



## Global Banking Industry Outlook

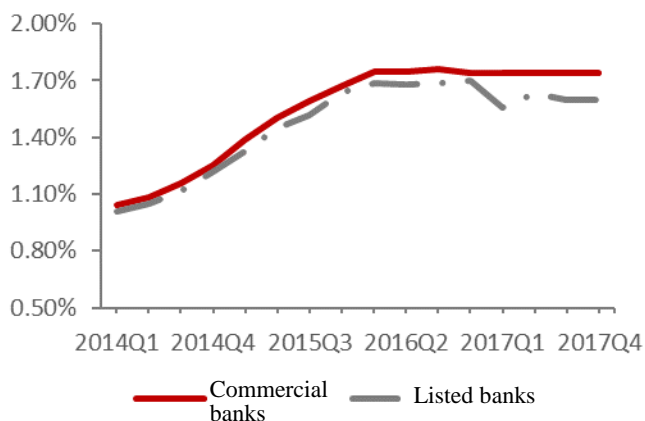
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### Highlights

- In 2018Q1, global banking industry made further progress. Specifically, China's banking industry maintained a good momentum of steady forward on a whole with controllable risks, while further improving the quality and efficiency of serving the real economy.
- Global banking industry is expected to improve further in general, yet with some potential hazards, in 2018Q2. The efforts of preventing and controlling financial risks by China's listed banks have driven regulation and supervision to become increasingly stricter, which will in turn produce far-reaching implications upon their operation and management.
- The present report will discuss digital currency and the evolution of Global Systemically Important Banks (G-SIBs).

**NPL Ratios of China's Banking Industry**



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**Note:** The 2014-2016 data on listed banks refer to those on 16 listed banks, and the 2017 data on listed banks refer to those on 26 listed banks.

## **Banking Industry Marching into a New Era of Transformation-based Development in a Stabler Operating Environment**

### **-- Global Banking Industry Outlook (2018Q2)**

Global banking industry made further progress in 2018Q1. U.S. banks operated prudently, Eurozone and UK banking industry steadily improved their operation, Japanese banking industry witnessed a stable operation, banks in Southeast Asia, BRICS countries and Australia earned more profits, but Indonesia reported deterioration in banking asset quality. China's banking industry generally maintained a good momentum of sound development with controllable risks, and further improved the quality and efficiency of serving the real economy. Looking into 2018Q2, global banking industry is expected to continue to operate in a stable environment, and march into a new era of transformation-based development.

#### **I. Operation of Banking Industry in Major Economies and Outlook**

##### **I.1 The U.S. banking industry maintained a good momentum of further improvement in operation**

###### **I.1.1 Review of operation throughout 2017**

As of the end of 2017Q4, the U.S. banking industry<sup>1</sup> sized up steadily, with total assets increasing by 3.79% year on year and 1.03% quarter on quarter to USD17.42 trillion and total liabilities rising by 3.67% year on year and 1.14% quarter on quarter to USD15.46 trillion; profit growth rate eased, with net profit amounting to USD164.82 billion in 2017, 3.5% lower than a year ago; risk profile was basically stable, with tier 1 capital adequacy ratio ("CAR") growing by 24 BPs over the same period of last year and dropping by 8 BPs versus the prior quarter to 13.11% and NPL ratio falling by 21 BPs year on year and remaining at par with last quarter to 1.2%.

###### **I.1.2 Estimation on operation in 2018Q1**

Trump's tax reform plan was passed in late 2017, and has officially entered into force at the start of 2018. In a short term, large banks will make less profits because of the influence from one-off deferred tax assets impairment. But in the medium and long term, tax reform will promote economic growth, expansion of banking credit and earnings growth of asset management business, which will significantly elevate profits together with a cut in the banking tax rate from 35% to 21%. By our estimate, U.S. banks will operate well in 2018Q1, by a steady expansion of size, obvious increase of profit and continuous reduction of risk exposures.

###### **I.1.3 Outlook for operation in 2018Q2**

The U.S. banking industry is expected to take on the following characteristics in 2018Q2: Stable size expansion will go on with assets and liabilities registering a respective growth of 4.03% and 4.12% over end-2017 to USD17.76 trillion and USD15.75 trillion around; profitability will enhance further with net profit increasing by 1.14% over a year ago to USD48.85 billion around; risk profile will continue improving, tier 1 CAR will stand at about 13.26%, up 11 BPs year on

<sup>1</sup> Banking data are sourced from the Federal Deposit Insurance Corporation ("FDIC").

year, and NPL ratio will remain 1.10% around, down 13 BPs year on year.

## **I.2 Banking operation in the Eurozone further improved steadily**

### **I.2.1 Review of operation throughout 2017**

As of the end of 2017Q4, size of the banking industry in the Eurozone expanded steadily, with outstanding deposits totaling to EUR17.55 trillion, a year-on-year increase of 3.17%, and outstanding loans adding up to EUR18.31 trillion, a year-on-year increase of 4.15%; showing an enhancement of profitability, major banks<sup>2</sup> reported ROA for 2017 at 0.52% and ROE at 8.36%, up 0.01 and 0.46 percentage point year on year respectively; risk level declined further, with tier 1 CAR of major banks growing by 0.74 percentage point compared with the same period of last year to 13.6%, and their NPL ratio dropping by 0.74 percentage point year on year to 2.41%.

