

IPAF and the Future of Asian NPL Markets

China Huarong Asset Management Co., Ltd.
Research and Development Department
Yan Hongbo
March 10, 2015

1. Opportunities and Challenges for Asian Public AMCs

1.1 The Recovery and Risk of the Asian economy

1.2 The Trend of Asian NPL markets

1.3 Challenges and Opportunities for Asian public AMCs

2. Regionalizing and Institutionalizing of Asian NPL Markets

2.1 Goals

2.2 Directions

1. Opportunities and Challenges for Asian Public AMCs

1.1 The Recovery and Risk of the Asian Economy

As the world economy recovers from the financial crisis, the growth momentum in Asia is generally weak and the economic performance of countries across the region continues to diverge from each other, with problems of economic vulnerability and financial imbalances increasingly serious.



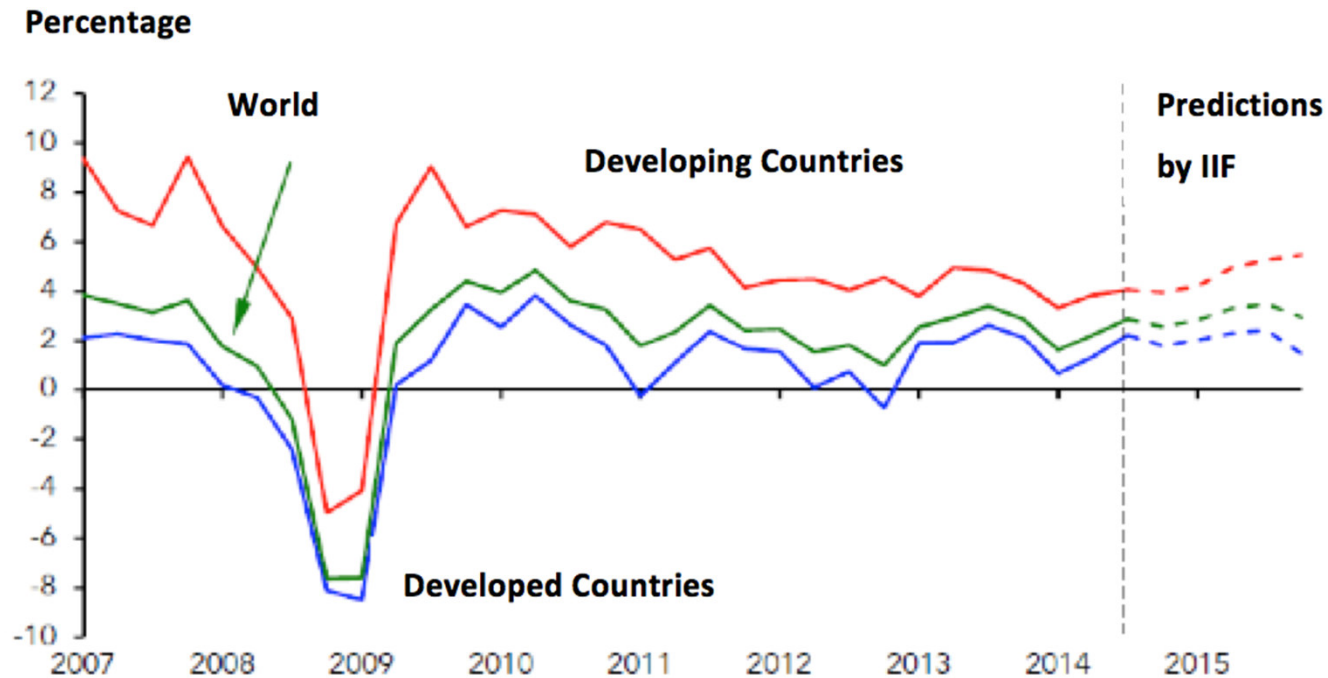
1.1.1 The slump of the world economy will stall the recovery of the Asian economy

(1) The world economy is still in the process of profound adjustment with unresolved underlying and structural problems in major economies.

- ◆ United States
- ◆ Europe
- ◆ Japan
- ◆ China

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

Figure 1 real GDP growth around the globe



Sources: Institute of International Finance (IIF)

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

(2) Global trade is weakening

- ◆ **Weak global export growth**
- ◆ **Exacerbating trading environment**

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

(3) Intensifying divergence of monetary policies of major economies

- ◆ US quits its QE program.
- ◆ Eurozone and Japan continue QE policies.

The end of the QE program in the US and the expectation of a higher interest rate will have a significant impact on Asian economies, whose economic fundamentals and capabilities in shielding risks will face big challenges.

