

# Financial Stability Report 2017

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Based on 《中国金融稳定报告2017》 prepared by the  
Financial Stability Analysis group in People's Bank of  
China

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## A flavor of the report

当前，我国经济形势总体缓中趋稳、稳中向好，经济运行保持在合理区间，质量和效益提高。经济结构继续优化，创新对发展的支撑作用增强，改革开放取得新突破，对外开放布局进一步完善。但与此同时，我国经济运行仍存在不少突出矛盾和问题，产能过剩和需求结构升级问题犹存，经济增长内生动力不足，金融风险有所积聚，非金融企业杠杆率高企、地方政府债务风险、局部房地产泡沫风险、银行业资产质量下降、金融产品创新无序发展等风险值得关注。

2017年，要全面贯彻党的十八大和十八届三中、四中、五中、六中全会精神，统筹推进“五位一体”总体布局和协调推进“四个全面”战略布局，坚持稳中求进工作总基调，牢固树立和贯彻落实新发展理念，适应把握引领经济发展新常态，坚持以提高发展质量和效益为中心，坚持以推进供给侧结构性改革为主线，适度扩大总需求，加强预期引导，深化创新驱动，全面做好稳增长、促改革、调结构、惠民生、防风险各项工作，促进经济平稳健康发展和社会和谐稳定。

# 目录

01

宏观经济

Macro-economy

02

银行业

Banking

03

证券业

Securities &  
Futures

04

金融市场

Financial Markets

05

保险业

Insurance Firms

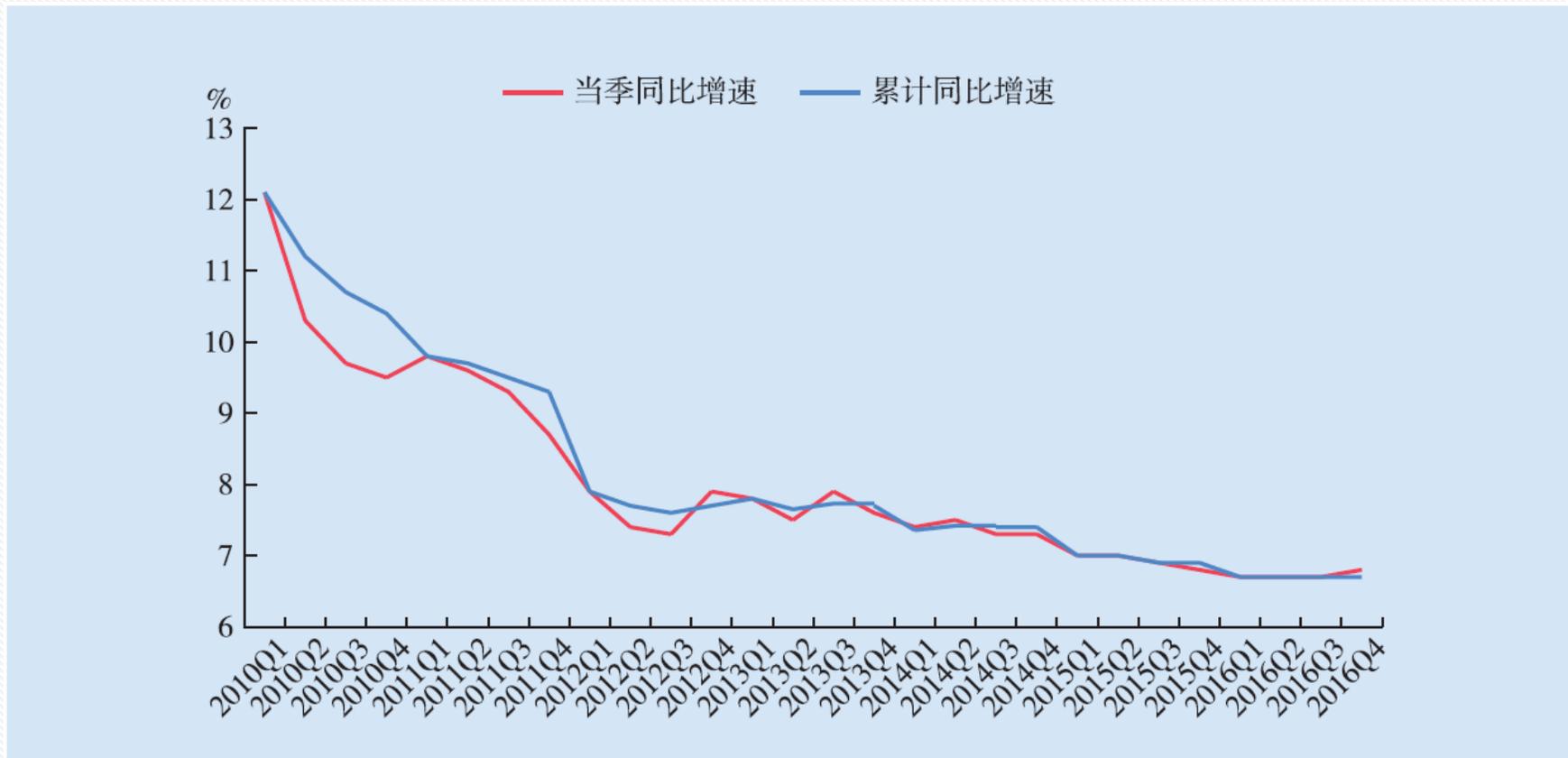
06

其他主题

Miscellaneous

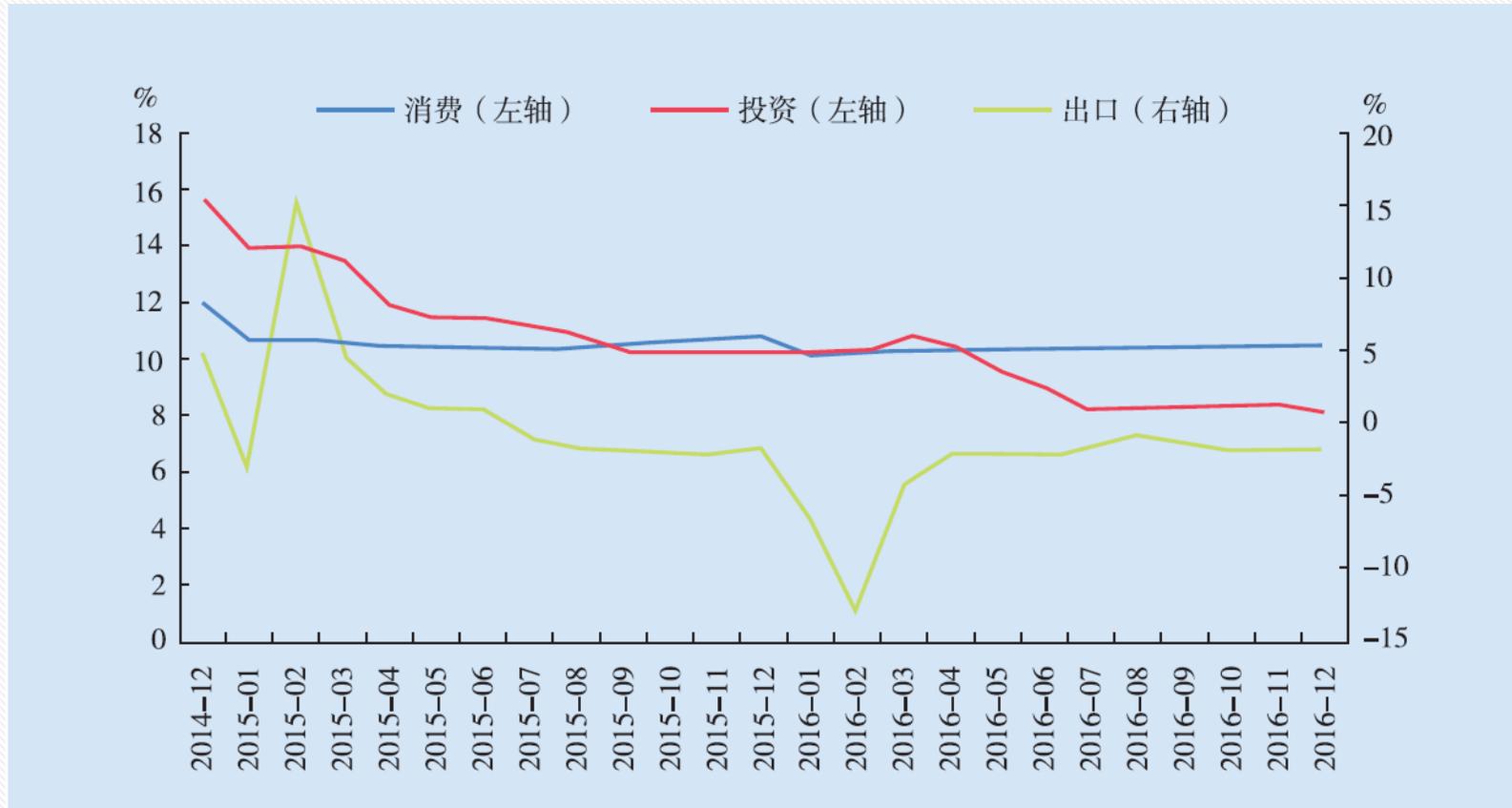
# **I. The Macro-economic and Monetary Condition**

# China Economic Growth



- Nominal GDP in 2016 posted 74.41 trillion RMB, a 6.7% y-o-y increase.
- Composition of GDP: primary = 8.6%, secondary = 39.8%, tertiary = 51.6%

# What drives the Chinese economy?



- Tangible asset investment increased by 7.9%. *Question is from which sector. Real estate?*

*SOEs v.s. non-SOEs?*

- Consumption increased by 10.4%, Total imports & exports decreased by 0.9%

# Going abroad

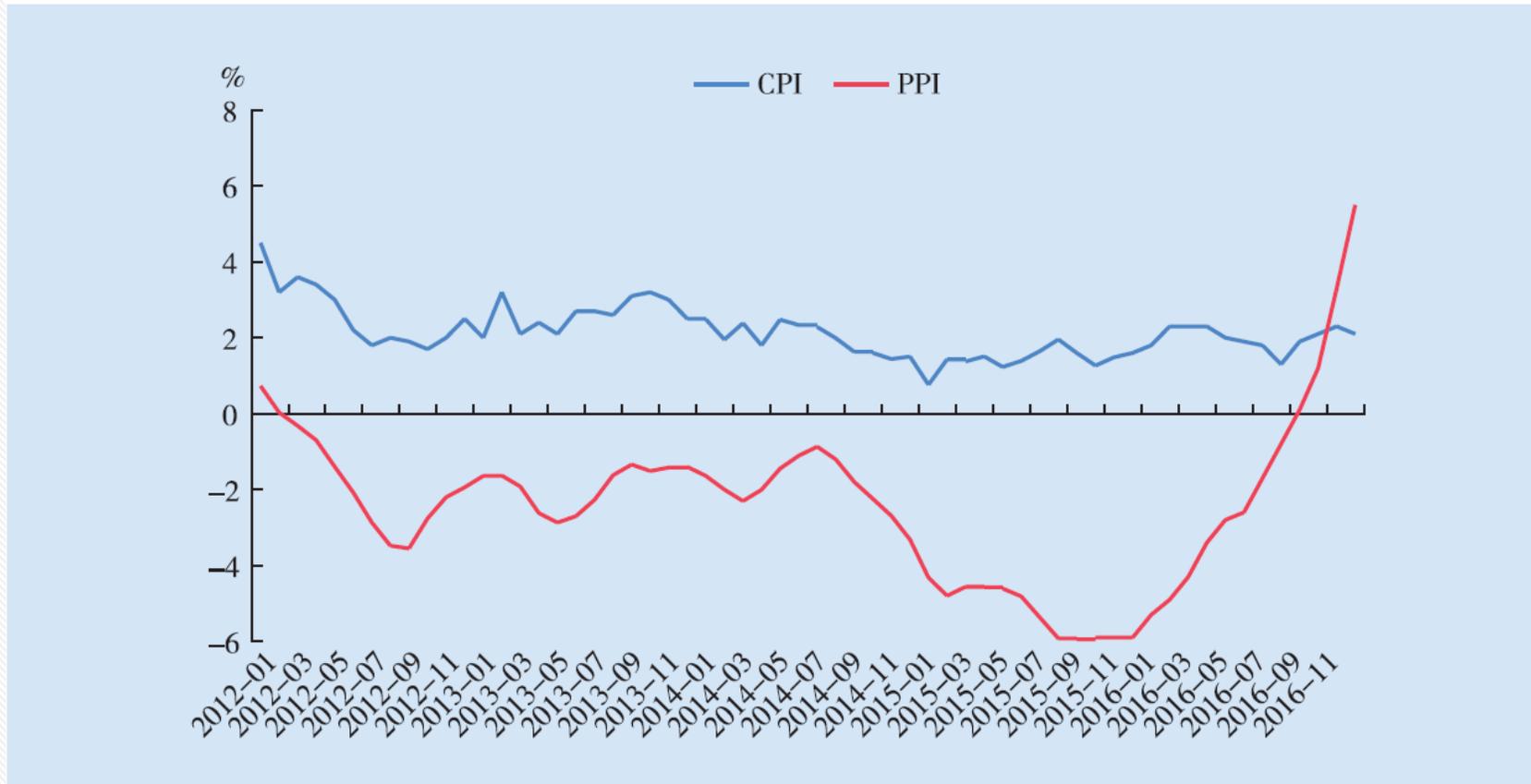
- Starting from 2016, the Chinese government initiated a more stringent regulation on money outflow. Any money outflow larger than 50,000 Yuan must be reported.
- Recently press belonging to the government has criticized companies that use debt financing from domestic banks to do overseas acquisitions which most likely destroy value.
- RMB was added into the currency basket of SDR by IMF on Nov. 30, 2015.



