Making China's financial system better serve the real economy

People's Bank of China

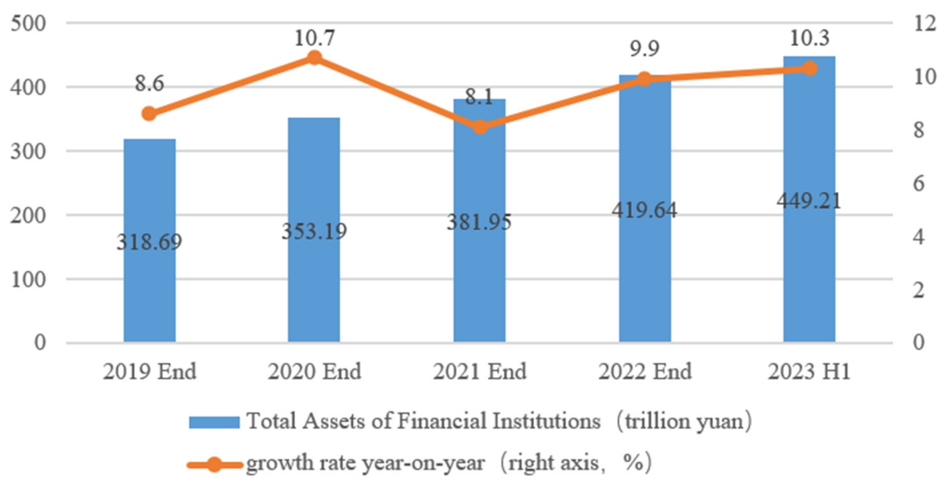
Finance is at the centre of the modern economy and the lifeblood of the real economy. In recent years, China has continued to improve the quality and efficiency of financial services provided to the real economy, and a virtuous circle between finance and the real economy has gradually taken shape. The structure of the financial system is closely related to a country's history, institutional setting and political system, which vary from country to country. The primary purpose of China's financial system is to serve the real economy. Bank credit, the bond market and the stock market have different priorities and work together to support the development of the real economy.

1. Overview of China's financial system

China's financial system has continued to develop in the past decades, and now covers a wide range of institutions conducting banking, securities, insurance, funds and futures businesses in a fully competitive manner. In recent years, the total assets of financial institutions have increased at an average annual rate of more than 9%. By the end of the second quarter of 2023, the total assets of financial institutions stood at CNY 449.21 trillion, an increase of 10.3% over the same period the previous year. China's banking system and bond and stock markets have provided strong support for long-term stability and healthy development of the economy and society. Fintech has effectively supported inclusive finance and improved the quality and efficiency of financial services.

