



Financial Reform in China (revisited)

Howard Davies
Director, LSE

Sheikh Zayed Theatre

13 October 2009

Last year I concluded that the crisis...



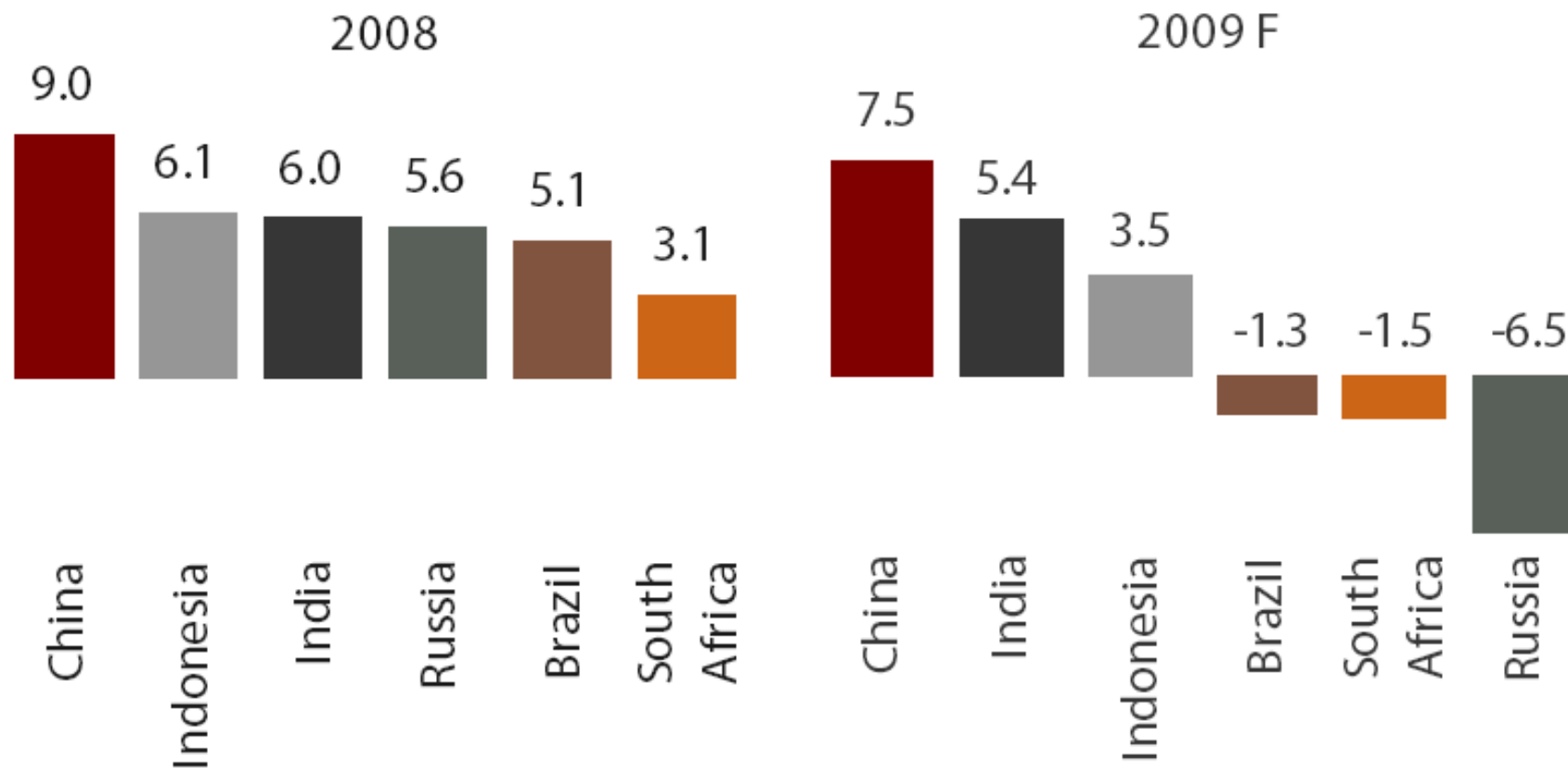
- would cause a slowdown in Chinese exports
- cut foreign capital imports
- have only a modest impact on Chinese banks, unless asset prices weakened further, but
- that it had raised serious doubts in China about the future direction of financial reform

...so what has happened since?

All the BRIIC economies slowed



Real GDP growth for BRIICS countries %,
2008 estimates and 2009 forecasts

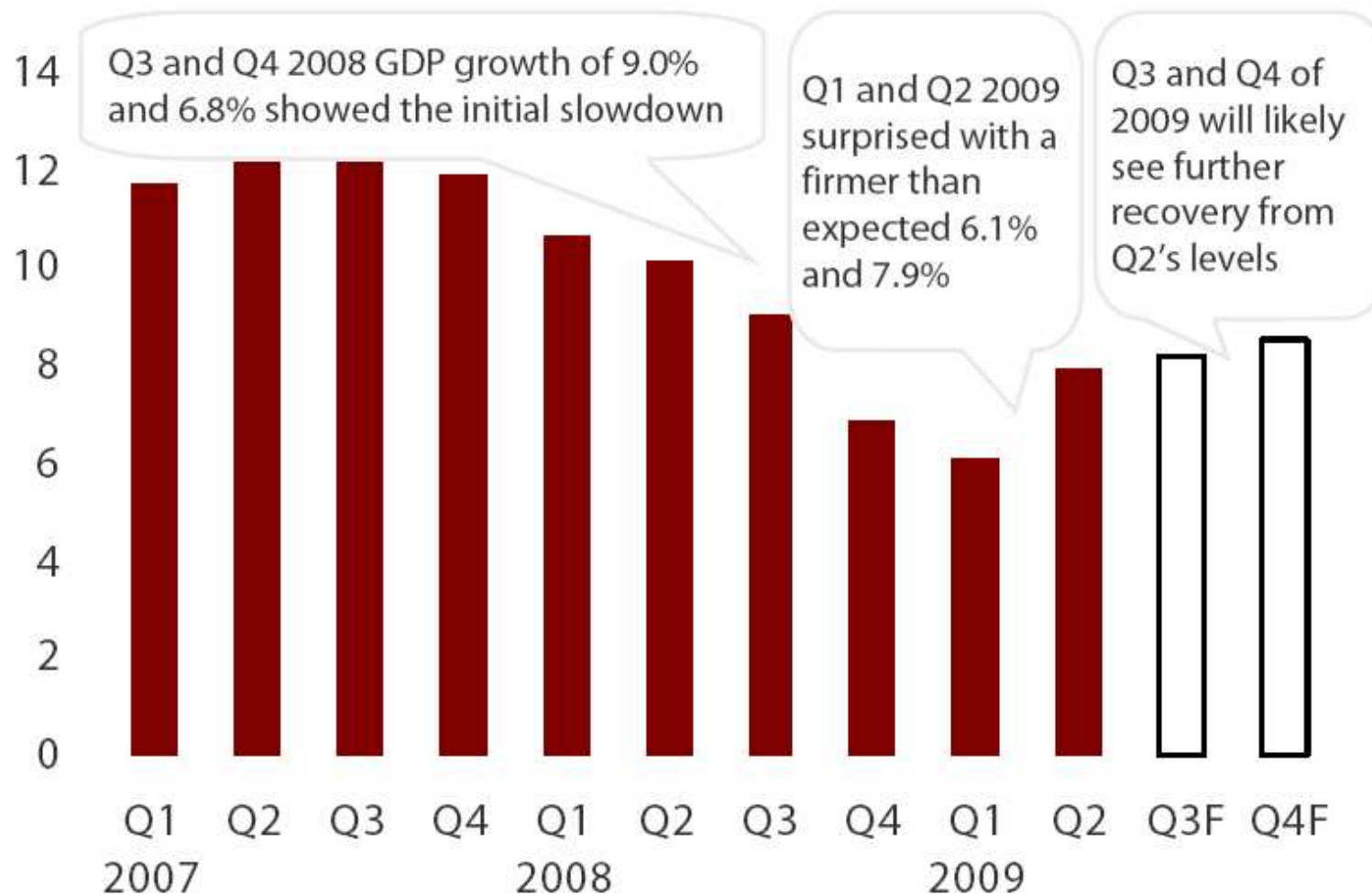


Source: The China Analyst, September 2009.

In China, economic growth slowed, but by less than many feared



China's quarterly GDP growth, % year-to-year, 2007-2009



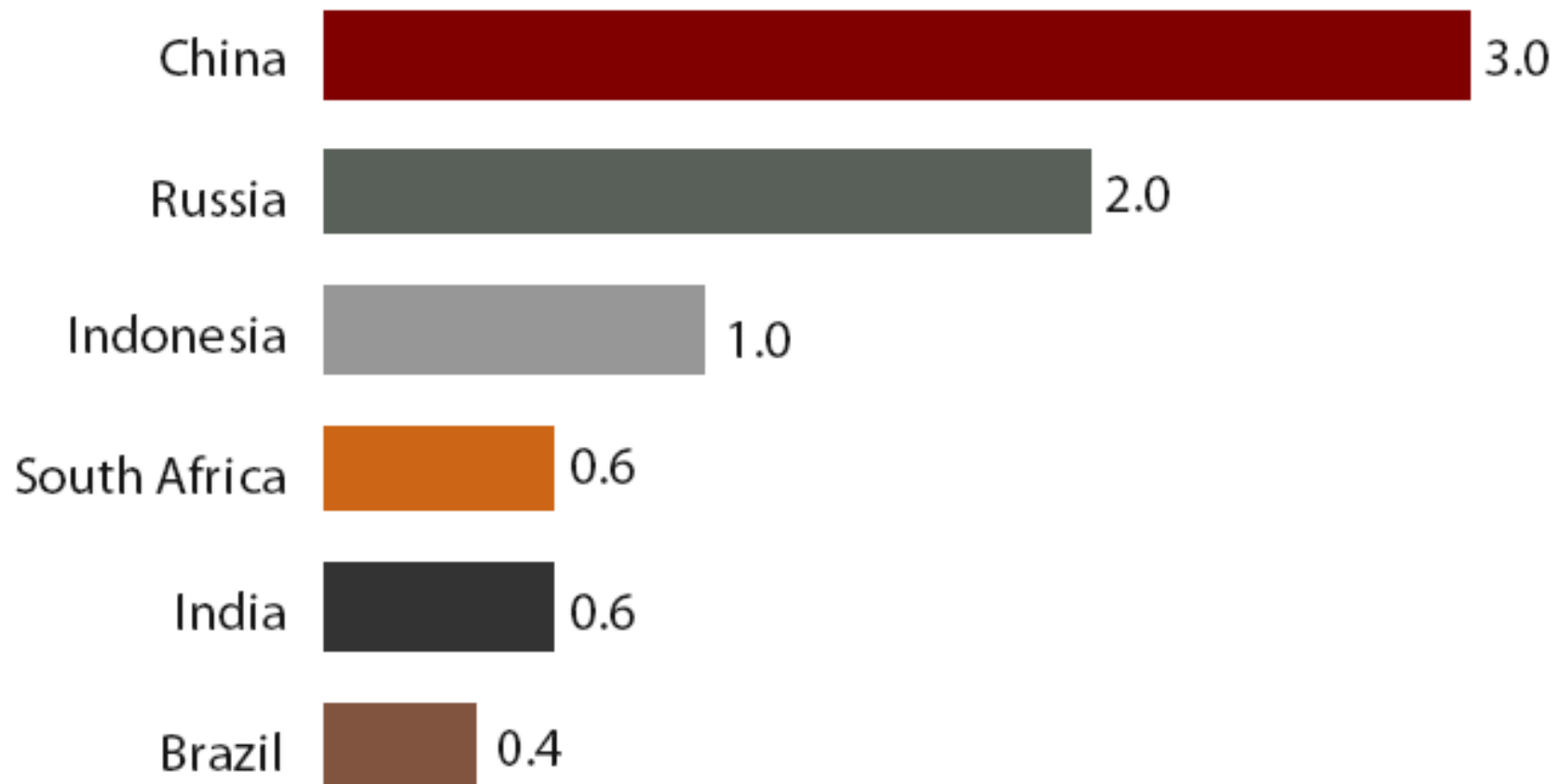
Note: Q3F and Q4Fin 2009 are forecasts.

Source: The China Analyst, September 2009.

