China Has Made Significant Progress in Stabilizing Leverage and Promoting Growth

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Abstract: China's effort to steadily deleverage has delivered positive results in recent years, with the leverage ratio rising at a much lower rate of 7.3 percentage points in the 2017-2019 period. In 2020, China's macro leverage ratio rose relatively fast due to the COVID-19 impact. In the face of the severe pandemic, the Communist Party of China (CPC) Central Committee with Comrade Xi Jinping at its core has exercised strong leadership and made decisions resolutely. With coordinated efforts to advance both pandemic control and economic and social development, China has achieved major strategic success in fighting the pandemic as the Chinese economy is picking up stably and life and production are returning to normal, providing fundamental support for the stabilization of the macro leverage ratio. In Q4 2020 and Q1 2021, China's macro leverage ratio recorded net falls for two consecutive quarters. Meanwhile, financial support for the real economy has become more efficient and the structure of leverage is improving. With the weakening of the COVID-19 impact, the economy will stabilize and total debt will be aligned with economic growth. So China's macro leverage ratio is projected to remain basically stable this year.

Keywords: macro leverage ratio, economic growth, stabilization of leverage

I. China's macro leverage ratio fell by a net 2.6 percentage points in Q1 2021 while total debt was basically stable due to effective pandemic control

According to preliminary figures, in Q1 2021 China's macro leverage ratio stood at 276.8 percent, down by 2.6 percentage points from end-2020. By sector, the leverage ratios of non-financial enterprises, the government sector, and the household sector registered 160.3 percent, 44.5 percent, and 72.1 percent, respectively, falling by 0.9 percentage points, 1.3 percentage points, and 0.4 percentage points, respectively, from end-2020. This shows sectoral leverage ratios have decreased across the board by varying degrees.

China's effort to steadily deleverage has shown positive results since 2017 when the persistent rapid rise in its leverage ratio started to turn around. Falling by 3 percentage points in 2018, China's leverage ratio saw an overall increase of 7.3 percentage points in the 2017-2019 period, decelerating considerably from the previous years.

In 2020, China pursued a flexible and appropriate monetary policy, which was adjusted as appropriate to boost support for the real economy and played an effective role in countering the COVID-19 impact. Despite the surge of 23.5 percentage points in China's macro leverage ratio for that year, China's economic growth became more resilient and its real economy saw a quick recovery, which laid a solid economic foundation for its continued effort to stabilize leverage. Since Q2 2020, China's macro leverage ratio had climbed at an increasingly lower rate quarter by quarter, posting rises of 14 percentage points, 7.2 percentage points, and 3.9 percentage points, respectively, for the first three quarters of 2020. Then it dropped by 1.6 percentage points in Q4 2020 and by 2.6 percentage points in Q1 2021. This shows that China's policy coordination has been successful in stabilizing the economy while keeping the macro leverage ratio basically stable. Moreover, further progress has been achieved.

Table 1: China's Leverage Ratios Since 2016 (%)

