BOC Research Institute

Global Banking Industry Outlook

2023Q3 (Issue 55) **July 3, 2023**

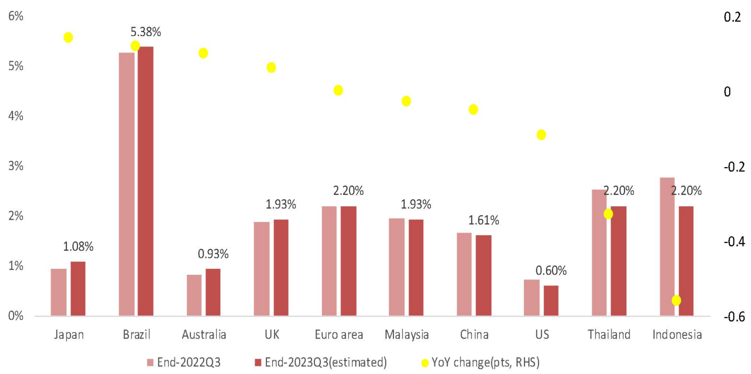
Highlights

● 2023Q3 will see a still-sluggish world economy amid the confluence of short- and long-term risk factors. Under such stress, the banking sector will face prominent credit and liquidity risks as well as hurdles to scaling and capital replenishment.

● 2023Q3 will witness a continued recovery in China' s economy. The Chinese banking sector will move forward steadily with a focus on both size and efficiency of business, make robust profits to enhance risk resilience and ensure asset quality and capital adequacy.

● At present, the global banking sector is facing major risk challenges. This report provides a special analysis on the liquidity risk of European and US banks, quality of Chinese banking assets since the onset of the COVID-19 pandemic, mortgages prepayment risk and consumer protection issues.

Estimated NPL Ratios and Changes in Major Economies at the End of 2023Q3



Source: BOC Research Institute

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Facing Risks and Challenges in Financial Cycle Reversal

-- Global Banking Industry Outlook (2023Q3)

The world economy has been on a bumpy road to recovery in 2023 to date. Under the lingering fallout from US and European banking crises, uncertainty has spread across the global financial system. The banking profitability has been dampened significantly by mounting pressure, prominent risks, lack of momentum for expansion and obstacles to capital replenishment. China remains on track for economic recovery amid persistent challenges. The Chinese banking industry has taken the initiative to increase support for the real economy, steadily expand assets and liabilities and emphasize both volume and efficiency of business development, manifesting steady improvements in asset quality. Overall, global banks should face up to the shift in economic and financial cycles to mitigate risks and meet challenges. This report provides a special analysis on the liquidity risk of European and US banks, quality of Chinese banking assets since the onset of the COVID-19 pandemic, mortgages prepayment risk and consumer protection challenges.

I. Global Banking Review and Outlook

I.1 Global banking environment faces challenges

Banking prospects are bleak amid a lackluster world economy. In April 2023, the IMF released a report predicting an annual growth of 2.8% for the world economy in 2023, down 0.1 percentage point from its January estimate. In June, the World Bank revised global growth slightly upwards to 2.1%, up 0.4 percentage points from its January estimate, but still in the low range (Table 1). Compared with the end of Q1, the Global Economic Policy Uncertainty Index went higher, especially in major economies in Europe and the United States (Fig. 1). Manufacturing PMI indices in the world's major economies are significantly below the 50-point boom-or-bust line, with significant declines seen in the euro area and the United Kingdom (Fig. 2). Overall, global economic growth will remain sluggish in a highly uncertain business environment, posing challenges to the banking industry.

Table 1: Growth Forecasts for Global Economies (%)

Year / Region	2018	2019	2020	2021	2022	2023^f	2024^f	2022	2023^f	2024^f
					IMF (April 2023)			WB (June 2023)		
United States	2.9	2.3	-2.8	5.9	2.1	1.6	1.1	2.1	1.1	0.8
Brazil	1.8	1.2	-3.3	5.0	2.9	0.9	1.5	2.9	1.2	1.4
Japan	0.6	-0.4	-4.3	2.1	1.1	1.3	1.0	1.0	0.8	0.7
Euro area	1.8	1.3	-8.3	5.2	3.1	2.2	1.7	3.5	0.4	1.3
Russia	2.8	2.2	-2.7	5.6	-2.1	0.7	1.3	-2.1	-0.2	1.2
Developing countries	4.5	3.7	-2.0	6.7	4.0	3.9	4.2	3.7	4.0	3.9
Global	3.6	2.9	-3.1	6.2	3.4	2.8	3.0	3.3	2.7	2.9

Source: IMF, World Bank, BOC Research Institute Notes: The superscript "f" stands for "forecast".

Fig. 1: Economic Policy Uncertainty Index

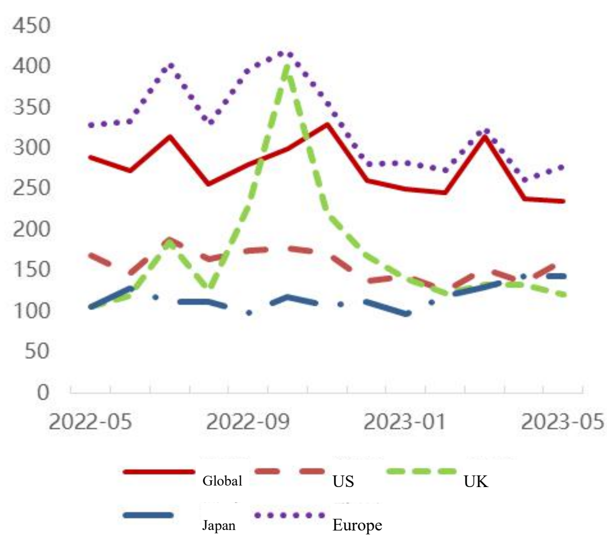
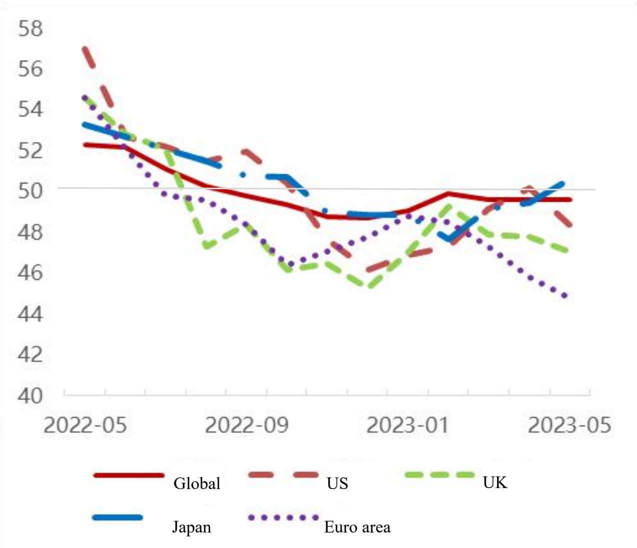