Total assets of financial institutions

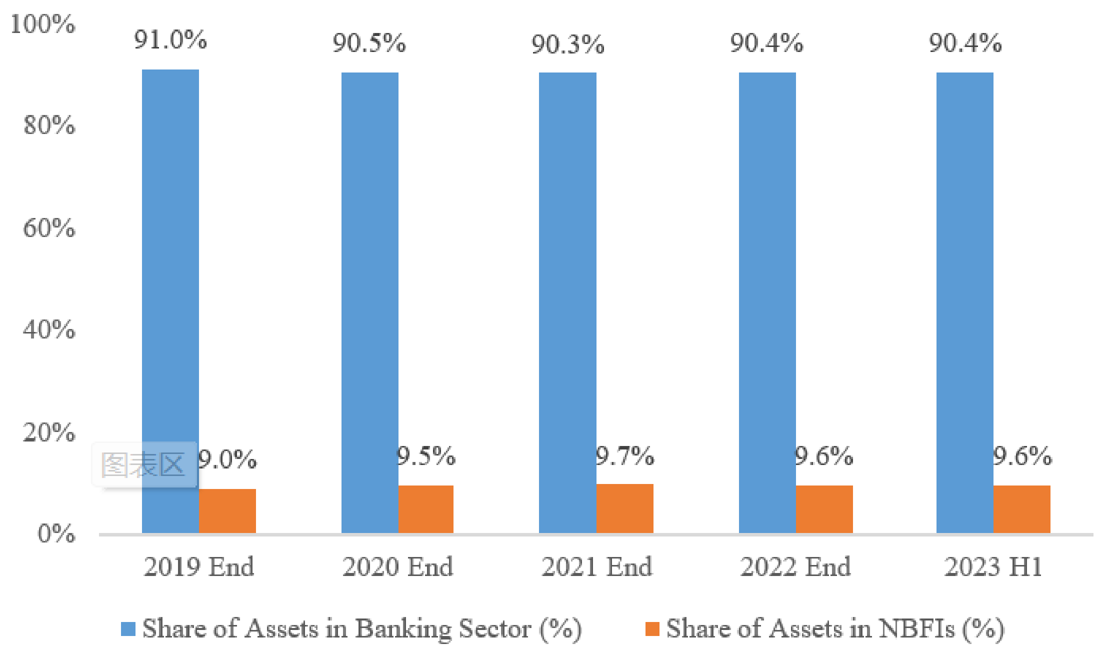
Figure 1



Source: People's Bank of China.

Broken down by types of financial institution, the banking sector has played a dominant role, accounting for more than 90% of total financial sector assets. Non-bank financial institutions (NBFIs) including securities and insurance firms have developed rapidly, and their share of total assets has stabilised at around 9.5% since 2021. In general, the assets in China's banking, securities and insurance industries account for, respectively, 90%, 3% and 7% of total financial industry assets. In addition to their growing share in total assets, NBFIs have played an increasingly important role the money market and bond market, thereby becoming important players in monetary policy transmission. At present, NBFIs are the most important net borrowers in the market. During the first half of 2023, the amount of repurchase and interbank borrowing conducted by securities and insurance companies and other NBFIs totalled CNY 403.2 trillion.

Share of banking sector and NBFIs in total financial assets — Figure 2



Source：People's Bank of China.

Broken down by indirect and direct financing, total social financing (TSF)[1] has continued to grow rapidly, the banking sector remains the dominant channel of financing and direct financing channels have become more streamlined. By the end of September 2023, the stock of TSF was CNY 372.5 trillion, an increase of 9% year on year (Table 1). During the first three quarters of 2023, the cumulative increase in TSF was CNY 29.3 trillion, an increase of CNY 1.4 trillion over the same period in 2022. Among the various components of TSF, CNY loans issued by financial institutions to the real economy increased by CNY 19.5 trillion, an increase of CNY 1.5 trillion over

[1] TSF refers to the total amount of funds received by the real economy from the financial system. It can be measured by its flow or by its stock. It includes CNY loans, foreign currency loans, entrusted loans, trust loans, undiscounted bankers' bills of acceptance, corporate bonds, government bonds, domestic equity financing by non-financial enterprises, etc.

the same period in 2022, accounting for 66.6% of the increase in TSF in the same period. At present, indirect financing dominated by banks accounts for about 71% of the total stock of TSF and direct financing (corporate bonds, government bonds and equity financing) accounts for about 29%, a figure which has remained stable in recent years.

Stock of TSF to the real economy

Table 1

	TSF stock（CNY trillion）	Growth rate (yoy, %)	Share of CNY loans (%)	Share of net financing of corporate bonds (%)	Share of government bonds (%)	Share of equity financing on the domestic stock market by non-financial enterprises (%)
End-2019	251.41	10.7	60.3	9.4	15	2.9
End-2020	284.75	13.3	60.2	9.7	16.2	2.9
End-2021	314.12	10.3	61	9.5	16.9	3
End-2022	344.22	9.6	61.7	9	17.5	3.1
End-Q3 2023	372.50	9.0	62.5	8.4	17.8	3

Sources: People's Bank of China.

The rapid development of fintech in China has helped promote financial inclusion. In recent years, new technologies such as AI, big data, cloud computing, distributed ledger and e-commerce have integrated deeply with traditional financial services. This integration has improved financial innovation, created new businesses in areas such as mobile payment, fintech credit and online wealth management, and also promoted financial inclusion by extending coverage of basic financial services, especially to underserved customers in remote areas. Empowered by digital technologies, traditional financial institutions have increased support to small and micro businesses, effectively making financing more accessible. As of the end of the third quarter of 2023, outstanding inclusive loans to micro and small businesses (MSBs) stood at CNY 28.7 trillion, an increase of 16.9% compared with the beginning of the year. In addition, the coverage and quality of inclusive finance has improved. These types of loans were extended to 42.605 million clients (those with outstanding loans), an increase of 3.728 million (8.75%) compared to the beginning of 2023 (See Box A for details).

