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Bank profitability and GDP growth in China: a note

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Abstract

This article examines the effect of GDP growth on bank profitability in China over the period 2003–2009. The one-step system GMM estimator is used to test the persistence of profitability in the Chinese banking industry. The empirical findings suggest that cost efficiency is positively related to bank profitability, while lower profitability can also be explained by higher taxes paid by banks. In addition, there is a negative relationship between GDP growth and bank profitability. Furthermore, the results show that (1) the profitability in the Chinese banking industry is significantly affected by the level of non-performing loans, and (2) Chinese banks with higher levels of capital have lower profitability. Finally, we find that the departure from a perfectly competitive market structure in the Chinese banking industry is relatively small.

Keywords:

bank profitability GDP GMM China

JEL Classifications:

G21 E00 C23

Notes

1. It accounts for 66% of total financial assets and 17.5% of GDP (as of 2006).

2. The factors include asset turnover ratio, ratio of long-term debt to short-term debt, overdue loan ratio, stagnant loan ratio, lost loan ratio, core capital ratio, capital adequacy ratio, capital risk ratio, asset profitability ratio, and capital profitability ratio.

3. Logarithm of GDP is used as the indicator of economic growth.

4. The bank-specific variables include size, capitalization, liquidity, cost efficiency, credit risk, non-traditional activity. The inflation, unemployment rate and GDP growth rate are used as the macroeconomic determinants.

5. The bank-specific variables mainly include technical efficiency, liquidity, capitalization, etc, while the macroeconomic variables include concentration, GDP growth, inflation, volatility of interest rate, etc.

6. Correlation among variables is tested through the correlation matrix and shows that there is no multicollinearity problem in our sample; these results are available upon request.