SECTOR UPDATE

Banking – China

1H24 Result Wrap-up: Walking A Tightrope

China banks reported a smaller earnings decline in 2Q24 on lower impairment charges and strong trading income. We estimate that the 80bp mortgage repricing could hit banks' earnings by 6.5bp and 9.2% in 2025. The fundamental weakness due to macro headwinds and mortgage repricing news could weigh on share prices. Nonetheless, the depressed valuations and resurging dividend yields after the recent correction could be a silver lining again for defensive plays. Maintain OVERWEIGHT. Top pick: CMB.

WHAT'S NEW

- **1H24 earnings largely in line.** For the six state-owned banks (SOE) and 10 joint-stock banks (JSB) that we assessed, these major Chinese banks delivered a combined net profit of Rmb960.7b, down 0.5% yoy, slightly better than in 1Q24. Negative revenue growth was seen across most national banks except for Agricultural Bank of China (ABC) in 1H24, mainly due to NIM compression (-19bp yoy on average) and prolonged fee income (-12.4% yoy), partly offset by strong trading income amid a bullish bond market. Cost-savings (+0.3% yoy) and lower impairment charges (-9.1% yoy) were not enough to overcome the top-line weakness.
- **Quality over quantity.** As the PBOC has downplayed the importance of credit growth and muted retail loan demand, we have observed that Chinese banks have slowed their balance sheet expansion, with loan growth declining further to 8.8% (vs 1Q24: 10.1%). Corporate lending remains resilient, but muted retail loan growth persists due to early mortgage repayments and sluggish credit card demand. Meanwhile, the regulator's efforts to curb financial arbitrage activities through manual interest subsidies have led to deposit outflow in the 2Q24, resulting in a further deceleration of yoy deposit growth to 6.1% (vs 1Q24: 7.9%).
- **Fee income sluggishness persisted** with -12.4% qoq on average for the major banks. The JSBs still experienced double-digit yoy decline while SOE banks recorded a deeper yoy fee decline to -10% in 1H24, mainly attributed to: a) bancassurance and mutual fund fee rate cuts, b) weakened investor sentiment amid volatile capital market, and c) lower bank card fees. Despite some recovery in wealth management product demand due to deposit outflow and plummeting treasury yield, it was insufficient to offset the fee decline from insurance sales against a tougher base. On the flip side, non-interest income (NII) for China banks in 1H24 remained relatively flattish (+0.5% yoy), underpinned by strong trading income from bond investments due to a steep decline in treasury yield (-35bp hoh). Looking ahead, the bond trading gains sustainability could be a key concern for NII growth in 2H24 as the state banks could lock in more profit in 3Q24 by selling off more China government bond (CGB) to support the PBOC in stabilising the CGB yields.
- **Stabilisation in NIM – The calm before the storm?** Most of the major banks saw mild sequential NIM compression in 2Q24, largely within our expectation, thanks to lower funding cost as the function of previous deposit rate cuts and regulatory efforts to suspend the manual subsidies on corporate deposits. However, depressed asset yield and declining CASA ratio remained as key drags for the banks' margin.

OVERWEIGHT

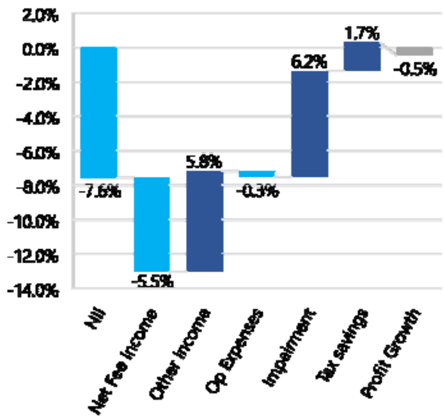
(Maintained)

SECTOR TOP PICK

Company	Ticker	Rec	Share Price (HK$)	Target Price (HK$)
CMB	3968 HK	BUY	29.65	42.00

