

SECTOR UPDATE

Banking – China

Majority Joint Stock Banks And State-owned Banks Have Lowered Deposit Rate By 10bp; Expect More Rate Cuts To Bolster Economy

The 1Q22 China Monetary Policy Report indicated that most of the banks in China have lowered their interest rates. The new weighted average deposit rate of China financial institutions in end-Apr 22 was 2.37%, decreasing 10bp from the previous week. Weak trade figures raise the risk of China's GDP shrinking. We expect more rate cuts to be taken to bolster the economy. Top picks are CMB (3968 HK) and CCB (939 HK) with a target price of HK\$82.9 and HK\$8.05 respectively. Maintain MARKET WEIGHT.

WHAT'S NEW

- **Market interest rate self-regulatory mechanism committee established a market-based adjustment mechanism for deposit interest rates.** Intense competition for deposits has caused most time deposits rate and large-denomination certificates rate to rise close to the self-regulatory ceiling. This has hampered the effective monetary policy transmission and in Apr 22, the PBOC advised the interest rate self-regulatory mechanism committee to construct a market-oriented deposit rate adjustment mechanism. Members of the self-discipline mechanism will adjust the level of the deposit interest rate based on the 10-year government bond yield and the one-year loan prime rate (LPR).
- Under this framework, banks can still independently decide on the actual adjustment range of their deposit interest rates based on their own conditions and changes in market interest rates. The PBOC will incentivise financial institutions that make effective and timely market-based adjustments to deposit interest rates eg further decreasing the deposit cost or adjusting the medium-term lending facility (MLF) rate. After the implementation of the new mechanism, banks' deposit interest rates will be more market-driven and help in stabilising debt costs and support further falls in loan interest rates, in line with declining market interest rates.
- **Most banks' deposit interest rates were reduced by 10bp in end-Apr 22.** Following the above changes, state-owned banks such as the Postal Savings Banks of China, China Construction Bank and the majority of joint-stock banks reduced the interest rates on their time deposits and large-denomination certificates deposit with maturity period of more than one year in end-Apr 22. In the final week of April (25 Apr 22 - 1 May 22), the China weighted average interest rate on new deposits in financial institutions was 2.37%, down 10bp from the previous week.
- The reduction of deposit interest rates will not affect demand deposits, only time deposits. We expect a 30% reprice of fixed deposits. According to our analyses, the sector's: a) NIM, b) interest income, c) net interest income, d) total revenue, and e) pre-tax profit will increase by 1.21bp, 0.58%, 0.43%, and 1.07%, respectively. Generally, banks with higher time deposit to total liability ratio will benefit more.
- **China cuts rate floors on mortgages for first-time homebuyers.** China's central bank and banking and insurance regulator on 15 May 22 moved to lower interest rate floors on mortgages for first-time homebuyers by 20bp off the benchmark LPR. We opine this will: a) help to lead local governments and banking institutions to further modify their credit policies, especially in terms of mortgage interest rates, b) aid real estate firms to actively promote and sell property, especially in combination with the recent advantages of low mortgage interest rates, encouraging real estate companies to fully drive the activity of real estate transactions, and c) further lower the cost of property buyers together with the recent easing of policies in many regions, as it can further relieve the pressure of property purchasers. This would generate improved conditions for active market transactions in mid-to-late May 22.

PEER COMPARISON

Company	Ticker	Rec	Price @	Target	Market	Upside/(Downside)	PE		P/B		P/PPOP		Yield		ROE	
			13 May 22	Price	Cap	to TP	2022F	2023F	2022F	2023F	2022F	2023F	2022F	2023F	2022F	2023F
			(lcy)	(lcy)	(lcy b)	(%)	(x)	(x)	(x)	(x)	(x)	(x)	(%)	(%)	(%)	(%)
CCB	939 HK	BUY	5.46	8.05	1,379.1	47.4	3.6	3.3	0.4	0.4	2.0	1.8	8.3	9.0	12.2	12.2
CMB	3968 HK	BUY	42.60	82.9	1,081.1	94.6	7.0	6.2	1.0	0.9	4.0	3.6	4.3	4.9	15.7	16.8

Source: Bloomberg, Wind, UOB Kay Hian

MARKET WEIGHT

(Maintained)

SECTOR PICKS

Company	Ticker	Rec	Share Price (HK\$)	Target Price (HK\$)
CCB	939 HK	BUY	5.46	8.05
CMB	3968 HK	BUY	42.60	82.9

