

Global Banking Industry Outlook

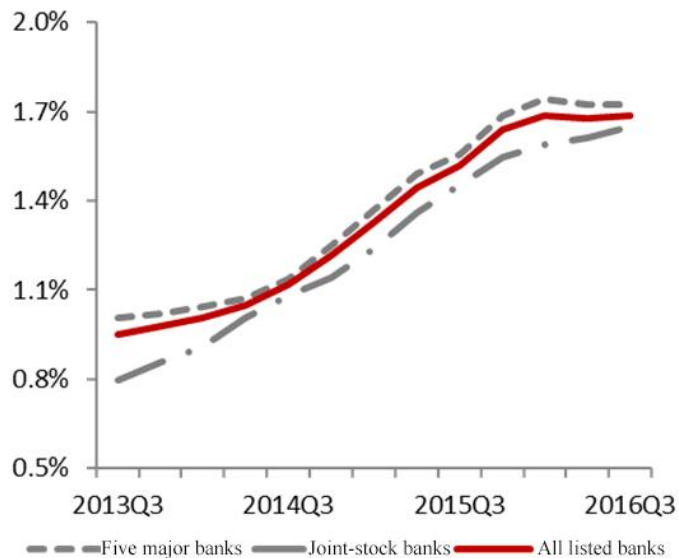
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Highlights

- In 2016, global large banks showed such features as rally of size, reduction of profitability and accumulation of systematic risk overall; China's listed banks scaled up steadily and witnessed stable yet quicker growth of profits. We expect that China's listed banks will grow by 3.0% year on year in 2016 and the NPL ratio increase to 1.70%.
- In 2017, the business performance of global banks will continue to be discrepant: the U.S. banking industry will be sound in general; the Eurozone banks will have to bear great pressure if they want to improve business results; the UK banking industry will face great uncertainties; Japanese banks will still embrace a tough year; China's listed banks, with relatively prudent operation, are expected to register the same growth rate of net profits as 2016 and score a slight rise of NPL ratio to 1.8%.

NPL Ratios of 16 Listed Banks



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Sharpen Core Competitiveness and Deepen Transformation for Sustainability

-- Global Banking Industry Outlook (2017)

In 2016, 30 Global Systematically Important Banks ("G-SIBs") showed such features as rally of size, reduction of profitability and accumulation of systematic risk. By countries, the U.S. banking industry was sound in general; the Eurozone banks embraced great challenges overall; the UK banking industry faced great uncertainties; Japanese banks saw a bleak profitability prospect while adopting negative interest rates; Chinese banks managed to maintain the stability of profitability, lift the proportion of non-interest income to a new high and slow the upswing of both NPL amount and NPL ratio, thus putting risks under control on the whole. Looking into 2017, large international banks will still expand their size slowly, find it hard to improve profits in the short run and continue to advance strategic transformation, but the probability of systematic risk will increase; in the context that China will further accelerate the shift of old and new growth engines and the connection between old and new economic models, listed banks will still meet the test that the operating environment is changing profoundly, but are expected to bottom out because transformation has made certain progress and adaptability is being boosted.

I. Operational Characteristics of G-SIBs

In retrospect of 2016, G-SIBs took on the following characteristics mainly in the course of operation and management:

First, size growth rallied amid the weak recovery. Against the backdrop of fragile resuscitation of global economy and heightened pressure from financial regulators since 2009, G-SIBs have been downsizing overall. From 2010 to 2015, asset scale of 30 G-SIBs has shrunk by 0.74% from USD48.27 trillion to USD47.91 trillion. When it came to the year 2016, the recovery of global economy still lacked in strength but was better than 2015, and the shrinking trend of G-SIBs was reversed. As of the end of 2016Q3, total assets of G-SIBs increased by USD2.68 trillion or 5.6% over 2015 to USD50.59 trillion. As the size expansion picked up speed, G-SIBs could extend greater support to the real economy, typically the proportion of loans in total assets has enlarged from 37.5% in 2014 to 38.4% at the end of 2016Q2. However, in large banks of some regions, e.g. large banks of Japan that adopted a "negative interest rate" policy in 2016, albeit a rapid expansion of asset scale, bank credit volume has been obviously contracted.

