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Taiwan Financials | Asia Pacific

CBC Pauses Rate Hikes Again

CBC is pausing rate hikes again in December; adjusted NIM expansion for Taiwan's banks in 2023 is still mainly supported by CS gains from the wide USD-NTD spread.

CBC maintained the policy rate at 1.875% after the Fed decided to pause rate hikes on December 13: This is aligned with both consensus and Morgan Stanley's estimates. The CBC's decision is based mainly on the expectation that the inflation rate will decline to 1.89% in 2024 (from previous forecast of 1.83%), still higher than the historical CPI of ~1%. The CBC also lowered its forecast for 2023 GDP growth to 1.4% (from previous forecast of 1.46%), but raised 2024 GDP to 3.12% (from previous forecast of 3.08%) based on better exports and investment in 2024. This implied that the CBS is likely to maintain a tightening monetary policy in 2024.

Banks' adjusted NIM expansion likely to maintain strength in 4Q23: While the CBC is pausing hikes in the policy rate again this time, the USD-NTD spread remains wide. Thus, we believe demand in the currency swap (CS) business and the expansion of adjusted NIM (adding back CS gains) will remain strong in 4Q23, which would benefit CTBC (2891.TW) and Mega (2886.TW) given their larger FX businesses. Looking ahead to 2024, with higher rates for longer policy from the CBC, we expect the impact of the Fed's rate cut on NIM to be relatively smaller compared to 2019-20's rate cuts.

Rate cut expectation likely enhance insurers' book value; while CS costs remain high: The Fed lowered the median dot plot interest rate forecast to 4.6% for 2024, lower than its September forecast of 5.1%, which brought the 10-year US government bond yield down to ~4% on December 14 from a record high of ~5% on October 30, leading to rising bond and stock prices. This will enhance book value of insurers and provide upside potential on their earnings from capital gains, which may support valuations. However, with asset reclassification on bonds and higher base for TAIEX in 2023, we do not expect unrealized and realized gains to be as much as in the last rate hike cycle in 2019-21. As well, 2024 currency swap cost is likely at a high level of >3% (vs. average <1.5% in the past 20 years) with potential FX loss amid NTD appreciation against USD trend, leading to higher hedging cost pressure. This will cause lower after-hedge recurring yields in 2024, in our view.

Stock implications: We still prefer banks over insurers for their relatively resilient earnings and higher dividend yields, especially in 1H24. **CTBC (2891.TW)** and **SinoPac (2890.TW)** remain preferred plays. CTBC expanded its adjusted NIM of 1.7% in 2023 (vs. 1.63% in 4Q22) on the back of increasing LDR for both NTD and FX position and CS gain. Its 2023 cash dividend yield of 4.5-5% is also the highest among peers.

