BOC Research Institute

Global Banking Industry Outlook

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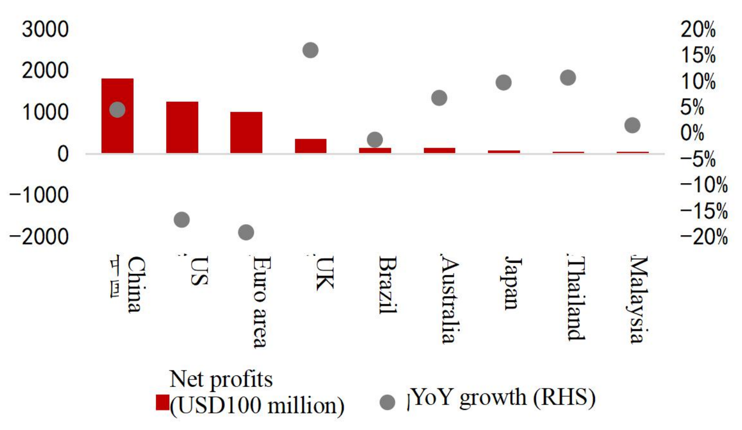
Highlights

●In the first half of 2024, as global economy still grows slowly, the banking industry will show a stronger aversion to risks and further decelerate expansion. The boosting effects of interest margins will fade, resulting in sliding profitability. Increasingly exposed to risks associated with some industries, banking asset quality will be under mounting pressure of decline.

●In the first half of 2024, China's economic will recover steadily. The banking industry will contribute to China's initiative to build itself into a financial powerhouse, support the high-quality development of the real economy, while ensuring its solid expansion of operation, steadily enhancing profitability and further improving asset quality.

●A modern industrial system is indispensable to a financial powerhouse. This report provides a special analysis on supporting the development of sci-tech innovation enterprises through technology finance, supporting the industrial upgrade in the Yangtze River Delta and GBA through industrial finance, and the trends of the global banking industry supporting the building of industrial systems.

Estimated Net Profits and YoY Growth Rates of the Banking Industry in Worldwide Economies in 2024H1



Source: Central banks and regulator y authorities, financial reports of banks, BOC Research Institute

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The Banking Industry Supports the Construction of a Modern Industrial System in the Process of Building China into a Financial Powerhouse

— Global Banking Industry Outlook (2024Q2)

In 2023, thanks to high interest margins, the global banking industry showed certain desire for expansion, with net profits improved and asset quality and capital position kept relatively stable. In the first half of 2024, as the outlook of global economic recovery is filled with more uncertainties, the banking industry will see a challenging operating environment and slow down expansion. Net interest income will grow at a slower pace, leading to a sharp decline in profitability. Risks associated with small and medium-sized banks in Europe and the US will attract market attention again, adding to the risk of asset deterioration. By contrast, with the recovery of China's economy, the banking sector will enjoy a better operating environment, and the financial industry will operate soundly on the whole. Upholding the political consciousness and people-centeredness of finance, the banking sector will increase support for the high-quality development of the real economy, solidly expand operation, steadily enhance profitability and continuously improve asset quality, contributing to China's initiative to build itself into a financial powerhouse. This report provides a special analysis on supporting the development of sci-tech innovation enterprises through technology finance, supporting the industrial transformation in the Yangtze River Delta and GBA through industrial finance, and the trends of the global banking industry supporting the building of industrial systems.

I. Global Banking Review and Outlook

I.1 The global banking industry still operated in an uncertain environment

Global economic growth was still slow, putting pressure on banking operation. According to the forecast by BOC Research Institute Global Economic and Financial Research Team, in 2024, global economy will maintain the low growth rate of 2.5%. the US economic growth will decline to 2.0%. Due to insufficient domestic demand and fluctuating foreign demand, the euro area will see weak economic recovery, with the economic growth expected to be 0.6% for the full year. Driven by expanding domestic demand and fast-growing trade, developing economies including India, Brazil and Mexico will enjoy a strong momentum of growth, with the full-year economic growth estimated to be 6.5%, 1.7% and 2.4%, respectively. In terms of development trends, in 2024Q1, manufacturing PMI in major developed economies showed a few signs of improvement, with the US manufacturing PMI dipping below the boom-or-bust line of 50, and the manufacturing PMI of the UK, Japan and euro area still within the range of contraction, suggesting the weak momentum of recovery across the developed world.