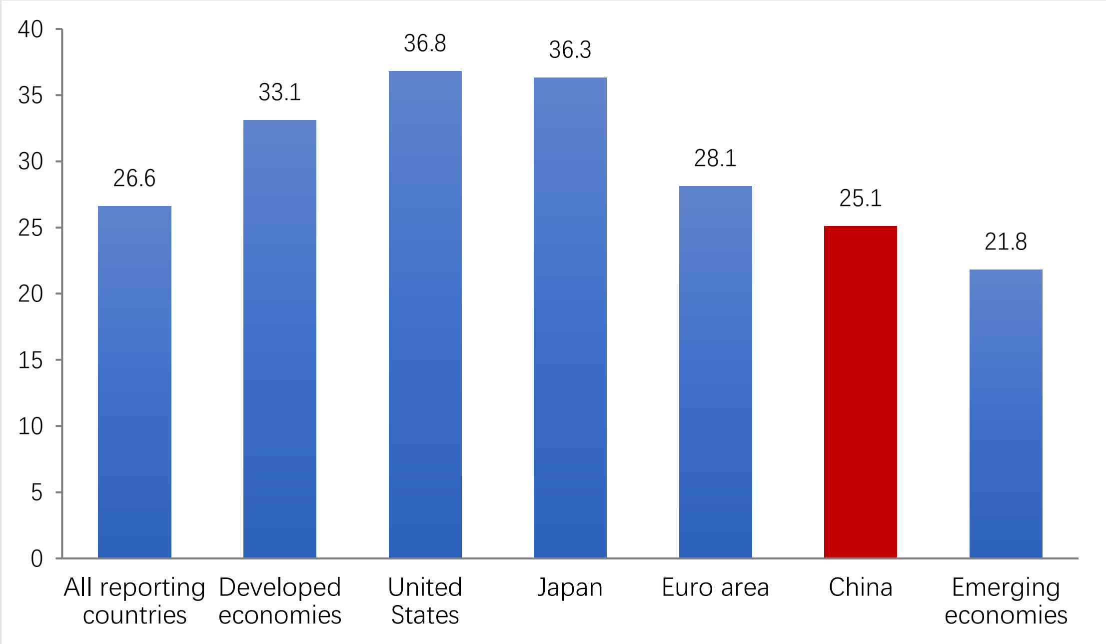
	2016	**2017**	**2018**	**2019**	**2020**	**Q1 2021**
Household sector	52.2	57.0	60.5	65.1	72.5	72.1
Government sector	36.7	36.0	36.4	38.6	45.7	44.5
Non-financial enterprises	159.8	159.0	152.2	152.1	161.2	160.3
Overall leverage ratio	248.6	252.0	249.0	255.9	279.4	276.8

Source: PBC Statistics and Analysis Department.

Compared with major developed economies, China has seen a smaller rise in its macro leverage ratio during the pandemic. Since the outbreak of COVID-19, countries around the world have actively adopted stimulus policies to combat recession, sending their macro leverage ratio fast rising. According to BIS statistics for Q3 2020, the reporting countries, i.e., 43 economies as a whole, recorded a leverage ratio of 251.9 percent, up by 26.6 percentage points from end-2019. **China has seen a smaller rise in its leverage ratio than developed economies.** In Q3 2020, its leverage ratio increased by 25.1 percentage points from end-2019, a rate quite lower than the 33.1 percentage points, 36.8 percentage points, 36.3 percentage points, and 28.1 percentage points recorded for developed economies, the United States, Japan, and the euro area, respectively. Compared with emerging market countries, whose leverage ratio for Q3 2020 rose by 21.8 percentage points from end-2019, China saw a slightly bigger rise. Nevertheless, this difference will narrow down, with China's macro leverage ratio posting net falls in Q4 2020 and Q1 2021.

Figure 1: Rises in Leverage Ratios (end-2019 to Q3 2020)

Percentage points



Sources: PBC Statistics and Analysis Department (for China data) and BIS (for data on the other countries).

II. Effective pandemic control has contributed to effective recovery of the real economy and provided fundamental support for the stabilization of the macro leverage ratio

In 2020, in the face of the severe COVID-19 impact, the CPC Central Committee with Comrade Xi Jinping at its core made decisions resolutely. With coordinated efforts to advance both pandemic control and economic and social development, China has achieved major strategic success in fighting the pandemic as the Chinese economy is picking up stably and life and production are returning to normal, providing vital support for the stabilization of the macro leverage ratio.

First, the rebound in economic growth, made possible by scientific pandemic control, has been essential to stabilizing the macro leverage ratio. The slowdown in nominal GDP growth as a result of the pandemic led to a higher macro leverage ratio in 2020, which has been brought down in Q1 2021 as the economy steadily recovers. According to calculations of the PBC's Statistics and Analysis Department, China's macro leverage ratio rose by 23.5 percentage points year on year in 2020, an acceleration of 16.7 percentage points from the previous year, of which 9.7 percentage points, or 58.4 percent, was attributable to slower growth of nominal GDP. With China's GDP recovering in Q1 2021 and registering a year-on-year growth rate of 18.3 percent, the macro leverage ratio fell by 2.6 percentage points from end-2020, as compared with an increase of approximately 14 percentage points in the same period a year earlier. Of the 16.5 percentage point decrease in the leverage ratio, 15 percentage points, or 90.8 percent, was contributed by the pickup in nominal GDP growth.

