China / Hong Kong Industry Focus

Hong Kong Banking Sector

Refer to important disclosures at the end of this report

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Catching the interest rate hike cycle

HSI: 22,419

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- **Interest rate hike in HK may be higher than expected in 2H22, benefiting HK banks**
- **Expect HK economy recovery in 2H22 to support loan growth and asset quality**
- **Weak CNY/HKD and better stock market outlook in 2H22 supportive of HK bank performance**
- **Valuation still attractive; prefer BOCHK (2388 HK) to HSB (11 HK) with BUY on both**

HK interest rate hike might be higher than expected. HK banks' share performance is highly correlated with US and HK interest rate movements. While HK interest rate hikes usually lag US movements by a few months, and the aggregate balance remains high now, we expect the HIBOR might rise faster than expected, with signs that the HK interest rate swaps (IRS) and 12M-HIBOR are increasing sharply. Our house view expects the 1M-HIBOR to reach 2.28% by the end of the year.

Looking for steady HK economy recovery in 2H22. Our house view expects a 1.7% y-o-y growth in HK GDP in 2022, among the higher end of the government's guidance of 1%-2%. HK banks will benefit from 1) loan growth: We expect a steady 5%-6% y-o-y loan growth in HK, despite higher interest; and 2) improving asset quality. Also, the relatively weaker CNY/HKD is also supportive to HK banks' performance. Fee income was largely affected by the market volatility in 1H22, but we expect it to show a recovery trend in 2H22. We expect more expansion potential in 2023 for HK's GDP recovery and cross-border business, with border reopening the potential catalyst.

Positive sector view and prefer BOCHK (2388 HK). Overall, we are positive about the HK banking sector, as we have a positive outlook on its primary share price drivers and expect a recovery in ROE and profit growth in FY22/23F from the low base in FY21. We believe the positives are not yet fully priced in, given the sector is still trading below its five-year average. Among the names we cover, we prefer BOCHK (2388 HK) for the best asset quality among peers, and a strong loan growth pipeline. We also recommend BUY for HSB (11 HK), as it is the major beneficiary of the interest rate hike.

Recommendation & valuation

Company Name	Price HK$	Target Price Local$	Recom	Mkt Cap US$m	PE 23F x
BOCHK (2388 HK)	31.55	37.40	BUY	42,507	9.7
HSB (11 HK)	138.20	163.00	BUY	33,671	12.9

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")

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More positive view on impact of interest rate hikes

Interest rates are one of the primary share price drivers of the Hong Kong banking sector. We have made a Hong Kong banking sector index, which is the average performance of six Hong Kong or regional banks (Fig 1) relative to the HSI. We set the beginning date of 1 Jan 2005 as 1 for the index. Thereafter, above 1 indicates a relative outperformance compared to the HSI, while below 1 indicates an underperformance.

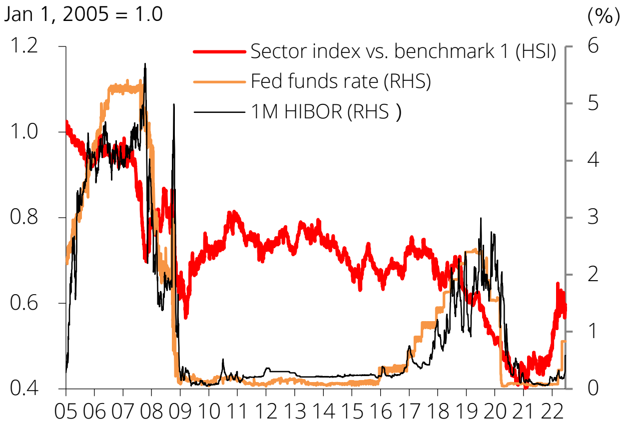
We found that interest rates, including both the US (Fed Funds) and HK (HIBOR) rates, are one of the primary share price drivers of the sector (Fig 2).

Fig 1: Stocks included in the banking sector index

	Ticker	Stock name
Stock 1	5 HK Equity	HSBC
Stock 2	11 HK Equity	Hang Seng Bank
Stock 3	23 HK Equity	Bank of East Asia
Stock 4	2356 HK Equity	Dah Sing Bank
Stock 5	2888 HK Equity	Standard Chartered
Stock 6	2388 HK Equity	BOCHK

Source: DBS HK

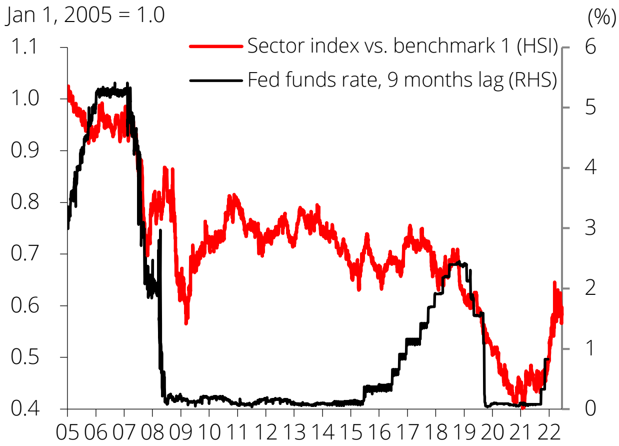
Fig 2: Sector performance vs. interest rates



Source: Bloomberg Finance L.P., DBS HK

In fact, sector performance reacts when there's an expectation of an interest rate movement, ahead of the real change in interest rates. The interest rate shows higher correlation of 0.66 compared with 0.6 with sector performance if we use the 6-month lag data (Fig 3) instead of the original data. After years of unexciting performance, the HK banking sector was performing strongly recently, in expectation of the US interest rate hike cycle to carry on into 1H23, indicating that HK banking sector is likely to continue to outperform in 2H22, if the share price movement is usually around 6 month ahead of the real interest rate change.

Fig 3: A higher correlation with sector performance if we use Fed fund rate 6 months lag



Source: Bloomberg Finance L.P., DBS HK

We have also conducted a correlation study between individual share price performance and the US/HK interest rate from 2017 until now (Fig 4). Key findings are: 1) All banks' share price performances, especially that of HSB and HSBC, show a significant correlation with the interest rates, while BOCHK may have a higher exposure to the RMB and a relatively lower correlation with the US/HK interest rates; 2) the correlation with the US rate is higher than that of the HK rate, which can be explained by the time lag between the HK and US rate movements and the share price movements reacting to "expectation" rather than actual interest rate revisions; and 3) banks, in general, show higher correlation with the 3M HIBOR, while the difference between the 1M and 3M US rates is not significant, which might be because the 3M HIBOR usually moves earlier than the 1M HIBOR.

Fig 4: Share price correlation with interest rates since 2017

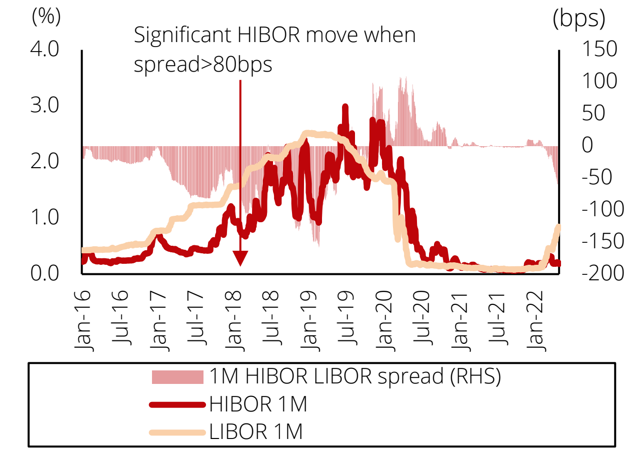
	1M HIBOR	3M HIBOR	1M Fed Rate	3M Fed rate
HSB	0.56	0.60	0.83	0.81
BOCHK	0.21	0.29	0.58	0.60
HSBC	0.40	0.48	0.73	0.74
SCB	0.34	0.40	0.62	0.63

Source: Bloomberg Finance L.P., DBS HK

More upside in HK interest rate in 2023 due to the lagging effect. The HK interest rate moved a few months later than the LIBOR and Fed Funds Rate in past interest rate cycles. While the Fed rate has climbed from 0.08% to 1.58% YTD, 1M HIBOR movement was much smaller, from 0.15% to 0.87% (Fig 5).

