

China Banking Sector

Implications of Jan LPR drop

Sector re-rating driver is still the expectation on asset quality improvement. LPR cut is in line and it has limited impacts on banks' earnings. As the sector is trading at historical bottom (0.5x 2022E P/B), we think some banks with strong balance sheet become attractive. Maintain OUTPERFORM on banking sector and our top pick is Postal (1658 HK, Buy) with target price of HK\$7.20.

- On 20 Jan 2022, 1-yr LPR dropped 10 bps to 3.70% and 5-yr LPR dropped 5 bps to 4.6%.** It is the first 5-yr LPR cut since April 2020. After cutting RRR, regulators continue to reduce borrowing cost by lowering 15 bps on 1-yr LPR (cut 5bps at Dec 21 and 10 bps at Jan 22) and 5 bps on 5-yr LPR shows PBOC's attitude on no speculation on residential property (房住不炒) and reducing borrowers' interest expense burden.
- In our view, impacts on banks' earnings is quite limited in FY22.** Unlike ordinary floating rate loan, although mortgage rate is pegged to 5-yr LPR, interest rate of existing mortgage will not drop. Because most of mortgage will be re-priced in Jan every year based on 5-yr LPR of Dec in last year, existing mortgage will experience a rate change in FY23, not FY22. The new 5-yr LPR will only affect the rate of new issued mortgage in FY22. As we assumed 85% of total ordinary loan (total non-mortgage loan) is pegged with 1-yr LPR, loan affected by 20 Jan's LPR cut will be RMB 46,337bn. FY22E banks' net interest income will drop RMB 46bn, as 1.4% of pre-tax profits in FY22E. In FY23 and FY24, as all the mortgage and more ordinary floating rate loan will be affected, net interest income will drop RMB 111bn and RMB 156bn, as 3.2% and 4.2% of pre-tax profits in FY23E and FY24E respectively. Although LPR drop will lead to a lower lending rate, banks still have multiple tools to reduce the negatives from declining interest income, such as less credit loss, lower deposit cost, improving CIR, etc. In conclusion, actual profit decline should be lower than theoretical estimations.
- Currently, the key concern on banking sector is asset quality, not NIM compression;** thus, the LPR drop will not change the re-rating trend in banking sector.
- Valuation/Key risks.** Our top pick is Postal (1658 HK, Buy), based on GGM. Target price is HK\$7.20, implying 0.79x 2022E P/B and 0.72x 2023E P/B. Currently it is trading at 0.7x P/B, equivalent to 3-yr historical mean. Less concern on property default risk and slowing down GDP growth will be the catalysts on stock re-rating.

Valuation Table

Name	Ticker	Mkt Cap	Rating	Closing price	TP (LC)	Upside	P/E	P/B	Yield
PSBC	1658 HK	602	BUY	6.34	7.20	14%	5.5	0.7	5.5%
CCB	939 HK	1,489	BUY	5.86	6.33	21%	3.9	0.4	7.7%
SPDB	600000 CH	255	HOLD	8.64	9.34	8%	4.4	0.4	6.2%
BOSH	601229 CH	104	BUY	7.26	9.04	25%	4.2	0.5	6.8%
CQRC	3618 HK	33	HOLD	2.95	2.80	-5%	2.6	0.2	11.5%
BOCS	601577 CH	34	HOLD	8.19	8.32	2%	4.1	0.6	6.1%

Source: CMBIS estimates based on 2022E earnings. Closing price @ 19 Jan, Mkt cap (LC bn)

OUTPERFORM
(Maintain)

China Banking Sector

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Stocks covered

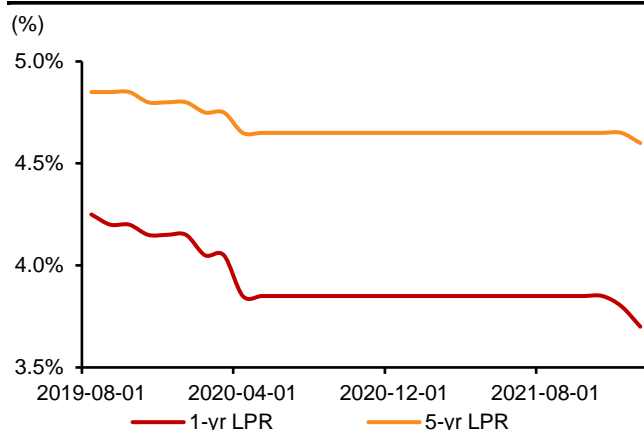
Ticker	Rating	TP (LC)	Upside
1658 HK	BUY	7.2	14%
939 HK	BUY	7.1	21%
600000 CH	HOLD	9.34	8%
601229 CH	BUY	9.04	25%
3618 HK	HOLD	2.8	-5%
601577 CH	HOLD	8.32	2%
601658 SH	BUY	7.07	25%
601939 SH	BUY	7	16%
601077 SH	HOLD	3.6	-10%

Source: CMBIS estimates

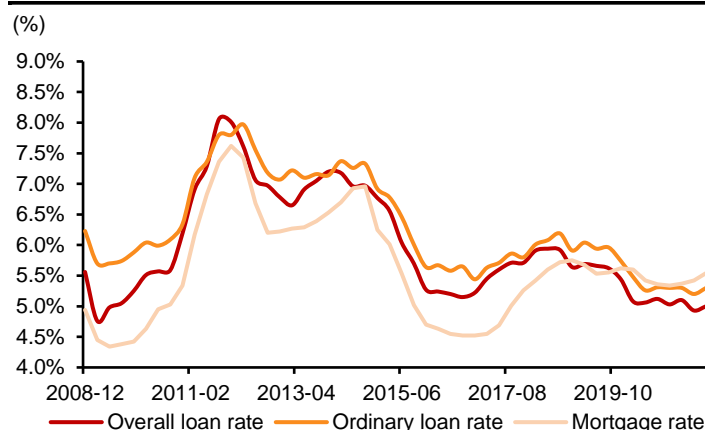
Recent Reports:

- China Banking Sector – Implications of 5 bps cut on 1-yr LPR – 21 Dec 2021 ([link](#))
- China Banking – Looking for the safe harbour – 9 Dec 2021 ([link](#))

Focus Charts

Figure 1: LPR change


Source: PBOC

Figure 2: Market lending rate


Source: PBOC

Figure 3: Estimates on loan affected (RMB bn)

Total loan	Fixed rate loan	Loan pegged to 1-yr LPR	Loan pegged to 5-yr LPR
192,690	28,904	115,614	48,173

Source: CBIRC, CMBIS estimates

Figure 4: Estimates on NII impacts (RMB bn)

NII change	FY22E	FY23E	FY24E
NII change caused by 1-yr LPR change	(45)	(90)	(135)
NII change caused by 5-yr LPR change	(1)	(21)	(21)
Total NII change	(46)	(111)	(156)
Estimated pre-tax profit	3,156	3,409	3,618
NII change as % of pre-tax profit	-1.4%	-3.2%	-4.2%

Source: CBIRC, CMBIS estimates

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