Bank Runs in China

5 November 2019 | Marcel von Pfyffer, Arminius Capital

In February this year, we outlined the risks of a financial crisis in China. (Published as one of our Geld Zug commentary articles). One of the triggers for a financial crisis was a rash of problems among China's small banks. This trigger may be taking shape right now. Another small bank suffered a run last week, making it the fourth small bank to get into trouble since May.

Henan Yichuan Bank, in the inland province of Henan, has assets of only CNY 62 billion (about AUD $13 billion). Last week, locals rushed to withdraw their deposits, even though the central government guarantees all bank deposits up to a maximum of CNY 500,000 (AUD $100,000). Despite public expressions of support from the bank regulator, the run continued this week. There are no details on the bank's financial position, but the national corruption watchdog has announced that the bank's former chairman is "under investigation".

This bank run was preceded by runs on three similarly sized regional banks over the last six months: the Baoshang Bank in Inner Mongolia, the Jinzhou Bank in Liaoning province, and the HengFeng Bank in Shandong province. All three were bailed out by the regulator, but the runs spooked the inter-bank lending market as speculation mounted as to which bank might be next to go under.

The difficulties at these small, local banks do not represent any threat to the Chinese banking system, which comprises more than AUD $50 trillion in assets. The central authorities exercise very tight control over the five big State-owned banks, which account for nearly 40% of loans, and over the dozen largest private-sector banks, which account for about 15% of loans. There is no question that these banks would receive comprehensive government support.

In addition to the big banks, however. there are some 4,000 regional banks which account for around 40% of banking system assets. Many of these small banks have long been run for the effective benefit of local governments, local businessmen, and their cronies. 420 of these small banks received a "Fail" rating in China's first stress tests on banks, according to PBOC's 2018 Financial Stability Report. Hence in the worst case the gross banking assets at risk are less than 4% of the total banking system, an amount which the central government could easily pledge in support.

Although the bank regulators have increased their supervision of these problem banks, they simply do not have the resources to monitor them all closely. Hence it is possible that a series of insolvencies in a particular region or industry would lead to a surge in bad loans in multiple banks. The bank regulators could easily find themselves facing more bushfires than they can quickly put

out. In such circumstances, the inter-bank lending market might freeze up again as lenders worried whether all their counterparties were solvent.

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