

China's Banking Sector Old Problems Overcome – New Problems Ahead

Conference on European Economic Integration (CEEI) 2011

“European Integration in a Global Economic Setting – China, Russia and CESEE”

Vienna, 22 November 2011

Markus Taube

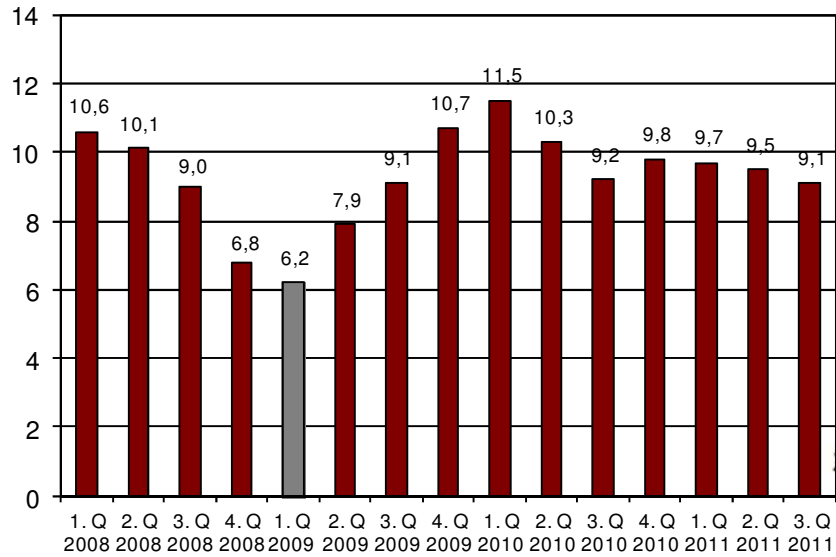
Storyline

- I. State of the Chinese Economy
- II. Banking Sector Development
- III. Risk Assessment: The Real Estate „Bubble“
- IV. Shadow Banking
- V. The Way Ahead

Storyline

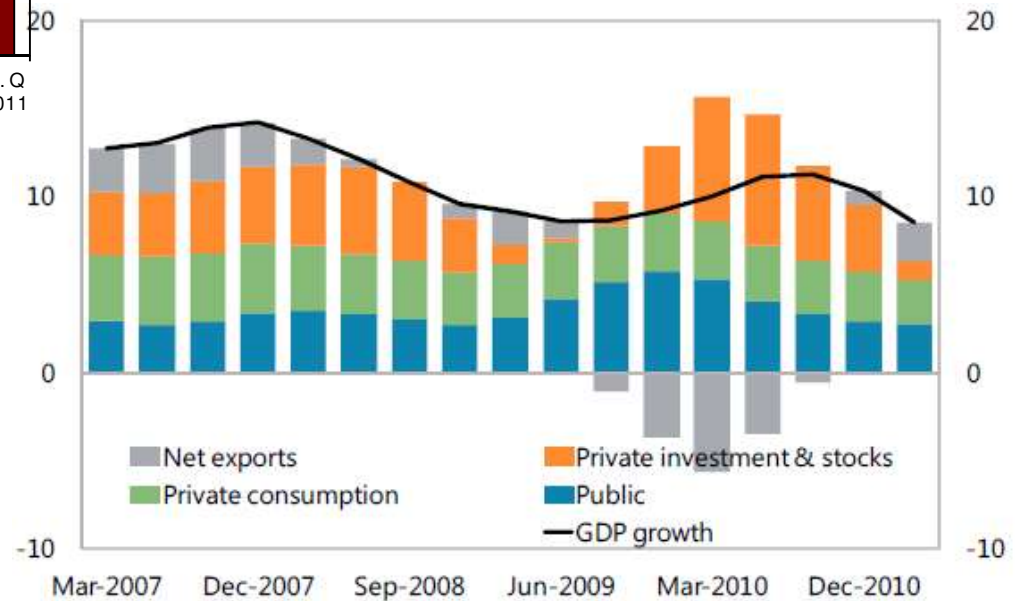
- I. State of the Chinese Economy
- II. Banking Sector Development
- III. Risk Assessment: The Real Estate „Bubble“
- IV. Shadow Banking
- V. The Way Ahead

Slowing but still strong growth



GDP growth
%, quarterly, yoy

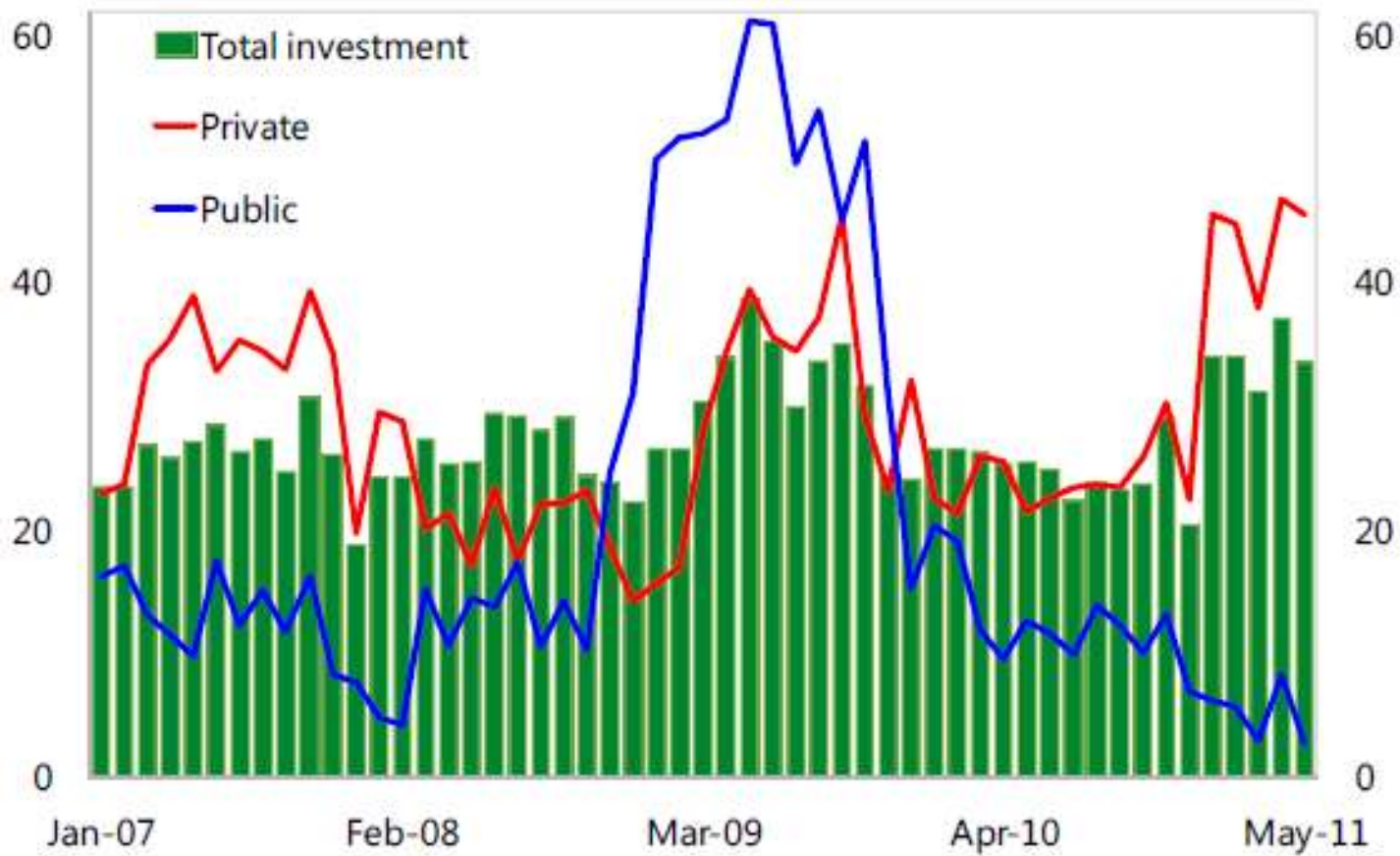
Contribution to GDP growth
%, annual average