### **I.2.2 Estimation on operation in 2018Q1**

The economic growth rate of the Eurozone in 2017 is the fastest in the decade. The confidence in early 2018 is still at a high level, which is conducive to the overall operation of the banking industry; the Eurozone will possibly exit from the QE policy, and thus boost the confidence of the banking industry; key interest rates will maintain the current level, providing a predictable interest rate environment for banking development. Therefore, we estimate that European banking operation will make further progress while remaining stable in 2018Q1: the size will grow moderately, operating efficiency will continue to improve, risk indicators will remain stable, and asset quality will further improve slightly.

### **I.2.3 Outlook for operation in 2018Q2**

Eurozone banking industry is expected to have the following characteristics in 2018Q2: the size will keep on growing steadily, with deposits and loans rising to EUR17.85 trillion and EUR18.61 trillion respectively; profit-making may be changeable, with ROA and ROE of major banks hovering around 0.55% and 8.61% respectively; bank capital will remain stable, and asset quality will turn better steadily, with CAR staying at around 13.60% and NPL ratio at 1.94%.

## **I.3 UK banking industry made improvements steadily**

### **I.3.1 Review of operation throughout 2017**

As of the end of 2017Q4, the largest five banks in the UK<sup>3</sup>, easing the momentum of scaling down, reported assets at GBP5.04 trillion, down 4.5% compared with the same period of last year; net profit increased sharply, e.g. the largest five banks made net profit of GBP12.9 billion, being 14.5 times that of a year ago; capital adequacy and asset quality improved further, with average tier 1 core CAR and tier 1 CAR adding by 7.2% and 4.3% year on year to 14.3% and 17.1% respectively, and average NPL ratio falling by 0.38 percentage point quarter on quarter to 2.12%.

### **I.3.2 Estimation on operation in 2018Q1**

The Brexit talk remains the largest factor influencing banking development in the UK. Besides, EU has successively released a series of new regulatory rules since 2018, putting UK banks at increasingly higher compliance cost. By our estimate, UK banks will continue to operate stably in 2018Q1, exposing to low risks overall: size-down will be steady, net profit will trend to grow further, CAR will possibly edge down, and NPL ratio will remain stable.

<sup>2</sup> Including 38 banks, e.g. ABN AMRO.

<sup>3</sup> Namely, HSBC Holdings, Barclays Bank, Royal Bank of Scotland, Lloyds Bank and Standard Chartered Bank.

### **I.3.3 Outlook for operation in 2018Q2**

The 2008 financial crisis still has a lingering impact on the largest five banks in the UK. They will further downsize assets and have estimated total assets at GBP4.9 trillion in 2018Q2; according to the market expectation, the Bank of England will hike interest rate in May, and the largest five banks will keep the momentum of profit growth; the Brexit talk will remain largely uncertain, and the five largest banks will continue with prudent operation, without any obvious change in asset quality and capital adequacy over 2018Q1.

### **I.4 Japanese banking industry operated stably**

#### **I.4.1 Review of operation throughout 2017**

The size of Japan's largest five banks<sup>4</sup> kept swelling stably as of the end of 2017Q4. Their combined assets, at JPY842 trillion, grew by 1.0% over last quarter; net profit improved thanks to short-term factors, testified by the fact that the largest five banks scored net profit of JPY2,312.8 billion in April-December 2017, rising by 10.3% over the same period of last year mainly attributable to the short-term factors including earnings from stock sell-off and transfer of provisions into the profit base; the risk profile was good, with average tier 1 CAR of the largest five growing by 31 BPs quarter on quarter and 147 BPs year on year to 14.14%, and average NPL ratio falling by 4 BPs quarter on quarter and 16 BPs year by year to 0.77%.

#### **I.4.2 Estimation on operation in 2018Q1**

The Bank of Japan ("BoJ") does not change its easing monetary policy, and the negative interest rate policy still puts pressure upon profit level and profitability of banks' principal business. We estimate that Japanese banks will maintain the stability of their business results in 2018Q1: the size will further expand moderately, profit growth will remain stable, and risk profile will be good.

#### **I.4.3 Outlook for operation in 2018Q2**

By our estimate, Japan's five largest banks will take on the following characteristics in 2018Q2: they will continue to size-up moderately with total assets growing to JPY855 trillion; net profit level will remain stable, with the single-quarter figure reaching JPY750 billion to JPY800 billion; risk profile will ameliorate further, with tier 1 CAR reaching a good level of 14.09%-14.24%. The NPL ratio is expected to decline to 0.65-0.70% around with the improvement of corporation performance.

### **I.5 Major member countries of ASEAN showed varied performance in banking operation**

#### **I.5.1 Review of operation throughout 2017**

Asset size steadied bigger. As of the end of 2017Q4, total assets of Malaysian, Thai and Indonesian banks grew by 2%, 3.8% and 10% year on year to MYR1.85 trillion, THB18.4 trillion and IDR7,387 trillion, respectively.

However, they performed differently in profit-making. Profit before tax of Malaysian banks increased by 11% year on year to MYR36.2 billion, while net profit of Thailand's and Indonesia's banking industry added up to THB187.3 billion and IDR226 trillion, down 6% and up 18% year on year respectively.