A large fiscal stimulus helped offset declining overseas demand



Fiscal stimulus measures, average % of GDP,
forecasts for 2009 - 2010

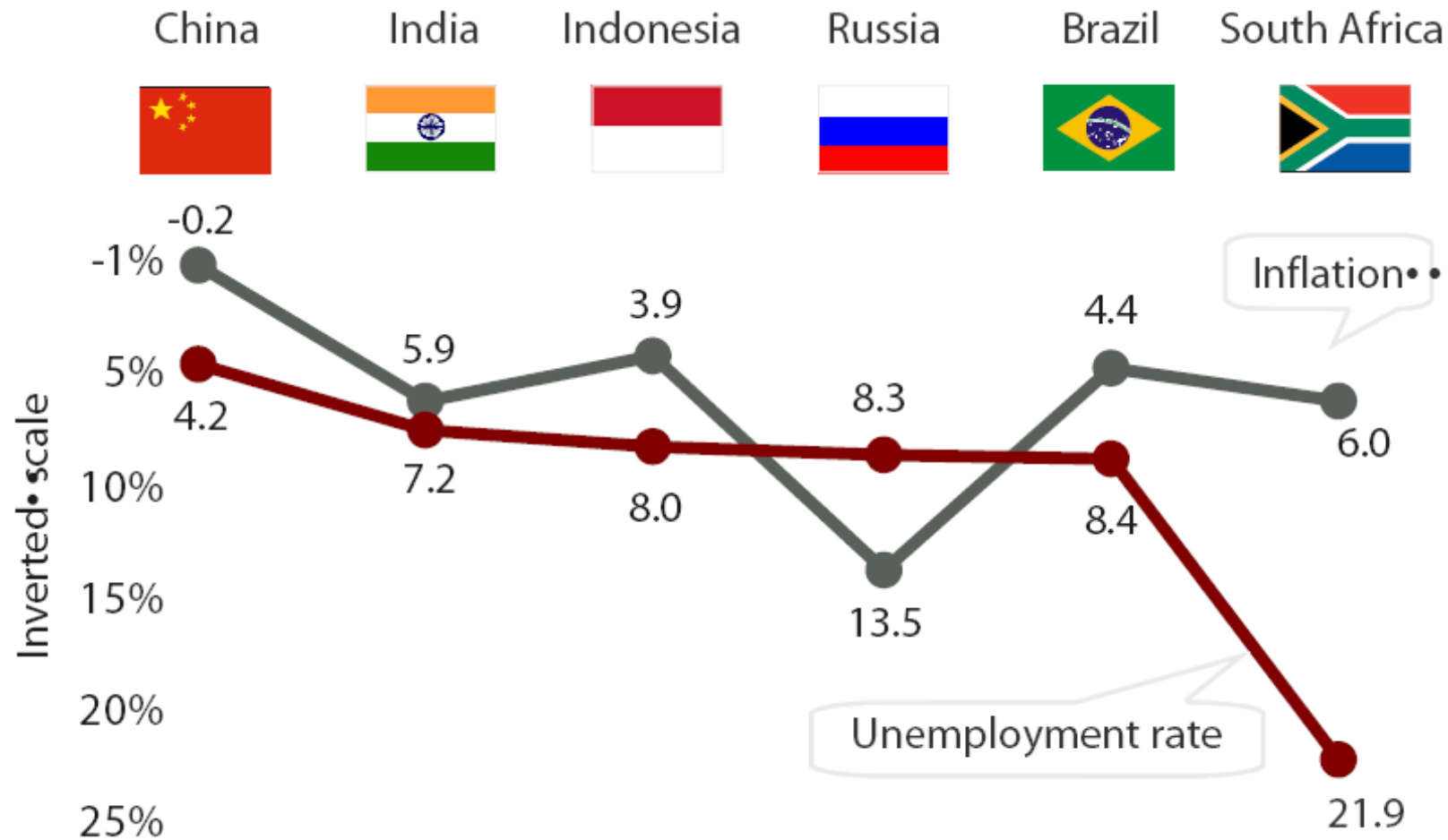


Source: The China Analyst, September 2009.

China remains a strong and stable performer among the BRICs...



Unemployment and inflation in BRIICS countries, %, 2009 forecasts

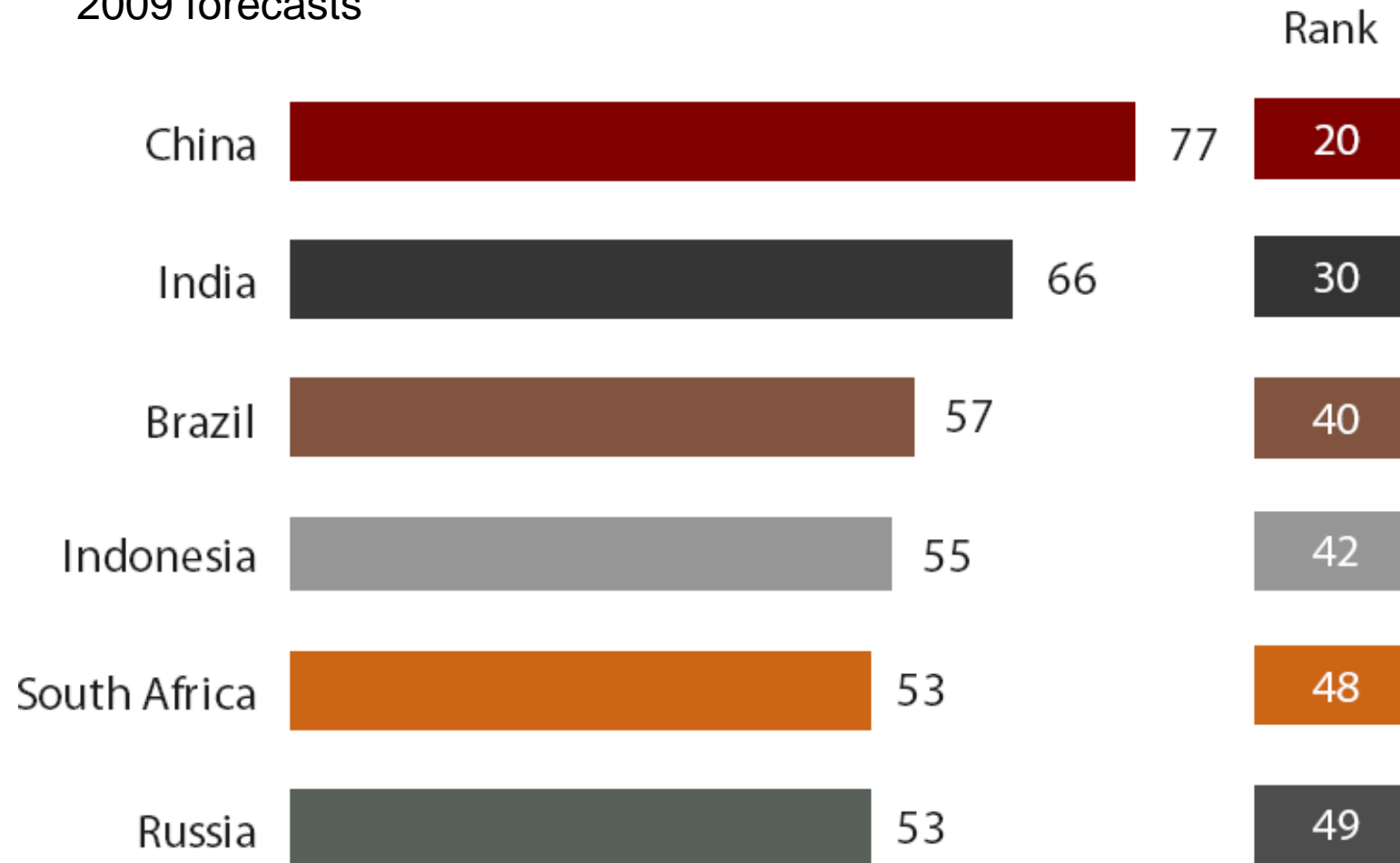


Source: The China Analyst, September 2009.

...with assessed competitiveness higher than the rest



Competitiveness in BRIICS countries, points (Max = 100),
2009 forecasts

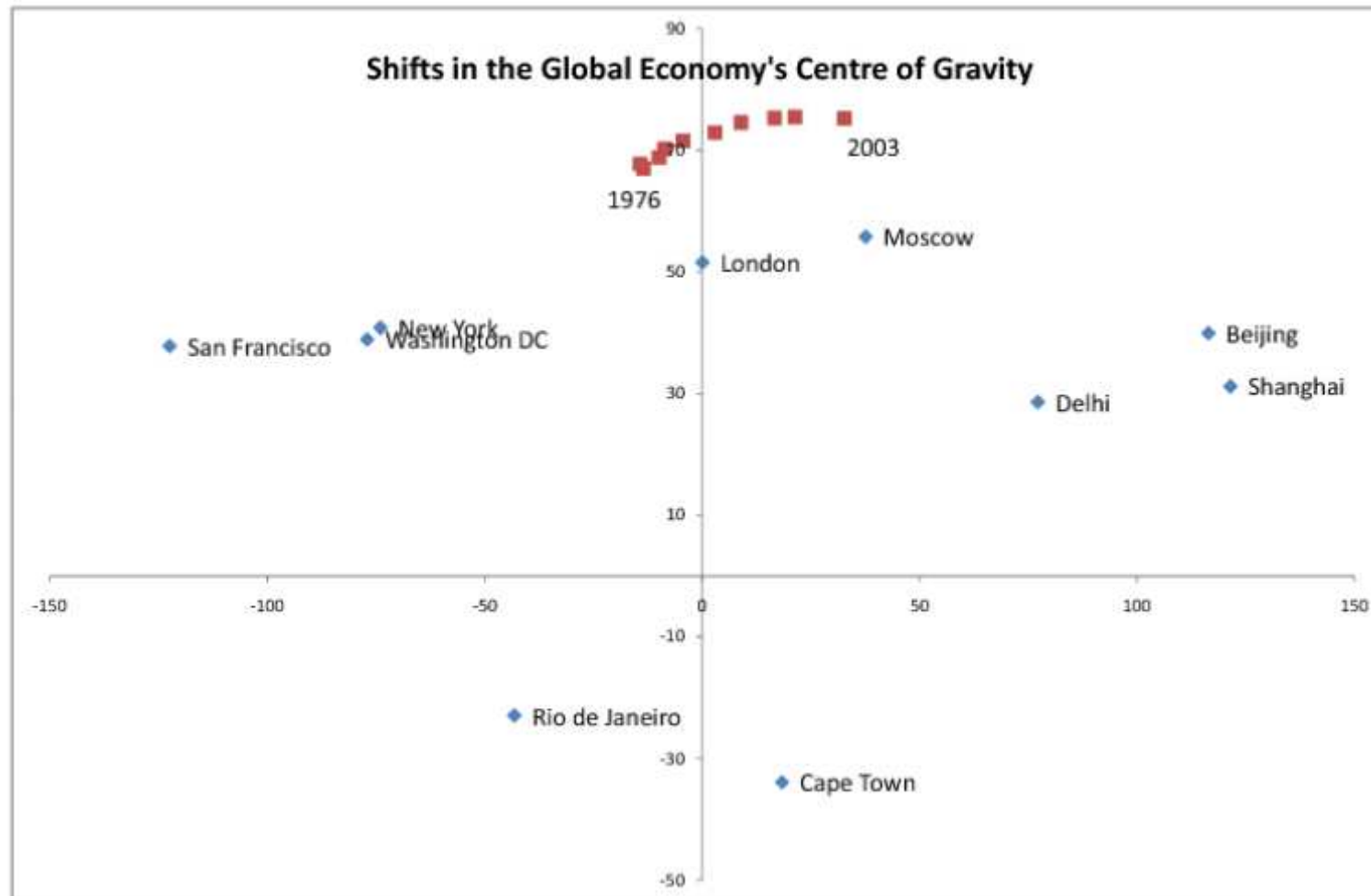


Source: The China Analyst, September 2009.

Over the last 30 years, the world's economic centre of gravity has drifted nearly 2,000km eastwards...



The movement of the world's economic centre of gravity, thousand km, 1976-2003

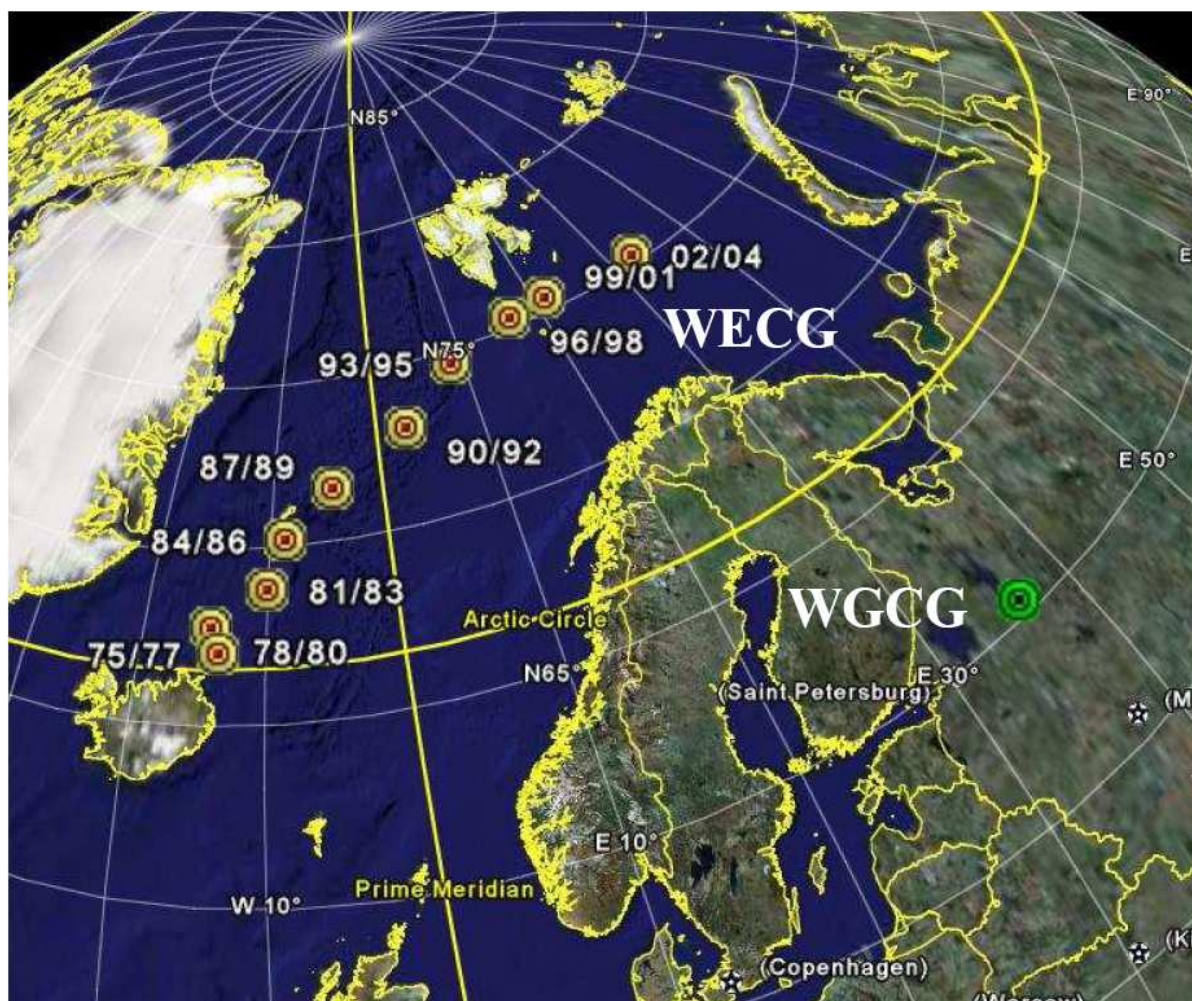


Source: Quah D (2009): The shifting distribution of global economic activity.

