

How one Chinese region shows risks of relying on heavy borrowing

REUTERS, Shenyang, China

A flurry of construction in the Chinese city of Shenyang belies a regional economy in crisis, a striking example of the increasingly diminishing returns from a policy of investing heavily in infrastructure to prop up economic activity.

A new exhibition center has just opened its doors in the city, the capital of Liaoning province in northeastern China, and the skyline is dotted with cranes working on high-end shopping malls and apartments.

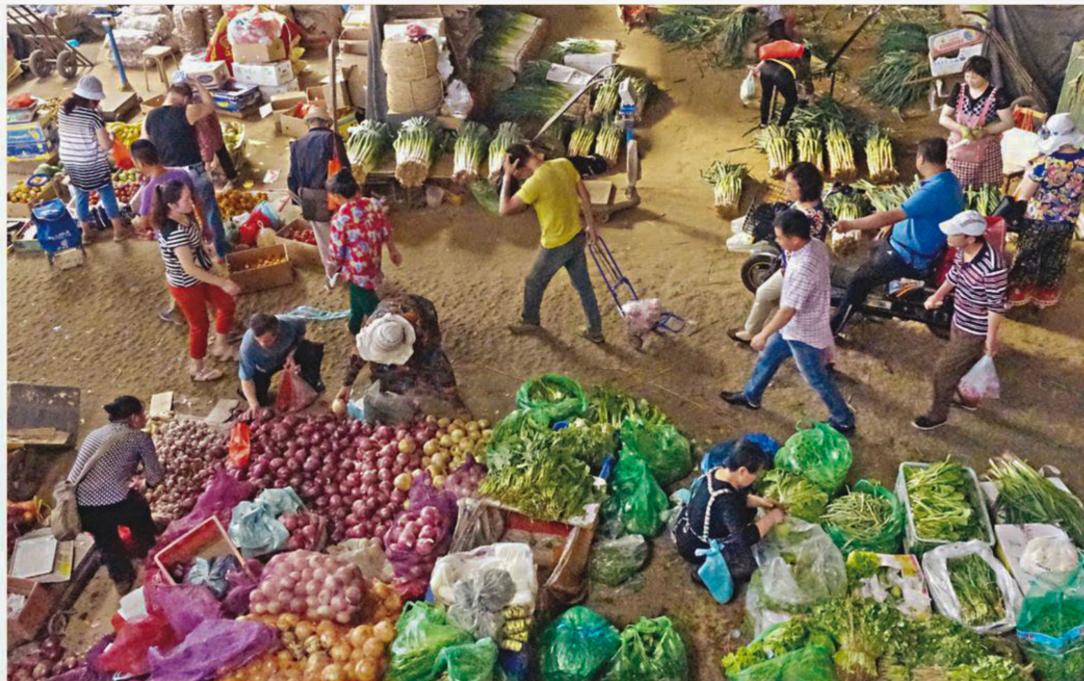
But beyond Shenyang's building sites, the real Liaoning is different. After years of investment in infrastructure, some of it encouraged by the central government, Liaoning is China's only shrinking provincial economy, its population is in decline and its debt is almost three times annual revenues.

Liaoning highlights the risks of relying on repeated borrowing to invest in infrastructure and fuel economic activity - a regular fall-back policy China has used when GDP risks missing annual targets, including in 2016.

It also points to the urgency for China to move away from a reliance on state firms, which for decades provided China's economic backbone. Most other provinces have reduced their reliance on state-firms to a much greater extent than Liaoning and its neighbors, Heilongjiang and Jilin. But they still wield considerable influence nationwide.

Traditionally, state-raised investment funds have been channeled through state-owned enterprises (SOEs) because they are big tax payers and employers. This has provided a life support mechanism for many dying state industries while crowding out the private sector on which China is staking its future.

Some local authorities have provided all sorts of preferential support to state firms, said Han Liang, a section-chief in the Liaoning government pricing bureau, "over protecting them and making them



People shop at a market in Dalian, China.

REUTERS/FILE

lose their motivation to innovate."

Liaoning's provincial government, and its local development and reform commission, declined repeated requests for comment.

Nowhere are Liaoning's challenges more evident than in Benxi, a city 29 miles (46 km) from Shenyang and dominated by a single SOE: the struggling Benxi Iron and Steel Group (Bengang).

Like Liaoning, Bengang is well past its economic heyday. Its chimneys, smelters and stockyards stretch nearly a mile along the banks of the Taizi river flowing through Benxi.

It provides around 60,000 jobs and

most tax income for the city government, but it is struggling to compete with coastal plants because they have better access to markets and cheaper foreign feedstock. In 2015, it reported its first net loss since the global financial crisis in 2009.

The firm is being squeezed by central government efforts to reduce steel production nationwide and so has branched out into real estate investment, in turn crowding out private players.

General manager Chen Jizhuang said in a pep talk delivered at a meeting with company employees in December that its "indomitable, evergreen genes" would enable it to overcome all its difficulties.

But the firm appears to be resting its hopes on yet another round of government spending.