Risk profile was good. As of the end of 2017Q4, CAR and NPL ratio of Malaysia's banking industry arrived at 17.1% and 1.54% respectively, up 0.6 and down 0.07 percentage point year on

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<sup>4</sup> Including Bank of Tokyo-Mitsubishi UFJ Ltd., Mizuho Financial Group, Inc., Sumitomo Mitsui Financial Group, Resona Holdings and Sumitomo Mitsui Financial Group.

year; the two figures of Thailand's banking industry were 17.95% and 3.08% respectively, up 0.18 and 0.09 percentage point compared with the same period of last year; CAR and NPL ratio of Indonesian banks rose by 0.25 percentage point and kept fundamentally the same with a year earlier at 23.18% and 2.9% respectively.

### **I.5.2 Estimation on operation in 2018Q1**

On January 25, 2018, the Bank of Malaysia raised interest rate for the first time since July 2014, which would affect the development of real estate market to a degree but benefit the increase of banks' net interest margin; in 2018, the Thai government plans to invest USD47 billion in the three coastal provinces in the east for the purpose of rejuvenating local backward economy and stimulating credit demand; Indonesia is dedicated to improving the environment of doing business, and this sets to encourage direct investment growth and credit demand increase. We expect Malaysian and Indonesian banks to sustain stable operation and Thai banks still to face the pressure of rising NPLs and falling profit in 2018Q1.

### **I.5.3 Outlook for operation in 2018Q2**

With respect to size, total assets of Malaysian, Thai and Indonesian banks are expected to grow by 3%, 5% and 8% year on year to MYR1.91 trillion, THB18.7 trillion and IDR7,588 trillion respectively.

In terms of profit, estimated profit before tax of Malaysian banks is to increase by 3% year on year to MYR9.5 billion, while net profit of Thai and Indonesian banking industry is expected to decline by 4% and grow by 30% year on year to approximately THB46.8 billion and IDR74 trillion respectively.

In regard to risk, CAR and NPL ratio of Malaysia's banking industry will arrive at 17.5% and 1.58% respectively, representing a growth of 0.1 and a fall of 0.07 percentage point year on year; the two figures of Thailand's banking industry will be 17.9% and 3.14% respectively, up 0.31 and 0.03 percentage point compared with the same period of last year; CAR and NPL ratio of Indonesian banks will rise by 0.56 and fall by 0.09 percentage point compared with a year earlier to 23.3% and 2.85% respectively.

## **I.6 Outlook for banking development in BRICS countries and Australia**

### **I.6.1 Banking industry in South Africa will maintain basic stability**

2017 saw a stable expansion of banking size in South Africa. As of the end of Q4, total assets grew by 5.8% year on year to ZAR5.15 trillion and total liabilities increased by 3.6% to ZAR4.06 trillion. Net profit, registering a big leap-forward, totaled to ZAR84.67 billion across the year, representing a year-on-year growth of 5.82%. Risk exposure was improved, with core tier 1 CAR rising by 0.58 percentage point year on year to 13.43% on average and NPL ratio dropping by 0.02 percentage point to 2.84%.

In 2018Q1, Cyril Ramaphosa was elected president of South Africa. He promised in the State of the Union Address in 2018 that the domestic economy will return to a stable growth rate of 5%, which will contribute to the sound development of the banking industry. We estimate that the operating performance of South African banks will remain stable in Q1: the scale will continue to be stable, profit will decline slightly, and risk conditions will be stable.

Looking forward to 2018Q2, it is expected that the banking industry in South Africa will exhibit the following characteristics: the scale will continue to increase, with assets reaching ZAR5.2-5.4 trillion and liabilities reaching ZAR4.15-4.2 trillion; net profit will remain flat year on year at ZAR21-22 billion around; in the context of controllable overall risks, CAR will continue to rise.

### **I.6.2 Banking operation in Brazil will turn better**

In 2017, assets volume of Brazilian banking industry enlarged slightly to BRL8.63 trillion, up 1.43% year on year; profitability enhanced significantly with combined profit of the four largest banks<sup>5</sup> totaling to BRL57.6 billion, up 14.59% year on year; risk picture remained basically stable, with CAR of Brazilian banks rising by 1.24 percentage points year on year to 17.97% and NPL ratio falling by 0.1 percentage point to 3.7%.

In 2018Q1, the benchmark interest rate in Brazil fell for the eleventh time in a row, the IOF for domestic outward remittances was raised, S&P and Fitch downgraded Brazil's sovereign credit rating from BB to BB-. In spite of certain challenges, Brazilian banking industry still had a strong ability to recover, and the operation remained stable: the size and profit trend was stable, and the asset quality was good.

Ahead, Brazilian banking industry is expected to show the following characteristics in 2018Q2: the size will increase steadily, credit inventory and asset size will increase by 2% year on year; profitability level will rise, and net profit will reach BRL35 billion, representing a year-on-year increase of nearly 7%; overall risk control is predicated, CAR will remain at about 18%; and NPL ratio will stay at 3.6-3.7%.

### **I.6.3 Operation of Russian banks will continue to improve**

In 2017, the size of Russian banking industry expanded steadily. The assets reached RUB85.2 trillion, representing a year-on-year increase of 6.0%; due to provisioning, the profit decreased, and annual net profit decreased by 17.7% year on year to RUB790 billion; capital adequacy was slightly lower, with CAR dropping by 1 percentage point over last quarter to 12.1% and core tier 1 CAR falling by 0.7 percentage point to 8.5%; non-performing loans decreased steadily, the ratio of non-performing loans to enterprises remained at 6.4%, and that to individuals dropped from 7.9% at the beginning of the year to 7.0%.