As global benchmark rates remained high, the banking industry was exposed to mounting risks. Since the start of 2024, major developed countries have maintained high interest rates. Specifically, the European Central Bank kept the three key rates unchanged, with MRO (main refinancing operations), MLF (marginal lending facility rate) and DF (deposit facility rate) respectively at 4.50%, 4.75% and 4.00%. The target range of the US federal fund rate was kept at 5.25%-5.50%. The UK benchmark rate was still 5.25%. In the persistent high-interest environment, the US banking industry saw elevated credit cost, a weaker role of net interest margins in boosting profitability, heightened risks associated with commercial properties, and worsening quality of assets. Impacted by the repricing of commercial properties, New York Community Bank had to increase provisions for bad debts, causing net profits to drop sharply. Also, it cut dividends to meet stricter regulatory requirements, leading to slumping stock prices and sparking market concerns over small and medium-sized banks once again. The Bank of Japan ended its negative interest rate policy, raising policy rates from -0.1% to 0-0.1%. Emerging economies varied in monetary policies. To be specific, Chilean Central Bank lowered the benchmark rate by 100 bps to 7.25%; the Bank of Brazil cut the benchmark rate by 50 bps to 11.25%; Hungarian National Bank reduced the benchmark rate twice, which fell by 175 bps in total to 9.00%. By contrast, to combat domestic inflation, Turkey's central bank hiked the benchmark rate by 250 bps to 45%.

Regulation was intensified to prevent risks and ensure the steady development of the banking system. Since the start of 2024, as blockchain and AI are increasingly integrated with finance, the Bank for International Settlements and the Financial Stability Board have stepped up regulation over cryptocurrencies and digital assets, achieving synergetic regulation across the globe by establishing a unified regulatory framework. Some developing countries maintained a loose environment for and a clear regulatory concept about fintech, pioneering in such emerging financial areas as cryptocurrencies and virtual banks, in the hope of overtaking those ahead of them on the bend. Meanwhile, focusing on the impact of financial market fluctuations and economic recession on financial stability, European countries and the US identified the weak links of the banking system through stress tests, and urged banks to improve the capacity to address risks under extreme conditions and strengthen supervision of the credit risk associated with counterparties and network attack risk, to ensure they can deal with the increasingly complex risk conditions.

Fintech innovation kept springing up, enabling the digital transformation of the banking industry. The application of technologies like AI and big data analysis has created online service platforms for financial institutions, enabling them to manage risks and provide customer services in a more targeted and data-driven manner. American Express and PayPal introduced new modes of digital payment, simplifying the payment process, satisfying the increasingly diversified consumer demands, and improving the inclusiveness of financial services. The Bank of America refined the digital platform for corporate business, providing customers with services like peer comparison, safety risk warning, and trade and credit business assessment. In addition, financial regulators, large banks, and fintech companies have been actively exploring the potential of technologies like AI and blockchain to enhance financial product regulation and innovation.

I.2 The global banking industry shows new features in operation

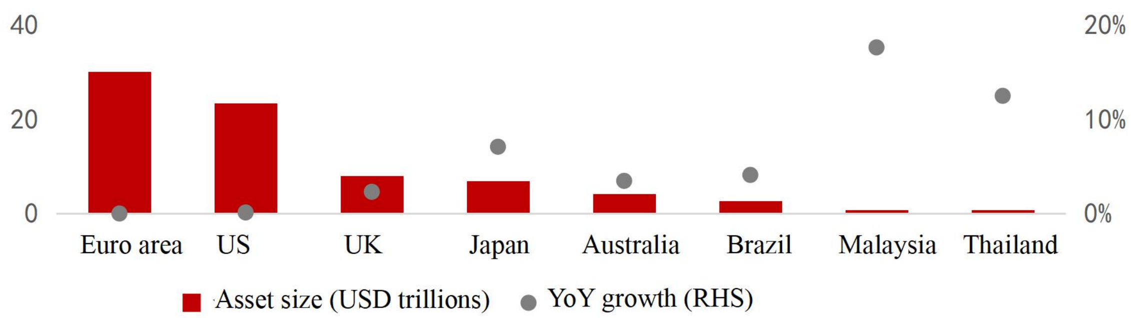
Since the start of 2024, global economic recovery has slowed down, blurring the prospects of banking operation. According to estimates, in the first half of 2024, the global banking industry will continue to experience a deceleration in expansion. The credit environment will become more challenging, with elevated lending costs likely to result in a decline in banking profits. The quality of loans to key industries may deteriorate, leading to increased provisions across banks. With the tightening regulation, the capital adequacy ratio is expected to remain stable.

