



BANK FOR INTERNATIONAL SETTLEMENTS

Panel I: The current landscape: markets and players, competitors and complementarities*

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* The views expressed in this presentation are those of the authors and not necessarily those of the Bank for International Settlements.



Some questions

1. What are shadow banks?
2. Why are there shadow banks?
3. Should we worry?
4. What should we do about them if we do worry?



What is shadow banking?

- An institution that is not considered to be a bank but that intermediates credit



Why are there shadow banks?

- Regulatory arbitrage
 - US: Interest rate ceilings + high inflation → money market funds
 - China: interest rate ceilings, bank lending caps for banks, stricter enforcement of loan/deposit ratios, high reserve requirements for banks
- Shortcomings of the regulated banking system
 - Chinese banks concentrate on state-owned enterprises and fail to meet private firms' credit demand
- Greater flexibility allows them to be more efficient than banks



Should we worry?

- Systemic risk
 - How fragile are shadow banks?
 - Capital
 - Liquidity
 - Does their failure of lead to contagion?
 - Through direct exposures (loans, guarantees)
 - Through indirect exposures (price effects after fire sales)
 - Through its impact on confidence
- Consumer protection
- Market integrity



What should we do if we do worry?

- Fix problems that led to rise of shadow banking in the first place (inefficient regulation, wrong incentive structures at banks)
- Enlarge regulatory perimeter
 - Make them banks and regulate them as such
 - Make them different from banks (eg banning redemption at par or at stale prices)
- Regulate counterparties to reduce connections
 - But will only cut direct links, not links through fire sales, common lenders, etc

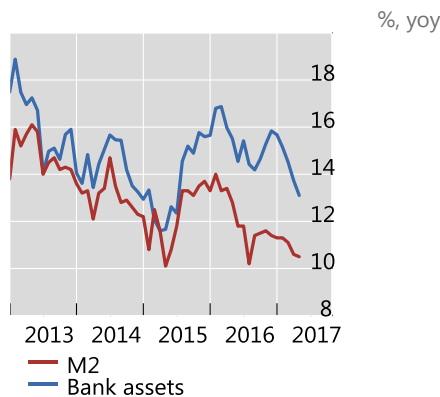


Recent developments in Chinese shadow banking

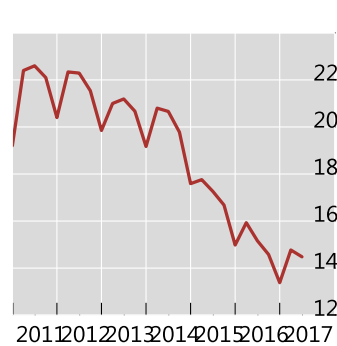
Balance sheet indicators of Chinese commercial banks

Graph 1

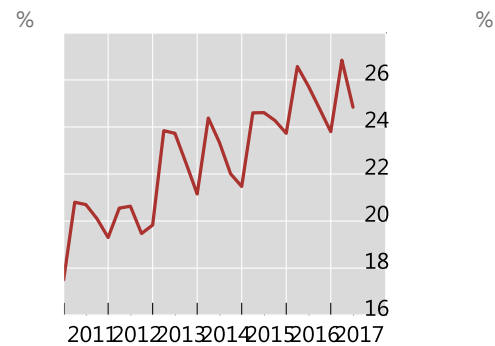
Growth of M2 and bank assets



Return on equity



Non-interest income/total income



Sources: People's Bank of China; WIND.

Shadow bank vs shadow of the banks

- Bank assets outgrow M2
- With profits under pressure, banks rely on non-interest income to boost profits

