

# **CHINA'S RISING FINANCIAL RISKS AND LIQUIDITY PROBLEMS**

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## **Executive Summary**

1. Since 2017, China's financial risk as indicated by the high level of both direct and indirect debt of firms, local government and households has become unprecedentedly complex. To manage the high financial risks, China's financial authorities and other relevant departments have issued nearly 160 new regulations and adopted nearly 70 flexible temporary policies since 2017.
2. However, China's financial sector seems to be increasingly trapped in dilemma: the urgent risk management in the financial sector and the lack of liquidity in the real economy.
3. By the end of 2017, the leverage ratios of China's government, private sector and the overall economy had been much higher than the corresponding leverage levels of Thailand in 1997, the year Asian financial crisis erupted.
4. The frequency of events involving financial risk has increased sharply since early 2018. In the business sector, there are more debt defaults by listed companies and margin calls on pledged shares due to the excessive proportion of equity pledged.
5. The first half of 2018 witnessed the peer-to-peer platform crash in the field of internet finance. The default risk of local financing platforms and the financial risks caused by various shadow banking businesses are also at breaking point.
6. On the other hand, the financing difficulties of real economic activities in China are also increasing. The financing costs of enterprises are rising in different financing channels which are also shrinking due to stricter regulations and higher risks.
7. China would have to effectively reduce the financing costs of the real economy while controlling the overall risks of the financial system, and develop and regulate financing channels well. However, there are still many fundamental problems in China's financial market and regulatory system.

8. The role of the government and the market is unclear. Financial regulators cannot effectively supervise local government's illegal financing behaviour in the financial market.
9. The segmented markets of financial transactions reduce the liquidity of products and the price discovery ability of the market leading to confusion in the valuation of similar products and increases the difficulty of risk management.
10. The boundaries of the responsibilities of the regulatory authorities are unclear. The intertwining of regulatory policy transmission and information disclosure has caused confusion in financial market operation and regulation.