Analysis of the Impact of the Epidemic on Chinese Commercial Banks

Jingyan Lin(✉)

The University of Sydney, Sydney, Australia
jlin8780@163.com

Abstract. The epidemic will temporarily impact the commercial banks, which can be divided into three dimensions. First, the shortcomings of online functions lead to limited development of commercial banks. Second, the rapid growth of non-performing assets has dragged down the pace of bank expansion and income growth. Third, the epidemic economy is under pressure, interest rates are forced to decline, and the trend of narrowing bank interest spreads will accelerate. To deal with these three effects, the author offers three suggestions.

Keywords: non-performing assets · bank interest margin · post-epidemic era

1 Introduction

COVID-19 has already constituted a global pandemic, and its impact on economic development and people's lives will be long and complex. All walks of life in China have been deeply affected. The pandemic has disrupted the normal development of the world economy, and the traditional economic development cycle has been forced to turn into a downward cycle due to the impact of COVID-19, which has a tremendous negative impact on Pro cyclical industries, including the banking sector. Commercial banks have taken preventive measures, such as rotating operations, making appointments in advance and limiting the number of transactions they handle. The volume of transactions has declined dramatically, and the efficiency of transactions has also been significantly reduced. At the beginning of the outbreak in early 2020, people were quarantined in their homes and stayed indoors due to the pandemic. The economy was at a standstill, industrial production was halted, and the loan business volume of Chinese commercial banks fell sharply. After the epidemic was under control, to resume production and solve the economic difficulties faced by various industries, many enterprises took out loans to solve the liquidity difficulties. Therefore, local and foreign currency loans from Chinese commercial banks have increased steadily.

2 Problems Faced by Commercial Banks in the Post-epidemic Era

2.1 The Shortcomings of Online Functions Lead to Limited Development of Bank Loan Business

The backwardness of the bank's online platform has caused the bank to miss out on the loan business that was not much during the epidemic. Due to the need for epidemic prevention and control in China, some companies and individuals chose to work from

G. Vilas et al. (Eds.): ICEMED 2023, AEBMR 254, pp. 100–104, 2023.
https://doi.org/10.2991/978-94-6463-224-8_15

home. This makes the disadvantages of traditional commercial banks' online APP and online banking services such as incomplete types and inconvenient operations gradually emerging. From the business model of commercial banks, although many banks have realized that the online loan business needs to be continuously increased and improved, many commercial banks have not allocated funds and manpower to transform their online loan business. At present, most of the loan business cannot be processed online and remotely, and commercial banks have a high demand for manual operation and review. This makes it inconvenient for enterprises and individuals who need to handle business remotely, and it is difficult for banks to carry out business, resulting in limited loan business development of commercial banks.

2.2 Fast-Growing Rate of Non-performing Loan Balance and Non-performing Loan Ratio

Since the beginning of the epidemic, the non-performing loan balance and non-performing loan ratio of commercial banks have increased, which has affected the credit asset quality of commercial banks [1]. At the end of the second quarter of 2022, the balance of non-performing loans of China's commercial banks reached 2.95 trillion yuan, an increase of 106.9 billion yuan from the beginning of the year [2]. Under the background of the epidemic crisis, the non-performing assets of commercial banks mainly come from two aspects: First, the impact of bankruptcy of corporate customers is to generate a large number of bad debts, especially SMEs. These kinds of enterprises have relatively weak anti-risk capabilities in the epidemic since they lack sufficient cash reserves. Even if the company does not close, the delay in resuming work and business also affects the earning capacity of the company [3]. In addition, affected by the sluggish foreign economy, some enterprises highly dependent on overseas markets have also experienced a decline in business performance and reduced solvency. Thus, the quality of bank credit assets has deteriorated, making it difficult for companies with unbearable cash flow to repay loans on time. Second, citizens are forced to stay indoors so that they are unable to work and receive wages. In March 2022, the unemployment rate reached 5.9% at one point [4]. They could not afford the repayments on time. Both corporate and personal loans cannot be refunded. The number of non-performing loans continues to rise. Asset risks have exceeded the estimated range which cause serious default on interest and debt [5].

As the aspects mentioned above, the risk of default increases, and banks must increase provisions for credit impairment losses. From an accounting perspective, an increase in the provision for impairment losses leads to increased expenses. The growth of costs leads to declining operating profits of commercial banks. Under the prudential principles of accounting standards, banks should consider the possibility of future losses and include them in their earnings statements. From the overall balance sheet of the banking industry, the non-performing loan ratio at the end of 2019 was 1.86%. At the end of 2020, the non-performing loan ratio was growing to 1.92% [6]. Data from both enterprises and banks showed that the epidemic had a particular impact on the quality of bank credit assets.

2.3 Bank Interest Margin Narrowed

To begin with, coronavirus has negatively impacted the profitability of Chinese commercial banks. The epidemic prompted monetary policy to shift to marginal easing, resulting in an asymmetric decline in the rate of return on interest-bearing assets and the cost rate of interest-bearing liabilities, narrowing banks' net interest margin. According to the definition, the net interest margin = (total interest income - total interest expenditure)/the average value of the calculation at the beginning and end of the interest-bearing asset period [7]. Loose monetary policy has a systemic impact on the relative size of the return on interest-bearing assets and the cost rate of interest-bearing liabilities, which would affect the net interest margins of the banks.

