

2015 BOK—IMF Conference

Asia's Shadow Banking: The Case of China

Alfred Schipke

IMF Senior Resident Representative,

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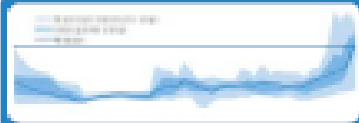
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Roadmap

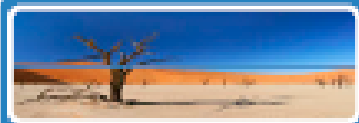
- Setting the stage
- China's shadow banking system and risks
- Financial system development and potentially new areas of risk
- Buffers
- Takeaways

Setting the stage

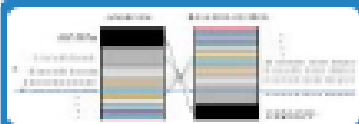
Risk indicators for shadow banking



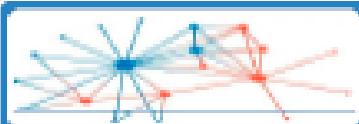
High leverage



Liquidity mismatches



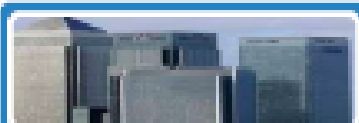
Asset/liability maturity mismatches



High interconnectedness with banks

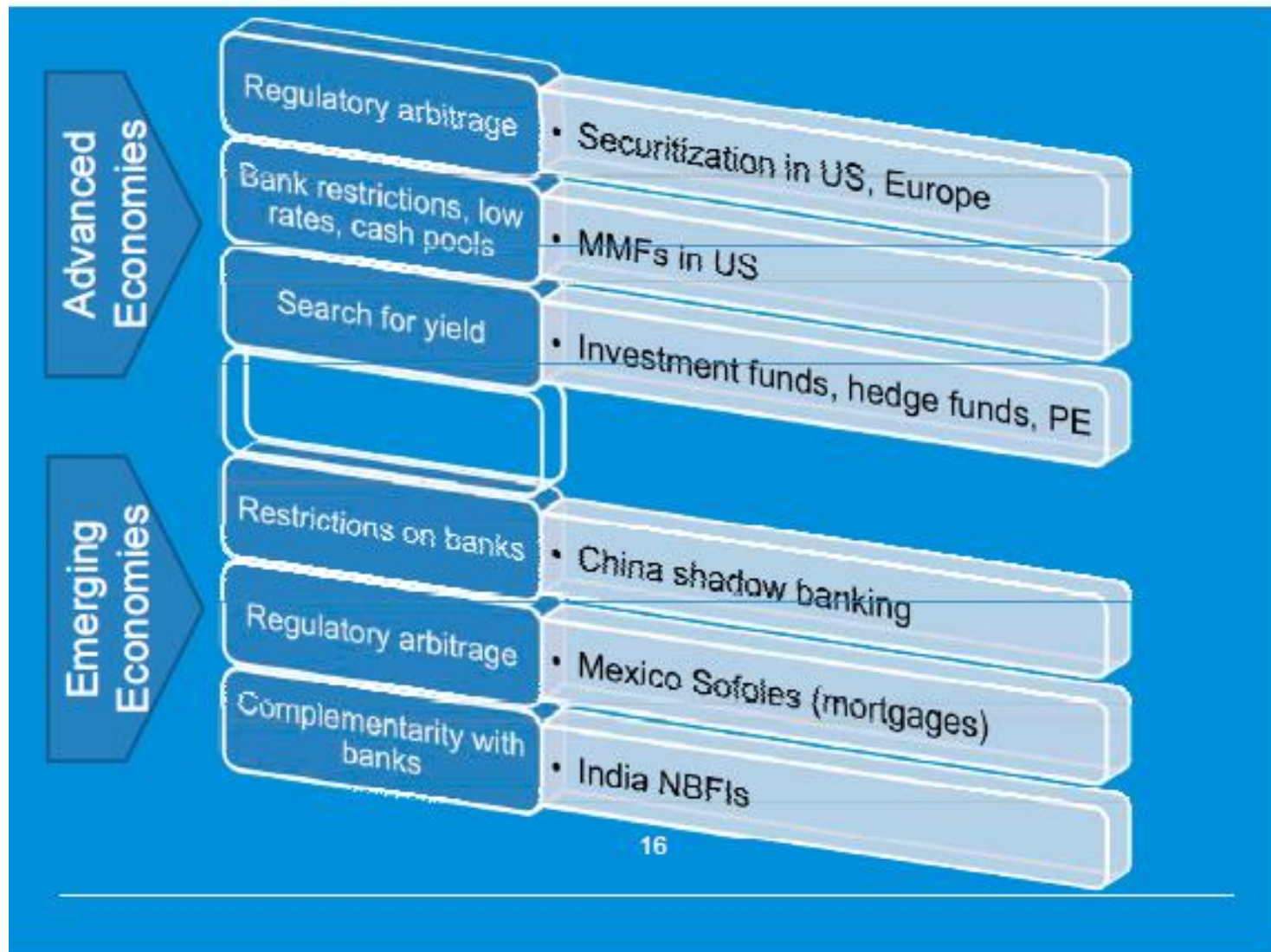


(very) rapid growth



(very) large entities/sectors

Drivers differ across countries....



...so do risks

Risks in Asia (within countries)

Based on RCGA survey (2014)

Leverage risk

- Japan, Korea, Thailand

Maturity and liquidity mismatch

- China, India, Japan, Malaysia, Pakistan, Philippines, Thailand

Interaction banks/shadow banks

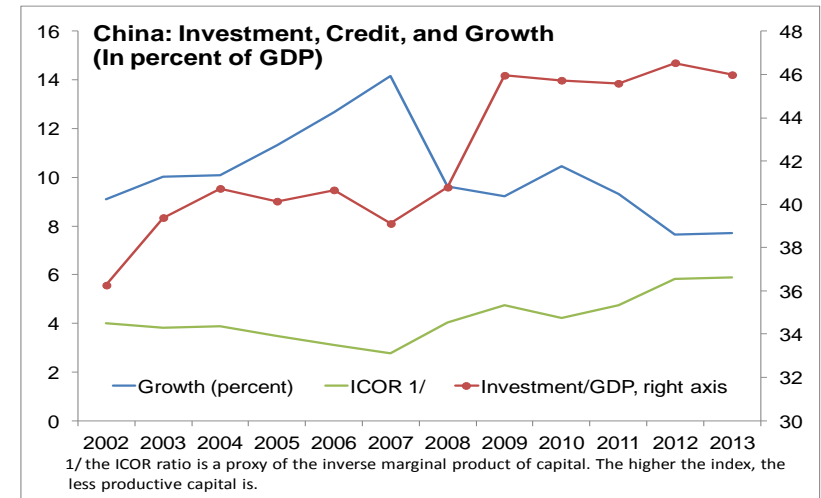
- Spillover to banks: Australia, India, Korea, Malaysia, Philippines
- Dependence on bank funding: Pakistan

Regulatory arbitrage

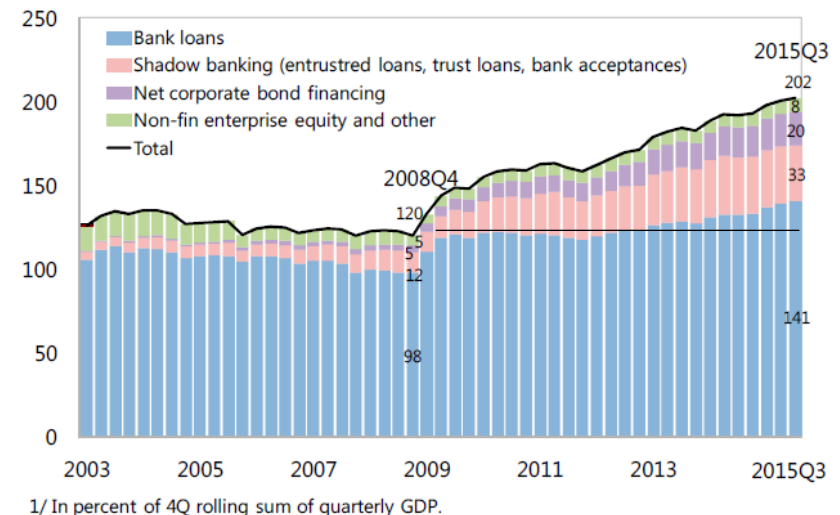
- India, Malaysia, Philippines, New Zealand

