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China Banking Monitor 2024

April 11, 2024

Creating Opportunities

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Index

Main takeaways

Banks performance was affected by a lackluster macro environment which was primarily dragged by property market. Aggregate credit growth remained steady in 2023.

Bank assets growth saw steady expansion in response to regulators' renewed call for more credit support to corporate and house borrowers amid the deep housing market correction.

Banks' profitability deteriorated due to falling lending rates and narrowing interest margins. ROA and ROE registered the lowest records in more than a decade.

Both the NPL ratio and special-mention loan ratios declined, benefiting from a sustained NPL disposal, however, asset risks are rising.

The recently implemented capital rule will potentially free up capital for banks with large mortgage exposure. However, lenders are subject to pressures of capital shortfall due to the prospective implementation of TLAC rule in 2025.

Although the bank's exposure to the housing sector is declining, the risks associated with local government financial vehicles (LGFVs) are still a concern.

Banks interconnectedness with the shadow banking system picked up slightly. The decline of interest rates in the interbank market has encouraged smaller banks to rely more on interbank funding.

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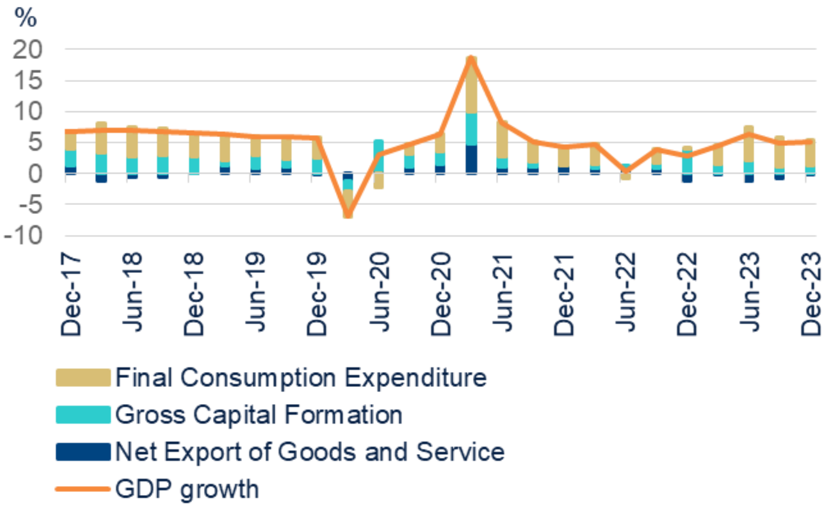
01

Macroeconomic environment

China banks were affected by a lackluster macro environment weighed by property market

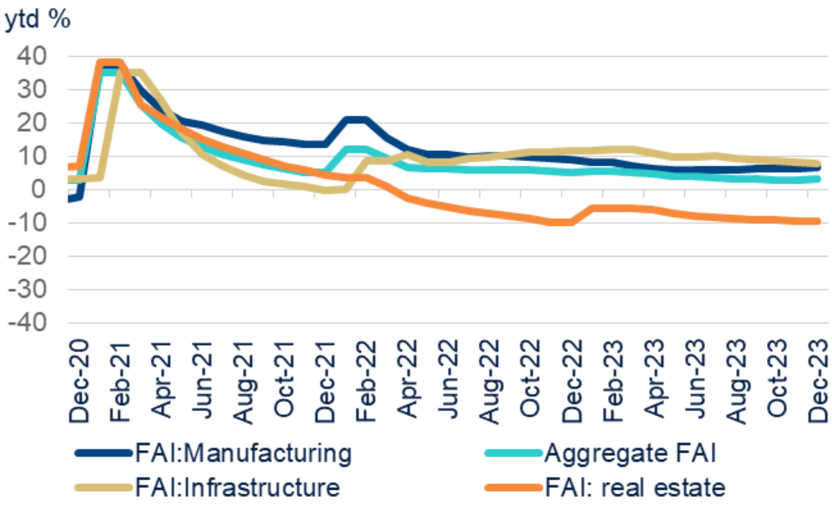
China's two year average GDP growth of 2023 and 2022 has dipped below 5%

THE GDP GROWTH CONCLUDED 2023 AT 5.2%, WITH 2022-23 TWO YEAR AVERAGE AT 4.1%



Source: CEIC & BBVA Research.

WEAK REAL ESTATE FAI STILL WEIGHED ON FAI

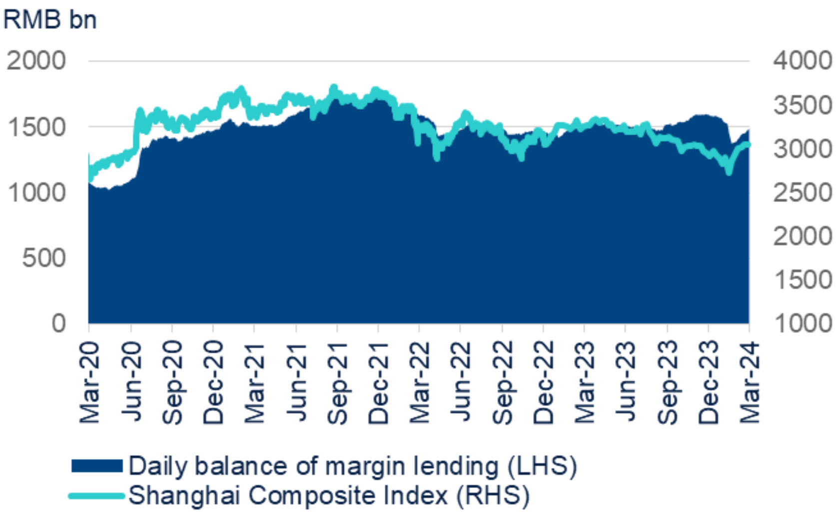


Source: CEIC, Haver & BBVA Research.

The economic growth concluded 2023 GDP at 5.2%, with the 2022 and 2023 two year average dipping to 4.1%. A number of headwinds are weighing heavily on construction and investment, including the beleaguered property market, local government debt overhang, and weak consumer & business confidence, etc.

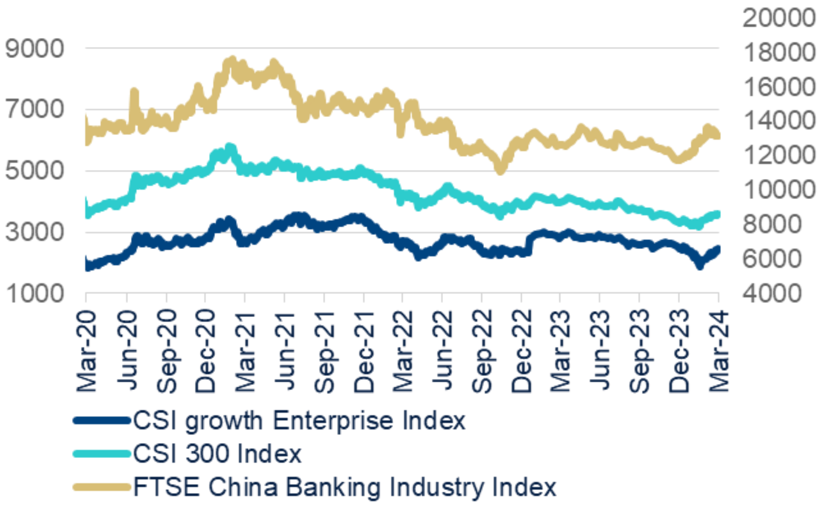
China's stock market touched a new low at the beginning of 2024 amid the slowing economy and continued FDI outflow

SHANGHAI COMPOSITE INDEX TOUCHED NEW LOW AT THE BEGINNING OF 2024



Source: Wind & BBVA Research.

…AS WELL AS CSI 300 INDEX AND FTSE CHINA BANKING INDUSTRY INDEX

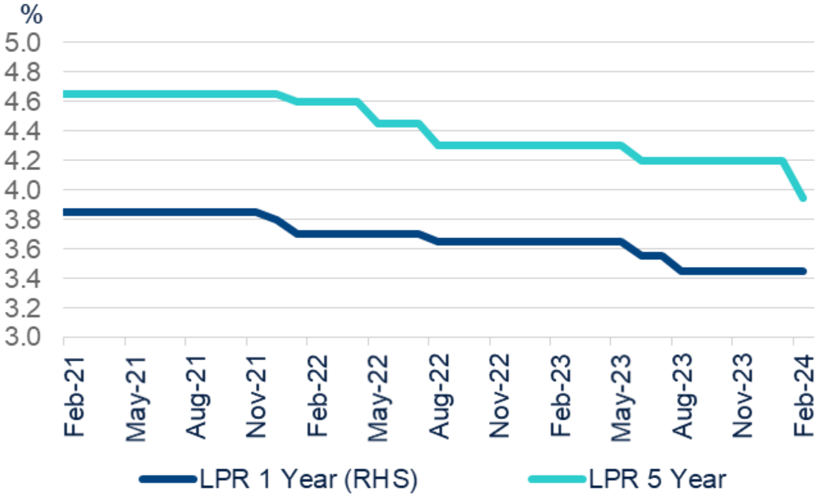


Source: Wind & BBVA Research.

The sluggish economic recovery and loss of investors' confidence hit the stock market hard, with both the Shanghai composite index and CSI 300 index touching new lows at the beginning of 2024.

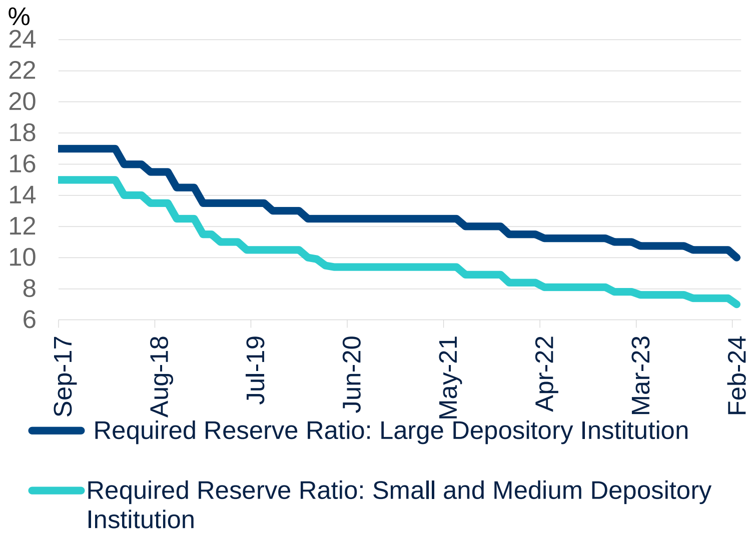
Expansionary monetary policies were deployed to prevent growth hard-landing

THE PBOC CUT THE LOAN PRIME RATE (LPR) THREE TIMES SINCE JUNE 2023



Source: Haver & BBVA Research.

…AND HAS CUT REQUIRED RESERVE RATIO (RRR) THREE TIMES SINCE MARCH 2023

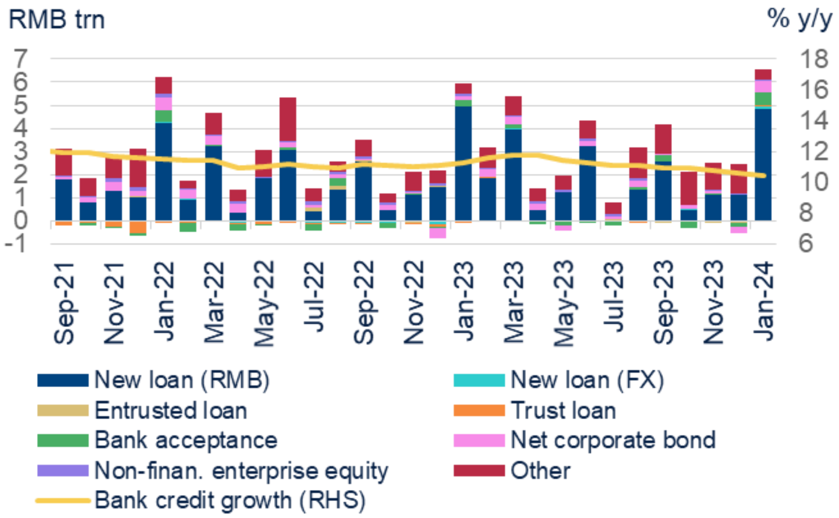


Source: CEIC & BBVA Research.

To bolster the economy, the central bank has cut the 1-year loan prime rate by 80 bp since Covid to 3.45%. The five-year loan prime rate, the reference rate for mortgage, has also dropped by 90 bps. In order to relieve banks' pressure, the central bank cut reserve requirement ratio three times and lower deposit rates to release banks' pressure.

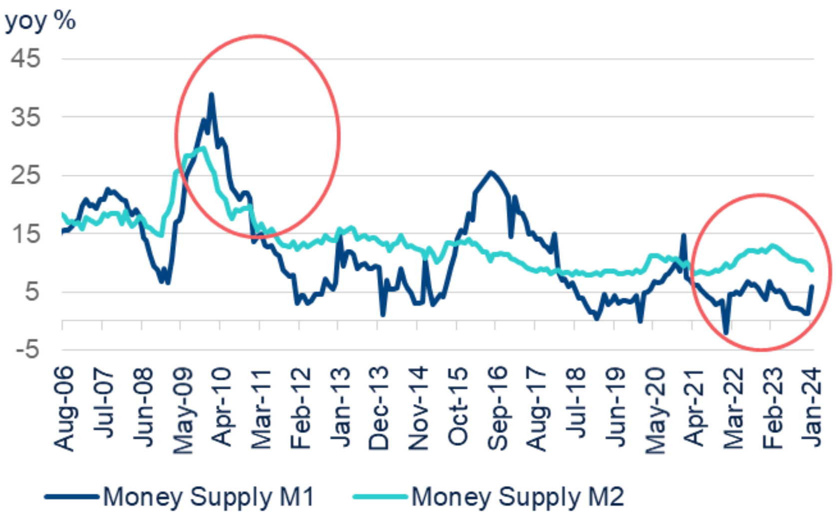
Credit growth remained steady in 2023 amid a slowing economy but rebounded quickly in January 2024

TOTAL SOCIAL FINANCING REMAINS WEAK, WHICH IS BROADLY IN LINE WITH 2022



Source: CEIC & BBVA Research.

