BOC Research Institute

# Global Banking Industry Outlook

**2020Q2 (Issue 42)** **March 30, 2020**

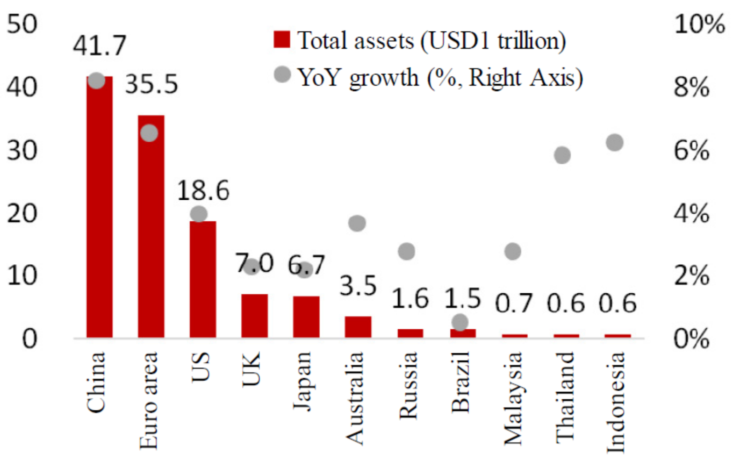
## Highlights

● The global banking sector showed overall solid growth in 2019. Assets expanded mildly with stable overall quality and weaker profitability. Some emerging markets faced rising risks.

● Since 2020 began, the global COVID-19 pandemic has added to the downside pressure on the world economy. The central banks' increasingly easing policies will shrink banks' interest rate spreads. The financial market upheaval has pushed up market risk. The global banking sector is expected to show marked slowdown in expansion with gloomy profit prospects in 2020H1, with the credit risk escalating in regions hit hard by the virus. Despite the low probability of a systemic banking crisis, special attention should be paid to the risks among small and medium-sized banks.

● China's banking industry showed solid growth in 2019, but the NPL ratio is expected to rise and profit growth to decline in 2020H1 due to the COVID-19 outbreak, albeit with a stable risk mitigation ability.

**Size and Growth of Assets of Major Economies in 2019**




Source: BOC Research Institute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# Tackle New Challenges from Unexpected Major External Shocks

## -- Global Banking Industry Outlook (2020Q2)

The COVID-19 outbreak and the crude oil market disputes have sent the global financial market into drastic turbulence since 2020 began. The downside economic pressure has increased sharply. Central banks have en masse taken actions to relax their monetary policies substantially. The benchmark interest rates continue to move down. Financial supervision adjustments have been phased in. The global banking sector is facing sudden major challenges such as shrinking customer demand, rising credit risk and liquidity crunch. However, a banking crisis is unlikely to happen in the near future as the global banking industry maintained relatively solid growth and strengthened its risk mitigation ability in the past year. The short-lived COVID-19 impact will further boost the transformation of the banking model. How to manage risks and embrace “contactless” new forms and models of business will become a new topic for future banking.

### I. Global Banking Review and Outlook for 2020H1

#### I.1 The global banking sector showed relatively solid growth in 2019

**The assets expanded steadily in a whole, with notable increase in developed economies.** The banking assets of economies like China, the euro area, the US, the UK, Japan, Australia, Russia, Brazil, Thailand, Indonesia and Malaysia accounted for more than 80% of global banking assets. At the end of 2019, the banking assets of the 10 major economies totaled USD116.1 trillion, up 5.9% YoY (Figure 1). Banking assets grew faster in emerging economies. As at the end of 2019, China’s banking assets reached USD41.7 trillion, up 8.1% YoY; Malaysia, Thailand and Indonesia recorded an asset growth rate of 2.7%, 5.8% and 6.1%, respectively. However, Brazil’s banking assets edged up by 0.4% and Russia’s by 2.7%. The banking assets of developed economies showed faster growth than the previous year. At the end of 2019Q3, the euro area’s banking assets stood at USD35.5 trillion, with an estimated annual growth rate of 6%. Specifically, the French banking assets grew by over USD1 trillion or 12.9% during 2019Q1-Q3, showing outstanding performance. Belgium, Italy and Denmark registered faster growth, all above 10%. Germany and Spain recorded 3.4% and 3.8% in asset growth respectively during Q1-Q3 (Table 1). The US, the UK, Japan and Australia showed mild growth of 3.9%, 2.2%, 2.1% and 3.6% respectively.

**Figure 1: Banking Assets in Major Economies**[1]

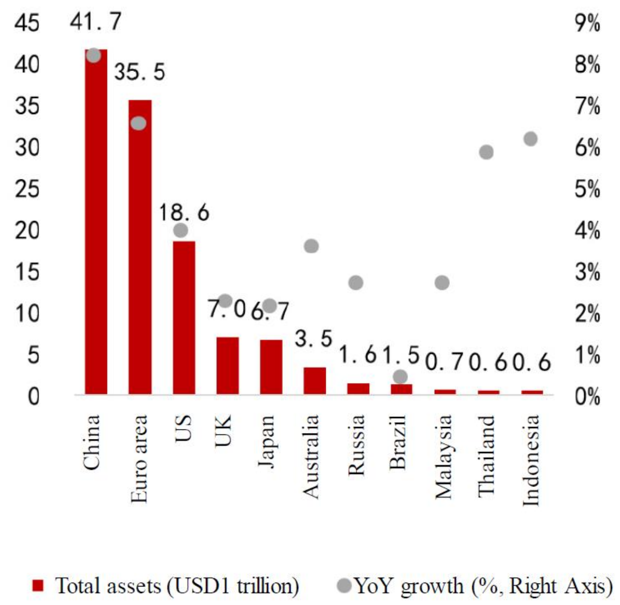



**Table 1: Banking Assets of Major Euro Area Countries (2019Q3)**

| Country | Total assets (USD100 million) | Change over year beginning (USD100 million) | Growth over year beginning (%) |
|---|---|---|---|
| France | 88,338.9 | 10,084.5 | 12.9 |
| Germany | 43,644.2 | 1,431.4 | 3.4 |
| Spain | 37,646.6 | 1,383.2 | 3.8 |
| Italy | 27,698.7 | 3,103.5 | 12.6 |
| The Netherlands | 23,656.6 | 611.5 | 2.7 |
| Belgium | 13,016.6 | 2,405.8 | 22.7 |
| Sweden | 9,856.0 | 655.2 | 7.1 |
| Denmark | 8,761.8 | 817.6 | 10.3 |
| Finland | 8,036.0 | 388.6 | 5.1 |
| Austria | 7,076.2 | 362.9 | 5.4 |

