

China Banking Industry (OUTPERFORM) – Strong earnings growth makes banking counters good choices for both aggressive and defensive investors

- ❖ Sector operations in Dec 11: Matured wealth management products and budget appropriations result in massive deposit inflow and eases the pressure on banks' loan/deposit ratios; joint-stock lenders increased loan issuance. In Dec 11, total new loans tallied Rmb1.42trn. Inclusive of budgetary appropriations, commercial banks' general deposits surged by more than Rmb2.6trn, driven mainly by savings deposits and corporate demand deposits. Loans issued during the period totaled Rmb640.5bn. The growth was faster both YoY and MoM, which was in line with the fine-tuning of China's macro policy and also contributed to the flow of deposits back onto the balance sheet. Joint-stock banks, which had been under regulatory lending restrictions, logged an increased share of new loans while the market share of policy banks decreased. The percentage of short-term loans in total loans hit a two-year high of 70%. In full-year 2011, Mainland banks issued total loans of Rmb7.74trn (close to the Rmb7.5trn target).
- ❖ Sector operation in Dec 11: The decline in funds for foreign exchange funds accelerated and the issuance of financial bonds helped boost capital. In Dec 11, outstanding funds for foreign exchange decreased by a steeper Rmb100.3bn, the third consecutive month of decline. This has a substantial adverse impact on base money supply in the banking system, and we believe the People's Bank of China (PBOC) will have to boost the money multiplier by adjusting RRR. In Dec 11, Rmb130bn in financial bonds were issued, the highest in nearly two years and a major part of capital source for commercial banks. We believe the trend will continue in 2012E due to a warming debt market and government policy towards lending to SMEs.
- ❖ Jan 12E operations at a glance: Outflow of deposits, steady lending and tight capital. In Jan 12E, banks are expected to register a decline in deposits, mainly due to budgetary payments and cash withdrawals during the holiday season. We see a high probability that outstanding M0 at end-Jan 12E will be high and that deposit growth at banks will be negative. Commercial banks have abundant reserves of credit and loan projects, with median loan growth in Jan 12E estimated at Rmb800bn. Although the supply of capital in the banking sector was tight prior to the CNY holidays, but is expected to gradually loosen up after the holiday season. We believe that money market rates will decline over time and that the median interest rate of 7-day repurchases may be between 3-3.5%.
- ❖ Forecast for 2012E social financing: Moderate increase in volume, adjustment in structure and balanced pace. In 2012E, we forecast total social financing will rise 6% YoY (to ~Rmb13.5trn, including Rmb8trn in new RMB-denominated loans). New Corporate bonds (CB) financing may increase to Rmb1.75trn and that from new entrusted loans may decrease to Rmb1.2trn, while bankers' acceptances (BA) may continue to shrink. Total social financing is likely to be more evenly distributed among calendar quarters compared to 2011. In 1Q12E, the amount is estimated to be Rmb4.09trn (~2% YoY).
- ❖ Risks associated with investing in the sector: (i) Harsher-than-expected regulation and tighter-than-expected monetary policy; (ii) given the deterioration in the economic and financial environments, risks to platform, real estate, and personal loans could pose challenges to banking operations and asset quality.
- ❖ Investment strategy: The prospects for visible and strong earnings growth could catapult sector valuations. We have increased our estimate for 2011E earnings growth in the banking sector from 27% to 30% YoY. Year-to-date in 2012, the banking sector and our recommended banks have logged strong gains in both absolute and relative terms. In view of improving liquidity and anticipated robust growth in 2011E and 1Q12E earnings, we remain upbeat about the prospects for a short-term rally in the banking industry.

Peers' comparison - China Banking Industry (HK)

Company	Price (HK\$)	PER (x)			PEG (x) 10-12E	P/B (x) 12E	Yield (%) 12E	RoE (%) 12E
		10	11E	12E				
Hong Kong -average		8.6	7.4	6.2	0.6	1.2	4.4	21
ICBC (01398.HK)	5.42	9.2	7.5	6.5	0.5	1.4	5.4	24
CCB (00939.HK)	6.09	8.9	7.4	6.3	0.5	1.3	5.5	23
BoC (03988.HK)	3.28	6.9	5.8	4.8	0.3	0.9	6.2	20
ABC (01288.HK)	3.75	9.3	8.1	6.7	0.5	1.4	5.2	22
BoComm (03328.HK)	6.10	7.5	6.3	5.2	0.4	1.0	4.0	21
Minsheng Bank (01988.HK)	7.20	8.9	6.5	5.0	0.3	1.0	2.7	22
CMB (03968.HK)	17.02	11.3	10.5	8.6	0.8	1.6	2.8	20
CITIC Bank (00998.HK)	4.89	7.5	6.4	5.4	0.4	1.0	4.0	19
CQRC Bank (03618.HK)	4.37	7.9	8.0	7.0	1.3	1.1	3.7	16

Source: Respective companies, Bloomberg, CSI

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Investment rating system

Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

地址:	香港中环 添美道 1 号 中信大厦 26 楼	Address:	26/F CITIC Tower 1 Tim Mei Avenue Central, Hong Kong
电话:	(852) 2237 9250	Tel:	(852) 2237 9250
传真:	(852) 2104 6580	Fax:	(852) 2104 6580
电邮:	hkresearch@citics.com.hk	Email:	hkresearch@citics.com.hk
网址:	http://www.citics.com.hk	Website:	http://www.citics.com.hk