From the perspective of loan interest rates, loose monetary policy significantly has sharply reduced the yield on banks' interest-bearing assets. The decline of LPR effectively drives the decline of loan interest rates. The corporate loan interest rate for the whole year of 2021 will be 4.61%, a decrease of 0.1 percentage point from 2020 and a decrease of 0.69 percentage point from 2019, the lowest level in more than 40 years [8].

Deposit rates are falling more slowly than lending rates. The main reason is that the inter-bank deposit function is similar. In times of poor stock and fund market performance, investors generally consider deposits to be one of the safest investments to keep the principal from being lost while earning less money for the investor. There is little difference in the risk of deposits between banks, so the competitiveness of deposit products is mainly reflected in interest, which makes the competition for banks to use deposit interest to attract deposits more intense. Banks will use different deposit products, such as large-denomination certificates of deposit, to increase the deposit threshold while maintaining the previous interest as much as possible to attract deposits. Therefore, if there is no policy guidance, banks will worry that the deposit rate will lead to the loss of customers and reduce the source of funds and related businesses. As a result, they lack incentives to lower deposit rates in a timely manner. Therefore, the reduction of bank deposit interest rates is not timely [4].

3 Economic Risks

There is a changing trend in the global economy. In the backdrop of the COVID-19 pandemic in 2020, the global economy experienced an average contraction of 3.6%, indicating a significant economic downturn. At the beginning of 2022, global energy prices started to rise. Against the backdrop of increased commodity prices and limited recovery in the global supply chain, there has been a slight increase in inflation levels worldwide. According to the report "World Economic Outlook Update: Pandemic Persistence, Difficult Recoveries, and Rising Inflation" released by the International Monetary Fund in January 2022, global economic growth is projected to decline from 5.9% in 2021 to 4.4% in 2022, marking a downward adjustment of 0.5% from the growth expectations in October 2021. The report highlights multiple risks to the global economic outlook, including uncertainties in the development of the pandemic, potential negative impacts of the tightening monetary policy in the United States on global financing conditions and capital flows, uncertainties in the easing of the global supply chain, risks of continued inflationary pressures, slowdown in the growth of China's real estate sector, and geopolitical tensions in Eastern Europe leading to potential risks in international energy supply and trade cooperation.

4 Conclusion

To deal with these three effects, the author offer three suggestions.

First, it is necessary to reduce deposit costs and reasonably maintain the net interest margin. To begin with, banks should strengthen the cost control of liabilities, reduce the proportion of high-interest structured deposits, and put an end to improper deposit innovation products. Moreover, we should give play the role of the interest rate self-regulation mechanism. Because the ability of small banks to absorb savings deposits is weaker than that of large banks, there are some scruples about reducing deposit interest rates. Large banks should take the lead in lowing deposit rates and driving small and medium-sized banks to reduce deposit interest rates through industry self-discipline. At the same time, the central bank and the China Banking and Insurance Regulatory Commission should strengthen the supervision of bank deposit interest rates.

Second, commercial banks should focus on eliminating the risks of loans and non-performing assets. Banks should reasonably dispose of existing non-performing assets through different means such as asset securitization and public auction. The incremental non-performing investments should be strictly controlled by the bank's approval process and data analysis. It is essential to have a clear distinction of personal responsibility. If there are incremental non-performing assets, the bank can hold individuals liable.

Third, commercial banks need to increase investment in financial technology and explore the business innovation model. Commercial banks should pay more attention to user experience to determine what the customer needs. They can then innovate the application, simplifying the operation process and fitting the customer's needs. In addition, it is also vital to accumulate and analyze customer data. In the short-term, investment in exploring new models will increase the cost of commercial banks, but in the long run, it will reduce the cost of banks and improve their operational efficiency.

References

1. Xiaoling Wang, Jiahui Zhang, Research on the problems and Countermeasures of China's commercial bank loan business in the post epidemic Era[J], *SHANGYEJINGJI*, 2022, 4:179–180
2. Zifei Chen (2022, September 2) China's financial risk is heating up. Retrieved from https://www.rfa.org/mandarin/yataibaodao/jingmao/ec-09022022082530.html
3. LU Min-feng. Research on Epidemic Crisis and Commercial Bank's Digital Countermeasures [J].Southwest Finance, 2020(05):36–43.
4. CEIC DATA (2022). China unemployment rate. Retrieved from https://www.ceicdata.com/zh-hans/indicator/china/unemployment-rate
5. LU Min-feng. The Strategies for Developing Digital Small and Micro Finance of Commercial Banks in the Context of COVID-19——Based on the Perspective of Future Bank Development [J]. Journal of Xinjiang Normal University (Philosophy and Social Sciences), 2020, 41(06):28–42. DOI: https://doi.org/10.14100/j.cnki.65-1039/g4.20200707.002.

6. CEIC DATA (2022). China NPL ratio. Retrieved from https://www.ceicdata.com/zh-hans/indicator/china/non-performing-loans-ratioLuo
7. Qi, Tian Wen. Research on the profitability of Chinese commercial banks under the impact of the new crown pneumonia epidemic [J]. Financial Economics, 2021(03): 82–90. DOI: https://doi.org/10.14057/j.cnki.cn43-1156/f.2021.03.011.
8. Guangming Daily (2022, January 19). Business lending rates in 2021 at lowest level in more than four decades. Retrieved from http://www.gov.cn/xinwen/2022-01/19/content_5669232.htm