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China's Wenzhou City Caps Private Lending Rates to Curb Risk (2)  
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(Updates with comment from analyst in the fourth paragraph.)

By Stephanie Tong

Oct. 3 (Bloomberg) -- China's Wenzhou city set an upper limit on the interest rates that private non-bank lenders can charge borrowers in an effort to control risk in the city's banking industry, the government said on its website.

Private non-bank institutions can only lend at an interest rate that doesn't exceed four times the country's benchmark lending rate, according to the statement dated Sept. 28. Wenzhou is located about 470 kilometers (292 miles) south of Shanghai.

The city government also asked banking institutions to increase financing support to small and medium-sized businesses by setting a ceiling on interest rates for loans to those companies. Interest shouldn't exceed 130 percent of China's benchmark rate, the statement said. The country's one-year lending rate is currently at 6.56 percent.

"Given the large proportion of private lending in Wenzhou, we note that defaults on private borrowing could trigger a negative chain effect throughout the lending system," May Yan, an analyst at Barclays Capital in Hong Kong, wrote in a report dated today. "We don't expect such contagion effects to be limited to Wenzhou."

The risk for Chinese banks will be shared by the informal lending system as private lenders may help offload substantial week credit by extending loans that banks don't want to take, Yan said. The informal lending system was estimated at about 4 trillion yuan (\$629 billion), according to the Barclays report.

"In the end, how banks will be impacted by increasing bankruptcies in the corporate sector funded by shadow banking and informal lending largely depends on whether banks will be required by the central government to support the failed corporate," Yan said.

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--Editors: James Gunsalus, Russell Ward

To contact the reporter on this story:

Stephanie Tong in Hong Kong at +852-2977-6542 or [stong17@bloomberg.net](mailto:stong17@bloomberg.net)

To contact the editor responsible for this story:

Chitra Somayaji at +852-2977-6486 or [csomayaji@bloomberg.net](mailto:csomayaji@bloomberg.net)