Second, the low-interest rate environment deprived of banks' high return on assets (ROA). Currently, major economies like the U.S., Eurozone, Japan and UK all set their interest rates at a low level. 14 out of the 30 G-SIBs are headquartered in the regions adopting negative interest rates. However, we must give considerable attention to the negative impact of "low interest rates": due to mismatch of banks' assets and liabilities in the aspects of maturity, interest rate sensitivity and currency, banking operation trends to yield narrower interest margin and less profits. In 2016H1, the average return on net assets of G-SIBs was 6.2%, decreasing by 1.9 percentage points compared with the same period of last year; and the average net interest margin arrived at 1.6%, falling by 10BPs from a year earlier. All of the above-mentioned trends are related to the widespread low interest rate policy worldwide.

Third, operation strategies had to align with the changes of political environment. In 2016, the promulgation of a series of policies and the political changes in major economies have exerted strong influence on the business development strategies of G-SIBs: China introduced the "Belt and Road" initiative, causing Chinese-funded G-SIBs to make presence in regions along the routes of

this initiative, and this initiative has also provided important business opportunities for international development of Chinese G-SIBs in the next 5 to 10 years; in consideration of Brexit, banks with regional headquarters or business line headquarters in London that rely on “passports” to do business in other European countries have to think over reshuffling their organizational structure in the EU, and some of them may move headquarters out of London; After Donald Trump won the presidential election, the U.S. financial regulation and supervision are expected to loose a bit. So large international banks having long been under stringent regulatory constraints of the U.S. will reassess their business development strategies in the country, not ruling out the possibility of investing more in the U.S.-based businesses.

Fourth, regulatory pressure propels lean management to become the mainstream of development. In the wake of the crisis, global financial supervision was strengthened. In this context, G-SIBs have gradually given up the "large and comprehensive" development strategy they pursued before the crisis, but resorted to the lean management of strictly controlling the cost as the mainstream of development.

The first is downsizing overseas business. Overseas business of G-SIBs contributed 45% to total income on average in 2010, but the figure declined by 6 percentage points to 39% in 2015.

The second is strengthening the development of digital channels. G-SIBs have been making greater efforts to improve digital channels in lieu of outlets step by step. In 2015, outlet number of some non-Chinese G-SIBs decreased by 20.3% over 2008, alongside a sharp increase of customers served via digital channels.

The third is cutting jobs radically to lower cost-to-income ratio. At the end of 2015, headcount of G-SIBs was 4.398 million, representing a reduction of 0.134 million or 2.96% over 2011. If not reckoning the headcount of Chinese-funded G-SIBs that is rising, their foreign counterparts have witnessed more than 10% reduction of headcount as of 2011. Steep job cuts helped G-SIBs control costs effectively and continue to decrease the cost-to-income ratio in spite of a diminution in their earnings. The cost-to-income ratio of 30 G-SIBs was 68.6% in 2011 and came down to 66.9% in 2015.

The fifth is "black swan" events breaking out frequently and systematic risk accumulating incessantly. In 2016, uncertainties in global financial industry soared and fluctuations of financial market became markedly violent, thereby adding too many uncertainties to the banking system. Right now, a number of signs are showcasing the increasingly higher fragility of banking system: at the end of 2016Q2, average PB ratio of G-SIBs was only 0.7x, over 85% of the G-SIBs have broken the net and one third of the G-SIBs scored a PB ratio of less than 0.5x; external rating and rating outlook of some G-SIBs were downgraded consecutively, producing significant negative impact on their liquidity management; NPL ratio of individual banks has surpassed 20%, significantly impairing their normal functioning.

2017 will be undoubtedly a tough year for G-SIBs. We expect that large international banks will present the following development tendencies:

First, size will continue to expand slowly. When trade de-globalization is ongoing and global economic recovery is weak, scale-up speed of G-SIBs will remain slow, at less than 5% throughout 2017.

