China Flash

China confirms postponement of Basel III implementation

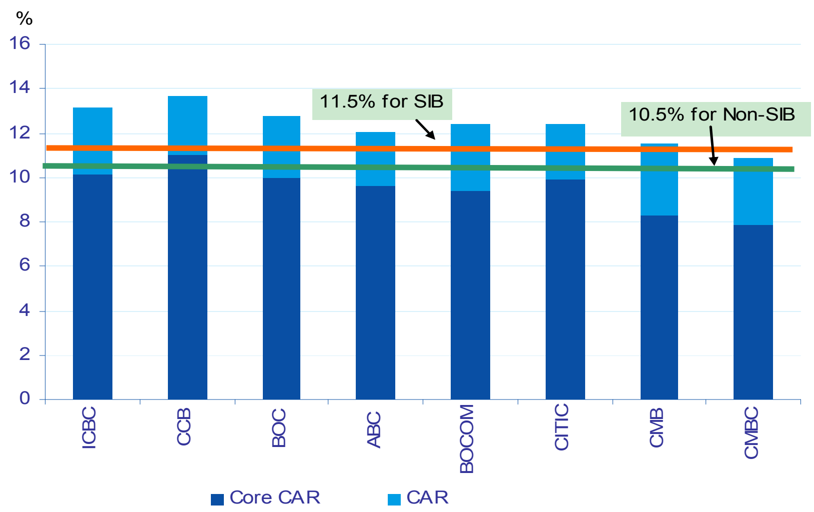
The State Council yesterday confirmed a one-year postponement in the start of Basel III implementation to January 2013. Such a postponement had been widely anticipated ever since media reports surfaced early this year (for details, see our Banking Watch from last April on the relaxation of banking regulations). The new timetable remains consistent with the agenda proposed by the Basel Committee requiring that banks start implementation in 2013, with full implementation by 2019. In our view, the postponement will have some positive effect on bank profitability in the near-term and should be seen as an element of the government's growth-supportive policy initiatives, albeit at the cost of a modest increase in financial sector risk. It should also be borne in mind that the original timetable was well ahead of Basel III requirements.

- **The postponement is in line with growth supportive policy measures.** The authorities originally planned to begin implementing the Basel III rules from the start of 2012. However, the economic slowdown and heightened external uncertainty has caused the authorities to postpone implementation amid concern that it might restrain banks' lending capacity. In addition, the postponement may be motivated by a desire to avoid forcing banks to raise capital in a difficult market environment.
- **The latest announcement contains new regulatory rules to support growth.** While the ultimate capital requirements for Systemically Important Banks (SIBs) and non-SIBs will remain at 11.5% and 10.5% respectively (chart 1), SME and household loans will be assigned lower risk weights than under the original proposals, in a bid to encourage credit expansion. In their policy announcement, the authorities also pledged to ensure a gradual implementation phase-in so as to maintain a healthy pace of credit growth.
- **Looking ahead, we continue to believe that banks may need to raise more capital to meet the new regulatory rules.** Although bank capital levels remain adequate for the time being, the projected slowdown in profits may weigh on banks' ability to generate capital organically over the next few years (see our latest Banking Watch on the profit outlook).

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

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

Chart 1
Capital requirements for SIB and Non-SIB are 11.5% and 10.5% respectively



Source: CEIC and BBVA Research

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

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