

## **The Dynamic Evolution of Non-Performing Loans in the Chinese Banking and the Assessment of Resolution Mechanisms**

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### **Abstract**

The article examines the dynamics of non-performing (NPL) and potentially problematic loans in China's banking system in the context of maintaining financial stability. The growth of problematic assets in recent years has been driven by a combination of macroeconomic and institutional factors, including the slowdown of economic growth, the consequences of the COVID-19 pandemic, structural imbalances in the corporate sector, and the increasing debt burden of regional state-owned enterprises. These trends pose systemic risks and require the implementation of effective restructuring and securitization mechanisms. The purpose of the study is to analyze the current dynamics of NPLs and potentially problematic loans in the Chinese banking sector and to assess the effectiveness of restructuring and securitization measures as key tools for sustaining financial stability. To achieve this goal, the research applies methods of macroeconomic and comparative analysis as well as a systemic approach to evaluating the impact of asset management policies on the resilience of the banking system. Based on statistical data from the China Banking and Insurance Regulatory Commission (CBIRC), the People's Bank of China (PBOC), and the International Monetary Fund (IMF), the study identifies that debt restructuring measures and the development of the asset-backed securities (ABS) market help

mitigate the negative effects of rising NPLs on banks' capital and lending activity. It is shown that asset securitization and the establishment of asset management companies (AMCs) contribute to reducing systemic risks, improving liquidity, and restoring confidence in the banking sector. The results of the study have practical significance for improving supervisory mechanisms and risk management practices in the banking industry, as well as for developing recommendations to ensure the stability of China's financial sector under conditions of macroeconomic uncertainty.

### For citation

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### Keywords

Non-performing loans, potentially problematic assets, China's banking system, debt restructuring, securitization, financial stability, risk management, NPL.

## Introduction

China's modern banking system is one of the largest and most dynamically developing in the world. Its stability directly affects not only the country's domestic economy but also the condition of global financial markets [China Banking and Insurance Regulatory Commission, 2024]. However, despite large-scale state support and regulatory oversight, in recent years the Chinese banking sector has experienced a steady increase in the share of non-performing (NPL) and potentially problematic loans [International Monetary Fund, 2023]. This trend reflects the accumulation of structural risks associated with overheating of the credit market, the slowdown of economic growth, and the lingering effects of the COVID-19 pandemic, which placed additional pressure on both the corporate and public sectors [China Huarong Asset Management Co., Ltd., 2024].

According to the China Banking and Insurance Regulatory Commission (CBIRC), the NPL ratio of the Chinese commercial banks fluctuated between 1.6% and 1.9% during 2018–2024, while the actual volume of potentially problematic assets is significantly higher than official estimates [People's Bank of China, 2024]. This discrepancy stems from the peculiarities of national reporting, partial concealment of losses in bank balance sheets, and the dependence of regional financial institutions on state support [Basel Committee on Banking Supervision, 2017].

The growing amount of problematic loans threatens not only the liquidity and profitability of individual banks but also the overall stability of the financial system. In an environment where traditional rehabilitation methods – such as debt write-offs or direct fiscal injections – have proven only partially effective, the role of market-based instruments such as debt restructuring and asset securitization becomes increasingly significant [Li, Zhang, 2022]. These mechanisms enable the redistribution of risks, attract off-budget capital, and help restore investor confidence [Liu, 2021].

Moreover, the relevance of the topic extends beyond China's domestic context. As one of the world's largest creditors to developing economies, China exerts a tangible influence on cross-border capital flows [World Bank, 2024]. Consequently, the condition of its banking system and the quality of its assets directly affect international financial stability [Xu, 2020].

Therefore, the analysis of non-performing and potentially problematic loan dynamics, along with the evaluation of the effectiveness of restructuring and securitization tools, represents a relevant and practically significant research direction for developing measures to ensure the financial resilience of China and countries with similar banking structures [OECD, 2023].

## Main part

The purpose of this study is to analyze the dynamics of non-performing and potentially problematic loans in China's banking system and to assess the effectiveness of restructuring and securitization tools in maintaining the stability of the financial sector.

To achieve this purpose, the following objectives were set:

- To analyze the trends in the share of non-performing and potentially problematic loans in China's banking system during 2018–2024;
- To identify key macroeconomic and institutional factors contributing to the growth of non-performing loans;
- To examine the measures implemented by the Chinese regulators and commercial banks for debt restructuring and management of distressed assets;
- To evaluate the role and effectiveness of asset securitization mechanisms in mitigating systemic risks and supporting bank liquidity;
- To determine the impact of restructuring and securitization on the overall financial resilience of China's banking system and identify possible areas for improvement.

Achieving these objectives allows for a comprehensive understanding of non-performing loans as a critical challenge to the modern financial sector and provides a basis for developing recommendations aimed at strengthening the stability of banks under conditions of economic uncertainty.

The methodological framework of this study is based on a combination of systemic, statistical, and comparative approaches aimed at a comprehensive analysis of the dynamics of non-performing and potentially problematic loans in China's banking system.

