

December 19, 2016

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## Survey Structure

### Survey Of 12 Banks Regional:

- ▶ Five Tier 1 cities
- ▶ Seven Tier 2 cities

### Bank Type:

- ▶ Five Big Four banks
- ▶ Three Mid-Tier Banks
- ▶ Four City Commercial Banks

### Interviewee Positions:

- ▶ Five mortgage officers
- ▶ Five commercial loan officers
- ▶ Two Forex managers

### Repeat sources: all

- ▶ Interviews conducted December 5-9 2016

## Objectives

To understand demand for commercial and mortgage loans in November, assess capital flight trends, and get bankers' view of loan demand in the coming quarter.

### Summary Conclusions:

- ▶ Mortgage demand fell off rapidly in November
- ▶ Q3 loan demand was slightly improved, but banks remain in competition to lend to "safe" borrowers, and many banks are laying off staff.
- ▶ Capital flight increased significantly in November. The cost of moving money also rose.

## Finance

# Brooding Crisis

- ▶ All Chinese asset classes save commodities declined in the week to December 16, as the U.S. dollar reached its highest point in 14 years. The RMB struggled to remain under 7 to the US dollar and closed at 6.9545 on Friday.
- ▶ China's bond market halted futures trading on December 15 when the 10-year and five-year Treasury bonds fell by 2% and 1.2% respectively despite restricted trading.
- ▶ The PBOC injected USD 35.9 bln on December 16 to calm the banks and reduce the gap between onshore and offshore Renminbi trading.
- ▶ Our quarterly banking survey, conducted before the current market tension, indicated higher capital flight and lower confidence in Chinese assets.

## Banks Under Pressure

Despite high levels of mortgage lending, banks are making less money, requiring employees to work more hours, cutting bonuses, and worrying over competition from bond issues.

"It's not easy to be optimistic," said one banker we interviewed. "Everyone is competing to lend to the same borrowers." Other lending offers agreed: all the banks we surveyed from December 5-9 said that they wanted to lend to central-level State-owned enterprises, government financing platforms, and large listed companies, but the competition to lend to them is intense.

"There is no way to deal with [the situation] realistically," said a loan officer in Zhengzhou. "There will be a shakeout in banking and people will leave the industry."

One bank in Shanghai was implementing a system it calls "9-9-6": employees must work from 9 am to 9 pm, six days a week, for the same salary but no bonus (which is typically a large proportion of com-

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pensation). Competition from bond issuances, the banks said, is wreaking havoc on margins. Everyone is competing on price.

On the mortgage side of the house, housing purchases have dropped in November as quickly as they rose, as purchase restrictions have been placed on the hottest markets and mortgage discounts reduced. But mortgage lending in the first three quarters of 2016 exceeded any of the banks' expectations, with some lending double or triple what they had originally planned to lend. Bankers say that households are depleting their savings and spending forward, and some worry about future household solvency.

Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>How is mortgage lending in Q4?</b>	In Q4, our mortgage lending pretty much stopped.	Our mortgages in Q4 have been on a par with Q3.	Our Q4 mortgage lending is unsatisfactory from a loan officer's point of view. We're way down compared with the first three quarters.
<b>Will lending grow a lot in Q1 next year?</b>	No, but maybe mid-year things will pick up.	Q1 will be better than Q4 but it won't grow a lot.	Growth in Q1 will be hard. First, we don't know how much money the central bank will make available. Second, local policies are not very conducive to real estate sales.
<b>What was the mortgage growth last month?</b>	Mortgage lending was down a bit in November compared with October. The growth YTD has been 120%.	We're up 100% since the start of the year.	November was pretty much flat YoY. We used some commercial loan funding to extend mortgages. We had a gap in the amount of money being repaid. We were up 80% YTD.
<b>What caused the growth this year?</b>	1. banking policy remained loose (low down payment ratio requirement and low interest rates) 2. Purchase restrictions led to rapid short-term growth 3. Real estate prices in central business districts are high and purchase restrictions are concentrated there so trading volume rose in the Binhai Zone, outside those areas.	Transaction volume is high, prices are high, and there has been a good return on investment in property.	Government policy is not supportive of real estate right now, resulting in the recent slow growth in mortgage loans. The local Price Bureaus have not been approving developers' prices but the developers do not want to lower their prices, so the volume of available property is low, while credit policies are pushing many investors out of the market.
<b>What is the average mortgage interest rate?</b>	You get a 5% discount on the basis rate for first homes and a 10% increase on the rate for second homes.	4.41%	Usually 4.41%

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>How have you performed against this year's mortgage quota?</b>	100%	140%	98.40%
<b>Where is all the mortgage demand coming from?</b>	It's still people who need places to live and people who are upgrading.	First-hand and second-hand home buyers	Most of them are buying their first homes. Some are buying in the names of children.
<b>What kind of customer is getting mortgages now? First-time buyers? Second-apartment buyers?</b>	The policy is tighter and the checks on people's status as first- or second-units buyers are becoming more stringent.	After the new restrictions the proportion of new buyers rose so the overall mortgage volume declined.	It's like there's going to be nothing to eat. On one hand mortgages are being limited and on the other a lot of land is going on auction.
<b>Other</b>	The new housing purchase restrictions	Watch the new CBRC policy on individual accounts	I hear that the government is afraid housing prices will not rise before the 19th Party Congress and they want to tamp things down to allow for some growth. Who knows.

