Corporate Leverage in China: Why has It Increased Fast in Recent Years and Where do the Risks Lie?

Wenlang Zhang
CITIC Securities Company Limited

Gaofeng Han
Hong Kong Monetary Authority

Brian Ng
Hong Kong Monetary Authority

Steven Chan
Hong Kong Monetary Authority

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Summary

Rapid credit growth in recent years has ignited concerns over the indebtedness of the Mainland Chinese economy and associated risks to its financial stability. Using firm-level data, this paper examines China's corporate leverage at a disaggregated level and the driving forces of leverage growth in recent years. It also studies whether firms have made use of their borrowing to engage in credit intermediation activity.

Our analysis indicates that China's corporate sector does not appear to be over-leveraged in aggregate, but some industries, particularly real estate developers and firms in the industries with substantial over-capacity, have continued to increase their leverage. By ownership, it is mainly state-owned enterprises (SOEs) that have increased their leverage, while private enterprises have deleveraged in recent years.

Using a corporate finance model, our research shows that SOEs' leveraging has been mainly driven by institutional factors, such as implicit government support amid lower funding costs than private firms. If SOEs, particularly in the real estate sector and overcapacity industries, had borrowed without such support, their leverage would have been much lower. Moreover, some SOEs did not use credit obtained via formal financing channels to expand their businesses, but instead used it for credit intermediation.

Leveraging driven by institutional factors has resulted in a weakening in fund-use efficiency and a deterioration in corporate debt-servicing capacity. Non-financial corporate credit intermediation activity adds to the risks of lower banks' asset quality. It may also mislead policy makers because headline figures of credit expansion would tend to overstate the credit allocated to the real economy and understate credit allocated to the financial sector. Our analysis suggests that, if corporate credit intermediation activities are taken into account, the credit intermediation chain would be longer than indicated by the headline figures. This also suggests quantity indicators, such as credit growth, may have become less informative of China's monetary conditions in recent years.