CHALLENGES AND OPPORTUNITIES FOR CHINA’S GROWING ECONOMY AND DEVELOPING FINANCIAL SYSTEM

Past and Future Contributors to Economic Growth

China’s rapid economic growth over the past three decades has positioned it as one of the major economic powers in the world today. Its real gross domestic product (GDP) has grown at an average rate of 9.9% over this period, which is almost three times the world average. As of mid-2010, China had surpassed Japan to become the second largest economy in the world, behind only the United States. This remarkable growth can be traced to Deng Xiaoping, who initiated China’s transition from a centrally planned economy to a socialist market-oriented economy beginning in 1978.

The main driver in China’s rapid economic growth in recent years has been investment. It has been funded primarily with the retained earnings of firms and loans from banks, with the issuance of stocks and bonds having played a relatively minor role, though one that has become more important recently for a growing number of firms. Despite its substantial contribution to growth, there were concerns that so much investment in the past few years was contributing to excess capacity in some sectors of the economy. These concerns diminished somewhat as a result of the global recession that began in the summer of 2008. Indeed, the Chinese government put into place a $584 billion stimulus package to prevent the growth of the economy from slowing too much due to a decline in net exports. This action did keep the economy growing at a fairly rapid pace, but led to an increase in the projected budget deficit to approximately 3% of GDP in 2009. However, a deficit of this size is quite manageable and far smaller than those in other major countries. Furthermore, there are some concerns that the stimulus package also contributed to an increase in real estate construction that may lead to future problems to

1 On a cautionary note, some concerns have been raised regarding the accuracy of China’s reported GDP numbers. All statistics and estimates published by the IMF and the Chinese Bureau of Statistics, however, are roughly consistent with respect to real GDP growth rates.
the extent that the extremely rapid increase in real estate prices in the past few years turns out to be unsustainable. Although excess capacity had not yet created major problems for China by mid-2010, there are nonetheless two broader concerns that have attracted far more interest. First, China's growth is imbalanced insofar as it depends so heavily on investment and relatively little on consumption. Consumption only accounts for one-third of GDP. In contrast, consumption accounts for about two-thirds of GDP in both India and United States. A reason for such a big difference is that people in China save much more due in large part to far less government support for education, health care, and retirement than is the case in the United States. Actions are being taken by the Chinese government to provide more support in these areas so as to provide greater incentives for consumption to become a far bigger factor in contributing to economic growth. This would bring about more balanced growth.

Secondly, the export sector has also been an important contributor to China's growth, with exports having exceeded imports every year over the past decade. This only serves to underscore the important role that China's opening up beginning in the late 1970s has played in its growth story. However, the contribution of exports to growth and employment has mainly led to tremendous development and urbanization in the eastern coastal areas of China. This situation has created a widening income gap between those working in these areas and those located in the interior. While the government has tried to improve economic conditions in the inland regions of the country, it has also been careful to avoid taking any precipitous actions that would adversely affect growth and employment in the export sector. The concern in this regard is that the growth in exports and, in turn, the increasing income disparities between regions is due in large part to the exchange rate policy. China has allowed only a limited appreciation of its currency so as to not curb exports and thereby adversely affect economic growth. Most importantly, in deciding upon its exchange rate policy for the longer run, the government certainly realizes that actions taken to rebalance growth toward consumption will not only lessen China's heavy reliance on investment but also reduce its dependency on exports for job creation and economic growth.

At the same time, the huge build-up in foreign exchange reserves due to the limited appreciation of its currency carries a high opportunity cost insofar as these reserves certainly exceed the level needed to cover imports and debt obligations. One would therefore expect China to slow its accumulation of reserves, with the added benefit of lessening potential protectionist measures being enacted against China by other countries.

### Increasing Integration into the World Economy

China made a major decision to begin the process of opening its economy to the world in the late 1970s and has made tremendous strides since then. Indeed, both China's exports and imports exploded over the past three decades, increasing more than 7800% and 5600% by 2008, respectively, before declining somewhat in 2009 as a result of the global recession. The growth in China's trade, moreover, has far surpassed the growth in world trade over this same period. As a result of this growth, China is now the second largest trading nation in the world when measured by the sum of exports and imports, behind only the United States. China, moreover, is far more 'open' than the United States when openness is measured by the ratio of exports plus imports to GDP.