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TAIWAN FINANCIALS

Asia Pacific

Industry View

Attractive

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Key Charts and Tables

Exhibit 1: The Fed and CBC both paused rate hikes in December

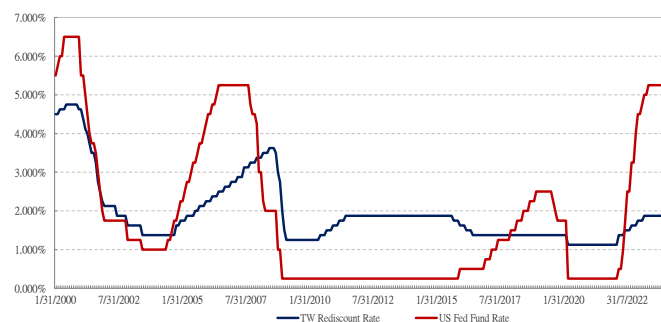


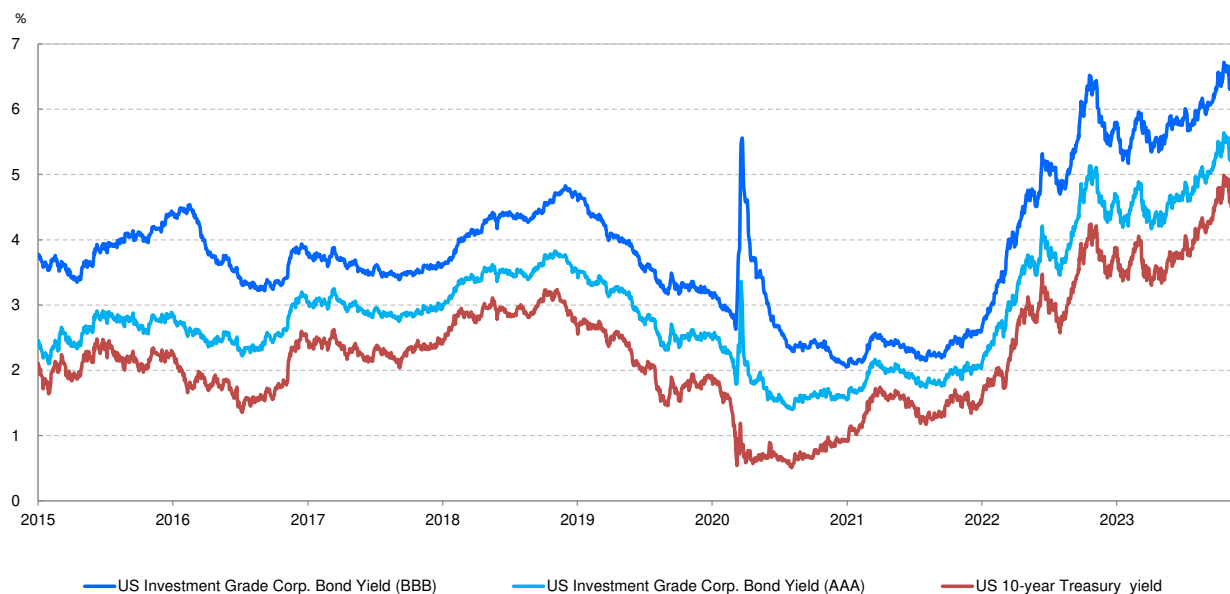
Exhibit 2: 2023 adjusted NIM estimates

	2022 NIM(%)	2023E adjusted NIM(%)
Cathay United Bank	1.36	1.56
Taipei Fubon Bank	1.04	1.3
CTBC Bank	1.57	1.7
Mega Bank*	0.96	0.94
First Bank	1.11	1.12
E.Sun Bank	1.23	1.3
Yuanta Bank*	0.9	0.92

Source: Company data; Morgan Stanley Research; Note*: Mega and Yuanta do not disclose adjusted NIM.

Exhibit 3:

Yields of US AAA and BBB corporate bonds have dropped to 4.8% and 5.8%, respectively, in December



Valuation Methodology and Risks

SinoPac Financial Holdings Company (2890.TW)

Base case, Gordon Growth model. Key assumptions:

- 6.8% cost of equity, based on 6.5% market risk premium, 2% risk-free rate, and 0.74x beta
- Sustainable ROE of 9.2%, based on 2020-25E ROE of 8.0-12.3%
- Terminal growth rate of 2%

We apply the resulting 1.5x P/B multiple to our 2024 book value estimate, above its 2019-21 P/B range.

Risks to Upside

- Stronger-than-expected solar loan demand, driving net interest income
- Wide USD/NTD spread leads to strong currency swap (CS) gain
- Better-than-expected fee income growth
- TAIEX ADT up to 300-400bn level

Risks to Downside

- NIM compression or a spike in NPLs
- Deeper-than-expected rate cuts in the US and/or Taiwan
- Declining loan book from negative economic outlook

CTBC Financial Holding Co Ltd (2891.TW)

Base case, sum of the parts.

- Bank business: Gordon Growth model, assuming 7.9% cost of equity, 10.5% sustainable ROE and 2% terminal growth rate. We apply the resulting 1.4x multiple to our 2024 book value estimate.
- **Life business:** We apply a discount of 140bp to the company's EV assumption.

Risks to Upside

- Better revenue growth from fee income and loan growth.
- Positive rate hike outlook in the US and Taiwan.
- Steepening yield curve to boost Taiwan Life's profit.

Risks to Downside

- NIM compression or a spike in NPLs.
- Deterioration in the health of Taiwan's exporters, which results in corporate defaults, leading to an increase in bad debt charges.
- Uncertainties in overseas business especially in China.

