Wu Xiaoling: Strengthening China's financial industry in the process of opening up

Speech by Ms Wu Xiaoling, Deputy Governor of the People's Bank of China, at the Sino-US Economy and Trade Forum, Beijing, 14 February 2006.

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Ladies and Gentlemen,

It is a great pleasure to join such a distinguished audience to discuss about issues related to trade and economic cooperation between China and the United States. As two large countries in the world, China and the United States maintains a friendly cooperative relationship between each other not only fits in with their respective fundamental interests, but also helps to create a favorable environment for world development. It is an independent choice of the Chinese people to embark on the way transiting to the market economy and it is an internally generated force that pushes China to open to the outside world and actively integrate into the world economy. Opening up has not only brought China vitality, but also deepened the reform process which helped to create a better platform for the Chinese economy to integrate into the world economy. China is developing in the process of opening up while the rest of the world is benefiting from China's development.

China's financial industry has also benefited from the opening up process. In October 1979, Mr. Deng Xiaoping, the late architect and mastermind of China's reform and opening up, asked Mr. Rong Yiren to establish the China International Trust and Investment Corporation (CITIC), a holding company with its business spreading from the financial sector to various other industries. The incorporation of CITIC has opened for China a window to the outside world in terms of external financing. After that, China began to introduce foreign financial institutions in the country by allowing them to set up representative offices, operational entities and even joint-equity institutions in China, turning a new chapter in the reform and opening up of the Chinese financial industry.

It is the financial reform and opening up that has brought China out of the rigid doctrine that confined the country to a self-pride fallacy of " a nation of no domestic and external debt", and helped China to learn to use financial instruments and foreign capital to develop the Chinese economy. In conventional Chinese wisdom, borrowing debt becomes a feasible choice only when other options are exhausted. In the past, a Chinese usually needs to save several months or even years before he or she could offer to buy some relatively expensive goods, and borrowing money is considered to be something shameful and reflecting one's incapability. Under the centralized command economy, we were once proud of being a country with neither domestic nor foreign debt. With the deepening of China's economic interactions with the outside world since the start of reform and economic opening up, mentality of the Chinese people has witnessed tremendous changes. In 1979, China resumed external borrowing which was suspended for 20 years, and financed a total of US$3.5 billion externally in the year. In 1981, the Chinese government decided to issue treasury bonds totaling 4.9 billion yuan. With steady progress of the financial industry, consumer credit has gradually become popular among the Chinese people who find their livelihood is increasingly dependent on various services and facilities provided through the financial system. In 1985, the Shenzhen Branch of the China Construction Bank issued the first ever home mortgage loans to a customer in China. As of the end of 2005, China's outstanding balance of government bonds reached 2.7 trillion yuan, and that of foreign debt and house mortgage loans amounted to over US$260 billion and 1.84 trillion yuan respectively. China's financial assets totaled 37.5 trillion yuan, 2.06 times of the GDP.

It is the financial reform and opening up that has enabled the Chinese financial institutions to improve its business performance and management level amid market competition, especially in competition with the foreign institutions. At the same time, the foreign financial institutions has also benefited from the opening up of the Chinese financial industry. The foreign financial institutions have brought competition incentives for their Chinese counterparts to improve and transform business strategies and management by setting good examples in the conduct of intermediary business, patent application of certain banking products, charging fees on account services, disintegrating the customer market and introducing the concept of check and balance in building up the internal control system etc. As the most open and developed city in Mainland China in terms of the financial industry, Shanghai harbors the best branch offices of the Chinese financial institutions with respect to profitability, asset quality and product innovation, with its financial openness not posting a competitive barrier for growth of the domestic institutions. With the development of the Chinese economy, the deepening of financial reform, steady improvement of management skills in the Chinese financial institutions and the strengthening of profitability, the Chinese banks realized profits totaling 253.2 billion yuan in 2005, compared with 23.2 billion yuan in 2001. At the same time, asset quality also evidently improved, with the NPL ratio dropped from 25.4 percent in 2001 to 9.8 percent in 2005. Foreign financial institutions harvested profits amounting to US$446 million, increasing by 227.6 percent over that of 2001 which was registered at US$196 million.