# The Real Estate Market

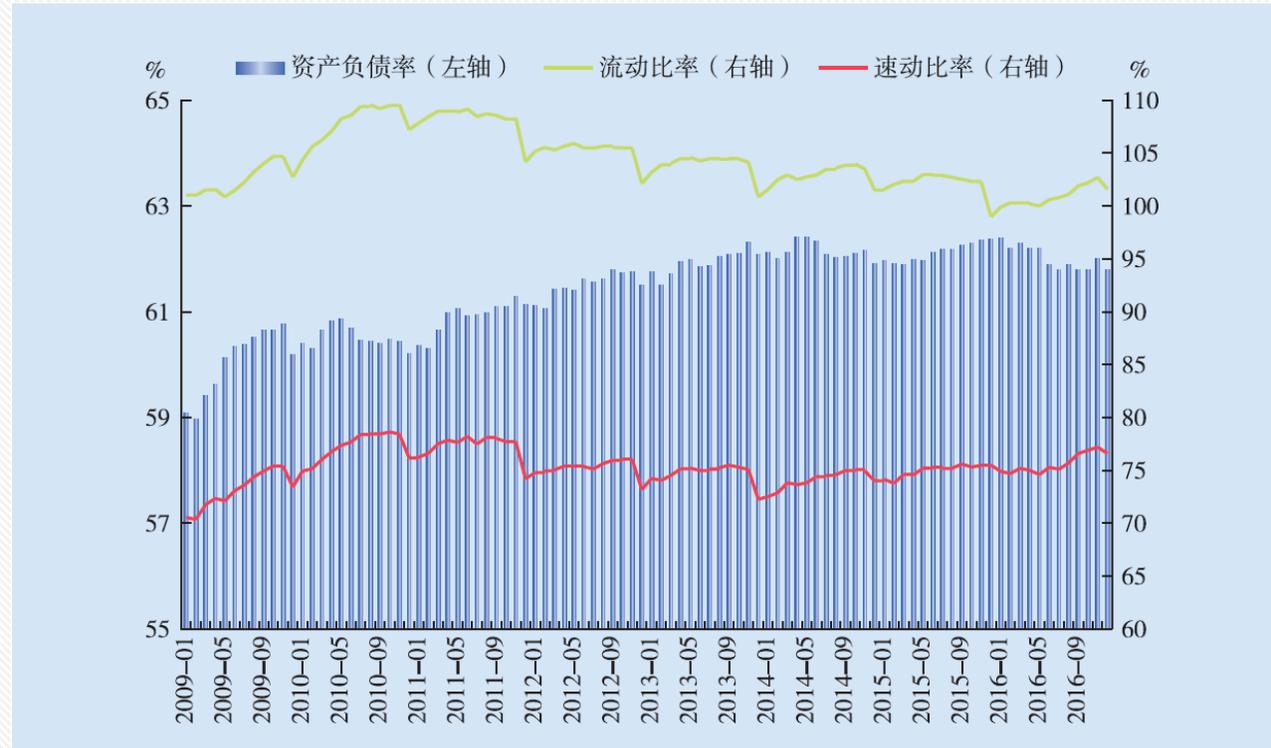
- The housing market in 2016 has witnessed a large increase in sales and prices, as well as voluminous money inflow.
- In total 1.57 billion squared meters of new housing has been sold in 2016, marking a **22.5%** y-o-y increase. After the regulation in the 4th quarter, the increase in sales has been slowed down.
- Housing price increases spread from major cities to secondary cities (such as Chengdu) in the second quarter after regulations hit the former. The government then began to control the housing price in secondary cities in October.
- Real estate loan balance / Total loan balance = **25%**, New real estate loan issuance / Total newly issued loans = **44.8%**

# Inflation



- In 2016, the CPI went up by 2.0% y-o-y, 0.6% higher than last year.
- PPI decreased by 1.4% and PPIRM by 2.0%. After being negative for 54 consecutive months, PPI became positive in September and continued to increase afterwards.

# Industrial firms

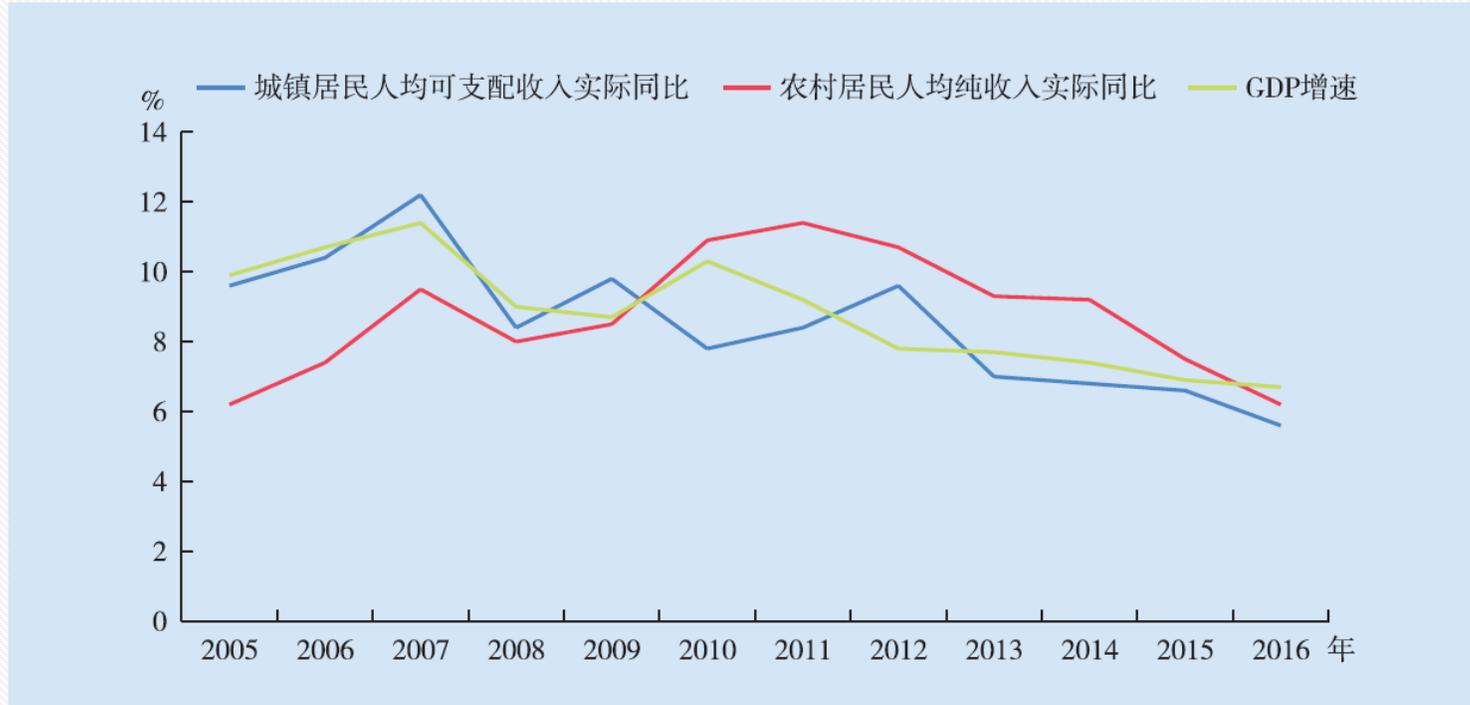


- In general, firm operational performance improved in 2016. According to the survey to 5,000 firms by PBC, book leverage of firms declines to 61.8%, current ratio is equal to 101.6%, quick ratio 76.6% and interest coverage 4.1.

- Implications of a joke “*net profits of most listed companies are not enough to buy an apartment in Shenzhen*”

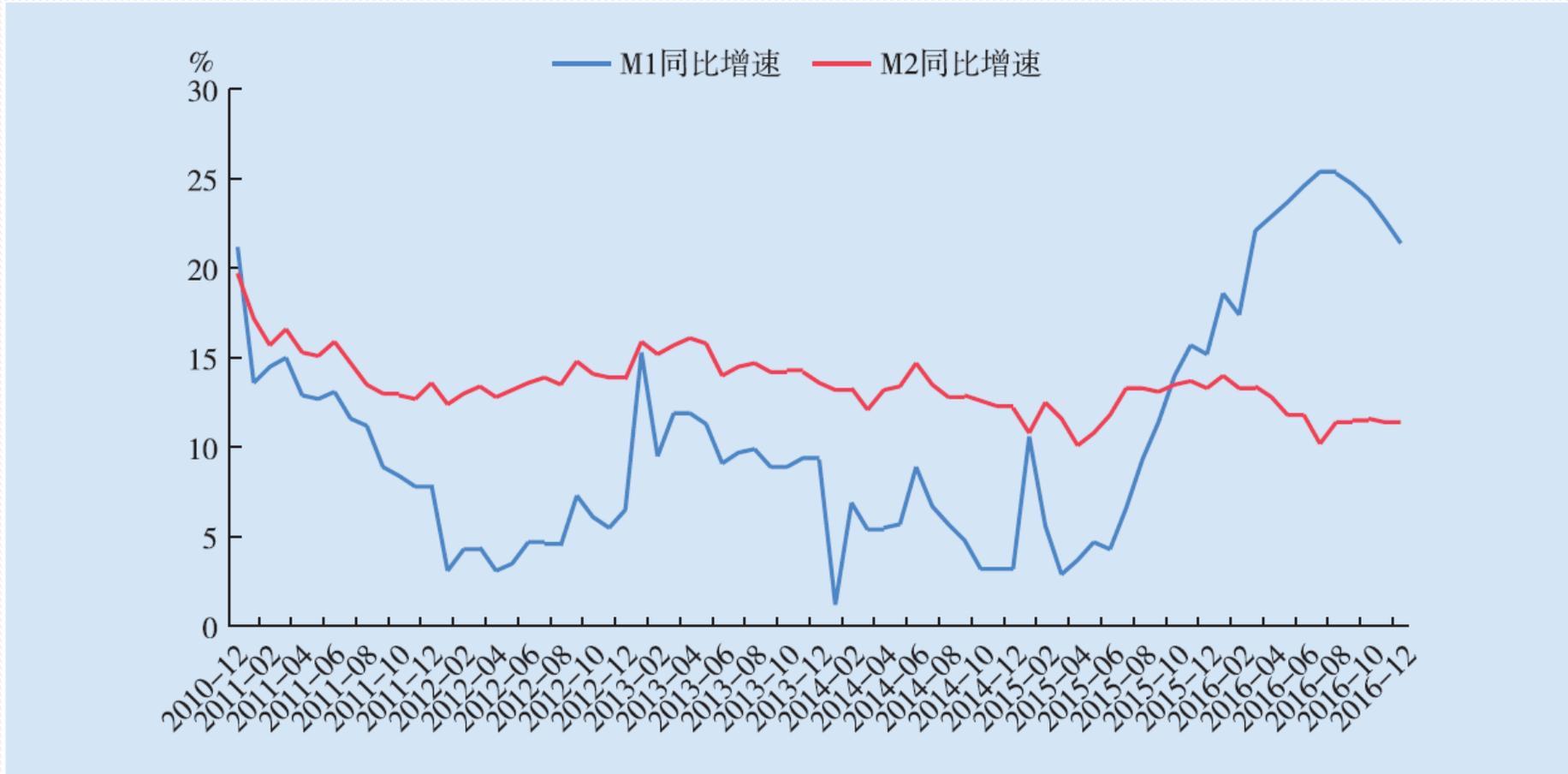
Net profit margin of firms declined to 1.4% from 2.0%

# The household



- Unemployment rate = 4.02%, urban disposable income per capita = 33616 Yuan, Rural = 12363 Yuan.
- Household saving = 60.7 trillion (+9.9% y-o-y), household loan = 33.4 trillion (+23.5% y-o-y)
- Wealth management account balance = 29.1 trillion (+23.6% y-o-y), brokerage wealth management business = 17.58 trillion (+48% y-o-y), A-share investment = 14.62 trillion.