NBS 2011, IMF 2011

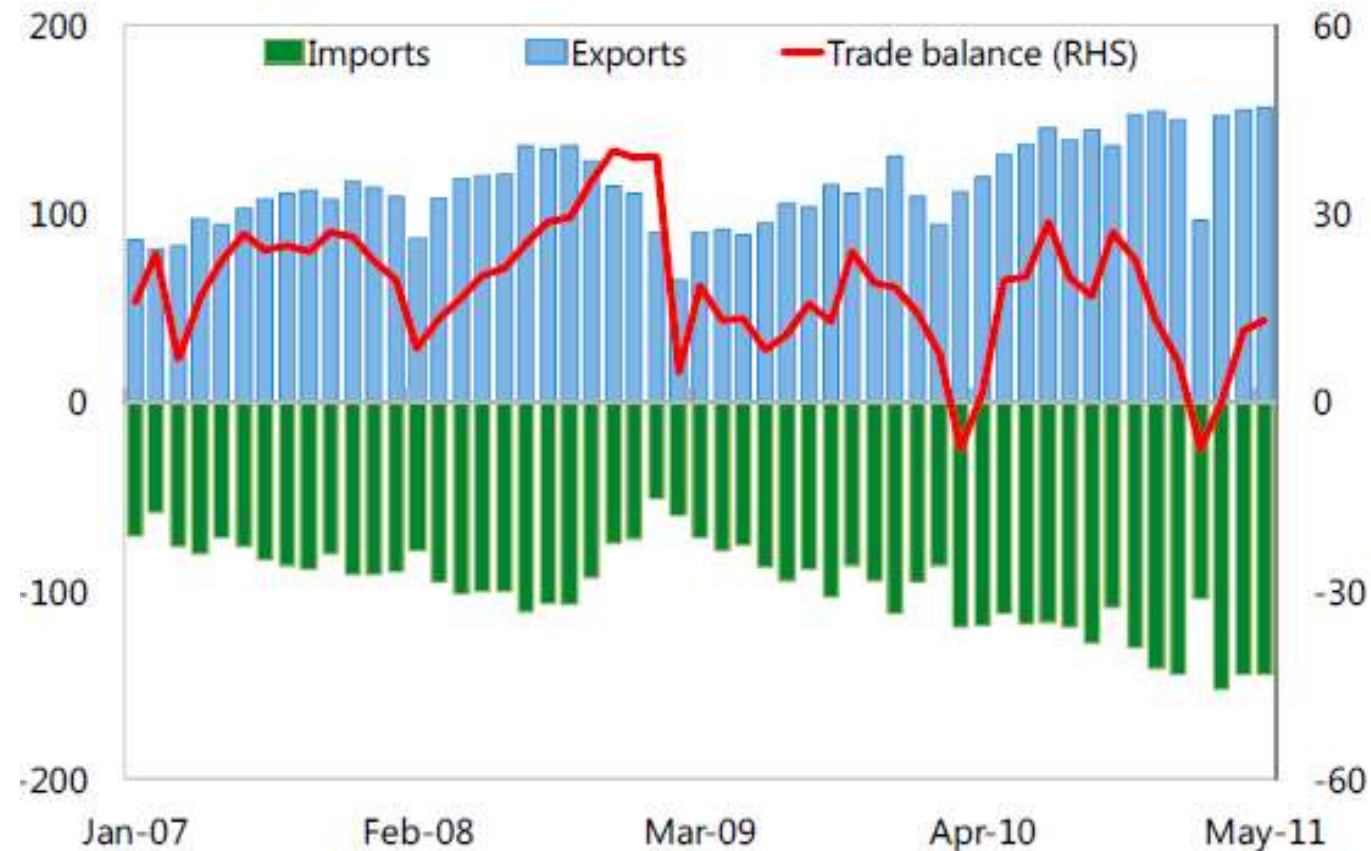
Private investors are back

Fixed Asset Investment, yoy growth

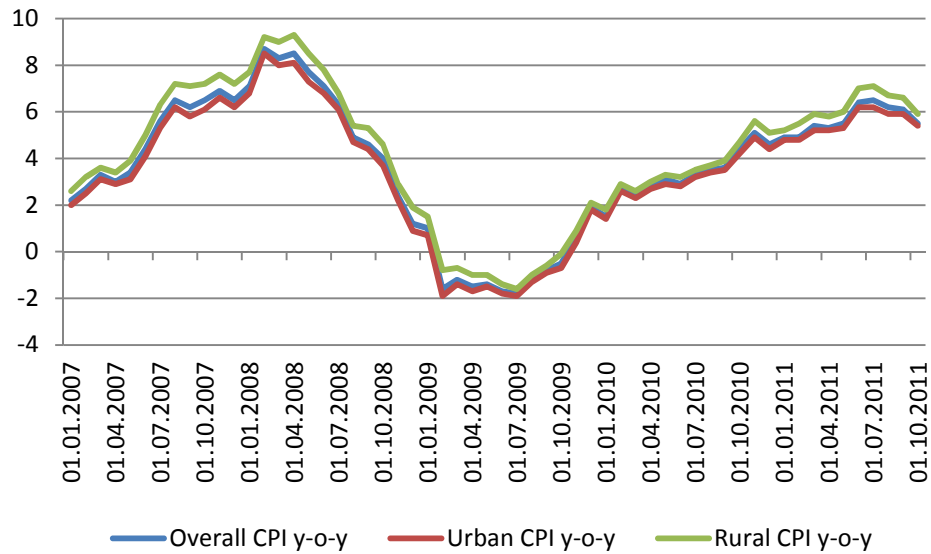


Strong exports and increasingly dynamic import activity

Trade Development, monthly, US\$ billion

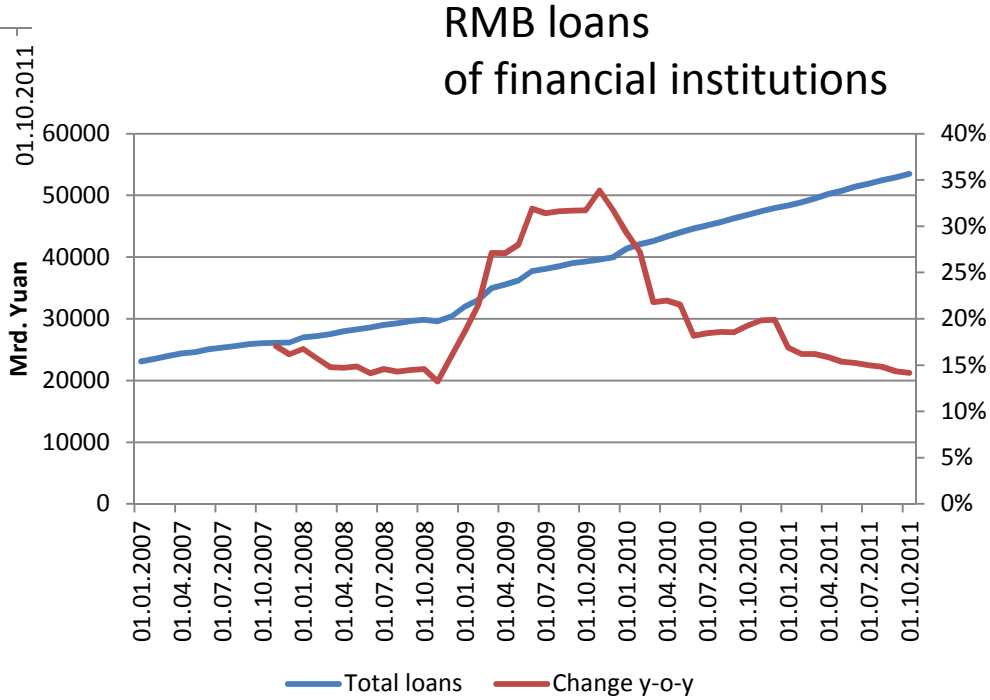
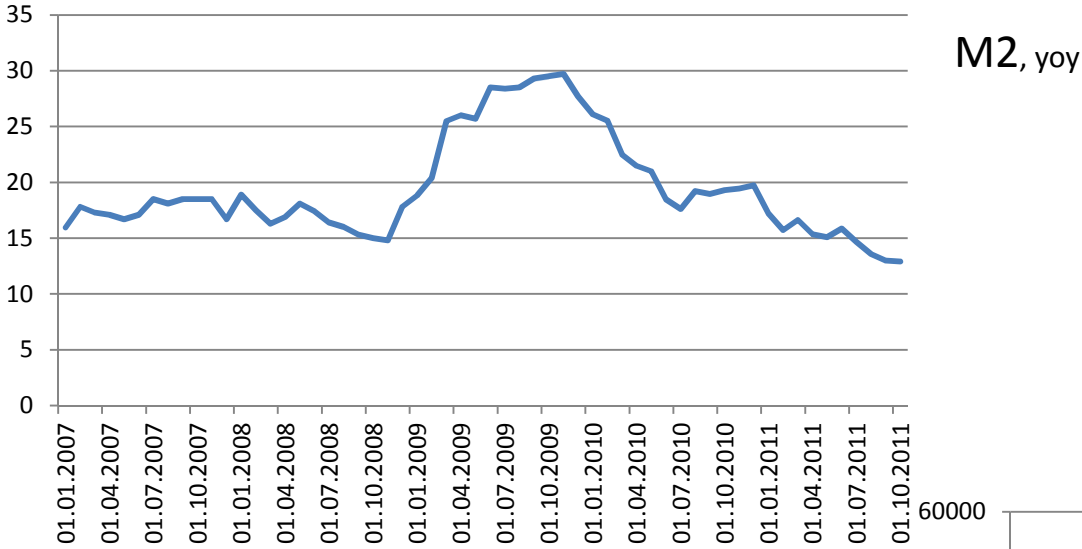


Inflation is coming down