1. Further slowing banking expansion

In 2023, driven by tailwinds like high interest margins, the banking industry appeared willing to expand the scale. At the end of 2023, the banking assets in the US totaled USD23.7 trillion, up by 0.3% year-on-year, mainly driven by credit card loans, which amounted to USD1.1 trillion, a year-on-year increase of 10.6%. The banking assets totaled USD29.9 trillion in the euro area, up by 4.5% year-on-year, USD7.7 trillion in the UK, up by 2.7% year-on-year, USD4.2 trillion in Australia, up by 2.1% year-on-year, and USD2.9 trillion in Brazil, up by nearly 30% year-on-year. In Asia Pacific, banking expansion was more obvious. The banking assets totaled USD726.09 billion in Thailand, up by 6.5% year-on-year, and USD772.58 billion in Malaysia, up by over 50% year-on-year.

In 2024, the global economic environment remains complex and uncertain and the trends of economic growth are still unclear, which will result in a stronger aversion to operating risk across the banking industry. According to estimates, at the end of 2024Q2, the banking assets in the US will expand slightly by 0.1%. The severe risky environment will cause banks to tighten lending conditions and become more cautious in credit granting. The European banking industry may pursue expansion in Asia Pacific, with the total assets flat with the same period of 2023. Banking assets will grow by 2.3% in the UK, 3.5% in Australia, and 4.1% in Brazil. In Asia Pacific, banking assets will expand fast, recording a year-on-year growth of 7.1% in Japan, 12.5% in Thailand and 17.6% in Malaysia (Fig.1).

Fig. 1: Estimated Size and YoY Growth of Banking Assets in Major Economies[1] at the End of 2024Q2



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

2. Shrinking size of profits

In 2023, the expansion of net interest income due to elevated interest margins contributed to the enhanced profitability of banking institutions. However, the growth dividends resulting from the implementation of substantial rate increases were not sustainable, with some economies reporting a decline in net banking profits by the end of the year. In the US, net banking profits totaled USD257.33 billion,

[1] The data of 37 major banks are adopted for the banking industry in the euro area. The data of the top 5 banks are adopted for the UK banking industry, including HSBC, NatWest Group, Lloyds Bank, Standard Chartered Bank and Barclays Bank. The data of three major financial groups are adopted for Japan's banking industry, including Mitsubishi UFJ Financial Group, Sumitomo Mitsui Banking Corporation and Mizuho Financial Group.

down by 2.5% year-on-year, and USD40.84 billion in 2023Q4 alone, a year-on-year slump of 41.5%. Net banking profits in the euro area amounted to USD202.81 billion, up by 47.9% year-on-year, but the growth was 25 percentage points lower than the previous three quarters. Net banking profits in the UK totaled USD47.29 billion, up by 38.1% year-on-year, but the growth was 22 percentage points lower than the previous three quarters. From April to December 2023, Japan's top 3 financial groups recorded a combined net profit of USD19.34 billion, up by 54.7% year-on-year, but the growth was over 5 percentage points lower from the period of April-September. Net banking profits in Australia totaled USD27.19 billion, down by 1.2% year-on-year. Growth of net banking profits in emerging economies slowed or slid.

In 2024, global economic growth will be challenged, with risks arising from some industries affecting banking profitability. According to estimates, in the first half of 2024, the net banking profits in the US will fall sharply by 16.7% year-on-year. Net banking profits in the euro area will drop by 19.2% year-on-year. Net banking profits in the UK are expected to increase by approximately 16.0% year-on-year. However, this represents a much slower rate of growth compared to previous years. The Reserve Bank of Australia has once again raised interest rates at the end of 2023. This is expected to prolong the boosting effects of interest margins, which should drive up net banking profits by 6.7% year-on-year. In Brazil, the net banking profits will slide by 1.3% year-on-year. In Asia Pacific, as the banking industry enjoys large room for expansion in some areas, profitability growth can be sustained to some extent. From April to June, the net banking profits in Japan will grow by about 10% year-on-year. In the first half of 2024, the net banking profits will record a year-on-year expansion of 10.6% in Thailand, and 1.5% in Malaysia.

