<u>Edited transcript of DBS third-quarter 2022 results media briefing, 3 November 2022</u>

Edna Koh Good morning and thank you for joining DBS's third-quarter results media briefing.

Chng Sok Hui Good morning everyone.

<u>Overview</u>. We achieved a record performance in the third quarter. Net profit rose 23% from the previous quarter to $2.24 billion and return on equity reached 16.3%, both at new highs. Total income rose 20% to a record $4.54 billion as net interest margin recovered to pre-pandemic highs and business momentum was sustained.

Net interest margin climbed 32 basis points to 1.90%, accelerating from the increases in the previous two quarters amid faster rate hikes. Loan momentum was healthy as non-trade corporate and housing loans grew faster than in the first two quarters.

Fee income was maintained as increases in card and loan-related fees compensated for lower wealth management fees.

On the back of the strong top line performance, the cost-income ratio improved four percentage points to 40%.

For the nine months, net profit rose 8% to $5.85 billion, also a new high. Total income rose 10% to $12.1 billion as higher net interest margin and loan growth more than offset lower fee income. Expenses grew 7%, resulting in profit before allowances rising 12% to $6.96 billion.

Asset quality continued to be resilient. Non-performing assets fell 5% from the previous quarter and the NPL ratio improved to 1.2%. Specific allowances were minimal for the quarter and eight basis points for the nine months. General allowances of $153 million was set aside.

Capital and liquidity remained strong and well above regulatory requirements.

The board declared a third-quarter dividend of $0.36 per share, bringing the dividend for the nine months to $1.08 per share.

<u>Third-quarter performance.</u> Compared with the previous quarter, total income rose 20% to a record $4.54 billion.

Net interest income was 23% or $566 million higher as a result of a 32-basis-point expansion in net interest margin and healthy loan momentum.

Fee income was stable while other non-interest income rose 32% or $183 million from higher Treasury Markets non-interest income, treasury customer income and investment gains.

Expenses were 10% or $167 million higher. The positive jaw resulted in a 27% increase in profits before allowances to $2.72 billion.

Specific allowances for the quarter were $25 million or two basis points of loans compared with eight basis points in the previous quarter.

Total allowances were higher as $153 million of general allowances were set aside during the quarter, compared to a $23 million write-back in the previous quarter. Additional general allowances were set aside as a prudent measure. General allowance overlays of $350 million were added even as baseline general allowances were reduced by $200 million due to portfolio improvements.

Nine-month performance. Nine-month total income rose 10% from a year ago to a record $12.1 billion driven by higher net interest income.

Net interest income increased 22% or $1.36 billion to $7.66 billion from a 20-basis-point expansion in net interest margin and loan growth of 6%.

Fee income fell 10% or $279 million to $2.43 billion as lower wealth management and investment banking fees more than offset growth in other activities. Other non-interest income was little changed at $1.99 billion.

Expenses rose 7% or $329 million to $5.13 billion led by higher staff costs.

General allowances of $18 million were taken compared with a $413 million write-back a year ago from portfolio improvements. Specific allowances fell to eight basis points of loans from 14 basis points a year ago.

Net interest income. Net interest income of $3.02 billion was 23% higher than the previous quarter.

The group's net interest margin, represented by the black line, rose 32 basis points during the third quarter to 1.90%. The increase was faster than the three basis points in the first quarter and the 12 basis points in the second quarter as the impact of rate increases was more fully felt.

The commercial book net interest margin, which excludes Treasury Markets and is represented by the red line, increased by 45 basis points during the quarter to 2.30%. This reflects the higher funding cost for the Treasury Markets book as seen in the change in net interest income for Treasury Markets on the chart. Taking into account both net interest income and non-interest income, Treasury Markets income was unchanged during the quarter, with higher funding cost offset by gains in other income.

For the nine months, net interest income increased 22% to $7.66 billion as net interest margin rose 20 basis points and loans grew 6% from a year ago. Commercial book net interest margin rose 30 basis points.

Going forward, the group's net interest income and net interest margin will benefit from the 75 basis points Fed rate hikes announced in late September, the 75 basis points announced today, and further increases in Fed funds rate.

On the asset side, net interest income and the interest margin will benefit from the repricing of about $180 billion of fixed-rate instruments and fixed-deposit-rate-linked home loans in future periods.

