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Stock Market Liquidity and Bank Non-performing Loans: Evidence from China

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Abstract: *This paper examines the impact of stock market liquidity on bank stability in China using financial and stock market data. Based on 2,141 bank-year observations from 2008–2018, I finds that higher stock market liquidity enhances bank stability by reducing non-performing loans. Post-crisis analysis reveals that this positive relationship persists after the 2008 global financial crisis. Further, the crisis and bank ownership structure influence the effect of market liquidity: the crisis increased non-performing loans more during illiquid periods, and state-owned banks are more vulnerable to declining liquidity than non-state-owned banks. The findings offer new insights and practical implications for financial stability and policy.*

Keywords: *stock market liquidity, bank non-performing loans, bank stability*

1. Introduction

Banks and stock markets are crucial to China's financial economy, as they provide funding for companies. Financial innovations and liberalization have strengthened their connection, with both institutions supporting firms rather than competing. Exploring their relationship is vital, as the stability of the economy depends on these two sectors.

However, research on the link between stock market liquidity and bank stability is limited. The only relevant study, by Ama Samarasinghe, used cross-country data and found a positive association between stock liquidity and bank stability (Samarasinghe, 2023)[1]. No such examination exists for the Chinese stock market, leaving the applicability of Samarasinghe's global findings to China uncertain. Besides, There is a conflict between the opportunity hypothesis, which links high stock market liquidity to bank stability, and the cannibalization hypothesis, which suggests the opposite. This paper aims to address these two research gaps.

This paper examines the impact of stock market liquidity on bank stability in China, finding that higher liquidity reduces non-performing loans. Two explanations are proposed: first, increased liquidity boosts firms' cash flow through stock transactions, improving loan repayment and enhancing bank stability. Second, the opportunity hypothesis suggests that favorable capital markets (high liquidity) encourage firms to issue more equity, lowering non-performing loans and strengthening bank stability (Hanselaar et al., 2019)[2]. Thus, I hypothesize that stock market liquidity is negatively linked with non-performing loans in China.

I use data from 337 Chinese banks (2008-2018) to explore the impact of stock market liquidity on bank stability, measured by non-performing loans. The findings show that higher stock market liquidity leads to lower non-performing loans, improving bank stability. This result is statistically significant and robust, even after excluding 2008 crisis data. Further analysis reveals that state-owned banks experience higher non-performing loans when stock liquidity decreases, reflecting their unique financial responsibilities.

The findings of this paper contribute to academic literature by addressing the insufficient empirical evidence on the relationship between stock market liquidity and the banking industry (Samarasinghe & Uylangco, 2022)[3]. No studies have yet examined this relationship within the context of the Chinese stock market. Analyzing these effects provides valuable insights into the relationship between financial markets and the banking sector. Specifically, the results will help determine whether banks and stock markets are complementary or competing. Additionally, this study offers practical and policy implications, such as the potential for banks to improve risk management by enhancing their ability to obtain stock market information.

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The rest of this paper is organized as follows: Section 2 presents the literature review and hypothesis development. Section 3 outlines the data selection, research design, summary statistics, and correlation analysis. Section 4 discusses the main regression results, robustness tests, and additional analyses. Section 5 concludes the paper.

2. Literature Review and Hypotheses Development

2.1 Evidence on the correlation between stock liquidity and bank non-performing loans

Stock market liquidity is an vital measure of stock market value and has been used in prior research to assess capital market quality (Samarasinghe, 2023; Samarasinghe & Uylangco, 2022). Liquidity refers to the stock market's ability to execute large transactions quickly, cheaply, and with tight spreads (Ding et al., 2016)[4]. Greater cash conversion happens with easier transaction competition (Arnihud et al., 1997)[5]. Based the liquidity shock hypothesis, sudden declines in stock market liquidity lower equity prices (Kiyotaki & Moore, 2019)[6], reducing firms' investment funds, output and causing a potential recession (Apergis et al., 2015)[7]. Thus, stock market liquidity is a key indicator of market efficiency.