3. Mounting risk of asset deterioration

In 2003, the global banking industry operated in a turbulent environment. Although regulators took timely steps and stopped risks from further spreading and evolving, the quality of banking assets was somewhat impacted, and provisions increased remarkedly. At the end of 2023, the NPL ratio of the US banking industry was 0.86%, up by 0.13 percentage point year-on-year. In the euro area, the banking NPL ratio was 2.00%, and the banking balance sheet was showing “early signs of stress”, according to the Financial Stability Report released by the European Central Bank. In the UK, the banking NPL ratio was 1.88%, and the asset quality was relatively stable. The banking NPL ratio was 0.87% in Australia and 1.05% in Japan, up by 0.08 percentage point and 0.09 percentage point, respectively. The asset quality in emerging economies was relatively sound.

In 2024, the banking industry will still be exposed to severe risks. The slumping stock price of New York Community Bank at the beginning of the year once again sparked market concerns over the risks associated with the US commercial properties and the evolution of the ongoing European and US banking crisis. It’s expected that at the end of 2024Q2, the global banking industry, especially in Europe and the US, will see a big downward pressure on asset quality. In the US, the banking NPL size will expand by more than 20% year-on-year, and the NPL ratio will be 0.93%, up by 0.15 percentage point year-on-year. The banking NPL ratio in the euro area, UK, Japan and Australia will climb by 0.01, 0.02, 003 and 0.10 percentage point, respectively. The banking NPL ratio in Brazil will rise by 0.02 percentage point to 6.02%. The banking industry in Asia-Pacific emerging markets will see steady risk levels.

4. Relatively stable capital conditions

In 2023, the global banking industry earned considerable profits, which created big room for the replenishment of capital from internal sources. The banking capital adequacy ratio was 15.25% in the US, up by 0.31 percentage point year-on-year; 18.80% in the euro area, up by 0.10 percentage point year-on-year; 16.72% in the UK, up by 4.81 percentage points year-on-year; 15.70% in Japan, up by 0.73 percentage point year-on-year, and 19.81% in Australia, up by 2.21 percentage points year-on-year. Among emerging economies, the banking capital adequacy ratio rose to 18.53% in Malaysia, and by 0.72 percentage point to 20.12% in Thailand.

In 2024, to prepare for the outbreak of risk events, regulators will raise the minimum capital requirements, and the banking industry will further step up capital replenishment. According to estimates, at the end of 2024Q2, the banking capital adequacy ratio in the US will reach 15.5%. Banking regulation in the euro area and UK will be more prudent, with the capital adequacy ratio to be improved significantly to 20.8% and 18.3%, respectively. The banking capital adequacy ratio in Australia and Japan will be 19.8% and 16.0%, respectively. The banking capital adequacy ratio in emerging economies will show a steady upward trend as well, rising by 5.4 percentage points in Malaysia and 0.6 percentage point in Thailand.

II. China’s Banking Review and Outlook

II.1 The banking industry operated in an increasingly better environment as the economy picked up

China’s economy maintained a good momentum of recovery, and the banking industry actively played its role as a major force supporting the high-quality development of the real economy.

First, China’s economy showed a trend of recovery growth, with stronger support from the banking industry. In 2023, China solidly advanced high-quality economic development, with GDP growing by 5.2% year-on-year. Since the start of 2024, the momentum of economic pickup has been more pronounced. The banking industry stayed focused on the areas of high-quality development, including new-type infrastructure construction, advanced manufacturing, green transition and future industries. It actively responded to the national strategy of expanding domestic demand, and strongly supported the expansion of consumption, focusing on a variety of scenarios related to the basic necessities of life. It took a combination of measures to support high-level opening-up, providing high-quality financial services for imports and exports and helping enterprises nurture new drivers of foreign trade to promote the stablization and boost the quality of foreign trade.

Second, appropriate and effective fiscal and monetary policies were introduced at proper times, to push the banking industry to meet the reasonable demands of market participants for financing. The *Report on the Work of the Government* released in March 2024 defined the macroeconomic policy orientations for 2024. Specifically, proactive fiscal policies will be properly intensified to boost both quality and effectiveness, with the deficit ratio to be set at 3%, general public budget expenditure to be increased by RMB1.1 trillion, and super-long-term special treasury bonds to be further issued to fund the implementation of major national strategies and the building of security capacities in key areas. Prudent monetary policies will be flexible, proper, precise and effective, to guide the banking industry to meet the reasonable financing demands of various sectors and provide high-quality services for the development of the real economy. At the aggregate level, on February 5, PBC cut the deposit reserve ratio by 0.5 percentage point, injecting about RMB1 trillion of liquidity into the market. On February 20, the 1-year LPR remained unchanged, while the LPR with a term of five years or more was unexpectedly lowered by 25 bps, effectively bringing down the cost of aggregate financing to the real economy.

