FOCUS | Banking Industry

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INDUSTRY: BANKING

NEUTRAL

Upcoming ruling on reserve requirement

Bank Indonesia will revise the reserve requirement regulation with an increase in the secondary RR to 4% from 2.5%. The LDR RR criteria also will be changed. We believe the impact of the change in the secondary RR will be minimal but expect loan growth to slow down because of the changes in the LDR RR rules. Maintain Neutral on the sector which is trading at 2.4x P/BV 2013F.

Change in reserve requirement regulation. Bank Indonesia will soon change the regulations on reserve requirement, especially on the secondary and LDR reserve requirement. The regulation, to be fully implemented by1 December 2013, will only impact the reserve regulation on the rupiah-denominated third party funds:

1. The primary reserve requirement on rupiah third party funds is kept at 8%;
2. The secondary reserve requirement on rupiah TPF will be increased to 4.0% from 2.5%;
3. Loan-deposit-ratio reserve requirement will be changed with banks with LDR of 78-92% do not have to add reserve requirement.

Banks have ample liquidity for rising secondary reserve requirement. Banks have sufficient funds to meet the increase in the secondary reserve. Based on total rupiah deposits of Rp2,816tr as of May 2013, banks have to add Rp42.2tr onto this reserve. The average primary reserve stood at 8.5% of total deposits while the secondary reserve was at 12.2% of the total deposits as of May 2013.

Loan growth to slow down on LDR reserve requirement. LDR reserve requirement has been impacting three banks under our list: BCA, BII and Bank Jatim. What is still uncertain here is whether the central bank will still use the 14% CAR threshold for banks with high LDR to avoid the LDR RR. If the threshold is no longer used, some other banks (CIMB Niaga, Panin, BTN, Danamon) will be affected as their LDRs were above 92% as of June 2013. We have yet to factor in the downward revision in loan growth into our forecasts.

Maintain Neutral on the sector. With the impact on LDR RR is still uncertain we maintain our Neutral call on the sector which is trading at 2.4x and 2.1x P/BV for 2013F and 2014F. At this juncture BRI remains as our top pick.

FIGURE 1. BANK VALUATION AND RECOMMENDATION

Company	Code	Recom.	Price (Rp)	TP (Rp)	Mkt. Cap. (Rp bn)	P/E (x) 2013F	P/E (x) 2014F	P/BV (x) 2013F	P/BV (x) 2014F	ROE (%) 2013F	ROE (%) 2014F	Yld (%) 2013F	Yld (%) 2014F
BCA	BBCA IJ	NEUTRAL	10,300	10,300	253,947	19.3	16.2	4.0	3.4	22.9	22.7	1.6	2.2
BRI	BBRI IJ	BUY	7,800	10,600	192,419	9.5	7.9	2.4	2.0	28.0	27.8	2.9	3.7
BNI	BBNI IJ	BUY	4,100	5,300	76,459	9.6	7.6	1.5	1.4	17.2	18.9	2.8	4.2
Danamon	BDMN IJ	NEUTRAL	4,525	6,000	43,371	11.1	8.7	1.4	1.2	13.1	15.0	2.8	2.7
BTPN	BTPN IJ	BUY	4,200	5,500	24,529	10.4	8.4	2.4	2.0	26.4	25.8	-	2.4
Panin	PNBN IJ	BUY	690	850	16,614	7.4	5.9	0.9	0.8	12.9	14.1	-	2.7
BTN	BBTN IJ	BUY	1,130	1,700	11,936	7.0	5.2	1.0	0.9	15.2	18.0	3.4	4.2
BJB	BBJB IJ	NEUTRAL	1,010	1,300	9,793	7.1	5.7	1.5	1.3	21.8	23.8	6.8	7.3
Jatim	BJTM IJ	BUY	375	575	5,594	5.7	4.9	0.9	0.9	17.2	18.6	10.5	11.5
Average		**NEUTRAL**				**11.8**	**9.7**	**2.3**	**2.0**	**21.1**	**21.5**	**2.3**	**2.7**

Source: Mandiri Sekuritas estimates

Change in reserve requirement regulation
Bank Indonesia will change the regulation on reserve requirement, especially on the secondary and LDR reserve requirement, which was introduced in 2010. The regulation, which will be fully implemented in 1 December 2013, will only impact the reserve regulation on the rupiah-denominated third party funds:

1. The primary reserve requirement on the rupiah-denominated third party funds (TPF) is kept at 8%;
2. The secondary reserve requirement on ruthe piah TPF will be increased to 4.0% from 2.5%;
3. Loan-to-deposit ratio (LDR) reserve requirement will be changed accordinglly, namely banks with LDR of between 78-92% do not have to add their reserve requirement;

There is no change in reserve requirement for foreign-currency TPF, which is set at 8% and is placed in Bank Indonesia demand deposit.

