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China Financials | Asia Pacific

Doubling down in anti-involution and de-leveraging

China policy makers are doubling down on the harder but more sustainable path to address over-capacity risks in China rather than via the path of re-leveraging up to boost short-term demand. Two recent policies have further increased our confidence of lower financial risk over the long run.

Stricter State Council policy to enforce timely payments to SMEs and new NDRC policy to prevent irrational price competition should help reduce irrational competition and financial risks. Specifically, the new State Council policy has set more specific standards on timing of product and service delivery, further shortened maximum payable period, and require (rather than encourage in previous policies) SOEs to pay SMEs by cash rather than payable bills. More detailed monitoring and enforcement system is also established with a focus on large corporates with higher payables. This policy will help further contain the leverage of large corporates, reduce SME credit risk via improving SME's cash flow and contain irrational capacity expansion by large corporates. Separately, NDRC and SAMR released standards of cost accounting, which is a key parameter when judging if any corporates are engaged in irrational pricing setting and competition. Both new policies are key to effectively push forward anti-involution efforts despite already positive CPI and PPI.

New policies show the dedication to a more sustained path to lower over-capacity and financial risk, despite some near-term pain. We believe the Fair Competition Review Regulations issued by the State Council in June 2024 mark the official start of anti-involution efforts. One of the key requirements in the document that prevents illegal and improper tax reduction by local governments to support industrial capacity expansion continue to be a key tool in the anti-involution tool box, with even more strict enforcement in 2026. We have seen many policies rolled out since then that have successfully led to more rational capacity expansion and over-capacity reduction, with nearly 90% of manufacturing sectors having slowed capacity expansion vs. 1H24 and overall industrial investment growth running below demand growth since September 2025.

Dedicated anti-involution efforts also create room for further de-leveraging in other parts of the financial system. We believe policies since mid-2024 have been targeting the root causes behind the over-capacity risks and have put a series of long-term control on the risks. With continued efforts and already notable progress on the rationalization in industrial investment growth, we have seen additional de-leveraging efforts, including more strict control on LGFV debt, higher return requirements on projects supported by local special bonds, and higher tolerance for needed household de-leveraging. Despite the drag on near-term credit demand, it will reduce long-term risks quicker, support loan pricing and NIM, and support a further re-rating for China financial stocks, in our view.

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Two more policies to further reduce irrational competition and financial risks

We continue to believe that optimize industrial supply via various types of anti-involution policies than boosting already stretched domestic demand via leverage is a much more sustainable solution to over- capacity issues and related financial risks in China. We continue to see policy moving toward this more sustainable path.

Notably, we have seen two more policies that help shape China development toward this direction:

1. NDRC and SAMR released the Notice on Matters Relating to Cost Accounting in Cases of Low-Price, Disorderly Competition in Key Industrial Products, aiming to further address irrational price competition in selected industrial manufacturing industries and safeguard fair competition and orderly market conditions.
2. On September 10, the General Office of the State Council released a circular on strengthening the governance of delayed payments to SMEs.

Cost Accounting for Low-price, Disorderly Competition: Another concrete step in the anti-involution campaign

The notice focuses on industrial sectors where irrational price competition remains acute and clarifies how regulators should determine firms' individual production costs, including the use of audited accounting records, industry-average costs where firm-level costs cannot be directly established, and adjustments for capacity utilization. The authorities explicitly linked the measure to the broader campaign of anti-involution and said its objective is to encourage industries to shift from competing primarily on price toward competing on quality and innovation.

We view this as another meaningful step toward addressing China's overcapacity problem from the supply side rather than attempting demand stimulus. Importantly, the notice does not administratively set product prices or prohibit normal price competition; rather, it creates a more enforceable basis for identifying disorderly pricing and gives regulators clearer tools for market monitoring, cost investigations, regulatory guidance and enforcement. In our view, this is consistent with the emerging direction of anti-involution policy: improving industry economics by reducing destructive price competition and accelerating the exit or restructuring of inefficient capacity. If implemented consistently, such measures should help restore margins and investment discipline in affected industries while reducing the financial risks associated with sustaining excess capacity through continued leverage.

Addressing payment delays to SMEs: Not a new policy objective but a renewed push to strengthen implementation

The new measures include encouraging large companies to limit payment terms to within 60 days and make payments in cash, establishing stronger monitoring of large enterprises

with unusually high accounts payable, tightening disclosure and enforcement, strengthening the role of SOEs as timely payers, and incorporating payment discipline into government procurement and investment-project supervision.

We believe the new rules will help control shadow leverage at large corporates, ensure more rational capacity expansion, improving cash flow at SMEs and reduce hidden financial risks.

The underlying policy is clearly not new. China began a nationwide campaign to clear arrears owed to private and small enterprises as early as late 2018, followed by repeated clearing campaigns and a dedicated Regulation on Ensuring Payments to SMEs in 2020. The government launched another special campaign against SME payment arrears in 2022, while the payment regulation itself was substantially revised in 2025 and took effect in June that year.

The repeated need for campaigns and progressively stronger rules suggests that the rules have been loosely implemented and delayed payments have remained sufficiently widespread. **The latest circular therefore set up more explicit industry-specific payment rules** (i.e., a "60-day cash payment" etc.) to close implementation gaps. We think stronger enforcement could be particularly helpful for smaller suppliers with shorter receivable cycles and improving cash flows without requiring them to take on additional leverage, which would also benefit from financial resource allocation perspective.

Date	Policy / action	Major requirements
2018-2019	Nationwide campaign to clear arrears owed to private firms and SMEs	• Focused on **overdue payments owed by government departments, affiliated institutions and large SOEs** to private enterprises and SMEs. • Required local authorities to establish arrears ledgers and clear priority arrears by specified deadlines. • Required authorities to prevent new arrears and strengthen audit / inspection. • Responsibility allocated under "local management, tiered responsibility, regulator responsible."
July 2020	Original Regulation on Ensuring Payments to SMEs	• Established **a permanent legal framework covering payments by government agencies, public institutions and large enterprises to SMEs**. • Required timely payment and prohibited large enterprises from using their dominant position to delay payment. • **Introduced basic rules** on payment periods, inspection / acceptance, overdue interest and disclosure of overdue government payments. • Allowed non-cash payment instruments subject to contractual agreement
May 2022	Special action to prevent and resolve SME payment arrears	• Required **undisputed arrears to be cleared as fully as possible**. • Where immediate payment was difficult, required a clear repayment plan. • Required faster resolution of disputed arrears through negotiation or legal channels. • Targeted malicious arrears and contracts containing unreasonable payment conditions or excessively long payment periods.
Sept 2022	Business-environment / government-credit measures	• Required overdue government payments to SMEs to be disclosed. • Targeted disguised arrears, including delaying contracts, invoices or acceptance procedures. • Targeted false repayment reporting. • Strengthened public supervision.