The banking non-performing loans ratio(NPLs) is a reliable indicator of banking risk and stability, reflecting the bank's credit risk and loan quality (Wang et al., 2023)[8]. Loans become non-performing when borrowers fail to repay within 90 days (Nwafor & Nwafor, 2023)[9]. According to adverse selection theory, banking profitability declines when larger loans are issued, as they increase the likelihood of borrower default, leading to higher bank uncertainty and potential losses (Vuong et al., 2023)[10]. Non-performing loans are a primary driver of banking crises due to their reflection of default risk. The bad luck theory suggests that non-performing loans are closely related to bank efficiency; high NPLs increase operational costs, harming efficiency (Berger & DeYoung, 1997)[11]. Many studies have used NPLs to represent bank stability (Benavides-Franco et al., 2023[12]; Jiajia et al., 2023[13]; Nwafor & Nwafor, 2023; Park & Oh, 2022[14]; Shim, 2019[15]; Wang et al., 2023), with some combining NPLs with other variables to assess the correlation between stock market liquidity and bank stability (Samarasinghe, 2023). Therefore, NPLs are a suitable measure of banking stability.

Established literature highlights the crucial role of stock markets in banking development, with stock market progress contributing to bank growth (Song & Thakor, 2010)[16]. I Increased stock market liquidity improves firms' and individuals' loan repayment abilities, benefiting bank stability. The funds generated from stock transactions enhance business purchasing power and recruitment capacity, raising company values and repayment capabilities, leading to lower non-performing loans and greater bank stability (Brogaard et al., 2017)[17]. In contrast, low stock liquidity harms companies, increasing banking default risks and deposit withdrawal demands (Vuong et al., 2023). During COVID-19, the Chinese stock market's struggles caused significant debt repayment failures and credit issues in the banking sector (Tran et al., 2023)[18]. Additionally, the opportunity hypothesis posits that high stock market liquidity encourages firms to raise funds through stock investments rather than bank loans (Samarasinghe & Uylangco, 2021)[19]. This increased liquidity allows banks to securitize high-quality credit, which reduces non-performing loans (Song & Thakor, 2010). Both explanations suggest a potential positive relationship between stock market liquidity and banking stability.

Existing research on the relationship between stock market liquidity and bank stability in China is limited, with none specifically using non-performing loans to represent bank stability. One study used the Lerner index to measure bank stability and found a positive association with stock market liquidity in a cross-country sample (Samarasinghe & Uylangco, 2021). Another study, using multiple banking indicators including non-performing loans, found that high stock market liquidity strengthens bank stability in 44 countries (Samarasinghe, 2023). However, neither focused on non-performing loans or the Chinese stock market, leaving a gap in research. Additionally, conflicting theories exist: the opportunity hypothesis suggests a positive correlation, while the cannibalization hypothesis argues that high stock liquidity can harm bank stability, as stock markets may reduce bank activity and limit lending capacity. (Allen et al., 2015[20]; Hellwig, 1994[21]; Von Thadden, 1998[22]). Sophisticated stock markets attract investors, reducing bank activity, while lower deposit demand limits lending capacity due to high costs for alternative funding. Thus, testing the nature of the relationship is crucial.

In sum, there is a lack of evidence regarding the influence of stock market liquidity on non-performing loans in China. While previous studies have shown an association between global stock market liquidity and bank stability, there is insufficient practical evidence to confirm that this relationship holds true in the Chinese stock market. This paper aims to fill this gap by examining the effect of stock market liquidity

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on banking stability in China. In the following discussion, I propose one possible effect of stock liquidity on non-performing loans in China.

2.2 Hypothesis Development: stock market liquidity and non-performing loans in China

In his previous research, Samarasinghe (2023) empirically measured the correlation between global stock market liquidity and bank stability, concluding that high stock liquidity benefits bank stability globally. He used five variables, including non-performing loans, to represent bank stability and financial data from 44 countries, including China. Among these, 18 developing countries with emerging markets shared similar financial characteristics with China (Samarasinghe, 2023). Thus, I hypothesize that the relationship between stock market liquidity and bank stability in China will align with the findings of this previous research.

Based on Wang's research, which shows that NPLs are positively related to bank risk-taking, high NPLs increase risk-taking, leading to poor bank stability (Wang et al., 2023). Therefore, the non-performing loans index is negatively associated with banking stability. Based on this, I propose the following hypothesis:

H: *Stock market liquidity is negatively associated with non-performing loans in China.*

3. Data and Methodology

3.1 Data and sample selection

This research collects financial data from the Chinese Securities Market and Accounting Research (CSMAR) databases. The sample includes 337 Chinese banks, including 5 large state-owned commercial banks and 332 non-state-owned commercial banks from 2008 to 2018. The final sample includes 2141 bank-year observations. Stock market liquidity is measured using Amihud illiquidity, with detailed justification in Section 3.3. The Amihud illiquidity is calculated using stock price and trading volume data obtained from CSMAR. The dependent variable, non-performing loans, is directly sourced from CSMAR's bank financial data. Though the majority of the sample consists of Chinese banks, a few foreign banks operating in China are also included, as the Chinese stock market influences their stability as well.