<u>Loans.</u> Underlying loan momentum was healthy in the third quarter as non-trade corporate and housing loans grew faster than in the first two quarters. Excluding trade loans, loans increased $7 billion or 2% in constant-currency terms from the previous quarter.

Non-trade corporate loans rose $8 billion or 3% over the quarter from broad-based growth across the region and sectors. Housing loans increased $1 billion or 2% from higher loan disbursements and lower run-offs. These gains were moderated by a $5 billion or 10% decline in trade loans as maturing exposures were not replaced due to unattractive pricing.

Loan growth for the first nine months was $16 billion or 4%. The growth was predominantly in non-trade corporate loans.

<u>Deposits.</u> Deposits were stable from the previous quarter at $533 billion.

Over the nine months, deposits rose $24 billion or 5% in constant-currency terms. Fixed deposits grew $62 billion while Casa declined $38 billion. Most of the decline in Casa was seen in the third quarter, of which Singapore-dollar Casa decline was $11 billion. Nevertheless, Singapore-dollar savings deposit market share rose 0.4 percentage points in the third quarter as the industry Singapore-dollar savings balance declined at a faster rate.

The growth in fixed deposits was predominantly in foreign currencies, and it was used to fund foreign currency loan growth. This enabled us to swap less from surplus Singapore-dollar Casa deposits which continue to earn attractive returns. The pace of decline in Casa has been in line with our expectations. Notwithstanding the decline in the third quarter, our Casa balances remain more than a $100 billion higher than before the pandemic.

The liquidity coverage ratio and net stable funding ratio were at 133% and 114% respectively.

<u>Fee income.</u> Third-quarter gross fee income was stable from the previous quarter at $923 million.

Wealth management fees fell 4% from the previous quarter to $323 million as market conditions remain weak, dampening sales of investment products. Investment banking fees declined 17% to $25 million as deal flows were also impacted by the adverse market conditions. These declines were moderated by higher Card fees, which rose 10% to $223 million as travel spending continued to recover towards pre-pandemic levels. Loan-related fees rose 7% to $122 million. Transaction service fees was stable at $230 million.

Gross fee income over the nine months was 8% lower than a year ago at $2.86 billion. The decline was due to lower wealth management and investment banking fees, partially offset by growth and other fee activities.

<u>Expenses.</u> Third-quarter expenses rose 10% from the previous quarter to $1.83 billion led by higher staff costs.

With total income rising faster than expenses, the cost-income ratio improved from 44% to 40%.

Nine-month expenses rose 7% from a year ago to $5.13 billion led by higher staff cost. The nine-month cost-income ratio was 42%, an improvement of two percentage points from a year ago.

Non-performing loans. Asset quality remained resilient.

New non-performing asset formation in the third quarter remained low, and there were significant upgrades and repayments during the quarter. Write-offs were at a similar level to the previous quarter.

As a result, non-performing assets fell 5% from the previous quarter to $5.60 billion, while the NPL ratio improved from 1.3% to 1.2%.

Specific allowances. The resilient asset quality resulted in third quarter specific allowances declining to $25 million or two basis points of loans.

Nine-month specific allowances for credit exposures declined 40% from a year ago to $260 million or eight basis points of loans, compared to 14 basis points a year ago.

General allowances. Total allowance reserves stood at $6.71 billion, with $2.81 billion in specific allowance reserves and $3.90 billion in general allowance reserves.

Total general allowances increased $153 million during the quarter. Additional general allowance overlays of $350 million were taken as a prudent measure even as baseline general allowances were reduced by $200 million due to portfolio improvements.

The $6.71 billion of allowance reserves resulted in an allowance coverage of 120% and of 216% after considering collateral.

Capital adequacy. The group's CET-1 ratio declined 0.4 percentage points from the previous quarter to 13.8%.

Profit accretion was partially offset by dividend distributions. Risk-weighted assets increased, led by strong growth in non-trade corporate loans. There was also a modest impact on CET-1 from marked-to-market losses on fair value through OCI securities as a result of higher interest rates.

The CET-1 ratio of 13.8% remained above our target operating range of between 12.5% to 13.5%, while the leverage ratio of 6.1% was twice the regulatory minimum of 3%.

