China Flash

Latest banking indicators hint at challenges ahead

The China Banking Regulatory Commission (CBRC) has released 2013 aggregate banking indicators, showing still healthy, but weakening trends. Overall profit growth of commercial banks moderated to 14.5% in 2013 from 18.9% last year due to slower credit growth. While declining, the profit outturn exceeded our expectations (10%) due to wider interest margins and lower NPLs than anticipated. The former is due to limited progress in deposit rate liberalization, while the latter may reflect banks' discretion in classifying loans despite deteriorating asset quality. Meanwhile, bank liquidity and capital ratios remain healthy. Nevertheless, the environment for banks is becoming more challenging as GDP and credit growth slow and, going forward, as interest rate liberalization proceeds, undermining net interest margins. Individual full-year financial results will be released at end-March.

- **Slower lending growth leads to weakening, though still-strong profits in 2013.** Net profit growth slowed to 14.5% in 2013 from 18.9% in the previous year (Chart 1). Profit growth slowed in line with a decline in credit growth, to 14.2% from 15.0% in 2012. Profit results would have been lower were it not for stable net interest margins (Chart 2) due to the limited progress in deposit rate liberalization (the binding deposit rate cap remains despite the removal of the non-binding lending rate floor last June).
- **Liquidity and capital ratios remain healthy.** Banks' aggregate loan-to-deposit ratio edged up to 66.1% at end-2013, from 65.3% in the previous year (Chart 3). However, periodic rate spikes in the interbank market since June suggest that liquidity conditions have tightened. Meanwhile, capital levels remain healthy, as measured by the CAR, which stood at 12.2% at end-2013, based on the new Basel III basis.
- **Despite a low NPL ratio, asset quality has deteriorated.** While the NPL ratio remains low at 1.0% due to strong asset growth (in the denominator of the ratio), the level of NPLs has continued to increase (Chart 4), rising by 20% to RMB 592 billion at end-2013.
- **Looking ahead, profit growth is likely to decline further on deteriorating asset quality, among other factors.** The following developments will weigh on bank profits in the coming years: (i) narrowing net interest margins (NIMs) as interest rate liberalization proceeds and competition in the banking industry increases; (ii) slowing GDP and credit growth; and (iii) financial losses on bank balance sheets from shadow banking activities and impaired credits to local governments.

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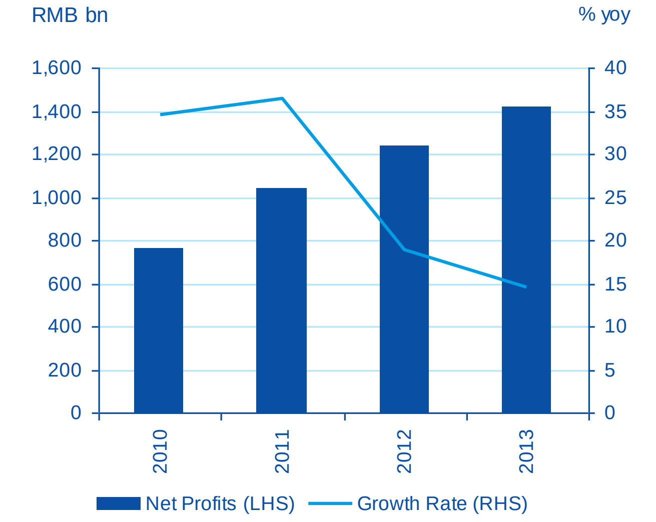
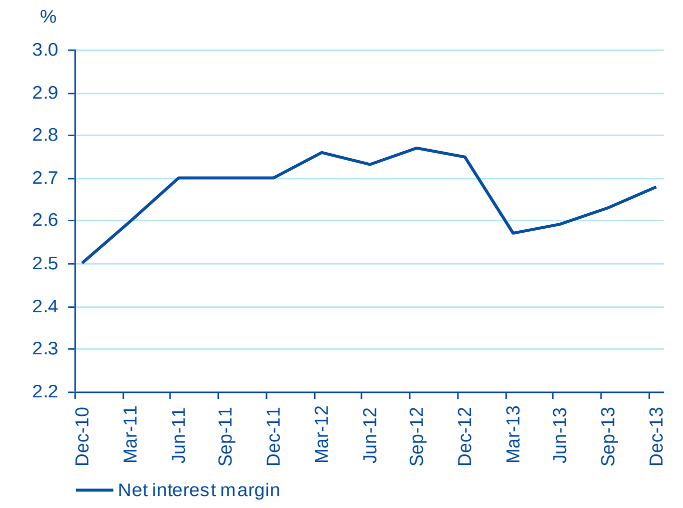
Chart 1
Though still strong, profit growth slowed in 2013



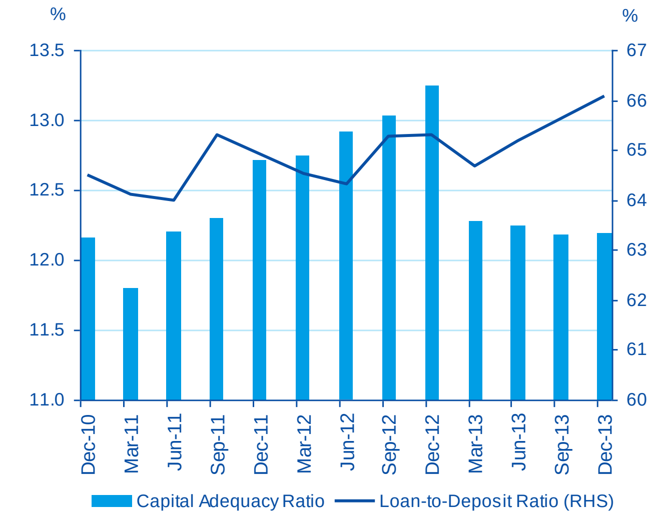
Source: CBRC, CEIC and BBVA Research

Chart 2
Net interest margins have held up



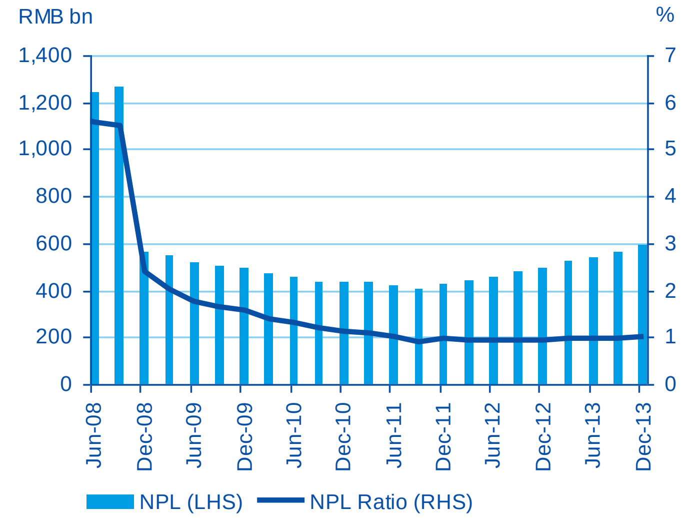
Source: CBRC, CEIC and BBVA Research

Chart 3
CARs and loan-to-deposit ratios are healthy



Source: CBRC, Wind and BBVA Research

Chart 4
NPLs are rising, despite a low ratio



Source: CBRC, Wind and BBVA Research

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