

RBA Governor Philip Lowe warns of threats from ‘highly indebted’ China

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Governor of the Reserve Bank of Australia, Philip Lowe, addresses the Australian Financial Review BHP Business Summit in Sydney, Wednesday, March, 7, 2018. (AAP Image/Dean Lewins) NO ARCHIVING

The Reserve Bank governor has declared China’s “complex, opaque, and highly indebted” economy a threat to financial stability and growth, foreshadowing the chance of “serious accidents” as the economic giant — Australia’s biggest trading partner — tries to curb its ballooning debts.

Speaking at the University of Technology in Sydney tonight, Dr Philip Lowe said the Reserve Bank was studying China’s financial system “very closely” given its “unusually high” debt burden, which has soared to the equivalent of 260 per cent of its national income from 150 per cent a decade ago — a bigger rise than any major nation.

“Among the largest economic risks that Australia faces is something going wrong in China,” Dr Lowe said. “And perhaps the single biggest risk to the Chinese economy at the moment lies in the financial sector and the big run up in debt there over the past decade,” he added.

Dr Lowe, speaking as a guest of the Australia-China Relations Institute, said it was in both nations' "strong interest in managing this important relationship well".

"The deepening relationship has also benefited China in many ways," the governor said. "We will of course have differences from time to time, but we will surely be better placed to deal with these if we understand one another well".

The Reserve Bank now employs three staff full-time in Beijing to monitor Chinese economic and financial developments.

"The complex web that has developed in China is characterised by opaque risk transfers, implicit guarantees and complex connections," the governor said. "The influence of the state and the incentives within financial institutions have almost surely distorted credit allocation and led to some poor lending decision" he added.

More than 3500 "shadow banks" have emerged in China, which provide an array of riskier financial products outside the state-controlled banking system.

"The extent that experience elsewhere in the world is any guide, it is difficult to escape the conclusion that this complex web in a highly indebted economy is a risky situation," Dr Lowe said. Combined, shadow banks now make up 45 per cent of credit, up from 25 per cent a decade ago.

"The build-up of financial risks like those seen in China is almost always followed by a marked slowdown in GDP growth," the governor said, stressing an economic collapse in China wasn't inevitable.

Chinese President Xi Jinping recently called for a gradual reduction in the level of debt compared to GDP, and authorities are trying to increase transparency and impose more stringent oversight of shadow and official banks.

But Dr Lowe said it was "too early to tell whether the authorities will be successful in managing the transition from a growth model heavily dependent upon the accumulation of debt to one where credit is less central".

"It is a very significant task," he added. Credit growth has slowed to around 7 per cent, the same level as GDP growth.

“A stable and robust financial system in China is clearly in Australia’s interest. So too is a prosperous China as part of a rules-based international system,” Dr Lowe said.

China, the nation’s biggest trading partner overall accounting for a third of exports and around one fifth of our imports, was increasingly important for our education and tourist sectors.