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S&P Global
China Ratings

Chinese Mega Banks' Capital Levels Drop Slightly in Q2 as COVID-19 Recovery Efforts Lead Lending Growth

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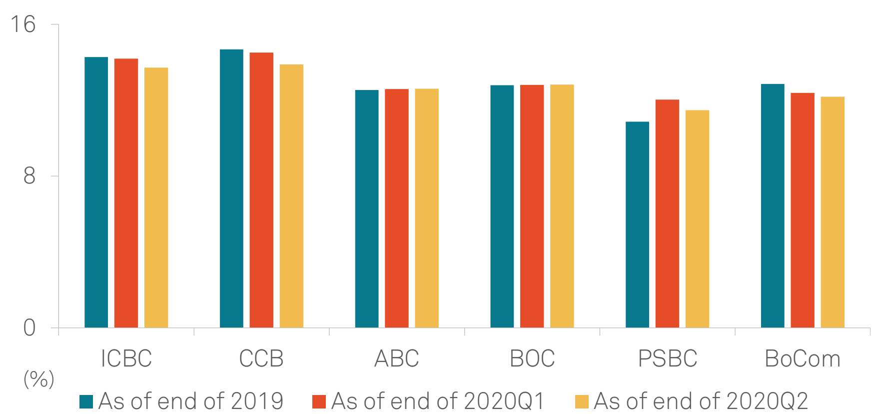
S&P Global (China) Ratings today said that Chinese state-owned mega banks reported a mild drop in their capital adequacy ratios as of the end of June 2020, due to continued fast lending growth and slightly lower profitability. Although uncertainty still remains over the effect of COVID-19 on credit costs, we expect the mega banks' overall stand-alone credit profiles to remain stable as China's economy steadily recovers from the pandemic.

Capitalization pressure has eased significantly due to the issuance of hybrid bonds. As of the end of June, the mega banks' asset-weighted average tier-1 capital adequacy ratio was 13.1%, down by 28 basis points from the end of 2019.

Chart 1

Reported Tier-1 Capital Adequacy Ratio



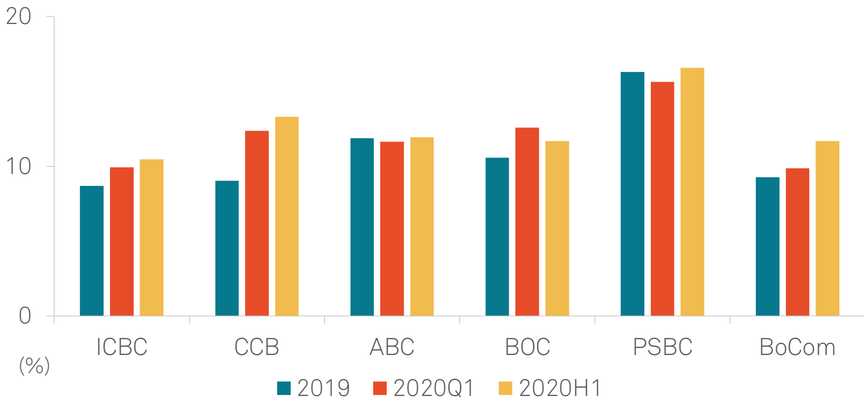
Note: ICBC - Industrial and Commercial Bank of China Limited, CCB - China Construction Bank Corporation, ABC - Agricultural Bank of China Limited, BOC - Bank of China Limited, PSBC - Postal Savings Bank of China Co., Ltd., BoCom - Bank of Communications Co., Ltd.

Source: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

The mega banks saw substantial business growth in the first half of the year as they pumped credit into the real economy to fight against the pandemic. The six mega banks achieved average loan growth of 8.4% and deposit growth of 8.8% in the first six months of 2020. Micro and small enterprises ("MSE") saw the most significant lending increase, following government requirements for mega banks to increase their lending to MSEs by 40% over 2020, with MSEs deemed critical to stabilizing employment. In the first six months, mega banks' lending to MSEs increased by 30.8% compared to the end of 2019, significantly outpacing overall lending growth.

