



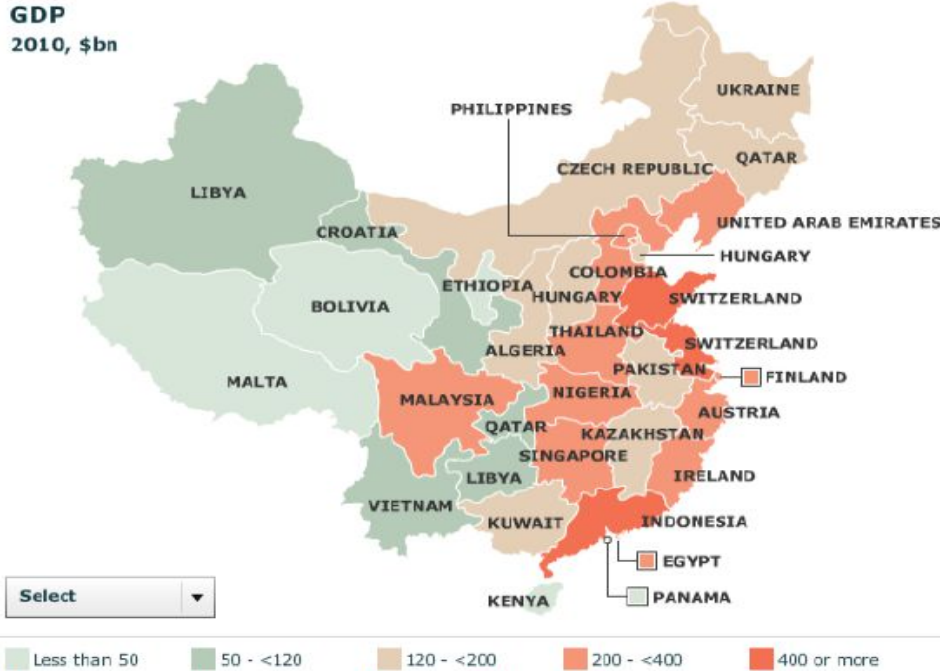
# China Economy Practical Perspective

Han Shen Lin  
Jan 12, 2021

# Big Picture

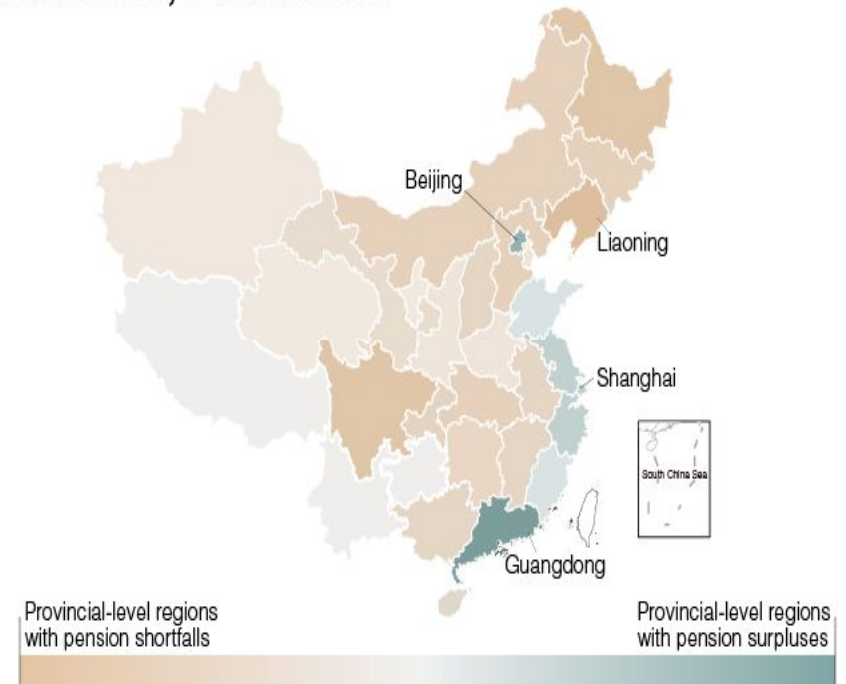
- China is a composite of diverse and unequal economies
- Country-wide policies must reconcile with localized policies (i.e. financing, welfare, etc.)

## GDP Comparison: China Province - Country Equiv.



Source: Economist

## Pension Rich, Pension Poor



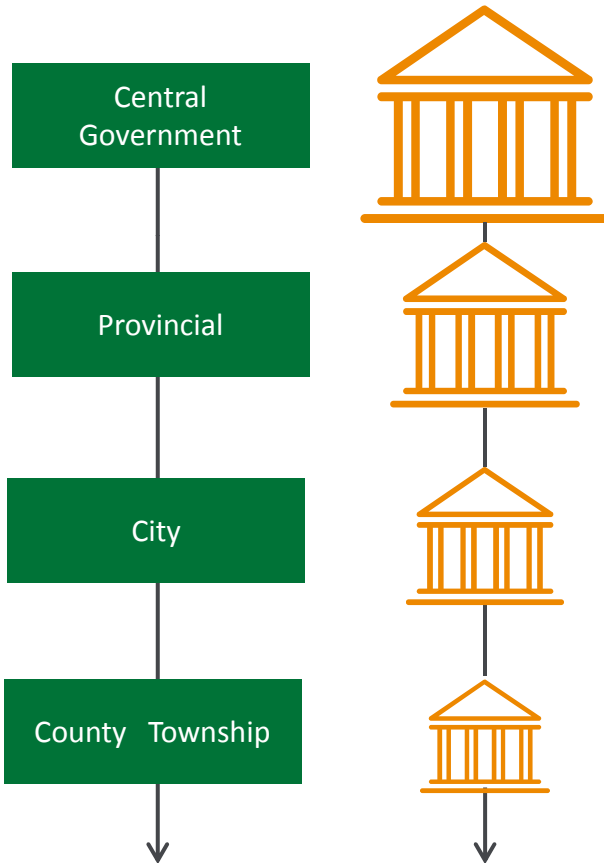
Sources: Ministry of Finance, Caixin Data

Caixin

# Governance Structure

Centralization vs. Decentralization: “The Mountain is High, the Emperor is Far Away”  
Central Government guidance may be loosely interpreted at lower government levels