March 2025	Revised Regulation on Ensuring Payments to SMEs	• **Government agencies / public institutions generally must pay within 30 days**, with contractual extensions capped at 60 days. • **Large enterprises are strongly encouraged to pay within 60 days from delivery**; alternative contractual terms must be reasonable under industry norms and trading practices. • Prohibited clauses linking SME payments to receipt of payment from third parties. • Required explicit and reasonable inspection / acceptance periods; if acceptance is deliberately delayed, the payment clock starts from the contractual acceptance deadline. • **Non-cash payment instruments** such as commercial bills and electronic receivables **must be explicitly agreed** and cannot be forced on SMEs or used to disguise longer payment periods. • Strengthened supervision through inspections, interview and complaint handling
Sept 2026	State Council General Office Notice on Strengthening Governance of Delayed Payments to SMEs	• Requires to **specify four key payment elements**: Payment-period starting point, payment method / process, delivery or inspection / acceptance standards and deadlines, and maximum payment period. • Encourages industry-wide adoption of **maximum 60-day payment periods** and model contracts. • **Central SOEs must pay SMEs entirely in cash**; local SOEs are instructed to follow similar requirements. Government procurement is also required to use cash payment. • Where contracts do not specify payment method, government bodies, public institutions and large enterprises must **use cash rather than commercial bills or electronic receivables.** • Reduces the maximum maturity of electronic payment certificates to **six months** and prohibits financing of certificates with longer maturities. • Establishes monitoring of large corporates, with particular focus on **companies with large accounts payable but ample cash assets**. • Allows joint regulatory interviews, rectification orders, joint sanctions and public disclosure for serious violations. • Requires listed companies with large payables to disclose payment methods, average payment periods and use of commercial bills / electronic receivables. • Brings SOE payables, bills and electronic receivables into the regulatory system and calls for **look-through monitoring through treasury systems.** • Gives financing support to large corporates that demonstrably reduce payable periods and payable balances, including support for **replacing supplier credit with bank loans or bond financing**.

Continued anti-involution efforts since mid-2024 have helped to contain overcapacity issues

Government policy started addressing overcapacity issues in major industries in mid-2024

A number of policies have been published since mid-2024 to guide rational capacity expansion, from both a financial and non-financial perspective.

On the financial front, we have seen a gradual reduction in funding support for capex expansion. First, the PBOC reduced its window guidance on manufacturing loan growth in 2024. Meanwhile, the State Council published Rules for Fair Competition Review in June 2024, explicitly prohibiting the granting of preferential treatment to enterprises by local government, which used to be one of the key methods for local government to attract industrial investment. The launch of the initiative on "Timely Payment to SMEs" and "Guidance on Government Investment Funds" marks a further step toward limiting the unnecessary buildup of capex by reducing funding support. The latest circular on strengthening the governance of delayed payments to SMEs marks a further step to contain large corporates' leverage.

On the non-financial front, a number of ministries (such as NDRC, MIIT and MEE) also published documents to guide rational capacity expansion in some industries, especially those that have experienced rapid development in recent years (such as lithium-ion battery and solar) and traditional ones with low efficiency. These include strict controls on new capex buildup, elimination of low-quality capex and capex replacement/swap.

Theme	Date	Department	Document	Contents
Tax subsidy / local incentives	June 2024	State Council	Rules for Fair Competition Review	Prohibit the granting of preferential treatment to enterprises by local government
Capacity control	May-Jul 2024	NDRC, MIIT, MEE, SAMR, NEA	Energy Saving & Carbon Reduction Plan	Strictly prohibit or control new capacity in key industries, including steel, petroleum refining, synthetic ammonia, cement, metal, and electrolytic aluminum
Tax subsidy / local incentives	July 2024	The Third Plenum	The Third Plenum Decisions	Regulate policies on tax breaks, and strictly prohibit illegal policy incentives
Capacity control	July 2024	July politburo meeting	July politburo meeting	Facilitate the exit of inefficient industrial capacity and prevent fierce competition
Capacity control	Oct 2024	MIIT	Implementation Measures for Capacity Replacement in the Cement and Glass Industries (2024)	Tighten capacity replacement for cement and glass
				Prevent inefficient capacity from being used for replacement and restrict cross-provincial capacity inflows into regions with low utilization

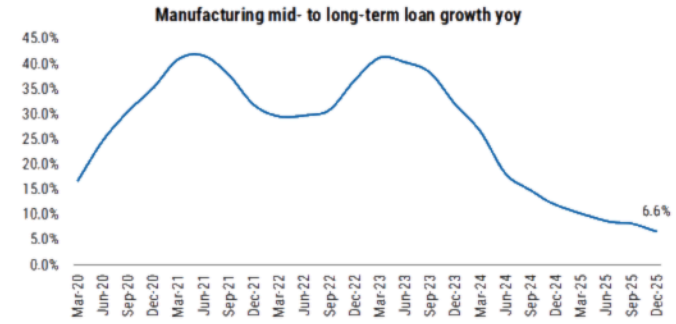
Capacity control	Nov 2024	MIIT	Standards for the Solar Manufacturing Industry (2024)	Guide solar firms to curb new manufacturing projects that simply expand existing capacity
Price competition	Dec 2024	Central Economic Work Conference	2024 Central Economic Work Conference	Explicitly call for comprehensive rectification of "involution-style" competition
Capacity control	Jan-Mar 2025	NDRC, MIIT and other departments	Action Plan for high-quality development of copper / new energy saving / aluminum industry	Push copper refining from capex expansion to efficiency enhancement Avoid haphazard investment of lithium-ion battery capex Restrict total capex of electrolytic aluminum
Funding support	March 2025	State Council	Revised Regulation on Ensuring Payments to SMEs	Government agencies / public institutions generally must pay within 30 days, with contractual extensions capped at 60 days Large enterprises generally must pay within 60 days from delivery
Capacity control	May 2025	NDRC	NDRC May press conference	Guide new energy vehicles and solar industry to focus on tech innovation Avoid blindly building up new capacity for aluminium oxide and coal chemical
Capacity control	Aug - Sep 2025	MIIT and four other departments	Steel Industry Stable Growth Plan (2025–26)	Strictly prohibit new capacity, continue crude-steel output reductions and strengthen capacity replacement
Price competition	Aug - Sep 2025	MIIT and six other departments	Automobile Industry Stable Growth Plan (2025–26)	Further regulate auto-sector competition through cost investigations, price monitoring and production-conformity inspections
Capacity control	Aug - Sep 2025	MIIT and five other departments	Building Materials Industry Stable Growth Plan (2025–26)	Strictly prohibit new capacity in cement clinker and plate glass
Capacity control	Aug - Sep 2025	MIIT and seven other departments	Non-ferrous Metals Industry Stable Growth Plan (2025–26)	Maintain tighter controls on expansion in major non-ferrous sectors Targets only ~1.5% annual growth in output of ten major non-ferrous metals in 2025–26
Price competition	Sep - Oct 2025	NDRC, SAMR	Announcement on Governing Disorderly Price Competition and Maintaining a Sound Market Price Order	Establish a broader anti-involution framework for industries with severe price competition
Capacity control	May 2026	MIIT	Steel Industry Capacity Replacement Implementation Measures	Further tighten steel capacity governance to promote capacity reduction

Funding support	Sep 2026	NDRC, SAMR	Notice on Cost Accounting for Low-Price, Disorderly Competition in Important Industrial Products	Investigate firms suspected of disorderly below-cost pricing and calculate firm-level or industry-average costs
Funding support	Sep 2026	State Council General Office	Notice on Strengthening Governance of Delayed Payments to SMEs	Encourages industry-wide adoption of maximum 60-day payment periods and model contracts.