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

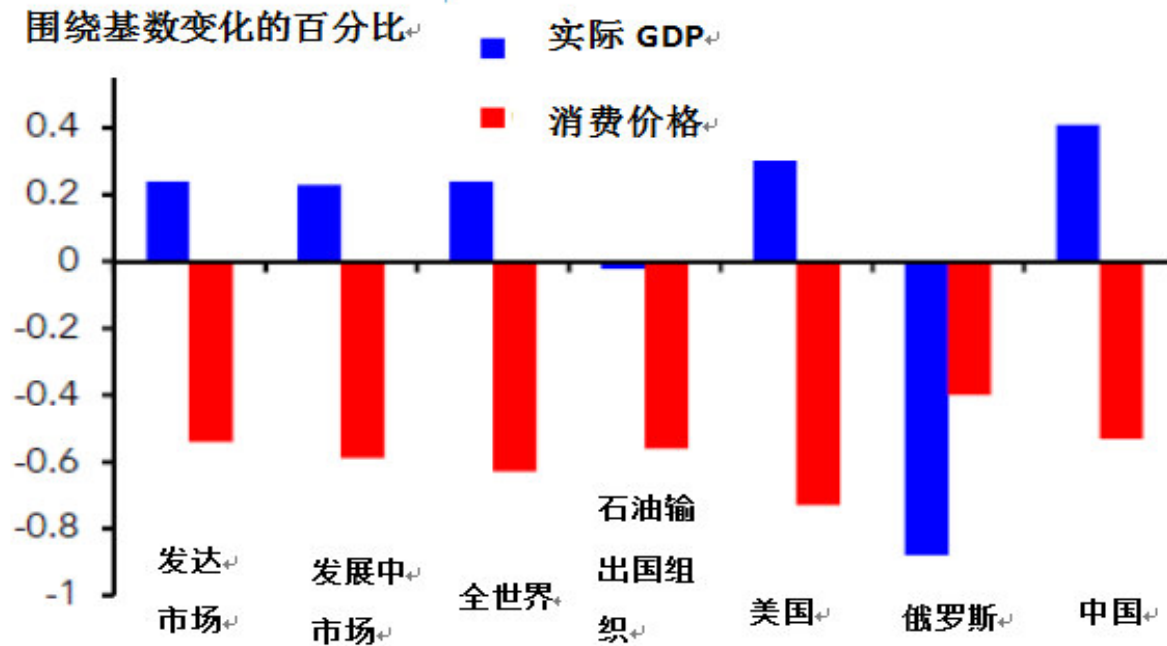
(4) The declining prices of international commodities

- ◆ In 2014, the prices of international commodities slumped.

The decline of commodity prices makes it difficult for countries and regions with saturated investments and excessive production capacities to effectively drive their economic growth.

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

Figure 2 The impact of oil prices on real GDP and consumer prices



Sources:IIF

1.1.1 The slump of the world economy will stall the recovery of the Asian economy

(5) Higher risks from non-economic factors such as geopolitics

- ◆ **Ukraine crisis Conflicts in the Middle East**
- ◆ **Geopolitical risks: economic methods and strategic planning are intertwined**

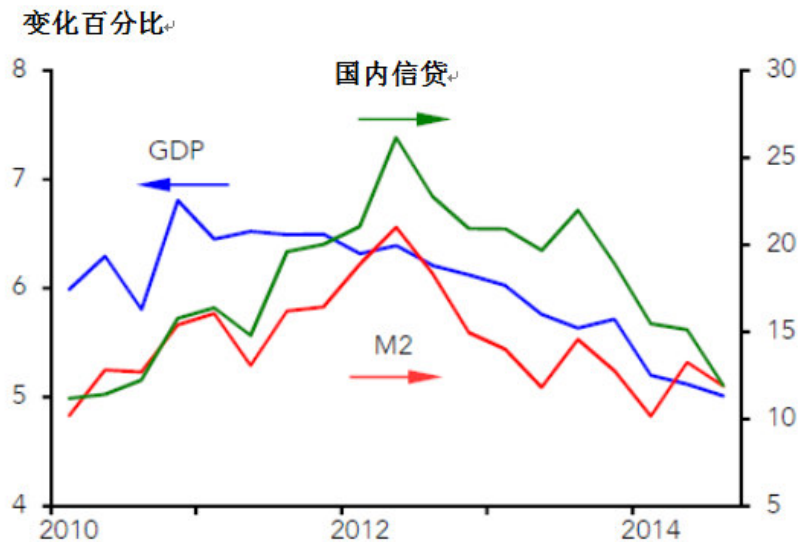
1.1.2 The vulnerability of Asian economy and financial imbalances are increasingly serious