Box A

Rapid development of fintech has helped promote financial inclusion

Fintech has developed rapidly in China in recent years. Products and applications are increasingly diversified, while financial services have seen a big jump in efficiency and inclusion.

Greater use of electronic payment, mobile payment in particular, has made basic financial services more accessible. Fintech companies can serve underserved customers in some underdeveloped regions, because the marginal cost is low. During Covid-19, the use of electronic payment further increased. The penetration rate of mobile payment is now close to 86% in China. Almost all domestic deposits, withdrawals and remittances can be executed in real time.

Fintech has improved lending services to small and micro businesses as well as the self-employed. Empowered by digital technologies, financial institutions can digitalise every aspect of credit approval and risk control procedures, which enables them to provide services more quickly, target risks better, and serve more people. Meanwhile, reliance on collateral is reduced, which aligns well with the financing needs of small and micro businesses, which typically borrow in small amounts but need the money urgently.

The People's Bank of China (PBOC) is encouraging financial institutions to strengthen the use of fintech, make innovations in risk assessment, improve the efficiency of loan approval, and expand the coverage of small and micro clients. Empowered by fintech, financial institutions can digitalise client acquisition and expand service scenarios. For example, some banks have developed online products called "quick loans to MSBs", which enables contact-free services on a 24/7 basis, and completes the loan approval process (registration – identification – amount estimate – loan application – loan disbursement) within three minutes, much faster than the previous cycle of one to two weeks.

Looking ahead, the PBOC will continue to implement projects to improve financial institutions' ability to provide services to MSBs, encourage financial institutions to boost investment in inclusive financial technology, develop featured credit products and make them more convenient for the financing of small, medium-sized and micro enterprises.

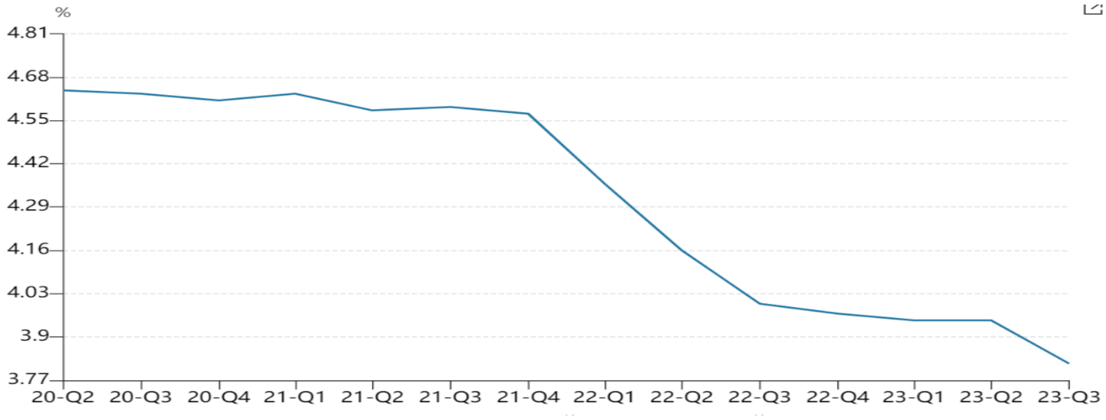
2. Credit has grown rapidly with an improved structure

Lending by financial institutions is growing rapidly. At end-September 2023, outstanding CNY loans had grown 10.9% year on year to CNY 234.6 trillion. Currently, the amount of outstanding loans is roughly 10 times the yearly increase of new loans, maintaining a strong support to meet the financing needs of the real economy. In the first three quarters of 2023, new CNY-denominated loans amounted to CNY 19.7 trillion, increasing by CNY 1.6 trillion year on year.

