DANIEL'S TOUR OF CHINA

September 2018

HAWKSMOOR
FUND MANAGERS

4. SHADOW BANKING

The term 'Shadow Banking' suggests a black market of banking conducted by unscrupulous people when in fact it is more akin to our Alternative Finance sector which was born out of the withdrawal of bank finance following the Great Financial Crisis.

A lack of alternatives

Shadow banking in China is broadly the same, as individuals or businesses sought better terms on loans, some form of finance given their poor credit rating, or higher returns on investments than the big banks were offering. At the time the only options available to most retail investors was cash on deposit or speculating on the property market with nothing in between (there is no desire to invest in the stock market given its volatility and ultimately flat performance for 10 years and no access to the bond market).

Therefore the non-bank finance sector simply grew to meet the demand for alternative options, probably seen on offer in other parts of the world. But while it remained unregulated it expanded too rapidly, investors got too greedy, loans were given to bad credits and providers made false promises.

"The general rule in China seems to be that if the government says don't do something then you don't do it, but if there is nothing to say you can't do it, then go for it until you are forced to stop."

Government clamp down

That is what happened three years ago when evidence of fraud, bribery and widespread defaults prompted a government clamp down and the introduction of regulation on a variety of products (such as peer-to-peer lending) that had boomed in the preceding period.

Four state owned Asset Management Companies (AMCs) were created to be the 'bad banks' and house these non-performing loans (NPLs), freeing up the regulated banks to focus on providing loans and mortgages for better quality companies and individuals – much stricter criteria for loans is now in force. Meanwhile, these bad loans have been maturing with much higher recovery rates than expected.

New initiatives

This improved profitability is enabling the AMCs to expand into other areas such as insurance and wealth management products in order to meet the needs of a

AGENDA

24th September - Hong Kong

- Head of Moody's China
- Moody's Asia Property
- Kaisa Group Holdings (Property Developer)
- BNP Paribas top ranked China strategist
- Agile Group (Property Developer)
- Gleneagles Hospital (Private Hospital)
- Head of Moody's South East Asia
- Deutsche Chief Economist
- Deutsche Asia Chief Economist

25th September - Shenzen

- Shenzhen Investment Holdings (State Owned Property Developer)
- Shenzen Investment Holdings' new science park
- Huawei headquarters and innovation centre (technology company)
- SF Holdings distribution centre (logistics company)

26th September - Shanghai

- Fosun International (conglomerate)
- Greenland Holding Group (State Owned Property company)
- Shui On Properties (Property Developer)
- Xintiandi – new mixed use retail/ dining centre developed by Shui On
- Yingde Gas (industrial gas producer, owned by private equity)

27th September - Beijing

- Metallurgical Group (State Owned Steel producer)
- Aluminium Corporation of China (State Owned Aluminium producer)
- Orient Advisers (State Owned Asset Management Co.)

28th September - Beijing

- Bank of China (State Owned Bank)
- Lenovo campus and technology centre

population that has a culture of saving. For example, this year is likely to see the first Exchange Traded Fund of local and central government bonds that can be marketed to retail investors.

While this can help fill some of the gaps left by the closure of the shadow banking sector, there remains a lack of credible investment opportunities for individuals since

- the local stock market is deemed too risky
- individuals can't invest much, if anything, overseas due to capital controls
- the property market is only available to the very rich, and likely to slow anyway
- the deposit rate for cash is not attractive enough.

Eventually, the local stock and bond market will be the natural home for savers, but in the short term the equity market seems heavily reliant on **foreigners who are more influenced by macro considerations than company fundamentals.**

"Therefore, given the negative headlines on slowing growth still to come, I'm not expecting a resurgent stock market in the short-term even after the 20% fall we've seen so far this year."