

5 June 2018

Financial Services | Banks

## Banks

**Overweight** (Maintained)

### RRR Cut Around The Corner?

**Maintain OVERWEIGHT, with ABC and BOC as Top Picks. We anticipate further RRR cuts in the next six months, as China backs up credit expansion and reduces financing costs for the real economy. Continued weakening in M2 and TSF growth may trigger selective easing – and not a broad-based loosening – in policies by the PBoC. Our sensitivity analysis suggests that a 50bps RRR cut could lift banks' earnings by 0.3%, assuming all funding released is to support loan growth.**

**RRR is still above the historical average.** The People's Bank of China (PBoC) has cut the reserve requirement ratio (RRR) twice in 2018, including a 50-150bps targeted RRR cut for inclusive finance in January and a 100bps conditional RRR cut to replace the Medium-term Lending Facility (MLF) in April. After the PBoC's move, official RRRs for big and small banks now stand at 16% and 14% respectively, still above the historical mean of 12.5% (see our 18 Apr report: [RRR Cut Positive For Margin And Credit Growth](#)).

**Expect further RRR cuts to support credit growth.** China's deleveraging efforts have been slowing down both M2 and total social financing (TSF) growth over the past few months. The new asset management will continue to drive off-balance sheet credit back to bank loans. This would require necessary liquidity support to reinforce banks' lending capacity, especially with the lacklustre deposit growth. Meanwhile, recently-issued liquidity measures guided banks to lessen the duration mismatch, thereby increasing their demand for long-term stable funding (please refer to our 28 May report: [Limited Impact From Liquidity Risk Measures](#)).

**June might be a good window.** According to PBoC statistics, over half of the CNY4trn MLF balance will mature in 2H18, weighing on banks' liquidity condition. RRR cuts could effectively reduce banks' reliance on short-term wholesale funding, thus optimising their liability structure. Seasonal factors, ie corporate tax payment and fluctuation in fiscal deposits, also suggest that June would be a timely period for a RRR cut. Moreover, a cut looks imminent for joint-stock banks with elevated LDR and narrowing margins.

**Quantify the impact on banks.** Our sensitivity analysis indicates that a 50bps conditional RRR cut to replace MLF would lift commercial banks' earnings by 0.16%, through the reduction of interest expense. Also, an unconditional RRR cut of the same magnitude would boost sector earnings by 0.3%, if all funding released is used to support loan growth. Smaller banks might benefit more in the short term, from the ease in funding pressure. However, big banks would enjoy greater NIM and earnings upside, as their larger deposit base would free up more funds.

**Greater policy flexibility ahead.** PBoC should maintain its stable and neutral monetary policy stance to facilitate deleveraging, in our view. However, there is likely greater policy flexibility to cater for the real economy. We expect another 50-100bps RRR cut in the next six months to cushion the impact of the new asset management regulations.

**Still OVERWEIGHT.** We believe the potential RRR cuts and the upcoming dividend payout would underpin China banks' re-rating in the coming months. Recent share price weakness appears to offer an good opportunity to buy on dips. Top picks are Agricultural Bank of China (ABC) and Bank of China (BOC).

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

**Top Picks** **Target Price**  
Agricultural Bank of China (1288 HK) – BUY HKD5.80  
Bank of China (3988 HK) – BUY HKD5.90

### Impact of the 50bps unconditional RRR cut

Company	Impact to FY18 forecast	
	NIM (bp)	Net profit (%)
ICBC	0.7	0.32
CCB	0.7	0.33
ABC	0.7	0.37
BOC	0.5	0.32
BoCom	0.5	0.32
CMB	0.5	0.19
CITIC	0.4	0.31
MSB	0.4	0.26
CEB	0.5	0.31
<b>Average</b>	<b>0.6</b>	<b>0.31</b>