Source: Central banks and regulatory authorities, financial statements of banks, BOC Research Institute

**Profitability weakened and net interest margin (NIM) narrowed markedly.** The net profits of banks in 10 major economies totaled USD822 billion in 2019, up merely 0.04% from 2018. China's banking sector achieved a net profit of USD286.4 billion, up 8.9% from the previous year, but its ROA was 0.87%, down 3 bps YoY (Figure 2). Net profits of banking sectors in the US, the euro area, the UK, Japan and Australia all declined, down 1%, 5.5%, 9.3%, 16.7% and 5.4% from 2018 respectively, with ROA down 5 bps, 7 bps, 0 bp, 5 bps and 7 bps respectively (Figure 3). Net profits of banking sectors in Russia, Thailand and Malaysia increased by 51.5%, 30.8% and 10.1% YoY respectively, with ROA up 7 bps, 3 bps and 1 bp respectively. NIM shrank evidently. NIM of the US, the UK and Australian banks fell by 12 bps, 23 bps and 5 bps respectively in 2019, compared with a decline of 3 bps in Japan and 1 bp in the euro area (as of September 2019). When it comes to emerging economies, banking NIM fell by 23 bps and 1bp in Indonesia and Malaysia respectively, remained unchanged in Thailand and rose slightly by 2 bps in China.

[1]The euro area data are as at the end of 2020Q3. The UK banking data consist of five major banks, namely HSBC Holdings plc, The Royal Bank of Scotland, Lloyds Bank, Standard Chartered Bank and Barclays Bank. The big five contributed about 60% of the UK's total banking assets. Japan's banking data are for Q1-Q3 of FY2019 (April 2019 to December 2019) and composed of three major financial groups, namely Mitsubishi UFJ Financial Group, Sumitomo Mitsui Financial Group and Mizuho Financial Group, which cotributed about 60% of Japan's total banking assets. Brazil's banking data consist of five major banks, namely the Banco Do Brasil, Itaú Unibanco, Caixa Econômica Federal, Banco Bradesco SA and Banco Santander, which contributed 85.6% of Brazil's total banking assets.

**Figure 2: Banking Profits in Major Economies**

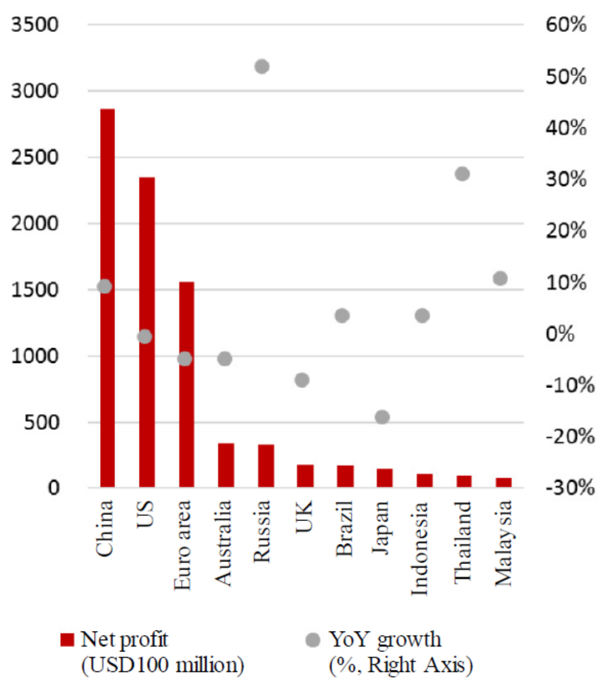
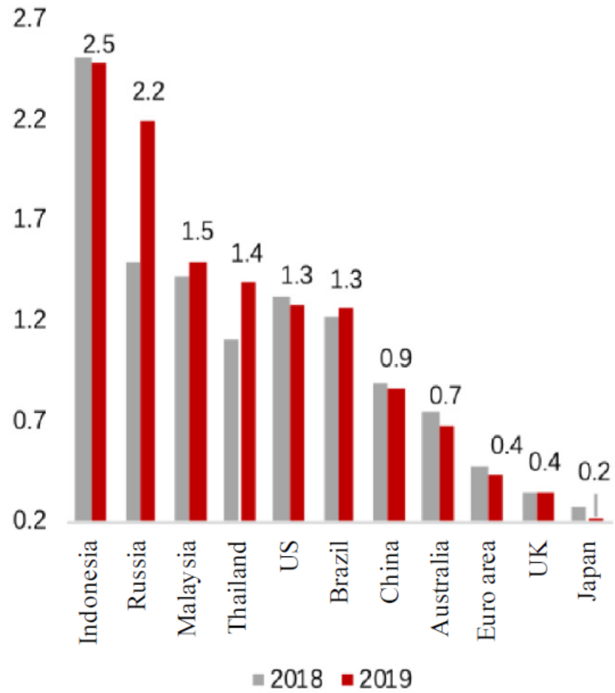



**Figure 3: Banking ROA Changes in Major Economies (%)**




Source: Central banks and regulatory authorities, financial statements of banks, BOC Research Institute

