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China's Economy

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Private Enterprises and Small and Micro Businesses Are Receiving More Financial Support in China

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- Executive Summary -

China's Economy	Private Enterprises and Small and Micro Businesses Are Receiving More Financial Support in China
<p>Private enterprises (particularly small and micro businesses) play a crucial role when it comes to economic activity and employment, for example, but they faced tougher business conditions entering 2018 as the government stepped up efforts to tackle financial risk. There are concerns this could lead to economic destabilization, with the Chinese government announcing a series of support measures from late 2018 onwards. On the financial front, the government strengthened bank lending and introduced new support schemes in order to improve cash flow conditions and so on. These support policies are expected to ensure stability for the time being. However, as financial institutions focus on providing loans to private enterprises under government pressure, there is a danger that new risk factors might emerge.</p>	

Private Enterprises and Small and Micro Businesses Are Receiving More Financial Support in China

There are concerns that policy side effects could lead to new financial risks

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1. Private enterprises and small and micro businesses are becoming important targets of policies to support the economy

Since 2018, business support for private enterprises and small and micro businesses has become a priority policy issue in China. These firms account for 60% of GDP and 80% of all urban jobs¹, for example, so they play a crucial role in stimulating economic activity and maintaining social stability. At the National People's Congress (NPC) held in March 2019, Premier Li Keqiang also emphasized the importance of these firms when he commented that robust small and micro businesses were the drivers of economic activity and jobs growth.

The main reason why the Chinese government is ramping up its policy support is because these firms are finding it harder and more expensive to raise funds as a result of efforts to tackle financial risk (an issue positioned as one of China's three tough battles in the run up to 2020). Bank lending is the main source of funding in China, but private enterprises and small and micro businesses have traditionally found it hard to obtain financing this way and they are required to pay higher interest rates compared to state-owned enterprises. As such, these firms are being forced to turn to other non-bank lending channels (such as the shadow banking sector) in order to raise funds². However, the Chinese authorities cracked down on the shadow banking sector from late 2016 onwards as part of moves to tackle financial risk, with private enterprises and small and micro businesses now finding it even harder to get money. For example, the average interest rate for ordinary loans rose from 5.4% to 6.2% from Q4 2016 to Q3 2018 after short-term rates were lifted, and they continue to move around 6% now. With other fundraising costs also rising, the interest payment burden of private enterprises shot up in 2018 (Figure 1).

Some observers also suggest private enterprises and small and micro businesses are also being put under pressure by Chinese government initiatives related to strengthening pollution control (another 'tough battle' alongside tackling financial risk) and structural reform (eliminating overcapacity and strengthening the collection of social insurance charges, for example)³. In 2018, infrastructure investment was pushed down by moves to tackle financial risk, with the economy also slowing as consumer spending dipped after an automobile tax break was phased out, for instance. This also saw more private enterprises defaulting than usual (Figure 2). In September 2018, an article calling for private enterprises to

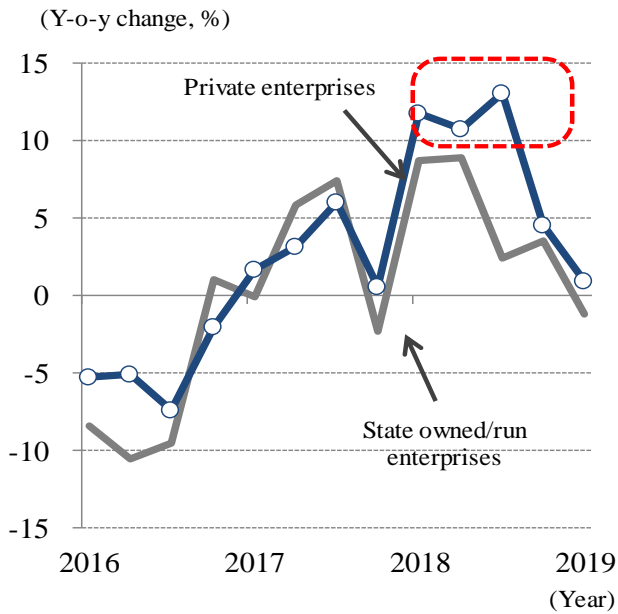
¹ 刘鹤: 不支持民营企业发展的行为必须坚决予以纠正 (新华网) October 19, 2018).

