SECTOR UPDATE

Banking – China

Improved 4Q24 Outlook Amid Policy Supports

China banks reported improved earnings growth, driven by narrower revenue declines, strong trading gains and lower credit costs. We expect the sequential NIM decline to worsen in 4Q24 due to policy rate cuts. However, we believe China banks will maintain positive earnings growth for 2024, supported by the low base effect in 4Q23 and the stimulus package announced in late-Sep 24. Maintain MARKET WEIGHT. Top pick: CMB.

WHAT'S NEW

- **China banks registered better-than-expected earnings.** According to National Financial Regulatory Administration (NAFR), China banks delivered improved earnings growth of 0.74% yoy in 3Q24 (vs flattish in 2Q24), mainly thanks to better top-line performance (-0.2% yoy), aided by: a) narrower net interest income and fee income declines, and b) strong trading gains. Among the banks, SOE banks generally outperformed joint-stock banks (JSB) in terms of earnings growth. Agricultural Bank of China led the pack with a 5.9% yoy earnings growth among its SOE peers.

- **Loan and deposit growths remained sluggish.** 3Q24 loan growth decelerated to 8.1% yoy from 8.8% in 1H24, dragged by both corporate and retail loan books, indicating weakened credit demand. Corporate deposits declined by 3.2% yoy (1H24: 2.9%), due to tightened regulations on deposit interest subsidies while retail loan growth moderated to 10.5%, driven by the transfer of funds to broker deposits, following improved stock market sentiment after the policy turnaround in late-Sep 24.

- **NIM pressure lingered in 3Q24.** Based on our calculations, China banks' quarterly NIM fell 3bp qoq to 1.51% (2Q24: flattish qoq). SOE banks recorded a 2bp sequential NIM compression to 1.43%, similar to 2Q24, while JSBs experienced a 1bp qoq NIM dilution to 1.63%. The lacklustre NIM performance was mainly due to sluggish credit demand which led to lower loan yields and an increase of low-yielding discount bills in the new loan mix. However, it was partly offset by a deposit cost decline after the deposit rate cut in Jul 24.

- **Fee weakness easing.** Most banks reported a smaller fee income decline in 3Q24, mainly due to the low base effect in 3Q23 and increased insurance sales before the full suspension of life insurance products with a 3.0% guaranteed return rate. We believe: a) the waning impact of bancassurance and mutual fee rate cuts, and b) recent pick-up in equity market turnover amid the policy turnaround could help reverse the fee income sluggishness in 4Q24.

- **Strong other NII was the key revenue driver in 3Q24,** which surged 70% yoy on average, driven by investment gains from bond trading and foreign exchange gains. We believe that some banks sold a portion of their long-term government bonds in 3Q24 to help the PBOC in stabilising long-term treasury yields. While this may boost trading gains, it could also negatively impact long-term NIM performance as banks will need to reinvest funds at lower yields given the falling interest rates. Although the trading gains from bond investments are expected to remain robust in 4Q24 (10-year treasury yield: -10bp qtd), the renminbi depreciation following the US election will pose some headwinds to the banks' other non-interest income (NII).

MARKET WEIGHT

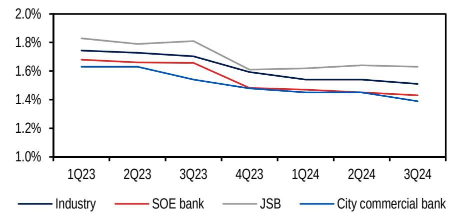
(Maintained)

SECTOR TOP PICK

Company	Ticker	Rec	Share Price (HK$)	Target Price (HK$)
CMB	3968 HK	BUY	34.50	49.00

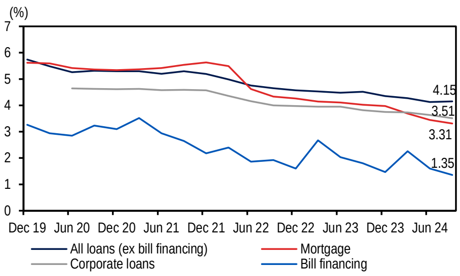
Source: UOB Kay Hian

NIM TREND



Source: NAFR, UOB Kay Hian

NEW LOAN WEIGHTED AVERAGE RATE



Source: PBOC, UOB Kay Hian

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PEER COMPARISON

Company	Ticker	Rec	Price @ 26 Nov 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	939 HK	BUY	5.84	6.70	1,485,235	14.7	4.1	4.0	0.4	0.4	7.4	7.6	9.9	9.7	1.4	1.4
CMB	3968 HK	BUY	34.50	49.00	870,085	42.0	5.3	5.0	0.7	0.7	6.4	6.8	15.1	14.2	1.9	1.9

Source: Bloomberg, UOB Kay Hian

CHINA BANKS RESULTS AT A GLANCE (3Q24)