China is a country that honors its commitments. The Chinese government has been fulfilling its WTO commitments strictly on time or even ahead of schedule in terms of opening up the financial sector. In December 2005, five more cities, namely Harbin, Changchun, Lanzhou, Yinchuan and Nanning, were opened ahead of schedule to foreign financial institutions for local currency business, bringing the total number of cities allowed for RMB business from 18 up to 25. In the areas of securities and insurance business, the Chinese government has almost fulfilled all commitments concerning market access and business scope except that the Sino-foreign joint equity brokers are not allowed to provide underwriting services for issuance of A shares.

For the time being, foreign banks equity taking in a Chinese bank is subject to a ceiling of 25 percent, or a limit of 20 percent in the case the equity is bought by a single foreign financial institution, if these foreign banks intend to be treated same as their local Chinese partners in terms of business conduct. By the end of 2006 when the domestic market is fully open to foreign banks for local currency business, such a proportional limit will only hold significance for taxation purpose, and bears no restrictions on the conduct of business.

China’s practice since its accession to the WTO has shown that although the business growth rate of foreign banks in recent years was higher than that of domestic banks, the market share of foreign banks in China’s banking sector does not see dramatic changes. In 2001, foreign banks accounted for 1.8 percent of the total banking assets, 0.35 percent of the RMB loans, and 14.7 percent of foreign exchange loans. While in 2005, these figures rose respectively to 1.89 percent, 0.55 percent and 20.97 percent. With restrictions on RMB business to be removed in 2006, the market share of foreign banks in RMB business is likely to further expand.

By 2005, 25 foreign banks have taken stakes in altogether 20 domestic banks, with some banks investing in different domestic banks. In our view, in the share-holding reform of the state-owned commercial banks, the main purpose of inviting strategic investors is to introduce advanced business concepts and management skills so as to further improve the corporate governance of domestic banks. With regard to introducing strategic investors, the Chinese regulatory authorities have laid guiding principles called “long stake holding, governance improving, business cooperation and avoiding peer competition”. Under the precondition that the State holds the majority of stakes, more involvement by the foreign and public investors will do no harm but to improve corporate governance and business management in the state-owned commercial banks.

In the process of banking reform, introducing strategic investors is unlikely to threaten China’s financial security. I agree with Mr. Cheng Siwei, Vice Chairman of the Standing Committee of the National People’s Congress, that financial security here is a macro concept. At the micro level, safeguarding financial security is to preserve soundness of individual financial institutions and avoid systemic risks resulting from the failure of a single institution. At the macro level, pursuing financial security is to maintain a balanced development of the national economy and keep the currency value and exchange rate basically stable, which is closely related to the macroeconomic management capability of a country. With the State still holding the majority of stakes, participation of strategic investors will help to produce stronger state-owned commercial banks rather than undermine China’s financial security. What is important is to manage the structural balance of the economy and create a more flexible mechanism for the economy so as to make it more adaptable to the changing situation, otherwise the performance of the individual financial institutions could be impaired. Promoting economic reform and opening up and rationalizing the economic system are essential to the sound development of the financial sector. While introducing foreign strategic investors, we expect that domestic investors could also be involved in the reform process. In this case, we need to quicken the steps in reform of domestic capital market so that the Chinese investors could benefit from the economic reform.

The opening up of China’s financial market has provided good opportunities for foreign investment, enabling investors from various countries to capitalize on China’s rapid development. The reform of China’s financial sector and its development also need a relatively easy external environment that understands China’s reform efforts. Currently, the lopsided development of the world economy, large fluctuations of oil prices, escalating "twin deficits" of the United States and other unstabilizing factors has not only brought uncertainties to the world economy but also produced stern challenges to the Chinese financial reform and development. China's financial reform and opening up is a long journey that requires arduous efforts to conquer, therefore we need to continue to steadily advance the reform according to the guiding principles and policies, further liberalize the financial market, and strive to build a mutually beneficial relationship between China and its foreign partners.

Thank you.