Opinion **Inside Business**

No more exceptionalism for US banks in China

End of an era with foreign lenders no longer immune to the growing tensions between Beijing and the west

PATRICK JENKINS

China's big banks in aggregate more than quadrupled their Russia exposure to $10bn in the 14 months to March © Qilai Shen/Bloomberg

Patrick Jenkins 11 HOURS AGO

There was a time not that long ago when foreign banks in China were prospering in spite of the growing tensions between Beijing and the west. The beginnings of today's hostile geopolitics had come to the fore by the autumn of 2020 — the language of decoupling and cold war II had been forged. Yet the financial services and professional services sectors had seemed strangely immune to the new permafrost.

That exceptionalism is now clearly waning, US officials and bankers say. The clearest evidence has been the freezing out of US consultancies, in particular the April raid on Bain & Company.

It is surprising that this hasn't happened sooner. Ever since sanctions were imposed on Russia after the country's invasion of Ukraine, Russian banks were frozen out of dollar-based international financial markets. The backlash has seen large parts of the world become increasingly angry about the weaponisation of the dollar. China and other Brics countries have been explicit about wanting to challenge dollar supremacy.

Anecdotal accounts suggest western banks in China, though not yet the subject of open hostility, may soon become so. "Go back a year or two and US banks were being actively courted," says one senior US diplomat. "Then Bain happened. I think US banks will suffer next."

Last week came news that could spur that financial decoupling. The Financial Times reported that Chinese banks had suddenly become some of the biggest foreign financiers of Russian banks — taking the place of western institutions restricted by sanctions and regulatory pressure.

The Industrial and Commercial Bank of China, Bank of China, China Construction Bank and Agricultural Bank of China in aggregate more than quadrupled their Russia exposure to $10bn in the 14 months to March, denominating the lending in renminbi, not dollars. It is unclear whether the Chinese institutions are then using their easy access to dollars, through reserves and through commercial relationships with western banks, to convert the currency.

Either way it will raise new questions for US and European banks that do business in China. “Western banks will be rethinking their own China risk appetite,” said one senior banker, pointing to three potential areas of concern in their dealings with Chinese banks — cash management and clearing; investment banking; and lending. If bank risk committees are not proactive about re-examining this and other risks stemming from China’s more belligerent attitude to western interests, they are sure to be nudged by regulators and policymakers.

This will be particularly relevant for big US banks as well as the likes of Standard Chartered and HSBC — probably the most hamstrung western institution given how crucial greater China is to its global business.

The Chinese banks’ rise in Russia should not obscure another troubling fact revealed by the KSE data: they remain smaller players in the country than several western banks. Austria’s Raiffeisen and Italy’s UniCredit remain the two biggest financiers, according to the data from the Kyiv School of Economics. Despite the banks’ claims that they are seeking to withdraw, regulators say more effort is needed: any bank that lends to Russia is de facto funding the war against Ukraine. Raiffeisen and Unicredit both dispute the KSE data and say their Russian assets are down by a third and 40 per cent respectively. They both say they are committed to shrinking their businesses further or selling them.

Citigroup also retains substantial Russian exposure. Although the tally is down by 30 per cent, it retains the third-largest international exposure to Russia, ahead of China’s ICBC, according to the KSE. The bank says it is not funding Russian banks. And it stresses the exposure relates to local dividends that cannot legally be distributed, and client custody balances which cannot legally be abandoned. It is winding down its consumer business, having been thwarted in an attempt to sell it.

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Assuming that western banks continue the withdrawal trend and China's banks fill the gap, the Sino-Russia axis will only be further strengthened. But it will certainly not aid recent efforts by the US to drop the talk of decoupling from China and stave off a fracturing of the global economy. And it may also backfire for President Xi Jinping's long-held ambitions to internationalise the renminbi. "The more that China cosies up with Russia," says a former HSBC executive, the more the west is unlikely to take up the renminbi. "They're just going up a cul-de-sac."

patrick.jenkins@ft.com