: Key Performance Trends
Capital Ratios



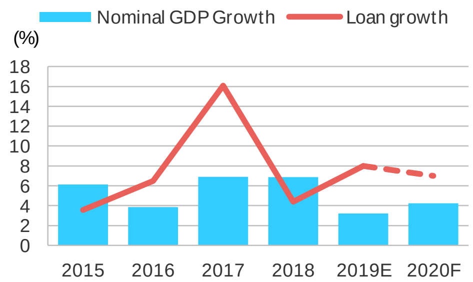
Source: Fitch Ratings, Fitch Solutions, HKMA

Hong Kong: Key Performance Trends
Loans/deposits and Liquidity Coverage Ratio



Source: Fitch Ratings, Fitch Solutions, HKMA

Hong Kong: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, Fitch Solutions, HKMA

Japan

Fitch's Sector Outlook: Negative

Fitch has revised the sector outlook on Japanese banks to negative, reflecting our expectation for further pressure on profitability, a gradual deterioration in asset quality, and more sluggish capital accumulation. The subdued operating environment, domestic structural challenges, and additional uncertainties overseas pose downside risks to our forecasts. We expect asset quality to remain healthy despite a gradual rise in risk appetite to support profitability, but the extent of any greater risk appetite will be limited by earnings pressures dragging on risk-buffer accumulation.

Rating Outlook: Stable

The outlook on most of the banks' IDRs is stable. For the banks whose IDRs are support-driven, the outlooks reflect the Stable Outlook on Japan's sovereign rating. For those banks whose IDRs are standalone-driven, Fitch expects their intrinsic credit profiles to remain largely steady, however ratings headroom differs across the banking groups.

What to Watch

Revenue Shift and Cost Control

Fitch views the execution of business plans – including revenue growth and cost reduction – as key to long-term sustainability of earnings. We expect the pressure on NIMs to ease, but revenue growth may disappoint initially as the transition to less volatile and 'asset-light' businesses from market-driven revenues will take time to yield results. A focus on relationships with more revenue opportunities would take time to materialise. Incremental credit costs – given fewer reversals of loan-loss allowances and slightly weaker asset quality – would also exert pressure on profitability.

Fitch views the swift execution of cost controls as important as revenue growth will take time. The redeployment of manpower to align with future business needs, reducing the number of employees beyond natural attrition, and the incremental costs in technology pose challenges. A lack of sustainable improvement in operating earnings from delays in addressing structural challenges could weigh on the ratings.

Risk Appetite

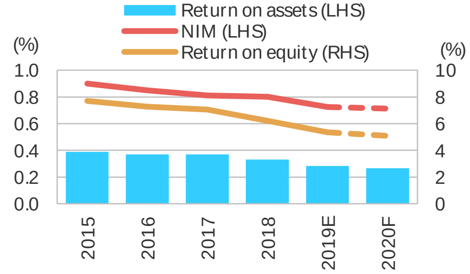
Banks, particularly 'mega banks'[a], will continue to expand overseas (organically and inorganically) in light of subdued domestic loan demand, but we expect overall loan growth to be modest. Banks will seek higher returns on securities investments and products by taking additional market and credit risks, although with limited incremental return and exposing earnings and capital to higher volatility. Fitch expects any growing risk appetite to be gradual, well-controlled and accompanied by higher loss-absorption buffers – anything to the contrary would be credit negative.

Capital Ratios Under Pressure

We expect capitalisation to remain at current levels, but slower capital growth from low earnings retention, increase in investments, higher dividend pay-out ratios and higher risk-weighted assets would pressure the sustainability of current capitalisation and leverage levels.

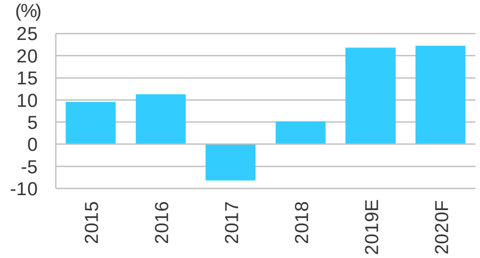
[a] The three largest financial groups in Japan, namely: Mitsubishi UFJ Financial Group, Inc. (A/Negative/a), Sumitomo Mitsui Financial Group, Inc. (A/Stable/a), Mizuho Financial Group, Inc. (A-/Stable/a-)

