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ASIA NEWS | Updated April 4, 2012, 11:35 a.m. ET

Chinese Premier Blasts Banks

By DINNY MCMAHON, LINGLING WEI and ANDREW GALBRAITH

Chinese Premier Wen Jiabao told a national audience on Tuesday that China's state-controlled banks are a "monopoly" that must be broken up, in a blunt appeal for a shake-up of the creaky financial system of the world's No. 2 economy.

In a blunt appeal, Chinese Premier Wen Jiabao told a national audience that China's state-controlled banks are a 'monopoly' that must be broken up. Lingling Wei has the story. Photo: Feng Li/Getty Images

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In an evening broadcast on state-run China National Radio, Mr. Wen told an audience of business leaders that China's tightly controlled banking system needs to change.

"Let me be frank. Our banks earn profit too easily. Why? Because a small number of large banks have a monopoly," said Mr. Wen, according to the transcript of the program on the broadcaster's website. "To break the monopoly, we must allow private capital to flow into the finance sector."

Mr. Wen's comments tap into a rich vein of popular anger against China's biggest banks that has been building in recent months online and in the media.

The backlash was initially prompted by frustration at what has been perceived as banks' payments of low interest rates on deposits and indiscriminate levying of fees. It has worsened in recent weeks as lenders posted record profits, even as the economy slows and some companies struggle to access credit.

Mr. Wen's push is part of a broader set of issues over China's growth, and came on the same day that Beijing unveiled programs intended to support the development of the country's capital markets and to spread international use of the yuan.

Among them, China's security regulator said it would more than triple the amount that foreigners would be allowed to invest in China's heavily restricted financial markets to $80 billion.

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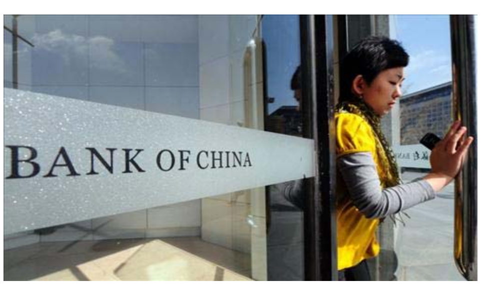

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Mr. Wen formally came into office in 2003 with a reputation as a reformer but has acknowledged publicly his regrets that he didn't go far enough. The premier is expected to step down in a once-a-decade leadership change that begins late this year.

The country's economic expansion is set to slow in coming years after racing ahead at a torrid pace over the past decade, raising questions over whether China can switch from a model based on exports and investment to one that relies more on a rising consumer culture.

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That has led to a nationwide conversation over China's tight grip on its financial system, which favors big state-owned firms but has been criticized by economists and even some reformers in China for impeding more balanced growth.

Many in China now believe a crisis will come without economic reform.

Mr. Wen's remarks, in the export-oriented province of Fujian, are further indication that long-delayed economic reform is now at least a topic for public debate.

His comments challenge a widespread assumption that reform will have to wait for years until the new leadership under Xi Jinping, China's designated next party chief, is installed and has established a power base and cemented allegiances.

To realize the economic transformation, "private companies should be encouraged to get into the financial-services industry," said Fang Xinghai, director-general of Shanghai Municipal Financial Services Office and a former World Bank economist, in an interview at China's Boao Forum for Asia this week.

For decades, China's economic growth has relied to a large extent on the captive savings of ordinary Chinese moved at cheap rates to state-owned enterprises. The system penalizes savers and rewards borrowers, perpetuating an economic imbalance marked by high rates of investment and suppressed consumption.

That model is increasingly seen as unsustainable. To lift the economy, many economists believe China must now transfer more money to consumers and aid its service sector, which is based on private enterprise.

Some economists argue that low interest rates are partly a consequence of China's efforts to keep its currency undervalued. The central bank fears that higher rates would attract speculative capital, fueling inflation.

It would raise the cost to the People's Bank of China of "sterilizing" the liquidity created through its massive intervention in the currency markets. The process involves the PBOC buying dollars and selling yuan, which must then be mopped up through local currency bond issues. The interest on those bonds is a heavy burden on the nation's finances.

Meanwhile, critics say that the Big Four state banks have grown bloated and complacent by living off the guaranteed spread between deposit and lending rates, currently at around three percentage points. An equivalent measure in the U.S. is about 3.5 percentage points, but it isn't guaranteed.

Critics say it has impeded innovation in products and services, and encouraged lending to state-owned enterprises that has an implicit government guarantee.

The effect is that many private companies, the main generators of jobs, are starved of capital, the critics say.