² For example, according to a survey of 12,860 firms carried out by the Chinese Academy of Fiscal Science (a Ministry of Finance think tank) in 2017, private enterprises face bank borrowing costs of 6.1–6.8% compared to just 4.4–4.7% for state-owned enterprises (降成本: 2018 年的调查与分析 (财政研究) 10th period, 2018). A survey of 1,495 firms conducted in 2017 by the Development Research Center of the State Council and the National Bureau of Statistics also put private sector fundraising costs (including non-bank loans) at 8.17%, higher than the 6.90% paid by state-owned/run enterprises (企业家对宏观形势及企业经营状况的判断, 问题和建议 (管理世界) 12th period, 2017).

³ 民营经济困境背后 (东方财富网) October 18, 2018).

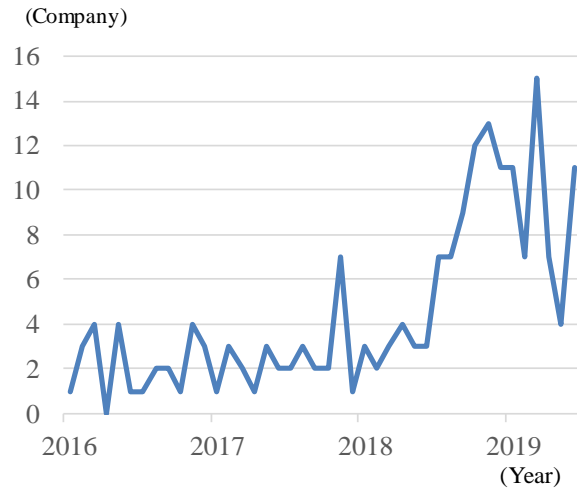
'exit the economy' was widely shared in the Chinese media, with concerns growing about the future of private enterprises and small and micro businesses⁴.

Figure 1: Industrial firm interest payments



Source: Prepared by Mizuho Research Institute based on materials from the National Bureau of Statistics and CEIC Data

Figure 2: No. of private enterprises defaulting



Note: Private enterprises are classified by Wind.
Source: Prepared by Mizuho Research Institute based on materials from Wind

2. The Chinese government has announced a torrent of support measures since late 2018

The strain on private enterprises and small and micro businesses was starting to destabilize the economy. At a symposium on private enterprises, held on November 1, 2018 and presided over by Xi Jinping, the general secretary spoke approvingly about the positioning and important roles played by private enterprises while also announcing moves to provide more support through various measures (reducing costs and easing fundraising difficulties, for example)⁵. The financial authorities and so on then announced a series of measures to support private enterprises and small and micro businesses, with these firms also positioned as an important target of economic policies in 2019 too.

Key policies released so far are outlined in Figure 3. As mentioned above, fundraising is becoming the biggest concern, with the authorities noticeably providing more support on the financial front. The government has employed various methods to boost the supply of funds to private enterprises and small and micro businesses, with financial institutions (banking, insurance and securities, etc.) mobilized and local governments setting up support funds, for example. Furthermore, at the NPC and subsequent meetings such as the State Council gathering, the government announced a number of targets, including boosting outstanding loans to small and micro businesses by 30% year-on-year (a policy centered around the big five state-owned commercial banks); cutting financing costs to small and micro businesses by 1%Pt compared to 2018; and increasing the issuance (compared to 2018) of private-sector corporate bonds and financial-institution finance bonds aimed at small and micro businesses.

Figure 3: Major support measures for private enterprises and small and micro businesses released

⁴ 吴小平: 私营经济已完成协助公有经济发展 应逐渐离场 (“新浪” September 12, 2018).

