

S.M.E. credit crisis 'could sweep China'

After a wave of businesses failures in Wenzhou caused by firms forced to borrow at steep rates, economists fear the problem will be contagious

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The failure of a number of small and medium-sized businesses in Wenzhou marks the beginning of a much larger wave of corporate bankruptcies across the rest of China, economists warn.

"Recent events represent a series of liquidity problems facing SMEs in China," said Yao Wei, Societe Generale's chief Asia-Pacific economist. "It is definitely not the end."

Since January local media had reported 19 medium-sized corporate bankruptcies in Wenzhou, said a report by Barclays Capital.

They accounted for only a small fraction of the 3,993 companies in the southeastern seaboard city known for its entrepreneurial spirit, but the market was concerned the failures could mark the beginning of a credit crisis among SMEs, the report said.

SMEs are increasingly borrowing money from non-bank sources at interest rates ranging from 20 per cent to 180 per cent because of credit tightening by banks. May Yan, the analyst who wrote the report, said the corporate failures in Wenzhou would inevitably be contagious and spread to other parts of the mainland.

"I am not surprised to see that SMEs are going bust," Yao said. "The fact that they are willing to borrow money at such high interest rates reflects that they are either desperate for cash or that they are involved in speculation, because no real business can generate that high a return to cover the repayment."

Yao said Inner Mongolia, with its active underground lending and overheated property market fuelled by a mining boom, could be the next area to see SMEs fold.

Guangdong and the Pearl River Delta, with their high concentrations of SMEs, export-focused firms and non-bank lending activities, might face similar problems, said Joy Yang, chief economist for Greater China with Mirae Asset Securities.

Yang said the central government would help cushion the liquidity crisis among SMEs by making credit more affordable and accessible.

Last week the Wenzhou government imposed a cap on the interest rates charged on loans by non-bank lenders to try to rein in the rampant underground-loan market.

Yang said firms in the mining and property sectors might not get much help because the government wants to encourage consolidation in these sectors. It also hopes to control inflation caused by rising property and commodity prices. But this would worsen the plight of SMEs that used properties as collateral when borrowing from non-bank lenders.

A mainland lawyer, who asked not to be named, said: "As property and commodity prices are likely to drop due to the global economic slowdown, it could lead to a reduction in collateral values, and the possible bankruptcy of SMEs."

Yao from Societe Generale expects the SME liquidity crisis, combined with the general economic slowdown at home and abroad, to bring GDP growth in 2012 down to 8.3 per cent. This compares with 10.4 per cent last year, and 9.5 per cent in the second quarter of this year.