

# Corporate Credit Management in China

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May 30, 2019

# Speaker Bios

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William has been with Wells Fargo for 15 years in various international banking roles in FIG (Domestic Banks), ITS and Global Advisory. He has been leading the US-based Greater China Desk efforts during the past three years.

Before joining Wells Fargo, William worked in international trade business in Panama and China for over 10 years, including running his own export business in China.

William received his Master of Business Administration degree from the Wharton School of the University of Pennsylvania and his Bachelor of Art degree in English Literature from Nankai University. William lives in Greater Philadelphia area with his wife and younger daughter.



Han has covered China for Wells Fargo for 13 years with senior roles in Global Advisory, FIG, and Global Payments Services

He completed his undergraduate in business at the University of Michigan, and has advanced degrees in international studies (Johns Hopkins School of Advanced International Studies), finance (NYU Stern) and Chinese commercial law (Fudan University Law School).

Han previously served in the U.S. Marine Corps and is a Returned Peace Corps Volunteer (Ukraine). He currently serves on the Board of Governors, American Chamber of Commerce Shanghai and is an Executive Education instructor at NYU Stern where he teaches a course on the China Financial System for their Masters of Science in Global Finance program. Han lives in Shanghai with his wife and two daughters.



Based in Tokyo, Sean has been with Wells Fargo for 18 years and oversees strategic corporate trade finance initiatives throughout Wells Fargo's APAC region. During his career at Wells Fargo, he has held senior leadership positions in trade & supply chain finance, treasury management and electronic payments in the United States.

Sean started his career with PNC Financial Services in corporate banking. Before joining Wells Fargo, he was a senior director at a FinTech company. Sean earned his B.S. degree in business from Gannon University and holds an M.B.A. in finance and information technology from Duquesne University. Additionally, he has a Certified Treasury Professional designation from the Association for Financial Professionals, and holds a Certificate in International Cash Management from the Association of Corporate Treasurers in the United Kingdom.

# Macro Economy

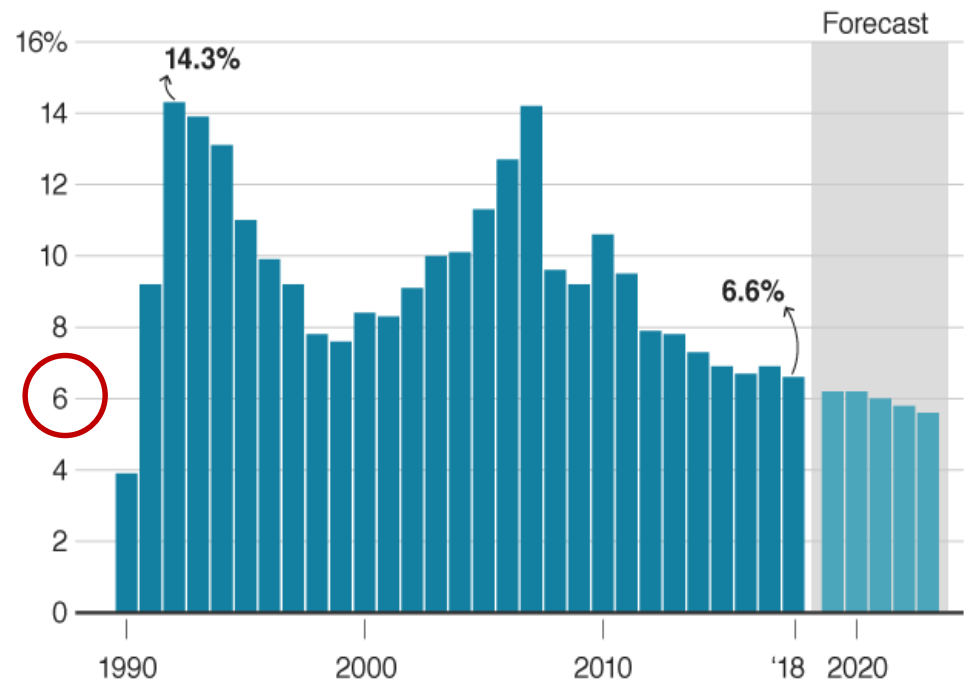
# China GDP – Input or Output?

- Gross Domestic Product (GDP) is a broad measurement of a nation's overall economic activity. ( Consumption + Investment + Government Spending + Net Exports )

<https://www.investopedia.com/terms/g/gdp.asp>

- Does not distinguish between wealth creation vs destruction activities
- Is GDP, as applied in China, an “Input” or an “Output” (Michael Pettis- Guanghua School of Management, Beijing University)
- If not to be taken at face value, can the GDP's directional trend be considered a signal of government intent?

## China's slowing economy



Source: IMF

BBC

<https://www.bbc.com/news/business-47450223>

# Challenge is Rebalancing Spending Such That....

## Consumption



### Borrowing Binge

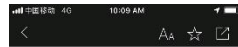
— Net new short-term loans to households

Unit: Billions of yuan



Sources: People's Bank of China, Caixin Data, CEIC

<https://www.caixinglobal.com/2019-04-22/chart-of-the-day-record-rise-in-new-short-term-household-loans-101407151.html?key=4jqc%28U9Dv0s21kwd0t3vLk2FE7c4pKton4GnDhqqG875fWYHAmQ%3D%3D>



### China's Services Sector Expands at Fastest Pace in 15 Months: Caixin Survey

By Liu Jieda  
May 06, 2019 09:45 AM



China's services activity expanded at the fastest pace in 15 months in April on solid growth in both domestic and foreign demand, a Caixin survey showed Monday.

Caixin

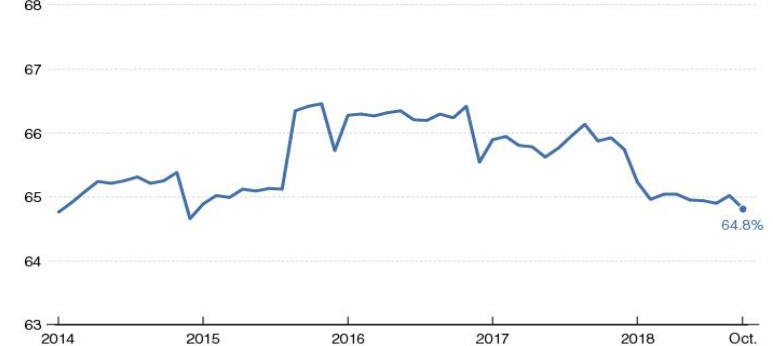
## Investment



### Deleveraging SOEs

— Debt-to-asset ratio

(%)



Note: SOEs excluding financial institutions

Sources: Ministry of Finance, CEIC, Caixin Data

## Government



- 2019 Announced Cuts to Taxes & other Company fees Total: \$298bn
- VAT for transport/ construction sectors: Cut from 10% to 9%
- VAT for manufacturers: Cut from 16% to 13%
- Cut Reserve Ratio of small/medium banks to provide \$41.5Bn in funds