Monthly data from ~400,000 industrial firms show continued rationalization in industrial investment, with improving profitability

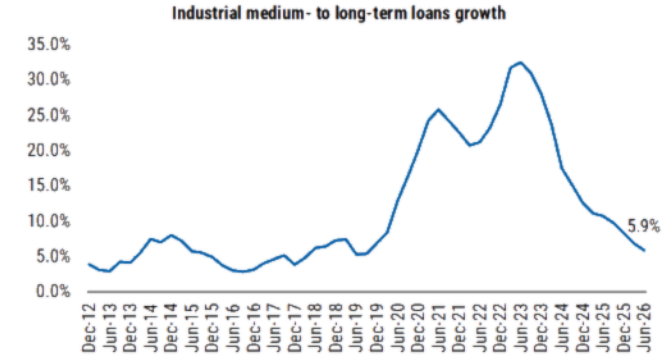
The continued moderation in industrial credit growth is a more effective way to contain capacity expansion, in our view. After years of rapid loan growth driven by window guidance, mid- to long-term manufacturing loan growth (a major support for capex) started to moderate from a peak of >30% in 2023 to 6.6% by end 2025, as policymakers started to reduce window guidance. The PBOC guided banks to support industrial medium- to long-term loans with real demand in its 2Q24 monetary report, instead of maintaining high growth in industrial loans. With less credit support, corporates will have limited room for capex buildup. We see this as a more effective and market-oriented way to control the build up of any new capex.

Exhibit 1: Manufacturing mid- to long-term loan growth continued to moderate...



Source NBS, CEIC, Morgan Stanley Research

Exhibit 2: ...as did industrial mid- to long-term loan growth



Source NBS, CEIC, Morgan Stanley Research

Multiple anti-involution efforts and a notable slowdown in manufacturing mid- to long-term loan growth have sent manufacturing capex to a meaningfully slower growth, while total industrial demand remained stable (albeit increasingly dependent on external demand). The gap between nominal manufacturing output growth and capex growth, which is a major signpost for industrial credit risks, has reversed from a positive gap of 5.5% at the end of 2024 to negative since September 2025. This suggests new risk formation in the sector should be slowing down materially.

Exhibit 3: The gap between manufacturing FAI and IP has closed since September 2025 with continued moderation in manufacturing FAI growth



Source: NBS, CEIC, Morgan Stanley Research

China has the world's most comprehensive industrial sector, spanning all major manufacturing categories and hundreds of thousands of enterprises across the supply chain. The breadth and decentralization of this industrial ecosystem create significant divergence across sub-sectors and, in our view, support a more balanced development model with lower overall volatility as industries move through different cycles.

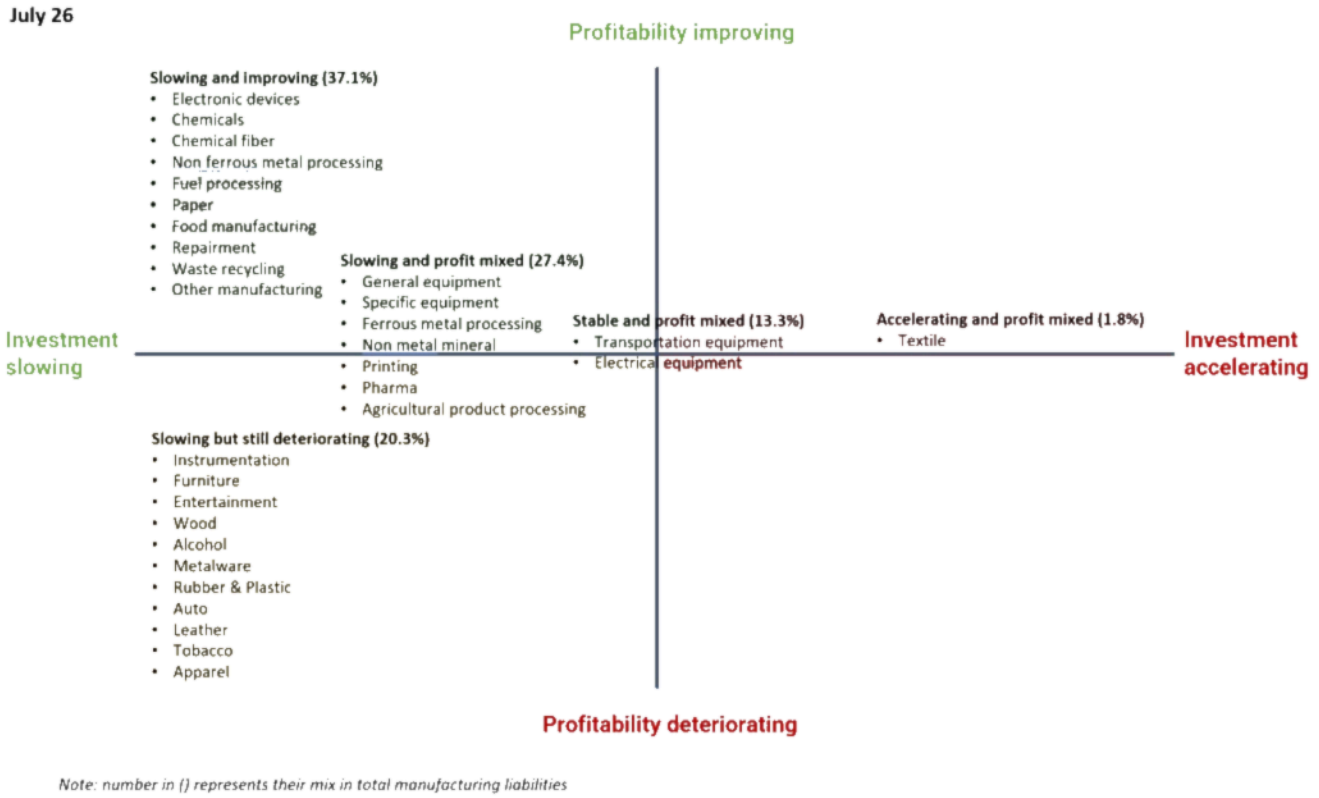
Our analysis shows that China's 31 manufacturing sub-sectors are at different stages of the cycle. As of July 2026, 37% of these sub-sectors (by liabilities) recorded improving profitability, while 85% (by liabilities) had slowed capex growth relative to 1H24.

- For example, electrical equipment manufacturing appears to be one of the clearest early-cycle beneficiaries, with sub-sector profits improving steadily since March 2025.
- In contrast, the auto manufacturing sub-sector has seen a slower moderation in FAI growth, which has weighed on profitability.

This greater divergence across industries should support sustainable industrial credit demand in the mid-to-long term, with more market-oriented resource allocation to sub-sectors with ongoing industrial and technology upgrades amid rational investment growth.

We believe China's full industrial supply chain with new diversified cycles should help support more steady credit demand and help spread out credit risk digestion. We believe positive PPI, reduced industrial credit risk, and a new credit demand cycle will support financial asset yields over time.