The primary reserve requirement on the rupiah TPF is placed in Bank Indonesia demand deposit account and it does not earn interest for the first 5% level; thereafter earns 2.5% pa interest, provided the RR level is at least 8%.

The secondary reserve requirement is the minimum reserve to be maintained by banks and comprises of the Certificates of Bank Indonesia (SBI), Government Debenture Debt (SUN) or Sharia Government Securities (SBSN), all of which are earning assets.

The LDR reserve requirement is the additional reserve commercial banks should maintain in the form of current account with Bank Indonesia if the LDR is outside the 78%-92% range. It remains unclear whether the central bank will impose additional reserve requirement on banks, but using the previous regulation the disincentive will be as follows:

- If the LDR is below the 78% minimum LDR banks will have to set aside: 0.1 x (78%-LDR) of the total rupiah deposits
- If the LDR is above the 92% maximum target (previously 100%) and the CAR is below 14% they will have to set aside: 0.2 x (LDR-92%) of the total rupiah deposits.
- If the LDR is >92% and CAR >14% there is no need to add reserve requirement.

Banks have ample liquidity for rising secondary reserve requirement
Data from Bank Indonesia shows that banks have sufficient funds to increase their secondary reserves. Based on the total rupiah deposits of Rp2,816tr as of May 2013 banks have to add Rp42.2tr (1.5% of total rupiah deposits) onto this reserve. The average primary reserve was 8.5% of total deposits as of May 2013 (as BI does not provide details on rupiah and foreign currency reserve we assume the level of primary reserve is the same for both rupiah and foreign currencies). The secondary reserve stood at 12.2% of the total deposits in May 2013 and we derive this from the excess funds in the form of SBI, T-bills and bonds (of which 91% are the government bonds). Among the type of banks, foreign banks have the highest portion in primary and secondary reserves while the regional banks the lowest.

Given ample liquidity in the sector currently, we believe additional secondary reserve requirement won'tt have any significant impact on banks and the ruling is more for the prudential banking practice to keep the liquidity in the system.

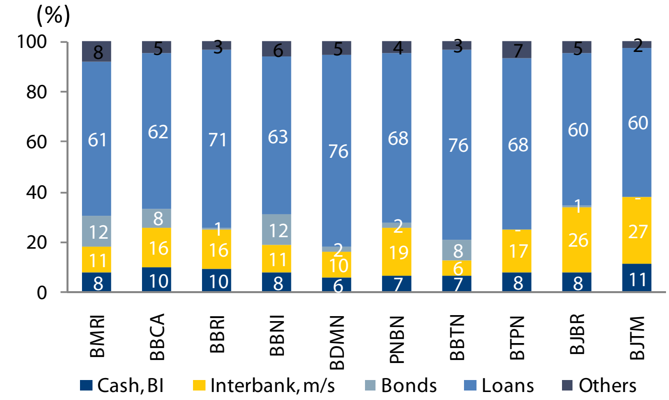
FIGURE 2. BANKS HAVE MORE THAN 4% IN SECONDARY RESERVE AS OF MAY 2013

	Total deposits (Rp tr)	Rp deposits (Rp tr)	Primary RR (Rp tr)	Secondary RR (Rp tr)	1st RR (%)	2nd RR (%)	Gross LDR (%)	CAR (%)
Industry	**3,350**	**2,816**	**286**	**409**	**8.5**	**12.2**	**85.8**	**18.7**
State banks	1,193	1,005	102	178	8.5	14.9	85.9	17.5
Forex private banks	1,401	1,201	113	139	8.1	9.9	82.9	16.4
Non-forex private banks	111	111	9	9	8.1	8.3	85.6	22.5
Regional banks	333	331	29	20	8.6	6.1	71.6	17.8
Joint venture banks	146	80	16	18	10.7	12.0	115.4	20.1
Foreign banks	166	88	18	45	10.7	27.2	110.7	33.6