Dividends. The board declared a dividend of $0.36 per share for the third quarter, bringing the dividend for the nine months to $1.08 per share.

Based on yesterday's closing share price and assuming that dividends are held at $0.36 per quarter, the annualised dividend yield is 4.1%

In summary. We achieved record third-quarter and nine-month performance despite challenging financial market conditions, a testament to the strength of our franchise.

Business momentum was sustained, asset quality was resilient, and the inherent value of our deposit franchise became more apparent with higher interest rates. These positives enabled us to more than offset pressures on markets-related income.

The record third-quarter ROE of 16.3% underscores the significant structural improvements we have made over the past few years, including from digital transformation.

Our transformed franchise, balance sheet strength and leverage to rising interest rates will enable us to continue delivering healthy shareholder returns in the coming quarters amidst external headwinds.

Piyush Gupta Thanks, Sok Hui.

I think several things stood out this quarter.

Business momentum. Underlying business momentum continued to be quite strong. Our corporate loans grew about $8 billion for the quarter. The growth was broad-based across regions – India, Taiwan, Australia, UK, and Singapore – as well as across industries – property, TMT, and energy. Interestingly, our Singapore mortgage book grew too. We grew $300 million-400 million in the first half of the year, but over $1 billion in the third quarter. Our bookings held up despite a little slowdown in the market. The only area that didn't grow was trade, and a lot of that was deliberate. As rates have been going up, it is hard to hold credit spreads there and we have been letting the low-margin loans run off.

Liquidity remains healthy. Sok Hui pointed out that there continues to be a conversion from Casa to fixed deposits. In the Singapore-dollar book, our Casa ratio is still 93%. In the US-dollar book, there is more conversion from Casa to fixed deposits, but it is consistent with our models. Our overall Casa levels are over a $100 billion higher than they were just a couple of years ago. LCR and NSFR are fine too. Around the region, liquidity seems to be comfortable.

Fee income was flattish on quarter, and wealth management seems to be stabilising. Capital markets continue to stay challenged. There was no ECM activity, although in the last few weeks we have begun to see some activity in China's bond market. Card fees have been improving as economies continue to open and travel activity continues to increase.

On wealth management, the big plus was net new money inflows into the region. In the first nine months, total inflows were about $15 billion, double of what we normally get. A lot of that money is waiting to be invested so I think there's some upside.

Asset quality has been pristine. We saw little new NPA formation and our NPL rates are down to 1.2%. We continued to see upgrades and repayments. GP overlays of $350 million were added given the uncertain outlook next year. I don't think any of us has seen a 5% interest rate in a long time. If rates head to around 5%, what impact that has on Asia and potential credit are unknown. Through the three quarters of this year, general allowances were reduced by $350 million because of improvements in our book. We added the $350 million back this quarter so that we return to GP levels we had at the end of last year.

Outlook for 2023. The base case in our second-quarter briefing was that inflation starts going down and the Fed funds rate levels off at 3.5%. However, I highlighted the possibility of a tail-risk event where inflation remains sticky and the Fed funds rate doesn't level off at 3.5%. I expect inflation rates to start levelling off partly from a base effect in the coming quarter, but still remain high. We could see a recession in the US and a sharper slowdown in Asia if rates head north of

5%. The outlook for China is uncertain. Our original base case was that China would open up after the Party Congress, but it seems like it could take a few quarters more.

Nevertheless, our loan pipeline looks quite healthy. We expect a mid-single digit growth next year. However, if we see a sharp slowdown in Asia early next year, the pipeline may disappear. We might see a moderation in fourth-quarter growth for an idiosyncratic reason. Given current US-dollar and renminbi rates, it is much cheaper to borrow onshore in China than offshore in international markets. As such, several of our China clients are switching their borrowings from international to local markets. Since we are not as competitive in the local market, we might see a softening of loan momentum.

Double-digit fee income growth led by wealth and cards is possible, partly because of base effects. If there is some degree of optimism in the markets and you don't see continued negative news on China, you should see some upside to fee income.