The costs of corporate loans and consumer credit have continued to decline. In 2023, open market operation (OMO) repo operations and the medium-term lending facility (MLF) dropped 20 and 25 basis points (bp) respectively, causing the one-year and five-year loan prime rate (LPR) to decline by 20 bp and 10 bp to 3.45% and 4.20% respectively. In September 2023, the weighted average rate on new corporate loans and on personal mortgage loans registered 3.82% and 4.02%, respectively, down 0.18 percentage points (pp) and 0.32 pp year on year, both representing historical lows. As of end-September 2023, the interest rates of nearly 50 million existing mortgage loans with a total amount of CNY 22 trillion were cut on average by 0.73 pp to an average level of around 4.27%. Lower financing costs have helped promote investment and consumption by enterprises and households, and support economic development.

Weighted average rate on corporate loans

Figure 3



Source：People's Bank of China.

The credit structure has continued to improve. In terms of the nature of the lending institutions, the stock of credit extended by large domestic commercial banks[2] accounted for 48.6% of the total by the end of September 2023, exhibiting an overall upward trend and playing a leading role in the expansion of total credit. **In terms of the nature of the borrowers,** by the end of the third quarter of 2023, the outstanding loans of enterprises and public institutions accounted for 65.3% of the total, an increase of about 1 pp from the end of 2022. The outstanding loans of the household sector accounted for 33.9% of the total, a decline of 1.1 pp from the end of the previous year. Generally speaking, the share of household loans has declined in recent years, which is mainly due to the profound shifts occurring in China's economic structure and the significant changes in the supply-demand relationship within the real estate market. It also reflects the fact that households have adjusted the allocation of their assets and liabilities. **In terms of the nature and duration of the loans,** the incremental household loans mainly came from an increase in operating and consumption loans. This reflects the post-pandemic recovery of production and business activities of the self-employed and small and micro business owners, as well as improvement in consumer demand. New corporate loans reached CNY 15.67 trillion in the first three quarters of 2023; medium- and long-term loans increased by CNY 11.93 trillion, providing sufficient medium- and long-term support for investment.

[2] Large domestic commercial banks are those with total assets equal to or more than CNY 2 trillion (as of year-end 2008, denominated in both CNY and foreign currencies) and include ICBC, CCB, ABC, BOC, CDS, BOCOM and the Postal Savings Bank of China.

Total amount and structure of outstanding CNY-denominated loans from end-2019 to Q3 2023

Table 2

	End-2019	End-2020	End- 2021	End-2022	End-Q3 2023
CNY loans (stock, CNY trn)	153.11	172.75	192.69	213.99	234.59
Growth rate (yoy, %)	12.3	12.8	11.5	11.1	10.9
of which：	**based on type of lending institution**				
Loans by large state-owned commercial banks (stock, CNY trn)	72.58	81.32	90.70	102.63	113.99
Share (%)	47.4	47.1	47.1	48.0	48.6
of which：	**based on type of borrower**				
Loans to households (CNY trn)	55.32	63.18	71.10	74.93	79.62
Share (%)	36.1	36.6	36.9	35.0	33.9
Loans to non-financial enterprises and government departments / organisations (CNY trn)	96.27	108.44	120.45	137.52	153.19
Share (%)	62.9	62.8	62.5	64.3	65.3

Sources: People’s Bank of China; author’s calculations.

In addition, banks continue to ramp up credit support for key fields and weak links, such as small and micro enterprises and green development. Support for inclusive finance, for example vis-à-vis small and micro enterprises, is stable. By the end of September 2023, the balance of China’s inclusive loans to small and micro enterprises and the number of accounts increased by 24.1% and 13.3% respectively from the same period in the previous year. The weighted average interest rate of newly issued loans to small and micro enterprises in August was 4.81%, a decline of 0.55 percentage points from the same period in the previous year. By continuously increasing support for key fields and innovation, at the end of September 2023 the balance of medium- and long-term loans to the manufacturing sector had increased by 38.2% from the same period in the previous year. Moreover, the balance of medium- and long-term loans to the infrastructure sector had increased by 15.1% from the same period in the previous year.

