Guo Shuqing: Promoting the new development paradigm and preventing the resurgence of financial risks

Speech by Mr Guo Shuqing, Party Secretary and Deputy Governor of the People's Bank of China and CBIRC Chairman, at the 13th Lujiazui Forum, Shanghai, 10 June 2021.

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Secretary Li Qiang, Mayor Gong Zheng, Governor Yi Gang, Chairman Yi Huiman, ladies and gentlemen, friends,

Good morning!

It gives me great pleasure to attend the Lujiazui Forum again to exchange views with colleagues from home and abroad on topics of common interest.

Shanghai is a vibrant city and has witnessed miracles taking place one after another. Since last year, Shanghai has, in accordance with General Secretary Xi Jinping's instructions, advanced epidemic prevention and economic and social development in a coordinated manner, with greater strides made for further reform and opening-up and new progress achieved in becoming an international financial center. The city remained third in the latest Global Financial Center Index (GFCI), with its rating very close to the second. During the 14th Five-Year Plan period, financial regulators in China will make concerted efforts with Shanghai as well as Chinese and foreign financial institutions to deepen financial reforms and promote financial openness in Shanghai.

Since 2020, in response to the unprecedentd pandemic, developed countries have all launched super-stimulus packages. Such fiscal expansion is accompanied by ultra-loose monetary policy. The US Federal Reserve has nearly doubled the size of its balance sheet, and that of the ECB and the Bank of Japan expanded by more than a half and a quarter, respectively. These extraordinary measures have helped stabilize markets and confidence in the short run, but their negative side effects would befall other countries. **First,** financial assets and property markets in developed countries have seen significant price increases. In particular, stock markets reached record high very quickly. It's just like climbing steep mountains: it's hard to go up, but even harder to go down. **Second,** inflation has come as if it were scheduled, at a higher rate than was expected by our US and European counterparts. As for how long it will last, it doesn't seem that short as many experts predicted. **Third,** when fiscal spending has been largely supported by money printing, it is like an airplane getting stuck in a spinning vortex: it would be very hard for the airplane to get out easily on its own.
Before 2008, the Fed balance sheet was less than about US$800 billion, but it has now expanded to almost $8 trillion. Meanwhile, the ratio of the US federal debt to its GDP has surged to a record high since the World War II. **Fourth,** uncertainties still loom large with the pandemic raging across the world, and the global supply chain and industry chain are facing a high risk of being disrupted or even broken. During such times, countries should have worked together to overcome difficulties; nevertheless, a small number of developed countries have kept making troubles, pursuing the so-called unilateralism, and placing their own interests above everything else, which has actually damaged the interests of their peoples. For example, retaining high tariffs on Chinese goods can push inflation up even faster. **Fifth,** given the spillover effects arising from floodgates opened by the US and Europe, emerging market economies and developing countries are forced to take countermeasures, albeit painful. The central banks of Russia, Turkey and Brazil have started to raise interest rates, and some developed economies have also signaled that they would implement contractionary policy. How these policy orientations would impact the world economy from a macro-economic perspective is still unclear for the moment.

China didn't flood the market with liquidity while strengthening its macro policy responses. Some countries criticize that China failed to implement adequate policy responses and make sufficient contribution to global economic recovery, which is evidently a bias or misconception. In fact, China has made quite strong policy efforts. For monetary policy, in 2020, a total of RMB19.6 trillion of new loans were extended, up 12.8%, and aggregate financing grew by RMB 35 trillion or 13.3%, which is rarely seen across the world. By lowering interest rates on loans and reducing service charges, the financial sector injected RMB 1.5 trillion to the real economy last year.For fiscal policy, in 2020, China cut taxes and fees by over RMB2.5 trillion for businesses and residents. A budget deficit rate of 3.7%, new anti-epidemic government bonds, special local government bonds, and additional investments by policy banks have added up to over 10% of China's nominal GDP.More importantly, our policies yielded the best results. In 2020, China saw positive economic growth, contributing to the recovery of our neighboring countries and major trading partners, thus preventing the world from plunging into more severe contraction. China has provided around half of the global end products for a very long time, without raising the export price, hence setting a solid foundation for pandemic containment and global economic recovery. If money printing by the most developed country has triggered global inflation, then the goods made by hundreds of millions of workers in China are the "key anchor" in taming it.

Why is our central bank able to keep its balance sheet unchanged although the Chinese government has extended considerable fiscal and financial support? First of all, it is attributed to big-picture-oriented, well-coordinated, scientific and reasonable macroeconomic decisions by the CPC Central Committee and practical, well-targeted and effective planning and directions by the State Council as well as its Financial Stability and Development Committee.Secondly, it is attributed to the commitment of the financial sector to containing outflow of funds from the real economy to the virtual economy and lowering internal leverage ratios, which contributed to scaling-back of interbank wealth management, interbank investment, entrusted loans, and trust channeling activities and contraction of high-risk shadow banking.Thirdly, it is also attributed to a unique advantage of our central bank's balance sheet: reserve ratio maintained at a high level through sustained sound monetary policy and legacy burdens relieved thanks to interest rate liberalization.Therefore, unlike developed countries where the central banks have purchased assets to expand their balance sheets, China has encouraged banks to extend more loans to the real economy by cutting the reserve requirement ratio and appropriately increasing targeted refinancing. At the same time, China also guided the channeling of private savings into direct and securities investments, thereby significantly enhancing its capacity to produce and supply products urgently needed by China and the rest of world. The transition to a green economy has also been boosted as a result.

