Debt

The Next Crisis for China Lurks in the Shadows

- Some $5.86 trillion in unsupervised lending hangs over the economy
- "The central government will have to take responsibility for local debt"

China's growing reliance on shadow banking is contributing to its debt problem. Since 2010 the value of the unregulated loans, investments, and other financial products of this sector has almost doubled, to as much as 36 trillion yuan ($5.86 trillion). That's equal to 69 percent of gross domestic product, says Haibin Zhu, chief China economist at **JPMorgan Chase** in Hong Kong. "Shadow banking poses systemic risks," warned Moody's in a May 13 report.

The question is how much of this capital carries an implicit guarantee that the national government must cover. "It is our belief that at some point the central government will have to take responsibility for local debt," says Derek Ovington, head of regional banks in Asia at CLSA Asia-Pacific Markets. The official debt burden of central and local government, which does not take the localities' shadow banking activities into account, is just below 30 percent

of GDP, Moody's says. In contrast, Ovington estimates that shadow banking liabilities and consumer, corporate, and government debt are now more than 200 percent of GDP. "The longer the government takes to address this, the bigger the problem becomes."

In the shadow sector all manner of players, from securities firms to pawnshops, cater to the borrowing and investment needs of those who want to bypass loan quotas, interest rate caps, and other restrictions. Both banks and nonbank institutions have created wealth-management products such as trusts, in which affluent Chinese invest. A trust may lend the money at well above the official rate to companies struggling to stay afloat.

Developers and local governments have tapped shadow finance to work around restrictions on property development, bank lending, and infrastructure projects. The money can flow to questionable investments that may not quickly provide returns, says JPMorgan's Zhu. Local governments are sitting on 12.8 trillion yuan in debt, according to Fitch Ratings. Add in loans from the shadow banks and the total could be closer to 18 trillion yuan, Fitch says.

Although trust assets, a major part of shadow banking, grew 65 percent in the first quarter, the economy isn't expanding any faster. Companies and local governments are simply using the new credit to service earlier loans. "This is not going into the real economy," says Chen Xingdong, chief China economist at **BNP Paribas** in Beijing.

Chen points out that local governments have land and companies they could liquidate to pay liabilities. Beijing could inject cash into banks, if necessary. The central government has ordered banks to limit the size of their wealth-management products and monitor loans to local governments more closely. Despite the risks, the shadow banks perform a service by channeling capital to cash-strapped private enterprises and local governments. That's why a broader clampdown on shadow finance seems unlikely: Beijing wants to tame shadow banking, not kill it. Only major reform can change this precarious situation. —*Dexter Roberts*

The bottom line *China's official figure for government debt is only 30 percent of GDP, but local governments are borrowing heavily from shadow bankers.*

Fonte: Bloomberg Businessweek, New York, p. 13-14, 20 a 25 May 2013.