# Money supply

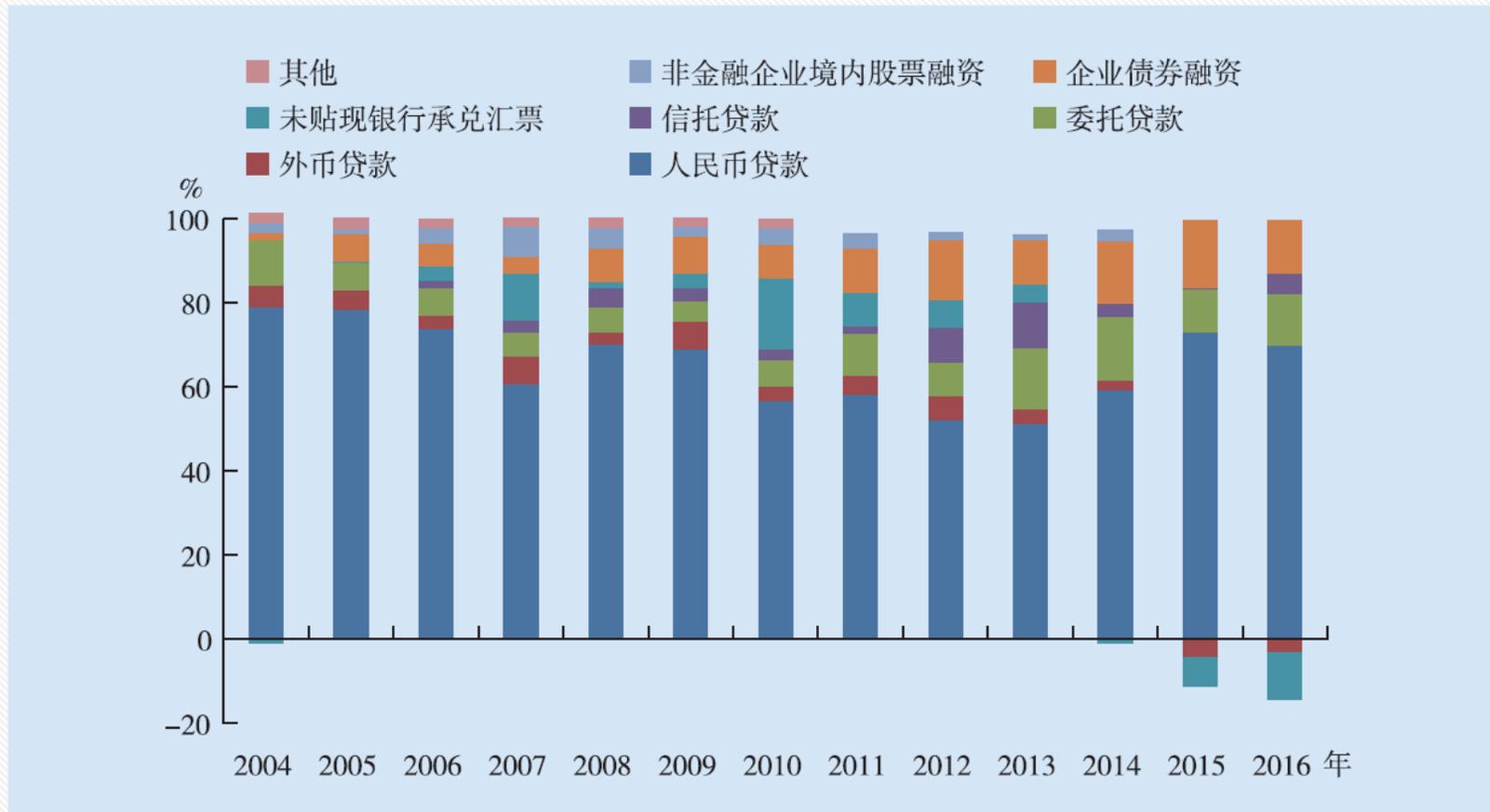


- M2 = 155.01 trillion, 11.3% y-o-y increase, 2% lower than 2015;
- M1 = 48.66 trillion, **21.4%** y-o-y increase, 6.2% higher than 2015.

# The high growth rate of M1

- M1 posted a **21.4%** y-o-y increase compared to the 11.3% increase of M2.
- **Contributing factor I: More demand deposits in the enterprise sector.** The opportunity cost of demand deposit becomes lower due to the low interest rate.
- **Contributing factor II: Local government debt exchange program.** Previously, local government debt was mainly in the form of bank loans and trust loans, featuring short maturity and high interest rates. In 2015, Ministry of Finance gave 1 trillion local government bond quota to allow local governments to exchange various types of maturing debt into standard long-term government bonds via private placements. Some argue that this program is the Chinese version of QE.
- **Contributing factor III: Voluminous transactions in the real estate market.**

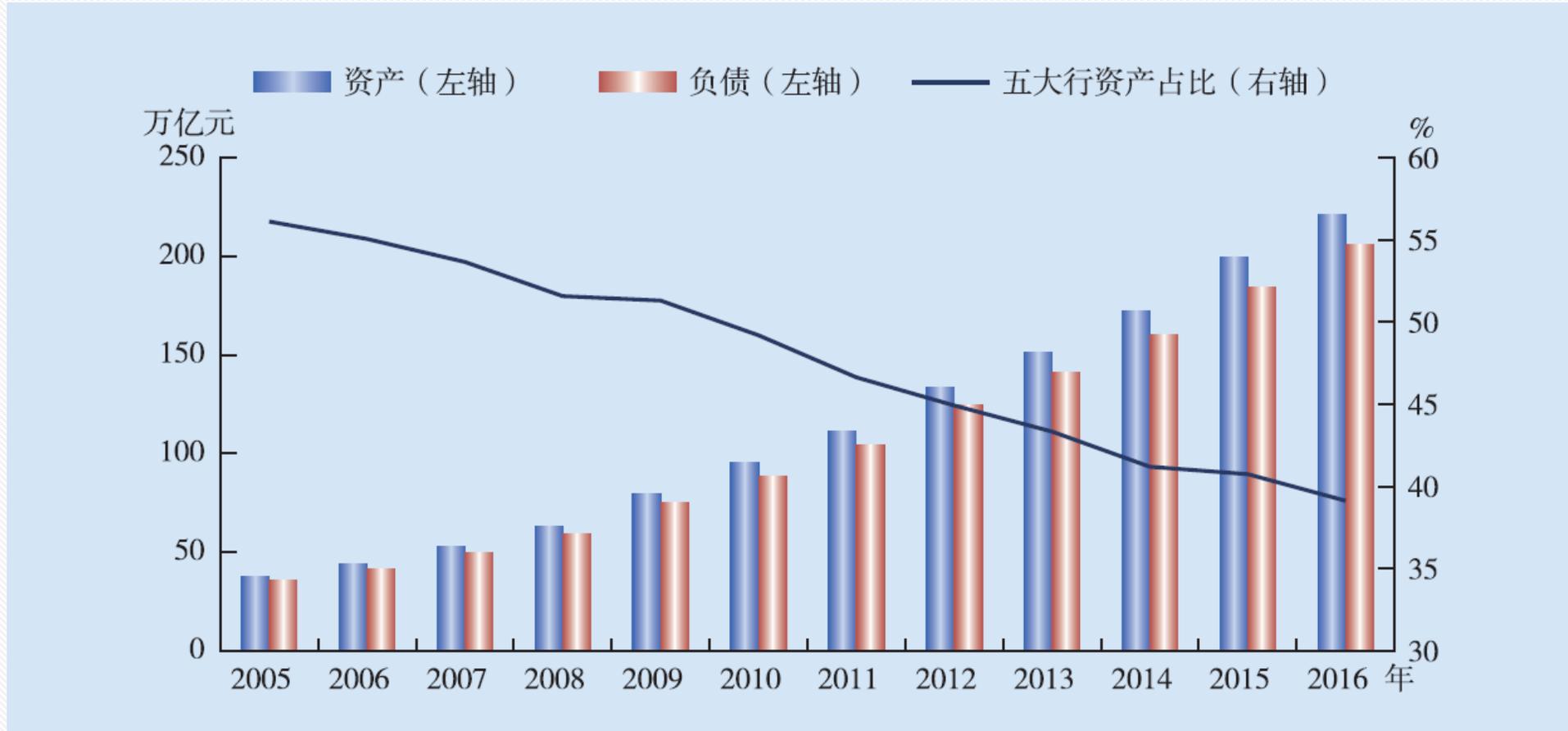
# Financing decomposition



- Total financing = 155.99 trillion, a 12.8% y-o-y increase.
- Trust and entrusted loans (17.1% of total financing amount) increased significantly.
- Lending denominated in foreign currencies registered a second-year decline.

## **II. The Banking Sector**

# Bank assets and liabilities



- Total assets = 232.25 trillion (up 15.8%); total liabilities = 214.82 trillion (up 16.04%)

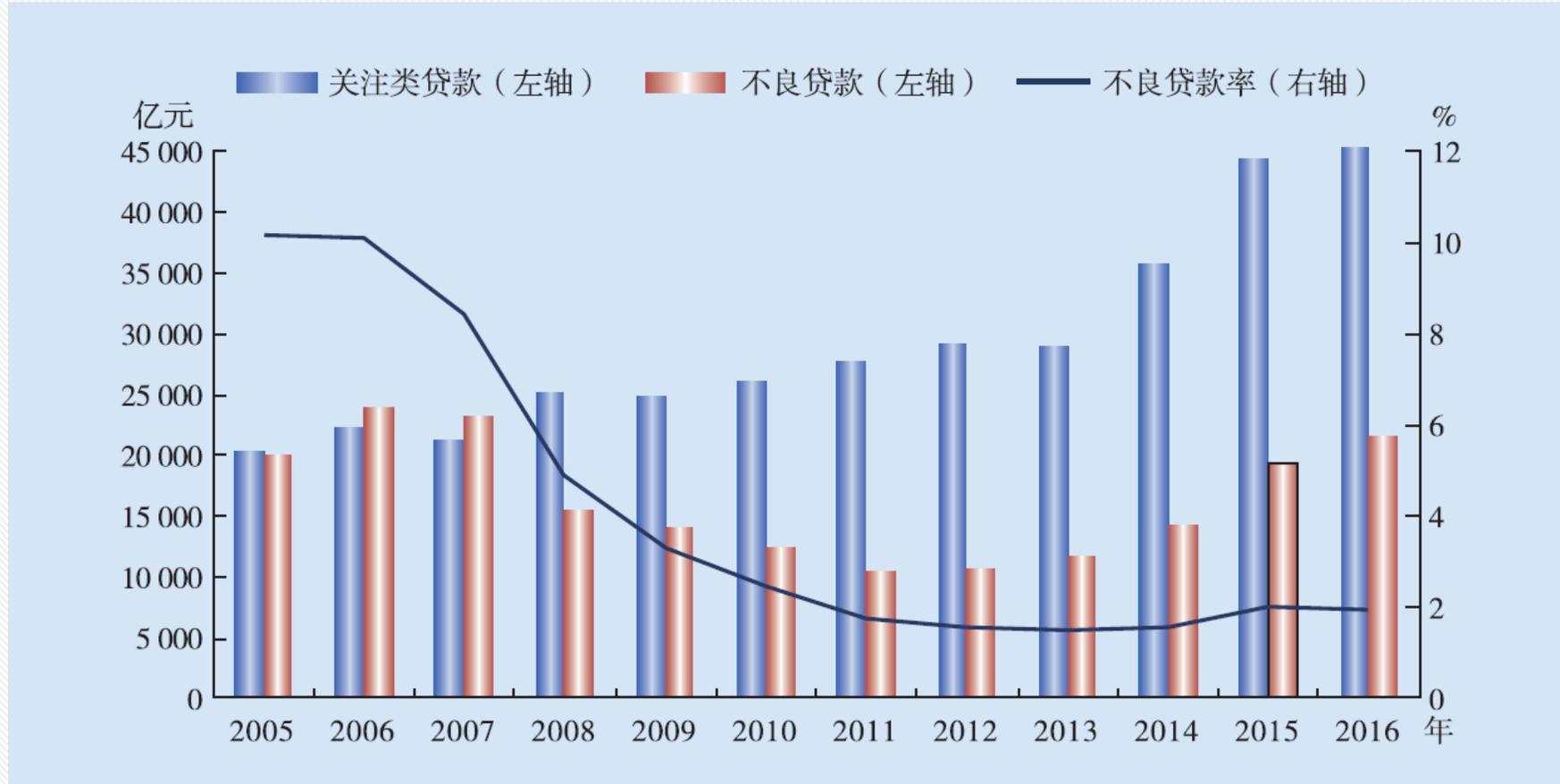
- The fraction of top-five banks' assets = 37.29%. # city commercial banks = 134; # rural commercial banks = 1114; # rural cooperative banks = 40; # rural cooperatives = 1125; # village & town banks = 1443.

# The growth of credit



- Total deposits = 140.42 trillion (up 12.53%); total lending = 106.6 trillion (up 12.53%).
- The increase of credit slows down.

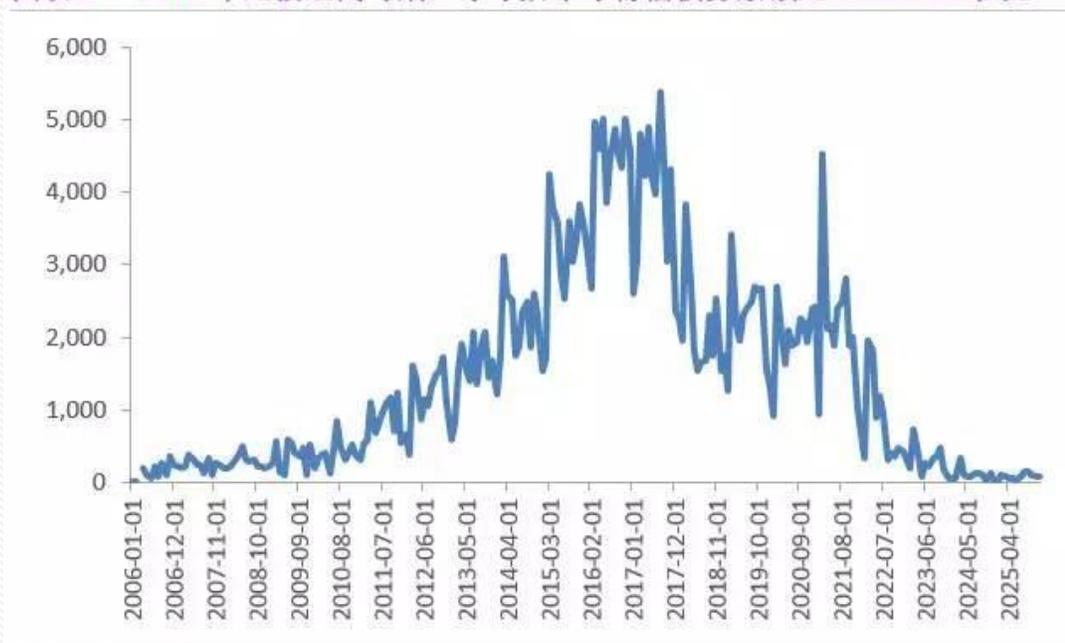
# Special-mention loans and NPLs of banking institutions