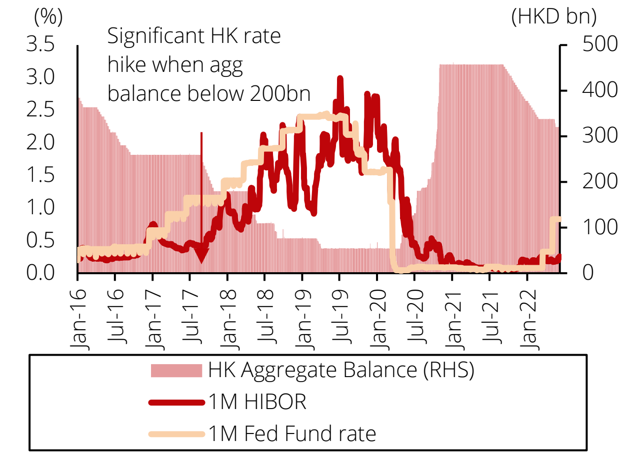
To stabilise the HKD, which is has been trading at around 7.84-7.85 against the USD lately, HKMA will soon have to issue Exchange Fund Bills and Notes or buy HKD to extract liquidity in the market. Though the aggregate balance has dropped quickly from HKD 320bn to HKD 230bn in recent two weeks, there's still plenty of interbank liquidity in Hong Kong. During the previous rate hike cycle, the HK interest rate showed a more significant hike when the aggregate balance fell to lower than the HK$200bn level or the HIBOR-LIBOR spread was higher than 80bps to create enough room for arbitrage (currently c.65bps). There may still be more time till we see a significant hike in the HK interest rate. As such, the market generally expects the more positive impact on HK banks to be felt in 2023, while the impact in 2H22 will be lower.

Fig 5: HIBOR vs. LIBOR



Source: Bloomberg Finance L.P., DBS HK

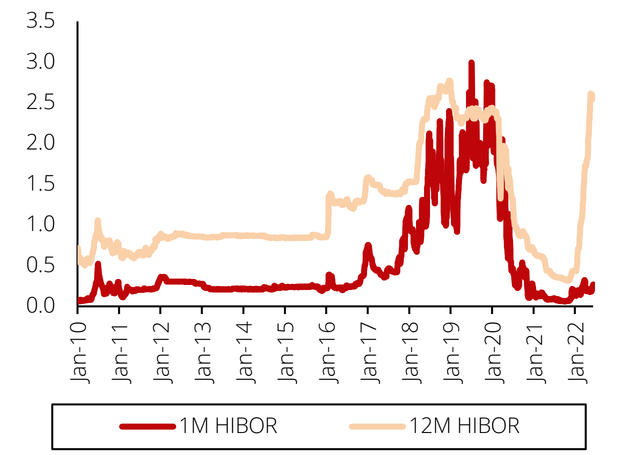
Fig 6: HIBOR vs. Fed Funds Rate and aggregate balance



Source: Bloomberg Finance L.P., DBS HK

But what's the difference between this round and the 2016-18 interest upward cycle? While the market has mostly followed the pattern seen during 2016-18 to forecast the HK interest rate movements, our house view expects a higher rate hike. This time, the pace of the US interest hike is much faster than the previous round and so the time lag between the HK and US rates may be shorter. In our house view, the Fed Funds Rate Target will increase from 0.5% to 3.5% by the end of this year. 1M-HIBOR is expected to reach 2.28% by end-2022. Supportive signals include 1) the 12M-HIBOR, a longer-term indicator of interest, which has already leapfrogged from 0.43% in early Jan to 3.29% lately; and 2) the climbing interest rate swap on HIBOR.

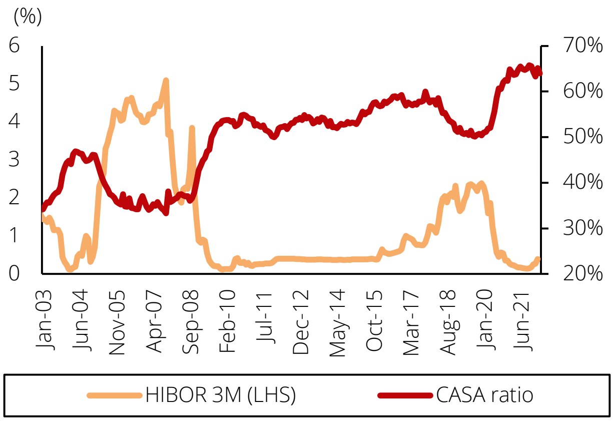
Fig 7: 12M-HIBOR indicates a higher HK rate outlook



Source: Bloomberg Finance L.P., DBS HK

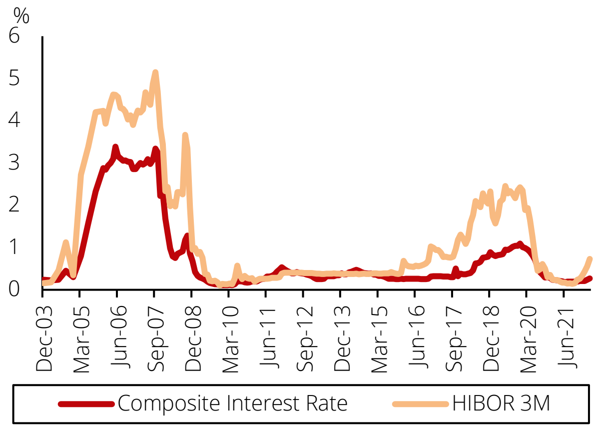
Positive impact on HK banks' NIM and NII. We expect the interest hike in loan yield to exceed that of deposit funding costs, which indicates a higher NIM for HK banks. Though the CASA ratio is highly negatively correlated with HIBOR movements and we expect it to further drop in 2022, it's likely to be higher than 50%, according to the pattern seen in 2016-2018 (Fig 8). This indicates a controllable increase in funding costs, as there's usually no interest cost in CASA. Overall, we see funding costs trending the same as the HIBOR 3M, but the extent of movement tends to be lower (Fig 9).

Fig 8: CASA ratio >50% during previous interest rate hike



Source: Bloomberg Finance L.P., DBS HK

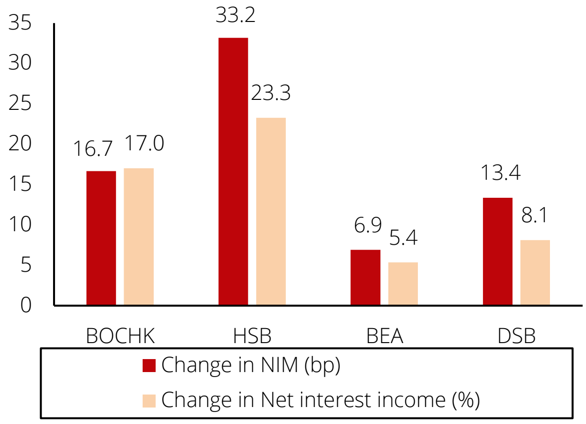
Fig 9: Funding cost movement lower than HIBOR 3M



Source: CEIC, Bloomberg, DBS HK

HSB has the highest NIM sensitivity to HIBOR movement. If all others remain the same, we estimate HK banks to see 5%-24% higher NII and 7%-33% bps higher NIM if HIBOR increases by 100bps, based on FY21's data (Fig 10). Among them, HSB would benefit the most from the HIBOR hike, as it has higher exposure to the relevant currencies (e.g., HKD and USD). It has 69% of its FY21 assets in HKD, which is the highest among its peers.

Fig 10: FY21 HK bank sensitivity to 100bp HIBOR hike

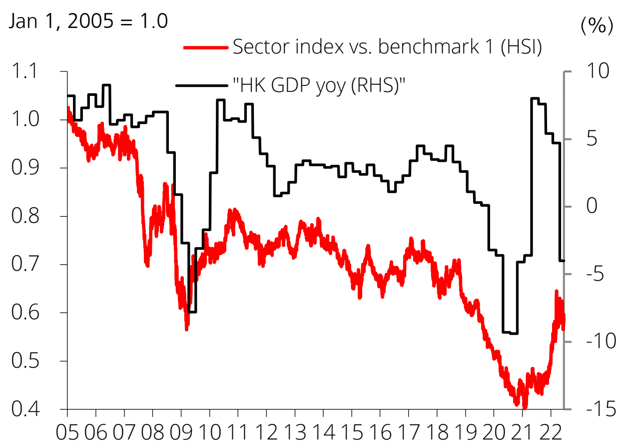


Source: Corporates, DBS HK

A 1.7% y-o-y growth in HK GDP in 2022F to drive up banks' performance

HK GDP as another share price driver. The HK banking sector's performance relative to GDP showed a high positive correlation of c.0.73 during 2005 to 2021 (Fig 11). It's easy to understand, as GDP growth affects banks' loan growth and asset quality, and thus affects the banks' revenue and costs.

