Analysis of the Interest Rate Marketization Risk of Local Banks in Henan Province—Taking Four Joint Stock Commercial Banks as an Example

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Abstract

With the accelerating process of interest rate marketization, the local banks in Henan Province face a greater risk of interest rate marketization, managing risk effectively can promote the development of local banks in Henan Province and the economic development of Henan Province. This paper analyzes the present situation of management of interest rate marketization in Henan Province, then puts forward some suggestions, such as promoting the development of intermediate business; promoting the product innovation; strengthening the management of assets and liabilities, improving the quality of employees, strengthening the management of non-performing loans, and etc.

Keywords: local banks; interest rate marketization; asset liability ratio

I. Introduction

After the 1970s, some developed countries such as Japan, the United States, and some developing countries in Latin America gradually deregulated the interest rate control, and interest rate marketization reform was gradually begun.

China also began to reform the economic system since 1978, and inter-bank offered rates were officially released until 1996[1]. Foreign currency lending rates and large amount of foreign currency deposit interest rates were liberalized in 2000, domestic and foreign interest rate marketization were promoted actively. In 2013, financial institutions lending rate control was fully liberalized. One year or more (not including one year) fixed deposit interest rate floating cap was released in August 2015. The central bank no longer set deposit interest rates floating cap on the commercial banks and rural cooperative financial institutions in October 2015.

Interest rate marketization, making more diversified financing, enhancing the profitability of financial institutions, further upgrading financial services and providing strong support for the development of the real economy, is conducive to economic restructuring, improving the efficiency of resource allocation and the development of economic society.

II. Relevant Theory

(I) Interest rate marketization

Interest rate marketization refers to that interest rates of financial institutions, decided by market supply and demand which independently adjust interest rates by judging the trend of financial market and their financial conditions, financial institutions determined to interest rate decisions, and the direct controls on

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interest rates by government or central bank is relaxed. The nature of interest rate marketization is to give full play to the role of the market in capital allocation, effectively to achieve the optimal allocation of funds, and eventually forms a mechanism, which based on the central bank benchmark interest rates, making money market interest rate as the intermediary, and determined financial institutions lending and deposit rates by market supply and demand.

(II) Interest Rate Risk

Interest rate risk
The rangeability of rate in commercial banks is bigger than in the past after the marketization of interest rate. Capital flow speeded up, liquidity risk would be brought to commercial banks in carrying out interest rate marketing; In addition, interest rate marketization bring market interest rate a larger fluctuation, the interest rate risk of commercial bank is also increased; Then interest rate marketization is bound to intensify competition among commercial banks from quantity to quality. So interest rate risk which is brought to commercial banks in carrying out interest rate marketing and affects the effect of the government or the central bank's macro-control, would cause a certain influence to the stability of the economy.

The measurement indexes of Interest Rate Risk

Ratio of net interest income to operating income
The ratio of net interest income to operating income= net interest income / operating income, it reflects how much of the operating income came from net interest income. The greater the ratio, the higher proportion of interest income in operating income; The smaller the ratio, the lower proportion of interest income in operating income.

Asset liability ratio
Asset liability ratio = liabilities/assets, it reflects the proportion of the debt capital in the total capital, and it reflected the solvency. The greater the ratio, less money belongs to the owner, more funds belong to the debt, capital chain rupture, bankruptcy, low solvency, and the other financial crisis may be caused due to not timely debt service; but when asset liability ratio is low, it is conducive to the recovery of creditors, but not conducive to play the role of financial leverage. Therefore, the asset liability ratio meeting the requirements of various economic entities is very necessary.

Capital adequacy ratio
Capital adequacy ratio = (total capital - corresponding capital deductions)/risk-weighted assets, it reflects the extent of the commercial bank against risks and the level which banks bear the loss of their own capital. The smaller the ratio, the lower proportion of capital funds which used to cover the risk by banks and other financial institutions, and the lower stability of banking operation; The greater the ratio, the stronger stability of banking operation.

