

China – When will the FX regime be adjusted?

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2. China

- **Tight credit policy will remain in place**
 - investment remains overheated and inflationary pressure has not eased
 - credit curbs vs. interest rate hikes
- **Credit squeezing is beginning to bite**
 - fixed investment growth to slow from 24% in Jan.-Feb. to below 12% by the year end
- **GDP growth slowdown will be modest**
 - consumption to hold up well
- **No change in RMB policy under speculative environment**

3. Banking reforms are the key to stop credit misallocation

RMB 1.4 trn NPLs were transferred from state banks to AMCs

First major step in 1999-2000

Progress in NPL sale has been slow (Rmb bn)

Total NPLs acquired in 1999	1400
Amount of asset disposed by Jun 03	424
As % of total assets	30
Proceeds from asset sales	80
Recovery ratio	19%



Next steps?

- Joint ventures with foreign investment banks
- Selling to foreign investors

More complicated assets, lower recovery rate

The banks' NPL ratio still high

	<u>Big four banks</u>	<u>Total banking system</u>
Total loans, Rmb bn	8184	13129
NPL ratio (%)	26	23
Total amount of NPLs (%)	2135	3020



Another round of massive fiscal bailing out in 2004



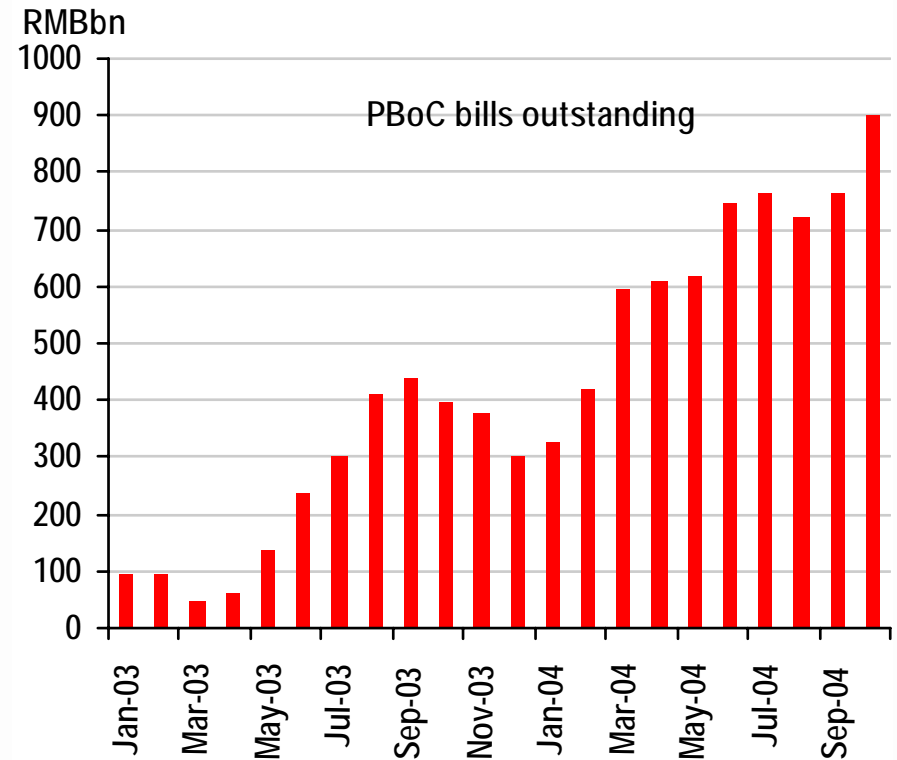
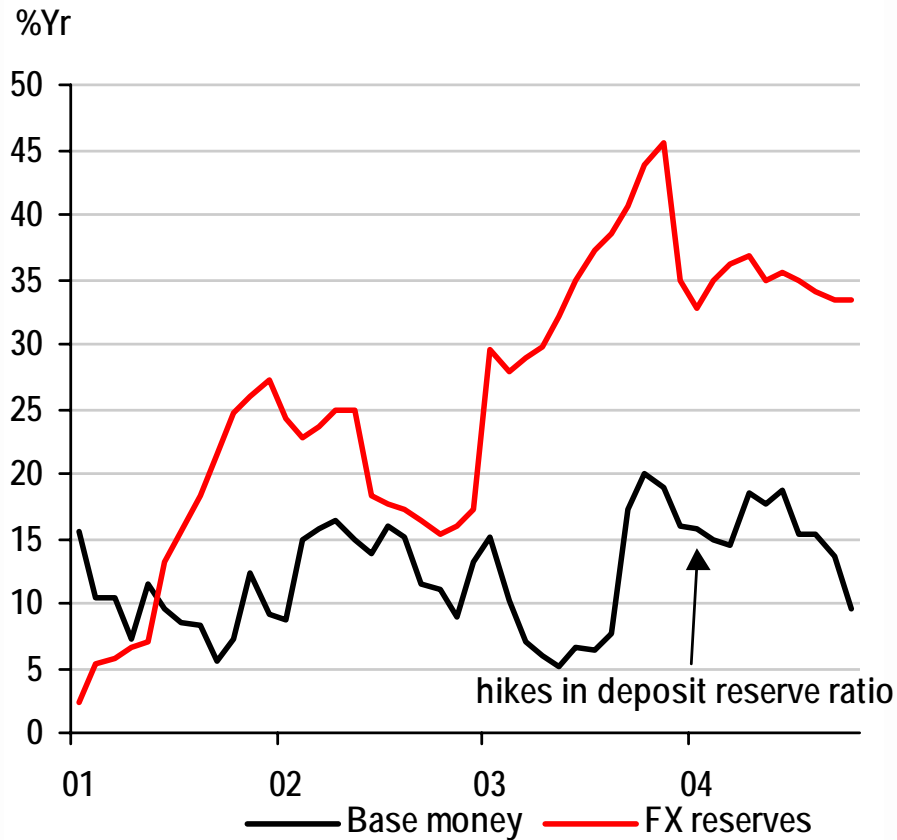
- Rising bad loan provision from 0.3% to 1% of total assets
 - Using 70-80% of net profits to write down NPLs
- Without a massive fiscal bail-out, it would take 10 years for the banks to reduce NPL ratio to below 15%**



