

China Banking Sector

Expecting asset quality to deteriorate in 2H22

Although 1Q data showed an improvement on banks' asset quality, we think the situation may deteriorate in 2H22. Meanwhile, the slowdown of property loan and lower LPR will put pressure on banks' NIM. Those negatives have been reflected in current valuations but may need catalysts to support sector re-rating. Maintain **OUTPERFORM** on banking sector, and our top pick is PSBC (1658 HK, BUY) with a target price of HK\$8.40. Key catalysts are potential liquidity injection and economic recovery.

■ **Asset quality improved in 1Q but should deteriorate in 2H22 due to Shanghai lockdown.** In terms of NPL, sector NPL balance reached RMB 2.91tn at the end of 1Q22. NPL balance of city banks grew 14.1% YoY, while sector NPL change was only 4.5% YoY. In 1Q22, NPL ratio of SOEs and JSBs were both 1.35%, improving 2.3 bps and 1.9 bps QoQ respectively. But city banks NPL ratio deteriorated 5.5 bps QoQ. On a year-on-year basis, NPL ratio of SOEs, JSBs, and rural commercial banks improved 12.5 bps, 9.7 bps and 33.1 bps, but city banks NPL ratio deteriorated 1.6 bps. At the end of 1Q22, special mention loan ratio was 2.31%, decreasing 0.3 bps QoQ and 11 bps YoY. Although the asset quality data improved in 1Q22, we believe banks' asset quality should be under pressure in next few quarters due to Shanghai lockdown. Our view on asset quality change is supported by deteriorating TSF and total retail sales.

■ From the perspective of loan, SME loan slowed down and property loan remained muted. SME loan growth recorded a two-year low. At the end of 1Q22, SME loan balance was RMB 20.7tn, +24.6% YoY. The growth rate was at the historical low since 2Q20. In 1Q22, property development loan balance reached RMB 12.5 tn, -0.4% YoY. At the same time, mortgage balance was RMB 38.8 tn, +8.9% YoY. Both mortgage growth and development loan growth recorded a historical low during last decade. Based on our channel check, the decrease of property loan growth may add hurdles to banks' lending strategy, since banks may have to increase allocation to some lower risk reward assets instead of development loan.

■ **Maintain OUTPERFORM on banking sector and PSBC as our top pick.** Our target price of PSBC at HK\$8.40 implies 0.91x 2022E and 0.85x 2023E P/B. The stock is trading at 0.66x/0.61x FY22/23E P/B, almost equivalent to +1SD of 3-yr historical mean.

Valuation Table

Name	Ticker	Mkt cap (LC bn)	Rating	Closing price (LC)	TP (LC)	Upside	P/E (x)	P/B (x)	Yield
PSBC	1658 HK	544	BUY	5.89	8.40	43%	5.1	0.6	5.84%
CCB	939 HK	1,389	BUY	5.57	8.10	45%	3.7	0.4	8.07%
SPDB	600000 CH	236	HOLD	8.03	9.00	12%	4.1	0.4	6.62%
BOSH	601229 CH	94	BUY	6.60	8.68	32%	3.8	0.5	7.44%
CQRC	3618 HK	32	HOLD	2.83	3.05	7%	2.4	0.2	11.99%
BOCS	601577 CH	32	HOLD	7.99	8.30	3.88%	4.1	0.6	6.25%

Source: CMBIGM estimates based on 2022E earnings. Note: All closing prices are as of 16 June

OUTPERFORM
(Maintain)

China Banking Sector

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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

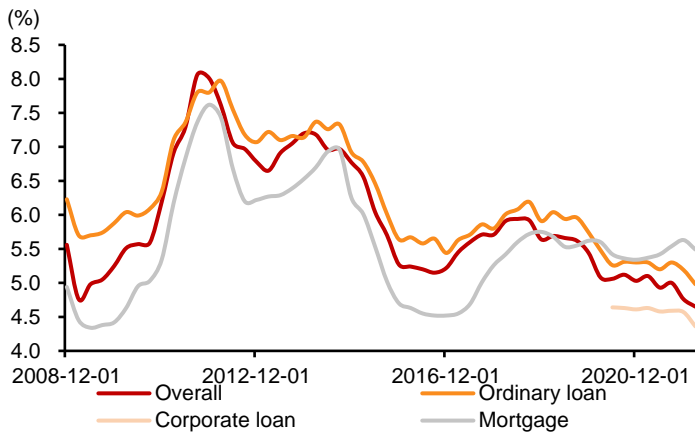
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- China Banking – Looking for the safe harbour ([link](#))
- China Banking – Implications on loan and deposit rate cut ([link](#))
- China Banking – Scenario analysis on banks' balance sheet ([link](#))