In 2018Q1, the Russian central bank announced to lower its key interest rate by 0.25 percentage point. S&P's raised its sovereign rating of Russia from junk BB+ to investment grade BBB-, and raised the ratings of some large banks. It is estimated that the operation of Russian banking industry will improve: the size will continue to grow, the profit will keep unchanged from last year, and CAR and NPL ratio will remain stable.

Russian banking industry is expected to take on the following characteristics in 2018Q2: size-up will appear obviously with assets hitting RUB86-87 trillion; profit level will remain flat with a year ago with net profit standing between RUB600 billion to RUB800 billion; capital adequacy will remain stable at 12%-12.5%; NPL ratio will stay steady, with non-performing corporate loans and non-performing personal loans standing at 6.2-6.5% and 7.2-7.5% respectively.

### **I.6.4 Indian banking industry will fall under higher risk pressure**

In 2017, the growth rate of Indian banking industry stabilized, and the major banks<sup>6</sup> reported assets at approximately INR108.07 trillion, up 10.12% year on year; the liabilities were around INR100.13 trillion, up 10.00% year on year; profitability improved, and the major banks realized a net profit of INR304.3 billion, representing a year-on-year increase of 27.17%; asset quality

<sup>5</sup> Including Banco do Brasil, Banco Itau SA, Banco Bradesco and Santander Bank.

<sup>6</sup> Including 15 top banks, namely State Bank of India, HDFC Bank, ICICI Bank, Punjab National Bank, Bank of Baroda, Bank of India, Axis Bank, Canara Bank, Union Bank of India, IDBI, Central Bank of India, Syndicate Bank, Indian Overseas Bank, Yes Bank and Kotak Bank.

deteriorated, CAR increased, NPL ratio<sup>7</sup> was 9.53%, up 2 percentage points year on year, and tier 1 CAR was 10.83%, rising by 0.38 percentage point year on year.

In 2018Q1, India's macro economy continued to improve. The Indian government has completed reforms such as amendment of the Bankruptcy Act, and the release of economic growth potential has contributed to the development of Indian banking industry. However, the banking industry still has hidden concerns, including a prominent imbalance and contradiction in structure, unresolved problems with non-performing assets, and troubles with bank internal control. It is estimated that Indian banking industry can still maintain stable growth: the size will present steady growth, profitability will improve, and risk indicators tend to deteriorate, with tier 1 CAR of the major banks falling to about 10% and their NPL ratio reaching 10.2%.

Looking into 2018Q2, Indian banking industry is expected to show the following characteristics: the size will grow steadily with the assets of major banks increasing to INR113.5 to 114.0 trillion, up 5.0-5.5% from the beginning of the year; the profitability will be good, and the major banks will achieve a net profit of INR171.2 -176.5 billion, representing an increase of 12.5-16.0% year on year; the risk profile is worthy of attention, while the major banks will keep their tier 1 CAR at above 10% and control their NPL ratio within the range of 9.8-10.5%.

### **I.6.5 Australian banking industry will remain stable**

In 2017, Australian banking industry sized up from the previous quarter but sized down over a year ago. The asset size reached AUD4.53 trillion, a quarter-on-quarter increase of 0.7% and a year-on-year decrease of 1.0%. Net profit increased significantly, and the net profit for the year was AUD35.91 billion, a year-on-year increase of 27.5%; capital adequacy hit a record high, and NPL ratio operated at a low level. CAR reached 14.7%, an increase of 10 BPs from the previous quarter, and NPL ratio continued to drop to 0.37%.

In 2018Q1, the Australian economy continued to grow, making it the advanced economy without walking into recession for the longest period of time (27 years), and also offering more potential for banking business growth. Therefore, we estimate that the development of the Australian banking industry is stable: the scale has increased slightly, the net profit has grown steadily, capital adequacy ratio has continued to rise slightly, and the non-performing loan ratio is at a relatively low level.

Looking ahead to 2018Q2, Australian banking industry is expected to take on the following characteristics: the size will continue to grow with assets of AUD4.6 trillion; net profit will increase slightly to AUD9.8 billion; CAR and NPL ratio will remain stable with the former rising slightly and the latter staying at a relatively low level of below 0.4%.

## **II. China's Banking Industry Review and Outlook**

### **II.1 Banking operation in 2017**

In 2017, China's banking industry generally maintained a good momentum of sound development at a controllable-risk level, and further improved the quality and efficiency of serving the real economy. Both assets and liabilities increased at a slower speed; growth rate of net profit picked up, but profitability declined; deposits accounted for a smaller proportion, loans took up a bigger proportion while non-interest income managed to contribute increasingly more; the NPL ratio remained stable, and allowance-to-NPL ratio grew; CAR held steady while loan-to-deposit ratio continued to rise.

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<sup>7</sup> Indicators data in the report are estimated weighted average figures of single indicators of the 15 major banks in India, e.g. NPL ratio and tier 1 CAR.

### I.2.1 Assets and liabilities grew at a slower speed

As of the end of 2017, total assets and total liabilities of China's commercial banks were RMB252.4 trillion and RMB232.9 trillion respectively, up 8.68% and 8.40% from a year earlier. The assets and liabilities of China's Big Five were RMB92.8 trillion and RMB85.6 trillion respectively, up 7.18% and 7.05% from a year earlier; the assets and liabilities of joint-stock banks were RMB45.0 trillion and RMB41.9 trillion respectively, up 3.42% and 2.72% from a year earlier; the assets and liabilities of urban commercial banks were RMB31.7 trillion and RMB29.5 trillion respectively, scaling up by 12.34% and 11.86% on a year earlier; the assets and liabilities of rural commercial banks were RMB32.8 trillion and RMB30.4 trillion respectively, expanding by 9.78% and 9.64% year on year.