Chart 2

Loan Growth Year-on-Year

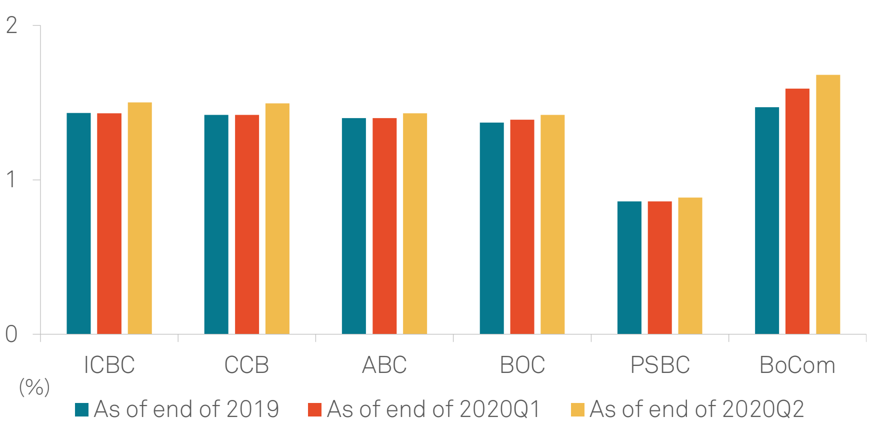


Sources: CBIRC, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Mega banks' reported non-performing loan ("NPL") ratios saw a mild increase in the second quarter. As of the end of June, their average NPL ratio was 1.4%, up by 7 basis points from the end of 2019. Meanwhile, the mega banks' average special mention loan ("SML") ratio was 2.2% as of the end of June, down by 18 basis points from the end of 2019. The improving SML ratio can, in our opinion, be partly attributed to borrowers having easier access to credit in the first half of the year due to government and central bank intervention.

Chart 3

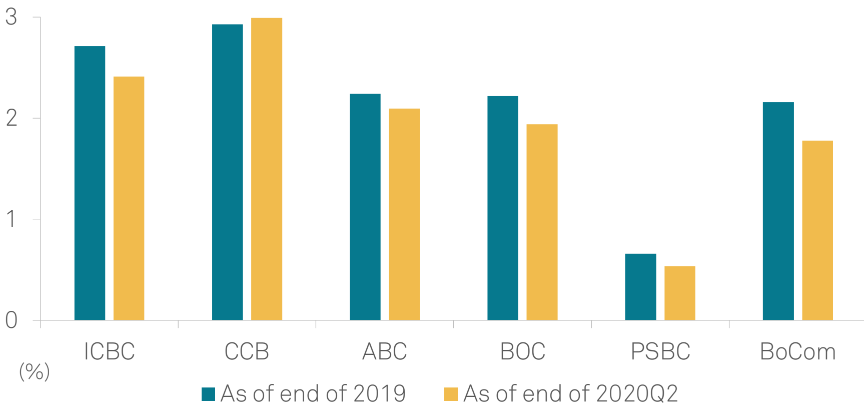
Reported NPL Ratio



Source: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

Chart 4

Reported SML / Gross Loan Ratio



Source: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

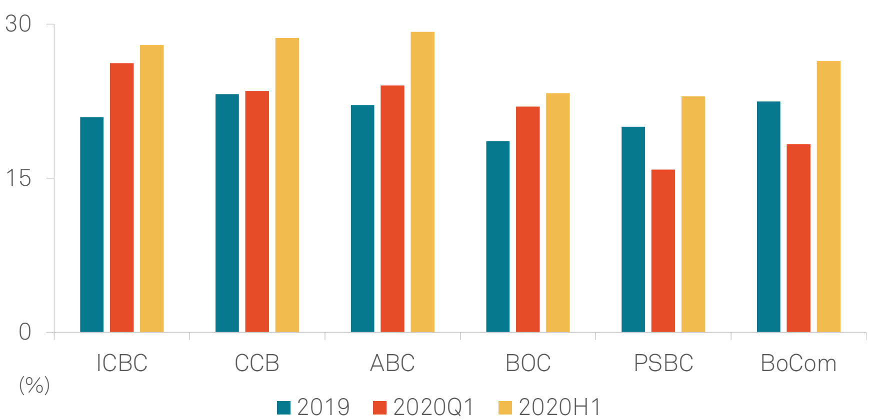
We believe that China's steady economic recovery has helped stabilize systemwide asset quality, and the overall impact of COVID-19 on asset quality will be dependent on the progress of the economic recovery in the latter half of this year. After a YoY GDP drop of 6.8% in the first quarter, China's GDP growth bounced back to positive growth of 3.2% in the second quarter.

