BBVA | RESEARCH

Economic Analysis
02 April 2013

China Flash

Annual 2012 bank financial results show healthy profit, but with challenges ahead

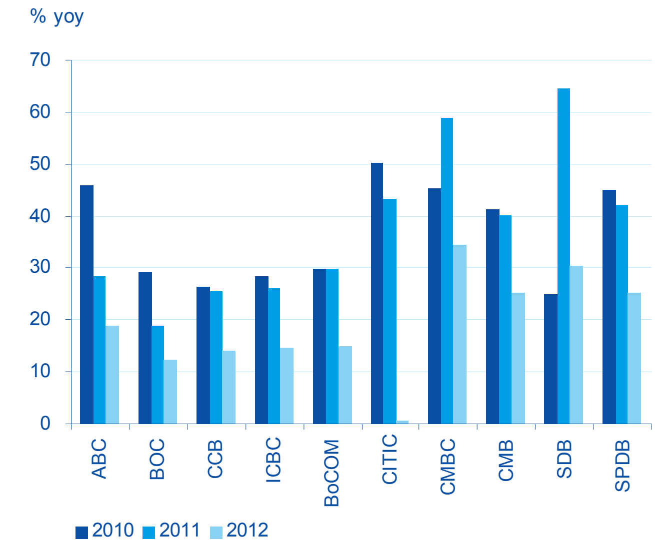
Full-year 2012 financial results released over the past two weeks for the 16 listed banks (accounting for around two-thirds of outstanding bank credit in China) show moderating, but still-strong profit growth, along with healthy liquidity and capital adequacy ratios. The positive results are due to stable net interest margins, despite slowing domestic GDP growth and signs of deteriorating asset quality, and are broadly consistent with the sector-wide trends reported last month by the China Banking Regulatory Commission (CBRC) showing overall profit growth of 19% (see, *China Flash, March 4*). Nevertheless, deteriorating asset quality is evident (particularly among the medium-size listed banks), a trend that is likely to continue over the next couple of years due to the recent rapid pace of credit growth and ongoing downshift in GDP growth. Given an expected further tightening of interest margins and regulations, we maintain our projection of slowing profit growth in the coming years.

- **Profit growth remained strong on stable net interest margins.** Most listed banks posted double-digit profit growth rates in 2012 (Chart 1), although the momentum has moderated. The strong outturns were partly the result of stable net interest margins (Chart 2), particularly for the large listed banks (ABC, BOC, ICBC, CCB and BoCOM). Net interest margins held up even amidst two asymmetric interest rate cuts in June and July, in which lending rates were effectively reduced by more than deposit rates (Chart 3). This outturn may be due to the stronger pricing power of the larger banks, enabling them to offer lower deposit rates than their smaller peers.
- **However, asset quality deteriorated.** Non-performing loans (NPLs) of most listed banks increased in 2012 by varying degrees (Chart 4). In particular, the decline in asset quality was more pronounced for medium-size banks, most likely due to their higher exposure to private firms, which have been more susceptible to the economic slowdown than state-owned enterprises (SOEs).
- **The outlook is for declining profits in the years ahead.** We maintain our projection of bank profit growth slipping to single-digits over the next five years (see *Banking Watch, May 2012*) from narrowing net interest margins (as a result of continuing interest rate liberalization), a downshift in GDP growth (to around 7.8% on average during 2013-17 from 9.3% in 2008-12), declining asset quality, and tighter regulations associated with capital requirements under Basel III and a clamp-down on off-balance-sheet activities to curtail the growth of shadow bank lending.

