

After all the skepticism of official figures, all the worry about growth, finally I have found a Chinese city with a sense of optimism and faith in its own future: Chongqing. I am almost nostalgic: it was only about 18 months ago that Beijing and Shanghai felt the same way.

Chongqing is a beautiful place, much improved since Bo Xilai took over in 2007. What was 10 years ago a rustbelt city whose tank factories had unconvincingly been turned into commercial motorcycle and car manufacturers now is luxuriant and relatively clean, with massive new industrial and residential districts under active construction. Cement is still being mixed, earth still being moved. Local bankers are upbeat. They feel the debt problem is manageable and fast growth—last year 16%—will continue.

The city feels a little like the train on fire in the Chinese story: as long as it keeps moving, the people in the front cars don't feel the heat. Few people there have anything bad to say about Bo Xilai, who, like any great pothole politician, was supremely skilled at bringing national money to Chongqing. But the city is a poster child for debt-driven growth, and, as the money gets turned off, Chongqing is likely to come to a rude landing.

Here are some random notes from meetings with bankers today:

Loans: Banks said that borrowers are adjusting the frequency of their loan payments, from monthly to quarterly or once or twice yearly, without affecting whether the loan is rated as non-performing. Since less frequent payment affects profitability, the bank will generally want the borrower to offer something in return for the adjustment, like bringing in new business.

“Lend new to pay old”: The practice of extending new loans to pay old is so common now that it has its own slogan, “jie xin huan jiu.” Bankers said that the majority of their loans are either rolled over or repaid with new loans.

Gray market lending: Financial institutions in Chongqing are now buying packages of high-interest, short-term loans from gray-market lenders and turning them into securities that are bought and sold on the Chongqing Financial Exchange. Companies and wealthy individuals are eligible to buy the securities.

Taking away with one hand, giving with the other: Just about every bank now says that it has reduced its exposure to the property sector; some say they have no property loans at all. But they also buy the majority of their loan portfolio from trusts, and the trusts are heavily exposed to property. What happens is that the banks, restricted in their lending to property developers, refer a property applicant to a trust. The trust makes the loan at a high, market rate, with a bank guarantee. The bank then buys the loan from the trust, all overnight.

Short-term lending: A plethora of small institutions have cropped up to provide loans with terms averaging about two weeks at rates of 0.25% per day in order to help borrowers secure title to assets that will enable them to borrow from banks or trusts. The banks have a significant business in repo loans with terms under two weeks.

Many of these gray-market lenders have background relationships with the banks via related-party shareholders, local people say, and so feel they have implicit support from the government.

Collateral: Several loan managers said they pretty much ignore the financial statements of companies applying for loans, since the accounts so often have little relationship to reality. Instead, they talk to the company president and get a sense for his or her integrity. For example, does he often visit Macao? Personal trustworthiness, local bank managers say, is the most important criterion for lending.

Why banks are raising equity: The bankers we met spoke at length about the high profitability of the banks last year, and yet most were raising new capital. Why? we asked. Two reasons: 1) so that existing owners could sell out, and 2) because a certain amount of the capital is raised to increase “retail deposits” in order to maintain the required ratios.

Another way to increase deposits: banks in Chongqing “support each other” by selling each other commercial paper and using the proceeds to increase deposits.

Said one banker we met with about Bo, “He bankrupted the city, but made it a lot better for the average person.” That may be literally true.

Anne

PS: Send me a note to opt out.