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Our favoured markets for 2020

We prefer Egypt and Pakistan. Nigeria, Vietnam, Ghana and Sri Lanka banks also look attractive

- **Across our emerging market coverage of 20 markets,** we forecast 12% median loan growth, 11% top-line growth and 14% net profit growth in 2020. We forecast 16.3% ROE in 2020f, up from 16.1% in 2019f.
- **Favoured markets**
  - **Egyptian banks** are attractively valued with strong growth and profitability prospects.
  - **Pakistan banks** should deliver the biggest ROE improvement over the coming 12-18 months on higher margins.
  - **Nigerian banks** are cheap, but with limited near-term growth.
  - **Vietnam banks** benefit from a strong macro environment which supports growth and asset quality.
  - Among smaller markets, banks in **Ghana, Rwanda and Sri Lanka** appear attractive.
- **Underweight markets**
  - We would limit exposure to **GCC banks**, where growth and margin dynamics appear unfavourable relative to elsewhere.
  - The outlook in **Argentina** is extremely uncertain; any moves to cut interest rates or restructure debts to put the economy on a firmer footing could stress the banks.
  - After their strong rally in 2019, **Russian banks** do not scan well in terms of valuation and risk profile.

Table 1: Country-level sector scorecard – major markets

	Overall rank	Fundamental valuation	Valuation vs history	Macro environment	Growth	Margins	Credit risk	Profitability	Profit trajectory
EGY	green	green	green	yellow	green	green	green	green	yellow
PAK	green	yellow	yellow	yellow	yellow	green	yellow	yellow	green
NGA T1	yellow	green	green	green	red	yellow	red	yellow	red
VNM	yellow	yellow	yellow	green	yellow	red	yellow	green	yellow
KEN	yellow	yellow	red	yellow	yellow	green	yellow	yellow	yellow
BGD	yellow	yellow	yellow	red	green	green	yellow	red	green
RUS	yellow	yellow	yellow	yellow	yellow	yellow	red	yellow	yellow
ARG	red	red	green	yellow	yellow	yellow	yellow	green	red
KSA	red	red	red	red	red	red	green	red	yellow

Source: Tellimer Research, Bloomberg. Note: green = attractive, yellow = neutral, red = unattractive.

Contents

Sector themes

External drivers

- **Monetary outlook:** Loosening in Egypt, Ghana; tightening in Russia, Argentina
- **Fiscal outlook:** Loosening in Sri Lanka, Ghana; tightening in Saudi Arabia
- **Crowding out** of the private sector in Egypt, Ghana, Kenya, Nigeria
- **Regulations:** Tightening in Vietnam, volatile in Bangladesh, Nigeria

Sector drivers

- **Asset quality:** Improving in Egypt, Ghana, Mauritius, deteriorating in Pakistan
- **Liquidity conditions:** Easing in Bangladesh; tightening in Saudi, Vietnam
- **Intra-sector performance divergence** is wide in Bangladesh, Egypt, Kenya, Nigeria, Sri Lanka, Vietnam; stock-picking remains key
- **International expansion** is taking place in Nigeria, Kenya, Mauritius, despite investors' limited appetite for such strategies
- **Technology** is having a growing influence, notably in Nigeria and Kenya, but banks in all markets are having to rapidly adapt
- **Capital ratios** are strong in many markets, notably Ghana, Nigeria, Saudi; this should help protect dividend yields
- **Fee income:** Increasingly in focus in Ghana, Nigeria, Vietnam

2020 sector outlook

Within our coverage universe, we forecast net profit growth of 14% in 2020f, with the strongest performance in Mauritius and Pakistan, and the weakest performance in Nigeria. We forecast the strongest revenue growth in Argentina, although these are contingent upon there being no debt restructuring. GCC banks are likely to generate the weakest revenue growth. We see the strongest balance sheet growth in Argentina banks and Egypt, while we expect the slowest growth in Nigeria and the GCC.

We forecast the highest ROE generation in Argentina and Ghana, while we expect the lowest numbers to come from Sri Lanka and Saudi Arabia. For ROA, Argentina once again tops our list, together with Rwanda, while Bangladesh and Sri Lanka are laggards.

Our fundamental outlook for 2021 is summarised in the appendix.