## China governance structure

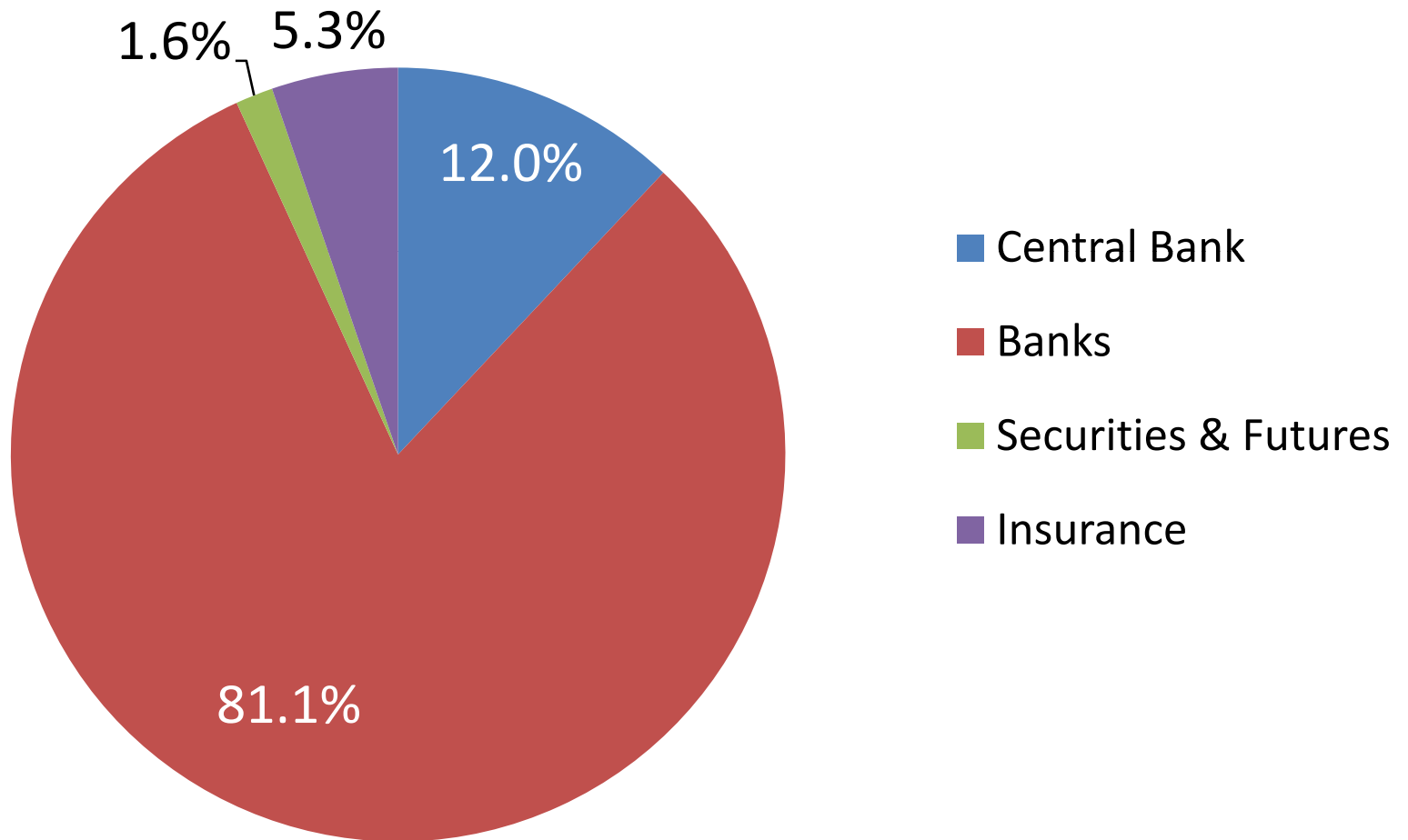


## Implications

- One Party rule, but multiple voices and interests within
  - Financial - Peoples Bank of China
  - Security - Military
- Tensions may exist not only between the central gov't and lower governments; but also between lower governments.
  - Rotations of government officials to risk mitigate against local protectionism
- Media Headlines may be targeting domestic vs. international audiences
- Regulations are purposely vague to maximize policy flexibility (i.e. use of window guidance, or “interim” measures) but also allow a degree of customization based on local conditions.

# Assets of China's Financial Sector

All discussions about China's financial system start with its banking system



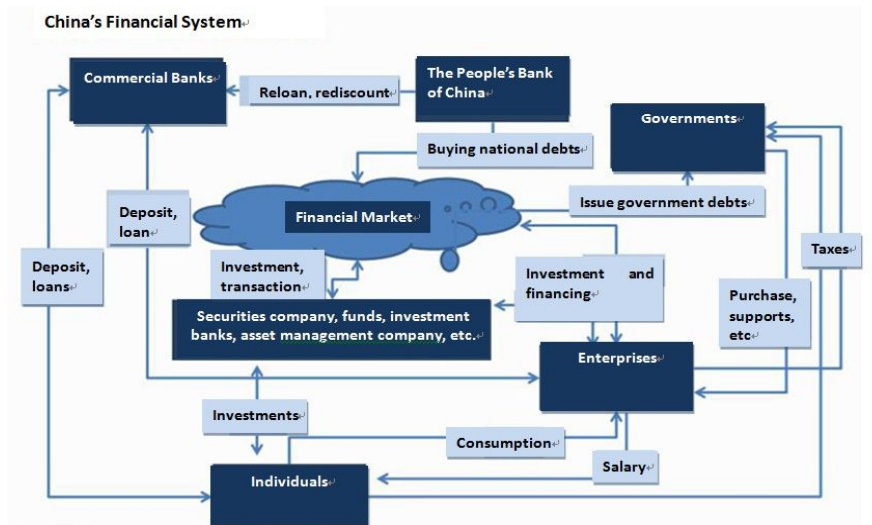
Source: PBOC Financial Stability Report 2017

# Financial System

## Financial System Stability Ultimately Relies on Beijing's Capacity and Policy Credibility

### Intervention Tools

- Liquidity injections by the PBOC
- Changes in Required Reserve Ratios
- Implicit / Explicit State Guarantees



Source: Dr. Charlie Xiao-chuan WENG, Fudan Law School

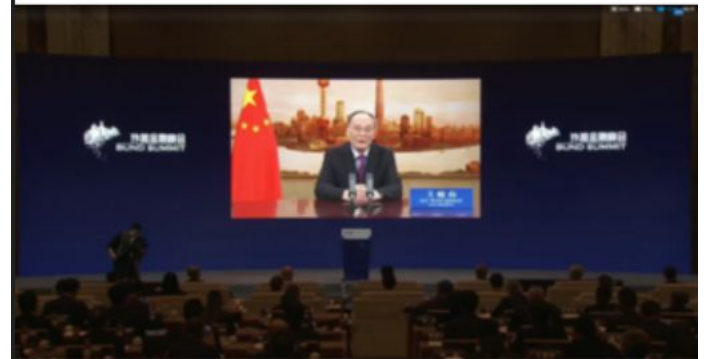
### Regulators may guide behavior via

- Interim Measures
- Window Guidance
- Issued Notices
- Self-Inspections & Ad-hoc inquiries