Third, financial regulation was tightened to comprehensively and effectively ensure the development of the banking industry. Since the start of 2024, financial regulation has shown a trend of being increasingly tougher. **In terms of preventing risks,** the mechanism for coordinating urban real estate financing was developed to support the reasonable financing demand of real estate projects in a more targeted manner and promote the steady and healthy development of the real estate market. **In terms of shoring up weak links,** the *Management Measures for Financial Leasing Companies (Draft for Comments)* were released to promote effective regulation over financial leasing. The *Management Measures for Fixed Asset Loans*, the *Management Measures for Working Capital Loans* and the *Management*

Measures for Personal Loans were revised, in a bid to push banking and financial institutions to improve credit management capacity and enhance the quality and efficiency of their financial services. The *Management Measures for Consumer Finance Companies* were revised and released to ensure the high-quality development of the sector. **In terms of promoting development,** the *Notice on Strengthening Financial Services for Tech Enterprises across Lifecycles* was issued to create an enabling financial environment for sci-tech innovation. The *Measures for Regulation over and Rating of Auto Finance Companies* were enacted to complete and improve the risk regulation system for auto finance companies, guiding them to focus on main business and promote auto consumption. The *Notice on the Matters Related to the Over-the-Counter Business in the Interbank Bond Market* was issued to promote the high-quality development of the bond market.

Fourth, the financial industry operated solidly on the whole. Insurance, securities and funds sectors generally maintained sound development, forming an ecosystem characterized by both competition and collaboration along with the banking sector. In 2023, insurance companies registered an original insurance premium income of RMB5.1 trillion, up by 9.1% year-on-year. The number of newly increased policies was 75.4 billion, up by 36.1% year-on-year. Securities fluctuated drastically due to market conditions, and have gradually recovered and stabilized recently. Funds showed a good start. At the end of February 2024, the size of publicly offered funds was RMB29.30 trillion, up by 8.8% year-on-year, and the number was 11,643, up by nearly 10% year-on-year. In 2024, China's economy will continue to pick up, reinforcing the foundation for the development of the financial industry. Insurance, securities and funds will give full play to respective advantages, to facilitate economic development through sound operation.

II.2 The banking industry supported the high-quality development of the real economy, demonstrating the power of finance

China's banking industry fulfilled the political consciousness and people-centeredness of finance, gave active play to its financing role, and supported the high-quality development of the real economy. It achieved solid growth in the size of assets and liabilities, steadily enhanced profitability, further improved asset quality, and recorded sound capital adequacy.

1. The banking support for the real economy will remain unabated, driving the expansion of assets and liabilities

In 2023, China's commercial banks achieved steady expansion, with assets totaling RMB354.8 trillion, up by 11.0% year-on-year, and liabilities RMB327.1 trillion, up by 11.2% year-on-year. In 2024, the banking support for the real economy will remain unabated, with loans and deposits continuing to grow and driving the growth of assets and liabilities. It's expected that the assets and liabilities of commerical banks will maintain a high growth of around 10% for the full year, reinforcing the foundation for profitability.

Loans: The banking industry will stick to equilibrium in credit supply, and beef up support for the real economy, with the credit granted to technology finance, green finance, inclusive finance, pension finance and digital finance as well as other key areas of the real economy to maintain fast growth. **As for technology finance,** the banking industry will expand the coverage of featured products and services, such as debt-equity financing, option loans and IPR pledge financing, and fully support the accelerated invention of disruptive technologies and frontier technologies, with the year-on-year growth of technology loans likely to be above 30%. **As for green finance,** the banking industry will focus on areas like green consumption, green building, green transport and clean energies, improve differentiated green credit strategies in terms of the assessment mechanism and loan pricing, and advance the expansion and structural optimization of green loans, which is expected to maintain a high growth of over 30%. **As for inclusive finance,** the banking industry will develop products and services better aligned with the operation characteristics and development needs of micro and small enterprises, individually-owned businesses and rural operation entities, increase granting of first-time loans, renewed loans, credit loans, and medium and long-term loans, and establish the long-term mechanism to ensure the sustainable development of inclusive finance. It's expected that the inclusive loans to micro and small-sized enterprises will maintain the earlier momentum of growth, expanding at a rate of over 25% year-on-year. **As for pension finance,** the banking industry will advance the integrated services related to pension finance, and gradually refine the mechanism for managing the credit granted to the elderly care industry. Based on the development orientations and operating characteristics of the elderly care industry, it will develop credit products in a targeted manner, and establish supporting mechanisms for credit approval, credit rating and interest rate pricing. The year-on-year growth of elderly care-related loans is estimated to be no lower than the average growth of all loans.