Note: Assuming further RRR cut is effective in 2H18.  
Source: Company data, RHB

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	HKD4.14	HKD5.80	40.1	5.4	0.7	5.7
Bank of China	BUY	HKD4.19	HKD5.90	40.8	5.6	0.7	5.5
China CITIC Bank	BUY	HKD5.43	HKD6.50	19.7	5.0	0.5	6.2
China Construction Bank	BUY	HKD8.15	HKD10.30	26.4	6.5	0.9	4.7
China Merchants Bank	BUY	HKD33.00	HKD37.50	13.6	8.6	1.3	3.6
ICBC	BUY	HKD6.62	HKD8.50	28.4	6.4	0.9	4.7
Bank of Communications	NEUTRAL	HKD6.34	HKD6.30	(0.6)	5.4	0.6	5.7
China Everbright Bank	NEUTRAL	HKD3.96	HKD4.00	1.0	5.3	0.6	5.9
China Minsheng Banking Corp	NEUTRAL	HKD7.56	HKD7.90	4.5	4.8	0.6	3.0

Source: Company data, RHB

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## Sensitivity Analysis On RRR Cut

Figure 1: Earnings impact from 50bps RRR cut to China's commercial banks

Case 1 - Conditional RRR cut to replace MLF	(CNYbn)	Calculation
Deposits of commercial banks	132,000	A
Funding released to repay MLF	660	$B = A \times 0.5\%$
Interest rate of 1-year MLF	3.3%	C
Interest rate of required reserve at PBoC	1.6%	D
<b>Increase in NII</b>	<b>5.5</b>	$E = B \times (C-D) \times (184/365)$
FY18F CIR	31.8%	G
FY18F tax rate	20.4%	H
FY18F net profit	1,870	I
<b>Increase in NII as percentage of FY18F net profit</b>	<b>0.16%</b>	$J = E \times (1-G) \times (1-H) / I$

Case 2 - Unconditional RRR cut to boost loan growth	(CNYbn)	Calculation
Deposits of commercial banks	132,000	A
Funding released to support new loans	660	$B = A \times 0.5\%$
Average loan rate	6.0%	C
Interest rate of required reserve at PBoC	1.6%	D
Sector NPL ratio	1.8%	E
<b>Increase in NII</b>	<b>11.8</b>	$F = B \times (C-D-E) \times (184/365)$
FY18F CIR	31.8%	G
FY18F tax rate	20.4%	H
FY18F net profit	1,870	I
<b>Increase in NII as percentage of FY18F net profit</b>	<b>0.34%</b>	$J = F \times (1-G) \times (1-H) / I$

Note: Assuming further RRR cut is effective in 2H18.

Source: Wind, CBIRC, RHB

Figure 2: Impact to individual banks in the case of a 50bps unconditional RRR cut

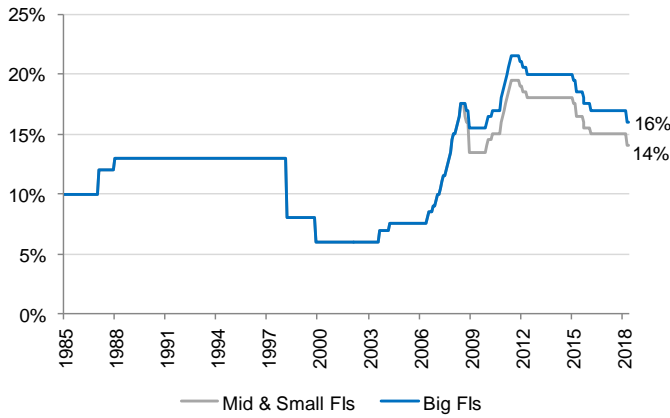
Company	Increase in NII (CNYm)	FY18F avg interest- earning assets (CNYbn)	Impact to FY18 forecast	
			NIM (bp)	Net profit (%)
ICBC	1,736	25,876	0.7	0.32
CCB	1,431	21,990	0.7	0.33
ABC	1,467	21,158	0.7	0.37
BOC	1,071	19,632	0.5	0.32
BoCom	465	8,822	0.5	0.32
CMB	295	6,507	0.5	0.19
CITIC	248	5,806	0.4	0.31
MSB	251	5,929	0.4	0.26
CEB	200	4,154	0.5	0.31
<b>Total / average</b>	<b>7,164</b>	<b>119,873</b>	<b>0.6</b>	<b>0.31</b>

Note: Assuming further RRR cut is effective in 2H18.