Table 2: Financial forecasts summary – 2020f

Sector outlook	Median	ARG	BGD	EGY	GHN	KEN	MUR	NGA T1	NGA T2	Other East Africa	Other GCC	PAK	RUS	KSA	LKA	VNM
Growth																
Net interest income	12%	24%	15%	11%	12%	8%	16%	2%	6%	11%	7%	20%	10%	6%	9%	16%
Non-interest income	10%	20%	10%	17%	7%	10%	6%	8%	15%	11%	6%	10%	12%	10%	12%	12%
Total operating income	12%	18%	15%	12%	12%	9%	11%	5%	7%	12%	6%	17%	10%	8%	10%	15%
Operating costs	9%	20%	11%	13%	10%	8%	12%	4%	6%	9%	6%	10%	4%	7%	7%	13%
Pre-provision profit	12%	18%	18%	0%	14%	8%	10%	6%	12%	13%	7%	25%	15%	10%	8%	15%
Net profit	14%	8%	18%	5%	18%	9%	15%	-3%	-3%	17%	7%	28%	18%	6%	24%	20%
Net loans	13%	30%	16%	21%	17%	9%	13%	8%	8%	15%	7%	8%	10%	6%	15%	16%
Assets	11%	20%	15%	16%	16%	10%	15%	5%	8%	12%	7%	9%	8%	6%	17%	12%
Deposits	12%	20%	16%	16%	19%	10%	12%	8%	8%	12%	6%	10%	11%	6%	18%	13%
Ratios																
Net interest margin	4.5%	4.6%	3.7%	5.0%	8.3%	6.8%	2.9%	5.1%	4.7%	8.4%	2.6%	4.0%	4.2%	3.0%	3.7%	3.5%
Non-NII/ assets	1.4%	3.3%	1.6%	1.0%	3.6%	3.4%	1.2%	2.3%	2.1%	4.0%	1.0%	1.0%	1.7%	1.2%	1.0%	0.9%
Revenues/ assets	5.7%	23.9%	5.1%	5.8%	12.4%	10.0%	4.1%	7.4%	6.8%	12.5%	3.6%	4.9%	5.9%	4.0%	4.7%	4.0%
Cost/ income	45%	24%	54%	27%	47%	50%	49%	64%	68%	54%	36%	48%	37%	33%	46%	40%
Cost/ assets	2.7%	5.8%	2.9%	1.6%	5.6%	5.1%	2.0%	3.8%	5.3%	6.7%	1.3%	2.4%	2.2%	1.6%	2.1%	2.0%
NPLs/ loans	4.5%	4.0%	5.0%	3.0%	8.4%	7.1%	6.0%	5.8%	4.2%	5.8%	2.3%	5.6%	9.0%	1.6%	4.8%	1.4%
Credit risk costs	0.99%	0.00%	1.00%	0.40%	2.93%	1.21%	0.60%	1.00%	1.00%	1.63%	0.65%	0.80%	1.40%	0.67%	1.02%	1.42%
Loans/ deposits	82%	90%	98%	50%	43%	76%	66%	53%	72%	71%	110%	49%	97%	81%	95%	99%
Tier 1 ratio	15.2%	N/A	8.6%	N/A	22.0%	19.1%	15.5%	23.6%	15.6%	17.2%	16.8%	13.1%	13.5%	19.2%	11.7%	N/A
CAR	17.5%	N/A	11.5%	21.5%	22.6%	23.2%	21.0%	25.8%	17.0%	18.3%	18.7%	16.0%	13.9%	20.6%	15.7%	N/A
ROA	1.7%	4.6%	1.1%	3.0%	3.4%	2.2%	1.5%	2.3%	2.0%	3.7%	1.5%	1.3%	2.3%	1.9%	1.0%	1.7%
ROE	16.0%	33.6%	14.3%	19.4%	23.7%	16.8%	12.9%	16.7%	13.4%	20.8%	12.0%	16.1%	16.7%	12.2%	10.8%	21.5%

Source: Tellimer Research. Based on median data of our coverage in each market. Note: Other East Africa includes Rwanda, Tanzania, Uganda

Favoured markets

Among the larger markets we cover, we favour banks in Egypt and Pakistan. Nigeria banks scan well from a valuation perspective, however their growth prospects appear limited. Vietnam banks benefit from a favourable macro backdrop, but their margins are tight versus global peers, which puts pressure on internal capital generation.

In contrast, we would underweight banking sector positions in Saudi Arabia (poor valuation and growth profile) and Argentina (significant macro uncertainty is not reflected in valuations). In a global context, Russia banks do not fare well from a credit risk perspective.

Table 3: Country-level sector scorecard – major markets

	Overall rank	Fundamental valuation	Valuation vs history	Macro environment	Growth	Margins	Credit risk	Profitability	Profit trajectory
EGY	Green	Green	Green	Yellow	Green	Green	Green	Green	Yellow
PAK	Green	Yellow	Yellow	Yellow	Yellow	Green	Yellow	Yellow	Green
NGA T1	Yellow	Green	Green	Green	Red	Yellow	Red	Yellow	Red
VNM	Yellow	Yellow	Yellow	Green	Yellow	Red	Yellow	Green	Yellow
KEN	Yellow	Yellow	Red	Yellow	Yellow	Green	Yellow	Yellow	Yellow
BGD	Yellow	Yellow	Yellow	Red	Green	Green	Yellow	Red	Green
RUS	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Red	Yellow	Yellow
ARG	Red	Red	Green	Yellow	Yellow	Yellow	Yellow	Green	Red
KSA	Red	Red	Red	Red	Red	Red	Green	Red	Yellow

Source: Tellimer Research, Bloomberg. Note: green = attractive, yellow = neutral, red = unattractive.