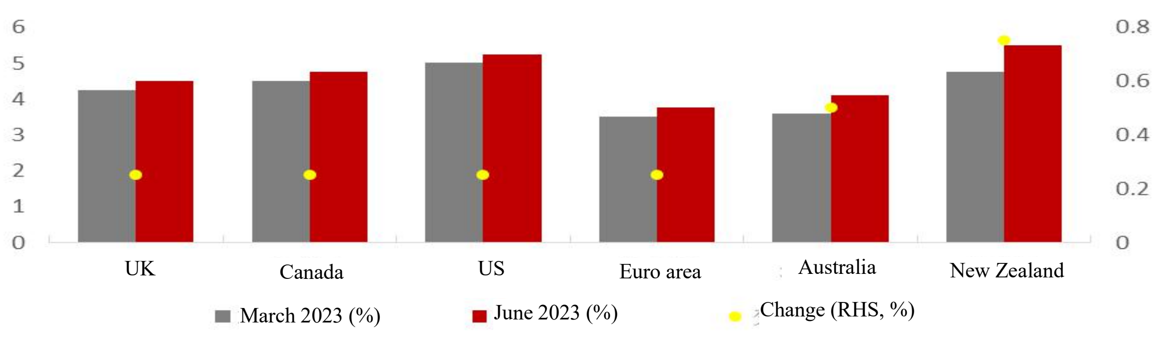
Fig. 2: Manufacturing PMI



Source: Wind, BOC Research Institute

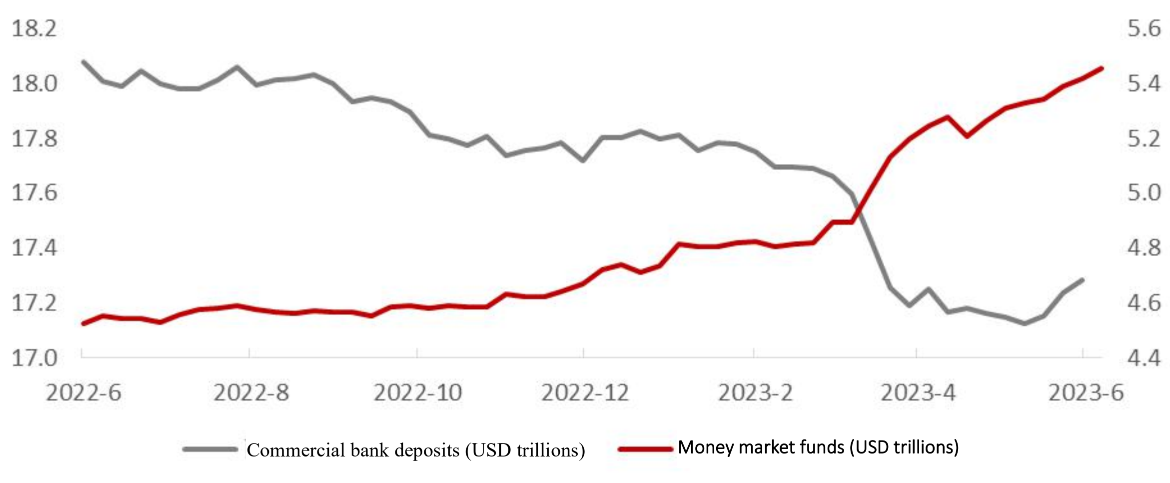
Major economies are slowing down the pace of interest rate hikes, with interest rate risks and liquidity risks remaining significant in the global banking sector. In Q2, major countries in Europe and the United States reduced the magnitude and pace of rate hikes. The US Federal Reserve (the Fed) raised interest rates by 25 bps in May and announced a pause in June, keeping the target range of the federal funds rate at 5% to 5.25%. The three key interest rates in the euro area have been raised twice in a row by a total of 50 bps, a much smaller size than in Q1 (100 bps). The United Kingdom and Canada hiked rates by 25 bps to 4.5% and 4.75%, respectively. New Zealand and Australia kept raising interest rates to 5.5% and 4.1%, respectively, after two hikes. Rate hikes softened in emerging economies weakened, with Brazil and Russia keeping their benchmark rates unchanged (Fig. 3). In an environment of persistently high interest rates, the First Republic Bank went bankrupt following the failure of Silicon Valley Bank and Signature Bank. The banking liquidity crisis spread quickly to other small and medium-sized banks across the United States, sending related bank stocks into plunges and the bond market into violent turbulences. Amid the escalating market panic, large numbers of depositors in the United States have moved their deposits from banks to safer money market funds in fear of a banking liquidity crisis (Fig. 4).

Fig. 3: Changes in Policy Rates of Selected Economies



Source: Central banks, BOC Research Institute

Fig. 4: Sizes of US Commercial Bank Deposits and Money Market Funds



Source: The Fed, Investment Company Institute, and BOC Research Institute

Financial supervision continued to tighten, putting stricter requirements on the banking risk management. In response to the banking crisis, major economies successively issued regulations and requirements in Q2 to strengthen the liquidity review of banking and non-banking institutions and guide banks to properly cope with financial market uncertainties. The Fed issued the *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* to examine the causes of Silicon Valley bank failure. The European Court of Auditors reviewed the European Central Bank (ECB)'s deficiencies in credit risk management of banks. The Fed, the European Commission and the Bank of England (BoE) separately proposed to reform the deposit insurance system and strengthen supervision over the credit risk and liquidity risk of banks, in a bid to safeguard customer deposits and keep the financial system stable. The Reserve Bank of India (RBI) released its annual report vowing to enhance supervision over non-bank financial enterprises in 2023-2024. In a word, the world's major economies have strengthened banking supervision and crisis management, trying to avoid bank runs in a high interest rate environment and injecting a "cardiac stimulant" into the banking system.

Table 2: Selected Financial Regulatory Policies and Their Impact (2023Q2)

	Date	Financial regulatory policies	Main impact
Global	June 2023	The Basel Committee summed up lessons from the banking crisis and stressed the need to strengthen the effectiveness of supervision. It reiterated that all the Basel III requirements should be fully implemented and agreed to consult on revisions to the *Core Principles for Effective Banking Supervision*.	Guiding the banking sector to strengthen the management of liquidity risk and interest rate risk, making risk identification and response more forward-looking and making the global banking system more resilient.
United States	April 2023	The Fed analyzed the causes of Silicon Valley bank failure: (1) Silicon Valley Bank's board of	The report systematically analyzed the causes of