"The year 2017 is a new round of the central government's Rejuvenate the Northeast projects and it is also a key year for Bengang to set off on a new road and seize new opportunities," Chen told staff, according to the firm's website.

Bengang declined several requests seeking interviews with senior officials.

Liaoning, Heilongjiang and Jilin were once powerful industrial bases responsible for much of the coal, steel and heavy industry that underpinned China's economy in the 1960s and 1970s.

Hong Kong hands out generous budget, paints brighter outlook

REUTERS, Hong Kong

HONG KONG handed out billions of dollars in tax cuts and poverty relief on Wednesday to reflate its economy, and projected a brighter outlook this year amid growing concerns over rising trade protectionism and higher interest rates.

The government bumped up its economic forecast for 2017 by a full percentage point to 2 to 3 percent and said the economy grew at 1.9 percent last year, faster than expected by economists.

The trade-reliant economy is carrying more momentum in the new year due to a pick-up in exports and private consumption, and a more stable Chinese economy, helping to boost annual growth to 3.1 percent in the final quarter of 2016 - its fastest since the June quarter of 2015.

"The property market was much better in the December quarter and that filtered into the pick-up in private consumption but I don't see that momentum sustaining due to rising U.S. interest rates," Kevin Lai, chief economist for Asia excluding Japan at Daiwa Capital Markets said.

The Hong Kong dollar is pegged to the greenback and expectations of two to three U.S. interest rate hikes this year will trigger increases in local mortgage rates.

Financial Secretary Paul Chan said in his maiden budget address that an improved labor market and construction projects worth nearly HK\$87 billion this year, had also bolstered consumer confidence that would feed into the local economy. He warned, however, that the city's astronomical property prices continued to be an issue.

"The uncertain external environment and interest rate trend may trigger abrupt shifts in capital flows and heighten volatility in local asset prices, with repercussions on consumption and investment sentiments and on macro-economic stability," Chan told lawmakers.

The strong growth data sent the local stock market .HSI to a fresh 18-month high.

Credit Rating Agency Moody's said in a research note that the budget was relatively balanced and fiscally prudent but doubted Hong Kong would meet its bullish GDP forecast.

"We do not expect a material rebound in global trade which will weigh on Hong Kong's exports, while growth in domestic demand will be somewhat dampened by higher interest rates," Moody's wrote. "We expect three to four interest rate increases by the U.S. Federal Reserve this year which will push interest rates up in Hong Kong."

On the property market, which Chan called exuberant and "out of tune with the local economy" despite a raft of cooling measures, he said the government would "substantially" increase residential flat supply in the next few years.

India's bankers sceptical over RBI proposal on bad loans

REUTERS, Mumbai

A proposal by India's central bank to set up new private or state companies that would buy up bad debt from lenders was met with widespread scepticism by bankers on Wednesday, who warned the plan would add more complexity and delay any restructuring.

Banks in India have record stressed loans of \$133 billion, or 12.34 percent of their total loans, as of last September, and economists say dealing with them has become imperative given the load is constraining lending and delaying much needed private investment.

Reserve Bank of India Deputy Governor Viral Acharya, in a major speech to bankers on Tuesday, proposed the creation of a private-based agency or a government asset management entity to buy and restructure the soured loans.

But in a sign of the difficulties the RBI would face, bankers expressed opposition to the new proposal, saying it would take too long to agree on how the scheme would

work and then risk further delays as the institutions are set up.

Instead, bankers urged the RBI to stick to an existing framework drafted by previous Governor Raghuram Rajan, which forces banks to first admit to the true extent of bad loans they hold and then gives them flexibility to restructure them, including by selling them off to private companies.

"Creating an institution itself is not an easy task," said a senior banker at a state-run lender, who declined to be identified commenting on the RBI.

"The better way would be to use the existing infrastructure," he added.

Critics of the existing RBI framework for restructuring bad loans have warned it leaves too much discretion to banks to solve the problems - a view echoed by Acharya, who called for a new approach of "tough love" for lenders.

But the creation of a so-called "bad bank" also has its own critics, including Rajan, who believed such an approach would simply shift the soured debt from banks to another

firm, and said the focus needed to be on how to restructure the bad loans.

Ultimately, much will depend on the government's stance.

The Finance Ministry appears open to Acharya's approach, having already proposed in January setting up a bad bank to buy soured loans from lenders and then restructure them, including by converting the debt to equity.

But even if the government and the RBI agree on creating an institution to deal with bad debt, the structures differ under the existing plans, and the differences would need to be ironed out.

Acharya was careful to avoid saying his proposal would create a bad bank, saying he wanted institutions with a narrow mandate to deal with soured loans, while warning that an unduly broad mandate risked creating "mission creep."

Instead, he said his speech marked the start of fresh discussions on a topic that has cast a shadow over the economy.

"There are many details to work out. But I hope this provides a start," Acharya said.

Lloyds profit hits 10-year high

REUTERS, London

Lloyds Banking Group reported its highest full-year profit in a decade on Wednesday, as the taxpayer-backed bank nears a complete recovery from its crisis-era past.