Mortgage Officers	Big Four Bank Tier 2 East	Big Four Bank Tier 1
<b>How is mortgage lending in Q4?</b>	You could say the fourth quarter is ice compared with fire in the first three quarters. The XX market rose to a new high because of the G-20 meeting in September. Our living environment attracted a lot of people from outside the city, and naturally there have been a lot of speculators as well. After the Policy 928 came out limiting purchases, things cooled but transactions were still good in October. Then in November, transaction volumes, lending--everything dropped rapidly.	Compared with the second and third quarters our Q4 mortgage lending is down, but we're still seeing a slow growth trend.

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>Will lending grow a lot in Q1 next year?</b>	The first quarter is when banks open their doors. Lenders are bonused on their volume. So they tend to hold back in Q4. Next quarter will definitely be much bigger than this one.	I think the first quarter next year will maintain the trend of Q4 this year but volumes will be higher than in Q4.	
<b>What was the mortgage growth last month?</b>	There was no growth in November year on year. YTD, mortgage lending is up 60%.	We've had a 15% growth year to date in mortgage lending.	
<b>What caused the growth this year?</b>	The property market soared this year, so that triggered mortgage growth. Interest rates then declined, and policy has been more relaxed.	First-home buying, upgrades, and second homes for families living together	
<b>What is the average mortgage interest rate?</b>	4.41%	4.20%	
<b>How have you performed against this year's mortgage quota?</b>	250%	85%	
<b>Where is all the mortgage demand coming from?</b>	People getting married, people ungrading their homes, people investing	Mostly people who need housing and who are buying their first homes.	
<b>What kind of customer is getting mortgages now? First-time buyers? Second-apartment buyers?</b>	Some potential buyers became unqualified and others for good reasons decided to keep looking for a while.	The new restrictions raised the threshold for buyers.	
<b>Other</b>	The new policy in Hangzhou brought transactions down a lot but let's see what happens with prices.	Watch for purchase policies, indicators from the PBOC, and lending policy	
<b>Commercial Loan Officers</b>	Mid-Tier Bank Tier 2 East	Big Four Bank Tier 1	Big Four Bank Tier 1

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>Has loan demand in your market grown or shrunk this year? Why?</b>	Loan demand has not changed significantly but we are more inclined to lend to the aviation industry, education, highways, urban public utilities, urban rail transit industry and the environmental protection industry.	Loan demand is definitely better. I am disposed to lend to warehousing and logistics, the One Belt, One Road program, and the Free Trade Zones.	Demand for loans is better than at the beginning of the year. The new hot spots are PPP projects and the transformation of shantytowns in the new city zones being developed by local governments.
<b>How much are collateralized loans growing?</b>	We're up 1% in the month compared with 2015. I think the new loan policies will mean our lending drops by 30% in the quarter compared with Q3.	Our collateralized loans are down 5% MoM. That is mainly because the loan deposits are going out to the borrowers and we have not approved new quota. I expect lending in Q4 to be down 8% compared with Q3.	Our loans were down in November compared with 2015 and I expect the fourth quarter will be down compared with Q3.
<b>How do you see housing demand right now?</b>	It's kind of weak right now but it depends on the district and the type of buyer.	There's no change here in Shanghai but there's an obvious drop in demand in Tier 2 and Tier 3 cities.	In Tier 1.5 cities the prices have risen so much that there are now cooling measures in place that limit demand.
<b>NPLs of each category grow MoM and YoY? What were the reasons?</b>	No change	All our NPLs have been worked off and we don't have NPL pressure.	Coal and other commodity prices have picked up and inventories are down. The economy has improved. Short-term NPL pressure is less. In the long term, I couldn't say.
<b>How is the growth in foreign trade loans?</b>	No change compared with last year	Foreign trade related loans are up a lot this year because of the depreciation of the RMB. We are selling a lot of hedging products to trading companies.	The volume is down compared with the beginning of the year because the government has put a lot of controls on access to hard currency.
<b>How is the competition in banking now?</b>	Competition is more intense than in years past, There are more channels for financing and more disintermediation of banks.	The finance market went through a consolidation and now things are pretty steady. But there are more financing channels and competition should increase in the future.	There is intense competition. In the first three quarters, money was being raised through bonds, which put a lot of pressure on us. There is a price war going on.
<b>What are you doing to overcome this?</b>	This is negative for banks but not for the economy generally.	Traditional banks need to focus on low-cost parts of lending and on stable cash flows.	Banks need to use volume to make up for pricing.
<b>How does your lending compare with your credit target this year?</b>	Our target was 30% higher [than in 2015] and we have fulfilled 150% of the target.	The target for individual loans has pretty much been met.	Our lending target rose by 20%. We achieved 2% [of the increase].