Japan: Key Performance Trends
Profitability



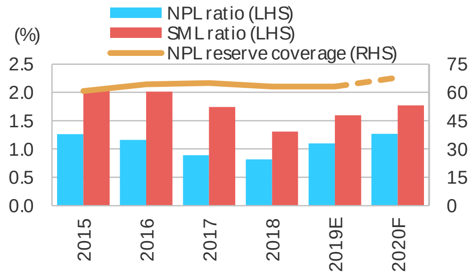
Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

Japan: Key Performance Trends
Credit costs as % of pre-provision operating profit



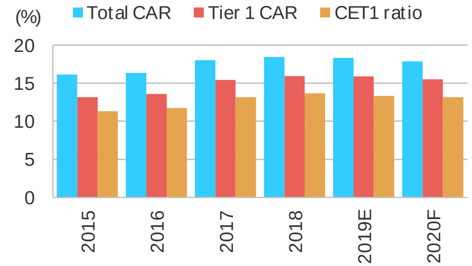
Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

Japan: Key Performance Trends
Impaired loan ratio



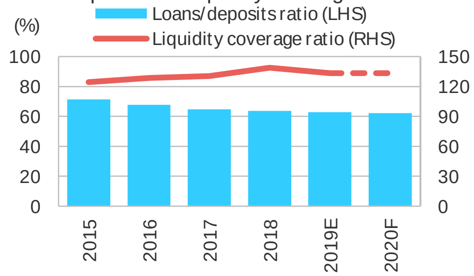
Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

Japan: Key Performance Trends
Capital ratios



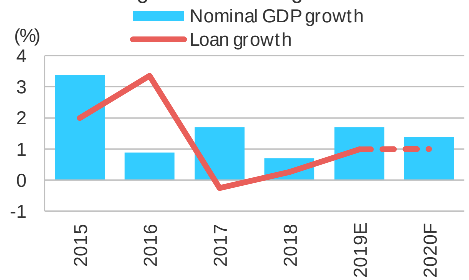
Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

Japan: Key Performance Trends
Loans/deposits and liquidity coverage ratio



Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

Japan: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, Fitch Solutions, MUFG, SMFG, MHFG

South Korea

Fitch's Sector Outlook: Stable

Korea's commercial banks are likely to deliver a broadly steady performance, albeit with slightly narrower margins and higher credit costs in 2020. Fitch expects the accommodative monetary and fiscal measures to largely offset the immediate impact from macroeconomic headwinds, including a weakened global trade environment. The banks' strengthened underwriting standards and risk controls should also help to limit any significant rise in delinquencies.

Tighter lending standards imposed on the banks by the regulator should moderate loan growth and help improve liquidity and funding profiles. The banks' efforts to boost cost efficiency through digitalisation and revenue contribution from overseas should also help internal capital generation.

Rating Outlook: Stable

Fitch has a stable outlook on the IDRs of all rated Korean banks. The outlooks on VR-driven IDRs reflect our expectation of banks maintaining steady intrinsic credit profiles, while the rest reflect the support providers' ability and propensity to support. Silence on bail-in power in the proposed resolution regime change confirms the sovereign's undiminished propensity to provide necessary support for the system.

What to Watch

Unexpected, Significant Economic Downturn

Challenges would intensify if the export-oriented economy further falters due to escalating trade tensions or a sharp slowdown in China (neither being Fitch's base expectation). A severe economic downturn would increase asset-quality pressures, especially among small- and medium-sized businesses on which banks have focused increasingly in the last five years.

Aggressive Expansion

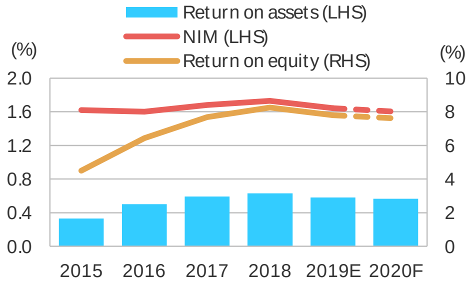
Rapid overseas expansion into developing countries, as opposed to our expectation of a piecemeal approach, would increase exposure to markets where the operating environment has proved to be much tougher and more volatile than in Korea. Moreover, capacity for internal capital generation could weaken if a bank holding company's common-equity double leverage (industry average: 125% at end-3Q19) increases when expanding into non-bank financial institutions (FIs).

