SECTOR UPDATE

# Banking – China

Playing Safe Amid Tariff Fears

**Trump's unprecedented reciprocal tariffs triggered a massive sell-off in the Hong Kong market. On 30 Mar 25, China's four SOE banks also announced their capital-raising plans, with the dilution impact largely in line with our expectations. We believe the potential risks from Trump's tariffs are manageable for Chinese banks. Hence, investors may shift back to defensive, high dividend yield names like Chinese banks amid the sentiment hit from the tariff shocks. Upgrade to OVERWEIGHT. Top pick: CCB.**

## WHAT'S NEW

- **Tariff for tariff escalates trade tensions further.** The Trump administration's announcement of a sweeping 34% tariff on Chinese goods last week triggered a sharp sell-off in the Hong Kong market on Monday after the Qingming holiday. The Hang Seng Index (HSI) tumbled 13.2%, while the Hang Seng Mainland Bank Index (HSMBI) dropped 9.1%, wiping out all gains made since the start of the year. On Wednesday, Trump raised tariffs on Chinese goods to 125% in response to China's retaliatory tariffs of 84% in the escalating trade war. However, in an unexpected move, he also announced a 90-day pause on tariffs and reduced them to 10% for most countries, except China, which may provide temporary relief to the market.

- **Four large SOE banks announced capital raising.** China Construction Bank (CCB), Bank of China (BoC), Bank of Communications (BoCom), Postal Savings Bank of China (PSBC) together plan to raise up to Rmb520b of capital through private placements of A-shares, with the Ministry of Finance (MoF) being the major strategic investors to subscribe to Rmb500b of bank shares. The government shareholding through MoF and Central Huijin will increase around 2ppt-16ppt for each SOE bank and the replenishment will be completed by end-25. The Rmb500b of funding is expected to be raised from the issuance of special treasury bonds. The details are shown below.

SOE BANKS RECAP DETAILS

| (Rmbb) | CCB | BoC | BoCom | PSBC |
|---|---|---|---|---|
| Placement size | 105 | 165 | 120 | 130 |
| Issue price (Rmb) | 9.27 | 6.05 | 8.71 | 6.32 |
| Implied 2024 P/B (x) | 0.73 | 0.74 | 0.67 | 0.76 |
| New shares as % of enlarged share base | 4.3 | 8.5 | 15.6 | 17.2 |
| Issuance target: | | | | |
| MoF | 105 | 165 | 112.4 | 117.6 |
| Other investors (SOE) | 0 | 0 | 7.6 | 12.4 |
| Government new direct shareholding (%) | 59.0 | 67.7 | 34.8 | 15.5 |

*Source: UOB Kay Hian*

## ESSENTIALS

- **Assessing the dilution impact.** The pricing falls within 0.6x-0.8x of 2024 P/B, reflecting a premium of 5-24% over their current A-share price. In term of dilution impact, PSBC and BoCom would be more impacted (15.6% and 17.4%) from the capital replenishment due to their relatively low CET1 ratio while CCB and BoC faced a smaller equity dilution impact.

- **Strengthening balance sheet.** We see that the Big 6 banks do not have imminent capital pressure as their CET1 ratios as of Dec 24 were well above the minimum regulatory requirement. Based on our calculations, the Rmb520b of capital injection will boost the CET1 ratio of the involved SOE banks by 100bp on average. We believe the key reasons to recapitalise the SOE banks are to help SOE banks ease the ongoing pressure from NIM compression and better digest the potential NPL formation. The recapitalisation also aims to help the G-SIB banks (CCB, BoC and BoCom) meet the phase 2 total loss-absorbing capacity (TLAC) requirement by 2028.

OVERWEIGHT

(Upgraded)

SECTOR PICKS

| Company | Ticker | Rec | Share Price (HK$) | Target Price (HK$) |
|---|---|---|---|---|
| CCB | 939 HK | BUY | 6.13 | 7.50 |

*Source: UOB Kay Hian*

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PEER COMPARISON

| Company | Ticker | Rec | Price @ 9 Apr 25 (HK$) | Target Price (HK$)) | Market Cap (HK$ m) | Upside to TP (%) | PE 2024 (x) | PE 2025F (x) | P/B 2024 (x) | P/B 2025F (x) | Yield 2024 (%) | Yield 2025F (%) | ROE 2024 (%) | ROE 2025F (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CCB | 939 HK | BUY | 6.13 | 7.50 | 1,558,082 | 22.3 | 4.4 | 4.2 | 0.4 | 0.4 | 7.0 | 6.9 | 10.3 | 9.8 |
| CMB | 3968 HK | BUY | 41.25 | 49.00 | 1,069,192 | 18.8 | 6.6 | 6.3 | 0.9 | 0.9 | 5.2 | 5.4 | 15.1 | 14.1 |

