The Big Read Chinese business & finance

Chinese economy: Beijing's war on the credit boom

A campaign led by vice-premier Liu He to reduce the danger of uncontrolled lending could strangle the private sector

Tom Mitchell in Singapore 17 HOURS AGO

Like many small businesses across China, Zheng Weijun's freight company had struggled to obtain credit from the state-dominated banking system. But in 2018 the 12-lorry business discovered Fincera, a peer-to-peer platform in Hebei province that collected money from retail investors starved of returns and channelled it to borrowers, mainly small trucking and logistics companies.

"We qualified for a Rmb200,000 [$31,000] loan and used it to expand the business," Zheng says, adding that Fincera charged his company 9 per cent interest annually. "The traditional financial system does not reach down to us."

Just a year later, however, the credit dried up after Hebei police accused Fincera of "illegal fundraising" — something it denies. "The government shut it down and offers no alternative," Zheng complains, adding that his company's recent loan applications have been rejected by state banks. "How are we to judge whether a [P2P] platform is good or bad? We only care that Fincera was willing to offer us a loan."

Fincera's founder and chair, Li Yonghui, was detained by police in December 2019 and is awaiting trial. The platform's operations — it had Rmb9bn under management — are now in limbo, with investors unable to get their money back and borrowers unsure of how to repay their loans.

Li Yonghui, chair of Fincera, a peer-to-peer lender in Hebei province, was detained in 2019 and is awaiting trial. The Chinese government shut down Fincera leaving investors unable to get their money back and borrowers unsure of how to repay their loans © REUTERS

A former Fincera employee, who asked not to be named, argues that "there were no issues" at a platform that was delivering credit to a neglected sector of the Chinese economy. "They completely shut down the business anyway," he says. "Accounts and systems were frozen, no one could manage anything. The police just took control and asked borrowers to pay the money back, but they are not going to be able to devote much manpower to that."

Fincera, its clients and investors are collateral damage in a wide-ranging crackdown on financial risk waged by President Xi Jinping and vice-premier Liu He, the Chinese Communist party's most powerful financial official, for the past five years. While the US is pledging to "go big" as its economy comes out of the pandemic crisis, China's leaders are focused on the threat of excessive risk-taking in the financial system.

The campaign initially focused on P2P platforms and other components of China's once rampant shadow banking sector — the off-balance sheet activities that financial institutions used to funnel credit to borrowers, especially those in the private sector who found it difficult to borrow directly from banks. It has since been extended to internet finance and property.

Some analysts warn that in curbing the credit-fuelled excesses of the past decade, Xi and Liu risk an overcorrection that could stifle innovative areas of financial activity and, ultimately, economic growth. From 2016 to 2019, the average annual increase in China's corporate bankruptcies exceeded 30 per cent.

President Xi Jinping, right, and vice-premier Liu He. Some analysts warn that in curbing the credit-fuelled excesses of the past decade, Xi and Liu risk stifling innovative areas of financial activity and economic growth © Jason Lee/Pool/AFP via Getty Images

"China achieved tremendous catch-up growth by allowing market forces to play a larger role and by changing the incentives driving individual and entrepreneurial behaviour," says Diana Choyleva, chief economist at Enodo Economics in London. "Top-down party control has been a drawback, not an engine, for growth."

Zhu Ning, deputy dean at the Shanghai Advanced Institute of Finance, argues that Liu's approach is necessary to disabuse people of the notion that the government will bail out everyone from individual investors to large banks and bond issuers when their bets go awry.

"The attempt to deleverage and rid the financial system of prevalent government guarantees may induce undesirable consequences and market panic," he says. "But it is more of a trade-off between short-term and long-term goals . . . China has to work hard on preventing potential risks from interrupting its growth trajectory and sustainability in the long run."

'Borrowed money must be repaid'