The centre has moved from Iceland to Spitsbergen



Projection of the World's Economic and Geographic Centre of Gravity (WECG and WGCG), 1975/1977 – 2002/2003



Source: Grether JM, Mathys N (2008): Is the World's Economic Center of Gravity Already in Asia?

....pulled by Chinese cities...



Top 15 Cities according to Distance Growth Rate, % change (1975 – 2004)

		City	Country	Change (%), 1975-2004
Gainers	1	Krasnojarsk	Russia	-17.06
	2	Qiqihar	China	-16.99
	3	Huhehot	China	-16.96
	4	Daqing	China	-16.95
	5	Baotou	China	-16.94
	6	Datong	China	-16.87
	7	Beijing	China	-16.79
	8	Harbin	China	-16.75
	9	Changchun	China	-16.73
	10	Tientsin	China	-16.70
	11	Shenyang	China	-16.67
	12	Taiyuan	China	-16.67
	13	Shijiazhuang	China	-16.66
	14	Fushun	China	-16.65
	15	Anshan	China	-16.64

Source: Grether JM, Mathys N (2008): Is the World's Economic Center of Gravity Already in Asia?

...leaving Europe behind.



Bottom 15 Cities according to Distance Growth Rate, % change (1975 – 2004)

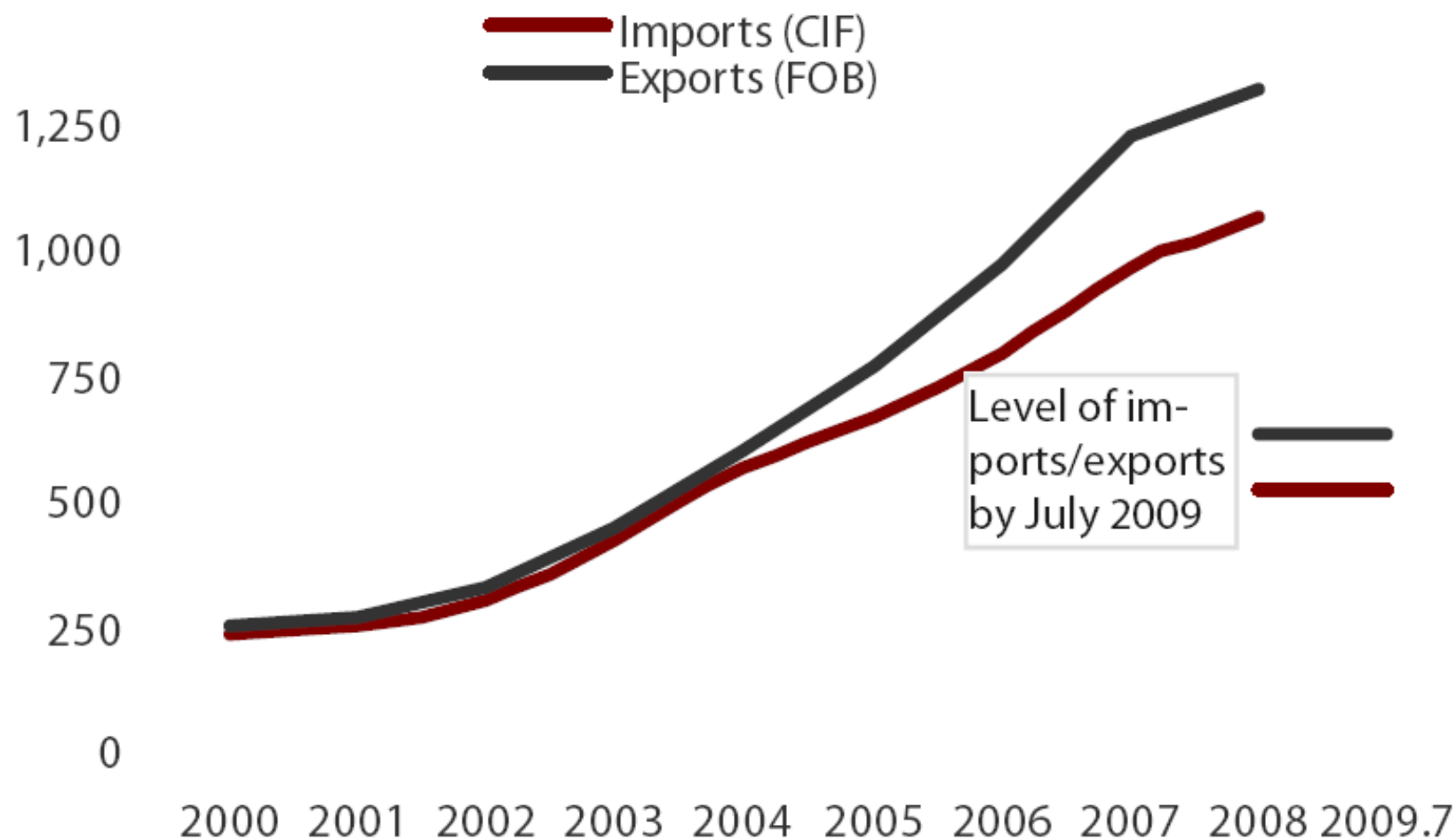
		City	Country	Change (%), 1975-2004
Losers	1	Dublin	Ireland	23.86
	2	Porto	Portugal	23.22
	3	Lisbon	Portugal	22.67
	4	Glasgow	Great Britain	22.59
	5	Liverpool	Great Britain	22.24
	6	Manchester	Great Britain	21.82
	7	Birmingham	Great Britain	21.73
	8	Leeds	Great Britain	21.44
	9	Sheffield	Great Britain	21.43
	10	Newcastle upon Tyne	Great Britain	21.34
	11	Sevilla	Spain	20.97
	12	Madrid	Spain	20.86
	13	London	Great Britain	20.78
	14	Casablanca	Morocco	20.38
	15	Rabat	Morocco	20.23

Source: Grether JM, Mathys N (2008): Is the World's Economic Center of Gravity Already in Asia?

Export growth levelled off, but exports did not fall in absolute terms



China's total imports and exports, \$ Billion, 2000 – July 2009



Source: The China Analyst, September 2009.

Although we must be sceptical about these figures



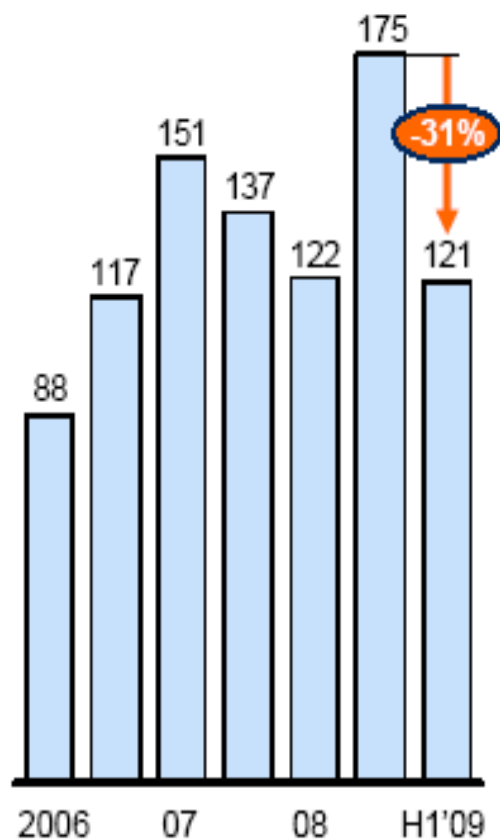
Source: The Economist, Is China deliberately understating the size of its trade surplus?, 5 September 2009.

China, Germany, and Japan have experienced sharp declines in their current account surpluses

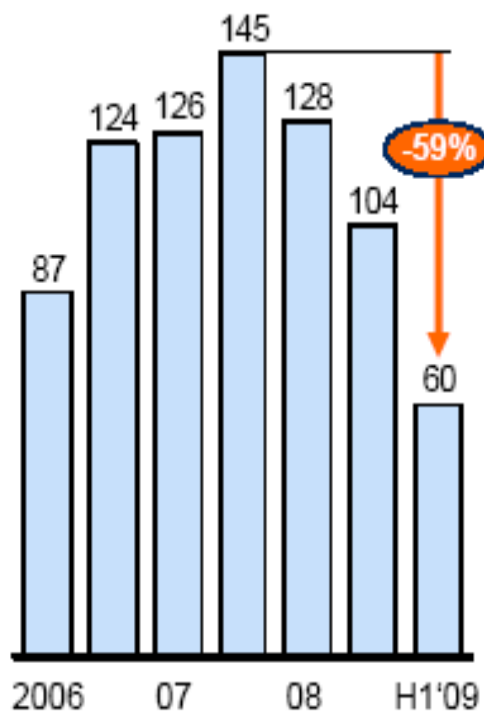


China's goods trade balance, German and Japan's current account balances, \$ Billion, half-yearly, using 2008 exchange rates, 2006 – H1 2009

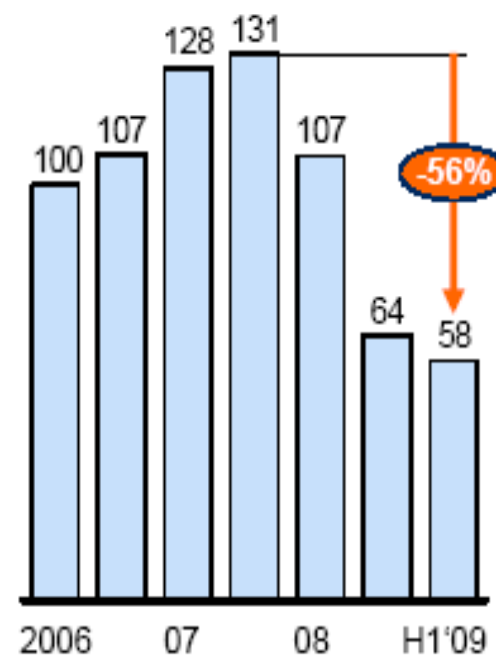
China's goods trade balance¹



German current account balance



Japan's current account balance



¹ China does not publish quarterly current account statistics; however, the monthly goods trade statistics have historically accounted for about 70% of China's current account surplus.

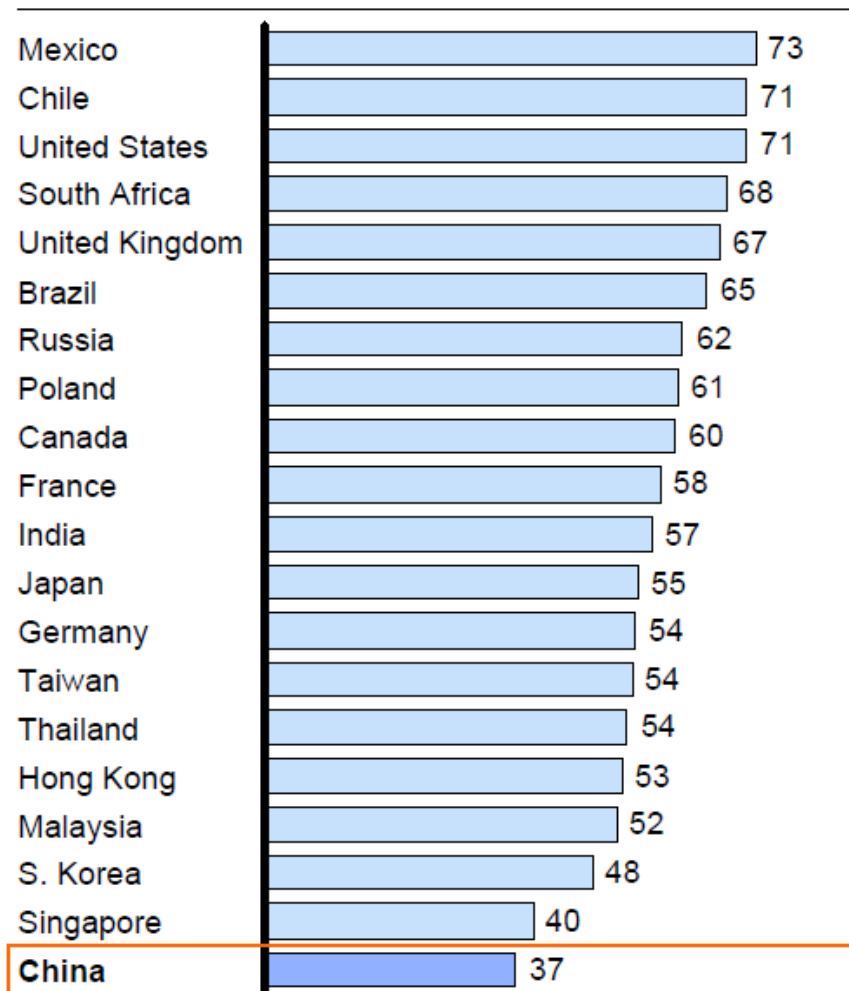
Source: McKinsey Global Institute, Global capital markets: Entering a new era, September 2009.