Among smaller markets under our coverage, we favour Ghana banks, together with Rwanda and Sri Lanka. GCC banks scan poorly relative to other global investment alternatives. Domestic growth potential for Mauritius banks appears modest, but they have better prospects in their international operations.

Table 4: Country-level sector scorecard – minor markets

	Overall rank	Fundamental valuation	Valuation vs history	Macro environment	Growth	Margins	Credit risk	Profitability	Profit trajectory
GHN	Green	Green	Green	Yellow	Yellow	Green	Yellow	Green	Yellow
LKA	Yellow	Yellow	Yellow	Yellow	Green	Yellow	Green	Yellow	Green
OEA*	Yellow	Green	Green	Green	Yellow	Green	Red	Yellow	Yellow
NGA T2	Yellow	Yellow	Yellow	Green	Yellow	Yellow	Yellow	Yellow	Yellow
MUR	Yellow	Yellow	Yellow	Yellow	Red	Red	Green	Yellow	Yellow
Other GCC	Red	Red	Green	Red	Red	Red	Yellow	Red	Red

*Source: Tellimer Research, Bloomberg. Note: green = attractive, yellow = neutral, red = unattractive. *Other East Africa includes Rwanda, Tanzania and Uganda.*

Country summaries

Argentina

Outlook

Economic stagnation has hit private sector credit demand, leading banks to raise their holdings of high-yielding Central Bank notes; any monetary loosening could negatively impact sector profitability. Banks recently experienced sizeable deposit withdrawals and capital controls, though liquidity and solvency remain healthy.

In terms of long-term prospects, Argentina's private-sector credit to GDP ratio stands at 15%, well below the 47% regional average. This signals plenty of room for growth, though to close the gap Argentina will first need to stabilise its economy, reduce inflation and interest rates, and recover confidence in its domestic currency.

Key themes

- **Record-high earnings are unsustainable.** Over the past decade, the Argentine banking industry's earnings have grown at a CAGR of 42%, from ARS7.9bn (US$2.1bn) in 2009 to ARS258.2bn (US$5.9bn) in the twelve months to September 2019 ("LTM19"). In particular, LTM19 earnings are 75% higher yoy.

- **Profitability is dependent upon Central Bank notes offering high yields.** This yield, also considered the market reference rate, climbed from 30% in early 2016 to >70% in October 2018 and >80% in September 2019. Banks raised their note holdings to 17% of total assets in September 2019, from 11% a year earlier.

- **Commercial banking business remains on a downward trend.** High yields on Central Bank notes encouraged banks to walk away from their usual financial intermediary role. In fact, net interest income in LTM19 was a loss of ARS197.2bn (US$4.5bn), compared to a profit of ARS123.4bn (US$5.8bn) in the comparative period, as loan yields failed to match higher funding costs. The banks were, however, able to offset these losses with securities income.

- **The industry has withstood high levels of deposit withdrawals.** After the result of the primary elections held in mid-August 2019, private-sector ARS deposits decreased 15%, while foreign-currency deposits plunged 40%. However, the Argentine banking industry maintains healthy figures for liquidity (31% liquid assets/ total assets) and solvency (16.3% CAR).

Key risks

- **Monetary policy uncertainty.** Any changes to the current environment, including a possible restructuring and/or a cut in yields, would have a strongly negative impact on banks' income and profitability.
- **Higher NPLs.** Economic stagnation has translated into worsening asset quality. The non-performing loans ratio was 4.8% in September, from 2.2% a year ago.

Bangladesh

Outlook

- Bangladesh remains one of the fastest-growing economies in our coverage and is forecast to generate 7-8% GDP growth in 2020 (7.8% forecast by ADB, 7.6% by IMF, 7.2% by World Bank). Liquidity should improve due to less competition from government-issued National Savings Certificates. Accordingly, we expect loan growth of 16% (up 5ppt YoY). Revenues are likely to rise by 15% in 2020, with earnings up 18% in 2020 and 20% in 2021. We see ROE averaging 14.3% in 2020, 15.8% in 2021. A key risk relates to the possibility that loan rate caps will be introduced; we see this as unlikely except on large corporate loans.