Britain's biggest mortgage lender said pretax profit was 4.2 billion pounds (\$5.25 billion), more than double the 1.64 billion pounds booked in the same period a year earlier.

The profit is a boost to the British government as it aims to return Lloyds to full private ownership in the next few months after the bank was rescued in a 20.5 billion pound taxpayer bailout during the 2008 financial crisis.

Lloyds, which is most exposed among the major British banks to any downturn in the economy, has continued to confound expectations that the economic upheaval caused by last year's vote to quit the European Union would squeeze profits.

"Our performance is inextricably linked to the health of the UK economy which has been more resilient than the market expected post referendum," the bank said in a statement.

Lloyds' higher profit was driven by lower provisions to compensate customers mis-sold loan insurance after the bank set aside what it hopes will be a final 1 billion pound provision last year.

The bank has so far set aside more than 17 billion pounds to pay customers back the cost of the insurance, more than any other bank, in what is Britain's costliest consumer scandal.

Total income was slightly below last year and there was a 14 percent increase in bad loan charges in an early warning that some customers could be struggling to cope with post-Brexit economic uncertainty.

UK economy picks up in late 2016 but signs of Brexit hit appear



Workers walk to work during the morning rush hour in the financial district of Canary Wharf in London.

REUTERS/FILE

REUTERS, London

BRITAIN'S economy accelerated at the end of 2016 but growth for the whole year was weaker than previously thought and there are signs of weakness ahead, data showed, suggesting the Brexit vote will start to take its toll in 2017.

The pound fell after the figures, which no longer showed Britain as the fastest-growing major advanced economy last year.

Gross domestic product rose by 0.7 percent in the fourth quarter compared with 0.6 percent in the previous three months, marking the strongest showing since the fourth quarter of 2015, the Office for National Statistics (ONS) said.

While the figures were boosted by a rebound in trade, business investment fell and slowing household spending growth raised questions about the outlook for 2017.

The ONS trimmed its estimate for 2016 growth to 1.8 percent from 2.0 percent, reflecting weaker stock-building that led to a downward revision first quarter figures.

Germany's economy grew by 1.9 percent in 2016, data showed earlier this month. Separate ONS data showed Britain's dominant services sector expanded in December at the slowest pace in seven months.

Angus Armstrong, director of macro-

economics at Britain's National Institute of Economic and Social Research, said the familiar pattern of consumers driving the economy was likely to fade.

"The UK economy needs another driver if it is not to have a significant slowdown in 2017," he said. "The pattern of strong consumer spending and weaker business investment can only be a limited one."

The ONS said household spending increased 0.7 percent on the quarter, slowing from 0.9 percent in the third quarter and marking the weakest growth in a year.

The Bank of England has said it expects overall economic growth this year of 2.0 percent, much stronger than most economists polled by Reuters expect. But it also predicts a growing squeeze on consumers as inflation rises due to the pound's fall since June's vote to leave the European Union.

There are already signs this has started. Data last week showed retail sales fell in each of the three months to January and the BoE this month signaled that it is in no hurry to raise interest rates with so much Brexit-related uncertainty ahead.

Business investment fell 1.0 percent in the fourth quarter compared with the July-September period. Investment by companies was 0.9 percent lower compared with the fourth quarter of 2015.

Saudi Aramco taps JPMorgan, Morgan Stanley for IPO; HSBC a contender

REUTERS

Oil giant Saudi Aramco has asked JPMorgan Chase & Co and Morgan Stanley to assist with its upcoming mammoth IPO and could call on another bank with access to Chinese investors, a source with direct knowledge of the matter said.

The US banks have joined boutique investment bank Moelis & Co in being tapped for coveted roles in what is expected to be the world's biggest initial public offering worth some \$100 billion.

HSBC Holdings Plc has emerged as the leading contender for a role among a list of five banks that could provide a pipeline to Chinese investors - an important part of the offering, the source said, adding that the

other four are Chinese banks.

The final lineup for banks could still be adjusted, the source said, declining to be identified due to the sensitivity of the matter.

The IPO is the centrepiece of the Saudi government's ambitious plan, known as Vision 2030, to diversify the economy beyond oil. Up to 5 percent of the world's largest oil producer is likely to be listed on both the Saudi stock exchange in Riyadh and on one or more international markets. Aramco, formally known as Saudi Arabian Oil Co, declined to comment, as did JPMorgan, Morgan Stanley and HSBC.

The Wall Street Journal reported earlier that JPMorgan, Morgan Stanley and HSBC had been selected as lead underwriters.

Citigroup Inc was also among those asked to pitch for an advisory position with Aramco, Saudi-based industry sources said last month.

The IPO plan has been championed by Deputy Crown Prince Mohammed bin Salman, who oversees the country's energy and economic policies. Last year, he said he expected the IPO would value Aramco at a minimum of \$2 trillion, and that the figure might end up being higher.

Saudi Arabia is considering two options for the shape of Aramco when it sells shares in the national oil giant next year: either a global industrial conglomerate or a specialised international oil company, industry and banking sources have told Reuters.