A closer look at China's shadow banking drivers

- Growth model (credit financed investment)
- Regulatory constraints (banking sector)
 - Loan quotas, LTD ratio, lending guidance to certain sectors, deposit ceiling, high reserve requirements
- Indirect interest liberalization
- Fragmented regulatory framework



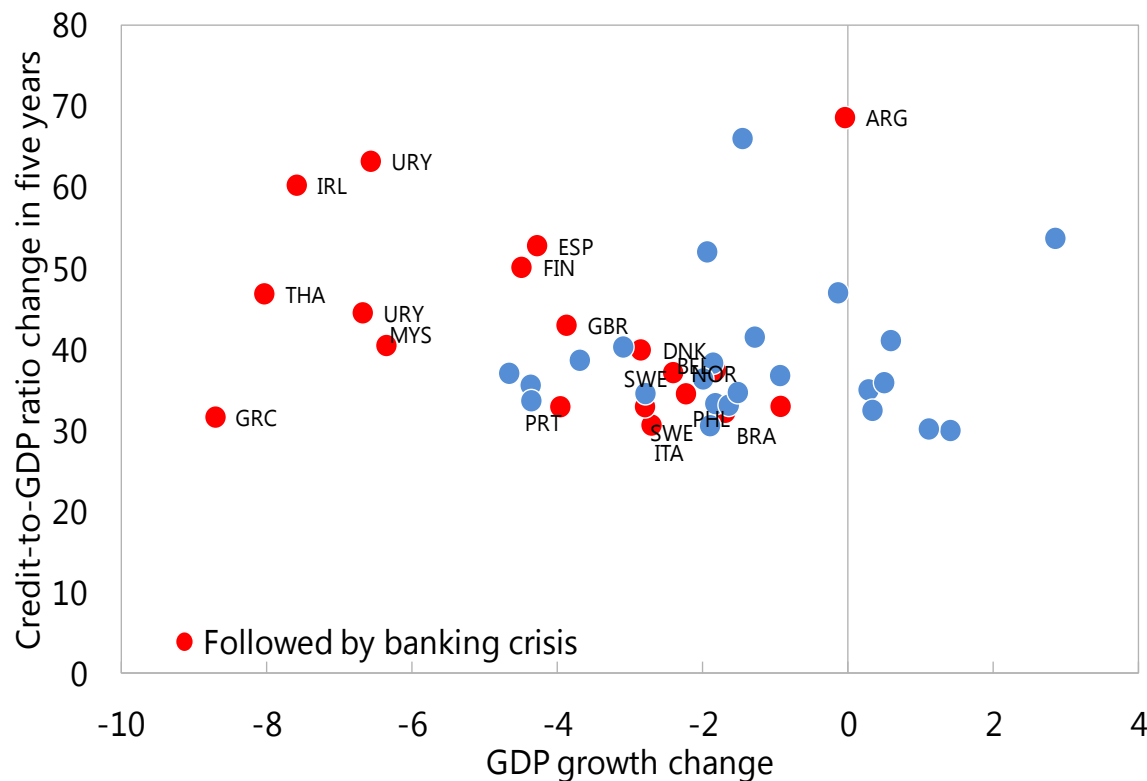
Social Financing Stock
(In percent of GDP)^{1/}