Second, profitability will be hardly improved substantially. So far, there is no indication that Japan and European countries will discontinue the "negative interest rate" policy, European banks have no foundation for continuously improving their NPL problem, NPLs of Chinese banks seriously erode upon their profits; comparatively speaking, the Fed's rate hike will be conducive to NIM amelioration of large banks in the U.S. In general, there is no micro-foundation for G-SIBs to fully

improve profitability. We expect that profitability of G-SIBs will possibly drop further in 2017 with full-year ROE staying at about 6%.

Third, strategic adjustment will go on. In 2017, in face of external adversities, G-SIBs will press ahead with strategic transformation mainly in the following aspects: further optimizing the international business landscape; expediting the development of digital channels on the basis of science and technology and further reducing physical outlets and headcount.

Fourth, some banks will have a higher probability of systematic risk. In 2017, UK will continue the process of leaving the EU and the resulting financial risk will rise, which will deal a heavy blow to the financial market. What's more, the NPLs in the Eurozone and the high leverage of banks in emerging economies will emerge as the key ferments of systematic risk. All in all, there will be a higher probability for banks to expose to systematic risk in 2017.

II. Banking Industry Operation and Outlook of Major Economies

II.1 U.S. banking industry

II.1.1 Operating profile

Scale-up continued, while deposits and loans accounted for a larger share. As of the end of 2016Q3, the U.S. G-SIBs had total assets of USD10.8 trillion, up 3.3% from a year earlier with the growth picking up speed by 2.4 percentage points from the end of Q2; total liabilities were USD9.6 trillion, up 3% year on year with the growth rate 1.5 percentage points higher than the end of Q2. In terms of the structural changes of assets and liabilities, outstanding loans accounted for 27.9% of total assets, registering a year-on-year growth of 0.3 percentage points; deposits represented 62.9% of total liabilities, up 0.5 percentage points from a year earlier.

Profitability increased while operating efficiency continued to improve. In 2016Q3, the U.S. G-SIBs reported net profits of USD25.9 billion, up 2.0% from a year earlier; ROA and ROE was 1.0% and 9.6% respectively, up 0.2 and 0.5 percentage points from a year earlier; NIM was 1.8%, up 0.1 percentage points; the cost-to-income ratio stood at 64.0%, down 3.2 percentage points from a year earlier.

Asset quality improved and CAR edged up. As of the end of 2016Q3, the NPL ratio of U.S. G-SIBs fell by 0.1 percentage points year on year to 0.9%. In addition to the improvement of asset quality, their CAR also increased slightly. As of the end of 2016Q3, the tier 1 CAR rose by 0.9 percentage points compared with the same period of last year to 14.4%.

II.1.2 Regulatory environment

Republican candidate Donald Trump became the President-elect of the United States. His election will exert the following influence on the financial regulatory environment of the U.S.:

The first is to weaken the Fed's power. In the opinion of Trump, the Fed's QE policy has caused high inflation rate and depreciation of U.S. dollar but just played a limited role in inhibiting "asset bubbles". Besides, Trump also envisaged on how to build the relationship between U.S. Government and the Fed, i.e. allowing the Government Accountability Office to oversee the policy meetings of the Federal Open Market Committee (FOMC) in each year, strengthen surprise inspections of the Fed and ensure the Fed's policy is aligned with the economic development of the U.S.

The second is to loose the regulation and supervision of financial industry. Trump openly criticized the Dodd-Frank Act because it made banking lending and job creation increasingly difficult. Vice

President-elect Mike Pence also advocates the reduction of government interventions in economy. So it is foreseeable that they will devote to relaxing regulation and supervision of the U.S. financial industry.

II.1.3 Outlook

We expect that the U.S. banking industry will show the following three development trends in 2017:

Trend 1: Trump will unveil fiscal stimulus package to increase investors' expectation on economic growth and inflation. The medium & long-term market interest rates will continue to rise, while the yield curve will steepen. In general, these changes will be conducive to profit-earning of banks.

Trend 2: Trump may unveil plans to dismantle the Dodd-Frank Act, thus relaxing the financial regulatory environment and creating more opportunities for business development of banks.

Trend 3: The implementation of the Heightened Standards and the Enhanced Prudential Standards has demanded higher on the risk management practice of large banks. Therefore, large U.S. banks will attempt to build more scientific risk management framework and manage liquidity risk more prudently.