- NPLs = 2.19 trillion, NPLs/Total = 1.91% (down 0.02%)
- Special mention loans = 5.28 trillion; Over-due loans = 3.24 trillion (up 15.33%)
- *Roll-overs could mask potential NPLs.*

# “The Maturity Wall” in 2016

图表9： 2016年是偿还高峰期，今年下半年待偿债券余额是23462.92亿元

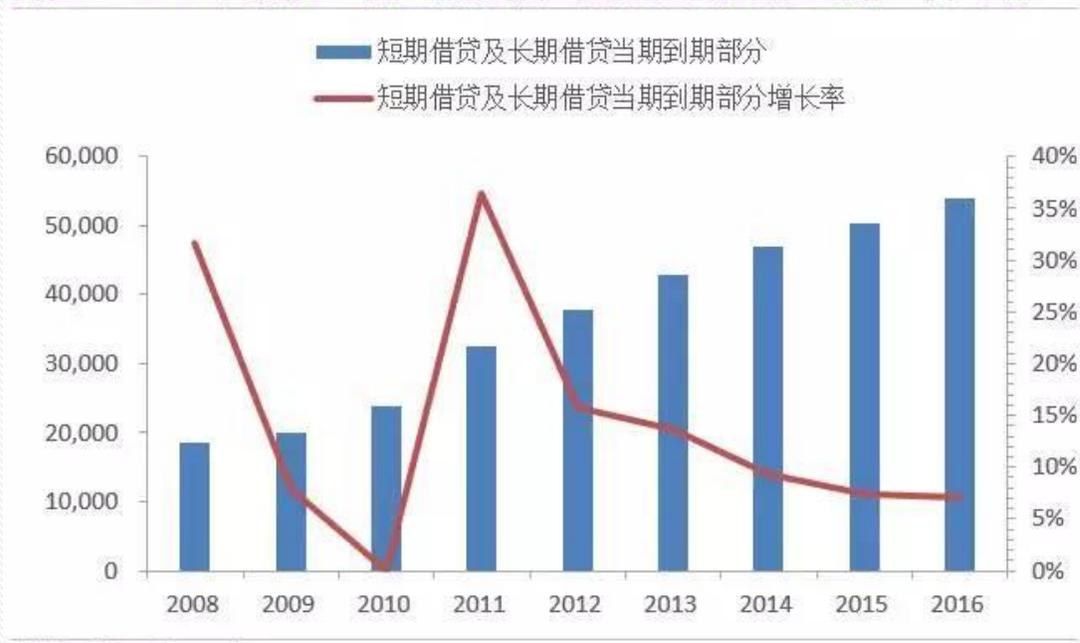


资料来源：联讯证券，wind

联讯麒麟堂

Maturing bond face value

图表7： 2012年开始企业的短期借贷及长期借贷当期到期总额增长率在下降



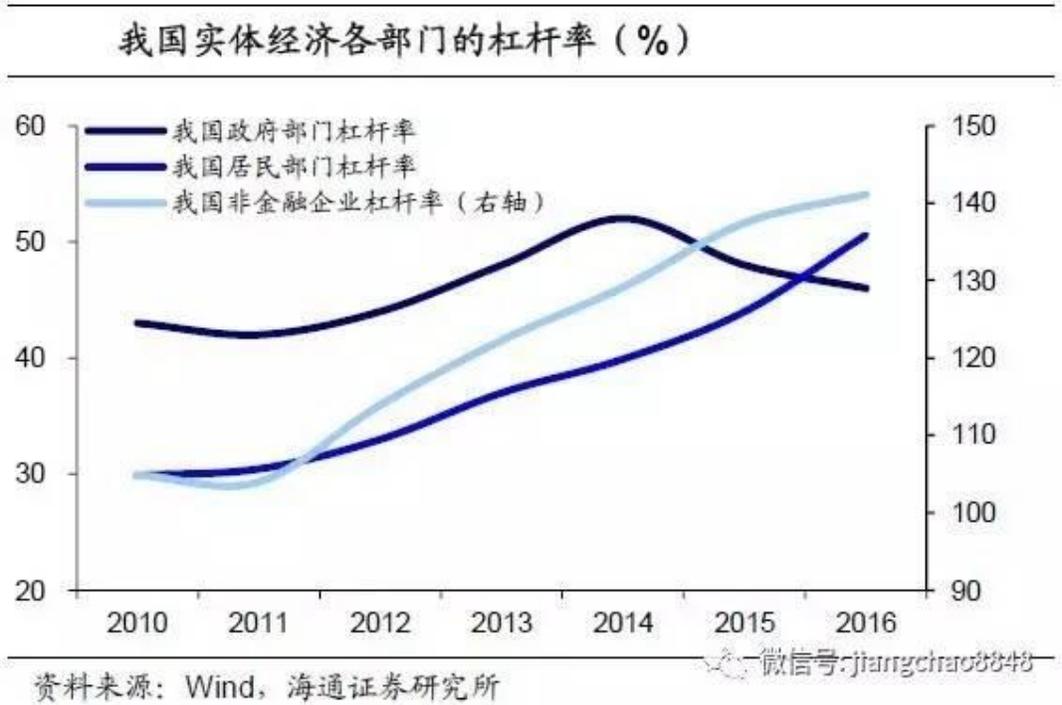
资料来源：联讯证券，wind

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Maturing bank loans

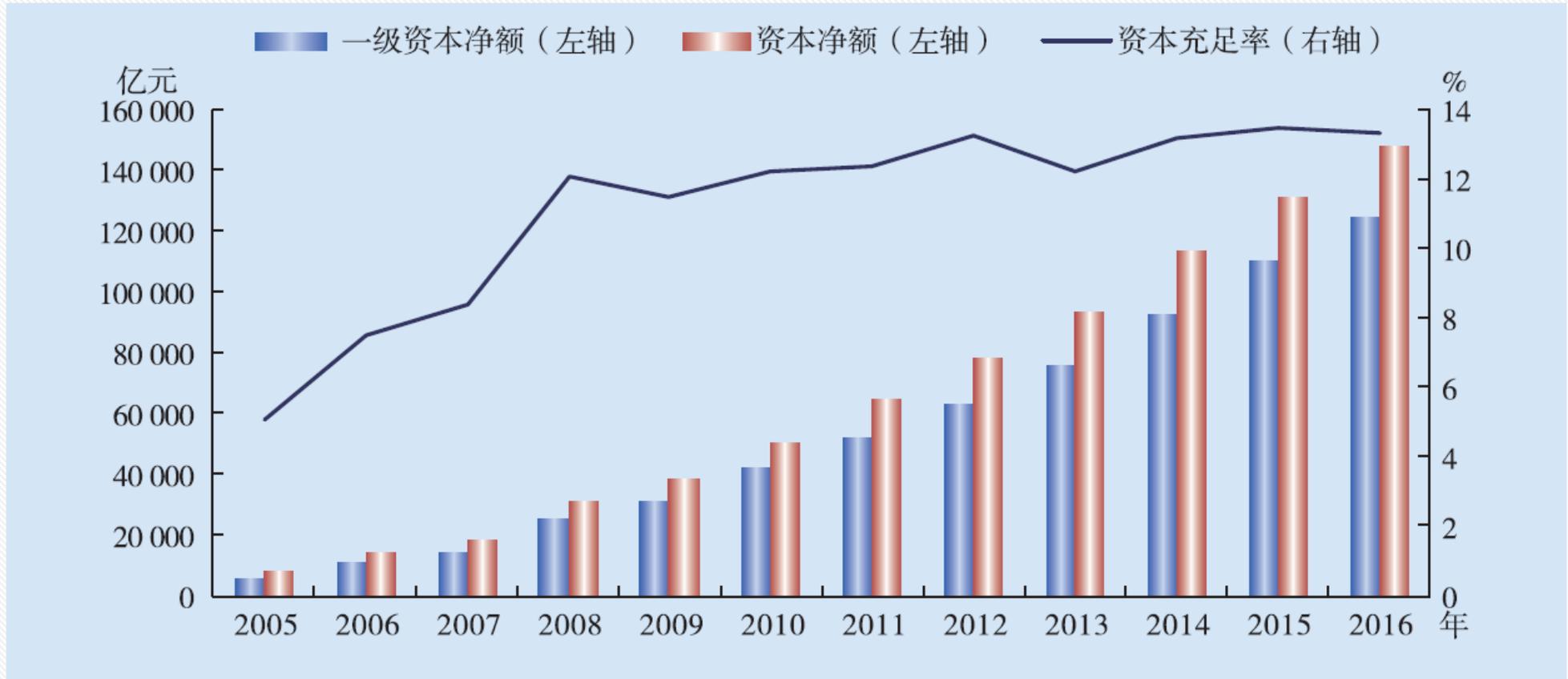
## Deleveraging (降杠杆)

- Leverage ratio in the enterprise and household sector has increased enormously.
- Perhaps more dangerously, we have no data on local government leverage.
- On October 10, 2016, the central gov. issued a guideline to push forward the deleveraging of industrial firms.



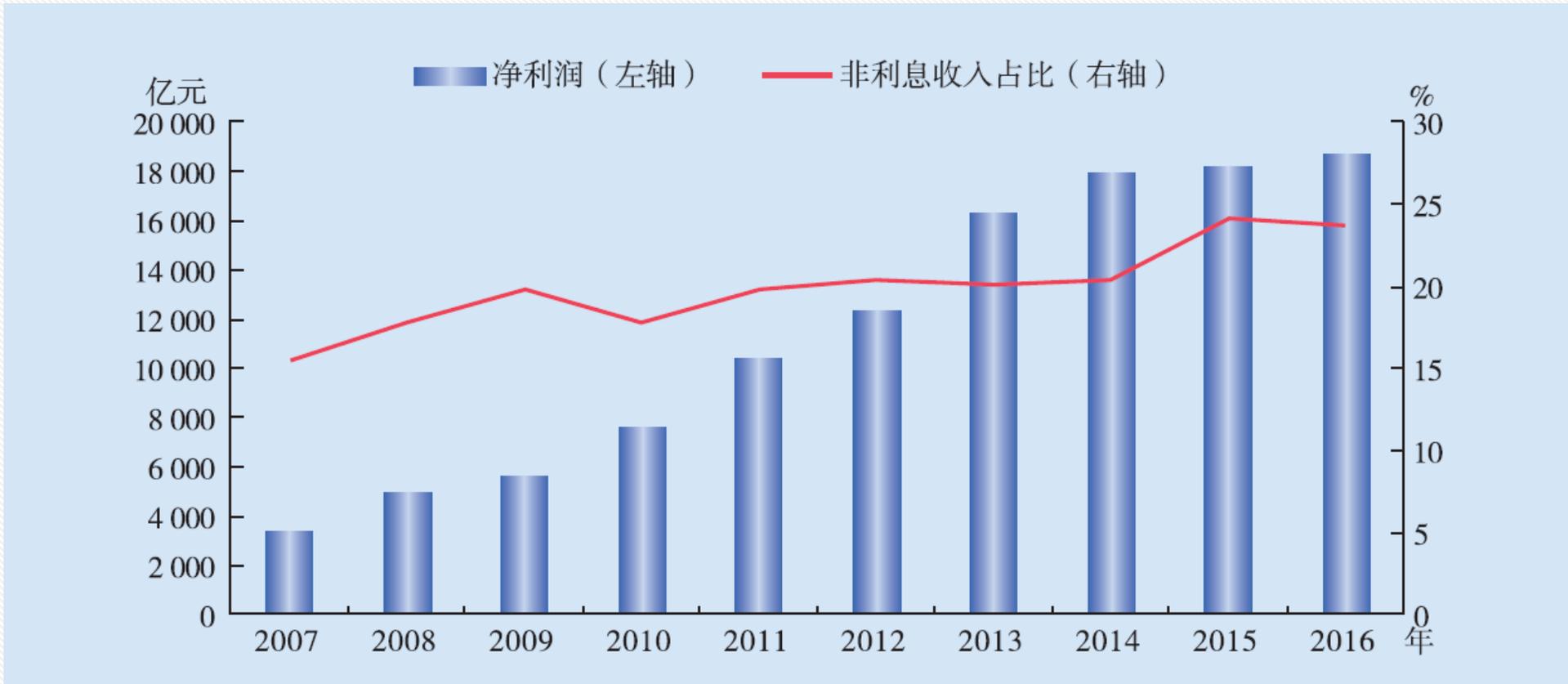
- A key component of it is the **debt-for-equity swap** which help firms reduce their mounting debt but leave banks more strapped for capital.
- The Report has emphasized the dominant role of *market* in the debt-for-equity swap transaction.

# Capital adequacy ratio declines moderately



- Capital adequacy ratio = 13.28% (down 0.17%)
- Core tier-one capital adequacy ratio = 10.75%
- Core tier-one capital / total capital = 80.97%, indicating high capital quality.

## Profit growth continues slowing down



- Net profit = 2.07 trillion (up 3.65%); ROA = 0.96%, ROE = 12.61%
- Lending-deposit interest gap = 2.09% (-0.38%) possibly due to interest rate liberalization
- Non-interest income / Total income = 26.61%

## Further assessment of the banking sector

- **Credit risks:** Credit risks concentrate in low-end manufacturing firms and industries with capacity surplus. Leverage increases for non-financial firms. Some firms borrow new loans to pay back maturing ones and even use new debt financing to pay interest. Zombie firms are still receiving new credit.
- **Operational and compliance risks:** Weakness in internal control and corporate governance. Fraud spreads from traditional business to inter-bank and off-balance sheet business, e.g. Guangfa Bank fake guarantee agreement, Banker's Acceptance Bill Fraud.
- **Real estate market bubble risks:** New credit instruments such as loans backed by real estate assets and loans for down payment have reinforced the increase of housing prices. Real estate loan balance posted 5.7 trillion, taking up a proportion of 44.8% of new loans in 2016. Non-performing real estate loan ratio is 0.77%.