On net interest margin, our current model suggests that it should get to about 2.25% if the Fed funds rate gets to 4.75%. There are several points to note regarding net interest margin. First, as Sok Hui pointed out, the funding cost of the treasury book drags the group's overall net interest margin. The commercial book net interest margin is much higher. Second, the 2.25% incorporates the fact that cost of funds will increase more rapidly going forward. When we modelled for a 3-3.5% Fed funds rate previously, I mentioned a net interest income sensitivity of $18 million-20 million per basis point of Fed funds rate. That sensitivity may not hold as we get to 4-5% rates. Finally, we have $180 billion of assets in our fixed-rate and FHR portfolios. About a quarter of these will reprice by the end of next year, and another quarter in 2024. We thus expect to see some tailwinds from the repricing of the fixed-rate book.

Our cost-income ratio continues to be good. Obviously, it's held by the income line. We expect cost growth to be in the high-single digits of 9-10% next year, but the cost-income ratio will still be headed down.

Finally, we think ROE will comfortably be above 15%. At a 5% interest rate, we would expect to see some new cost of credit. As such, we have assumed specific allowances to be about 20 basis points of loans in our ROE calculations.

I will take questions now.

Chris Wright (Euromoney) The various Citi consumer purchases are gradually going through, with UOB completing a couple of them this week. Could you update us on your Citi Taiwan transaction and whether the increased geopolitical noise around Taiwan and China has given you any concerns? Second, the fintech festival is under way and we saw announcements about Project Guardian involving DBS. Without getting into the weeds of that specific transaction, what is your view on where DeFi might take us and what does it mean for banks like DBS?

Piyush Gupta On the first question, that process is going smoothly. Unlike UOB, which is closing the transaction and the operations separately, we are doing the legal and operations closing all at once. We have targeted the transaction to be completed in August next year. We're working closely with Citi to make sure that the systems are up to snuff and I think we're firmly on track.

We spent a lot of time thinking through the geopolitics when we decided on the deal. Our strategy takes a healthy view on North Asia. If geopolitical tensions come to a stage where there is war, Taiwan is the least of our issues. The incremental exposure we have to Taiwan is not material.

Regarding your second question on DeFi, I think that the power of the technology is game-changing because it eliminates the need for a hub-and-spoke arrangement. It creates the architecture to do point-to-point dealings, whether person-to-person or entity-to-entity. The point-to-point dealings for authentication, identity, value transfer, and confirmations, can make a fundamental difference to what I call the back office of the world. I think the opportunities are very real. People conflate the notion of DeFi with crypto. I think there is a long way before private money will replace official money. DeFi does more by bringing efficiency to the overall system.

Goola Warden (The Edge) How much upside to net interest margin and net interest income is likely with a 5% Fed funds rate? How much do you expect credit costs to be? Could you repeat the details on the $180 billion of assets? What was the impact on your CET-1?

Could you also give us a flavour of the loan and investment banking pipelines for next year? How is the acquisition of Lakshmi Vilas Bank tracking in terms of income and credit costs? On DeFi, how would it impact your institutional business? Will you lose anything in fees when you get improvements in efficiency?

Piyush Gupta On NIM, we said that when Fed funds rate gets to 4.75%, net interest margin will be around 2.25%.

Our asset quality this year has been fantastic – specific allowances were only two basis points of loans in the third quarter. On one hand, you could make the case that credit cost continues to be benign next year as you're not seeing any stress in the portfolio. On the other hand, it is logical to expect a higher credit cost as rates go up to 4.5-5%. In our planning assumptions, we assumed a normalised credit cost of about 20 basis points.

On the $180 billion of assets, half of it is in loans and the other half is in securities. The loans are fixed-rate and FHR lending. Two-thirds of our housing loans do not reprice immediately since they are tied to fixed-rate and FHR lending. We also have fixed-rate loans in our corporate loan book. Maybe Sok Hui can give some colour on the securities.

Chng Sok Hui The fixed-rate securities are in the Corporate Treasury book. They're mainly held-to-collect and do not have a fair value through OCI effect.

Piyush Gupta On the outlook for investment banking, we started seeing some fixed income and bond issuances from China in the past few weeks. We have a healthy pipeline for both ECM and DCM. If some degree of market confidence returns, we will have the opportunity to bring a number of deals to the market.

On Lakshmi Vilas Bank, it is doing well. India continues to be the fastest-growing franchise over the past couple of years and our outlook for next year continues to be promising. We believe that the country is on the cusp of tremendous momentum. However, profit margins for Lakshmi Vilas Bank are still negative because we're still integrating the business. Nonetheless, they are consistent with our model and plans. The underlying portfolio quality of the book has been better than we thought, and we have had recoveries.

