

# China Banking Sector

## Rising credit support from targeted RRR cut & ER rate cut

We see enhanced credit support in a more precise manner through PBoC's 1ppt targeted RRR cut for mid & small banks and lower interest rate for ER (excess reserve) for all financial institutions.

- **RRR cut of 1ppt for mid & small banks.** PBoC will lower RRR by 1.0ppt (0.5ppt each on 15 Apr and 15 May) to 6% for rural commercial banks, rural credit cooperatives, and village banks etc. According to the central bank's statement, this will release RMB400bn long-term funding and reduce bank's annual interest expenses by RMB6bn. Lower RRR will improve smaller banks' funding strength and lending capacity, especially to MSEs and industries affected by COVID-19. It will also facilitate LPR decline, despite less likelihood for benchmark deposit rate cut in near term (PBoC's deputy governor indicated on 3 Apr multiple factors still need to be assessed before cutting benchmark deposit rate).
- **Why target at rural banks?** 1) Rural banks have extensive and direct reach to MSEs, which are vulnerable to macro downturn and have imminent financing needs; 2) Regional small banks tend to face greater difficulties in deposit growth and bear higher funding cost vs large peers; 3) RRR cut will reduce potential liquidity and credit risks for smaller banks. We note that the spread of NCD issuance rates between large and small banks have widened in 1Q20.
- **Interest rate cut for ER will facilitate govt bond financing.** China banks' ERR (excess reserve ratio) has been declining since 2000, mainly due to improving efficiency in payment and settlement systems, and enhanced liquidity management ability of banks. However, 2.4% ERR as of 4Q19 was the peak in recent four years, implying banks' reluctance to extend credit in full force. Together with RRR cut, PBoC plans to lower interest rate on ER to 0.35% from current 0.72% on 7 Apr, aiming to promote the efficiency of funding usage. Recall that the last ER rate cut was in late 2008 during GFC, and banks' ERR fell to 1.55% in 2Q09 from 5.11% in 4Q08. This time around, we believe banks would deploy parts of ER to govt bonds, which have decent liquidity and little credit risk. It echoes authorities' initiative to kick off special treasury issuance and expand the scale for local govt special bond. Based on our estimate, reducing ERR to 1% and investing freed-up capital in govt bonds would boost FY20E NIM by 1bp and lift earnings by 0.8% for banks under our coverage.

### Valuation Table

Name	Ticker	Price (Local ccy)	TP (Local ccy)	Rating	P/B (x) FY20E	P/E (x) FY20E	Yield FY20E	ROE FY20E
ICBC	1398 HK	5.15	7.50	BUY	0.61	5.1	6.0%	12.5%
CCB	939 HK	6.13	9.10	BUY	0.60	5.0	6.1%	12.6%
ABC	1288 HK	3.05	4.70	BUY	0.50	4.4	7.0%	11.9%
BOC	3988 HK	2.93	4.60	BUY	0.43	4.1	7.6%	11.0%
PSBC	1658 HK	4.61	6.70	BUY	0.66	5.4	5.7%	12.7%
CITICB	998 HK	3.70	5.60	BUY	0.34	3.2	8.0%	11.0%
CEB	6818 HK	2.95	4.90	BUY	0.40	3.6	8.8%	11.8%
BoCom	3328 HK	4.64	6.20	HOLD	0.41	3.9	7.9%	10.9%
MSB	1988 HK	5.60	6.30	HOLD	0.45	3.9	7.7%	11.9%
PAB	000001 CH	12.61	19.80	BUY	0.81	7.9	2.0%	10.8%

Source: Bloomberg, CMBIS estimates

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### China Banking Sector

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#### Historical P/B of H-share China banks