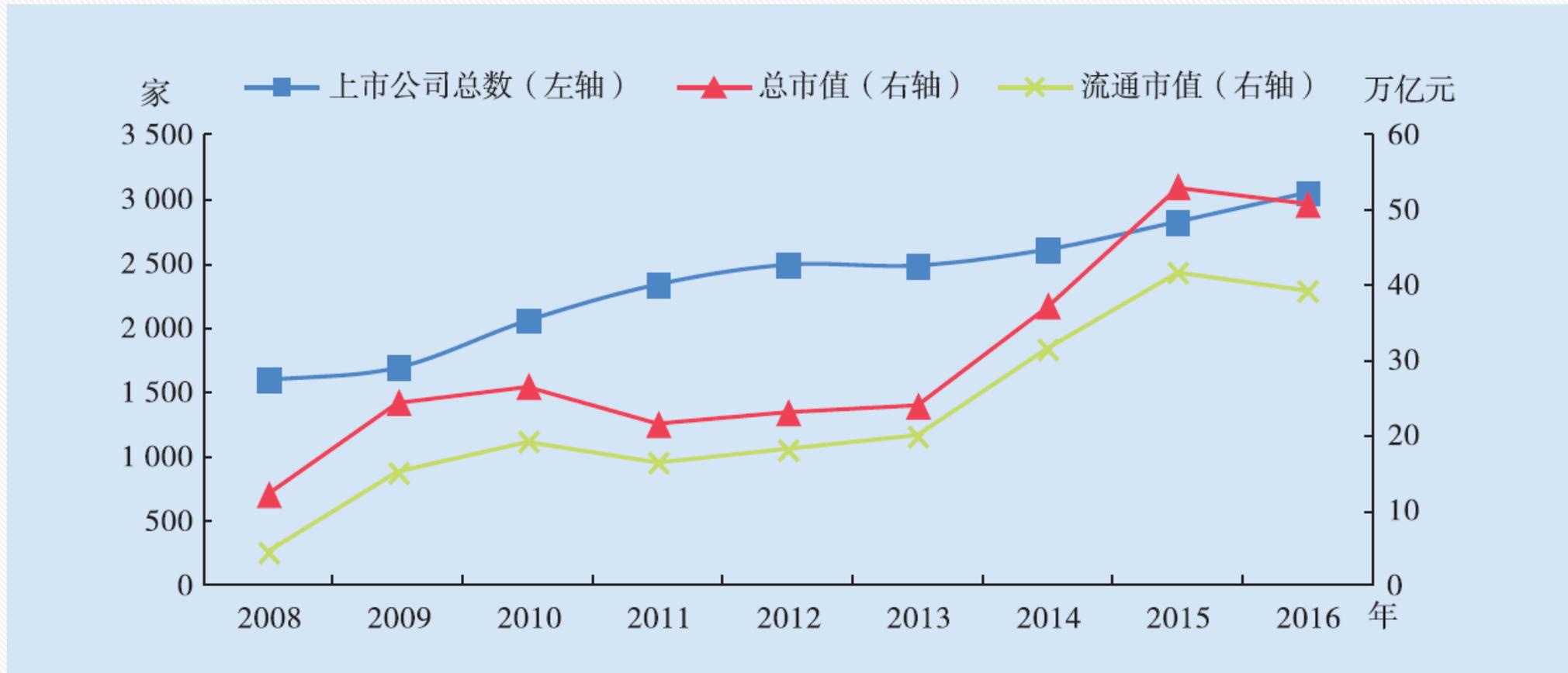
## **Further assessment of the banking sector, contd.**

- **Risks in Off-balance-sheet business:** Off-balance-sheet business reached 253.52 trillion Yuan. Off-balance sheet asset value is as large as the value of assets on banks' balance sheet. Guarantee = 19.03 trillion, Commitments = 16.08 trillion, Financial asset service = 164.63 trillion.

- **Risks in internet finance and illegal fund-raising:** Illegal fund-raising in P2P lending, farmers' cooperative, real estate, PE, etc. Ponzi games such as 消费返利. Illegal exchange. Bitcoin speculation.

### **III. Securities and Futures Sector**

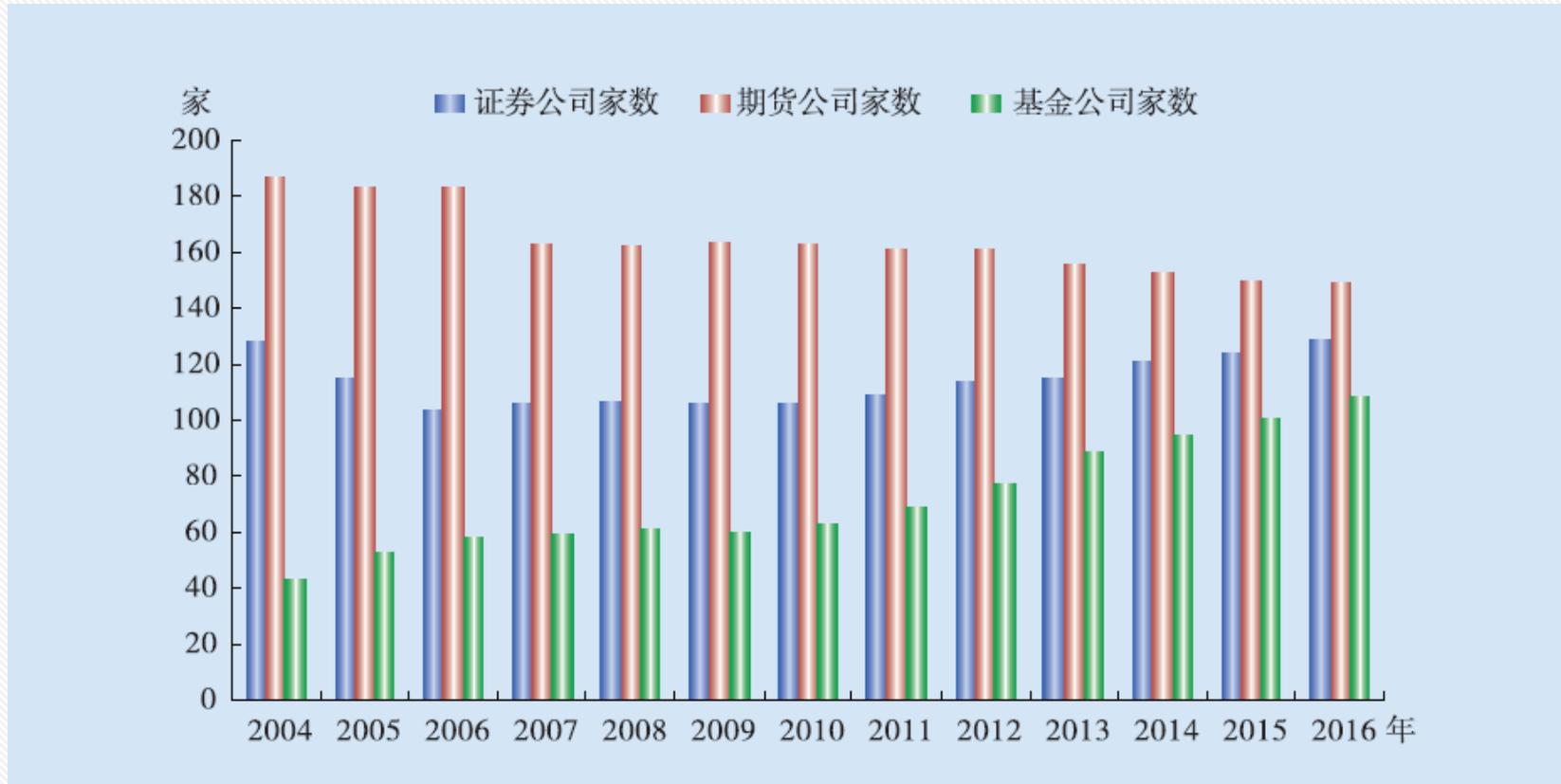
# Brokerage firms



- 225 newly listed firms; Total market cap decreased by 50.77 trillion (due to the stock market crash in mid2015)

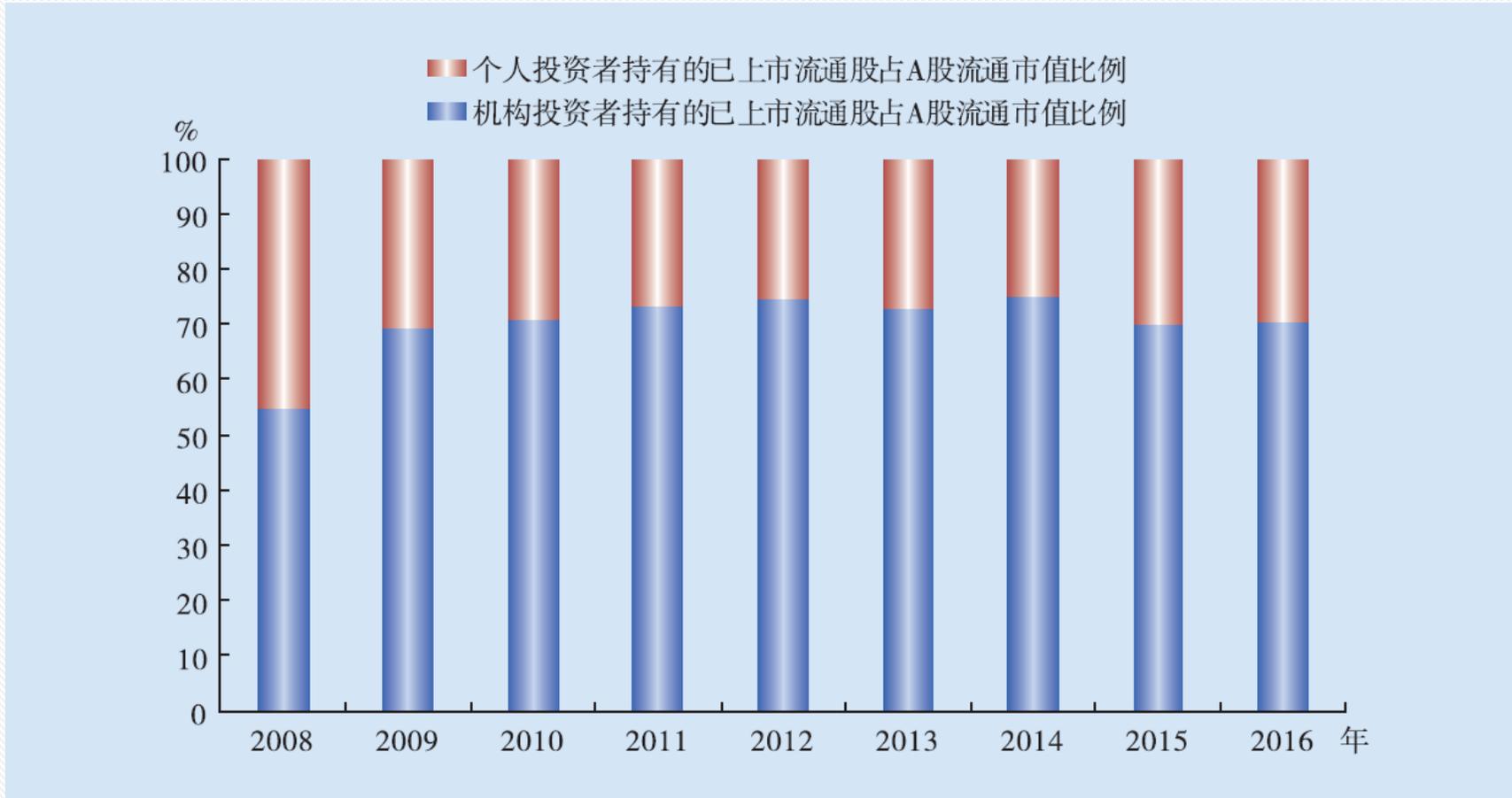
- # Firms listed in 新三板 = 10163; # newly listed = 5034; Fund raised = 139 billion.

## Size of the securities and futures sector



- Brokerage firms total assets = 4.37 trillion (-0.68%), Futures firms = 0.11 trillion (+17.68%)
- # PE firms = 17433, # PE funds = 46505, Amount committed = 10.24 trillion (+100.78%)
- Financial innovation: e.g., FOF

# Institutional v.s. individual holdings



- Institutional holdings / Total liquid share value = 70.64%

- Seems to be much higher than my prior !