On DeFi, if you take the view that people will deal with each other directly in the future, you could easily argue against the need for banks, central banks and stock exchanges. In that case, none of us will have any jobs because everybody deals with each other directly. I don't think that will happen any time soon. Historically, P2P arrangements come with their own sets of risk. What we are likely to wind up with is an intermediated form of DeFi where various intermediaries will still have a role. Forty to 50 years ago when people started going directly to capital markets, some argued against the need for commercial banks. But a new role evolved as commercial banks got investment banking arms to help issuers reach out to investors. I think that similar roles are likely to happen in the DeFi metaverses. We still need people to create context and access, as well as help shepherd the system. I think there are opportunities for DeFi to drive down costs too. For instance, you can improve the customer experience or reduce settlement time.

Chanyaporn Chanjaroen (Bloomberg) You said that wealth management would help drive a double-digit growth in fee income next year. Will that be due to stronger inflows or more transactions? Could you also share your views on inflows into Singapore next year? Where it will be coming from? Do you expect China's lockdown to continue for two to three more quarters and will that drive more inflows into Singapore?

Piyush Gupta It is very hard to predict what will happen to inflows and when China's lockdown will end. We have been seeing inflows from other parts of the world besides North Asia. We've got $15 billion of inflows year-to-date, and a lot of that is sitting on the sidelines as deposits. If market conditions become better, I expect that money to be put to work.

A large part of the wealth business in Asia is linked to animal spirits. Recurring income in that business is only about 20%, while 80% comes from trading. Therefore, you should expect to see a recovery if market sentiment picks up.

Prisca Ang (The Straits Times) When do you think the US economy will enter a recession and cause a slowdown in Asia? Is this at the 4.75% Fed funds rate or earlier? Second, are you worried about declining Casa deposits? Are there other reasons behind the decline besides the move to fixed deposits? Third, interest rates on fixed and savings deposits have gone up by quite a bit. Do you think this is sustainable given that the outlook for next year is a bit uncertain and loan demand might fall a little?

Piyush Gupta On the first question, I think Powell is also trying to guess when the economy will enter a recession. I was in Washington for the World Bank IMF conference and most people think you would see a recession at the 5% handle. There's also a view that the Fed will continue to hike rates till they force a recession because they want to bring inflation down. You can already see consumption coming off in the third quarter. That should create some slowdown in GDP growth.

Your second question was on the switching of Casa to fixed deposits. Our Casa ratios went up to extraordinarily high levels when interest rates were near zero. That reflected the fact that the alternative use of money was not very profitable. When rates go up, it's not unexpected to see a switch from Casa to fixed deposits because returns on fixed deposits become attractive.

Our models have already taken into account the switching of Casa to fixed deposits and how that raises our cost of funds. So far, they have been consistent with the Casa outflows that we are seeing. We still have a lot of liquidity in the system, so it's not a matter of great concern.

Chng Sok Hui On your question about how sustainable higher fixed deposit rates are, we have to consider the returns on their potential deployment. Interbank assets and alternative deployments provide a margin above fixed deposit rates, so I think higher fixed deposit rates can be sustained if external rates continue to go up.

Anshuman Daga (Reuters) Last quarter, you mentioned that inflation was a big uncertainty and it was hard to translate what it meant for the macro economy. Has your outlook changed from the previous quarter? Additionally, are there any changes to your outlook on geopolitical uncertainty from last quarter?

Piyush Gupta My base case last quarter was a 3.5% Fed funds rate because I thought you would see a moderation in inflation. However, due to the Russia-Ukraine conflict and wage inflation, CPI rates continue to be high. Now, we're talking about a 5% Fed funds rate. At 5%, I think the US will enter a recession and Asia will have a slowdown. There is a material shift in outlook because the rates regime is much higher than we had anticipated three months ago.

In terms of geopolitics, tensions between the East and the West have been on the cards, in particular due to the US Chips Act and Pelosi's visit to Taiwan. However, what surprised me was the outcome of China's Party Congress. That has raised questions on when China will open up and where it would go directionally in the medium term.

Edna Koh That's all the questions we have for today, thank you everyone.