Deposits: In 2024, deposit growth will decline from the earlier super-high level to a normal one. Time deposits and residential deposits will still dominate the trend. With the continued pickup of the national economy and the stabilization of the financial market, investors will gradually adjust their mindset and expectation, and various types of quality assets will be appealing again, thus diverting some funds away from deposits. Accordingly, market participants will adjust their balance sheets, diversify the purposes of funds, and push some deposits to be released in a reasonable and orderly manner and flow into financial markets, such as wealth management and bond markets, and consumer markets, thus stablizing the growth of deposits. Overall, steadily growing deposits will provide support for the large-scale development of banks.

2. The decline of net interest margin (NIM) will narrow, and non-interest business will face structural opportunities, jointly driving the growth of operating income

NIM remains the key to interest income. At the end of 2023, the NIM of commercial banks was 1.69%, down by 0.22 percentage point from the beginning of the year, hitting a new historical low, and likely to maintain the downward trend in the days ahead. Sources of pressure on NIM in 2024: **First,** LPR was lowered in 2023, pushing existing loans, including personal mortgage loans and corporate loans, to be repriced at the start of 2024. **Second,** the rates on existing mortgage loans were cut, with the influence on NIM expected to extend into 2024Q3. **Third,** with the swap of urban construction bonds, reducing banking liability cost is a major means to ease related debts. **Fourth**, the growing popularity of time deposits elevates banks' liability cost to some extent. Meanwhile, tailwinds build up as well. **First,** the listed deposit rates of commercial banks were lowered, possibly mitigating the pressure on NIM. **Second,** fewer mortgage loans were repaid in advance, which is of positive significance to stabilizing the banking loan structure and NIM level. To sum up, in 2024, NIM of commercial banks will still go down, but the decline will narrow, and scale will be the key to supporting the growth of interest income across commercial banks. If we assume interest-generating assets grow at the same rate as total assets, net interest income is expected to grow by 4% in 2024. As credit supply expands fast in the first half of the year, the growth of net interest income is likely to be higher than the full-year level.

Non-interest income faces structural opportunities. In 2023, non-interest income accounted for 19.93% of the total income of commercial banks, a year-on-year increase of 1.1 percentage points. In 2024, income from commission fees is generally under pressure, yet with structural opportunities in some areas. **First,** wealth management is expected to regain fast growth. **Second,** income from asset management still enjoys room for growth. **Third,** expectation for further relaxing monetary policies remains, likely to push bond yields further downward and drive up income from investment. Overall, in 2024, the non-interest income of the banking industry, including income from asset management, income from wealth management, investment returns, changes in fair values, exchange gains or losses and income from related transactions in the financial market, will record a year-on-year growth of about 2%, with its proportion to operating income kept around 20%. The year-on-year growth and proportion of non-interest income will be even higher in the first half of the year.

3. Asset quality will be basically stable, yet with certain risks seen in some areas

At the end of 2023, the NPL ratio of commercial banks was 1.59%, down by 0.04 percentage point year-on-year. Outstanding NPLs totaled RMB3.2 trillion, up by 8.1% year-on-year. The balance of loan loss provision was RMB6.6 trillion, up by RMB0.47 trillion year-on-year. In 2024, with the continued reduction of key risks in the financial area, commercial banks will pay more attention to credit risk management and take a combination of measures to address NPLs, elevating asset quality on the whole. Meanwhile, some structural issues are worth attention.

In the business dimension, the mounting risk associated with non-performing personal loans deserves attention. In the first half of 2023, 37 of the listed banks disclosing relevant data in China recorded a year-on-year rise in the ratio of non-performing personal loans. At the end of 2023, the size of non-performing personal loans hit a quarterly new high of RMB47.52 billion, up by more than six times year-on-year. In particular, credit card overdraft represented 60.8% of the total, constituting the major source of non-performing personal loans.