## Financial Sector Should Avoid 'Wrong Paths' of Speculation, Bubbles and Ponzi Schemes, Vice President Says

By Timmy Shen

Oct 24, 2020 02:18 PM



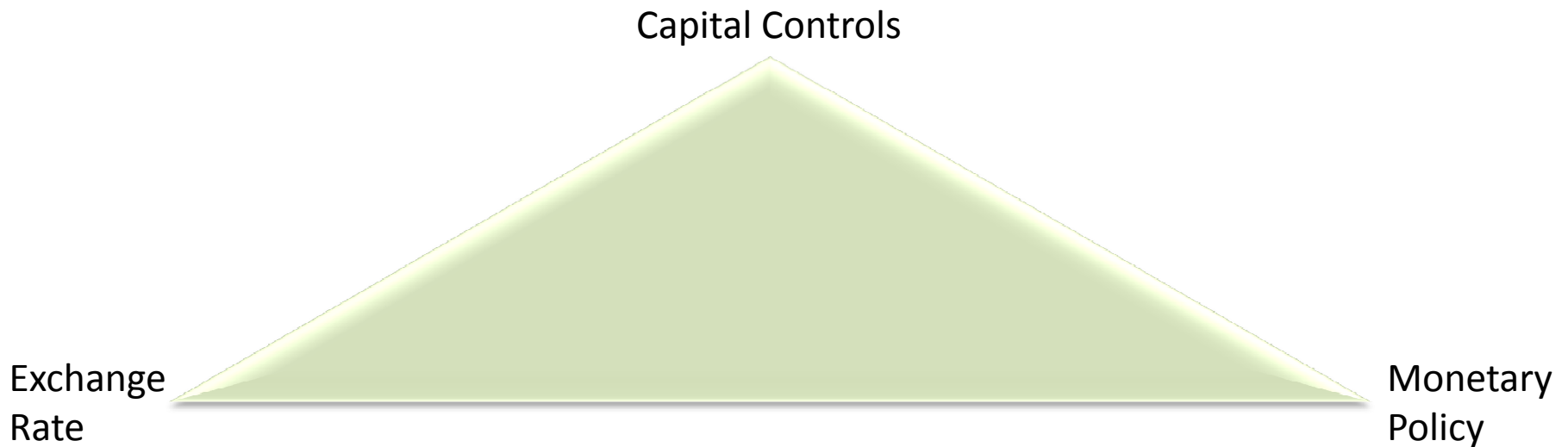
Vice President Wang Qishan's pre-recorded speech is played to attendees at the Bund Summit in Shanghai on Oct. 24.

China's finance industry should stay off the "wrong paths" of speculation, self-circulating financial bubbles and Ponzi schemes, Vice President Wang Qishan told a financial summit on Saturday.

<https://www.caixinglobal.com/2020-10-24/financial-sector-should-avoid-wrong-paths-of-speculation-bubbles-and-ponzi-schemes-vice-president-says-101618463.html>

# China (Scalene) Impossible Trinity

According to this theory, a country cannot achieve the free flow of capital, a fixed exchange rate and independent monetary policy simultaneously. - Investopedia



\* <https://blogs.wsj.com/chinarealtime/2017/04/14/the-trilemma-according-to-chinas-central-bank/>

# Capital Controls- Conclusion

China capital controls are asymmetric: Easier for FX Entry into China than FX Exit

RQFII: 2020 Initiative to encourage inbound capital

## What is RQFII?:

RMB Qualified Foreign Institutional Investor (RQFII) allows licensed foreign institutional investors to transact in onshore renminbi-denominated securities. Recently combined with QFII.

## What does it offer?:

- RQFII holders, using HK raised RMB, may
1. Invest into mainland securities markets.  
(Inter-bank bond and exchange-traded bond market, stock markets)
  2. Issue public or private funds or other investment products using their RQFII quotas.

## Limits:

Funds not to be invested outside the mainland.

Trying to bring out FX the old fashioned way

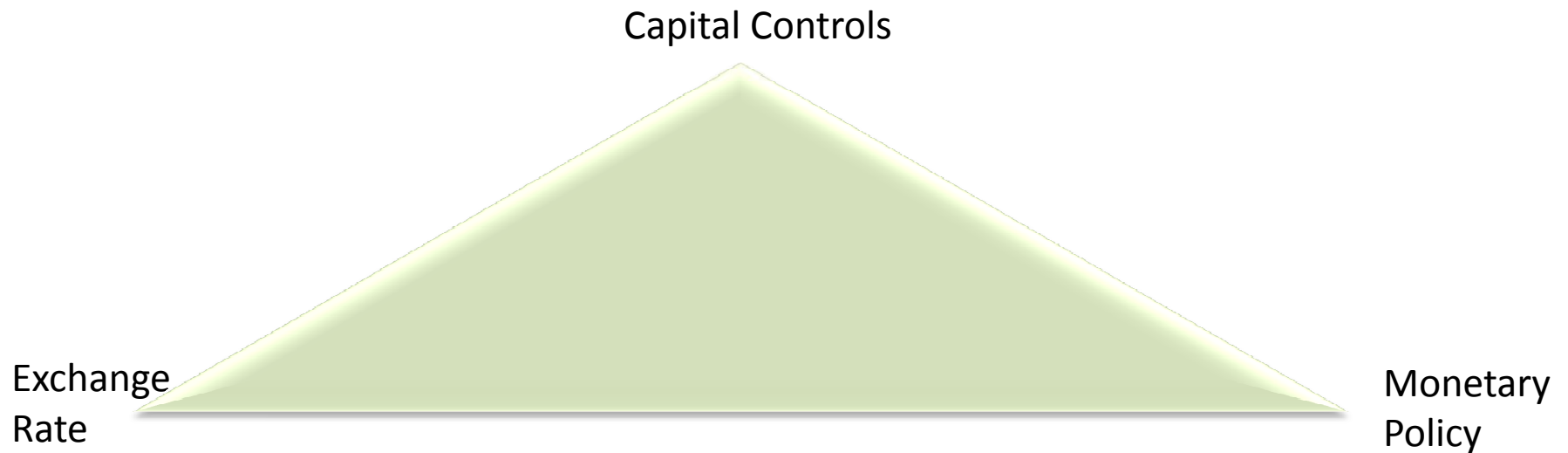


China cracks down on 'financial ants' smuggling cash to Hong Kong, FT, April 2, 2017

<https://www.ft.com/content/6aa1faca-bd2e-11e6-8b45-b8b81dd5d080?mhq5i=e3>

# Exchange Rate

“The Dollar is Our Currency, but It’s Your Problem” – U.S. Treasury Secretary John Connally to foreign finance ministers, 1971





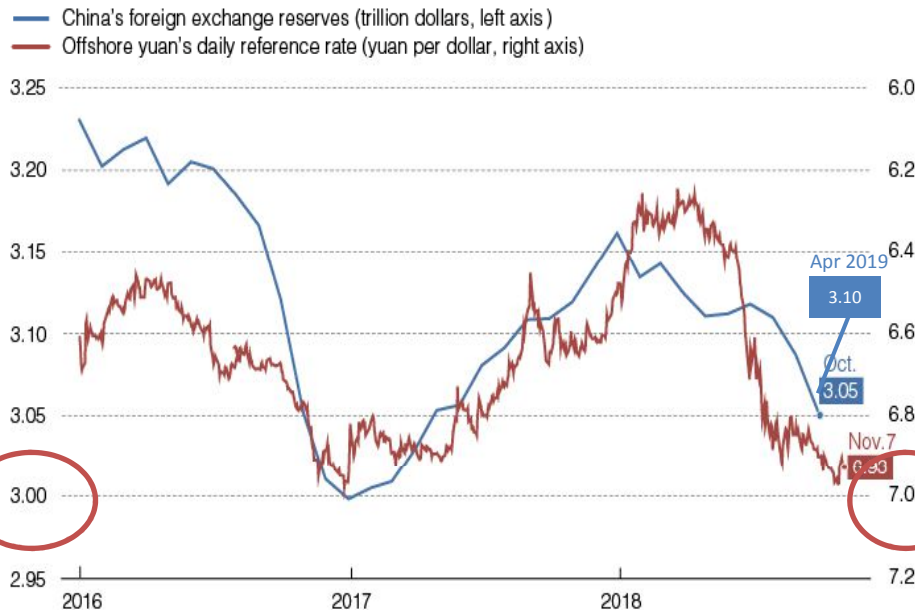
# Exchange rates and Forex Reserves

The goal is to keep the USD/RMB rate stable – Not an easy task without sufficient Reserves