(1) The declining prices of commodities will have a complicated impact on Asian countries

- ◆ Net importers of commodities such as India, the Philippines, Thailand and Pakistan
- ◆ Exporters of commodities such as Malaysia, Indonesia and Kazakhstan
- ◆ Negative impacts of a slowing Chinese economy

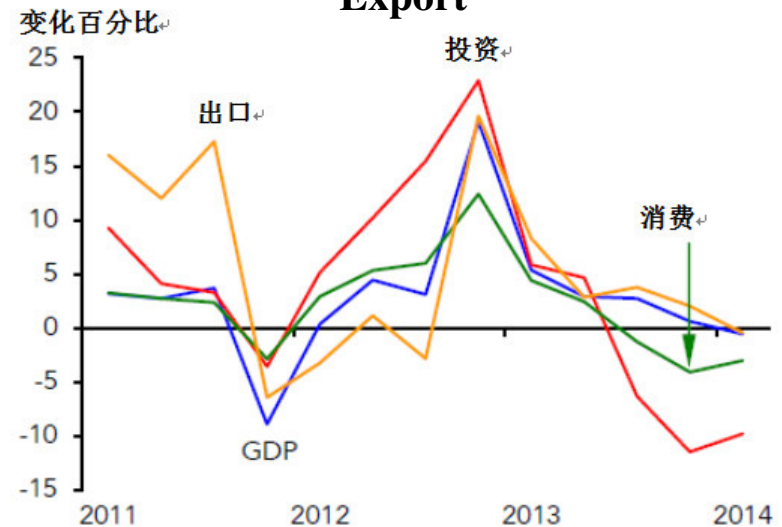
1.1.2 The vulnerability of Asian economy and financial imbalances are increasingly serious

Figure 3 Real GDP, M2 and domestic credits of Indonesia



Source: Bank Indonesia

Figure 4 Real GDP, Individual consumption, Investment and Export



Source: National Economic and Social Development Board (Thailand)

1.1.2 The vulnerability of Asian economy and financial imbalances are increasingly serious

(2) A weak economic growth, the depreciation of yen and the Fed raising interest rates will trigger potential risks in Asian financial markets.

- ◆ The amount of debts in Asia
- ◆ Debt to GDP ratio
- ◆ Lower profits for enterprises and bigger volatility of financial systems

1.2 The Trend of Asian NPL Markets

The financial imbalances caused by deformed medium- and long-term financing structure in Asian economies, the financial risks of capital outflows caused by a strong US dollar and the adjustment of economic structures will lead to the increase of NPLs in Asian financial system in 2015.

1.2.1 Deformed financing structure leads to rapid increase of non-performing financial assets

Since the financial crisis in 2008, large amount of capital has flown into Asian economies. Despite the economic prosperity, many Asian countries have underlying issues of imbalanced financing structures.

- ◆ Inclusive financial policies adopted by India and potential risk of rising NPLs
- ◆ Bank credit business model of Kazakhstan and great pressure on solving the NPL problems

1.2.2 Capital outflows because of a strong US dollar will exacerbate the NPL level of banks

- ◆ Countries with high leverage, balance of payments disequilibria and high level of foreign debts (e.g. Indonesia)
- ◆ Countries with less burden of debts or adequate reserves but with deficits in current account and fiscal (e.g. Thailand, Pakistan, etc.)
- ◆ Countries with good balance of payments but economic growth relying heavily on exporting resources (e.g. The Philippines and Kazakhstan)

1.2.3 The adjustment of economic structures results in risk exposure in some industries

Asian countries are in different phases of industrial transformation and structural adjustment and some industries will face risks in a downward economy.

- ◆ South Korea: policy adjustment in real estate sector and increasingly active private lending
- ◆ China: cost of production factors, environmental pressure, excessive production capacity, leverage ratio; local government debts, risks of shadow banking