NBS 2011
CCB Int'l 2011

Money supply and formal sector loans back to normal

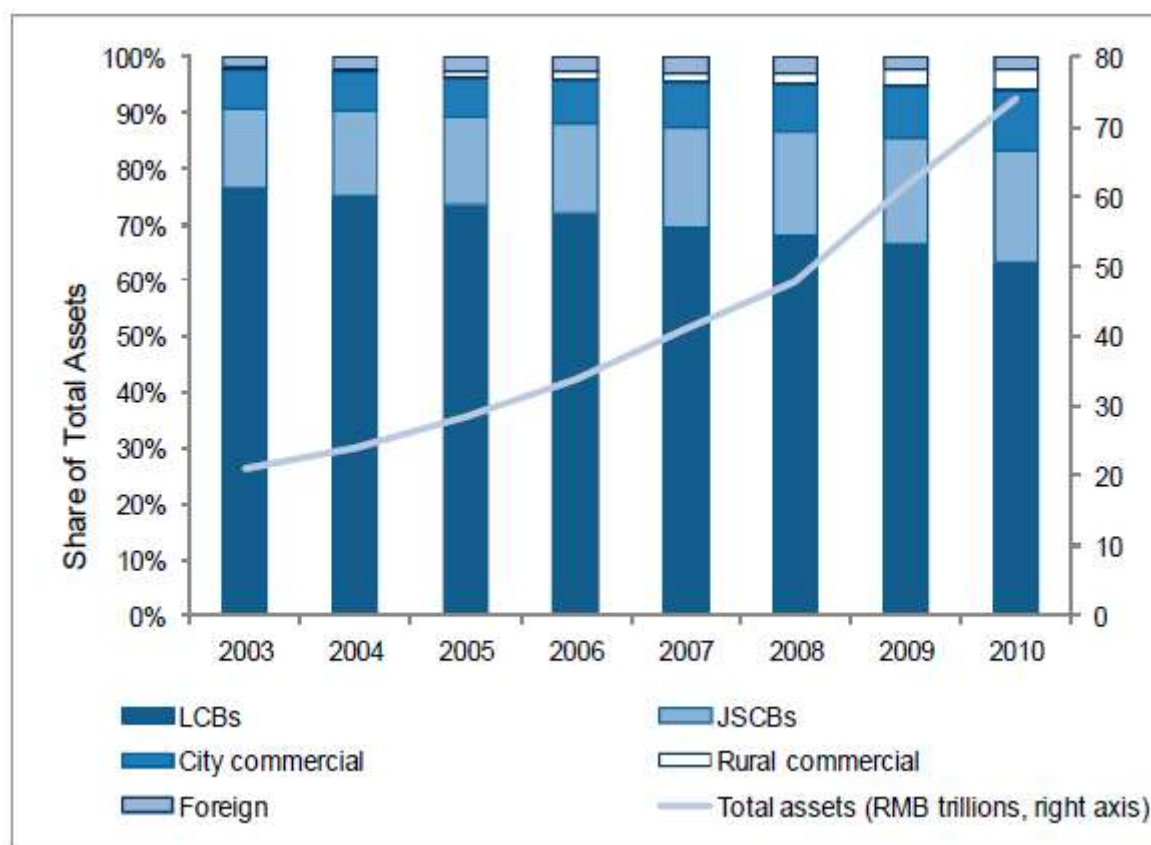


CBRC 2011
Bloomberg 2011

Storyline

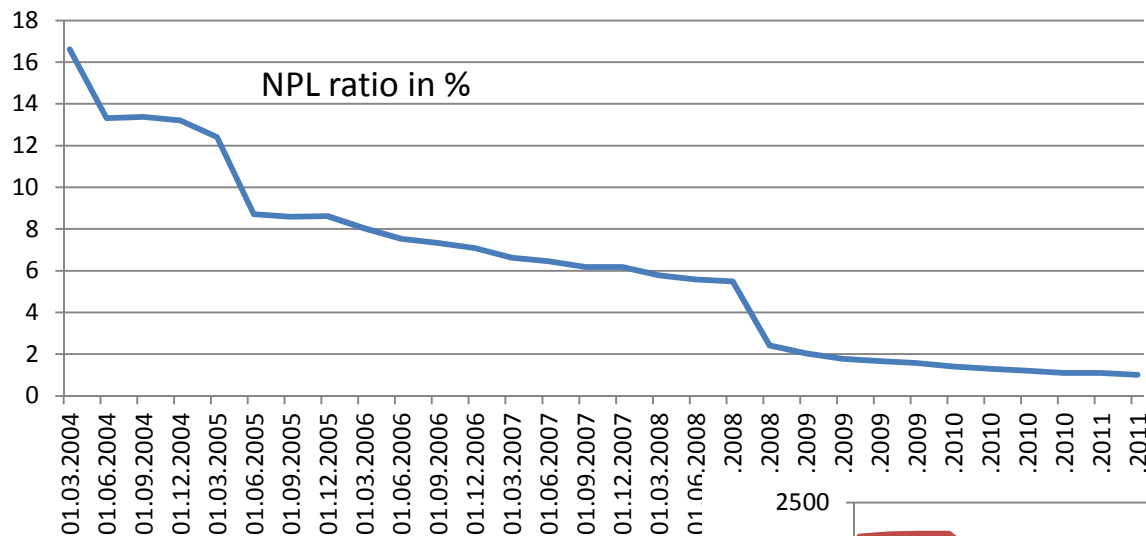
- I. State of the Chinese Economy
- II. Banking Sector Development**
- III. Risk Assessment: The Real Estate „Bubble“
- IV. Shadow Banking
- V. The Way Ahead