In the industrial dimension, sectors like real estate, accommodation and catering, public facility management and manufacturing are exposed to certain risks. Residential willingness to purchase homes has been reduced since 2023, causing the fund chain of real estate developers with heavy reliance on high liabilities, leverages and turnovers to be tighter. some high-profile real estate developers have attracted negative headlines, which has had an impact on the market's confidence and the quality of banking loans related to houses. Severely impacted by the pandemic, **accommodation and catering operations** appear less resilient in operation and progress slowly in restoration. Moreover, as the sector sees a lot of SMEs and is closely related to residential consumption that takes time to fully recover, the growth of operating income will be affected, limiting the capacity of relevant entities in repaying loans. **Public facility management**, covering areas like water resources management, ecological protection and environmental treatment, and municipal facility management, depends heavily on local fiscal support. As some areas will face the debt issue, the quality of relevant banking loans will be challenged.

4. Reasonable provisions will be recorded and cost control will be intensified to promote the normalized growth of profits

At the end of 2023, commercial banks recorded a provision coverage of 205.14%, 0.71 percentage point lower year-on-year, and a cost-income ratio of 35.26%, 1.29 percentage points higher year-on-year. In 2024, banks will further push for reasonable provision, and leverage the trend of digital transformation to digitalize various businesses faster. Cloud computing and big data technologies will be used to boost financial management and resources allocation capacities and facilitate cost control. The slight year-on-year increase in the growth of operating income in 2024, combined with cost control and efficiency improvement, is expected to push the net profits of commercial banks up by about 3%.

5. More capital will be consumed as the size expands, but capital adequacy will be sound thanks to the reinforced replenishment of capital from internal profits and the replenishment of capital from diverse outer sources

In 2023, the banking industry generally kept a stable capital adequacy ratio, which was 15.06% at commercial banks, down by 0.11 percentage point year-on-year. In 2024, the banking capital adequacy ratio will still be sound.

In terms of the replenishment of capital from internal sources, the growth of net profits will stabilize, consolidating banks' capacity to replenish capital from inside. While choosing profit-sharing proportions and withdrawing surplus accumulation funds as appropriate, banks will further convert part of the retained income and excess provision into capital, to strengthen the internal supply of capital that plays a "blood generating" role. **In terms of the replenishment of capital from outer sources,** as the operating income, net profits and share dividends of commercial banks grow, the outer supply of capital, which plays a "blood transmitting" role, will be bolstered through steadily expanding channels like capital increase and bond issuance. In particular, convertible bonds, preferred shares, perpetual bonds, subordinated bonds and special bonds, which have bright prospects, are expected to be held by investors in larger quantities.

III. Special Research: The Banking Industry Supports the Building of a Modern Industrial System

III.1 Supporting the development of sci-tech enterprises through technology finance

In China, technology finance develops fast, with significant achievements including the initial establishment of a diversified technology finance service system comprising venture capital, stock market, bond market and banking credit, and the formation of a market-based system, represented by government guidance funds, that empowers technology finance.

China still faces challenges in developing technology finance. First, there is an urgent need to improve the financing structure. Indirect financing, which dominates China's financing structure, can hardly meet the demands of sci-tech innovation enterprises for funds and financial risk management at the same time. **Second, there is an urgent need to improve supporting conditions.** The development of technology finance requires the close cooperation between financial institutions and professional scientific research institutions, and the shoring up of the vulnerabilities through the rule-of-law, fiscal and tax, scientific research, credit and talent systems by the government. **Third, there is an urgent need to strengthen**

policy support. The development of technology finance needs to be backed by stronger overall planning and policy coordination, as well as the solid, rational and objective efforts of relevant regulators. **Fourth, there is an urgent need for financial institutions to strengthen capacity building,** as they are still in short of well-planned strategies, diversified service models, differentiated credit and risk management systems, and professional talents with strong abilities.

Regulators should improve the multi-tiered financial system. They should support various types of financial institutions in providing technology finance services, and guide venture capital and private equity investment institutions in technology investment, to meet the financing needs of sci-tech innovation of different types and at different stages. **Policy support should be strengthened.** Relevant supporting infrastructures should be refined, including technology finance information platforms, technology patent databases and technology finance service platforms. Supporting policies related to fiscal funds, tax and credit should be provided. The technology finance regulatory system should be improved, and the regulatory rules and standards adaptive to the development of technology finance should be established. **Banks' operating capacity should be boosted.** The integrated and linked operation mechanism should be intensified at large commercial banks at various levels, coordination between the commercial banks and their comprehensive operation branches in key areas should be enhanced, and mutual project recommendation and equity-debt linkage should be advanced.