II.2 Eurozone banking industry

II.2.1 Operating profile

Growth of deposits and loans was differentiated, yet their growth rate decelerated. As of the end of 2016Q3, the deposit balance in the Eurozone totaled EUR16.88 trillion, a year-on-year decrease of 0.64%, with the growth rate decelerating by 2.06 percentage points from Q2; in the same period, the outstanding loans in the Eurozone totaled EUR17.45 trillion, a year-on-year increase of 2.04%, with the growth rate decelerating by 0.59 percentage points from Q2.

Profitability fell slightly and operating efficiency declined. As of the end of 2016Q3, ROA of major banks in the Eurozone was 0.4%, down 0.1 percentage points from Q2; ROE stayed unchanged from Q2 at 7.4%; NIM stood at 1.4%, decreasing by 0.1 percentage points from Q2; cost-to-income ratio was 66.8%, up 8.4 percentage points from Q2.

CAR kept rising and NPL ratio declined dramatically. As of the end of 2016Q3, tier 1 CAR of major banks in the Eurozone was 13%, up 0.3 percentage points from Q2, and their NPL ratio stood at 2.5%, down 0.5 percentage points from Q2.

II.2.2 Regulatory environment

The European Commission will continue to promote banking reform. In November 2016, the Commission proposed a series of measures aimed at improving the regulatory framework and ensuring that banks can continue to support the real economy. The proposals include the following key elements: 1. Measures to increase the resilience of EU institutions and enhancing financial stability, mainly including more risk-sensitive capital requirements, implementing methodologies that are able to reflect more accurately the actual risks, a binding Leverage Ratio (LR) and a binding Net Stable Funding Ratio (NSFR). 2. Measures to improve banks' lending capacity, say, enhancing the capacity of banks to lend to SMEs and to fund infrastructure projects, reducing the administrative burden of non-complex, small banks, making Capital Requirements Directive (CRD)/Capital Requirements Regulation (CRR) rules more proportionate and less burdensome for smaller and less complex institutions. 3. Measures to further facilitate the role of banks in achieving deeper and more liquid EU capital markets to support the creation of a Capital Markets Union, e.g. avoiding disproportionate capital requirements for trading book positions, reducing the

costs of issuing/holding certain instruments, avoiding potential disincentives for those institutions that act as intermediaries for clients in relation to trades cleared by CCPs.

NPL problem is drawing increasing attention. Recently, the European Banking Authority (EBA) said in a report that banks should take concrete actions, in particular active management of NPLs to improve profits in the current low-interest rate environment. EBA will continue to strengthen coordination with the European Central Bank (ECB), etc., actively promote the setup of banking union and reinforce regulators' cooperation in reducing NPLs. As for NPL control, European regulatory authorities stress fast, resolute tackling.

Regulatory reforms should go ahead steadily for the ultimate goal of enhancing total loss absorbing capacity (TLAC). Right now, European banks are carrying out the TLAC requirements on a steady footing. The TLAC framework sets an additional capital requirement for G-SIBs while meeting the capital requirement of Basel III. Different from the government's provision of assistance by using the money of taxpayers, TLAC is an internal bailout mechanism, requiring banks to independently weather through crisis first. The policy's implementation will further enhance risk absorbing capacity of the banking industry.

II.2.3 Outlook

In 2016H1, large European banks reported gains of trading income, reduction of operating expenses, decrease of restructuring expenses, decline of goodwill and intangible asset write-downs and improvement of business results. However, the prospect of economic recovery remains fragile, the "negative interest rate" policy will hardly quit in the short term, banks will find it more difficult to increase income and are still under huge transformation pressure.

II.3 UK banking industry

II.3.1 Operating profile

Retail deposits continued to grow while wholesale deposits remained elevated. As of the end of 2016Q3, total M4 in the UK reached GBP2,224.73 billion, growing by 6.2% year on year, quicker than Q2 by 2.4 percentage points. Among the M4, retail deposits and cashes amounted to GBP1,618.04 billion, up 4.0% year on year, 1 percentage point higher than Q2; wholesale deposits were GBP608.49 billion, up 13.2% year on year, 7.4 percentage points higher than Q2.