		directors and management failed to manage their risks; (2) regulators did not fully appreciate the extent of the vulnerabilities as Silicon Valley Bank grew in size; (3) regulatory response was inadequate; and (4) the existing regulatory framework is not binding or agile enough.	Silicon Valley bank's failure, acknowledged shortcomings in the Fed supervision and planned to revisit the regulatory framework.
	May 2023	The Federal Deposit Insurance Corporation (FDIC) issued the *Options for Deposit Insurance Reform*. There are three options: Limited Coverage, Unlimited Coverage, and Targeted Coverage.	The proposal explores where the deposit insurance system reform should go to better safeguard financial stability, protect depositors and reduce the negative impact of bank resolution.
	May 2023	The FDIC collects special fees to cover the costs paid by the Deposit Insurance Fund (DIF) to reimburse the depositors of Silicon Valley Bank and Signature Bank. The special fees are levied on banks with assets of more than USD50 billion, charged at 0.125% annually for two years on their uninsured deposits as of the end of 2022.	The DIF is replenished to safeguard customer deposits and bolster market confidence in the banking system. Banking institutions with more than USD50 billion in assets will pay 95% of the total amount charged, but the impact will be insignificant.
Europe	April 2023	The European Commission recalibrated the bank crisis management and deposit insurance framework: The proposal facilitates the use of deposit guarantee schemes in crisis situations to shield depositors, protect the interests of depositors and isolate the crisis from other banks. The new framework extends depositor protection to public entities (i.e. hospitals, schools, municipalities), as well as client money deposited in certain types of client funds (i.e. by investment companies, payment institutions, e-money institutions).	The proposal allows the authorities to take effective measures to remove failed banks from the market in a timely manner, with the aim of preserving financial stability, protecting taxpayers' and depositors' money, supporting the development of the real economy and enhancing the competitiveness of the financial industry.

	May 2023	The European Court of Auditors found deficiencies in the ECB's management of banks'credit risk: First, the minimum capital requirements were imposed on higher-risk banks that should have been subject to higher regulatory requirements. Second, when credit risk management problems emerged in the banking sector, the ECB failed to take effective supervisory measures to control risk transmission. Third, the banking supervision was understaffed, leading to a protracted supervision process and delayed assessment.	The ECB should strengthen its supervision of credit risk in the banking sector, especially for delinquent borrowers.
The United Kingdom	May 2023	The Prudential Regulation Authority (PRA) published its strategic priorities for 2023-2024: (1) enhance the safety, soundness and financial resilience of the banking and insurance sectors; (2) strengthen risk identification and prevention in artificial intelligence, climate risk and crypto assets; (3) establish a more simple, flexible and effective financial regulatory system; (4) make regulators more inclusive and digitalized.	Effectively enhance the competitiveness and vitality of the financial market, improve the information collection capacity of the banking and insurance sectors and thus boost the efficiency of supervision.
	June 2023	The BoE proposed to overhaul the deposit insurance regime, including pre-funding compensation schemes and reviewing whether banks are sufficiently solvent before they are sold or shut down.	The proposal aims to better protect small and medium-sized depositors in the event of a crisis.
India	June 2023	The Reserve Bank of India (RBI) will establish a capital buffer mechanism for the banking sector and strengthen the review of bank's liquidity reserves.	Higher requirements are placed on the liquidity management of banks to enhance financial stability.

Source: Publicly available data and BOC Research Institute.

Artificial intelligence (AI) has become a key instrument for the banking sector's digital transition as the FinTech momentum continues unabated. In Q2, countries made breakthroughs in the development and testing process of central bank digital currencies (CBDCs), the Bank of Israel has planned to issue its CBDC. The Central Bank of Brazil tested the privacy and security of the digital real at pilot institutions. The BoE and the Bank for International Settlements (BIS) made progress in exploring the scalable and highly-available API layer. ChatGPT set off a wave of global interest in AI technologies. Its interactive chatbot features fit deep into banking operations, such as account balance retrieval and recent bank statement query. The Financial Services Commission of Korea and the Monetary Authority of Singapore are actively exploring AI solutions to optimize the regulatory environment for financial data. HSBC uses AI to fully mine and analyze public data to launch a corporate ESG index. In addition, tech firms have moved into the financial sector, with Apple and Habitto launching a savings account feature that offers depositors a deposit rate well above the market level.

Table 3: Major FinTech Events (2023Q2)

Type	Entity	Date	Event
Central Bank Digital Currency (CBDC)	Bank of Israel	April 17, 2023	The Bank of Israel has planned to issue its CBDC and announced details of the action plan for the potential issuance of a digital shekel (SHAKED).
	Bank of Canada	May 8, 2023	The Bank of Canada launched an online public consultation on the features, including security features, that could be included in a digital Canadian dollar, and how to use the digital currency.
	Central Bank of Brazil	May 24, 2023	The Central bank of Brazil released a list of 14 pilot institutions to test the privacy and security of the Digital Real, planning to fully implement the Brazilian CBDC by the end of 2024.
	BoE and BIS	June 16, 2023	The BoE and the BIS issued a report on their pilot Project Rosalind, stating that a highly available and scalable API layer could facilitate retail payments in CBDC.
Open banking	UK regulators	April 17, 2023	The Joint Regulatory Oversight Committee's (JROC) published a plan for open banking development, covering five key themes: leveling up availability and performance; mitigating the risks of financial crime; enhancing consumer protection; improving information flows management; promoting additional services.
	Saudi Central Bank	June 7, 2023	The Saudi Central Bank announced to allow Tarabut Gateway, Umg Alholol Trading Co. and Drahim App to test its open banking solutions in its regulatory sandbox.
Digital platforms	Monetary Authority of Singapore	May 9, 2023	The Monetary Authority of Singapore planned to launch a digital platform for financial institutions to share information on suspected illegal transactions and cooperate in the fight against financial crime.
Artificial intelligence (AI)	The Financial Services Commission of Korea	May 17, 2023	The Financial Services Commission of Korea planned to establish an AI database in the financial sector to improve the regulatory environment for financial data and set up a financial AI laboratory.
	Monetary Authority of Singapore	May 31, 2023	The Monetary Authority of Singapore and Google Cloud signed a memorandum of Understanding (MOU) to collaborate on generative AI solutions.
	HSBC	May 31, 2023	HSBC has launched an ESG index that uses AI to measure a company's ESG improvement and

			financial performance developments.
	Italian banking group	June 5, 2023	Italian banking group Sella launched an international incubation program dedicated to startups focused on AI in finance.
Savings accounts	Apple and Goldman Sachs	April 17, 2023	Apple and Goldman Sachs jointly launched a savings account feature, allowing users to set and manage their savings accounts through the Apple Card at an annual interest rate of 4.15%.
	Habitto	June 13, 2023	Fintech startup Habitto opened its first savings account, offering a 0.3% interest rate on the first JPY1 million of deposit.