# Regulations

## Several new guidelines

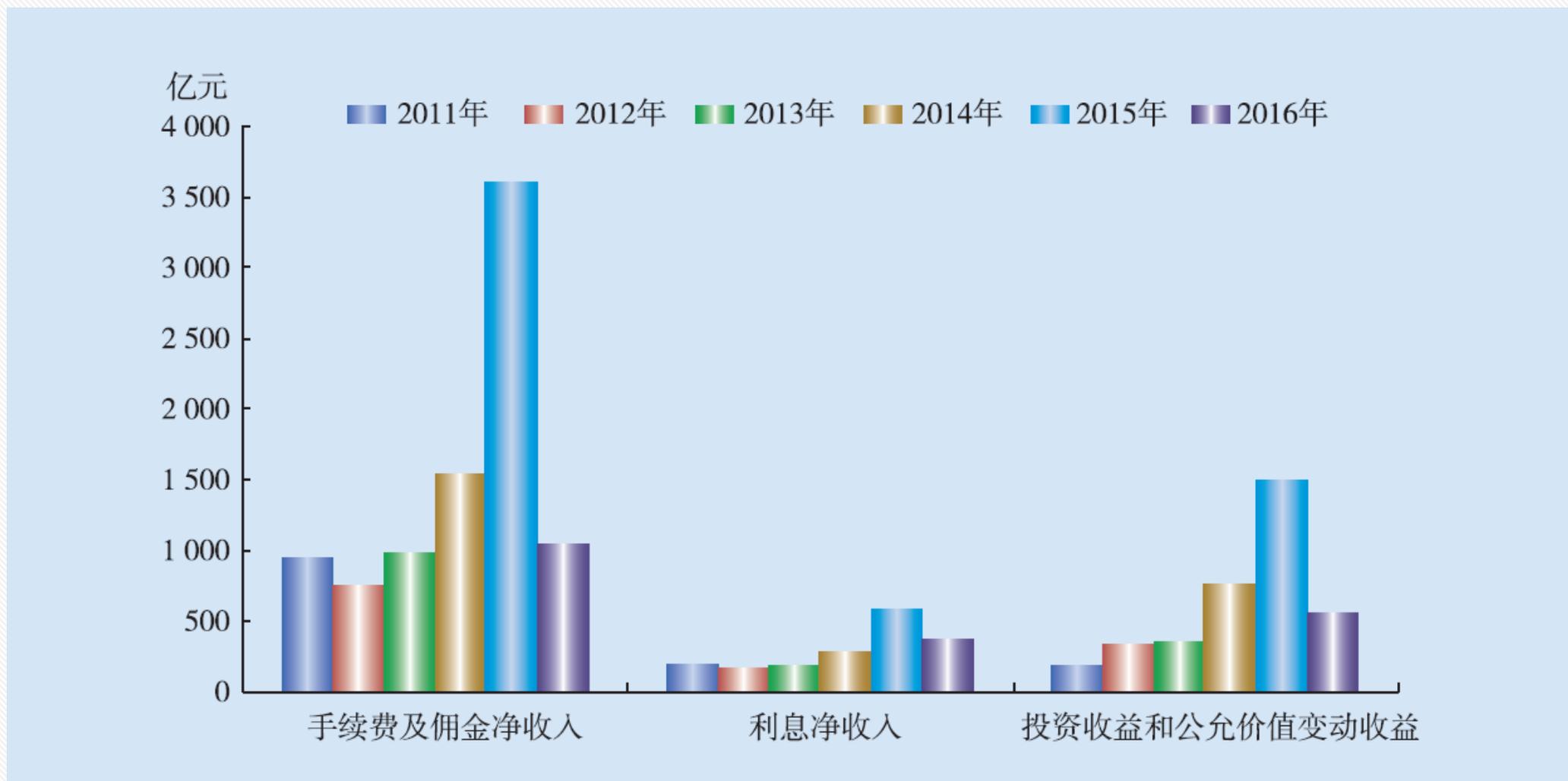
- Listed Firm Stock Incentive Guidelines
- Listed Firm Major Asset Restructuring Guidelines
- **Brokerage Firm Risk Management Indicator Guidelines**: It is a result of reflecting abnormal fluctuations of the stock market by the CSRC. Borrowing from Basel III, it has made changes on several aspects: (i) improve the calculation of net capital and risk-based capital; (ii) leverage ratio has been refined.  $\text{new leverage ratio} = \text{core net capital} / \text{on- and off-balance-sheet assets}$ ; (iii) add liquidity coverage ratio and net stable funds ratio into the regulation; (iv) refine indicators for specific segments; (v) counter-cyclical regulation; (vi) include subsidiaries into the overall risk management framework.

## Enforcement

- 302 cases (+23%) in year 2016, related to illegal disclosure, insider trading and market manipulation

## Soundness assessment

- **Profitability of listed firms:** Among 3212 listed firms, 241 of them report a loss.
- **Brokerage firms:** Brokerage firms have pretty robust capital ratio. However, due to the decline in stock market transactions and the de-leveraging in asset management area, there is a massive decline in profits. Aggregate operating income in 2016 = 327.994 billion, a *42.97% decline* compared to 2015.
  - Brokerage business: 105.295 billion (down 60.87%)
  - Underwriting: 51.999 billion (up 24.32%)
  - Financial advisory business: 16.416 billion (up 19.02%)
  - Investment consulting: 5.054 billion (up 12.86%)
  - Asset management: 29.646 billion (up 7.85%)
  - Security investment return: 56.847 billion (down 59.78%)
  - Interest net income: 38.179 billion (down 35.43%)



**The decomposition of brokerage firms' net income**

## Assessment, contd.

- **Funds:** Mutual funds net value posted 9.16 trillion, a 9.7% y-o-y increase.

Among all mutual funds, 7.71% are equity funds, 21.93% are hybrid funds (a 5.43% decrease), 15.55% are bond funds (a 7.12% increase) and 46.77% are money market funds.

- **Money market funds:** There has been a rapid increase of the total size of MMFs.

However, MMFs are under substantial liquidity pressure as a consequence of credit risk events in the bond market in 2016.

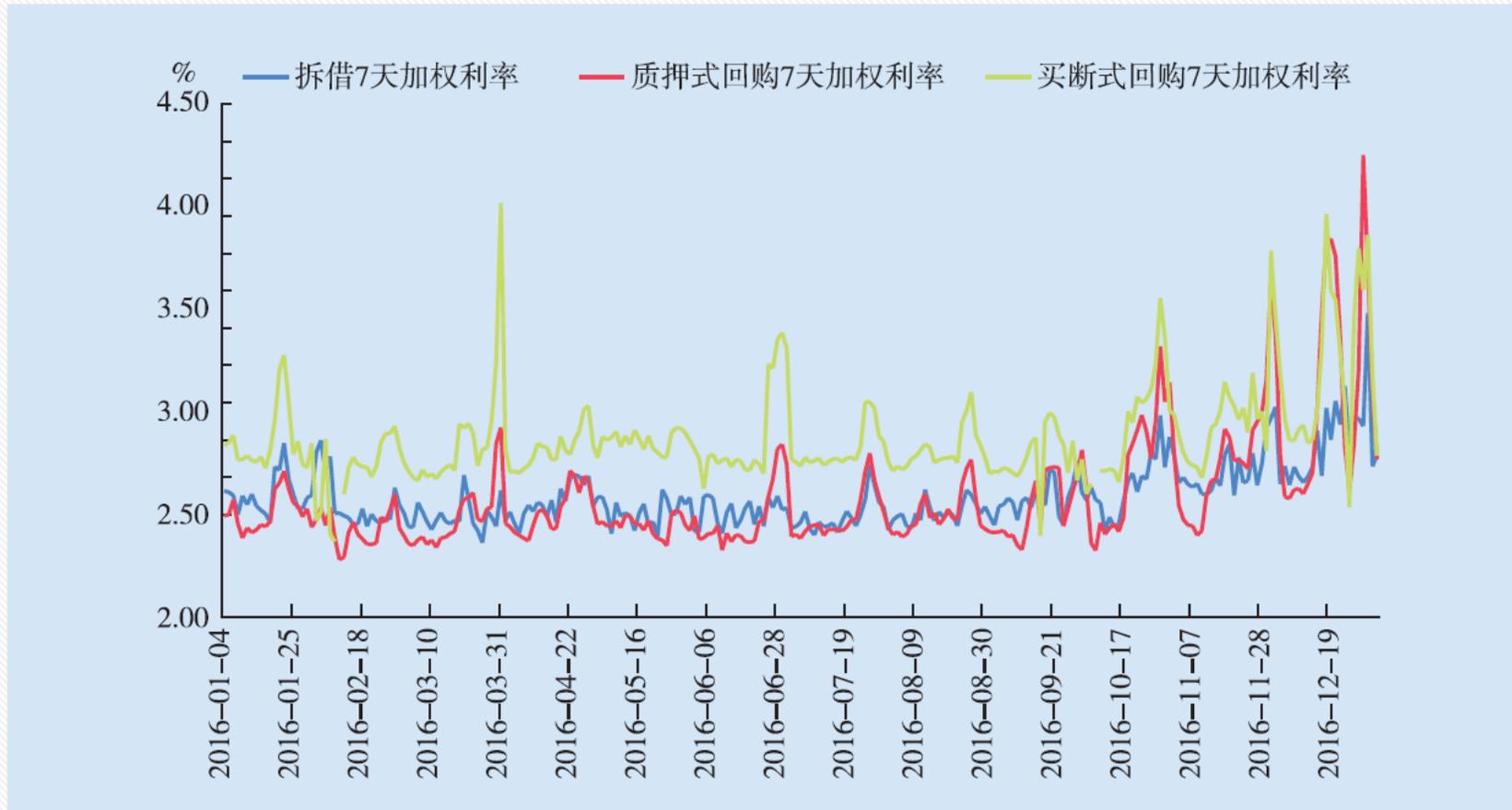


MMF net assets amount and fraction (2010-2016)

Milestone: Yu'e Bao went online in 2013

## **IV. The Financial Market**

# The money market



- Money market transaction volume reached historical high.
- Higher volatility of the money market interest rate. Money market interest rates shoot up starting from October, 61 bps higher than the 4th quarter of 2015.

## The bond market

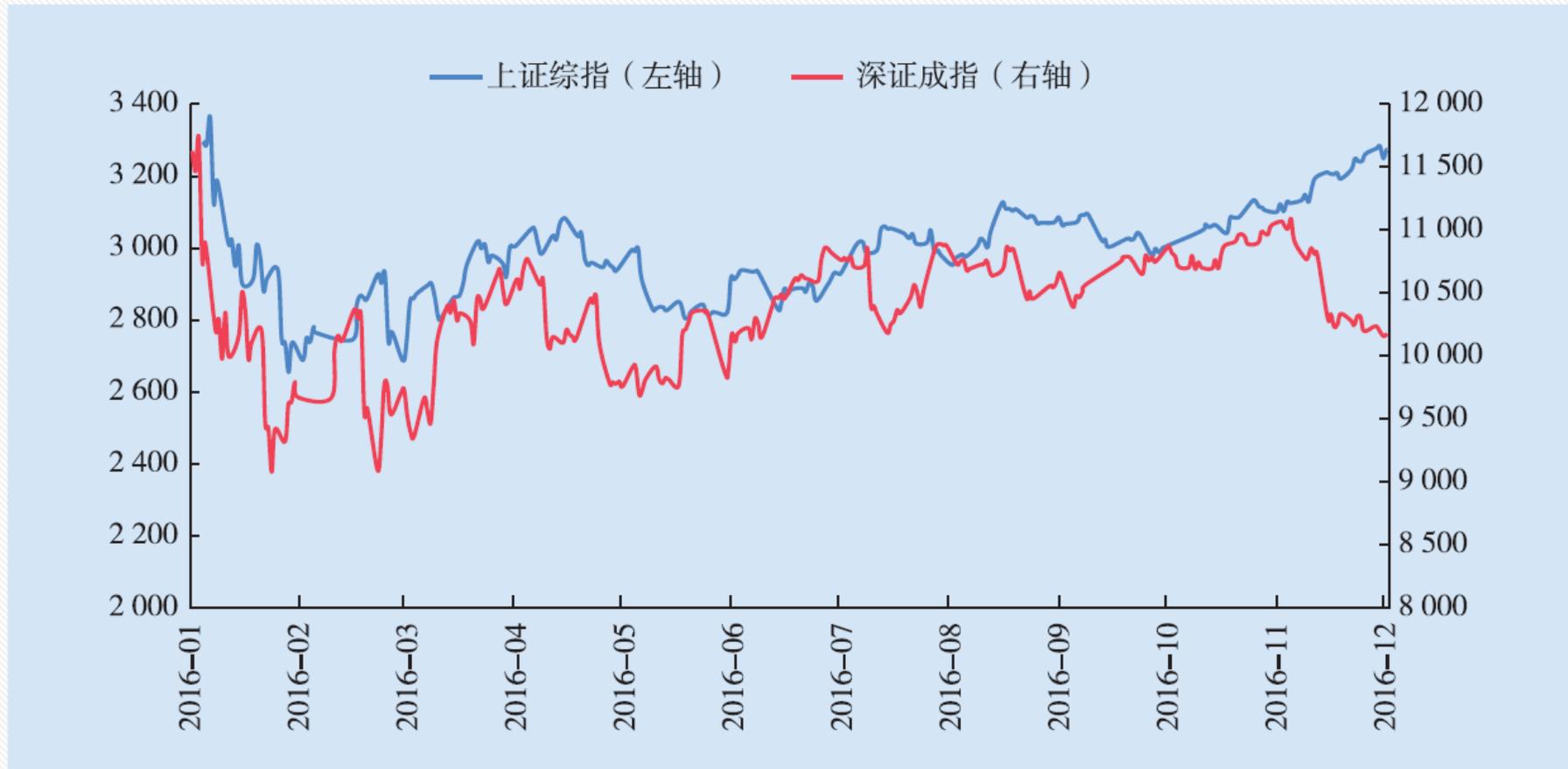
- **Transaction volume increases massively, bond index shows a moderate increase.**

Daily average inter-bank bond transaction dollar volume = 506 million Yuan, a 45.4% y-o-y increase. Inter-bank bond index increases by 1.9%.