Source: Bloomberg, CMBIS

#### Historical P/B of A-share China banks



Source: Bloomberg, CMBIS

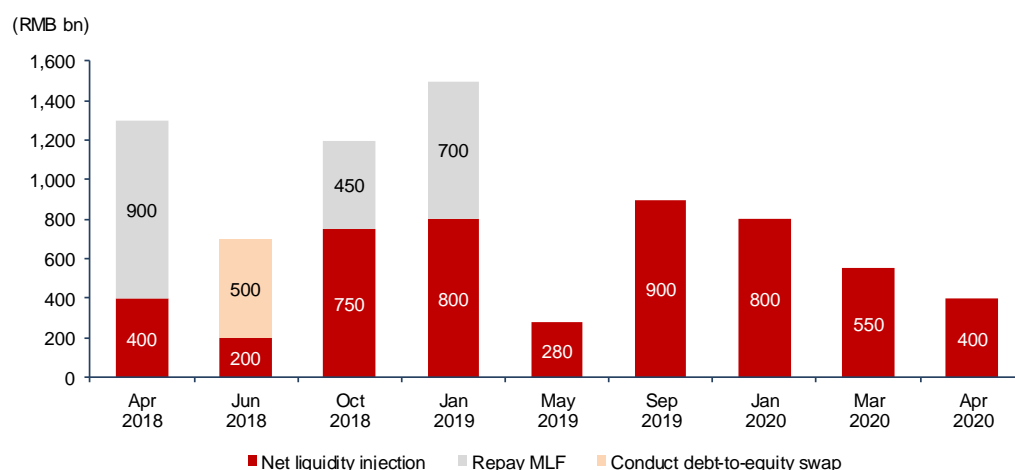
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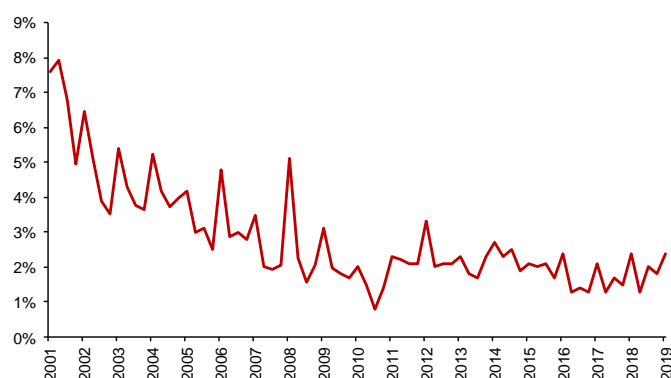
**Figure 1: Summary of RRR cuts since 2018**

Announcement date	Extent of RRR cut	Effective date	Target financial institutions	Funding released	Key objectives
17 Apr 2018	1.0ppt	25 Apr 2018	Large, joint-stock, city, non-county rural, & foreign banks	RMB1.3tn (RMB400bn after repaying MLF)	Repay MLF and increase banking system's funding stability
24 Jun 2018	0.5ppt	5 Jul 2018	Large, joint-stock, city, non-county rural, & foreign banks	RMB700bn	Support debt-to-equity swap and MSE loans
7 Oct 2018	1.0ppt	15 Oct 2018	Large, joint-stock, city, non-county rural, & foreign banks	RMB1.2tn (RMB750bn after repaying MLF)	Repay MLF, reduce banks' funding cost, and increase support for MSE and private enterprises
4 Jan 2019	1.0ppt	15 & 25 Jan 2019 (0.5ppt each)	All deposit-taking FIs	RMB1.5tn (RMB800bn after repaying MLF and RRR cut for inclusive finance); Reduce banks' annual interest expense by RMB20bn	Repay MLF, hedge liquidity fluctuation due to seasonal factor, and further increase support for MSE and private enterprises
6 May 2019	2-3ppt	15 May, 17 Jun, 15 July 2019	Around 1000 rural banks (operate within county level or total assets < RMB10bn)	RMB280bn	Implement lower RRR for mid&small banks and lower MSE financing cost
6 Sep 2019	0.5ppt broad-based cut; 1.0ppt targeted cut	16 Sep 2019 for broad-based RRR cut; 15 Oct & 15 Nov 2019 for targeted RRR cut	0.5ppt for all FIs (excl. finance, financial leasing & auto finance); 1.0ppt for city commercial banks operating within single province	RMB900bn (incl. RMB800bn for broad-based cut and RMB100bn for targeted cut); Reduce banks' annual interest expense by RMB15bn	Support real economy, lower social financing cost, and increase city commercial banks' support for MSE and private enterprises
1 Jan 2020	0.5ppt	6 Jan 2020	All FIs (excl. finance, financial leasing & auto finance)	RMB800bn; Reduce banks' annual interest expense by RMB15bn	Increase stable funding sources for financial institutions to support the real economy
13 Mar 2020	0.5-1.0ppt for large banks qualified for inclusive finance RRR cut; 1.0ppt for JSBs qualified for level-1 inclusive finance RRR cut	16 Mar 2020	Large, joint-stock, city, non-county rural, & foreign banks	RMB550bn (incl. RMB400bn for all banks and RMB150bn for qualified JSBs); Reduce banks' annual interest expense by RMB8.5bn	Give incentive for inclusive finance and increase support for JSBs
3 Apr 2020	1.0ppt for mid&small banks; Lower ER interest rate to 0.35% from 0.72%	15 Apr & 15 May 2020 (0.5ppt RRR cut each); 7 Apr 2020 for ER interest rate cut	Rural banks and credit cooperatives, village banks, and city commercial banks operating within single province (RRR cut); All FIs (ER interest rate cut)	RMB400bn; Reduce banks' annual interest expense by RMB6bn	RRR cut to reduce social financing cost and increase support to MSE; ER interest rate cut to improve efficiency of banks' funding usage