3.2 Dependent variable: non-performing loans ratio

In this paper, I use non-performing loans (NPLs) as the dependent variable to represent bank stability. The NPL ratio, calculated by dividing the sum of sub-prime loans, doubtful loans, and loss loans by the total loans, serves as a good indicator of banking stability. The numerator represents non-performing loans, which can result in bank losses, making NPLs a key indicator of bad assets crucial for maintaining bank stability (Jiajia et al., 2023). Samarasinghe (2023) also included NPLs as one of the bank stability indicators, emphasizing their importance in representing bank stability.

3.3 Independent variable: stock market liquidity measurement

I use the Amihud illiquidity measure (Amihud, 2002)[23] to represent Chinese stock market liquidity. It is calculated as the daily stock's average absolute return divided by the daily stock trading volume. This measure reflects how the stock price corresponds to daily order flow, capturing the transaction ability of the stock market while avoiding significant price changes (Samarasinghe, 2023). A higher Amihud illiquidity value indicates low stock liquidity, and vice versa. It is used because it avoids significant price impacts, accurately reflecting stock market conditions (Galariotis et al., 2016)[24]. Further, the Amihud measure has been validated as a good indicator of stock market liquidity in existing literature, including studies Goyenko et al., 2009[25], Fong et al., 2017[26], and Samarasinghe (2023).

To address small values in the Amihud illiquidity measure, I follow Samarasinghe's method by adding a constant after division and taking the natural logarithm. Due to data differences, the results are smaller than in previous research. I then multiply the measure by 100,000,000, instead of Samarasinghe's 10,000 multiplier. The equation is as follows:

$$Amihund_{i,d} = 100{,}000{,}000 * ln\left(1 + \frac{|r_{i.d}|}{vol_{i,d}}\right)$$

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Here, $|r_{i.d}|$ represents the stock i's absolute return on day d and $vol_{i,d}$ refers to the trading volume in RMB for stock i on day d, calculated by multiplying the number of shares traded by the closing price. Then, I calculate the average of each year's daily stock market liquidity numbers to represent the relative year's Chinese stock market liquidity.

Following prior literature (Berglund & Mäkinen, 2019[27]; Dietrich & Wanzenried, 2011[28]; Martins et al., 2019[29]; Moutsianas & Kosmidou, 2016[30]; Pasiouras & Kosmidou, 2007[31]; Samarasinghe, 2023), I control for deposit growth ($growth$), interest income share ($interest$), funding costs ($cost$), CPI growth rate ($cpig$), bank size ($size$), and capital adequacy (cap). Details of the variables definition are shown in Table 1.

Table 1. Variables Definitions

Variables	Symbol	Definitions
Dependent Variable		
Non-performing loans	*NPLs*	Non-performing loans to gross loans ratio
Explanatory and Control Variables		
Amihud illiquidity measure	*illiquidity*	The Amihud measure reflects market liquidity, calculated as the average ratio of absolute daily return to trading volume, with higher values indicating lower liquidity.
Deposit growth	*growth*	Annual growth in deposits
Interest income share	*interest*	The interest income-to-operating income ratio
Funding costs	*cost*	The ratio of interest expenses over bank deposits
CPI growth rate	*cpig*	CPI annual growth rate
Bank size	*size*	Bank size measured by logarithm of total assets
Capital adequacy	*cap*	The ratio of total equity to total assets

Note: *"NPLs"* is independent variable. "*illiquidity"* is dependent variable. Other are control variables.

3.4 Model specification

To investigate the association between stock market liquidity and NPLs in China, I use the following regression model:

$$NPLs_{i,t} = \beta_0 + \beta_1 stock\ iliquidity_{i,t} + \beta_2 growth + \beta_3 interest + \beta_4 cost + \beta_5 cpig + \beta_6 size + \beta_7 cap + \varepsilon_{i,t}$$

where the subscripts i, t refer to the bank and year respectively. The dependent variable is the non-performing loans ratio ($NPLs$) and the independent variable is the stock illiquidity ($iliquidity$) which is measured by the Amihud illiquidity measure. The rest of the control variables are introduced in Table 1. And this equation is designed to test H.