Household Leverage

Loan growth to households and self-employed individuals risks exceeding nominal GDP growth in light of looser monetary policy and the steady property market. Higher household leverage (184% of disposable income by end-2018) may heighten the banks' structural vulnerability to economic shocks, although we do not anticipate near-term stress.

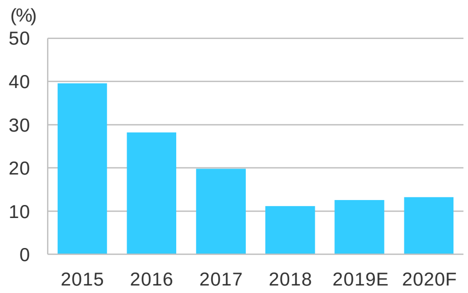
Various macro prudential measures put in place since 2H17 may prevent rated banks from lending significantly to vulnerable households without adequate collateral or guarantee backstops, but they still have indirect exposure through the overall economy.

Korea: Key Performance Trends
Profitability



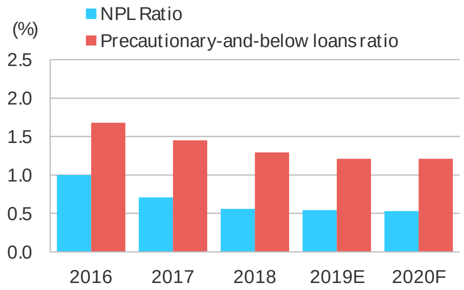
Source: Fitch Ratings, banks

Korea: Key Performance Trends
Credit costs as % of pre-provision operating profit



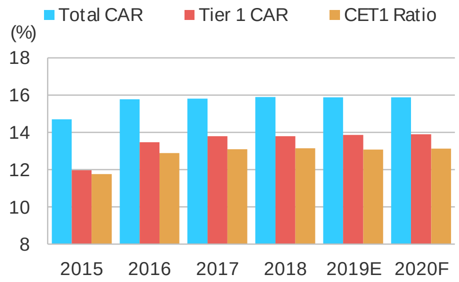
Source: Fitch Ratings, banks

Korea: Key Performance Trends
Asset quality



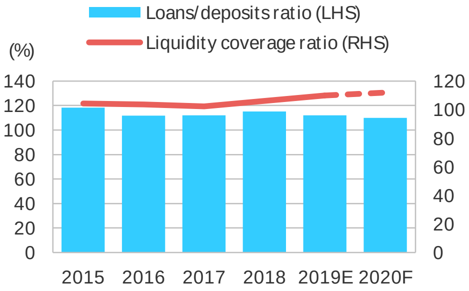
Source: Fitch Ratings, banks

Korea: Key Performance Trends
Capital ratios



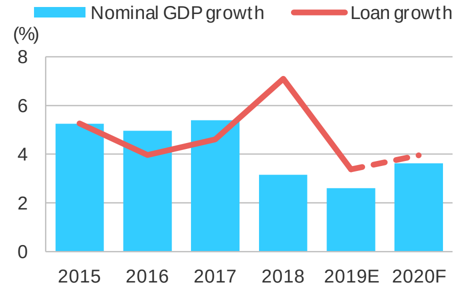
Source: Fitch Ratings, banks

Korea: Key Performance Trends
Loans/deposits and liquidity coverage ratio



Source: Fitch Ratings, banks

Korea: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, banks

Note: The charts above are for commercial banks only

Macao

Fitch's Sector Outlook: Stable

Fitch's 2020 outlook reflects moderate growth expectations for banks despite a contraction in 2019's GDP due to declines in merchandise trades, gaming revenue and tourist spending. We expect growth in loans to individuals and constructions, as well as lending opportunities in the Greater Bay Area, to support the growth of Macao banks.

Rating Outlook: Stable

The outlook on all Fitch-rated Macao banks mirrors our outlook on their parents as their ratings are driven by institutional support. As such, the ratings are sensitive to Fitch's perception over their parents' ability and propensity to provide timely and adequate support.

What to Watch

Headwinds from Gaming Revenue

Fitch expects banks' asset quality to remain benign, due to stable employment; unemployment has remained low at 1.8%, despite a 0.6% yoy decline in gaming revenue in 1H19. Banks have shown resilience during previous downturns, eg credit costs were still manageable in 2015 when gaming revenue dropped severely. Challenges stem from a persistent fall in gaming revenue, mainly from China tourists, which could have a heavier impact on employment, which in turn would affect bank asset quality. Gross gaming revenue made up 70% of Macao's GDP in 1H19.