<https://www.bbc.com/news/business-47450223>

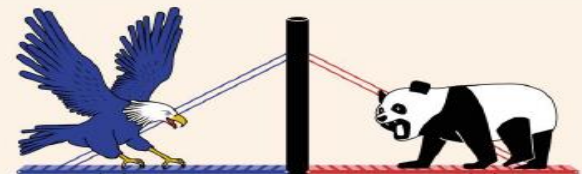
## Net Exports



### Donald Trump declares trade war on China

No sovereign power could accept the humiliating demands being made by the US

MARTIN WOLF + Add to myFT



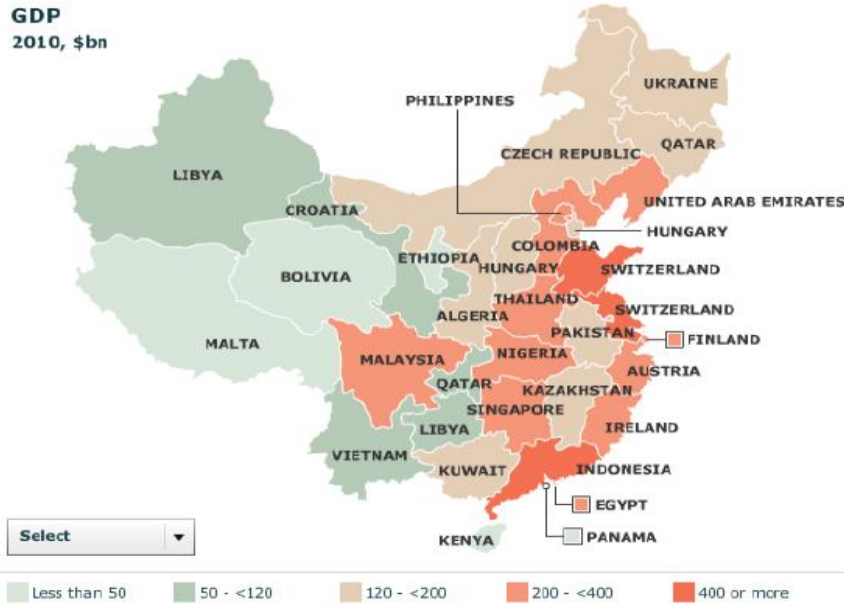
- Impact:** Your guess is as good as ours, but if the trade conflict escalates, expect more China domestic stimulus measures and potential RMB depreciation

# Governance Overview

# China – A Composite of Different Economies

- China is a composite of diverse and unequal economies
- Country-wide policies must reconcile with localized policies (i.e. financing, welfare, etc.)

## GDP Comparison: China Province - Country Equiv.



Source: Economist

## Pension Rich, Pension Poor



Ministry of Finance, Caixin Data

Caixin



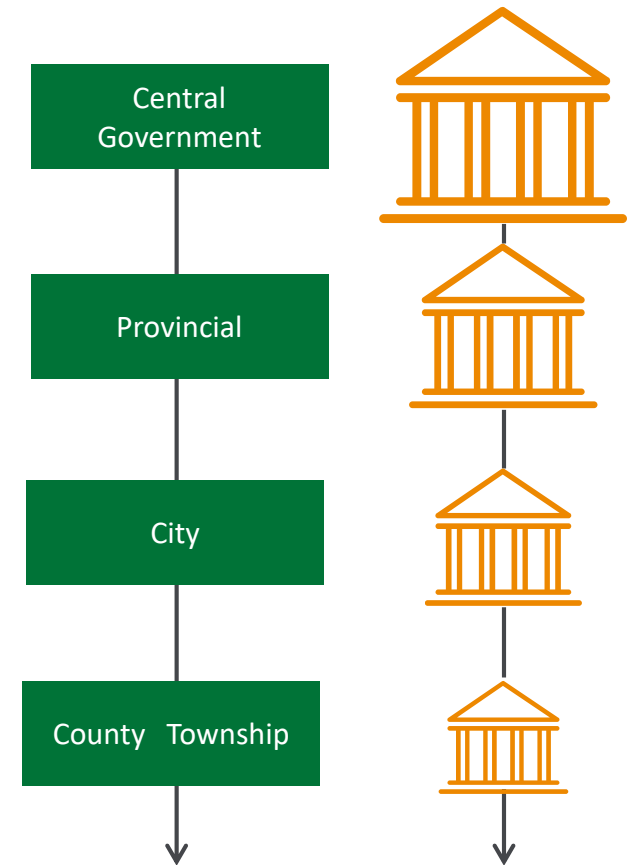
# Governance Structure – Top vs. Down

- Centralization vs. Decentralization: “The Mountain is High, the Emperor is Far Away”
- Struggle more than just political. Implications in tax system, credit allocation, etc.

