

China Banking Sector

A mixed blessing

SUMMARY. Jul's credit growth came in below expectation on disappointing new loans and off-balance sheet financing. On the flip side, CBIRC's regulatory indicators pointed to encouraging 2Q19 operating results for China banks. We see further margin pressure but attractive risk-reward for the sector, given current undemanding valuation.

- **Both TSF and bank loans missed estimate** at RMB 1.01tn (-17.6% YoY) and RMB 1.06tn (-27.4% YoY), lower than consensus forecast by 37.8% and 17.2% respectively. YoY growth in TSF balance moderated to 10.7% from 12-months high of 10.9% in Jun. The negative surprise was mainly due to a sharp contraction in off-balance sheet credit, more than offsetting the strong issuance of corporate and special LG bonds. In particular, undiscounted acceptance bills pulled back RMB 456bn, likely driven by increasing bill financing as banks tried to uphold credit growth amid weak demand. In terms of new loan mix, over 40% was mortgage while only 28% was from corporate segment. The strict control on SOEs' leverage and tightened property sector financing may further weigh on banks' loan growth in 2H19.
- **CBIRC data suggests improving 2Q19 results.** Banking sector's 1H19 earnings growth picked up to 6.5% YoY (vs 6.1% YoY in 1Q19), driven by faster asset growth of 9.4% YoY (vs 8.7% YoY in 1Q19) despite softer NIM (-4bp QoQ). Nationwide large and joint-stock banks saw falling NPL ratio and rising provision coverage, whereas regional city commercial banks suffered from deteriorating asset quality. We believe this was mainly due to the latter's accelerated risk exposure under authorities' push for more stringent loss recognition standard.
- **Maintain Outperform.** Weakening TSF growth could raise market expectation for benchmark rate cut to spur credit demand. That said, we anticipate PBoC to use a combination of open market operation interest adjustment and RRR cut, to keep sufficient system liquidity and gradually lower effective lending rate. H-share China banks are trading at 0.6x FY19E P/B, around 1SD below historical mean. The distressed valuation has largely priced in the sector's narrowing NIM trend, in our view. We still favor retail-oriented JSBs that could deliver better-than-peers NIM and earnings growth. **Top picks are PAB (000001 CH) and CEB (6818 HK).**

Valuation Table

Name	Ticker	Price (Local ccy)	TP (Local ccy)	Rating	P/B (x) FY19E	P/E (x) FY19E	Yield FY19E	ROE FY19E
ICBC	1398 HK	4.98	7.60	BUY	0.63	5.1	6.0%	13.1%
CCB	939 HK	5.73	9.30	BUY	0.60	4.7	6.4%	13.4%
ABC	1288 HK	3.01	5.30	BUY	0.53	4.4	7.0%	12.7%
BOC	3988 HK	3.00	5.20	BUY	0.47	4.3	7.3%	11.5%
CITICB	998 HK	4.07	5.90	BUY	0.40	3.9	7.0%	10.9%
CEB	6818 HK	3.31	4.60	BUY	0.49	4.4	5.9%	11.5%
BoCom	3328 HK	5.30	6.40	HOLD	0.50	4.6	6.7%	11.3%
MSB	1988 HK	5.13	6.20	HOLD	0.44	3.8	7.9%	12.1%
PAB	000001 CH	15.12	17.00	BUY	1.05	9.5	1.1%	11.6%

Source: Bloomberg, CMBIS estimates

OUTPERFORM (Maintain)

China Banking Sector

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PBoC monthly data summary

Key indicators (RMB bn)	Jul - 19	Jun - 19	Jul - 18
New TSF	1,010	2,263	1,488
YoY (%)	-17.6	52.1	-18.2
New loans	1,056	1,664	1,453
YoY (%)	-27.4	-9.7	76.1
M1 YoY (%)	3.1	4.4	5.1
M2 YoY (%)	8.1	8.5	8.5