At the same time that China has been rapidly integrating into the world economy through trade, it has been running surpluses every year since 1990, with the exception of 1993. The surpluses, moreover, have been increasing over time, reaching a record $297 billion in 2008, before dropping to $196 billion in 2009. This, of course, means that some other countries have been running trade deficits with China. The most notable country in this regard is the United States, with its official figure for the trade deficit reaching a record of $268 billion in 2008, before declining to $227 billion in 2009. To reduce its deficit, the United States, among other countries, has been pressuring China to allow its currency, the yuan or renminbi (RMB), to appreciate to a far greater degree than so far allowed.

In keeping with greater openness, China has relaxed some direct investment inflow and outflow restrictions in recent years. At the same time, however, other types of capital inflows remain more restricted and most outflows of capital even more so. China did, however,

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2 The eastern coastal areas account for about two-thirds of GDP and have a GDP per capita that is about twice the national average, according to the China Statistical Yearbook.
3 For purposes of comparison, India ranks 18.
4 According to the US Census Bureau, the total US trade deficit in 2008 and 2009 was $816 billion and $536 billion, respectively.
5 In addition, the United States filed a complaint with the World Trade Organization (WTO) in early February 2007 charging China with unfairly subsidizing exports by Chinese companies.
6 The qualified foreign institutional investors (QFIs) are allowed to invest in A shares (shares denominated in RMB). There are also B shares (shares denominated in US or HK dollars) that are available to domestic (since 2002) and foreign (since 1992) investors in China’s two stock exchanges. H shares, N shares, and S shares are shares of Chinese companies listed in Hong Kong, New York, or Singapore, respectively.

III. EFFECTS OF FINANCIAL GLOBALIZATION
China, the largest emerging market economy, is now the largest exporter of capital in the world, while the United States, the largest mature market economy, is by far the largest importer of capital, as shown in Figure 24.1. A large portion, estimated by most to be about two-thirds, of China’s foreign exchange reserves in recent years have been invested in US dollar-denominated bonds, which has helped keep US interest rates lower than otherwise. To the extent that the composition of its portfolio shifts away from bonds to equities, and away from US dollar-denominated securities to other currency-denominated securities, prices in world securities markets may undergo relative changes. However, it’s unlikely that China will take any action that results in abrupt or large shifts in the composition of its reserves any time in the near future. It is somewhat ironic that China is such a large exporter of capital, given that the returns to investing more of the reserves in private firms domestically exceed the returns on US Treasury securities.

At the moment, the securities that China has been accumulating with its growing stock of foreign exchange reserves are assets on the balance sheet of the People’s Bank of China (PBOC). By shifting the composition of the portfolio to higher-yielding investments, the PBOC could increase the earnings on its assets. The trade-off, however, would be a riskier portfolio. To the extent that another institution is used to invest a portion of the foreign exchange reserves in higher-yielding assets, the risk

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of sizeable capital losses on the balance sheet of the PBOC is correspondingly reduced. In this regard, in September 2007, the China Investment Corporation (CIC) was established as a state-owned investment company, or sovereign wealth fund, with an initial capitalization of $200 billion. The CIC invests in domestic financial institutions as well as other projects abroad. The CIC, for example, spent about $67 billion to acquire Central Huijin Investment Company Limited, an investment arm of the PBOC that holds shares of the four biggest banks. The CIC has also acquired ownership stakes in three large international financial firms: $3 billion in Blackstone Group, $5 billion in Morgan Stanley, and $100 million in VISA. It has also invested nearly $5 billion in several energy companies in Canada and Russia. Since its establishment, the CIC has grown in size to roughly $300 billion in assets as of mid-2010.

The buildup in foreign exchange reserves at the PBOC has resulted from sterilization actions taken by the government in response to its current account surpluses. To help prevent excessive growth in the money supply that would worsen inflation and excessive bank credit being extended that would contribute to overinvestment as foreign currency is exchanged for RMB, the PBOC has sold bonds paying relatively low interest rates to banks, rates lower than those charged on loans made by banks. This type of operation enables the PBOC to earn profits insofar as the interest earnings on its assets exceeds the interest paid on its liabilities, including the bonds it issues to sterilize trade surpluses and the reserves it requires banks to deposit with it.