Eswar Prasad, a Cornell University economist and former senior International Monetary Fund official, said Mr. Wen's remarks reflect "a growing frustration among reform-minded officials that the large banks are deploying their political clout to preserve their privileges and block broader reforms to the financial system."

Other overhauls finding increasing backing by Chinese officials include proposals to improve Chinese companies' ability to conduct initial public offerings in local stock markets and to allow more openness to foreign investors.

The major question is whether increasing rhetoric and new initiatives toward economic revisions will lead to broader reform. Prior efforts have faltered amid Beijing's drive to keep a tight rein on the economy and opposition from interest groups.

"The Chinese government has said similar things for many, many years and I have yet to see drastic, concrete action," said Victor Shih, an associate professor at Northwestern University.

Gary Hufbauer, a former senior U.S. Treasury official now at the Peterson Institute for International Economics, said if Beijing follows through with Mr. Wen's pronouncements, "It would be a dramatic step towards a true market economy."

But, he added, "Whether this will materialize, one has to take these statements with a grain of salt."

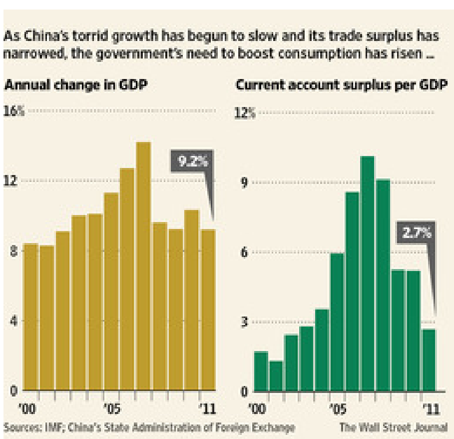
In his comments Tuesday, Mr. Wen referred to a pilot program announced last week intended to legitimize portions of China's informal lending system.

Economists say China's state-controlled banks favor lending to state-owned industrial and construction firms.

That has fueled the investment that has been a mainstay of China's economy, but some say it is now outmoded because it means credit doesn't get to the small firms and consumers who will help drive the economy toward greater consumption.

The program is focused on the city of Wenzhou—an eastern center of commerce with a reputation for fostering entrepreneurship—and the reform push includes legitimatizing and tracking the city's wide network of informal nonbank lenders.

"Those parts of the Wenzhou trial that prove a success should immediately be expanded to the rest of the country," he said, according to the broadcaster.



China's largest banks—Industrial & Commercial Bank of China, Bank of China, Agricultural Bank of China and China Construction Bank—reported combined profits of 632.21 billion yuan ($99 billion) for 2011, despite a slowing economy.

In their public comments, they have defended their lending to smaller companies and entrepreneurs and said they were embarking on further outreach. The lenders couldn't be reached to comment late Tuesday.

The four banks, plus Bank of Communications, China Development Bank and the Postal Savings Bank, account for more than 55% of all outstanding loans in China's banking system.

Meanwhile, the China Securities Regulatory Commission said it raised the total amount foreigners can bring in under what is known as the Qualified Foreign Institutional Investor, or QFII, program to $80 billion.

The program provides the only way investors can convert foreign currency to invest in China's yuan-denominated securities markets.

Foreign investors have long clamored for greater access to China's financial markets, in large part to benefit from the yuan's appreciation. But China has been loosening constraints because its slowing economy and moderating trade balance with the rest of the world have eased pressure on the yuan to appreciate in value, making it more of a two-way bet and reducing investment flow.

Separately, the regulator said Tuesday the foreign fund managers would be able to repatriate 70 billion yuan from overseas to invest in mainland stocks and bonds, up from a current quota of only 20 billion yuan, in an effort to foster greater international use of the Chinese currency. The regulator is curtailing where the additional 50 billion yuan allocation can be invested.

The move boosts China's effort to increase the yuan's use internationally, in what is seen as a challenge to the U.S. dollar's de facto role as the global currency of choice.

Derek Scissors, who follows Chinese economic policies at the Heritage Foundation, a Washington, D.C.-based think tank, said capital outflow from China and slowing foreign direct investment has likely worried the government. "China responds to stress," he said.

Last month, Mr. Wen gave what is expected to be his final news conference marking the end of the National People's Congress, China's rubber-stamp lawmaking body. Asked whether he had work left undone, Mr. Wen responded, "I have regrets, and things left to do."

—Andrew Browne, Ian Talley and Carolyn Cui
contributed to this article.

Write to Dinny McMahon at dinny.mcmahon@wsj.com and Lingling Wei at lingling.wei@wsj.com

A version of this article appeared April 4, 2012, on page A1 in some U.S. editions of The Wall Street Journal, with the headline: Chinese Premier Blasts Banks.