Mainland, Property Concentrations – No Immediate Risk

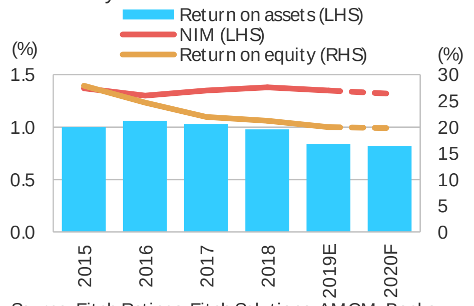
Mainland China Exposure (MCE) remains high, at 41% of total system assets at end-1H19, with property-related loans constituting around 37% of total loans. These exposures pose the biggest risks to the banking sector. That said, we do not expect any significant credit deterioration – given a stable outlook for property-prices and banks' low LTV ratios on mortgage loans. Macao's MCE exposure has a low impaired-loan ratio of less than 0.2%, with about 50% of exposures backed by parental guarantees and/or guarantees from other mainland banks.

Slow Progress on Regulatory Framework

Regulatory progress in updating Macao's banking law and other relevant rules and regulations have lagged our expectations. However, the leniency of the local regulatory framework is partly mitigated by more stringent oversight from their parent banks' home regulators, as most of the Macao banks are either subsidiaries or branches of foreign banks.

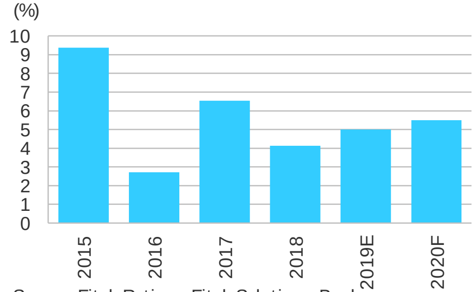
Managing money-laundering and financial crime risks remain a challenge, despite Macao having obtained satisfactory results in a report by The Asia/Pacific Group on Money Laundering (APG; an autonomous regional anti-money laundering body) in October 2019.

Macao: Key Performance Trends
Profitability



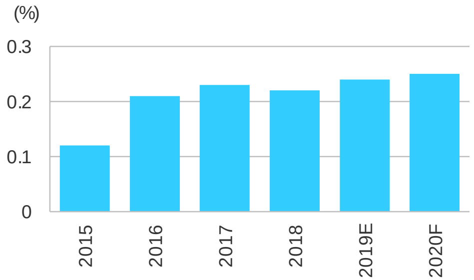
Source: Fitch Ratings, Fitch Solutions, AMCM, Banks

Macao: Key Performance Trends
Credit costs as % of pre-provision operating profit



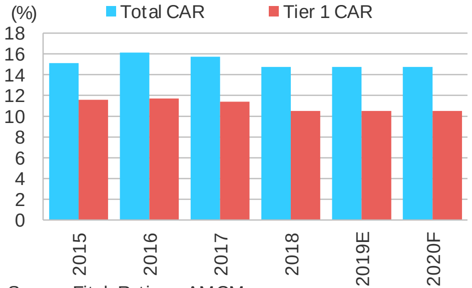
Source: Fitch Ratings, Fitch Solutions, Banks

Macao: Key Performance Trends
Impaired loan ratio



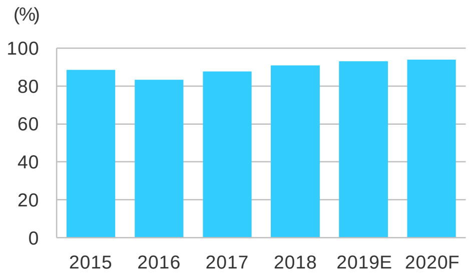
Source: Fitch Ratings, AMCM

Macao: Key Performance Trends
Capital ratio



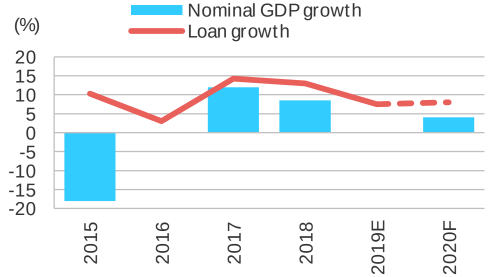
Source: Fitch Ratings, AMCM

Macao: Key Performance Trends
Loans/deposits Ratio



Source: Fitch Ratings, AMCM

Macao: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, Fitch Solutiions, AMCM