BROAD M2 MONEY SUPPLY GREW 9.7% IN DEC FROM A YEAR EARLIER-THE LOWEST SINCE MARCH 2022

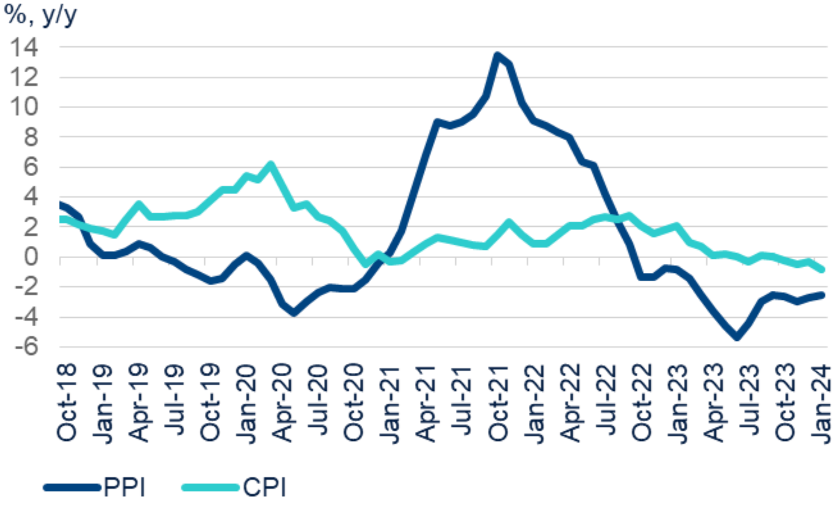


Source: Wind & BBVA Research.

Growth of outstanding total social financing (TSF), a broad measure of credit and liquidity in the economy, stood at 9.5% in 2023, which is generally stable compared with 9.6% seen at the end of 2022. However, new bank loans jumped to an all-time high of RMB 4.92 trillion in January 2024, as the central bank moved to revive the lackluster economy.

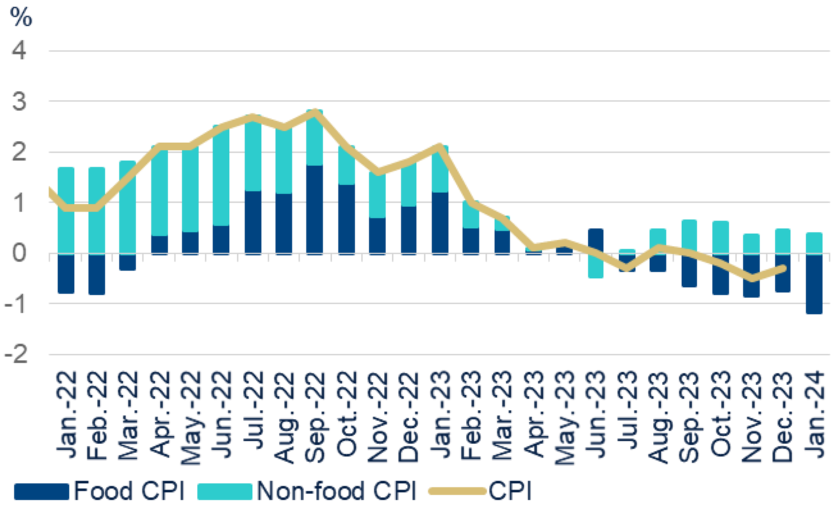
The economy is also facing persistent deflationary pressure

STARTING FROM MID-2023, CPI HAS BEEN LINGERING AROUND 0% FOR MORE THAN HALF YEAR



Source: CEIC & BBVA Research.

CPI WENT DOWN MOSTLY DRAGGED BY FOOD CPI, WHILE NON-FOOD CPI FARES WELL

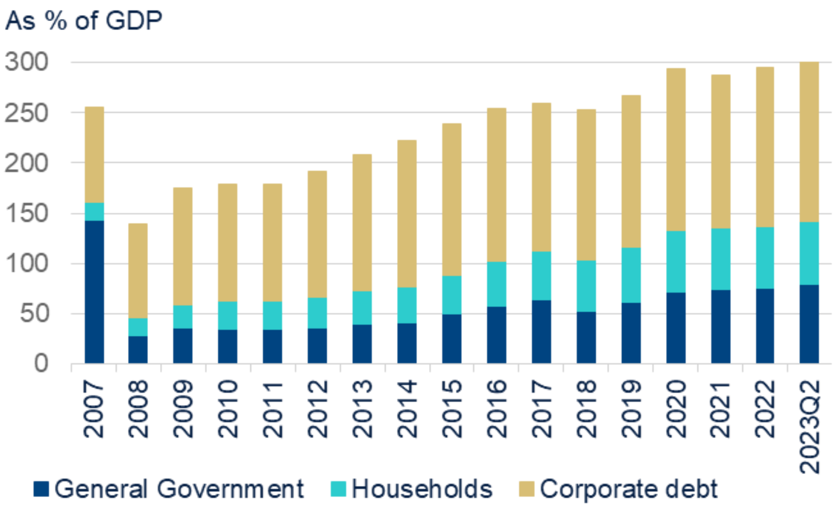


Source: Wind & BBVA Research.

Amid weak domestic demand, the economy is confronting persistent deflationary pressure in 2024, necessitating additional policy stimulus. Reversing a deflationary environment is challenging, amid significant adjustments in the real estate sector.

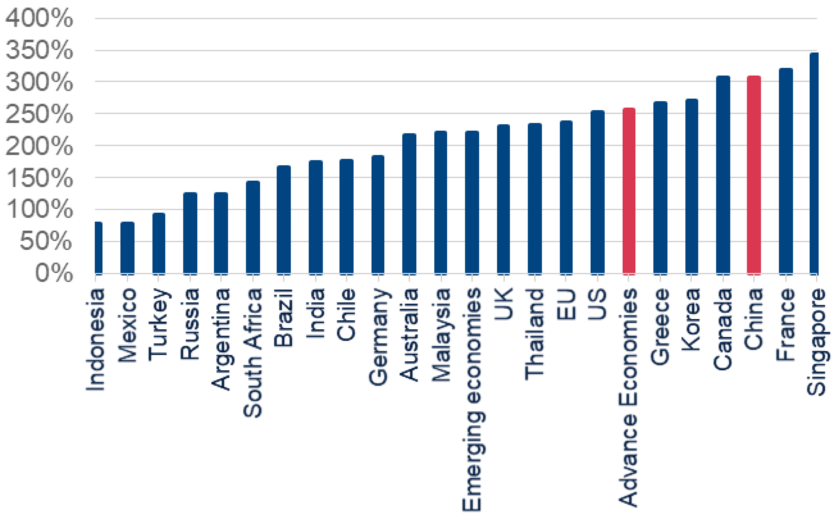
China's debt overhang concentrates on local government and corporate sector

CHINA'S MACRO LEVERAGE RATIO REACHED 307.5% TILL Q2 2023



Source: CEIC & BBVA Research.

CHINA'S MACRO LEVERAGE RATIO IS HIGHER THAN EMERGING AND ADVANCED MARKETS AVERAGE



China's macro leverage ratio, defined as total debt as % of GDP, reached a record high of 307.5% in Q2 2023, which is 14.2 percentage points higher than the same period last year. However, the debt overhang issue primarily focuses on local government debt and corporate debt, while homebuyers are rushing to pay down mortgages due to lowered mortgage rates.

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Performance of banking Sector

Asset quality related to property developers is subject to headwinds

Main messages

Banking assets growth

Banking assets experienced a stable expansion in 2023, increasing by 9.9% to RMB 417.3 trillion, driven by both loan and non-loan assets. In terms of loan growth components, the housing sector loan tumbled due to a sluggish real estate sector, while consumer loans continued to recover after bottoming out in 2023. Meanwhile, corporate loan remained resilient to support the real economy.

Banking profitability

Banks' profitability deteriorated due to a narrowing net interest margin (NIM), with both the return on assets (ROA) and return on equity (ROE) reaching their lowest levels in more than a decade.

Asset quality

Although the non-performing loan (NPL) ratio declined due to sustained bad loan resolution, the asset risks are rising due to transitional volatility due to the deep correction in the property market. City and rural commercial banks are particularly vulnerable to further asset quality deterioration due to their less diversified asset portfolio, relatively low capital adequacy ratio, and exposure to the real estate sector.

Bank capitalization

Banks' capital capitalization remained stable. The new Basel-based capital rule, effective since January this year, will potentially free up the capital for banks with large mortgage exposure. However, lenders are subject to pressure from capital shortfalls due to the prospective implementation of TLAC rule in 2025.

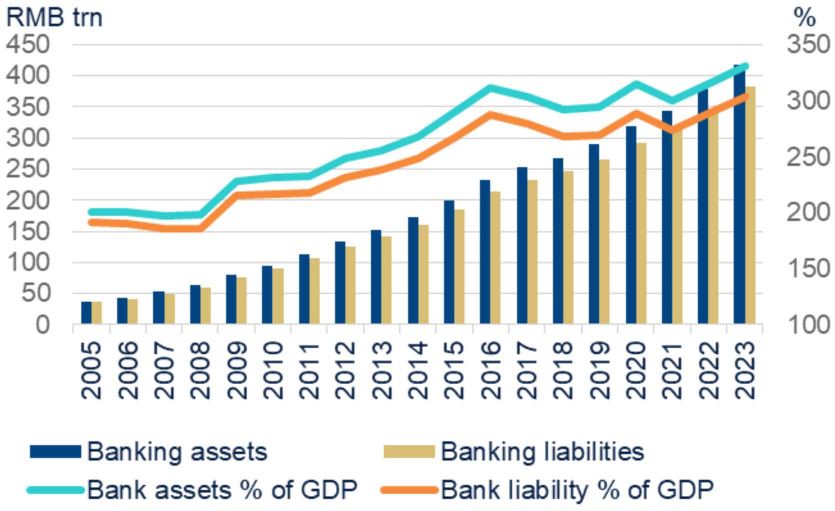
A snapshot of financial fundamentals of Chinese banks

	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4
Asset quality and credit risk										
Loans/total assets	55.8%	55.9%	56.2%	56.1%	56.4%	56.4%	55.0%	55.0%	55.3%	54.9%
Loans/GDP	164.9%	167.7%	166.9%	171.3%	174.9%	177.6%	178.8%	182.9%	186.1%	188.5%
NPL ratio	1.75%	1.73%	1.69%	1.67%	1.66%	1.63%	1.62%	1.62%	1.61%	1.59%
(NPL+special-mention loan) ratio	4.11%	4.06%	4.00%	3.98%	3.93%	3.86%	3.78%	3.76%	3.81%	3.78%
Provisions/NPLs	197.0%	197.0%	200.7%	203.8%	205.5%	205.9%	205.2%	206.1%	207.9%	205.1%
Profitability & efficiency										
NIM	2.07%	2.08%	1.97%	1.94%	1.94%	1.91%	1.74%	1.74%	1.73%	1.69%
Cost to income ratio	29.0%	32.1%	27.7%	28.9%	30.0%	34.0%	29.1%	30.3%	31.6%	35.3%
ROE	10.1%	9.6%	10.9%	10.1%	9.3%	9.3%	10.3%	9.7%	9.5%	8.9%
ROA	0.82%	0.79%	0.89%	0.81%	0.75%	0.76%	0.81%	0.75%	0.74%	0.70%
Solvency										
Tier 1 ratio	12.1%	12.4%	12.3%	12.1%	12.2%	12.3%	12.0%	11.8%	11.9%	12.1%
Core Tier 1	10.7%	10.8%	10.7%	10.5%	10.6%	10.7%	10.5%	10.3%	10.4%	10.5%
Leverage ratio	7.0%	7.1%	7.0%	6.8%	6.8%	6.9%	6.7%	6.6%	6.7%	6.8%
NPLs/ Capital	7.0%	10.4%	10.3%	10.4%	10.3%	10.1%	10.2%	10.4%	10.2%	9.9%
Liquidity and funding										
Deposits/Total assets	69.4%	80.5%	80.5%	80.9%	80.9%	80.8%	83.1%	82.5%	82.3%	81.7%
Non-deposits funding (Central bank, bonds, NCDs, …) / Total assets	30.6%	19.5%	19.5%	19.1%	19.1%	19.2%	16.9%	17.5%	17.7%	18.3%
Loan to deposit ratio	79.1%	79.7%	78.7%	78.4%	78.7%	78.8%	77.6%	77.7%	78.2%	78.7%
Liquidity coverage ratio	142.2%	145.3%	143.2%	146.3%	142.7%	147.4%	149.5%	150.9%	143.5%	151.6%

Source: National Financial Regulatory Administration, China’s Depository Corporations Survey & BBVA Research.

