The Fragility of Chinese Banks

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Chinese Bank assets as a % of GDP (“on B/S”)

Source: Wigram Capital Advisors
Type of Banks:
De-centralization meant growth of provincial banks
Weaker Regulation of unlisted Banks (in current Dollars)

Source: UBS research
Note: The China unlisted bank numbers exclude the assets of China's three policy banks
From Lending to Shadow Lending to Shadow Lending^2

- Savers
- Originating Bank
  - Deposit
  - Interbank Loan
  - Interbank Deposit
  - OFI 1
- OFI 1
  - OFI claims
- OFI 2
  - Interbank Loan
  - Deposit
- Trust
  - WMP
  - AMP
  - TBR
  - Loan
- Bank 3 Guarantee
- Corporate
  - Loan/Bond swap
  - Local Govment
  - Overdue but Not impaired
  - Overdue but Not impaired
Type of Assets: Shadow Lending growth from “Market Discipline”, Capital Arbitrage, Limiting regulation

We have substantially increased our investments in trust beneficiary rights and directional asset management plans due to the following reasons.

Firstly, we are able to reach more customers with financing needs through trust companies and securities companies. Secondly, the returns of investments in trust beneficiary rights and directional asset management plans are also generally higher than other investment products on the market. As of June 30, 2013, the weighted averages of the agreed return on trust beneficiary rights and on directional asset management plans were 6.98% and 6.06%, respectively, which were higher than the weighted averages of the agreed return on government bonds and bonds issued by policy banks as of the same date, which were 3.23% and 4.00%, respectively. In addition, most of our investments in bank guaranteed trust beneficiary rights or directional asset management plans have a risk weighting of 25% in calculating the risk weighted assets under the Capital Administrative Measures, which contribute to a more efficient use of our capital.

(source: Bank of Chongqing prospectus, page 135)

<table>
<thead>
<tr>
<th></th>
<th>Stated CT1 CAR</th>
<th>Impact of normalizing risk weighting from 25% to 100% on TBRs on CT1 CAR (bps)</th>
<th>Impact of applying loan provisioning (2.5%) to TBRs on CT1 CAR (bps)</th>
<th>Revised CT1 CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evergrowing Bank</td>
<td>8.71%</td>
<td>-318</td>
<td>-156</td>
<td>4.54%</td>
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<tr>
<td>Bohai Bank</td>
<td>8.64%</td>
<td>-315</td>
<td>-174</td>
<td>4.38%</td>
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<tr>
<td>Guangfa Bank</td>
<td>8.12%</td>
<td>-87</td>
<td>-40</td>
<td>6.90%</td>
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<tr>
<td>Zheshang Bank</td>
<td>8.62%</td>
<td>-111</td>
<td>-46</td>
<td>7.10%</td>
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<tr>
<td>Chongqing Sanxia Bank</td>
<td>8.74%</td>
<td>-173</td>
<td>-63</td>
<td>6.50%</td>
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<tr>
<td>Xiamen Intl Bank</td>
<td>8.17%</td>
<td>-234</td>
<td>-497</td>
<td>4.97%</td>
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<tr>
<td>Jizhou Bank</td>
<td>8.64%</td>
<td>-208</td>
<td>-101</td>
<td>5.79%</td>
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<tr>
<td>Bank of Zhengzhou</td>
<td>8.66%</td>
<td>-183</td>
<td>-81</td>
<td>6.20%</td>
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</tbody>
</table>

Source: Banks’ financial information and UBS
One of the largest capital flights in recent history

Source: Duquesne, Haver.
No Fiscal room

The pressure on funding markets reflects that China's PSBR is now approaching 10% of GDP.

China: Public Sector Borrowing Requirement
Central and Local Government Bond issuance as a % of GDP
Conclusions

1. The speed, extent and type of credit growth are concerning.

2. Risks concentrated in shadow loans (capital arbitrage), smaller provincial banks (with poor supervision or unlisted), and overcapacity sectors (with a strong SOE presence).