I have been on the road this week, meeting with financial institutions of various levels of fly-by-nightiness. My first reaction was to call my husband and ask him to move some Renminbi out of China to the U.S. The principle here is: when in doubt, pull it out. I would also bet now on some mid-term depreciation of the currency.

The gradualist, long-years-of-slow-growth scenario for the Chinese debt denouement now appears remote. Now, the question is how long the crisis can be delayed and how big it will be. I am not optimistic.

Some snapshots from the meetings:

- ***Edgy derivatives***: The hand-in-glove relationship of trusts and banks enables the banks to experiment in risky securities they could not create in their own names. There are now formal exchanges on which trusts can buy packaged loan securities from banks. (These do not seem to be much used because of laborious bureaucratic procedures to remove legal liability from the banks.) Several banks are selling securities derived from the factored receivables of various industrial companies; they package them by level of risk and discount rate. One bank said they had agents selling the securities to the retail market. One institution offers securities that represent the cash flow (!) from local government financing platforms.
- ***No real owner of the debt***: Each trust, when asked who would be responsible in case of default, responded with awkward silence. One bank said that they have side agreements with companies whose receivables they buy, specifying that the company is responsible for payment if the debtors do not pay within three years. The bank officer said, “The companies don't report it this way.”
- ***Rising average rates***: A PBOC official estimated that gray-market lending in the Yangtze River Delta area exceeds 20% of total lending. Several economists I reality-checked with said it might be up to 40%. Gray market lending rates start at 25% annually. The Chinese government is actually more ignorant about this than the i-banks, it seems: reports by the PBOC and Chinese Academy of Social Sciences teams that have studied the issue rely heavily on research by foreign investment banks.
- ***Quick money***: Gray market lenders said they are lending bridge loans to cover trade and property transactions. In other words, companies near default borrow at minimum rates of 2-4% per month to get a few weeks of working capital.
- ***Tight liquidity***: Several banks said that the reduction in the RRR enabled them to sell more commercial paper to other banks but not to make new loans. This is because they had long ago passed the “red line” in loan-to-deposit ratio.
- ***Looking for capital***: I have seen people with a technical school education who have never looked at a balance sheet managing north of a billion dollars. The trusts in China dwarf the hedge fund world in New York; the fund managed by one state oil company is bigger than Wellington, for example, and I don’t think the Chinese one has quite the same fiduciary checks and balances. Nevertheless, you cannot have a meeting that does not end with the trust, the bank, the city, or the company asking for investment capital.

Many of the financial institutions now are descendants of the bank bailout that extended from 1998 until through the first few years of this century. China AMC, now a huge fund manager, was the basket into which the regulators tossed non-performing assets in order to emancipate the banks from their debt. There are SOE funds that were formed when regulators directed them to acquire bankrupt city funds. The originating institutions, which squandered so many billions of RMB, often remain minority shareholders but have no control anymore.

The pro-camp would say that the authorities managed to bury that debt without creating a big economic drag. The anti-camp would say that these sedimentary layers of debt indicate a much weaker asset foundation for future Chinese growth.

Here are some of the signs I will now watch for:

- ***Leverage***: The trusts have no limits on the amount of leverage they are permitted to use. If their loans grow faster as proportion of their assets, that will be a concern.
- ***Deterioration in the value of assets***: principally, real estate. This is the foundation supporting the banks.
- ***Velocity of lending***: Many gray market lenders are in the business of one- and two-week loans to cover acquisition of real property that can be used as security for a loan with a more reasonable rate of interest. If these companies begin funding overnight transactions, watch out.
- ***Continuing trade deficit***: If China's national balance sheet sees declining assets and growing liabilities, that may be a way to set the clock for crisis.
- ***Major defaults***: A couple of trusts have been rumored to have defaulted and been bailed out. It would be not at all surprising if 20% were to be unable to meet their obligations. Then what?

Yesterday, I heard from a local journalist that the Propaganda Bureau would shutter Sina Weibo for 10 days as a warning against allowing discussion of a government coup, as occurred two weeks ago. Today there is news that there have been arrests of prominent bloggers, closing of several websites, and Tencent, too, is being targeted. Meanwhile, one sees on formerly commercial billboards all over the country images of the apocryphal solider-hero of the Maoist era, Lei Feng, smiling with inner delight as he reads from the works of Mao Zedong. You think, how can the leadership be so out of touch that they believe this kind of thing resonates with anyone in China?

Last night, a very smart investor said to me, "This is the year when Chinese people learn the truth about the economy." I think that is true.

One institution we met this week said that its biggest business now is asset assessments for wealthy Chinese applying for Canadian immigrant visas. Think about that. Lei Feng notwithstanding, it is one sign that the time for the Chinese growth miracle is almost up.

Best,

Anne