

# Opportunities and Risks for Chinese Banks from Sub-prime Crisis

By Ismail Ertürk  
Senior Fellow in Banking  
and Director of Finance Programme  
MBS Worldwide



The impact of sub-prime crisis on Chinese banks has been so far limited to negligible write-downs arising from small exposure to mortgage-backed securities (MBS) and off-balance sheet leveraged special purpose vehicles (SPVs). The number of banks involved is equally small. Compared with the systemic risk that sub-prime lending related problems have unleashed in the U.S. and in some European countries this picture in China looks fairly good. Without totally discounting some secondary yet potentially de-stabilizing effects of financial crisis on the Chinese banks that currently grips the U.S. and the European banks I attribute the immunity of Chinese banks to the direct effects of sub-prime crisis to structural reasons.

The causes of sub-prime crisis are embedded structurally to the U.S. banking system. In fact it is hard to distinguish between the U.S. economy and the U.S. financial system. In very general terms it is possible to say that the German economy manufactures machines, the Chinese economy consumer goods, the Japanese economy electronics, the Middle Eastern economies oil, etc. What does the U.S. economy manufacture? Since the early 1990s the U.S. economy manufactures financial assets both for domestic and international consumption. Mortgage-backed securities are such products that are exported to countries like Norway, France, Germany, the U.K., Switzerland and China.

In order to be able to understand why this current financial crisis is so severe and requires such unprecedented government intervention we need to take notice of this structural transformation of the U.S. economy and the vital role that the U.S. financial system -which includes actors ranging from mortgage brokers to investment banks to rating agencies to mono-line insurance companies and to non-saving households- plays in this structure. The U.S. is a financialized economy where opaque financial institutions constitute the largest industry with the largest profits. The Chinese banks on the other hand are financed by stable high household savings and finance in turn a high-growth industry and commerce. The balance sheets of individual Chinese banks are firmly embedded to real economic activities and do not constitute a trading platform in a complex web of intra-bank financial transactions. Of course they also benefit from recent government sponsored re-capitalization and stock market floatation at very high price-earnings multiples.

Another positive factor is the region's recovery from the 1997 financial crisis. Therefore the reasons for negligible effects of sub-prime crisis on Chinese banks are structural. Chinese economy and therefore its banks are not financialized. The sources of revenues for the Chinese banks are not households and financial markets, but trade and industry that grow at high rates. Needless to say that this kind of banking has its own risks but these are not likely to create a systemic risk at levels currently being experienced in the financialized U.S. banking system. As a result Chinese banks are better capitalized at current conjuncture which should provide them with opportunities to profitably increase market share in Asian and world financial markets.

However, the current financial crisis causes the weakening of the U.S. dollar and puts long-term pressure on the Renminbi and other regional currencies like Hong Kong dollar. Low U.S. dollar interest rate coupled with weak U.S. dollar is another long-term problem for this region as it is likely to encourage speculative financial transactions both in the financial and non-financial sectors. Weak U.S. economy is also another concern as lending to the exporters to the U.S. will become riskier. However I believe that the opportunities for the Chinese banks to profitably increase market share in both commercial and investment banking are greater than the risks that the weak U.S. dollar and the weak U.S. demand for exports pose.

*Note: Views expressed in the above article is the author's and do not represent those of Manchester Business School*

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