Fig 11: HK GDP vs. sector performance



Source: Bloomberg Finance L.P., DBS HK

Positive outlook in 2H22. Despite a weak 1Q22 due to the impact from the fifth wave of Omicron, our house view expects a 1.7% y-o-y growth in HK GDP in 2022, which is in the higher end of the 1%-2% GDP growth expected by the government and higher than the market consensus. We expect the HK GDP growth to further expand to 2.7% y-o-y growth in 2023. Meanwhile, our house view expects the unemployment ratio to drop below 5% in 2H22. Yet, a stronger recovery of GDP growth will only be seen after the border between Hong Kong and mainland China is reopened, which is not expected to happen this year.

Fig 12: DBS view on HK GDP growth

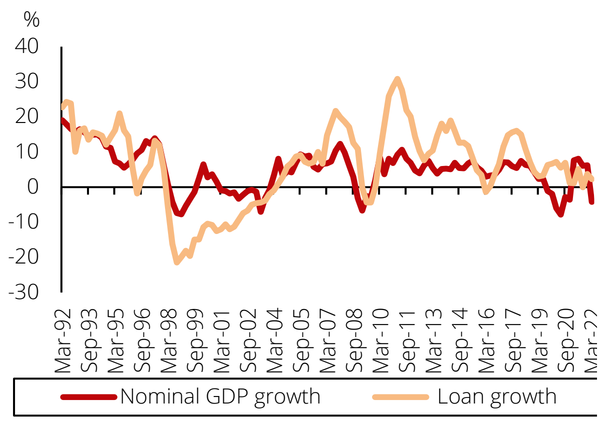
	1Q22	2Q22F	3Q22F	4Q22F
GDP	-4.0	-0.6	4.3	6.7
Unemployment ratio	5.0	5.1	4.5	3.7

Source: Bloomberg Finance L.P., DBS HK

Following a positive outlook on HK's economic growth in 2022, we expect HK banks to benefit from two major aspects:

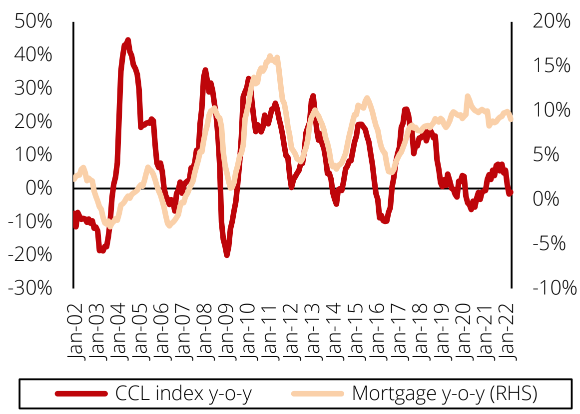
1) Expect loan growth to recover to mid-single digit. We found a high positive correlation of c.0.67 in the long run between nominal GDP growth and loan growth in HK (Fig 13). Though the higher interest rate will have a marginally negative impact on credit demand, we see economic recovery as the primary driver of loan growth in 2H22. HK total loans showed a c.2.2% y-o-y growth in 1Q22, despite the turbulence in GDP growth. This is supported by steady mortgage loan growth in 1Q22 (Fig 14). Although the Centa-City Leading (CCL) Index (based on current contract prices in Centaline Property Agency transactions) has trended by 4% lower in 1Q22, mortgage demand remains stable with 1% growth in the same period. Looking ahead, we expect HK banks' loan growth to rebound to 5%-6% y-o-y in 2022 and an even higher expansion in 2023 from 3.8% as of end-2021.

Fig 13: HK loan growth positively correlated with GDP growth



Source: Bloomberg Finance L.P., DBS HK

Fig 14: Mortgage loans maintained solid growth

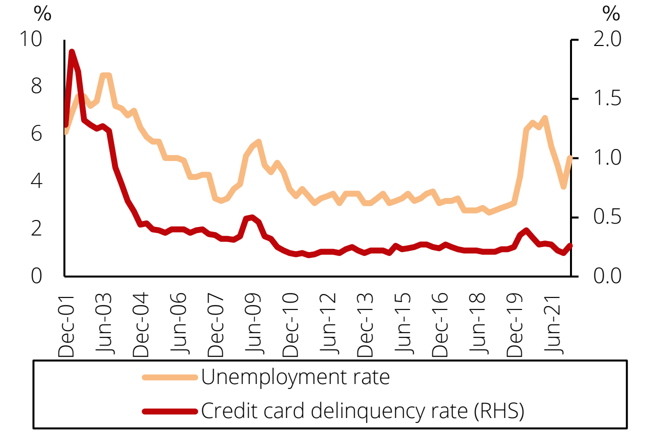


Source: Bloomberg Finance L.P., DBS HK

2) Benign asset quality

On the retail loan side, the unemployment ratio is a good indicator of retail loan asset quality. The credit card delinquency rate in HK improved from the recent peak of 0.39% in Jun 2020 to 0.2% by the end of 2021, and deteriorated again to 0.26% in 1Q22, with the unemployment ratio increasing to 5% from 3.8% in the same period (Fig 15). Looking ahead, we expect asset quality to improve in 2H22 from 1Q22, with the expectation of a dropping unemployment ratio.

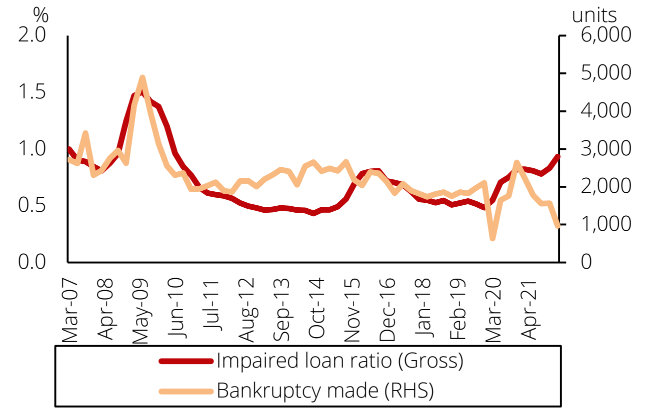
Fig 15: Unemployment rate vs. credit card charge-off



Source: Bloomberg Finance L.P., DBS HK

On the corporate loan side, we see the bankruptcy ratio as an indicator; it is trending the same as the impaired loan ratio in the long run (Fig 16). Again, despite the volatility in 1Q22, the impaired loan ratio has stabilised from the upward trend in 2020. The bankruptcy cases in HK declined by 41% y-o-y in 2021 and dropped by 56.2% y-o-y in 1Q22. This is a positive signal. We expect the good momentum to carry on over the rest of the year and improve banks' asset quality.

Fig 16: Impaired loan ratio vs. bankruptcy cases

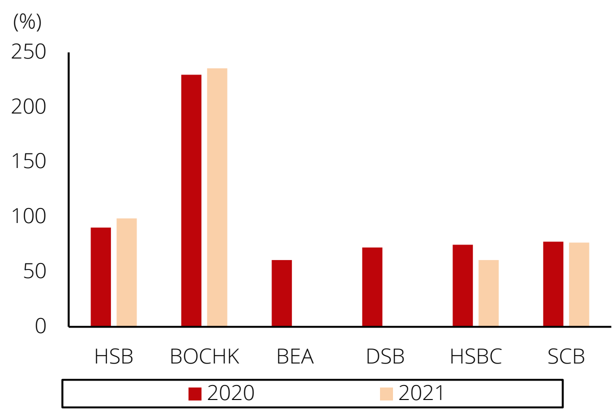


Source: Bloomberg Finance L.P., DBS HK

Exposure to areas of concern controllable. The key area of concern in terms of credit risk for HK banks is China property sector exposure. For example, HSB and BOCHK have c.RMB75-100bn in exposure to the China property sector, or roughly 6%-7% of their total loans. There will still exert short-term pressure in this sector due to a higher NPL ratio, but we expect steady development in the long run, with the government loosening policy restrictions on the China property sector.