- RMB too strong: China exporters are hurt (though importers benefit)
- RMB too weak: Criticism for being a “Currency Manipulator” (according to the U.S.)
- RMB just right?: FX reserves > \$3Trn; Rate around 7 (psychological market threshold)



## China's Shrinking Forex Hoard



Sources: People's Bank of China, Treasury Markets Association

<https://www.ft.com/content/f642c6e-7cf1-11e9-81d2-f785092ab560>

<https://www.caixinglobal.com/2018-11-08/chart-of-the-day-chinas-forex-hoard-hits-18-month-low-on-strong-dollar-101344503.html?rkey=4joj%2BU9DvvDs21kwdd13vFL%2FE7ci4pKGTewftl30ciB4Zo4YcuXfQ%3D%3D>

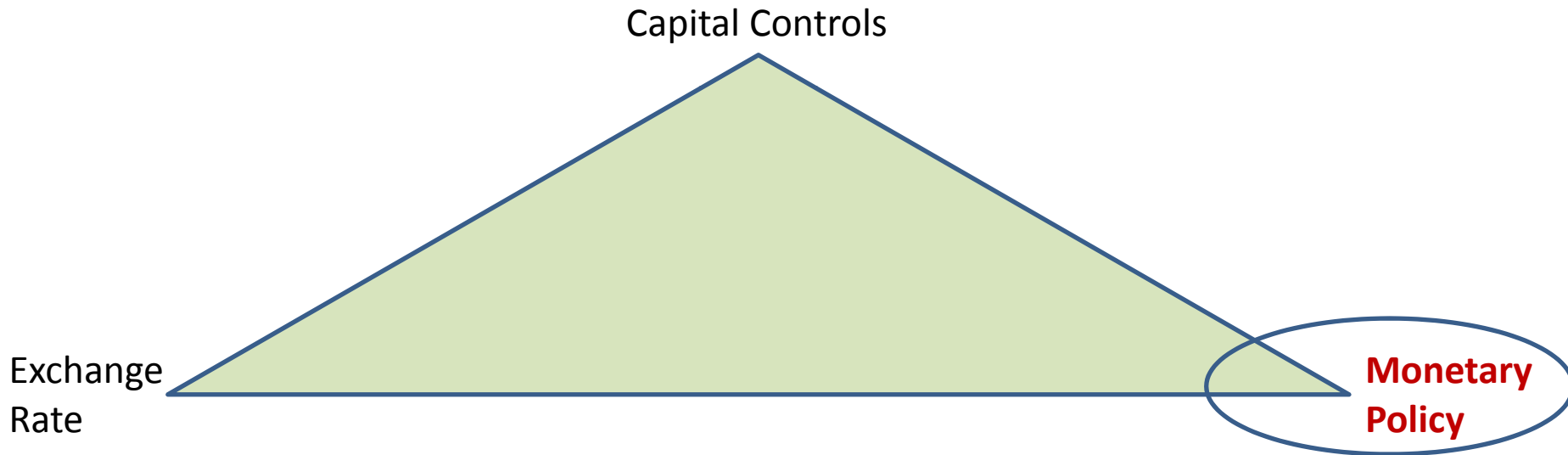


(Tokyo) — Whole numbers don't really matter when it comes to exchange rates.

That's the message that China's former central bank chief Zhou Xiaochuan had for the participants in the currency market who have been wringing their hands as the value of the yuan approaches 7 per U.S. dollar.

<https://www.caixinglobal.com/2019-05-31/exclusive-the-number-seven-doesnt-mean-much-for-yuan-ex-central-bank-chief-says-101422366.html>