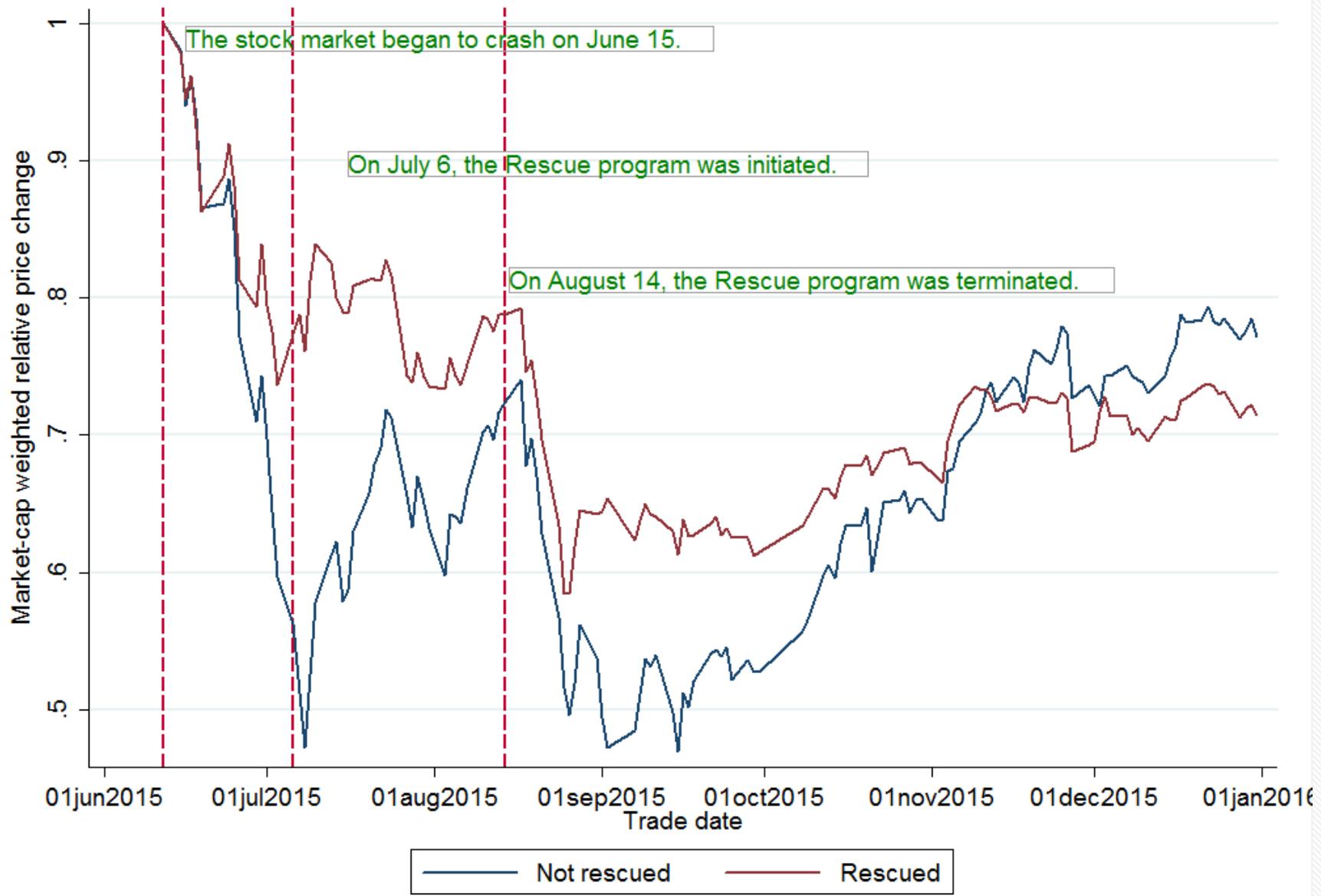
- **Bond market experiences a strong start but a weak ending.** At the end of 2016, the yield of 1Y, 3Y, 5Y, 7Y and 10Y treasuries increases by 35, 24, 15, 16 and 19 bps. Treasury futures hit the lower bound several times as a consequence.

- **A more diversified investor base and higher participation by foreign institutions.** The inter-bank bond market accommodates 14127 qualified investors, a number that is 4491 larger than that in year 2015.

# The stock market



- The stock market became more stable after a period of large fluctuations in early 2016.
- The A-share market triggered **melt-down** twice in the week right after the introduction of the melt-down system. SSE Composite Index and Shenzhen Component Index declined by 16.95% and 26.54%, respectively.

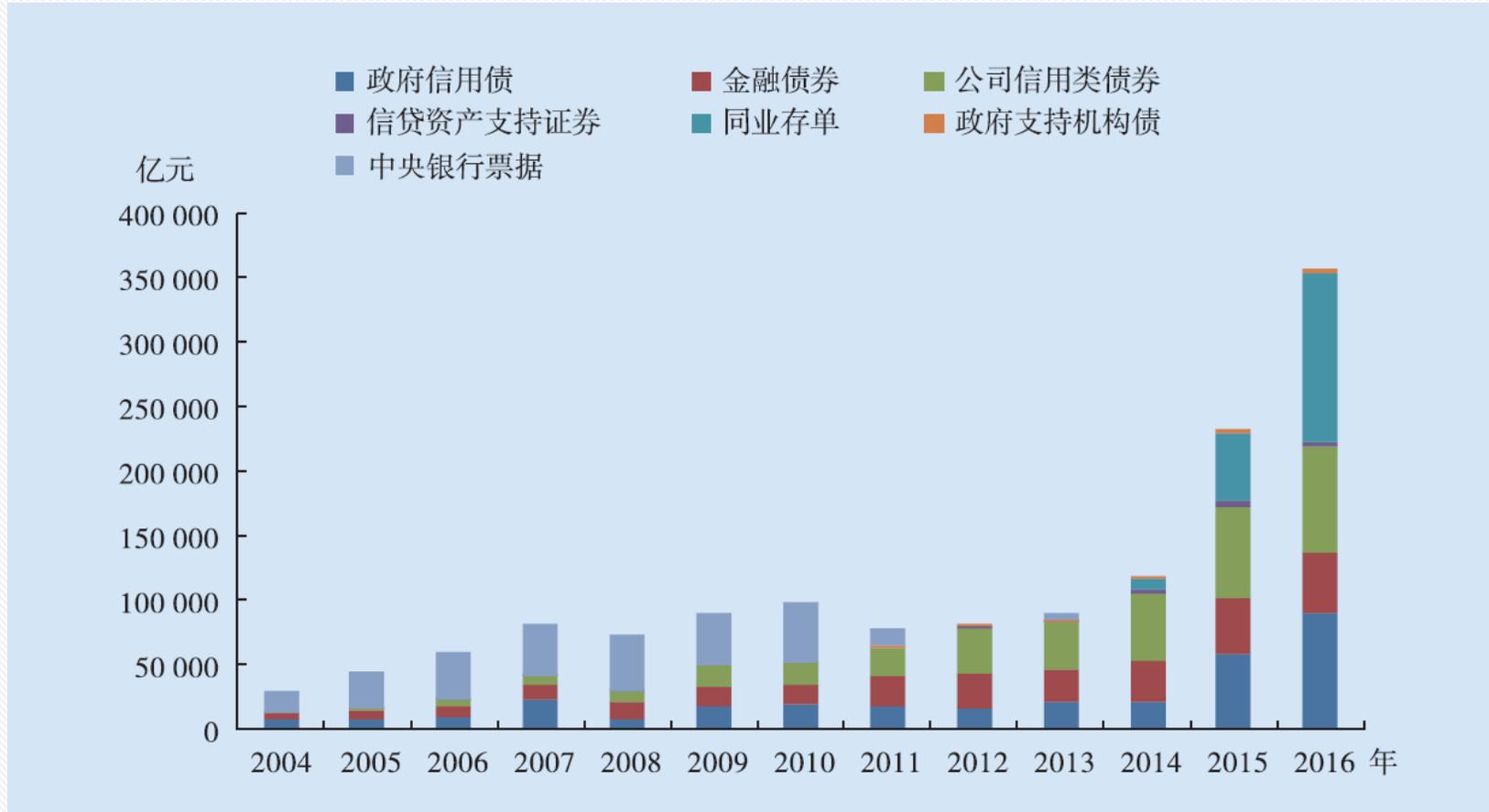


The Chinese Stock Market Crash in Mid-2015

## Other markets

- Stock index futures transaction volume experienced a massive decline, due to regulations.
- Commodity futures price increased substantially, possibly a consequence of price rebound, higher demand and the supply-side reform.
- SSE 50 ETF: price correlation = 96.91%, space of arbitrage is limited, transactions by institutional investors / all transactions = 56.71%

# Debt market financing



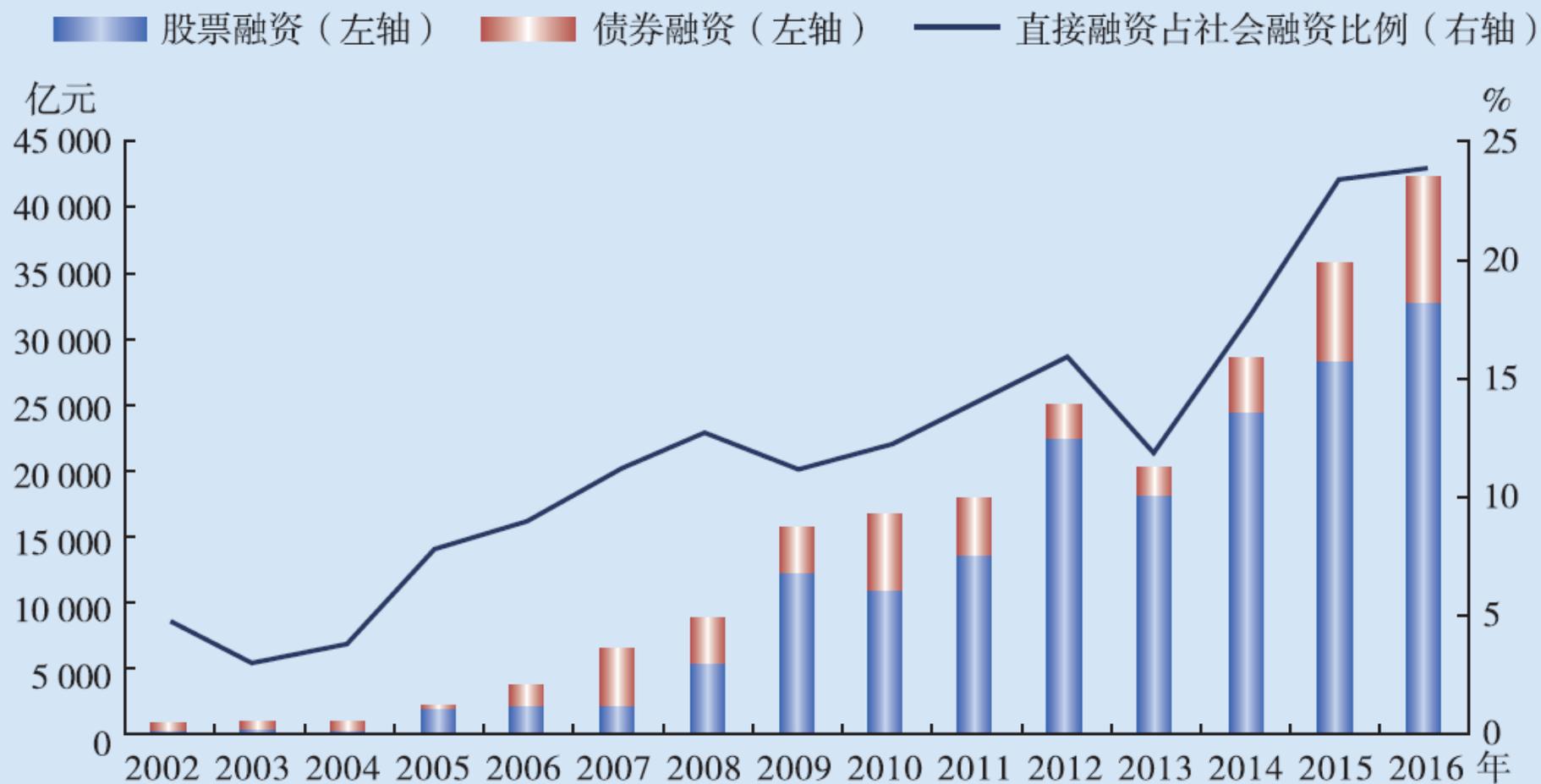
- Local government bond issuance amount increased by 58% and inter-bank notes by 140%.
- Corporate bond issuance amount increased by 203% and enterprise bond by 45.6%.