**Banking assets quality was stable in developed economies, yet exposed to higher risks in some emerging economies.** Banks in developed economies gradually shed their pressure in terms of NPL recovery and disposal. By the end of 2019, both balance and ratio of NPLs of banks declined in the US, the UK and the euro area. The balance of NPLs fell by 1.9%, 4.9% and 6.4% respectively from 2018. The NPL ratio decreased by 5 bps, 2 bps and 30 bps respectively from 2018. The NPL ratio of Japanese and Australian banks increased by 4 bps and 2 bps respectively over the previous year, with their balance of NPLs up 3.6% and 9.6% respectively. Asset quality was mixed among banks in emerging economies. The NPL ratio of Thailand and Malaysian banks remained basically stable, up 5 bps and 4 bps respectively from the previous year. Chinese banks' balance of NPLs grew by 19.2%, while the NPL ratio up 3 bps. The NPL balance of Russian banks grew by 19.8%, while their NPL ratio rose by 68 bps to 5.4%. Brazil's banking NPL ratio fell by 29 bps, but remained high at 6.1%. Indonesian banks recorded a growth rate of 24.9% in balance of NPLs, putting the asset at a risk level deserving vigilance (Figure 4). The capital adequacy ratio (CAR) of banks in major economies showed a steady rise, except for Russia where CAR stood at a low level of 9.3% (Figure 5), suggesting significant pressure to replenish capital in the future.

**Figure 4: NPLs of Banks of Major Economies**

As at the end of 2019, %

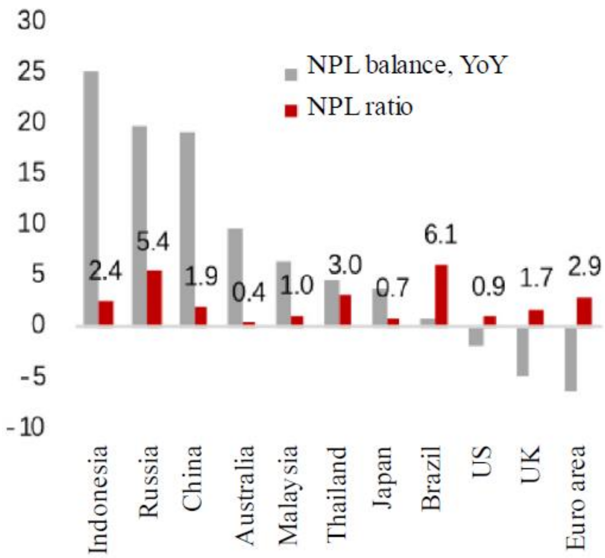
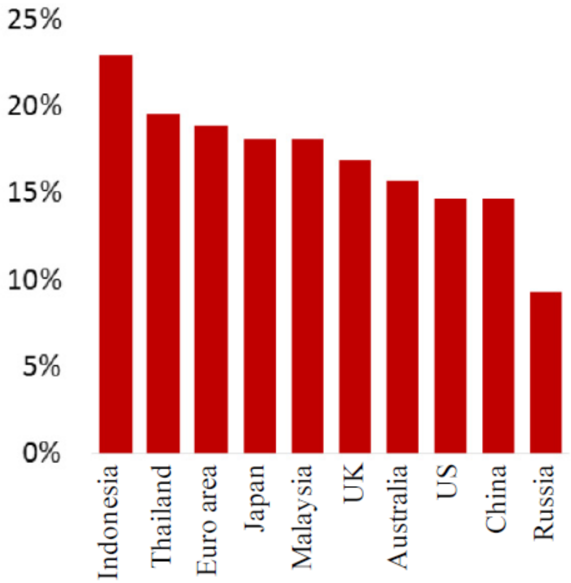



**Figure 5: Capital Adequacy Ratios of Major Economies**

As at the end of 2019, %




Source: Central banks and regulatory authorities, financial statements of banks, BOC Research Institute

### I.2 The banking industry has been affected by unexpected adversities since 2020 began

**The global economy is under mounting downside pressure.** The COVID-19 outbreak and crude oil market disputes came as unexpected major attacks on the global economy in early 2020. In February, the JPMorgan Global PMI fell to 46.1, a ten-year low below the boom-or-bust line. The IMF's World Uncertainty Index (WUI) has risen to 374 recently and the World Trade Uncertainty Index (WTU) soared to 174.34, each a ten-year high. The surging downside pressure on the global economy will greatly affect the banking development in terms of customer demand and asset quality.

**The global interest rates continue to go down.** Since 2020 began, major central banks have started a new wave of monetary easing in response to the spread of COVID-19. On March 3, Australia's central bank cut interest rates by 25 bps to 0.5%, a record low, while the US Federal Reserve (the "Fed") cut interest rates by 50 bps. On March 15, the Fed further slashed interest rates to an all-time low, adjusting the target range to 0 to 0.25%, and lowering the federal discount rate to 0.25%. In March, the Bank of Canada cut interest rates twice by a total of 100 bps and lowered its benchmark rate to 0.75%.The Bank of England lowered its benchmark rate by 50 bps to 0.25%. The Bank of Korea lowered its benchmark rate by 50 bps to 0.75%, below 1% for the first time in its history. The Bank of Japan and the European Central Bank kept their interest rates negative while vowing to further ease the monetary policy, in an effort to ensure sufficient liquidity and financial market stability. In emerging markets, Malaysia's central bank has cut interest rates twice, with the overnight rate down to 2.50%. Brazil, Russia, Indonesia and Thailand all reduced their policy rates by 25 bps (Table 2). The global COVID-19 pandemic and soaring downside pressure on the economy have pressed central banks to further relax their monetary policies, which will squeeze the profitability (especially NIM) of global banks.