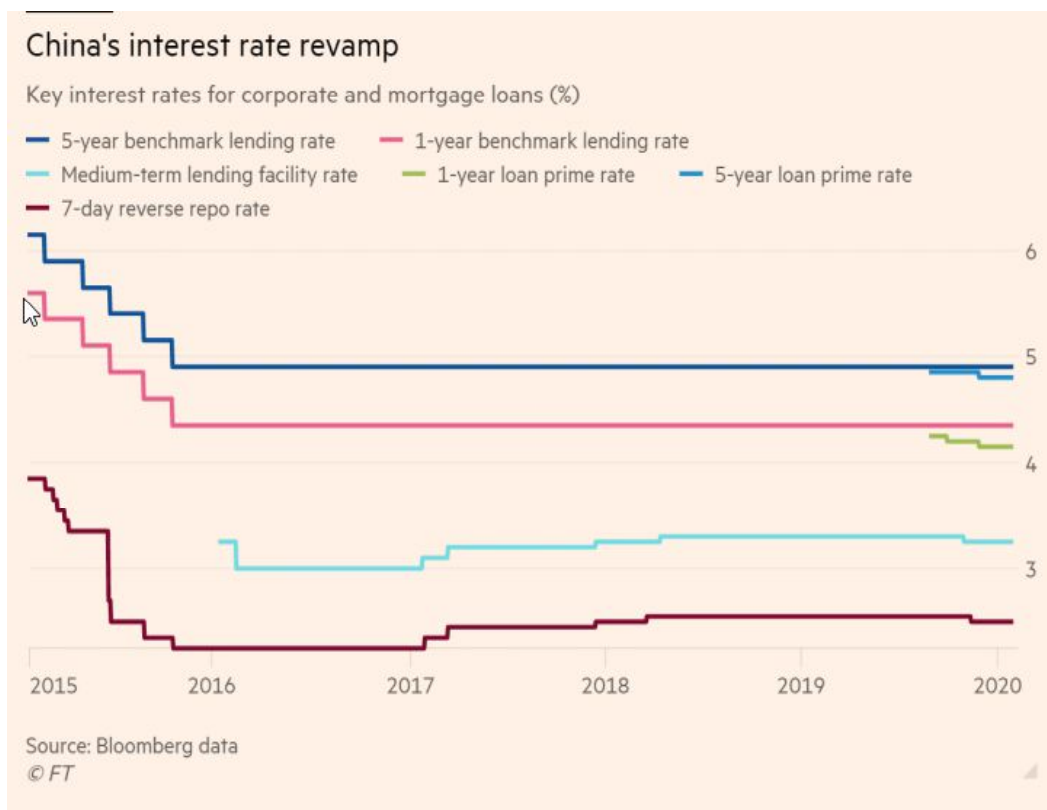
# Monetary Policy



# Loan Prime Rate (Sept 2019)

LPR: The key go-forward rate to replace previous benchmark rates

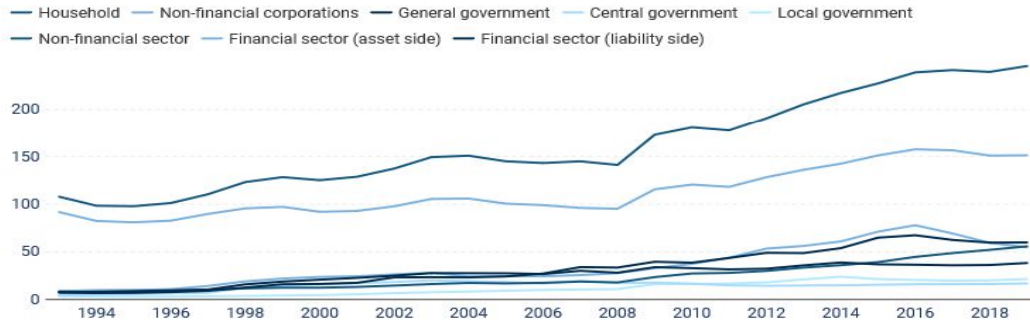
- LPR is determined by taking the Medium term lending rate (MLF), set by PBOC, with a market-based spread added based on the average lending rate provided by 18 commercial banks to their best credit customers
- LPR Today
  - 1 Year: **3.85%**
  - 5 Year: **4.65%**
- 7-day repo rate will remain as is to manage short-term liquidity
- The PBOC still maintains levers on liquidity via
  - MLF
  - 7-day repo rate
  - Reserve requirement ratios



# China's Debt as a % of GDP

China's Debt % of GDP estimated at 260%+ Sizable but comparable to other major economies

## China's internal debt



Debt to GDP ratio

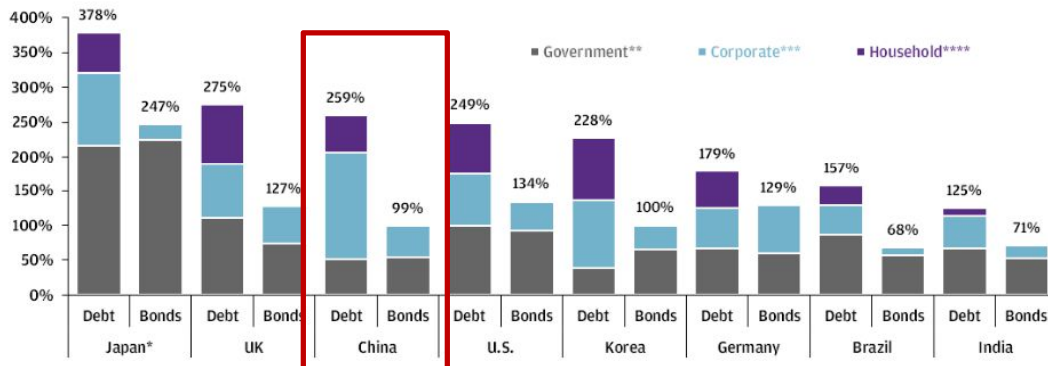
Chart: SCMP • Source: National Institution for Finance and Development

<https://www.scmp.com/economy/china-economy/article/3084979/china-debt-what-next>

A country's total borrowing can look very different than its bond market

## EXHIBIT 2: DEBT AND BONDS AS A % OF GDP

Total market value of debt and bonds, nominal 2018 GDP



Source: BIS, Bloomberg Finance L.P., IMF, J.P. Morgan Asset Management. Debt valuation is as of 1Q19, bond valuation is as of October 31, 2019.

\*The difference in Japan's government borrowing in debt and in bonds is due to the differing valuation dates.

\*\*Government bonds include onshore-listed central and local government bonds for all countries.

\*\*\*Corporate debt is borrowing by non-financial corporations; Corporate bonds are all onshore-listed corporate bonds.

\*\*\*\*Household borrowing is only accounted for in total debt as individuals do not issue bonds. Data are as of October 31, 2019.

<https://am.jpmorgan.com/au/en/asset-management/adv/insights/market-insights/market-bulletins/what-is-in-the-chinese-fixed-income-universe/>

> FINANCE

## China to Set New Rules to Keep 'Too Big to Fail' Banks From Bringing Down Financial System

By Timmy Shen

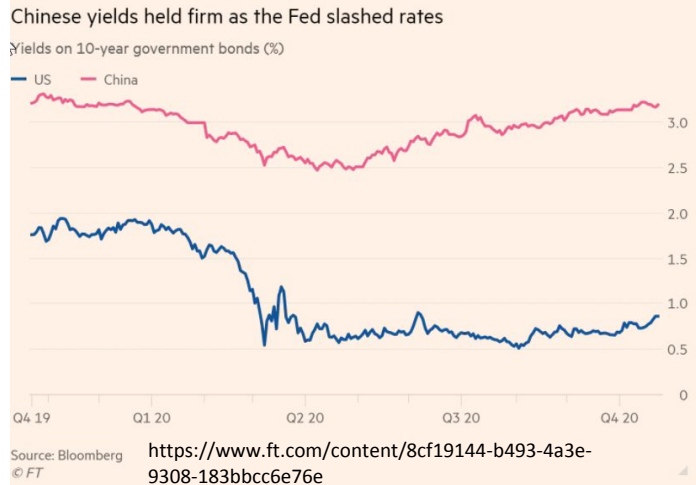
Sept 30, 2020 08:16 PM



China has issued long-anticipated draft rules governing its global systemically important banks' (G-SIBs) ability to absorb losses in an effort to guard against systemic financial risks.

# Reduce Bank Reliance by Deepening Capital Markets

## Encourage offshore capital to onshore



## Increase transparency in financing

Oct 23, 2020 07:41 PM

FINANCE

### S&P Becomes China's First Wholly Foreign-Owned Ratings Agency for Exchange-Traded Bonds

By Timmy Shen

S&P Ratings (China) is the first wholly foreign-owned credit ratings agency to win approval to conduct the credit ratings business in China's exchange-traded bond market.

**S&P Ratings (China) Co. Ltd.**, New York-listed S&P Global Inc.'s wholly owned subsidiary on the Chinese mainland, **announced** (link in Chinese) Thursday it has registered with the country's securities watchdog to carry out credit ratings business in China's exchange-traded bond market, making it the first wholly foreign-owned credit ratings agency to do so.

<https://www.caixinglobal.com/2020-10-23/sp-becomes-chinas-first-wholly-foreign-owned-ratings-agency-for-exchange-traded-bonds-101618216.html>

## Disrupt traditional capital raising?

Ant Group + Add to myFT

### Ant Group under scrutiny over exclusive sale of shares in IPO

Chinese company sold exposure via its mobile payments platform in deal with 5 funds



Ant is waiting for approval from China's securities regulator for what analysts expect to be the world's largest IPO, raising up to \$30bn © REUTERS

<https://www.ft.com/content/f53bb803-af1b-45a5-a95c-ba214bcc855e>

## Strengthen bank capital buffers

### Planned Perpetual Bonds Issuance (Top 4 China Banks)

Bank	Issuance Amt (RMB Bn)
Bank of China	40.0 (Coupon: 4.5%, 1/25/19)
Agri.Bank of China	120.0
ICBC	80.0
China Construction Bank	40.0
Others	240.0
<b>Total</b>	<b>520.0 (\$77.0 Bn)</b>

<https://www.caixinglobal.com/2019-05-01/chinese-banks-plan-to-issue-77-billion-of-perpetual-bonds-101410719.html>

# Credit Growth and Liquidity Increases Continue

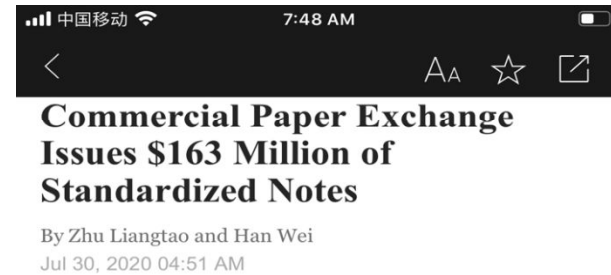
## Jumpstarting the Economy Takes Priority



Local governments are prohibited from using special bond proceeds to repay existing debt, fund white elephant projects or pay pensions.