Key themes

- **Liquidity expected to ease.** The recent reform in the operation of National Savings Certificates has increased inflows to the banking system. We have already seen banks lowering deposit rates, signalling that liquidity conditions have improved. Moreover, a lower external deficit is likely to result in further monetary easing, in our view. Note that slow growth in tax revenues and lower NSC sales could compel the government to borrow more heavily from the banking system, which could result in liquidity conditions tightening once more.
- **Banking sector's health is not improving.** Based on reported data, the banking system has a 12.0% NPL ratio and 67% provisions coverage. However, we estimate a c25% “problem loan ratio” (based on reported NPLs, re-scheduled & restructured loans and stayed order loans) with only c25% provision coverage. Given a c11.7% system Capital Adequacy Ratio, the health of the banking sector remains weak. Moreover, there is no sign of corporate governance issues being resolved, while a recent relaxation to the central bank’s reclassification policy and an already slack large-loan rescheduling policy points to a lack of institutional backbone to address these issues.
- **Intra-sector divergence likely to widen.** Though liquidity is set to improve, we expect weak banks to offer above-average savings rates to attract deposits, while better-managed banks continue to receive funds at cheaper rates.

Upside risks

- **Faster-than-expected consolidation** could take place if systemic challenges force weaker banks into the arms of stronger peers.

Downside risks

- **Systemic risks** due to high NPLs and weak capitalisation of the banking sector, which could damage investor sentiment.
- **Implementation of loan rate cap.** A proposed 9% universal loan rate cap would substantially hit sector profits. Banks with higher-yielding books would be more impacted (more retail/ SME exposure). But we think a more likely scenario is for rate caps to be applied only to large corporate loans, with much more modest profit implications.

Egypt

Outlook

- Pharos expects real GDP growth to improve from 5.7% in FY18/19 to 5.9% in FY19/20, with the transportation, communication, tourism and manufacturing sectors offsetting weaker construction data, and household consumption also improving. Inflation is forecast to average 8.5% in FY19/20, below the central bank's 9% target for end-2020. Falling inflation should allow interest rates to fall, with Pharos projecting 300bps of cuts in 2020. The current account deficit is forecast to moderate to 1.7% of GDP in FY19/20 due to a growing hydrocarbon surplus. FDI should rise as more petroleum exploration concessions are granted. These factors should allow EGP to adopt a stable to appreciating trend. Regarding the fiscal position, a FY19/20 deficit of EGP420bn is forecast by Pharos, likely serviced through short-term domestic debt.
- Falling interest rates should underpin solid credit growth prospects. While currently working capital and retail lending driven, we see the commencement of the corporate capex cycle in H2 20 given the favourable macro outlook and lower rates. Margin pressure should be offset by banks shifting to lower cost funding, such as demand deposits; loan/ deposit ratios should also rise. ROE, provisions coverage and capital ratios should remain high.

Key themes

- **Falling interest rates.** The central bank cut its deposit rate by 450bps to 12.25% during 2019, and we forecast a further 300bps reduction over the next 12 months. Structurally, this should be negative for bank margins, but we think mix shifts will lessen the effect. Lower rates should also underpin already strong loan growth, given that corporate capex has not yet featured in this credit cycle.
- **Withholding tax on T-Bills.** The impact of this law will become more apparent in 2020 but think Egyptian banks will mitigate the impact; we forecast a shift from T-bills to lending, and an increased focus on lowering funding costs.
- **New capital requirements,** raising the minimum to EGP5.0bn from EGP500mn could trigger dividend retention, capital raising and/ or M&A activity.

Upside risks

- **Meaningful structural reform** is focused on promoting private sector investment and reducing corruption. Banks will benefit from a stronger bankruptcy framework.

Downside risks

- **Geopolitical risk.** Egypt is surrounded by unstable regimes and proxy conflicts in the neighbouring regions of Syria, Palestine, Yemen, Libya, Lebanon.
- **Global financing conditions.** Egypt remains dependent on capital inflows. A deterioration in global risk appetite could raise the economy's funding costs.

Other GCC (Oman and Kuwait)

Outlook

- For Kuwait, the IMF projects real GDP growth of 3.1% in 2020 and 2.6% in 2021, up from 0.6% in 2019, which was hit by oil sector production cuts. Oman should see a sharper rebound, from 0.0% growth in 2019 to 3.7% in 2020 and 4.3% in 2021, due to an expected rise in natural gas output. GCC banks are among the most sensitive within our global coverage to US monetary policy; last year's rate cuts are likely to pressure margins. Volume growth will thus likely become the main revenue driver.

Key themes

- **Index flows rather than fundamentals continue to drive regional equities.** The confirmed upgrade of Saudi Arabia to Emerging Market status, with Kuwait following suit, have driven sizeable capital inflows to those markets, driving up valuations. We think further inflows are likely.
- **Banking fundamentals appear unexciting.** single-digit percent loan growth, flat margins and limited scope to cut costs leaves cost-of-risk as the main driver of earnings growth in the region.
- **Sensitivity to oil prices still intact.** Despite well-publicised moves to wean their economies off hydrocarbons, oil prices (and production volumes) remain the key driver of public spending and economic activity in the GCC. Slowing oil demand recently convinced key global producers within OPEC (plus Russia) to extend output cuts in 2020, but the burden of these cuts has disproportionately been borne by the GCC. Technological change represents a key long-term threat for the region.