Source: Company data, RHB

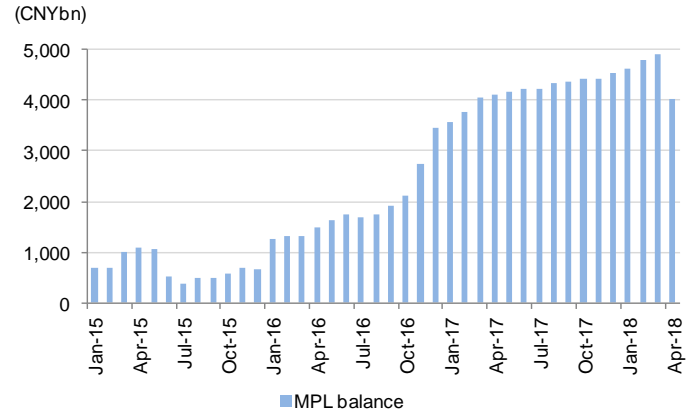
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**Figure 3: Current RRR was above the historical mean of 12.5%**



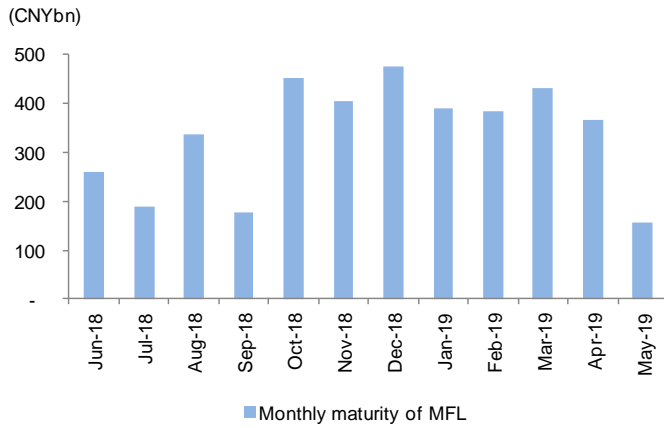
Source: Wind, RHB

**Figure 4: MFL balance declined by CNY900bn in April due to the repayment with funding from the previous RRR cut**



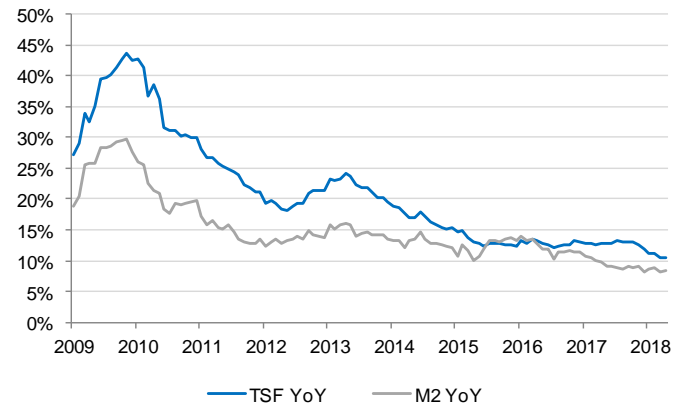
Source: Wind, RHB

**Figure 5: MLF's maturity schedule in the next 12 months**



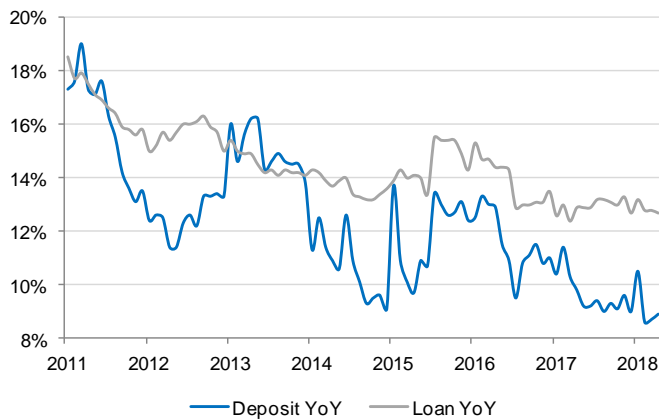
Source: PBoC, RHB

**Figure 6: Both M2 and TSF growth are at historical lows**



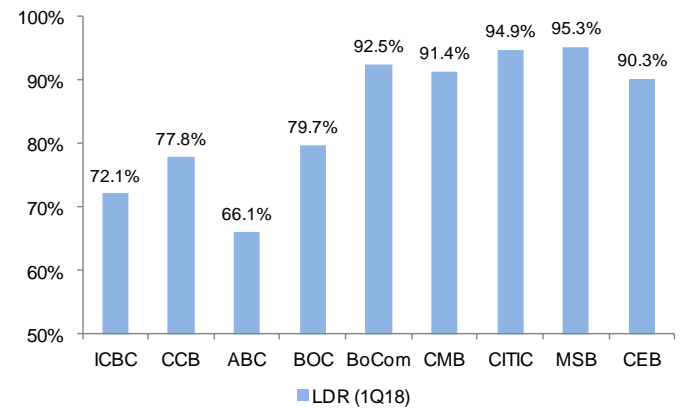
Source: Wind, RHB

**Figure 7: Deposit growth has been lagging behind loan growth**



Source: Wind, RHB

**Figure 8: LDR for joint-stock banks was all above 90% as of 1Q18**



Source: Company data, RHB

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Figure 9: Valuation summary for banks under our coverage

Company	Ticker	Rating	Mkt cap (USDbn)	3M ADT (USDm)	Price (HKD)	P/E		P/BV		Dividend yield		ROE	
