# This publication was archived on 4 July 2016

This article is no longer current. Please refer to Overseas Business Risk - China

## China Financial Policy Focus – August 2014

**Part 1** looks ahead at what to expect in the coming 6 months. **Risks**: real estate & non performing loans, non-bank financial institutions challenge to the statusquo. **Reforms**; HK-Shanghai "Stock Connect", & (perhaps) loosening the cap on deposit rates & introduction of deposit insurance scheme). **Part 2** is our "deep dive" – this time into financial sector reforms in **Shanghai's Free Trade Zone**. **Part 3** wraps up developments over the past quarter (securities market reform, slowing credit growth, new banks).

### Part 1: Forward Look

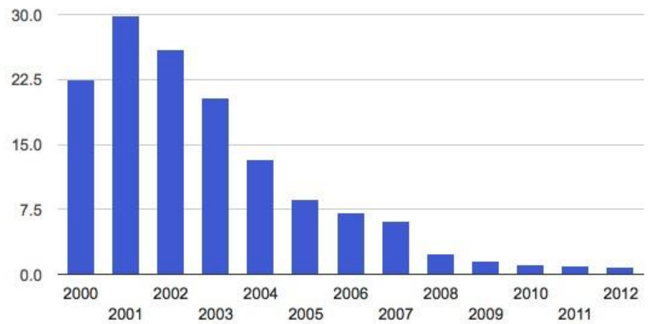
| 2014 | Event | Comment |
|---|---|---|
| August | Release of new Insurance policy guidance. ("10 national conditions" ) | The State Council and China‟s Insurance Regulator (CIRC) will release opinions on "Fasten the Development of Modern Insurance Industry". The last "Opinions" was in 2006. The State Council approximates to UK‟s Cabinet. The seniority of this document shows China‟s central government pays high attention to the financial reforms in the insurance sector. |
| mid September | UK- China Economic & Financial Dialogue (EFD) | Vice Premier Ma Kai meets the Chancellor in London, there will be an investment conference, and financial regulatory dialogue. |
| October | Shanghai-Hong Kong Stock Connect will take effect | Announced by the Chinese securities regulator (CSRC) in April, two markets have been preparing for the connection, details yet to be confirmed but likely that Chinese and HK institutions will be able to respectively purchase one another‟s equities (under a quota). |
| Q3-Q4 | Non-Performing Loans is likely to increase. | China‟s Banking Regulator (CBRC) has publicly stated they expect non performing loans (NPLs) to increase in the second half of year, especially in manufacturing and retail industries, as well as metals-trading firms. By the end of June, NPLs at Chinese banks is 1.08%, which increased 0.08% from the beginning of this year. The chart below visualises the historical context: NPLs are down from 30% in 2001. The uptick in NPLs likely reflects i) an increased honesty in accounting and ii) the effect of the credit expansion. |
| Q2-Q4 | Real estate risk is expected dominate headlines. | A downturn in real estate prices in China‟s small-mid sized cities might signal the peak of China‟s real-estate run. Prices fell from May-June in 55 of 70 Chinese cities. Nobody knows how it will play out, Chinese households borrow less than their UK counterparts, but corporates are exposed. |

# This publication was archived on 4 July 2016

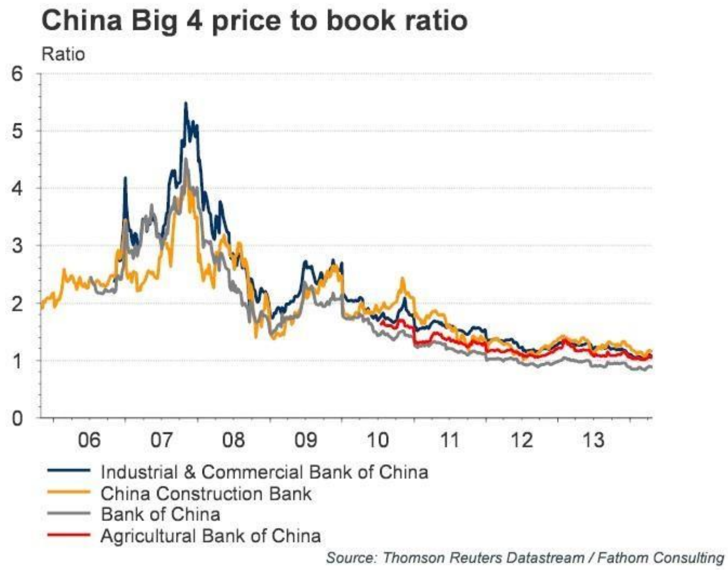
This article is no longer current. Please refer to [Overseas Business Risk - China]