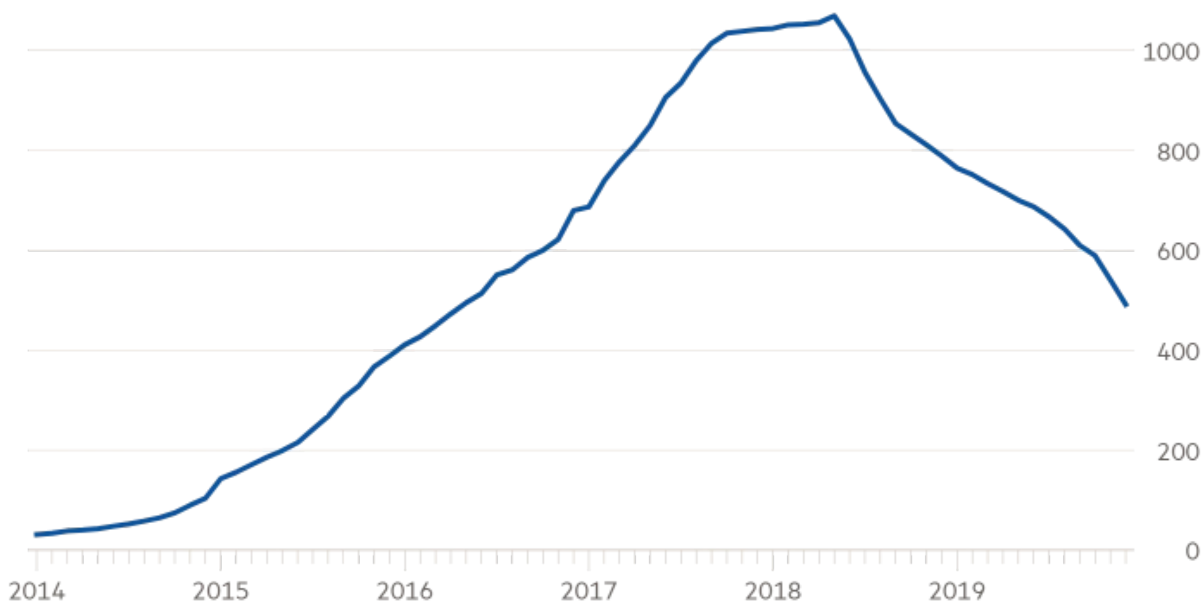
During Xi's first term in power, Liu operated in the shadows as one of the president's most trusted advisers. Yet, even before he became a vice-premier and was promoted to the Communist party's politburo in March 2018, Liu wielded far more power over financial and economic policy than the country's premier, Li Keqiang — who is nominally responsible for the economy. Liu's expansive portfolio now stretches as far as trade negotiations with both the US and EU.

"It is necessary to establish good standards of behaviour, psychological guidance and supervision," he said in May 2018, shortly after his promotion, "so that society understands borrowed money must be repaid, investment entails risk and those who do evil things will have to pay a price".

The P2P industry was just one of Liu's many targets after its meteoric growth — and the collapse of some platforms — raised concerns about the sector's stability. In the four years to May 2018, outstanding P2P loans soared from just Rmb30.9bn to more than Rmb1tn, according to Wind, a Chinese data provider. By the end of 2019 that figure had more than halved, to Rmb492bn.

The rise and fall of Chinese P2P loans

Value of outstanding peer-to-peer loans in China (Rmb bn)



Sources: Wind, WDZJ
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In addition to targeting P2P platforms such as Fincera, authorities ultimately reporting to Liu have ordered sweeping investigations into the shadow banking sector, overseas investments by some of the country's largest private-sector conglomerates and large bond issuers responsible for a series of high-profile defaults late last year.

Most recently, Xi and Liu, who also heads the powerful Financial Stability and Development Committee that oversees the central bank and China's banking and securities regulators, have made global headlines by training their sights on Jack Ma's Ant Group, China's largest fintech company.

On Monday, Xi chaired a high-profile meeting that increased the pressure on Ant and other internet platforms. According to state media, the party's central finance and economics committee warned that "some platform companies are developing in non-standard ways that present risks . . . It is necessary to accelerate the improvement of laws governing platform economies in order to fill in gaps and loopholes in a timely fashion."

Ant Group headquarters in Hangzhou. Ant's $37bn initial public offering was scrapped just days after Liu's financial stability committee warned of 'the rapid development of financial technology and innovation' © Qilai Shen/Bloomberg

The outcome of the dramatic crackdown on Ma's empire and the fintech industry will be a defining moment for the party's relationship with the private sector, especially as Xi prepares to begin an unprecedented third term in power in 2022.