- On risk control front, SOEs hold more provision than other banks. To prepare for the headwind, national banks maintain a higher provision coverage ratio than regional banks. At the end of 1Q22, provision coverage ratios of SOEs, JSBs, city banks and rural commercial banks were 245%, 210%, 182% and 134%, changing 26 pps, 6 pps, 0.4 pps and 10 pps YoY. In 1Q22, provision coverage of city banks dropped 7 pps QoQ, while other banks lifted their provision coverage ratio.

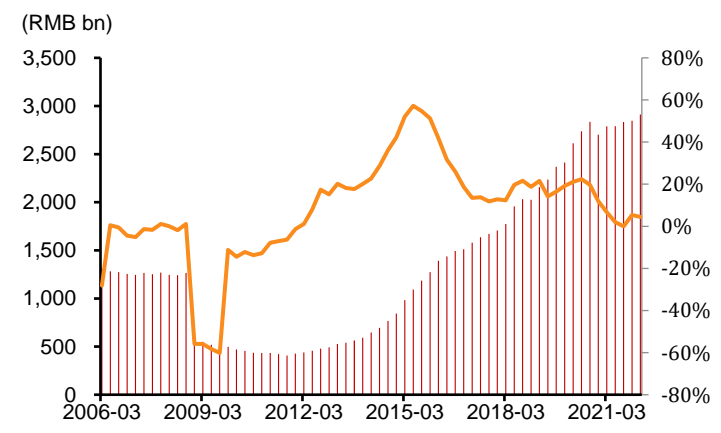
Focus Charts

Figure 1: Market lending rate



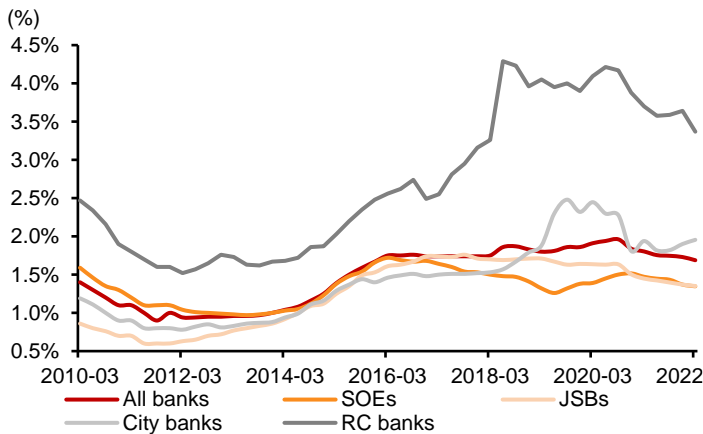
Source: Company data, CMBIGM estimates