Retail loan growth slowed down while institutional loan growth picked up speed. As of the end of 2016Q3, outstanding retail loans stood at GBP1,303.64 billion, up 4.6% year on year, 0.1 percentage points lower than Q2. Specifically, real estate mortgage loans rose by 4.6% year on year to GBP1,147.2 billion while consumer credits grew by 6.8% to GBP126.19 billion. Outstanding loans of non-financial institutions totaled GBP562.39 billion, up 3.1% year on year. Outstanding net loans in the construction sector decreased by 3.4% year to year to GBP33.2 billion.

II.3.2 Regulatory environment

In 2016, the UK Parliament established the core status of the Bank of England in its economic and financial system, made the Prudential Regulation Authority (PRA) as a part of the Bank of England and set up the new Prudential Regulation Committee to end its subordinate role, all aimed at strengthening the cooperation of internal and external banking regulators and further normalizing the regulation of banks and also reflecting the government's determination to further heighten banking supervision.

In the future, the UK banking regulatory risk will arise mainly from the uncertainties of the negotiation on leaving the EU. Brexit will have significant negative impact on the UK's financial industry. The current focus of regulation is placed on how to prevent the outbreak of systematic

risk after the UK exits from the EU.

II.3.3 Outlook

In 2017, so many economic uncertainties of the UK will pose more challenges to its banks. As a result of Brexit, the "passporting" mechanism will be altered, the regulatory environment of the UK and the EU will become different and financial risk will be incurred, thus negatively affecting the operation and development of the world's large banks, especially challenging the UK-based but covering-EU business model of European and American large banks. To make up for the shares UK lost in the European market, it will possibly open wider to countries and regions outside the EU. To this end, UK must calibrate its financial regulatory system with those countries and regions. This may emerge as a key point of attracting financial institutions of those countries and regions, partly offsetting the Brexit's weakening of UK status as international financial center and thus sustaining the competitiveness of UK market.

II.4 Japan's banking industry

II.4.1 Operating profile

Monetary aggregates continued to expand while lending rate fell further. Due to the implementation of a new round of economic stimulus package, the growth of monetary aggregates in Japan continued to climb. As of the end of October 2016, the broad money supply (M3) totaled JPY1,271 trillion, an increase of 3.7% year on year. The annualized yield of long-term and short-term incremental loans of Japanese banks was 0.58% and 0.81% respectively, both down 0.1 percentage points from the same period of previous year.

Deposits and loans steadied higher with the growth of deposits still exceeding that of loans. Speaking of Japanese banks, as of the end of October 2016, their deposit balance was JPY656.8 trillion, up 3.9% from a year earlier; their loan balance was JPY504.2 trillion, up 2.4% from a year earlier.

Profitability fell sharply. In FY2016H1, the three Japanese G-SIBs reported combined net profits of JPY1,207.9 billion, down 11.9% year on year; average ROA was 0.4%, down 0.1 percentage points year on year; average ROE was 7.7%, down 1 percentage point year on year.

II.4.2 Regulatory environment

(1) FSA published the Financial Administrative Guideline for the new year

On October 21, the Financial Services Agency (FSA) published the Financial Administrative Guideline for 2016, specifying the priorities of regulatory policies in the new year: first, make efforts to counter "Japanese-style financial exclusion". In the new year, FSA will take actions to address the asymmetry of information and standards between financial institutions and companies and urge financial institutions to adopt the business model of customer-centered in real sense. Second, strengthen inspection on operation sustainability of regional banks. Based on the estimation of FSA, more than 60% of Japan's regional banks will suffer a loss by FY2024. In the new year, FSA will divide regional banks into "Type I banks", "Type II banks" and "Problematic banks" for categorized inspection and monitoring and urge them to study in depth own liquidity risk, credit risk, interest rate risk and profitability, among other issues.