Main concern: overall credit growth

Credit Booms and Change in GDP Growth Rates

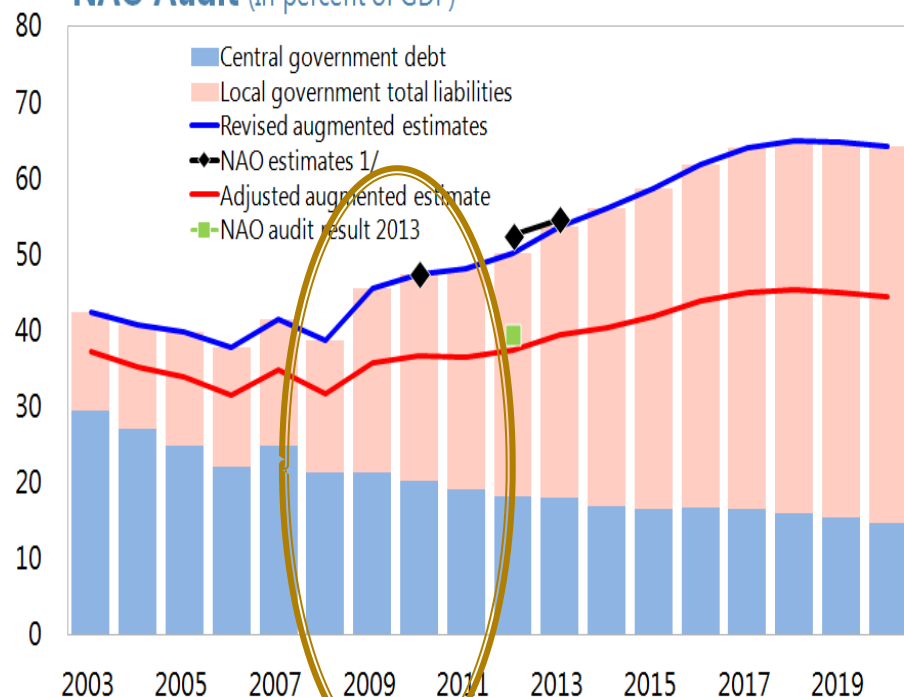
(In percentage points)



Source: IMF staff estimates and calculations.

Local government finances

General Government Debt: Augmented Measure and NAO Audit (In percent of GDP)



Sources: NAO; and IMF staff estimates.

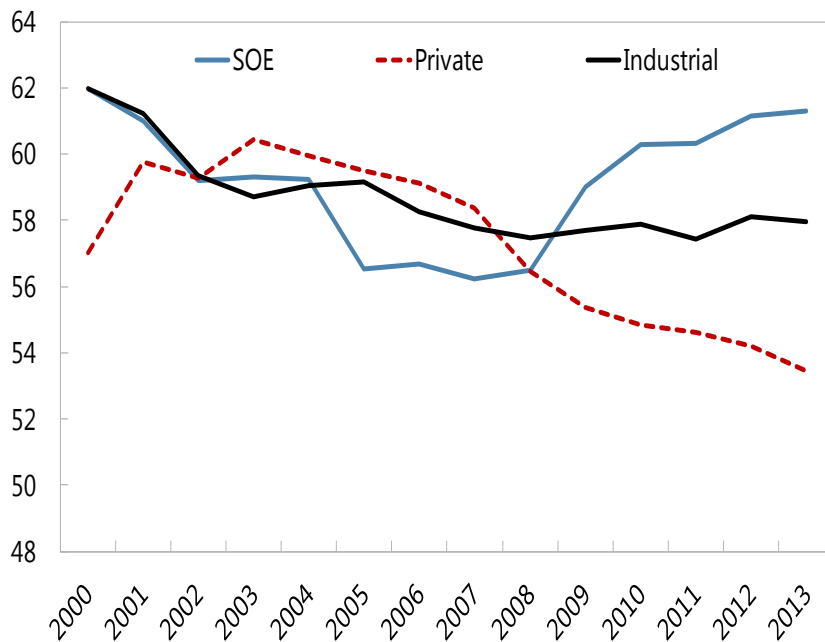
1/ including explicit government debt, government guaranteed debt, and the liabilities that the government may incur obligations.

■ Emerging strategy:

- Revised budget law to constrain local
- government borrowing
- Debt swaps

Corporate leverage

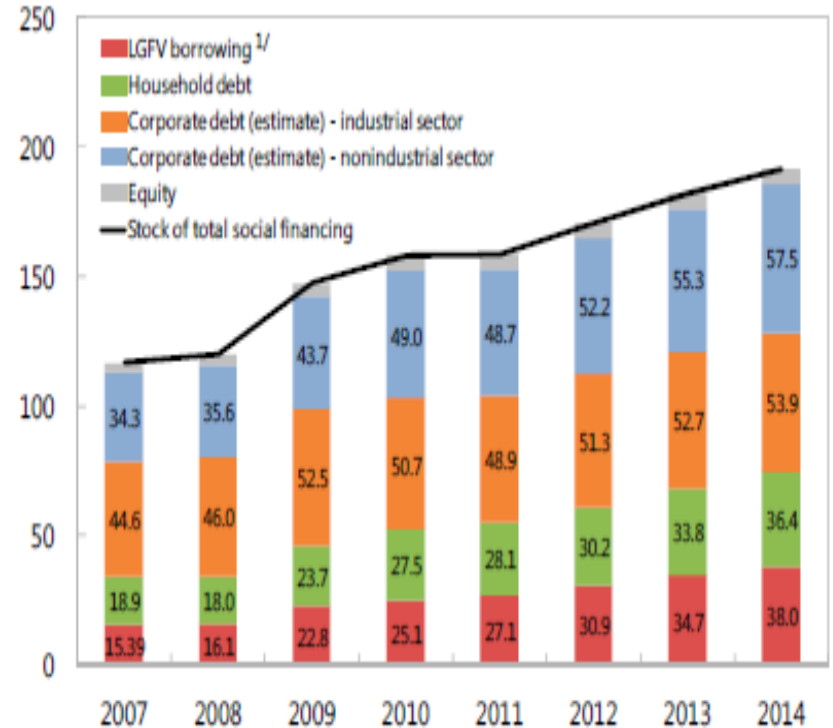
Leverage by Ownership



Sources: NBS, Staff estimates

Total Credit by Sectors

(In percent of GDP)



^{1/} Includes all local government debt except local government bonds.

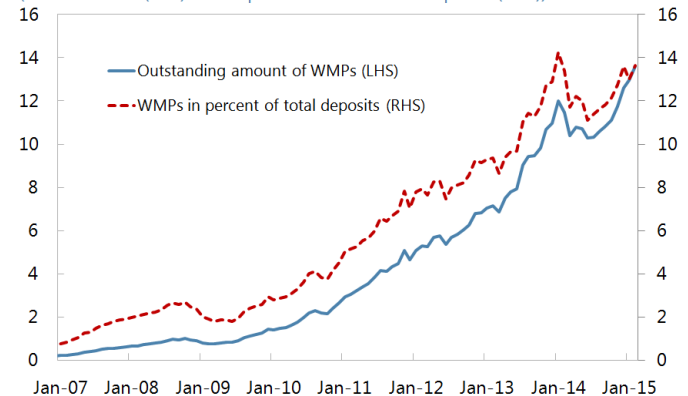
Shadow banking in China

Chinese shadow banking: growth, products, and linkages

- Shadow banking grew rapidly
 - Trust loans, bankers' acceptances, entrusted loans, beneficiary rights
 - Financing via WMP
- Growth stronger in smaller banks
- Linkages to banking sector (directly and reputational risk)

Banks' Wealth Management Products

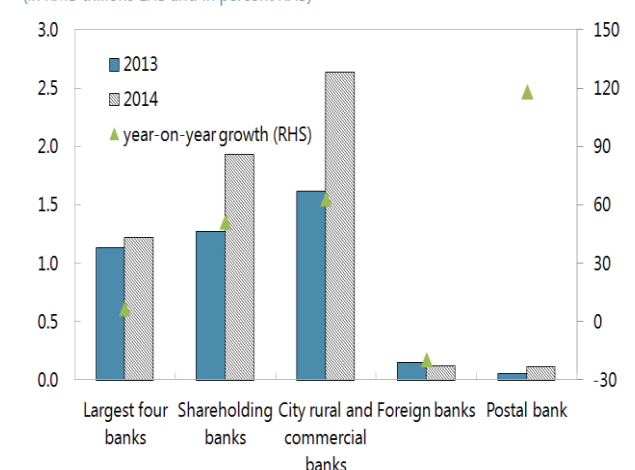
(in RMB trillion (LHS) and in percent of total bank deposits (RHS))



Sources: WIND, staff estimate

Issuance of WMPs by Bank Types

(in RMB trillions LHS and in percent RHS)

