

China Banking Sector

LPR reform within expectation; Earnings impact limited

SUMMARY. As a further step to merge the duo-track interest rate systems, PBoC aims to adjust the LPR mechanism for greater marketization and guiding effect on banks' lending rate. Despite a downward trend for LPR ahead, we see limited impact on banks' NIM and earnings.

- **Reform of LPR quotation system.** On 17 Aug, the PBoC's announced to adjust the mechanism of Loan Prime Rate (LPR), so as to improve the efficiency of interest rate transmission and lower the financing cost of real economy. Key measures include: 1) Increase no. of quotation banks to 18 from 10; 2) Reduce the quotation frequency to monthly from daily; 3) Cover more maturities by including >5-year tenor, in addition to current 1-year tenor; and 4) Change LPR's calculation method to adding certain bps on top of MLF rate, instead of self-determined by banks.
- **More market-oriented loan pricing.** As the pricing of new loans will be based on LPR onwards, we expect greater flexibility and volatility for banks' lending rate, better reflecting the movement of market rate. Also, the new LPR would be more representative after expanding the type of quotation banks. In particular, the risk-pricing ability will play a more significant role in banks' profitability.
- **All eyes on the first new LPR quotation.** According to the announcement, new LPR will be released for the first time on 20 Aug. Given the short time-span for banks to figure out the reformed mechanism, the first new LPR quotation may not deviate much from previous value. However, we believe PBoC will gradually guide down LPR by lowering MLF rate in coming months.
- **Earnings impact is manageable.** We believe PBoC's move was largely in line with market expectation, as interest rate reform has been frequently talked about by authorities in the past months. Different from benchmark interest change, only newly extended rather than outstanding loans will be based on LPR, therefore the impact to banks' NIM and profit should be mild. Banks with stronger loan pricing ability (retail-focused JSBs) and higher proportion of non-interest income would better withstand the earnings pressure, in our view. **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	4.96	7.60	BUY	0.64	5.1	5.9%	13.1%
CCB	939 HK	5.73	9.30	BUY	0.62	4.8	6.3%	13.4%
ABC	1288 HK	3.02	5.30	BUY	0.54	4.5	6.8%	12.7%
BOC	3988 HK	2.99	5.20	BUY	0.48	4.3	7.2%	11.5%
CITICB	998 HK	4.05	5.90	BUY	0.41	3.9	6.9%	10.9%
CEB	6818 HK	3.23	4.60	BUY	0.48	4.4	5.9%	11.5%
BoCom	3328 HK	5.27	6.40	HOLD	0.51	4.7	6.6%	11.3%
MSB	1988 HK	5.05	6.20	HOLD	0.44	3.8	7.9%	12.1%
PAB	000001 CH	14.90	17.00	BUY	1.03	9.3	1.1%	11.6%

Source: Bloomberg, CMBIS estimates

OUTPERFORM
(Maintain)

China Banking Sector

Terry Sun, CFA
(852) 3900 0836
terrysun@cmbi.com.hk

Karen Sui
(852) 3761 8775
suixiaomeng@cmbi.com.hk

Historical P/B of H-share China banks



Source: Bloomberg, CMBIS

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Figure 1: Changes in the LPR quotation system

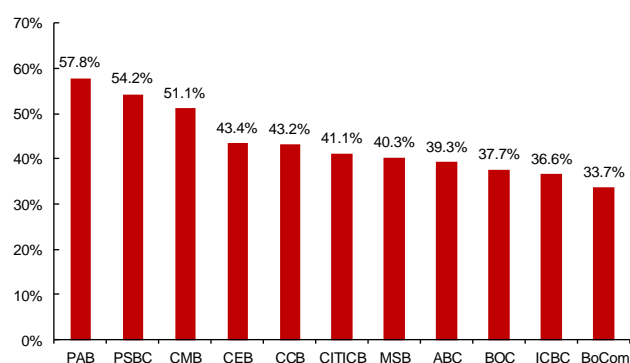
Change	New	Original
Bank	18 banks: 5 SOE banks, 5 JSBs, 2 city commercial banks, 2 rural commercial banks, 2 foreign banks, and 2 private banks	10 banks: 5 SOE banks and 5 JSBs
Frequency	Monthly: 9:30am on 20 th of every month	Daily: 11:30am on every trading day
Tenor	Two tenors: 1-year & >5-year	One tenor: 1-year
Calculation	LPR: Open market operation rate (MLF) + certain basis points (based on banks' funding cost, supply-demand dynamic, risk premium)	LPR: self-determined by banks
Implementation	Start from 20 Aug 2019	25 Oct 2013 to 16 Aug 2019

Source: PBoC, CMBIS

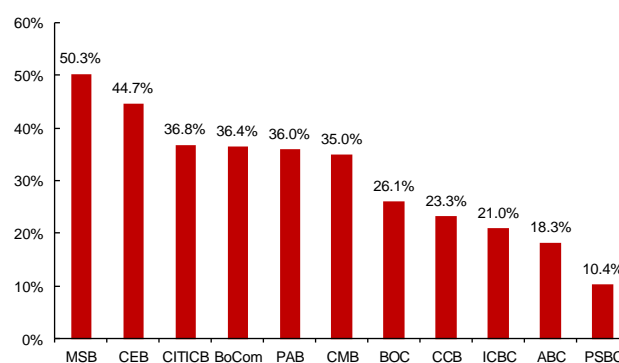
Figure 2: LPR quotation banks

No.	Banks	Type
1	ICBC	SOE bank
2	CCB	SOE bank
3	ABC	SOE bank
4	BOC	SOE bank
5	BoCom	SOE bank
6	CMB	Joint-stock bank
7	CITICB	Joint-stock bank
8	MSB	Joint-stock bank
9	Industrial Bank	Joint-stock bank
10	SPDB	Joint-stock bank
11	Bank of Taizhou	City commercial bank
12	Bank of Xi'an	City commercial bank
13	Shanghai RCB	Rural commercial bank
14	Guangdong Shunde RCB	Rural commercial bank
15	Standard Chartered (China)	Foreign bank
16	Citibank (China)	Foreign bank
17	WeBank	Private bank
18	MYBank	Private bank

Source: CFETS, CMBIS

Figure 3: Retail loan as of total loans (2018)

Source: Company data, CMBIS

Figure 4: Non-interest income as of total revenue (2018)

Source: Company data, CMBIS

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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