People’s Republic of China (PRC) map

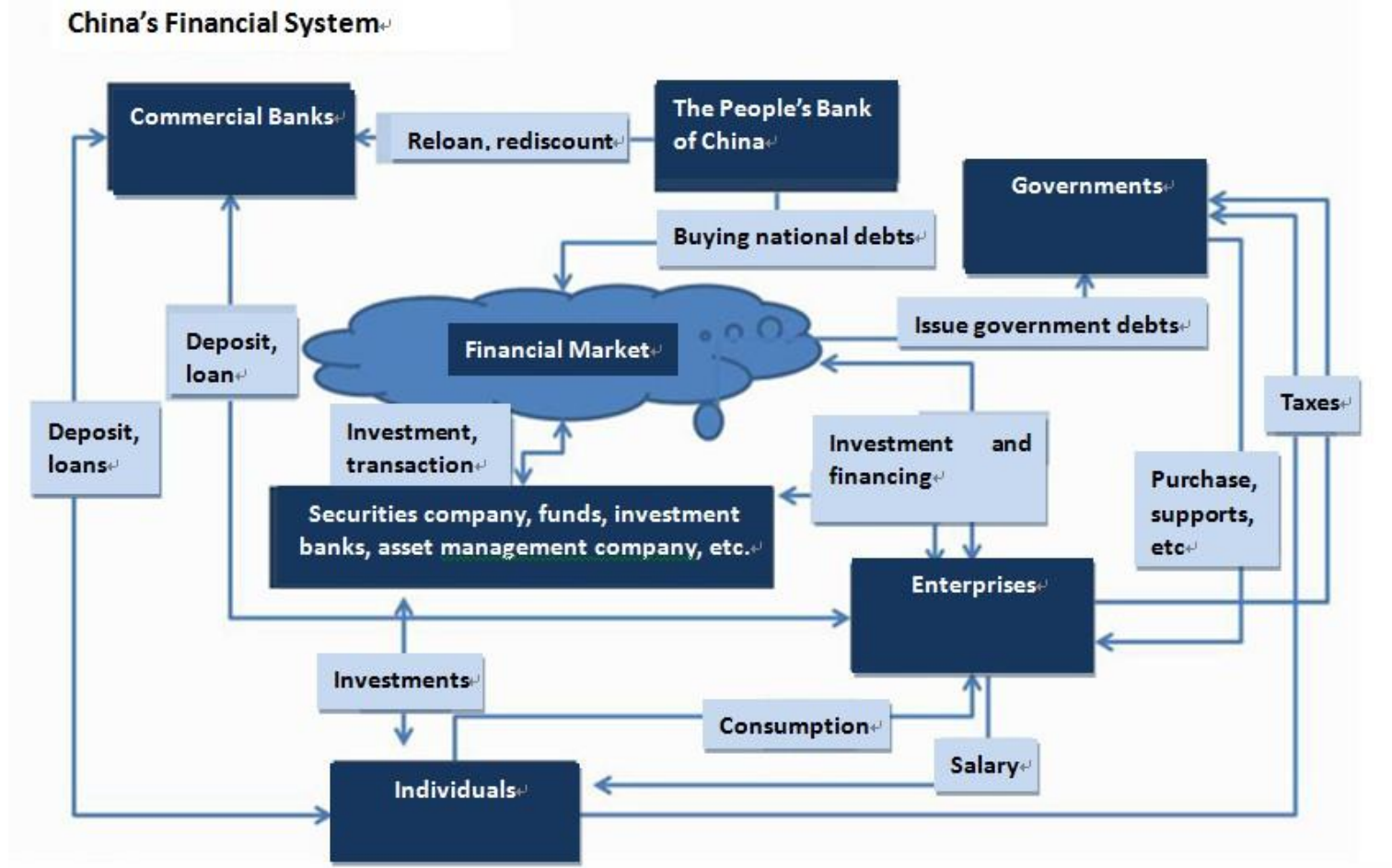


China governance structure



# Financial System

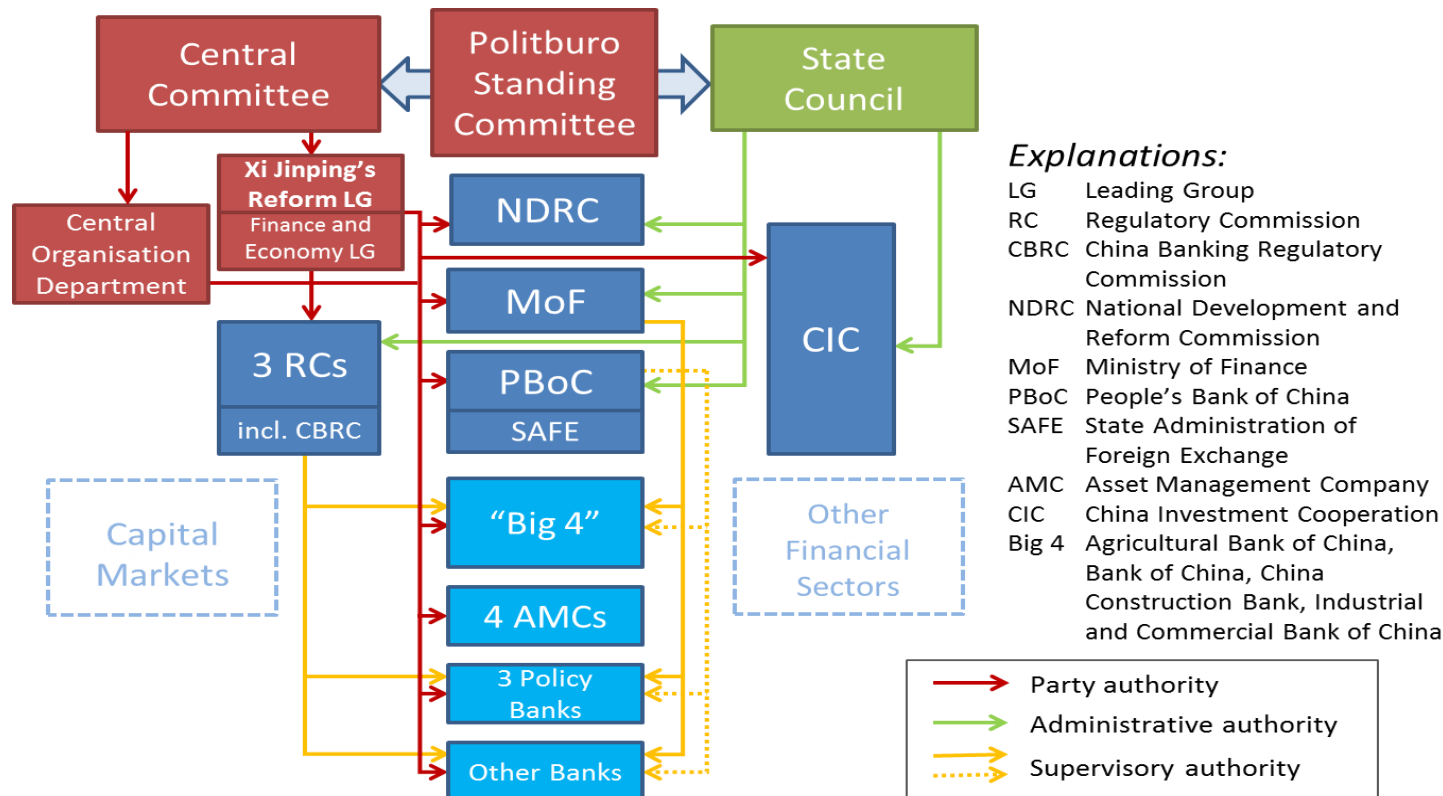
- Like any financial system, there are multiple participants involved



# Financial System Policy

- Unlike many financial systems, there is a high degree of party / gov't intervention

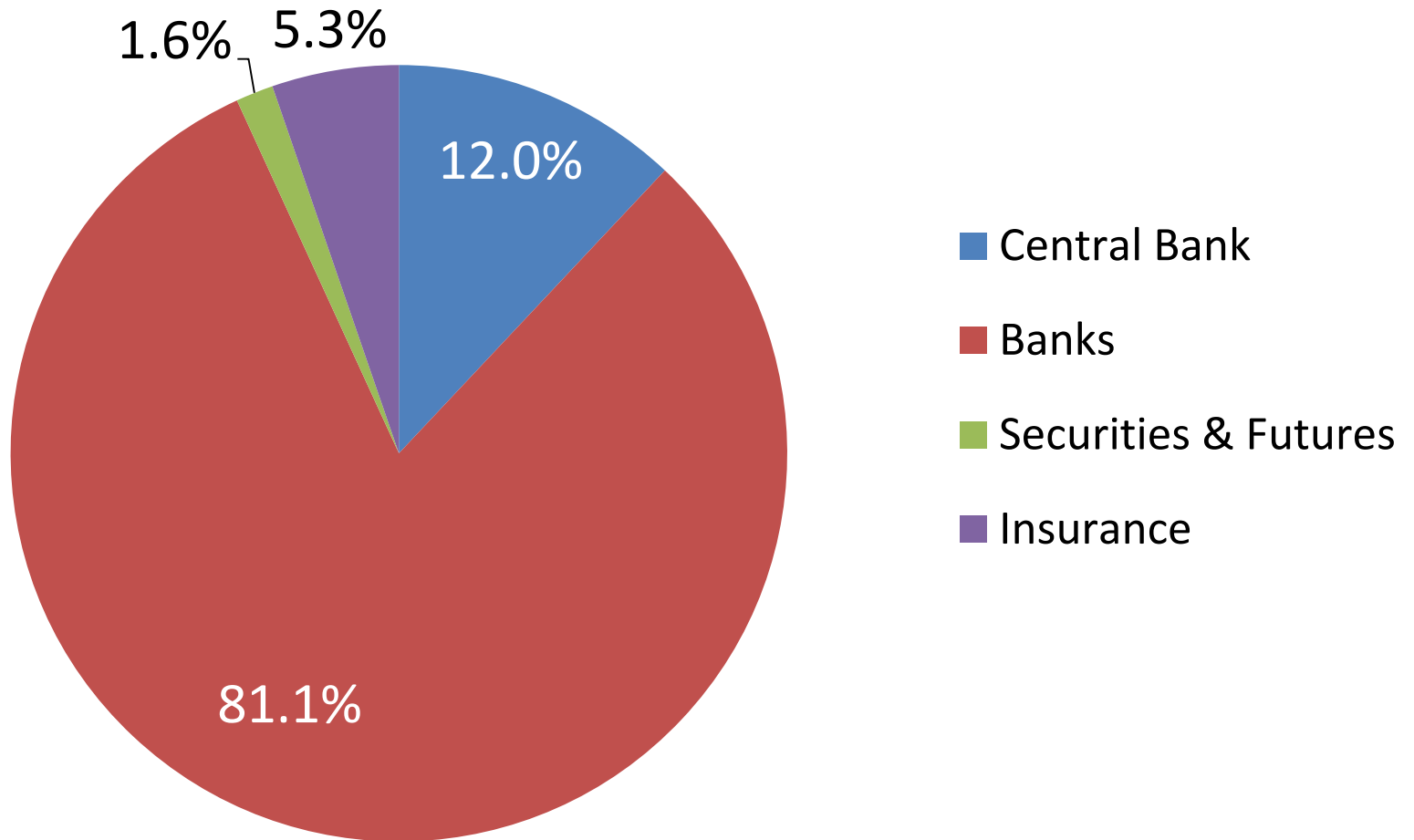
*“There is no such a thing as separation between the party and the government. There is only a division of functions. We must take a clear position and be straight-forward on this issue.” – Wang Qishan, Vice President, PRC (2018)*