As of the end of 2017, total assets and total liabilities of listed banks<sup>8</sup> were RMB150.1 trillion and RMB139.1 trillion respectively, up 7.5% and 7.3% from a year earlier. The growth rate was down by 4.5 and 5.2 percentage points compared with the same period of 2016 respectively (Figure 1 and Figure 2).

Figure 1: YoY Growth of Assets

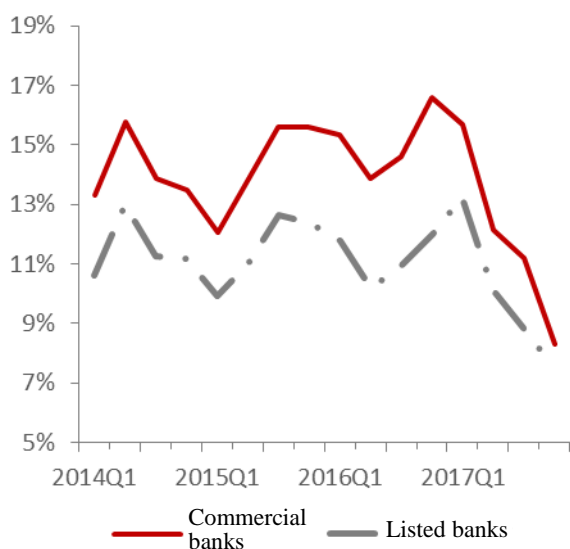
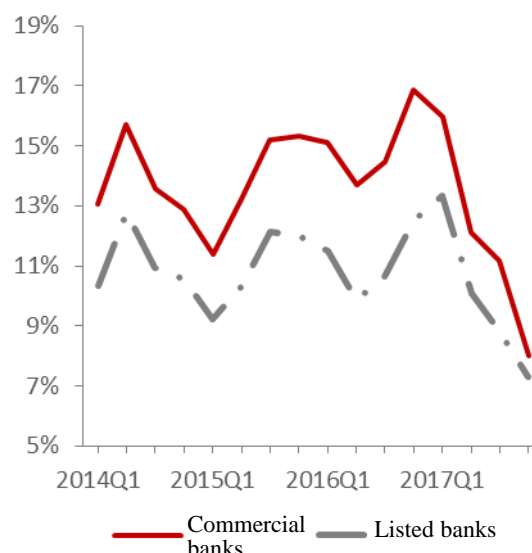


Figure 2: YoY Growth of Liabilities

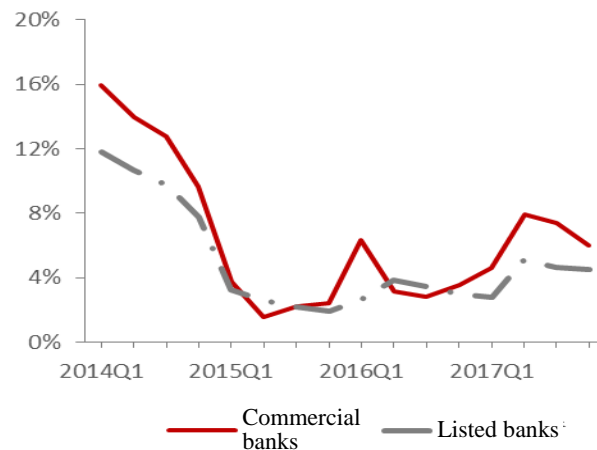


### I.2.2 Net profit growth picked up speed but profitability declined further

As of the end of 2017, China's commercial banks reported cumulative net profit for the year at RMB1.7 trillion, up 5.99% year on year. The growth rate was up 2.45 percentage points from a year earlier. Listed banks are estimated to maintain a 4.5% around growth rate of net profit throughout 2017, down 1.5 percentage points over 2016 (Figure 3).

<sup>8</sup> For the purpose of the Report, data for 2017 and onward are the figures about the 26 commercial banks which are listed in China's A-share market, including the five largest commercial banks (ICBC, ABC, BOC, CCB and BOCOM), joint-stock commercial banks (Merchants Bank, SPDB, Minsheng Bank, CITIC Bank, Industrial Bank, Everbright Bank, Huaxia Bank and Ping An Bank), urban commercial banks (Bank of Beijing, Bank of Nanjing, Bank of Ningbo, Bank of Jiangsu, Bank of Hangzhou, Bank of Shanghai, Bank of Guiyang and Bank of Chengdu), and rural commercial banks (Wuxi Rural Commercial Bank, Changshu Rural Commercial Bank, Jiangyin Rural Commercial Bank, Wujiang Rural Commercial Bank and Zhangjiagang Rural Commercial Bank). Data for 2016 and prior years are the figures about former 16 A-share-listed banks. Data for 2017Q4 are estimated.

Figure 3: YoY Growth of Net Profit



In 2017, ROA and ROE of commercial banks stood at 0.92% and 12.56%, down 0.06 and 0.82 percentage point from a year earlier. Specifically, ROA of large commercial banks decreased by 0.05 percentage point from 2016 to 1.02%; ROA of joint-stock commercial banks fell by 0.05 percentage point from 2016 to 0.83%; ROA of urban commercial banks declined by 0.05 percentage point from 2016 to 0.83%; and ROA of rural commercial banks went down 0.11 percentage point from 2016 to 0.90%.