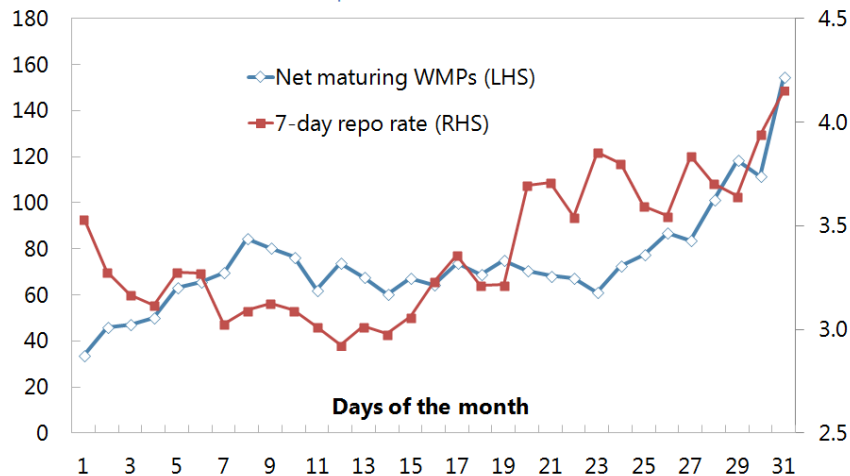


Sources: CEIC, WIND, and staff estimates.

Shadow banking: interest rates and monetary policy

Average Monthly Maturing of WMP and Repo Rates

(in billions of RMB (LHS) and in percent)



Sources: WIND and staff estimates.

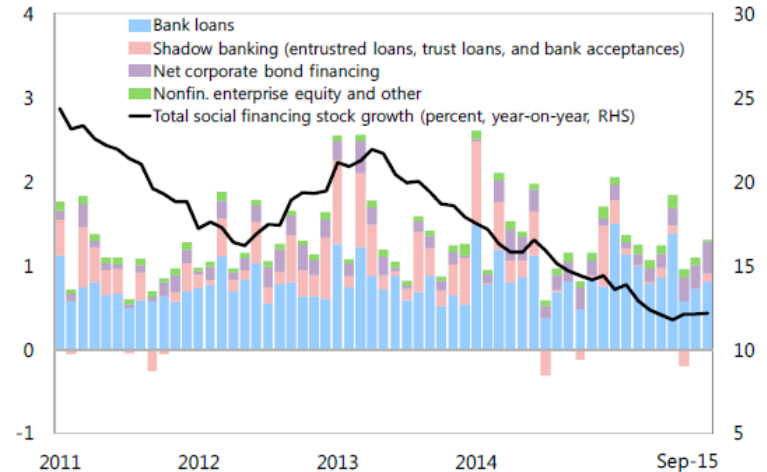
- Maturing of banks' WMP tended to peak at month-end and quarter-end partly due to regulatory arbitrage to meet loan-deposit ratios (LDR)
- Maturing of WMPs correlated to interbank rates volatility and rise in interbank rates, possibly complicating the use of interest rate on monetary policy
- Tightening of regulation on banks deposit variation CBRC Doc. No. 267, Sep 2014)
- appears to have changed WMP operation—weaker linkages with interbank rates.

Tightening of regulation...but are new risks emerging?

- Tightening of shadow banking regulation
- Slowdown in shadow banking activity
- Reduction in interbank volatility
- Emerging new risks?

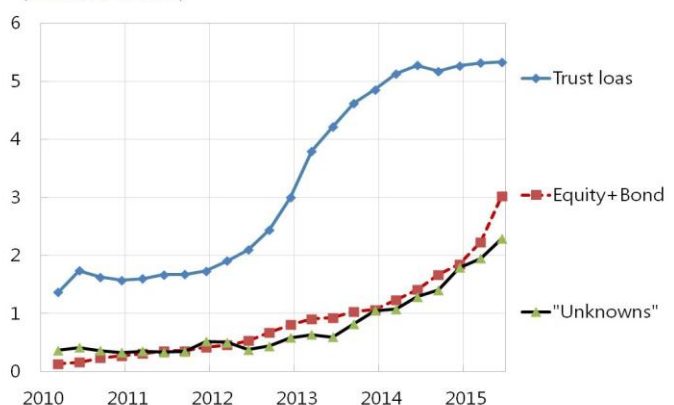
Social Financing Flow

(In RMB trillion)



The aggregate portfolio of trust industry

(in trillions of RMB)



Sources: China Trustee Association, Staff estimate

From shadow banking to new risks?