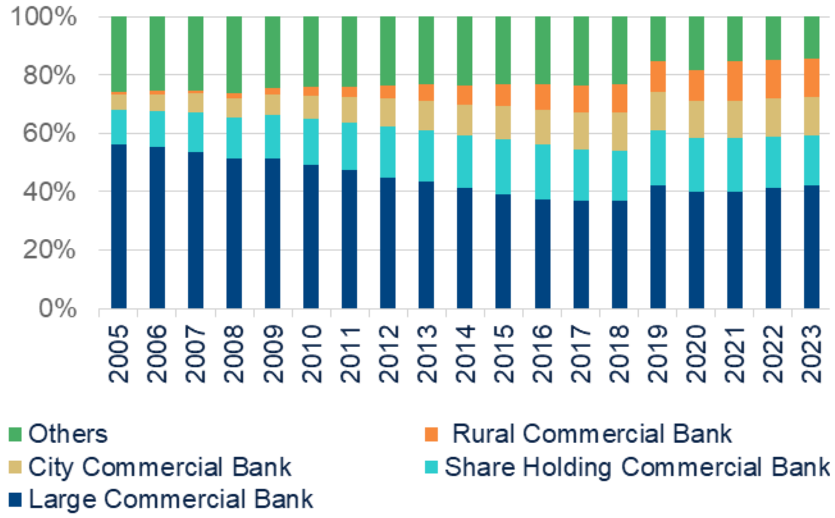
Bank assets growth saw a steady expansion in 2023

BANKING ASSETS MAINTAINED ITS FAST GROWTH RATE



Source: CBIRC & BBVA Research.

LARGE AND SHAREHOLDING COMMERCIAL BANKS STILL DOMINATE IN BANKS' ASSETS

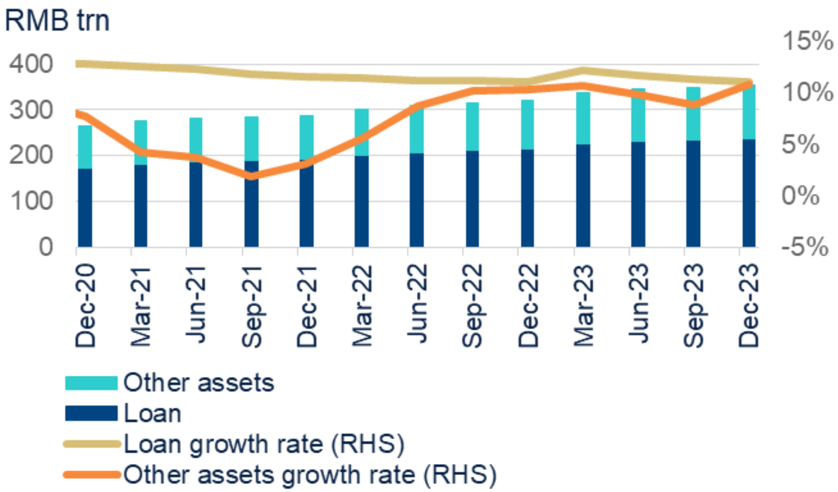


Source: CBRIC & BBVA Research.

China's banking sector assets maintained a fast growth rate of 9.9% in 2023, reaching RMB 417.3 trillion compared to RMB 379.4 trillion in 2022, in response to regulators' call for more credit support to corporate and house borrowers. Moreover, our breakdown data showed that large and share-holding banks jointly accounted for 69.8% of the total commercial banks' assets.

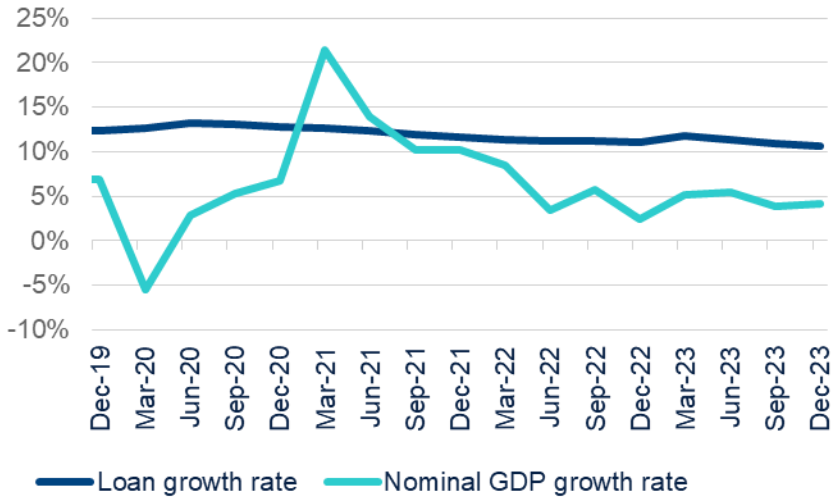
Both loan and non-loan assets growth contributed to the banking asset expansion

LOAN AND NON-LOAN ASSETS GROWTH CONTRIBUTED TO THE BANKING ASSET EXPANSION



Source: CEIC & BBVA Research.

…AND LOAN GROWTH RATE STILL EXCEED NOMINAL GDP GROWTH RATE

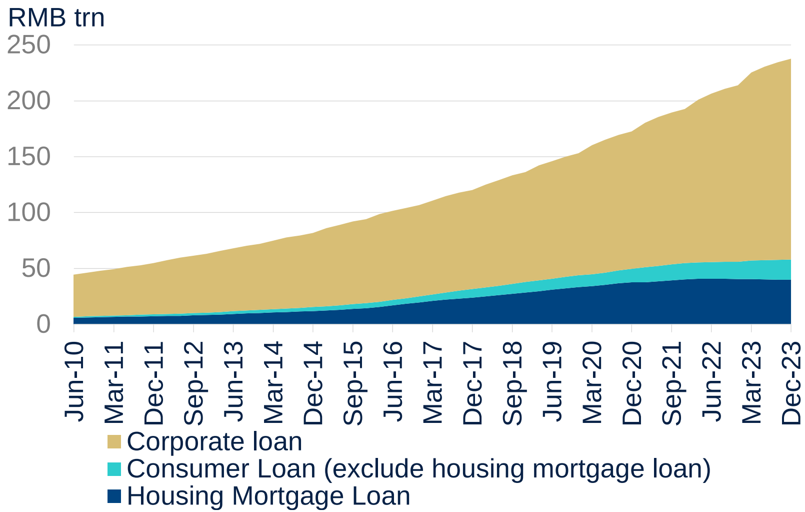


Source: CEIC & BBVA Research.

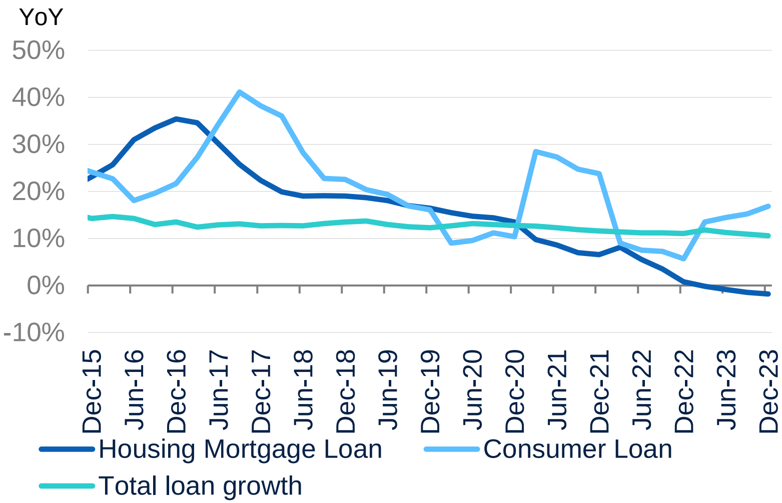
Loan growth rate reached 11.0% in 2023, slightly declined from 11.1% in the previous year. By contrast, the growth of non-loan assets contributed to the banking asset expansion, which picked up to 10.8% in 2023 from 10.4% in 2022, driving by increased interbank activities and financial investments.

Housing mortgages loan growth tumbled

LOANS WERE DRAGGED BY HOUSING MORTGAGE LOAN



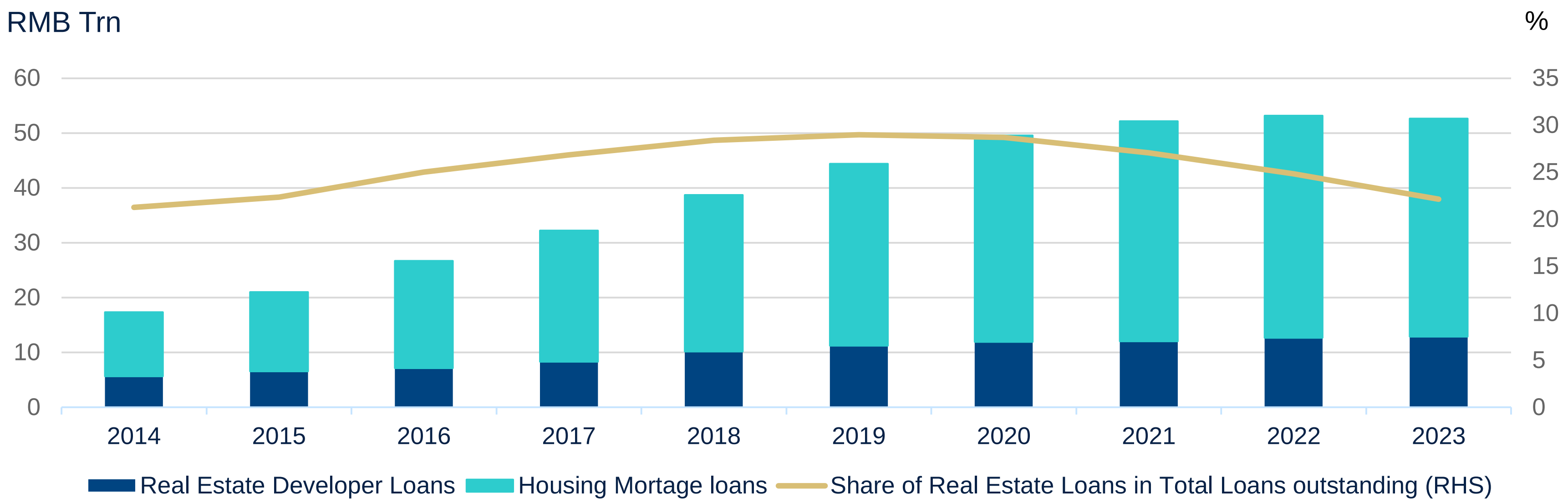
HOUSING MORTGAGES LOAN GROWTH TUMBLED



Source: CEIC & BBVA Research.

Housing mortgage loan growth has dipped to -1.8% y/y in the Q4 2023, as housing mortgage loan demand were severely affected by the sluggish real estate sectors. In contrast, consumer loans continued to recover after bottoming out of 5.7% at the end of the previous year. Meanwhile, corporate loans remained resilient, with growth at 13.7%, thanks to government’s call for boosting the real economy.

Banks' exposure to housing sector continued trending down



Source: CEIC & BBVA Research.

The proportion of mortgage loans plus real estate developer loans to total outstanding loans slowed down to 22.2% in Q4 2023 from 24.8% in the same period last year (peak level: 29% as end of 2019). Despite the decreasing exposure to real estate, there are still some caveats to consider, including weak mortgage demand and the increasing credit risk associated with property-related assets.

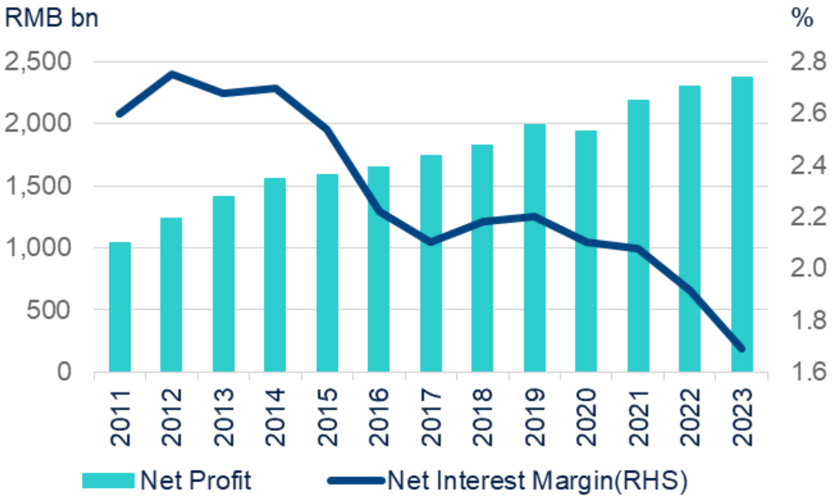
By contrast, green loan growth slowed from the peak but remained strong

Source: CEIC & BBVA Research.

In response to the national priority of development new energy infrastructure and to advance carbon neutrality initiative, banks are accelerating lending and investment in green projects including renewable energies, electric vehicles and new infrastructure etc. Green loan growth maintained a high growth of 36.5% at end 2023, slightly declined from the 41.4% registered in the previous quarter.

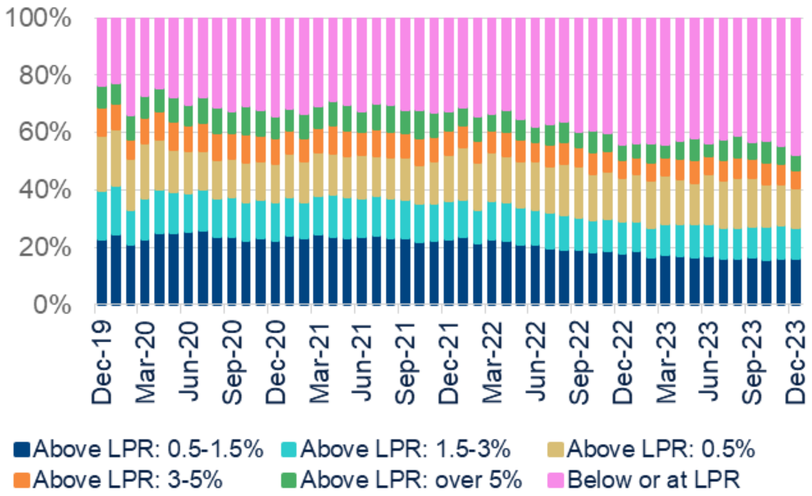
Banks' profitability deteriorated amid falling lending rates and narrowing interest margins

NET INTEREST MARGIN (NIM) SAW FURTHER DECLINES



Source: CBRIC & BBVA Research.