Figure 2: Sector NPL balance and growth



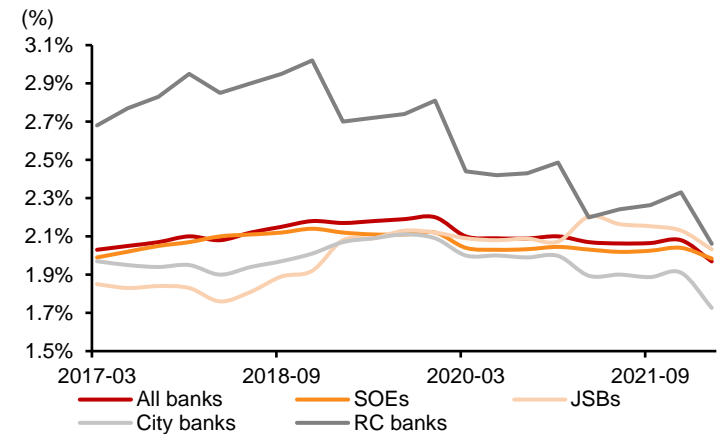
Source: Company data, CMBIGM estimates

Figure 3: Sub-sector NPL ratio



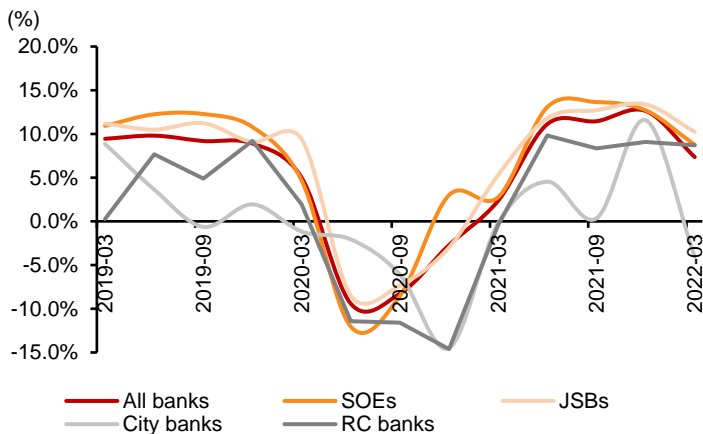
Source: Company data, CMBIGM estimates

Figure 4: Sub-sector NIM



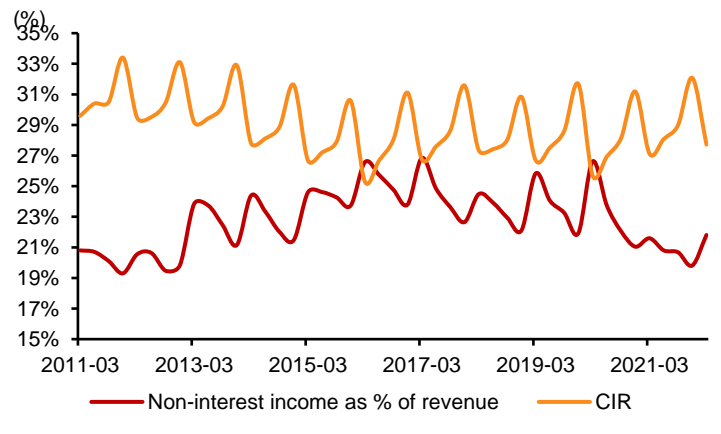
Source: Company data, CMBIGM estimates

Figure 5: Sub-sector earnings growth



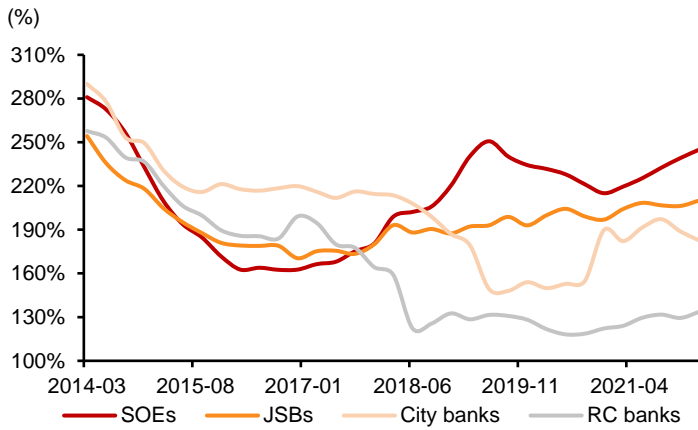
Source: Company data, CMBIGM estimates

Figure 6: CIR and non-interest income as % of revenue



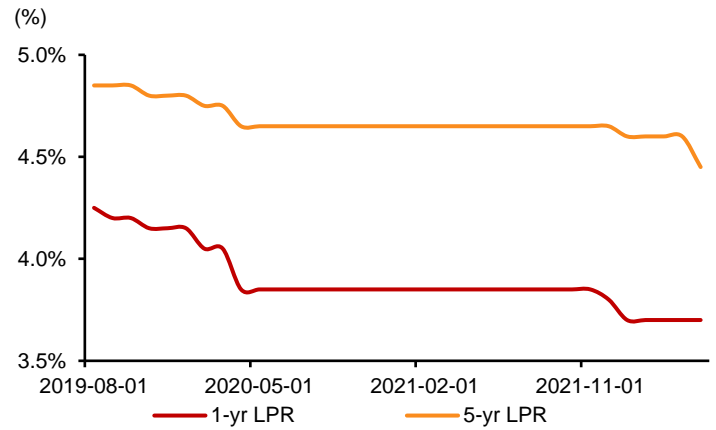
Source: Company data, CMBIGM estimates

Figure 7: Sub sector provision coverage ratio changes



