



China banking sector

Bank lending dominates China's domestic financing

- **New bank lending in Jun came in ahead of market expectations. RMB loans accounted for 76.7% of aggregate new financing in 1H16, versus 50.0% in the same period of 2013.**
- **While aggregate financing remained weak in 1H16, RMB loans continued to grow at a more rapid pace.**
- **Pressure on banks' NIM is alleviating, in our view, as Chinese banks are increasingly dominating the financial system, M1 growth rate has substantially outpaced that of M2 and lending rates have stayed stable.**
- **We see the increasing likelihood for the PBoC to implement another interest rate cut in 2H16.**

RMB loans continued to grow at fast pace

By end-Jun, RMB loans grew at 14.3% YoY, which is 0.1% lower than last month but 0.9% higher than the same period of last year. Meanwhile, M2 increased 11.8% YoY, equal to last month, but M1 increased 24.6% YoY, which is 0.9% and 20.3% higher than last month and the same period of last year, respectively.

PBoC warns of China falling into a liquidity trap

In regards to the high growth rate of M1 and the large divergence between M1 and M2, Sheng Songcheng, the department head of survey and statistics at PBoC, in a quasi-official meeting pointed out that China seems to be falling into a liquidity trap.

China banks' increasing dominance in the financial system

We are not surprised about the results and regard the following factors to be the primary causes for the phenomenon stated above. (1) In China, return-risk patterns are generally worsening. (2) Business fields that could absorb large quantity of capital are largely reduced. (3) General risk appetite in China is decreasing. (4) Internet finance, credit agencies and shadow banking are facing higher risks, undergoing market consolidation and confronted with severer regulatory requirements.

For these reasons, much off-balance sheet lending is coming back to the balance sheet, cheap credit from banks is more crucial for corporates' survival, it is more difficult for non-banking institutions to attract funding, government policies keep encouraging banks to support the economy, and there is also large financial needs caused by government debt replacement and infrastructure investments; hence, it comes naturally that banks become the dominator in the financial markets.

It is also delightful to see the stable increase in the loan provision ratio of China's banking industry (c3.25% at end-Jun), which have built sufficient buffer to absorb the mounting asset quality risk, in our view, though the NPL ratio has increased to 1.18% as of end-Jun.

Albert Xu

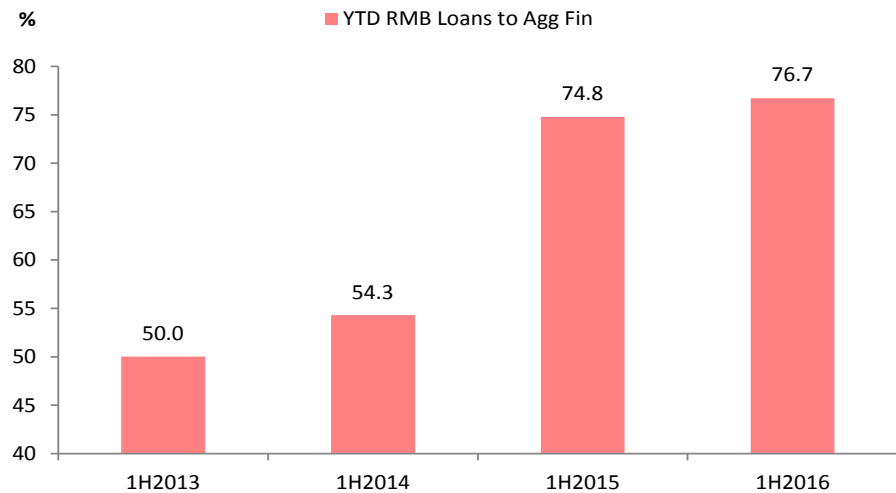
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Indicators and Charts

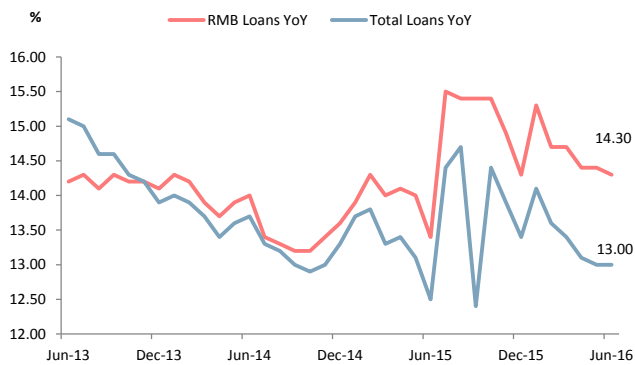
In Jun, new aggregate financing was RMB1.63tn, which is RMB945.7bn more than last month, but RMB209.1bn less than same period of last year. New RMB loans to the real economy accounted for 84.7% of total new aggregate financing. For 1H16, total new RMB loans to the real economy accounted for 76.7% of total new aggregate financing to real economy, which is 1.8% higher than the same period of last year.