Source: Publicly available data and BOC Research Institute

I.2 Global banking risk building up

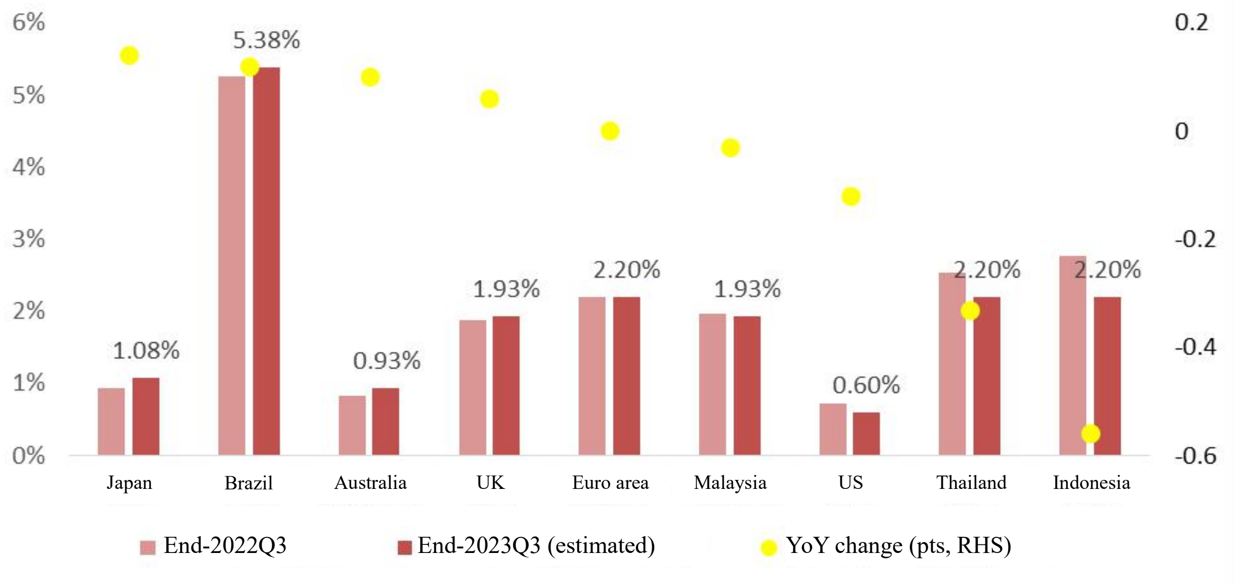
Uncertainty is spreading through the global banking system amid the elevated interest rates in major advanced economies and the lingering fallout from the European and US banking crisis. In this context, credit risk and liquidity risk are prominent in the banking sector. Weak credit demand and heightened lending standards have been slowing down the expansion of banking assets. The capital bond market is volatile and diverging, hampering banks' capital replenishments. The non-interest business is struggling to recover, with overall profitability on the decline.

1. Banks became more vulnerable with prominent credit risk and liquidity risk

Since 2023 began, the global banking sector has been under pressure in an environment of mixed long-term and short-term uncertainties. Non-performing loan (NPL) ratios are rising in most global banks as advanced economies lack growth momentum and emerging economies are hit by imported inflation. In the developed economies, the Q1 NPL ratio increased by 0.02, 0.03, 0.04 and 0.08 percentage points quarter-on-quarter in the banking sector of the United States, the United Kingdom, Australia and Japan, respectively. In emerging economies, Malaysia, Indonesia, Thailand and Brazil saw the banking NPL ratio up 0.02, 0.05, 0.13 and 0.17 percentage points, respectively. Also, the banking sector of major developed economies is exposed to substantial liquidity risk as the interest-rate hike cycle continues and the banking crisis still has a slow-burn impact.

To fend off risks, some banks have chosen to tighten credit conditions and further increase provisions to keep the asset quality relatively controllable. By the end of Q3, the banking NPL ratio trends may diverge among major economies. The NPL ratio of the US banking sector is expected to fall by 0.12 percentage points year-on-year to a low level of 0.6%, while Indonesia, Thailand and Malaysia are expected to see the NPL ratio falling by 0.56, 0.33 and 0.03 percentage points year-on-year, respectively, thanks to local economic recovery. European banks are trying to maintain solid asset quality, with their NPL ratio expected to remain unchanged at around 2.2%. Economies such as Japan, the United Kingdom, Australia, and Brazil are likely to see a year-on-year rise in the banking NPL ratio. Japan's banking sector is deteriorating the fastest. The Brazilian banking NPL ratio has further increased to 5.38% (Fig. 5). Meanwhile, banks in developed economies may continue to feel the liquidity strain, as neither the floating losses on the asset side nor the deposit runoffs on the liability side have been effectively solved.

Fig. 5: Estimated Banking[1] NPL Ratios in Selected Economies



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

2. Commercial banks' concerns about risks add to the difficulty in expansion.

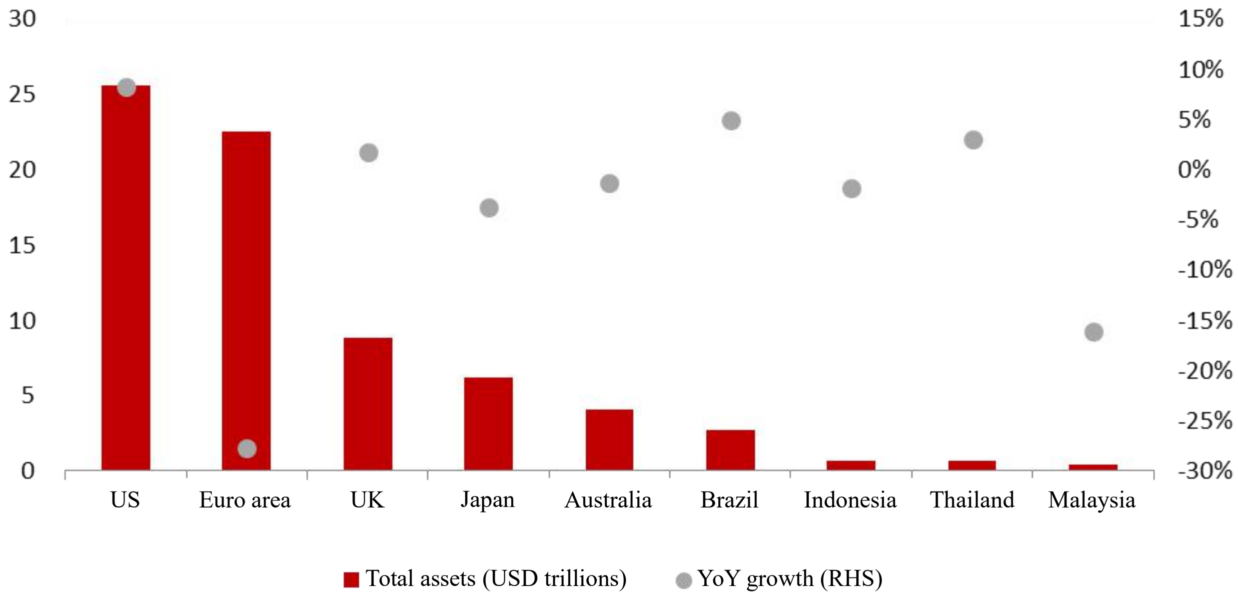
The highly uncertain business environment and pessimistic market expectations have put banks under greater operating pressure in 2023, making the expansion of assets a difficulty. The major developed economies are obviously under pressure. In Q1, the banking assets in the euro area fell by 7.3% quarter-on-quarter or 10.7% year-on-year to USD26.5 trillion. Banking assets in Japan and the United Kingdom dropped by 1.6% and 0.6%, respectively, to USD6.3 trillion and USD7.8 trillion. The United States and Australia edged up 0.5% and 0.4% respectively. Emerging economies saw stronger expansion momentum in the banking sector, with the banking assets in Brazil and Indonesia increasing by 3% quarter-on-quarter, and those in Malaysia upgoing up 3% quarter-on-quarter.