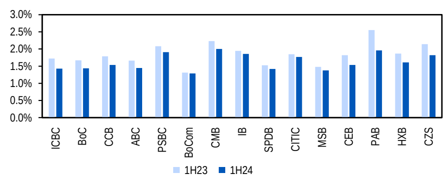
Source: UOB Kay Hian

CONTRIBUTING FACTORS TO PROFIT GROWTH



Source: Respective banks, UOB Kay Hian

NIM TREND



Source: Respective banks, UOB Kay Hian

ANALYST(S)
Kenny Lim Yong Hui
+603 2147 1924
kennylim@uobkayhian.com

PEER COMPARISON

Company	Ticker	Rec	Price @ 13 Sep 24 (HK$)	Target Price (HK$)	Market Cap (HK$b)	Upside/ (Downside) to TP (%)	PE 2024F (x)	PE 2025F (x)	P/B 2024F (x)	P/B 2025F (x)	Yield 2024F (x)	Yield 2025F (x)	ROE 2024F (%)	ROE 2025F (%)	NIM 2024F (%)	NIM 2025F (%)
CCB	0939 HK	BUY	5.45	6.00	1,385,352	10.1	3.8	3.7	0.4	0.4	8.0	7.9	10.0	9.9	1.5	1.6
CMB	3968 HK	BUY	29.65	42.00	829,933	41.7	4.7	4.4	0.6	0.5	7.2	7.7	14.6	14.0	2.0	2.0
ICBC	1398 HK	Not Rated	4.22	n.a.	2,013,894	n.a.	3.9	3.9	0.4	0.4	8.0	8.1	9.9	9.4	1.4	1.3
ABC	1288 HK	Not Rated	3.50	n.a.	1,665,522	n.a.	4.3	4.2	0.4	0.4	7.3	7.4	10.2	9.8	1.4	1.4
BOC	3988 HK	Not Rated	3.38	n.a.	1,342,791	n.a.	4.1	4.0	0.4	0.4	7.7	7.8	9.4	9.0	1.4	1.3
BoCoM	3328 HK	Not Rated	5.30	n.a.	465,118	n.a.	4.1	4.0	0.4	0.3	7.8	8.0	9.0	8.7	1.2	1.2
PSBC	1658 HK	Not Rated	4.11	n.a.	479,557	n.a.	4.5	4.3	0.4	0.4	7.0	7.3	9.9	9.6	1.9	1.8

Source: Bloomberg, UOB Kay Hian

- **Stable asset quality.** China banks we assessed reported a relatively stable NPL ratio at 1.21% on average (-1bp hoh), due to larger NPL write-offs. On an industry basis, the annualised NPL formation ratio in 2Q24 moderated 15bp yoy to 0.58%, as per our estimate. Corporate NPL ratio fell 10bp hoh on average, driven by improved asset quality in developer loans. Nonetheless, the retail loan book asset quality gauged our concern as the NPL ratio rose 11bp qoq, where deterioration was seen in almost every line item, led by credit card and consumption loans. The difference between credit cost and NPL formation ratio was 20-30bp for major banks in 2Q24. The rising trend of retail NPLs could be a key concern for banks, as it may limit their ability to further reduce credit costs in order to boost their profits.

ASSET QUALITY WAS FAIRLY BENIGN IN 1H24

1H24	------------ Total NPL ------------		--------- Corporate NPL ---------		------------ Retail NPL ------------	
	%	hoh chg (bp)	%	hoh chg (bp)	%	hoh chg (bp)
ICBC	1.35	-1	1.69	-12	0.90	+20
BoC	1.24	-3	1.33	-15	0.88	+12
CCB	1.35	-2	1.69	-19	0.84	+18
ABC	1.32	-1	1.70	-13	0.79	+6
PSBC	0.84	+1	0.54	-1	1.14	+2
BoCom	1.32	-1	1.54	-11	0.98	+17
CMB	0.94	-1	1.13	-6	0.90	+1
CITIC	1.19	+1	1.25	-12	1.30	+11
MSB	1.47	-1	1.32	-14	1.69	+17
PAB	1.07	+1	0.66	+3	1.42	+5
Average	1.21	-1	1.29	-10	1.08	+11