						2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
ICBC	1398 HK	BUY	313.1	220.0	6.6	6.4	5.9	0.85	0.77	4.7%	5.2%	13.9%	13.8%
CCB	939 HK	BUY	260.5	349.6	8.2	6.5	6.0	0.88	0.80	4.7%	5.4%	14.2%	14.0%
ABC	1288 HK	BUY	184.2	101.9	4.1	5.4	5.1	0.69	0.63	5.7%	6.0%	13.8%	13.3%
BOC	3988 HK	BUY	169.4	174.2	4.2	5.6	5.1	0.66	0.60	5.5%	6.0%	12.2%	12.2%
CMB	3968 HK	BUY	113.5	86.3	33.0	8.6	7.4	1.35	1.19	3.6%	4.1%	16.7%	17.1%
CITIC	998 HK	BUY	44.2	42.1	5.4	5.0	4.6	0.55	0.50	6.2%	6.8%	11.5%	11.5%
BoCom	3328 HK	NEUTRAL	65.4	24.1	6.3	5.4	5.0	0.58	0.54	5.7%	5.7%	11.2%	11.2%
MSB	1988 HK	NEUTRAL	42.3	34.6	7.6	4.8	4.9	0.64	0.58	3.0%	3.2%	13.0%	12.3%
CEB	6818 HK	NEUTRAL	31.2	6.2	4.0	5.3	5.0	0.58	0.53	5.9%	6.3%	11.3%	11.2%
<b>Average</b>						<b>6.2</b>	<b>5.6</b>	<b>0.81</b>	<b>0.74</b>	<b>4.9%</b>	<b>5.4%</b>	<b>13.4%</b>	<b>13.3%</b>

Note: Prices are as at 4 Jun 2018

Source: Bloomberg, RHB

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**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

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