Policies continue to guide the optimisation of the credit structure. In 2020, to help small and micro enterprises cope with the impact of Covid-19, the PBOC innovatively launched two facilities, namely the loan repayment extension facility for small and micro enterprises and the uncollateralised loan facility for small and micro enterprises. From 2020 to 2021, Chinese banking institutions granted deferral of principal and interest repayment in an amount of CNY 16 trillion, out of which CNY 13.1 trillion was for micro, small and medium-sized enterprises. A total of CNY 10.3 trillion in uncollateralised loans was disbursed for micro, small and medium-sized enterprises. These two facilities effectively reduced repayment pressures on enterprises during the height of the pandemic, and alleviated the financing difficulties of those enterprises that were lacking collateral. From the beginning of 2022, the loan repayment extension facility was converted into the inclusive credit facility for small and micro enterprises, to be effective until the end of 2024. In this new facility, the PBOC provides subsidised re-lending to locally incorporated banks in an amount as a certain proportion of the incremental loans to small and micro enterprises. The PBOC will continue to improve the financial sector's ability to serve micro, small and medium-sized enterprises. For this purpose, we will continue to guide financial institutions to optimise institutional arrangements such as internal funds transfer pricing, performance appraisal and accounting, in order to make them willing and able to lend to micro, small and medium-sized enterprises.

Improving the credit structure and making it well aligned with high-quality development could improve growth potential. First, loans to micro, small and medium-sized enterprises have kept growing at a rate of above 20% year on year in the past four years in a row, and helped create jobs. **Second**, support for a green economy has been steadily increasing. Since 2022, the year-on-year growth rate of green loans has remained at around 40%.

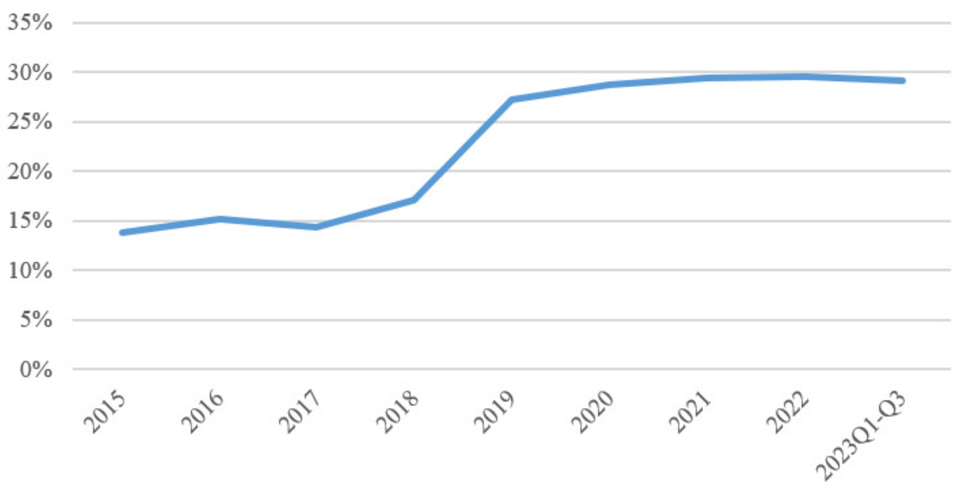
Going forward, the PBOC will continue to implement an accommodative monetary policy and keep it flexible, appropriate, well targeted and effective. The PBOC will maintain sufficient liquidity, and ensure that the size of TSF and the money supply are in line with economic growth and price expectations. We will also use structural monetary policy instruments to guide financial institutions to promote green transformation and financial inclusion.

3. As the capital market steadily develops, the proportion of direct financing has been on the rise

In recent years, China's bond and stock markets have developed rapidly, resulting in a steady increase in the proportion of direct financing. By the end of September 2023, the proportion of direct financing to TSF reached 29.2%.