New Zealand

Fitch's Sector Outlook: Stable

Fitch's view reflects the strong asset quality of the New Zealand banking sector which we believe will continue through 2020, although impairment charges could rise. However, NIMs face greater pressure, with credit growth likely to remain subdued, which may drag on earnings. However, any significant deterioration is unlikely, given the strong focus on cost management to offset lower income and the generally stable asset quality.

Rating Outlook: Negative

Our outlook reflects our negative outlook on the four foreign-owned major banks, which is in turn driven by the outlook on their respective parents. The standalone credit profiles of the major banks should remain stable, underpinned by their strong franchise in the local market – combined, they account for around 85% of system loans.

What to Watch

Capitalisation to Improve

Fitch expects capital positions to improve in 2020 – and possibly significantly over the medium term – in response to the proposed capital requirements by the Reserve Bank of New Zealand (RBNZ). The additional capital requirement of 3pp-4pp of risk-weighted assets (on top of higher risk weights) may be large, but we believe it can be met through retained earnings, balance-sheet management and capital injections from parents, if required.

Credit Growth to Remain Subdued

Fitch expects credit growth in New Zealand to reflect the potential impact from the new capital rules and weak consumer sentiment. There was some easing in the mortgage rules by the RBNZ in early 2019, and lower interest rates which may support credit growth through 2020. However, we expect the banks to remain cautious on balance-sheet growth, due largely to the current focus on capital strengthening and margin management.

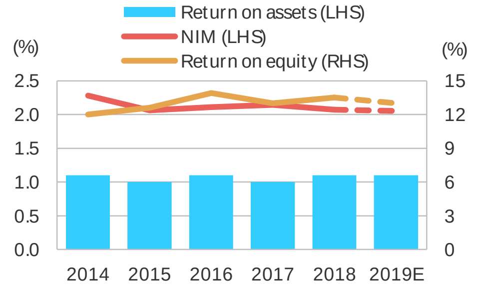
Parental Support to Continue

Regulatory developments in both New Zealand and Australia may lead the Australian parents of the large New Zealand banks to reassess aspects of their operations. However, Fitch believes the New Zealand subsidiaries remain core to the Australian parents due to returns which are still solid and the strong competitive positions of the banks, with IDRs continuing to be aligned with the parents as a result.

Low Interest Rates Support Asset Quality

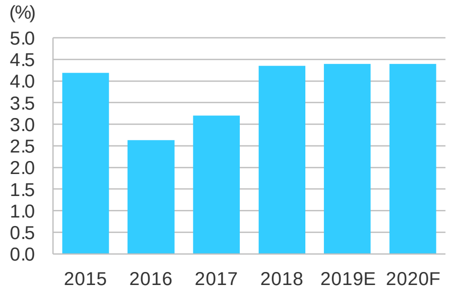
Low interest rates could pressure earnings, but will be supportive for asset quality. Fitch expects the impaired-loan ratio of the banking sector to remain sound over the next 12 months. However, there could be a moderate increase in delinquency, reflecting the soft economic outlook and high household debt.

New Zealand: Key Performance Trends
Profitability



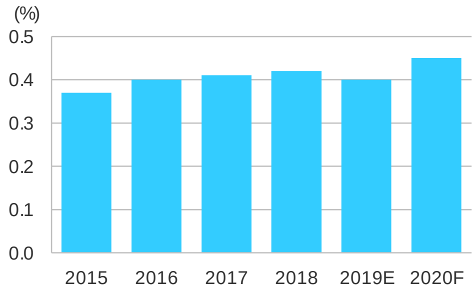
Source: Fitch Ratings, RBNZ

New Zealand: Key Performance Trends
Credit costs as % of pre-provision operating profit