But China still shows low per capita private consumption and low consumption share of GDP



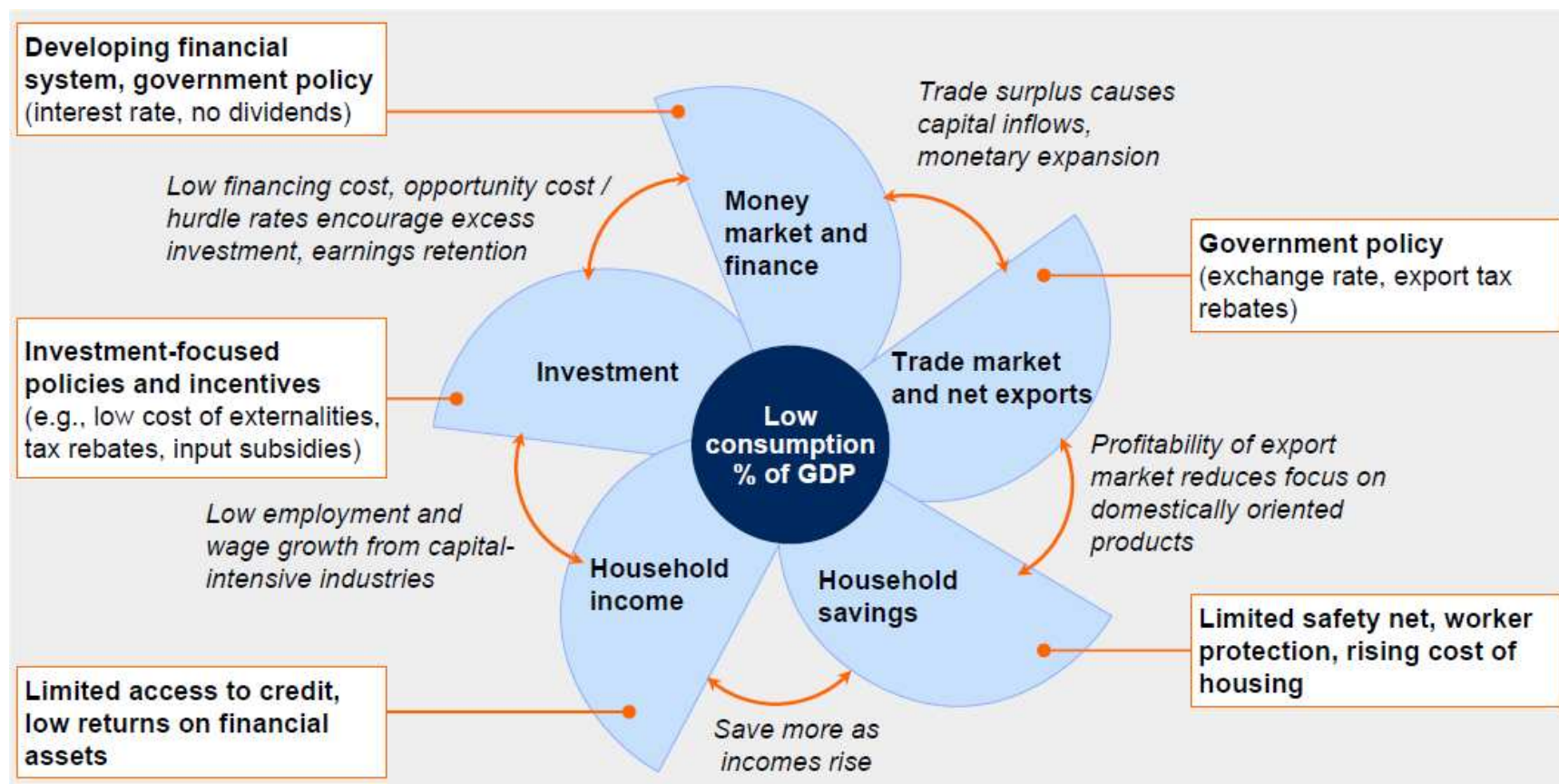
Private domestic consumption as share of GDP, 2008

%



Source: McKinsey Global Institute, If you've got it, spend it: Unleashing the Chinese consumer, August 2009.

China's entire growth model pushes down the consumption share of GDP

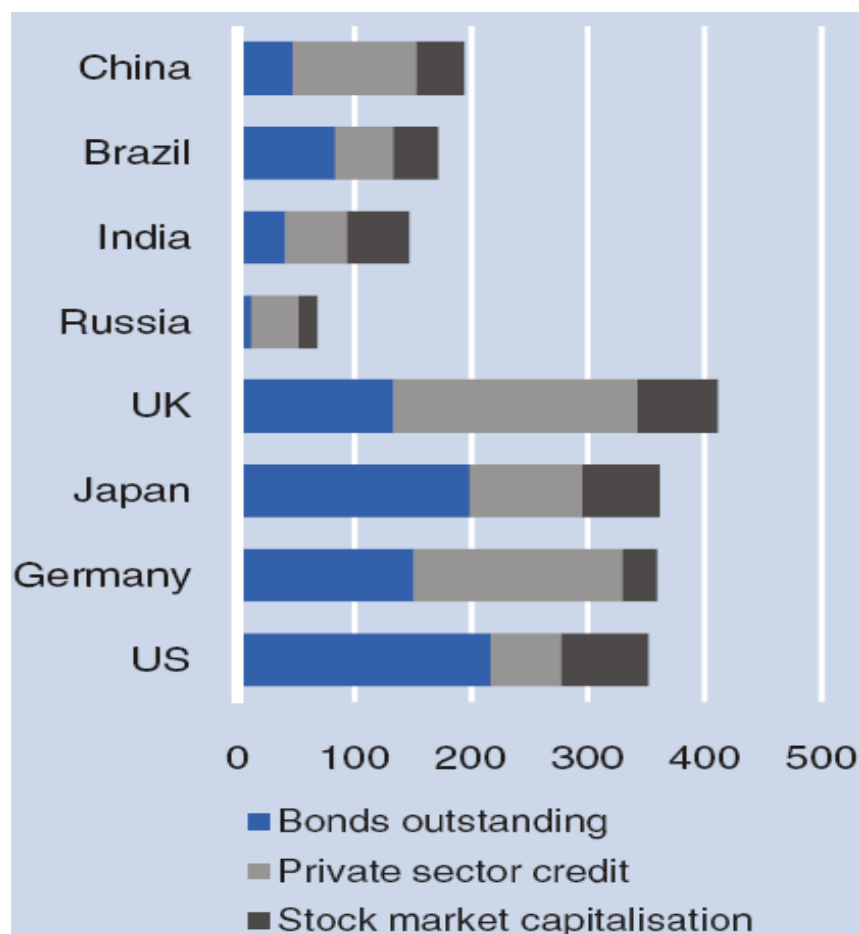


Source: McKinsey Global Institute, If you've got it, spend it: Unleashing the Chinese consumer, August 2009.

China's financial markets are large by emerging market, but small by developed market standards



Financial markets in comparison, % of GDP, 2008

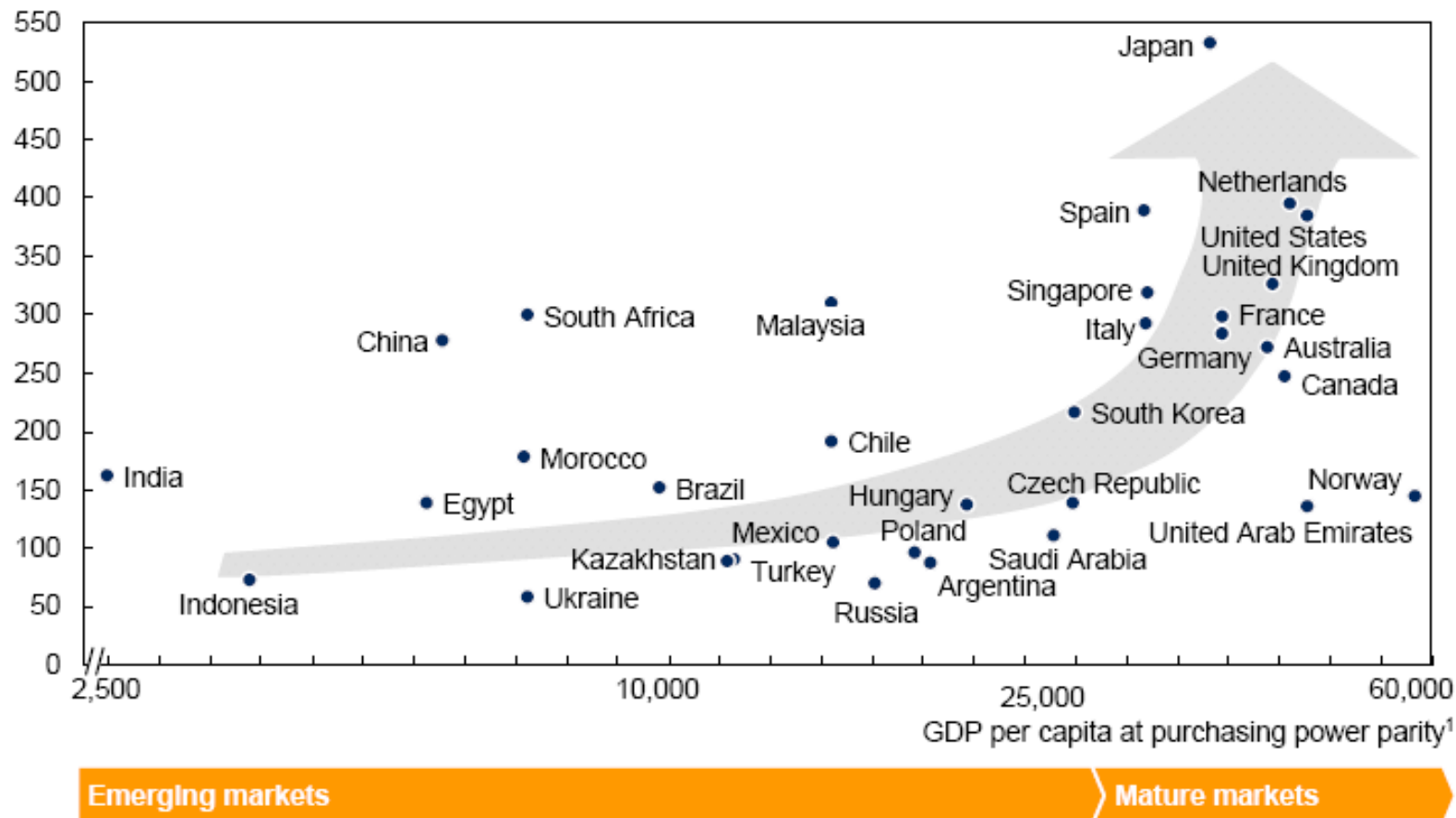


Source: Deutsche Bank Research, China's financial markets – a future global force?, 16 March 2009.

But in relation to GDP per capita the financial markets are quite well-developed



Financial depth: Value of bank deposits, bonds, and equity as % of GDP, 2008



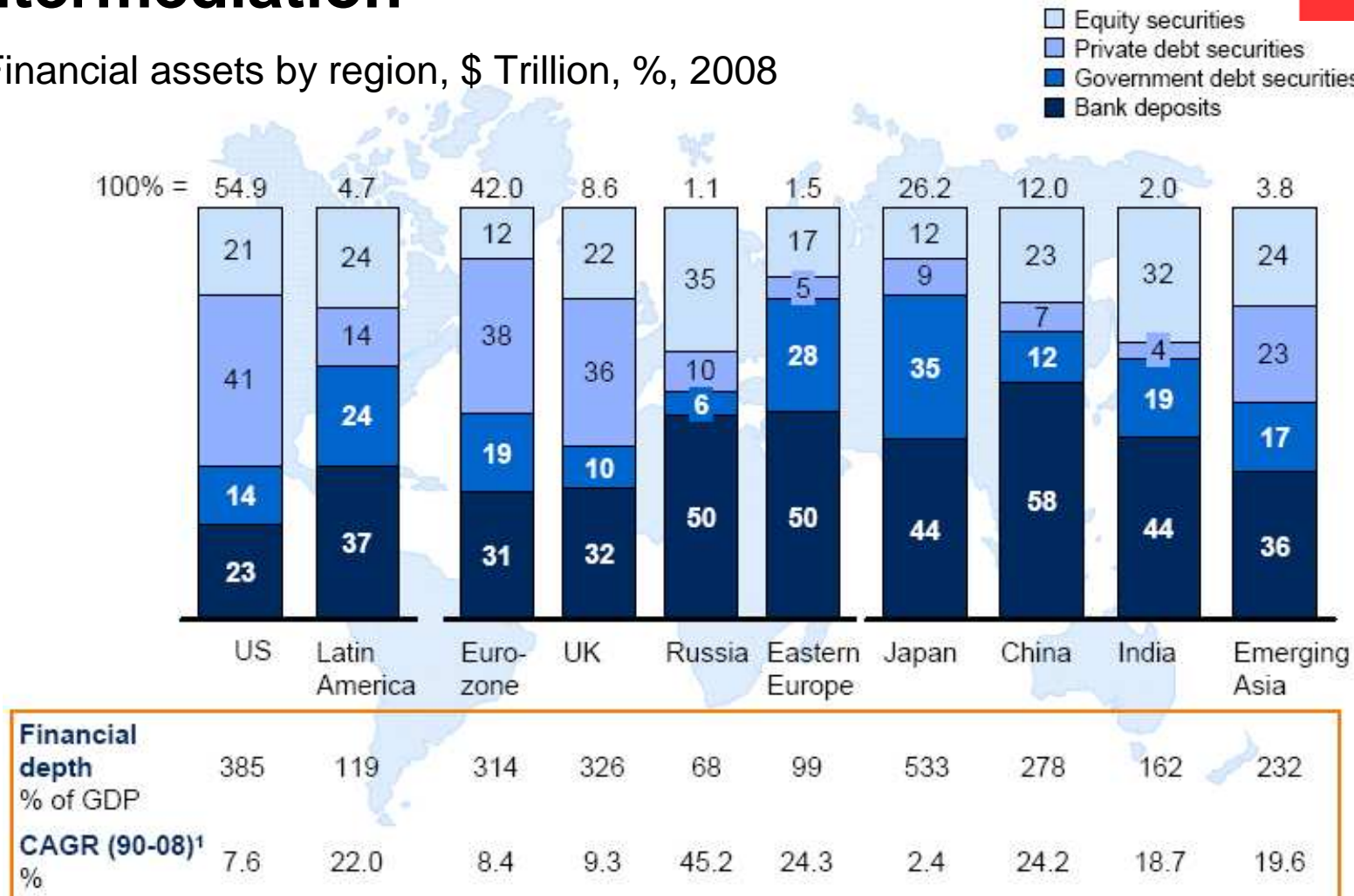
¹ Log scale.