China's central government is pushing local governments to issue the remaining 1.51 trillion yuan (\$220 billion) of new special-purpose bonds that are intended to spur the economy by the end of October — and they can't use the borrowings for just any old thing.

Source: Caixin Global



The Shanghai Commercial Paper Exchange

The **Shanghai Commercial Paper Exchange Corp. Ltd. (SCPE)** delivered the first batch of standardized notes under China's newly issued rules governing a new business designed to increase liquidity support for financial institutions and expand credit to small businesses.

# Green Financing

There are multiple drivers for Green Financing in China

- “China’s low carbon/green economy transition needs huge amounts of funding.”
- “Urbanization is a macro trend leading to major environmental investments.”
- “Small and medium-sized enterprise growth is hampered by the limited availability of financing.”
- “High levels of household savings in China & foreign investors represent a demand opportunity”
- “China’s finance sector is heavily dependent on banks, and financial instruments are relatively limited in availability”
- “China is committed to reforming its bond market, as well as greening its financial system and introducing green bonds”

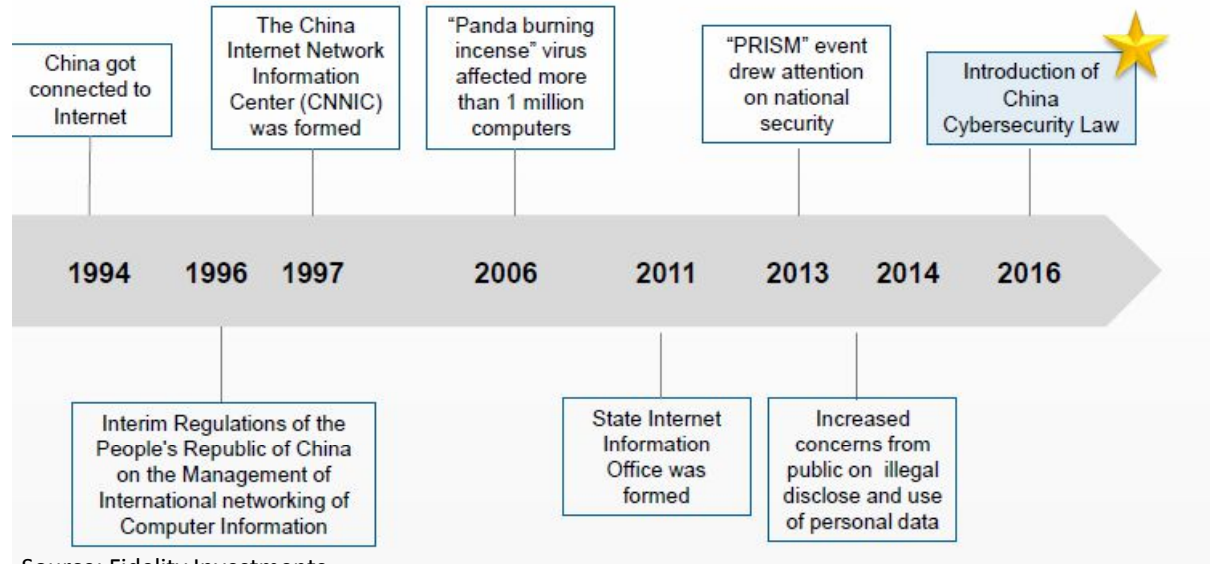


Source: [https://www.iisd.org/system/files/publications/growing\\_green\\_bonds\\_en.pdf](https://www.iisd.org/system/files/publications/growing_green_bonds_en.pdf)

# Cybersecurity

Chinese government's objective is protecting national security, not personal privacy.  
Key issues: What to comply with?, By When?, and Penalties if not?

- The Cybersecurity Law of the People's Republic of China ("the Cybersecurity Law" or "the Law") took effect on June 1, 2017



Source: Fidelity Investments

- Scope: Regulates all network services and activities

- An entity (such as a bank) is a Critical Information Infrastructure provider (CII) if any aspect of its network deals with "important" or "sensitive" data (not defined but which impacts national security, public welfare and interests)
- It's not enough to localize your data: access by individuals outside of China must also be controlled. Procurement should be sourced from qualified local vendors.



# Fintech

# Fintech: The Good & Bad – From China Perspective

Fintech encompasses diverse offerings; but China's acceptance is shaped by strategic goals

Includes technological innovation such as

- 1. *Currencies* – Digital currencies, bartering, mobile payment
- 2. *Capital-raising* – P2P (Crowd funding), Crypto-Assets (i.e. Bitcoin, ICOs), newly accepted forms of collateral for financings (Patents)
- 3. *Changes to Existing Markets* – Robo-Advisors, AI-driven investment management
- 4. *Infrastructure* – Blockchain
- 5. *Rules / Governance* – Reg-tech, Portable IDs

Fintech View Through a China Lens

What does China want to Accomplish?

1. Made in China 2025 (Tech)
2. RMB Internationalization
3. Belt Road Initiative / Greater Bay Area
4. SME / Deleverage / Anti-Corruption

Case Studies:

1. Mobile Fintech
2. P2P Lending
3. AI-Blockchain Patent Financing
4. Crypto-Assets
5. Digital Currency / Electronic Payments

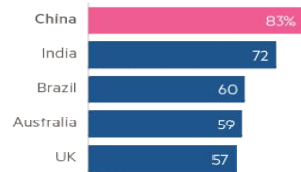
# Case #1: Mobile Fintech

## China is a leader in fintech services adoption

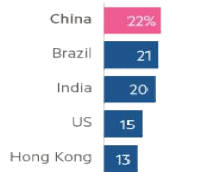
### China leads in adopting fintech services

Adoption rate (%)