(2) Cooperation between banks and FinTech companies is picking up speed

Japanese Government says in its Japan Revitalization Strategy 2016 that the government will join non-government forces in exploring the development and application of open Application Programming Interface (API). In this context, Japanese Bankers Association held the Workshop on

Open API, and the participants exchanged ideas and discussed such practical issues as bank API related standards and security. A relevant report will be prepared in the near term. In the sphere of regulation, FSA set up the Working Group on Financial System in order to probe into related regulatory orientations and priorities with reference to regulatory experience of the EU. In the meantime, Financial Information System Center (FISC) has started to amend the regulations on information security of financial institutions because the regulations in force now disregard bank API.

II.4.3 Outlook

Driven by the new round of stimulus package of the Japanese Government, Japan's banking industry is expected to have a better but not ideal operating environment. In 2017, Japanese banks will still face severe challenges.

First, Japan's economic growth remains relatively weak. Year to date, private consumption making up 60% of the GDP has been sluggish, with the quarter-on-quarter growth of merely 0.5% in Q3; private businesses were under-invested, with investment in this sector growing negatively quarter on quarter in Q1 and Q2 and being at par with the prior quarter in Q3.

Second, the negative interest rate policy will have lingering effects. The likelihood for already negative interest rates to fall further in near term has been reduced, but it is still very possible to maintain the existing QE scale. We expect that the negative interest rate policy will continue to deal adverse shocks to banking development of Japan in 2017.

III. China's Banking Industry Review and outlook

III.1 Operating situation of the banking industry in 2016Q3

In 2016Q3, the operation of listed banks took on the following characteristics: assets and liabilities continued to grow steadily but at a slower pace; profit growth picked up thanks to cost control to a degree; the change in the proportion of deposits and loans was mixed, non-interest income contribution was lifted to a new high of 30%; rise of both the NPL amount and NPL ratio was brought down, overall provision coverage ratio approached the regulatory red line; CAR steadied higher, loan-to-deposit ratio growth saw marked disparities.

III.1.1 Assets and liabilities continued to grow steadily yet at a slower pace

As of the end of 2016Q3, total assets and total liabilities of listed banks were RMB130.1 trillion and RMB120.5 trillion respectively, up 11.0% and 10.7% from a year earlier. The growth rate was down by 1.7 and 1.5 percentage points compared with the same period of 2015 respectively.

III.1.2 Profit growth picked up thanks to cost control in part

In 2016Q3, listed banks reported operating income and net profit of RMB2,800.08 billion and RMB1,074.75 billion respectively, up 2.1% and 3.5% from a year earlier. The growth rate decelerated by 7.7 and accelerated by 1.3 percentage points compared with the same period of last year. In 2016Q3, ROA and ROE of listed banks dropped by 0.1 and 2.2 percentage points year on year to 1.06% and 15.52% respectively.

In 2016Q3, cost-to-income ratio of listed banks was 26.42%, down 0.1 percentage points year on year. Listed banks further heightened cost management mainly by strictly controlling property and equipment expenditure and rationally reducing administrative and operating expenses, which contributed partially to the stability of banking profits.

III.1.3 The change in the proportion of deposits and loans was mixed, non-interest income contribution was lifted to a new high of 30%

As of the end of 2016Q3, deposit balance of listed banks represented 73.8% of total liabilities while the loan balance represented 51.3% of total assets, down 1.1 and 0.3 percentage points respectively year on year. In 2016Q3, non-interest income of listed banks contributed 31.8% to total income, up 5.0 percentage points year on year.

III.1.4 Rise of both NPL amount and NPL ratio was brought down, overall provision coverage ratio approached the regulatory red line

As of the end of 2016Q3, outstanding NPLs of listed banks amounted to RMB1.1 trillion, up 24.3% from a year earlier, 25.8 percentage points lower than the same period of 2015; NPL ratio, at 1.69%, rose by 0.2 percentage points year on year.

In 2016Q3, provision coverage ratio of listed banks stood at 162.3%, down 19.2 percentage points over the same period of 2015. The ratio of the five major banks and joint-stock banks were 153.6% and 178.4% respectively, down 24.5 and 10.8 percentage points from the same period of last year. In particular, the ratio of some listed banks has already fallen below the regulatory red line of 150%.