Changing Composition of the Financial System

Throughout the past three decades of fast growth, China has undergone tremendous structural changes in its economy. There has been significant and continuing industrialization, urbanization, and integration into the world economy. The financial system has also undergone major changes, with the PBOC ending its monopoly of the banking sector and being recast as the nation’s central bank in the late 1970s and early 1980s. At the same time, four state-owned commercial banks (the so-called Big Four) were established to take over the role of the PBOC in allocating credit throughout the economy. In the mid-1990s three policy development banks were established to relieve the Big Four of the responsibility of making loans to implement the policies of the government, thereby enabling them to operate more fully as true commercial banks.

Beginning in the late 1990s, still further changes in the financial system occurred. The Big Four had accumulated enormous nonperforming loans (NPLs) as a result of their earlier policy-directed lending so the government undertook a series of actions to address this problem. These actions became more urgent when China became a member of the WTO in December 2001 and committed to fully opening up its banking sector to foreign firms by December 2006. China opened its banking sector to foreign firms so that they could gradually expand their operations in all cities of the country and the range of banking services offered over the 5-year period. At the same time, China opened up other parts of its financial sector to foreign firms.

Current Financial Regulatory Structure

Between the formation of the People’s Republic of China in 1949 and late 1970, the PBOC functioned as both a central bank and as the primary commercial bank. It engaged in deposit-taking and lending activities in accordance with the central plan of the government. This ‘monopoly’ of the banking sector ended in 1979 when the PBOC gave up part of its commercial operations with the formation of the Agricultural Bank of China (ABC) and the Bank of China (BOC). This was followed by giving up the remainder of its commercial banking operations with the formation of China
Construction Bank (CCB) and the Industrial and Commercial Bank of China (ICBC) in 1983. These four institutions, the Big Four, simply continued providing the commercial banking functions previously provided by the PBOC, with ABC specializing in agricultural financing, BOC specializing in foreign exchange and trade financing, CCB specializing in construction and infrastructure financing, and ICBC specializing in urban commercial financing. The PBOC was designated by the State Council as the nation’s central bank and the regulator and supervisor of the banking system.

To improve the commercialization of the banking industry in the 1980s, the Big Four were allowed to expand into new commercial banking businesses beyond those in which they had specialized. New commercial banks and other nonbank financial institutions were established beginning in the late 1980s to develop a more modern financial system. This included joint-stock commercial banks with nationwide banking licenses and urban commercial banks with licenses to engage in commercial banking activities within their designated geographic areas. Then, in 1994, three policy development banks, the China Development Bank, the Export–Import Bank of China, and the Agricultural Development Bank of China, were established to take over the policy-lending functions of the Big Four. In 1995, the National People’s Congress passed the Commercial Banking Law, which enabled the Big Four to operate more like genuine commercial banks and segregated the business operations of banks, securities firms, and insurance companies. This separation subsequently led to the establishment of three separate regulatory agencies to oversee each industry. The CSRC was established initially in 1992 to oversee the two stock exchanges but was also given supervisory responsibility of the securities market in 1998. The China Insurance Regulatory Commission was established in 1998 to oversee the insurance industry. Lastly, the China Banking Regulatory Commission (CBRC) was established in 2003 to oversee the banking industry. These three agencies assumed the majority of the regulatory and supervisory functions of the PBOC over financial institutions.

**FIGURE 24.2** Financial regulatory structure in China. Source: Milken Institute.

China has a bank-centered financial system, with the banking sector accounting for two-thirds of the assets in the financial system. The weakness of such a system is that when firms operate in a capital markets-oriented financial system, like in the United States, they have a greater opportunity to access external funds by issuing...
stocks and bonds, thereby significantly lessening the need to rely on credit from banks.\textsuperscript{12} This difference in financial system development is not surprising: arms-length finance, such as occurs with the issuance of corporate debt and equity, requires a much more sophisticated, timely, and reliable information network as well as a more developed legal framework for contracts, when compared with bank finance. As a result, these complementary parts of the financial system usually develop later in a country’s development so that most developing economies rely on a more heavily bank-based system. Yet the development of a balanced financial system is beneficial. Most importantly, when the financial condition of banks deteriorates and loan growth is curtailed, firms are usually in a position to obtain alternative funding in a more balanced financial system than the one that currently exists in China. In 2009, the China nonfinancial sector, including state and municipal governments, raised about $1.9 trillion, of which 80.5% was from bank loans, 3.8% from stocks, 9.4% from corporate bonds, and 6.3% from government bonds.\textsuperscript{13}