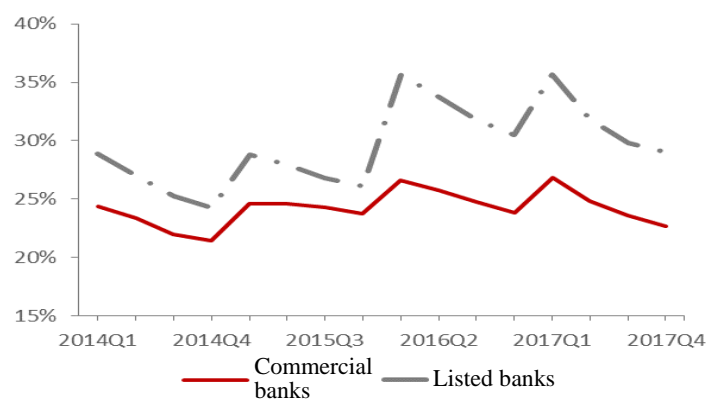
In 2017, cost-to-income ratio of commercial banks was 31.58%, up 0.47 percentage point year on year. And the cost-to-income ratio of listed banks is estimated at 30.89%, up 2.97 percentage points year on year.

### I.2.3 Deposits/liabilities declining, loans/assets rising, and non-interest income/total income fell

As of the end of 2017, commercial banks' deposits accounted for 76.13% of their total liabilities, a decrease of 0.12 percentage point from 2016, and loans accounted for 49.69% of total assets, representing an increase of 1.86 percentage points from 2016. It is estimated that in 2017, the ratio of listed banks' deposits to total liabilities will be 72.5%, down 0.5 percentage point year on year, and the proportion of loans in total assets will be 52.5%, up 1.0 percentage point year on year.

In 2017, non-interest income of commercial banks accounted for 22.65%, down 1.15 percentage points from a year earlier. Non-interest income of listed banks will make an estimated contribution of 29.0% to total income, down 1.5 percentage points year on year (Figure 4).

Figure 4: Non-interest Income/Total Income



## II.2.4 NPL ratio remained stable, allowance-to-NPL ratio rallied

As of the end of 2017, outstanding NPLs of commercial banks amounted to RMB1.7 trillion, up 15.77% from a year earlier, 2.89 percentage points lower than the same period of 2016; NPL ratio, at 1.74%, was at par with 2016. Among them, NPL balance of large commercial banks was RMB772.5 billion, representing a year-on-year decrease of 0.46% which marked the first-time decline since 2013, and the NPL ratio was 1.53%, down 0.15 percentage point from the end of 2016; NPL balance of joint-stock commercial banks was RMB385.1 billion, up 13.03% year on year which was 21.32 percentage points lower than 2016, and the NPL ratio was 1.71%, down 0.03 percentage point from the end of 2016; urban commercial banks' NPL balance was RMB182.3 billion, reporting a year-on-year increase of 21.70% which was 1.80 percentage points lower than 2016, and the NPL ratio was 1.52%, up 0.04 percentage point from the end of 2016; NPL balance of rural commercial banks was RMB356.6 billion, up 51.81% year on year which scored an increase of 25.66 percentage points from 2016, and the NPL ratio was 3.16%, increasing by 0.67 percentage point compared with the end of 2016 (Figure 5 and Figure 6).

Figure 5: Growth of NPL Balance

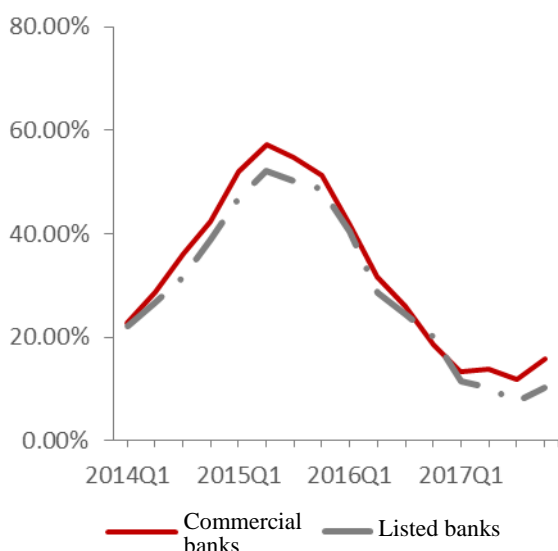
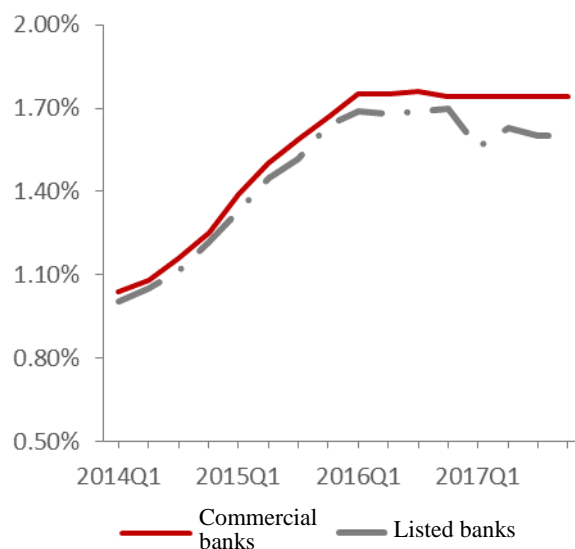


Figure 6: NPL Ratio



As of the end of 2017, allowance-to-NPL ratio of commercial banks stood at 181.42%, up 5.02 percentage points over the end of 2016. Specifically, the ratio of large commercial banks ascended by 17.84 percentage points from the end of 2016 to 180.45%; the ratio of joint-stock commercial banks increased by 9.58 percentage points compared with the end of 2016 to 179.98%; the ratio of urban commercial banks declined by 5.41 percentage points from the end of 2016 to 214.48%; and the ratio of rural commercial banks fell by 34.79 percentage points over the end of 2016 to 164.31%.