⁵ 习近平: 在民营企业座谈会上的讲话 (“新华网” November 1, 2018). For details, see 関志雄 難局に差し掛かる中国における民营企业の発展 (経済産業研究所 “中国経済新論” December 28, 2018).

since October 2018

Method	Outline
Support via financial policies	<ul style="list-style-type: none"> ✓ Relending and rediscounting limits have been lifted from RMB 150 billion to RMB 300 billion to support lending by financial institutions to private enterprises and small and micro businesses. ✓ The requirements regarding hypothecated assets have been relaxed when it comes to financial institutions borrowing from the People's Bank of China (PBOC) via the Medium-term Lending Facility (MLF). The limit for loan assets extended to small and micro businesses that are acceptable as collateral has been lifted from RMB 50 billion to RMB 100 billion.
The introduction of fundraising support tools	<ul style="list-style-type: none"> ✓ The authorities have introduced credit risk mitigation warrants (Chinese CDS). These are issued by private-sector financial institutions using foundation funds provided by the PBOC. The authorities are also looking into establishing equity finance tools for private enterprises. ✓ Permission has been granted for the issuance of corporate bonds or insurance/securities-industry asset management products to be used to alleviate fundraising difficulties faced by struggling private enterprises.
The establishment of fundraising support funds	<ul style="list-style-type: none"> ✓ Regional governments and state-owned enterprises connected to regional governments have set up a series of funds (totaling RMB 700 billion as of late January 2019) to support private enterprises facing temporary hardships.
Encouraging lending through macro and micro prudence	<ul style="list-style-type: none"> ✓ The PBOC has asked financial institutions not to indiscriminately withdraw credit from healthy firms that are facing temporary difficulties. ✓ The government introduced a 'one two five' target for banks, with large banks required to extend at least a third and small and medium-sized banks at least two-thirds of all new corporate loans to private enterprises, with over 50% of all new bank loans set aside for private enterprises over the following three years. ✓ Lending to small and micro businesses will be increased by at least 30% year-on-year (a policy centered around the big five state-owned commercial banks) ✓ An indicator has been added to the Macro Prudential Assessment (MPA) system to encourage lending to private enterprises. ✓ Tolerance levels regarding the occurrence of non-performing loans have been increased when it comes to the assessment of branches and bank employees issuing loans to private enterprises.
Tax cuts	<ul style="list-style-type: none"> ✓ The criteria have been relaxed when it comes to small and micro businesses eligible for preferential corporate income tax treatment, with the floor for value added tax also lifted.
Other	<ul style="list-style-type: none"> ✓ The authorities are looking at supporting small and micro businesses through government procurement. ✓ Markets have been opened up by eliminating irrational barriers to market entry, for example.

Source: Prepared by Mizuho Research Institute based on 关于加强金融服务民营企业的若干意见, 中国银保监会关于进一步加强金融服务民营企业有关工作的通知, 关于促进中小企业健康发展的指导意见, and statements by government officials, etc.

3. Risks are being controlled through policy; side effects should be monitored from here on to ensure new financial risks do not emerge

We are steadily starting to see the results of this strengthened financial support. For example, outstanding loans (particularly to small firms) soared by over 20% y-o-y from the end of 2018 to the end of March 2019, up sharply compared to the total growth of outstanding loans (around 10%) (Figure 4). Furthermore, by the end of May 2019, the interest rate on loans extended by the big five banks to small and micro business had fallen by 0.65%Pt compared to 2018. These results may be due in part to inflated figures about loan amounts, for example, but if the government continues to position financial support at a key policy, the cash flow situation will probably ease for small and micro businesses going forward. In fact, the interest payment burden has been easing since Q4 2018. However, there remain headwinds related to exports and so on, so the impact of these measures will probably manifest itself in diminished risk (the maintenance of stable employment and financial conditions through improved cash flows and a reduced debt burden)

rather than in a boost to the real economy (through increased capital investment and so on)⁶.