# Banking System

# Assets of China's Financial Sector

- Financing is all about banks, particularly the Big 4 + Bank of Communications



# People's Bank of China – Loan/Deposit Benchmark Rates

- Loan rates are liberalized. Roughly 70-80% of all China financing is bank-based
- Deposit rates are theoretically liberalized, but may follow window guidance

Tenor	Loan	Deposit	130%	140%	150%	SHA Deposit Window Guidance
<b>0/N</b>		0.35	0.455	0.637	0.956	0.45
<b>1 Day</b>	4.35	0.8	1.04	1.12	1.2	1.04
<b>7 Day</b>	4.35	1.35	1.755	1.89	2.025	1.755
<b>3M</b>	4.35	1.1	1.43	1.54	1.65	1.55
<b>6M</b>	4.35	1.3	1.69	1.82	1.95	1.755
<b>6M-1Y</b>	4.35					
<b>1Y</b>	4.35	1.5	1.95	2.1	2.25	2.1
<b>1Y-3Y</b>	4.75					
<b>2Y</b>	4.75	2.1	2.73	2.94	3.15	2.94
<b>3Y</b>	4.75	2.75	3.575	3.85	4.125	3.85
<b>3Y-5Y</b>	4.75					
<b>&gt;5Y</b>	4.9					
Loan : No Rate Floor						
Deposit : Maximum Rate Offered = SHA Window Guidance Rate						

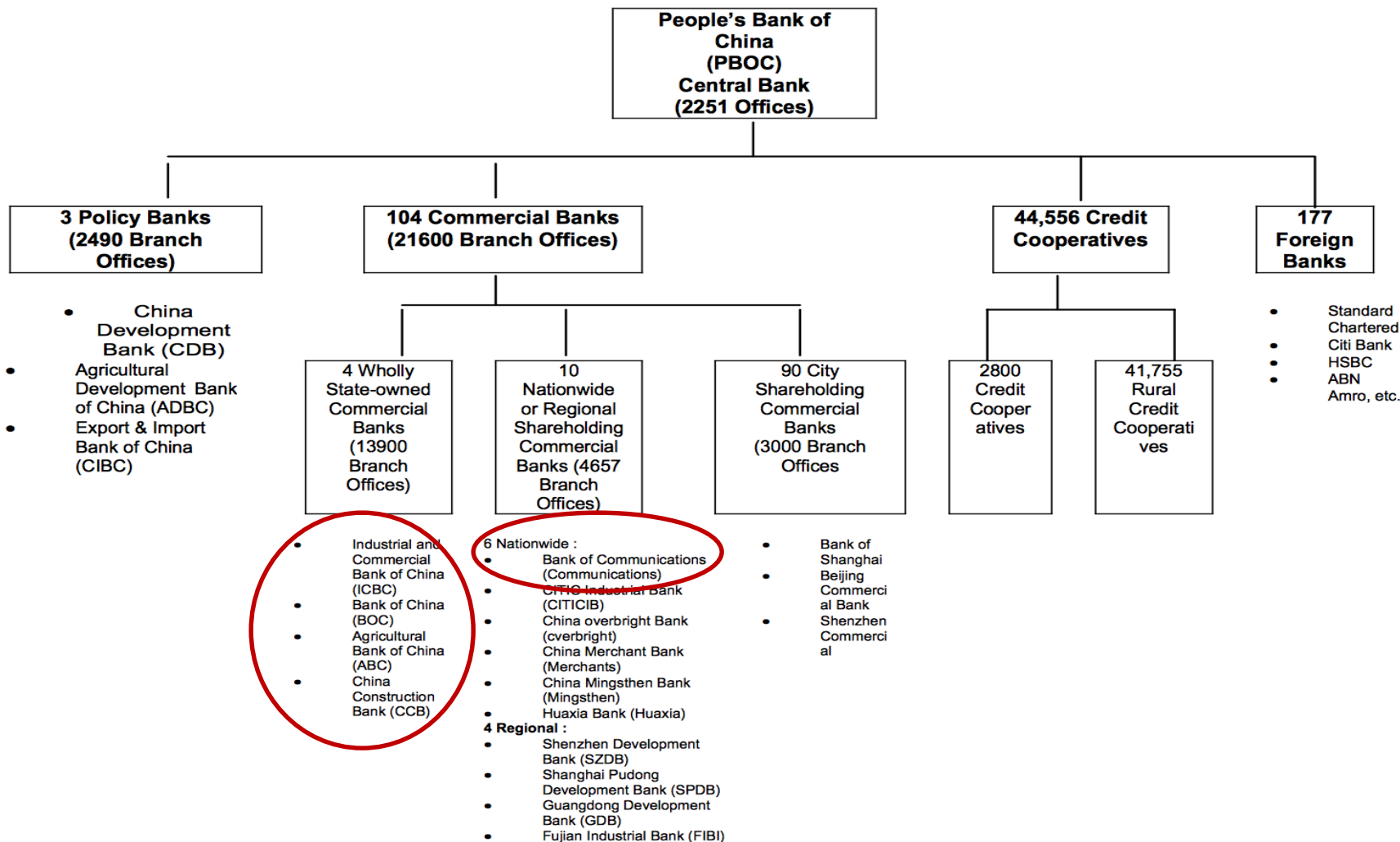
Source: People's Bank of China  
Benchmark Rates

Note: Figures under 130%, 140%, 150% columns  
reflect the Deposit rate x 130%, 140%, 150%