表6-1

2016年主要债券品种发行情况

债券品种	发行额（亿元）	同比增长（%）
中央政府债券	30 545	45.6
地方政府债券	60 458	58
中央银行票据	0	—
金融债券	182 152	78.4
其中：国开行及政策性银行债	33 571	28.9
同业存单	129 731	144.7
公司信用类债券	82 242	22.4
其中：非金融企业债务融资工具	51 358	-5.5
企业债券	7 326	45.6
公司债券	23 372	203.2
国际机构债券	412	258.3
合计	355 892	55.5

## Direct financing of non-financial firms



## Sources of debt financing for non-financial firms

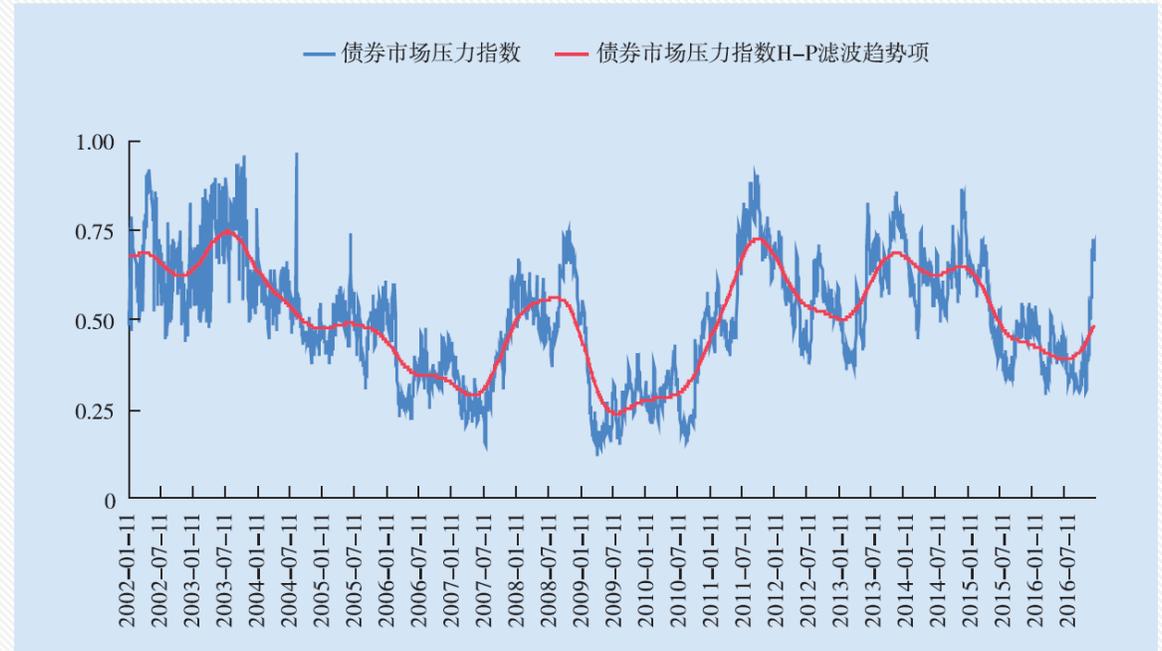
图表4： 银行信贷是占比最大的部分，超过总融资规模的 70%，其次是企业债券，加起来超过非金融企业部门债务余额的 85%



资料来源：联讯证券，Wind

# Assessment

- Bond yield increased significantly at the end of 2016.
- The market pressure index, which is a composite of interest rate risks, institutional investor pessimistic expectations and credit risks, shoot up in the second half of 2016.



The difference in yield between 1-year (5-year) MTN and 1-year (5-year) treasury is 121.4 bps (146.5 bps), which is lower than that in 2015.

However, credit risks in the bond market might be under-estimated because of investors' expectation of *almost-certain bailout* whenever there are defaults.

## Default in the bond market

- Since 2016, there are 28 issuers that have defaulted on 65 of their publicly issued debt instruments with the total face value exceeding 40 billion Yuan.
- The new phenomenon has many implications on the financial landscape in China.

发债主体	债券简称	发行规模 (亿元)	兑付或 付息日	期限	票面 利率	主承销商	备注
广西有色金属集团	13桂有色 PPN002	5	4/23	3年	5.56%	光大银行、 国开行	本息违约，兑付日银 假期顺延至4/25
保定天威集团	11天威 MTN2	15	4/21	5年	5.70%	建设银行	本息违约
东北特殊钢集团	13东特钢 MTN002	8	4/12	5年	5.63%	农业银行	4504万元应付利息 违约
中煤集团山西华昱能源	15华昱 CP001	6	4/6	1年	6.30%	浦发银行	本息违约，4/13足 额偿付本息
东北特殊钢集团	15东特钢 SCP001	10	4/5	90天	6.00%	渤海银行	本息违约，兑付日因 假期顺延至4/5
东北特殊钢集团	15东特钢 CP001	8	3/28	1年	6.50%	国开行	本息违约

## **V. Insurance Firms**

# The expansion of the insurance industry



- Total assets = 15.12 trillion (+22.3%); Total insurance premium = 3.1 trillion (27.5%)
- 9 more insurance companies

# Insurance firms



- Risk-taking asset allocation: 18.55% allocation to bank deposit (-3.23%) and bonds (-2.24%) and 36.02% allocation to alternative investment (+7.37%).
- Average return = 5.66%, lower than last year, still in line with the 10-year average.

## Warnings on insurance money allocation

- Tilt toward equity investment: During year 2016, insurance companies have become the major shareholder in more than 120 A-share listed firms.
- Maturity mis-match: Many of them focus on short-horizon investment, holding shares for less than one quarter.
- Regulation arbitrage: Use complex products to mask underlying risks
- Illegal conduct: illegal transactions with affiliates, tunnelling and fake new equity financing.
- Source of financing is highly suspicious. A new type of insurance contract called universal life insurance (万能险) has become the major source of income for many insurance companies, especially mid- and small-sized ones.
- Anecdotes: **Baoneng v.s. Vanke, Anbang Insurance Group**
- Regulation: “保险业姓保 (*Insurance firms should do what they are supposed to do*).”

## **VI. Miscellaneous Topics**

# Asset management

Asset Managers	Amount under management (trillion Yuan)
Bank in-balance-sheet	5.9
Bank off-balance-sheet	23.1
Trust companies	17.5
Mutual funds	9.2
PE	10.2
Brokerage firm asset management	17.6
Fund companies	16.9

## Risks

- liquidity risks in fund pools
- Multi-layer products --> contagion
- Lack of regulation on shadow banking
- Almost certain bailout

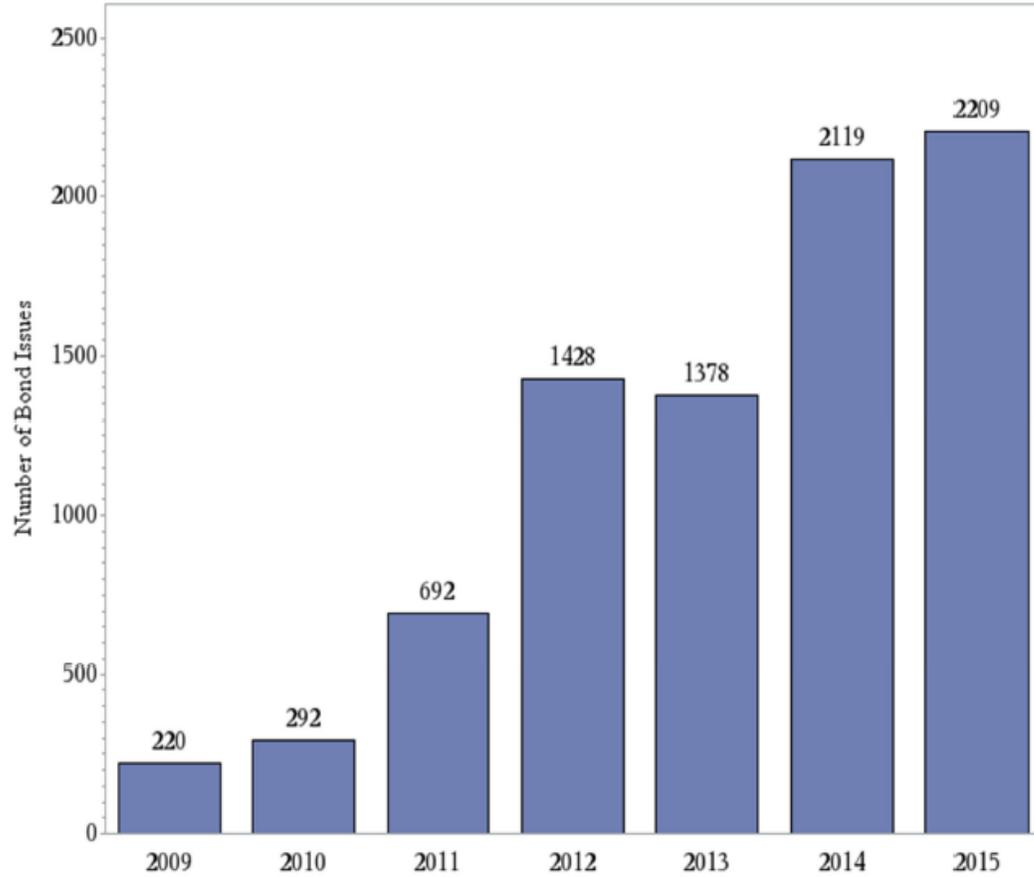
**Thanks for listening !**



**中国人民银行**

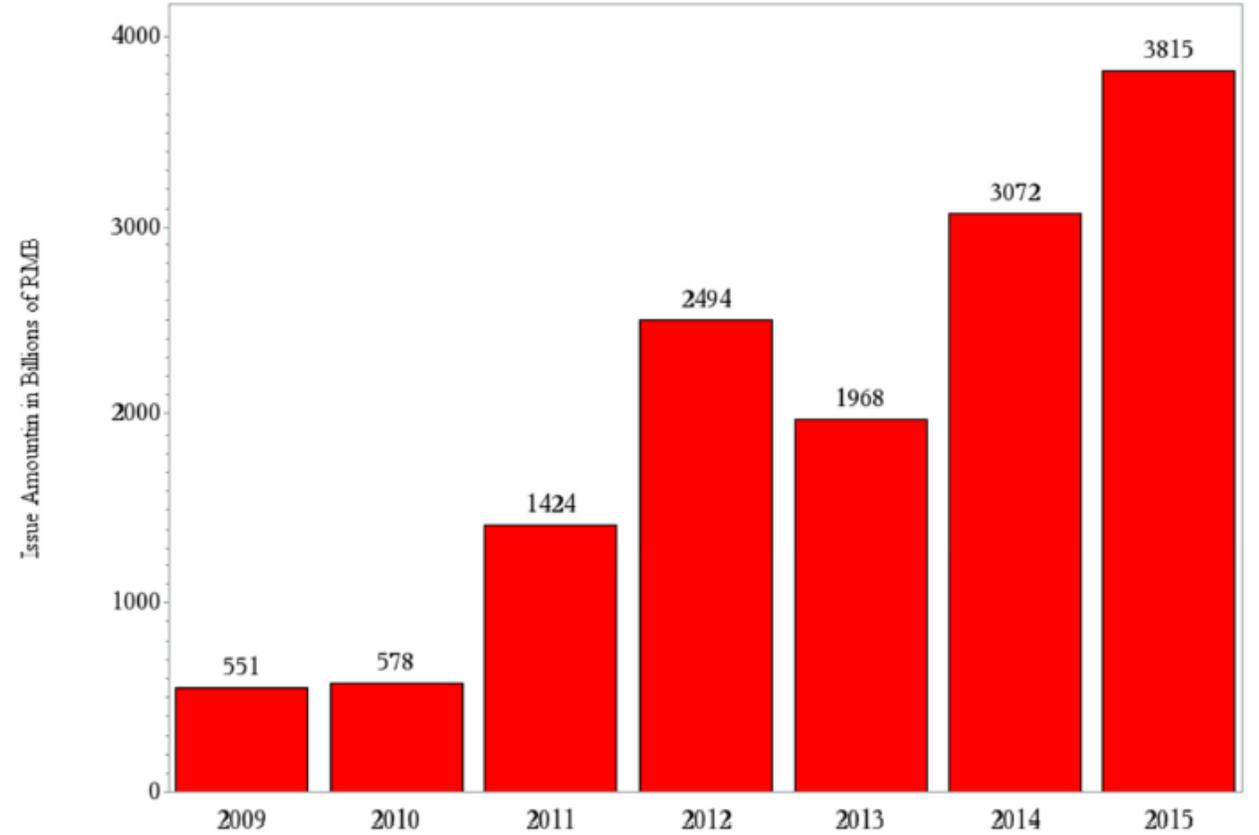
# The issuance of non-governmental bonds

Number of Issues By Year



**Figure 3.** Numbers of Non-governmental Public Bond Issues in China from 2009-2015. Source: WIND

Aggregate Amount of Issues by Year



**Figure 4.** Total Amount of Non-governmental Public Bond Issues in China from 2009-2015 (in Billions of RMB). Source: WIND

# Credit rating agencies

Name	Chinese Full Name	Global Partner	Website	Head-quarter	Regulatory Approval**				
					PBoC	CIRC	CSRC	NDRC	NAFMII
Brilliance	上海新世纪资信评估投资服务有限公司	S&P*	<a href="http://shxsj.com">shxsj.com</a>	Shanghai	Yes	Yes	Yes	Yes	Yes
Chengxin_Moody	中诚信国际信用评级有限责任公司	Moody's*	<a href="http://ccxi.com.cn">ccxi.com.cn</a>	Beijing	Yes	Yes	No	Yes	Yes
Lianhe_Fitch	联合资信评估有限公司	Fitch*	<a href="http://lhratings.com">lhratings.com</a>	Beijing	No	Yes	No	Yes	Yes
Dagong	大公国际资信评估有限公司	None	<a href="http://dagongcredit.com">dagongcredit.com</a>	Beijing	Yes	Yes	Yes	Yes	Yes
Chengxin	中诚信证券评估有限公司	None	<a href="http://ccxr.com.cn">ccxr.com.cn</a>	Shanghai	No	Yes	Yes	No	No
Jincheng	东方金诚国际信用评估有限公司	None	<a href="http://dfratings.com">dfratings.com</a>	Beijing	No	Yes	Yes	Yes	Yes
Lianhe	联合信用评级有限公司	None	<a href="http://lianhecreditrating.com.cn">lianhecreditrating.com.cn</a>	Beijing	Yes	Yes	Yes	Yes	No
Pengyuan	鹏元资信评估有限公司	None	<a href="http://pyrating.cn">pyrating.cn</a>	Shenzhen	Yes	No	Yes	Yes	No

# Bond issuers

