

China medium and small banks

An assessment of Brexit and China's monetary conditions

Company name	Stock code	Mkt cap HKDmn	Spot 27 Jun	Trade ccy	PT 16E	Upside %	PBR x		PER x		Div Yld %	
							15A	16E	15A	16E	15A	16E
CQRC	3618 HK	35,433	3.81	HKD	5.85	53.5	0.76	0.67	4.88	4.76	5.25	5.38
Huishang	3698 HK	39,227	3.55	HKD	4.63	30.4	0.95	0.87	6.34	6.10	4.48	4.65
Harbin	6138 HK	21,991	2.00	HKD	3.39	69.5	0.66	0.59	4.88	4.44	5.35	5.87
Shengjing	2066 HK	47,997	8.28	HKD	11.39	37.6	1.16	1.02	7.74	6.79	3.38	3.86

Source: Company data, CSCI Research estimates

- While the general China banking sector is braced for the chills from the market turmoil caused by the Brexit, the mid- and small-sized Chinese banks would be barely affected, in our view.
- We believe PBoC will maintain its loose monetary stance, with credit supply growing at a rapid pace and the monetary multiplier expanding, which are favourable for the mid- to small-sized banks at the growth stage.
- On the flip side, RMB devaluation is the key risk for Chinese banks (and all RMB assets), which would be moderate and in a gradual pace in our view. Meanwhile, we believe the growth factors will outweigh the currency risks for mid- and small-sized Chinese banks.

Brexit creates uncertainties and headwinds for global financial markets:

It is hard to quantify the adverse impacts of UK's exit from the European Union on its local economy and the global markets. Nonetheless, it would surely negatively impact financial institutions with exposures to UK and EU, due to losses from forex translations, slowdown in earnings, cost of geographic asset allocation and changes in regulatory measures. However, with operations primarily based in mainland China, Chinese mid and small-sized banks will barely suffer from the financial and economic turmoil seen in Europe. On the contrary, a setback in prices would create entry opportunities for China banking stocks, given the supportive valuations and fundamental quality at present.

Monetary policies of China to remain loose for multiple goals:

PBoC made an announcement immediately after the Brexit, and Governor Zhou Xiaochun made a speech and conducted a dialogue with IMF Lagarde regarding China's monetary policies, in IMF meetings which took place after the Brexit. Four policy targets are clearly stated, namely price stability, economic growth, employment and balanced international payments. We expect monetary conditions in China to remain loose as counter-cyclical adjustments and CNY to depreciate against USD in a gradual but more volatile way.

Investment themes:

We see good positioning opportunities for China mid and small-sized banks on the back of attractive valuations and high business qualities, including solid customer deposit base, competitive cost of funding, retail-dominated franchises and strong capital position. We like China Merchants Bank (3968 HK, NR) in terms of mid-sized banks and CQRC Bank (3618 HK, Buy) in terms of small-sized banks.

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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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