From shadow banking to equity markets—the recent episode

- Initial relaxation of margin lending
- Lessons: financial oversight, countercyclical macro prudential measures, communication
- Broader macro-implications limited:
 - 80 percent are retail investors
 - Impact on real economic activity (wealth relatively small)

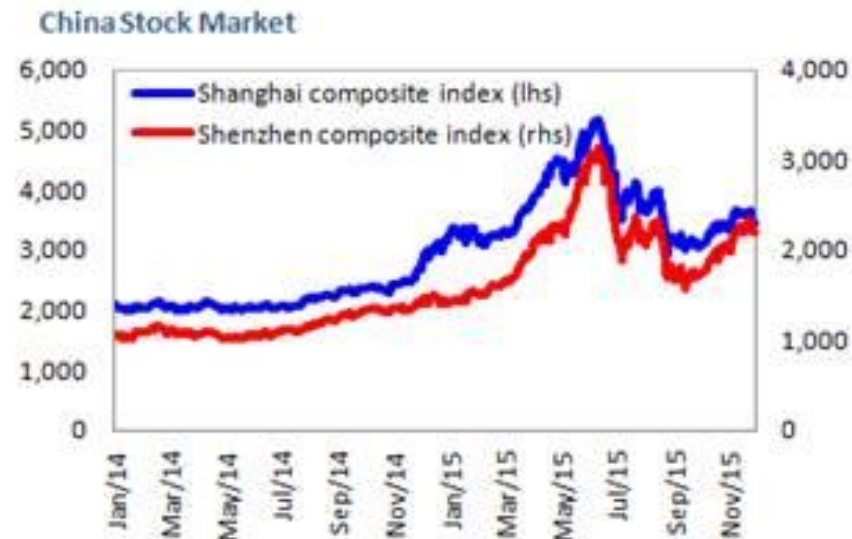


Table 2

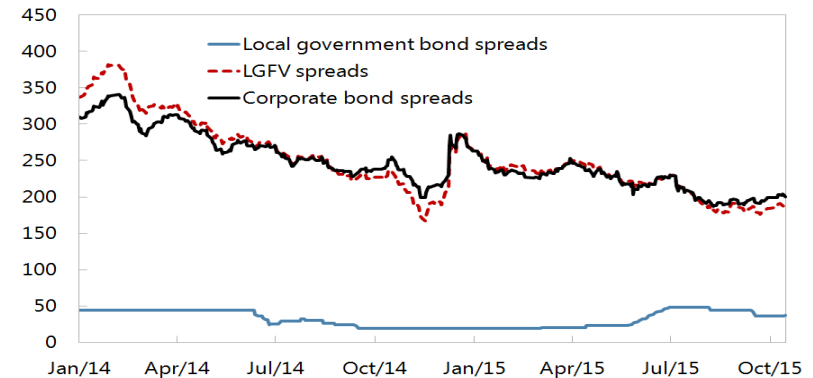
	Today's closing	Relative to 2014 trough (Jan 20)	Relative to 2015 peak (Jun 12)	Relative to recent trough (Jul 8)
Shanghai composite index	3445.7	73.0	-33.3	-1.8
Shenzhen composite index	12037.9	60.0	-33.5	9.0
Chinex (high-tech stocks)	2672.6	94.7	-31.5	13.1

From shadow banking to bond markets?

- High corporate debt major risk factor (110 percent of GDP)
- Relaxation of regulation and low credit spreads
- Surge in corporate bond issues
- Reducing in debt service cost, extension of maturities
- Risk: defaults, re-pricing of risks, pressure on monetary policy