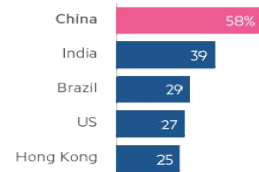
#### Money transfer and payments



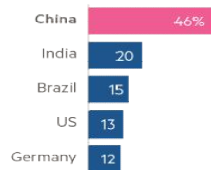
#### Financial planning



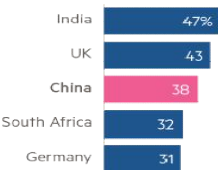
#### Savings and investments



#### Borrowing



#### Insurance

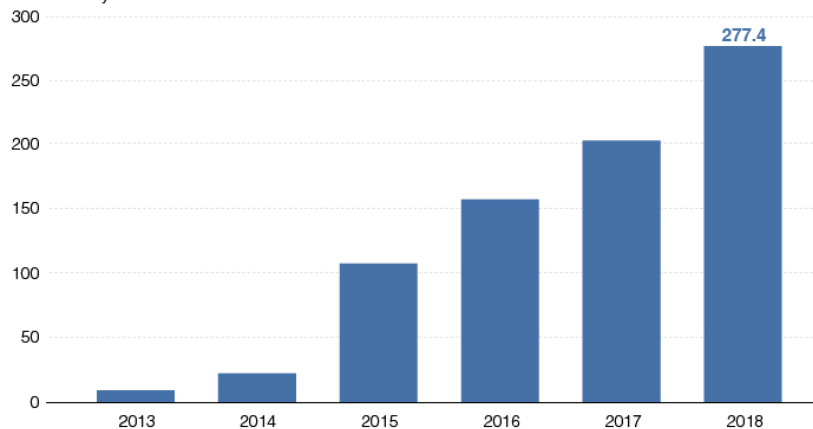


Source: EY FinTech Adoption Index © FT

### The Rise of Mobile Payments

■ Mobile payment transaction volume

Unit: Trillion yuan



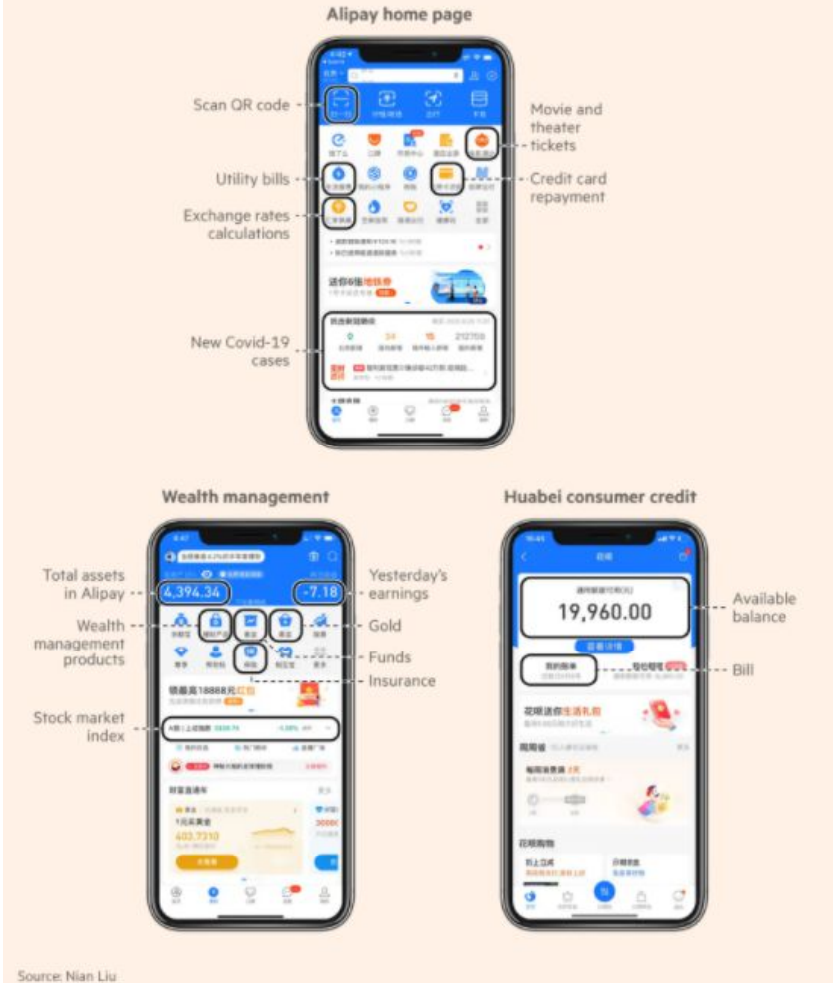
Sources: People's Bank of China, Caixin Data, CEIC

Caixin

<https://www.caixinglobal.com/2019-03-22/chart-of-the-day-chinas-mobile-payment-transaction-volume-hits-4151-trillion-in-2018-101395789.html?key=4jqcK28U9Dv0s21kwdt13vFL%2FE7c4pKGGXpS1GXN4fVjM309uw%3D%3D>

### Alipay, Ant Group's flagship superapp

From online payment to buying gold, it's an online supermarket of financial offerings



<https://www.ft.com/content/c636a22e-dd3f-403e-a72d-c3fb375459c>

# Case #1: Mobile Fintech

## Financial System Liquidity Will be Impacted if not Regulated

- Third party payment groups were draining banking system liquidity (See graph)
- Prone to financial risk (embezzlement, questionable investments) and difficult to monitor
- New regulations require 100% of customer deposits placed as reserve funds in non-interest bearing custodial accounts managed by state-owned central clearing house NetsUnion or UnionPay with funds placed with PBOC
- Impact: Tencent and Alipay lost about \$1Bn combined in revenue\*

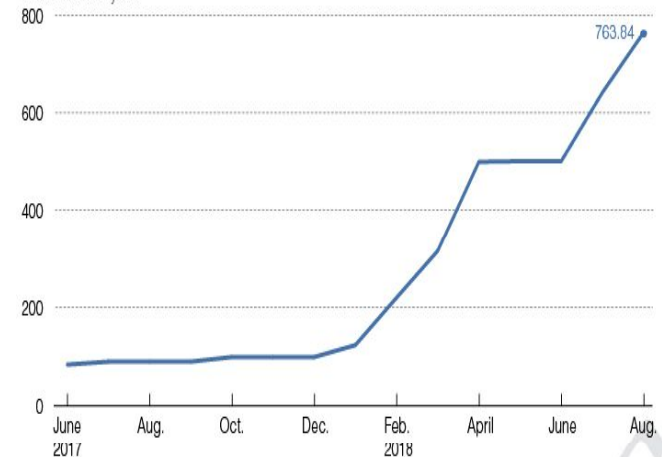


<https://www.economist.com/briefing/2020/10/10/what-ant-groups-ipo-says-about-the-future-of-finance>

### Banking Client Funds

— Outstanding deposits from nonfinancial institutions

Unit: Billions of yuan



Sources: 财新数据 CEIC  
Caixin Data 财新数据集团旗下公司

Original Source: People's Bank of China

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<https://www.caixinglobal.com/2018-09-19/chart-of-the-day-online-payment-firms-banking-more-client-funds-101328090.html?rkey=4joic%2BU9DvDs21kwdd13vFL%2FE7ci4pKSY58M91%2BZHLpTPSFmyvPeQ%3D%3D>