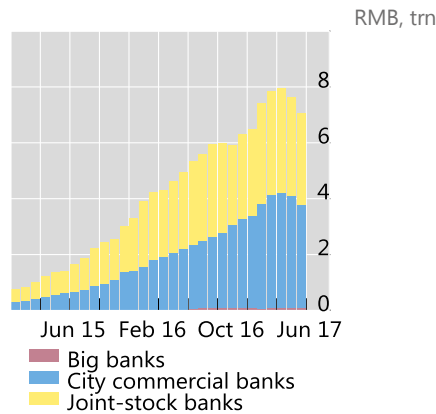


Recent developments in Chinese shadow banking

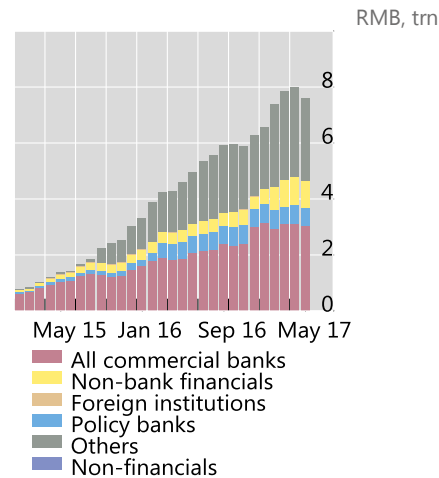
Certificates of deposit

Graph2

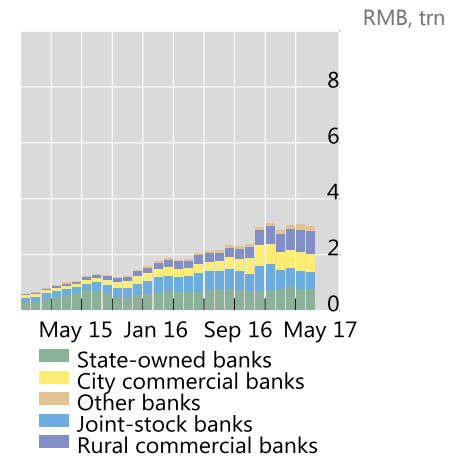
Amounts outstanding by issuer



All holders of CDs



Holdings of CD by bank



Source: WIND.

- Regulators continue to tighten rules on banks' "overambitious" balance sheet expansion
- Banks shift to new funding sources to finance b/s expansion



Recent measures to curb expansion

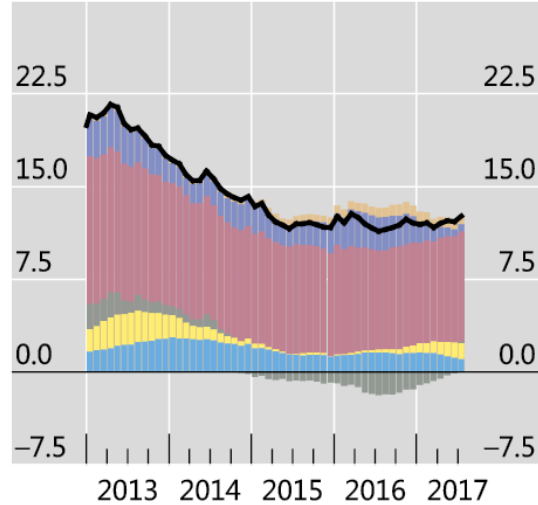
- Fundamental trade-off: growth or financial stability
- In 2017 H1 focus shifted to dealing with financial stability risks
 - PBoC's Macroprudential Assessment (MPA) extended in 2017 to cover off-balance sheet WMPs, from 2018 also negotiable interbank CDs
 - Banking regulator fired barrage of regulatory directives making regulatory arbitrage more difficult and curbing reliance on interbank funding
 - Securities regulator made it more difficult for securities firms to serve as conduits for banks' channeling business
 - Higher interest rate and tighter financial conditions reduce incentives to lever up



Are having some effect on flows

Total social financing

Percentage points yoy changes, per cent

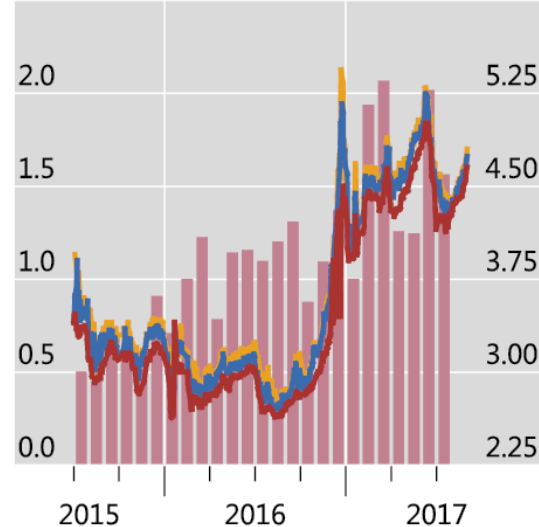


— Aggregate social financing (rhs)
 Contributions (lhs):
 Entrusted loans Bank loans
 Trust loans Corp bond financing
 Banker's acceptances Non-fin equity financing

Trust loans picking up again, bonds and entrusted loans slowing

Interbank NCDs

Lhs: RMB trn Rhs: %



Lhs: Rhs:
 ■ New issues — Joint-stock banks
 — City comm. banks
 — Rural comm. banks

Surge in interbank NCDs in early 2017

Bond market

Lhs: % Rhs: RMB bn



5-y bond yield (lhs): Issuance (rhs):
 — 5-y govt ■ Corp. bond
 — Corp. AAA
 — Corp. AA

Much lower corporate bond issuance in early 2017



Are having some effect on flows ...

... but level remains high