In Q3, It is expected that there will be no significant changes in the high interest rate environment, and the growth of global banking assets will remain under pressure amid insufficient loan demand and weakening credit market as many banks fear of liquidity risk are tightening their lending standards. Among major developed economies, the US banking loans have recovered somewhat from a sharp decline in Q1, expected to increase by 3.3% and 2.3% in Q2 and Q3, respectively, with total banking assets up 8.3% year-on-year at the end of Q3. The euro area's banking assets will plummet by 27.7% year-on-year at the end of Q3. The United Kingdom, Australia and Japan are expected to see year-on-year growth in banking assets of 1.8%, -1.3% and -3.8%, respectively (Fig. 6). The banking scale-up in emerging economies is also throttled by the high interest rate environment. Brazil with stronger momentum for expansion is expected to grow its banking assets

[1]European data cover 37 major banks. The UK data cover five major banks, namely HSBC Holdings, National Westminster Bank, Lloyds Bank, Standard Chartered Bank and Barclays Bank. The big five contribute about 70% of the UK's total banking assets. Japan's banking data cover three major financial groups, namely Mitsubishi UFJ, Sumitomo Mitsui and Mizuho Financial Group, which contributed about 60% of Japan's total banking assets.

by 5% year-on-year at the end of Q3.

Fig. 6: Estimated Size of Banking Assets in Selected Economies at end-2023Q3



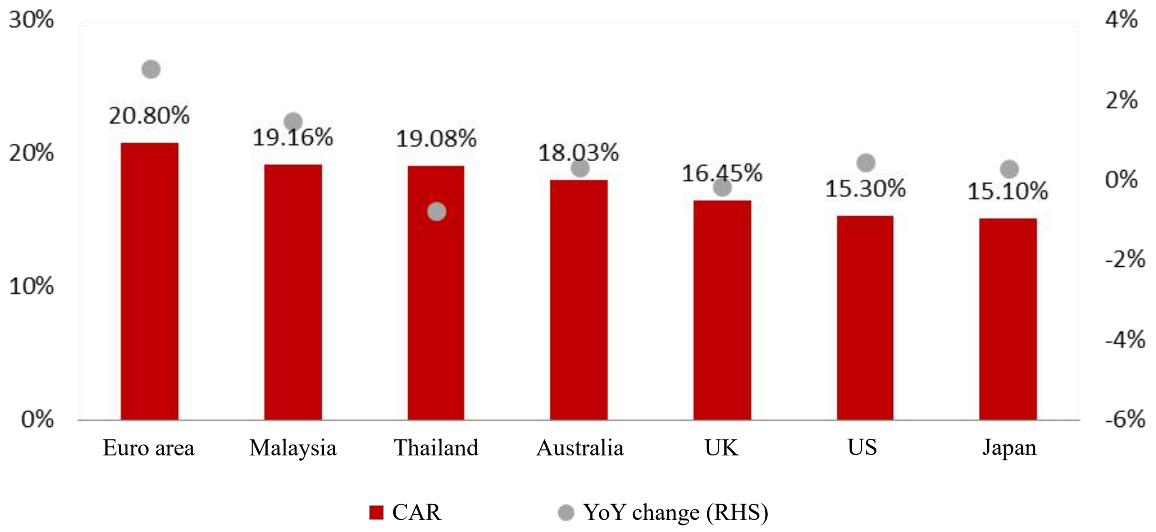
Source: Central banks and regulatory authorities, financial statements of banks, BOC Research Institute

3. The market closely monitors risks in the banking industry, making capital replenishments a bigger challenge

The banking capital adequacy ratio (CAR) in major economies has picked up in 2023 from a low base. Among major developed economies, the Australian banking sector with notable growth registered a CAR of 19.6% in Q1, up 1.9 percentage points quarter-on-quarter. The euro area's banking CAR was 19.4%, an increase of 0.7 percentage points quarter-on-quarter. Japan's three largest banking groups rose by 0.34 percentage points to 15.31%. The United States' CAR edged up 0.13 percentage points to 15.07%. The five largest banks in the United Kingdom fell slightly by 0.12 percentage points quarter-on-quarter to 16.8% (Fig. 7). Emerging economies showed mixed performance, with the banking CAR falling in Indonesia and Malaysia and recovering slightly in Thailand.

It is expected that in Q3, most economies will have a restrained ability to replenish capital due to the increasing short-term volatility in the capital market and the elevated cost of capital replenishments in a high interest rate environment. To boost the ability to cover risks, however, the global banking sector is more eager to replenish the capital base. In some countries, the banking sector may leverage the well-developed local financial markets to raise the CAR slightly. The banking CAR is expected to rise to 20.8% in the euro area, and to around 15.3% in the United States. Some economies will see limited banking capital replenishments amid bleak macroeconomic expectations. The banking CAR in Japan, the United Kingdom and Australia will likely fall to about 15.1%, 16.5% and 18.0% at the end of Q3, respectively. The banking CAR in emerging economies is relatively stable with narrow fluctuations.

Fig. 7: Banking CAR in Selected Economies at the End of 2023Q3 (Estimated)



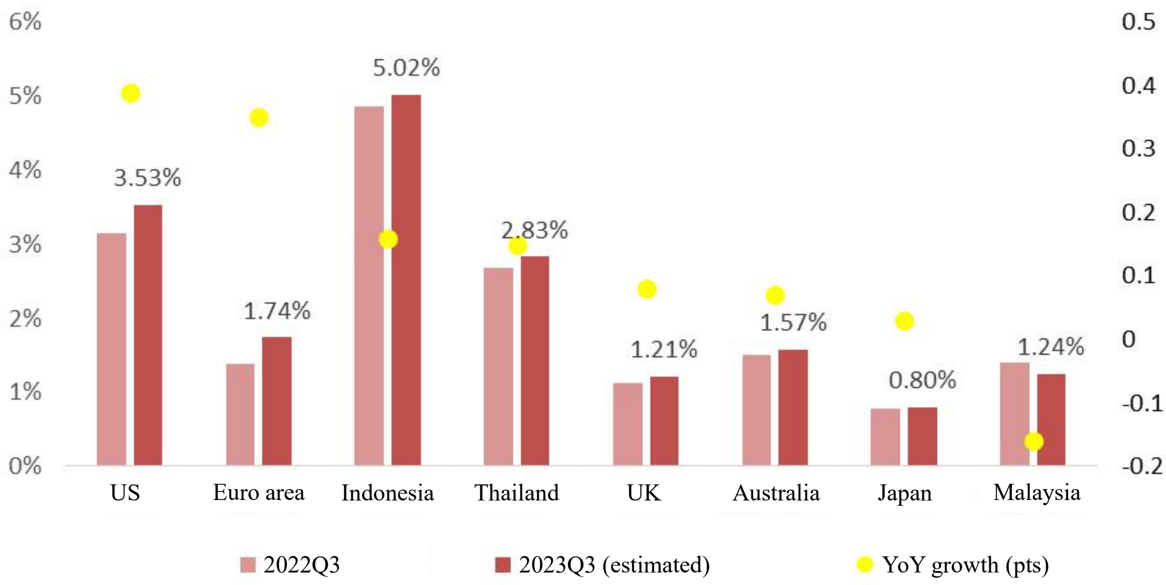
Source: Central banks and regulatory authorities, financial statements of banks, BOC Research Institute

4. Bank profits may decline amid uncertainties in the market environment

In a high interest rate environment, the interest income of banks in major developed economies has increased sharply to drive earnings higher. The net profit of US banks was nearly USD80 billion in Q1, up more than 30% year-on-year. The euro area's and the United Kingdom's banking net profits grew by 28.9% and 49.7% in Q1, respectively, and the Australian banking sector also achieved good profits. Emerging economies are under greater pressure. Due to the increasing household debt ratio and NPL ratio, Brazil's banking sector set aside huge loss provisions, with the net profit down 27.5% in Q1.

