

Hong Kong Banks

It's Just Fast – Our Thoughts on Loan Growth and Implications

- **Loan growth faster-than-expected** – Sector loan growth reached 12.5% YTD to August 2013, or annualized to 19.3%. The YTD growth was stronger than our estimates (and likely further ahead of street consensus). Recall that Citi started raising sector loan growth estimates in July 2013, premised on [our analysis on leading China corporate](#), but the latest growth further exceeds our expectations. We raise sector loan growth estimates again to 13-16% for 2013E from previous bottom up average of 11-13%.

- **Possible Implications upon strong loan growth**

- **Possibility #1: NIM to benefit from increased pricing power**– We believe this scenario is likely. The sustained loan demand in domestic corporate, trade finance and offshore uses overcame the concerns of slowing mortgages. With increased demand, banks can defend pricing power, be able to pass through any increase in funding costs or even results in higher NIM via a managed increase of loan-to-deposit ratio.
- **Possibility #2: NIM to stay flat but asset quality & liquidity improves** – We believe this scenario is also likely if new loans taken by banks are focused on short tenure trade finance or well-collateralized positions. Such a business exposure may NOT lead to NIM expansion like #1 above but could shorten asset maturity (a favorable strategy for a rising rate environment) or to improve average asset quality with better-guaranteed/collateralized assets.
- **Possibility #3: Banks to suffer from uncompensated risks** – This scenario is unlikely in our view. In this scenario, banks would have misjudged the risks from loans exposures and are NOT properly compensated by higher interest income. But we think this scenario is unlikely because (i) more loans were supported by short maturity trade finance, (ii) HK banks operate in commercial basis with little regulatory/government intervention, (iii) no substantial changes in competitive dynamics and, (iv) solid track record on asset quality with supportive credit infrastructure (e.g., shared credit database).
- **Able to meet internal business budgets prior to year-end** – Fast YTD loan growth may also allow banks to meet internal growth budget prior to year-end. Banks could have a buffer to absorb expiring trade finance; with willingness to slow down growth near end-2013, year-end deposit competition may moderate.

Overall, we believe fast loan growth YTD is a positive. Reiterate positive stance on the sector, prefer **BoCHK** (top pick), **HSB** (non-consensus) and **DahSing**.

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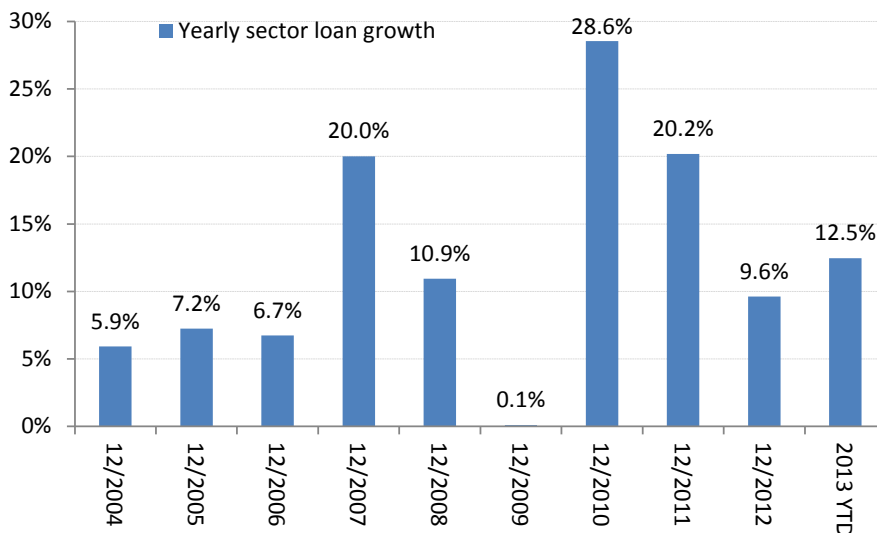
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How fast is sector loan growing?

Sector loans grew by 1.2% mom in August-2013, and this took YTD 8mth-2013 loan growth to 12.5% (or annualized at 19.3%). We believe the growth was a positive surprise to street consensus as the market has been worried on (i) slow residential mortgage market, and (ii) a potential reversal / slowdown of trade finance. However, statistics released from HKMA revealed that domestic corporate, trade finance and offshore loans continue to grow; more than enough to offset the slow mortgages.