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>Do you have plans to lay people off? Why or why not?</b>	I haven't heard of any.	Not yet but I understand we are cutting salaries.	The mid-tier banks are cutting staff and lowering salaries. At the big SOE banks I haven't heard of that but they are cutting a few front-of-the-house staff and lowering compensation.
<b>Other issues?</b>	Prices for steel, cement, non-ferrous, glass are all rising. It seems that inflation is back.	XX (competitor bank) is starting the "9-9-6" system. Employees are required to work from 9 am to 9 pm, six days a week. At the same time, the bank has halted all bonuses.	If commodities prices can stay high then the fourth quarter might be okay but we have to see.
<b>Has your shadow market activity increased or decreased?</b>	Increased	At the moment we don't have shadow banking activity	This year all the bond issuance has reduced our off-balance sheet lending.
<b>What kinds of shadow institutions do you work with?</b>	It depends on the need.	We don't do off balance sheet lending right now.	We work with trusts and fund companies.
<b>Have you paid attention to the Xinhua Trust case, seeking repayment for a loan extended as private equity? Do you have private equity-collateralized lending?</b>	No, we don't.	No, we only take the equity of listed companies as collateral.	The risk associated with that type of lending is very high. We do it only with AAA rated borrowers.

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>Commercial Loan Officers</b>	Commercial Bank Tier 2 East	Commercial Bank Tier 2 West	
<b>Has loan demand in your market grown or shrunk this year? Why?</b>	You should ask that question in two parts. Good assets have less demand. Private companies have a lot of demand but can't borrow. We don't really dare lend to new industries.	The current regional economy is poor. Banks select two categories of customers: high-quality, state-owned, listed companies in monopoly industries with good cash flow and, if private, then large enterprise groups that are industry leaders. We focus on supporting five sectors: high-quality real estate, high-level government financing platforms, environmental industries, monopolies such as health, electricity, gas, and water, and education.	
<b>How much are collateralized loans growing?</b>	I have no way to answer the question. Most of our loans are collateralized with real estate. We don't project loan growth based on the type of guarantee.	In addition to high-quality State-owned enterprises, we lend based on property collateral. We have reduced lending based on guarantees. I expect the fourth quarter will be up 1-5% YoY.	
<b>How do you see housing demand right now?</b>	In this cycle the housing growth has been driven strictly by money. The economy is weakening and the average person has less money to spend. People are eating up their savings and buying for the future. The increase cannot last.	The Chengdu market in June and July this year had a big wave of buying. Prices in some districts were up 100% and on average were 50-60% higher. Some districts are still going to grow.	
<b>NPLs of each category grow MoM and YoY? What were the reasons?</b>	Our bank is in good shape because we started relatively recently. The big old state banks are in rough shape.	Of course NPLs are growing. The loan balance is also growing.	
<b>How is the growth in foreign trade loans?</b>	Our bank pretty much has no foreign trade loans.	Our foreign trade clients are all weak now. That's largely because the currency depreciation has increased their risk and they cannot access credit.	

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>How is the competition in banking now?</b>	The competitive environment is very negative. There are no good assets left and people are competing on price.	It's not easy to be optimistic. In Sichuan, the economy is still in poor shape. Everyone is competing to lend to the same borrowers: SOEs, government financing platforms central-level SOEs, listed companies, monopolies, and large consumer companies. Everyone is now focused on profit and setting aside other targets, such as weakening deposits.	
<b>What are you doing to overcome this?</b>	There is no way to deal with it realistically. There will be a shakeout in banking and people will leave the industry.	We need to apply more prudence to deal with credit assets, raise the threshold and place more emphasis on asset quality and profits.	
<b>How does your lending compare with your credit target this year?</b>	Because we opened recently, our lending target rose by 50% and we have more or less completed that target.	The economy continued to worsen in 2016 and we had negative loan growth. It has been very hard to achieve our target. I think we will accomplish 60% of the annual target.	
<b>Do you have plans to lay people off? Why or why not?</b>	There will be big cuts in compensation and people will leave on their own.	Pay cuts have become common, and also layoffs, principally of the marketing staff. Account managers are being cut. Back-office, low-paid staff are leaving of their own accord.	
<b>Other issues?</b>	Because asset quality is deteriorating, all the banks this year have flocked to government financing platforms and that has only concentrated the risk.	There's intense competition for high-quality customers.	
<b>Has your shadow market activity increased or decreased?</b>	Shadow activity should be dropping because of regulatory scrutiny.	Our shadow loans are quite small and there's no obvious change.	
<b>What kinds of shadow institutions do you work with?</b>	It's harder to do shadow banking now because of the regulatory scrutiny.	We have decided not to work with financial leasing companies, small loan companies, trusts, or guarantors. The economic deterioration makes it too dangerous.	



