Banking

Dark Clouds Gathering On The Horizon

Highlights

- The US and Japan are confronted with rising bond yields and a surge in interest payments. Both the US and Japan have not entered a fiscal or sovereign debt crisis, but they are starting to feel the financial strains.
- The upward pressure on bond yields is exacerbated by elevated energy prices caused by the Middle East conflict, which is likely to be prolonged, as the US finds it increasingly difficult to extricate itself.
- Downgrade to MARKET WEIGHT. Our preferred pick is OCBC (BUY/Target: S$32.50) for its diversified growth from wealth management (63% of its fee income), trading income and insurance. We downgraded DBS (HOLD/Target: S$74.70) as valuation is stretched with 2027 P/B at 2.97x.

Analysis

- We previously highlighted Singapore banks as a hedge against potential sovereign debt crises in developed countries.
- **Is the US entering a fiscal crisis?** The US' federal debt, budget deficits, and interest costs are on the rise. According to the Congressional Budget Office, the federal deficit is projected at US$1.9t in 2026. The IMF estimated that US general government debt would reach 142% of GDP in 2031, compared with 124% in 2026. Interest payments are now one of the fastest-growing expenditure, exceeding US$1t annually. The US fiscal trajectory is becoming progressively unsustainable. Persistent budget deficits of around 6% of GDP, rising entitlement spending, and growing interest expenses could crowd out public investment. The US is not yet facing a full-blown fiscal crisis, but US treasury yields are now structurally higher.
- **Is Japan entering a fiscal crisis?** Japan's fiscal position is the most stretched among developed economies, with gross government debt at 233% of GDP in 2026. Bank of Japan's gradual normalisation of monetary policy has materially increased debt-servicing costs after many years of ultra-low interest rates. An ageing population and a shrinking workforce also place pressure on social security and healthcare spending. Japan is approaching a turning point. Expansionary fiscal policies and permanent tax cuts could reverse the recent decline in the debt-to-GDP ratio. Consequently, confidence in government finances is being undermined and Japan's fiscal standing is expected to gradually deteriorate.
- **Looming threat from a prolonged gulf crisis.** While the US achieved early battlefield successes, Iran has escalated the conflict by targeting American bases, commercial shipping routes, and regional allies. The Strait of Hormuz is the most important energy chokepoint, carrying roughly one-fifth of global oil supplies. The sustained disruption to shipping has triggered higher oil prices and inflationary pressures, creating domestic political challenges for US policymakers. Iran's ability to use drones and missiles has forced the US to expend costly defensive systems, creating an expensive war of attrition. The US could get bogged down as it becomes increasingly difficult for the US to extricate itself from a prolonged conflict in the Middle East.

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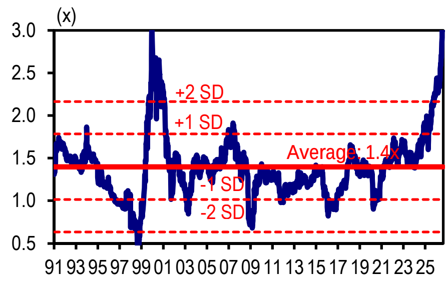
MARKET WEIGHT (Downgraded)

Sector Picks

Company	Ticker	Rec	Share Price (S$)	Target Price (S$)
DBS	DBS SP	HOLD	76.00	74.70
OCBC	OCBC SP	BUY	30.98	32.50

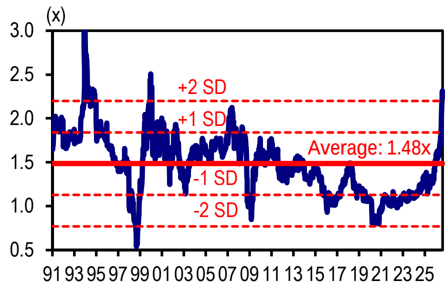
Source: Bloomberg, UOB Kay Hian

P/B – DBS



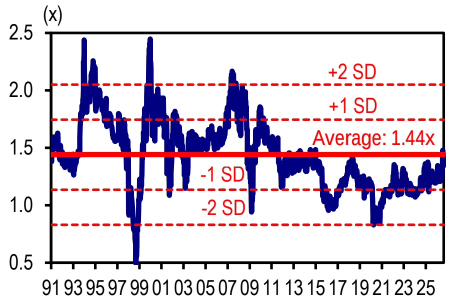
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