Source: UOB Kay Hian

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ESSENTIALS

- Weak trade figures may result in a lower GDP, thus actions may be taken to bolster the economy.** As Shanghai's lockdowns tightened in Apr 22, China's export and import growth slowed significantly. Export slowed to 3.9% yoy (Bloomberg: 2.7% yoy, Mar: 14.7% yoy), the worst rate since Jul 20. For the second consecutive month, imports were unchanged at 0.0% yoy (Bloomberg: -3.0% yoy, Mar: -0.1% yoy). China's trade surplus increased to US\$51.12b in Apr 22 from US\$47.38b in Mar 22. The outlook for China's economic growth has continued to deteriorate as a result of the prolonged COVID-19 epidemic in Shanghai and other cities adopting a more severe containment strategy to prevent a potential rise in infections. Due to the disruptions on industry productions and logistics bottlenecks, trade activities will continue to be impacted at least until May 22. Import demand will also be badly affected by the lockdowns and high commodity prices arising from the Russia-Ukraine conflict. Thus, there is a growing downside risk to China's growth outlook.
- Hence we expect the PBOC to increase its monetary policy easing; the one-year MLF rate is likely to be reduced this month to stimulate credit demand, following a 25bp reduction in banks' reserve requirement ratio (RRR) on 25 April.**
- Previous RRR cut impact was not significant.** Effective from 25 Apr 22, China's central bank has cut the RRR for all banks by 25bp, small commercial banks and selected rural lenders will benefit from a further reduction of 25bp, releasing about Rmb530b in long-term liquidity and the weighted average RRR for financial institutions will be lowered to 8.1% after the cut. Although this will help nudge down bank lending rate, the reserve cut alone will have little impact to boost growth. To support credit growth, it needs to be followed up by cuts to policy rates and a relaxation of loan quotas. As the headwind builds, the government's 5.5% GDP growth target in 2022 may now be hard to achieve without more aggressive stimulus measures. To achieve the 5.5% growth target, we anticipate additional interest rate reduction in the near future.
- Expect another 10-15bp LPR reduction in 1H22.** Given China's sluggish economy, we anticipate the PBOC strengthening its monetary policy easing. Therefore, MLF will likely be cut this month. Historically, the PBOC has bolstered the economy by injecting liquidity into the banking sector through open market operations. The one-year LPR decreased by 30bp in 2020 (the worst year of COVID-19) from 4.15% to 3.85%. Since Nov 21, the LPR has declined by 15bp. If it decreases by a further 10bp in May 22, it would have dropped by a total of 25bp in six months, which is close to the decline in 2020. Thus, following the probable MLF reduction, this could indicate a 10-15bp LPR decline in 1H22.
- The reduction of deposit interest rates will only affect time deposits; hence we expect a 30% reprice of fixed deposits. As for loan, we assume 40% reprice of loans this year, if LPR is reduced by 10bp. According to our analyses, the sector's: a) NIM, b) interest income, c) net interest income, d) total revenue, and e) pre-tax profit will decline by 1.34bp, 0.65%, 0.470%, and 1.180%, respectively (refer to the table below). a) Postal Savings Bank of China, b) Bank of Guiyang, and c) Chongqing Rural Commercial Bank outperformed the other 42 banks.**
- The decline in real economy financing costs will produce substantial benefits for corporate operations and bank asset quality. Consequently, this will reduce the credit cost of the banking industry and maintain a stable profit growth rate.**

TOP 5 OUTPERFORMERS

NII top 5 outperformers	NIM top 5 outperformers	Total income top 5 outperformers	Pre-tax profit top 5 outperformers	Overall outperformers
Postal Savings Bank of China	Postal Savings Bank of China	Postal Savings Bank of China	Postal Savings Bank of China	Postal Savings Bank of China
Bank of Guiyang	Bank of Guiyang	Bank Of Nanjing	Bank Of Nanjing	Bank of Guiyang
Chongqing Rural Commercial Bank	Bank Of Nanjing	Bank of Guiyang	Bank of Guiyang	Chongqing Rural Commercial Bank
Bank Of Nanjing	Chongqing Rural Commercial Bank	Chongqing Rural Commercial Bank	Chongqing Rural Commercial Bank	
Changshu Rural Commercial Bank	Bank of Lanzhou	Bank of Ningbo	Shanghai Rural Commercial Bank	

Source: WIND, UOB KAY HIAN

ACTION

• **We maintain MARKET WEIGHT on the sector given the weak economy in China.**

The slowing economy is lowering loan demand, and the primary concern is asset quality. Although significant NIM compression is not a primary worry for the banking sector, banks have guided for NIM will remain compressed in 2022. Hence, we do not see any re-rating catalysts for the sector in the near term.

- **China Construction Bank (939 HK/BUY/Target: HK\$8.05).** We think CCB's valuation and dividend yield will be attractive to long-term investors. Its low valuation and above-average asset quality are good defensive plays. Maintain BUY with a target price of HK\$8.05, which is based on the Gordon Growth Model and which implies 0.58x 2022F P/B and a dividend yield of 8.3%.

- **China Merchants Bank (3968 HK/BUY/Target: HK\$82.90).** CMB is one of the best quality banks in China for its asset quality, strong private banking business and high reserve buffer. Maintain BUY. Based on the Gordon Growth Model, we derive our target price of HK\$82.90, which implies 1.90x 2022F P/B.