Second, the macro management policies have provided targeted support during the pandemic to effectively stabilize the economy. In response to the outbreak of COVID-19, the sound monetary policy of China has become more flexible, appropriate, and targeted. By improving the effectiveness of its policies in providing direct support for the real economy, the PBC has intensified financial support aimed at stabilizing businesses and safeguarding employment and has channeled more funds to the real economy. At the same time, China has pursued a fiscal policy that is more proactive. Net financing via issuances of government bonds totaled RMB8.32 trillion in 2020, surpassing that in 2019 by RMB3.6 trillion. Due to the effective support from these macro management policies, the Chinese economy has stabilized and rebounded steadily since Q2 2020, recording growth rates of 3.2 percent, 4.9 percent, and 6.5 percent for Q2, Q3, and Q4 of 2020, respectively.

Third, China's macro leverage ratio is stabilizing this year not because of credit contraction but because China has maintained the continuity and stability of its macro policies. In 2021, China will pursue a sound monetary policy that is flexible, targeted, reasonable, and appropriate, keeping in place the policies allowing micro and small businesses (MSBs) to defer principal and interest payments for inclusive MSB loans and the policies promoting unsecured MSB loans. Accordingly, commercial banks will continue ramping up support for inclusive lending to MSBs. In Q1 2021, aggregate financing to the real economy (AFRE) increased by a cumulative RMB10.24 trillion, representing its second largest quarterly rise despite a slowdown from a year before. Meanwhile, in line with the decisions of the Central Economic Work Conference and the plans laid down in the *Report on the Work of the Government*, China will enhance the quality, efficiency, and sustainability of its proactive fiscal policy. Government debt will increase by RMB7.22 trillion according to the budget, remaining basically stable when excluding the influence of the government bonds issued specially for COVID-19 control. As China has maintained the continuity and stability of its macro policies, its economy has been picking up in Q1 so that its macro leverage ratio is stabilizing.

III. Financial support for the real economy has become more efficient while the leverage structure is improving

Currently, financial support for the real economy has become more efficient as rapid stabilization of the economy has been made possible with relatively small debt increases. In Q1 2021, total debt climbed by 11.5 percent year on year, a low level on record, down by 0.9 percentage points from end-2020 and by approximately 5 percentage points compared with the average growth in total debt over the years 2009-

2019. The steady recovery of China's economic growth in the context of slower debt growth is an indication of smoother transmission from the macro management policies to the real economy and much more efficient use of debt money. In other words, small debt increases have generated enough support to bring economic growth quickly back to a reasonable range. This is mainly due to the fact that China's monetary policy always gives high priority to serving the real economy. Financial support policies have been carried out in a tiered, incremental manner; the fight against financial risks has directed financial institutions towards serving the real economy and prevented them from expanding blindly; and financial reforms have moved ahead stably to improve the quality and effectiveness of financial services. All these measures have increased the efficiency of financial services for the real economy.

At the same time, the structure of the macro leverage ratio is improving.

1. The corporate sector, whose financing conduct has been subjected to enhanced regulation, has seen a relatively stable leverage ratio

Existing risks in the corporate sector have been resolved step by step in recent years. Being one of the highest among the world's major economies, the leverage ratio of China's corporate sector has constituted around 60 percent, and therefore the most important component, of China's macro leverage ratio. From 2017 to 2019, as China pushed ahead with its effort to stabilize leverage, the leverage ratio of its corporate sector fell for three consecutive years by 7.6 percentage points in total, which helped mitigate potential risks and made room for future increases in corporate debt.

