

## China Banks: Moderating Growth with Structural Optimization

China's banking sector will continue to navigate a complex operating environment in 2026, balancing the dual mandates of supporting economic growth and preventing systemic risks. We expect the sector's credit risk profile to remain broadly stable, albeit with intensifying polarization among institutions. While large state-owned banks maintain strong capital buffers and resilient asset quality, supported by recent government capital injections, smaller regional banks face mounting pressures. A prolonged low-interest-rate environment has squeezed net interest margins ("NIMs") to historical lows, weighing heavily on banks' profitability and internal capital generation. Consequently, lower-tier banks with weaker asset-liability management and greater exposure to vulnerable borrowers are increasingly relying on external capital instruments, raising concerns over the risks associated with hybrid capital instruments. Looking ahead, the sector's asset expansion will likely moderate as it transitions towards structural optimization, with well-positioned national players expected to further enhance their market leadership.

### Policies Balancing Growth and Risk Prevention

China's banking sector in 2026 will continue to operate under a policy framework emphasizing both growth promotion and risk prevention. Against a backdrop of moderate macroeconomic headwinds, we expect monetary policy to remain accommodative. The central bank will likely sustain ample liquidity through tools such as reserve requirement ratio cuts and interest rate reductions to support real economy growth. At the same time, regulatory priorities will increasingly focus on the quality and structure of credit extension, with resources accelerating towards the "five major articles" (technology finance, green finance, inclusive finance, pension finance, and digital finance).

Preventing and resolving systemic financial risks remains paramount, particularly with respect to credit vulnerabilities at small and medium-sized financial institutions. Regulators are actively advancing risk mitigation through mergers and acquisitions, recapitalization, and other mechanisms to address challenges at smaller banks. In addition, prior comprehensive local government debt resolution measures have materially alleviated asset quality pressures on some regional and joint-stock banks.

### Moderating Asset Expansion and Diverging Asset Quality

In 2025, total assets of commercial banks reached RMB406.35 trillion, representing a year-on-year growth of 9.00%, down from 9.50% in 2024 and 11.11% in 2023. The deceleration was primarily due to weaker borrowing needs amid the deep adjustment in the real estate sector and ongoing local government debt resolution efforts, which have curtailed the financing scale of traditional infrastructure projects. Concurrently, regulatory guidance has shifted away from pursuing aggressive credit growth. Instead, it increasingly focuses on the high-quality deployment of financial resources toward the real economy, particularly the "five major articles" and advanced manufacturing. Looking ahead to 2026, we expect the banking sector's asset expansion to continue at a moderate pace, reflecting the sector's ongoing shift from scale-driven growth to structural optimization. Underpinned by their stronger capital positions, large state-owned banks are likely to outpace other peers, and to further increase their market share.

In terms of asset quality, Chinese banks' overall non-performing loan ("NPL") ratio remained broadly stable at around 1.5% in 2024 and 2025, as property-related risk exposure has moved past the phase of concentrated deterioration and credit risks related to local government financing vehicles ("LGFVs") have remained broadly controllable amid ongoing debt-resolution efforts. However, asset quality has diverged across sectors and regions. Weak risk resilience among micro, small and medium-sized enterprises during the economic slowdown has led to rising defaults, while softer household income has pushed up non-performing ratios for personal loans. As a result, asset-quality pressure is more evident at smaller banks with deeper exposure to lower-tier borrowers, particularly regional banks in less developed areas.

### **Profitability Under Pressure from Prolonged NIMs Compression**

The profitability of Chinese banks continues to face downward pressure. The sector's net interest margin narrowed to 1.42% in 2025 from 1.52% in 2024. Consequently, key profitability indicators softened further, with return on assets ("ROA") declining to 0.60% and return on equity ("ROE") falling to 7.78%, compared to 0.63% and 8.10%, respectively, in the prior year. Persistent NIMs compression has been driven mainly by policy-led rate cuts aimed at supporting the real economy; a decline in higher-yielding assets, particularly property development loans and residential mortgage loans amid prolonged property market downturn; and the replacement of higher-yielding LGFV loans with lower-yield government bonds as part of local government debt resolution efforts. In addition, the continued shift towards time deposits has slowed the repricing of Chinese banks' liabilities. During periods of falling interest rates, their funding costs tend to lag the decline in asset yield, resulting in a squeeze on NIMs.

We expect the overall pace of NIMs compression among Chinese banks is likely to moderate. Banks with stronger pricing discipline, stable access to low-cost funding and more diversified revenue streams are likely to navigate the cycle earlier and see a recovery in profitability. By contrast, banks with weaker customer franchises, less effective asset-liability management and greater asset-quality pressure may continue to face margin compression, with their long-term profitability and credit profiles coming under increasing strain.

### **Capital Adequacy Broadly Stable though Rising Hybrid Capital Risks for Smaller Players**

China's banking sector maintained broadly stable capital adequacy at end-2025. Although the sector's capital adequacy ratio and core Tier 1 capital ratio edged down to 15.46% and 10.92%, respectively, from 15.74% and 11.00% at end-2024, overall capital buffers remained adequate. Large state-owned commercial banks remained the sector's strongest-capitalized institutions in 2025. The Ministry of Finance injected RMB500 billion into Bank of China, China Construction Bank, Bank of Communications and Postal Savings Bank of China through issuing special government bonds, strengthening their core Tier 1 capital and overall loss-absorption capacity. We believe the capital injections also enhance these banks' ability to fulfil policy mandates, including supporting credit expansion in strategic sectors while maintaining balance-sheet resilience.

In contrast, profitability constraints have weakened the internal capital generation of most other banks, making them increasingly reliant on the issuance of hybrid capital instruments, such as Tier 2 capital bonds and perpetual bonds, to replenish capital. At the same time, some small and medium-sized banks face significant pressure on their capital adequacy, owing to deteriorating asset quality and a concentrated schedule of capital instrument maturities or redemptions. We have observed cases where weaker rural commercial banks have opted not to exercise call options on their capital bonds and deferred interest payments.

## Key Financial Data of China's Commercial Banks

	2021	2022	2023	2024	2025
Total Assets (RMB billion)	281,770	312,750	347,490	380,515	406,349
- Growth rate (%)	8.79	10.99	11.11	9.50	9.00
NPL (%)	1.73	1.63	1.59	1.50	1.50
Provision coverage (%)	196.91	205.85	205.14	211.19	205.21
NIMs (%)	2.08	1.91	1.69	1.52	1.42
ROA (%)	0.79	0.76	0.70	0.63	0.60
ROE (%)	9.64	9.33	8.93	8.10	7.78
Capital adequacy ratio (%)	15.13	15.17	15.06	15.74	15.46
Core tier-1 capital adequacy ratio (%)	10.78	10.74	10.54	11.00	10.92

Source: National Financial Regulatory Administration and Lianhe Global's calculations

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