Source: PBoC, CMBIS

Historical P/B of H-share China banks



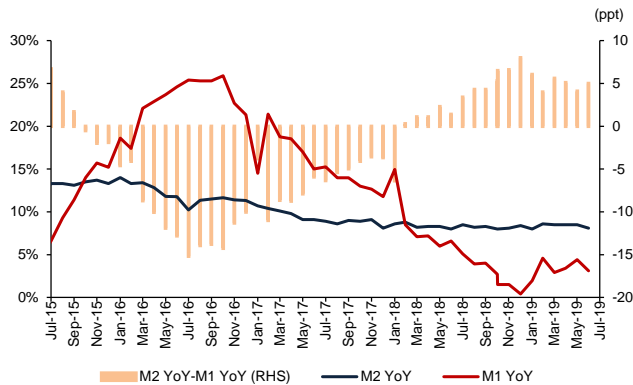
Source: Bloomberg, CMBIS

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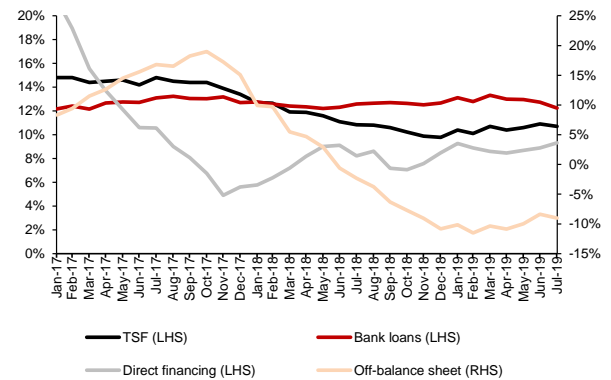
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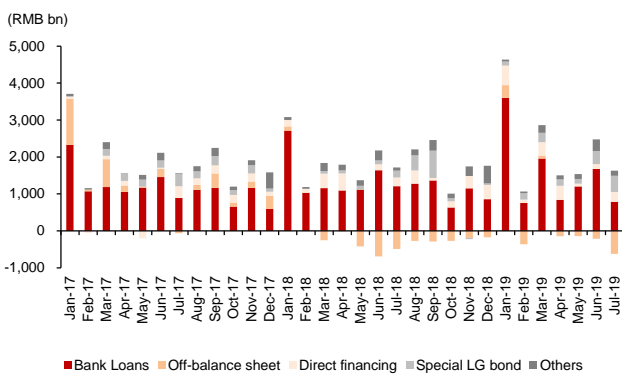
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Figure 1: M1 and M2 growth