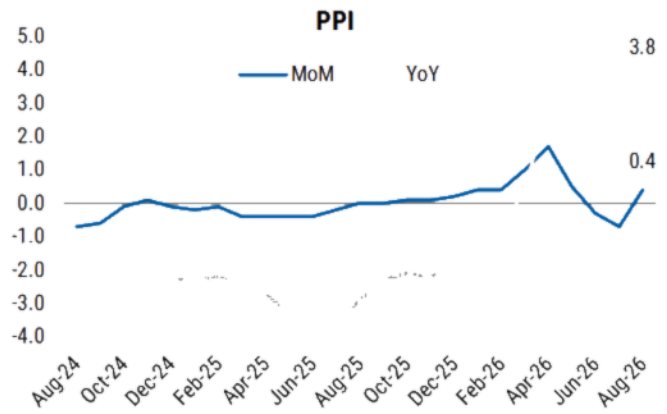
Exhibit 4: 85% (in terms of liabilities) of sectors slowed capex in July 2026; 37% of manufacturing sub-sectors showed better profit trends in July



Note: number in () represents their mix in total manufacturing liabilities

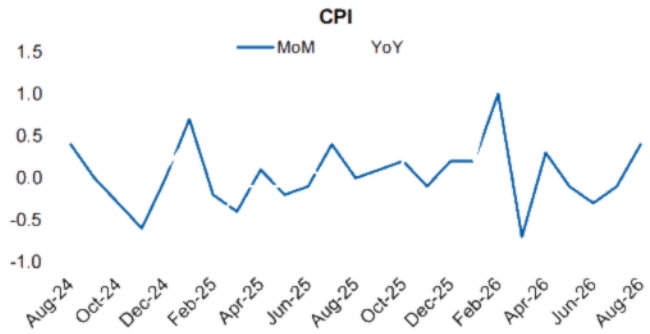
Source NBS, CEIC Morgan Stanley Research Note: number in () represents their mix in total manufacturing liabilities

Exhibit 5: PPI growth improved since mid-2025



Source NBS, CEIC Morgan Stanley Research

Exhibit 6: CPI also improved recently



Source NBS, CEIC Morgan Stanley Research



Exhibit 7: Overall manufacturing firms' YTD profits growth was 18.8% yoy in July 2026



Source: NBS, CEIC, Morgan Stanley Research

With better controlled capacity expansion and strong export growth, policy makers also pushed accelerated de-leveraging efforts

With better controlled industrial capacity expansion and demand support from strong export growth, it created more room for de-leveraging efforts and financial risk control. As a result, we have seen stronger push for local government, particularly LGFV de-leveraging efforts and tolerance for accelerated household de-leveraging. Despite some near-term pain, we believe this will ensure more stable financial system sooner and will actually support a quicker and stronger profit rebound for major banks in China.

Despite the progress, further household de-leveraging remains necessary in certain segments of household credit that have grown rapidly in recent years

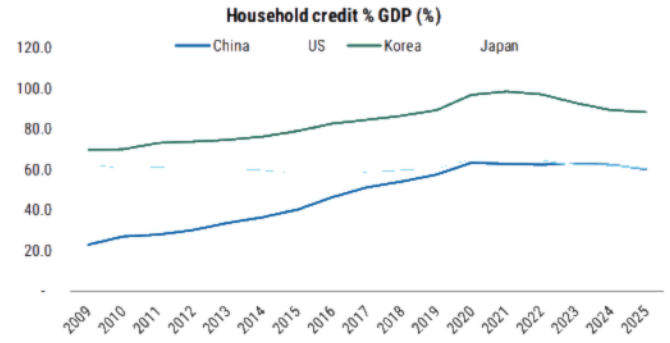
Following years of rising household leverage in China, we continue to expect household de-leveraging in 2026 despite the progress made in recent years. While the household debt-to-GDP ratio declined from 63.6% in 2020 to 60.5% in 2025, due to slower growth in mortgages, credit cards and P2P-related lending, we believe slower growth in consumer loans and personal business loans remains necessary over the next two years, particularly following the withdrawal of several policy support measures.

Despite the continued slowdown in overall retail credit growth from more than 10% before 2021 to around 0.6% in 2025, consumption loans and operating loans have continued to outpace overall growth. This largely reflects policy support for inclusive lending and the introduction of measures to boost consumption during the post-pandemic period. We believe both segments face a growing need for de-leveraging and normalization.

Recent policy developments also point to a more prudent approach toward consumption and operating loans. Rising credit card NPL ratio, reduced regulatory emphasis on quantitative inclusive lending targets, tighter oversight of operating loan usage, and efforts to curb excessively low consumer lending rates all suggest a shift away from growth at any cost toward more risk-adjusted expansion. In our view, a reasonable medium-term trajectory for household credit growth would broadly align with disposable income growth, or 3-4%. Such an outcome would improve the long-term sustainability of banks' retail lending businesses while supporting healthier consumption patterns.

China Financials: Further de-leveraging or positive development loop? How to invest? (9 Jul 2026)

Exhibit 8: Household credit % GDP in China continued to climb from ~23% in 2009 to ~64% in 2020, where it remained relatively stable before declining in 2025



Source: FRED, PBOC, WIND, CEIC, Morgan Stanley Research

Exhibit 9: Excluding operating loans, household leverage has declined since 2021



Source: PBOC, WIND, CEIC, Morgan Stanley Research

Recent developments suggest that LGFV financing discipline is tightening further

Enforcement is becoming both more granular and more personal. On September 11, 2026, the Central Commission for Discipline Inspection and MoF jointly disclosed six hidden-debt cases involving new borrowing, under-reporting, and false debt resolution, while reiterating that violations would be handled on a "discover one, investigate one, hold accountable one" basis. This suggests that LGFV discipline is no longer merely a matter of financing rules; it is increasingly being embedded in fiscal supervision and local officials' political incentives. Separately, the Xiaoshan case, publicly criticized in June 2026, involved both new hidden borrowing and a false LGFV exit. Taken together, we think these developments indicate that LGFV tightening remains firmly in place.

Bond issuance for LGFVs has become more restrictive. According to the *Shanghai Securities News* (July 13, 2026), regulators have recently restricted short-dated debt instruments for LGFVs refinancing existing obligations. At the same time, projects funded by local government special bonds are facing higher requirements on cash flow and investment returns. Policymakers have increasingly emphasized that special-bond proceeds should be directed toward projects with higher quality and stronger repayment capacity. In our view, this should channel funding toward projects with more credible economic returns, while reduce the underlying risks.