The Chinese government recognizes this weakness of its current financial system and has taken actions to facilitate further development of its capital markets. For example, revisions were made to the Company Law and Securities Law, which became effective on 1 January 2006, that strengthened minority shareholder rights, and beginning on April 2005 all nontradable shares (mostly state-owned shares) in state-owned enterprises (SOEs) listed on China’s two stock exchanges were required to be converted into tradable shares. The SOEs constitute about 60% of the listed companies in China. By 2007, the share conversion process had been completed in 98% of companies listed on domestic stock exchanges. Also, on 15 February 2006, the Ministry of Finance issued new accounting practices to bring Chinese accounting practices largely in line with International Financial Reporting Standards. Furthermore, the development of the corporate bond market, as well as the banking industry, will benefit by better protecting the rights of creditors. Specifically, a new Enterprise Bankruptcy Law was approved by the National People’s Congress in 2006, which established new rules for filing bankruptcy.

Although banks account for two-thirds of the total financial assets in China, the top five state-owned commercial banks (Big Five) account for roughly 48% of total bank assets, or about one-third of all financial assets.\textsuperscript{14,15} The Big Five also clearly dominate in terms of total loans and total deposits, at shares of 43 and 53%, respectively. The relatively high concentration of financial assets in just five institutions underscores all the attention they receive because in a way they provide a major indicator of the health of the entire financial system and, more broadly, the economy. Investors in these banks, in turn, are making a play on the continued high productivity and rapid growth in the Chinese economy.

### Major Recapitalization of the ‘Big Five’ State-Owned Banks

To achieve the transition from a centrally planned economy to a socialist market-oriented economy, the banking sector had to be relieved of the burden of holding large amounts of NPLs that had accumulated over the years. The Big Four in particular had historically been collecting deposits and then using them to fund projects as directed by the government. Credit was not allocated on the basis of risk and return considerations, which are crucial factors in a market-oriented economy to ensure the efficient allocation of credit. To put the Big Four in a position to pay greater attention to risk and return trade-offs, their balance sheets had to be strengthened and their capitalization improved. Strengthening the financial condition of the Big Four became especially important once China became a member of the WTO.\textsuperscript{16} By removing bad loans and injecting capital, the goal of the government was to enable the Big Four to go public by issuing stock as well as become not only competitive with foreign banks entering China but more generally to become internationally competitive banks.

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\textsuperscript{12} Of course, in most countries, including the United States, small and medium size enterprises (SMEs) typically encounter problems when trying to obtain external funding. Venture capital funds can provide some, albeit limited, assistance in this regard.

\textsuperscript{13} 2009 Annual Report, Chinese Banking Regulatory Committee.

\textsuperscript{14} The Bank of Communications was added to the ‘Big Four’ to create the ‘Big Five’ state-owned banks.

\textsuperscript{15} In 2009, there were roughly 3857 banking institutions in China, with about 3056 being rural credit cooperatives. There were five state-owned commercial banks (Big Five), 3 policy development banks, 12 joint-stock commercial banks, 143 city commercial banks, and 43 urban credit cooperatives, among other banking institutions.

\textsuperscript{16} In November 2006, China said it would fulfill its WTO commitment of giving foreign banks full access to its banking market if they incorporate their China operations locally. This requirement is related to the plan by the Chinese government to introduce a deposit insurance scheme as deposits in branches outside a bank’s home country can be uninsured, which is the case for branches of a US bank located outside the country. As of mid-2010, such a system had not yet been implemented.

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**III. EFFECTS OF FINANCIAL GLOBALIZATION**
To assist in addressing the loan problems of the Big Four, four asset management companies (AMCs), Cinda, Oriental, Great Wall, and Huarong, were established in 1999, one initially designated for each of the four state-owned banks. At that time $169 billion of NPLs were transferred from the Big Four to the AMCs in exchange for 10-year bonds with an annual interest rate of 2.25%. Overall, $200 billion in NPLs was transferred to the AMCs or sold to other entities from 1999 to 2006. In addition, $80 billion in capital was injected into the Big Four from 1998 to 2006, with $45 billion to BOC and CCB in 2005 and $15 billion to ICBC in 2005. In 2008, $19 billion was injected to ABC. As a result of these efforts, the NPL ratios (i.e., NPLs to total loans) of each of the Big Four have declined sharply from 2002 to 2009. While three of the Big Four have seen their ratios fall to 1.5% in 2009, the fourth, ABC, also experienced a dramatic decline in its ratio from 23.5% in 2007 to 2.9% in 2009, with the help of the government. In addition, the fifth of the big state-owned banks, Bank of Communications, also experienced a sharp decline in its NPL ratio after 2003.