Key risks

- **Kuwait.** Key upside risks include infrastructure projects driving the potential for greater than expected private sector investment activity, which would positively impact our loan growth forecasts. A rise in equity markets, debt markets and transactional activity could increase banks' fee income. Key downside risks include high credit risk concentration and scope for political and geopolitical tensions (including succession risk), which could affect investor confidence.
- **Oman.** Oil prices are currently well below the fiscal break-even level. Sovereign credit downgrades could affect the country's ability to raise US dollar debt funding and put pressure on the currency. The limited level of structural reform is disappointing; succession risk is also a concern. However, we think potential financial and political support from its wealthier GCC neighbors (Kuwait, Saudi Arabia, UAE) should provide adequate cushioning against any major downturn.

Ghana

Outlook

- Ghana continues be one of the fastest-growing economies in Sub-Saharan Africa with forecast growth of c5.6% in 2020 (IMF). The recently concluded financial sector clean-up should support continued healthy loan growth and improvements in asset quality. However, we see scope for volatility on account of the forthcoming general elections. We project loan growth of 17% and ROE of 23.7% (vs 32.3% 5-year historical average) in 2020.

Key themes

- **Deepening of financial markets.** Following a financial sector clean-up which has so far cost cGHS22bn, we see the government now pushing for an expansion of the financial markets. In November 2019, the Ghana Fixed Income Market (GFIM) introduced new guidelines for the bond market and launched the Global Market Repurchase Agreements (GMRA), which is expected to lead to the development and growth of a robust repo market.
- **Continued growth in non-interest and fee income.** As local banks ramp up their digital banking technology, we should see higher non-interest revenues and improvements in the cost/income ratio as efficiency gains materialise..

Upside risks

- **Review of tax administration could increase revenue mobilisation.** The government highlighted that its focus for 2020 was on reforming tax revenue institutions, intensifying compliance and broadening the tax net. If properly implemented, this could lead to substantial increases in tax revenue.
- **Potentially higher asset yields due to increased government borrowing.** The 2020 budget projects a deficit of GHS19bn (4.7% of GDP), which we expect to be financed from both local (GHS8bn) and foreign sources (GHS11bn). With increased issuance of longer-dated bonds in the domestic market to fund its deficit, there is a rising expectation of higher interest rates, which could lift margins for the banks.

Downside risks

- **Fiscal slippages due to election spending.** Following the reading of the 2020 budget, it is possible that weaker-than-expected revenue mobilisation could cause the government to exceed its budgeted deficit of 5% of GDP.
- **Slowdown in economic growth brought on by inflation,** on the back of increased utility tariffs and transportation costs, which could lead to short term pressure on aggregate demand and limit loan growth prospects. Weaker growth could also limit asset quality improvements and cost of risk moderation.

Mauritius

Outlook

- The IMF projects 3.7% GDP growth in 2019 and 3.9% in 2020, which is broadly in line with the performance of the past few years. Inflation is projected to rise from 0.9% in 2019 to 2.8% by 2021. Long-term growth of the economy will depend on the success of initiatives to lift labour productivity and broaden the country's export base. Better physical infrastructure (such as recent and planned investments in road, rail, seaport and airport facilities) and improved education and training of the workforce will be key to realising the economy's potential, as outlined in the Vision 2030 document. Key challenges include a lack of cost competitiveness (as reflected in a sizeable current account deficit), limited political appetite for structural reform and an ageing population. The banking system can be considered mature in a developing markets context, so volume growth will largely be driven by banks' international operations.

Key themes

- **Infrastructure to spur growth.** The construction sector should benefit from a continued high level of public sector investment. Although this is not typically bank-financed, second order effects may support an improvement in domestic credit demand.
- **Positive loan growth.** Although domestic lending growth is likely to be modest, we see good prospects for international lending. Our discussions with management suggest the loan pipeline remains strong.
- **Excess liquidity remains an issue for domestic margins.** High international liquidity and low interest rates, combined with limited credit appetite from the private corporate sector and the potential for larger corporates to issue bonds, have created excess liquidity in the system, putting pressure on loan yields.

Upside risks

- **Growth.** An acceleration in the implementation of public investment, and greater participation by the private sector, would increase domestic loan growth of both banks considerably.
- **Margins.** We expect the banks' margins to gradually improve in the medium term as better loan growth reduces the amount of excess liquidity in the system.
- **Policy and technology.** The adoption of appropriate policy measures and technology, as well as innovation in the way of doing business, could propel the economy to a higher growth path. However, we have so far seen limited appetite to undertake meaningful structural reforms to help catapult the economy to a higher growth path.