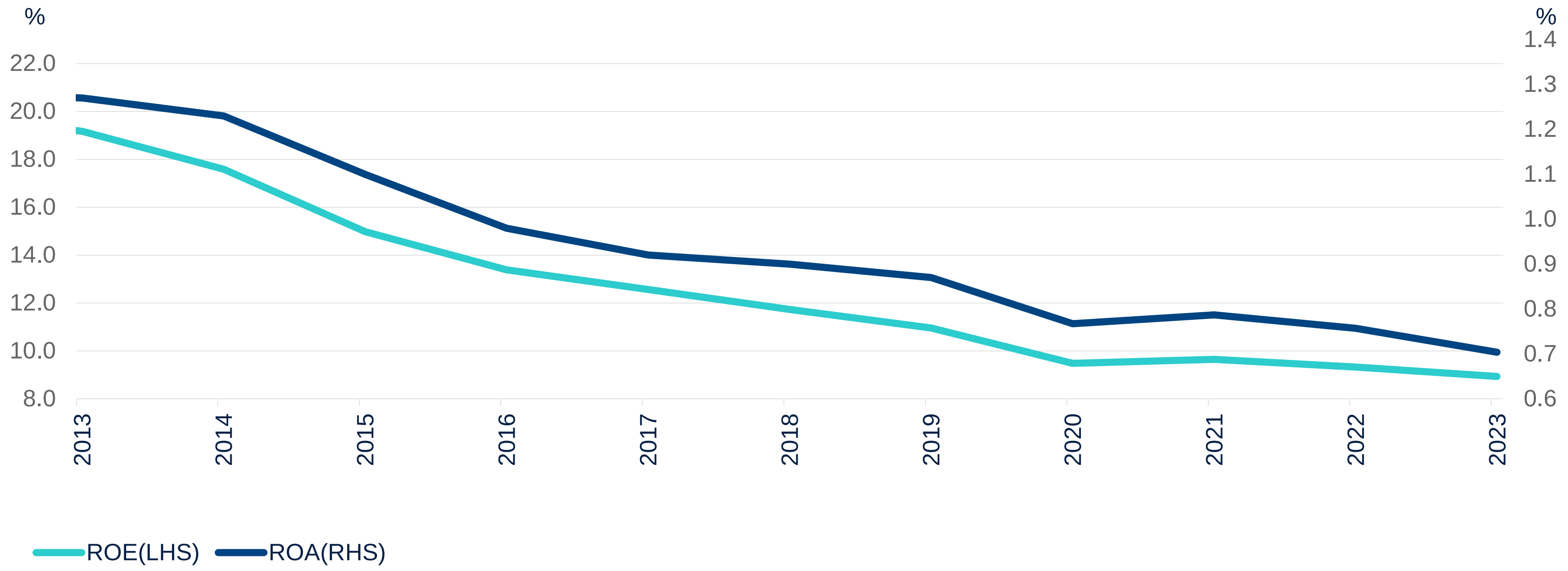
THE PROPORTION OF LENDING RATE BELOW OR AT LPR CONTINUES TO RISE



Source: CBRIC & BBVA Research.

Net Interest Margin (RHS) suffered pressure amid lending rate cut and declined to a record low of 1.73 in Q4 2023, 51 bp lower than the pre-Covid level. The recent 25 bp reduction to the banks' five-year LPR will squeeze banks' NIMs by six basis points (bp), partly reflecting policy aim to support certain strategic sectors with cheaper bank financing and repricing existing mortgages.

ROA and ROE registered the lowest record in more than a decade

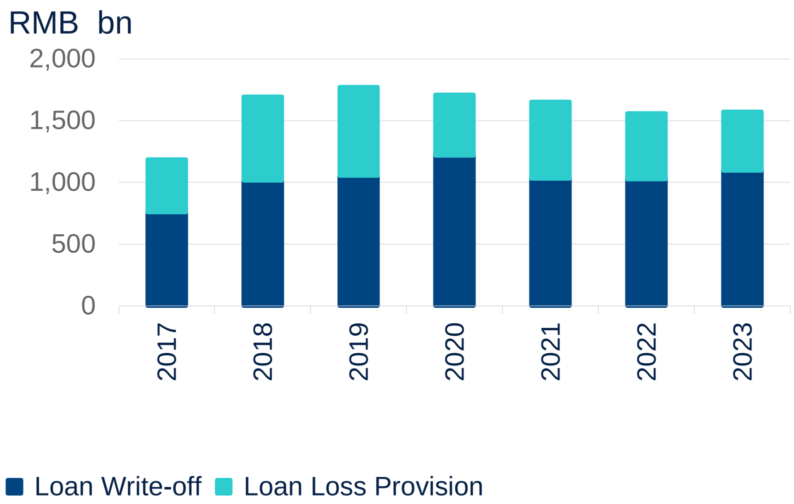


Source: CBRIC & BBVA Research.

Weighed by the declining net interest margin, both ROE and ROA dropped to 8.9% and 0.7% in 2023 respectively from 9.3% and 0.76% in 2022, registering their lowest levels in more than 10 years.

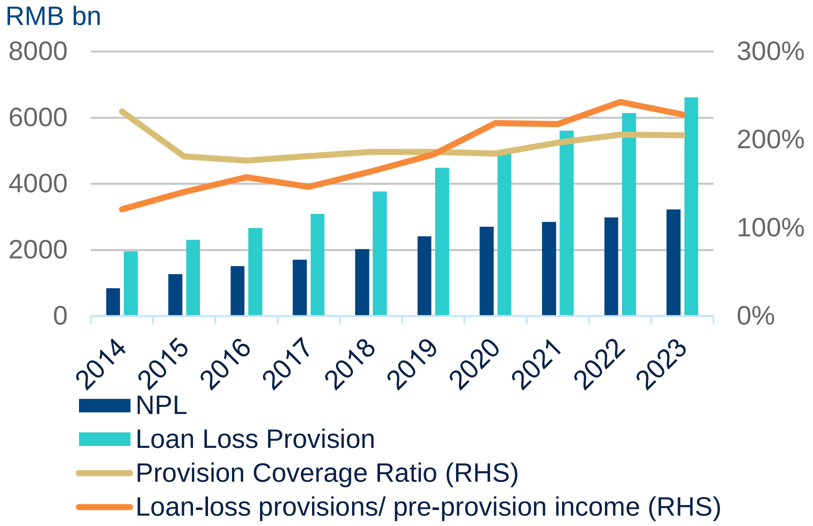
Bank’s provisions for bad loans have accelerated

BAD LOAN RESOLUTION ACCELERATED WHILE LOAN LOSS PROVISION DECLINED



Source: CBRIC & BBVA Research.

CHINESE BANK LOAN LOSS PROVISION STILL MORE THAN TWO TIMES OF NPL

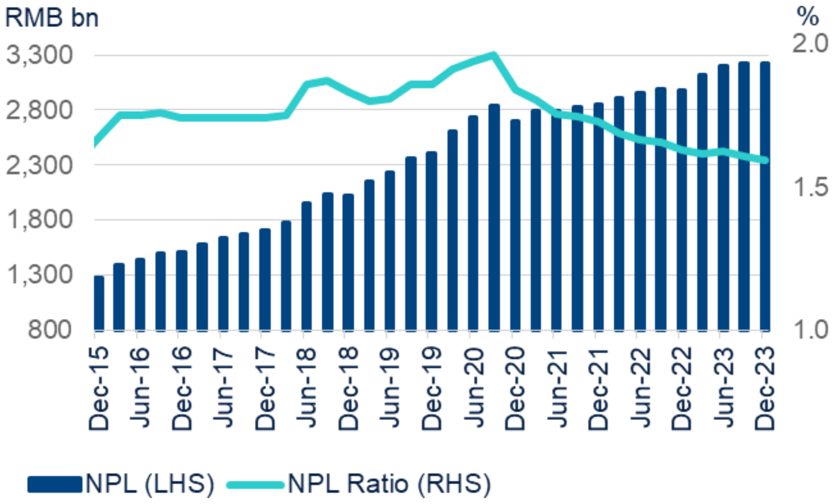


Source: CBRIC & BBVA Research.

Banks’ loan resolution for bad loans have picked up to RMB 1097 billion, a 6.8% increase from last year. In contrast, the loan loss provision declined in response to the authorities’ call to reduce large banks’ provision coverage to channel the fund to support the real economy and replenish core tier one capital.

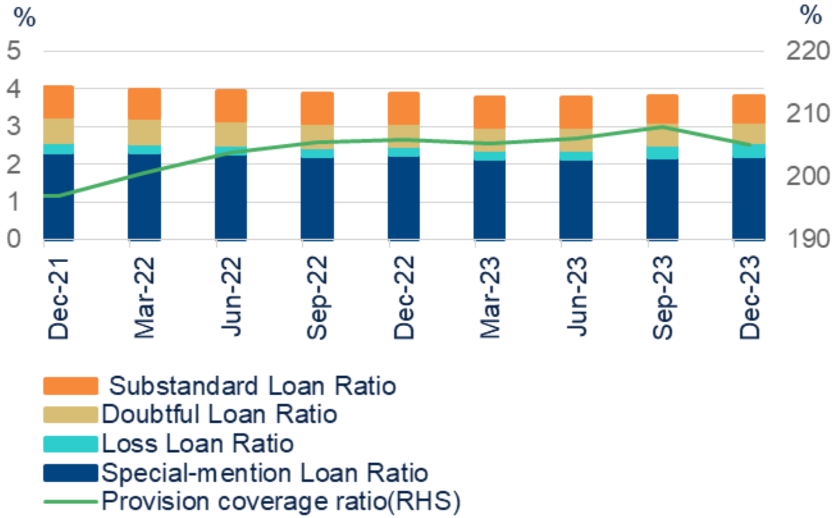
Both NPL ratio and special-mention loan ratios declined benefited from sustained NPL disposal. However, asset risks continue to rise

NPL RATIO MODERATED WHILE NPLS LEVEL REMAINED HIGH



Source: CEIC & BBVA Research.

…SPECIAL- MENTION LOAN RATIO ALSO DECLINED AS CONTINUOUS DISPOSAL OF BAD LOANS

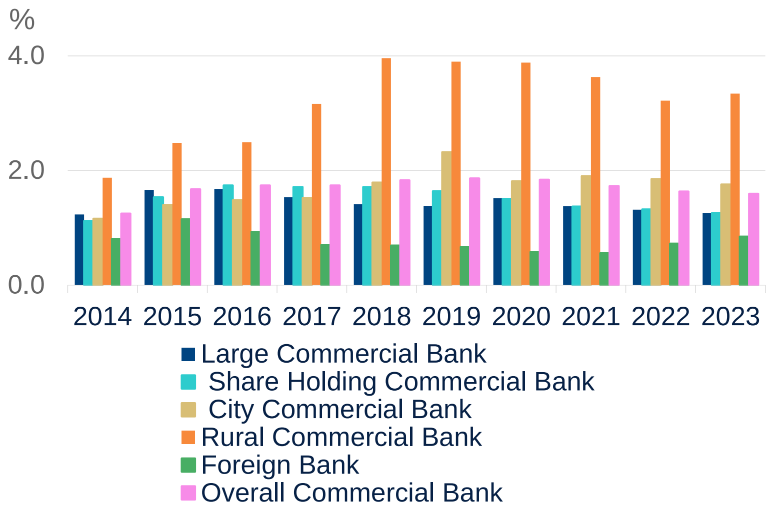


Source: CEIC & BBVA Research.

The NPL ratio and special-mention loan ratios both slightly edged down to 1.59% and 2.20% respectively in the Q4 2023, benefiting from sustained NPL disposal efforts. Nevertheless, banks still face risks arising from transitional volatility. The repayment crisis of Dalian Wanda and default risk of Country Garden have raised concerns over banks' asset exposures to the property developers.

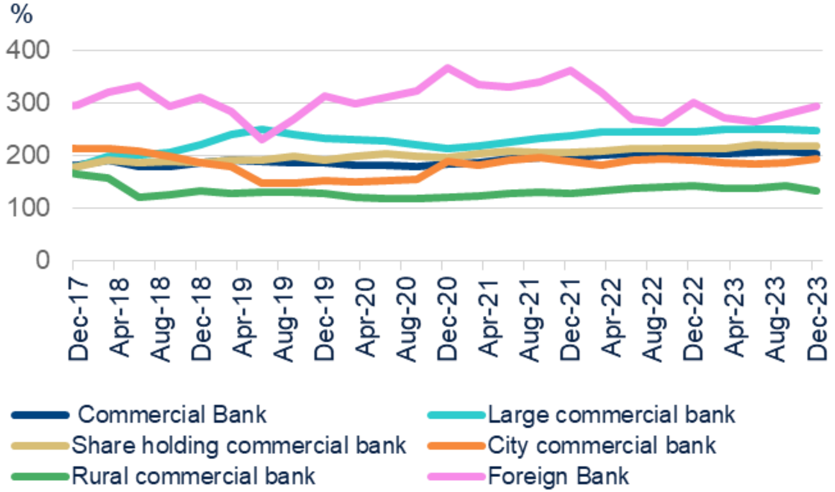
Loan quality diverged between big banks and regional banks

RURAL COMMERCIAL BANKS ARE VULNERABLE TO FURTHER ASSET DETERIORATION (NPL RATIO %)



Source: CEIC & BBVA Research.