In general, local asset quality in HK is stable with a low NPL ratio, while exposure to some other regions, like Russia or Southeast Asia, would be a potential risk. While we do predict a higher ECL in 1H22 in these regions, given the relatively small exposure, we expect the risks are controllable overall. Among the major peers, BOCHK reports the highest loan loss coverage ratio in 2020-21, indicating a more resilient risk profile.

Fig 17: Provision coverage ratio

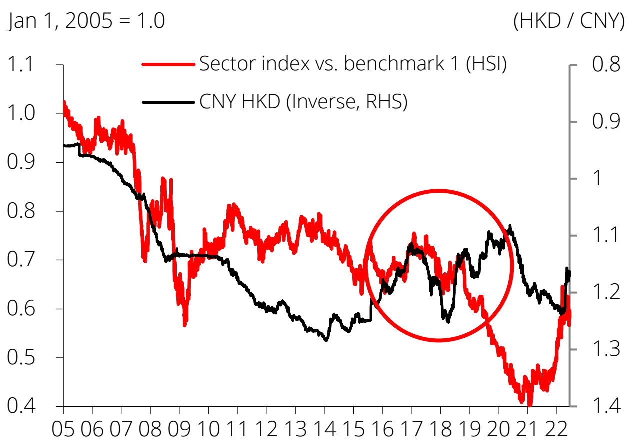


Source: Corporate, DBS HK

Weaker CNY supportive of sector performance

CNY/HKD is another critical factor. From our empirical research, we found the CNY/HKD also shows some correlation with the HK bank sector's performance (Fig 18). For example, during the last interest upward cycle in 2016-18, though the interest rate kept the upward trend, sector performance was weak in 2017-18, trending alongside a stronger CNY.

Fig 18: CNY impact on sector performance

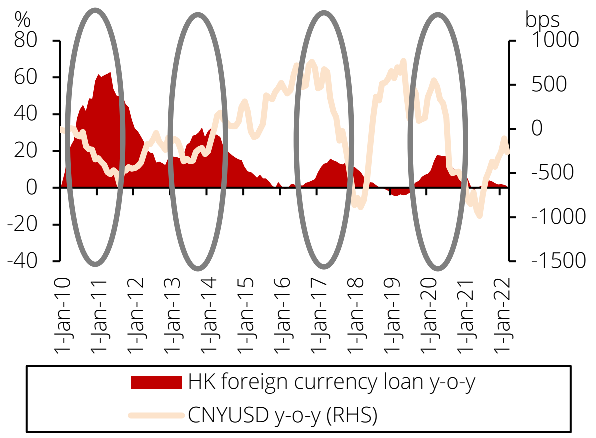


Source: Bloomberg Finance L.P., DBS HK

A weaker CNY may lead to weaker FX loan growth, but HK banks have higher RMB exposure on the liability side. We have seen a strong negative correlation of c.-0.6 between HK banks' FX loans and USD/RMB movements. FX loans showed strong growth when the RMB showed a strong appreciation trend towards the USD (downward trend as shown in Fig 19). As the RMB gets weaker and domestic interest rate declines, China corporates have lower incentives to engage in offshore lending. As such, we expect weaker FX loan growth in HK in 2022.

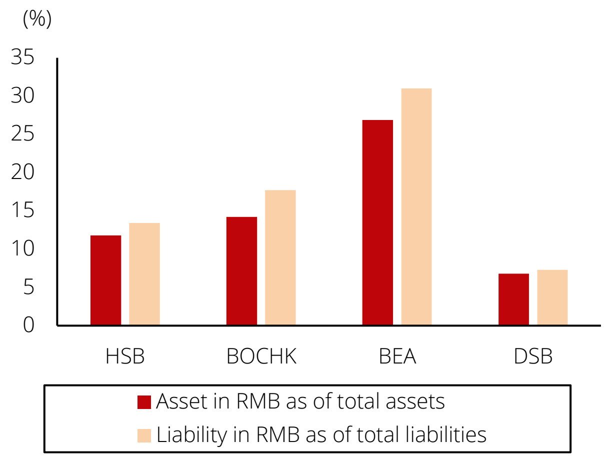
However, on the other hand, though the weaker RMB has some marginally negative impacts on banks' assets, the impacts on the liability side would be higher, given all major HK banks have higher exposure to RMB liabilities than RMB assets (Fig 20). The cost side would drop more than the asset side, indicating an overall positive impact on banks' earnings. Usually, currency movements tend to be linked with interest rate changes. When the CNY depreciates, it implies a lower interest rate in China and lower funding costs as well if HK banks absorb RMB deposits.

Fig 19: Weaker FX loan growth with weaker RMB



Source: Bloomberg Finance L.P., DBS HK

Fig 20: FY21 RMB exposure in assets and liabilities



Source: Corporates, DBS HK

Expect weak CNY to be supportive to HK banks' performance. Looking ahead, our house view expects CNY/USD to reach 6.85 in 3Q22 and gradually drop to 6.7 by 2Q23. We expect the CNY to remain weak in 2022. The expected recovery in 2023 is also quite mild. This would be supportive to HK banks' performance, based on our previous analysis.

Fig 21: DBS house view on RMB rate

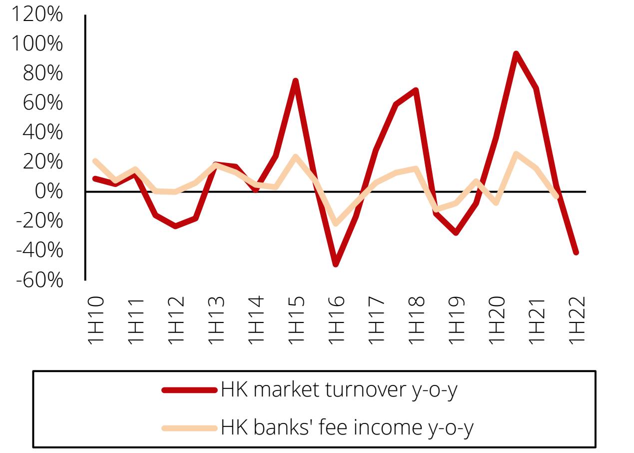
	3Q22	4Q22	1Q23	2Q23
CNY/USD	6.85	6.80	6.75	6.70

Source: Corporates, DBS HK

Looking for better fee income performance in 2H22

Challenging environment for fee income in 1H22. Apart from the NII, fee income takes up around 18%-25% of the total income of HK banks in FY20/21. The growth of total fee income in major HK banks shows a high correlation of 0.74 with the HK market's trading volume (Fig 22). The fifth wave of COVID-19, uncertainties from geopolitics, and the expectation of US interest hikes brought high market volatility to 1H22. 1H22 saw a c.41% y-o-y drop in HK market transaction volume, which is the second worst half-year performance since 2010, only better than -49% in 1H16. In 1H16, HK banks' fee income declined by c.21.7% y-o-y. We expect fee income growth in 1H22 to also be under high pressure, following an already weak 2H21, which saw a 2.9% y-o-y decline.

Fig 22: HK banks' fee income vs. HK market turnover



Source: Corporates, Wind, DBS HK

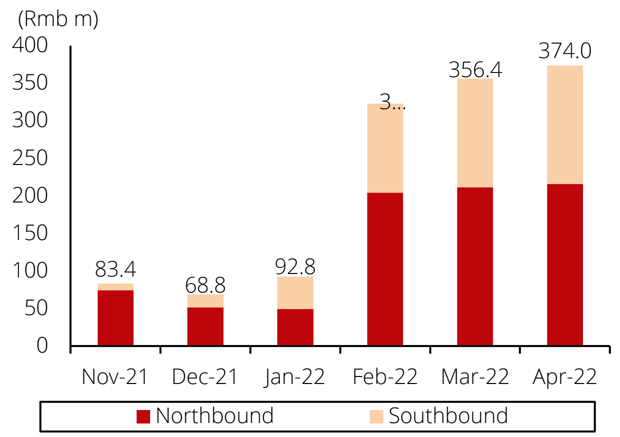
Expect a better 2H22. We expect a recovery in HK market transaction volume in 2H22 compared with 1H22, with the positive outlook on HK economy recovery. Looking back at the last interest hike cycle, we saw 2H16 HK market transaction volume decline by c.17% y-o-y. Though it was a y-o-y decline, the extent of the drop was better than in 1H16. We are expecting a similar pattern this year, especially as the HK market valuation is already near the bottom and very attractive now.