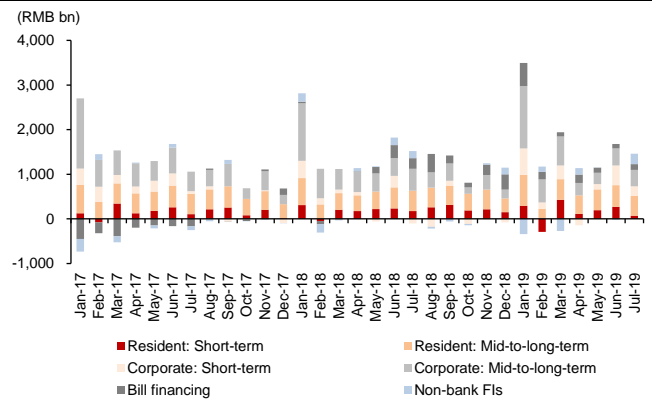
Source: PBoC, CMBIS

Figure 2: YoY growth of TSF balance

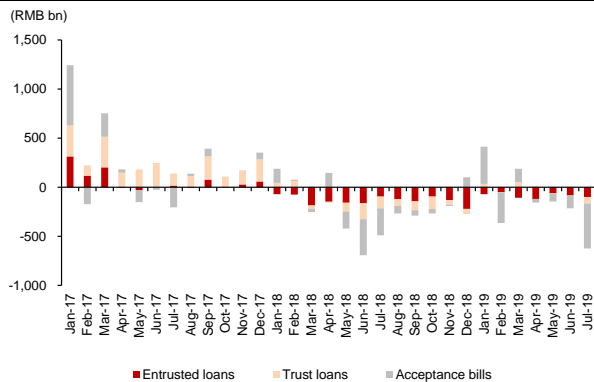
Source: PBoC, CMBIS

Figure 3: New TSF breakdown

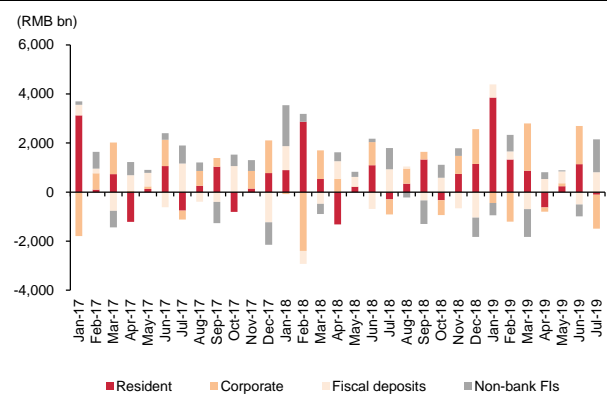
Source: PBoC, CMBIS

Figure 4: New loan breakdown

Source: PBoC, CMBIS

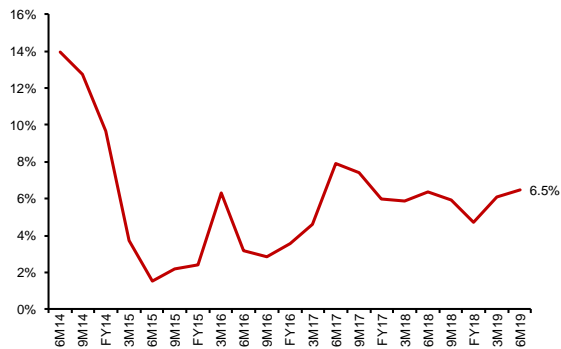
Figure 5: Off-balance sheet financing breakdown