THE PROVISION COVERAGE RATIO FOR RURAL COMMERCIAL BANKS STILL BELOW THE REGULATORY REQUIREMENT

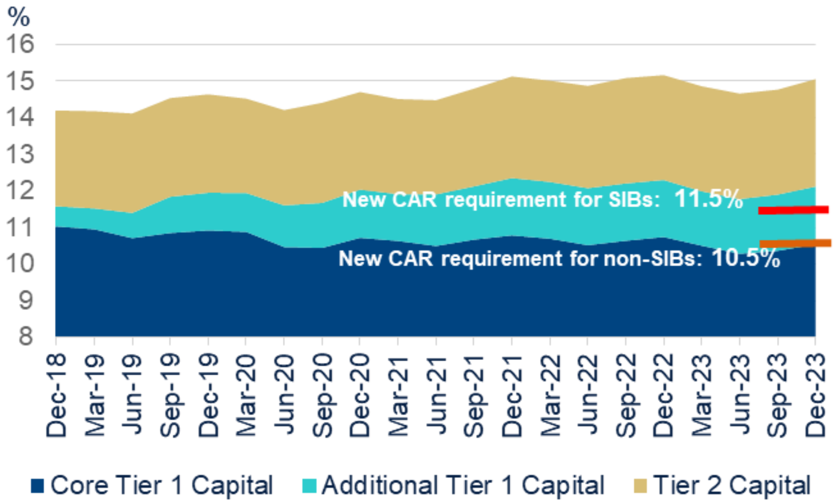


Source: CEIC & BBVA Research.

Rural and city commercial banks are still vulnerable to further asset quality deterioration given their less diversified asset portfolios and higher exposure to real estate. In particular, the provision coverage ratio for collectively rural commercial banks declined to 134.4% end of 2023 from 143.2% a year ago, lower than the upper bound of supervisory requirement of 150%.

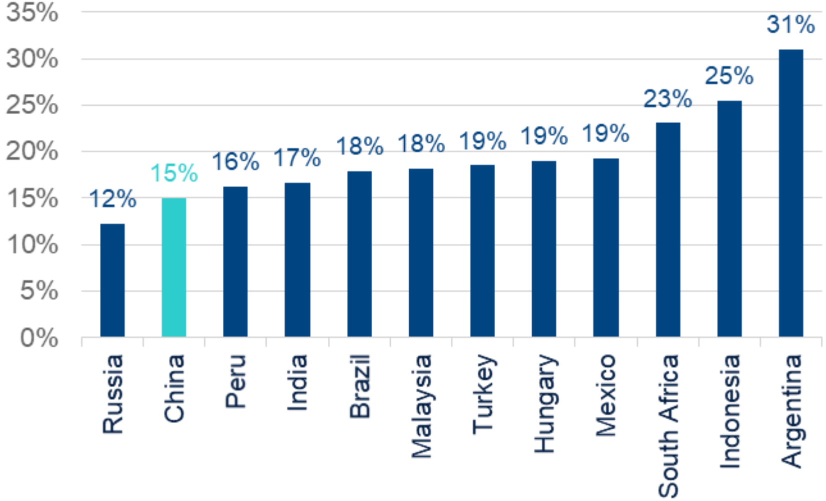
Banks' capitalization remained stable, but face pressure in raising new capital

CORE TIER 1 CAPITAL ADEQUACY RATIO HAS DECLINED SLIGHTLY



Source: CEIC & BBVA Research.

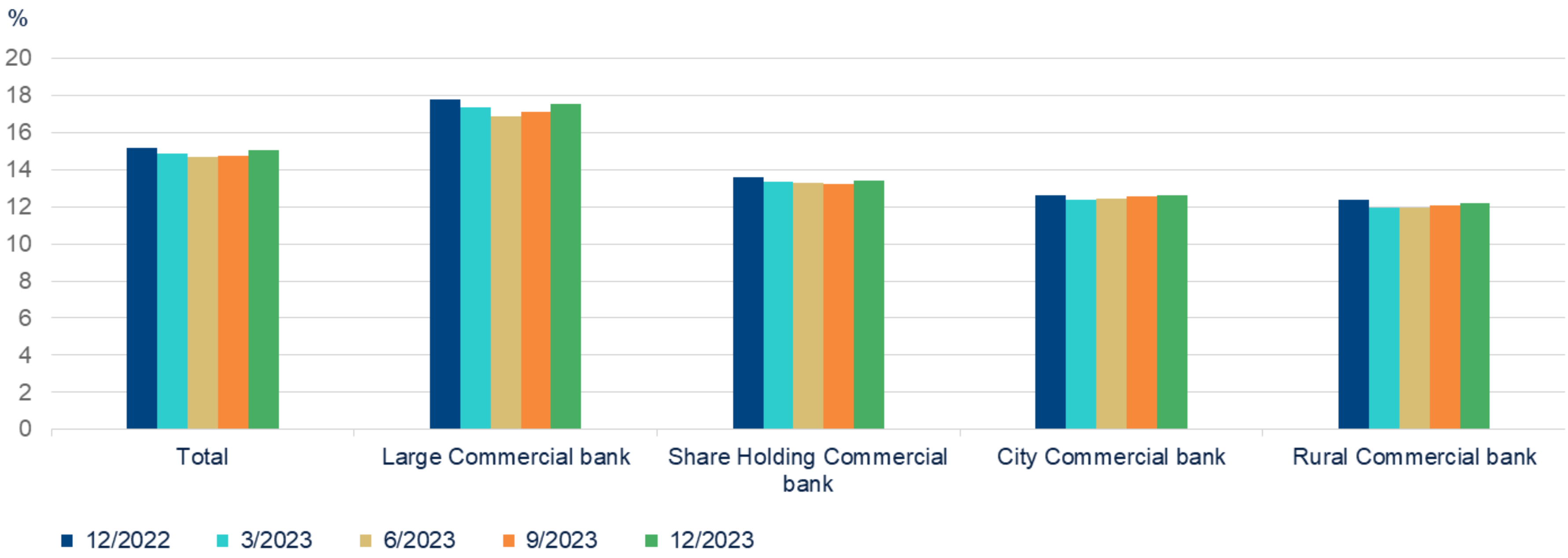
AND CHINESE BANKS' CAR STILL LAG BEHIND THEIR MAJOR EMS PEERS



Source: CEIC & BBVA Research.

Bank capitalization remained stable, while the core tier 1 capital ratio edged down to 10.5% at end-2023, 2 basis points lower than a year ago. Meanwhile, additional tier 2 capital ratio rose by 7 basis points over the same period, driven by the issuance of perpetual bonds.

A diverged capital buffer distribution among big and smaller banks



Source: CBRIC & BBVA Research.

City and rural commercial banks have lower capital adequacy ratios due to their larger exposure to the property sector as well as their higher sensitivities of funding costs.

SUMMARIZE THE REVISIONS TO RISK WEIGHTS UNDER THE FINAL BASEL III CAPITAL RULE

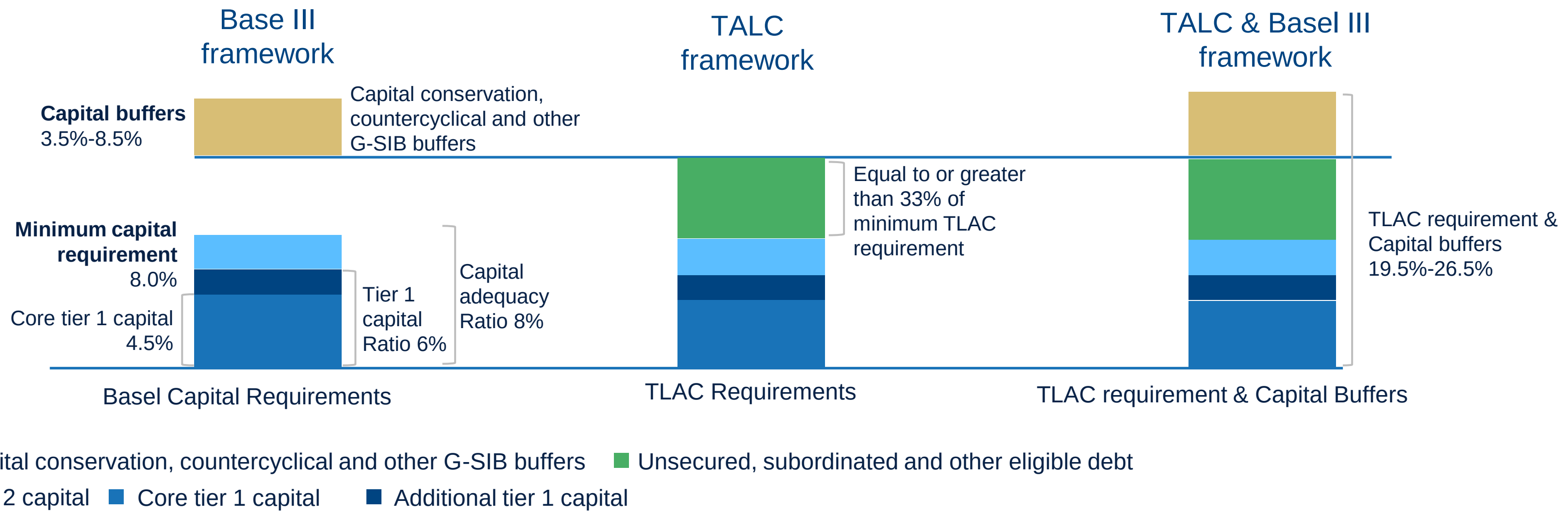
Items	Final Basel III rule changes from the draft mad in Feb 2023
1	The risk weighting of persounal housing loans has been significantly reduced for first-tier banks. Where the loan-to-value ratio is 50%, or less, the risk weighting in official measures is now 20%, as compared to 40% made in the draft. Similar reductions are applied to other loan-to-value ratios.
2	The risk weighting for equity investment in industrial and commercial enterprises has been reduced from 400% to 250%. The same reduction applies to equity held in industrial and commercial enterprises following market-based debt-equity swaps, as well as equity investment that is subject to major state subsidies and government oversight.
3	The credit conversion factor for domestic letters of credit for trade in services has been reduced from 100% to 50%.

Source: China Banking and Insurance Regulatory Commission & BBVA Research.

The final regulations on managing commercial banks' capital have come into effect from the Jan this year. Some metrics for calculating lenders' risk-weighted assets (RWAs) have been relaxed from the draft version in February, and they are somewhat less strict than the existing standards.

China moves towards TLAC launch

RELATIONSHIP BETWEEN TLAC AND BASEL III

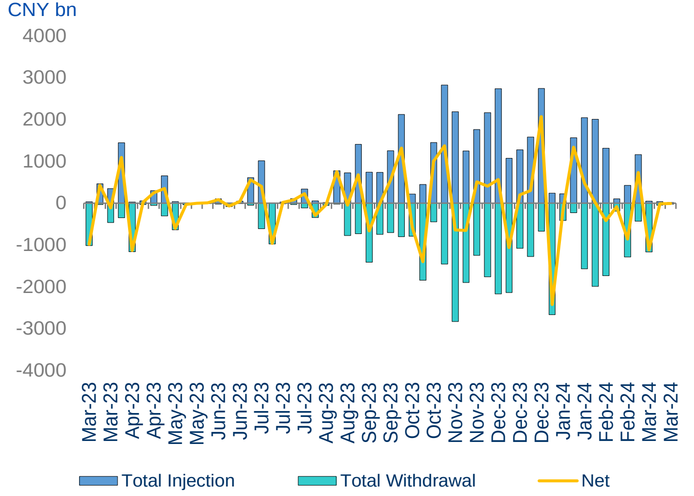


Source: FSB & BBVA Research.

China's new Basel-based capital regulation rules will ease strain on banks ahead of TLAC rollout, which will be implemented at the start in 2025. The capital shortage major banks faced will be less than we previously projected, with the top four Chinese banks will need to raise RMB 2.5 trillion in capital to meet the regulation needs by the year end.

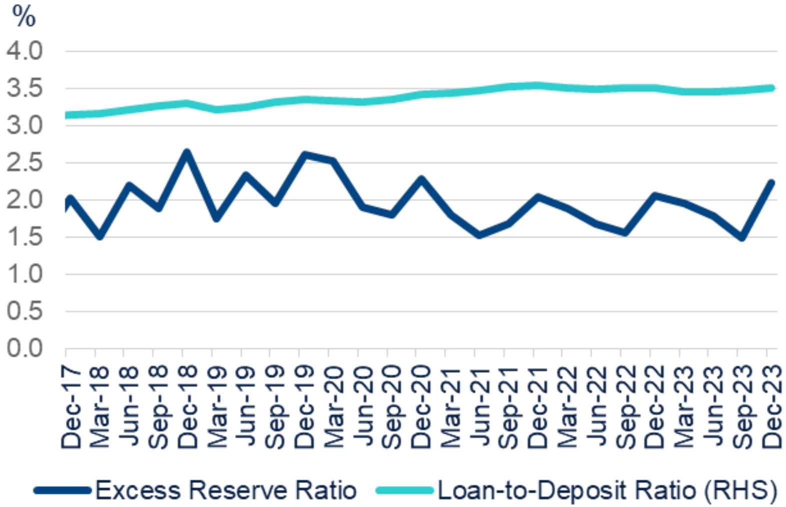
Banks' liquidity remained adequate

CHINA PBOC ACCELERATED OPEN MARKET OPERATIONS IN THE SECOND HALF YEAR



Source: Bloomberg & BBVA Research.

EXCESS RESERVE INDICATES THAT LIQUIDITY IN THE BANKING SYSTEM REMAIN ADEQUATE



Source: CBRIC & BBVA Research.