Figure 1: YTD RMB loans as percentage of aggregate financing



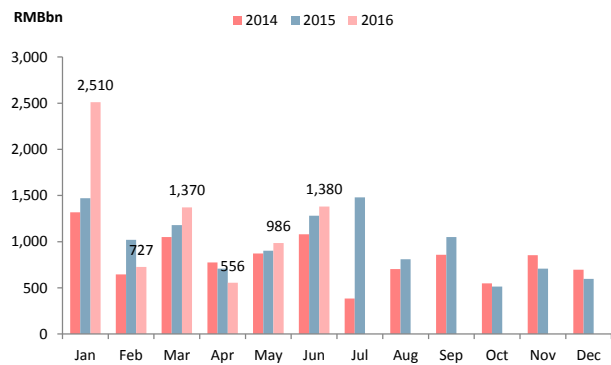
Source: PBoC, CSCI Research

Figure 2: Growth of loans



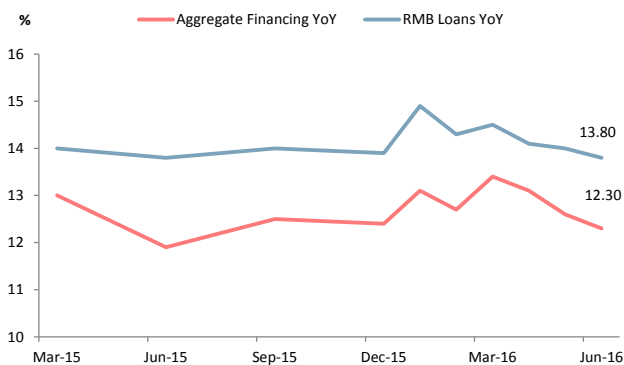
Source: PBOC, CSCI Research

Figure 3: Monthly new loans



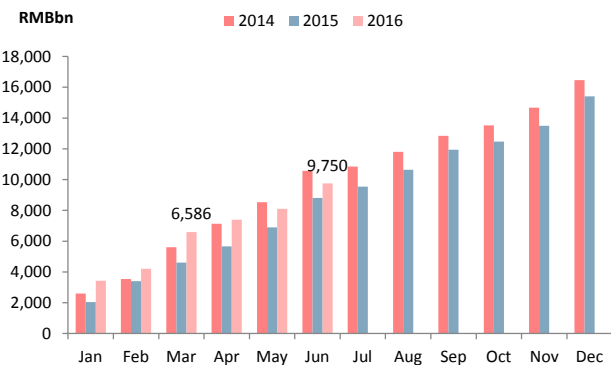
Source: Company, PBOC, and CSCI Research

Figure 4: Balance growth of aggregate financing

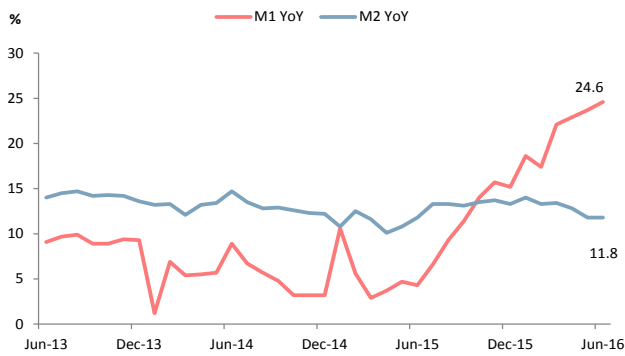


Source: PBOC, CSCI Research

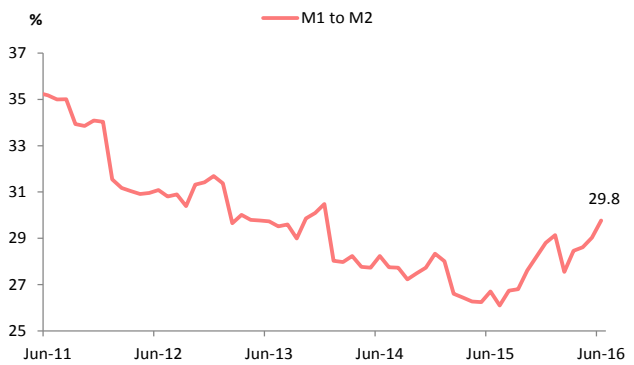
Figure 5: New aggregate financing YTD



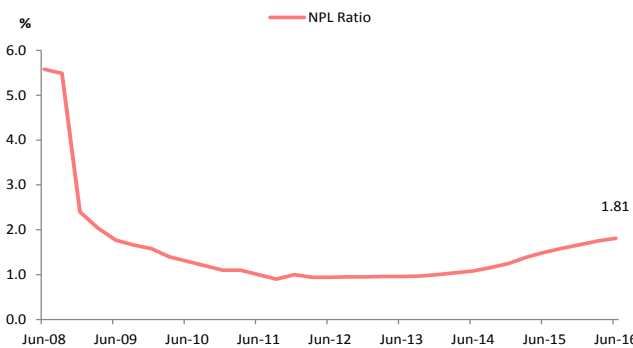
Source: Company, PBOC, and CSCI Research