3.5 Summary statistics and correlations

Table 2 is the summary statistics for key variables. The average non-performing loans ratio is 1.69%, with a standard deviation of 1.49, which aligns with previous observations. (Zhang et al., 2023)[32]. The average Amihud illiquidity is 0.062, with a standard deviation of 0.022.

Table 2. Descriptive Statistics

	Obs	Mean	Sd	Min	Max
NPLs	2141	1.692383	1.494938	0	26.76
illiquidity	2141	.0623823	.0220197	.0430325	.1559417
cpig	2141	-.0011036	.0181278	-.0618742	.0403786
size	2141	25.03927	1.838288	19.05955	30.95244
cap	2141	15.45545	26.73224	-10.22	649
interest	2141	1.530008	.5628628	.301193	20.89026
cost	2141	.0302221	.0310486	.0066403	.8883917
growth	2141	.184	.2182111	-.827	6.3194

Table 3 presents the correlation of variables. Stock illiquidity is significantly positively related with $NPLs$ at a 1% level, suggesting that higher stock illiquidity may reduce firms' loan repayment ability. The other control variables are significantly negatively related to $NPLs$ at a 1% level. The CIP growth

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rate shows a clear relationship with stock illiquidity.

Table 3 Correlation matrix

	NPLs	illiquidity	cpig	size	cap	interest	cost	growth
NPLs	1.000							
illiquidity	0.082***	1.000						
cpig	0.011	0.130***	1.000					
size	-0.216***	0.016	0.012	1.000				
cap	-0.073***	-0.009	-0.003	-0.176***	1.000			
interest	-0.072***	-0.002	-0.028	0.225***	-0.096***	1.000		
cost	-0.082***	0.014	-0.021	0.242***	-0.022	0.570***	1.000	
growth	-0.153***	-0.011	0.021	-0.068***	0.031	-0.011	-0.015	1.000

Standard errors in brackets, * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

4. Results and Discussions

4.1 Main Results

The regression results of stock market liquidity on bank non-performing loans are presented in Table 4. The Amihud measure ($illiquidity$) states a statistically significant relationship with the non-performing loans ratio ($NPLs$) at a 1% level. This result underscores the strong connection between stock market liquidity and banking stability. Lower Amihud values, representing higher liquidity, correlate with fewer non-performing loans, which improves bank stability. The positive coefficient between stock illiquidity and non-performing loans suggests that high liquidity reduces bank default risks and boosts stability. This supports the hypothesis that stock market liquidity is negatively associated with non-performing loans in China.

Table 4. Stock liquidity and Bank Non-Performing Loans

	(1) NPLs
illiquidity	6.571***
	[1.351]
cpig	-2.097
	[1.636]
size	0.234***
	[0.086]
cap	-0.005
	[0.004]
interest	0.053
	[0.086]
cost	-2.057
	[1.915]
growth	-0.449***
	[0.123]
_cons	-4.432**
	[2.178]
bank	yes
year	yes
r2	0.038
N	2141

Note: All definitions can be found in Table 1. Column (1) shows regression results with stock illiquidity as the independent variable and NPLs as the dependent variable. I control for deposit growth, interest income share, funding costs, CPI growth, bank size, and capital adequacy, including country and year fixed effects. Robust t-statistics are provided, with *, **, and *** indicating significance at the 10%, 5%, and 1% levels.

As for the economic significance, 1 standard deviation increase in the Amihud measure is linked with an increase in $NPLs$ of 0.145 (6.571*0.022). With a sample mean of $NPLs$ equal to 1.69, the effect is significant, corresponding to 8% of its mean value. This result supports the idea that high stock market liquidity increases bank stability.

These findings suggest that high stock market liquidity benefits bank stability. Banks should focus on improving risk management and enhancing their ability to gather relevant information to capitalize on potential profits. Given that bank stability is crucial for overall financial stability, regulators should consider easing stock market transaction regulations and strengthening infrastructure to help maintain

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bank stability.

4.2 Additional Results

4.2.1 Robustness Test and Additional analysis- Impact of global financial crisis

Due to the Global Financial Crisis from 2007 to early 2009, the Chinese stock market crashed, losing more than two-thirds of its market value (Athreye et al., 2021)[33]. These abnormal stock price fluctuations during the Global Financial Crisis negatively impacted Chinese banks and created an unusual relationship between stock liquidity and bank stability. To ensure robustness, I excluded the 2008 and 2009 observations to prevent the global financial crisis from distorting the results. As shown in Table 5, column (2), the Amihud illiquidity measure remains statistically significant with the market bank stability measure, even after excluding these years.