**Table 2: Changes in Policy Rates in Major Economies from 2018 to 2020Q1 (%)**

| Country | Interest rate | 2018 | 2019 | 2020Q1[2] | Change from year beginning |
|---|---|---|---|---|---|
| US | Federal funds rate | 2.50 | 1.75 | 0.25 | -1.50 |
| Japan | Target policy rate | -0.10 | -0.10 | -0.10 | -- |
| Euro area | Deposit facility rate | -0.40 | -0.50 | -0.50 | -- |
| UK | Benchmark rate | 0.75 | 0.75 | 0.25 | -0.50 |
| Canada | Benchmark rate | 1.75 | 1.75 | 0.75 | -1.00 |
| Australia | Money-market target rate | 1.50 | 0.75 | 0.50 | -0.20 |
| South Korea | Benchmark rate | 1.75 | 1.25 | 0.75 | -0.50 |
| South Africa | Repo rate | 6.75 | 6.50 | 6.50 | -- |
| Brazil | Overnight rate | 6.50 | 4.50 | 4.25 | -0.25 |
| China | 1-year LPR | 4.31 | 4.15 | 4.05 | -0.10 |
| Russia | Key rate | 7.75 | 6.25 | 6.00 | -0.25 |
| India | Benchmark rate | 6.50 | 5.15 | 5.15 | -- |
| Indonesia | Benchmark rate | 6.00 | 5.00 | 4.75 | -0.25 |
| Thailand | Overnight rate | 1.75 | 1.25 | 1.00 | -0.25 |
| Malaysia | New overnight policy rate | 3.25 | 3.00 | 2.50 | -0.50 |

Source: Wind, BOC Research Institute

**Global financial markets have sunk into great turbulence.** Brent crude prices have fallen by nearly 60% since 2020 began. Stock market "circuit breakers" were triggered in more than 10 countries, including the US, Canada, Brazil and the Philippines. As of March 17, Frankfurt DAX, FTSE 100, Dow Jones Industrial Average and Nikkei 225 were down 34.7%, 32.3%, 30.1% and 26.7% respectively from the beginning of the year. SSE Composite Index and Hong Kong's Hang Seng Index were down 9.6% and 19.2% from the beginning of the year. The long-term government bond yields in major economies dropped significantly. Specifically, the 10-year US Treasury yield averaged 0.73%, down 61.2 bps from the year beginning. The 10-year China government bond yield stood at 2.66%, down 16.8 bps from the year beginning. The market volatility increased significantly. The tight liquidity of some financial institutions has fueled a sharp rise in USD money market rates, posing severe challenges to bank liquidity management.

**Financial supervision policies have been gradually adjusted.** In 2020Q1, national financial regulators slowed their pace of strict supervision in response to the COVID-19 outbreak. They launched series of policies aimed at maintaining financial stability and encouraging banks to support the recovery of the real economy (Table 3). In February 2020, Fed Governor said that the assets of large foreign banks in the US had been shrinking by more than 50% over the past 10 years, so these banks should no longer comply with the same regulatory standards as large banks. In response to the virus outbreak, the UK, Japan and China introduced financial support measures encouraging banks to provide credit and other financial service support for pillar industries and SMEs in difficulties. Besides, the spread of the virus has turned contactless online financial services into a major trend. The development of financial technology (FinTech) and regulatory technology (RegTech) have begun to accelerate. Australia has passed the *Competition and Consumer (Consumer Data Right) Rules*. ANZ Bank and other three major banks will share product data with recognized third-party data furnishers as required by users, thus boosting the open banking development. Malaysia's central

[2] As of March 17, 2020.

bank issued an updated exposure draft on the licensing framework for digital banks that incorporates the proposed simplified regulatory framework for digital banks applicable during the foundational phase. Sweden, Russia and South Korea have made fresh progress in the pilot program on regulatory sandbox and digital currency.

**Table 3: Selected Financial Regulatory Policies and Their Influences in 2020Q1**

| | Time | Main financial regulatory policy developments | Main effects |
|---|---|---|---|
| **US** | February 2020 | The Fed said it would consider improving and relaxing the supervision of foreign banks according to their size and risk profile. Previously the Fed imposed type-specific supervision on foreign banks. All US institutions of the eight global systemically important banks, UBS, Credit Suisse, Deutsche Bank and Barclays Bank were subject to the strictest supervision requirements and compliance review. | The regulatory standards for foreign banks, especially large foreign banks, will probably be further relaxed and no longer be subject to the same regulatory requirements as large US-based banks. |
| **Hong Kong, China** | February 2020 | Financial institutions authorized by regulatory agencies are required to support customers plunged by COVID-19 into financial difficulties pursuant to the *Hong Kong Approach to Consumer Debt Difficulties* and the *Hong Kong Approach to Corporate Difficulties*, and provide temporary relief arrangements for such borrowers under the principle of prudent risk management. | Banks are required to flexibly manage the ceiling of loan term according to circumstances and to provide timely support for customers in need under the principle of risk prudence, taking into account the epidemic developments. |
| | March 2020 | The counter-cyclical capital buffer requirement was lowered from 2% to 1% | The CAR requirements on banks are relaxed to increase credit supply |
| **Mainland China** | February 2020 | CBIRC issued the *Notice on Further Improving Financial Services for Epidemic Prevention and Control*, mainly including the following requirements: enhancing financial services to support enterprises to resume work and production; strengthening the application of science and technology and the innovation of financial services; enhancing the awareness of mission and fulfilling social responsibilities; improving the mechanisms to implement the requirements of epidemic prevention and control; improving work style and the quality and efficiency of financial supervision services. | Commercial banks are required to respond actively to the policy call by increasing financial support for enterprises, improving financial services to further help enterprises resume work and production, fulfilling the responsibility for epidemic prevention and control and helping enterprises out of difficulties. |
| **Australia** | February 2020 | The *Competition and Consumer (Consumer Data Right) Rules* came into effect on February 6. The four large banks, namely ANZ Bank, Westpac Group, Commonwealth Bank and | Bank data such as interest rate, fee rate, credit cards and mortgages will be shared to boost the development of Australia’s open banking system, which will intensify |

| | | | |
|---|---|---|---|
| | | National Australia Bank, are required to share product data with recognized data recipients according to user requirements. | banking competition. |
| **UK** | March 2020 | The Coronavirus Business Interruption Loan Scheme was proposed to encourage banks to provide loans to SMEs with a maximum limit of GBP1.2 million. | The scheme is a part of a wider package of financial measures taken by the UK government in response to the COVID-19 outbreak. It will partly help UK banks and enterprises survive the crisis. |