1.3 Opportunities and Challenges for Asian public AMCs

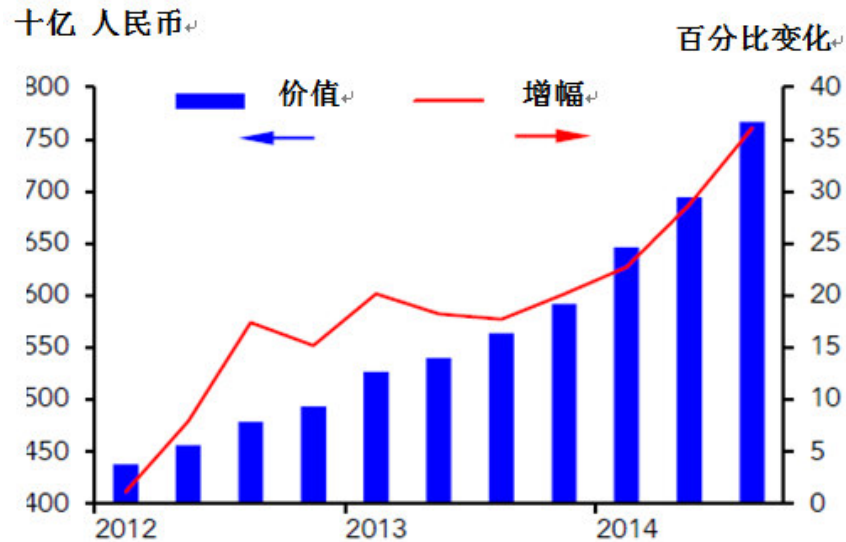
1.3.1 Opportunities for Asian public AMCs

(1) The increase of NPLs in Asian financial systems create more opportunities in the market for asset acquisition and business expansion

- ◆ Pakistan: rising NPL ratio
- ◆ Kazakhstan: large amount of distressed assets
- ◆ China: RMB 842.6 billion of NPLs in commercial banks with NPL ratio of 1.25% that has risen for 13 consecutive quarters by the end of December 2014

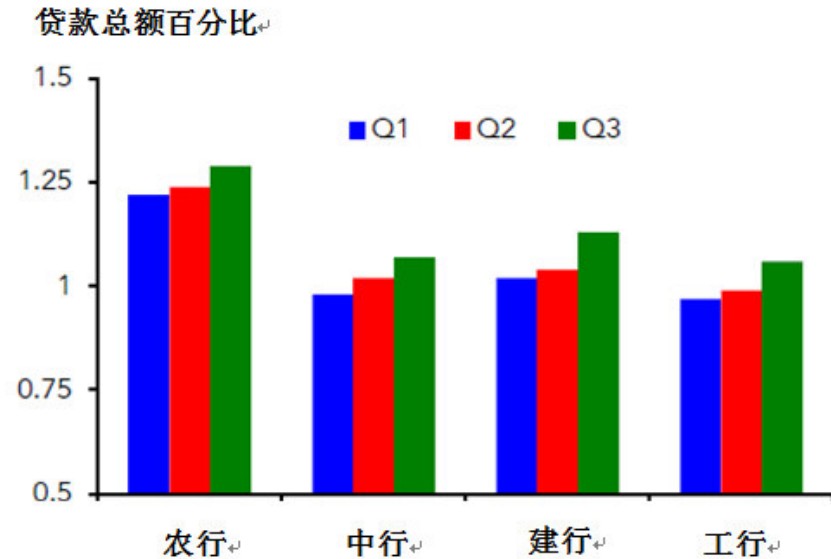
1.3.1 Opportunities for public AMC's in Asia and China

Figure 5 NPL volume of the banking sector in China



Source: CEIC

Figure 6 NPL ratio of China's "big four" banks in 2014



Source: IIF

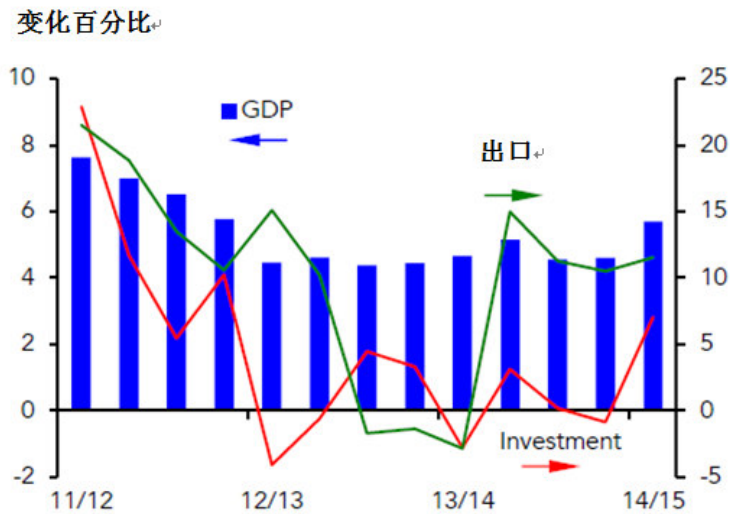
1.3.1 Opportunities for Asian public AMCs