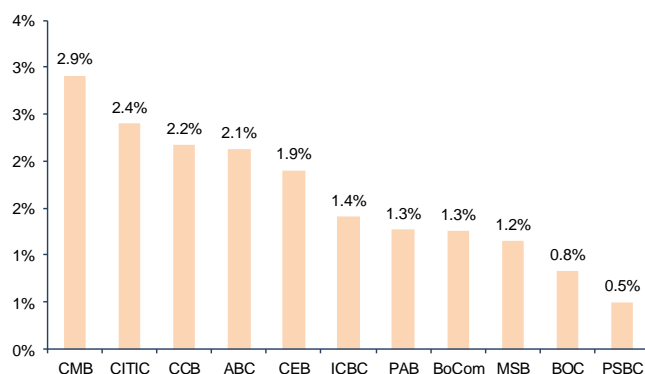
Source: PBoC, CMBIS

**Figure 2: Liquidity injection through RRR cuts since 2018**

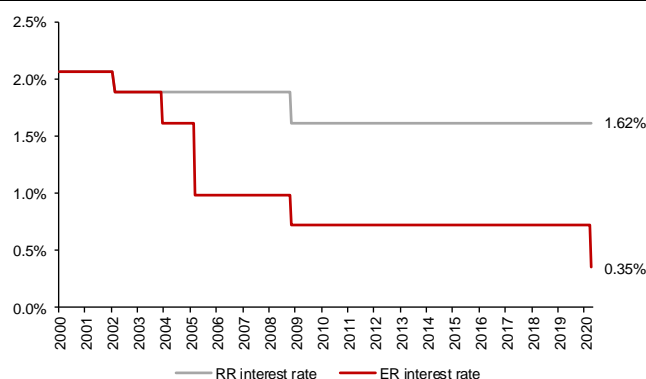
Source: Wind, CMBIS estimates

**Figure 3: Excess reserve ratio for China's financial institutions**

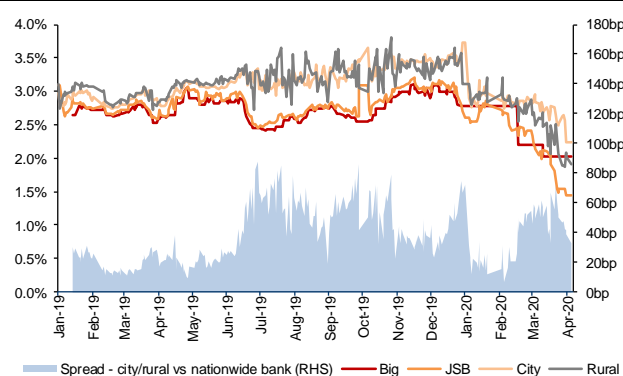
Source: Wind, CMBIS

**Figure 4: Excess reserve ratio for major China banks (as of 4Q19)**

Source: Company data, CMBIS

**Figure 5: PBoC's interest rate for banks' required and excess reserves**

Source: Wind, CMBIS

**Figure 6: Spread of NCD issuance rates between big and small banks increased in 1Q20**

Source: Wind, CMBIS

**Figure 7: Earnings impact if banks use ER over 1% to invest in gov't bonds**

(RMB mn)	FY19 total deposits	ERR	Capital freed up if ERR goes to 1%	Avg of 10Y treasury & LG bond yields	Increase in interest income	NIM impact	Net profit impact
ICBC	22,977,655	1.41%	93,115	2.80%	1,937	0.7 bp	0.43%
CCB	18,366,293	2.17%	215,013	2.80%	4,472	1.7 bp	1.16%
ABC	18,542,861	2.12%	208,178	2.80%	4,330	1.7 bp	1.25%
BOC	15,817,548	0.84%	-	2.80%	-	-	-
BoCom	6,072,908	1.25%	15,416	2.80%	321	0.3 bp	0.25%
PSBC	9,314,066	0.50%	-	2.80%	-	-	-
CITICB	4,073,258	2.40%	56,869	2.80%	1,183	1.7 bp	1.62%
MSB	3,637,034	1.15%	5,551	2.80%	115	0.2 bp	0.15%
CEB	3,017,888	1.91%	27,367	2.80%	569	1.1 bp	1.00%
PAB	2,459,768	1.27%	6,613	2.80%	138	0.3 bp	0.29%
<b>Average</b>		<b>1.50%</b>			<b>13,065</b>	<b>1.0 bp</b>	<b>0.77%</b>