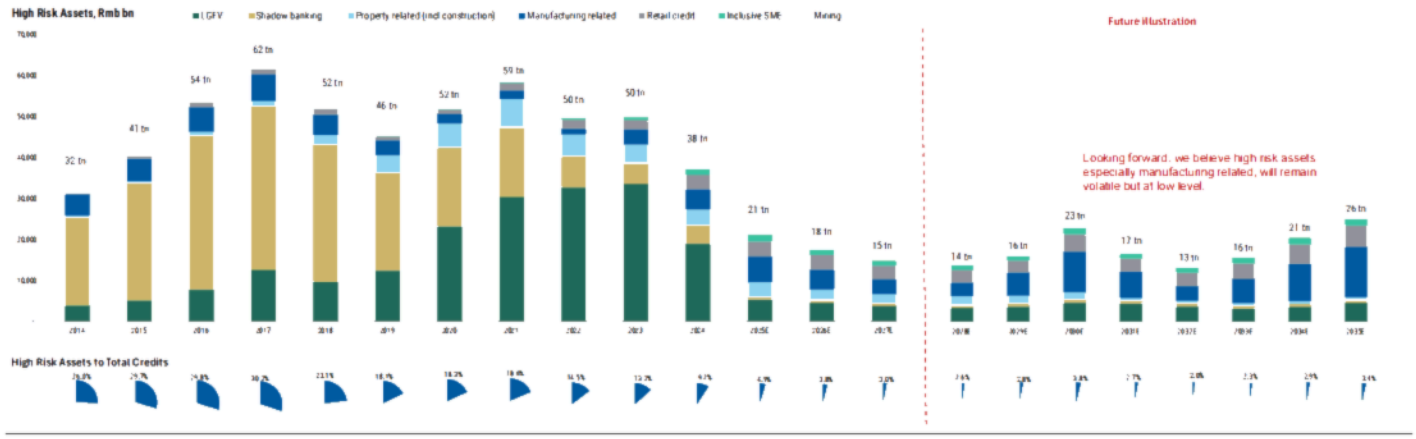
10-year de-risking process has cleaned up most financial risks

As we have highlighted in previous reports, China's relatively smooth financial clean-up over the past decade has benefited from periodic monetary and fiscal support measures (e.g., various forms of window guidance on loan growth), which helped cushion the tightening effects of the de-risking process. We believe the eventual withdrawal of many of these measures is necessary to support more sustainable long-term financial system growth.

The financial clean-up has successfully reduced high-risk assets in the financial system from Rmb62tn, or 30.2% of total financial assets, in 2017 to Rmb21tn, or less than 5% of total financial assets, in 2025. This reduction spans high-risk credit exposures across industrial sectors with excess capacity, property, LGFVs, shadow banking, retail lending, and inclusive SME financing.

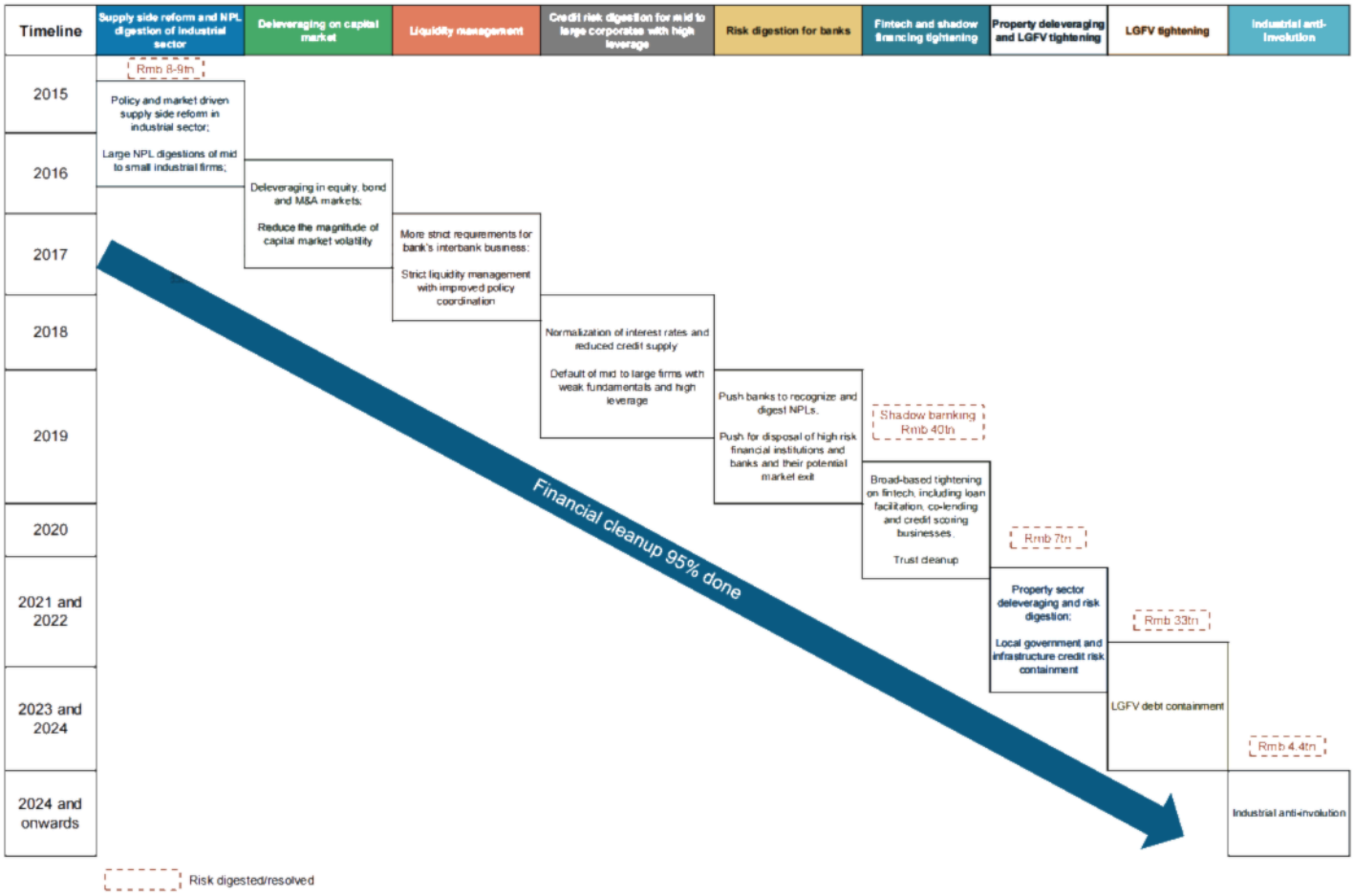
Please see: Financial system bottoming in 2025, and a Shift back to positive development mode.

Exhibit 10: Perceived movement of high-risk assets



Source: CEIC, PBoC, Wind, SSE, Trust Association, AMAC, NFRA, China Bank Association, Morgan Stanley Research

Exhibit 11: Most financial risks have already been cleaned up over the past 10 years

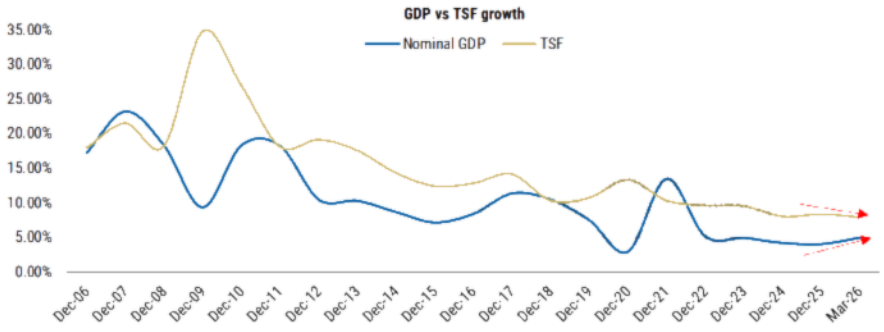


Source: Morgan Stanley Research

Through policy coordination, TSF growth has gradually slowed from the mid-teen levels seen around a decade ago to 7.2% currently, while maintaining a relatively orderly trajectory.

