

Informal Finance in China



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Main Messages

- ❖ Micro- and small-sized enterprises (MSEs) need informal finance, yet their issues are beyond the financial arena
- ❖ Risks of informal finance can be contained with macro-prudential management, and with financial sector restructuring and financial market opening



Background

- ❖ Chinese economy in transition
- ❖ SMEs account for 60% of GDP, 50% of tax, 70% of total exports, 75% of total work force, and 90% of newly increased positions. Yet, they only takes less than half of bank loans

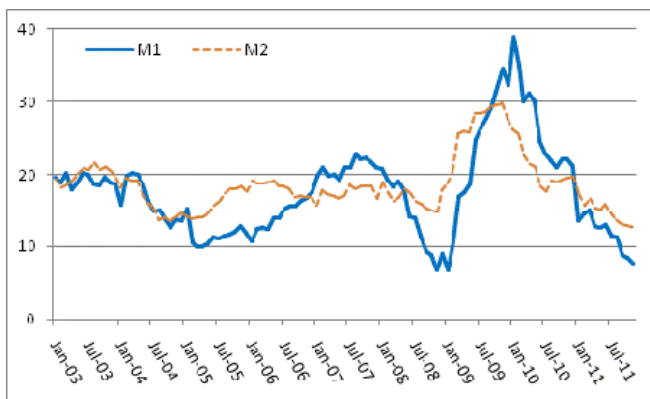
SME Loan	All			SMEs		
	New loan	Outstanding	NPL ratio	New loan	Outstanding	NPL ratio
2007	2.61	18.53	7.80%	1.35	10.18	12.50%
2008	3.20	21.04	3.50%	1.40	10.91	5.50%
June 2009	4.64	25.16	2.95%	2.66	13.69	4.50%

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Background

- ❖ Pro-cyclicality of monetary policy and financial supervision

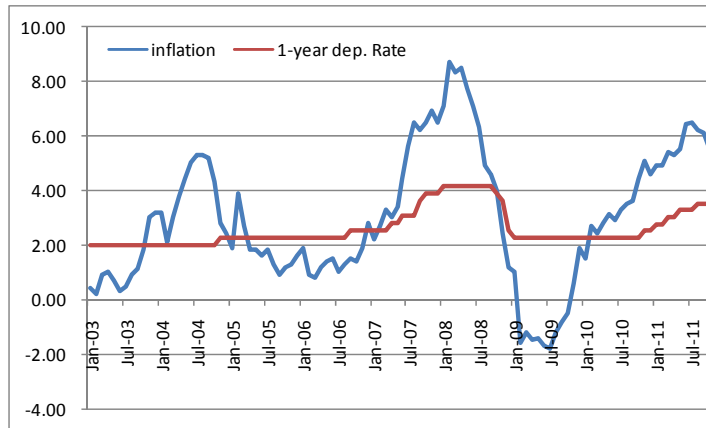


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Background

❖ Inflation vs. deposit rate



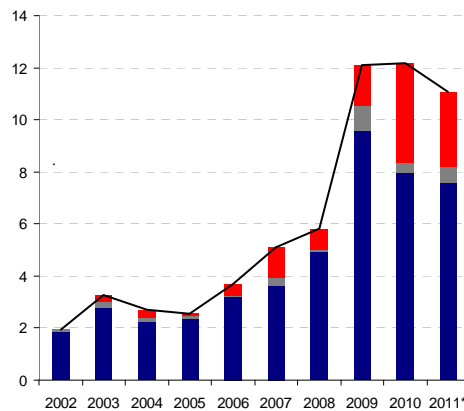
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Background

❖ Off-balance sheet lending (CNY tr.)

■ Loan in Local Currency ■ Loan in Foreign Currency
■ Off balance sheet lending — Total lending



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Demand for Informal Finance

- ❖ Lagged financial reform
 - Demands for funding of SMEs/MSEs can't be met by formal financial system; yet, idle funds with nowhere to go
 - Lack of financial regulation
- ❖ Lack of legal supports
 - Lenders' Regulation unable to promulgate
 - Usury is not "protected by law", but not "illegal if within 4 times of base lending rate".

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Demand for Informal Finance

- ❖ Issues of MSEs/SMEs are beyond the financial arena
 - Tax burden
 - Many sectors are monopolized
 - Many SMEs are export-oriented

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Wenzhou: Case Study

- ❖ 300,000-400,000 SMEs, 80% need informal finance
- ❖ Total scale
 - In 2001: CNY30-35 billion (more than 50% of bank lending)
 - In 2011: CNY110 billion (20% of bank lending)
- ❖ Interest rate
 - In mid-2011: 24.4%; in mid-2010: 21%

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Wenzhou: Case Study

- ❖ Funding sources
 - Local entities: 30%
 - Local residents: 20%
 - Other areas: 20%
 - Others

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Wenzhou: Case Study

❖ Usages

- Production, operation: 35%
- Real estate: 20%
- Individuals to informal intermediaries: 20%
- From informal intermediaries: 20%
- Others (other investment, speculation, etc.)

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Wenzhou: Case Study

❖ Risks of informal finance can be contagious

- A portion of informal lending has been funded by credit obtained from the banking sector. PBC estimates that 10% of Wenzhou's curb market funds came from bank credit.
- When a business fails because of curb market borrowing, it will also not be able to pay its formal creditors and its suppliers.
- Deteriorated credit environment in Wenzhou.

❖ Risks are exaggerated by the media and the local government

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Policy responses

- ❖ Reduce tax burden for MSEs/SMEs, allow private funds to enter some currently monopolized areas
- ❖ Establish a deposit insurance system
- ❖ Promulgate lenders' regulation
- ❖ Liberalize the financial sector
- ❖ Macro-prudential management of financial risks