Peer Comparison

			Price	Target	Market	---------- PE ----------		---------- P/B ----------		------- P/PPOP -------		--------- Yield ---------		------------- ROE -------------	
Company	Ticker	Rec	21 Aug 26	Price	Cap	2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F
			(S$)	(S$)	(US$m)	(x)	(x)	(x)	(x)	(x)	(x)	(%)	(%)	(%)	(%)
DBS	DBS SP	HOLD	76.00	74.70	170,398	19.0	18.4	3.04	2.97	15.3	14.7	4.3	4.6	16.3	16.6
OCBC	OCBC SP	BUY	30.98	32.50	109,679	17.4	16.7	2.19	2.06	14.9	14.6	3.0	3.1	12.6	12.7
UOB	UOB SP	NR	40.53	n.a.	52,716	12.1	11.3	1.27	1.22	8.6	8.3	4.3	4.5	10.9	11.1
Average						16.1	15.4	2.17	2.08	13.0	12.6	3.9	4.1	13.2	13.5

Source: Bloomberg, UOB Kay Hian

Valuation/Recommendation

- **The new normal of higher bond yields.** We expect government bond yields to stay elevated due to resilient economic growth bolstered by the investment cycle for AI and still-elevated inflation. In Singapore, non-oil domestic exports (NODX) rose 24% yoy in Jul 26, driven by a 112% surge in the electronics sector, supported by robust global demand for AI-related products. Singapore's core inflation was rather benign at 1.6% for Jun 26. Yield for 10-year Singapore government bonds rose 25bp ytd to 2.37%. The rise of bond yields in Singapore is mild compared to the US (yield for 10-year treasury bonds rose 52bp ytd to 4.69%) and Japan (yield for 10-year JGBs rose 78bp ytd to 2.85%).
- **A prolonged conflict in the Middle East** could gradually weaken banks' asset quality. Sustained disruptions to energy markets and shipping routes could keep energy prices elevated, thus dampening business investment. Highly leveraged borrowers in transportation, logistics and aviation sectors become financially stressed. Companies exposed to supply chain disruptions or higher operating expenses may face refinancing challenges. Exposures to the transportation, storage & communications sector are 7.4% for DBS Group Holdings (DBS), 7.4% for Oversea-Chinese Banking Corp's (OCBC) and 5.5% for United Overseas Bank (UOB).
- **Downgrade to MARKET WEIGHT.** Singapore banks deserve to trade at a premium for their structural resilience. On a YTD basis, DBS and OCBC's share prices have rallied 35% and 56% respectively. On the other hand, United Overseas Bank's (UOB) share price has gained a relatively modest 15%. Thus, we trim our OVERWEIGHT position to MARKET WEIGHT.
- We have raised the risk-free rate used in our Gordan Growth Model from 2.2% to 2.5% due to recent increase in 10-year Singapore government bond yields. Our preferred pick is OCBC (BUY/Target: S$32.50) for its strategic shift to accelerate growth. OCBC is more sensitive to growth in wealth management fees, which accounted for 63% of its fee income. It has delivered the strongest and most diversified 2Q26 results with earnings growth at 22% yoy, driven by wealth, trading income and insurance. We downgraded DBS (HOLD/Target: S$74.70) as valuation is stretched with 2027 P/B at 2.97x, although it remains the leader in wealth management and scale of earnings.

DBS Group Holdings (HOLD/Target: S$74.70)

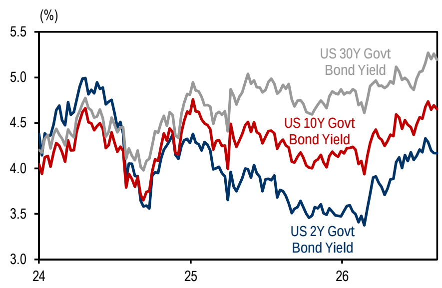
- High net worth clients have entrusted DBS with a greater share of their assets through its booking centres in Singapore and Hong Kong. It has doubled its AUM since 2019, representing a six-year CAGR of 12.2%. The proportion of AUM invested was high at 58% in 2025. Wealth management fees grew by a sterling 29% in 2025 and 33% yoy in 1H26.
- Asset quality is pristine with NPL formation muted at S$126m in 1Q26 and S$155m in 2Q26. NPL ratio is low at 1.0%, while loan-loss coverage is healthy at 130%. DBS has ample management overlay for general provisions of S$2,400m.
- DBS provides a dividend yield of 4.6% for 2027 with latent potential for more capital management exercises. We expect DBS to raise its quarterly DPS by 6 S cents to 72 S cents starting 4Q26.
- **Downgrade to HOLD.** Our target price of S$74.70 is based on 2.92x 2027F P/B, derived from the Gordon Growth Model (ROE: 16.2%, COE: 7.0% (previous: 6.7%), growth: 2.2%).