As of the end of 2017, NPL balance of listed banks is estimated at RMB1.32 trillion, representing a year-on-year increase of 10.27% which eases by 9.84 percentage points from 2016; the NPL ratio is 1.60%, down 0.1 percentage point from 2016; and the allowance-to-NPL ratio is 170.0%, up 10.0 percentage points from the end of 2016.

## II.2.5 CAR grew and loan-to-deposit ratio increased further

As of the end of 2017, CAR, tier 1 CAR, and core tier 1 CAR of commercial banks was 13.65%, 11.35% and 10.75% respectively, up 0.37 percentage point, 0.1 percentage point and unchanging

from the previous year. Specifically, CAR of large commercial banks ascended by 0.42 percentage points from 2016 to 14.65%; the ratio of joint-stock commercial banks increased by 0.64 percentage point over 2016 to 12.26%; the ratio of urban commercial banks rose by 0.33 percentage points from 2016 to 12.75%; and the ratio of rural commercial banks fell by 0.18 percentage point over 2016 to 13.30%. It is estimated that CAR of listed banks will remain the same with 2016 at 13.0% by the end of 2017.

As of the end of 2017, the loan-to-deposit ratio of commercial banks was 70.55%, up 2.94 percentage points from a year earlier. Listed banks are estimated to increase their loan-to-deposit ratio by 0.74 percentage point over 2016 to 76.22% at end-2017 according to estimation.

## II.2 Outlook for banking operation in 2018

### II.2.1 Operating environment of banks in Q1

Year to date, the following factors have exerted a big influence on the operation of banks:

**The macro-economy continued to improve.** The increasingly better performance of macro-economy in 2017 has been carried into 2018. Fixed asset investment, total retail sales of consumer goods and aggregate imports & exports reported varied growth. Banking institutions and entrepreneurs sector continued to boost their confidence. According to the PBOC's *Bankers' Survey Report, 2018 Q1*, bankers' macroeconomic confidence index was 81.9%, up 2.8 percentage points from the previous quarter. Overall loan demand index was 70.9%, up 5.2 percentage points from the previous quarter. In the meanwhile, the monetary policy remained stable and slightly tight in order to effectively support the deleverage in the financial industry. In February, the inter-bank weighted average interest rates and the weighted average interest rate of pledged repurchasing, among other key market rates, edged up from the same period of last year. GDP and M2 are expected to grow by 6.9% and 8.7% around in Q1 respectively. On the one hand, the macro-economy continues to provide a stable operating environment for the banking industry. The recovery of the real economy will further stimulate the gradual recovery of credit demand. And on the other hand, the monetary policy which remains stable but has tightened slightly drove the tightening of liquidity and the upward shift of average market rates, which thus favoring banks' interest margin business and becoming a positive factor of supporting the growth of banking performance.

**Supervision and regulation continued to tighten.** Since the beginning of the year, regulatory authorities such as the CBRC have continued their regulatory thinking in 2017 to rectify market disorders and prevent and control key business risks. The CBRC issued the *Circular on Further Deepening Banking Market Disorders* on January 13, and successively released the *Management Measures for Large-value Risk Exposure of Commercial Banks* and the *Management Measures for Entrusted Loans of Commercial Banks*, etc., to regulate related business development of commercial banks. The *Interim Measures for Equity Management of Commercial Banks* and the *Guidelines on Conduct Management of Employees in Banking Institutions* issued by the CBRC have further improved the corporate governance of commercial banks and the standardized management of bank employees. On February 27, the CBRC issued the *Circular on Adjusting the Regulatory Requirements for Loan Loss Provisions of Commercial Banks*, and the PBOC published the No. 3 Announcement No. 3 of 2018 in support of the issuance of capital-replenishing bonds by banking institutions, both of which are positive for commercial banks to strengthen NPL disposal, enhance the capability of supplementing capital and pumping more resources into the real economy. In addition, since the beginning of the year, the CBRC and the PBOC, etc. have imposed large-amount fines and increased penalties for illegal operations and major cases.

In conclusion, we expect net profit of listed banks to grow by about 4.8% year on year, assets and

liabilities to rise by around 8.5% and 8.0% respectively, and NPL ratio to fall slightly to 1.59% or so in 2018Q1.

## II.2.2 Outlook for operation

2018 is the first year for the full implementation of the requirements of the 19<sup>th</sup> National Congress of the CPC in China, and it is also the first year for the new administration to govern. The good economic performance in 2017 has won the time and space for economic transformation and development in 2018. It is expected that the economy will continue to operate steadily in 2018, the three tough battles of combating major risks, targeted poverty alleviation, and pollution prevention and control will achieve positive progress, and the fundamentals of long-term economic improvement will continue to be consolidated and developed, but structural problems and deep-seated contradictions in economic development will still exist. The report delivered at the 19<sup>th</sup> National Congress of the CPC mapped out the blueprint for China's future development and pointed out the direction for banking development in the future. In the following three quarters of 2018, its impact on the banking industry will mainly focus on the following aspects.