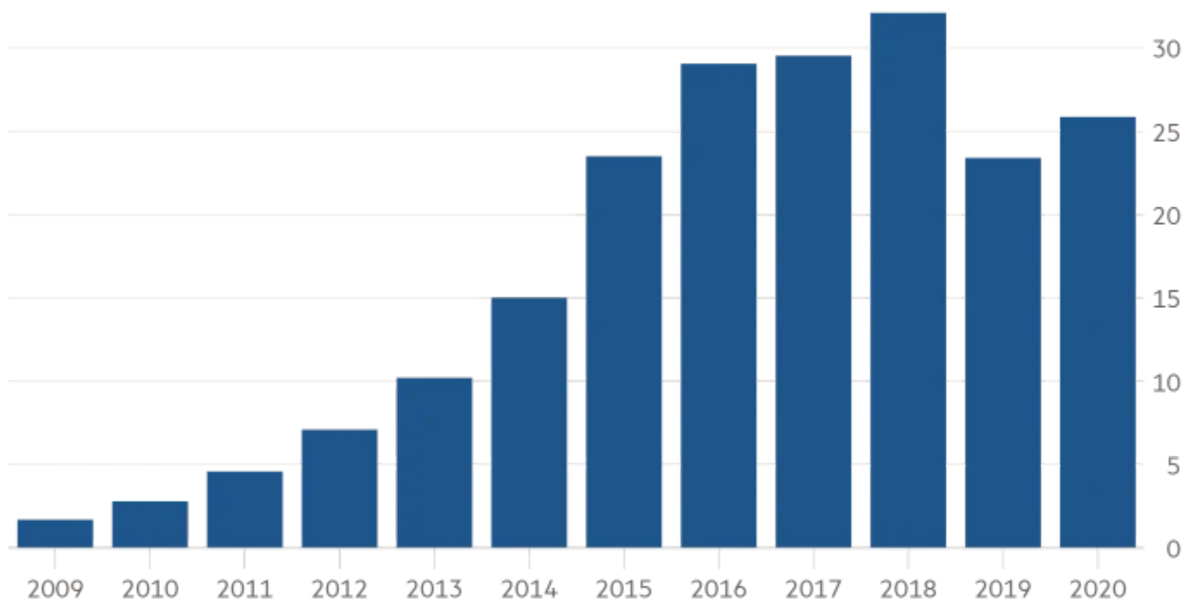
Ant's $37bn initial public offering, which would have been the world's largest had it proceeded as scheduled last November, was scrapped just days after Liu's financial stability committee warned that "with the rapid development of financial technology and innovation, it is necessary to strengthen supervision in order to effectively guard against risks". Alibaba, Ma's ecommerce group, is the subject of a parallel anti-monopoly investigation launched by China's market regulator.

Not even the all-important property sector, a critical motor for the world's second-largest economy, has been spared. In November, Guo Shuqing, head of the banking regulator and also the central bank's top party official, said the real estate industry was the country's biggest "grey rhino in terms of financial risks", accounting for about 40 per cent of total bank lending. The pronouncement followed concerted efforts by Chinese regulators to enforce "red lines" aimed at curtailing developers' leverage.

Chen Long at Plenum, a Beijing-based consultancy, says the real estate market is "the only major bright spot" in otherwise "mediocre" post-pandemic consumption, with property sales now on their strongest run in five years. But, adds Andrew Polk at the advisory group Trivium in Beijing, a reckoning is coming: "One consistently winning bet has been that if Guo calls out a problem, it gets addressed."

Wealth management products exceeded Rmb30tn before China's crackdown

Value of outstanding products at year-end (Rmb tn)



Source: Wind
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Financial risk as 'national security'

In the spring of 2016 an anonymous article by "an authoritative person" was published on the front page of the People's Daily — the party's flagship newspaper. It warned about the dangers of the country's rising debt levels in part due to a Rmb4tn stimulus programme launched in the wake of the global financial crisis. The mysterious author was Liu. A year later, Xi officially designated financial risk as a matter of "national security".

Such views help explain why the Chinese government's fiscal and economic response to the coronavirus pandemic has been relatively restrained. Beijing did let overall debt levels climb and tolerated a bigger budget deficit last year. But even as economic output fell almost 7 per cent in the first quarter of 2020 — the first year-on-year decline in decades — it still shunned "helicopter money" largesse and other forms of financial support showered by other governments on their citizenry.

At the annual session of China's parliament, which closed on March 11, the government also signalled its intention to rein in most of the support measures it authorised last year to help weather the pandemic.

"Last year the economy was driven primarily by the traditional levers of infrastructure and real estate investment, which hit record levels," says Jeremy Stevens, chief China economist for Standard Bank. "Policymakers, loath to go down this path, felt they had no choice.

The annual session of the Chinese parliament at which the government announced it was to rein in most of the support measures that started last year in response to the pandemic © Nicolas Asfouri/AFP via Getty Images

"[They] know this comes at the expense of tomorrow's growth, reinforces structural imbalances in the economy and exacerbates over-reliance on credit and infrastructure," he adds. "China had an already stressed financial system to boot — a reality exacerbated by [aggressive] bank forbearance and lending last year."