Proportion of direct financing in the stock of aggregate financing to the real economy

Figure 4



Source：People's Bank of China; author's calculations

As for the bond market, it has played an important role in supporting the real economy. **First,** the market has continued to grow in size. By the end of September 2023, outstanding bond volume was about CNY 154 trillion, up by 56% from the end of 2019. China's bond market is the second largest in the world. **Second,** channels for direct financing have been broadened. More uncollateralised special bonds have been rolled out, such as bonds for green development, mass entrepreneurship and innovation, and rural area revitalisation. These could help new growth drivers to take shape. By the end of September 2023, the outstanding uncollateralised bonds for enterprises stood at CNY 32.4 trillion. Uncollateralised bonds have become the second largest financial instrument to channel funds to the real economy, exceeded only by bank loans. From January to September 2023, net financing through bonds amounted to CNY 7.6 trillion, accounting for 25.9% of TSF, an increase of 3.8 pp from the same period in 2017. **Third,** the development of the bond market has supported the implementation of China's proactive fiscal policy. At end-September 2023, China's government bond balance stood at CNY 66.2 trillion, with an average annual growth rate of 15.8%. **Fourth,** development of the bond market has enhanced the ability of financial institutions to support the real economy. Bonds issued by financial institutions stood at CNY 37.2 trillion at end-September 2023 and have become one of the major sources for policy banks and other financial institutions to replenish capital. Through issuance of financial bonds, policy banks set up special funds for infrastructure investment and key projects. In addition, banks can replenish capital by issuing perpetual bonds. By the end of September 2023, the balance of various types of capital replenishment bonds of commercial banks had reached CNY 6 trillion, which increased the average capital adequacy ratio of commercial banks by about 3 pp.

For the stock market, the A-share market provides an important channel for financing the real economy. From January to September 2023, 204 companies raised CNY 312.5 billion through initial public offerings（IPOs）on the Shanghai and Shenzhen stock exchanges. Among the over 5,200 A-share listed companies, many are industry leaders and small champion companies. They all play an important role in innovation, employment creation and economic stability.

Financing through the A-share stock market Table 3

Year	2016	2017	2018	2019	2020	2021	2022	Q1–Q3 2023
A-share financing (CNY trn)	1.45	1.18	0.68	0.69	1.16	1.47	1.32	0.74

Sources China Securities Regulatory Commission.

Positive progress has been made in opening up the capital market. As for the bond market, first, efforts have been made to attract more foreign investors and issuers. As a result, foreign institutional investors in the bond market have expanded from foreign central banks, CNY clearing banks and participating banks to commercial banks, asset managers and pension funds. By the end of September 2023, 1,110 foreign institutional investors from more than 70 jurisdictions had entered China's bond market, and the number of foreign institutional investors has been growing at an average rate of about 100 per annum since 2017. **Second**, various connect programmes have linked the mainland market with the global bond market in an orderly manner. The northbound and southbound connect programmes were launched sequentially under the Bond Connect scheme. The mainland bond market is now connected with that of Hong Kong SAR through interlinking of their respective infrastructures, so that overseas institutions can access the Chinese bond market through "one entry point". At the end of September 2023, foreign investors held CNY 3.3 trillion in domestic bonds, up by 48% from the end of 2019.

Steady progress has been made in connecting the stock market with overseas stock markets, to allow enterprises to capitalise on the markets and resources both at home and abroad. The stock market connect scheme has been expanded from the previously launched Shanghai-London Stock Connect to the Shenzhen-London Stock Connect and then to other jurisdictions such as Switzerland and Germany. By the end of 2022, 14 A-share listed companies had issued global depositary receipts (GDRs) in the United Kingdom and Switzerland, raising about USD 9.2 billion in total.

However, the proportion of direct financing has remained subdued, and there is significant room for improvement. In recent years, the size of direct financing has increased significantly. But it still accounts for less than 15% after excluding government bonds (see Table 1 for details), which is dwarfed by the dominant position of indirect financing. This structural imbalance between direct and indirect financing is not in line with the shift towards an innovation-driven economic development model. Indirect financing dominated by banks prefers large traditional enterprises deemed to have mature operations and low risks, and naturally stays away from small and innovative enterprises deemed to have high risks and high returns. On the one hand, over-reliance on indirect financing for economic development would not only give rise to a high leverage ratio, but also have the potential to cause systemic financial risks. On the other hand, bank savings and wealth management products can no longer meet households' growing demand for asset preservation. At present, financial products with stable returns are limited in the capital market. The supply and demand mismatch has distorted the allocation of economic resources, which is not conducive to sustainable development of the economy.