China's banking system

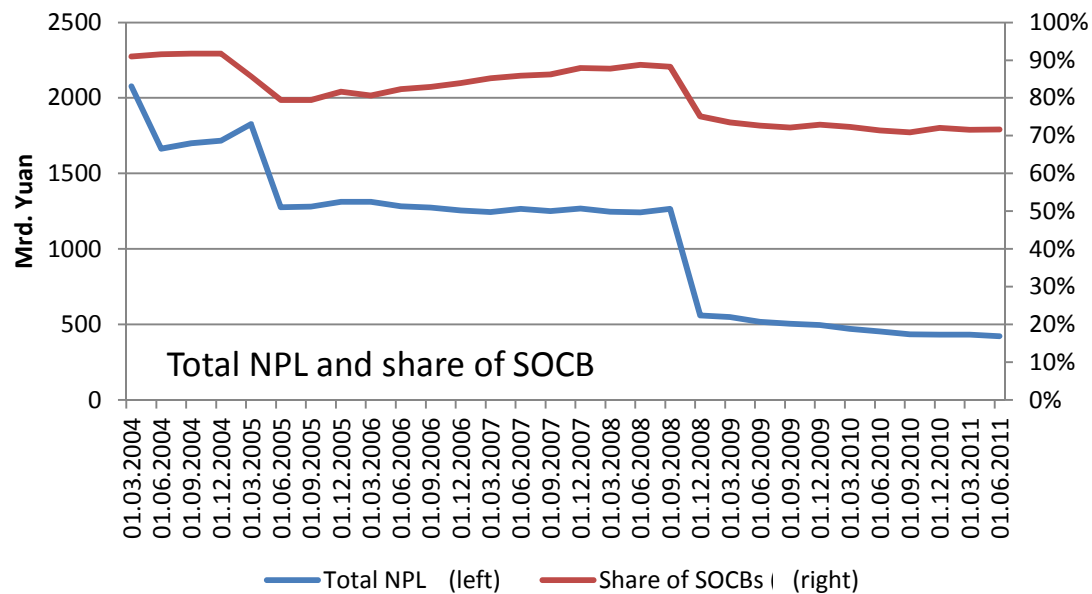


Increasing diversity,
but still dominated by the big-4

The 'old' problems are gone

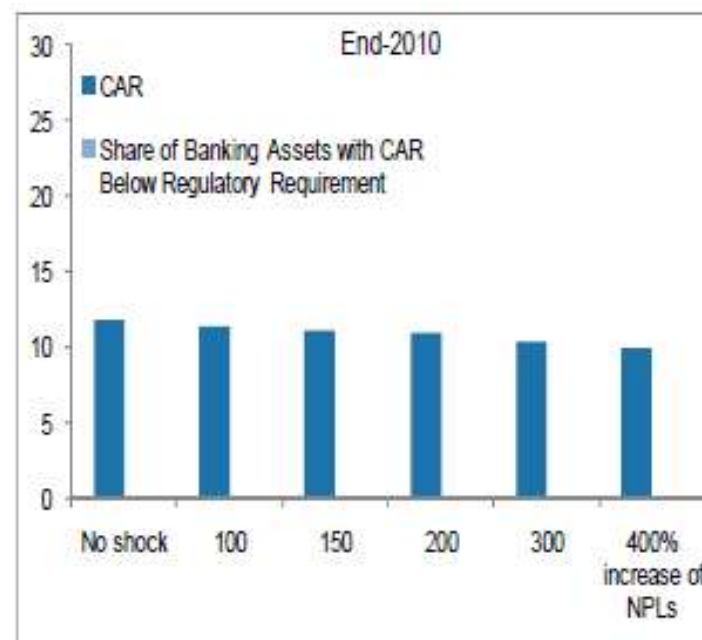
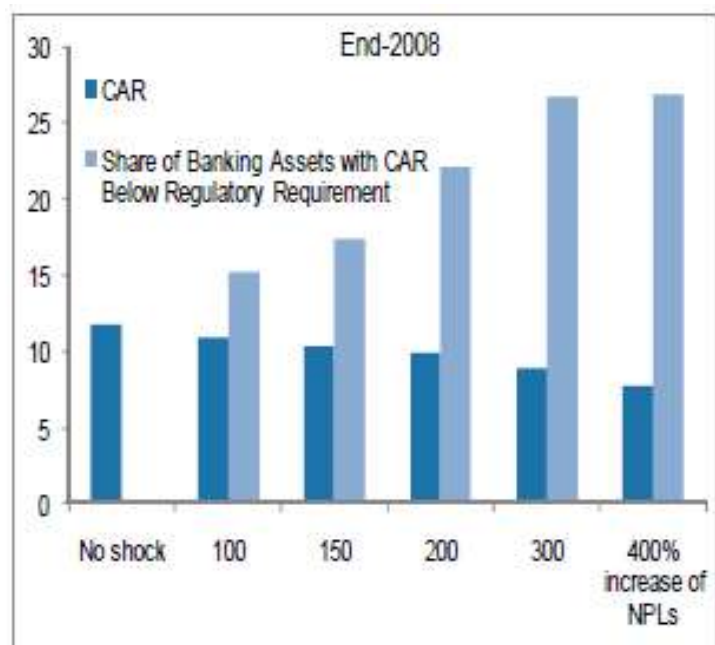


The problem of NPLs appears to have been overcome – and it remains an SOCB issue.