China has entered a new stage of development and we will fully implement the new development philosophy, actively advance supply-side structural reform, and constantly foster the pattern of mutually-reinforcing domestic and international circulations. As for the financial sector, we must promote greater opening-up, improve corporate governance, accelerate market-based mergers and acquisitions, regulate online platforms, and ensure fair competition. Efforts are required to step up digital transformation of conventional financial services to enable more targeted financial services to the real economy and prevent and tackle financial risks with more precision. Financial inclusion should be promoted with a view to strengthening financial services to micro and small businesses and vulnerable groups so as to effectively achieve common prosperity. Green finance should be developed to secure effective financial support in achieving carbon-neutrality as committed. The development of technology-empowered finance should be promoted to support independent innovation and technological self-reliance.

The most prominent task now is to further increase the share of direct financing. Bond and equity financing contributed 37 per cent to the growth of aggregate social financing last year. There is a great potential, particularly in the bond market. However, legislation needs to be further improved to pave the way for its healthy development. There is an urgent need for governments at all levels, businesses, intermediaries and investors to realize that escaping from debt repayment obligations is not only unethical, but also illegal and even criminal. The way to fundamentally change that is to accelerate the introduction of the registration-based system with information disclosure established as a core requirement and effectively strengthen investor eligibility supervision to ensure that issuers, intermediaries and investors fulfill their respective obligations and bear their respective responsibilities in accordance with the law.

After a three-year battle to resolve major financial risks, the risks we faced on many fronts tend to decline. However, risk prevention remains an eternal theme in regulating the financial sector. We must remain vigilant in times of peace, and never shall we relax our efforts. In view of current situations, our efforts should be mainly focused on the following aspects:

First, measures should be taken to actively deal with a possible rebound in nonperforming loans. Given the implementation of the loan payment deferral policy for micro, small and medium businesses hit by the epidemic, it is expected that some of the loans deferred will eventually turn into bad assets. Credit risks facing the banking institutions are on the rise due to housing bubbles and housing-related financial products in some regions, debt service pressure of a number of local governments’ financing platforms and the growing default ratio of some large and medium-sized companies. The situation for some small and medium-sized financial institutions are more severe. Therefore, banks must properly classify their assets and increase loan loss provisions to ensure faster disposal of nonperforming assets.

Second, we must strictly guard against any resurgence of shadow banking activities. China’s high-risk shadow banking is different from other countries, as it has the characteristics of “circulating within the financial system” and “being loan-like”. The size of China’s shadow banking is still large and easy to rebound with a slight chance even after it dropped by RMB20 trillion from the peak after rectification. Efforts must be made to prevent financial institutions from over-leveraged and complex cross-sector financial products, and put an end to all kinds of “loan-like” products before they emerge. The new asset management rules must be implemented effectively to ensure successful overhaul of existing asset management products.

Third, we must firmly crack down on illegal public offerings of securities. Currently, there are a large number of public equity products disguised as private equity ones in the financial markets. Many of the illegal fund-raising cases were essentially illegal public offerings of securities which were issued to unqualified investors, with the number of investors exceeding the 200 limit, thereby causing severe damages to the market, communities and individuals. Upon discovering such disguised offerings, punishments must be imposed in accordance with the law, and the issuers and related parties must be held liable for fraudulent offering, financial fraud or false disclosure.

Fourth, effective steps must be taken to prevent financial derivatives investment risks. In the previous cases, many retail investors invested in financial derivatives and incurred great losses. In mature financial markets, however, institutional investors are the key players in financial derivatives, because they are not suitable for unqualified individuals. Given uncontrollable and even unpredictable factors, the prices of financial derivatives are highly volatile and therefore investors need to be professionally competent and highly risk tolerant. Speculation in derivatives by common retail investors is equivalent to disguised gambling, and they are sure to suffer losses. Investors that speculate in currency, gold or other commodity futures hardly have any chance of getting rich, as they are set to pay the same heavy price as those betting that property prices will never fall.

Fifth, we must remain vigilant against Ponzi schemes. Nowadays, we have seen a resurgence of investment frauds that promise high returns and could be disguised as financial technology or Internet finance, but they are illegal fund-raising in essence. All individuals should bear in mind that there is no such thing as a free lunch and that principal-guaranteed investments offering high returns are financial fraud. They need to be more alert, beware of risks and improve capability to identify risks, and stay away from illegal financial activities.

We hope that the participants here at this Forum, while offering insightful views, can patiently help promote such basic financial literacy.

Many thanks to the moderator for his kind introduction and support.

I wish this forum a complete success!

May new progresses be made in building Shanghai into an international financial center.

Thank you all.