

25 June 2018

Financial Services | Banks

Banks

Overweight (Maintained)

RRR Cut To Promote Deleveraging

Stocks Covered: 9
 Ratings (Buy/Neutral/Sell): 6 / 3 / 0
 Last 12m Earnings Revision Trend: Positive

Maintain OVERWEIGHT on the sector with ABC and BOC as our Top Picks. We believe the 50bps RRR cut announced on 24 June was within expectations, given the State Council's recent advice to support MSE lending with various monetary policy tools. Debt-to-equity swap, a measure to lower financing burden for the real economy, was introduced as a key policy guidance. The central bank's move also aims to stabilise market sentiment after recent sell-offs led by China-US trade tensions and accelerating bond defaults, in our view.

RRR cut was in line with expectations. On 24 June, the People's Bank of China (PBoC) announced a 50bps cut in the reserve requirement ratio (RRR), effective 5 Jul 2018. Targeted financial institutions include five state-owned banks, 12 joint-stock banks, Postal Savings Bank of China (PSBC), city commercial banks, non-county level rural commercial banks, and foreign banks. We believe the cut was well-expected by the market, as the State Council's meeting on 20 June had suggested the deployment of various policy tools, including RRR cut, to support financing for micro and small enterprises (MSEs). Meanwhile, the central bank said it would maintain a stable and neutral monetary policy, control the pace of deleveraging, and create a suitable monetary environment for supply-side reform.

How is it different from previous cuts? Apart from lowering financing costs for MSEs, debt-to-equity swap (DES) was introduced as a key policy guidance. Moreover, total funds released amounts to CNY700bn (CNY500bn for DES; CNY200bn for MSE loans), more than the CNY450bn and CNY400bn from respective RRR cuts in January and April. The PBoC intends to promote corporate deleveraging by injecting more low-cost funding to banks, thereby enhancing their ability to implement DES initiatives. However, the policy effectiveness remains to be seen, in our view, given capital constraints and the return of uncertainty for DES projects.

Effort to stabilise market sentiment. The China-US trade dispute and recent bond defaults have put the stock market in a risk-off mode. The RRR cut is likely to offer timely support for market sentiment, while lowering the risk of a liquidity crunch due to mounting capital outflows.

Further policy easing remains on the table. After the PBoC's move, the RRRs for big and small banks will decline to 15.5% and 13.5%, still above the historical mean of 12-13%. We believe further policy easing is likely in 2H18, to smooth the liquidity condition amid shadow banking clean up, and to prepare banks for on-loading existing credits in off-balance sheet channels. Possible triggers include continued weakness in total social financing (TSF) growth and further acceleration in bond market defaults.

Maintain OVERWEIGHT. The RRR cut is positive for banks' NIM and profit trend, as it would lower funding cost and spur loan growth. Our sensitivity analysis indicates that a 50bps RRR cut would boost FY18F sector earnings by 0.3%. For the impact on individual banks, please refer to our 5 June report: [RRR Cut Around The Corner?](#)

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
Agricultural Bank of China	BUY	HKD3.77	HKD5.80	53.8	5.0	0.6	6.1
Bank of China	BUY	HKD3.90	HKD5.90	51.3	5.3	0.6	5.8
China CITIC Bank	BUY	HKD5.07	HKD6.50	28.2	4.7	0.5	6.6
China Construction Bank	BUY	HKD7.38	HKD10.30	39.6	6.0	0.8	5.1
China Merchants Bank	BUY	HKD29.80	HKD37.50	25.8	7.9	1.2	3.9
ICBC	BUY	HKD6.03	HKD8.50	41.0	6.0	0.8	5.1
Bank of Communications	NEUTRAL	HKD6.16	HKD6.30	2.3	5.3	0.6	5.8
China Everbright Bank	NEUTRAL	HKD3.75	HKD4.00	6.7	5.1	0.6	6.1
China Minsheng Banking Corp	NEUTRAL	HKD7.06	HKD7.90	11.9	4.6	0.6	3.2

Source: Company data, RHB

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Not Rated: Stock is not within regular research coverage

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