Source: PBoC, CMBIS

Figure 6: New deposit breakdown

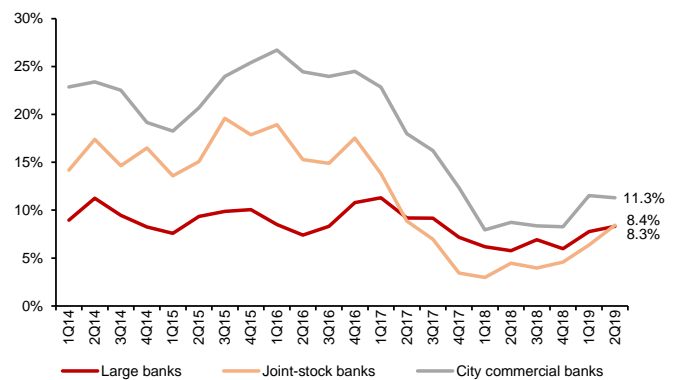
Source: PBoC, CMBIS

Figure 7: Net profit YoY growth



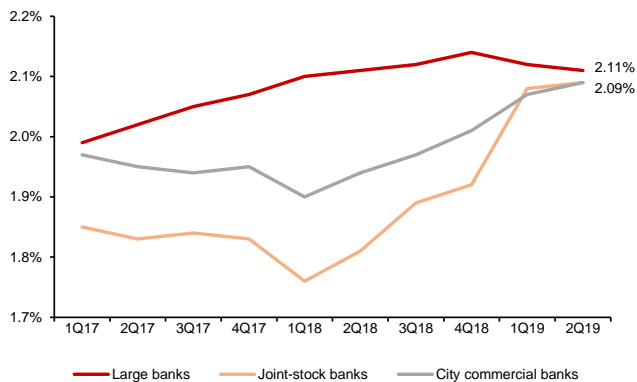
Source: CBIRC, CMBIS

Figure 8: Total assets YoY growth



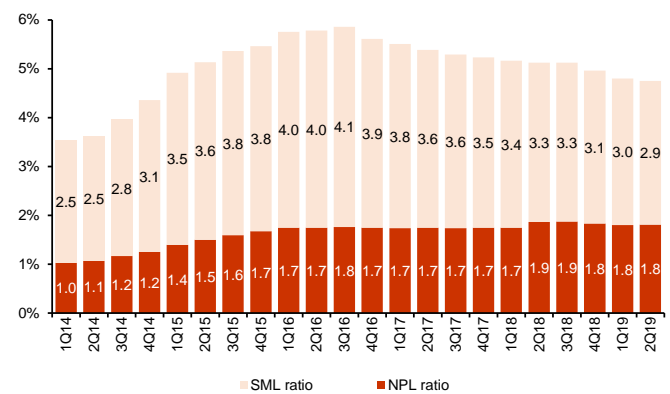
Source: CBIRC, CMBIS

Figure 9: Net interest margin



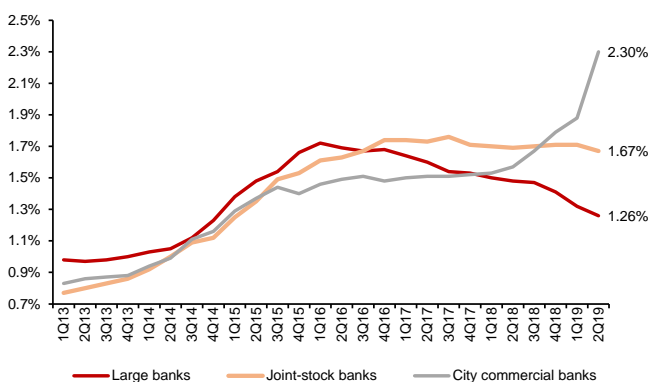
Source: CBIRC, CMBIS

Figure 10: NPL + SML ratio



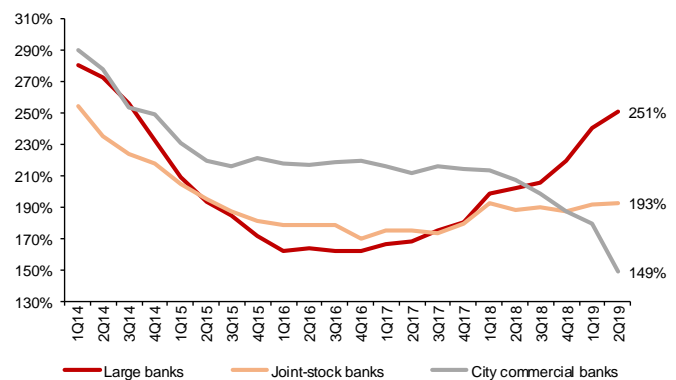
Source: CBIRC, CMBIS

Figure 11: NPL ratio

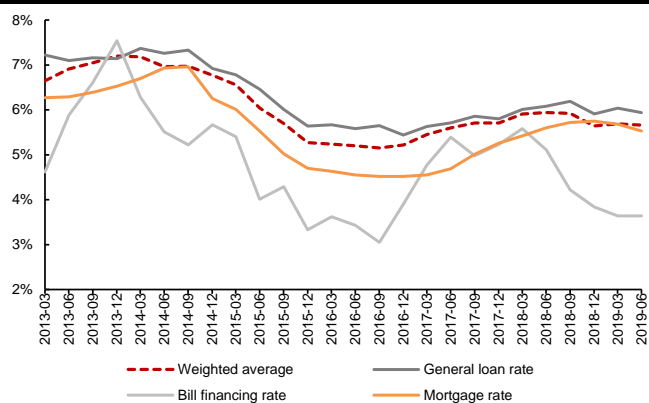


Source: CBIRC, CMBIS

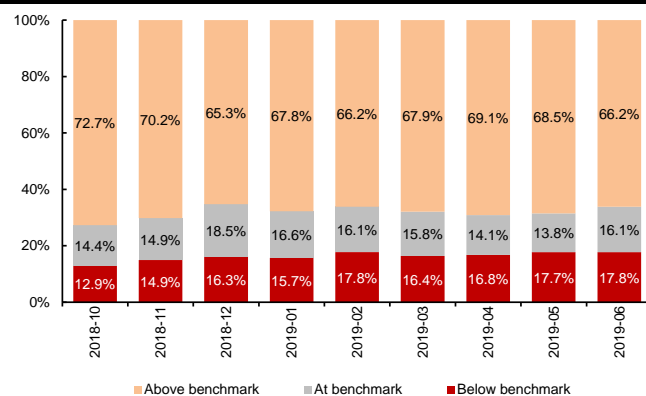
Figure 12: Provision coverage ratio



Source: CBIRC, CMBIS

Figure 13: Average lending rate

Source: PBoC, CMBIS

Figure 14: Proportion of loan priced vs benchmark

Source: PBoC, CMBIS

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