It is expected that the net interest margin (NIM) of most banks will continue to expand in Q3, but their profit growth will slow down amid sluggish scaling. The US banking sector is expected to see NIM further expand to about 3.5%, and its net profit may shrink by 1.5% year-on-year due to a sharp slowdown in outstanding loans and gradual recognition of losses on securities investments. The NIM rose to 1.7% in the euro area, 1.5% in Australia, 1.2% in the United Kingdom and 0.8% in Japan, but all with poor earnings expectations. The NIM continues to widen in emerging economies that passively raise interest rates, hitting 5.0%, 1.6% and 1.2% in Indonesia, Thailand and Malaysia respectively, where the net profit growth may outpace that of developed economies.

Fig. 8: Banking NIM in Selected Economies



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

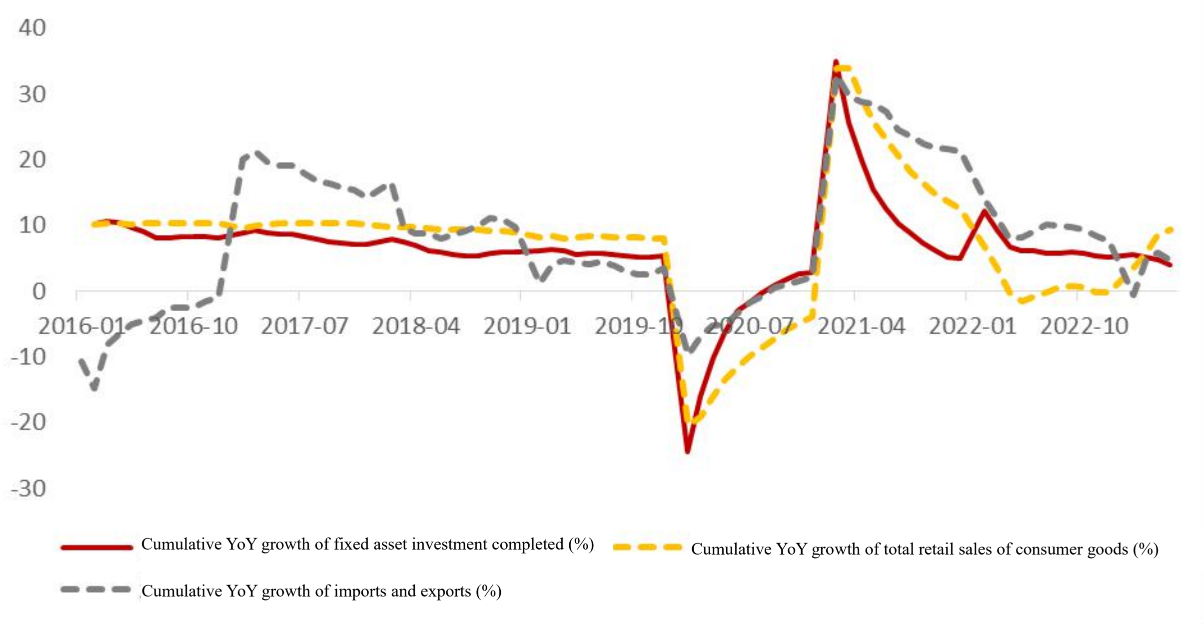
II. China's Banking Review and Outlook

II.1 The banking sector faces both challenges and opportunities in an ongoing economic recovery

The domestic economy has continued to recover in 2023. However, the banking sector still faces some challenges as the international environment is still complex and grim, coupled with the domestic pressure in structural adjustments.

First, the macro economy continues to recover, but three major growth drivers are divergent in performance. In terms of investment, the national fixed asset investment was RMB18.88 trillion in the first five months of 2023, an increase of 4% year-on-year. At present, investment is still very crucial for economic recovery and development, with bank credit focused on infrastructure investment, manufacturing investment and green and high-tech fields. China's total retail sales of consumer goods reached RMB18.76 trillion in the first five months, up 9.3% year-on-year. With the strategy of expanding domestic demand implemented and the pro-consumption policy in play, the banking sector has seized the window period of consumption recovery to grow in such business scenarios as supermarket shopping, catering and tourism, automobile purchase and other large-ticket items. In terms of trade, China's import and export value reached RMB16.77 trillion in the first five months, an increase of 4.71% year-on-year (Fig. 9). Banks developed cross-border finance with vigor to provide high-quality financial support for exports and imports.

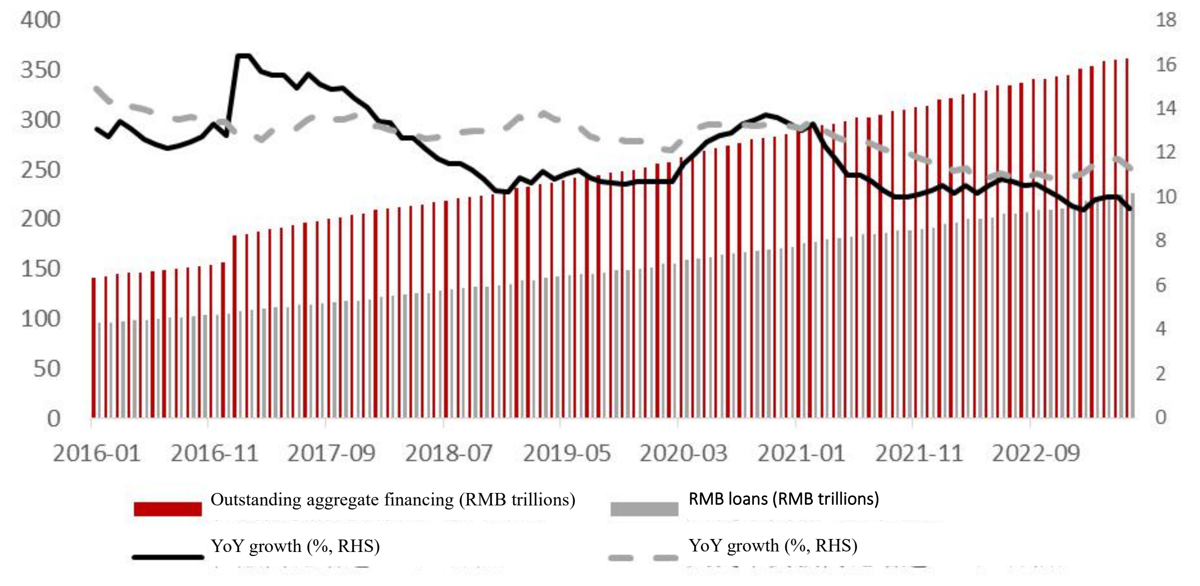
Fig. 9: YoY Growth Rates of China's Investment, Consumption and Trade