	NII	Fee Income	Other NII	Revenue	Opex	PPOP	Impairment	NPAT
ICBC	-1.1%	-11.1%	164.7%	1.3%	0.5%	1.6%	6.5%	3.8%
BoC	-8.2%	6.2%	120.8%	6.6%	22.6%	-2.0%	-17.2%	4.4%
CCB	-7.3%	-7.6%	435.6%	-2.7%	0.9%	-4.1%	-24.6%	3.8%
ABC	2.6%	-6.9%	35.2%	3.4%	0.7%	4.0%	10.5%	5.9%
PSBC	0.7%	0.8%	-2.2%	0.5%	-4.1%	8.8%	53.5%	3.5%
BoCom	2.0%	-12.4%	-0.7%	3.2%	3.3%	3.2%	-0.9%	1.2%
CMB	-0.8%	-12.9%	11.4%	-2.6%	-10.3%	1.6%	8.5%	0.8%
CEB	-8.8%	-18.0%	8.4%	-8.7%	-2.1%	-11.6%	-51.2%	3.6%
SPDB	-6.5%	-0.7%	34.3%	0.0%	1.4%	-0.7%	-5.0%	69.9%
Industrial	-1.2%	-5.5%	28.4%	1.8%	-2.3%	3.7%	26.4%	-10.4%
CITIC	3.7%	0.1%	29.1%	6.2%	12.4%	3.4%	-4.9%	6.3%
MSB	-2.8%	13.3%	-1.4%	-0.5%	4.8%	-47.0%	14.1%	-18.2%
PAB	-18.4%	-13.1%	41.8%	-11.7%	-10.0%	-12.4%	-19.8%	-2.8%
Sector avg	-3.5%	-5.2%	69.7%	-0.2%	1.4%	-4.0%	-0.3%	0.2%
SOE avg	-1.9%	-5.2%	125.6%	2.1%	4.0%	1.9%	4.6%	3.8%
JSB avg	-5.0%	-5.3%	21.7%	-2.2%	-0.9%	-9.0%	-4.5%	-3.5%

Source: Respective banks, UOB Kay Hian

- **Asset quality remained largely benign but surge in retail NPL pressures garnered attention.** The non-performing loan (NPL) ratio stayed flattish qoq at 1.56% as of 3Q24. However, the special mention loan (SML) ratio of China banks edged up 6bp qoq to 2.28%, as we saw growing asset quality pressure from the retail segment, particularly for credit card and mortgage loans, as evidenced by a rising overdue loan ratio and SML ratio across the retail book of China Merchants Bank (CMB) and Bank of Communications (BoCoM). Despite that, we observed that China banks were more willing to release provisions by trimming credit costs (-11bp yoy on average in 9M24) to boost earnings growth. We noted that large SOE banks have stronger incentives to do so, given their upcoming capital-raising exercises.

ESSENTIALS

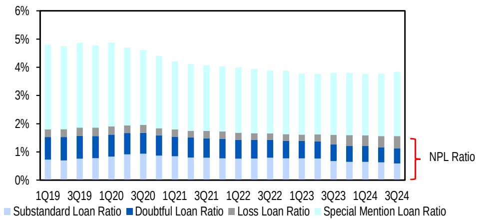
- **4Q24 NIM outlook dulled by mortgage repricing and LPR cuts.** Nonetheless, SOE banks' managements guided that the sequential NIM compression in 4Q24 is manageable, given the mortgage repricing policy took effect only in late-October and a deposit rate cut of a similar quantum was made to neutralise the policy rate cuts impact.

- **PBOC's efforts to ease NIM pressure.** According to the PBOC's statement in its 3Q24 monetary policy report, the central bank called for improved transmission of policy rate cuts and urged banks to restore orderly competition by avoiding offering excessively high deposit rates and significantly reducing lending rates to corporate clients. The PBOC has taken a few initiatives to regulate the competition such as: a) making more timely deposit rate adjustments, b) prohibiting deposit interest subsidies, and c) urging banks to avoid issuing loans with after-tax interest rates lower than the yields of comparable-maturity treasury bonds.

ACTION

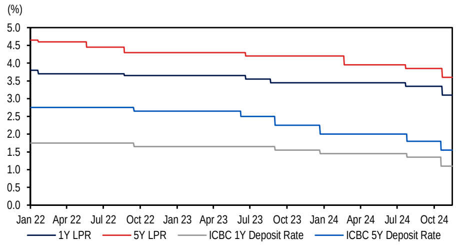
- **Maintain MARKET WEIGHT on the China banking sector.** Although China banks are most likely to deliver positive earnings growth for 2024, the NIM pressure and sluggish credit demand will continue to cloud their revenue prospects in 2025. We think large SOE banks and smaller regional banks have more incentives to release provisions in order to retain positive earnings growth ahead of equity-raising exercises in 2025. H-share China banks are now trading at 0.43x 2025F P/B (-1.0SD). However, we think further upside potential is limited for SOE banks and a few JSBs due to the potential EPS dilution impact from the upcoming equity-raising exercises. Additionally, we suggest reducing exposure to large SOE banks, as we are uncertain whether the big banks will raise dividend payouts after the capital injection to maintain their DPS and dividend yield, which are key components of the investment thesis for SOE banks.

NPL TREND



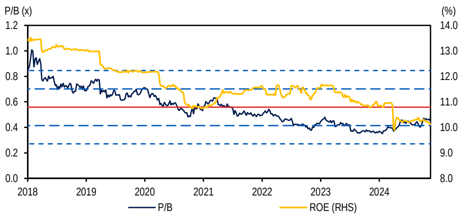
Source: NAFR, UOB Kay Hian

LPR AND DEPOSIT RATE CHANGES



Source: PBOC, ICBC, iFinD, UOB Kay Hian

SECTOR P/B VS ROE



Source: Bloomberg, UOB Kay Hian

- **China Merchants Bank (3968 HK/BUY/Target: HK$49.00).** Management's tone on the earnings outlook is the most upbeat since 2022 after multiple positive operating trends were observed following the stimulus package rollout in late-Sep 24. Hence, we continue to like CMB as it is the key beneficiary if there is any additional policy supports and it has no equity-raising risk in the near term. Our target price of HK$49.00 is derived from the dividend discount model (cost of equity: 13.6%, terminal growth rate: 3.5%, payout ratio: 33.9%) and implies 0.95x 2025F P/B (-0.8SD). CMB is now trading at a 0.68x of 2025F P/B (-1.5SD) with an attractive dividend yield of 6.8%.

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