Source: McKinsey Global Institute, Global capital markets: Entering a new era, September 2009.

China is unusually dependent on bank intermediation



Financial assets by region, \$ Trillion, %, 2008



¹ Compound annual growth rate using 2008 exchange rates.

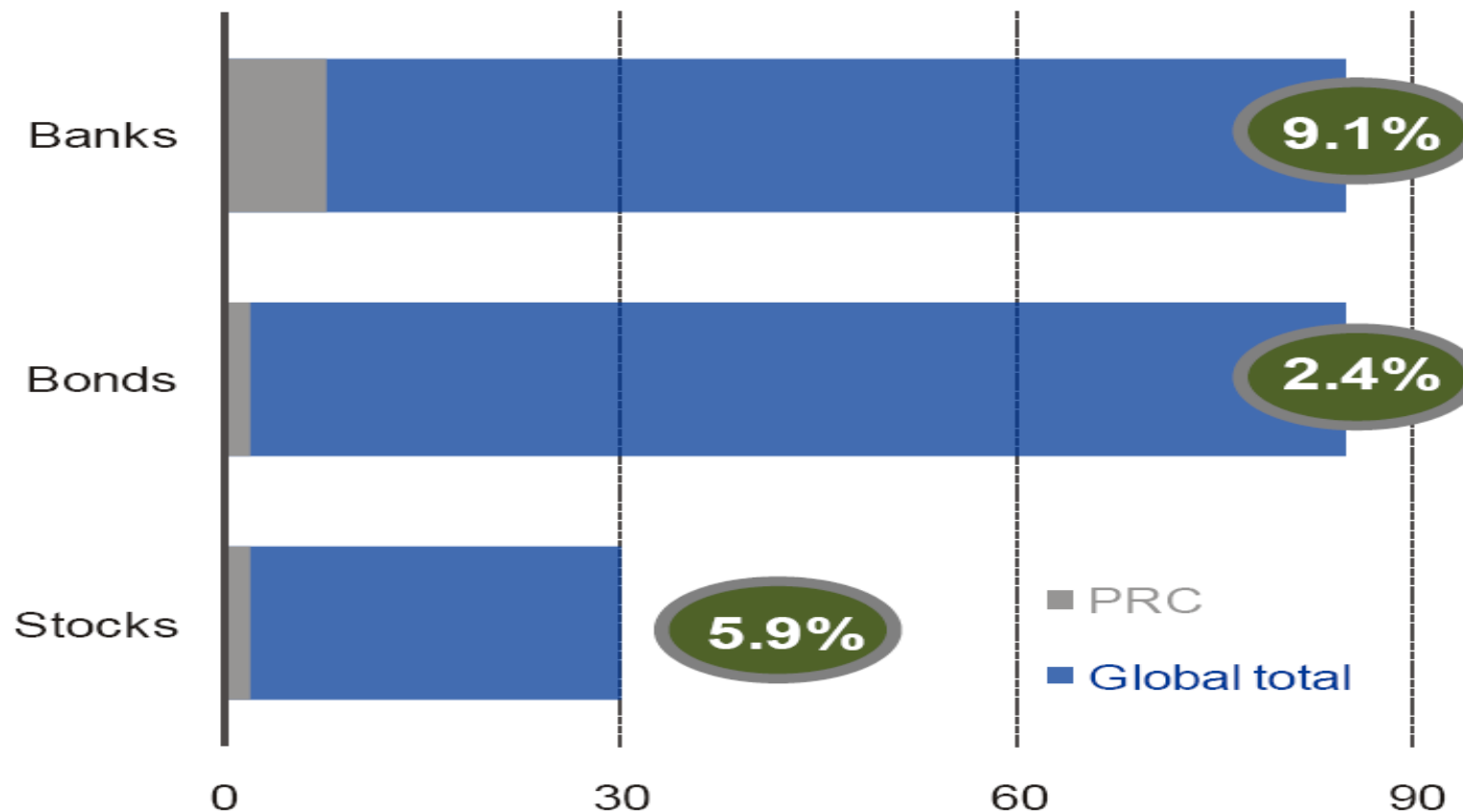
Note: Some numbers do not sum due to rounding.

Source: McKinsey Global Institute, Global capital markets: Entering a new era, September 2009.

China's share of global stock and bond markets is small



Bank assets (2007), debt securities outstanding (2008), stock market capitalisation (2008), PRC and global total, \$ Trillion and PRC % of total

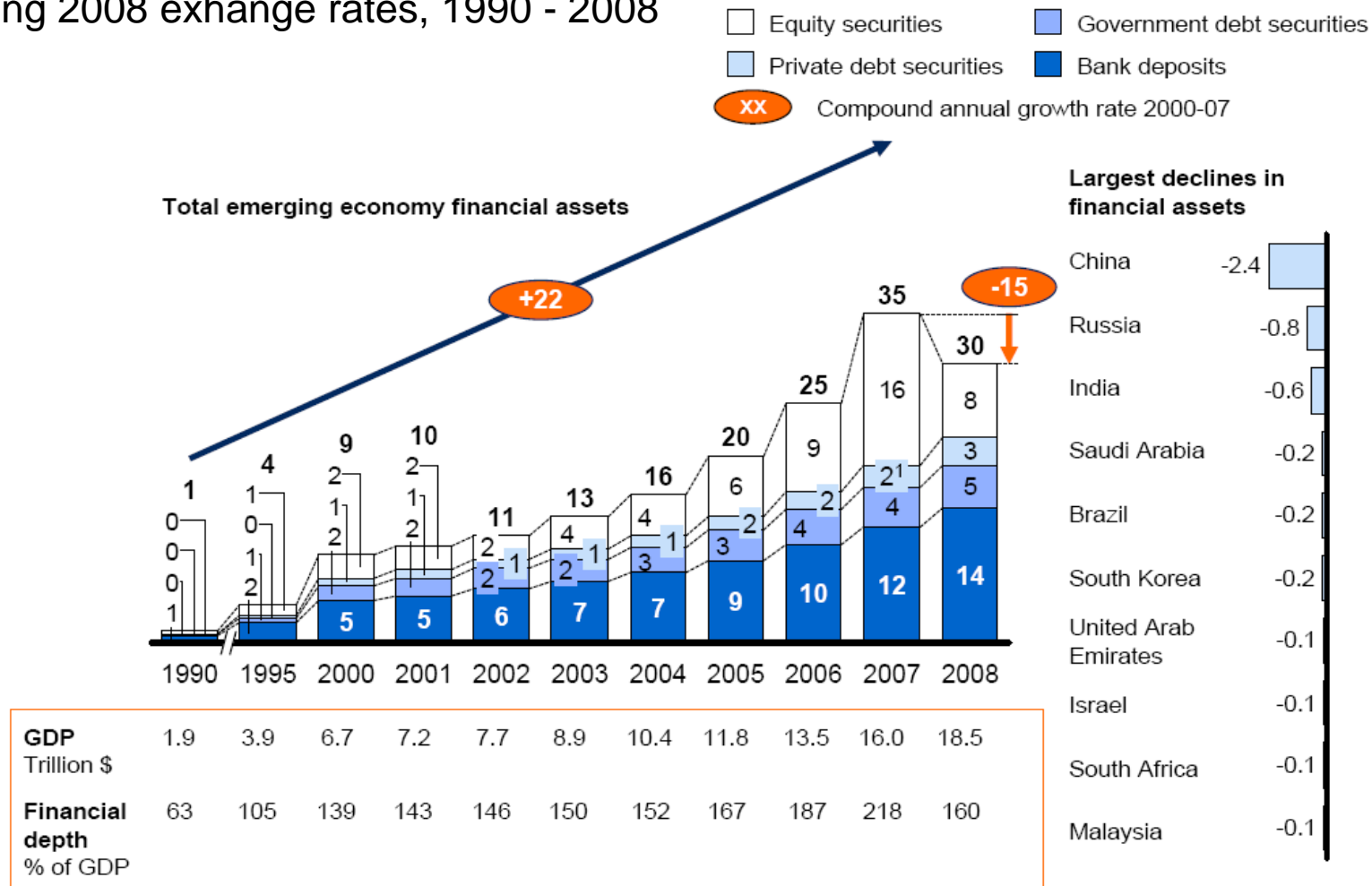


Source: Deutsche Bank Research, China's financial markets – a future global force?, 16 March 2009.

Emerging economy financial assets fell by \$5 trillion in 2008



Financial assets in emerging economy, \$ Trillion,
using 2008 exchange rates, 1990 - 2008



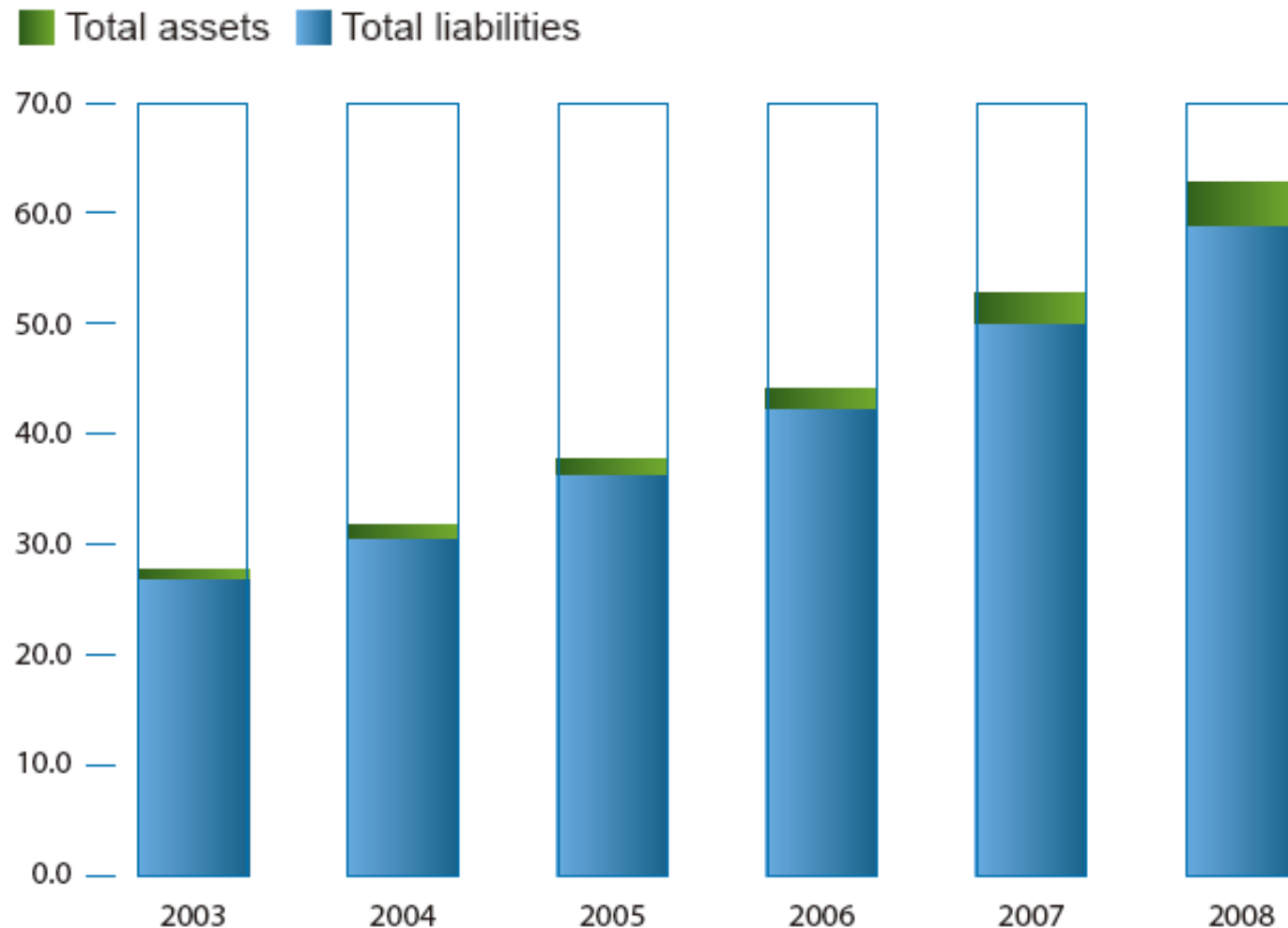
Note: Figures may not sum due to rounding.