Source: Wind, BOC Research Institute

Second, the fiscal and monetary policies were front-loaded in the year, guiding banks to meet market financing needs and ensure steady operation. Local governments carried out investment plans for major projects in an orderly manner toward the target investment size for the year. The local government special bonds were issued at a fast pace, with total issuance growing by 16.55% year-on-year to RMB1.93 trillion in the first four months. The monetary policy remains prudent to support economic recovery, ensuring a reasonable increase in liquidity and relatively stable interest rates. The liquidity remains reasonably ample, helping banks control the intensity and pace of credit issuance, properly manage the maturity matching and liquidity risk management and promote the orderly growth of credit and aggregate financing to the real economy. At the end of May, RMB loans and aggregate financing to the real economy rose by 11.3% and 9.5% year-on-year (Fig. 10). Meanwhile, the banking sector has consolidated its support for key areas and weaker links of high-quality economic development, such as green development, sci-tech innovation, infrastructure construction, inclusive finance and small and micro businesses, with the credit supply expanding steadily with an increasingly improved structure. In terms of interest rates, PBOC lowered the reverse repo rate for open market operations (OMOs) and the standing lending facility (SLF) rate by 10 bps each in June, boosting market confidence. With the 1-year and 5-year LPR lowered by 10 bps each, the banking sector continues to help market players alleviate the pressure on financing costs and carry out "for-the-people" financial work.

Fig. 10: Scale and growth Rate of Aggregate Financing and RMB Loans



Source: Wind, BOC Research Institute

Third, financial regulation focused on guarding against risks while ensuring the steady development of the banking industry. The National Financial Regulatory Administration (NFRA) was officially inaugurated to promote full coverage of financial supervision. In April, risk alerts on "China Time Bank" was issued to effectively protect public interests and maintain good market order. An inter-ministerial joint meeting on illegal fundraising crackdown was convened to safeguard the fundamental interests of the people. While guarding against risks, financial regulators further pushed for shoring up weaknesses, boosting development and improving public wellbeing, guiding banks to strike a balance among business development and risk prevention. In terms of shoring up weaknesses, the *Notice on Strengthening the Quality of Financial Services for Small and micro Businesses in 2023* was issued, encouraging banks to deepen their financial services for the broadest-based market players, such as small and micro businesses and self-employed individuals, and play a greater role in supporting economic recovery and industrial development. In terms of boosting development, the *Notice on Promoting the Key Work on Rural Revitalization Across the Banking and Insurance Sectors in 2023* was issued, in a bid to further boost banks' rural financial service capabilities and provide strong support for achieving common prosperity. The policy on centralized management of multinational corporations' cross-border funds in local and foreign currencies was refined to further facilitate cross-border trade, investment and financing and better serve the high-quality growth of the real economy. In terms of improving public wellbeing, the leading group for targeted assistance work held a meeting to ensure those lifted out of property will not sink back into poverty in large number and help increase the income of local farmers. Financial consumers' complaints and claims were handled in a further streamlined process to enhance the general public's sense of gain (Table 4).

Table 4: Key regulatory Developments in the banking Sector (2023Q2)

Type	Date	Issued by	Content of document
Forestalling risks	April 19	Former CBIRC	Risk alerts were given on false information such as "listing of China Time Bank", thereby regulating the use of the word "bank", cleaning up online information,

			cracking down on irregularities and maintaining good market order.
	April 20	Former CBIRC	China's Inter-ministerial Joint Conference Office for the Disposal of Illegal Fund Raising held its 2023 work meeting. It was pointed out at the meeting that the illegal fund-raising risk profile is grim and complex now, the existing risks will be "uncovered" sooner or later and there are more triggers of incremental risks. These risks are widespread and even concentrated in a few areas. Heavy-handed crackdown will continue unabated to prevent any resurgence or reoccurrence in risks. By further implementing the Regulations, regulators will work hard to nip cases in the bud, strengthen management at the source, pay due attention to demands from victims and create a safe and stable social environment.
Shoring up weaknesses	April 27	Former CBIRC	The *Notice on Strengthening the Quality of Financial Services for Small and micro Businesses in 2023* was issued, requiring banking institutions to strengthen targeted support, gain in-depth understanding of the comprehensive financial service needs of small and micro businesses, align customer needs with their own business strategy, and support the reasonable financial service needs of small and micro businesses in the fields of accommodation, catering, retail, education, culture, tourism, sports, transportation and foreign trade, so as to help distressed businesses, expand domestic demand and stabilize industries.
Boosting development	April 14	Former CBIRC	The *Notice on Promoting the Key Work on Rural Revitalization Across the Banking and Insurance Sectors in 2023* was issued, pointing out that the banking sector should focus on the key areas of building agricultural power, strengthen the capacity building on rural financial services, improve the rural financial service system, allocate more internal resources related to agricultural finance, continue to strengthen the guiding role of supervisory assessment and steadily increase agriculture-related credit supply.
	May 19	PBOC, SAFE	Pilot projects will be carried out in Beijing, Guangdong and Shenzhen to optimize and upgrade the policy on centralized operation of multinational corporations' cross-border funds in local and foreign currencies. The policy upgrades include the following: First, the existing policy requirements related to the centralized

			management of cross-border funds of transnational corporations are integrated and refined to benefit more companies. Second, multinational corporations are given more freedom in managing funds across borders, allowed to determine the pooling ratio of foreign debts and overseas loans at their discretion under the macro-prudential principle. Third, multinational companies are supported in conducting centralized management of cross-border funds in RMB. Fourth, the filing process and review of the documentation regarding use of funds are simplified.
Improving public wellbeing	May 6	Former CBIRC	The leading group for targeted assistance work held a meeting. It was pointed out at the meeting that banks should be more responsible and committed to ensuring those lifted out of property will not sink back into poverty in large numbers, vigorously support the development of local industries and the increase of local farmers' income, fully unleash financial assistance, use and manage assistance funds effectively, play a strong role of pilot and bring the targeted assistance work to a higher standard.
	June 2	NFRA, PBOC and CSRC	The *Announcement on the Work Arrangements for Handling Financial Consumers' Complaints and Claims* was issued, so as to ensure smooth transfer and alignment of the PBOC's duty of financial consumer protection and the CSRC's duty of investor protection and effectively protect the legitimate rights and interests of financial consumers.

Source: Publicly available data and BOC Research Institute.