Key Assumptions – DBS

(S$m)	2024	2025	2026F	2027F	2028F
Net Interest Income	14,424	14,500	14,496	15,359	16,120
Non-Interest Income	7,873	8,400	9,497	9,869	10,395
Total Income	22,297	22,900	23,993	25,228	26,515
Pre-Provision Operating Profit	13,259	13,528	14,108	14,688	15,338
Net Profit	11,289	10,933	11,360	11,722	12,242
% Chg	12.2	(3.2)	3.9	3.2	4.4
Loan Growth (%)	3.4	3.3	7.5	4.5	4.5
NIM (%)	2.14	2.02	1.87	1.86	1.86
Fees, % Chg	23.2	17.5	16.6	8.9	8.4
NPL Ratio (%)	1.09	1.03	0.98	0.98	0.97
Credit Costs (bp)	14.0	17.8	15.2	17.1	17.1

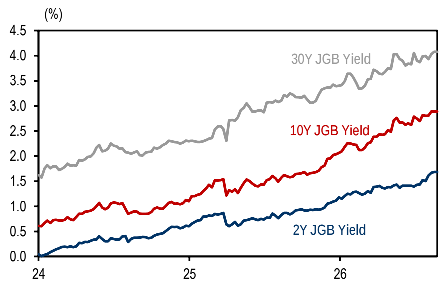
Source: UOB Kay Hian

US 2Y, 10Y and 30Y Treasury Yields



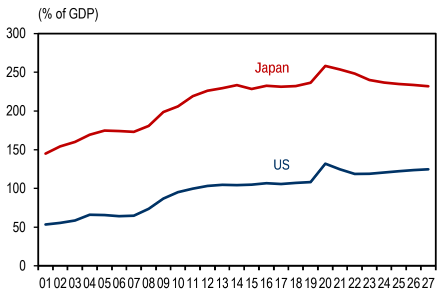
Source: Bloomberg

Japan 2Y, 10Y and 30Y JGB Yields



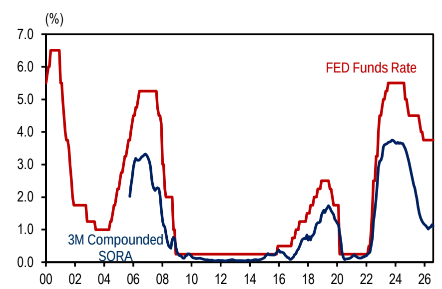
Source: Bloomberg

US And Japan Government Gross Debt As % Of GDP



Source: Bloomberg

US Fed Funds Rate Vs 3M SORA



Source: Bloomberg

Oversea-Chinese Banking Corp (BUY/Target: S$32.50)

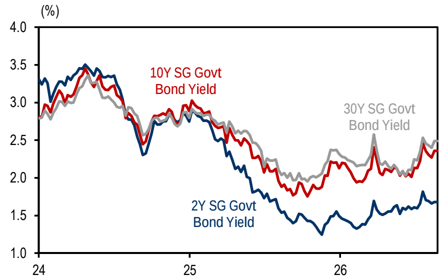
- The acquisition of HSBC's International Wealth and Premier Banking business will bolster growth of wealth management onshore by adding 336,000 customers, 26 branches and AUM of S$6.6b in Indonesia. There is minimal overlap as HSBC's customers are predominantly professionals and white-collar executives, while customers of OCBC NISP, OCBC's listed banking subsidiary in Indonesia, are entrepreneurs and businessmen. The acquisition is aligned with its New Frontier strategy to deepen its domestic presence within the ASEAN region in Malaysia and Indonesia.
- OCBC has embarked on a strategic shift to capture growth at its twin wealth hubs of Singapore and Hong Kong. Management targets to deliver Whole-of-Wealth value proposition across the banking, wealth management and insurance businesses.
- NPL formation was manageable at S$123m in 1Q26 and S$300m in 2Q26. OCBC has the lowest NPL ratio of 0.9%, but the highest loan-loss coverage remained strong at 163%.
- **Maintain BUY.** Our target price of S$32.50 is based on 2.16x 2027F P/B, derived from the Gordon Growth Model (ROE: 12.8%, COE: 7.25% (previous: 6.95%), growth: 2.5%).