Note: SHA = Shanghai

# Banking System

## Organizational Structure of China's Banking System

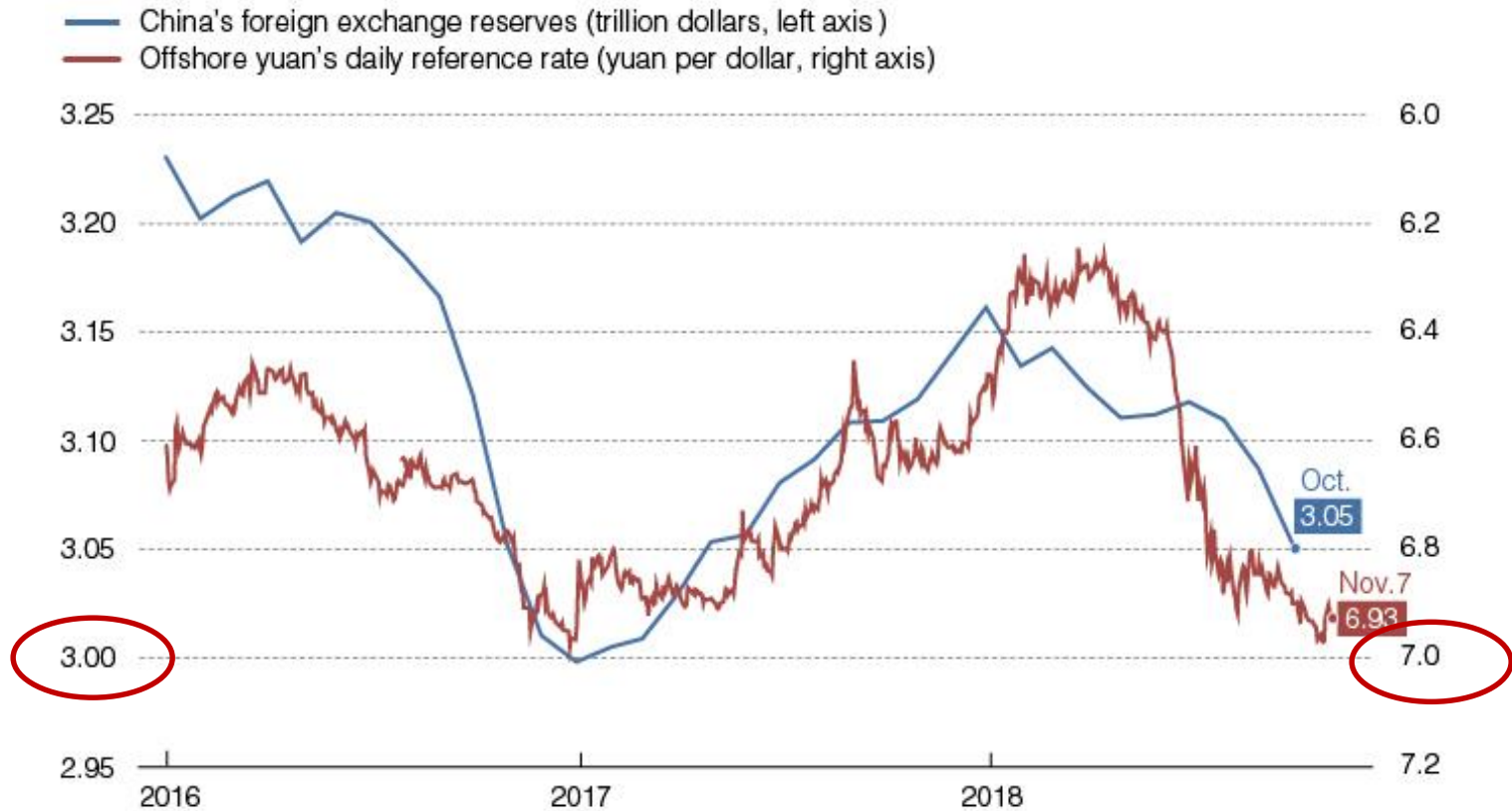


# Exchange Rates and China Foreign Reserves



# If You Only Remember Two Numbers : 7 and 3

## China's Shrinking Forex Hoard



Sources: People's Bank of China, Treasury Markets Association

<https://www.caixinglobal.com/2018-11-08/chart-of-the-day-chinas-forex-hoard-hits-18-month-low-on-strong-dollar-101344503.html?rkey=4joj%2BU9DvvDs21kwdd13vFL%2FE7ci4pKGTewftI3OciB4Zo4YcuXfQ%3D%3D>

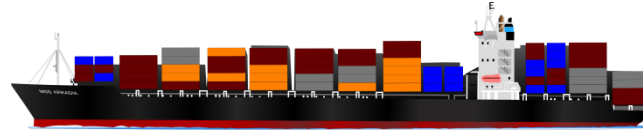
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# US – China Trade Dispute Update

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## 2017 U.S. – China Trade Snapshot

**U.S. exports to China: \$130BN**



Top exports:

- agricultural products
- aircraft
- automobile
- electrical machinery



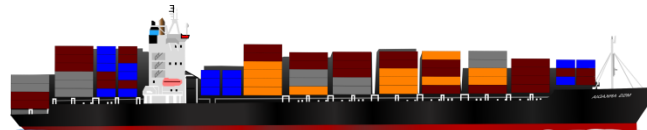
**Deficit = -\$375BN**



Top exports:

- consumer electronics
- clothing
- machinery

**China exports to U.S.: \$505BN**

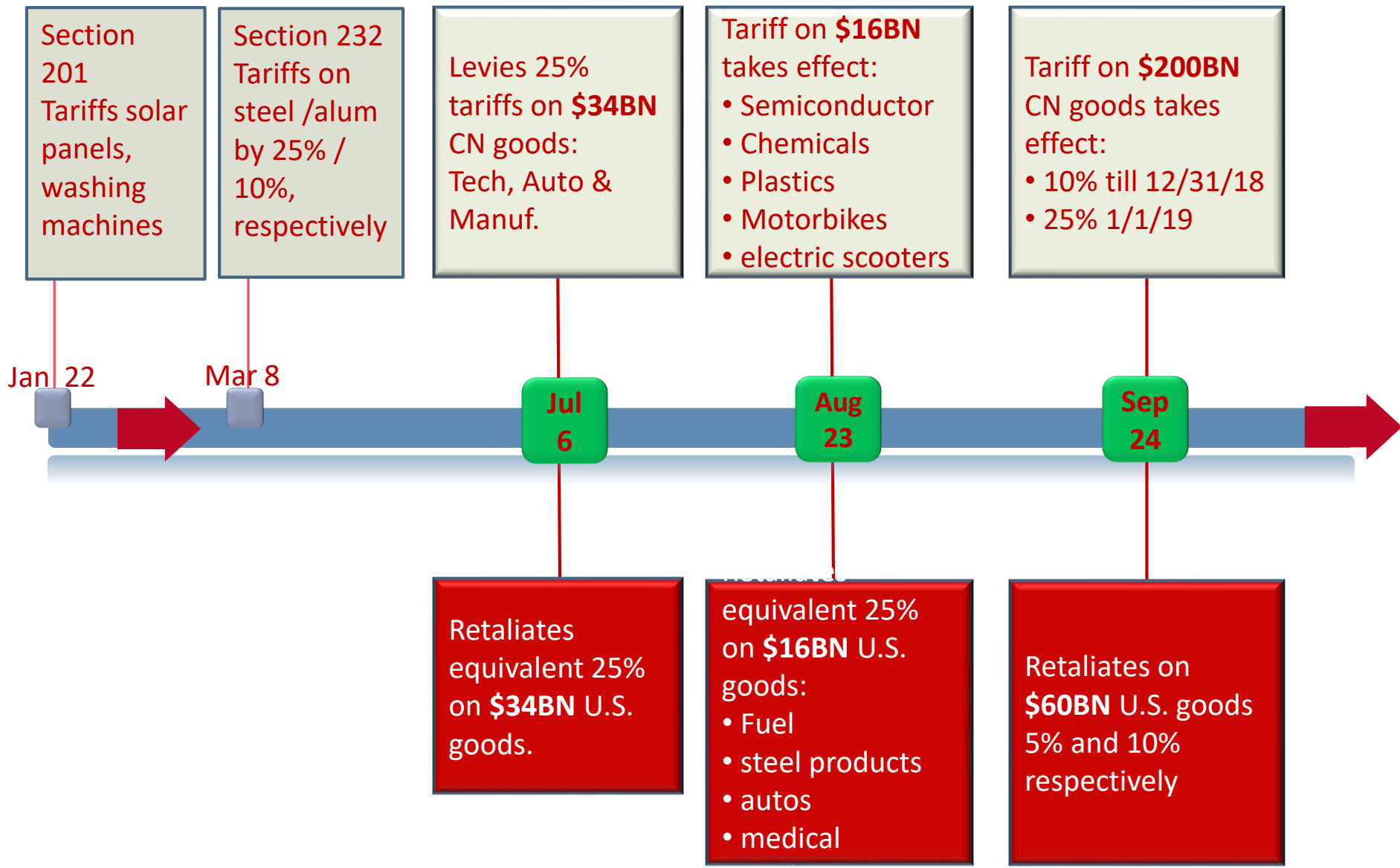


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# The Timelines

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# Timeline: Tariff Rounds in 2018





### **12/1 2018: G-20 Summit: Truce Reached**

- U.S. postponing increase of tariff from 10% to 25% of \$200BN Chinese goods for a 90-day period, starting 12/1/2018.
- China promising increase of U.S. purchase etc.
- March 1, 2019 deadline for a trade deal, or tariff increase from 10% to 25% on March 2 2019

### **Post Truce Actions**

- **Auto tariff**  
12/14: suspends increased tariffs on U.S. vehicles and auto parts (imposed in retaliation in July)
- **Soybeans**  
Restarted purchase, estimated at least combined 2.5mm tons in December.

### **Growing at a slower pace**

Deceleration 2H2018, with trade war considered a substantial factor.