Source: UOB Kay Hian

1H24 CHINA BANKS RESULTS AT A GLANE

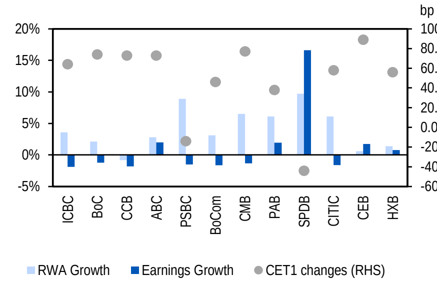
	NII	Fee Income	Other NII	Revenue	Opex	PPOP	Impairment	NPAT
ICBC	-6.8%	-8.2%	11.9%	-6.3%	-0.2%	-8.3%	-16.5%	-1.9%
BoC	-3.1%	-7.6%	22.8%	-0.6%	3.8%	-2.7%	0.0%	-1.2%
CCB	-5.2%	-11.2%	199.4%	-3.4%	-1.7%	-4.0%	-8.1%	-1.8%
ABC	0.1%	-7.9%	19.9%	0.4%	0.9%	0.1%	-1.3%	2.0%
PSBC	1.8%	-16.7%	1.2%	-0.1%	4.1%	-6.1%	-16.5%	-1.5%
BoCom	2.2%	-14.6%	-10.0%	-3.5%	1.4%	-6.3%	-9.3%	-1.6%
CMB	-4.2%	-18.6%	37.3%	-3.1%	0.0%	-4.6%	-13.7%	-1.3%
IB	4.2%	-19.4%	8.7%	1.8%	-3.2%	3.7%	10.2%	0.9%
SPDB	-3.9%	-12.0%	6.4%	-3.3%	-10.3%	-0.4%	-15.4%	16.6%
CITIC	-0.8%	-14.2%	41.5%	2.6%	5.9%	1.4%	-0.8%	-1.6%
MSB	-5.4%	-11.0%	-4.4%	-6.1%	-3.3%	-7.5%	-9.9%	-5.5%
CEB	-12.1%	-21.7%	34.3%	-8.7%	-3.8%	-10.5%	-23.7%	1.7%
PAB	-21.6%	-20.6%	56.7%	-13.0%	-10.0%	-14.1%	-28.5%	1.9%
HXB	-7.1%	-17.7%	38.6%	1.5%	3.5%	0.6%	-1.3%	0.8%
CZB	-1.4%	-5.7%	40.2%	6.2%	10.1%	4.6%	5.0%	3.3%
CBB	-13.4%	-3.9%	69.3%	0.5%	-6.4%	5.2%	31.0%	-9.8%
Total	-3.7%	-12.4%	21.2%	-2.8%	0.3%	-4.1%	-9.1%	-0.5%
SOE	-3.0%	-9.9%	17.5%	-2.5%	1.4%	-4.3%	-8.2%	-1.0%
JSB	-5.7%	-17.0%	27.3%	-2.9%	-2.0%	-3.2%	-9.4%	0.8%