| | | |
|---|---|---|
| Q2-Q4 | Growth of non-bank financial sector challenges established banks | China"s "big 4" banks trade at less than book value (ie markets believe they actually destroy value) – in part thanks to the rise of wealth management products and internet-finance alternatives which offer bank-like services while circumventing cumbersome regulation and the cap on rates banks can offer depositors. |
| | Interest rate liberalisation & deposit insurance | Governor Zhou Xiaochuan said on 10 July, PBoC thinks Interest rate liberalisation will be realised in two years. Introduction of a deposit insurance scheme remains on the cards – probably this year. |

**Chinese Non Performing Loans – the recent uptick put in historical context**




**Chinese Banks: Stock Market valuation suggests they are worth less than the value of their assets**



# This publication was archived on 4 July 2016

This article is no longer current. Please refer to [Overseas Business Risk - China]

**Part2: Financial Reforms at Shanghai Free Trade Zone (SFTZ)**

The Shanghai FTZ covers an area of nearly 29km on the eastern outskirts of the commercial hub. It was approved by China's State Council, or cabinet, in July 2013 to be a test bed for a wide range of marketoriented reforms, including easing restrictions on finance, investment and trade, a move widely hailed as a crucial step in the country's reform and opening up.


According to Shanghai municipal government, SFTZ is designed for trading business. However, financial service is one of the most important components since it is a fundamental base for the real business. Each of China‟s four financial regulators are all trying to initiate pilot policies in the free trade zone, such as Cross-border use of RMB, capital market liberalisation, commodity future, Energy business and gold trade business under Shanghai future exchange.

People‟s Bank of China (PBOC)- Cross-border use of RMB
In February, PBoC Shanghai branch released “The Notice on Expanding of RMB Cross-Border Use in the Shanghai FTZ”. PBoC, the China‟s central bank announced a further guidance “Opinions of PBoC on financial measures to support Shanghai FTZ” in June. There are five highlights from PBoC‟s “Opinions” document:

# This publication was archived on 4 July 2016

This article is no longer current. Please refer to [Overseas Business Risk - China]

- To streamline the process of RMB use in cross-border trade and direct investment by enterprises. The cross-border payment, receipt and exchange involved in the investment can be directly processed by banks.
- To facilitate cross-border investment by Individuals. To provide RMB settlement service to individual activities under current account, and direct outward investment.
- Financial institutions and enterprises in the SFTZ are allowed to borrow offshore RMB to use in certain industries under national macroeconomic regulation and control direction.
- Enterprises located the SFTZ can conduct two-way RMB fund pooling business within their enterprise group based on the need of business operation to provide centralized receipt and payment service from current account transactions of their affiliated enterprises located in China and overseas.
- Enterprises in the SFTZ can conduct cross-border RMB payment under current account with the overseas associated enterprises.

The first two opinions have been extended to the whole country from Shanghai FTZ. The remaining three are under further study, according to PBoC. They also considering further reforms to clear the obstacles of cross-border use of RMB, to enlarge the RMB outflow and to promote RMB from a payment currency to pricing currency in the cross-border trade.

### Separate unit-Free Trade Accounting Unit (FTU)

Shanghai FTZ has released details of the Free Trade Account which is the key component of Separate Unit-Free Trade Accounting Unit (FTU). The short story is that no-body exactly knows what this is or how it will work.