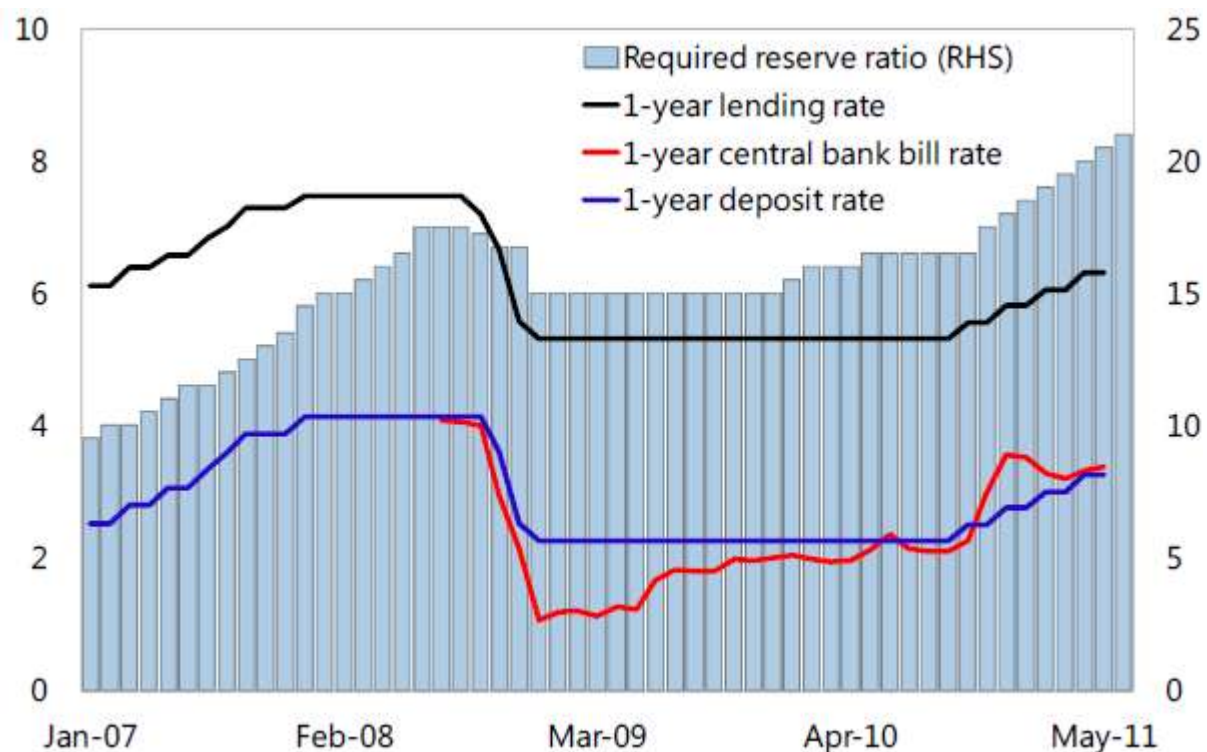
CBRC 2011
Bloomberg 2011

Substantially strengthened, impressive crisis resistance



Thanks to the substantial decline of their NPL burden as well as strengthened equity capital positions all banks would withstand a NPL-quadrupling crisis upholding capital adequacy ratios of more than the required 8%.

Post-crisis tightened monetary policy



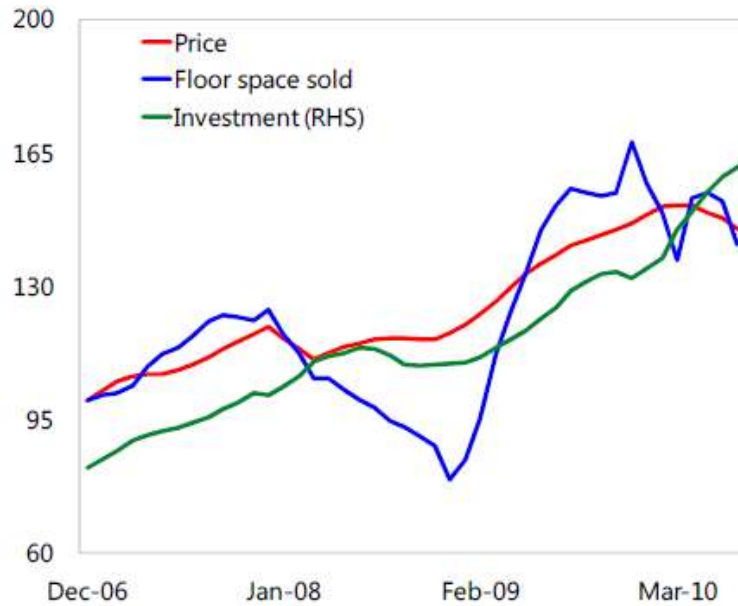
With inflation coming down and GDP growth slowing down
China's monetary policy may have reached a turning point
allowing for a loosening of policies in the next months

– liquidity spillovers in the informal sector are to be prevented

Storyline

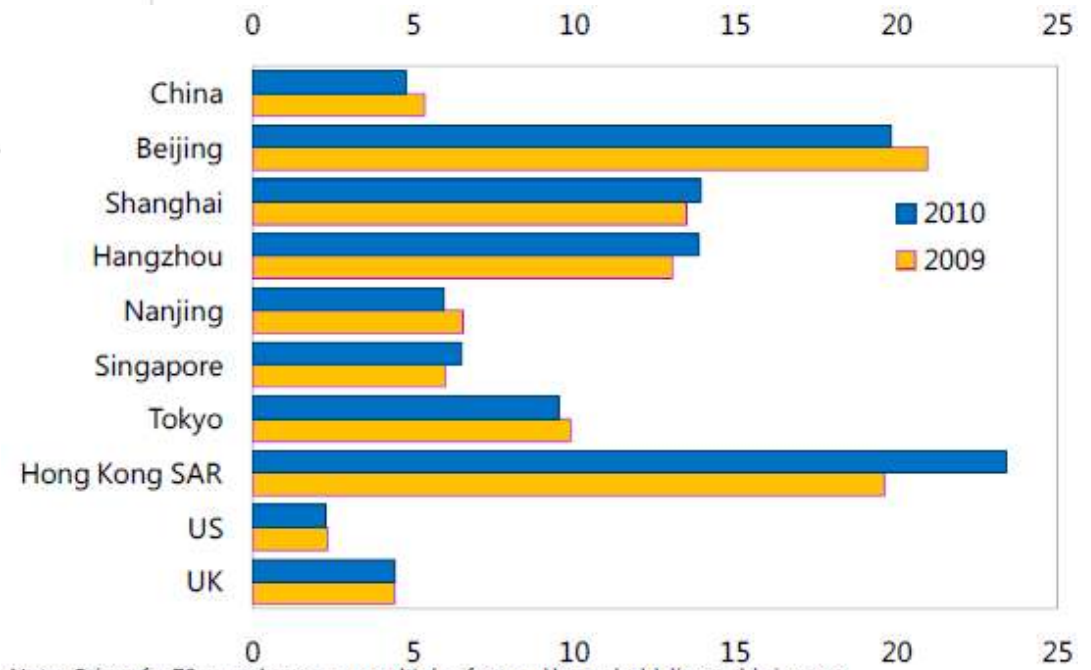
- I. State of the Chinese Economy
- II. Banking Sector Development
- III. Risk Assessment: The Real Estate „Bubble“**
- IV. Shadow Banking
- V. The Way Ahead

A bubble?



Residential housing

100 = Dec 2006, sa



Housing affordability

Price-to-income ratio

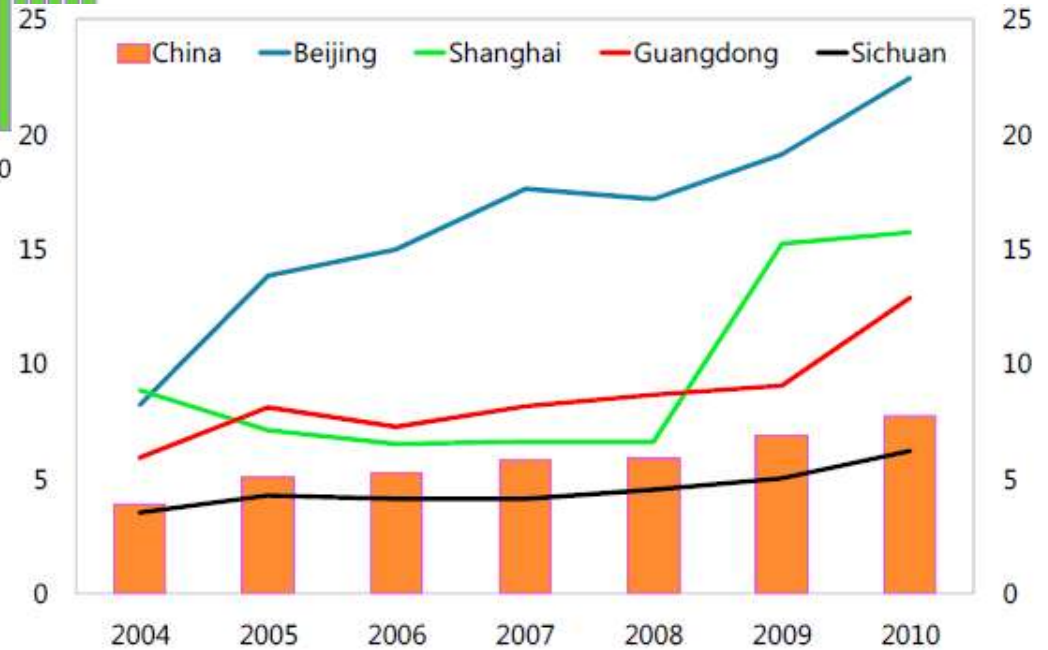
IMF 2011

Note: Price of a 70 sq.m. home as a multiple of annual household disposable income.