Key Assumptions – OCBC

(S$m)	2024	2025	2026F	2027F	2028F
Net Interest Income	9,755	9,150	9,169	9,744	10,301
Non-Interest Income	4,718	5,464	6,506	6,519	6,868
Total Income	14,473	14,614	15,676	16,263	17,170
Pre-Provision Operating Profit	8,672	8,710	9,317	9,497	10,028
Net Profit	7,587	7,422	8,053	8,373	8,849
% Chg	8.1	(2.2)	8.5	4.0	5.7
Loan Growth (%)	7.6	6.9	9.0	4.4	4.4
NIM (%)	2.20	1.92	1.71	1.71	1.73
Fees, % Chg	9.2	22.4	15.6	9.7	8.8
NPL Ratio (%)	0.89	0.95	0.87	0.88	0.89
Credit Costs (bp)	22.4	20.1	20.8	20.1	20.1

Source: UOB Kay Hian

SG 2Y, 10Y and 30Y Government Bond Yields



Source: Bloomberg

Sector Catalyst/Risk

- **Catalysts**: Singapore's strong fiscal standing, which attracts constant influx of safe haven liquidity, thus boosting Singapore banks' AUM, wealth management fees and trading income.
- **Risks**: Economic downturn caused by uncertainties from prolonged Middle East conflict and elevated energy prices.

Projected DPS And Dividend Payout Ratios

	---------DBS (HOLD/S$76.00/Target: S$74.70)---------			----------OCBC (BUY/S$30.98/Target: S$32.50)-----------			------- UOB (NOT RATED / S$40.53) -------		
Year to 31 Dec	FY25	FY26F	FY27F	FY25	FY26F	FY27F	FY25	FY26F	FY27F
EPS (S ¢)	384	400	413	163	178	186	276	340	367
DPS (S ¢)	306	330	348	99	94	96	181	171	184
Payout Ratio (%)	79.7	82.4	84.3	60.7	52.7	51.7	65.6	50.2	50.0
Dividend Yield (%)	4.0	4.3	4.6	3.2	3.0	3.1	4.5	4.2	4.5

Source: Bloomberg, UOB Kay Hian

Comparison Of Profit & Loss

2Q26	DBS	OCBC	UOB
Net Interest Income	S$3,581m	S$2,264m	S$2,297m
	-1.8% yoy	-0.8% yoy	-1.7% yoy
	+2.5% qoq	+1.9% qoq	-1.2% qoq
Fee Income	S$1,460m	S$739m	S$665m
	+25.1% yoy	+27.4% yoy	+4.6% yoy
	-1.5% qoq	+9.5% qoq	+4.4% qoq
Insurance	n.a.	S$382m	n.a.
	n.a.	+69.0% yoy	n.a.
	n.a.	-6.6% qoq	n.a.
Other Non-Interest Income	S$1,052m	S$785m	S$632m
	+14.7% yoy	+71.4% yoy	+28.2% yoy
	+69.4% qoq	+50.4% qoq	+36.8% qoq
Provisions	S$113m	S$156m	S$211m
	10bp	14bp	28bp
Net Profit	S$3,079m	S$2,221m	S$1,476m
	+9.0% yoy	+22.3% yoy	+10.2% yoy
	+5.1% qoq	+12.5% qoq	+2.6% qoq

Source: Respective banks, UOB Kay Hian

Comparison Of Key Ratios

2Q26	DBS	OCBC	UOB
Net Interest Margin (NIM)	1.87	1.70	1.74
	-2bp qoq	-6bp qoq	-8bp qoq
Loan Growth	+8.2% yoy	+12.3% yoy	+5.4% yoy
	+3.5% qoq	+4.9% qoq	+2.1% qoq
Deposit Growth	+11.2% yoy	+12.8% yoy	+5.2% yoy
	+1.3% qoq	+3.4% qoq	-0.2% qoq
NPL Ratio	1.0	0.9	1.6
	Unchanged	Unchanged	+0.1ppt qoq
Loan Loss Coverage	130	163	88
	-1ppt qoq	Unchanged	-12ppt qoq
Core Equity Tier-1 CAR	14.6	14.0	15.4
	-0.2ppt qoq	-1.2ppt qoq	+0.1ppt qoq
Book Value Per Share (BVPS)	S$24.69	S$13.73	S$29.99
	+3.7% yoy	+6.3% yoy	+4.8% yoy
	+1.3% qoq	-0.7% qoq	+0.7% qoq

Source: Respective banks, UOB Kay Hian