We believe there is further room for moderation as policymakers continue to phase out stimulus measures when conditions permit. As a result, we view TSF growth of around 6% as a more desirable and sustainable medium-term level. This should support more efficient credit allocation and a market-driven recovery in financial asset yields, while keeping financial firms focused on risk digestion rather than low-quality balance-sheet expansion.

Exhibit 12: The gap between TSF and GDP growth has been narrowing over the past 6 months - the same pattern happened in 2016 and 2017 and has benefited bank stocks



Source: PBOC, CEIC, Morgan Stanley Research

China Financials should continue to outperform in rest of 2026 and towards 2027

We continue to believe that China financials are more steady performers in a positive development loop, especially with smaller financial risks amid more actions to address overcapacity risks. We remain positive on financials and see broad-based financial outperformance in 2H26 and towards 2027. We expect a prolonged active capital market to support ROE expansion among leading brokers, while high savings levels and low deposit costs should sustain healthy growth for insurers despite some quarterly earnings volatility. For banks, we expect financial asset yield rebound and profit recovery should support steady performance in late 2026 and 2027.

Brokers: Capital market names are underappreciated beneficiaries of positive financial development loop

Rising trading volumes alongside household de-leveraging point to a more sustainable driver – asset reallocation rather than credit expansion. On the one hand, A-share trading activity has continued to rise and remain elevated in 2026, after 2025 ADT already exceeded the previous 2021 bull-cycle peak by around 50%; on the other, household deposit growth has slowed modestly, to 7.4% YoY in August 2026 from 9.7% in FY25, likely reflecting lower deposit yields and more rational credit growth, particularly in areas such as operating and consumer loans.

Household financial asset reallocation continued in 2026, following the rebound in equities' share of household financial assets to 10.5% in 2025 from a multi-year low of 9.3% in 2024, based on our estimates. We believe 2024 marked the trough before coordinated policy efforts successfully improved market sentiment following September 24, 2024. Even so, we believe current equity allocations remain 1-2 percentage points below the 13.3% level reached in 2021.

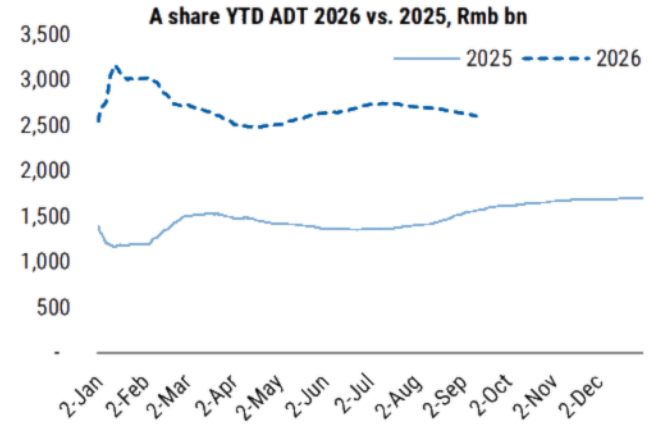
Primary and secondary market fundraising are entering a positive loop, while we remain in the early stages of a technology and industrial upgrade cycle characterized by rising capital intensity. Primary and secondary market fundraising reinforce one another. Historically, as private companies scale, they often progress to major IPOs or M&A transactions at a later stage. Supported by continued technological advances and encouraging developments in the Hong Kong IPO market, this private investment momentum has carried into 2026.

The elevated capital market trading and fundraising activities also translated into accelerating institutionalization trend:

- Mutual fund AUM rose to 40tn by Aug from 36tn+ at beginning of the year, despite the national team selling >1.5tn ETF.
- New launch of hybrid funds, which largely represent the active equity funds, has surged 2.5x yoy from Jan-July 2026.
- Private funds AUM added 5tn in last 12m, where 3tn was from securities funds and another 2tn from PE/VC funds.

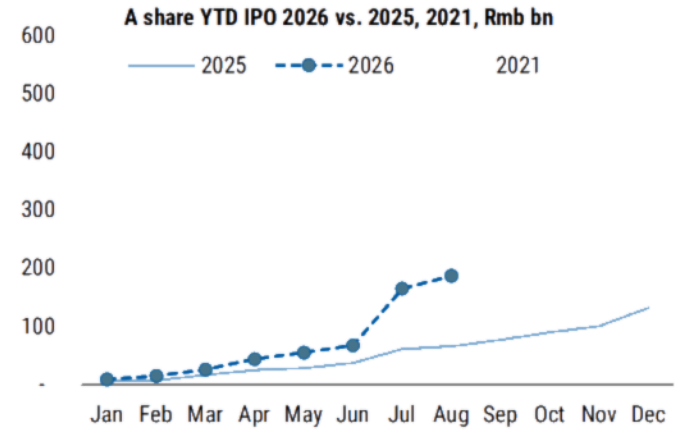
Growing participation of institutional investors has brought rising derivatives and equity trading demand, as well as led to further market share consolidation in brokerage business.

Exhibit 13: 2026 YTD A-share ADT tracking at >Rmb2.6tn, doubling YoY



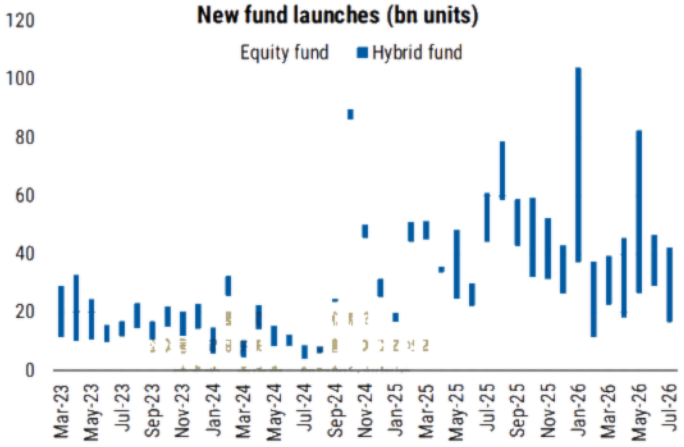
Source CEIC, Morgan Stanley Research. As of September 14, 2026.

Exhibit 14: A-share IPO YTD volume up 185% YoY



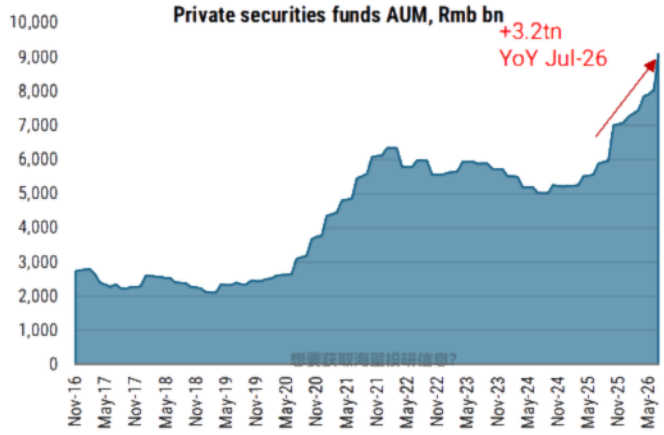
Source WIND

Exhibit 15: Newly launched hybrid mutual funds (largely representing actively managed equity funds) rose 254% YoY in Jan-Aug 2026



Source WIND

Exhibit 16: Private securities funds added a staggering Rmb3.2tn in AUM YoY as of July 2026



Source CEIC

Insurers: Solid fundamentals remain intact, despite near-term volatilities

Insurers delivered strong 1H26 results, with resilient and high-quality growth across both life and P&C names. Looking ahead, while the sector faces a challenging 3Q26 comparison base and near-term disruption from strengthened bancassurance regulations, we continue

to see evidence of high-quality execution.