One prominent Chinese financier, who advises the government on policy issues, says he avoided the Ant IPO because of this larger policy backdrop. "To me it was very clear a year ago that [tougher fintech] regulation was just around the corner — capital requirements, licensing for taking deposits and a much lower interest rate ceiling for online consumer lenders," the financier says.

"Five years ago everybody was talking about shadow banking," he adds. "Who is talking about shadow banking now? Thousands of P2P lenders have disappeared. It was a long, multiyear process. It is not overnight that this happened."

When regulators began attacking the shadow banking sector in 2017, the outstanding amount of wealth management products was estimated at Rmb29tn or 40 per cent of gross domestic product, according to official data. At the end of 2020 they were estimated to be worth Rmb25.9tn. But the crackdown made it even harder for smaller, private sector companies, such as Zheng's trucking business, to access desperately needed credit. China's private sector accounts for 80 per cent of China's urban employment and 60 per cent of economic output.

"Squeezing P2P lenders and the shadow banking sector does constrain lending to the private sector," says Eswar Prasad at Cornell University. "China," he adds, "seems to take the path of giving innovators a lot of room and then cracking down hard when they grow too powerful or the risks become too large to ignore."

Jack Ma, head of Ant Group, made a speech criticising Xi and Liu's orthodox attitude to financial risk two weeks before Ant's IPO was abruptly cancelled by the authorities © Aly Song/Reuters

Ma risks it all

Many believe Jack Ma sealed his own fate with a speech on October 24 — a fortnight before Ant's IPO was abruptly cancelled — when he seemed to criticise Xi and Liu's financial risk orthodoxy as a penny-wise, pound-foolish strategy. "Very often an attempt to minimise risk to zero is the biggest risk itself," the entrepreneur said.

The first sign that the Ant IPO might be in trouble came on October 31. And it came via Liu. His Financial Stability and Development Committee declared that "with the rapid development of financial technology and innovation, the relationship between development, stability and security must be properly handled". Within days top regulators rolled out strict new rules that would curb Ant's profitability, summoned Ma and senior Ant executives to emergency meetings, and cancelled Ant's IPO at the direction of Xi.

The committee added that "regulators must do their work conscientiously and treat similar businesses and institutions equally" — a recognition of the longstanding complaints by China's largest state-owned banks that Ant and other private-sector fintech competitors were benefiting unfairly from a supervisory regime that holds state banks to higher regulatory standards.

Xi has also been clear that his vision is of a future in which ever "stronger, bigger and better" state-owned enterprises continue to dominate the commanding heights of the world's second-largest economy.

"Security and development are now seen as inextricably linked and security trumps all other considerations," Choyleva says. "Xi's focus has been on identifying and pre-empting security challenges rather than [waiting to] deal with them once they arise."

China's private sector accounts for 80 per cent of urban employment and 60 per cent of the country's economic output © Qilai Shen/Bloomberg

Continuing crusade

For its advocates, the fate of Fincera is an example of the excesses of Liu's war on risk, especially when vague signals from Beijing — in this case about the dangers of P2P lending platforms — are taken to extremes by local officials.

Fincera was the largest P2P platform in central Hebei province, an industrial powerhouse with a population of 75m people. In July 2018, Hebei officials ordered by Beijing to investigate the sector said they had found no irregularities at the platform.

"That made us feel really comfortable," says one retail investor whose family invested almost Rmb10m in Fincera at the time. "The government said 'calm down, Fincera is legal'."

A year later, however, Hebei officials resumed their investigation of Fincera and other P2P companies in the province as part of Liu's broader crackdown on the sector. "Fincera has been subjected to countless investigations led by the Hebei Financial Bureau," Li, the company's chair, said in a social media post in July 2019. He added that his company "satisfies all centrally issued regulations" and is "operationally sound".

Five months later, Li took his daily pre-dawn walk and never returned. On the same day, busloads of police descended on Fincera's offices in Hebei and Beijing.

"It was basically all of my family's savings," says the investor, who asked not to be identified and now cannot get her money back. She fears she will have to sell her apartment: "We have become economic refugees."

Such pain, however, is unlikely to deter Liu and his lieutenants from carrying on their crusade.

"We will continue to see a sustained focus on risk," says Prof Prasad. "Even when they manage to control one aspect of leverage in the economy, it just pops up somewhere else. It's a never-ending battle."

Additional reporting by Xinning Liu, Sherry Fei Ju and Sun Yu in Beijing