

# China Banking Sector

## Banks' asset quality remained stable in 2Q22; LPR cut in line with market expectations

In 2Q22, banks continued to face NIM contractions, but the asset quality remained stable in spite of the headwinds from COVID restrictions. Earnings growth slightly slowed in 2Q22, dragged by NIM contractions and slower loan growth. The 15bps cut of 5-yr LPR and 5bps cut of 1-yr LPR on 22 Aug are in line with market expectations. We estimate the new round of LPR cuts will lower banks' FY22E/FY23E profits by 0.3%/2.5%, and the impacts will be manageable.

- Banks' asset quality remained stable in 2Q22.** Sector NPL ratio edged down 2bps QoQ to 1.67% at end-2Q22, and special mention loan ratio declined by 4bps QoQ to 2.27%. As SML ratio is a leading indicator on asset quality, in our view, NPL ratio will remain stable in 2H22. In 2Q22, NPL ratio of SOE banks, city commercial banks and rural commercial banks dropped 1bp, 7bps and 7bps QoQ respectively, while JSBs' NPL ratio remained flat. On the other hand, banks' provision coverage ratio increased 3.1pts QoQ, indicating enhanced buffer to weather through difficult market conditions. JSBs, city commercial banks and rural commercial banks enhanced provision coverage ratio by 2.5pts, 8.7pts and 3.9pts QoQ respectively, while SOE banks maintained thick provisions.
- Continual NIM contractions in 2Q22, but at a slower pace.** Sector NIM narrowed by 3bps QoQ to 1.94%, but at a slower pace compared to the 11bps contraction in 1Q22, likely thanks to the industry-wide deposit rate drop in 2Q22 under the regulators' guidance. SOE banks faced a NIM contraction of 4bps QoQ in 2Q22, and JSBs saw NIM decreased 2bps QoQ, while NIMs of city/rural commercial banks remained stable QoQ.
- Earnings growth slightly slowed in 2Q22.** In 1H22, banks' sector profits grew 7.1% YoY to RMB1.22 trillion, translating into 6.75% YoY growth in 2Q22, slightly slower than the 7.35% YoY growth in 1Q22. SOE banks and JSBs saw earnings growth slowed to 3.29%/8.96% YoY in 2Q22 (vs +8.75%/+10.24% YoY in 1Q22), while city commercial banks' profits growth rebounded to 15.29% YoY (vs 4.03% YoY decline in 1Q22).
- LPR cut in line with market expectation.** On 22 August 2022, PBOC lowered 1-yr LPR by 5bps to 3.65% and 5-yr LPR by 15bps to 4.30%. It is in line with market expectations. It is the 3<sup>rd</sup> LPR cut in 2022, following the rate cuts in Jan and May 2022. As the interest rates of infrastructure loans and most home mortgage loans are pegged to 5-yr LPR, and 85%-90% of the existing mortgage will be repriced in January next year, the impact on the interest income from existing mortgage will materialize starting from Jan 2023. We estimate the Aug LPR cut will lead to 0.3% drop of banks' profits in FY22E, and 2.5% cut of banks' profits in FY23E. And we expect the rate cuts are likely to stimulate the demand and ease concerns over asset quality.

### Valuation Table

Name	Ticker	Mkt cap (LC bn)	Rating	Close (LC)	TP (LC)	Upside	P/E FY22 E	P/B FY22 E	Yield
PSBC	1658 HK	481	BUY	4.88	8.40	72%	5.6	0.7	5.8%
CCB	939 HK	1,238	BUY	4.90	8.10	65%	3.8	0.5	8.0%
SPDB	600000 CH	212	HOLD	7.23	9.00	24%	4.1	0.4	6.1%
BOSH	601229 CH	83	BUY	5.85	8.68	48%	3.5	0.4	8.0%
CQRC	3618 HK	43	HOLD	2.69	3.05	13%	3.0	0.3	10.0%
BOCS	601577 CH	28	HOLD	6.94	8.30	20%	4.1	0.5	6.2%

Source: CMBIGM estimates based on 2022E earnings. Note: All closing prices are as of 22 August

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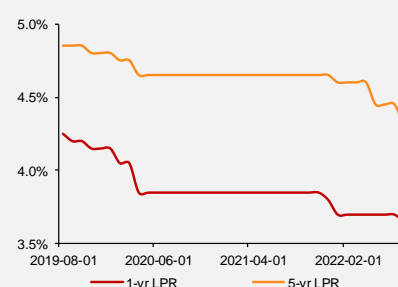
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### Stocks covered

Ticker	Rating	TP (LC)	Upside
1658 HK	BUY	8.40	43%
939 HK	BUY	8.10	45%
600000 CH	HOLD	9.00	12%
601229 CH	BUY	8.68	32%
3618 HK	HOLD	3.05	7%
601577 CH	HOLD	8.30	4%
601658.SH	BUY	7.07	38%
601939.SH	BUY	7.50	26%
601077.SH	HOLD	3.60	-8%

Source: CMBIGM estimates

### 1-Yr and 5-Yr LPR:



Source: CMBIGM estimates

### Recent Reports:

- China Banking – Looking for the safe harbour ([link](#))
- China Banking – Implications on loan and deposit rate cut ([link](#))
- China Banking – Scenario analysis on banks' balance sheet ([link](#))
- China Banking Sector – Expecting asset quality to deteriorate in 2H22 ([link](#))

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