Source: Publicly available data

### I.3 Global Banking Outlook

Looking forward to 2020H1, the ongoing COVID-19 spread across the world will put huge downside pressure on the global economy. Monetary policies will become extremely easing again, and national financial regulators will increasingly strengthen their counter-cyclical operations. The global banking sector faces an unfavorable business environment at present. However, a systemic banking crisis is unlikely to happen in the near future given its relatively solid growth up to the end of 2019, as evidenced by the insignificant size of non-performing assets, higher transparency of risks, strengthened ability to mitigate risks and markedly better banking fundamentals than those before the 2008 financial crisis. Besides, it will take time for the outbreak to send a ripple from the real economy to the banking system. It will have an impact on the profitability, risk level and business structure of banks over years.

**First, the scale growth will slow down significantly with a gloomy profit prospect.** In 2020H1 or even throughout the year, the global banking sector will slow down in scale growth significantly, notably in China, the euro area, the US, the UK and Japan, which are hit hard by COVID-19. Comparatively speaking, banking assets might maintain mild growth in less affected Southeast Asia, Russia and Australia. The banking sector shows a gloomy profit prospect in major economies. The massive redemptions by investors in a volatile market will seriously affect banks' commission income from asset management. A volatile financial market will affect the fair value and have a greater impact on profits and losses. Banks with a higher weight of non-interest income and more held-for-trading financial assets will be hit harder. They are mainly large European and American banks.

**Second, credit risks in regions and industries severely affected by the epidemic are on the rise.** From the perspective of asset quality, banking assets come under rising pressure of quality deterioration in areas with severe epidemic situations. Hard hit countries, such as China and Italy, have taken "lockdown" measures. The resulting suspension of production and work will ripple through weakening solvency of economic entities to the quality of banks' credit assets. For example, restrictions on the movement of people and commodities will immediately affect cross-border trade in goods, services and other related business activities. Industries relying heavily on cross-border activities (such as air transport and tourism) will face higher credit risk. In addition, the COVID-19 outbreak also severely impacts industries with crowd-gathering scenarios such as transportation, catering, hotels and tourism, pushing up the NPL ratio and credit risk significantly in these fields.

**Third, due attention should be paid to smaller banks as the rising volatility in financial markets exacerbates the liquidity risk of banks.** The COVID-19 outbreak has intensified panic and volatility in financial markets. Banks in countries or regions hit harder are facing the risk of credit rating downgrades, which will lead to higher costs of funds, more difficulty in financing and the risk of liquidity crunch. A more volatile financial market poses severe challenges to banks' liquidity management, especially when it comes to financial institutions with bigger risk exposure in the financial market and greater dependence on wholesale funding from peers, such as asset management companies, fund companies, securities companies and universal banks. Meanwhile, extra attention should be paid to the potential risks of complex financial institutions in regions with extremely volatile financial markets, such as the US and Europe. Banks with lower liquidity and CAR levels, especially small and medium-sized banks, will face greater management challenges or even serious liquidity or debt crisis. More failures of weaker and smaller banks are expected to occur in the future.

## II. China's Banking Review and Outlook for 2020H1

### II.1 China's banking sector moved forward steadily in 2019

According to CBIRC statistics, the total assets of China's banking sector realized steady growth in 2019, with basically stable quality of credit assets and profits, adequate risk reserves and solid liquidity position (Table 4).

**Table 4. China's Banking Data in 2015-2019 (RMB1 trillion, %)**

| | Indicator | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| **Total banking assets and liabilities** | Assets (RMB1 trillion) | 199.3 | 232.3 | 252.4 | 268.2 | 290.0 |
| | Liabilities (RMB1 trillion) | 184.1 | 214.8 | 232.9 | 246.6 | 265.5 |
| | Growth of assets, YoY (%) | 15.67 | 15.80 | 8.68 | 6.27 | 8.14 |
| | Growth of liabilities, YoY (%) | 15.07 | 16.04 | 8.40 | 5.89 | 7.71 |
| | Assets of large commercial banks (% of total) | 39.12 | 37.21 | 36.74 | 36.65 | 40.35 |
| **Profitability of commercial banks** | ROA (%) | 1.21 | 1.09 | 1.01 | 1.00 | 0.97 |
| | ROE (%) | 16.67 | 14.76 | 13.94 | 13.15 | 12.38 |
| | Net interest margin (%) | 2.53 | 2.27 | 2.06 | 2.13 | 2.19 |
| | Cost/income ratio (%) | 28.09 | 27.78 | 28.64 | 28.41 | 28.62 |
| **Risk profile of commercial banks** | NPL ratio (%) | 1.67 | 1.74 | 1.74 | 1.83 | 1.86 |
| | Provision coverage ratio (%) | 181.18 | 176.40 | 181.42 | 186.31 | 186.08 |
| | Capital adequacy ratio (%) | 13.45 | 13.28 | 13.65 | 14.20 | 14.64 |
| | Core tier 1 capital adequacy ratio (%) | 10.91 | 10.75 | 10.75 | 11.03 | 10.92 |

Source: CBIRC, BOC Research Institute

**First, assets and liabilities kept growing steadily.** The total assets and total liabilities of banking institutions reached RMB290 trillion and RMB265.5 trillion respectively at the end of 2019, up 8.14% and 7.71% YoY respectively, still representing fast growth. **Second, profitability slowed down.** At the end of 2019, commercial banks recorded RMB1.99 trillion in total net profit, up 8.91% YoY, and RMB10.96% in return on equity (ROE), both on the decline. **Third, credit risk mounted to greater pressure but risk resilience remained stable.** At the end of 2019, commercial banks recorded 1.86% in NPL ratio, showing a rising trend. PCR was 186.08% and CAR 14.64%, indicating stable risk resilience.