Table 5. Robustness test and Additional analysis-Impact of global financial crisis

	(1) Crisis	(2) Post_Crisis
illiquidity	7.758***	7.005***
	[2.449]	[2.069]
cpig	0.000	-8.096
	[.]	[5.094]
size	0.671	-0.115
	[0.857]	[0.147]
cap	-0.061**	-0.004**
	[0.028]	[0.002]
interest	0.218	-0.004
	[0.652]	[0.095]
cost	-6.982	0.703
	[4.393]	[2.207]
growth	-0.416	-0.384***
	[0.543]	[0.115]
_cons	-14.945	4.552
	[22.192]	[3.677]
bank	yes	yes
year	yes	yes
r2	0.467	0.121
N	138	2003

Notes: All definitions can be found in Table 1. This table regresses bank stability (NPLs) on stock market illiquidity (illiquidity) for two periods: Column (1) is for the crisis (2008-2009), and Column (2) is for the post-crisis (2010-2018). Bank and year fixed effects are included, with robust t-statistics and significance at the 10%, 5%, and 1% levels indicated by *, **, and ***.

The coefficient between $NPLs$ and the Amihud measure ($illiquidity$) aligns with the results from Table 4, reaffirming the hypothesis. The Amihud measure continues to show a statistically significant relationship with $NPLs$ at the 1% level. This confirms the strong connection between Chinese stock market liquidity and banking stability. High stock liquidity leads to larger $NPLs$ and improved bank stability. The robustness test, controlling for the Global Financial Crisis, further supports the positive relationship between stock market liquidity and bank stability. These findings strengthen the validity of the main results and hypothesis.

I also examine whether national stock market liquidity affects bank stability differently during and after the global financial crisis. Following Samarasinghe's method (2023), I perform an additional regression for the crisis period. The results, shown in Table 5, reveal that the coefficient for the crisis period (Column 1) is slightly higher than the post-crisis period (Column 2), suggesting that the global financial crisis amplified the effect of stock market liquidity on non-performing loans. Specifically, non-performing loans increased more during the crisis when stock market liquidity declined compared to the post-crisis period. A t-test on the two subsamples yields a p-value of 0.0499, indicating a significant difference between the two sets. This confirms that the 2008 global financial crisis influenced the effect of stock market liquidity on bank non-performing loans.

During a crisis, banks strengthen their liquidity-providing role, while trade creditors are less likely to increase trade payables in response to liquidity shortages (Tsuruta, 2023)[34]. This suggests that in periods of high stock illiquidity during a crisis, a larger proportion of bank loans become non-performing, as borrowers' ability to repay loans is diminished. Thus, the global financial crisis exacerbates the increase

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in non-performing loans when stock market liquidity declines.

4.2.2 Additional analysis- Ownership structure

The ownership structure impacts the connection between stock market liquidity and bank stability. Park & Oh (2022) prove that bank ownership affects financial stability, which in turn affects bank stability. In this study, I examine whether state ownership impacts bank stability in China by dividing the sample into two subsamples: state-owned banks (SOBs) and non-state-owned banks (Non-SOBs).

Table 6 shows that stock market liquidity positively impacts bank stability for both SOBs and Non-SOBs, with coefficients significant at the 1% level. This indicates that stock market liquidity has a strong, positive impact on bank stability regardless of ownership structure. In column (1), the $illiquidity$ and $NPLs$ coefficient is 11.915, and in column (2) it is 6.301. The higher coefficient for state-owned banks suggests that stock market liquidity has a larger impact on bank stability in these banks. Increased stock market illiquidity leads to a greater rise in non-performing loans for state-owned banks compared to non-state-owned banks. To test whether the differences between the SOB and non-SOB subsamples are genuine or caused by random factors, I conducted a t-test on these two subsamples. The p-value obtained was 0.0233, which is less than 0.05, indicating a statistically significant difference between the two groups. Therefore, I conclude that the bank ownership structure has a meaningful impact on how stock market liquidity affects bank non-performing loans.