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(as of November 30, 2023)

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	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1352	37%	273	43%	20%	605	39%
Equal-weight/Hold	1667	46%	303	47%	18%	708	46%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	591	16%	64	10%	11%	221	14%
Total	3,613		640			1535	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Stock Price, Price Target and Rating History (See Rating Definitions)

CTBC Financial Holding Co Ltd (2891.TW) - As of 12/13/23 in TWD
Industry : Taiwan Financials



Stock Rating History: 12/1/18 : O/I; 1/4/22 : NA/I; 1/5/22 : NA/NR; 1/12/22 : NA/NR; 3/1/22 : O/A

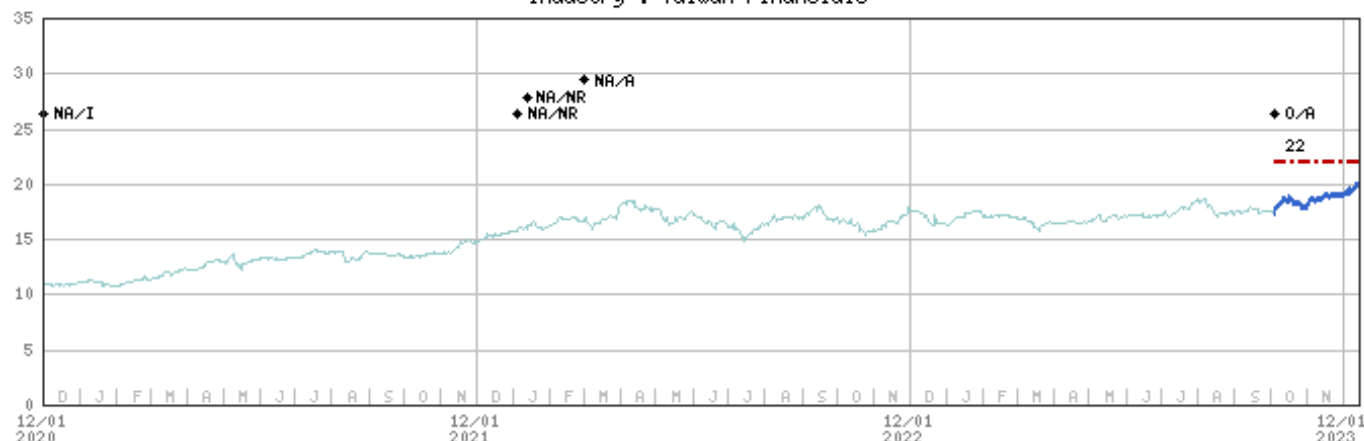
Price Target History: 8/15/18 : 24.8; 1/18/19 : 24; 11/11/19 : 25; 4/16/20 : 23; 11/23/20 : 23.5; 3/26/21 : 25.5; 1/4/22 : NA; 3/1/22 : 33.7; 4/20/22 : 33.5; 5/19/22 : 32.4; 8/24/22 : 32.3; 11/21/22 : 28.5; 3/13/23 : 28; 5/17/23 : 28.4; 8/18/23 : 30; 11/15/23 : 30.4

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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SinoPac Financial Holdings Company (2890.TW) - As of 12/13/23 in TWD
Industry : Taiwan Financials



Stock Rating History: 12/1/18 : NA/I; 1/5/22 : NA/NR; 1/12/22 : NA/NR; 3/1/22 : NA/A; 10/4/23 : O/A

Price Target History: 10/4/23 : 22

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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INDUSTRY COVERAGE: Taiwan Financials

COMPANY (TICKER)	RATING (AS OF)	PRICE* (12/14/2023)
Peggy Shih		
Cathay Financial Holdings Co Ltd (2882.TW)	E (12/07/2023)	NT\$45.90
Chailease Holding Co Ltd (5871.TW)	O (08/24/2022)	NT\$179.50
CTBC Financial Holding Co Ltd (2891.TW)	O (03/01/2022)	NT\$28.45
E.Sun Financial Holding Co (2884.TW)	U (01/04/2023)	NT\$25.75
First Financial Holding Co Ltd (2892.TW)	E (06/01/2023)	NT\$27.60
Fubon Financial Holdings Co Ltd. (2881.TW)	E (12/07/2023)	NT\$65.20
Mega Financial Holding Co Ltd (2886.TW)	E (03/01/2022)	NT\$39.55

SinoPac Financial Holdings Company (2890.TW)	O (10/04/2023)	NT\$20.00
Yuanta Financial Holding Co. Ltd (2885.TW)	E (11/29/2022)	NT\$27.00

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* Historical prices are not split adjusted.

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