### II.2 China's banking environment has changed considerably since 2020 began

The banking environment has undergone profound changes since 2020 began as COVID-19 spreads across China and the larger world.

**First, the economy suffered short-term shocks.** The COVID-19 impact has cooled down the economic activity in the short term, with GDP expected to shrink in Q1. Consumption and investment were hardest hit, with total retail sales of consumer goods down 20.5%, fixed asset investment down 24.5% and total value of imports and exports down 9.6% YoY from January through February. The manufacturing PMI contracted significantly to 35.7% in February, down 14.3 percentage points from the previous month. The overseas COVID-19 spread and the global economic uncertainty will further weigh on China’s imports and exports.

**Second, the monetary policy is flexible and appropriate, and liquidity is reasonably ample.** Since the COVID-19 outbreak started, PBOC has flexibly used a variety of policy tools to maintain reasonably sufficient liquidity. In early February, PBOC injected RMB1.7 trillion of liquidity through open market operations. It further implemented targeted reserve requirement ratio (RRR) cuts on March 13 to release RMB550 billion of long-term funds. Aggregate financing to the real economy increased by 10.7% in February, and broad money (M2) increased by 8.8% YoY, up 0.4 percentage point from last month. New loans totaled RMB905.7 billion. Short-term corporate loans increased significantly, and household-sector loans dropped markedly. 1-year and 5-year LPR fell by 10 bps and 5 bps respectively in February, while Shibor, weighted average inter-bank lending rate, weighted average pledged repo rate and other major market rates remained low.

**Third, regulators have guided financial efforts to fight the epidemic and contain the virus.** Since the COVID-19 outbreak began, the MOF, PBOC, CIBRC, NDRC and CSRC have issued regulatory policies directing financial institutions to support the real economy and win the tough battle against the virus (Table 5).

For the real economy, PBOC has flexibly used various policy tools and injected liquidity into the market. CBIRC encouraged financial institutions to further increase lending to manufacturers and establish a quick response mechanism for funding the emergency production of agricultural products and increase financial support for farmer activity in the spring season. For micro, small and medium-sized enterprises affected by the virus, PBOC has set up special on-lending and rediscounting limits and special credit line from policy banks. CBIRC directed financial institutions to support troubled enterprises with tentative deferral of debt service arrangements. CBIRC also encouraged financial institutions to increase the “first borrower rate” and unsecured loan ratio of small and micro enterprises, reduce their overall financing costs and increase policy preferences for inclusive finance. For producers of virus-containment supplies, PBOC has directed financial institutions to open up expedited channels for transfer of emergency funds and set up low-cost special-purpose credit support programs. MOF has granted interest subsidies for relevant corporate loans and optimize the financing security services for enterprises affected by the outbreak. CBIRC have encouraged deferral of interest payment and renewal or extension of loans to support the capacity expansion of anti-virus manufacturers.

To maintain the solid performance of financial institutions, regulators have encouraged banks to identify and dispose of non-performing assets in a timely manner, and paid close attention to credit risk and asset quality. 2020 marks an end to the transitional period for the new asset management regulations. Regulators have issued such policies as lowering the investment threshold, cancelling the face-to-face verification requirement for initial investment and allowing direct investment in stock markets, thus emphasizing the steady transformation of banks’ wealth management business and easing their operating pressure.

**Table 5: Major Fiscal and Financial Policies in Response to COVID-19 Outbreak**

| Time | Issued by | Description |
|---|---|---|
| January 26 | CBIRC | The *Notice on Strengthening Banking and Insurance Services to Cooperate in Prevention and Control of Novel Coronavirus Pneumonia Epidemic* was issued, emphasizing that loans to hard hit industries should not be blindly withdrawn, terminated or reduced. Banks are encouraged to reduce the loan interest rate appropriately, improve the loan renewal policy arrangements and increase unsecured loans and medium and long-term loans. |

