China sees bank risks in local-government financing

Written by Taipei Times
Monday, 08 March 2010 09:30 -

Chinese central bank Governor Zhou Xiaochuan (□□□) said that local-government financing vehicles using land as collateral may pose risks for the nation’s banks.

“When land prices rise, there may be over-valuation of land,” Zhou said at a press briefing in Beijing yesterday. “In the future, if land prices fall, there may be a difference in the assessment of the loan.”

China’s local governments are raising funds through investment vehicles to circumvent regulations that prevent them borrowing directly. The extra borrowing, not counted in official calculations, could lead to debt rising to 96 percent of GDP ratio next year and in “the worst case” trigger a financial crisis, Northwestern University professor Victor Shih (□□□) said last week.

Zhou said that while “many” local financing vehicles have the ability to repay, two types cause concern. One uses land as collateral, while the other can’t fully repay borrowing, meaning that the local governments may be liable, leading to “fiscal risks.”

The central bank will ensure lenders comply with regulations on evaluating loans, pricing risk and assessing the value of land, Zhou said, adding that they “should be prudent, meaning a bit conservative.”

Shih said that China needs to stop new projects funded by the local government entities and estimates that their borrowing so far may result in bad loans of up to 3 trillion yuan (US$439 billion).

Jonathan Anderson, an economist for UBS AG, said on Saturday that he saw a “classic red herring” in arguments that “enormous, hidden off-balance-sheet liabilities” of China’s local governments could precipitate a debt crisis.

China’s explosion of credit hasn’t been accompanied by, for example, the derivative exposures and short-term borrowing from abroad that were factors in past crises in China and the US, he said in an e-mailed report.

The use of local-government financing vehicles is a “micro-level” question, not one that affects judgments on the strength of a Chinese economy which is “nowhere near to a crisis or implosion,” Anderson said.

China will control new investment projects and urge local governments to avoid expanding investments “blindly, beyond their abilities,” said Zhang Ping (□□), head of the National Development and Reform Commission, China’s top economic planning agency.

“If not properly dealt with, such borrowing may bring about potential fiscal and financial risks,” Zhang said at yesterday’s briefing.

The finance ministry is mulling measures to ensure that local governments make rational decisions based on their fiscal revenues, Zhang said.

"We will strengthen monitoring and limit lending to high energy consuming or polluting projects or those in industries with over--capacity," he said.

Chinese Finance Minister Xie Xuren (□□□) pledged at the same briefing to increase oversight of fund-raising by local governments and guard against "latent" risks. Increased regulation is needed "to support the healthy development of the economy," he said.

Chinese officials allowed lending to explode from late 2008 to fight off the effects of the global financial crisis, with new loans rising to a record 9.59 trillion yuan last year.

Source: Taipei Times 2010/03/08