Source: McKinsey Global Institute, Global capital markets: Entering a new era, September 2009.

Bank assets and liabilities continue to grow strongly



Total assets and liabilities of banking institutions, RMB Trillion, 2003 – 2008



Source: China Banking Regulatory Commission, 2008 Annual Report.

Three of the world's top 12 banks (by capital size) are Chinese



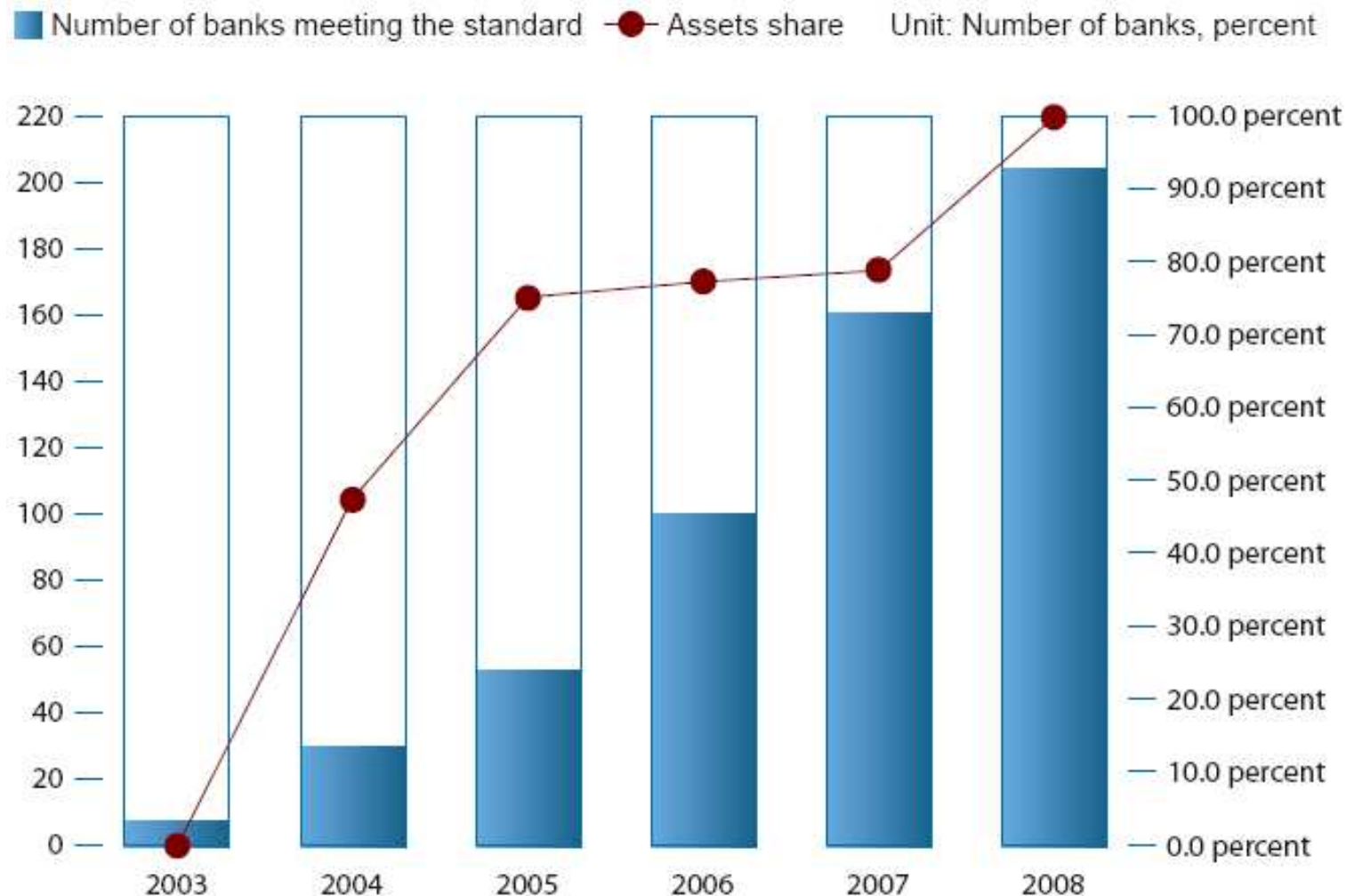
Ranking		Strength	Tier 1 Capital \$m	%ch
Latest	Previous			
1	4	JP Morgan Chase & Co New York (NY), USA, 31-Dec-08	136104	53.36
2	5	Bank of America Corp Charlotte (NC), USA, 31-Dec-08	120814	44.91
3	2	Citigroup New York (NY), USA, 31-Dec-08	118758	33.1
4	3	Royal Bank of Scotland Edinburgh, United Kingdom, 31-Dec-08	101818	14.55
5	1	HSBC Holdings London, United Kingdom, 31-Dec-08	95336	-9.18
6	23	Wells Fargo & Co San Francisco (CA), USA, 31-Dec-08	86397	135.58
7	6	Mitsubishi UFJ Financial Group Tokyo, Japan, 31-Mar-09	77218	-6.81
8	8	ICBC Beijing, China, 31-Dec-08	74701	12.72
9	7	Crédit Agricole Group Paris, France, 31-Dec-08	71681	4.3
10	9	Santander Central Hispano Santander, Spain, 31-Dec-08	65267	11.61
11	10	Bank of China Beijing, China, 31-Dec-08	64961	15.57
12	13	China Construction Bank Corporation Beijing, China, 31-Dec-08	63113	20.68

Source: The Banker, Top 1000 World Banks 2009, July 2009.

And reported capital adequacy has improved



Numbers and % share of banks meeting the CAR requirement, 2003-2008

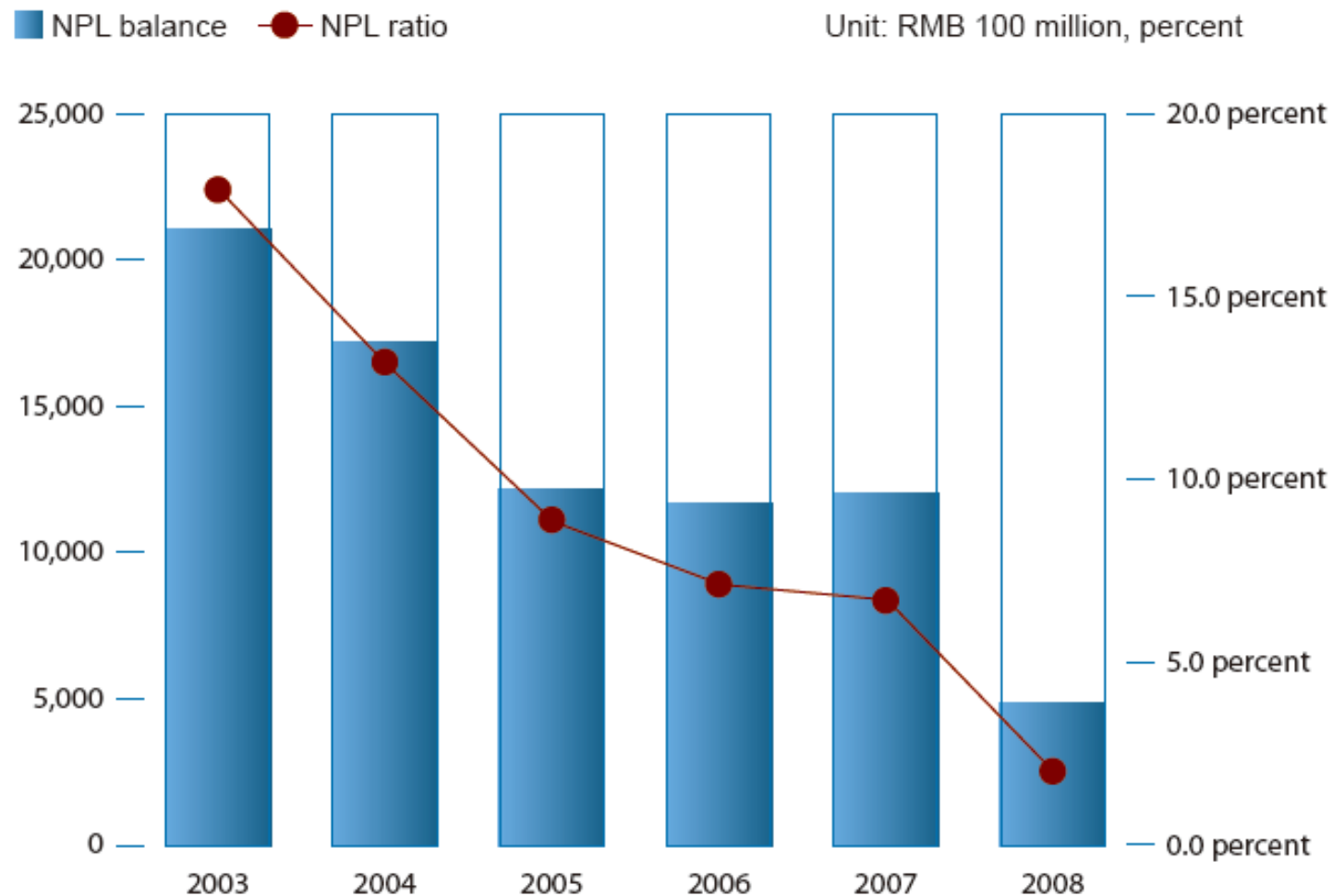


Source: China Banking Regulatory Commission, 2008 Annual Report.

The Non-Performing Loan Problem was much smaller at the end of 2008



NPL balance and ratio of major commercial banks, RMB 100 Million and % share, 2003-2008

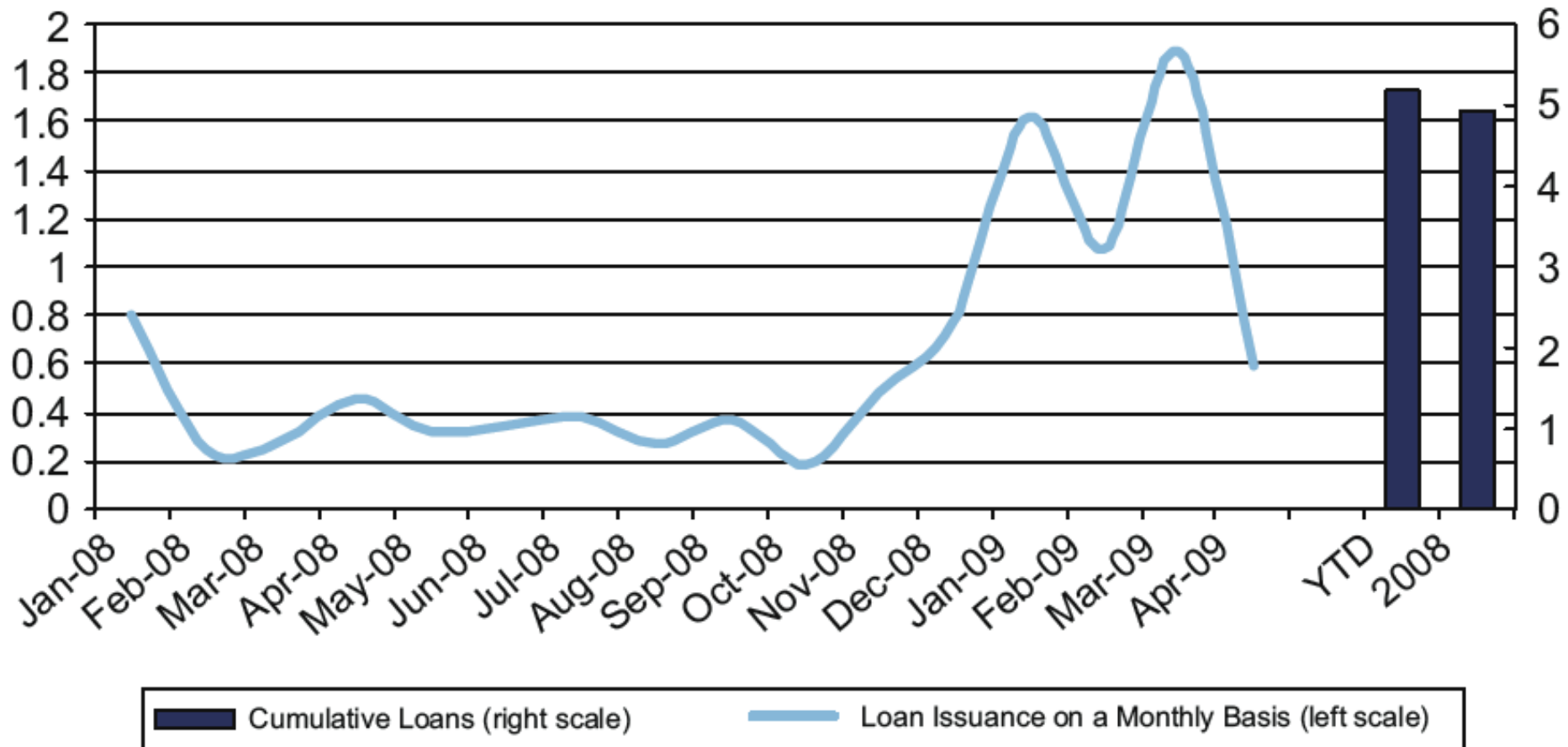


Source: China Banking Regulatory Commission, 2008 Annual Report.