As of June 2006, the AMCs had resolved $130 billion of $156 billion of NPLs acquired, generating $25 billion in cash proceeds. As of this writing, it has been an-  

<table>
<thead>
<tr>
<th>Nonperforming loans</th>
<th>Amount ($ billions)</th>
<th>% of total loans</th>
<th>% of all reported NPLs</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned commercial banks ('Big Five')</td>
<td>53.1</td>
<td>1.80</td>
<td>72.9</td>
<td>1.08</td>
</tr>
<tr>
<td>Joint-stock commercial banks</td>
<td>9.3</td>
<td>0.95</td>
<td>12.8</td>
<td>0.19</td>
</tr>
<tr>
<td>City commercial banks</td>
<td>5.5</td>
<td>1.30</td>
<td>7.6</td>
<td>0.11</td>
</tr>
<tr>
<td>Rural commercial banks</td>
<td>4.0</td>
<td>2.76</td>
<td>5.5</td>
<td>0.08</td>
</tr>
<tr>
<td>Foreign banks</td>
<td>0.9</td>
<td>0.85</td>
<td>1.2</td>
<td>0.02</td>
</tr>
<tr>
<td>Total</td>
<td>72.8</td>
<td>1.58</td>
<td>100</td>
<td>1.48</td>
</tr>
</tbody>
</table>

Source: People’s Bank of China, China Banking Regulatory Commission, and Milken Institute.

have been cleansed of substantial amounts of NPLs will continue to get into difficulty if excessive credit is extended and on inappropriate terms.

As a result of all the actions taken by the Chinese government to recapitalize and improve the overall financial condition of its banking industry, all of the Big Four were able to go public by July 2010. Moreover, China now has some of the biggest banks with the highest market capitalizations in the world. Four of China’s big banks in mid-2010 ranked among the 24 biggest banks by assets in the world. At the same time, ICBC is currently the most valued bank in the world by market capitalization.

**Banking Problems and Issues**

**Impacts of sterilization**

Table 24.2 shows a problem that is created for banks by the way in which the sterilization activities of PBOC

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17 The NPLs transferred in 1999 were made prior to 1996, and classified under the four-tier category system with NPLs being those loans overdue more than 1 year. The AMCs had a mandate when established to clean up all the NPLs they acquired within 10 years. As of mid-2010, it is anticipated that the AMCs will become financial holding companies.

18 Foreign firms have also injected capital into Chinese banks through the acquisition of ownership shares, although the total foreign ownership in a bank is limited to less than 20% for a single investor and to less than 25% for all foreign investors.

19 In January 2002, a new five-category loan classification system was introduced. Under this system, commercial banks are required to classify their loans into the following five categories: ‘pass,’ ‘special mentioned,’ ‘substandard,’ ‘doubtful,’ and ‘loss.’ A loan is classified as ‘nonperforming loan’ if it is classified as ‘substandard,’ ‘doubtful,’ or ‘loss.’ Also, a new provisioning system was introduced, requiring general provisions of 1% of total loans classified as pass to cover potential losses, and specific provisions of 2, 25, 50 and 100% of the amount of loans classified as special mentioned, substandard, doubtful, and loss, respectively. CBRC required that the Big Four and the joint-stock commercial banks adopt this classification system from 2004 and for all banks by the end of 2005. The provisioning requirements were to be implemented by the end of 2008.

20 In addition to the NPLs acquired in 1999, AMCs also purchased NPLs from private sources at discounted price after 2003.
are conducted using the financial statements reported by CCB in 2009. As may be seen, deposits fund 83% of total assets and depositors are paid an average rate of 1.51%. Yet loans and advances account for only 50% of total assets, while investments in debt securities account for 26%, which includes the PBOC securities issued for sterilization purposes. The average yield on loans is 5.37%, whereas the average yield on investments is a much lower 3.11%. The result is a net interest margin of 2.41%. This situation means that Chinese banks have a strong incentive to expand loan growth because they derive a major portion of their income from the net interest margin.21 A growing share of noninterest income, however, helps offset this situation as will an exchange rate policy that reduces the need for sterilization of currency inflows.