The difference in financial responsibilities between state-owned banks (SOBs) and non-state-owned banks (non-SOBs) can explain this phenomenon. SOBs are more often tasked with addressing financial emergencies and providing loans to support businesses during cash flow issues, especially during crises. This includes fulfilling social objectives prioritized by the government, which can lead to higher non-performing loans (Yuan et al., 2022)[35]. For instance, during the 2008 global financial crisis, the Chinese government initiated an economic stimulus program that encouraged state-owned banks to allocate credit to companies and local governments. This policy aimed to stabilize the economy but resulted in increased loan volumes and, consequently, higher NPLs. As a result, SOBs faced higher NPLs and lower stability compared to non-SOBs during periods of low stock market liquidity.

Table 6. Additional analysis- SOBs and Non-SOBs

	(1) SOBs	(2) Non-SOBs
illiquidity	11.915***	6.301***
	[4.198]	[1.179]
cpig	-2.957	-2.020
	[3.546]	[1.337]
size	0.546	0.237***
	[0.483]	[0.056]
cap	-0.136	-0.005**
	[0.124]	[0.002]
interest	0.434	0.048
	[1.749]	[0.098]
cost	-15.994	-1.974
	[37.668]	[2.204]
growth	0.249	-0.453***
	[2.203]	[0.124]
_cons	-14.213	-4.448***
	[12.812]	[1.415]
bank	yes	yes
year	yes	yes
r2	0.386	0.037
N	55	2086

Notes: All definitions can be found in Table 1. Column (1) presents results for state-owned banks, while Column (2) shows results for non-state-owned banks. All regressions include bank and year fixed effects, with robust t-statistics beneath each coefficient. Significance is indicated by *, **, and *** at the 10%, 5%, and 1% levels, respectively.

4.3 Discussion

The opportunity hypothesis suggests a potential relationship between stock market liquidity and bank stability. The number of non-performing loans is negatively associated with bank stability. The high amount of non-performing loans causes high bank uncertainty. In 2023, Ama Samarasinghe did a first empirical assessment to prove the positive correlation between stock market liquidity and bank stability

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(Samarasinghe, 2023). However, the research in testing this relationship is still rare and lacks sufficient support.

This study provides additional evidence on the relationship between Chinese stock market liquidity and bank financial stability. The findings indicate a strong and consistent positive association between stock market illiquidity and bank non-performing loans, with a 1% statistical significance. The key result shows that higher stock market liquidity leads to lower non-performing loans, thereby enhancing bank stability. This supports my hypothesis. High liquidity attracts firms and individuals to trade shares, reducing bank lending and default risks, which in turn raises bank stability. Banks should improve their stock market information to better manage future lending risks.

Because Samarasinghe's research used global data and this study only used Chinese data, I suggest future research can further investigate the different effects between the Chinese stock market and the global stock market on bank stability ($NPLs$). They can also research the factors that lead to this difference between China and the rest of the world.

I further examine the impacts of the 2008 global financial crisis and bank ownership structure on the relationship between stock market liquidity and bank stability ($NPLs$). I find that the global financial crisis reduced borrowers' repayment ability even under the same stock market liquidity conditions. Additionally, Chinese state-owned banks, due to their responsibility to support the national economy during periods of low stock market liquidity, experience higher non-performing loans compared to non-state-owned banks at the same liquidity level.

5. Conclusions

This paper studies the link between stock market liquidity and bank stability in China using 2141 bank-year observations from 2008 to 2018. The results show that higher stock market liquidity is associated with lower non-performing loans, supporting the hypothesis that liquidity enhances bank stability. Further analysis confirms the robustness of these findings, with the global financial crisis leading to higher non-performing loans. State-owned banks also experience more non-performing loans than non-state-owned banks under similar liquidity conditions.

This study contributes to the literature by providing further evidence on the relationship between stock market liquidity and bank stability (Samarasinghe, 2023). I examine how stock market liquidity affects bank NPLs, finding a negative relationship. The paper offers practical and policy implications, recommending that banks improve their risk management by enhancing their stock market information access. Analyzing bank stability is crucial for national economic growth, as stable banks support broader economic stability. Given the positive impact of stock market liquidity on bank stability, the government could encourage banks to participate in stock markets through appropriate policies and frameworks.

This study has some limitations. First, while the findings focus on the stock market and banking sector in China, caution should be exercised when generalizing the conclusions to banks in other countries. Second, the control variables used are based on existing literature, so other relevant factors affecting bank stability may not have been included. Third, while NPLs serve as a good indicator of bank stability, there could be other variables that offer a more comprehensive measure. Thus, the models might be subject to measurement errors when studying Chinese bank stability.

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