The rapid rise in the leverage ratio of the corporate sector in 2020 was a major reflection of China's macro management policies committed to stabilizing businesses and safeguarding employment. At end-2020, the corporate sector saw a 9.1 percentage point rise in its leverage ratio year on year, which contributed 38.5 percent of the 23.5 percentage point overall increase in the macro leverage ratio to become the biggest contributing factor behind. The rebound in the leverage ratio of the corporate sector was, on the one hand, closely associated with economic slowdown; on the other hand, it resulted from China's macro management policies during the pandemic, which placed more emphasis on providing direct support for the real economy and boosted financial support to stabilize businesses and safeguard employment.

Currently, the risks from debt increases in the corporate sector have been put under effective oversight. In Q1 2021, the corporate sector saw a debt growth of 7.7 percent, 1.2 percentage points lower than a year earlier. In terms of debt instruments, the new debts mainly consist of loans and bonds. Since 2020, corporate loans and bonds combined have grown by 12.6 percentage points as a ratio to GDP, contributing over 100 percent of the increase in the leverage ratio of the corporate sector. Furthermore, with the transitional period close to an end for the implementation of the new asset management rules, off-balance sheet liabilities of the corporate sector have been declining. Such liabilities as trust loans and entrusted loans have fallen by 3.9 percentage points as a ratio to GDP since 2020.

2. The government sector has seen its leverage ratio rise fast to counter the COVID-19 impact

In recent years, China has taken steps to regulate local government financing and to mitigate the risks of government debt. In the 2015-2017 period, the effort to deleverage reduced the leverage ratio of the government sector by 2.8 percentage points. Then in 2018 and 2019, guided by the policies on stabilizing leverage, the government sector maintained a relatively stable leverage ratio, which increased by 2.6 percentage points.

At end-2020, the leverage ratio of the government sector went up by 7.1 percentage points year on year, accelerating by 4.8 percentage points from the previous year and by 6.4 percentage points compared with its average annual rise in the 2008-2019 period. This acceleration, partly attributable to the COVID-induced economic slowdown, was mainly due to the fiscal policy turning more proactive to counter the COVID-19 impact. In 2020, with the conduct of macro management policies in a targeted, effective, timely, and reasonable manner, China was able to stabilize the fundamentals of its economy as well as employment.

In Q1 2021, the government sector saw a 1.3 percentage point fall in its leverage ratio, behind which was slower issuance of government bonds. In line with its 2021 budget plan, China will improve the quality and effectiveness of its proactive fiscal policy and make it more sustainable.

3. The leverage ratio of the household sector is playing a lesser role in pushing up the macro leverage ratio

The leverage ratio of China's household sector has been trending upward in recent years. Over the years 2008-2019, it rose from 18.2 percent to 65.1 percent at an average annual rate of 4.3 percentage points, registering stable rather than volatile annual rises.

At end-2020, China's household leverage ratio recorded a year-on-year growth of 7.4 percentage points, which contributed 31.3 percent of the overall increase in the macro leverage ratio, a big drop of 36.2 percentage points from the previous year. This shows the lesser role of the household leverage ratio in pushing up the macro leverage ratio.

Currently, the excessive debt growth in China's household sector has, to some extent, been contained, with the rates of debt growth in the sector generally trending downward since 2018. At the same time, the structure of household debt has been improving. The increase in household debt shows the following features. **First**, personal business loans under the policy-supported category of inclusive MSB loans have seen rapid growth, lending strong support to safeguarding and improving people's livelihood. Since the outbreak of COVID-19, China's macro management policies have attached importance to ensuring the operation of market entities, especially self-employed traders and MSB owners, and have innovated mechanisms to provide direct support to them in order to stabilize business operation and safeguard employment. At end-March, personal business loans posted a year-on-year growth of 24.6 percent, picking up by 11.5 percentage points from a year before. **Second**, home loans have grown at a slower pace. Since Q1 2018, growth in home loans has been slowing down. At end-March, the outstanding amount of personal home loans registered a year-on-year increase of 14.5 percent, 1.4 percentage points lower than a year before.

As the COVID-19 impact subsides in the future, economic growth will stabilize and total debt will be aligned with economic growth. So China's macro leverage ratio is projected to remain basically stable this year.