(2) The economic growth and the structural adjustment of some Asian countries provide public AMCs more opportunities for NPL business operation

- ◆ India:trend overall good
- ◆ Vietnam and South Korea: The adjustment of strategic and emerging industries
- ◆ China:new powerhouse for economic growth and benefits of reform

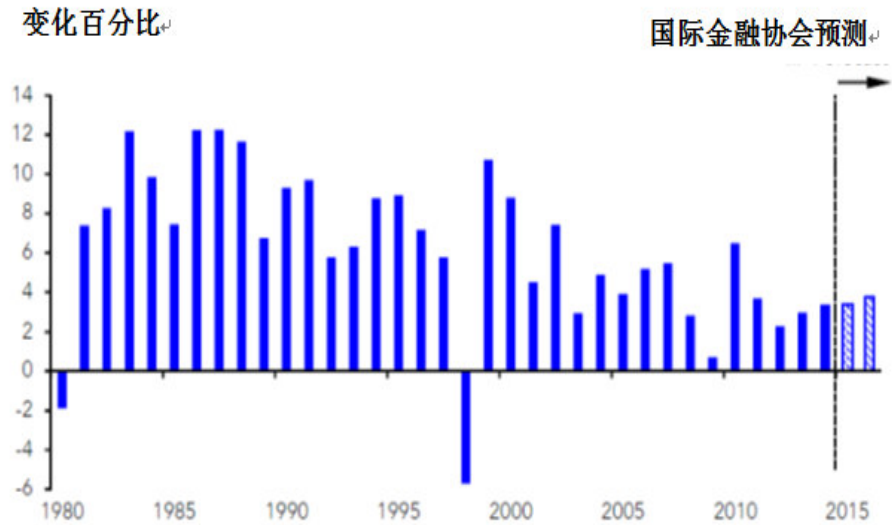
1.3.1 Opportunities for Asian public AMC's

Figure 7 Real GDP, Investment and Export of India



Source: Indian Reserve Bank

Figure 8 Real GDP of South Korea



Source: IIF

1.3.1 Opportunities for Asian public AMCs

(3) The improvement of techniques, management and policies help public AMCs to improve their operating efficiency.

- ◆ Much progress and development have been made in the construction of economic environment and financial systems since the Asian financial crisis in 1998
- ◆ Kazakhstan: The adjustment of financial system
- ◆ China: addressing financial risks and the market-oriented transformation of public AMCs

1.3.2 Challenges for Asian public AMCs

(1) More difficulty in NPL disposition in a downward economy.

- ◆ Kazakhstan: Large amount of distressed assets that are unable to attract investors and long period of NPL disposition
- ◆ China: decreased willingness and capacity to repay the debts among enterprises and decreased efficiency in NPL disposition in AMCs

1.3.2 Challenges for public AMC's in Asia and China

(2) Limited channels of financing hinder the expansion of NPL business

- ◆ High dependence of public AMC's on external financing
- ◆ VAMC: limited sources of capital and disposition efficiency needs to be improved
- ◆ Public AMC's in China: the advantage of low financing cost no longer exists; more strict regulation and more competition in financing business

1.3.2 Challenges for AMCs in Asia and China

(3) The disposition techniques of public AMCs need to be further improved.

- ◆ Vietnam: Debts and Assets Trading Company (DATC)
- ◆ Kazakhstan: Distressed Assets Fund
- ◆ China: Public AMCs

2. Regionalizing and Institutionalizing Asian NPL Markets

2.1 Goals of Regionalizing Asian NPL Markets

“Regional integration is a process that leads to greater interdependence through trade, investment and finance within a region.”

—Asian Economic Integration Monitor (AEIM),
July 2012

Regional Integration is unavoidable, which forms the context for regionalizing Asian NPL markets.

2.1 Goals of Regionalizing Asian NPL Markets

- (1) Improving the capacity to resist the shocks of financial crisis from outside Asia
- (2) Promoting the structural adjustment of Asian economic and financial structure
- (3) Serving as a cooperative platform

2.2 Directions of Regionalizing Asian NPL Markets

As the third chair of IPAF, China Huarong will carry out the mission of the forum and actively promote the communication and cooperation among members.

The Idea of Asian NPL Common Market

2.2 Directions of Regionalizing Asian NPL Markets

- (1) More support to NPL markets from authorities of member states
- (2) Improving the operating capacity of AMCs
- (3) Optimizing the role of IPAF as a cooperative platform

Thank you !