Figure 1. HK yearly sector loan growth

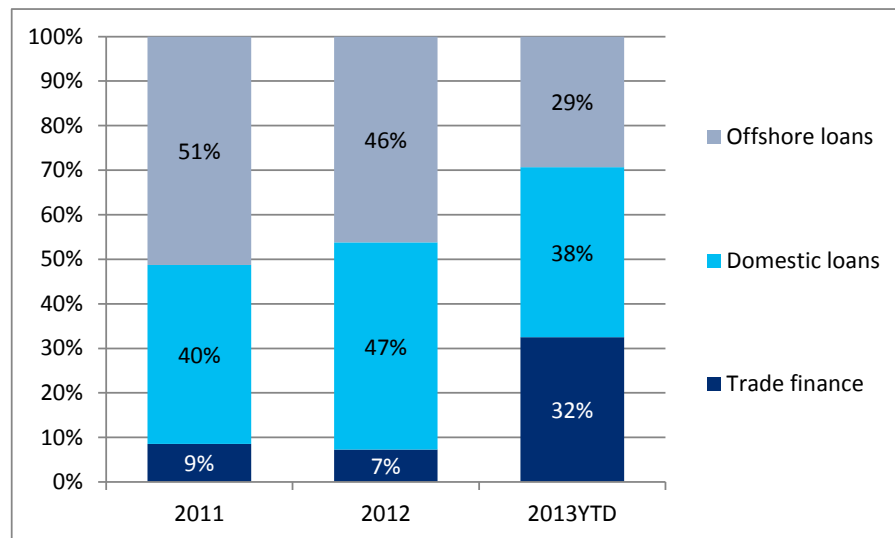


Source: HKMA, Citi Research *2013 YTD represents 8-mths growth till August-2013

What was driving loan growth? Possible to moderate in late-2013

Of the total loan growth, domestic loans accounted for 38%, trade finance 32% and offshore loans 29%. Trade finance became a more significant growth driver in 2013 vs. 2011-12. Approaching late 2013, some trade finance may expire. This could alleviate the liquidity situation and potentially reduce year-end deposit competition, but could likewise slow loan growth from the current faster-than-expected pace.

Figure 2. HK sector loan growth by segment (segment as % total yearly growth)



Source: HKMA, Citi Research *2013 YTD represents 8-mths growth till August-2013

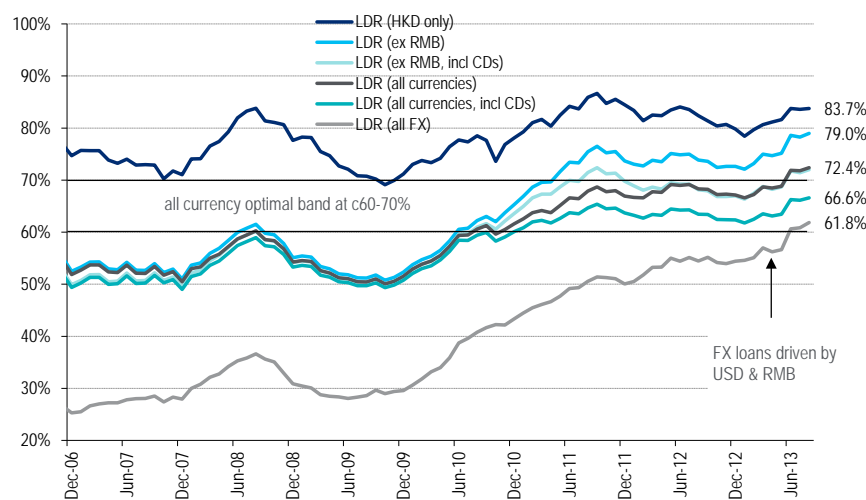
Is loan growth matched by deposit growth?

This question is important because if loan growth is not matched by deposit growth, banks would gradually approach internal or regulatory-guided threshold loan-to-deposit ratio; this may further result in rising deposit competition and pressure on NIM. At current juncture, sector LDR (all currency, including CDs) remained at 66.6% (Figure 3), still one of the lowest in Asia; and we continue to see moderate room for LDR to increase before substantial deposit competition could arise.