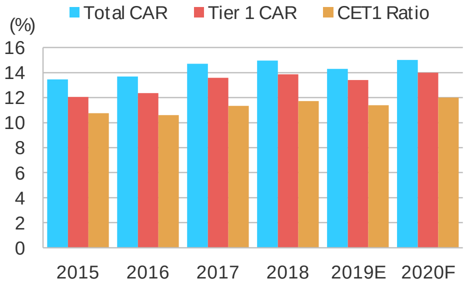
Source: Fitch Ratings, RBNZ

New Zealand: Key Performance Trends
Impaired loan ratio



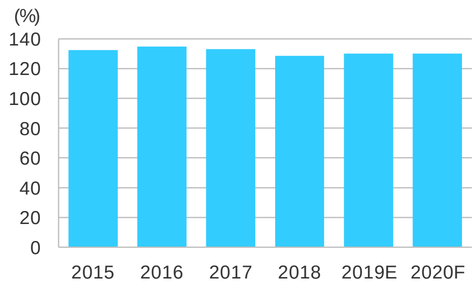
Source: Fitch Ratings, RBNZ

New Zealand: Key Performance Trends
Capital ratios



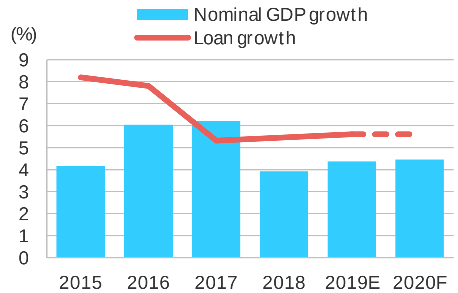
Source: Fitch Ratings, RBNZ

New Zealand: Key Performance Trends
Loans/deposits ratio



Source: Fitch Ratings, RBNZ

New Zealand: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, RBNZ

Singapore

Fitch's Sector Outlook: Negative

Fitch's outlook reflects our expectation that weak economic prospects amid ongoing US-China trade renegotiations will continue into 2020. This will increase downside threats to our forecasts, and pose further challenges to asset quality and profitability, with risks also arising from a general economic slowdown in the region in light of Singapore's open economy.

Rating Outlook: Stable

We believe there is sufficient headroom – based on our perceived levels of risk appetite across the major Singapore banks' – for ratings to withstand economic challenges – given their strong financial profiles, characterised by sound loss-absorption buffers and highly stable funding and liquidity profiles.

What to Watch

Greater China Exposure Untested

Singapore banks' operations in greater China are likely to face headwinds from a more challenging economic landscape in Hong Kong, if the social unrest persists, in addition to uncertainty from the US-China trade conflict. We foresee some pressure on asset quality, especially on SME loans, while we believe the banks' corporate loan quality should remain strong in light of their generally tight client selection and typically low-risk exposures – targeting large local and foreign corporations, top-tier China state-owned enterprises and short-term trade loans.

Stable Property Market

The domestic property market should remain relatively stable – akin to recent years – barring an external shock. This is likely to be underpinned by steady employment and household-income growth that has outpaced home-price growth since 2010. Any resurgence in real-estate sentiment is likely to be countered by the authorities maintaining a tight bias in their policy settings. On the other hand, the authorities have room to lean against price declines by reversing some of the earlier property macro-prudential measures, if needed.

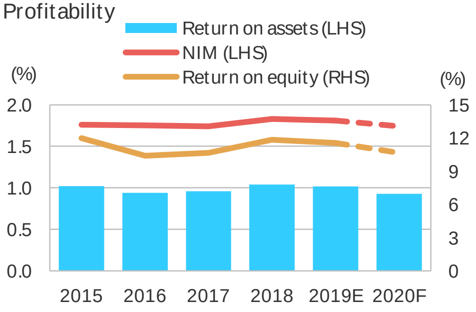
Weaker Trends

We expect banks' earnings to be weaker in 2020, affected by NIM compression (-7bp) and a normalisation in credit costs. NIMs should compress, owing to lower short-term interest rates in Singapore and other countries in the region. We expect the system NPL ratio to increase by 10bp to 1.6% by end-2020, with asset-quality risk from Hong Kong SME loans and tougher operating conditions around the region.

Overseas Expansion Increases Risk Profile

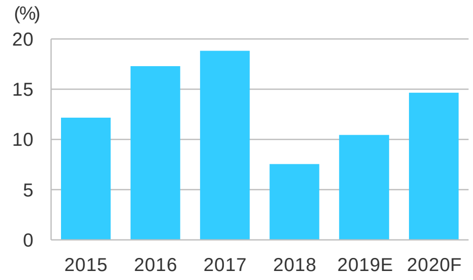
We believe Singapore banks would be open to M&A opportunities in the region on top of organic growth. However, we expect the banks to remain disciplined and retain sound financial buffers in any such corporate activity. Expansion will raise exposure to higher-risk emerging markets and the banks' overall risk appetite, which would pressure their ratings, unless adequately mitigated by stronger loss-absorption buffers.