Le Xia
Senior Economist
Xia.le@bbva.com.hk
+852 2582 3132

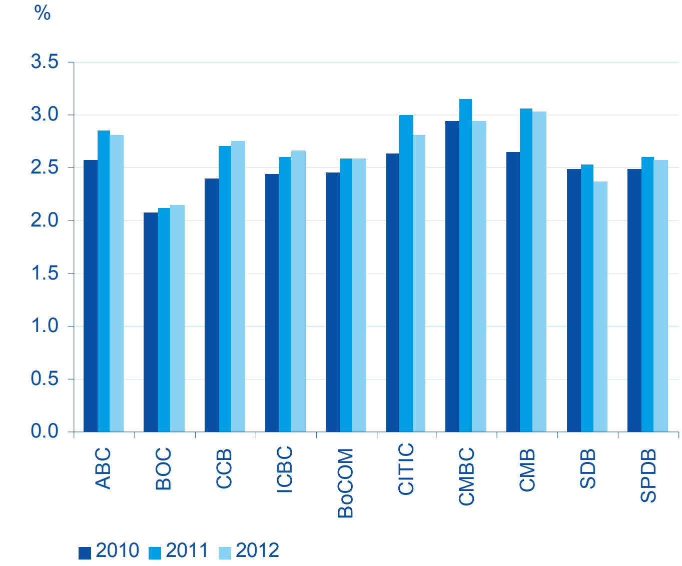
Stephen Schwartz
Chief Economist for Asia
stephen.schwartz@bbva.com.hk
+852 2582 3218

Chart 1
Banks profit growth is moderating…



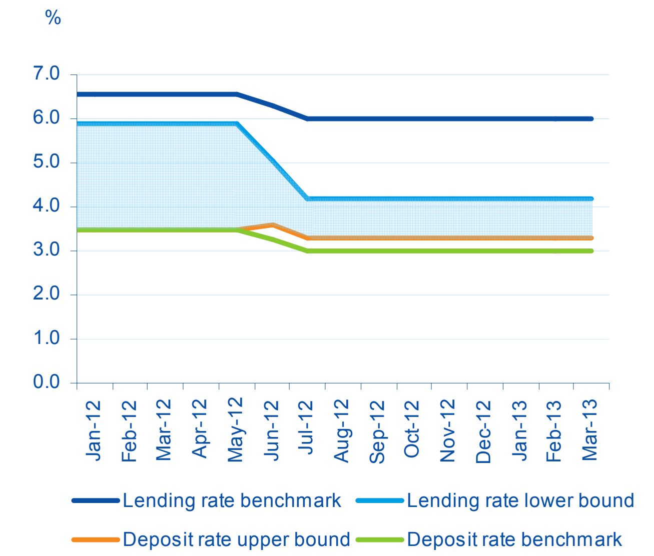
Source: Bank reports, Wind and BBVA Research

Chart 2
…as net interest margins have held up



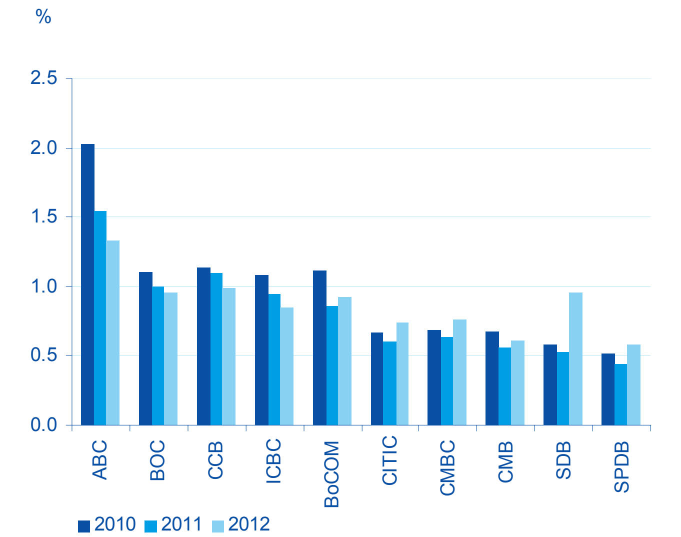
Source: Bank reports, Wind and BBVA Research

Chart 3
Asymmetric interest rate cuts may cause NIMs to narrow



Source: CEIC and BBVA Research

Chart 4
… and non-performing loans of some banks increased*



*Based on NPL data as available from reporting banks on April 2
Source: Bank reports, Wind and BBVA Research

BBVA | RESEARCH | 43/F., Two IFC, 8 Finance Street, Central, Hong Kong | Tel.: +852 2582 3111 | www.bbvaresearch.com