Source: Company data, CMBIS estimates

**Figure 8: Valuation summary**

Company	Ticker	Mkt cap (bn)	Last Price	TP	Rating	P/B (x)		P/E (x)		Yield		ROE	
		(Local ccy)	(Local ccy)	(Local ccy)		2020E	2021E	2020E	2021E	2020E	2021E	2020E	2021E
H-share													
ICBC	1398 HK	1,962	5.15	7.50	BUY	0.61	0.56	5.1	4.8	6.0%	6.3%	12.5%	12.1%
CCB	939 HK	1,541	6.13	9.10	BUY	0.60	0.55	5.0	4.7	6.1%	6.5%	12.6%	12.3%
ABC	1288 HK	1,280	3.05	4.70	BUY	0.50	0.46	4.4	4.2	7.0%	7.3%	11.9%	11.6%
BOC	3988 HK	1,049	2.93	4.60	BUY	0.43	0.40	4.1	3.9	7.6%	8.0%	11.0%	10.7%
PSBC	1658 HK	478	4.61	6.70	BUY	0.66	0.60	5.4	4.8	5.7%	6.5%	12.7%	13.2%
CITICB	998 HK	246	3.70	5.60	BUY	0.34	0.31	3.2	2.9	8.0%	8.9%	11.0%	11.2%
CEB	6818 HK	194	2.95	4.90	BUY	0.40	0.37	3.6	3.2	8.8%	9.6%	11.8%	11.9%
BoCom	3328 HK	384	4.64	6.20	HOLD	0.41	0.38	3.9	3.8	7.9%	8.3%	10.9%	10.6%
MSB	1988 HK	268	5.60	6.30	HOLD	0.45	0.41	3.9	3.7	7.7%	8.2%	11.9%	11.7%
CMB	3968 HK	881	33.95	-	NR	1.19	1.05	7.8	7.0	4.1%	4.6%	16.2%	16.2%
Average						0.61	0.55	5.0	4.6	6.4%	6.9%	12.5%	12.3%
A-share													
ICBC	601398 CH	1,795	5.14	7.80	BUY	0.68	0.62	5.7	5.3	5.4%	5.7%	12.5%	12.1%
CCB	601939 CH	1,410	6.40	9.50	BUY	0.70	0.64	5.8	5.4	5.3%	5.6%	12.6%	12.3%
ABC	601288 CH	1,171	3.40	5.20	BUY	0.63	0.58	5.5	5.2	5.6%	5.9%	11.9%	11.6%
BOC	601988 CH	960	3.49	5.00	BUY	0.57	0.53	5.4	5.2	5.7%	6.0%	11.0%	10.7%
PSBC	601658 CH	437	5.26	7.20	BUY	0.84	0.76	6.9	6.1	4.5%	5.1%	12.7%	13.2%
CITICB	601998 CH	225	5.13	7.30	BUY	0.52	0.48	5.0	4.5	5.2%	5.7%	11.0%	11.2%
CEB	601818 CH	177	3.59	5.50	BUY	0.55	0.50	4.8	4.4	6.5%	7.1%	11.8%	11.9%
PAB	000001 CH	245	12.61	19.80	BUY	0.81	0.74	7.9	6.9	2.0%	2.2%	10.8%	11.2%
BoCom	601328 CH	352	5.17	6.50	HOLD	0.51	0.48	4.9	4.7	6.3%	6.6%	10.9%	10.6%
MSB	600016 CH	245	5.71	7.00	HOLD	0.51	0.47	4.5	4.2	6.8%	7.2%	11.9%	11.7%
CMB	600036 CH	806	32.15	-	NR	1.23	1.09	7.9	7.0	4.1%	4.6%	16.4%	16.6%
Average						0.71	0.65	5.9	5.5	5.2%	5.6%	12.5%	12.3%

Source: Bloomberg, CMBIS estimates; CMB's valuation is based on Bloomberg consensus.

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