Local bubbles

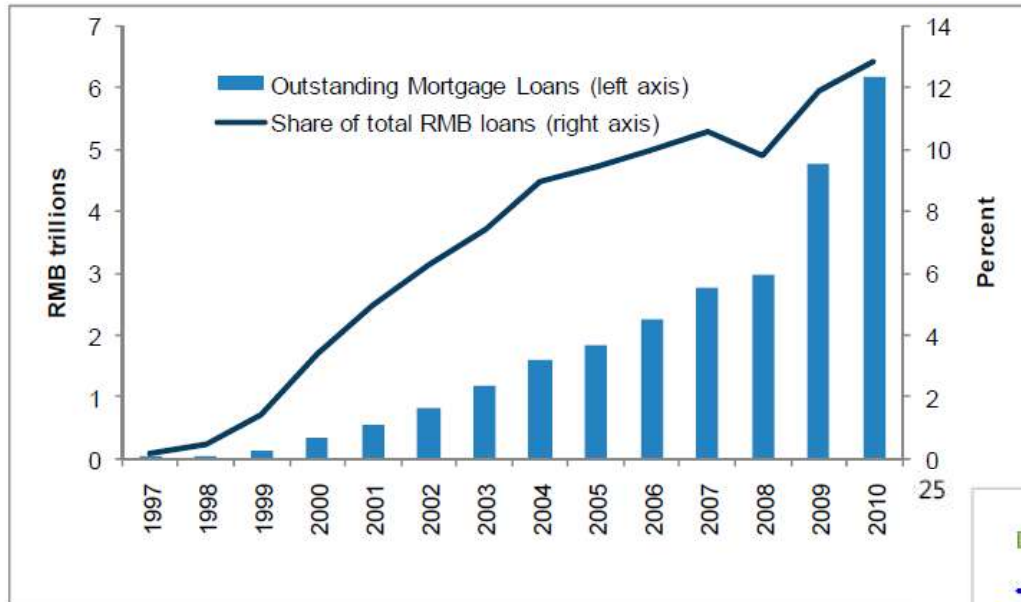


Property Prices
1000 Y RMB, /s.qm., sa, 3mma



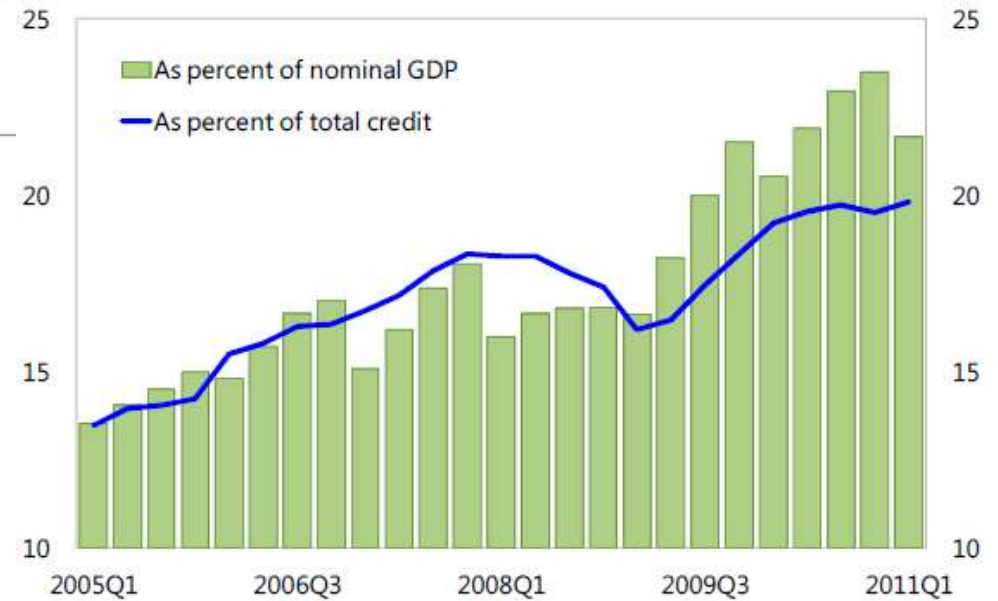
Commercial Real Estate
1000 Y RMB, /s.qm.

Banking sector exposure



Mortgage Loans
yearly

Real Estate Lending
quarterly



Hovering on a high plateau ,
formal sector (!) real estate lending
has recently leveled off.

Informal inflows in the sector are
understood to have remained high.

Fighting fire with fire – and more ...

Social housing in the 12th 5YP:

- ★ Construction respectively renovation of 35 million housing units
- ★ Provision of social housing for 20% of urban population from 7% end of 2010
- ★ 35% of all housing construction starts in 2011 based on government housing initiatives

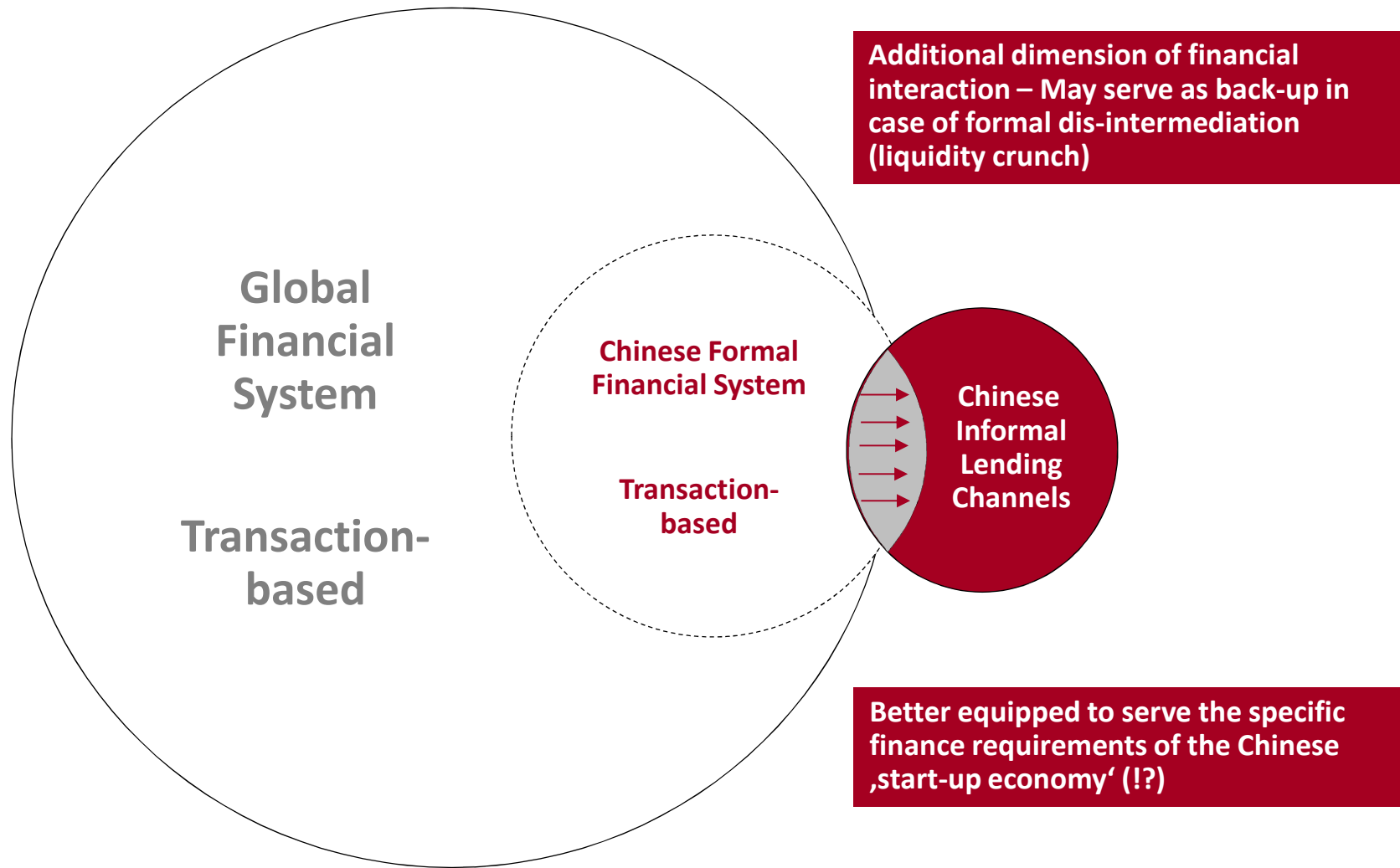
Additional measures:

- Increased *downpayment*-requirements for mortgage loans
- Higher interest rates (in general and depending on type of investment)
- Restrictive authorization procedures for purchase of 2nd and 3rd apartments
- Restrictive authorization of purchase requests by non-locals
- Real estate tax (pilot project in Shanghai und Chongqing)
- Charging of *business tax* for real estate resold during first 5 years after purchase
- Binding commitment of local governments to enforce price targets (maximum price increases per year coupled to disposable income development)

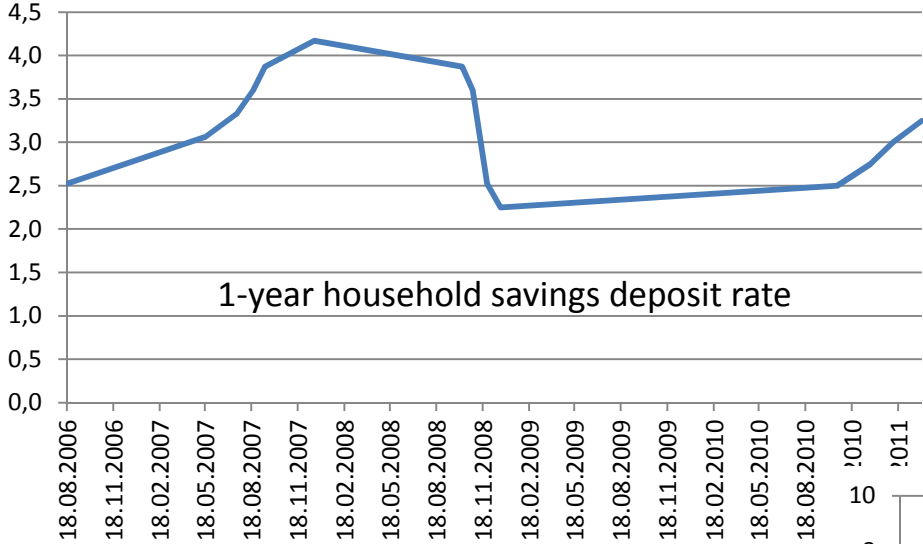
Storyline

- I. State of the Chinese Economy
- II. Banking Sector Development
- III. Risk Assessment: The Real Estate „Bubble“
- IV. Shadow Banking**
- V. The Way Ahead

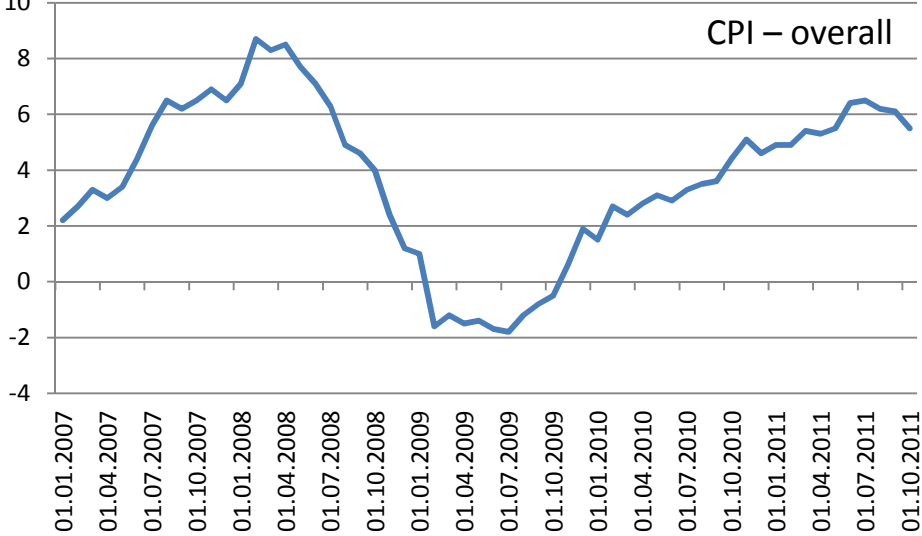
More than there seems to be



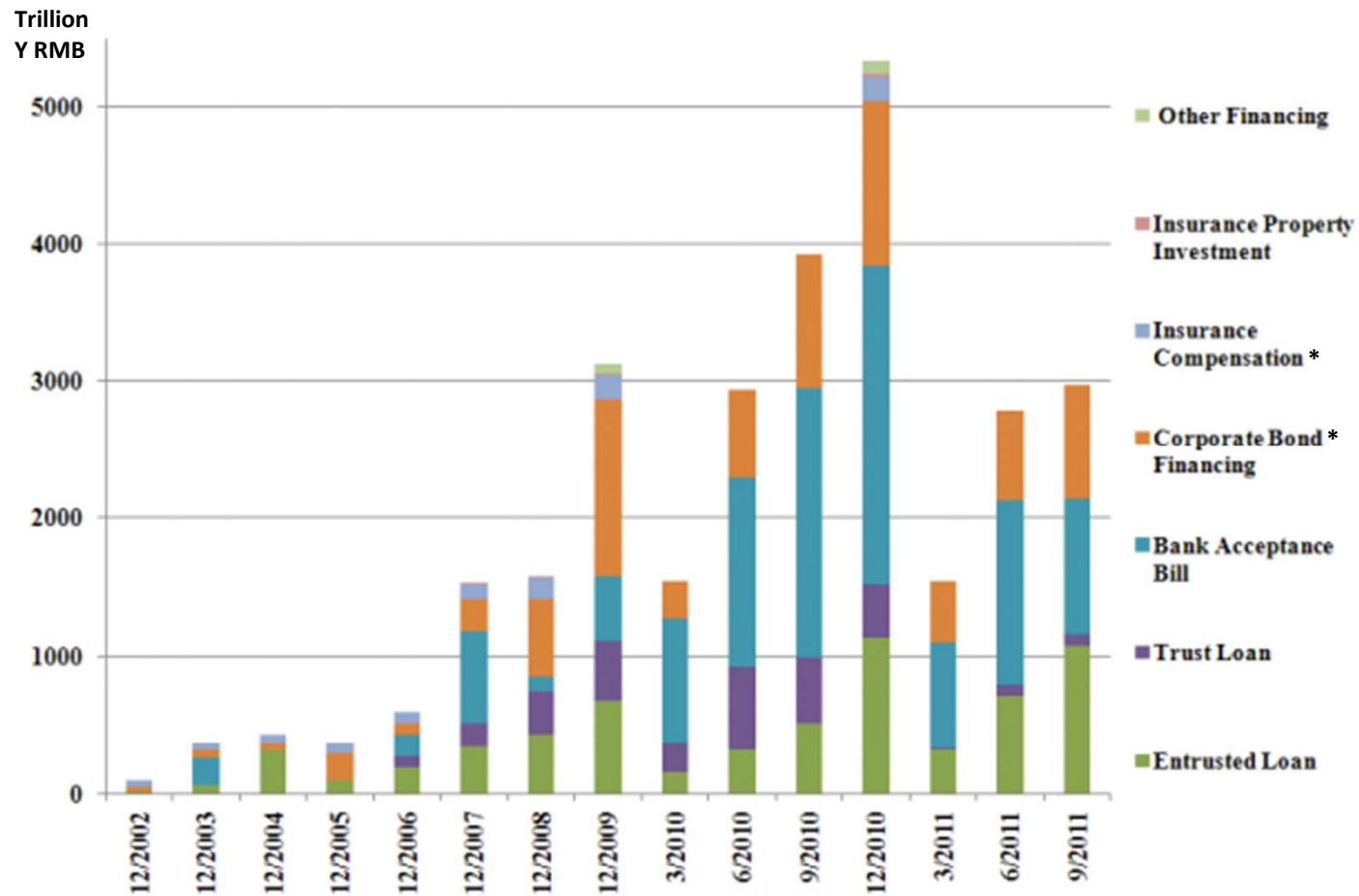
Negative real interest on savings accounts