III.1.5 CAR steaded higher, loan-to-deposit ratio growth saw marked disparities

In 2016Q3, CAR, tier 1 CAR, and core tier 1 CAR of listed banks arrived at 12.9%, 10.6% and 10.0% respectively, up 0.5, 0.5 and 0.3 percentage points from the same period of 2015. As of the end of 2016Q3, loan-to-deposit ratio of listed banks was 75.0%, an increase of 1.8 percentage points year on year.

III.2 Review of the operating performance of listed banks in 2016

In light of the economic, policy, reform and competition factors, we expect the assets and liabilities of listed banks to grow by around 10.5% and 10.0% respectively in 2016; the net profit is estimated to grow by around 3.0%, an increase of 1.1 percentage points from last year; the NPL ratio becomes higher to around 1.70%.

III.3 Ten forecasts on the operation of listed banks in 2017

2017 is key to building China into a moderately prosperous country and achieving the goals set in the 13th Five-year Plan. China will further accelerate the shift of old and new growth engines and the connection between old and new economic models. We expect that China's economy will steady overall, structural adjustment will make crucial progress, but some deep-rooted conflicts and problems will still exist. In this background, China's listed banks will still face the test that their operating environment is changing profoundly. Since transformation has made certain progress and adaptability has been constantly boosted, banks' operation will remain sound.

First, size will continue to expand at double digit. Based on estimation, China's M2 is to grow by about 12% and non-government financing scale expand by about 13% in 2017. Based on the relationship between bank size and money supply/non-government financing volume as well as other considerations, e.g. industrial structure, we expect the balance sheet growth of listed banks to remain at around 11% in 2017. In addition, the joint-stock reform for listing of small and medium-sized banks will pick up speed, which will possibly amplify the size of listed banks.

Second, the rise of NPL ratio will be slowed. In 2017, new NPL ratio (dividing total loans by newly increased NPLs) of listed banks will be kept at a similar level as 2016. Besides, the rise of NPLs will be slowed because listed banks have accumulated more experience on management and disposal of NPLs and they are utilizing a variety of market-oriented disposals like asset securitization and debt-for-equity swap. We expect that NPL ratio of listed banks will edge up to about 1.8% in 2017.

Third, NIM is expected to reach the bottom of the L-shape and the businesses with interest difference are still challenged. Different from 2016, the impact of existing loan repricing will basically disappear in 2017, demands of real economy will remain stable and the one-year time deposit rate will be also stable generally, bringing down the pressure on NIM of banks. Noteworthily, the replacement of business tax with value-added tax was put into implementation on May 1, 2016 officially, while the business tax was levied in the first four months of 2016. For this reason, the effect of VAT in lieu of BT will still exist in 2017H1 compared with the same period of last year. Furthermore, banks are also actively making strategic adjustment to improve their NIM, e.g. pumping credit resources into SME business and personal banking with higher earnings, actively taking low-cost demand deposits. In general, NIM of listed banks will go downward further to about 2.1% but the declining momentum will be dampened a lot in 2017.

Fourth, contribution of non-interest income to total income will be kept above 30% steadily. In 2017, the growth of net fee and commission income will remain subdued due to the unsatisfactory performance of real economy, market-based businesses such as investment will have relatively limited growth potentials, and insurance business income will continue to soar higher as an important engine of fueling the growth of non-interest businesses. Considering that spread income growth is still being challenged, we expect that non-interest income of listed banks will contribute slightly higher, at about 32%, to total income in 2017.

Fifth, cost-to-income ratio will come to the inflection point. We expect that cost-to-income ratio of listed banks will nudge down to about 28% in 2017, mainly a result of cost-saving against the income-increasing pressure and the flourishing development of information technology. However, in the medium and long term, cost-to-income ratio will rise somewhat: interest rate liberalization is deepening, the fighting for professional management talents and specialized business talents is increasingly fierce, and the incentive mechanism will become more market-oriented; meanwhile, the tightening of regulatory requirements will force banks to increase strategic expenses and inputs in compliance work. In the light of international experience, leading large banks in Europe, the U.S. and Japan usually keep their cost-to-income ratio at around 60%.