- Total Retail Sales of Consumer Goods Index, Nov 2018 YoY growth at 8.1%, the lowest in 15 years.
- PMI (both official PMI and a private survey PMI): Dec 2018 dropped below 50%, indicating contraction, with weakening pricing and new order indexes.
- Automobile industry: Est. 2018 annual sales at 28mm vehicles (including 23mm passenger vehicles), a 3% YoY decline and the first decline in 28 years (although the drivers are broader and more complex than trade war per se)

### **Liquidity easing, lowering of reserve ratio for banks:**

- **1/4/2019**: after lowering 3 times in 2018, lowered again by 1%, aimed at supporting SMEs

### **Tax Cuts:**

- New Personal Tax rule effective 1/1/2019 (partially started October 2018), increasing personal income tax threshold from RMB3,500 (USD515) to RMB5,000 (USD735)
- Expected tax cuts for corporate in 2019

## December stock markets:

- Dow: losing 8.5+%,
- S&P 500: losing 9%,
- Both Dow and S&P 500 worst December since 1931
- Nasdaq has worst December on record

## 1/2/2019 : Apple Forecast and China Exposure

- Apple lowered 2019 forecast, citing slower economic growth in China as a major cause
- Dow plunged over 600 points on 1/3/2019
- China-sensitive MNCs stocks fall across the board, raising concerns of the impact of slowing Chinese economy, albeit might evidence the effectiveness of U.S. trade pressure



Donald J. Trump  
@realDonaldTrump

Follow

Just had a long and very good call with President Xi of China. Deal is moving along very well. If made, it will be very comprehensive, covering all subjects, areas and points of dispute. Big progress being made!

8:03 AM - 29 Dec 2018

6,740 Retweets 28,813 Likes



7.9K 6.7K 29K





## 2019 Negotiations

1. **Jan 7 - 9, Beijing**
2. **Jan 30 - 31, Washington DC**
3. **Feb 11 - 15, Beijing**
4. **Feb 21 - 24, Washington DC**
  - **Feb 24**, President Trump announces extension of March 1 trade deal truce deadline
5. **Mar 28-29, Beijing**
  - **Mar 31**, China extends the suspension of additional tariffs on US autos and auto parts
6. **Apr 3-5, Washington DC**
7. **Apr 30-May 1, Beijing**

## Treasury Secretary Mnuchin May 1 Tweet



**Steven Mnuchin** ✓  
@stevenmnuchin1



.@USTradeRep Ambassador Lighthizer and I just concluded productive meetings with China's Vice Premier Liu He. We will continue our talks in Washington, D.C. next week.

♡ 279 3:49 AM - May 1, 2019

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## The Timelines: May 5 2019

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## New Turns in Tariffs

- **May 5** – President Trump’s tweet “The 10% will go up to 25% on Friday”
- **May 10**
  - US increases tariff from 10% to 25% on US\$200BN worth of Chinese goods
  - The increase will take effect from May 10 at 12:01 am (EDT)
  - USTR will hold a public hearing on June 17 on the possibility of imposing 25% tariffs on remaining US\$300BN worth of Chinese goods, including smartphones and laptops.
- **May 13** – China announces retaliatory tariff on US products
  - Will increase tariffs to various levels 5%, 10%, 20% and 25% on US\$60BN worth of US goods from June 1



### Dow Jones Industrial Average



SOURCE: TRADINGECONOMICS.COM | OTC/CFD

### Shanghai Composite Stock Market Index



SOURCE: TRADINGECONOMICS.COM | OTC/CFD

## RMB Pressure: the Mark of “7”



SOURCE: TRADINGECONOMICS.COM | OTC INTERBANK

### **Other Latest Developments**

- Reports of China's potential cancellation of orders of soybeans and pork from the U.S.
- **The Huawei Factor**
  - May 15: President Trump effectively bans Huawei with national security order

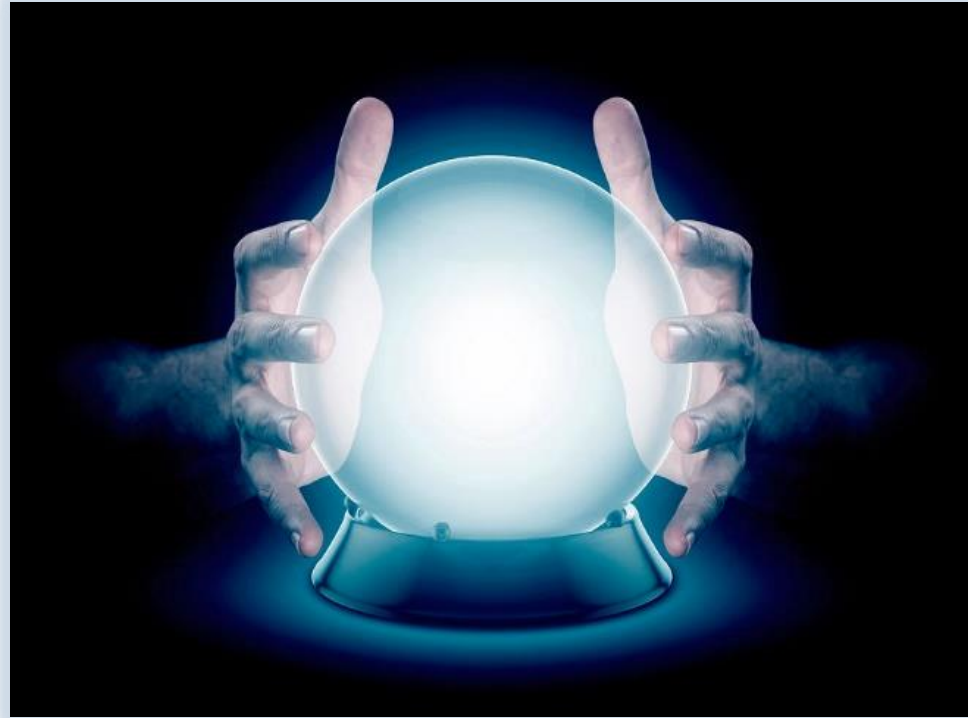
**Could it be:**

- **Misread or misjudgment from each other?**

**Or**

- **Change of minds and hearts from one or both sides?**

## Deal or No Deal?



- No sign of next round of negotiation
- Possible meeting between President Trump and President Xi at G20 Osaka summit (June 28 – June 29)



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## Impact on Global Supply Chain, Market and Opportunities

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## Supply chains significantly impacted

A recent AmCham China and AmCham Shanghai joint survey (May 16-20, 2019, with nearly 250 responses) shows responses below:

- **Adjusting supply chains**
  - Seeking to source and/or assembly outside of the U.S. : 25.2%
  - Seeking to source and/or assembly outside of China: 22.7%
- **Considering delaying or canceling investment decisions:** 33.2 %
- **No plans to relocate manufacturing facilities:** 64.6%
- **If relocating, destinations are:**
  - Southeast Asia and the Indian Subcontinent: 24.7%
  - Back to the U.S.: 5.96%

## Leaving China isn't easy

China has a range of advantages for manufacturing industries over many Asian countries.