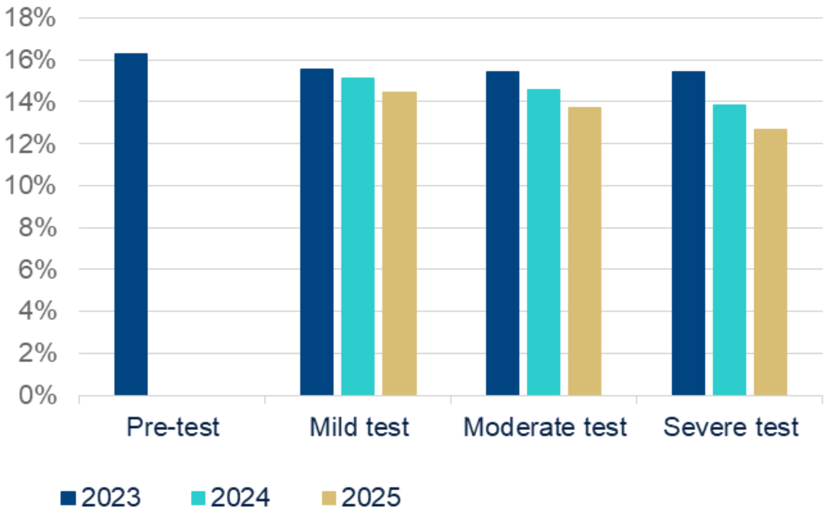
Liquidity in the banking system remains adequate after the PBoC ramp-up of cutting the required reserve ratio and the bench mark interest rate to help the shaky economy on a strong footing. The PBOC has boosted the pace of net liquidity injection through open market operations through 2023. Excess reserve ratio remained at 2.2% in Q4 2023, 10 basis points higher than a year ago.

Stress test has shown rising capital pressure across the sector (PBOC's Financial Stability Report)

GDP GROWTH RATE UNDER THREE SENARIOS

	Mild stress test	Moderate stress test	Severe stress test
2023	3.50%	2.80%	1.10%
2024	3.20%	2.60%	2.90%
2025	3.70%	3.40%	3.20%

CAPITAL ADEQUACY RATIO UNDER DIFFERENT MARCO-STRESS TESTING

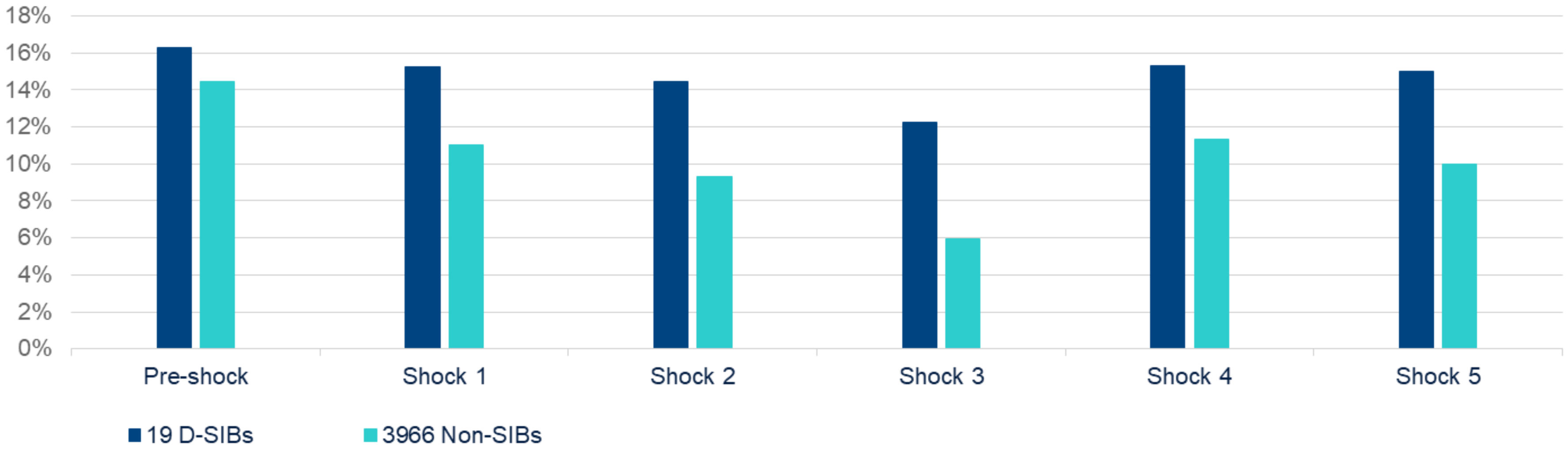


Source: Wind & BBVA Research.

The latest Financial Stability Report stress test result showed that, In a more severe scenario, with GDP growth assumptions at 1.1%, 2.9% and 3.2% in 2023, 2024 and 2025 respectively, the 19 D-SIBs' average CAR would drop to 12.7% by end-2025. Although it remains above the minimum requirement, the related risks warrant close monitor.

Stress test on NPL sensitivity showed the risks of small vulnerable banks in weaker economic regions are rising

NPL RATIO UNDER DIFFERENT SHOCKS



Source: Wind & BBVA Research.

Capital positions at 2020 out of the 3966 non-D-SIBs (accounting for 51.3% of total non-D-SIB assets) would fall below regulatory minimums if NPL ratios were to increase by 200% from the reported 2.7% at end-2022. D-SIBs are more resilient, indicating that the vulnerability of small banks are rising, although the danger of systematic risks remained low.

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03

Property market risks could exacerbate local government debt overhang problem

The potential weakness in the real estate market posted risks for China’s local government financial vehicles (LGFVs)

Main messages

Property market risks related with LGFVs

As land has been a crucial asset for local government financial vehicles (LGFVs) to finance their investments, many LGFVs find it difficult to sell their assets and service their debt due to the drop in housing prices.

Exposure to banks

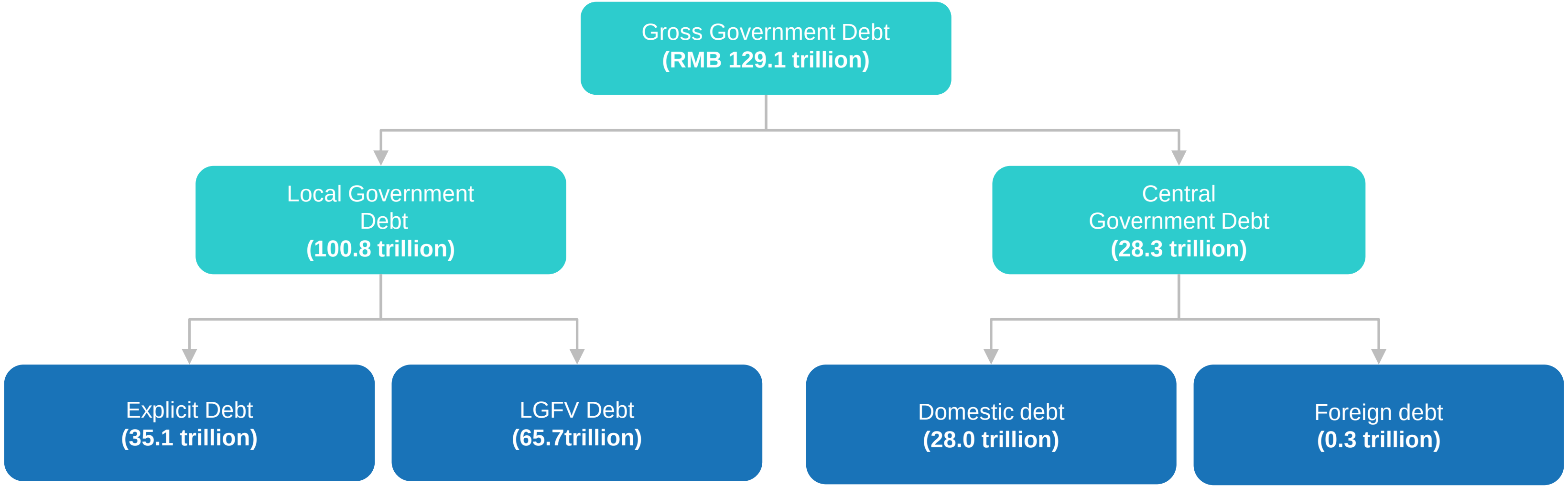
According to estimates, the LGFVs' debt amounted to RMB 65.7 trillion in Q3 2023, equivalent to around half of China's GDP. Banks have a greater exposure to LGFVs than to the housing sector, amounting to around 15% of banks' total assets.

Default risk

We expect that the default risk of LGFVs is still low compared to property companies due to the implicit government guarantee. We believe that local government are willing to continue supporting LGFV, as preventing systemic financial risks remains a top priority for the government. There is a possibility of isolated credit events occurring, and banks are likely to bear some of the costs associated with resolving the debt.

“Hidden debts” issued by the LGFVs debt will pose risks to the banking sector

DEBT STRUCTURE OF CHINA’S GOVERNMENT DEBT BY 3Q 2023

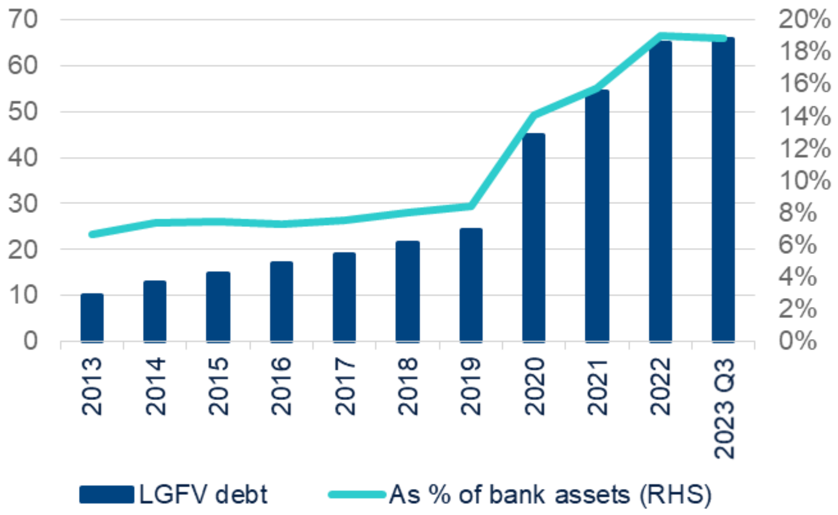


Source: CBRIC, S&P rating, CEIC & BBVA Research.

Due to the significant reductions in land-sale revenue in recent years, increasingly concerns are arising to the ability of local governments to pride support to the local government financial vehicles (LGFVs), which cities use to raise money for infrastructure projects, often at the urging of the central government when it needs to boost economic growth.

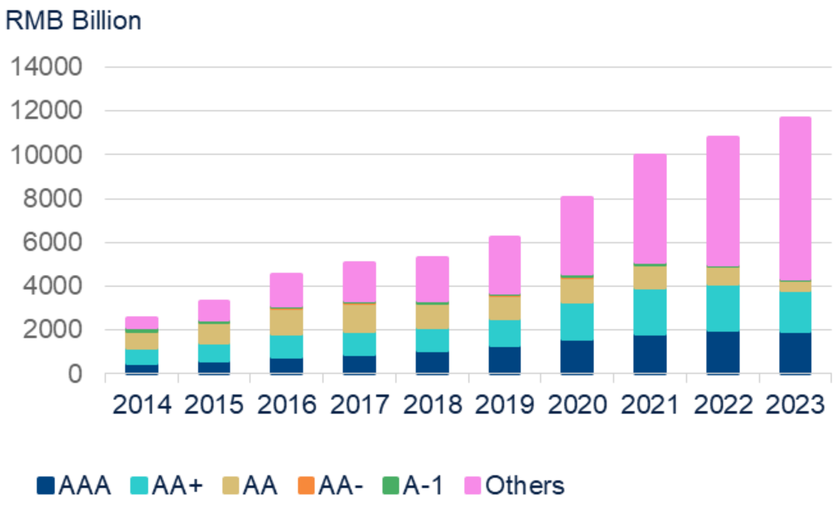
LGFVs debt have increased rapidly over the past several years

LOCAL GOVERNMENT DEBTS HAVE GROWN FAST IN THE PAST SEVERAL YEARS



Source: CBRIC, S&P rating, CEIC & BBVA Research.

DEFAULT RISKS AMONG WEAKER LOCAL GOVERNMENT FINANCIAL VEHICLES ARE RISING

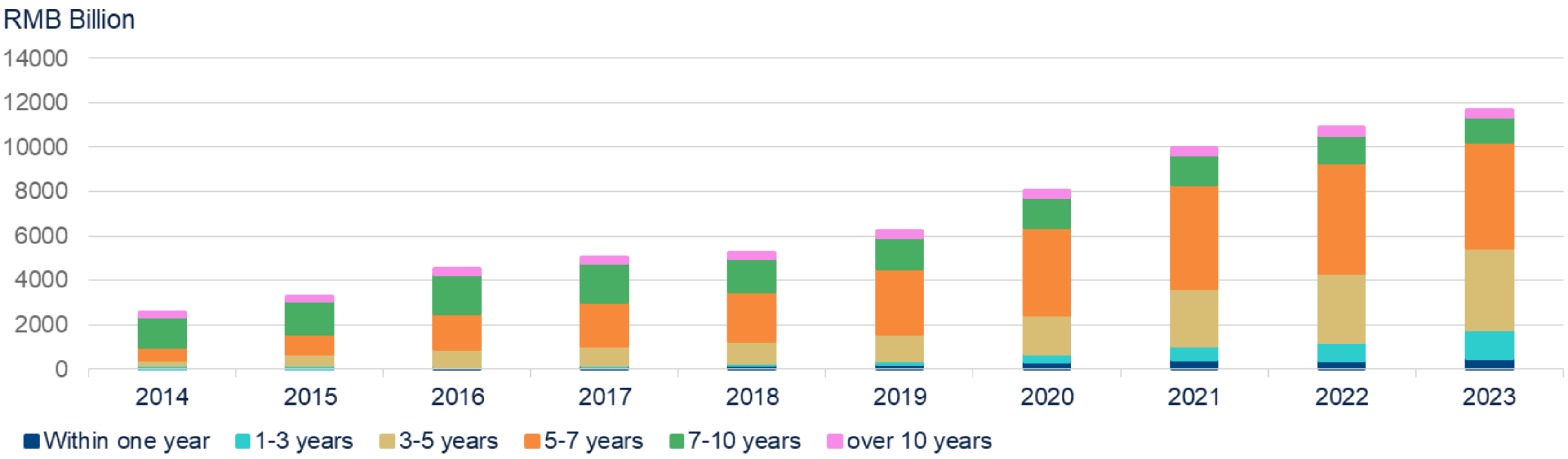


Source: PBoC & BBVA Research.