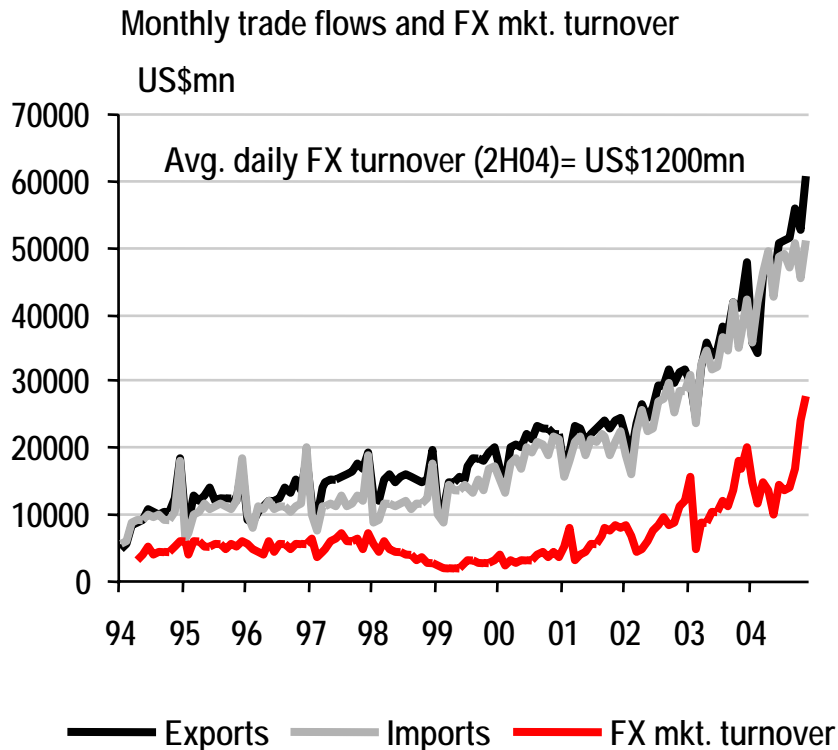
The big four to be listed on domestic and foreign markets by 2006

Will this make them real banks?

4. PBoC will keep sterilising FX reserve expansion



5. Making the market work



What has been done?

- an inter-bank foreign currency spot market (314 members, 4 currencies, daily volume USD500m)
- a few banks able to trade RMB forward contracts with customers

What needs to be done?

- introduce more bank participants to break the big four's oligopoly
- allow currency trading for financial transaction purposes
- establish a market-maker system
- introduce more trading products, including derivatives

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