Management Discussion and Analysis

Overview

	2017	2016	+/(–) %
Selected income statement items ($ million)			
Net interest income	5,528	4,991	11
Fee and commission income	2,161	1,931	12
Other non-interest income	1,162	1,140	2
Total income	8,851	8,061	10
Less: Total expenses	4,027	3,696	9
Operating profit	4,824	4,365	11
Less: Total allowance	727	594	23
Add: Share of profit of associates and joint ventures	110	6	>100
Net profit before tax	4,207	3,777	11
Less: Tax and non-controlling interests	816	681	20
Net profit after tax [1]	3,390	3,096	9
Selected balance sheet items ($ million)			
Net customer loans	232,212	221,734	5
Customer deposits	272,765	255,314	7
Total assets	358,592	340,028	5
Shareholders' equity [1]	36,850	32,873	12
Key financial ratios (%)			
Net interest margin	1.77	1.71	
Non-interest income/Total income	37.5	38.1	
Expense/Income ratio	45.5	45.9	
Overseas profit before tax contribution	40.8	37.4	
Credit costs (bp)			
Exclude general allowance	61	45	
Include general allowance	28	32	
Non-performing loans ratio [2]	1.8	1.5	
Return on average ordinary shareholders' equity [3]	10.2	10.2	
Return on average total assets	0.98	0.95	
Return on average risk-weighted assets	1.63	1.51	
Loan/Deposit ratio [4]	85.1	86.8	
Liquidity coverage ratios (LCR) [5]			
All-currency	147	154	
Singapore dollar	200	221	
Capital adequacy ratios			
Common Equity Tier 1	15.1	13.0	
Tier 1	16.2	13.1	
Total	18.7	16.2	
Leverage ratio [6]	8.0	7.4	
Earnings per ordinary share ($) [3]			
Basic	1.99	1.86	
Diluted	1.98	1.85	
Net asset value (NAV) per ordinary share ($) [7]	20.37	18.82	
Revalued NAV per ordinary share ($) [7]	23.19	21.54	

1 Relates to amount attributable to equity holders of the Bank.
2 Refers to non-performing loans as a percentage of gross customer loans.
3 Calculated based on profit attributable to equity holders of the Bank net of preference share dividend and perpetual capital securities distributions.
4 Refers to net customer loans and customer deposits.
5 Figures reported are based on average LCR for the respective period. A minimum requirement of Singapore dollar LCR of 100% and all-currency LCR of 60% shall be maintained at all times with effect from 1 January 2015, with all-currency LCR increasing by 10% each year to 100% by 2019. Public disclosure required under MAS Notice 651 is available in the UOB website at www.UOBgroup.com/investor/financial/overview.html.
6 Leverage ratio is calculated based on the MAS Notice 637.
7 Preference shares and perpetual capital securities are excluded from the computation.

Management Discussion and Analysis

Performance Review

The Group reported net earnings of $3.39 billion, 9% higher than a year ago.

On the back of higher net interest margin and healthy loan growth of 5%, net interest income rose 11% to $5.53 billion. Net interest margin increased six basis points to 1.77%, mainly attributed to higher yields from interbank balances and securities, a function of both our measured efforts in deploying excess funds into higher-yielding assets and a rising interest rate environment.

Fee and commission income registered a robust growth of 12% to $2.16 billion. Wealth management fees grew strongly by 36% to $547 million, driven by higher sales of treasury products and unit trusts. Fund management income increased 28% to $239 million and credit card fees rose 10% to $404 million. Higher net gains from the disposal of investment securities also contributed to the increase in other non-interest income to $1.16 billion.

From a business segment perspective, Group Retail income rose 9% to $3.99 billion driven by healthy loan growth and fee income growth from the wealth management and credit card businesses. Group Wholesale Banking income was stable, as volume growth was offset by tighter margins. Global Markets income fell 12% to $486 million largely due to lower trading income.

