CHINA AT THE FINANCIAL ECONOMIC CROSSROADS: THE CRITICAL NEXT STEPS

Conference Report on the 7th Wee Cho Yaw Singapore-China Finance and Banking Forum, “China at the Financial Economic Crossroads: The Critical Next Steps”, organised by the Centre for Asset Management Research and Investments (CAMRI) of the National University of Singapore (NUS) Business School on 18 June 2015, at The Westin Beijing Financial Street, Beijing. The conference was held under the ‘Chatham House’ Rule, which means that comments are not attributable.

The 7th Wee Cho Yaw Singapore-China Finance and Banking Forum, organized in Beijing by the NUS Business School’s Centre for Asset Management Research and Investments (CAMRI) on 18 June 2015, with the theme ‘China at the Financial Economic Crossroads: The Critical Next Steps’, attracted more than 200 participants, including many key professionals from across the financial services industry.

The proceedings emphasized issues centred on the reform of the Chinese financial services market as the nation attempts to keep its economy growing robustly, while simultaneously transforming itself into one of the leading economies of the world.

The forum highlighted four key themes:

1) Reforms in China’s short term money markets and long term interest rate sensitive capital markets should continue to be carried out in earnest to boost investors’ confidence and returns on their investments.

2) The influence of state-owned enterprises needs to be re-evaluated in order to promote growth.

3) Policies should align with market principles to contain risk, to maintain goals and to liberalise the Chinese currency and interest rate product markets.

4) Technology presents many new opportunities. China should take full advantage of technology to further grow its financial market as it did with its highly developed online money market sector.

While China has made strides in growing its markets, there have been some challenges. The growth and sophistication of its financial market and systems are praiseworthy. However, the remnants of China’s planned - or command - economy with state-owned enterprises (SOEs) dominating it, raise the question of whether China will be able to maintain the level of growth needed to become a fully developed economy.
A case in point is margin financing. The recent spate of margin financing issues in China suggests that there are justifiable concerns, and much needs to be addressed before its capital market can grow. Another example is fund management. While the industry has posted impressive growth over the past 15 years, the number of truly global Chinese fund management companies emerging has been fairly small.

With increasing interest rates, a high debt-to-GDP ratio, decrease in treasury holdings relative to the U.S., low proportion of equity financing relative to the total amount of social financing, and a low securitisation ratio compared to other countries, the development of China’s financial market would face further challenges. To overcome these challenges, Beijing should institute reforms that will allow the markets to play a more effective role in resource allocation.

The Forum identified several areas of reform that are critical for growth:

- a new round of financial liberalisation with a drive towards the internationalisation of the Renminbi,
- the liberalisation of China’s interest rate market across the yield curve, and
- an emphasis on further financial reforms.

Without such measures, China may find it difficult to press ahead with reforms of its SOEs and other domestic institutions. Any “wish list” of reforms for China would include necessary reforms in the money and debt markets. Liquidity is a major issue as most bonds are held by commercial banks until maturity, and investors in dire default cases expect to be bailed out by the government.

Additionally, many also hope that Beijing will expand the recognition of mutual funds to other jurisdictions, as well as speed up the approval of a “Free Trade Zone” for the fund management industry. The removal of the qualified foreign investor quota system will also facilitate market development. In terms of market forces, consumers of capital should be encouraged to adopt or re-assess risk assumptions. Attention can also be placed on subsidized resource and credit allocations to smaller enterprises so they can expand if not sustain activity.

Building a robust financial system for China requires that local circumstances be taken into consideration while aligning the system with global best practices. This necessitates reviewing the involvement of regional banks, the influence of provincial governments, and giving priority to national capital markets before local markets. Markets should be liberalised so that China can play a greater role in capital flows, and connect trading partners with investment destinations.

It is also imperative that there be discipline, consistency and commitment when implementing reforms. For instance, a return to the focus of preserving SOEs can easily result in their becoming monopolies again, with sharp declines in efficiency and competitiveness. Similarly, China cannot shut its doors to foreigners. Hence, it must work
towards either diversifying its shareholder base or reducing controls over state-owned industries.

For reforms to be accepted and practiced by the global financial community, they should be seen as fair and corresponding to a generally accepted legal framework. Beijing has made strides in financial legislation. The rule of law is the best way to promote reform in an orderly fashion.

In terms of implementation, the Central Government may wish to consider playing an active role in seeing that the reforms are exercised both at the policy and city levels. Given the size and diversity of the Chinese economy, the Government may do well to ensure that new reforms are phased in gradually. Given the relatively slower pace of China’s legal system in comparison to its leading global competitors, it is imperative that principles are established first before reforms are implemented.

While conforming to regulation helps safeguard financial markets, this may be difficult as current regulation in China is not well defined, particularly with respect to legal and risk liability, which has resulted in some opportunistic vendors misleading clients by not adequately informing them about the risks. It is with clearly defined regulation concerning legal risk and liability that China can proceed towards ensuring a mature financial market that offers sophisticated financial products.

In terms of innovativeness, China introduced “Xin Sanban” (New Third Board) which has seen the successful transfer of unlisted firms to this new economic board. This can potentially increase the range of financial products offered to absorb the high domestic liquidity. However, a significant drawback with the new board is that it does not target individual investors. In this respect, China can consider adapting supervisory requirements learned from abroad to address this issue. It is also just a matter of time before the A-Share Index will be completely open. While investors may enter the stock market in herds when interest rates are lowered, the upside is that such lower rates usually benefit the economy.

Technology has opened up new possibilities to solve challenges in financial markets. While the Chinese financial sector shares similar opportunities as its U.S. counterpart, its money market fund sector is unique, largely due to the Internet. The lack of checks and internal mechanisms for settlements has incentivised Internet financing. Hence, unlike in the U.S., many young Chinese obtain funds from online sources, which are e-distributed on the company’s Internet platform, as opposed to being tied to a third-party service provider or through an independent fund distributor.

Finally, the Forum concluded that it must be a priority for China to focus on expanding the scope of the capital market, as already exists in Hong Kong. In this regard, clear lines of defined operational responsibility and accountability will go a long way towards minimising the risks of potential institutional mismanagement, and acting as an implicit assurance to investors.