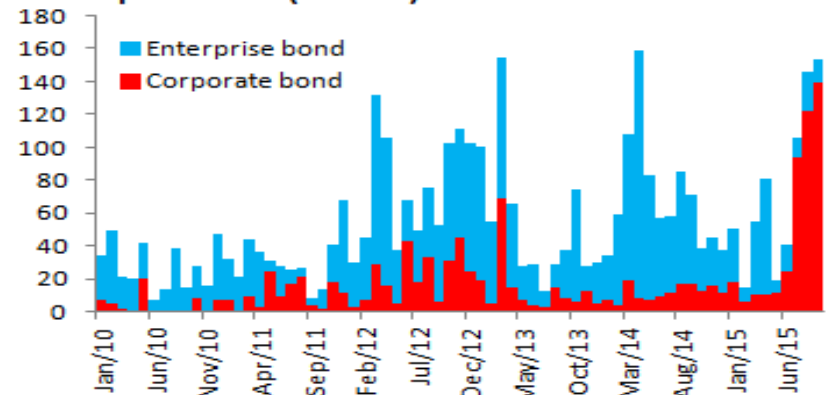
Bond Spreads over Sovereign Bonds

(5-year bonds; in basis points)



Sources: WIND.

China: Gross issuance of corporate bonds and enterprise bonds (RMB bn)

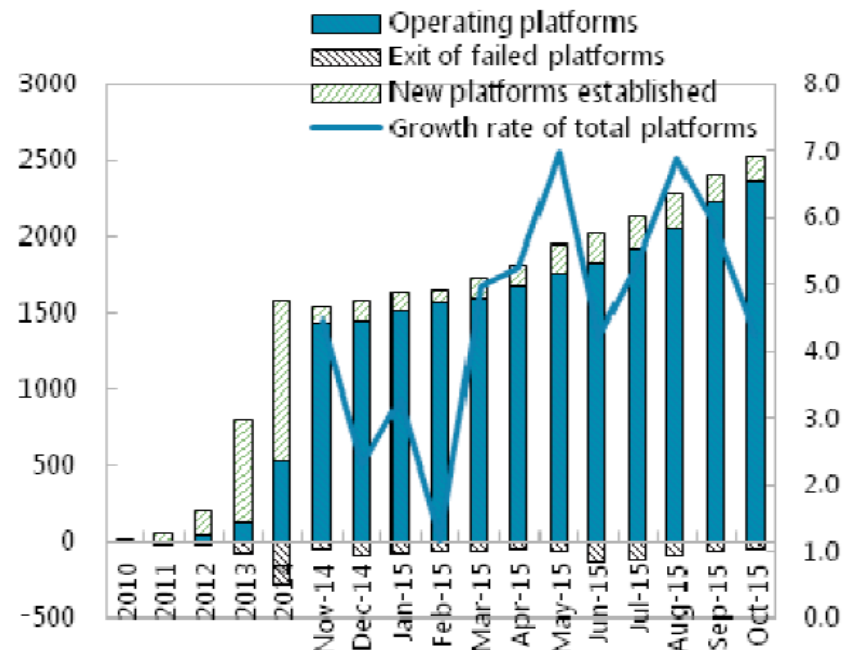


Source: WIND.

From shadow banking to P2P lending?

- Strong growth of P2P platforms...
- Increase in failed platforms
- Yields above other savings products...
- ...despite provision of guarantees (70 percent)
- Regulation limited
- Still relatively small though

Recent Growth Trend of P2P Platforms
(in number of platforms (LHS); in percent (RHS))



Emerging risks but also buffers

- Large FX reserves
- Low fiscal debt/low interest rates
- High degree of state control
- Liquid banking system
- Still relatively high potential growth

Experiences suggest need for regulatory reform

- Shadow banking and equity experiences
- China's regulatory structure shortcomings
 - Four regulatory agencies (PBC, CBRC, CSRC, CIRC) and others (NDRC, MOF)
 - Flow of information
 - Regulatory gaps
 - Not always clearly defined responsibilities
- Announcement to reform regulatory institutions

Takeaways

- China's strong surge in shadow banking initially driven by credit financed growth model and regulatory arbitrage
- Indirect interest rate liberalization and fragmented regulatory framework fostered the growth of the sector
- Recent tightening of regulation has constrained shadow banking activities and reduced interbank interest rate volatility
- While today shadow banking less of a concern, possible new emerging risks, including bond market
- Need for reform of the regulatory framework
- Recent experiences suggest that spillovers via financial channels to the rest of the world has increased
- Risks are increasing but buffers are still strong

Thank you

■ References

- Modernizing China: Investing in “soft” infrastructure; W. Raphael Lam, Markus Rodlauer, and Alfred Schipke. IMF (forthcoming).
- Global Financial Stability Report, IMF, 2014,.