Our constructive view is underpinned by three factors: (1) demand for savings-oriented products remains resilient despite a softer macro backdrop; (2) business quality continues to improve across both agency and bancassurance channels, supported by rising agent productivity and ongoing expense discipline in bancassurance; and (3) investment strategies are becoming increasingly prudent, with insurers maintaining broadly stable equity exposure while gradually increasing allocations to high-dividend assets. This should help mitigate earnings volatility over time, while more insurers have begun to disclose more robust underlying earnings metrics since 1H26.

We expect sales momentum in both agent and bancassurance channels to improve in late 3Q26 and 4Q26 relative to early 3Q26, which would reinforce our view that underlying insurance demand remains healthy. Meanwhile, balance sheet quality and risk management capabilities should continue to strengthen as insurers adapt to the evolving ALM (asset liability management) regulatory framework. Sector valuations also appear increasingly attractive, supported by solid net asset growth and satisfactory shareholder returns. Key watch points include: (1) the pace at which bancassurance channels adapt to the new regulations and regain growth momentum, and (2) the early progress of 2027 sales campaigns.

Banks: Steady performers with improving margin and profit outlook

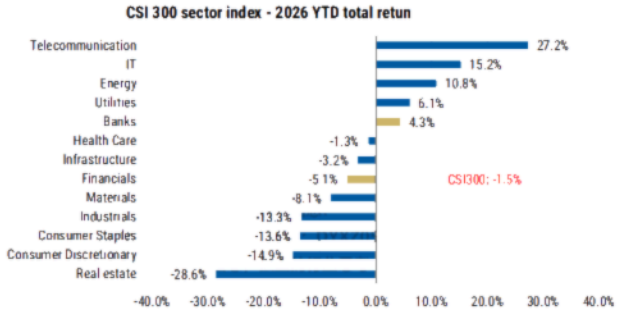
Continued anti-involution efforts should help to reduce over capacity and financial risks, which will benefit financial asset yields and banks' NIM. Specifically, we forecast a gradual 50bp recovery in financial asset yields over the next three years, with potential upside to a 70-80bp recovery over the same period in our bull-case scenario. We expect NIMs to stabilize sooner and begin a modest recovery from 2026 onward, which should support NII and revenue growth.

In addition, lower financial risks should reduce credit cost and support profit recovery despite some asset quality pressure from the retail side amid household de-leveraging. We expect China banks' ROEs to show further signs of stabilization in 2026, with the long-term ROE of our covered banks stabilizing at around 9%.

In fact, H-share banks have outperformed the market YTD, up 17.4% vs flat HSI. While the A-share market is dominated by IT and telecom, banks have still delivered a 4.3% increase YTD, well beating the overall market (i.e., CSI300 -1.5%). Given our expectation of reduced financial risks and sustained profitability recovery, we believe banks should continue to deliver steady performance.

China Banks: 2Q26 Wrap: Accelerated profit growth for SOE banks, with divergence among mid-sized banks (30 Aug 2026)

Exhibit 17: CSI 300 sector total return



Source: Bloomberg, as of September 14, 2026

Exhibit 18: HSI sector total return

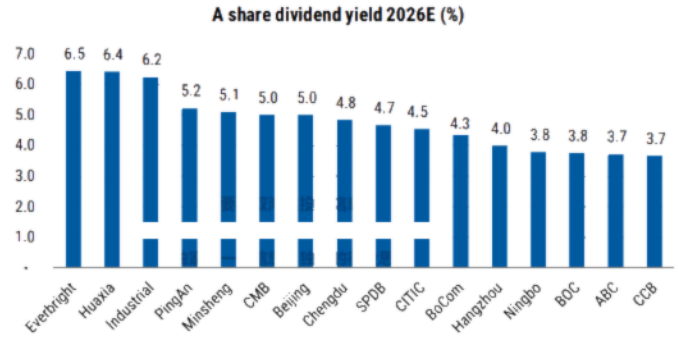


Source: Bloomberg, as of September 14, 2026

Dividend yields for A-share banks vary from 3.7-6.5%, and for H shares from 4.6-8%.

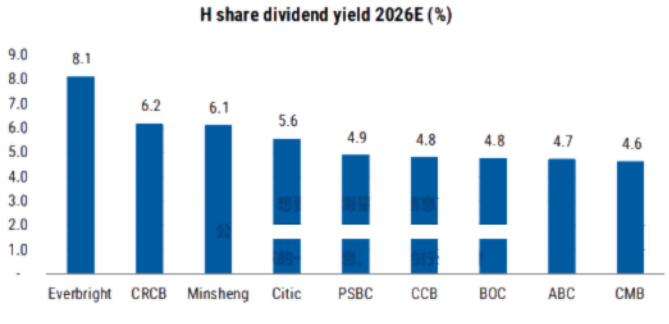
- **Bank of Ningbo** remains our Top Pick, with double-digit loan and profit growth, ongoing market share gains amid more rational competition, and superior products and services.
- **Industrial Bank** offers a still attractive dividend yield among all the A-share banks under our coverage at 6.2%.
- **CITIC Bank - H** remains attractive with a 5.6% dividend yield and healthy profit growth.
- Among SOE banks, we prefer **CCB-H** and **BOC-H** due to their stable profit growth with capital-injection dilution already fully reflected.

Exhibit 19: A-share dividend yield



Source: Morgan Stanley Research estimates (E). Close price of September 14, 2026

Exhibit 20: H-share dividend yield



Source: Morgan Stanley Research estimates (E). Close price of September 14, 2026

Exhibit 21:

Valuation for banks

		Ticker	Price	P/E		P/B		Div Yield		ROE		ROA	
				26E	27E	26E	27E	26E	27E	26E	27E	26E	27E
Chinese Banks								(%)	(%)	(%)	(%)	(%)	(%)
H Share Banks													
ABC	OW	1288.HK	6.42	6.7	6.4	0.65	0.61	4.7	5.0	10.0	9.9	0.6	0.6
CCB	OW	0939.HK	9.89	6.3	5.9	0.57	0.53	4.8	5.1	9.8	9.7	0.7	0.7
BOC	OW	3988.HK	6.09	7.0	6.7	0.60	0.56	4.8	5.1	8.7	8.7	0.6	0.6
PSBC	OW	1658.HK	5.39	6.6	6.2	0.57	0.53	4.9	5.2	8.4	8.9	0.4	0.4
CMB	OW	3968.HK	52.75	7.7	7.3	0.95	0.88	4.6	4.9	13.0	12.6	1.1	1.1
Citic	OW	0998.HK	8.51	5.7	5.2	0.52	0.49	5.6	6.0	9.5	9.6	0.7	0.7
Minsheng	OW	1988.HK	3.60	4.9	4.5	0.23	0.22	6.1	6.7	4.8	5.0	0.3	0.4
BoCom	UW	3328.HK	8.16	6.7	6.5	0.51	0.49	4.7	4.9	7.8	7.7	0.6	0.6
Everbnght	UW	6818.HK	2.83	4.2	4.0	0.24	0.23	8.1	8.6	6.6	6.7	0.5	0.5
CRCB	UW	3618.HK	6.30	4.8	4.6	0.43	0.40	6.2	6.5	9.1	9.0	0.7	0.7
Average				**6.1**	**5.7**	**0.53**	**0.49**	**5.5**	**5.8**	**8.8**	**8.8**	**0.6**	**0.6**
A Share Banks													
PingAn	OW	000001.SZ	11.85	5.5	5.2	0.48	0.44	5.2	5.5	8.9	8.8	0.7	0.7
Minsheng	OW	600016.SS	3.71	5.9	5.4	0.28	0.27	5.1	5.6	4.8	5.0	0.3	0.4
Industrial	OW	601166.SS	18.15	5.0	4.6	0.44	0.40	6.2	6.8	9.0	9.1	0.7	0.7
CMB	OW	600036.SS	41.83	7.1	6.7	0.88	0.81	5.0	5.3	13.0	12.6	1.1	1.1
Ningbo	OW	002142.SZ	35.76	7.4	6.4	0.96	0.86	3.8	4.3	13.6	14.1	0.8	0.9
Chengdu	OW	601838.SS	20.25	6.2	5.7	0.86	0.75	4.8	5.3	14.7	14.1	0.9	0.9
ABC	EW	601288.SS	7.00	8.6	8.1	0.83	0.78	3.7	3.9	10.0	9.9	0.6	0.6
CCB	EW	601939.SS	11.11	8.3	7.8	0.75	0.70	3.7	3.9	9.8	9.7	0.7	0.7
BOC	EW	601988.SS	6.64	9.0	8.5	0.76	0.72	3.8	4.0	8.7	8.7	0.6	0.6
CITIC	EW	601998.SS	8.94	7.0	6.5	0.64	0.60	4.5	4.9	9.5	9.6	0.7	0.7
SPDB	EW	600000.SS	9.40	6.5	6.0	0.44	0.41	4.7	5.0	6.7	7.1	0.5	0.5
Beijing	EW	601169.SS	5.68	7.0	6.7	0.42	0.40	5.0	5.2	6.1	6.1	0.3	0.3
Hangzhou	EW	600926.SS	17.69	6.3	5.7	0.84	0.73	4.0	4.4	14.1	13.6	0.8	0.8
BoCom	UW	601328.SS	7.62	7.3	7.1	0.56	0.53	4.3	4.5	7.8	7.7	0.6	0.6
Everbnght	UW	601818.SS	3.05	5.3	5.0	0.30	0.29	6.5	6.8	6.6	6.7	0.5	0.5
Huaxia	UW	600015.SS	6.37	3.9	3.8	0.30	0.28	6.4	6.6	7.9	7.6	0.5	0.5
Average				**6.6**	**6.2**	**0.6**	**0.6**	**4.8**	**5.1**	**9.5**	**9.4**	**0.6**	**0.6**

Source: FactSet, Morgan Stanley Research estimates (E). Close price as of September 14, 2016.

Valuation Methodology and Risks

Bank of Ningbo Co. Ltd (002142.SZ)

We continue to use a three-stage dividend discount model, probability-weighted 60% base, 20% bull, 20% bear, based on our view of asset yield rebound and smooth risk digestion for China's banks in a positive development loop, and an equally likely polarity for credit risks and global demand.The discount rate is 11.4% in the base case, and we assume 13.7% for second-stage and 13% for long-term ROE with a 58% dividend payout ratio in the long run.

Risks to Upside

- Noticeable reduction in policy intervention amid a rapid rebound in business fundamentals.
- Better-than-expected NIM and asset quality.
- Higher-than-expected non-interest income from stronger wealth management business revenue.

Risks to Downside

- Risks from potential change in leadership.
- Higher default risks from SME and retail business expansion.
- Pricing pressure from destructive competition in the market.

China Construction Bank Corp. (0939.HK)

3-stage dividend discount model, probability-weighted 60% base, 20% bull, 20% bear, based on our view of asset yield rebound and smooth risk digestion for China's banks, and an equally likely polarity for credit risks and global demand. Base case assumptions: 9.0% discount rate, 8.9% second-stage ROE, 8.3% long-term ROE, 34% long-term dividend payout. We apply a 1.14 RMB/HKD exchange rate and 10% discount on target P/B for H share price target.

Risks to Upside

- Noticeable reduction in policy intervention amid a rapid rebound in business fundamentals.
- Higher-than-expected non-interest income from stronger equity market.

Risks to Downside

- Further slowdown in China's macro economy.
- Accelerated deposit rate deregulation.
- Potential higher credit risk of SME loans as CCB shifts loan allocation to inclusive finance.
- Large social responsibility as state-owned bank.

China CITIC Bank Corporation Limited (0998.HK)

3-stage dividend discount model, probability-weighted 60% base, 20% bull, 20% bear, based on our view of asset yield rebound and smooth risk digestion for China's banks, and an equally likely polarity for credit risks and global demand. Base case assumptions: 9.8% discount rate, 9.2% second-stage ROE, 8.8% long-term ROE, 39% long-term dividend payout. We apply a 1.14

RMB/HKD exchange rate and 10% discount on target P/B for H share price target. **Risks to**

Upside

- Faster-than-expected fee growth.
- Better-than-expected asset quality.
- Noticeable reduction in policy intervention.

Risks to Downside

- Asset quality could deteriorate if economic trends worsen.
- Unexpected decrease/slowdown in fee income.
- Social responsibilities continue to weigh in.

Bank of China Limited (3988.HK)

3-stage dividend discount model, probability-weighted 60% base, 20% bull, 20% bear, based on our view of asset yield rebound and smooth risk digestion for China's banks, and an equally likely polarity for credit risks and global demand. Base case assumptions: 8.4% second-stage ROE, 8.2% long-term ROE, 35% long-term dividend payout. We apply a 1.14 RMB/HKD exchange rate and 10% discount on target P/B for H share price target.

Risks to Upside

- Noticeable reduction in policy intervention amid a rapid rebound in business fundamen- tals.
- Better-than-expected NIM and asset quality.
- Higher-than-expected non-interest income from stronger wealth management busi- ness revenue.

Risks to Downside

- Social responsibilities coupled with a market downturn.
- Further economic slowdown in overseas markets, which could put pressure on credit quality and asset yield.

Industrial Bank Co. Ltd. (601166.SS)

We continue to use a three-stage dividend discount model, probability-weighted 60% base, 20% bull, 20% bear, based on our view of asset yield rebound and smooth risk digestion for China's banks in a positive development loop, and an equally likely polarity for credit risks and global demand. The discount rate is 10.6% in the base case; we assume 9.3% for second-stage ROE and 9.5% for long-term ROE, with a 42% dividend payout ratio in the long run

Risks to Upside

- Faster-than-expected bond market development.
- More resilient credit demand leading to stronger NIM.
- Noticeable reduction in policy intervention.

Risks to Downside

- Slower-than-expected retail AUM growth, resulting in less support for the sale of asset management products.
- Worse-than-expected asset quality.
- Slower build-up of regulatory system for asset management that delays consolidation.