According to the theory, it will work as follows-
The capital account within SFTZ will be fully open up to the overseas market. PBoC set up FTU as a firewall (Comment: unclear how) to prevent the overseas money from flowing into the domestic market through the free trade account. One (Chinese) critic of this arrangement at the conference we arranged pointed out: “this amounts to transplanting Hong Kong into Shanghai...(if it‟s firewalled from the rest of the economy)”

# This publication was archived on 4 July 2016

This article is no longer current. Please refer to Overseas Business Risk - China

It is possible that the daily transfers from the FTU to PBoC everyday might exceed PBoC‟s requirement. In which case PBoC will inject the excess capital into the offshore markets, such as Hong Kong, London and Frankfurt. If this does indeed happen, this will help to enhance the liquidity in those offshore markets.

**Negative List of SFTZ**

The negative list is a central component to the SFTZ. It specifies in which areas foreign investment is not allowed, rather than the previous approach in China which listed the areas where foreign investment is permitted (a so-called „positive list‟). When the 2013 negative list was published last year it was criticised due to its length and complexity. Shanghai authorities have previously committed to updating the negative list annually.

On 1 July 2014 the Shanghai authorities released their first update of the negative list. The new list sets the number of prohibited areas at 139, compared with 190 areas previously. The investment environment was further liberalised, though not by much. In the financial sector, restrictions on investment banking were modified to specify that investment banking activities must meet specific regulations (rather than being entirely prohibited). Similar modifications were made to cover restrictions on investing in small loans companies. But large parts of the financial services sector remain restricted (e.g. prohibition of foreign firms being majority owners of (non-auto) insurance or securities firms in China).

Restrictions in the original List on foreign investment in banks, finance companies, trust companies, currency brokerage companies, small loan companies, and financing guarantee companies have been replaced with a general regulation stating that all investment in banking-related financial institutions must comply with applicable regulations in force. Typically, “bankingrelated financial institutions” refer to commercial banks, urban credit cooperatives, rural credit cooperatives, and other financial institutions and policy banks that are established within China and engaged in the money deposit business for the general public. Accordingly, it appears that the Revised List intends to remove the restrictions on foreign investors from investing in finance companies, trust companies, currency brokerage companies, small loan

# This publication was archived on 4 July 2016

This article is no longer current. Please refer to Overseas Business Risk - China

companies, and financing guarantee companies. However, given the vague language, how this change will be implemented remains to be seen.

### Businesses in SFTZ

By the end of June 2014, 39 banks opened 42 business points in SFTZ, including 14 branches and 4 sub-branches of Chinese banks, 23 sub- branches of foreign banks and 1 financial lease sub-company.

5 Chinese insurance companies set up branches in SFTZ by the end of May. Huatai Insurance Company established a marine business centre echoing CIRC‟s promoting policy on marine insurance. Shanghai municipal government plans to develop an insurance syndicate market like Lloyds. Foreign Health insurance companies (such as the UK‟s BUPA) are hopeful that they will be permitted to do business in the SFTZ that is currently forbidden in China – but it is not certain that they will receive approvals.

China‟s top securities regulator CSRC has allowed qualified individuals and units to invest in both domestic and foreign fund markets. It also approved a plan to build an international crude oil futures trading platform while foreign companies in the zone will be allowed to issue Renminbi bonds. Meanwhile, Shanghai Gold Exchange signed an MoU with PBoC Shanghai to launch China‟s international gold exchange market.

## Part 3: Recent Developments & What This Means

| 2014 | Event | Comment |
|---|---|---|
| 9 May | CSRC new " National 9 conditions "- opinions on the further development of capital market | China‟s Securities Regulator announced new "Opinions" on China‟s capital market development after the old "Opinions" in 2004. The new one demonstrates the further development of China‟s capital development towards marketization, legalisation and internationalisation. |

