

Australian
Leadership
Awards
- Fellowships

Executive Roundtable and Professional Placements

2 – 10 October 2008 • Melbourne, Canberra and Sydney

Session 2

Current Assessment:

Impacts of Global Financial Turbulence on Financial Systems in China

Mr Jin Jianhua

Shanghai Municipal Government Financial Services Office

Since the U.S. sub-prime crisis broke out last year, a number of financial institutions involved in the sub-prime industry are confronted with operation problems, which is far beyond our expectation. This year, another round of financial storm triggered by the sub-prime crisis emerges and diffuses in the overall financial system. Recently, the bankruptcy of Bear Stearns and Lehman Brothers shake the world, because of which many countries' capital markets plunged amazingly. Another effect of the sub-prime crisis is the ongoing economic slow down of U.S., as well as Europe, which might increase the possibilities of world economic slow down.

These years, economy and finance is more and more globalised. China's economy development is as well affected by world economy. China's financial market is further connected to the outside financial market. Under the circumstances of global financial turbulences, china's financial system is unavoidably affected, mainly in two aspects:

(1) Economic slow down causes potential financial risks

First of all, economic slow down and enterprises' profit decrease results in bad loan ratio increase. World economy turbulences lead to demand increase, which directly affects China's export, and further arouses over-production. These years, the proportion of export to China's GDP is expanding, from 22% in 1997 to 44% in 2007. Under the conditions of RMB appreciation, export tax rebate lowering, labour & raw materials price increasing, China's export increase rate slowed down in 1997. This year, China's export might keep on slowing down due to U.S. demand weakening. Accordingly, some domestic industries, especially industrial investments, have produced more than needed. Overproduction is hard to release, while in the past it could be easily offset by export. Overproduction seriously affects enterprises' profitability, results in employment problems, and further puts pressure on consumption increase and social stability. With regard to the banking in China, bad asset has been decreasing in the past years, mainly due to the increasing of enterprises' profitability as a result of economic development. Once enterprises' profitability decreases, the most direct impact is the repayment ability decrease, which might cause bad loan ratio to rebound.

Secondly, decrease of enterprises' profitability influences the capital market greatly.

Global economic and financial turbulences do not only influence China's listed companies' profitability, but also influence future economic anticipation of the public. In domestic capital market, this inevitably results in big adjustment of the evaluation system. In 2007, the average P/E ration of listed companies is as high as 50 to 60, or even higher. On the one side, high P/E ration itself is unsustainable; on the other side, companies' profitability decreases. As a result, decrease of share prices is unavoidable. Meanwhile, some listed companies invested in the capital market, Continuing going down of the capital market worsens some companies' profitability, who have invested in the capital market, and accordingly affects their share prices, trapping them in a vicious circle. Domestic A-share market index has dropped 60% comparing with highest level of Oct.2007. Total market value has reduced 20 trillion RMB.

(2) Global financial turbulences intensifies domestic financial fluctuations

Along with China's finance further opening up, domestic financial market is more connected and conjunct with global financial market. In other words, in case of global financial turbulences, exterior impacts to the domestic financial market are more intense. To be more specific, there are two aspects of influences.

First, linkage of domestic and overseas financial markets is reinforced. Currently, some domestic companies are listed on foreign markets. Some are both listed in domestic A-share market and foreign share markets such as Hong Kong. Global financial turbulences easily transmit to domestic markets. The recent synchronized decrease of domestic and foreign stock markets clearly indicates that China's capital market can no more stay away from exterior impacts. With regard to financial assets management, China further broadens its overseas financial market investment scope and enhances investment intensity. Once global financial markets turbulences intensifies, losses of domestic financial institutions emerge. Just a couple of days ago, Lehman Brothers filed for bankruptcy protection, asset losses of domestic banks such as China Merchants Bank, Industrial and Commercial Bank of China emerged. As a result, share prices of these financial institutions plunged. More over, withdrawal of international capital also has some impacts to China's financial markets, among with we should especially pay attention to QFII and large amounts of hot money. Recently, some famous international financial institutions such as Morgan Stanley are selling real estates they invested in China, which promotes the going down of China's real estate market, and might further trigger some financial risks in the realm of real estate.

Secondly, the gathering up of foreign financial institutions could also transmit risks. In April 2007, the first 4 foreign corporate banks opened up in Shanghai. Until now, totally 20 foreign corporate banks have been set up, 13 of which are located in Shanghai. Consequently, cross-border transfer of market risks is swifter. Take the corporation reform of foreign banks for example, even though it brings benefits to the host country in respects of regulation, taxation, etc, it does not put an end to cross-border transfer of financial risks. One these institutions have troubles, their parent companies can shift risks to domestic markets.