Figure 6: Growth of M1 and M2


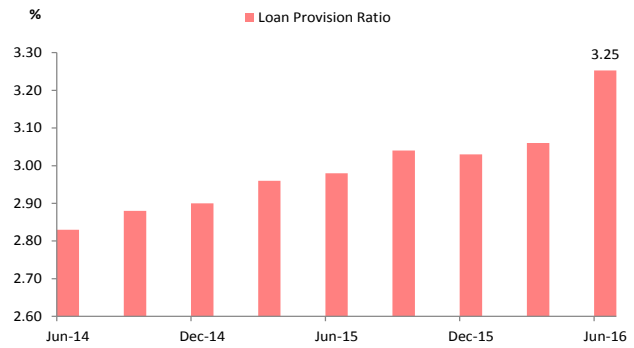
Source: PBOC, and CSCI Research

Figure 7: M1 as percentage of M2


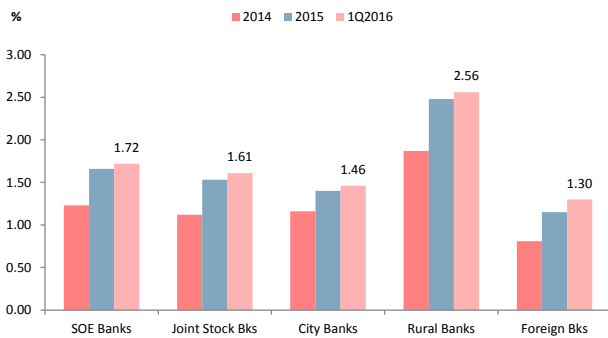
Source: PBOC, and CSCI Research

Figure 8: NPL ratio of Chinese banking industry


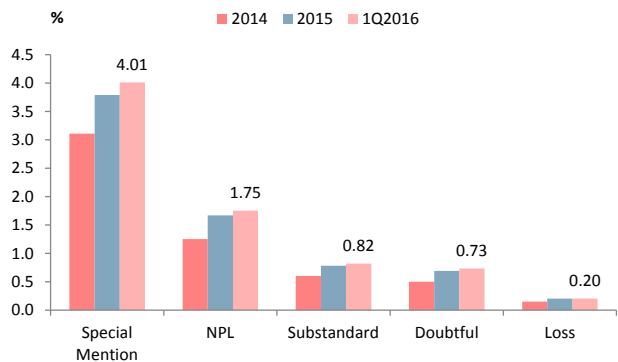
Source: CBRC, CSCI Research

Figure 9: Loan provision ratio


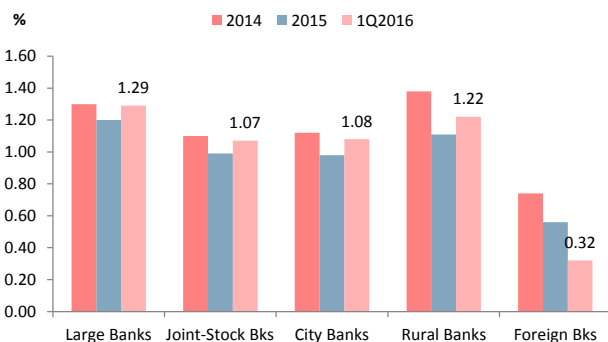
Source: CBRC, CSCI Research

Figure 10: NPL ratio by bank types


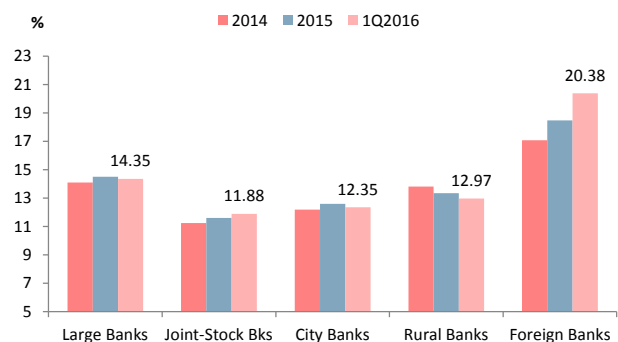
Source: PBOC, CBRC, CSCI Research

Figure 11: NPL ratio by categories


Source: PBOC, CBRC, CSCI Research

Figure 12: ROA ratio by bank types


Source: PBOC, and CSCI Research

Figure 13: CAR by bank types


Source: PBOC, and CSCI Research



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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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