The research employs macroeconomic analysis, economic and statistical modeling, comparative analysis, and a structural approach to financial risk assessment. The analysis relies on official data provided by the People's Bank of China (PBOC), the China Banking and Insurance Regulatory Commission (CBIRC), as well as international sources such as the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) [China Banking and Insurance Regulatory Commission, 2024].

The following indicators were used to assess the scale of non-performing loans:

- The non-performing loan ratio (NPL ratio) in total loan portfolios;
- The volume of potentially problematic assets (Special Mention Loans, SML);
- The loan loss provision coverage ratio;
- The capital adequacy ratio (CAR).

In addition, a dynamic analysis was applied to trace changes in NPL and SML ratios over 2018–2024, and a structural analysis was used to assess the impact of restructuring and securitization on key financial indicators of banks.

The comparative method was employed to contrast China's practices with international approaches to distressed asset resolution, particularly those adopted by South Korea and Japan during the Asian financial crisis [International Monetary Fund, 2023].

Thus, the chosen methodology ensures a comprehensive and objective assessment of the condition of China's banking loan portfolio and the effectiveness of stabilization instruments.

The analysis revealed that over the past six years, China's banking system has demonstrated a steady increase in the volume of non-performing and potentially problematic loans, despite a relatively stable official NPL ratio. According to CBIRC, the NPL ratio of the Chinese commercial banks stood at 1.74% in 2018, peaked at 1.92% in 2020, and stabilized at 1.63% in 2023, reflecting the authorities' active debt restructuring and write-off policies. However, *Special Mention Loans (SML)* continue to expand, and combined NPL+SML levels are estimated at around 6–7% of total loans [2 International Monetary Fund, 2023].

The key indicators used in the analysis include the Non-Performing Loan ratio (NPL), Special Mention Loans (SML), and Capital Adequacy Ratio (CAR), which are presented in Table 1.

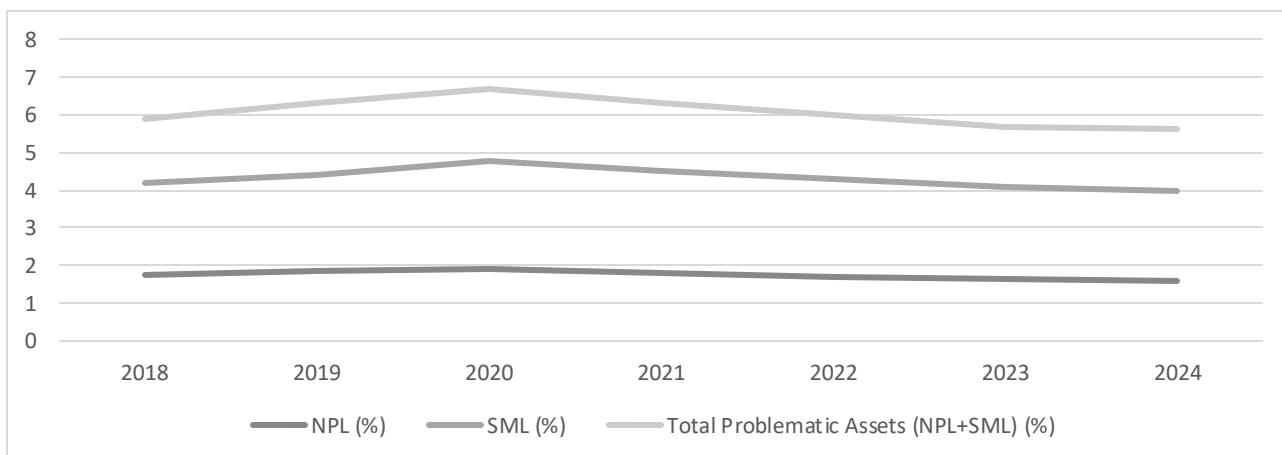
**Table 1 – Dynamics of NPL/ SML/ CAR in China's Banking System (2018–2024)**

Year	NPL (%)	SML (%)	NPL+SML (%)	CAR (%)
2018	1,74	4,2	5,9	14,2
2019	1,86	4,4	6,3	14,5
2020	1,92	4,8	6,7	14,3
2021	1,8	4,5	6,3	14,4
2022	1,69	4,3	6	14,6
2023	1,63	4,1	5,7	14,6
2024	1,61	4	5,6	14,7

Source: Source: China Banking and Insurance Regulatory Commission (CBIRC), People's Bank of China (PBOC), International Monetary Fund (IMF), author's calculations.

As shown in Table 1, the share of non-performing loans (NPL) in China's banking system has remained relatively stable over the analyzed period, while the share of special mention loans (SML) shows a gradual decline since 2020. This indicates that the policy measures implemented by Chinese regulators have contributed to mitigating the overall level of credit risk.

The overall dynamics of NPL and SML are further illustrated in Figure 1, which clearly shows a gradual reduction in problematic loan ratios from 2020 to 2024.



Source: Based on data from CBIRC, PBOC, IMF Annual Reports (2018–2024) and author's calculations.

**Figure 1 – Dynamics of Non-Performing and Potentially Problematic Loans in China's Banking System (2018–2024)**

The downward trend in both NPL and SML ratios after 2020 reflects the effectiveness of debt restructuring and asset securitization measures. The stabilization of the capital adequacy ratio (CAR) above the Basel III threshold confirms the overall resilience of China's banking sector.