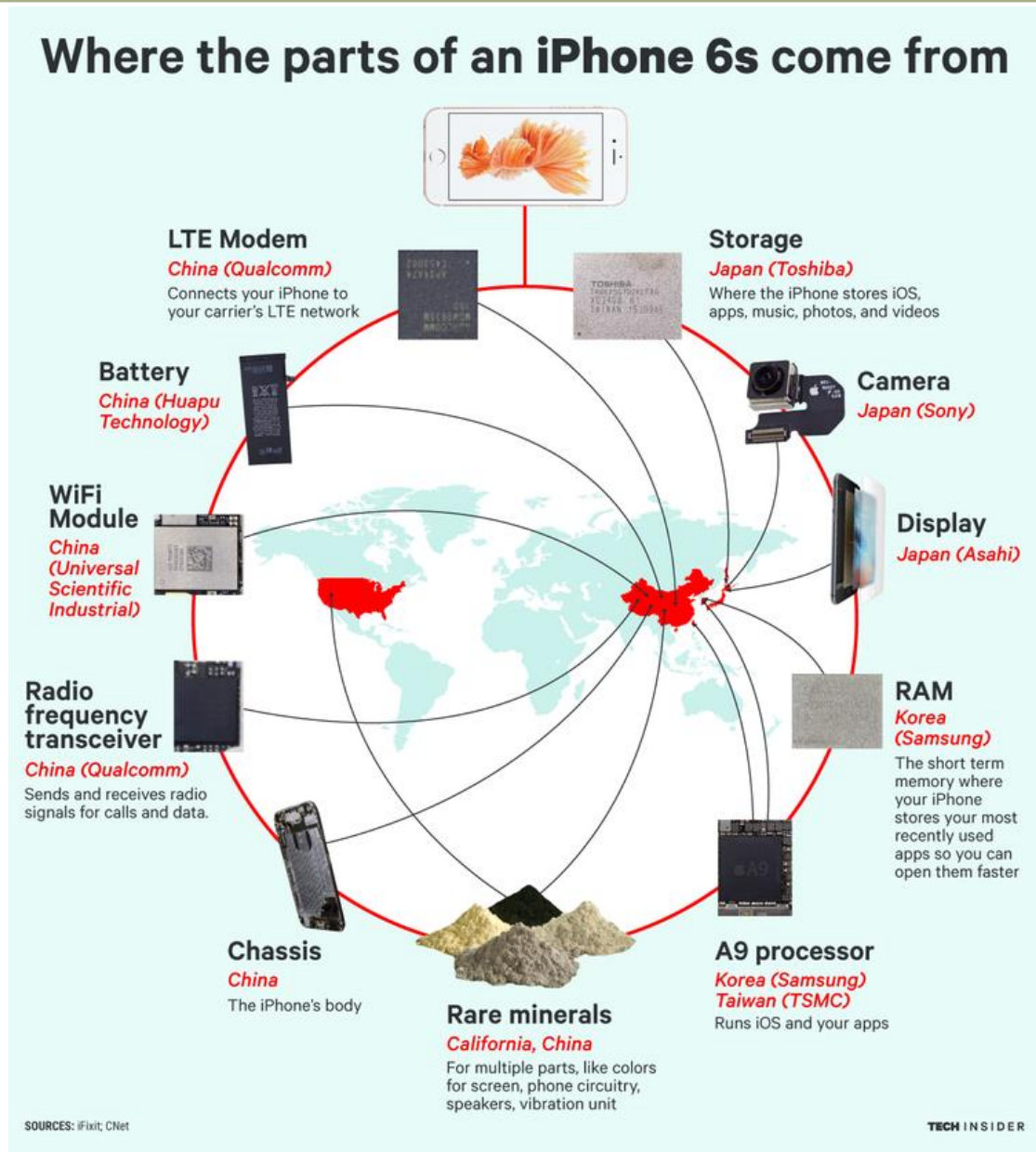
- Existing well equipped capacity
- highly trained workers
- Accumulated experiences
- Infrastructure: better roads, ports and power grids than most Southeast Asian countries

## Complex supply chains

- Involve multi-tier vendor/buyer coordination and resource optimization
- Changes on such supply chains are complex and take years to complete, unlike labor-intensive supply chains which has started relocating out of China even before the trade war

- **“iPhone 6s Example”**  
The illustration of a complex supply chain.

Source: [www.businessinsider.com](http://www.businessinsider.com)



# China Bankers Acceptance Drafts: An Overview

# What are Bankers Acceptances?

- **Banker's acceptances (BAs) are time drafts** — orders to pay a specified sum of money at a specified date; drawn on and accepted by a bank
- **The bank assumes the responsibility for paying the draft at maturity**
- **BAs are usually negotiable and constitute an unconditional promise to pay**
- **They are designed to raise funds and are self-liquidating**
- **BAs can be issued for terms up to 180 days and can be used to finance a wide variety of transactions, including:**
  - International shipments
  - U.S. domestic shipments (25 miles or more)
  - Storage of readily marketable staples secured by a warehouse receipt
  - Can be used to secure open account payments, refinance import letters of credit (L/Cs), and to discount export L/Cs

# Bankers Acceptance Drafts in China

- **China BAs are similar to traditional BAs with a few exceptions:**
  - Drawn on and accepted by banks in China
  - Transacted under open account
  - Domestic domestic (China) trade only
- **China BA is a fundamental and growing trade payment type** - may be issued, received, and/or transferred by corporations operating in China
- **Companies may hold to maturity, discount, or transfer depending on their working capital objectives and/or credit policy**
- **Regulation has evolved significantly over the past 10 years**
- **The PBOC has been actively pushing a move from paper BA drafts to electronic form**

# History of Acceptance Drafts in China

- **Phase I (1979 - 1999)**

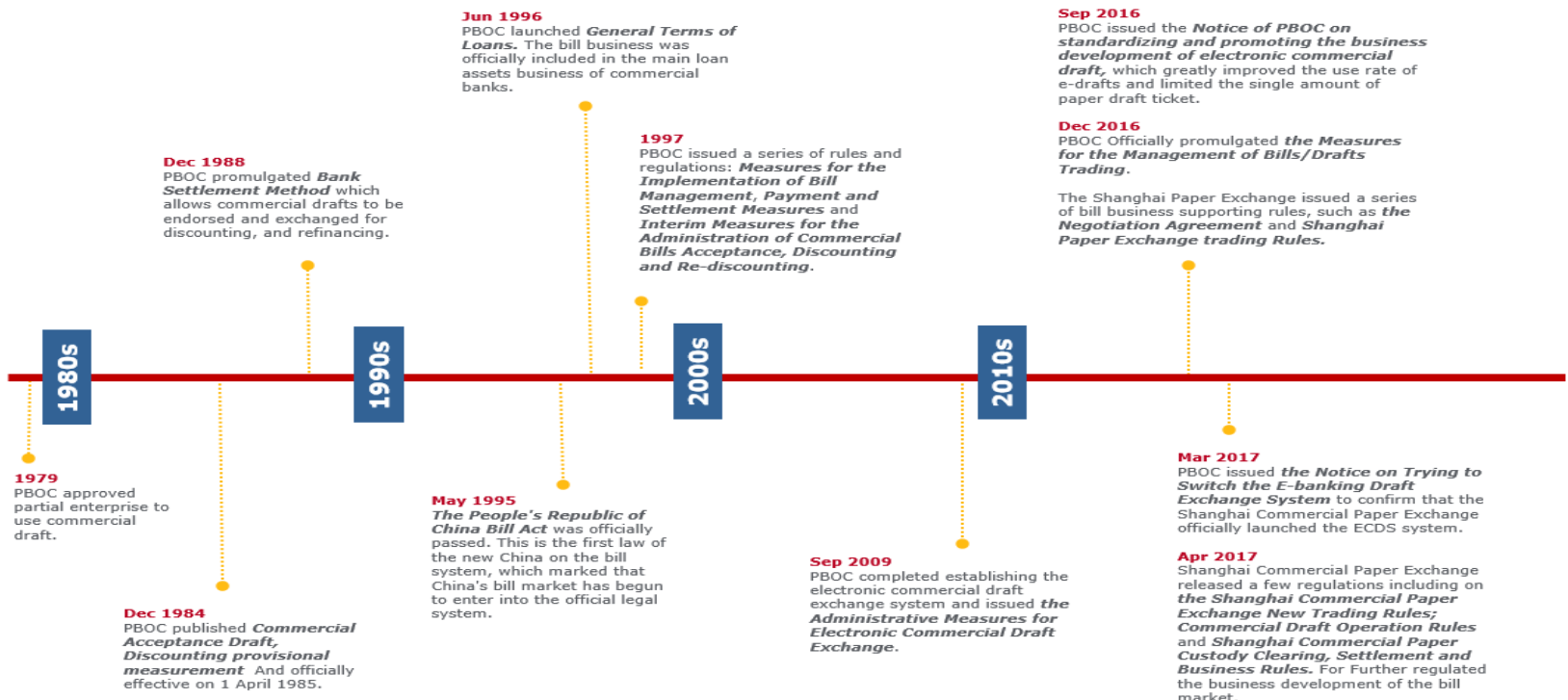
The bill market was mainly used as a payment & settlement tool and commercial credit guarantee exchange. Market participants were confined to state-owned commercial banks and a few large enterprise groups.