Near term, we are also comfortable for the next deposit growth data to be released from HKMA by end-Oct-2013. We expect Sep-2013 mom deposit growth to be strong, thanks to external liquidity inflow and the strong equity market which is exogenous for supporting deposit growth (Figure 4).

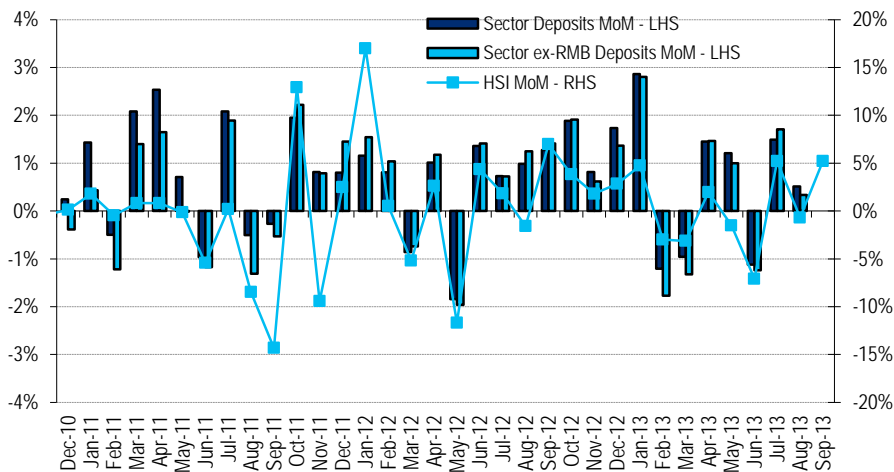
The next test to the sector, in our view, will come through by Nov/Dec-2013, year-end seasonality typically results in deposit competition. But as an offset, the fast YTD growth may allow banks to meet internal growth budget early, thus also allow banks to slow down growth near end-2013 and alleviate deposit competition.

Figure 3. HK banks – loan-to-deposit ratio (LDR)



Source: Citi Research, HKMA

Figure 4. Strong equity market in September-2013 likely point to solid deposit growth



Source: Citi Research, HKMA

Valuation Comp

Figure 5. HK banks valuation comp

	Stock	Rating	Target Px	Current	Mkt Cap	TP Upside	PB			PE			ROE			Dividend Yield		
Bank	Code		(HK\$)	(HK\$)	(US\$ bn)		2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E
Large banks																		
BoCHK	2388.HK	Buy	30.00	25.05	34.13	20%	1.75x	1.70x	1.62x	12.7x	11.9x	11.7x	14.9%	14.5%	14.1%	4.9%	5.5%	5.5%
HSB	11.HK	Buy	140.00	126.90	31.26	10%	2.63x	2.35x	2.21x	12.5x	9.1x	14.3x	22.6%	27.3%	16.0%	4.2%	4.3%	4.4%
Mid/small banks																		
BEA	23.HK	Neutral	33.00	33.00	8.68	0%	1.29x	1.22x	1.15x	12.4x	12.5x	12.5x	10.9%	10.0%	9.5%	3.2%	3.6%	3.6%
WHB	302.HK	Buy	94.00	113.60	4.32	-17%	1.76x	1.64x	1.54x	18.9x	16.2x	16.1x	9.9%	10.5%	9.9%	1.8%	2.3%	2.5%
DSBG	2356.HK	Buy	13.60	14.16	2.23	-4%	1.15x	1.07x	1.00x	12.4x	11.2x	10.3x	9.3%	9.9%	10.0%	2.2%	2.5%	2.7%
DSFH	440.HK	Buy	46.00	48.35	1.82	-5%	0.81x	0.76x	0.72x	11.5x	10.7x	9.6x	7.5%	7.3%	7.7%	2.4%	2.6%	2.9%
Mkt cap w. avg							2.04x	1.89x	1.79x	12.8x	11.0x	13.0x	17.2%	18.8%	14.1%	4.3%	4.6%	4.7%
Large banks							2.17x	2.01x	1.90x	12.6x	10.6x	12.9x	18.5%	20.5%	15.0%	4.6%	4.9%	5.0%
Mid/small banks							1.39x	1.31x	1.23x	14.0x	13.3x	13.2x	10.5%	10.1%	9.6%	2.8%	3.2%	3.2%

Source: Citi Research estimates, Companies, DataStream *priced 10-Oct-2013

Appendix A-1

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