China's Financial Integration: The Future of Bond Market

SPEAKER: Prof. Anoop Singh

CHAIR: Santosh Pai

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The speaker opened the discussion by arguing that since reform and opening, China had gradually moved to integrate itself with the global economy as was evident in the volume of trade and product integration across the economies and global supply chains. The time has come for China to embark on to the "*next stage of financial integration*" with effectively channelizing the savings and investment into more productive sectors. Although the current pace of integration is overwhelmingly focused on product and trade integration, however, on the financial side, it suffers from the nascency of its bond and equity markets. China's financial markets are predominantly dominated by the "public sector banks" or as the speaker put it, they are "bank-centric", which acts as a major source of resource mobilization and distribution of credit in the market. The Chinese banks, though gigantic, have remained confined to domestic operations with limited global integration vis-à-vis the G20 emerging markets, turning into one of the major spats in the ongoing trade war with the United States. In the wake of such developments, the Chinese government undertook reforms by gradually opening up its financial markets by removing entry restrictions on foreign players. This year, it is embarking on the removal of restrictions on foreign banks, excluding them from compulsory joint ventures with local companies.

Talking about the Belt and Road Initiative, the speaker said that it is one way by which China is seeking to raise its investment profile from debtor to creditor. Nevertheless, a closure look into the macro-financial context raises concerns over the stability of the financial system and the growing bond defaults, which is consequently inducing stress into the stock and bond markets. Therefore, the Chinese government has embarked on a "regulatory storm" in the last two years to tackle stability risks. Reducing the size of shadow banking, the interconnection between banks and non-banks and the rate of growth of credit were few such measures.

The speaker was of the view that, as China's economic growth rate is falling from 10% to 6%, the challenge that the government faces is to keep the economy growing, will be the primary goal of the party-state. There are serious concerns that the double-digit growth enjoyed by China for two decades came predominantly from "credit finance" and "debt finance" by public sector banks and foreign investments. With the rising debt levels and declining growth numbers, there has been a fall in productivity of the overall economy. Therefore, in recent times the National Party Congress has started to emphasise on the quality of the growth rather than the quality of the growth.

Now, the speaker gives us a bird's-eye view of the government initiatives taken to boost the investor confidence. He says that the emphasis on stimulus is one way that the government is proceeding forward for the time being to keep the economy growing at 6% growth rate. Nevertheless, with the financial integration taking centre stage in policymaking, the bond markets are at the centre of the controversy and they present an opportunity too for opening up of China's financial sector to the rest of the world. However, the bond market in China is dominated by the government and quasi-government players, which are squeezing out the liquidity, by leaving less room for the private sector enterprises that are desperately looking for new sources of capital.

China's bond market is highly fragmented with "*multiple regulatory authorities*" regulating similar products, this presenting a challenge for foreign players who are looking forward to investing in China's financial markets. Local Government Financial Vehicles (LGFV) are one of the favourites in the bond market, which are accorded AAA rating by many Chinese credit rating agencies, and according to the speaker, one of the safest to invest in.

Discussing about the recent developments and reforms in the financial markets, the speaker argued for the inclusion of Chinese bonds into the global bond index. In his opinion, it will induce financial trust in the global financial markets to spur the sovereign bond market. It will also make it more attractive for the foreign players to invest more in the Chinese government securities. However, tax uncertainties hurt the business sentiment in financial markets. People's Bank of China is considering the long pending regulatory reform to streamline the regulatory process. Signalling its openness in financial integration. The Chinese government has given green signal to allow foreign credit rating agencies to rate the Chinese financial products.

The session ended with questions and discussions revolving around the future of financial integration in China. Most of the people pointed out that the capacity of the capital markets needs to be strengthened due to its increasing sophistication, the overlapping of regulatory bodies and the multiplicity of rules in the financial market. Therefore, there is a need for further clarification of rules.

Responding to their queries, the speaker said that they require a calibration process, and in this context, the Chinese government is willing to work with multilateral bodies such as IMF for the process of financial integration. Nevertheless, concerns remain in the context of emergence of China as the global financial heavy weight vis a vis United States of America. Therefore, determining global rules in financial markets is imperative for maintaining a "*rule-based world order*". The speaker raises a significant question that by whose rule the countries would be playing? He pointed out the example of the Trans-Pacific Partnership (TPP) as a missed opportunity and an economic strategy by the US-led world order to make China adopt the global rules, instead of China dictating the rules of engagement unilaterally in financial markets in the future scenario. With US departure from TPP and World Trade Organization (WTO) in limbo, global financial markets are left in ambiguity.

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