- **Phase II (2000 - 2009)**

As a key credit scale adjustment tool, the bill market played a role of 'storage pool' in financial market. At this stage, the economy boom led to increased demand for financing and the bill market grew significantly.

- **Phase III (2010 ~ Present)**

China's economic development entered into a transition period, with financial deleveraging and supervision gradually strengthening. Electronic commercial draft system at this stage has been recognized and popularized the market as a way to improve efficiency and increase transparency.



# Paper Drafts vs. Electronic Drafts

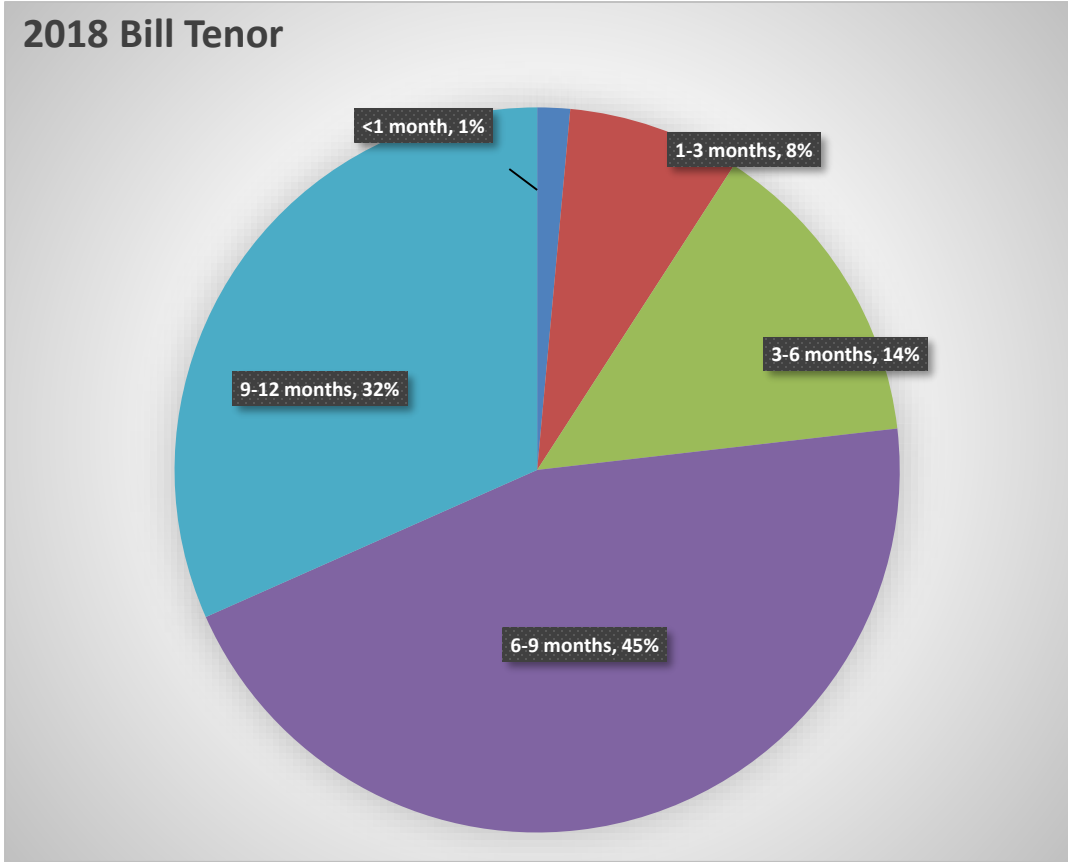
- When state firms dominated China, BA Drafts had been predominantly paper-based; immature regulation
- Paper drafts were the source of triangular debt and several high profile fraud cases arose.
- As a result, the People's Bank of China (PBOC) stepped in to aggressively combat fraud and regulate the market over the past several years.
  - Acceptance drafts fall under the PBOC negotiable instrument law and local law.
  - The PBOC has aggressively promoted a move from paper to electronic BA Drafts.
  - As of 1/1/18, the PBOC mandated that all commercial drafts with a value of RMB1 million or above must be issued by the electronic commercial draft system.
  - Every Acceptance Draft transaction will require the accompanying original contract and invoice from the applicant requesting for a discount.

## Results:

- Discounting activity grew 38.83% to 9.94 trillion yuan in 2018; of this discounted amount, **e-drafts made up 96.86%** (9.73 trillion yuan), with the remainder being paper drafts.



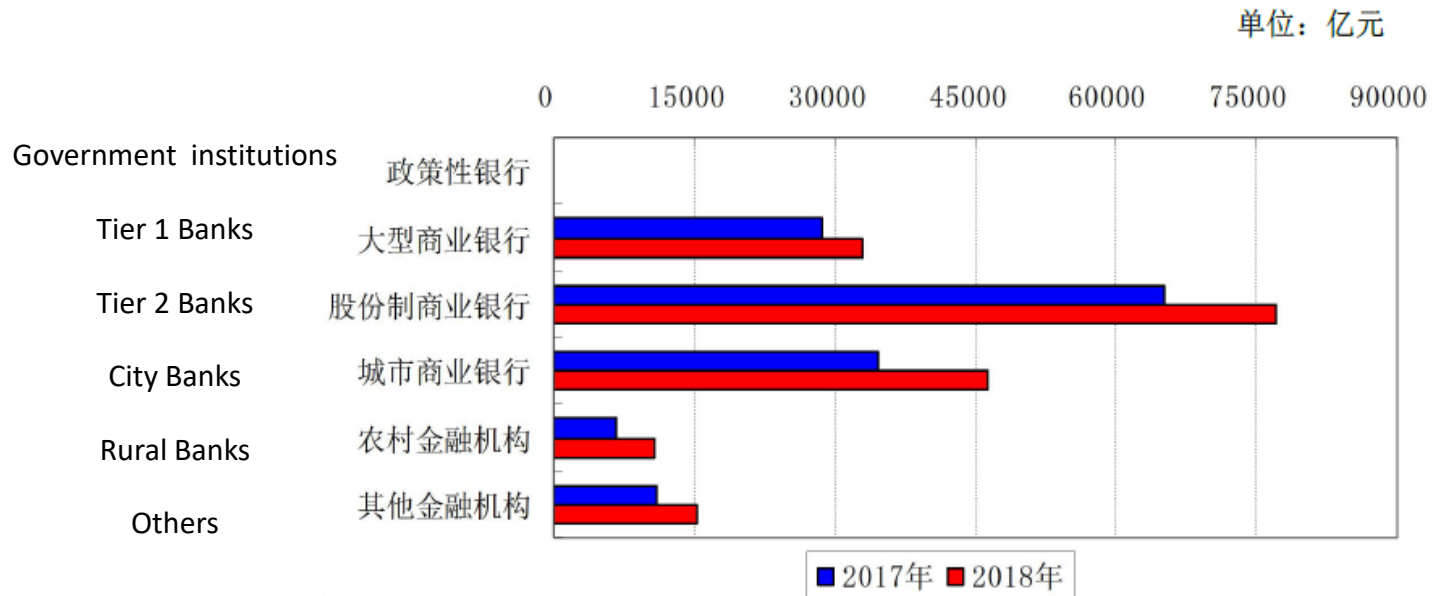
# China BA bill tenor



Source: Shanghai Commercial Paper Exchange Corp, Ltd.

# Acceptance by institution type

The amount of acceptance of various types of institutions in 2017-2018 (Unit: 100 million yuan)



Source: Shanghai Commercial Paper Exchange Corp Ltd.

# Questions