III. Interest Rate Risk Management Analysis of Henan Local Banks

(1) Introduction of Henan local Banks
Henan is a larger province in China, and its banking system is sound. The local banks in Henan Province are mainly composed of 17 city commercial Banks, 207 small and new rural financial institutions. 13 city commercial banks, including Xinyang bank, Kaifeng bank, Xinxiang bank and Xuchang bank formed a regional joint-stock commercial bank, which was the central bank. The development of local banks plays an
significant role in economic development of Henan Province\textsuperscript{[4]}.

(II) Interest rate risk management analysis of Henan local Banks

1 Analysis of the ratio of net interest income to operating income

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<tbody>
<tr>
<td>Zhengzhou bank</td>
<td>71.69</td>
<td>71</td>
<td>72.07</td>
<td>96.55</td>
<td>96.42</td>
<td>95.5</td>
<td>87.85</td>
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<tr>
<td>Luoyang Bank</td>
<td>95.95</td>
<td>95.42</td>
<td>93.26</td>
<td>96.06</td>
<td>96.38</td>
<td>95.69</td>
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<tr>
<td>Pingdingshan Bank</td>
<td>93.73</td>
<td>89.28</td>
<td>85.01</td>
<td>78.02</td>
<td>68.54</td>
<td></td>
<td></td>
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<tr>
<td>Central bank</td>
<td></td>
<td>95.32</td>
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<td>93.34</td>
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(Data sources: annual reports of each bank)

As is seen from table 1 that net interest income remains the main source of income of Luoyang bank, Zhengzhou bank and the central bank, while it accounts (accounted) for a relatively small proportion of operating income in Pingdingshan Bank. In general, net interest income which accounts (accounted) for about 80\% of operating income is still the main source of income of four local banks. In addition, net interest income to operating income of four local banks in 2009-2015 showed a downward trend from table 1, but the ratio is about 40\% of commercial banks in developed countries of Europe where intermediate business involved in many fields. The ratio of Henan local Banks is about 20\%, this proves that the intermediate business is slightly lower, and Henan local banks are still facing big challenges.

Analysis of asset liability ratio

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<tbody>
<tr>
<td>Zhengzhou bank</td>
<td>95.11</td>
<td>95.2</td>
<td>91.33</td>
<td>92.6</td>
<td>93.61</td>
<td>94.42</td>
<td>93.29</td>
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<tr>
<td>Luoyang Bank</td>
<td>94.25</td>
<td>93.63</td>
<td>93.73</td>
<td>91.88</td>
<td>92.04</td>
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<td>92</td>
</tr>
<tr>
<td>Pingdingshan Bank</td>
<td>90.18</td>
<td>85.6</td>
<td>87.82</td>
<td>89.92</td>
<td>88.08</td>
<td></td>
<td></td>
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<tr>
<td>Central bank</td>
<td></td>
<td>86.66</td>
<td></td>
<td></td>
<td></td>
<td>89.18</td>
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</tr>
</tbody>
</table>

(Data sources: annual reports of each bank)

As is seen from table 2 that asset liability ratio of each year is maintained at around 93\% in Zhengzhou bank, while it has declined since 2012 in Luoyang Bank, and it maintains below 90\% in most years in Pingdingshan Bank and Central bank. The core adequacy ratio of commercial banks cannot be less than 8\% according to the Basel III, which means commercial bank's asset liability ratio below 92\% is a normal level. Therefore, Luoyang Bank solvency is better, as well as Pingdingshan Bank and Central bank, Zhengzhou bank's asset-liability ratio is a bit high.

Analysis of capital adequacy ratio
Table 3. Capital adequacy ratio of four local banks in 2009-2015.

