

THOSE CHINESE BANKS MAY BE GOOD INVESTMENTS, AFTER ALL

Loans to property developers and individual purchasers of homes in the People's Republic of China (PRC) could well come back to haunt the PRC Government – somewhere down that yellow-brick road.

While a number of PRC banks has raised tens of billions of dollars in **I**nitial **P**ublic **O**fferings (IPOs) in the Hongkong Special Administrative Region (HKSAR) of the PRC and on select equity markets of the PRC, proper, the exposure of those banks with regard to property loans has yet to be published.

And such statistics may never be published because the PRC Government makes its own decisions, without the need of accountability, as what statistics should, and should not, be divulged, publicly.

According to **TARGET**'s usually reliable sources, commercial real-estate loans, afforded by PRC banks, amounted to about 2.68 trillion renminbi, as at September 30, 2005.

As for individual house mortgages, they stood at about 1.80 trillion renminbi.

The aggregate exposure to real-estate loans, therefore, had to be in excess of 4.48 trillion renminbi, as at the end of the 2005-year.

That amount of money would have been approximately 23.50 percent of the total loans of all of the PRC's banks for 2005.

Since the end of 2005, of course, that figure of 4.48 trillion renminbi has grown – it must have grown – but by how much, one cannot be sure until the PRC Government determines to release the statistics, as it sees fit, if at all.

Obviously, Beijing must be concerned about the heavy weighting of loans, afforded by PRC banks where property is the primary source of collateral.

And this must have been the thinking behind Beijing's tightening up of the rules, relating to mortgage lending practices and real-estate lending.

At the same time, however, Beijing is desirous of promoting the construction of low-priced housing in the country and wants to foster home-ownership where at all possible.

Meanwhile, the major cities of the PRC are gearing up for more and more foreign enterprises to establish bases in the country and, to that end, the PRC's banking industry is required to assist.

The commercial property capacities of a number of major PRC cities – Shanghai, Beijing, Chengdu (), Sichuan (), Nanjing (), Shenzhen (), Guangzhou (), Tianjin (), etc – are, clearly, inadequate, considering the pace of the country's industrialisation.

Ten years down the road, the situation will be even worse if material construction of industrial and commercial complexes as well as housing estates are not started, today.

For this reason, no doubt, the PRC's banks will continue to suffer (or enjoy) the present heavy weighting of loans, collateralised by the property assets of borrowers.

Stemming widespread speculative activity in the property market appears, therefore, to be of a fairly high

priority of the powers-that-be in the country because such activities could cut into the ambitious plans of the Government of the world's most-populous country.

Up-to-date statistics about the PRC's banking system are not readily available to anybody outside of the Government of the PRC and to publish such data without express permission of the Government may well be considered a crime, punishable by imprisonment plus a hefty fine since it would, almost certainly, fall into the category of the dissemination of PRC State Secrets without licence so to do.

The Government of the PRC does not publish many statistics about its banking industry so that one is left to speculate and to interpolate from official statistics, most of which are at least 6 months to one year old.

The Central Bank of the PRC is the **People's Bank of China (PBC)**, which, in December 2003, injected \$US22.50 billion (about \$HK175.50 billion) into Bank of China Ltd () (Code: 3988, Main Board, The Stock Exchange of Hongkong Ltd) and another \$US22.50 billion was injected into China Construction Bank Corporation () (Code: 939, Main Board, The Stock Exchange of Hongkong Ltd).

In addition to Bank of China and China Construction Bank, the PRC's 2 other major, State-owned players of the country's banking industry include Industrial and Commercial Bank of China (Asia) Ltd (()) (Code: 349, Main Board, The Stock Exchange of Hongkong Ltd) and the Agricultural Bank of China () (which has yet to be listed on the premier stock market of the HKSAR.

As at June 30, 2006, these 4, State-owned banks accounted for about 52.50 percent of the entire country's banking-sector assets.

But that figure of 52.50 percent was a reduction of about 4.54 percentile points, compared with the situation as it existed in the first half of 2003.

The recapitalisation of the banking system of the PRC, started, initially in December 2003, was repeated, at least in part, in April 2005, when the PBC made another \$US15-billion injection (about \$HK117 billion) into Industrial and Commercial Bank of China (Asia) Ltd.

The resultant effect of these cash injections was to boost the Capital Adequacy Ratio of the Big 4 State Banks.

As at December 31, 2005, the Capital Adequacy Ratios of 3 of the Big 4 Banks stood at:

Bank of China Ltd: 10.42 percent (2002: 8.15 percent);

China Construction Bank Corporation: 13.57 percent (2002: 6.91 percent); and,

Industrial and Commercial Bank of China (Asia) Ltd: 10.26 percent (2002: 5.54 percent).

The importance of the boost to the Capital Adequacy Rates of the PRC's major banks, inter alia, permitted them to write down, or write off, non-performing loans at a much faster rate than in past years.

Non-Performing loans of the Big 4 Banks fell from about 19.20 percent in the first quarter of 2004 to about 9.50 percent in the first quarter of 2006.

What is very evident, when looking at what transpired in the PRC with regard to its banking industry since 2003, is that the Central Government has been forced to play a key role in making certain that it is plain sailing for its banks, henceforth.

Clearly, such assistance has been deemed crucial.

It will, no doubt, be crucial in the next few years, also.

The capital injections by the PBC Government into 3 banks of the Big 4 Banks must be only one of the first steps in the rationalisation of the banking system in the fastest-growing economy of the world, today.

One may expect, for instance, for the PBC to make a capital injection into the Agricultural Bank of China in similar fashion to the recapitalisation of the other 3 major banks of the country.

A clean-up of rural banks could well follow in due course.

Banking IPOs will, most likely, continue in the HKSAR in order to boost Capital Adequacy Ratios, allowing the recipient banks of the IPOs to write down or write off some of their Non-Performing Loans.

According to bankers with whom **TARGET** () has interviewed, it is quite likely that the monetary amount of the Non-Performing Loans within the PRC banking system is about 1.30 trillion renminbi.

In terms of the PRC's Gross Domestic Product, as at June 2006, that amount of money is somewhere in the region of 6 percent.

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