Source: Bank Indonesia, Mandiri Sekuritas estimates

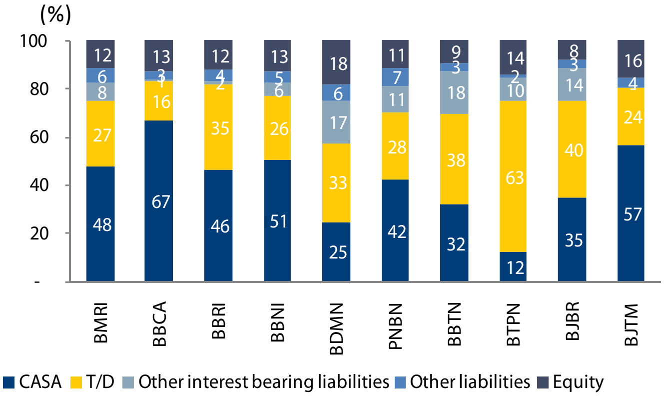
Figure 3 below shows each of 10 bank's assets breakdown in June 2013. In addition to the cash and accounts in BI the interbank, marketable securities and bonds account for an average 20% of total assets, which confirms the BI data on ample liquidity.

FIGURE 3. INDIVIDUAL BANKS ASSET BREAKDOWN – JUN 13



Source: Banks, Mandiri Sekuritas

FIGURE 4. INDIVIDUAL BANKS LIABILITY BREAKDOWN – JUN 13



Source: Banks, Mandiri Sekuritas

Loan growth to slow down on LDR reserve requirement

LDR reserve requirement has been impacting three banks under our list: BCA, BII and Bank Jatim. BCA has been increasing its LDR and still has high excess funds, BII is close to the LDR limit of 92% with <14% CAR as of June 2013, however they are in the process of conducting a rights issue so are likely to get away from this additional reserve requirement. Bank Jatim needs to increase its loans to reach the 78% LDR requirement.

What is uncertain here is whether the central bank will still use the 14% CAR threshold for banks with high LDR to get away from LDR RR. If the threshold is no longer used then some other banks (CIMB Niaga, Panin, BTN, Danamon) will be affected by the ruling given their LDR was above 92% in June 2013. We have yet to factor in this into our forecasts with downward revision on loan growth, which is in line with the slowing GDP growth.

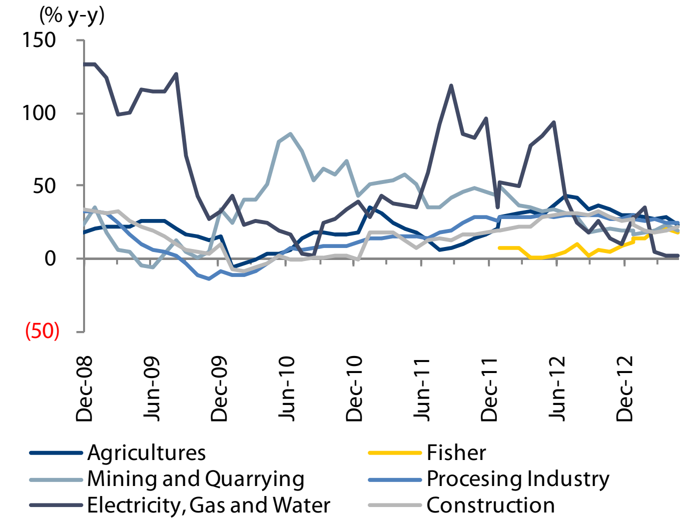
FIGURE 5. POTENTIAL IMPACT ON LDR RR ON BANKS, BASED ON JUNE 2013 FIGURES

Bank	B'berg Ticker	LDR (%)	CAR (%)	LDR within range of 78-92%?	CAR >14%?	Affected by LDR RR	Est. addt'l LDR RR %	Rp deposits Jun-13 Rp bn	Addt'l LDR RR Rp bn
Mandiri	BMRI	85	15.3	Yes	Yes	No	—	436,559	
BRI	BBRI	90	17.3	Yes	Yes	No	—	388,809	
BNI	BBNI	84	16.3	Yes	Yes	No	—	224,158	
CIMB Niaga	BNGA	101	16.1	No	Yes	No	—	122,573	
Panin	PNBN	96	18.3	No	Yes	No	—	94,983	
BTN	BBTN	111	16.7	No	Yes	No	—	82,033	
Danamon	BDMN	135	18.7	No	Yes	No	—	81,800	
bjb	BJBR	82	18.1	Yes	Yes	No	—	54,715	
BTPN	BTPN	91	22.7	Yes	Yes	No	—	47,748	
BCA	BBCA	74	16.4	No	Yes	Yes	1.8	347,079	6,203
BII	BNII	93	13.0	No	Below	Yes	0.3	72,128	201
Jatim	BJTM	75	22.8	No	Yes	Yes	0.3	27,166	79