### Allocation of credit

China’s banking sector has another issue that merits constant attention in the transition from a centrally planned economy to a socialist market economy. This issue involves the development of a ‘credit culture’ in which risk and return considerations are the primary determinants in the allocation of credit. This requires well-trained accountants, lawyers, and risk analysts who are capable of implementing a policy in which banks price loans on the basis of risk and extend credit to firms of all sizes and ownership structures on equal terms. Despite the progress that has recently been made, China still has a shortage of such skilled individuals. Furthermore, as regards pricing, Figure 24.3 shows that before 2004 the rates charged on loans and paid on deposits at banks were tightly regulated by the government so as to lock in a predetermined net interest margin. This was done by setting benchmark rates based upon which bank rates were allowed to vary only within specified limits. However, available information indicates that lending and deposit rates at banks are fairly well clustered even after 2004. This is partly due to the prevailing ceiling of deposit rates and the floor of lending rates, which limit competition among banks for deposits and suggests loans are not being priced fully on the basis of risk. Again, this pattern has been seen in other transition countries, with loan pricing being driven more by the needs and condition of the enterprise sector than the requirements of commercial banks. Studies also find that lending rates do not differentiate among different credit risks, and that banks seem to lend without regard to enterprise profitability. This behavior is consistent with that in other transitional economies in which the state enterprise sector had yet to downsize as much as needed, and was still absorbing a large share of bank credit.

![Table 24.2](image)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annualized</td>
<td>Deposits from customers</td>
</tr>
<tr>
<td>cost of deposits</td>
<td>1.51% Deposits from</td>
</tr>
<tr>
<td>from customers</td>
<td>customers/total assets</td>
</tr>
<tr>
<td>Average annualized</td>
<td>Loans and advances/total</td>
</tr>
<tr>
<td>yield on loans and</td>
<td>5.37% Loans and advances/</td>
</tr>
<tr>
<td>advances from</td>
<td>total assets</td>
</tr>
<tr>
<td>customers</td>
<td>50.15%</td>
</tr>
<tr>
<td>Average yield on</td>
<td>Investment in debt</td>
</tr>
<tr>
<td>investment in debt</td>
<td>3.11% Investment in debt</td>
</tr>
<tr>
<td>securities</td>
<td>securities/total assets</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>2.41%</td>
</tr>
<tr>
<td>Noninterest income/</td>
<td>20.70%</td>
</tr>
<tr>
<td>total income</td>
<td></td>
</tr>
</tbody>
</table>

Source: China Construction Bank and Milken Institute.

On October 29, 2004, the upper limit on lending rate was removed.

![Figure 24.3](image)

† Unlike banks in the United States, Chinese banks earn relatively a relatively small share of their total income from noninterest revenue. This situation, however, is changing. In the case of CCB, the percentage increased to 20.7% in 2009 from 8.95% in 2006.
To more fully document which firms get the credit in China, although private and foreign enterprises contribute slightly more than half of GDP, they receive only about one-fourth of total corporate loans from banks. Conversely, SOEs and collective enterprises contribute only about one-fourth of GDP but receive nearly half of corporate loans from banks. This suggests that credit is being allocated inefficiently, perhaps due still to excessive local, if not central, government influence in bank lending decisions, and is consistent with the lack of differentiation according to credit risk, just noted earlier. The fact that a relatively large share of foreign exchange reserves is invested in low-yielding US Treasury securities rather than channeled to highly productive private firms reflects the difficulties in addressing the existing inefficiencies in credit allocation.

SMEs contribute a disproportionate amount to GDP but receive a small proportion of bank loans. Although SMEs contribute three-fourths of total employment and more than half of national output, they only received one-fifth of bank loans in 2009. Informal sources account for most of the financing for the small- and medium-sized Chinese enterprises. This also implies that the cost of credit for SMEs is relatively high, since informal financial institutions usually charge higher interest rates than do state-owned commercial banks.

**Recent growth in bank credit**

A major concern has been the rapid growth in bank credit in 2009, as shown in Figure 24.4. The growth has clearly been excessive as compared to earlier years in the decade. Eighty percent of the borrowing by the nonfinancial sector has been provided by banks. Furthermore, most of the credit provided by banks has been provided by the Big Five. The major concern, of course, is that many of the loans that have been made have contributed to excess capacity in some sectors of the economy, and therefore may become nonperforming in the years ahead. The government is well aware of this situation and has taken actions to curtail the excessive growth in credit, with some of the growth already likely to lead to additional NPLs in the future.

**Further Reading**


