

Olivar & Associates, LLC

Hua Xin Hai Xin Building, People's Square

+86 183 2144 4514

Shanghai, China

January 11, 2016

The rise of Chinese Mobile banking and Mobile payment systems (Part 2)

When I'm talking with my Chinese friends about how low the interest rates are back home and even at Chinese banks, they tell me I should put some of my money in my Alipay or Tenpay account. I am very surprised to find out that they are receiving 5% to 6% interest. How can these firms afford to pay such a high interest rate? Is it the same as putting a deposit in the bank? Where do they invest the money? All of this will become clear in the next article.



Web-Banks vs. Traditional Banks

Mobile payment transactions are gaining considerable market share in the payment market in China. In the 3rd quarter of 2015, 4.54 billion transactions with a market value of 18.2 trillion yuan (\$2.8 trillion) were processed, a 350% year-over-year increase. Chinese authorities are well aware of this development and are giving greater authority to mobile banking and payment providers, also known as 'web-banks', to compete with traditional banks for deposits. Traditionally, the Chinese banking system has been characterized by a ceiling for deposit rates and a floor for bank lending, effectively creating a guaranteed profit for banks. With the deregulation of the financial system, a logical step was to start deregulating interest rates as well.

Chinese banks are fairly modern when it comes to technology, as all well-known banks have their own mobile banking app and online banking system. This allows users to check their balance on their phone, send money, or invest in financial products. The main reason why traditional banks are struggling to attract new deposits is not because they are at a technological disadvantage, but rather that they can't match the interest rates offered by the likes of Alipay and Tenpay.

Initially most people started using the apps for convenience reasons, but more and more people are transferring money into their mobile account because of the higher interest rates. In July, China published a proposal with new regulations that can shake up the online payment

sector. One of the regulations allows the owner of the payment system to charge transaction fees, creating potential huge profits.

Alipay and Tenpay stimulate users to invest their cash balance in so called 'wealth' products that offer different interest rates depending on the lock-up period. At the time of writing these range from 3.95% for cash that is available for immediate withdrawal to 5.6% for a 168 day time deposit. I was wondering why it was possible to receive such high interest rates when the official deposit rates were hovering around 2.75%, so a logical next step was to figure out where they invested the money.

Most of us are familiar with the financial products that are sold by banks in China and that promise very high yields, ranging from a conservative 6% to riskier yields above 10%. The funds from these products are lend out to real estate developers and local governments, both of which have increased their debt tremendously over the last couple of years to fund their investments. Now the economy is cooling down and real estate prices have started to fall in certain areas of the country, some of these companies have already started to default on their debt. These investments are too risky for mobile payment providers to attract large amounts of deposits.

It turns out that Alipay and Tenpay invest the money in the interbank market. The interbank market is the market where banks and other financial institutions extend loans to one another, usually for short periods. Interbank rates have soared in China during the last year because banks, particularly smaller banks, are desperate for cash since they have failed to attract enough deposits.

Although the web-banks promote these funds as deposit accounts, they are not similar to deposits at the bank. It is still an investment and there is risk involved, i.e. the principal is not guaranteed. The returns are indicated as an ideal (Lixiang, 理想) scenario, so the actual returns can differ. This does not seem to matter for most people and even companies that happily put their money in the account.

The development of web-banks and online payment systems will help China to further deregulate its financial system and integrate with the global financial system. In the next part we will discuss the Chinese banking system in more detail.

This report is published solely for information purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy any security. Olivar & Associates and one or more of its officers may have a position in the securities discussed herein.