Due to a combination of strong revenue momentum and continued cost discipline, the expense-to-income ratio declined slightly to 45.5%. Total expenses increased 9% over last year with higher staff costs, IT-related and revenue-related expenses, reflecting the Group's continual efforts in investing in talent, technology and infrastructure to enhance its product capabilities and services.

Specific allowance on loans and other assets increased 49% to $1.48 billion. As part of our ongoing portfolio assessment, the residual vulnerable exposures in the oil and gas and shipping sectors were recognised as non-performing assets (NPA) with collateral valuation marked down in the fourth quarter of 2017, thereby reducing lingering credit risks to the Group. Total allowances amounted to $727 million, as excess general allowance of $747 million was reversed.

Despite the reversal in general allowance, the Group continued to maintain a comfortable level of general allowance on loans of $1.96 billion as at 31 December 2017. This amount adequately satisfies the 1% general allowance requirement by the MAS as well as the expected credit loss requirements under Singapore Financial Reporting Standard (International) 9 Financial Instruments (SFRS(I) 9) which came into effect on 1 January 2018.

Contribution from associated companies rose from $6 million to $110 million, mainly due to investment losses in an associated company in the prior year.

Due to the one-off accelerated recognition of NPA on oil and gas and shipping exposures, the Group's NPA increased 26% year-on-year to $4.39 billion. Consequently, the non-performing loans (NPL) ratio stood at 1.8% as at 31 December 2017, while NPL coverage remained strong at 91%, or 195% after taking collateral into account.

The Group continued to maintain a strong funding position with a healthy loan-to-deposit ratio at 85.1%. Gross loans increased to $236 billion at 31 December 2017, with a year-on-year increase of 5% that was broad-based across most territories and industries. Customer deposits grew 7% from a year ago to $273 billion, led by growth in US dollar deposits.

During the year, the Group issued $4.13 billion in debt and perpetual capital securities to diversify its funding mix and refinance its debts due for redemption.

The average Singapore dollar and all-currency liquidity coverage ratios for the year were 200% and 147% respectively, well above the corresponding regulatory requirements of 100% and 80%.

Shareholders' equity increased 12% from a year ago to $36.9 billion due to higher retained earnings, issuance of US$650 million perpetual capital securities and shareholders' participation in the scrip dividend scheme.

As at 31 December 2017, the Group's Common Equity Tier 1 and Total CAR remained strong at 15.1% and 18.7% respectively. On a fully-loaded basis, the Common Equity Tier 1 CAR rose to 14.7% from 12.1% a year ago. The Group's leverage ratio was 8.0%, well above Basel's minimum requirement of 3%.

Net Interest Income

Net Interest Margin

	2017			2016		
	Average balance $ million	Interest $ million	Average rate %	Average balance $ million	Interest $ million	Average rate %
Interest Bearing Assets						
Customer loans	227,666	7,474	3.28	213,016	7,118	3.34
Interbank balances	58,869	997	1.69	49,656	637	1.28
Securities	25,650	605	2.36	29,135	536	1.84
Total	312,185	9,077	2.91	291,807	8,291	2.84
Interest Bearing Liabilities						
Customer deposits	264,516	3,018	1.14	252,293	2,878	1.14
Interbank balances/others	36,270	531	1.46	32,054	422	1.32
Total	300,786	3,548	1.18	284,347	3,300	1.16
Net Interest Margin [1]			1.77			1.71

1 Net interest margin represents net interest income as a percentage of total interest bearing assets.

Volume and Rate Analysis

	2017 vs 2016			2016 vs 2015		
	Volume change $ million	Rate change $ million	Net change $ million	Volume change $ million	Rate change $ million	Net change $ million
Interest Income						
Customer loans	490	(133)	356	422	21	443
Interbank balances	118	242	360	(32)	41	10
Securities	(64)	133	69	76	(64)	12
Total	544	242	786	467	(2)	464
Interest Expense						
Customer deposits	139	1	140	135	184	318
Interbank balances/others	56	53	108	28	54	82
Total	195	54	249	162	238	400
Net Interest Income	349	189	537	304	(240)	64

Net interest income rose 11% to $5.53 billion on the back of a higher net interest margin and healthy loan growth of 5%. Net interest margin increased six basis points to 1.77%, mainly attributed to higher yields from interbank balances and securities, a function of both our measured efforts in deploying excess funds into higher-yielding assets and a rising interest rate environment.