Source: Respective companies, UOB Kay Hian

ESSENTIALS

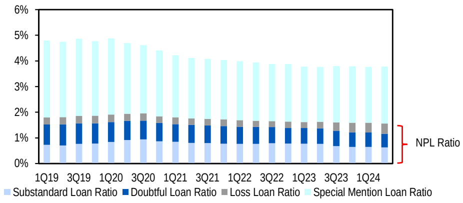
- **NIM outlook dulled by mortgage repricing.** Bloomberg reported on 30 August that China regulators are mulling to reduce existing outstanding mortgages rate by a total of about 80bp in a two-step way. The 80bp gap between the existing mortgage rate of about 4.2% and newly-issued mortgage rate of 3.4% could be the reason behind the move. We noted that even if we include the 35bp five-year LPR cuts in 2024 which will be reflected in Jan 25, the existing mortgage rate is still 45bp above the new mortgage rate. According to Bloomberg's latest report, the borrower may enjoy up to 50bp of immediate rate reduction as early as this month. The question left is that whether the regulators will allow homebuyers to refinance with a different bank which is expected to intensify the pricing competition and drive down the rate quickly.

RWA, EARNINGS AND CAR YOY TREND



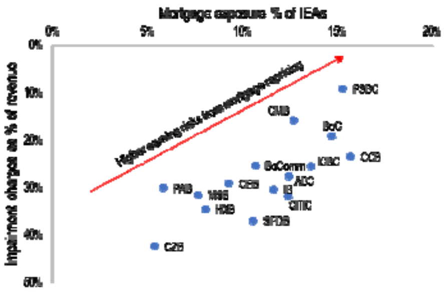
Source: Respective banks, UOB Kay Hian

NPL TREND



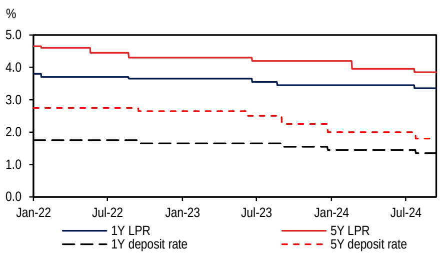
Source: NAFR, UOB Kay Hian

EARNING RISKS FROM MORTGAGE REPRICING



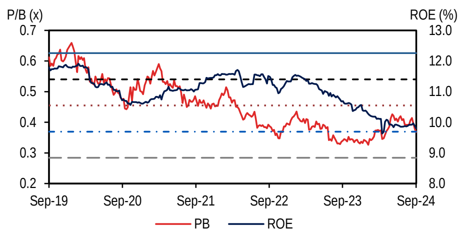
Source: UOB Kay Hian

LPR AND BANK DEPOSIT RATE MOVEMENT



Source: iFinD, UOB Kay Hian

SECTOR P/B VS ROE



Source: Bloomberg, UOB Kay Hian

STRESS TEST TO MORTGAGE RATE REPRICING

1H24	Mortgage exposure as % of loan book (%)	-------- NIM impact (bp) --------		------- NPAT impact (%) -----		Deposit rate cuts needed to fully offset (bp)
		2024	2025	2024	2025	
ICBC	22.1	-2.3	-9.9	-2.2	-10.3	-25
CCB	24.9	-2.6	-11.6	-2.4	-11.0	-32
ABC	20.8	-2.1	-9.0	-2.4	-11.2	-25
BoC	22.5	-2.4	-10.7	-2.6	-12.3	-29
BoCom	17.7	-1.8	-81	-2.2	-10.0	-21
PSBC	27.3	-2.5	-11.3	-3.4	-15.9	-17
CMB	20.1	-2.1	-9.5	-1.2	-5.3	-26
PAB	9.0	-1.0	-4.4	-0.8	-3.8	-10
Sector	15	-1.5	-6.5	-2.0	-9.2	-19

Source: Respective companies, Bloomberg, UOB Kay Hian

- **Banks' NIM and earnings may be hit by 6.5bp and 9.2% in 2025.** During the stress test, we assume 50bp cuts in 2024 and another 30bp reduction will occur in 2025. This scenario will hit the banks' 2024/25 NIM by 1.5bp/6.5bp respectively, translating into 2.0%/9.2% hit in 2024/25 earnings. Among them, the Big Four banks and China Merchants Bank (CMB) with higher mortgage exposure will face a larger NIM dilution but CMB has smaller earnings impact due to its higher NII contribution. We have compared the earnings risk between the banks from this event and we found that Postal Savings Bank of China (PSBC) could be the key victim due to its high mortgage exposure (27% of loan book) and lower credit cost buffer (impairment charges as percentage of top-line).