Singapore: Key Performance Trends
Profitability



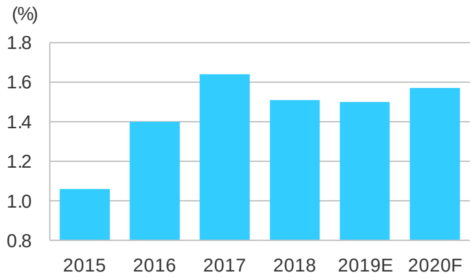
Source: Fitch Ratings, banks

Singapore: Key Performance Trends
Credit costs as % of pre-provision operating profit



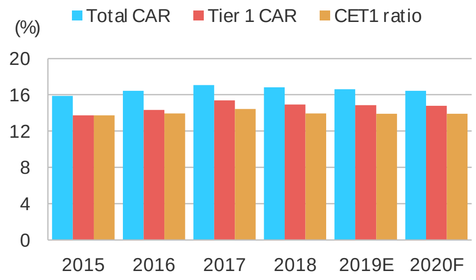
Source: Fitch Ratings, banks

Singapore: Key Performance Trends
Impaired loan ratio



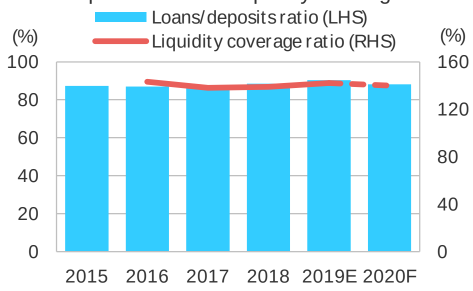
Source: Fitch Ratings, banks

Singapore: Key Performance Trends
Capital ratios



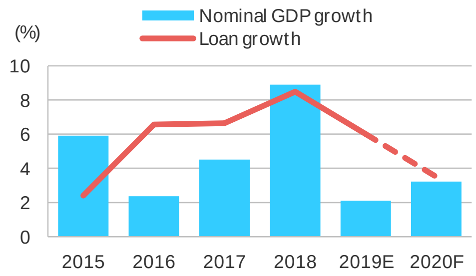
Source: Fitch Ratings, banks

Singapore: Key Performance Trends
Loans/deposits ratio and liquidity coverage ratio



Source: Fitch Ratings, banks

Singapore: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, BNM

Taiwan

Fitch's Sector Outlook: Stable

The stable sector outlook is underpinned by our view that reshoring of manufacturing activities and accelerating private investment since late-2018 – linked partly to changing production patterns prompted by the US-China 'Trade War' – will support economic growth. However, further escalation in the US-China 'Trade War' could still have a negative effect on Taiwan's economy.

Mitigating factors include ample domestic system liquidity and low interest rates, which should alleviate borrowers' debt-servicing burden. The mild recovery in property prices since late 2017 (housing prices rose by around 7% on average from the latest trough in 2016) and higher housing transaction volumes are also helping to underpin Taiwan's housing market, and in turn banks' loan quality – given their concentration on the property sector, and the heavy use of real estate as collateral.

Rating Outlook: Stable

Fitch has a stable outlook on all our rated banks. The outlooks on banks with VR-driven IDRs reflect our view that loss-absorption buffers have increased and are sufficient to withstand the degree of economic challenges we anticipate. The outlooks on the state banks and subsidiaries of foreign banks reflect our expectations of ongoing strong ability and propensity for sovereign and parental support.

What to Watch

US-China Trade Frictions

Taiwan's GDP growth has performed better than our prior expectations in 1H19, with real GDP expanding by 2.4% yoy in 2Q19, from 1.8% in 1Q19. Yet, the planned imposition of tariffs on a final list of about USD160 billion that includes consumer electronics products in mid-December 2019 will present a greater challenge to Taiwan's economic growth in 2020. This is in light of Taiwan's role as a supplier of intermediate goods across the global consumer-electronics supply chain.