Loan growth has been very rapid, and mainly to state-owned enterprises



Cumulative loans and loan issuance on a monthly basis, RMB Trillion



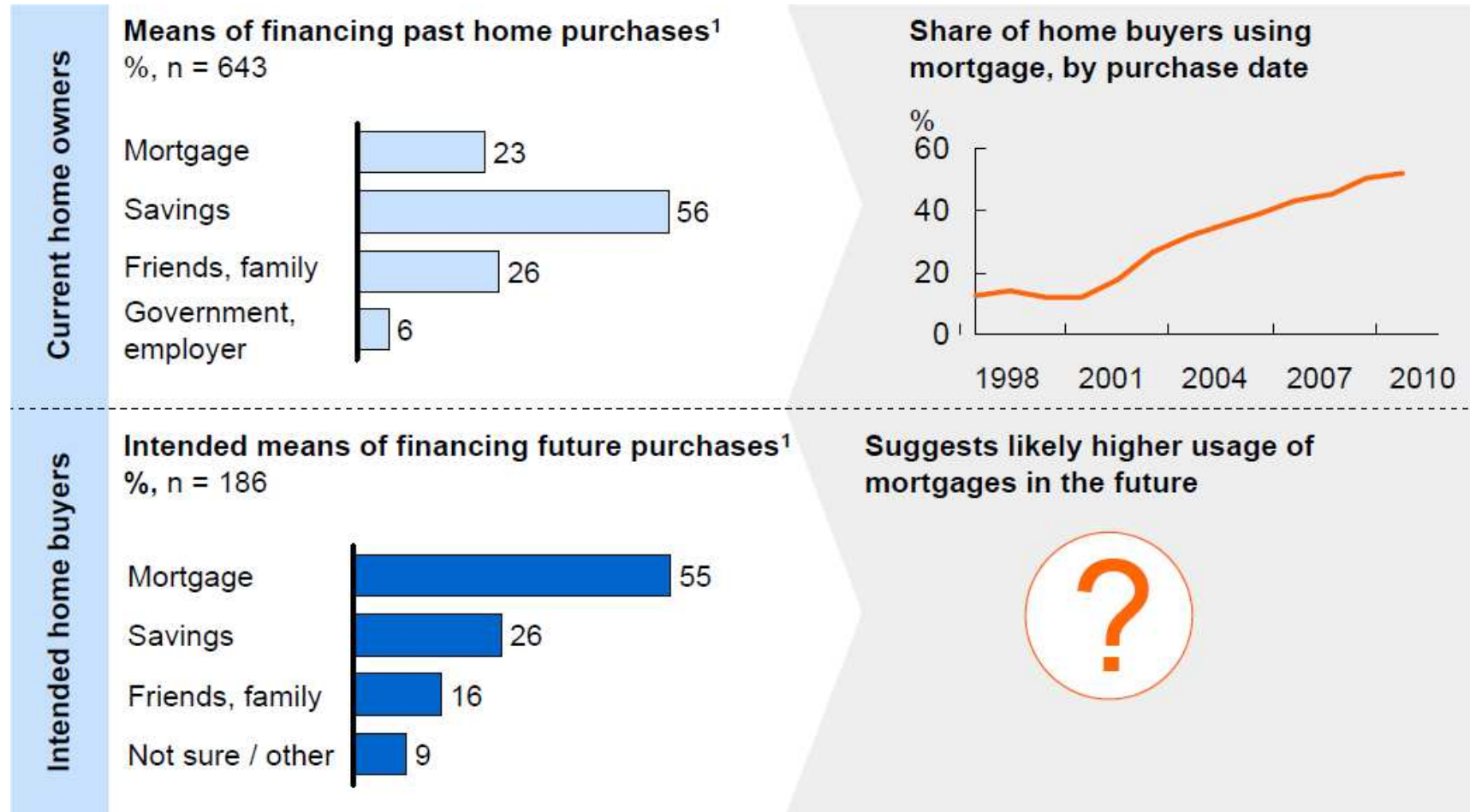
Source: European Union Chamber of Commerce in China, European Business in China Position Paper 2009/2010.

Lending has exploded since late 2007



- RMB 4 trillion stimulus package
- PBOC removed lending quotas, reduced reserve requirements and lowered interest rates
- Most of new lending has been to SOEs and government bodies for infrastructure projects

Comparisons of home-purchase data show that mortgage lending is on the rise



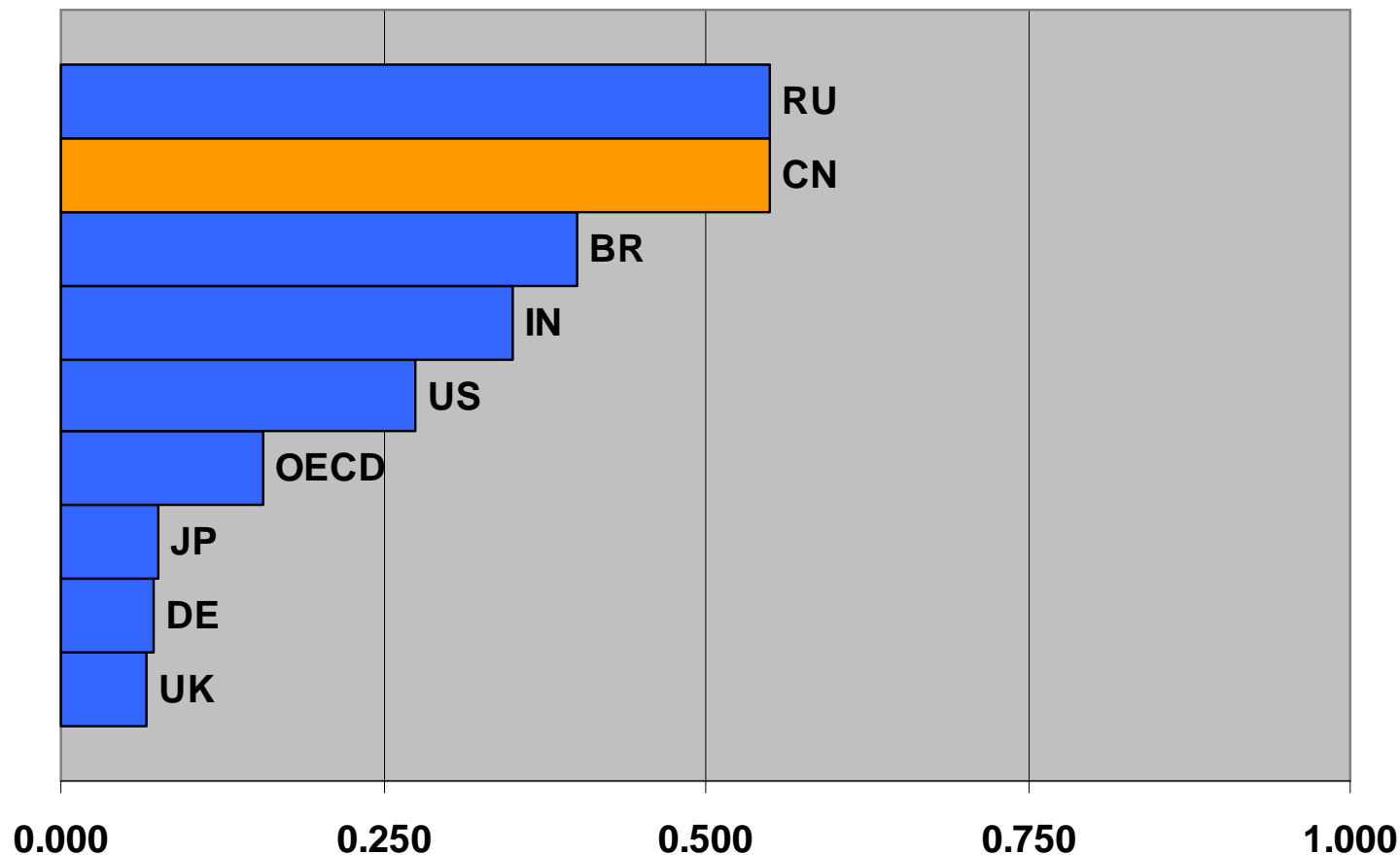
¹ Numbers do not sum to 100% because respondents were allowed to select multiple answers.

Source: McKinsey Global Institute, If you've got it, spend it: Unleashing the Chinese consumer, August 2009.

The Chinese banking market remains highly protected



OECD FDI regulatory restrictiveness indicator, national banking markets, (0=open, 1=closed), end-2006

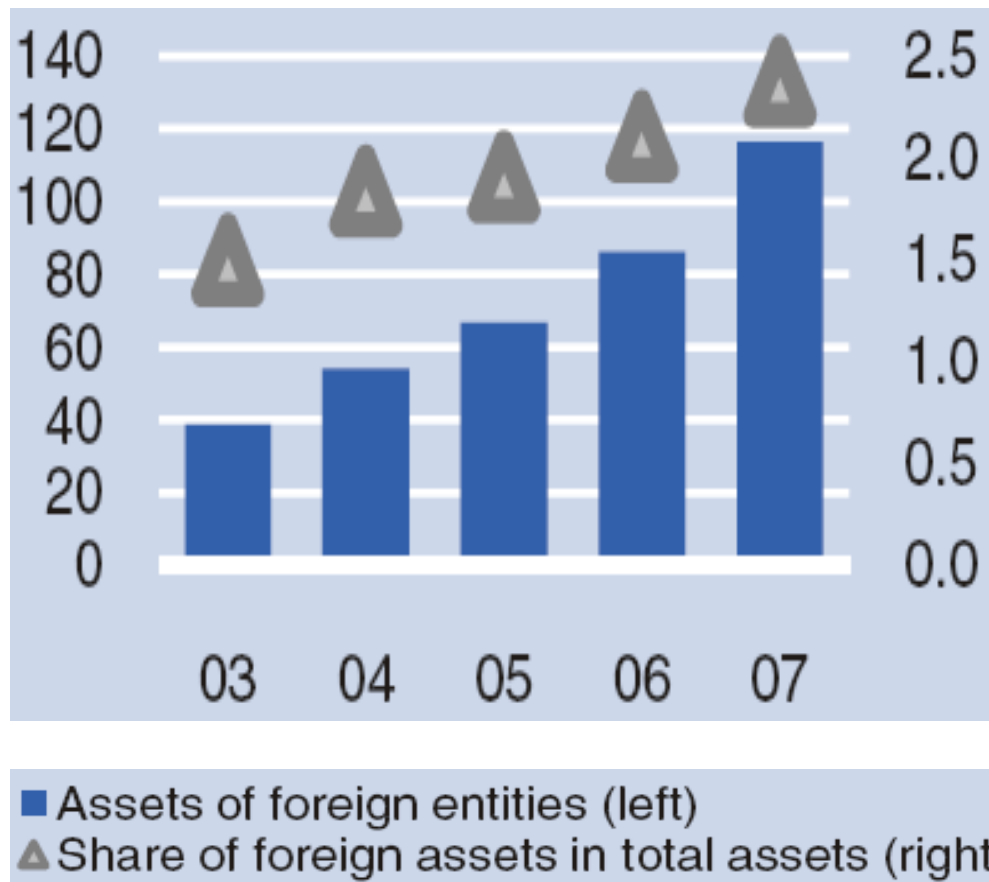


Source: Koyama, T. and Golub S. S. (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to more Economies", OECD Working Paper.

The foreign bank share remains small, and probably fell back in 2008



Assets of foreign banks in PRC, € Billion and % of total banking assets, 2003 - 2007



Source: Deutsche Bank Research, China's financial markets – a future global force?, 16 March 2009.

Recent reforms will somewhat liberalise the environment for foreign banks

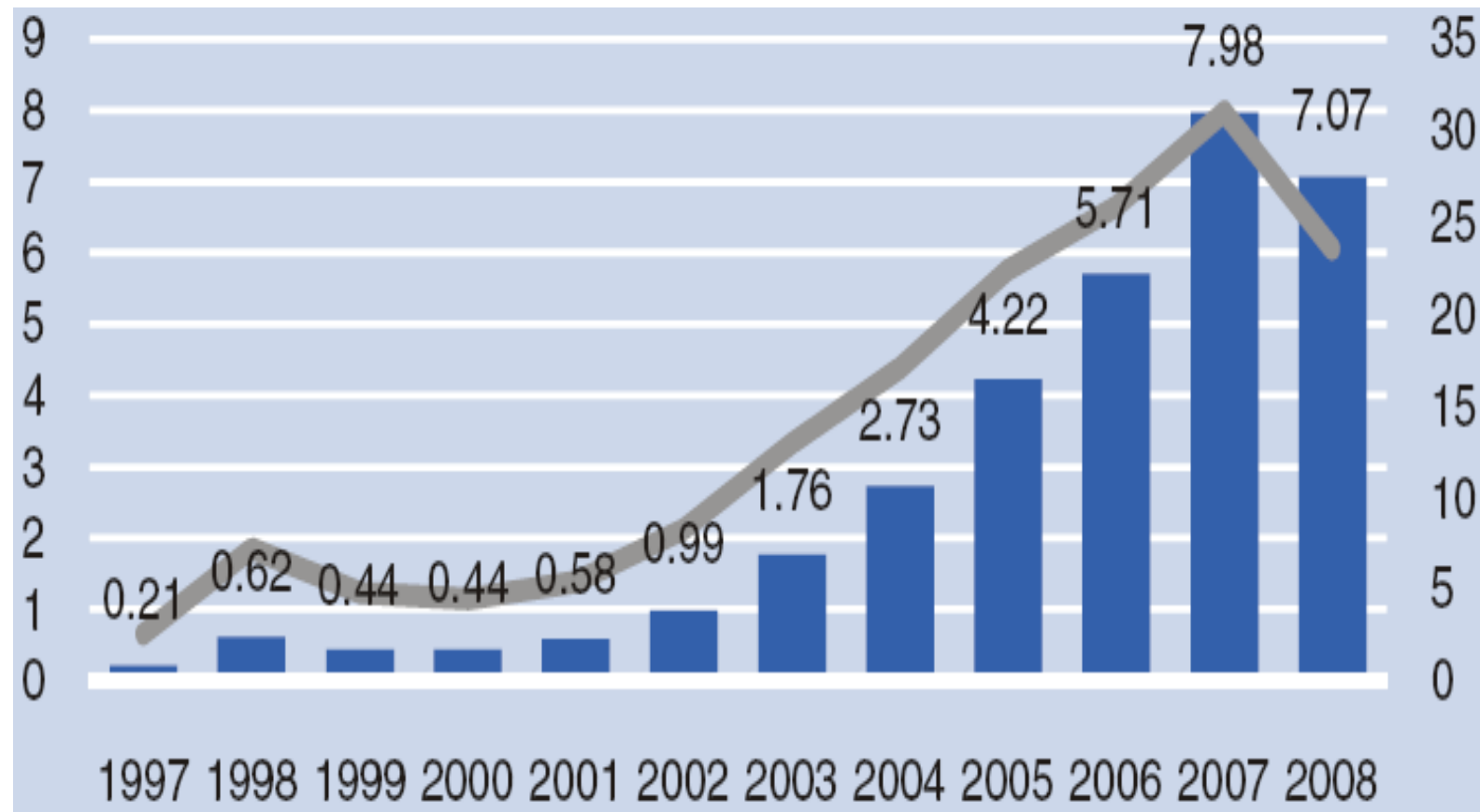


- allowed to underwrite and trade RMB bonds
- authorised to issue debit cards
- permitted to invest in consumer finance companies