II.2 China's banking sector values both volume and efficiency to ensure a steady recovery of the real economy

China's banking sector helps unleash the fundamental role of consumption and the critical role of investment. While strictly controlling risks, Chinese banks have steadily expanded their balance sheets with higher capital ratios.

First, China's banking sector is scaling up steadily in hedging macro uncertainties with proactive actions. The banking sector has stepped up counter-cyclical support for the real economy, with assets and liabilities continuing to expand. Chinese commercial banks' assets and liabilities totaled RMB330.1 trillion and RMB304.1 trillion at the end of 2023Q1, up 11.84% and 12.26% year-on-year, respectively, 2.11 and 2.65 percentage points faster than a year ago. Banking assets and liabilities maintain a steady expansion toward the end of the year, with commercial banks expected to grow by more than 11% in the year. Lending gained a bigger weight. At the end of April 2023, outstanding RMB loans accounted for 62.3% of aggregate financing over the same period, up 0.9 percentage points year-on-year, becoming an important, persistent driver of banking expansion. Considering the seasonality of credit supply, the bank lending is expected to begin the year with fast growth that will then moderate through the rest of the year.

Second, banks have made more interest concessions to the real economy, adapted themselves to the LPR decline and managed to keep the profits stable. In a modest economic recovery, the banking profit growth has slowed down compared with the same period last year, but the net profit maintains a positive growth year-on-year as strong buffers against risks. Commercial banks recorded RMB667.9 billion in accumulated net profits in 2023Q1, up 1.3% year-on-year, with the growth rate down 6.1 percentage points from the previous year. Their return on average equity stood at 10.3%, down 0.6 percentage points year-on-year. The slowing growth of profit is mainly attributable to the following factors. First, the good banking profits realized last year heightened the base for comparison. Second, the interest income was under pressure, for PBOC kept guiding banks to lower financing costs for the real economy, and the drop in LPR led to continued shrinking of banking NIM. It is worth noting that non-interest income of commercial banks accounted for 22.4% in Q1, up 0.4 percentage points year-on-year, putting an end to the year-on-year decline in the ratio of non-interest income since 2022H2. In 2023, offsetting price cuts with volume increase will remain the groundwork for keeping bank profits growing steadily. Toward the goal of ensuring stable growth, various policies are flexible and appropriate to generate synergies, providing a macro foundation for the growth of bank deposits and loans and laying the cornerstone of banking profitability. Meanwhile, diversification is steadily advancing, with a continued recovery expected for non-interest business fields including wealth management, agency services, custody and asset management. Commercial banks will likely see their net profit growth returning to the 6% level in 2023, becoming more resilient to risks.

Third, banking assets continue to improve in quality by enhancing responses to risks amid a recovering economy. While ensuring unabated support for the real economy, the banking sector has attached great importance to credit risk management. A raft of actions has been taken in 2023 to forestall and defuse potential risks and keep the asset quality generally sound. At the end of Q1, the balance of NPLs was RMB3.12 trillion, up 7.03% year-on-year, representing an NPL ratio of 1.62%, down 0.07 percentage points year-on-year. Commercial banks further strengthened their ability to cover risks. At the end of Q1, commercial banks recorded close to RMB6.4 trillion in balance of loan loss provisions, up 9.14% year-on-year, with a provision coverage ratio (PCR) of 205.24%, up 4.54 percentage points year-on-year. In a full-year view, business entities are in better operating conditions as the real economy is recovering steadily, and commercial banks see the asset quality further improving, with the NPL ratio expected to further go lower. It is worth noting that the recovery in some industries and regions still faces risks and challenges, which deserve extra attention of commercial banks.

Fourth, short-term fluctuations do not change the long-term trends. The banking sector has strengthened the ability to replenish capital and consolidated the groundwork for risk prevention and control. At the end of 2023Q1, commercial banks saw their capital ratios slightly decline year-on-year. The capital adequacy ratio (CAR) stood at 14.86%, a dip of 0.16 percentage points. Tier 1 CAR was 11.99%, down 0.26 percentage points year-on-year. The common equity tier 1 (CET1) CAR stood at 10.50%, down 0.2 percentage points year-on-year. All capital ratios went lower. From a molecular perspective, commercial banks' net profit growth slowed down, eroding the room for replenishing capital out of profits and affecting the internal sources of funding. From a numerator perspective, with credit expansion remaining on fast track, risk-weighted assets have increased to weaken capital adequacy. In Q3, capital ratios will remain stable as commercial banks' profitability picks up. Also, to further boost the capacity of serving the real economy and provide a better cushion against risk, commercial banks, especially small and medium-sized ones, will step up their capital replenishment efforts.

Fifth, the banking sector faces up to risks and challenges, forging ahead steadily on all fronts

of business. While keeping asset quality under control in key regions, commercial banks have steadily scaled up their business and achieved all-time highs in operating income and profit contribution. In terms of diversification, faced with such challenges as increased volatility of capital markets and weak demand for direct financing, banks maintain their strategic focus and stable business landscape across all fields of financial services. In terms of cross-border business, the banking internationalization has entered a stage of optimization and adjustment amid the lingering risk of global recession, hot inflation and high interest rates in developed economies, banking crisis in Europe and the United States and the Russia-Ukraine conflicts. China's banks are moderately scaling back their outlets and staffing while ensuring stable coverage of overseas markets. In 2023, commercial banks will comprehensively improve the quality and efficiency of businesses and spare no effort to financially serve the real economy. They will firmly grasp development opportunities in key regions, allocate more resources for them and strengthen regional risk management. As for diversifications, risks will be strictly controlled to avoid over-concentration. For cross-border business, the credit risk management of cross-border customers will be enhanced, and the credit strategy for cross-border business will be recalibrated according to policy changes in host countries to ensure stable asset quality.

Table 5: Forecasts on China's Commercial Banking Development Indicators in 2023

Indicator		2021	2022	2023Q1	2023H1(E)	2023Q3(E)	2023(E)
Size	Assets (RMB trillions)	288.6	319.8	330.1	338	346	355
	Liabilities (RMB trillion)	264.7	294.3	304.1	311	319	327
	Growth of assets, YoY (%)	8.58	10.8	11.8	11.5	11.3	11.0
	Growth of liabilities, YoY (%)	8.26	11.2	11.9	11.5	11.3	11.0
Profit	Net profit (RMB trillion)	2.18	2.30	0.67	1.34	1.85	2.44
	ROA (%)	0.79	0.76	0.81	0.8	0.8	0.8
	Net interest margin (%)	2.08	1.91	1.74	1.74	1.73	1.73
	Cost/income ratio (%)	32.08	33.97	29.1	30.5	31.0	31.0
Risk	NPL ratio (%)	1.73	1.63	1.62	1.61	1.61	1.61
	Provision coverage ratio (%)	196.9	205.9	205.2	208	209	210
	CAR (%)	15.13	15.17	14.86	15.0	15.1	15.2
	CET1 CAR (%)	10.78	10.74	10.5	10.7	10.9	11.0

Source: National Financial Regulatory Administration (NFRA), BOC Research Institute

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