Wealth Connect is a long-term opportunity. Despite the recent market fluctuations and closed HK/China border, we believe the Wealth Management Connect (WMC) scheme in the Greater Bay Area (GBA) will provide a long-term growth opportunity for HK banks. We expect the aggregate quota ceiling for WMC will be removed, similar to Stock Connect.

Additionally, the potential income contribution is more than RMB3bn, assuming a 1% management fee charged from selling financial products based on an RMB300bn aggregate quota. Other fee income would come from RMB settlements, custody fees, and channel fees from selling wealth management products issued by third-party financial institutions. Thus, this offers an upside to HK/China banks' fee income. (For more details, pls refer to our report on the China Financial Sector released on 29 Jul 2021.)

In Feb-Apr 2022, the monthly trading value of WMC was around c.RMB320-370m, of which around 60% was from northbound investors. The WMC value was less than 0.2% of the total quota for both northbound and southbound investment. As some account openings and sales and promotion activities require face-to-face communication, we believe the development potential will be further unlocked after the border reopens.

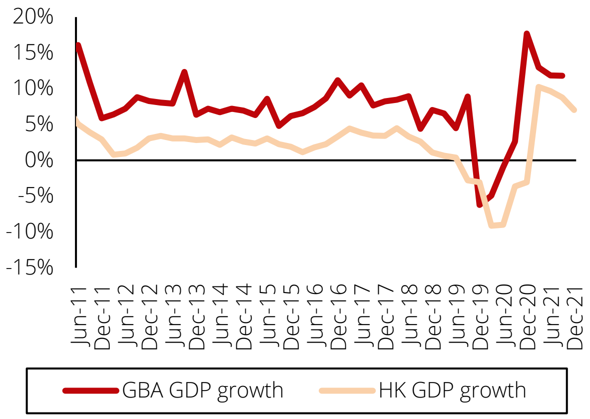
Fig 23: Monthly WMC value



Source: PBOC Guangzhou Branch, DBS HK

GBA's GDP growth has been strong, at an average of 7% per annum during 2014-2021, vs. HK at 2% (Fig 24). We expect increasing cross-border investments and transactions as well as the border reopening in 2023 to bring more fee income opportunities to HK banks. Various HK banks are prepared with talent, product offerings, and account opening processes to seize this opportunity.

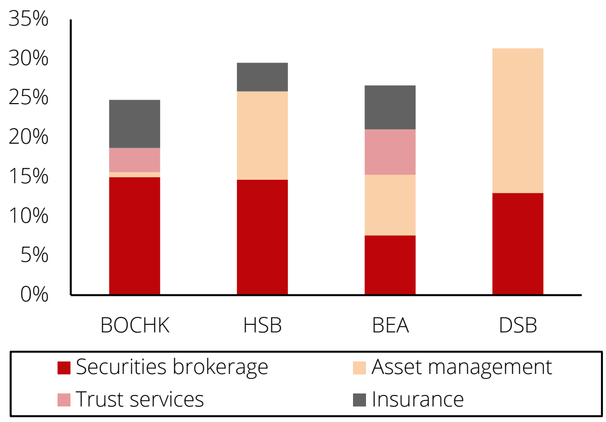
Fig 24: GBA GDP growth outpaces HK's growth



Source: Wind, DBS HK

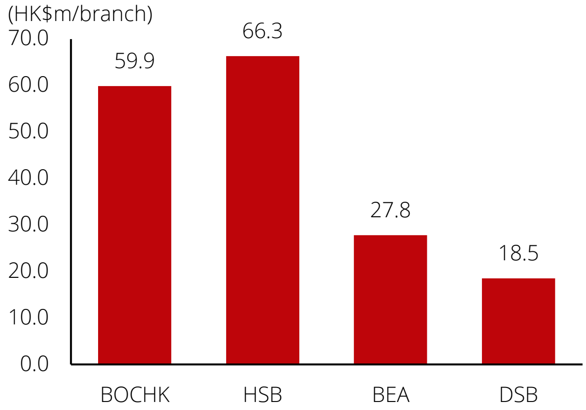
BOCHK has the most branch exposure in GBA while HSB leads in branch productivity. In FY21, the portion of fee income that may benefit from the WMC as of net profit was 25%-31% for the four major HK banks (Fig 25). Among the HK banks, BOCHK has more branches in the Greater Bay Area if BOC's branches are also counted. Leveraging on its parent company, its total branches in the region would be 1,109 vs. BEA with 85, HSB at 67, and DSB at 61. However, HSB has the highest branch productivity in terms of fee contribution due to its strong presence in the stock market and investment funds – each branch, on average, generated HK$66m in fee income in FY21 (Fig 26).

Fig 25: Potential of HK banks' fee income, which may benefit from WMC



Source: Corporates, DBS HK

Fig 26: Branch productivity in terms of fee income



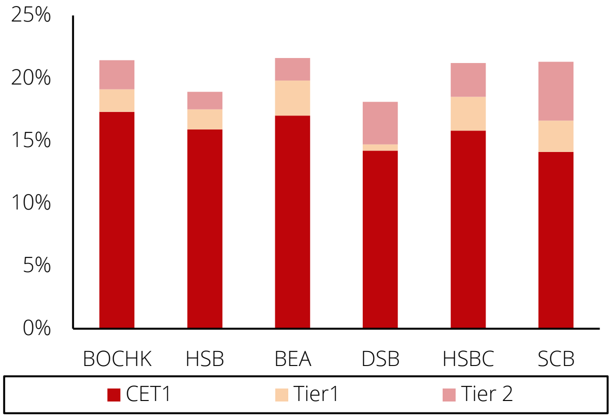
Source: Corporates, DBS HK

Capital level and regulation

Strong capital level of HK banks. Major banks in HK reported a c.14%-17% CET1 ratio and 18%-22% CAR ratio by the end of 2021 (Fig 27). This is well above the regulatory requirement of a 4.5% CET1 ratio after the buffers are considered: i.e., 1) 2.5% for Capital Conservative Buffer (CCB); 2) the Counter-cyclical Buffer (CCyB), which is 1% in HK since Mar 2020 (Fig 28); and 3) the Higher Loss Absorbency (HLA) of HK domestic systematically important banks ("D-SIBs), which is another 1%-3.5% buffer (Fig 29). Among the major HK banks, HSBC has the highest required buffer for D-SIBs of 2.5%. HSBC and SCB are also in the list of G-SIBs (Global Systematically Important Banks), while both their required HLA buckets in G-SIBs are 50bps lower than the HK D-SIBs requirements. The required CET 1 ratio would be 9%-10.5% for the major HK banks after all the additional buffers are added.

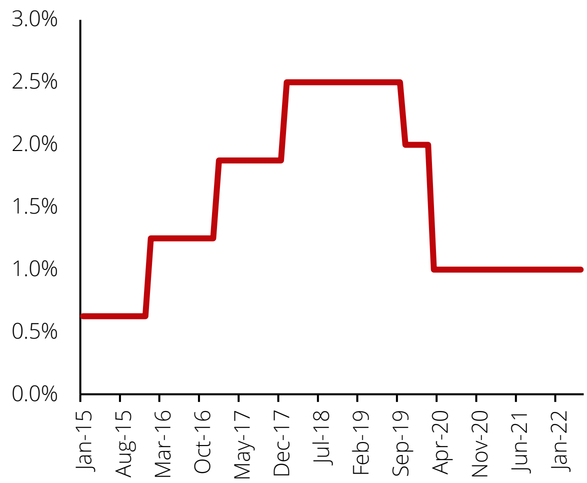
The revised Basel III implementation will take effect from July 2023. We expect major HK banks to maintain strong capital levels in the mid-term, as RWA (risk-weighted assets) may be reduced using the internal model under Basel III.

Fig 27: Capital ratio of HK banks by FY21



Source: Corporates, DBS HK

Fig 28: HKMA CCyB requirements



Source: HKMA, DBS HK

Fig 29: HK D-SIBs

HLA bucket	D-SIBs	HLA requirement Year 2022
5	N/A	3.5%
4	HSBC	2.5%
3	N/A	2.0%
2	BOCHK, SCB	1.5%
1	HSB, ICBC (Asia)	1.0%

Source: HKMA, DBS HK

The HKMA has published requirements on the loss-absorbing capacity (LAC) for the banking sector, which took effect from December 2018. Local D-SIBs, such as HSB, have already been following the LAC requirements. In FY21, HSB reported an internal LAC risk-weighted ratio of 22.2% and an internal LAC leverage ratio of 9.6%. The CET 1 capital ratio, after meeting the LAC requirements, is 10.2%, still well above its minimum required CET 1 ratio of 9%.