It is estimated that the LGFVs debt totaled RMB 65.7 trillion by the third quarter of 2023, or around 19 % of banking assets. Although the default risks among weaker local government financial companies are rising, we believe the default risks of LGFVs are lower than property developers due to the implicit government guarantee.

Most of LGFVs debt listed in stock exchange will mature in 5-7 years, while majority proportion of offshore debt will mature in 2 years

MOST OF LGFVS DEBT IN LISTED FIRMS WILL MATURE IN 5-7 YEARS



Source: Wind & BBVA Research.

Most of LGFVs det in listed firms will mature in 5-7 years, with RMB 4.65 trillion worth of bonds due over the next 12 months, roughly 13% more than what came due last year. Meanwhile, the LGFV sector faces around RMB 232 billion of maturing offshore US dollar bonds in 2024, accounting for 7% of total debt maturities in both onshore and offshore markets this year.

Chinese banks have larger exposures to local governments financing vehicles (LGFVs) than to the housing sector

BANKS' EXPOSURE TO HOUSING AND LOCAL GOVERNMENT DEBT

Source: Haver, IIF & BBVA Research. *total credit uses bank claims and other assets excluding bank claims on the central bank

According to a report by IIF, banks have larger exposures to local governments financing vehicles (LGFVs) than to the housing sector. However, we do not deem LGFVs pose a systemic risk to the banking system due to government bailout. However, idiosyncratic credit events could occur and banks will likely to bear some of the cost of debt resolution.

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04

Shadow banking activities

Banks interconnectedness with the shadow banking system has further decreased

Main messages

Shadow banking assets

Shadow banking assets continued to trend down, although at a softer pace. The broad shadow banking assets declined to RMB 49 trillion in 2023 from RMB 50.3 trillion in 2022. The decline was driven by undiscounted acceptance bills and other private credit.

Major components

Asset funded by WMPs edged up slightly, while exposures to both interbank and non-standard wealth management products declining. The balance of trust loans also grew marginally, with short term payment pressure increasing in response to the government’s call to help stabilize the real estate industry and reduce developers’ refinancing risks.

Interconnectedness to banks

Banks interconnectedness with the shadow banking system edged up slightly. The decline of interest rate in the interbank market has encouraged smaller banks to rely more on interbank funding.

Shadow banking components

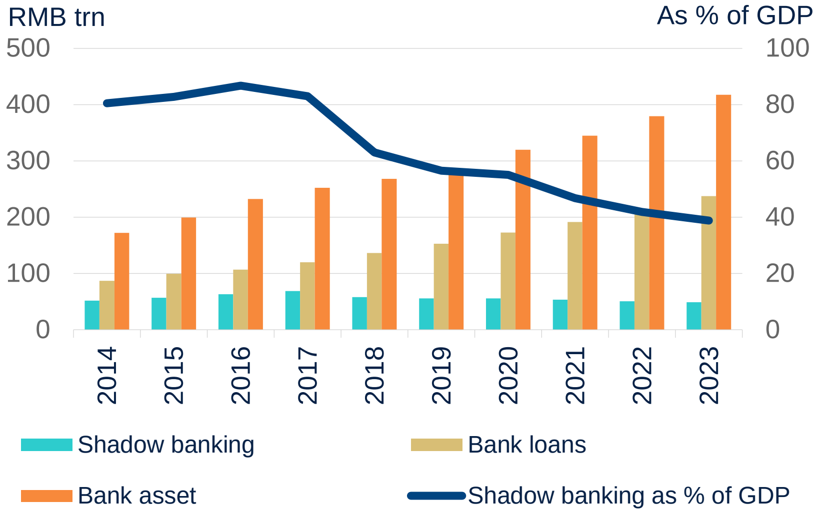
BREAKDOWN OF BANKS SHADOW BANKING SYSTEM

Credit Intermediation Products	2023 (RMB Trillion)	As % of total banking assets (%)	2022 (RMB Trillion)	As % of total banking assets (%)	2021 (RMB Trillion)	As % of total banking assets (%)	2020 (RMB Trillion)	As % of total banking assets (%)	2019 (RMB Trillion)	As % of total banking assets (%)	2018 (RMB Trillion)	As % of total banking assets (%)
Entrusted loans	11.3	2.7	11.2	3.0	10.9	3.2	11.1	3.5	11.4	4.0	12.4	4.7
Trust loans	3.9	0.9	3.8	1.0	4.4	1.3	6.3	2.0	7.5	2.6	7.9	3.0
Undiscounted bank's acceptance bills	2.5	0.6	2.7	3.0	3.0	0.9	3.5	1.1	3.3	1.2	3.8	1.5
Assets funded by WMPs/ AMPs	21.9	5.2	21.5	5.8	24.0	7.1	24.7	7.9	23.4	8.3	24.4	9.3
Bank's off-balance sheet	21.8	5.2	21.3	5.7	22.6	6.7	20.7	6.6	16.7	5.9	15.8	6.1
Securities firms and funds	0.0	0.0	0.2	0.0	1.4	0.4	4.0	1.3	6.7	2.4	8.6	3.3
Loans by finance companies	3.8	0.9	3.8	1.0	3.9	1.2	3.4	1.1	3.3	1.2	3.2	1.2
Others*	5.6	1.3	7.3	2.0	7.5	2.2	6.8	2.2	6.8	2.4	6.3	2.4
Total	49.0	11.7	50.3	15.8	53.7	15.9	55.8	17.8	55.7	19.7	58.0	22.1

Source: BBVA estimated based on Moody shadow banking report and China Banking Industry Financial Management Market Annual Report
*Includes financial leasing, microcredit, pawn shop loans, online “peer-to-peer” lending, asset-backed securities and consumer credit companies

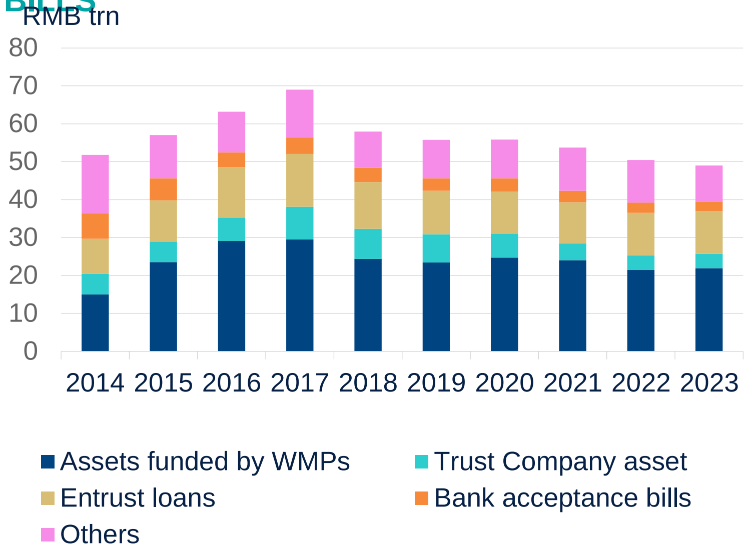
China shadow banking assets continued to trend down

SHADOW BANKING ASSETS AS % OF GDP CONTINUED TO TREND DOWN



Source: China Banking Industry Financial Management Market Annual Report 2023 & BBVA Research.

THE DECLINE OF SHADOW BANKING SECTOR IS WEIGHED BY BANK'S UNDISCOUNT ACCEPTANCE BILLS

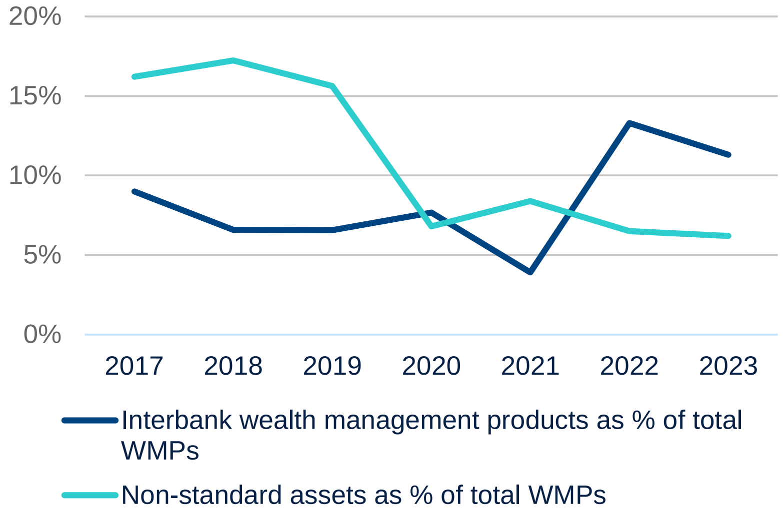


Source: PBOC, Moody report & BBVA Research.

As the government's policy focus shifts to promoting economic growth, the shrinkage of shadow banking assets continues to slow down. The broad shadow banking assets moderated to RMB 49 trillion in 2023 from RMB 50.3 trillion in the previous year, declining at a slower rate.

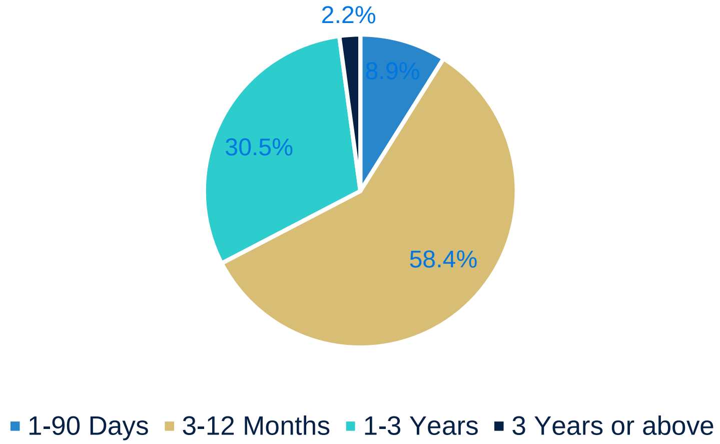
Interbank and non-standard wealth management products continued to shrink in 2023

PRINCIPAL PROTECTED WMPS OUTSTANDING HAS FURTHER DECLINED



Source: China Banking Wealth Management Market Annual Report & BBVA Research.

THE MAJORITY OF WMPS OUTSTANDING IN THE RECENT YEAR ARE 3-12 MONTHS

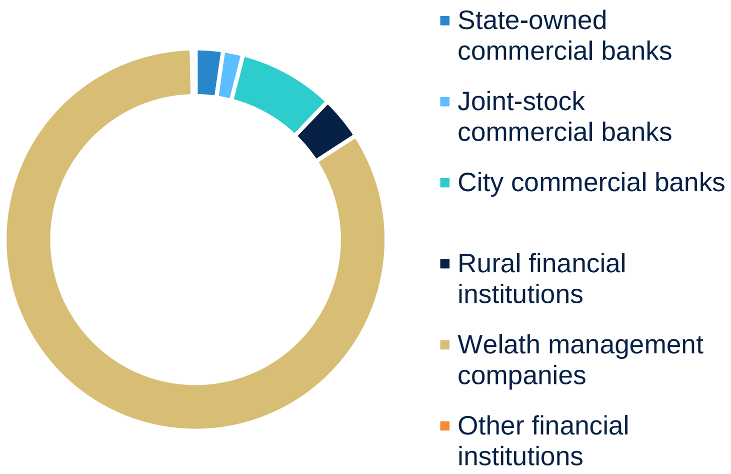


Source: Wind & BBVA Research.
*According to the WMPs that has published yield rate.

Although off balance sheet of WMPs edged up slightly to RMB 21.9 billon from 21.5 billion in the preceding year, both interbank and non-standard wealth management products as percentage of total wealth management products continued to shrink. The majority of WMPs outstanding have maturity of 3-12 months.

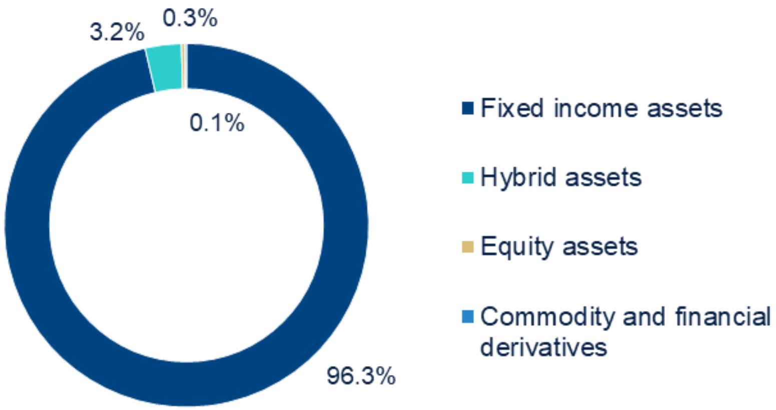
Banks established WMP companies to provide financing while ring fence associated risks

THE WMPS ARE MAINLY ISSUED BY WEALTH MANAGEMENT COMPANIES BY SIZE



Source: China Banking Wealth Management Market Annual Report & BBVA Research.