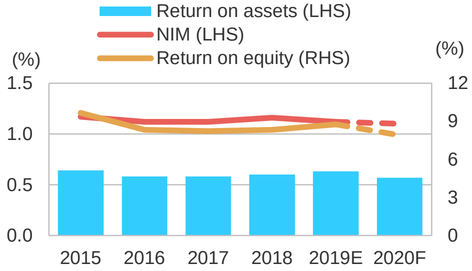
Severe China Slowdown

Taiwanese banks rank third in direct exposure to China (around 7% of assets) within APAC. A severe China slowdown – not our base case – would affect Taiwanese banks through direct losses on mainland exposure; broader stress from a weaker regional economic environment; and market risks from a negative shift in global investor sentiment.

Increase in System Leverage

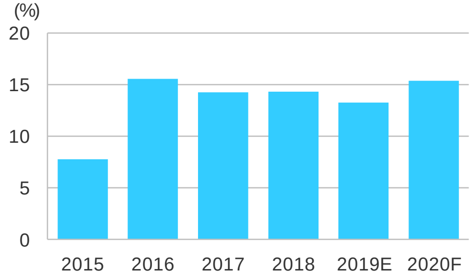
We forecast Taiwan's credit/GDP to rise steadily to about 187% in 2020 (2018: 178%), based on faster credit growth than nominal GDP growth amid the low-interest-rate environment. Associated risks are balanced against adequate regulatory oversight over Taiwanese banks and their sound financial strength. An unexpected sharp increase in system leverage that weakens borrowers' debt-serving ability, could lead us to revise the sector outlook to negative.

Taiwan: Key Performance Trends
Profitability



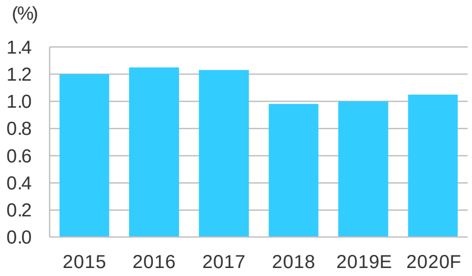
Source: Fitch Ratings, Fitch Solutions, Central Bank of the Republic of China (Taiwan) (CBC)

Taiwan: Key Performance Trends
Credit costs as % of pre-provision operating profit



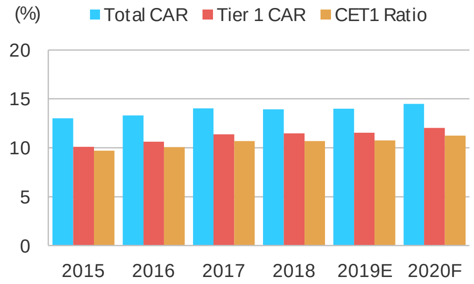
Source: Fitch Ratings, Fitch Solutions, CBC

Taiwan: Key Performance Trends
Impaired loan ratio



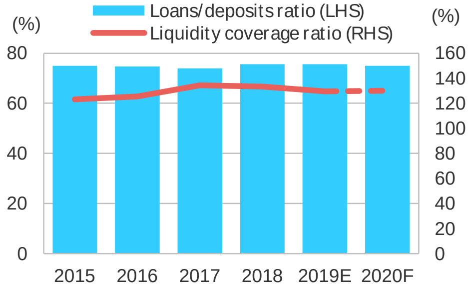
Source: Fitch Ratings, Fitch Solutions, CBC, banks

Taiwan: Key Performance Trends
Capital ratios



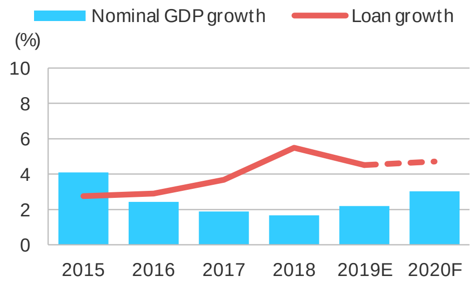
Source: Fitch Ratings, Fitch Solutions, CBC, banks

Taiwan: Key Performance Trends
Loans/deposits and liquidity coverage ratio



Source: Fitch Ratings, CBC

Taiwan: Key Performance Trends
Nominal GDP growth and loan growth



Source: Fitch Ratings, CBC, DGBAS

Outlooks and Related Research

2020 Outlooks
Global Economic Outlook (September 2019)
What Investors Want to Know: Asia-Pacific Investment-Grade Banks (November 2019)

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