As a subsidiary of an emerging market G-SIB, BOCHK has yet to follow the HK LAC requirements, but we expect that will not be the case for long. BOCHK may need to issue more bonds to meet the requirement specifying that one-third of the LAC tool should be bonds. Since China's TLAC requirement will take effect in 2025, BOCHK may have to meet HK requirements before its parent group BOC.

Stock comparison and valuation

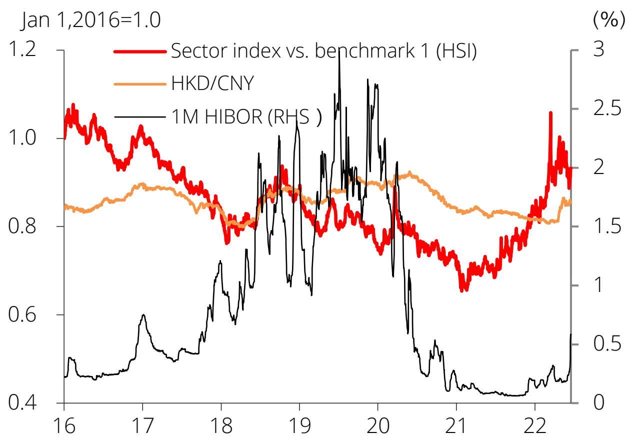
Positive outlook on HK banks. We have a generally positive view about HK banking sector performance in 2H22, with the interest rate hike, recovering HK GDP, a more stabilised stock market, and more cross-border business recoveries like WMC after the China-HK border reopens. The sector is now trading at an undemanding valuation below its five-year average P/B.

After taking a closer look at the sector's performance during the last interest rate hike cycle in 2016-2018(Fig 30), our key findings are: 1) In the early stage of the last round of the interest rate hike, the HK banking sector underperformed the HSI with the same trend of a strong CNY to HKD in 2016-2017; 2) sector performance showed more upside when the 1M HIBOR exceeded 1% and at the same time, the HKD was turning stronger; 3) the sector upward trend ended when the 1M HIBOR hit 2% and became more volatile in late 2018, mixed with the negative impact from social unrest in late 2019 and the COVID-19 outbreak in 2020.

If looking at the valuation perspective, both HSB and BOCHK has enjoyed a P/B re-rating in the past interest rate upward cycles (Fig 31). Their current P/B level of 1x and 1.4x forward P/B was much lower than their valuation peak during 2016-2018, which were around 1.6/2.3x respectively. We see plenty of re-rating room even a lower GDP growth than 2016-2018 was taken into consideration.

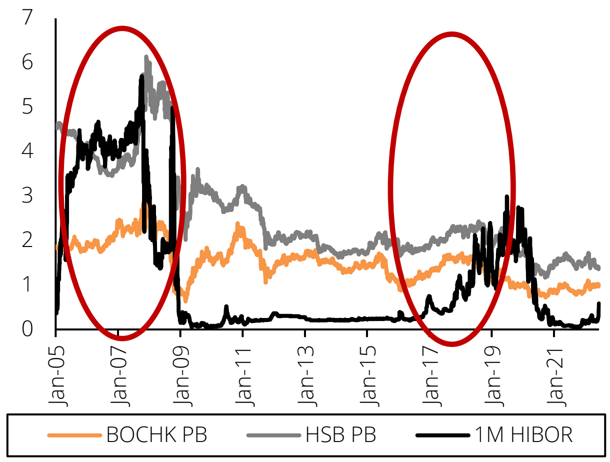
Thus, we are positive about the near-term performance of the HK banking sector, given 1) that in comparison with the early interest hike period of the last round, the CNY remained weak as China was loosening its monetary policy; 2) the current 1M HIBOR is around 0.8%, still with a high potential upside, and we expect less HIBOR volatility and it is likely to remain high in 2H22-2023 with the high inflation expectation in the US; 3) despite the sector having already picked up quite a lot since 2021, its relative performance to the HSI has just recovered to 2016's level and offers a 4%-5% dividend yield with an attractive valuation. With a higher-than-consensus outlook on the 1M HIBOR and 2022 HK GDP growth, we expect a further upside for the sector.

Fig 30: Sector performance in last interest hike cycle



Source: Bloomberg Finance L.P., DBS HK

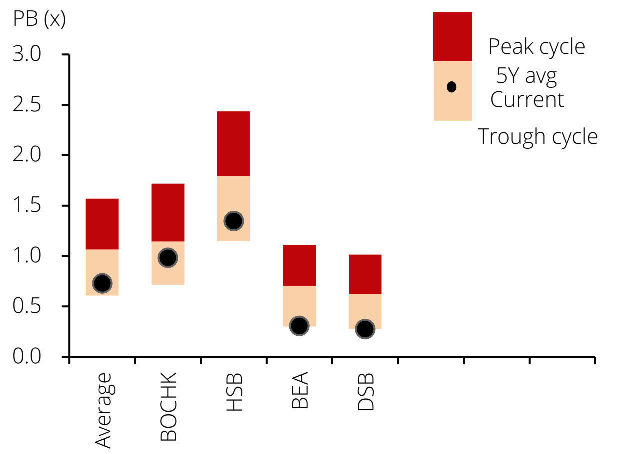
Fig 31: HK bank stocks re-rated in interest rate upward cycle



Source: Bloomberg Finance L.P., DBS HK

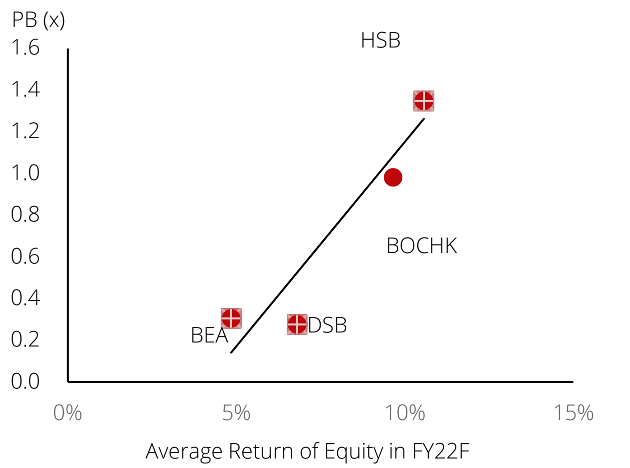
Catalysts and risks: Major catalysts are 1) higher interest rate hike than expected and 2) China/HK border reopening. Potential risks are 1) higher stock market volatility with higher uncertainties in the geopolitical environment and 2) another wave of COVID-19 and tightening social distancing measures.

Fig 32: 5-yr valuation



Source: Bloomberg Finance L.P., DBS HK

Fig 33: P/B vs. ROE

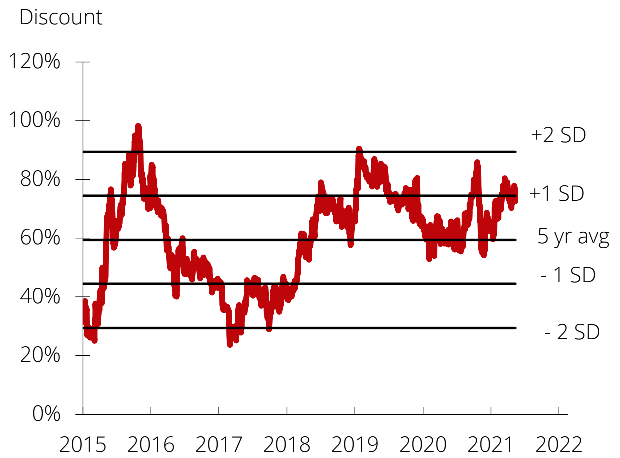


Source: Bloomberg Finance L.P., DBS HK

Top pick: BOCHK. From the sector, we prefer BOCHK, for it 1) is benefitting from its strong presence in GBA and ASEAN, which serves as the next revenue growth engine; 2) has solid asset quality and lowest credit cost among peers; 3) is currently trading at c.1x FY22F P/B or 0.9x FY23F P/B, lower than its five-year average of c.1.1x forward P/B – its valuation gap with HSB is also at the higher end among historical gaps (Fig 34); and 4) improving ROE in 2021 – reportedly the highest ROE among its peers – with the lowest cost-to-income ratio.