ASSUMING 10BP CUT ON BOTH LOAN RATE AND TERM DEPOSIT RATE

Bank	Mkt cap (Rmb)	NIM (%)	Net interest income chg	NIM chg x bps	Total income chg	Pre-tax profit chg
Industrial and Commercial Bank of China	1,612,265	2.11%	-0.61%	-1.29	-0.45%	-0.99%
China Construction Bank	1,188,429	2.13%	-0.70%	-1.48	-0.51%	-1.11%
Agricultural Bank of China	1,062,965	2.12%	-0.64%	-1.35	-0.51%	-1.24%
China Merchants Bank	929,529	2.48%	-0.78%	-1.93	-0.48%	-1.07%
Bank of China	890,429	1.75%	-0.83%	-1.45	-0.58%	-1.27%
Postal Savings Bank of China	495,839	2.36%	-0.13%	-0.30	-0.11%	-0.43%
Industrial Bank	415,484	2.29%	-0.68%	-1.56	-0.45%	-1.04%
Bank of Communications	347,827	1.56%	-0.86%	-1.34	-0.51%	-1.48%
Ping An Bank	283,132	2.79%	-0.55%	-1.54	-0.39%	-1.45%
Shanghai Pudong Development Bank	230,415	1.83%	-0.90%	-1.64	-0.64%	-2.06%
Bank of Ningbo	226,503	2.21%	-0.49%	-1.07	-0.30%	-0.78%
China CITIC Bank	206,717	2.05%	-0.81%	-1.67	-0.59%	-1.84%
China Everbright Bank	158,624	2.16%	-0.50%	-1.09	-0.37%	-1.07%
China Minsheng Bank	150,142	1.91%	-0.74%	-1.40	-0.55%	-2.60%
Bank Of Nanjing	110,070	1.88%	-0.31%	-0.58	-0.20%	-0.43%
Bank Of Jiangsu	103,092	2.28%	-0.57%	-1.30	-0.41%	-0.98%
Bank of Beijing	94,298	1.83%	-0.74%	-1.36	-0.58%	-1.52%
Bank of Shanghai	91,207	1.74%	-0.53%	-0.92	-0.38%	-0.90%
Bank Of Hangzhou	87,709	1.83%	-0.58%	-1.06	-0.42%	-1.16%
Huaxia Bank	81,091	2.35%	-0.69%	-1.63	-0.57%	-1.75%
China Zheshang Bank	68,568	2.27%	-0.74%	-1.68	-0.57%	-2.07%
Shanghai Rural Commercial Bank	60,664	1.86%	-0.45%	-0.84	-0.36%	-0.72%
Bank of ChengDu	60,469	2.13%	-0.46%	-0.98	-0.37%	-0.75%
Chongqing Rural Commercial Bank	40,518	2.17%	-0.28%	-0.62	-0.24%	-0.67%
Bank Of Changsha	29,438	2.40%	-0.43%	-1.03	-0.33%	-0.87%
Bank of Lanzhou	26,998	1.72%	-0.43%	-0.73	-0.33%	-1.66%
Bank of Suzhou	23,700	1.91%	-0.46%	-0.88	-0.32%	-0.89%
QILU BANK	23,637	2.02%	-0.43%	-0.88	-0.32%	-0.97%
Bank of Guiyang	22,157	2.26%	-0.25%	-0.57	-0.22%	-0.48%
Changshu Rural Commercial Bank	21,433	3.06%	-0.39%	-1.20	-0.34%	-0.97%
Bank of Chongqing	20,231	2.06%	-0.45%	-0.93	-0.36%	-0.86%
Bank of Qingdao	19,563	1.79%	-0.61%	-1.09	-0.42%	-1.45%
Bank of Zhengzhou	19,280	2.31%	-0.47%	-1.09	-0.38%	-1.42%
Qingdao Rural Commercial Bank	18,000	2.16%	-0.52%	-1.13	-0.41%	-1.27%
Bank of Xi'an	16,356	1.91%	-0.46%	-0.87	-0.38%	-0.89%
Xiamen Bank	15,386	1.62%	-0.81%	-1.31	-0.67%	-1.51%
Bank of Ruifeng	12,256	2.34%	-0.51%	-1.18	-0.46%	-1.11%
Wuxi Rural Commercial Bank	10,760	1.95%	-0.40%	-0.78	-0.32%	-0.79%
Rural Commercial Bank of Zhangjiagang	10,718	2.43%	-0.41%	-0.99	-0.32%	-1.09%
Zijin Rural Commercial Bank	10,434	1.83%	-0.65%	-1.19	-0.57%	-1.44%
Suzhou Rural Commercial Bank	9,556	2.24%	-0.59%	-1.32	-0.47%	-1.42%
Jiangyin Rural Commercial Bank	9,101	2.14%	-0.50%	-1.07	-0.42%	-1.07%
Average	221,785	2.07%	-0.65%	-1.34	-0.47%	-1.18%

Source: WIND, UOB KAY HIAN

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