Nevertheless, we expect uncertainty over asset quality to continue into 2021. The deferral of loan payments for MSEs is set to end by the end of March 2021.

Mega banks' credit costs have increased as a result of growing bad debt pressure. In the first half of 2020, the new provision/operating revenue ratio of the mega banks was 27.0%, up by 5.7 percentage points from 2019.

Chart 5

New Provision/Operating Revenue



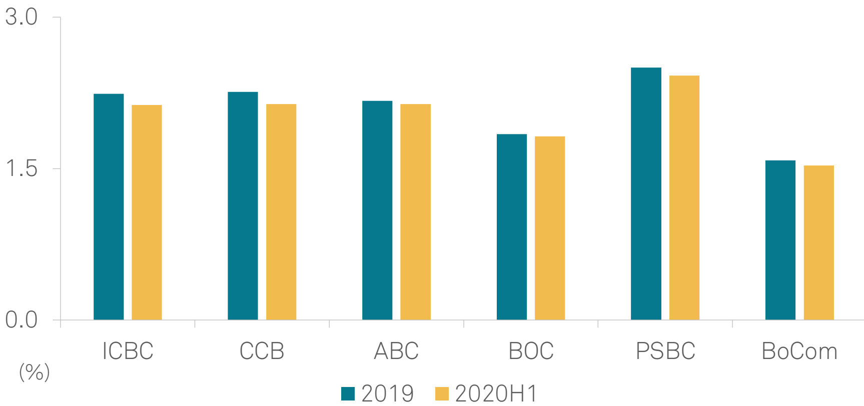
Source: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

The mega banks' net interest margins ("NIM") saw a mild drop in the first half of 2020, as the government looked to lower funding costs in the real economy. In addition, more accommodative monetary policy has also led to lower lending rates in the inter-bank market. This adds to the NIM pressure on PSBC and other mega banks that are typically net lenders in the wholesale market.

The average annualized NIM of the six mega banks was 2.1% in the first half of 2020, 7 basis points lower than the 2019 level. In the second half of the year, as monetary policy gradually "normalizes", given central bank intentions of not maintaining extremely low interest rates, we expect a yield recovery in the inter-bank lending business while the interest yield of loans will continue to be under pressure as the influence of the loan prime rate is further felt.

Chart 6

Reported Net Interest Margin

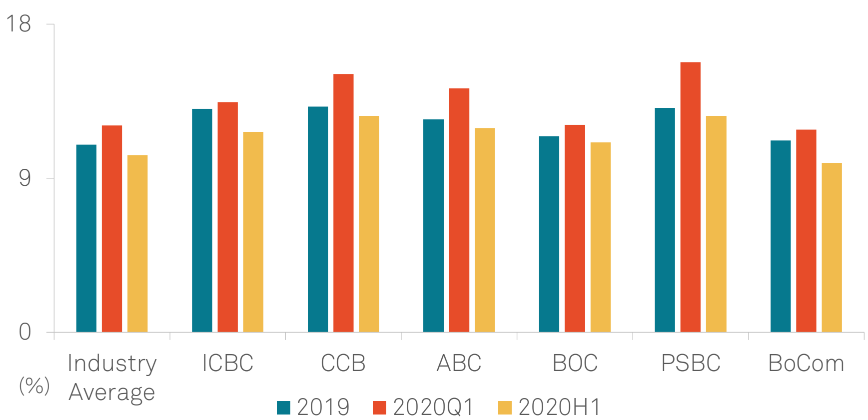


Source: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

Due to higher credit costs and lower NIMs, the mega banks reported lower half-year returns on equity, and we expect earning pressure to continue as asset quality uncertainty remains. The mega banks' average annualized ROE was 11.8% in the first half of 2020, 0.74 percentage points lower than the same period last year.

Chart 7

Reported Return on Equity



Note: ROEs of the first quarter and first half year are annualized.
Source: CBIRC, public information of banks, collected and adjusted by S&P Global (China) Ratings.

This report does not constitute a rating action.