The structure of problematic assets is dominated by loans issued to state-owned and municipal enterprises, as well as construction and infrastructure companies. The high proportion of SML loans indicates the accumulation of hidden risks within bank balance sheets, which may lead to further deterioration in asset quality amid slower economic growth and declining returns in the real estate sector.

Debt restructuring has become a primary tool for mitigating pressure on bank balance sheets. It includes loan term extensions, debt-to-equity swaps, and the establishment of Asset Management Companies (AMCs). The largest AMCs — *China Huarong*, *China Cinda*, *China Orient*, and *China Great Wall* — have collectively absorbed over 1.5 trillion yuan in distressed assets [China Huarong Asset Management Co., Ltd., 2024].

The asset securitization market (ABS) has also played a key role in risk redistribution and liquidity restoration. Between 2016 and 2023, the total issuance of asset-backed securities increased more than fourfold — from 1.2 trillion to 5.3 trillion yuan [4]. In 2022, the PBOC and CBIRC jointly introduced a simplified ABS issuance framework for second-tier commercial banks, enhancing participation by small and medium-sized institutions.

These measures produced measurable results:

- The loan loss provision coverage ratio rose from 176% in 2018 to 205% in 2023;
- The capital adequacy ratio (CAR) stabilized at 14.6%, exceeding Basel III requirements;
- Lending to the real economy maintained a stable upward trajectory despite liquidity fluctuations.

From a theoretical perspective, the findings confirm the importance of combining market-based and institutional mechanisms in maintaining banking system stability. Restructuring and securitization tools not only mitigate financial risks but also contribute to the development of adaptive asset management models in transitional economies.

The practical significance of the results lies in the applicability of China's experience to countries with similar structural challenges — particularly those with high corporate debt levels and state-dependent banking sectors. Developing national securitization markets and creating specialized AMCs can serve as effective instruments for enhancing financial resilience in other Asian and Eastern European economies.

## Conclusion

The conducted analysis of non-performing and potentially problematic loans in China's banking system demonstrates that the country's regulatory framework and restructuring mechanisms have effectively mitigated systemic risks in the post-crisis period. The combination of debt restructuring, asset management company operations, and the development of the asset securitization market (ABS) has stabilized the level of problematic assets and strengthened the capital position of commercial banks.

From a theoretical standpoint, the study highlights the importance of integrating market-based and institutional tools for maintaining financial stability in economies undergoing structural transformation. The experience of China confirms that the coordinated use of restructuring and securitization mechanisms not only restores bank balance sheet quality but also contributes to sustainable credit growth.

From a practical perspective, the results of this research can be applied in countries facing similar challenges — particularly those with high levels of corporate indebtedness and dominant state participation in the banking sector. Implementing effective debt restructuring policies, expanding securitization instruments, and developing specialized asset management companies can serve as key strategies for enhancing banking sector resilience and ensuring long-term financial stability.

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## Динамическая эволюция проблемных кредитов в китайской банковской системе и оценка механизмов их решения

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## Аннотация

В статье рассматривается динамика неработающих (NPL) и потенциально проблемных кредитов в банковской системе Китая в контексте обеспечения финансовой стабильности. Рост объемов проблемных активов в последние годы обусловлен сочетанием макроэкономических и институциональных факторов – замедлением экономического роста, последствиями пандемии COVID-19, структурными дисбалансами в корпоративном секторе и усилением долговой нагрузки региональных государственных предприятий. Эти тенденции создают угрозу системным рискам и требуют применения эффективных инструментов реструктуризации и секьюритизации активов. Цель исследования заключается в анализе текущей динамики NPL и потенциально проблемных кредитов в китайском банковском секторе, а также в оценке эффективности мер по их реструктуризации и секьюритизации как ключевых инструментов поддержания финансовой устойчивости. Для достижения поставленной цели в работе используются методы макроэкономического и сравнительного анализа, а также системный подход к оценке влияния политики управления активами на устойчивость банковской системы. На основе анализа статистических данных Китайской комиссии по регулированию банковской и страховой деятельности (CBIRC), Народного банка Китая (PBOC) и Международного валютного фонда (IMF) определено, что меры по реструктуризации задолженности и развитию рынка секьюритизации позволяют смягчить негативное воздействие роста NPL на капитал банков и их кредитную активность. Показано, что секьюритизация активов и создание специальных компаний по управлению проблемными долгами (AMCs) способствуют снижению системных рисков, повышению ликвидности и восстановлению доверия к банковской системе. Результаты исследования имеют практическое значение для совершенствования механизмов надзора и управления рисками в банковской сфере, а также для разработки рекомендаций по обеспечению устойчивости финансового сектора Китая в условиях макроэкономической неопределенности.

## Для цитирования в научных исследованиях

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## Ключевые слова

Проблемные кредиты, потенциально проблемные активы, банковская система Китая, реструктуризация задолженности, секьюритизация, финансовая стабильность, управление рисками, неработающие кредиты (NPL).

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