*Source: Bloomberg, UOB Kay Hian*

### IMPACT OF ANNOUNCED CAPITAL RAISE

| SOE Banks | Dilution (%) | A-share Premium (%) | CET-1 Ratio Boost (bp) | New CET-1 Ratio (%) |
|---|---|---|---|---|
| CCB | 4.3 | 5.3 | 48 | 15.0 |
| BoC | 8.5 | 11.8 | 86 | 13.1 |
| Bocom | 15.6 | 19.0 | 127 | 11.5 |
| PSBC | 17.4 | 24.2 | 151 | 11.1 |
| Average | 11.0 | 15.1 | 103 | 12.7 |

*Source: UOB Kay Hian*

- **Maintain DPS and support RWA growth.** We estimate that SOE banks would need to raise their payout ratios by an average of 4.1ppt from the current level of 30% to keep dividends flat. Additionally, we project that the four major SOE banks could support around Rmb4.2t in RWA expansion using the newly raised capital. This suggests a potential RWA growth of 8.8%. However, we believe it is unlikely that these banks will significantly raise their credit growth targets this year. Instead, this round of capital replenishment is more likely to support a more sustainable pace of loan growth over the long term.

### NEW CAPITAL RAISE TO MAINTAIN DPS AND SUPPORT RWA GROWTH

| SOE Banks | Payout ratio increase to maintain flat DPS (ppt) | Additional RWA Growth (Rmbbt) | Additional RWA Growth (%) |
|---|---|---|---|
| CCB | +1.5 | 0.7 | 3.1 |
| BoC | +2.8 | 1.2 | 6.3 |
| Bocom | +5.6 | 1.0 | 10.6 |
| PSBC | +6.5 | 1.3 | 15.1 |
| Average/Total | +4.1 | 4.2 | 8.8 |

*Source: UOB Kay Hian*

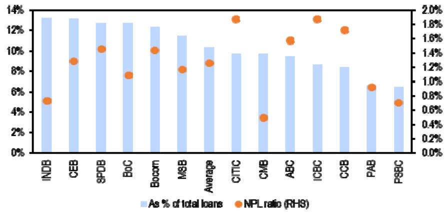
- **Rising asset quality pressure from manufacturing sector still manageable.** Since the gross margin of the Chinese exporters is unlikely to cover the 104% of reciprocal tariffs, we see rising asset quality pressure in this sector and banks with a higher-than-average exposure to manufacturing loans, with BoC and Bocom potentially more susceptible to the risks posed by escalating trade tensions. According to PBOC's disclosure, the manufacturing loan balance was Rmb24.6t, accounting for 9.6% of total system loans as of Dec 24. Although asset quality risks are rising, loans to US-focused exporters make up less than 10% of banks' total manufacturing loan portfolios.

  Our sensitivity analysis indicates that a 50bp rise in the manufacturing NPL ratio could result in an average of 4.9% impact on banks' pretax profit, assuming they fully account for credit costs on the new manufacturing NPLs. Among the SOE banks, BoC and Bocom are most sensitive to the new manufacturing NPL. That said, the actual impact could be milder if banks tap into their existing provision buffers to cushion earnings. We estimate that their provision coverage ratios would drop by an average of 10ppt to absorb the spike in manufacturing NPLs, if the banks choose to keep credit costs unchanged.

- **Sluggish trade activities could hit the banks' fee income.** We believe that weakening trade activity could also weigh on banks' fee income growth, particularly in the settlement and clearing fees. This impact is likely to be more significant for SOE banks, as these fees contributed a larger share of their overall gross fee income mix as of 2024. For instance, 31% of CCB's fee income came from settlement and clearing fees in 2024.

- **Long-awaited monetary stimulus to the rescue?** The PBOC has reiterated many times that it will cut RRR and interest rates at an appropriate time this year. Now that the tariff uncertainty has cleared, we believe this month is an appropriate window for the PBOC to cut the RRR. Given the larger-than-expected tariffs and seasonal cash shortages, we anticipate a larger 50bp RRR cut to be announced in the near term. In addition, the PBOC may deliver more rate cuts this year in response to the larger-than-expected tariffs, which would continue to weigh on banks' net interest margins (NIM). However, we believe SOE banks could offset some of this pressure by accelerating balance sheet growth on the back of new capital, which will help drive net interest income growth despite the NIM compression.