Compared with its peers, BOCHK has the lowest NIM. However, we don't think this would be a large concern, as 1) it's offset by higher loan growth – in FY21, BOCHK had total loan growth of 6.9% y-o-y, the highest among its peers, and thus, it had higher NII growth than HSB in both FY20 and FY21; 2) its lower NIM is largely due to it mainly lending to quality clients, e.g., China SOEs – it has the lowest exposure to risky sectors (property, manufacturing, and wholesale and retail) and credit card loans among peers, leading to its lowest NPL ratio and credit cost; and 3) it has a lower CASA ratio than HSB due to lower local recognition in HK – BOCHK is working to explore more opportunities such as government payments to improve its CASA ratio.

Fig 34: HSB/BOCHK P/B valuation gap



Source: Bloomberg Finance L.P., DBS HK

We also have a BUY recommendation on HSB. Though FY22 may still be faced with challenges in terms of fee income, we expect it to see more fee income expansion in 2023, as it's well positioned for the WMC. We expect the recovering fee income growth and loan growth to lead to an ROE recovery.

Fig 35: NIM trend

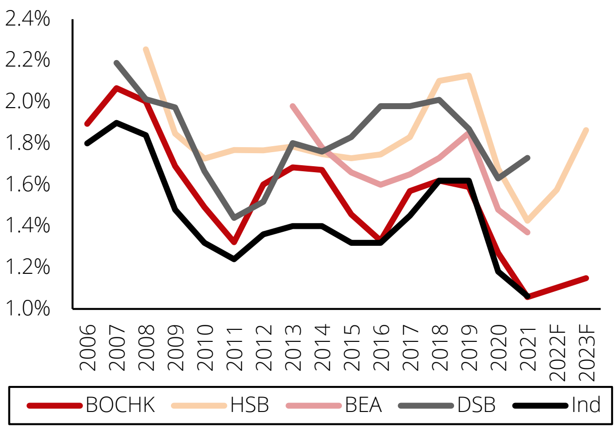


Fig 37: NII growth

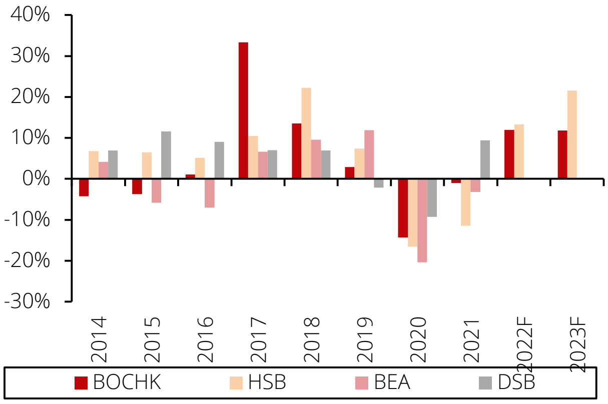


Fig 36: Loan growth

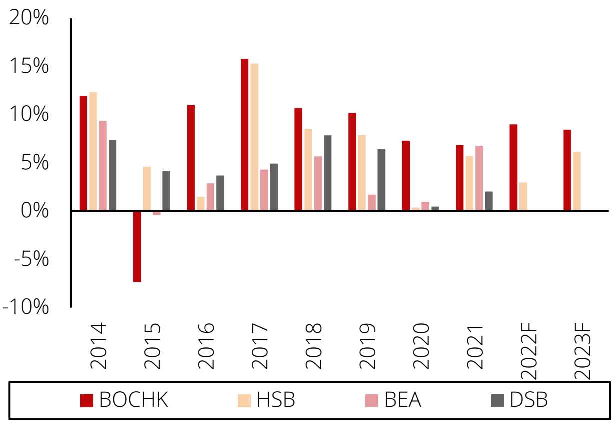
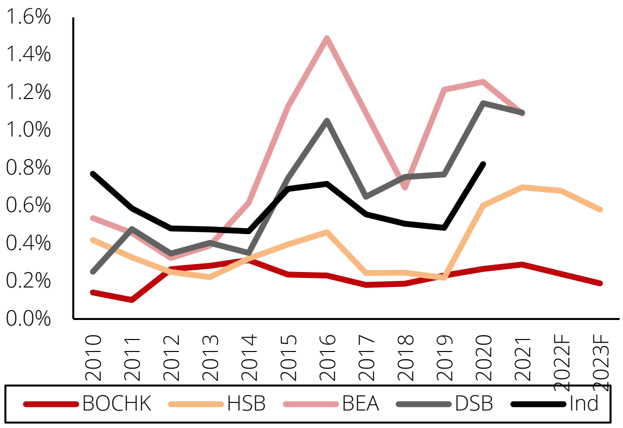


Fig 38: NPL ratio



Source: Corporates, DBS HK

Fig 39: Credit cost

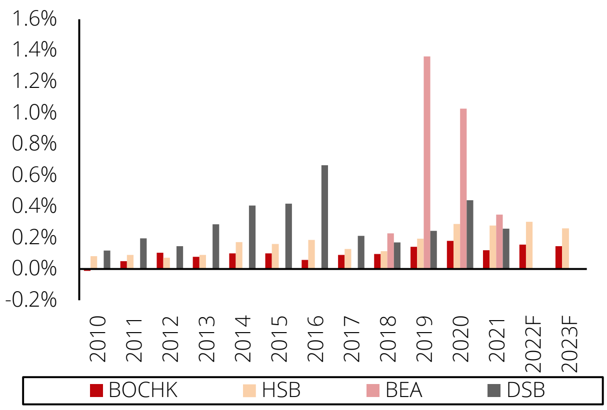


Fig 41: Core net profit growth

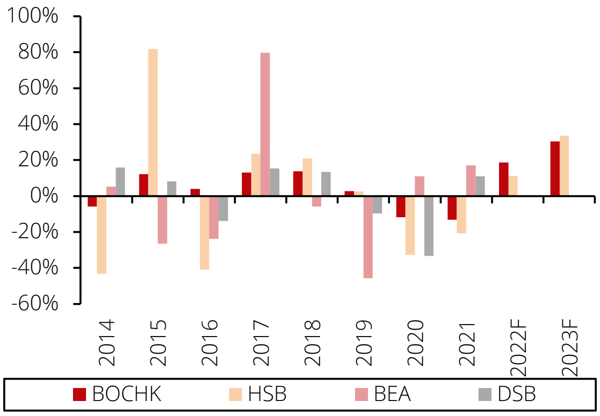


Fig 40: Cost-to-income ratio

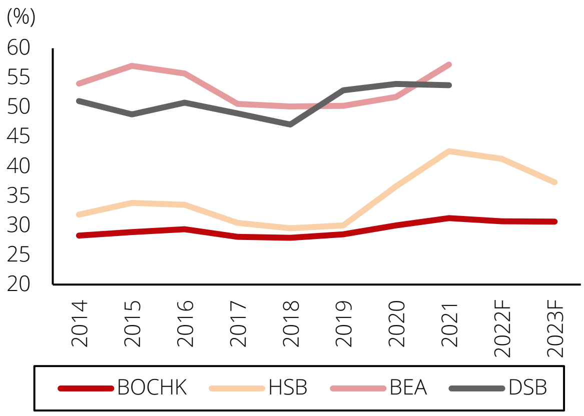
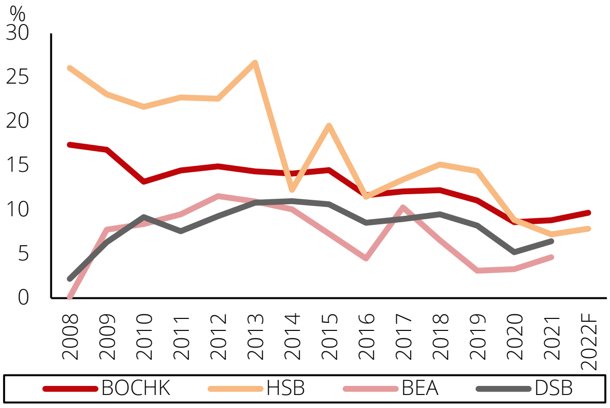