Growth in the bond market has stalled



Total annual issuance, RMB Trillion (left) and % of GDP (right),
1997 - 2008

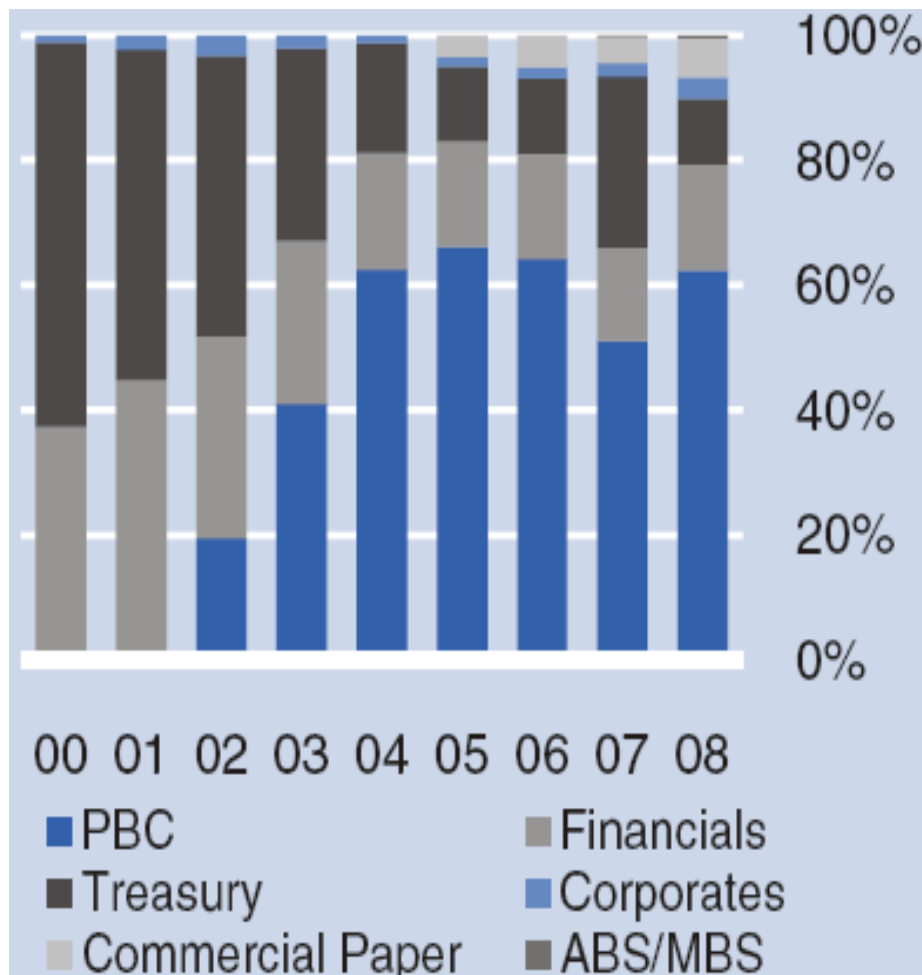


Source: Deutsche Bank Research, China's financial markets – a future global force?, 16 March 2009.

Public sector issuance dominates



Bond issuance by the type of bond, %, 2000 – 2008



Source: Deutsche Bank Research, China's financial markets – a future global force?, 16 March 2009.

The stock markets have had a roller-coaster ride



Shanghai & Shenzhen Composite Index, Index: December 2002 = 100, 2003 – Jan-Aug 2009

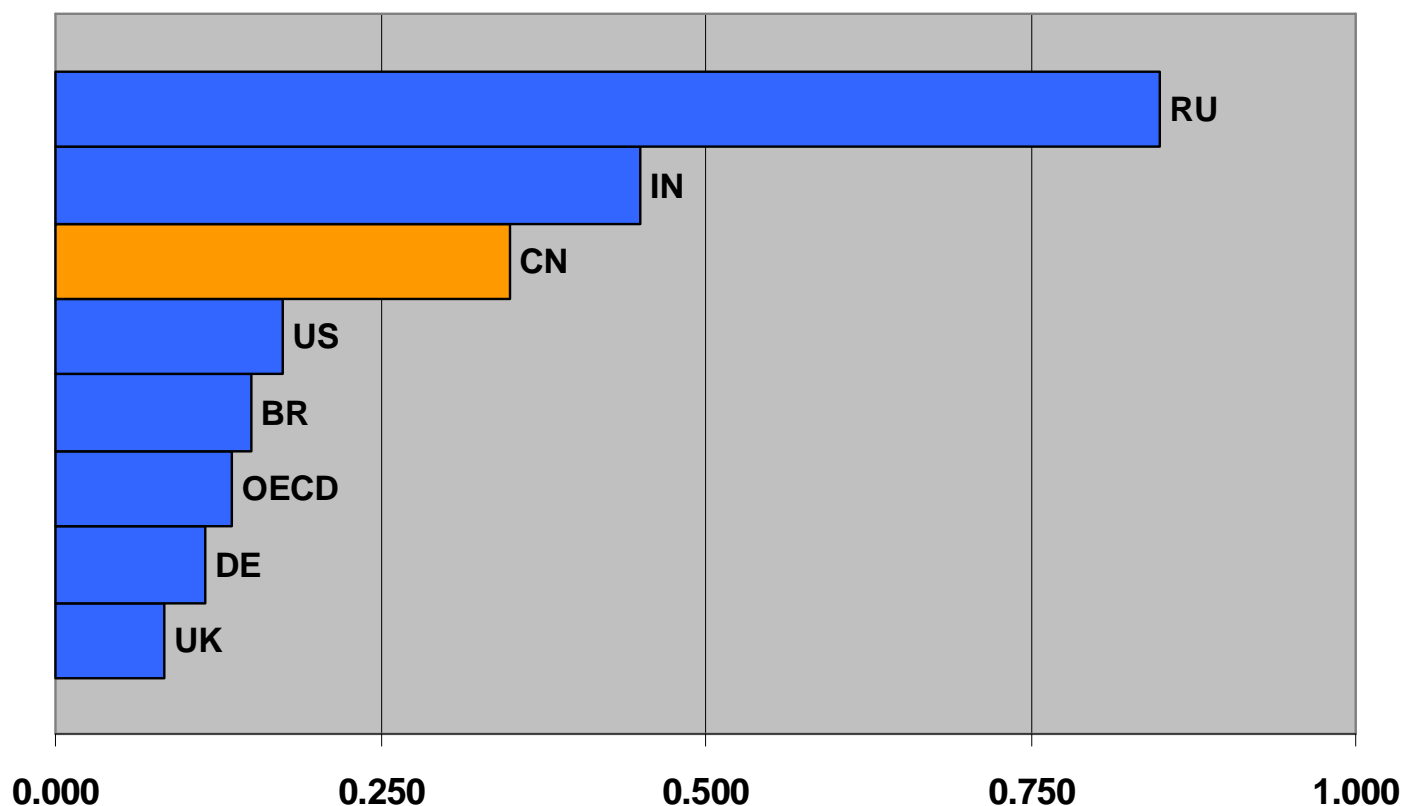


Source: The China Analyst, September 2009.

The Chinese insurance market has been opening up gradually



OECD FDI regulatory restrictiveness indicator, national insurance markets, (0=open, 1=closed), end-2006



Source: Koyama, T. and Golub S. S. (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to more Economies", OECD Working Paper.

Chinese financial centres are rising fast in global league tables



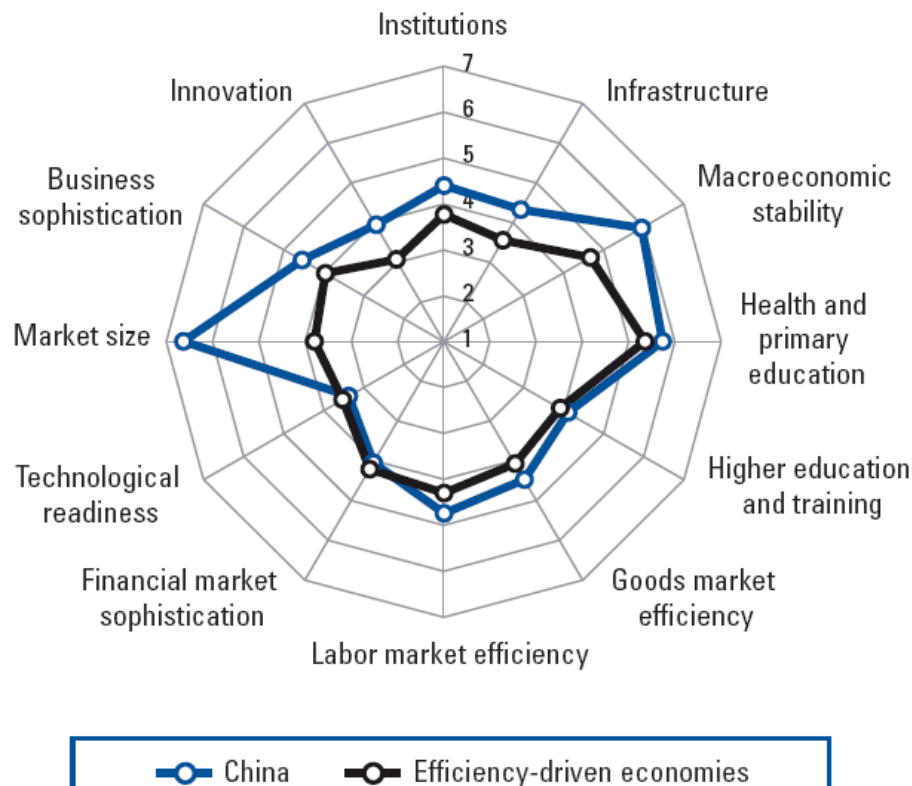
	GCFI 6 Rank	GCFI 5 Rank	Change in Rank
London	1	1	0
New York	2	2	0
Hong Kong	3	4	+1
Singapore	4	3	-1
Shenzhen	5	-	-
Zurich	6	5	-1
Tokyo	7	15	+8
Chicago	8	7	-1
Geneva	9	6	-3
Shanghai	10	35	+25
Sydney	11	16	+5
Frankfurt	12	8	-4
Toronto	13	11	-2
Jersey	14	13	-1
Guernsey	15	12	-3
Luxembourg	16	14	-2
San Francisco	17	17	0
Boston	18	9	-9
Paris	19	19	0
Washington D.C.	20	21	+1
Dubai	21	23	+2
Beijing	22	51	+29
Dublin	23	10	-13
Taipei	24	41	+17
Isle of Man	25	18	-7

Source: City of London Corporation, Global Financial Centres Index, Report - 6, September 2009.

Yet finance is still seen as a relative weakness for China



Stage of development, score (1-7), 2009 forecast



Source: World Economic Forum, The Global Competitiveness Report 2009-2010.

And competitiveness rankings on finance are weak



The Global Competitiveness Index, rank (1-133), 2009

	Rank/ 133
Foreign market size	1
Domestic market size	2
Pay and productivity	12
Venture capital availability	38
Legal rights index	58
Financing through local equity market	66
Soundness of banks	66
Strength of investor protection	71
Financial market sophistication	78
Access to loans	89
Regulation of securities exchanges	91
Restriction on capital flows	125

Source: World Economic Forum, The Global Competitiveness Report 2009-2010.

Future challenges



- Regulatory coordination, especially now four banks are allowed to invest in insurance companies
- Continued market opening to foreign firms – especially branch banking and securities
- Transparency and fairness in approval process
 - Foreign firms ‘are concerned that the speed of reform is slowing down...they face disadvantageous competition with their domestic peers because of unequal regulatory treatment’ – EU Chamber of Commerce

Conclusions



China has so far steered the economy skillfully through the financial crisis, but

- The economy remains unbalanced, with depressed consumption
- Very rapid loan growth could result in a revival of NPLs – more difficult to address in banks with overseas shareholders
- The challenges of broadening the financial sector and enhancing competition remain

My impression is that the Chinese authorities



- remain committed to reform
- remain committed to meeting global standards, and are now directly involved in formulating them, but
- are more convinced than ever that they should proceed at their own pace, and in their own way



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