4. China's financial system has remained stable

Financial risks are generally under control. The total assets of the banking industry account for about 90% of the total assets of the financial industry. As such, a stable banking system means financial stability. The results of a central bank rating of financial institutions conducted in the second quarter of 2023 showed that 24 major banks, accounting for about 70% of the combined assets of those rated banking institutions, had good ratings. This indicates that the overall operation of banking institutions is stable and risks are generally under control.

The main risk indicators are within a reasonable range, and China's financial system is resilient. As of the end of the third quarter of 2023, the non-performing loan (NPL) ratio in the banking sector was 1.65%. The provision coverage ratio of commercial banks was 207.9%, the capital adequacy ratio 14.66%, and the Liquidity Coverage Ratio 143.5%. The average risk coverage ratio and average capital leverage ratio of securities companies were 255.38% and 18.78% respectively. Moreover, the average comprehensive solvency adequacy ratio and core solvency adequacy ratio of insurance companies were 188% and 122.7% respectively.

The overall risk of small and medium-sized financial institutions is under control. Since 2018, China has prioritised defusing risks of high-risk institutions. The number of high-risk small and medium-sized banks has decreased from the peak of 600 to around 300. To date, the assets of these high-risk banks only account for about 1.7% of total assets. In those few provinces with a relatively high concentration of high-risk institutions, plans have been made or implemented to further defuse the risks through reforms. The PBOC will work with other relevant agencies to improve financial risk monitoring, assessment, prevention and control and to make the early correction mechanism for financial risks really binding, more standardised and enforceable.

The spillover of the real estate sector onto the financial system is limited. Outstanding real estate loans amount to about CNY 53 trillion, accounting for 23% of total bank loans. Around 80% of real estate loans are mortgage loans. China has always followed a highly prudential mortgage lending policy, and as a result, the NPL ratio for mortgage loans is only 0.52%. Loans to developers account for about 20% of real estate lending; their NPL ratio is 2.7%. In general, China's real estate sector is searching for a new equilibrium. As previously launched policy measures gradually take effect, there have been some positive signs in the real estate market. Looking ahead, as urbanisation continues and the large group of new urban residents is growing, the demand for basic and improved housing is likely to be substantial. This could help support healthy and stable development of the real estate sector.

Attention should be paid to the implications of the liquidity needs of NBFIs for financial stability, and monitoring and regulation should be strengthened. NBFIs have problems such as asset-liability mismatch, insufficient capital buffer, poor risk management and lack of deposit insurance coverage. In addition, they often borrow short and lend long, which results in frequent short-term liquidity demands. They borrow short-term funds from the money market, and raise leverage by rolling over maturities. This has made many NBFIs vulnerable to the month-end calendar effect, thus resulting in a temporary rise in financing costs.

A delicate balance needs to be struck between development and regulation to support healthy and steady development of big techs. The rapid development of fintech has enabled tech companies to thrive and prosper, which has improved efficiency, lowered transaction costs and enhanced financial inclusion. However, this rapid development of the fintech sector has also resulted in a number of problems such as unlicensed financial services, market monopoly, personal information leakage and potential contagion of financial risks. Therefore, from end-2019 China started to strengthen regulation of big techs through a multi-pronged approach. **First**, all financial activities were brought under financial supervision, and it was required that no financial services be offered without licences. **Second**, payment service providers were asked to focus on payment-related activities, and to cut off connections with financial products. **Third**, China strengthened antitrust efforts, so as to protect financial consumers. **Fourth**, we strengthened data protection by enacting new laws and regulations, and better regulating the credit information business. **Fifth**, prudential regulatory requirements were implemented in earnest with respect to online financial services. Certain big techs were asked to establish financial holding companies and bring all their financial services under the umbrella of these holding companies. After a period of intense efforts, we have now entered a phase of routine regulation and supervision. Going forward, the PBOC will continue to follow market principles and the rule of law, encourage some big techs to resolve the few remaining problems, beef up the regulatory regime and capacity, and tap the role of big techs in promoting growth, job creation and innovation.