Fitch Affirms China Merchants Bank at 'A-'; Outlook Stable

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Fitch Ratings - Hong Kong/Shanghai - 06 Sep 2023: Fitch Ratings has affirmed China Merchants Bank Co., Ltd.'s (CMB) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'A-', Short-Term IDR at 'F1', Government Support Rating (GSR) at 'a-' and Viability Rating (VR) at 'bb+'. The Outlook is Stable.

KEY RATING DRIVERS

Government Support Drives IDR: The bank's Long-Term IDR is driven by our assessment of a very high likelihood of government support, as expressed by the GSR. Our support assessment is based on the bank's size, domestic significance and leading consumer franchise, as well as its ownership by China Merchants Group, a large state-owned conglomerate.

Consumer Franchise Reinforces Systemic Importance: CMB's GSR and IDRs are underpinned by its market shares in retail deposit and consumer lending, which are similar to those of Bank of Communications Co., Ltd. (BOCOM, A/Stable), and larger market share in retail assets under management that is more aligned with some of the largest state banks. This supports our view that CMB is more likely to receive government support than other mid-tier banks in the event of stress.

D-SIB Designation: CMB's designation by the Chinese authorities as a domestic systemically important bank (D-SIB) in the same relative bucket as BOCOM in October 2021 also supports our GSR assessment. We do not expect China's implementation of a recovery and resolution plan framework to significantly diminish support prospects.

Short-Term IDR Reflects Support: The Short-Term IDR has been assigned at the higher of the two options of CMB's Long-Term IDR, reflecting our expectations that government support is more certain in the near term. CMB's VR has been assigned at the same level as its implied rating, which is lower than the GSR. Therefore, the VR does not drive the IDRs.

Stable OE: We expect China's economic growth to continue its moderate recovery in the rest of 2023, although lingering domestic challenges, particularly around the property sector, are likely to limit bank performance in 2023. The operating environment (OE) score of 'bbb-'/stable is above the 'bb' category implied score, as we believe China's strong external finances and economic size, incorporated in the Chinese sovereign rating (A+/Stable), will provide greater financial and economic stability than the implied OE score indicates.

Strong Retail Franchise: CMB's business profile score of 'bbb-' reflects its strong consumer franchise that has supported the bank's relatively resilient financial performance compared with peers and underpins its sustained funding cost advantage over other joint stock banks.

The score is lower than the 'a' category implied score to reflect issues related to management and governance that are not uncommon in China, given pressure from the authorities to support some segments of borrowers during challenging times. Fitch's criteria also notes that business profile scores are typically conditioned and constrained by the OE score, which also acts to limit the business profile assessment.

Declining Shadow-Banking Activities: The upward revision of CMB's risk profile score to 'bb+', from 'bb', reflects a decline in its shadow-banking activities, supported by China's strengthening regulatory framework. Its entrusted investments fell to 3% of its total assets by end-1H23, from 10% in 2017, the lowest among mid-tier banks.

Off-balance-sheet wealth management products (WMPs) declined to 24% of its total assets, from 35% during the same period, although the proportion remained above the mid-tier average. However, this is balanced against its larger focus on retail banking, especially residential mortgages, a business that we perceive to be less risky than corporate loans.

High Allowance Mitigates Asset-Quality Risks: The asset-quality score of 'bb+' is below the 'bbb' category implied score, reflecting CMB's large non-loan exposures. The bank has manageable direct exposure to property developers and local government financing vehicles at around 6% and 2% of total loans at end-1H23, respectively, although there could be spillover into related sectors if refinancing issues linger for these two sectors. CMB's asset-quality risks are mitigated in part by its high loan-loss allowance/impaired-loan ratio of 448% at end-1H23, the highest among mid-tier peers.

Resilient Earnings: The upward revision of CMB's earnings and profitability score to 'bbb-', from 'bb+', reflects the bank's earnings resilience despite economic challenges through the cycle as well as the reduction in its shadow-banking activities. We expect its impairment charges to remain below those of peers, given its retail focus, high loan-loss allowance ratio, and better earnings resilience due to its low funding costs and high contribution from fee income.

Highest Capitalisation Among Peers: We expect CMB's common equity Tier 1 (CET1) ratio to remain stable and above those of most peers in the next few years, supported by its above-peer profitability and larger exposure to residential mortgage loans, which have lower risk weights. The bank reported a CET1 ratio of 13.1% at end-1H23, which implies a score in the 'bbb' category. Our assigned score of 'bb+' is below this level to reflect our view that reported risk-weight calculations do not fully consider the extent of off-balance-sheet activities.

Stable LDR: The upward revision of CMB's funding and liquidity score to 'bbb-', from 'bb+', mainly reflects the reduction in its non-deposit funding, with off-balance-sheet WMPs declining to 31% of total deposits by end-1H23, from 43% at end-2021. The bank had a stable Fitch-calculated loan/deposit ratio (LDR) of around 79% at end-1H23, the lowest among mid-tier banks.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IDRs and GSR

The Long-Term IDR and GSR will come under pressure if we perceive that the central government's propensity or ability to provide timely extraordinary support to the bank has diminished. For example, a sovereign rating downgrade could reflect a weakened ability to provide support, while a lower propensity to support may be reflected through an enhanced resolution framework. However, we do not expect either scenario to occur in the near term.