Management Discussion and Analysis

Non-Interest Income

	2017 $ million	2016 $ million	+/(–) %
Fee and Commission Income			
Credit card	**404**	368	10
Fund management	**239**	188	28
Wealth management	**547**	403	36
Loan-related [1]	**471**	482	(2)
Service charges	**148**	134	11
Trade-related [2]	**272**	263	3
Others	**80**	93	(14)
	2,161	1,931	12
Other Non-Interest Income			
Net trading income	**775**	776	(0)
Net gain from investment securities	**127**	101	26
Dividend income	**23**	31	(25)
Rental income	**119**	118	1
Other income	**117**	114	3
	1,162	1,140	2
Total	**3,323**	3,071	8

1 Loan-related fees include fees earned from corporate finance activities.
2 Trade-related fees include trade, remittance and guarantees related fees.

Fee and commission income registered a robust growth of 12% to $2.16 billion. Wealth management fees grew strongly by 36% to $547 million, driven by higher sales of treasury products and unit trusts. Fund management income increased 28% to $239 million and credit card fees rose 10% to $404 million. Higher net gains from the disposal of investment securities also contributed to the increase in other non-interest income to $1.16 billion.

Operating Expenses

	2017 $ million	2016 $ million	+/(–) %
Staff Costs	**2,224**	2,050	8
Other Operating Expenses			
Revenue-related	**889**	826	8
Occupancy-related	**332**	324	3
IT-related	**365**	286	28
Others	**217**	210	3
	1,803	1,646	10
Total	**4,027**	3,696	9

Total expenses increased 9% over last year with higher staff costs, IT-related and revenue-related expenses, reflecting the Group's continual efforts in investing in talent, technology and infrastructure to enhance its product capabilities and services. Expense-to-income ratio declined to 45.5%, due to a combination of strong revenue momentum and continued cost discipline.

Allowance for Credit and Other Losses

	2017 $ million	2016 $ million	+/(–) %
Specific Allowance on Loans [1]			
Singapore	**733**	516	42
Malaysia	**177**	57	>100
Thailand	**131**	88	49
Indonesia	**258**	125	>100
Greater China [2]	**39**	168	(77)
Others	**68**	15	>100
	1,407	969	45
Specific Allowance on Securities and Others	**68**	22	>100
General Allowance	**(747)**	(398)	(88)
Total	**727**	594	23

1 Specific allowance on loans by geography are classified according to where credit risks reside, largely represented by the borrower's country of incorporation/operation (for non-individuals) and residence (for individuals).
2 Comprises China, Hong Kong and Taiwan.

Specific allowance on loans and other assets increased 49% to $1.48 billion, mainly from NPA in the oil and gas and shipping sectors. Specifically, a decision was taken to accelerate the recognition of these residual vulnerable exposures as NPA in the fourth quarter of 2017, and further haircuts were applied on their collateral valuations. With a reversal of $747 million of excess general allowance for the year, total allowances amounted to $727 million.

Despite the reversal in general allowance, the Group continued to maintain a comfortable level of general allowance on loans of $1.96 billion as at 31 December 2017. This amount adequately satisfies the 1% general allowance requirement by the MAS as well as the expected credit loss requirements under the SFRS(I) 9 which came into effect on 1 January 2018.