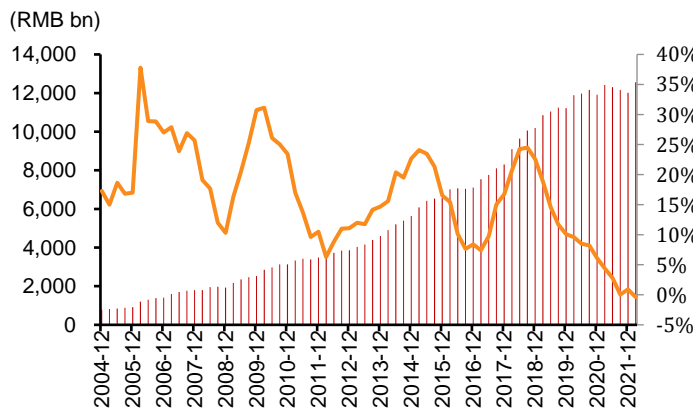
Source: Company data, CMBIGM estimates

Figure 8: Loan Prime Rate (LPR) changes



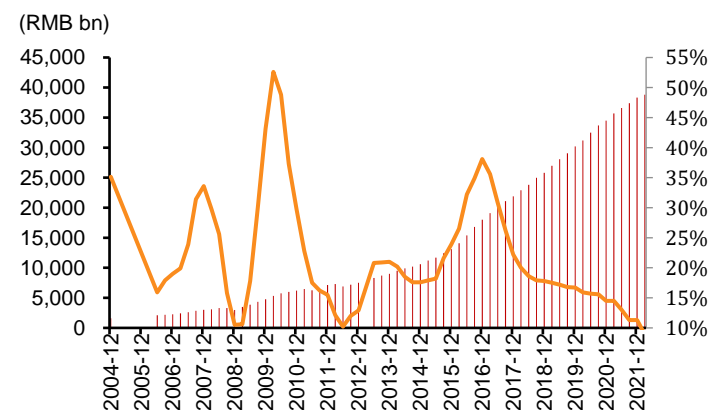
Source: Company data, CMBIGM estimates

Figure 9: Development loan balance and growth



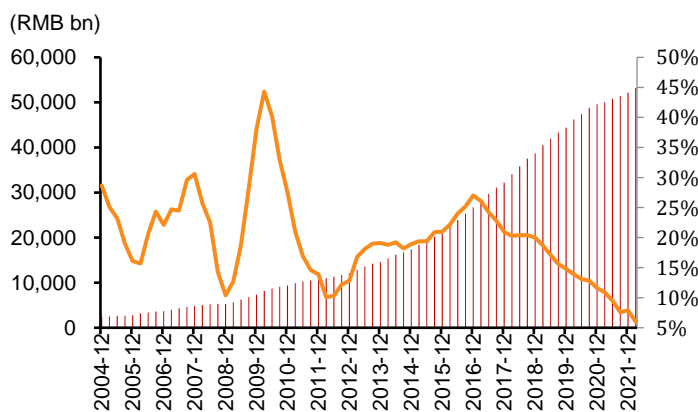
Source: Company data, CMBIGM estimates

Figure 10: Mortgage balance and growth



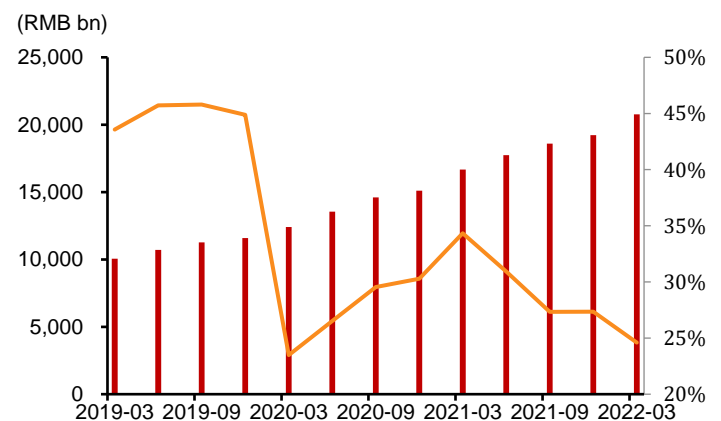
Source: Company data, CMBIGM estimates

Figure 11: All property loan changes



Source: Company data, CMBIGM estimates

Figure 12: Sector SME loan balance changes



Source: Company data, CMBIGM estimates

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