Source: Banks, Mandiri Sekuritas estimates

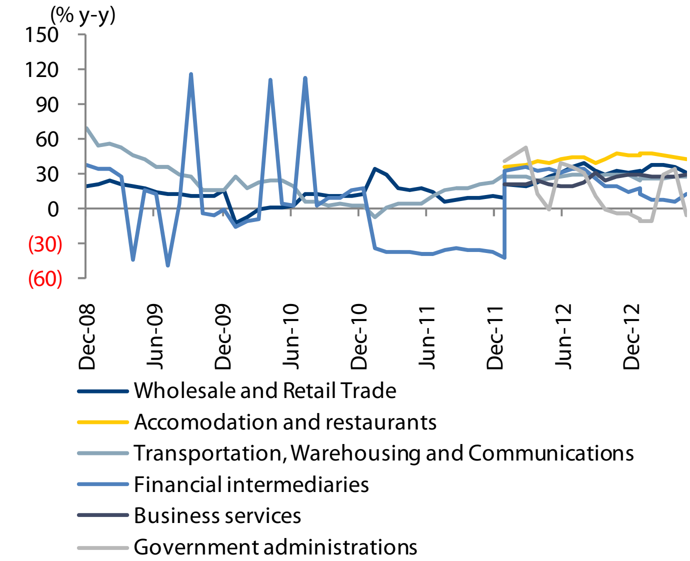
The new LDR RR rules, we believe, will force banks to slow down their loan growth, especially to certain industries. The following four figures show the loan growth in all of the 24 categories for which certain sectors posted high growth rates (>25% y-y in June 2013) including: wholesale and retail trading, hotels and F&B, transportation (figure 7); individual services (figure 8); apartment and shop house ownership (figure 9). While slowing loan growth is the first alternative for banks to meet the BI ruling, they can also opt for other alternatives to keep the LDR in check: 1) increasing total deposits through higher rates thus at the expense of margin or 2) moving more towards the higher yield loans so that the interest benefit is more than sufficient to compensate for the cost arising from additional reserve requirement.

FIGURE 6. LOAN GROWTH BASED ON SECTOR 1



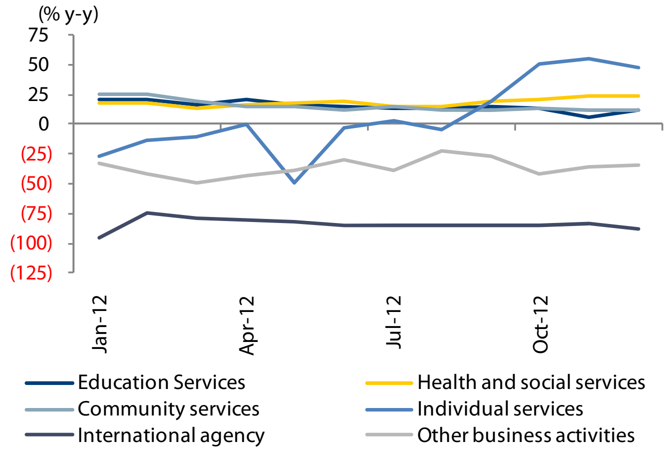
Source: Bank Indonesia, Mandiri Sekuritas

FIGURE 7. LOAN GROWTH BASED ON SECTOR 2



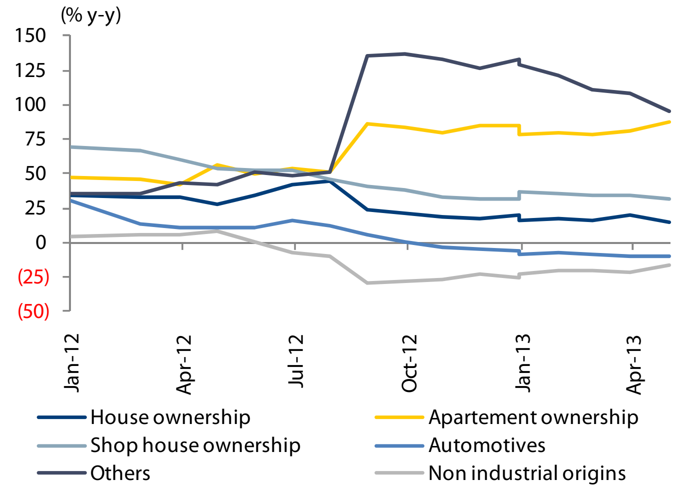
Source: Bank Indonesia, Mandiri Sekuritas

FIGURE 8. LOAN GROWTH BASED ON SECTOR 3



Source: Bank Indonesia, Mandiri Sekuritas

FIGURE 9. LOAN GROWTH BASED ON SECTOR 4



Source: Bank Indonesia, Mandiri Sekuritas

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