Management Discussion and Analysis

Customer Loans

	2017 $ million	2016 $ million
Gross customer loans	**236,028**	225,662
Less: Specific allowance	**1,855**	1,219
General allowance	**1,961**	2,709
Net customer loans	**232,212**	221,734
By Industry		
Transport, storage and communication	**9,388**	9,780
Building and construction	**53,646**	52,281
Manufacturing	**18,615**	15,747
Financial institutions, investment and holding companies	**19,090**	15,519
General commerce	**30,664**	30,269
Professionals and private individuals	**28,182**	26,950
Housing loans	**65,569**	61,451
Others	**10,874**	13,665
Total (gross)	**236,028**	225,662
By Currency		
Singapore dollar	**115,750**	112,160
US dollar	**44,507**	45,079
Malaysian ringgit	**24,000**	22,993
Thai baht	**14,006**	12,423
Indonesian rupiah	**4,853**	5,401
Others	**32,912**	27,606
Total (gross)	**236,028**	225,662
By Maturity [1]		
Within 1 year	**92,969**	80,940
Over 1 year but within 3 years	**42,828**	43,665
Over 3 years but within 5 years	**24,851**	27,655
Over 5 years	**75,379**	73,402
Total (gross)	**236,028**	225,662
By Geography [2]		
Singapore	**127,602**	125,529
Malaysia	**26,948**	25,767
Thailand	**14,977**	13,226
Indonesia	**10,718**	11,857
Greater China	**32,301**	27,232
Others	**23,482**	22,051
Total (gross)	**236,028**	225,662

1 Certain comparative figures have been restated to conform with the current year's presentation.
2 Loans by geography are classified according to where credit risks reside, largely represented by the borrower's country of incorporation/operation (for non-individuals) and residence (for individuals).

As at 31 December 2017, gross loans rose 5% to $236 billion driven by broad-based increase across most territories and industries.

Singapore loans were $128 billion as at 31 December 2017, an increase of 2% year-on-year, while regional countries contributed a strong growth of 9%.

Non-Performing Assets

	2017 $ million	2016 $ million
Non-Performing Assets (NPA)		
Loans (NPL)	4,211	3,328
Debt securities and others	178	152
Total	4,389	3,480
By Grading		
Substandard	2,411	2,185
Doubtful	128	270
Loss	1,850	1,025
Total	4,389	3,480
By Security		
Secured by collateral type:		
Properties	1,771	1,177
Shares and debentures	8	39
Fixed deposits	12	11
Others [1]	467	613
	2,258	1,840
Unsecured	2,131	1,640
Total	4,389	3,480
By Ageing		
Current	936	343
Within 90 days	600	285
Over 90 to 180 days	735	646
Over 180 days	2,118	2,206
Total	4,389	3,480
Total Allowance		
Specific	2,014	1,322
General	1,976	2,724
Total	3,990	4,046
As a % of NPA	91%	116%
As a % of unsecured NPA	187%	247%

	2017		2016	
	NPL $ million	NPL ratio %	NPL $ million	NPL ratio %
NPL by Industry				
Transport, storage and communication	1,209	12.9	965	9.9
Building and construction	428	0.8	210	0.4
Manufacturing	638	3.4	316	2.0
Financial institutions, investment and holding companies	92	0.5	76	0.5
General commerce	485	1.6	451	1.5
Professionals and private individuals	295	1.0	284	1.1
Housing loans	677	1.0	618	1.0
Others	387	3.6	408	3.0
Total	4,211	1.8	3,328	1.5

1 Comprise mainly of shipping vessels.

Management Discussion and Analysis

Non-Performing Assets (continued)