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<tbody>
<tr>
<td>Zhengzhou bank</td>
<td>14.67</td>
<td>11.61</td>
<td>18.45</td>
<td>15.26</td>
<td>12.08</td>
<td>11.12</td>
<td>12.2</td>
</tr>
<tr>
<td>Luoyang Bank</td>
<td>13.17</td>
<td>14.28</td>
<td>12.27</td>
<td>15.56</td>
<td>13.18</td>
<td>12.28</td>
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<tr>
<td>Central bank</td>
<td></td>
<td></td>
<td>19.58</td>
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<td>16.4</td>
</tr>
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</table>

(Data sources: annual reports of each bank)

As is seen from table 3 that capital adequacy ratio had declined since 2012 of Luoyang Bank and Pingdingshan Bank; it declined since 2013 of Luoyang Bank; and it declined in the past two years in Central bank. In general, capital adequacy ratios which mostly stable at around 13% in recent years of four local Banks in Henan Province all reached the minimum requirements of the “Basel agreement III” on the capital adequacy ratio shall not be less than 8%. The more capital adequacy ratio, banks are better able to withstand risks, and the better the operational stability, so in order to better adapt to the “Basel agreement III” on the capital adequacy requirements, there is still room for improvement in the capital adequacy ratio of local banks in Henan province.

IV. Suggestions on Strengthening Management of the Interest Rate Marketization Risk of Local Banks in Henan Province

(I) Accelerate the development of intermediary business, and accelerate the promotion of product innovation

Under the condition of interest rate marketization, deposit and loan spreads continue to decline, the competition in the deposit and loan business is becoming more and more intense, the state-owned commercial banks have a great advantage in the scope of business and the type of business, and this situation will be maintained in the short term, while local banks need to cultivate the profit growth point of the intermediary business, so that reduce their reliance on traditional deposit and loan business, to adapt to the market demand of the development of intermediary business, to improve their competitiveness. Intermediary business of low cost, stable income, good benefits, has become one of the important standards to measure the development level and comprehensive strength of the local banks, and low capital consumption of intermediary business has become a new profit growth point of local banks. Compared with commercial banks, local banks should make full use of their own flexibility, provide comprehensive financial services and financial products according to target customer's production, operation and management, in order to win the competition and accelerate the product innovation. Under the condition of interest rate marketization, accelerating the development of intermediary business, accelerating product innovation can strive for profit, retain profits into capital and better promote the development of local banks in Henan Province.

(II) Strengthen the management of assets and liabilities

Combined their own risk preference, business development goals and development characteristics, the local banks in Henan Province should strengthen the management of assets and liabilities, reasonably match the source and use of funds.

On the assets side, the bond investment has increased, but the dominant position is still credit assets. Local Banks should hold the opportunities of the bond market development, focus on investment floating short-term interest rate bonds, to reduce the proportion of credit assets, and increase the proportion of the investment business appropriately.
On the liability side, various channels should be used to increase customer stickiness, ensure the source of the deposit, improve the passive liability which relied on resident deposit enterprises and institutions deposit.

By strengthening the management of assets and liabilities, to better match the benefits and internal capital costs between assets and liabilities, improve the structure of assets and liabilities, ensure liquidity safety, control the market risk, and improve the income level.

(III) Improve the quality of employees, strengthen the management of non-performing loans
Non-performing loans which seriously affect the profitability of local banks restrict the economic development of Henan Province, so it’s crucial to strengthen its management. In the management of non-performing loans, the quality of employees needs to be further improved, promoting the talent training program, strengthening the communication with domestic and foreign commercial banks and etc can be used. The improvement of the quality of employees can reduce some unnecessary losses, and play an effective role in making decisions. So improving the quality of employees, strengthening management of non-performing loans let the local banks in Henan province occupy a place in the competition under the condition of interest rate marketization.

V Conclusions
With the accelerating process of interest rate marketization, the local banks in Henan Province face a greater risk of interest rate marketization, managing risk effectively can promote the development of local banks in Henan Province and the economic development of Henan Province. This paper analyzes the present situation of management of interest rate marketization in Henan Province, then puts forward some suggestions, such as promoting the development of intermediate business; promoting the product innovation; strengthening the management of assets and liabilities, improving the quality of employees, strengthening the management of non-performing loans, and etc. In the future research, more discussions will be finalized.

References
[1] Wu Qiong. Study on the interest rate risk management of commercial banks in China under the condition of interest rate marketization, taking the merchants bank as an example [D]. Kunming: Kunming University of Science and Technology, 2015.