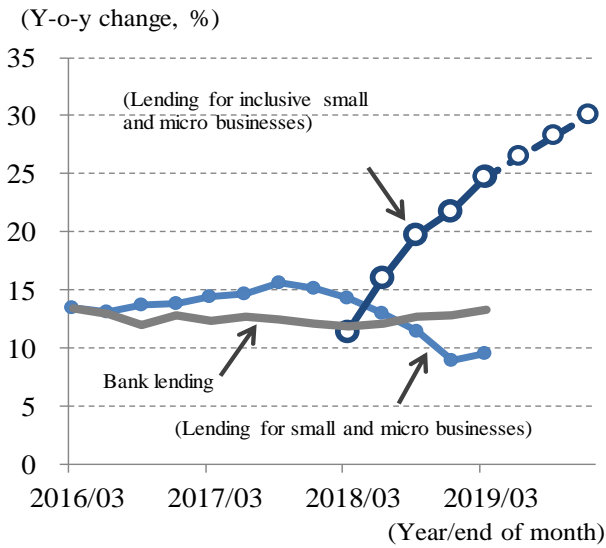
Market participants should be more concerned about the side effects of these measures rather than their actual results. In particular, with moves to control financial risk still underway, measures to strengthen financial support could lead to the emergence of new financial risks, so the situation will require monitoring. As mentioned above, financial institutions have been given several targets to hit in order to strengthen financial support. The NPL ratio is higher for small and micro businesses compared to large firms (Figure 5), so if financial institutions increase their tolerance levels regarding the occurrence of NPLs as they try to hit their targets, this could lead to an increase in chaotic financing as financial institutions relax their stance when it comes to borrower credit risk or real loan demand, for instance. This in turn could increase the burden on these financial institutions in future. In the same way, if private businesses issue more bonds than necessary, this could lead to an explosion of defaults.

An executive meeting of the Politburo Standing Committee⁷ was held on April 19, 2019. With regards to support for private enterprises and small and micro businesses, the meeting stated that financial supply-side structural reform would be accelerated, with efforts made to tackle fundraising difficulties and rising costs. This signaled that reforms would be prioritized from here on. Economic policy is currently swaying between maintaining stability and promoting reform. The key issue going forward will be how the Chinese government tries to support private enterprises and small and micro businesses. If it mainly pursues a traditional bureaucratic course by setting targets and so on, this could lead to the accumulation of new risks, though these could be avoided if it instead focuses on accelerating reforms. The course it pursues will be key when gauging the direction of financial risk going forward.

⁶ 大和香織 (2019) 中国景気対策の効果は発現するか～2019年1～3月期実質GDPの評価と政策効果検証～(みずほ総合研究所“みずほインサイト” April 23, 2019).

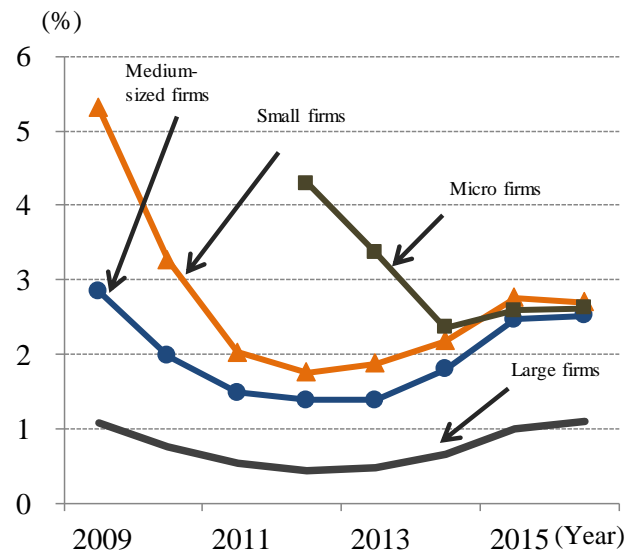
⁷ 中共中央政治局召开会议 中共中央总书记习近平主持会议 (“新华网” April 19, 2019).

Figure 4: Outstanding balance of loans to small and micro businesses



Note: Loans to inclusive small and micro businesses denote loans of RMB 10 million or less per firm. The forecast from April 2019 is based on the loan targets for the whole year.
 Source: Prepared by Mizuho Research Institute based on materials from CEIC Data and the China Banking and Insurance Regulatory Commission

Figure 5: NPL ratios by firm size



Note: Estimated from data regarding outstanding loans per firm and the NPL balance (borrowers requiring caution, borrowers at risk of bankruptcy, and bankrupt borrowers).
 Source: Prepared by Mizuho Research Institute based on PBOC materials

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