| | | |
|---|---|---|
| February 1 | PBOC, MOF, CBIRC, CSRC and SAFE | The *Notice on Further Strengthening Financial Supports to Prevent and Control the Novel Coronavirus Pneumonia Epidemic* was issued. The notice emphasizes the following requirements: keeping liquidity reasonably sufficient, increasing monetary and credit support and providing harder hit areas, industries and enterprises with such financial services as appropriately lowering lending rates and increasing unsecured loans and medium and long-term loans; strengthening the management of cash in circulation to ensure smooth payment and settlement; providing stronger credit support for key fields such as manufacturing, micro and small-sized businesses and private enterprises; ensuring the safety of financial infrastructure and maintaining the smooth and orderly operation of financial markets; and creating expedited channels to effectively improve the efficiency of foreign exchange and cross-border RMB business. |
| February 3-4 | PBOC | RMB1.7 trillion of funds were released through reverse repo operations in open market |
| February 7 | MOF, NDRC, MIIT, PBOC and NAO | The *Urgent Notice on Fighting the Battle against COVID-19 and Strengthening Financial Support for Key Enterprises Taking Part in COVID-19 Containment* was issued, emphasizing the necessity of properly managing the list of key enterprises taking part in COVID-19 containment and determining the scope of eligible enterprises and application procedures, with a focus on manufacturers of healthcare supplies for COVID-19 response. To support financial institutions to increase credit support through special refinancing facility. PBOC issued special on-lending to nine national banks and local banking corporations in key areas identified for COVID-19 response to support their preferential lending to enterprises on the list. As of March 13, RMB184 billion of special on-lending had been issued. The central pubic finance granted interest subsidies to bring down financing costs of enterprises. The weighted average interest rate of preferential loans is 2.56%. With a 50% interest subsidy, the actual financing cost of enterprises is about 1.28%. |
| February 7 | PBOC | The *Notice of the PBOC Financial Market Department on Bond Issuance by Financial Institutions during the Period of Prevention and Control of COVID-19* was issued. The notice emphasizes the requirement that validity of bond quota should be extended, and that the expedited channel and simplified process should be created for bond issuance by financial institutions in hard hit areas. |
| February 20 | MHRSS, MOF and STA | The *Notice on Tentative Reduction and Exemption of Employers' Social Security Contributions* was issued. According to the notice, all local governments, except in Hubei, are required to exempt micro, small and medium-sized enterprises from paying employer contributions to three social security programs for up to five months. Hubei province is encouraged to exempt all participating organizations (excluding government agencies and public service institutions) from paying employer contributions to three social security programs for up to five months. Enterprises sent by COVID-19 into major difficulties may apply for deferred payment of social security contributions. |
| March 1 | CBIRC, PBOC, NDRC, MIIT and MOF | The *Notice on Allowing Tentative Deferral of Loan Repayment by Micro, Small and Medium-sized Enterprises* was issued. For matured loans, banks are required to grant tentative debt service deferral arrangements for enterprises through loan extension or renewal. For loan interest, interest payment deferral arrangements should be granted to enterprises. As for new loan demand, expedited channel and simplified approval process should be created to accelerate lending to eligible borrowers, increase the ratio of unsecured loans and medium and long-term loans to micro, small and medium-sized enterprises and the "initial loan rate". |

| | | |
|---|---|---|
| | | Preferential-rate loans should be issued to private enterprises and micro, small and medium-sized enterprises. |
| March 16 | PBOC | Targeted RRR cuts were announced for inclusive finance. Eligible banks were granted a RRR cut of 0.5 to 1 percentage point, with an additional RRR cut of 1 percentage point made for eligible joint-stock commercial banks. RMB550 billion of long-term funds were released. |

Source: Publicly available data, BOC Research Institute.

**Fourth,** the intensifying competition will add to the pressure on smaller banks. Small and medium-sized city commercial banks and rural commercial banks have weaker asset quality and risk resilience than their larger peers. Their asset quality and profitability will be greatly impacted by the virus outbreak. As at the end of 2019, small and medium-sized rural commercial banks and city commercial banks recorded markedly higher NPL ratios than larger banks. Specifically, rural commercial banks had a NPL ratio of 3.90% and a NPL balance of RMB615.5 billion, far above those of joint-stock commercial banks and city commercial banks. Rural commercial banks had a low PCR, only slightly higher than the minimum regulatory requirement, indicating poor risk resilience (Table 6). The customers of smaller banks are mostly SMEs, which tend to be concentrated in local areas. Their loan structure bears a close tie to the local industrial structure. The COVID-19 epidemic may trigger an outbreak of collective defaults, thus impacting the asset quality. In addition, smaller banks are weak in innovation and their credit supply is much less than large banks', making it hard for them to promptly cushion the virus impact through online services.

**Table 6: Main Regulatory Indicators by Type of Commercial Bank (2019Q4)**

| | Large commercial banks | Joint-stock commercial banks | City commercial bank | Private banks | Rural commercial banks | Foreign banks |
|---|---|---|---|---|---|---|
| Balance of NPLs (RMB100 million) | 8,959 | 4,805 | 4,074 | 48 | 6,155 | 94 |
| NPL ratio | 1.38% | 1.64% | 2.32% | 1.00% | 3.90% | 0.67% |
| Return on assets | 0.94% | 0.86% | 0.70% | 1.05% | 0.82% | 0.63% |
| Provision coverage ratio | 234.33% | 192.97% | 153.96% | 391.12% | 128.16% | 313.90% |
| Capital adequacy ratio | 16.31% | 13.42% | 12.70% | 15.15% | 13.13% | 18.40% |
| Net profit (RMB100 million) | 10,606 | 4,233 | 2,509 | 82 | 2,287 | 216 |
| Net interest margin | 2.12% | 2.12% | 2.09% | 3.74% | 2.81% | 1.78% |

Source: CBIRC, BOC Research Institute

**Fifth, the COVID-19 outbreak has catalyzed digital banking.** Digital and online banking are important trends in the reform and development of commercial banks. In 2019, banking institutions processed 163.784 billion online banking transactions totaling RMB1,657.75 trillion, and enabled 121.451 billion mobile banking transactions totaling RMB335.63 trillion, up 38.88% YoY. Online transactions accounted for 89.77% of total transactions in the Chinese banking sector. Since the outbreak began, regulatory authorities have issued financial support policies encouraging banks to make their online financial services more convenient and available and enhance their ability to identify and manage risks using FinTech. Some commercial banks have provided online one-stop financial services and online loans to relieve the liquidity pressure of enterprises and meet their financial needs. They have created a cooperative, open and new ecosystem with integrated scenarios by designing and issuing wealth management products related to “epidemic prevention”, launching artificial intelligence-based online customer services, providing remote doctor consultation service and participating in government and livelihood services. Online business processes are backed by systematized management, agile organization and digital banking driven by data elements. The ongoing COVID-19 pandemic is expected to further catalyze the digitization of commercial banks.

### III.3 Banking Outlook for 2020H1 amid the COVID-19 Pandemic

The COVID-19 outbreak emerged in a different environment from that of the 2003 SARS outbreak. On the negative side: **First, they occurred in different stages of economic development.** China’s economy was on the fast track in 2003, but has slowed down to medium-to-high speed at present. Its growth has not bottomed out yet now, with profound changes in economic and consumption structures. **Second, the external environment remains a big uncertainty.** The current Sino-US trade frictions have not been resolved. Geopolitical risks remain prominent and will inevitably spur an economic turmoil. The sluggish global economy shows no clear signs of recovery. **Third, the long industry chain of enterprises may make them more vulnerable to shock.** China’s enterprises were in the stage of rapid growth with a shorter industry chain in 2013. At present, enterprises operate with a broader and longer industry chain and more cross-border links, likely to be impacted more broadly.

