
Event Report

China Development Forum 2008 “The Impact of the Financial Crisis on China”: A Keynote Address by Ding Wei

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Speaking to a standing-room only crowd on an early Friday evening in October, Ding Wei, executive chairman, corporate finance committee, managing director and head of investment banking for China International Capital Corporation Limited (CICC), spoke about how he has been watching with amazement from China as the financial crisis has unfolded in the United States. CICC is the first joint-venture investment bank in China and has consistently ranked No.1 on both the Non-Japan Asian IPO and international Chinese IPO league tables since 1997. The event was cosponsored by Columbia University’s Asia-Pacific Development Society and Center for International Business Education and Research (CIBER).

Ding Wei focused on three critical areas in his lecture: the direct impact of the crisis on China, the short- and long-term economic impacts of the crisis and the policy implications in the future.

Regarding the direct impact of the financial crisis on China, Mr. Wei related some staggering statistics to demonstrate why he thinks that the crisis on Wall Street will have a material but nonthreatening impact on the balance sheet of the nation. China has approximately \$3.6 trillion in assets, with \$1 trillion representing the holdings of U.S. debt by Chinese central banks. Of that trillion, 51 percent is held in U.S. government bonds, 42 percent in U.S.-government-sponsored entities (such as Fannie Mae and Freddie Mac) and just 7 percent in U.S. corporate debt. The most striking issue is the significantly large portion of Chinese assets that are held in the debt of Fannie Mae and Freddie Mac. Were the economy to continue to deteriorate, it is worth noting that there could be very sensitive political issues should those companies need to restructure. While Mr. Wei did not mention this highly concentrated exposure to the risks inherent in the

securities of these government agencies, he was quick to point out that the biggest near-term threat to China would be the depreciation of the U.S. dollar, because a small percentage change in the value of the dollar could translate into large nominal changes in the \$2 trillion of U.S. assets held by the Chinese institutions.

Moving to the short- and long-term economic impacts of the financial crisis on China, Mr. Wei seemed to take the position that while there would be a slowdown in the Chinese economy, this could be very beneficial for the rapidly growing country. One of the major issues facing policymakers in China before the crisis was how to slow the growth of the economy from its unsustainable level over the last five years of 10–12 percent of gross domestic product (GDP) with 8–9 percent inflation. While admittedly it is difficult to steer such a large ship in short periods, the slowdown in the United States provides Chinese policymakers the opportunity to review and revise China’s policies for its long-term strategic benefit. Because the country now has low levels of debt, there is tremendous room for fiscal policy to take short-term corrective actions if necessary. The opportunities for China mainly focus around balancing the current trade surplus with the United States and redirecting the resources to greater internal development. According to Mr. Wei, because the current levels of exports by China are not sustainable and the overcapacity of investment in the consumer-goods sector is at dangerously high levels, this wealth can and should be redistributed to the people of China, particularly the middle class, which has a low asset base that is offset by its demands for urbanization and development.

In addressing the dangers facing the Chinese economy, Mr. Wei was very concerned about the rise in inflation. With the demand for the U.S. dollar decreasing, a reduction in U.S. assets is inevitable. The rise in inflation can create huge social risks for the growing country because the labor force could see a large decline in its relative purchasing power if prices are not controlled. If inflation is unchecked, this could slow the country’s transition from an export-based economy to a consumption-driven economy, a transition that is critical to China’s development.

Mr. Wei also touched upon a number of issues primarily surrounding the nature of financial markets in a postcrisis environment. He predicts that there will be a large shift in the financial-services industry, from large institutions to boutique investment banks.

The use of excessive leverage by the large financial institutions has been a major cause of the crisis and has provided some excellent lessons for China. First, it is important to control these institutions’ appetite for principal investing and risk. Second, the material impact on Chinese institutions is low primarily because their leverage levels were moderated at about 2 percent. The

investment banks in China, Mr. Wei said, “haven’t learned the trick yet” of using excessive leverage, and they avoided many of the perils of the use of leverage because the pace of financial innovation in Chinese markets was much slower over the last decade. The country is also in a better position than the United States, because financial services represented only 3.6 percent of China’s GDP, compared with 8.8 percent for the United States.

As for CICC, the bank will continue its international focus, but it will now place greater emphasis on advising domestic companies on how to better compete in markets outside China. Mr. Wei sees a stronger focus moving forward on tightening up balance sheets globally, but in China he sees minimal impact on liquidity by the crisis because of historically low levels of debt.

While Mr. Wei remains optimistic about China’s present and future, he outlined several critical areas of concern: inflation, depreciation of the dollar and the balancing of the trade surplus. China has been able to avoid the direct impacts of the financial crisis that have caused great harm in many Western countries, yet its ability to continue to grow at its rapid pace of development is seriously in question. However, China’s fiscal conservatism and risk aversion have placed it at a significant competitive advantage in understanding its ability to manage through the crisis and respond from a position of fiscal and monetary strength.

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