	NPA/NPL $ million	NPL ratio %	Specific allowance $ million	Total allowance as a % of NPA/NPL %	Total allowance as a % of unsecured NPA/NPL %
NPL by Geography [1]					
Singapore					
2017	**2,058**	**1.6**	**934**	**97**	**207**
2016	1,291	1.0	468	180	387
Malaysia					
2017	**585**	**2.2**	**220**	**107**	**249**
2016	487	1.9	82	104	377
Thailand					
2017	**439**	**2.9**	**157**	**94**	**244**
2016	360	2.7	134	106	268
Indonesia					
2017	**694**	**6.5**	**312**	**59**	**132**
2016	638	5.4	208	45	134
Greater China					
2017	**132**	**0.4**	**76**	**151**	**262**
2016	307	1.1	230	107	140
Others					
2017	**303**	**1.3**	**156**	**55**	**90**
2016	245	1.1	97	44	62
Group NPL					
2017	**4,211**	**1.8**	**1,855**	**91**	**195**
2016	3,328	1.5	1,219	118	262
Debt securities and others					
2017	**178**		**159**	**98**	**101**
2016	152		103	78	82
Group NPA					
2017	**4,389**		**2,014**	**91**	**187**
2016	3,480		1,322	116	247

1 Non-performing loans by geography are classified according to where credit risks reside, largely represented by the borrower's country of incorporation/operation (for non-individuals) and residence (for individuals).

Due to the one-off accelerated recognition of NPA on oil and gas and shipping exposures, the Group's NPA increased 26% year-on-year to $4.39 billion.

Consequently, NPL ratio stood at 1.8% as at 31 December 2017, while NPL coverage remained strong at 91%, or 195% after taking collateral into account.

Customer Deposits

	2017 $ million	2016 $ million
By Product		
Fixed deposits	139,257	133,966
Savings deposits	66,404	61,951
Current accounts	57,570	51,690
Others	9,534	7,707
Total	272,765	255,314
By Maturity		
Within 1 year	268,233	249,750
Over 1 year but within 3 years	2,545	3,589
Over 3 years but within 5 years	1,174	978
Over 5 years	813	997
Total	272,765	255,314
By Currency		
Singapore dollar	123,806	122,736
US dollar	67,739	59,425
Malaysian ringgit	26,475	25,295
Thai baht	15,317	13,049
Indonesian rupiah	5,119	5,741
Others	34,308	29,068
Total	272,765	255,314
Group Loan/Deposit ratio (%)	85.1	86.8
SGD Loan/Deposit ratio (%)	92.3	89.7
USD Loan/Deposit ratio (%)	63.9	74.6

Customer deposits grew to $273 billion as at 31 December 2017, an increase of 7% year-on-year led by growth in US dollar deposits.

As at 31 December 2017, the Group's loan-to-deposit ratio and Singapore dollar loan-to-deposit ratio remained healthy at 85.1% and 92.3% respectively.

Debts Issued

	2017 $ million	2016 $ million
Unsecured		
Subordinated debts	4,827	5,926
Commercial papers	13,674	14,364
Fixed and floating rate notes	2,630	3,408
Others	1,801	1,687
Secured		
Covered bonds	2,247	758
Total	25,178	26,143
Due within 1 year	14,807	16,172
Due after 1 year	10,371	9,971
Total	25,178	26,143

Management Discussion and Analysis

Shareholders' Equity

	2017 $ million	2016 $ million
Shareholders' equity	**36,850**	32,873
Add: Revaluation surplus	**4,679**	4,456
Shareholders' equity including revaluation surplus	**41,529**	37,329

Shareholders' equity rose 12% from a year ago to $36.9 billion as at 31 December 2017 due to higher retained earnings, issuance of US$650 million perpetual capital securities and shareholders' participation in the scrip dividend scheme.

As at 31 December 2017, revaluation surplus of $4.68 billion relating to the Group's properties, was not recognised in the financial statements.

Performance by Business Segment [1,2]