Downside risk

- **Decline in commodity prices.** We see strong international lending prospects – but lower commodity prices (notably oil) could put this view at risk.
- **Downward MUR pressure** could take place if international competitiveness remains poor and the current account deficit climbs.

Nigeria

Outlook

- Economic growth has remained positive, albeit weak, in recent quarters and is projected to average c2.4% in 2019-21 by the IMF, ahead of the 1.9% achieved in 2018 but still weaker than many other emerging and frontier markets. Key tailwinds for banks include non-interest revenue support from e-banking income and growth from rest-of-Africa operations. The volatile regulatory environment is a key downside risk.

Key themes

- **Volatile regulatory environment.** The CBN's push to stimulate economic growth by improving credit supply within the economy has potential negative implications for banks' margins and asset quality. Further, the government's recent decision to temporarily shut all land borders, reorganise the CBN's open market operations and introduce/raise taxes and levies could result in near-term pressure on consumers and corporates, with knock-on implications for banks' profits and asset quality.
- **E-banking income should continue to support earnings.** We forecast a 22% pa increase in e-banking income for our covered banks in the medium term, which should be the key driver of non-interest revenue. In H1 19, our covered banks recorded a 51% yoy surge in e-banking income.
- **Rising profit share from rest-of-Africa** should continue to exceed that for Nigeria.

Upside risks

- **Medium-term loan growth could surprise to the upside,** particularly following the CBN's recent regulatory changes to drive more bank lending. There are also opportunities within the retail segment, which could support gross loan growth beyond our c10% average expectation for FY 20f-22f.
- **Non-core items could continue to provide earnings support.** Higher-than-expected trading income and loan recoveries, and lower effective tax rates could result in earnings beats similar to those seen for some banks in 9M 19.

Downside risks

- **Macro and regulatory backdrop**. Some banks show high earnings sensitivity to an expected downtrend in interest rates.
- **Digital competition.** With payment service bank licenses now issued, banks face more competition for retail/digital customers, as well as transaction volume pressure from new levies on e-banking channels.

Pakistan

Outlook

- Pakistan's economy appears to have stabilised. The PKR has found a firmer footing and has risen more than 8% in H2 19, helped by a 74% yoy reduction in the 4MFY20 current account deficit to US$1.47bn (there was a surplus of US$99mn in Oct 2019, the first monthly surplus in the past four years). Similarly, after 750bps of interest rate hikes since late 2017, the yield curve has inverted. With inflation expected to start falling in H1 20, we think monetary easing may follow. Despite this, we see net interest margins for our covered banks expanding by c40bps to 4.65% in 2020f, due to the lagged impact of asset re-pricing. This should more than offset a potentially higher cost of risk (c75bps in 2020-21) and likely more subdued loan growth (high single digits percent, at best). Together with the likely absence of losses on equity portfolio revaluation (which has been a material drag on 2019 profits) and a more normal effective tax rate (it was elevated in 2019), Pakistani banks should deliver strong earnings growth in 2020f. ROE should rise from 12.3% in 2019f to 15.5% in 2020f, and continue expanding thereafter.

Key themes

- **Strong net interest income growth.** Despite expectations of monetary easing from H1 20, lagged asset re-pricing should result in margins expanding by c40bps in 2020f to 4.65%. This should push NII growth to c20%yoy in 2020f.
- **Slower loan growth.** We expect sluggish credit growth (c8% yoy in 2020f for our coverage), with lending limited to strong corporate borrowers.
- **Manageable cost of risk.** Asset quality has largely held up so far, despite nascent pressure. We expect the cost of risk to average c75bps in 2020f (much lower than 170bps pa in the macroeconomic downcycle of 2008-11).

Upside risk

- **Swifter-than-expected economic growth,** which could boost private sector credit, including in the underpenetrated consumer and SME segments.

Downside risk

- **Greater-than-expected NPL formation** would hurt sector profitability and further limit banks' loan growth appetite.

Saudi Arabia

Outlook

- The IMF expects real GDP growth to recover to 2.2% in 2020 from an expected 0.2% in 2019. Accelerated work on key megaprojects should have a cascading positive economic impact, with an additional impetus to government finances provided by the successful Saudi Aramco IPO. We expect improved economic sentiment to lead to a gradual recovery in credit growth, aided by banks' better risk aptitude. Lower interest rates will negatively impact margins but this should be mitigated by better volume growth, a mix shift to higher margin products and a lower cost of risk. Banks' strong capitalisation levels should protect dividend payout prospects.