### MANUFACTURING LOAN AS % OF TOTAL LOAN AND NPL RAIO (2024)



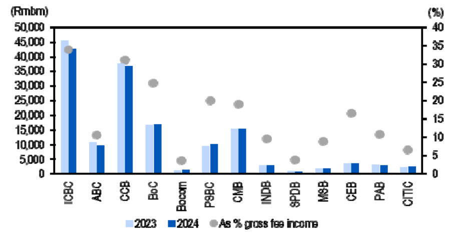

*Source: Respective companies, UOB Kay Hian*

### SENSITIVITY ANALYSIS ON A 50BP INCREASE IN THE MANUFACTURING NPL RATIO

| Banks | Impact to 2025F PBT (%) | Changes in provision coverage ratio if no additional credit cost is charged (ppt) |
|---|---|---|
| ICBC | -2.9 | -6.7 |
| ABC | -3.7 | -10.6 |
| CCB | -2.8 | -7.1 |
| BoC | -4.6 | -9.7 |
| Bocom | -5.1 | -9.1 |
| PSBC | -3.0 | -14.3 |
| CMB | -1.9 | -20.0 |
| INDB | -4.4 | -13.8 |
| SPDB | -16.8 | -8.4 |
| MSB | -7.5 | -5.3 |
| CEB | -5.0 | -9.0 |
| PAB | -2.0 | -7.6 |
| CITIC | -3.4 | -8.4 |
| Average | -4.9 | -10.0 |

*Source: UOB Kay Hian*

### SETTLEMENT AND CLEARING FEE CONTRIBUTION




*Source: UOB Kay Hian*

ACTION

- **Upgrade to OVERWEIGHT as defensive plays gain traction again amid tariff fears.** The unprecedented reciprocal tariffs by the Trump's Administration have worsened US-Sino relations and clouded China's economy outlook. Nevertheless, we expect China to step up with more aggressive stimuli to counter Trump's tariff hits by bolstering domestic demand. We see growing opportunities in Chinese banks given the rebound in the dividend yields following the recent market correction, as investors may rotate back into defensive, high dividend yield names amid the sentiment hit from tariff shocks.

  On 8 Apr 25, China's financial regulator raised the cap of equity asset allocation ratio for insurers based on their comprehensive solvency ratio positions. We believe this move will further drive capital inflows into high dividend yield bank stocks, particularly H-share banks, as insurance funds look to enhance their fair value through other comprehensive income (FVOCI) investments to help reduce earnings volatility.

- **Our new top pick is CCB (939 HK/BUY/HK$7.50),** given its modest equity dilution of just 4.3% from the recapitalisation and a solid yield of 6.8%. The stock is currently trading at 0.42x 2025F P/B (-1.1SD), down from 0.48x in Feb 25, offering an attractive yield and a significant 34% discount to its A-share counterpart.

- **We upgrade CMB (3968 HK/HK$49.00) to BUY,** as its valuation has become increasingly attractive (0.85x 2025F P/B, or -1.1SD) following a 15% share price pullback since its full-year results. Its current dividend yield of 5.3% is now comparable to state banks like Bocom and PSBC, which are facing more significant equity dilutions. Additionally, CMB will be one of the key beneficiaries if China introduces stimulus measures that exceed market expectations in response to the tariff impact.

ADJUSTED DIVIDEND YIELD AFTER CAPITAL RAISING

| | A share | | | H share | | |
|---|---|---|---|---|---|---|
| SOE Banks | Before recap (%) | After recap (%) | Changes (bp) | Before recap (%) | After recap (%) | Changes (bp) |
| CCB | 4.6 | 4.4 | -20 | 7.0 | 6.7 | -31 |
| BoC | 4.5 | 4.1 | -38 | 6.2 | 5.7 | -53 |
| Bocom | 5.2 | 4.4 | -81 | 6.2 | 5.3 | -97 |
| PSBC | 5.1 | 4.3 | -88 | 6.3 | 5.2 | -108 |
| Average | 4.8 | 4.3 | -57 | 6.5 | 5.7 | -72 |

*Source: UOB Kay Hian*

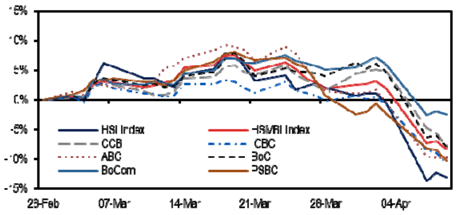
CCB PB


*Source: Bloomberg, UOB Kay Hian*

CMB PB


*Source: Bloomberg, UOB Kay Hian*

SOE BANK RECENT SHARE PRICE PERFORMANCE




*Source: Bloomberg, UOB Kay Hian*

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