- **Deposit rate cuts come to the rescue again?** Based on our estimate, the impact on NIM from the 80bp mortgage repricing could be fully offset by a 19bp parallel cut in time deposit rates across all maturities, and banks with have higher exposure in mortgage such as Big Four banks and CMB would likely require a larger magnitude of cuts. However, this is a more theoretical scenario, as regulators and banks may choose to preserve deposit rate cuts for future LPR cuts. Meanwhile, a 20bp reduction in deposit agency rate could also help PSBC to neutralise the earning impacts.

- **Not all aspects are negative to banks.** We expect it could potentially alleviate the elevated early mortgage repayments trend and mitigate the rising NPL in banks' mortgage books, which we have observed in recent results. If the regulators allow the borrowers to refinance with a different bank, the big banks with pricing advantages (low funding cost), are well-positioned to absorb the refinanced mortgages from other smaller banks to boost their mortgage loan book.

ACTION

- **Maintain OVERWEIGHT on the China banks.** We noted that the fundamental weakness due to macro headwinds and the mortgage repricing news could weigh on the share price. However, we think more policy supports from the regulators to protect the banks' margin such as deposit rate cuts and reserve requirement rate cuts could help to ease investor concerns about bank fundamentals. Additionally, it would not easily change the investor perception of Chinese banks as safe haven assets. The H-shares of China banks are currently trading at an undemanding valuation of 0.4x (-1 SD), and coupled with the resurging yield of 7-8% following recent corrections, they could still be attractive to investors, especially Southbound investors who lack investment opportunities in Mainland China amid an economic slowdown and lowering treasury yield.

- **CMB is still our top pick despite laggard ytd performance.** Despite CMB's higher mortgage exposure, the potential earnings impact is relatively smaller than its SOE peers, primarily due to its higher NII contribution. We continue to favour CMB due to its stronger-than-peers financial metrics, including ROE, asset quality and provision buffer with a decent dividend yield of 7.2%. We believe CMB is well-positioned to maintain its dividend level given its ample capital buffer.

Disclosures/Disclaimers

This report is prepared by UOB Kay Hian (Hong Kong) Limited (“UOBKHHK”), which is a licensed corporation providing securities brokerage and securities advisory services in Hong Kong.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKHHK. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKHHK may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKHHK and its associates (as defined in the Securities and Futures Ordinance, Chapter 571 of Hong Kong) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report (“Information”) has been obtained or derived from sources believed by UOBKHHK to be reliable. However, UOBKHHK makes no representation as to the accuracy or completeness of such sources or the Information and UOBKHHK accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKHHK and its associates may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKHHK and its associates are subject to change without notice. UOBKHHK reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKHHK, its associates and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKHHK, its associate and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKHHK may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the “Subject Business”); and (4) UOBKHHK may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report is prepared by UOBKHHK, a company authorized, as noted above, to engage in securities activities in Hong Kong. UOBKHHK is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKHHK (whether directly or through its US registered broker dealer affiliate named below) to “major U.S. institutional investors” in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”). All US persons that receive this document by way of distribution from or which they regard as being from UOBKHHK by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc (“UOBKHUS”), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKHHK.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority (“FINRA”) and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Analyst Certification/Regulation AC

Each research analyst of UOBKHHK who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKHHK or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKHHK's total revenues, a portion of which are generated from UOBKHHK's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

General	This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation.
Hong Kong	This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Indonesia	This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia (OJK). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report.
Malaysia	Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia.
Singapore	This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore. Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Thailand	This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand.
United Kingdom	This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients.
United States of America ('U.S.')	This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly.

http://www.utrade.com.hk