Negative real interest rates on savings accounts in the formal sector continue to drive savers into the (informal) shadow banking sector, draining the formal financial system of resources



The 'formal' shadow banking sector



"Social Finance"-Concept of NBS, * No shadow banking

PBOC 2011
China Economic
Watch 2011

The informal dimension of Chinese banking

	hard information	soft information
third party enforcement	<p>'Transaction-based lending'. Standard object of analysis in the law, finance & growth literature.</p> <p>Standardized information regime combined with highly formalized universalistic legal system.</p> <p>History (reputation) plays is – in principle – of no importance.</p>	<p>'Relationship lending' of the law, finance & growth literature. The evaluation of potential financial transactions is primarily based on information gathered by informal institutional arrangements (-> History rules!). Ensuing financial transaction are embedded in formal justiciable contractual relations.</p>
second party enforcement	<p>Requires close relationship between transaction partners in order to facilitate property rights enforcement inside a social network and without recourse to an external 'umpire'. Given this close relationship hard information can be expected to be systemically less important than soft information for most financial transactions.</p> <p>-> Low empirical value: hostage giving, pawnbroker</p>	<p><i>Obstacles to co-operation like adverse selection and ex-post opportunism, i.e. property rights enforcement, are solved by informal mechanisms, first of all social networks based on particularistic ordering regimes. Information required to make financing decisions is gathered in non-standardized form in the context of the underlying social network by means of frequent and multiplex interaction.</i></p> <p>-> History rules!</p>

Specific forms of China's 'shadow banking sector'

'Formal' Shadow Banking

- Off-balance-sheet lending
- Special Purpose Vehicle lending
- Direct company-to-company lending
- Trust companies / Wealth management organizations
- Leasing companies
- Regulated pawnshops
- Loan guarantee companies
- Small loan companies / microfinance organizations
- Offshore borrowing
- Private equity organizations

'Informal' Financial Intermediation

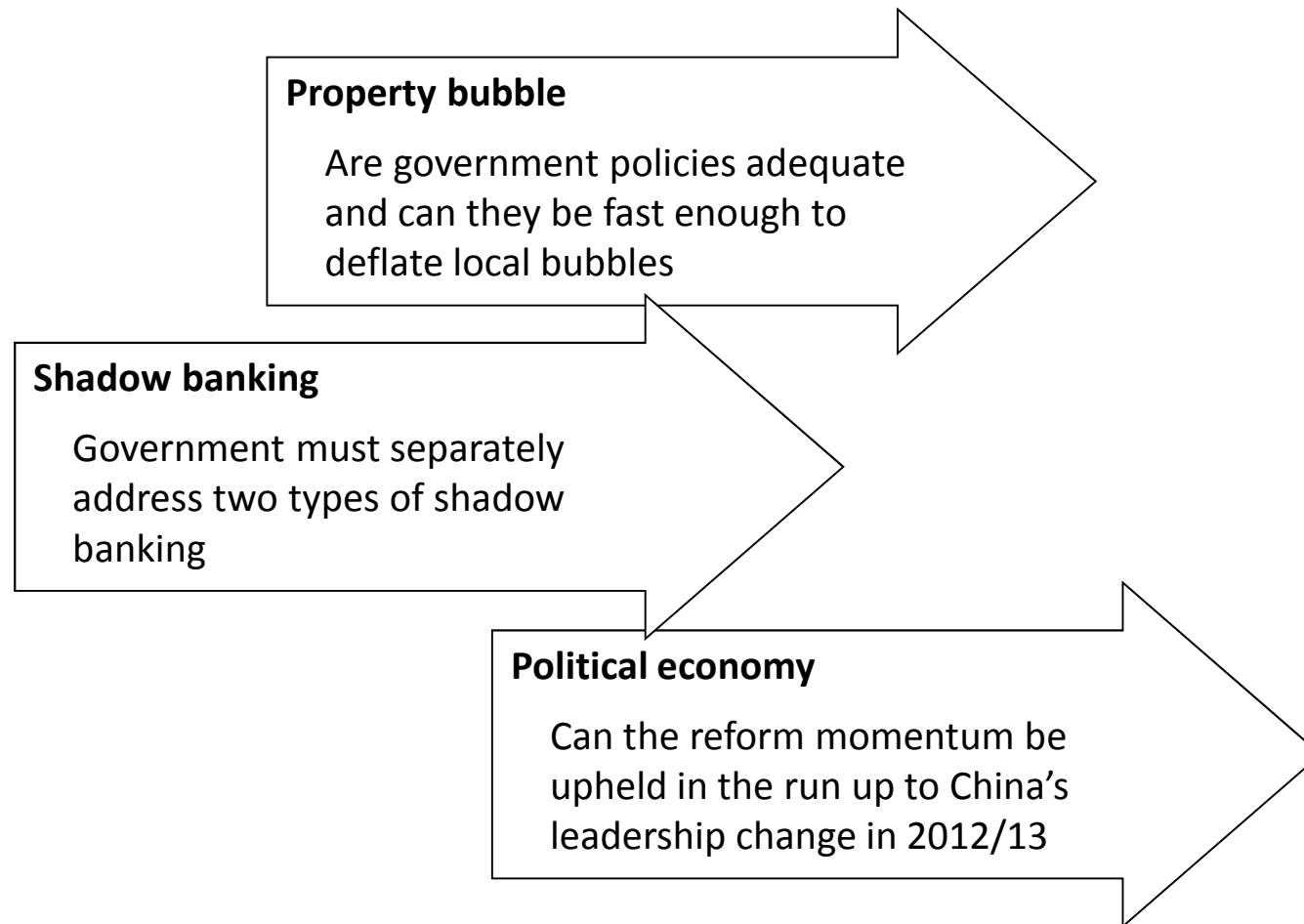
- Underground banks
- Private money houses
- Associations for mutual assistance
- Rotating savings and credit corporations (ROSCA)
- Private peer-to-peer lending
- Unregulated pawnshops
- Unauthorized offshore borrowing

Total volume of 'formal' plus 'informal' shadow banking unknown, but probably in the range of a minimum 20 trillion annual flow.

Storyline

- I. State of the Chinese Economy
- II. Banking Sector Development
- III. Risk Assessment: The Real Estate „Bubble“
- IV. Shadow Banking
- V. The Way Ahead**

Three major issues to look at



University of Duisburg-Essen

**Mercator School of Management
IN-EAST, Institute for East Asian Studies
Chair for the East Asian Economy / China**

Prof. Dr. Markus Taube

markus.taube@uni-due.de