	GR $ million	GWB $ million	GM $ million	Others $ million	Total $ million
2017					
Net interest income	**2,550**	**2,471**	**238**	**269**	**5,528**
Non-interest income	**1,438**	**1,090**	**248**	**547**	**3,323**
Operating income	**3,988**	**3,561**	**486**	**816**	**8,851**
Operating expenses	**(2,007)**	**(848)**	**(301)**	**(871)**	**(4,027)**
Allowance for credit and other losses	**(218)**	**(1,280)**	**1**	**770**	**(727)**
Share of profit of associates and joint ventures	**–**	**4**	**–**	**106**	**110**
Profit before tax	**1,763**	**1,437**	**186**	**821**	**4,207**
Tax					**(800)**
Profit for the financial year					**3,407**
2016					
Net interest income	2,436	2,443	162	(50)	4,991
Non-interest income	1,211	1,097	393	370	3,071
Operating income	3,647	3,540	555	319	8,061
Operating expenses	(1,827)	(793)	(291)	(785)	(3,696)
Allowance for credit and other losses	(189)	(826)	3	418	(594)
Share of profit of associates and joint ventures	–	2	–	4	6
Profit before tax	1,631	1,923	267	(44)	3,777
Tax					(669)
Profit for the financial year					3,108

1 Transfer prices between operating segments are on an arm's length basis similar to transactions with third parties.
2 Comparative segment information for prior year has been adjusted for changes in organisational structure and management reporting methodology.

Performance by Business Segment (continued)

Segmental reporting is prepared based on the Group's internal organisational structure. The Banking Group is organised into three major business segments – Group Retail, Group Wholesale Banking and Global Markets. Others segment includes non-banking activities and corporate functions.

Group Retail (GR)

Profit before tax increased 8% to $1,763 million from a year ago. Total income rose 9%, driven by double-digit growth in fee income from wealth management and credit card products. Net interest income grew 5% with higher loan and deposit volumes, partly offset by lower loan margin. Expenses were 10% higher from ongoing investments to support retail franchise growth. Total allowances increased $29 million to $218 million.

Group Wholesale Banking (GWB)

Operating profit was relatively flat at $2,713 million as compared to a year ago. Total income grew 1% as higher net interest income from volume growth was partially offset by loan margin compression on the back of price competition and widening SOR against SIBOR. Expenses increased 7% to $848 million, primarily from technology related costs and talent acquisition. Profit before tax declined 25% to $1,437 million due to increase in specific allowances from conservative collateral markdown and accelerated NPA recognition of oil and gas and shipping exposures.

Global Markets (GM)

Compared to a year ago, profit before tax declined 30% to $186 million. Total income fell 12% mainly due to lower contribution from trading income and unfavourable foreign exchange movements. Expenses rose 4% to $301 million, mainly due to staff related costs.

Others

Others segment recorded a gain of $821 million as compared to a loss before tax of $44 million a year ago, driven by higher income from central treasury activities, fund management, improvement in share of associates' profits and reversal of general allowance.

Management Discussion and Analysis

Performance by Geographical Segment [1]

	Total operating income		Profit before tax		Total assets	
	2017 $ million	2016 $ million	2017 $ million	2016 $ million	2017 $ million	2016 $ million
Singapore	5,090	4,590	2,491	2,364	217,979	210,937
Malaysia	1,014	986	581	548	35,373	33,845
Thailand	933	830	218	193	20,988	18,031
Indonesia	468	476	29	71	9,105	9,840
Greater China	757	648	419	300	46,298	40,233
Others	589	531	469	301	24,707	22,991
	8,851	8,061	4,207	3,777	354,450	335,877
Intangible assets	–	–	–	–	4,142	4,151
Total	8,851	8,061	4,207	3,777	358,592	340,028

1 Based on the location where the transactions and assets are booked. Information is stated after elimination of inter-segment transactions.

Total operating income registered a growth of 10% to $8.85 billion led by the growth in Singapore, Thailand and Greater China.

Profit before tax for 2017 grew 11% to $4.21 billion driven by broad-based growth across most of the geographical segments.

Capital Adequacy Ratios

The Group's CET1, Tier 1 and Total CAR as at 31 December 2017 were well above the regulatory minimum requirements.

Higher total capital was mainly due to an increase in retained earnings over the year, while lower risk-weighted assets was largely attributable to enhancements in RWA computation methodology.

As at 31 December 2017, the Group's leverage ratio was higher at 8.0%, primarily from higher Tier 1 Capital.