**First, the supply-side structural reform will boost banks' optimization of the industrial structure.** Through advancement of “cutting overcapacity and excess inventory, deleverage, reducing costs, and strengthening points of weakness”, banks will be able to optimize credit supply, actively adjust the credit structure, effectively support and guide the economic transformation and upgrading, and channel more resources out of highly-polluting, high-energy-consuming, and inefficient industries into emerging high-tech industries such as advanced manufacturing, big data and cloud computing and emerging industries such as biomedicine and new energy.

**Second, innovation-driven development will provide opportunities for digitalization of banks.** The report delivered to the 19<sup>th</sup> National Congress of the CPC clearly stated that innovation is the primary driving force for development, and “Internet Plus” has also been promoted as a national strategy. New economic forms, represented by e-commerce, have placed higher demands on the financial industry. At present, the use of cutting-edge technologies such as big data and cloud computing has become an important development direction for many commercial banks. To become digital, it is key for commercial banks to upgrade and perfect product systems and improve financial services on the basis of new technologies and thus meet the needs of new economic forms.

**Third, coordinated regional development will provide a new direction for the regional layout of banks.** According to the report delivered at the 19<sup>th</sup> National Congress of the CPC, we need to put in place new, effective mechanisms to ensure coordinated development of different regions. We will create networks of cities and towns based on city clusters, enabling the coordinated development of cities of different sizes and small towns, and speed up work on granting permanent urban residency to people who move from rural to urban areas. The Belt and Road Initiative, the coordinated development of the Beijing-Tianjin-Hebei region, and the development of the Yangtze Economic Belt, as well as the construction of Xiongan New Area and the Guangdong-Hong Kong-Macao Greater Bay Area have provided new growth poles for commercial banks, while the advancement of projects relating to urban rail transit, pipeline networks, and ecological protection have further clarified the key areas and directions of financial service provisions to the real economy.

**Fourth, the Beautiful China initiative will encourage commercial banks to practice green, sustainable development.** The report delivered at the 19<sup>th</sup> National Congress of the CPC said, building an ecological civilization is vital to sustain the Chinese nation's development, and it is a key part of building a beautiful China. The ecological advancement has proposed fresh requirements on commercial banks' development of green finance-related business. Green credit

and green bond will usher into a new period full of development opportunities.

**Fifth, opening-up on all fronts will facilitate the international drive of commercial banks.** The report delivered at the 19<sup>th</sup> National Congress of the CPC called for making new ground in pursuing opening-up on all fronts. With the gradual advancement of relevant policies, China's banking industry is facing new opportunities for international development. The Belt and Road Initiative, serving “brought in” and “going global” enterprises, internationalization of the renminbi, and support for two-way investment have become important areas of obtaining support from banks while they seek internationalization.

**Sixth, the people's ever-growing needs for a better life will help commercial banks develop retail banking.** Currently, the principal contradiction facing Chinese society has evolved. What we now face is the contradiction between unbalanced and inadequate development and the people's ever-growing needs for a better life. The people's increasing needs for a better life have become more and more diversified. In response, commercial banks need to improve financial services and support consumption upgrade of residents.

**Seventh, the rural vitalization strategy requires commercial banks to assume social responsibilities and support inclusive finance.** The report delivered at the 19<sup>th</sup> National Congress of the CPC required to pursue a rural vitalization strategy and address the issues relating to agriculture, rural areas, and rural people. Addressing these issues should have a central place on the work agenda of the Party. In recent years, commercial banks have practiced the development philosophy of engaging in inclusive finance, and continued to expand the financial coverage of serving counties and villages, but there are still weak links in rural finance. The implementation of the rural vitalization strategy requires commercial banks to assume due responsibilities, innovate products and services according to local conditions, and fully utilize FinTech and other means to improve the availability, access and satisfaction of financial services.

**And eighth, do not cross the risk line, which demands higher on the development of risk management system by commercial banks.** According to the report delivered at the 19<sup>th</sup> National Congress of the CPC, we must take tough steps to forestall and defuse major risks, carry out targeted poverty alleviation, prevent and control pollution, and forestall systemic financial risks. This requires commercial banks to earnestly implement regulatory requirements, always prioritize the prevention of financial risks, further improve the risk management system, ameliorate the risk monitoring, measurement and control system across all processes, all businesses and all products, and comprehensively enhance the risk management capability.

## II.2.3 Forecasts on operation indicators

**Table 3: Forecasts on Key Indicators of Chinese Listed Banks in 2018 (%)**

Type	Key indicator	2015 (R)	2016 (R)	2017 (E)	2018	
					Q1 (E)	Full year (F)
Size	Asset growth	12.4	12.0	7.5	8.5	9.0
	Liability growth	12.0	12.5	7.3	8.0	8.8
Profit	Net profit growth	1.9	3.0	4.5	4.8	4.5
Structure	Loan percentage	51.1	51.5	52.5	53.0	53.0
	Deposit percentage	74.1	73.0	72.5	72.0	72.0
	Contribution of non-interest income	26.1	30.5	29.0	30.0	30.0
Quality	NPL ratio	1.64	1.70	1.60	1.59	1.60
	Allowance-to-NPL ratio	169.2	160.0	170.0	170.0	165.0
Capital	CAR	12.8	13.0	13.0	13.0	13.0

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