Sixth, net profit growth rate will be basically flat. In 2017, listed banks will still encounter the following two issues when trying to increase their net profits: one is their operating income earning capability will be challenged, and another is the credit cost will continue to increase. With respect to NIM, although sound expansion of size will make up for the loss to a degree, interest income will still grow sluggishly and even edge down; in spite of the fast growth of non-interest income, if deducting the "other business cost" in exchange for the generation of other business (e.g. insurance) income, the net income may have only one-digit growth. Regarding credit cost, NPL amount of listed banks will still ascend. To keep provision coverage ratio no less than the regulatory red line of 150%, the provisions to be set aside will also increase, consequently eating banks' profits. In overall consideration, we expect overall growth rate of listed banks' net profits in 2017 will be the same as that in 2016.

Seventh, capital adequacy pressure will become heavier. In 2017, total assets of China's listed banks will maintain a two-digit growth, requiring much more capital, while the continuous increase of market, operational and compliance risks will also need more risk assets. In the context of zero growth of net profits and basic stability of dividend payout ratio, endogenous supplementation of capital will play a limited role. What's more, international regulation on the capital of China's big four banks is also heightened, e.g. adjusting the 2016 list of G-SIBs, asking them to meet the additional TLAC requirement.

Eighth, international development will seek for strategic optimization. In 2017, there will still be many uncertainties in economy and finance of the world and overall economy will resuscitate

slowly. In addition, risk factors such as Brexit, presidential elections in major countries and arrested globalization are increasing. As such, international development of banks will still be beset by a complicated environment. Plus the non-diminishing pressure on operation of local business and the significantly higher compliance risk due to enhanced foreign anti-money laundering regulation, we expect that listed banks will seek for strategic optimization in their internationalization drive in 2017.

Ninth, retail banking will enter into a new phase of development. Consumption is expected to sustain a stable growth in China in 2017, which may be as high as about 10.5%, obviously faster than the growth of investment and net export. In this context, we expect retail banking of listed banks to keep growing rapidly and even enter into a new phase of development in 2017. However, it is worth noting that the development of retail banking will remain uncertain mainly owing to the growth speed of residential mortgages and risk exposure to credit card business.

Tenth, FinTech will penetrate into traditional banking steadily. In 2017, China's listed banks will, on the basis of further deepening the layout of Internet finance, further explore how to apply big data, cloud, block chain, artificial intelligence and other new financial technologies into acquisition, investment and strategic cooperation, among other sectors, in diversified forms so as to sharpen brand-new core competitiveness.

China's listed banks should capture the structural opportunities in the shift of old and new growth engines and make efforts to promote innovation, deepen reform, control risks strictly and secure sound operation in order to support the development of real economy powerfully: first, follow the integrated operation trend echoing financial disintermediation and interest liberalization to realize the transformation of income model; seize the significant opportunities for development of personal banking and asset management business arising from residents' wealth growth and consumption upgrading to effect the transaction of business model; adjust regional and business landscape in line with the deepening of China's development strategy of key regions and the growth of emerging financial businesses like green finance and FinTech; leverage the advancement of information technology to improve financial service customization capability and operating efficiency and to facilitate the transformation of management model and service model.

Table 1: Forecasts on Key Indicators of Chinese Listed Banks (%)

Type	Key indicator	2015 (R)	2016				2017 (F)
			Q1(R)	Q2(R)	Q3(R)	Full year (E)	
Size	Asset growth rate	12.4	11.8	10.2	11.0	10.5	11
	Liability growth rate	12.0	11.5	9.9	10.7	10.0	10.5
Profit	Net profit growth rate	1.9	2.7	3.9	3.5	3.0	3.0
Structure	Loans/assets	51.1	51.3	51.0	51.3	51.5	52.0
	Deposits/liabilities	74.1	74.9	73.5	73.8	73	72.5
	Contribution of non-interest income	26.1	35.7	33.7	31.8	30.5	32.0
Quality	NPL ratio	1.64	1.69	1.68	1.69	1.70	1.80
	Provision coverage ratio	169.2	164.0	164.7	162.3	160	150
Capital	Capital adequacy ratio	12.8	12.7	12.8	12.9	13.0	13.0

Source: BOC Institute of International Finance

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