Fig 42: Core ROE



Source: Corporates, DBS HK

Fig 43: Major HK banks' operation comparison

Unit: HKD mn, otherwise indicated	11	2388	23	2356
FY21	HSB	BOCHK	BEA	DSB
Net interest income	23,822	31,941	11,185	3,944
Net revenue	33,182	48,982	16,283	5,384
Net interest income/net revenue (%)	72	65	69	73
Total loans in HK	742,439	1,083,205	262,209	98,550
-Corporate loan	401,528	581,799	136,874	47,772
-Consumer loan	340,911	501,406	125,335	50,778
Trade finance	41,732	73,611	6,088	8,123
Loans for use outside of HK	220,154	442,268	280,511	37,640
Corporate loan/total loan in HK (%)	54.1	53.7	52.2	48.5
Consumer loan/total loan in HK (%)	45.9	46.3	47.8	51.5
Total loans in HK/ total loan (%)	73.9	67.7	47.8	68.3
Risky sector/corporate loan (%)	69.2	54.3	70.8	67.2
Real estate sector/corporate loan (%)	56.8	42.0	61.7	51.7
Mortgage/consumer loan (%)	82.5	76.7	74.1	67.0
Credit card/consumer loan (%)	8.3	2.4	3.4	7.2
Non-performing loan	7011	4,321	5,977	2,454
NPL ratio (%)	0.70	0.27	1.09	1.70
Credit cost (bp)	27.9	13.4	34.8	24.3
Coverage ratio (%)	98.8	235.4	73.1	51.2
CET 1 (%)	15.9	17.3	17.0	14.2
NIM (%)	1.49	1.06	1.37	1.72
ROA (%)	0.9	0.9	0.7	0.8
ROE (%)	7.2	7.8	4.6	5.5
CASA as of total deposit (%)	83.0	65.3	43.6	45.9
Customer deposit	1,230,216	2,331,155	633,505	196,135
Fee income	6577	11872	3069	1197
Fee income/ net revenue (%)	19.8	24.2	18.8	22.2
WMC related fee income/total fee (%)	29.5	24.8	26.6	31.3
WMC related fee income/branch	66.3	59.9	27.8	18.5
Cost-to-income ratio	42.6	33.5	63.7	56.1
Net income	13960	24348	5270	1658
Net income growth y-o-y (%)	-21	-18	58	15

Source: Corporates, DBS HK

Fig 42: Peer table

Company Name	Code	Price Local$	Target Price Local$	Recom	Mkt Cap US$m	Fiscal Yr	PE 22F x	PE 23F x	Yield 22F %	Yield 23F %	P/Bk 22F x	P/Bk 23F x	ROE 22F %	ROE 23F %	FY21-23 Earnings CAGR %
H-share banks															
Agricultural Bk.Of Chin. 'H'*	1288 HK	2.96	3.10	HOLD	154,845	Dec	3.8	3.6	8.4	8.8	0.4	0.4	10.9	10.6	3.8
Bank Of Comms.'H'*	3328 HK	5.33	6.70	BUY	52,860	Dec	3.8	3.6	8.4	8.8	0.4	0.4	10.8	10.6	7.1
China Merchants Bank 'H'*	3968 HK	51.40	79.00	BUY	157,016	Dec	8.2	7.3	4.0	4.5	1.3	1.2	18.3	17.1	14.5
China Citic Bank 'H'*	998 HK	3.51	4.60	BUY	30,718	Dec	2.7	2.4	10.7	11.7	0.2	0.2	11.0	11.4	6.9
China Everbright Bk.'H'*	6818 HK	2.58	3.25	BUY	23,834	Dec	2.9	2.6	9.7	10.5	0.3	0.3	10.7	10.9	8.4
China Minsheng Banking 'H'	1988 HK	2.82	n.a.	NR	22,550	Dec	3.1	3.1	9.3	9.0	0.2	0.2	6.3	6.4	5.1
Chongqing Rur.Coml.Bk. 'H'	3618 HK	2.85	n.a.	NR	6,134	Dec	2.7	2.5	10.1	11.1	0.3	0.2	9.6	9.8	7.4
Postal Savings Boc.'H'*	1658 HK	6.06	8.10	BUY	72,421	Dec	5.8	5.2	5.5	6.1	0.7	0.6	12.5	12.9	14.0
A-share banks															
Agricultural Bank Of China 'A'*	601288 CH	3.01	3.20	HOLD	154,845	Dec	4.5	4.3	7.0	7.4	0.5	0.4	10.9	10.6	3.8
Bank Of Comms.'A'*	601328 CH	4.97	6.10	BUY	52,860	Dec	4.2	3.9	7.7	8.1	0.4	0.4	10.8	10.6	7.1
China Merchants Bank 'A'*	600036 CH	41.28	67.40	BUY	157,016	Dec	7.7	6.8	4.3	4.8	1.2	1.1	18.3	17.1	14.5
China Citic Bank 'A'*	601998 CH	4.74	5.00	HOLD	30,718	Dec	4.3	3.9	6.8	7.4	0.4	0.3	11.0	11.4	6.9
China Everbright Bk.'A'*	601818 CH	3.19	3.10	HOLD	23,834	Dec	4.1	3.8	6.7	7.3	0.4	0.4	10.7	10.9	8.4
China Minsheng Banking 'A'	600016 CH	3.70	n.a.	NR	22,550	Dec	5.1	4.8	6.1	5.9	0.3	0.3	6.3	6.4	4.9
CQ Rural Commercial Bank 'A'	601077 CH	3.96	n.a.	NR	6,134	Dec	4.3	3.9	6.7	7.2	0.4	0.4	9.7	9.9	9.6
Postal Savings Bank Of China 'A'*	601658 CH	5.28	7.40	BUY	72,421	Dec	5.9	5.3	5.4	6.0	0.7	0.7	12.5	12.9	14.0
Bank Of Shai. 'A'	601229 CH	6.55	n.a.	NR	13,872	Dec	4.1	3.8	7.3	7.9	0.5	0.4	11.7	11.9	7.2
Ping An Bank 'A'*	000001 CH	14.63	21.10	BUY	42,324	Dec	7.2	6.1	1.8	2.1	0.8	0.7	11.5	12.2	17.8
HK banks															
Hang Seng Bank*	11 HK	138.20	163.00	BUY	33,671	Dec	17.2	12.9	4.1	5.5	1.4	1.4	8.3	10.8	21.7
Boc Hong Kong Holdings*	2388 HK	31.55	37.40	BUY	42,507	Dec	12.4	9.7	4.2	5.3	1.1	1.0	8.8	10.7	22.1
Bank Of East Asia	23 HK	11.12	n.a.	NR	3,810	Dec	7.3	5.8	6.7	8.0	0.3	0.3	4.0	4.9	11.1
Dah Sing Banking Gp.	2356 HK	6.47	n.a.	NR	1,159	Dec	4.9	4.3	6.2	7.1	0.3	0.3	6.6	7.8	13.2
ASEAN banks															
Oversea-Chinese Bkg.	OCBC SP	11.46	15.00	BUY	37,282	Dec	9.6	8.3	5.0	5.7	0.9	0.9	10.1	11.1	13.6
United Overseas Bank	UOB SP	26.49	37.00	BUY	32,180	Dec	10.1	8.3	5.0	5.9	1.0	1.0	10.4	12.0	15.9
Rhb Bank Bhd	RHBBANK MK	5.72	6.00	BUY	5,480	Dec	8.8	7.4	6.0	6.9	0.8	0.8	9.2	10.6	10.5
Public Bank	PBK MK	4.46	4.45	HOLD	19,690	Dec	14.8	12.5	3.5	4.0	1.7	1.6	11.7	13.1	10.6
Global banks															
Bank Of America	BAC US	32.26	n.a.	NR	259,915	Dec	9.7	8.2	2.8	3.1	1.0	1.0	11.2	12.2	0.8
Citigroup	C US	47.21	n.a.	NR	91,678	Dec	7.0	6.6	4.4	4.7	0.5	0.5	7.3	7.5	(19.4)
Jp Morgan Chase & Co.	JPM US	115.82	n.a.	NR	340,169	Dec	10.1	9.0	3.6	3.8	1.3	1.2	13.0	13.7	(10.5)
Standard Chartered (Hkg)	2888 HK	58.95	n.a.	NR	22,293	Dec	8.4	6.6	2.2	2.8	0.5	0.4	5.8	7.0	39.9
Hsbc Holdings	5 HK	52.05	n.a.	NR	132,999	Dec	10.6	8.0	4.1	5.5	0.7	0.7	6.1	8.5	15.6

 # FY22: FY23; FY23: FY24

*Source: Thomson Reuters, *DBS HK*

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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
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SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 29 Jun 2022 09:29:38 (HKT)
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