Key themes

- **Improved economic sentiment to leads to better loan growth.** We expect the sector's loan book to expand in 2020f on the back of improved economic activity as work on megaprojects accelerates. In addition, corporate risk appetite could improve as lower interest rates reduce the need to deleverage balance sheets. We expect sector loan growth of 6.5% in 2020f vs 2.8% in 2018 and 4.1% 2019f. On the retail side, mortgages will likely remain the key focus; this product's attractive yields should limit the sector's margin sensitivity to lower interest rates.
- **Loan mix shift to mitigate margin compression.** Lower interest rates and likely lower banking system stress should improve banks' risk appetite, in our view. Mortgages would remain the preferred lending destination, while we also expect the sector to increase its exposure to the mass retail and SME segments as improved consumer sentiment transcends through the economy. We believe this shift in loan mix will make sector margins resilient to lower interest rates. However, we do remain mindful of the need for time deposits to fund asset growth, particularly for the smaller banks. We forecast net interest margins (based on our coverage universe) of c3.8% in 2020f vs 3.9% in 2019f.
- **Cost of risk to trend lower –** A boost to profitability is also expected from lower loan delinquencies. Lower financial stress in the economy, along with banks' already high provisions coverage, is expected to lower the cost of risk. Stage 3 loans are merely 2.1% of total loans; 67.5% of these have been provided for. The Stage 2 loans ratio is 9.6% with provisions coverage of 9.1%. (These ratios are as of end-18, which is the last available datapoint.)
- **Healthy capitalisation to support dividends –** Despite a greater growth orientation, we see the sector's dividend payout capacity remaining intact, with the dividend yield improving from 4.9% in 2019f to 6.7% in 2023f

Key risks

- Upside risks include reforms designed to boost the private sector and enable women to play a greater economic role. Downside risks include further US interest rate cuts.

Sri Lanka

Outlook

- Asia Securities forecasts GDP growth of 4.0% for 2020 and 4.4% for 2021, helped by the fiscal boost offered through recent tax cuts. Private sector credit expanded by 0.5% mom in October 2019, leading to 2.6% YTD growth, on track to be the lowest annual rate since 2014. However, private sector credit growth should come in at 15-18% yoy in 2020, on better corporate and consumer demand. For our Sri Lanka banks coverage, we project median loan growth of 15% for 2020, revenues rising 9% and earnings growing 19%. Improving economic conditions should help NPL ratios fall from Q2 20 onwards, with a corresponding decline in the cost of risk. The removal of Nation Building Tax could add a further 2-4 percentage point earnings tailwind to the sector.

Key themes

- **Asset quality to improve in 2020.** Better economic conditions should lead to stronger credit recoverability in 2020. In addition, one of the largest sectors under stress, construction, has received a sizeable stimulus by way of halved income taxes and lowered VAT, and is also benefiting from stronger demand. A second troubled sector, tourism, is gradually recovering, and the sector's improved earnings should support debt serviceability. Against this backdrop, we see the banks taking lower impairment charges in 2020 versus 2019.
- **Volume growth to increase on consumer finance and corporate demand.** Weak credit appetite pressured the sector in 2019, given weak economic fundamentals and low business confidence. Greater political stability post the general election and the fiscal stimulus to both corporates and individuals should lead to much better credit growth in 2020.
- **Margins will see a modest drop from current levels.** Banks will operate under a lending cap until March 2020 (rate reductions until December 2019 maintained until March 2020). As a result, we see the average weighted prime lending rate falling and remaining low until March. Against this backdrop, we expect most of the pricing adjustment to take place by end-19, with only a modest yoy drop in the net interest margin in 2020.

Upside risk

- **Faster recovery in credit quality.** Stronger repayments could drive NPLs lower, leading to a reversal in impairment provisions and stronger profits.
- **Removal of the Debt Repayment Levy (DRL).** While not likely immediately, a removal of DRL would give an 8-10% boost to bank net profits.

Downside risks

- **Margin contraction to continue into H2 20.** We incorporate a 25bps rate cut in early 2020; but further rate cuts in H2 20 would lead to higher margin pressure.

Vietnam

Outlook

- The World Bank projects Vietnam's real GDP growth to remain robust at c6.5% in 2020 and 2021. We project 16% loan growth in 2020 and 15.5% in 2021 for the seven banks that we cover. Revenues are likely to increase by 15% in 2020 and 14.5% in 2021, with earnings rising 20% pa due to margin expansion and service income growth, with lower risk costs at some banks. We see ROE averaging 22% in both years.

Key themes

- **Basel II is coming.** Most banks we cover (all 4 private commercial banks and recently BID) have been approved to apply Basel II capital adequacy requirements. However, CTG is unlikely to do so next year.
- **Most banks should at least maintain 2019 lending growth rates into 2020.** This is positive given that: (1) lending is still the key income source for banks; and (2) credit expansion will allow banks to cross-sell other products (card, settlement, insurance, etc.), which in turns boosts their service income.
- **Margin improvement is likely to remain difficult** due to increasing competition in retail lending and tightening regulations for funding, capital and consumer finance's direct disbursements. We forecast that banks with high CASA deposits or expanding consumer finance should be better placed to expand margins.
- **Attractive valuations but limited investability.** Vietnam banks currently offer a combination of historically low valuations (2020f PBR of 0.9x – 3.1x), and high profitability (ROEs of 19 – 25%). However, most private banks have reached their thresholds of foreign ownership.