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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>Have you paid attention to the Xinhua Trust case, seeking repayment for a loan extended as private equity? Do you have private equity-collateralized lending?</b>	I saw that. Yes, we do private equity lending but relatively little. The case will have dampened that channel.	The problem with the Xinhua Trust case was really just that it was a big sum. We don't have a lot of that type of lending.	
<b>Forex managers</b>	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	
<b>What was the volume of Forex purchases in November compared with last month and last year?</b>	Up by \$10 million compared with October and down by \$5 million compared with a year ago.	Down 18% compared with October and up 43% YoY.	
<b>Of the transactions, what proportion were in U.S. dollars?</b>	93%	98%	
<b>Did the proportion grow or shrink? Why?</b>	Up both month on month and year on year	Up both month on month and year on year	
<b>Do you think there was capital flight in November?</b>	The big event in the November foreign exchange was the Trump win in the US general election. Trump advocated the implementation of tight monetary policy and proactive fiscal policy, and this sent the dollar higher. The US stock market rose and more capital went back to the United States.	There was a lot of capital outflow in November mainly because of RMB exchange rate fluctuations. This month the offshore RMB against the US dollar has depreciated more than 2%, the lowest in eight years, and there is arbitrage between offshore and onshore.	
<b>Did November increase or decrease compared with October?</b>	Capital flight intensified mainly because of the RMB. Onshore it broke 6.9 and offshore 6.94 to the dollar.	Capital flight grew, mainly because of Trump and because Chinese exports may weaken. The RMB depreciation is expected to intensify.	
<b>What are the principal channels for capital flight?</b>	Overseas direct investment, fake trade invoices, insurance purchases, underground banks, fake purchases of services, such as travel and overseas study.	Banks, institutional investors, third-party trading companies, underground banks.	

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Mortgage Officers	Commercial Bank Tier 2 North	Mid-Tier Bank Tier 1	Big Four Bank Tier 2 East
<b>What was the cost of exporting capital in November?</b>	Higher than before because the government is trying to crack down on the channels.	The price has risen-- government crackdowns plus the expectatino of depreciation	
<b>Did you sign forward or swap agreements with the PBOC in November?</b>	I don't think so. We don't have the license to trade virtual products.	No	
<b>What else was important in the Forex market?</b>	The Italian constitutional referendum. The resignation of the prime minister,. This could mean exiting the EU and a weak Euro, strong dollar.	Trump's election, the new PBOC regulations on controlling foreign exchange, and the expansion of the Shanghai Free Trade Zone	
<b>Given that exports are declining, are you getting more or less Forex from exporters? Why?</b>	I expect exports to continue declining. Exporting enterprises are losing money.	Exports are declining, but our bank is expanding our foreign trade intermediary business. It's a fee business and we need more fee income.	

## Notable Quotes

“On mortgages, you could say the fourth quarter is ice compared with fire in the first three quarters. In November, transaction volumes, lending--everything dropped rapidly.” Mid Tier Bank Tier 2 East

“The first quarter is when banks open their doors. Lenders are bonused on their volume. So they tend to hold back in Q4. Next quarter will definitely be much bigger than this one.” Big Four Bank Tier 2 East

“Pay cuts have become common, and also layoffs, principally of the marketing staff. Account managers are being cut. Back-office, low-paid staff are leaving of their own accord.” Commercial Bank Tier 2 West

“Demand for loans is better than at at the beginning of the year. The new hot spots are PPP projects and the transformation of shantytowns in the new city zones being developed by local governments.” Big Four Bank Tier 1

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“We have decided not to work with financial leasing companies, small loan companies, trusts, or guarantors. The economic deterioration makes it too dangerous.” Commercial Bank Tier 2 West

“There was a lot of capital outflow in November mainly because of RMB exchange rate fluctuations.”  
Mid Tier Bank Tier 1

“I expect exports to continue declining. Exporting enterprises are losing money.” Commercial Bank Tier 2 Northeast

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