Chinese Banking Crisis. Are China's Banks Solvent?

In the May 5th edition of the Economist magazine, there appears an article on China's banks. It points to the high profitability of the banks and the low level of NPLs.

It points to a couple of sources of worry, bad local-government debt and souring property loans. Much of the debt is structured in SIV like vehicles called LGFVs. While the Economist is probably right in its economic assessment a greater threat lies in store. You only need a healthy sense of curiosity.

The Chinese should be thankful for the European shenanigans for distracting attention from some very interesting goings ons in the Chinese banking industry. If the government were forced to bring all bad loans on to the sovereign balance sheet, debt to GDP would be more than the 40% or so currently reported. That number would be in the range of 90% to 160% of GDP. Based on the creative accounting currently in use in China, at which end of that range would your guess be?

How did NPLs get from mid teens and mid twenties to low single digits in a few years? Simple. You sell the NPLs at face value to someone, like an asset management company for example. Can't afford it? No problem. Extend a loan to said asset management company. If you look closely at the balance sheets of all the big banks you will find a bunch of bonds issued during the banking reform years by asset management companies which proceeds were used precisely to buy NPLs from the banks which now hold these bonds. How can auditor possibly countenance this practice? Why are domestic financials prepared according to PRC GAAP and audited by firms whose names are the concatenation of a Big Four and some Chinese company? Most of these bonds are delinquent but not classified as non performing but are instead euphemistically referred to as receivables. The European crisis will seem small once the truth behind the Chinese economic miracle is uncovered.