

China bad debt disposals hit levels not seen for 20 years

Handling of non-performing loans seen as crucial to stability of economy

Don Weinland in Hong Kong, January 23, 2019

Disposals of bad debt in China are reaching levels not seen in nearly two decades as the banking sector grapples with an onslaught of poor-quality loans that amounted to about Rmb1.75tn (\$258bn) last year.

The handling of non-performing loans has become a top priority for Beijing and is viewed as a threat to financial and social stability if it is not dealt with correctly. Although banks report bad debt levels of less than 2 per cent of total loans, the true figure is expected to be multiples of that.

President Xi Jinping has made the reduction of corporate indebtedness a key element of his financial agenda over the past two years. That banks are stepping up disposals of bad debt reflects a new urgency to clean up the books of many of China's banks.

"The deleveraging campaign is now no longer as focused on credit tightening and more fixated on addressing problems in the existing stock of debt," said Jason Bedford, a UBS analyst, in a new report on China's distressed debt market that cites the figures.

With an estimated Rmb1.75tn in non-performing loans disposed of by banks last year, Mr Bedford noted that such sales have "reached highs unseen since the early 2000s".

Prices, on the other hand, have plummeted to a near decade low, as a glut of debt hits the market. One reason for the drop in prices is that more debt is coming from regional banks with poor-quality loans.

China's economic growth in 2018 slowed to levels not seen since 1990, when the country was under sanctions following the Tiananmen Square massacre. The deceleration of the economy is expected to put more pressure on the repayment of loans in the coming years.

"Given the various macro pressures in China, including trade wars and deleveraging efforts by local funding bodies, we observed that there was greater inclination by these agencies to release NPLs into the system in the second half of 2018," said Celia Yan, head of Greater China investments at ADM Capital.

China set up four centrally controlled asset management companies, known as AMCs, in 1999 to offload more than Rmb1.4tn in bad debt from the country's four largest banks. The process, which accounted for up to 24 per cent of total loans, amounted to a recapitalisation of the sector.

Since then, a number of provincial AMCs have opened up across the country. Private investors and some foreign investors have also moved into the market. But despite a rapid increase in disposals over the

past three years, uncertainty remains over whether or not the government will be forced to take greater measures.

“It’s a systemic problem,” said Alicia García Herrero, chief economist for the Asia-Pacific region at French bank Natixis.

The increase in disposals is in some senses good for the banks as they clean up their balance sheets, Ms García Herrero added. But the question over the need for a bigger response from the government still looms: “Recapitalisation opens a Pandora’s box. Who do you recapitalise first?” she said.

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