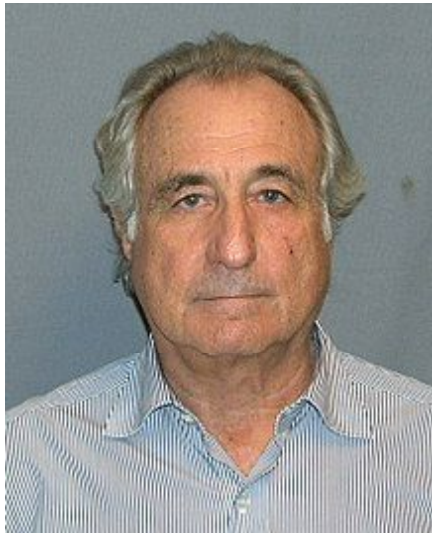
<https://www.ft.com/content/b472f73c-859e-11e8-96dd-fa565ec55929>

# Case #2: P2P Lending – Rise and Fall Of

## Illegal Fundraising falls under China Criminal Law

### Criminal Law – Article 192

- If Over 1MM (RMB) for individual or Over 5MM (RMB) for Company;
- The sentence equals
  - Imprisonment (10 Years+)
  - Death Penalty



Comparison	Bernie Madoff (U.S.)	Chengjie Zeng (China)
Crime	Securities & wire fraud, money laundering, etc.	Illegal fundraising and financial fraud
Impact (\$ / Victims)	\$64.8 Bn / 4,800 victims	\$460 mm / 57,000 victims
Conviction Date	2009 (Pleaded guilty)	2011 (Condemned)
Penalty	150 years imprisonment	Execution by Lethal Injection

[https://en.wikipedia.org/wiki/Bernie\\_Madoff](https://en.wikipedia.org/wiki/Bernie_Madoff)

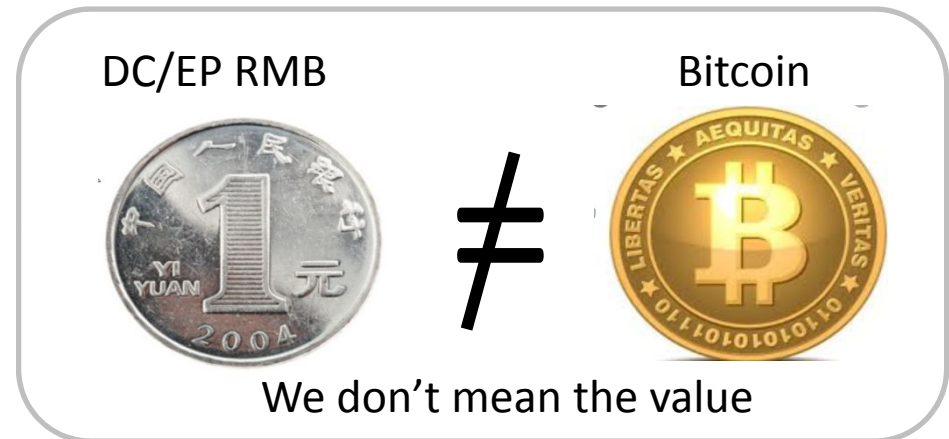
<https://www.theatlantic.com/china/archive/2013/07/chinas-bernie-madoff-was-executed-for-fraud-and-nobody-told-his-family/277789/>

# Case #5 China Digital Currency / Electronic Payment (DC/EP) (a.k.a China's Central Bank Digital Currency (CBDC))

How does the DC/EP differ from a crypto-currency?

## *Unlike crypto-currencies.....*

- DC/EP is centralized with the PBOC as the serving as the wallet registration center.
  - Users download a PBOC- approved electronic wallet app linked to a bank card and mobile phone number
- Banks are still involved in DC/EP issuance and redemption, and in handling KYC functions.
- DC/EP does not utilize a blockchain-like distributed ledger with a consensus-algorithm. This improves speed and scalability



## *But similar to crypto-currencies...*

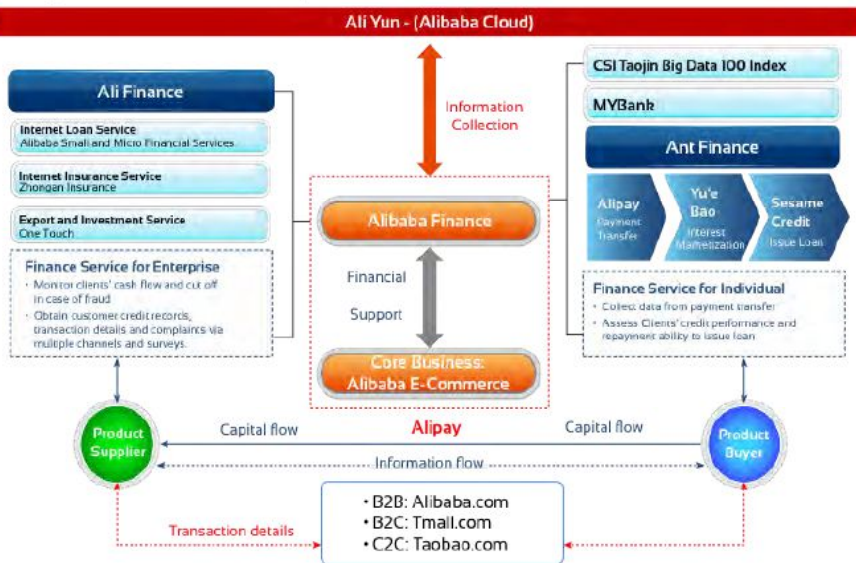
- DC/EP is Peer-to-Peer (P2P) - Payer to payee with no intermediary (i.e. UnionPay) processor in between
- Transactions are encrypted and users are anonymous to each other through use of public (payer/payee addresses) & private keys (to authenticate)
- Payments leave no record with a 3<sup>rd</sup> party or a bank (though identifiable by PBOC)

# Future: Data – The New Value

“The BASEL Accords are like an old people’s club...we can’t use yesterday’s methods to regulate the future.” – Jack Ma ( Founder - Alibaba / Ant Financial ), Oct. 2020

<https://www.ft.com/content/66808017-59fd-49d1-9016-34684001c978?desktop=true&segmentId=d8d3e364-5197-20eb-17cf-2437841d178a#myft:notification:instant-email:content>

## Payments were only the start



## Digital Bank Valuation (TenCent’s WeBank)

- Auction Value: \$21Bn
- 14<sup>th</sup> Most valuable, but ranking 27<sup>th</sup> by net assets
- Price to Book Ratio: 17.6
- Return on Assets: 2.17%
- Key Growth Impediment – Customers come to branch to open a deposit account
- “Even if WeBank and MYBank (Alibaba) turn out to be banks in name only, their integration into the Tencent and Ant product ecosystem, with their vast user bases and troves of Big Data, is the true source of these companies’ value\*”

Source: Kapronasia  
kapron ASIA

## Price-to-book & ROA Peer Comparison – 6/10/19

Peers	Citi	JPMC	BoA	WFC	CMB	WeBank
P/B	0.85	1.52	1.08	1.17	1.62	17.6
ROA	0.94	1.23%	1.21%	1.24%	1.28%	2.17%

\*Source: “Aborted auction reveals how much China’s digital banks could be worth,” Gabriel Wildau, FT, December 3, 2018

Ant IPO Financial  
Valuation: \$315Bn+



<https://fr.reuters.com/article/us-antfinancial-valuation-idUSKBN1HP1AA>

<https://finance.yahoo.com/quote/CIHKY/key-statistics?p=CIHKY>

End