The New York Times | https://www.nytimes.com/2021/04/02/business/china-foreign-banks.html

China Puts Limits on Foreign Banks, Worrying Businesses

New rules, aimed at taming big money flows and possibly controlling the Chinese currency, could give domestic rivals a competitive edge and make international firms more dependent on local lenders.

By Keith Bradsher

April 2, 2021, 5:21 a.m. ET

SHANGHAI — To defend against accusations by Washington and others that it doesn't play fair on trade, Beijing could point to the banks. Chinese leaders have been steadily lowering the barriers they had erected around the country's vast financial system, giving Wall Street and European lenders a greater shot at winning business in the world's second-largest economy.

Now the walls are going up again.

New Chinese rules have sharply limited the ability of foreign banks to do business there, making them less competitive against local rivals, according to three people with knowledge of the directives. One set of rules enacted in December and January restricts how much money foreign banks can transfer into China from overseas. Another that took effect on Wednesday required many foreign banks to make fewer loans and sell off bonds and other investments, two of the people said.

The new rules have caused a stir among the global bank executives and foreign companies in China that depend on those lenders for money, the people said. Among other concerns, they worry that the rules could make foreign-owned businesses more dependent on China's state-run banking system for the money they need to grow. That dependence could give Beijing another potential pressure point to use as it squares off against Washington and others over trade, human rights, geopolitics and other sticky issues.

Banks and trade groups have been reluctant to speak publicly for fear of triggering further regulatory measures. But in a January letter to China's central bank that was reviewed by The New York Times, the European Union Chamber of Commerce in China raised concerns about the money transfer limits.

"In some cases, the risk brought about by this major structural change may fundamentally overturn the strategic development direction of E.U. banks" in China, the letter said.

The new rules could complicate already thorny political issues, such as the U.S.-China trade war, a pending investment agreement between China and the European Union and long-simmering tensions over how Beijing controls the value of the Chinese currency. President Biden has shown little interest in letting up on the trade demands pressed by his predecessor, Donald J. Trump. The two sides are also clashing over human rights, particularly Beijing's repression of mostly Muslim ethnic minorities in the northwestern Chinese region of Xinjiang and its crackdown on democracy activists in Hong Kong.

President Biden has shown little interest in letting up on the trade demands pressed by his predecessor, Donald J. Trump. Doug Mills/The New York Times

International companies have been caught in the middle. Over the past two weeks, Chinese state media and the country's online community have encouraged boycotts of foreign businesses like H&M, the Swedish retailer, and Nike, the American athletic brand, after they vowed not to use cotton made by forced labor in Xinjiang.

The reasons behind China's new banking rules aren't clear, though they appear to have little to do with the tense political environment. They seem to be aimed instead at stemming big, potentially disruptive flows of money into the country.

"I can understand how this is about protecting financial stability," said Mark Sobel, a former United States Treasury official. "I can also understand how you could argue this is discriminating against foreign banks."

The People's Bank of China, the country's central bank and the issuer of the rules, didn't respond to requests for comment.

China, which keeps tight control over money flows in and out of the country, may be worried that a surge of funds into the country could lead to nasty surprises like inflation. Money poured into the country in the second half of last year as the Chinese economy threw off its pandemic doldrums while activity in much of the rest of the world shrank.

Measuring flows is difficult, but foreign investors last year increased their holdings of Chinese bonds by about $150 billion. China also surpassed the United States last year by taking in $163 billion worth of direct investments in factories, office buildings, companies and other assets.

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Big money flows into a country can also make its currency rise in value — and China appears to working hard to counter that.

China's currency, the renminbi, rose sharply in value against the U.S. dollar in the second half of last year. In May, $1 was worth about 7.15 renminbi. By year's end, $1 bought about 6.5 renminbi. That rise was bad news for China's exporters because it made their goods less competitive overseas.

But since the Chinese government enacted its new banking rules, the currency has begun to weaken. It now stands at about 6.6 renminbi to the dollar.

Over the past two weeks, Chinese state media and the country's online community have encouraged boycotts of foreign businesses like H&M, the Swedish retailer, after it and others vowed not to use cotton made by forced labor in Xinjiang. Nicolas Asfouri/Agence France-Presse — Getty Images

The new rules alone aren't likely significant enough to account for the sudden halt to the renminbi's rise. But they join other moves made by the Chinese government in recent months that have made moving money into China slightly harder and moving it out slightly easier. Combined, they could put pressure on the renminbi to weaken.

"This has started since last October, and they are all on the same side," said Michael Pettis, a finance professor at Peking University.

Outside factors have likely contributed to the renminbi's shift, including the resurgence of the U.S. economy, which could lead investors to steer their money there instead.

Chinese officials have stressed in recent months that their country is open to foreign investment, particularly banking.

"The inflow of foreign capital is inevitable, but so far, the scale and speed are still within our control," Guo Shuqing, the chairman of the China Banking and Insurance Regulatory Commission, which has worked closely with the central bank on the new policies, said during a news conference on March 2. "We continue to encourage foreign financial institutions to enter China for shared development."

In an unsuccessful attempt to head off a trade war with the Trump administration, China gradually relaxed or removed limits on foreign banks, insurers and money management firms. Big banks responded by expanding their mainland operations, including Citigroup, Credit Suisse, Goldman Sachs, HSBC, J.P. Morgan Chase, Morgan Stanley and UBS.

The global financial environment has encouraged money flows into China. With near zero interest rates elsewhere, international banks borrowed cheaply abroad. Until the new rules kicked in, they could send that money to China and

lend or invest it there, reaping higher returns.

China's currency, the renminbi, rose sharply in value against the U.S. dollar in the second half of last year. Jeenah Moon for The New York Times

The first of the new rules, issued in a memo to banks in December, appeared to be aimed at that trend. That rule limited the ability of global banks to raise money overseas and move it into China. The rule is being phased in through November but was written in a way that has already had a big effect on financial contracts involving bets on the renminbi's direction, said the people familiar with the notice.

Another measure communicated directly by Chinese regulators to foreign banks three weeks ago concerned the size of bank balance sheets, two of the people said.

Concerned about the rapid growth of credit in the Chinese economy, regulators ordered domestic and foreign banks to limit their balance sheets by Wednesday night to show only slight growth from last year. Because China has recently loosened limits on foreign purchases of bonds, many foreign banks had been buying more bonds for sale to foreign customers, expanding their balance sheets.

The full impact of the new rules will depend on how long they stay in place. Eswar Prasad, a Cornell University economist, predicted that China would eventually resume opening up to foreign financial institutions.

"They don't want to scare off foreign investors in the medium to long term," he said.

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