THE UNDERLYING ASSETS OF THE OUTSTANDING WMPS

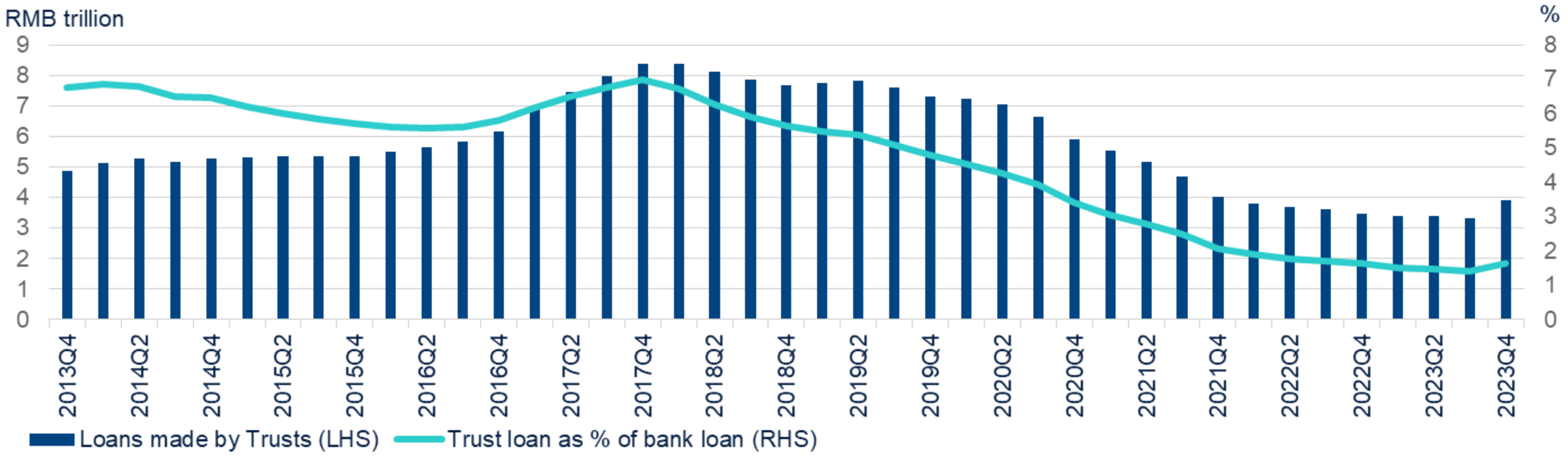


Source: Wind & BBVA Research.

The WMPs are mainly hold by wealth management companies as banks established independent WMP subsidiaries to ring fence associated risks. Most assets under the WMPS are corporate bonds.

The balance of trust loans assets picked up

TRUST COMPANY LOANS CONTINUED TO DECLINED



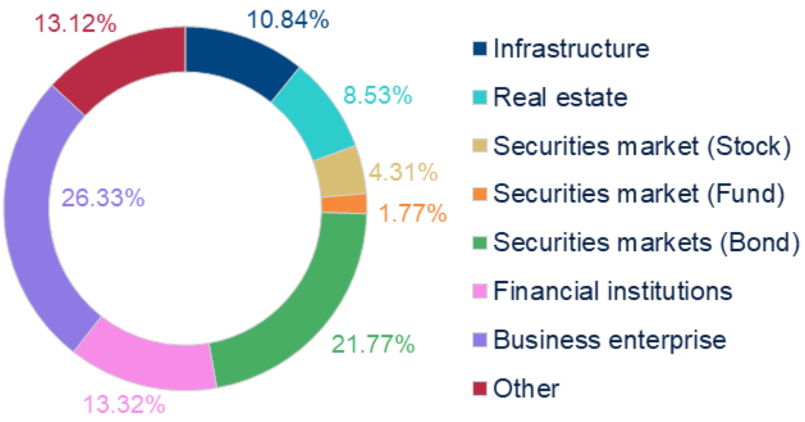
Source: China Trustee Association & BBVA Research.

The balance of rust loans grew moderately, with the balance of trust assets rising to RMB 3.9 trillion at the end of 2023 compared to RMB 3.3 trillion in the Q3, as the government encouraged the trust sector to help stabilize the real estate industry and reduce developers’ liquidity and refinancing risks.

Trust assets pivoting away from infrastructure and real estate to bond market

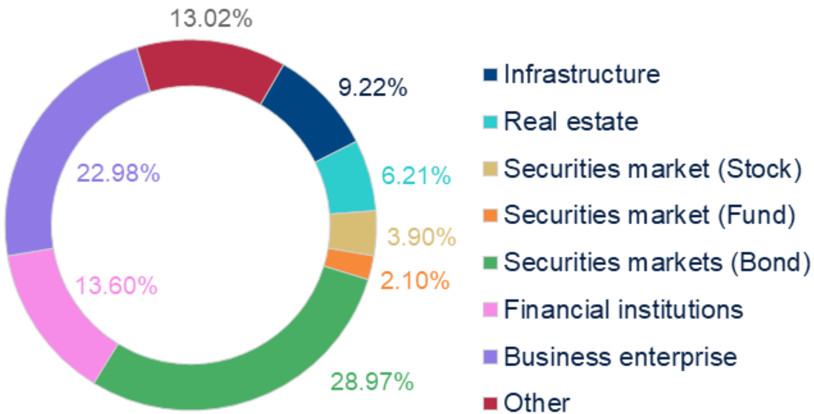
AUTHORITIES PUT STRICT MONITOR ON THE FINANCING CHANNEL FOR INFRASTRUCTURE AND REAL ESTATE

2022 Q4



Source: China Trustee Association & BBVA Research,

2023 Q4

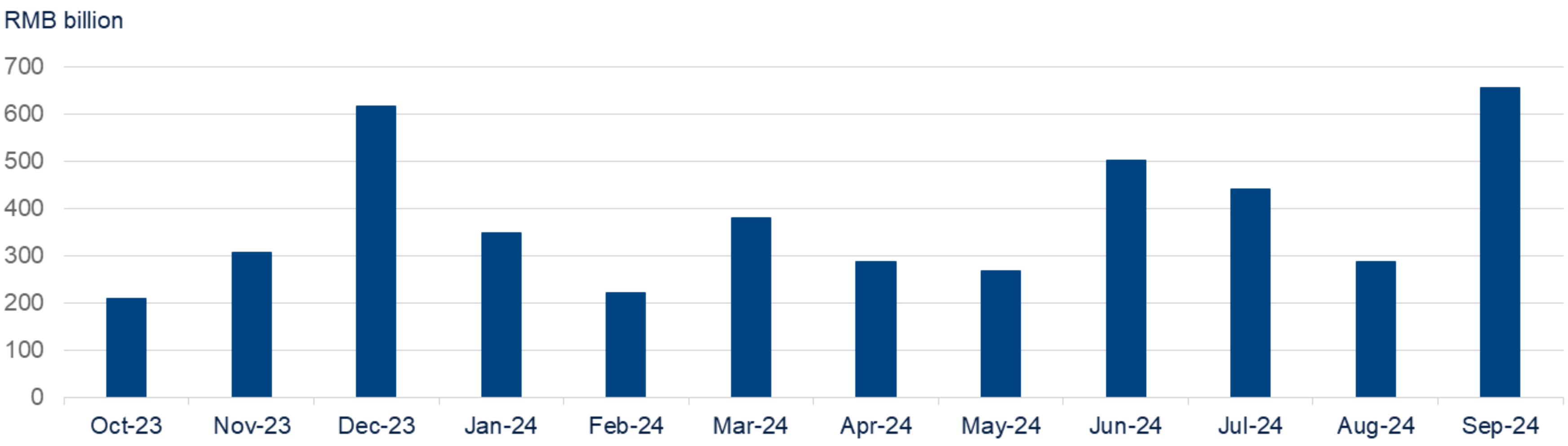


Source: China Trustee Association & BBVA Research,

Despite the trust sectors has scaled down its direct exposure to the real estate sector, the downturn in the real estate sector still poses significant credit risks to trust firms. Difficulties in the real estate market will affect the underlying asset quality and liquidity of trust schemes.

Short-term payment pressure on trust projects has increased significantly

TRUST EXPIRATORY STATUS

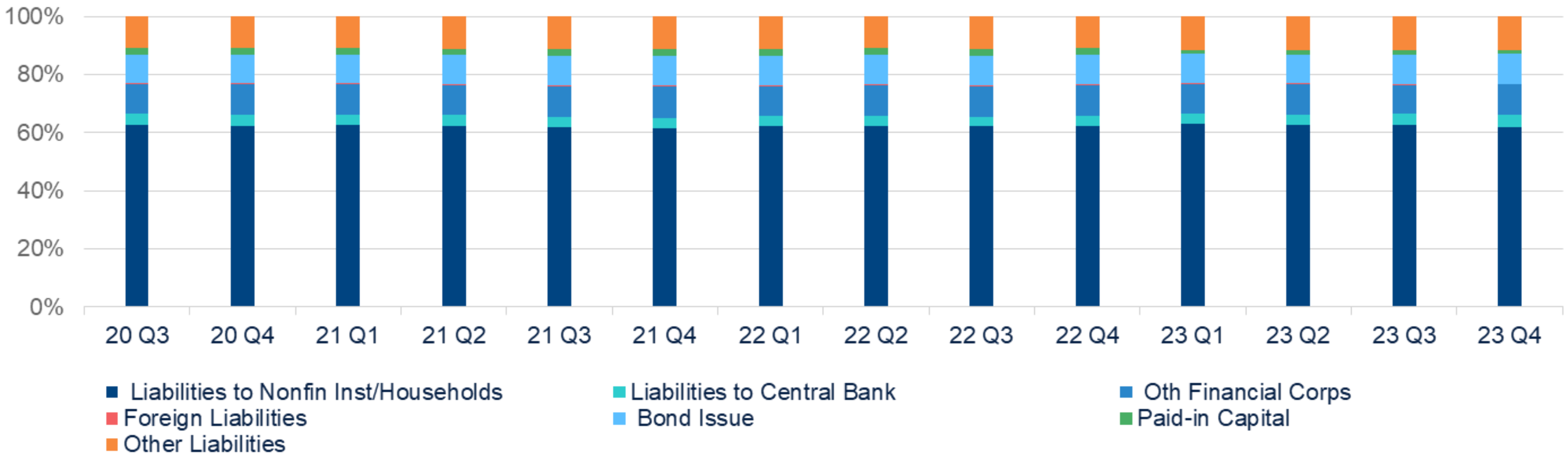


Source: China Trustee Association & BBVA Research.

The short-term repayment or refinancing pressure on trust projects will increase significantly. As of the end of the third quarter of 2023, the total number of trust projects due in the next 12 months increased by 22.1% from a year ago.

Banks' fund dependence of shadow banking system has edged up slightly

BREAKDOWN OF BANKS LIABILITIES



Source: Haver & BBVA Research.

The decline in interest rates in the interbank market has encourage smaller banks to take part in interbank activities, and the bank's reliance on nonbank financial institutions has slightly increased. However, there is a low possibility that shadow banking risks will spread more widely to the banking industry amid strict regulatory supervision.

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05

Banking sector outlook

Banking sector enter 2024 with greater headwinds

Banking sector enter 2024 with greater headwinds

Asset growth

Asset growth is likely to continue its growth in 2024, as the government continue pushing large lenders to channel new credit into public sector and help struggling real estate developer to finish their property projects and deliver quality property on time. Corporate lending is likely to drive the loan growth led by state owned banks. Loan to developer will also rise due to banks extending loans to help property developers complete the unfinished projects, while loan demand from households is expected to remain sluggish throughout 2024.

Asset quality

We expect China banks' asset quality will deteriorate in 2024. The key challenges will still come from the exposure to China property sector and local government financial vehicles (LGFVs). New nonperforming loan formation remains a major source of risk to asset quality.

Profitability

Banks' profitability will be challenged in 2024 as China's easing monetary policy will further squeeze the banking sector's average net interest margin (NIM). We expect there will be another three cuts in LPR in 2024, totaling 30 basis points (bps). This would further narrow the banking sector's average by another six to seven bps. If NIM declines further, the ROE will also deteriorate.

Capitalization

Banks' new capital rule will be generally favorable to Chinese banks as they are likely to enjoy incremental capital savings under slower risk weighted assets growth. However, lenders are subject to pressures of capital shortfall due to the prospective implementation of TLAC rule in 2025.

Shadow banking

Shadow banking as a provider of credit to the real economy will rose slightly in 2024 as the decline in interest rates in the interbank market will encourage smaller banks to use interbank funding facilities. However, there is a low possibility that shadow banking risks will spread more widely to the banking industry amid regulators' prudence regulation.

Disclaimer

This report has been produced by:

Chief Economist

Le Xia
le.xia@bbva.com

Lead Economist

Olga Gouveia
olga.gouveia@bbva.com

Betty Huang
Economist
betty.huang@bbva.com

ENQUIRIES TO: BBVA Research: Level 95, International Commerce Centre, Austin Road West, Kowloon, Hong Kong.
Tel. + 2582 3111 / Fax. +852-2587-9717 - bbvaresearch@bbva.com / www.bbvaresearch.com

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China Banking Monitor 2024

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Creating Opportunities