Upside risk

- **Positive progress in the recovery of NPLs and VAMC debts** could lower the provisions charge burden by more than our expectation.

Downside risks

- **The state bank's direction to lower lending rates** in the context of tightening funding regulations could limit margin expansion prospects.

Appendix 1 – Sector Outlook 2021

In Table 5 below, we present a summary of our 2021 financial forecasts for our covered markets.

Table 5: Financial forecasts summary – 2021f

Sector outlook	Median	ARG	BGD	EGY	GHN	KEN	MUR	NGA T1	NGA T2	Other E Africa	Other GCC	PAK	RUS	KSA	LKA	VNM
Growth																
Net interest income	10%	24%	16%	11%	12%	9%	14%	5%	7%	12%	7%	9%	5%	5%	13%	15%
Non-interest income	11%	20%	10%	18%	7%	11%	8%	10%	16%	11%	6%	14%	9%	3%	12%	12%
Total operating income	11%	18%	14%	12%	12%	10%	12%	7%	9%	12%	7%	11%	6%	6%	12%	15%
Operating costs	9%	20%	12%	15%	8%	8%	10%	4%	6%	10%	6%	9%	5%	3%	10%	12%
Pre-provision profit	14%	18%	16%	0%	17%	9%	14%	18%	17%	15%	7%	15%	7%	7%	14%	17%
Net profit	14%	8%	20%	12%	21%	10%	17%	6%	14%	17%	7%	15%	3%	9%	22%	18%
Net loans	12%	30%	16%	23%	15%	10%	12%	8%	8%	16%	7%	12%	8%	7%	16%	16%
Assets	10%	20%	14%	18%	15%	10%	14%	6%	8%	11%	7%	9%	7%	6%	13%	13%
Deposits	12%	20%	16%	19%	17%	10%	12%	8%	8%	10%	6%	12%	9%	6%	17%	14%
Ratios																
Net interest margin	4.5%	4.6%	3.8%	5.0%	8.2%	6.8%	2.9%	5.1%	4.7%	8.6%	2.6%	3.9%	4.2%	3.0%	3.8%	3.5%
Non-NII/ assets	1.6%	3.3%	1.7%	1.1%	3.4%	3.4%	1.1%	2.6%	2.2%	4.0%	1.0%	1.0%	1.7%	1.1%	1.0%	0.9%
Revenues/ assets	6.2%	23.9%	5.0%	5.8%	12.1%	10.0%	4.0%	7.5%	6.9%	12.6%	3.6%	4.9%	5.8%	4.0%	4.9%	4.2%
Cost/ income	45%	24%	53%	27%	45%	50%	49%	60%	66%	52%	36%	46%	36%	33%	46%	40%
Cost/ assets	2.9%	5.8%	2.9%	1.6%	5.3%	5.1%	1.9%	3.8%	5.3%	6.6%	1.3%	2.4%	2.1%	1.6%	2.1%	1.9%
NPLs/ loans	4.5%	4.0%	4.8%	3.0%	7.5%	7.1%	5.1%	5.6%	4.1%	5.9%	2.3%	5.7%	9.5%	1.7%	3.8%	1.4%
Credit risk costs	1.00%	0.00%	0.95%	0.50%	2.30%	1.30%	0.54%	1.10%	1.10%	1.54%	0.64%	0.79%	1.50%	0.58%	0.76%	0.85%
Loans/ deposits	81%	90%	99%	52%	42%	76%	66%	55%	71%	75%	111%	49%	99%	83%	95%	98%
Tier 1 ratio	15.3%	N/A	8.7%	N/A	23.1%	19.4%	14.9%	23.5%	15.9%	16.8%	16.7%	13.2%	14.0%	0.0%	10.8%	N/A
CAR	17.2%	N/A	11.5%	21.4%	23.6%	24.0%	20.1%	26.0%	17.0%	18.2%	18.5%	16.2%	14.4%	0.0%	14.7%	N/A
ROA	1.8%	4.6%	1.1%	2.9%	3.6%	2.3%	1.5%	2.4%	2.1%	3.8%	1.5%	1.4%	2.2%	2.0%	1.2%	1.8%
ROE	16.9%	33.6%	15.8%	19.0%	24.6%	16.9%	13.6%	16.9%	13.6%	20.5%	12.2%	16.7%	15.5%	12.5%	12.8%	21.1%

Source: Tellimer Research. Based on median data of our coverage in each market. Other East Africa comprises our coverage in Rwanda, Tanzania and Uganda.

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