A reduction in the status of China Merchants Group's importance as a majority state-owned conglomerate, significant dilution in the parent's ownership and control over CMB, or reduced significance in CMB's retail franchise may also affect our assessment of the state's propensity to support the bank.

CMB's Short-Term IDR will be downgraded if its Long-Term IDR is downgraded to 'BBB' or below.

VR

CMB may be more affected by a sharp deterioration in the housing market than peers, because of its larger mortgage exposure, although a worsening of the housing market is not our base case. A resumption of aggressive growth in entrusted investments or WMPs that increases CMB's risk appetite is credit-negative for the bank. These factors could be reflected in a sustained deterioration in the bank's financial metrics, such as a combination of the following reported core metrics:

- The four-year average of impaired loans/gross loans increasing to and remaining at around 4.0% (end-2022: four-year reported average of 1.0%), although our assessment of asset quality also considers other indicators, such as "special-mention" loans, loan-loss provisioning for on- and off-balance-sheet assets, and whether and to what extent we believe reported metrics understate any deterioration in asset quality

- The CET1 ratio falling to around 11.0% without a credible plan to raise it back towards current levels.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

IDRs and GSR

An upgrade of the sovereign ratings could lead to positive rating action on the bank's GSR and support-driven Long-Term IDR, if the sovereign rating indicates a greater ability to support CMB with no less propensity to provide support. An explicit policy role assigned to CMB by the Chinese regulator, similar to that of the state banks, would also be positive for CMB's Long-Term IDR.

CMB's Short-Term IDR can only be upgraded if its Long-Term IDR is upgraded to 'A' or above.

VR

A sustained reduction in the bank's risk appetite, such as a further decrease in shadow-banking activities or better transparency around these activities, a slowdown in growth and a sustained improvement in its underlying asset quality would be positive for the VR.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

CMB's IDRs (xgs) are driven by its VR. We have affirmed the Long-Term IDR (xgs) at 'BB+ (xgs)' and the Short-Term IDR (xgs) at 'B (xgs)'.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The bank's Long-Term IDR (xgs) could be downgraded if the VR is downgraded. The Short-Term IDR (xgs) could be downgraded if the VR is downgraded below 'b-'.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The bank's Long-Term IDR (xgs) and Short-Term IDR (xgs) could be upgraded if the VR is upgraded.

VR ADJUSTMENTS

The OE score of 'bbb-' has been assigned above the 'bb' category implied score for the following adjustment reason: sovereign rating (positive).

The business profile score of 'bbb' has been assigned below the 'a' category implied score for the following adjustment reason: management and governance (negative).

The asset-quality score of 'bb+' has been assigned below the 'bbb' category implied score for the following adjustment reason: non-loan exposure (negative).

The capitalisation and leverage score of 'bb+' has been assigned below the 'bbb' category implied score due to the following adjustment reason: leverage and risk-weight calculation (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

Sources of Information

The principal sources of information used in the analysis are described in the Applicable Criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

CMB's IDRs and GSR are directly linked to China's sovereign ratings.

ESG CONSIDERATIONS

CMB has an ESG Relevance Score of '4' for financial transparency due to structural issues around financial transparency and disclosure. These are not captured in headline performance metrics in China and affect our OE assessment as well as the financial profile. CMB, like other mid-tier banks, is more exposed to this risk than the state banks, due to its larger exposure to WMPs and entrusted investments stemming from the use of off-balance-sheet transactions. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT
RATING
PRIOR

China Merchants Bank Co., Ltd.
LT IDR
A-
Affirmed

A-
ST IDR
F1
Affirmed
F1
Viability
bb+
Affirmed
bb+
Government Support
a-
Affirmed
a-
LT IDR (xgs)
BB+(xgs)
Affirmed
BB+(xgs)
ST IDR (xgs)
B(xgs)
Affirmed
B(xgs)
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VIEW ADDITIONAL RATING DETAILS

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PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

- Bank Rating Criteria (pub. 02 Sep 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

- Dodd-Frank Rating Information Disclosure Form

- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

China Merchants Bank Co., Ltd.	EU Endorsed, UK Endorsed

UNSOLICITED ISSUERS

China Merchants Bank Co., Ltd. (Unsolicited)

With Rated Entity or Related Third Party Participation	Yes
With Access to Internal Documents	Yes
With Access to Management	Yes

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SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS
China Merchants Bank Co., Ltd.	-	Short Term Issuer Default Rating	Unsolicited
China Merchants Bank Co., Ltd.	-	Long Term Issuer Default Rating (xgs)	Unsolicited
China Merchants Bank Co., Ltd.	-	Long Term Issuer Default Rating	Unsolicited
China Merchants Bank Co., Ltd.	-	Short Term Issuer Default Rating (xgs)	Unsolicited
China Merchants Bank Co., Ltd.	-	Viability Rating	Unsolicited
China Merchants Bank Co., Ltd.	-	Government Support Rating	Unsolicited

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