# This publication was archived on 4 July 2016

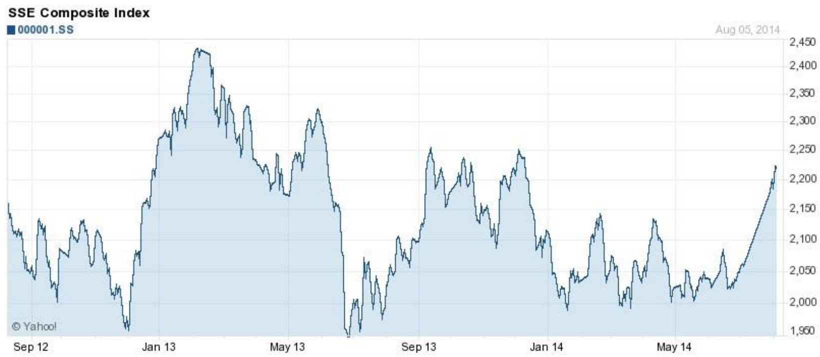
This article is no longer current. Please refer to [Overseas Business Risk - China]

| | | |
|---|---|---|
| 14 May | The State Council "No. 99" document on shadow banking | The State Council issued a "Guidance to Supervision on Trust Companies" to strengthen the supervision on shadow banking. PBoC, CBRC and CSRC took actions to suppress the growth of the shadow banking under this guidance. |
| 18 June | PBoC released "Opinions of PBoC on financial measures to support Shanghai FTZ" | Free trade account described above is the key element under the "Opinions". |
| 17-18 June | IFC issued the first RMB Green Bond in London | IFC issued RMB500m green bond in London. It was priced a yield 2%. HSBC is the sole manager. |
| 18 June | UK- China Financial Forum | China"s Premier Li Keqiang and Chancellor George Osborne hosted the UK-China financial forum in London which announced CCB as the UK"s RMB clearing bank. |
| 18 June | Two UK firms awarded RQFII licences | Blackrock and HSBC Asset Management (UK) were granted the RQFII licence during Premier Li visit UK |
| 30 June | Chinese Banks start to use new Loan-To-Deposit Ratio on 1 July | Chinese banks cannot lend out more than 75% of the deposits they accept. This ratio remains unchanged, but the regulator adjusted the calculation rulebook – in essence, this softens the regulation allowing banks to lend more. The tweak encourages lending to small business and agriculture. Putting this into context: the 75% ratio is conservative by international standards - in 2007 Northern Rock"s ratio was 377%, and the UK average 137%. China"s average is now 66%. |
| 25 July | Three (new) private banks have been approved by CBRC. | China has just one private (non-state) bank (Minsheng). The government stated in December they want more. Three private banks were awarded the licences including a bank initiated by China"s internet giant Tencent. |
| August 13th | Slower than expected credit growth. July"s data release:<br>- M2 (Money supply) rose 13.5% on year. (down from 14.7% in June)<br>- Total Social Financing (a broader measure of credit) fell to the lowest level since November 2008 | Analysts were "shocked" by the fresh data "a clear signal of no substantial monetary easing" (JP Morgan). Chinese banks made half as many loans in July than a year earlier (RMB385.2bn in July versus RMB700bn in last July). The monthly data needs treating with caution; the broad picture this year has been of continued (albeit slowing) credit growth – we"d want to see a few more data points before concluding China has kicked its credit addiction. |

# This publication was archived on 4 July 2016

This article is no longer current. Please refer to [Overseas Business Risk - China]

**Shanghai Equity Index: Strong rally since July**




## Disclaimer

The purpose of
the FCO Country
Update(s) for Business ("the Report") prepared by UK Trade & Investment (UKTI) is to provide information and related comment to help recipients form their own judgments about making business decisions as to whether to invest or operate in a particular country. The Report‟s contents were believed (at the time that the Report was prepared) to be reliable, but no representations or warranties, express or implied, are made or given by UKTI or its parent Departments (the Foreign and Commonwealth Office (FCO) and the Department for Business, Innovation and Skills (BIS)) as to the accuracy of the Report, its completeness or its suitability for any purpose. In particular, none of the Report‟s contents should be construed as advice or solicitation to purchase or sell securities, commodities or any other form of financial instrument. No liability is accepted by UKTI, the FCO or BIS for any loss or damage (whether consequential or otherwise) which may arise out of or in connection with the Report.