III.2 Innovative industrial financial models are needed to support the industrial development in the Yangtze River Delta region

Recent years have seen great headway achieved in the building of a modern industrial system, represented by industries worth over RMB100 billion, in the Yangtze River Delta region. High-capacity industries expand fast, with the industries worth over RMB100 billion showing different characteristics of development across the region. Strategic emerging industries, represented by integrated circuits, bio-medicine and AI, cluster in the Yangtze River Delta. Cross-provincial collaboration grows increasingly closer, with top enterprises playing a leading role and the layout of industrial chains continuously optimized.

The industries worth over RMB100 billion in the Yangtze River Delta face countless opportunities and challenges. While embracing the new opportunities arising from the growing trend of digitalized, green, integrated and high-end development, they are also challenged by intensified homogeneous competition and heavy reliance on the imports of high-end equipment, which somewhat affects industrial transformation and upgrading negatively.

Banks are suggested running pilot projects by supporting the development of the industries worth over RMB100 billion in the Yangtze River Delta. They should create innovative models of industrial finance with regional characteristics. For example, they can support the key industries identified in local economic plans, further unify the management of industrial finance business, build industrial finance platforms and innovative R&D bases in Shanghai, and foster a middle-office research team with strong expertise. They should accelerate the formation of new edges in technology finance, supply chain finance, green finance, inclusive finance and cross-border finance, establish digital platforms for industrial finance, and create new industrial finance models characterized by digital platforms, professional industrial services and scenario-based ecosystems.

III.3 Industrial transformation and banking development in GBA

The industrial transformation is steadily advanced across GBA. A comprehensive industrial, service, and high-tech industrial system, along with an industrial echelon comprising "industry, finance, and technology," has emerged. To meet the global trend of industrial development, vigorous efforts are made to drive the upgrade of industries into high-end, intelligent, digitalized, green and globalised ones.

Banks still see vulnerabilities and difficulties in supporting industrial transformation. First, a unified policy guidance and incentive system is unavailable. The sectors where banking loans are granted are still somewhat divergent from those defined by the government; unified standards used to identify strategic emerging enterprises are not in place; supporting review and approval processes, and risk management and performance assessment mechanisms are unavailable internally. **Second, financial institutions lack an effective business linkage mechanism.** In China, banks follow the rule of separate operation, with securities, insurance, equity investment and financial leasing run by their subsidiaries. Banks and their subsidiaries are required to separate operations, which makes it challenging for them to provide enterprises with efficient integrated services. **Third, the financial services supporting industrial transformation are not complete.** The unavailability of a nationally unified credit system, the backward evaluation and trading systems for intangible assets, the insufficient sharing of resources and information across the country, and the lack of local technology finance associations or alliances in many provinces or municipalities are cases in point.

Banks should drive the industrial transformation in GBA in many ways. They should strengthen the guidance for industrial transformation related businesses, and provide effective incentives to guide market expansion. They should provide differentiated service solutions with industrial features, and constantly enrich the financial product system. They should step up research on the policies and risks related to industrial transformation, and enhance the expertise in credit management.

III.4 The trends of the global banking industry supporting the building of industrial systems

First, the global banking industry vigorously supports the intelligent transformation of industrial systems, and empowers the growth of high-tech enterprises. Relying on the market-dominated banking system, the US combines the multi-tiered capital market (direct financing market) with the mature venture capital market (private equity investment), to support the growth of high-tech enterprises. In Germany, the technology finance system is guided by the government and dominated by the banking industry, with the “government + bank” financing model formed to power the development of tech enterprises. The UK banking industry increases investment in startups, and smoothens the financial channels facilitating the innovative development of the digital economy. Japan serves tech enterprises on a model that is dominated by indirect financing and supplemented by venture capital, and enriches the financing channels for small and medium-sized tech enterprises.

Second, the global banking industry actively drives the green transition of industries to support their sustainable development. (i) It vigorously expands the green finance business, channeling funds into green entities and projects. It drives the innnovation of green credit products, develops integrated green financial services, facilitates the green bond business, creates new green finance instruments, and enriches the financing and service models of green finance. **(ii) It provides risk valuation and professional consulting services, to lower enterprises’ compliance cost in green transition.** With rich management experience and toolkits in addressing the risks associated with green transition, international banks can help enterprises identify and manage potential risks arising from the environment and sustainable development, evaluate enterprises’ sustainbility performance, and provide related advice and solutions. **(iii) It leverages digital technologies to improve the quality and efficiency of green finance services.** In the process of green innovation, large internatioal banks skillfully combine the green finance business with emerging digital technologies to restructure the working process and boost the quality and efficiency of services.

Disclaimer

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