On the positive side: **First, e-commerce is full-fledged.** The virus outbreak will mainly affect industries focused on offline activities. At present, China has a well-established e-commerce value chain dominated by online activities, which can offset the shrinkage of offline activities. **Second, Internet banking has been growing fast.** Many banks have well-developed payment and settlement systems that enable direct online payment through various electronic devices and mobile terminals, minimizing the impact of the sharp drop in activities requiring people-to-people contact. **Third, China’s commercial banks are more resilient to risks.** China’s banking sector was in the early stage of reform in 2003, with a low market-based level, weak operating ability and heavy pressure on asset quality. At present, Chinese banks have a larger size of assets, much stronger operating ability and higher level of risk resilience.

Therefore, by reference to banking sector developments during the SARS outbreak, China’s banking sector will show the following characteristics in 2020H1 amid the COVID-19 pandemic:

**First, the scale of assets will continue growing rapidly.**

After the COVID-19 outbreak happened, local governments took such actions as postponing the post-holiday resumption of work and strengthening residential community control. These restrictions have greatly affected the resumption of work and production of enterprises and frustrated offline consumer demand. The resulting subdued producer and consumer demand for credit led to slowdown in banks’ credit growth. In January and February 2020, the balance of RMB loans increased by 12.1% YoY, down 1.3 percentage points from the same period of last year each. Considering that the domestic COVID-19 situation has been well contained in March, credit demand will gradually pick up. Commercial banks are estimated to maintain fast growth in assets and liabilities in Q1, at about 8% and 7.5% respectively. The proportion of loans is expected to further increase to about 53%, slightly below the end-2019 level.

Regulatory authorities have taken a range of actions encouraging more credit supply from banks to offset the impact of COVID-19 outbreak and support the real economy. In particular, CBIRC announced to allow a higher NPL level of commercial banks to speed up the pace of credit supply. The number of confirmed infections has been well controlled since March. All provinces have ceased to report any significant increase in confirmed cases. Local governments have approved resumption of work and production in succession. Producer activity and offline consumer spending have gradually picked up. Credit demand is recovering and the larger society is returning gradually to normal. Given the suppressed credit demand in Q1, some enterprises may “rush to work” to make up for the losses in Q1 after the epidemic is fully reined in. Thus credit demand may rebound significantly in Q2. These factors, coupled with the still-prudent monetary policy, will keep liquidity reasonably sufficient. Commercial banks are expected to realize faster growth in assets with an even higher proportion of loans in Q2.

**Second, the net profit growth may slow down.**

The COVID-19 outbreak has greatly curbed the in-store consumer spending. Thus banks’ off-line business income will be affected much. In terms of fee-based businesses, the COVID-19 outbreak will significantly lessen the day-to-day cash deposits and withdrawals and credit card use, and also reduce visits to cinemas, restaurants, hotels, shopping malls, tourist attractions and transportation. The related payments and settlements will show a cliff-like decline. As a result, income from day-to-day payments and settlements will shrink sharply. In terms of interest margin, the regulatory policy will direct banks to provide more favorable financial services to regions, industries and enterprises, especially SMEs, hit hard by the epidemic. Thus the overall interest margin of banks will shrink to some degree. Overall, the net profit growth of China’s banks will slow down in 2020Q1 due to the decline in fee-based income, estimated at about 9.2%.

When the epidemic situation gradually eases off, the payment and settlement volume of commercial banks, which fell sharply in Q1, will gradually be restored. More online and offline transaction demand will be reactivated. Other financial needs of producers and consumers will also pick up. Fee-based income will increase to fuel the net profit growth after Q2. As commercial banks will rely more on credit supply for net profit in 2020H1, commercial banks are likely to see a moderate pickup in net profit growth in Q2.

**Third, the NPL ratio will rise slightly and the risk resilience will remain stable.**

Thanks to the acceleration of write-offs, the NPL ratio of commercial banks did not increase markedly in 2019. All local governments have taken rigorous COVID-19 containment measures, which will affect the activity of businesses and put greater upside pressure on the NPL ratio. Given the high probability of a Q1 with weakened macro-economic data and subdued credit supply and demand, bank profits may drop slightly to soften the write-off capacity to some extent. City commercial banks and rural commercial banks in areas with stricter virus containment actions will be affected substantially due to their weak online service capacity. On the whole, commercial banks’ NPL ratio will rise slightly to about 1.88% in 2020Q1 amid the economic slowdown and COVID-19 pandemic, with a PCR of about 185%.

As the COVID-19 impact is intensive mainly in Q1, the economic activity will be back on track in Q2 as producer activity and consumer spending recover gradually, with the social credit risk trending lower. Meanwhile, commercial banks tend to speed up their pace of NPL write-off from quarter to quarter in a year, and the regulatory authorities have recently encouraged financial institutions to write off some NPLs at their discretion. This will help control the rise in NPL ratio of commercial banks in 2020Q2 and stabilize their asset quality.

The COVID-19 outbreak has made regulators tentatively more tolerant of NPLs of commercial banks, but this does not mean relaxing supervision. At present, the downward pressure on China’s economy remains high. It is still a formidable task to forestall and defuse systemic financial risks. The sound operation of banks is vital to stability of the financial system. Regulatory authorities will continue to support commercial banks’ efforts to replenish capital through diversified channels, strengthen provisions and boost their loss-absorbing capacity. CAR and PCR are projected to remain high in 2020Q2 to assure stable risk resilience.

## Disclaimer

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