LSE Public Lecture

China and Financial Reform

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LSE, Chair
Distribution of financial assets by region, 2006, %

1 Figures may not sum to 100%, because of rounding
2 Compound annual growth rate constant 2006 exchange rates

Source: McKinsey Global Institute global financial stock database
Value of bank deposits, bonds, and equities as % of GDP

Source: McKinsey Global Institute global-financial stock database
Non-Performing Loans (CBRC Figures)

% of loans outstanding

Year

2001
2003
2007

% of loans outstanding

30
17.9
6.7

All banks affected
Largely in Agricultural Bank of China

Note: CBRC = China Banking Regulatory Commission
Share of banking assets in banks meeting capital adequacy standards
Rapid Growth of Banking Assets and Liabilities
### Foreign Banks in China

**Impressive expansion…**

<table>
<thead>
<tr>
<th>Type</th>
<th>Count</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign bank subsidiaries</td>
<td>24</td>
<td>(119 branches)</td>
</tr>
<tr>
<td>Joint venture banks</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Foreign bank branches</td>
<td>71</td>
<td>(117 offices)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financials (end 2007)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>$171 billion</td>
<td>(+ 45% yoy)</td>
</tr>
<tr>
<td>Loans</td>
<td>$95 billion</td>
<td>(+ 62% yoy)</td>
</tr>
</tbody>
</table>
...But still modest market share

**Assets**
- 2.4% Foreign Banks
- 97.6% Chinese Banks

**Capital**
- -5.9% Foreign Banks
- 94.1% Chinese Banks

Legend:
- Light blue: Foreign Banks
- Dark red: Chinese Banks
Financial ‘Repression’ in China (1)

• The PBOC sets maximum interest rates on bank deposits

• Those rates, already low, have not kept ahead of inflation

• By Q1 2008 the real return on one-year deposits was minus 3.86%
Financial ‘Repression’ in China (2)

- Households are large net depositors in banks

![Bar chart showing gross deposits, borrowings, and net deposits for 2008 Q1 in RMB trillion. Gross Deposits: 19.1, Borrowings: 5.3, Net Deposits: 13.8.]
Financial ‘Repression’ in China (3)

• If households had received the 2002 interest rate, their income would have been RMB 255billion higher (4.1% of GPP)

• This ‘tax’ benefits corporate (net borrowers) banks, and government

• It is a major reason for low growth in consumer spending
“China’s Economic Growth is unsteady, unbalanced, uncoordinated and unsuitable”

Premier Wen Jiabao
National People’s Congress
March 2007
Monthly house price movement (Jan 2006-April 2008)
Performance of the Chinese Stock Market over the last year

HIGH 106.42 15/10/07, LOW 33.42 18/9/08, LAST 35.55 8/10/08
Source: DATASTREAM
Foreign Insurers in China

45 joint ventures with Chinese partners

Growth rates
- 30-50% p.a. life insurance
- 20-40% p.a. property and casualty

6% market share (2007)

Source: PWC
Economic growth is moderating

Source: NBS, staff estimates
1/ Monthly data, covering SOEs and large non-SOEs
2/ Quarterly data from national accounts
The RMB has strengthened against the US dollar

The nominal effective strengthening was smaller
External trade volumes have decelerated

Source: CEIC, staff estimates
YoY Growth of CPI (China)
Investment is slowing down

Source: NBS, staff estimates
1/ Deflated with the PPI
2/ Deflated with the retail price index
China and the Credit Crunch

• Export slowdown highly likely

• Reduction in foreign capital imports

• Modest **direct** impact on Chinese banks, but asset prices now weakening in China

But…
Major Questions about future direction of financial reform

• Should China continue to build Wall Street in Beijing?

• Should China continue to sell stakes in banks?

• Is it an opportunity for China to make a great leap forward overseas?
Leading Sovereign Wealth Funds

<table>
<thead>
<tr>
<th>Country</th>
<th>Fund</th>
<th>Size ($ Billion)</th>
<th>Year Created</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Arab Emirates</td>
<td>Abu Dhabi Investment Authority (ADIA)</td>
<td>500 - 875</td>
<td>1976</td>
</tr>
<tr>
<td>Singapore</td>
<td>Government of Singapore Investment Corporation (GIC)</td>
<td>100 - 330</td>
<td>1981</td>
</tr>
<tr>
<td>Norway</td>
<td>Government Pension Fund - Global (GPFG)</td>
<td>308</td>
<td>1990</td>
</tr>
<tr>
<td>China</td>
<td>China Investment Corporation, Ltd. (CIC)</td>
<td>200</td>
<td>2007</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Future Generations Fund</td>
<td>174</td>
<td>1976</td>
</tr>
<tr>
<td>Russia</td>
<td>Stabilization Fund for the Russian Federation</td>
<td>122</td>
<td>2004</td>
</tr>
<tr>
<td>Singapore</td>
<td>Temasek Holdings</td>
<td>108</td>
<td>1974</td>
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