Dealing with a Liquidity Crisis: Economic and Financial Policies in China during the Coronavirus Outbreak[1]

Zhiguo He Bibo Liu

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The coronavirus outbreak that began last December sharply curtailed economic activities across China. In response to this sudden, nationwide, and potentially devastating liquidity shock, many coordinated economic and financial policies were initiated by the Chinese authorities to help the economy battle against the epidemic. In particular, policy tools have been designed to support not only industries and regions but also small- and medium-sized firms that were disproportionally hit hard by the outbreak. We then discuss the effectiveness of the policy intervention based on a series of recent surveys which cover a representative sample of public and private firms. Some international comparisons are conducted, with some economic outlook going forward.

1. Liquidity Policies

• Loan term extension and debt rollover

For firms that have trouble repaying debts on time due to the COVID-19 outbreak, banks were instructed by top authorities in Beijing to extend loan terms or rollover the debts. Micro- and small-sized firms, and firms in Hubei were allowed to postpone repayment dates to June 30. As of March 22, according to the China Banking and Insurance Regulation Commission (CBIRC), around 20% of loans borrowed by micro-, small-, and medium-sized firms have been extended. By the end of March, the terms of loans worth 880 billion yuan have been extended, and loans worth 576.8 billion yuan have been rolled over. Penalty interests on overdue payments were exempted, and overdue debt caused by the outbreak would not be counted as a default (to avoid any negative impact on a firm’s credit record).

In the corporate bond market, the China Securities Regulatory Commission (CSRC) supported firms with normal operation, by relaxing the restrictions on issuing new bonds that repay maturing debts.

Similarly, individuals were allowed to defer the repayments of personal loans (e.g., mortgages and credit card bills) and renegotiate interest rates. The terms of entrepreneurship loans borrowed by individuals infected by the coronavirus could be extended by another year.

On the side of banks, in March the People’s Bank of China (PBOC) cut the required reserve ratio of some commercial lenders, a monetary policy tool frequently used by China, to release 550 billion yuan to the real economy. Other regulatory requirements were also loosened to encourage commercial lenders to support their

[1] He: University of Chicago, Booth School of Business, zhiguo.he@chicagobooth.edu. Liu: Tsinghua University, PBC School of Finance, liubb@pbcsf.tsinghua.edu.

borrowers; for example, debts overdue for more than ninety days are no longer required to be classified as nonperforming loans.

• Share pledge term extension

By the end of 2019, 40.5% of publicly listed firms in China had share pledge loans—i.e., shareholders are borrowing money from other institutions (banks, trust companies, or security firms) using their floating shares as collateral. The liquidity pressure on these share pledge loans—with an outstanding amount of about 2 trillion yuan at that time—is enormous. To cope with this pressure, the CSRC has allowed shareholders in Hubei to delay the repayment of share pledge loans to security firms by 6 months; the extension period in other provinces was 3–6 months. The CBIRC made similar arrangements on shares pledged to banks and trust companies.

2. Financial Policies

• The special relending program

On February 7, the PBOC set up a special "relending" program to provide low-interest loans to a group of shortlisted firms who are on the frontlines of the battle against the coronavirus (e.g., firms involved in the production, transport, and sales of epidemic-related medical supplies and daily necessities). According to the program, 300 billion yuan of funding from the PBOC were made available; it is called "relending" because the central bank first lends to various commercial banks that then lend to these shortlisted firms.

The list of these favored "frontline" firms was mainly drawn up by the National Development and Reform Commission (NDRC) and the Ministry of Industry and Information Technology (MIIT), which included more than 1,600 large companies. Another ten hand-picked provincial and municipal governments were also allowed to compile their own lists of "frontline" firms. Though the names of "frontline" firms are not publicly disclosed, a significant number of privately owned enterprises made the shortlist.

In terms of pricing, the PBOC put a ceiling of 100 bps below the prevailing one-year national LPR on the interest rates, and the Ministry of Finance (MoF) subsidized 50% of the borrowing cost. With these joint efforts, Beijing is pledging to cut the actual borrowing cost so that it is below 1.6% while the prevailing one-year LPR is about 4%. In practice, the cost is only 1.26% for loans made to 5881 firms before March end, based on the statistics released by CBIRC.

• The increased relending and rediscount quota

Soon after establishing the 300-billion-yuan special relending program, the PBOC increased relending and rediscount quotas to banks by 500 billion yuan. Local banks were allowed to obtain funds from the central bank, and then extend loans to small- and medium-sized firms, the agricultural industry, and farmers using a market-based approach—particularly, there was no a shortlist of “frontline” firms. With this initiative, loans of 276.8 billion yuan with average borrowing cost below 4.55% have been extended to 351.4 thousand borrowers as of March end. On March 31, the PBOC, following the instructions from the State Council, further increased the quota by 1 trillion yuan.

• Special loans for micro- and small-sized firms

At the end of February, the CBIRC instructed banks to extend more loans at favorable rates to micro- and small-sized firms that are privately owned after the outbreak. Specifically, the largest 5 state-owned banks will increase their loans to small firms by 30% in the first half of 2020, and three policy banks (the China Development Bank, the Export-Import Bank of China, and the Agricultural Development Bank of China) would also make special loans of 350 billion yuan to these firms.

• Relaxed regulations on Seasoned Equity Offering (SEOs)

In February 2020, the CSRC significantly revised the regulations on SEOs in the stock market to encourage equity financing. The SEO requirements for listed firms on the ChiNext market were considerably loosened, allowing more growth firms to raise capital. The restrictions on private placement of SEOs (e.g., pricing, lockup periods, number of investors) were also partially lifted.

3. Fiscal Policies

• Tax, fee and rent cuts

To support firms and individuals in the wake of economic paralysis, the MoF, the State Taxation Administration (STA), the General Administration of Customs (GAC), the NDRC, and local governments set out a series of cuts and extensions in tax, social security payments, and fees. They include (not an exhaustive list):

i. Most social welfare contribution paid by firms (pension, unemployment and vocational injury insurance) was exempted for up to 5 months for micro-, small-, and medium-sized firms, firms in Hubei, and self-employed business owners; and more than half of unemployment insurance premia were refunded if these firms kept all their workers. Payments by large firms were cut by half. The exemptions amounted to 123.9 billion yuan for February and are expected to exceed 500 billion yuan by June, according to the Ministry of Human Resources and Social Security.

ii. Rents owed by micro-, small-sized firms and self-employed business owners to state-owned properties are waived for 3 months.

iii. Tariffs were exempted for the import of medicines, medical supplies, and other vehicles used to fight against the outbreak.

iv. From March to May, Value-Added-Taxes for small-scale taxpayers in Hubei were exempted, and the tax rate was cut from 3% to 1% in other regions.

v. Road tolls were exempted; some service fees charged by ports, airports and railways were cut by 20%; and the price of electricity was cut by 5%.

Among these policy initiatives, the waiver on employers’ welfare contributions (which roughly amount to around 15% of wages) and the exempted rents owed to State-Owned Enterprises are the most significant relieving measure for the enterprise sector. Because coronavirus disrupted most existing businesses, reductions on Value-Added-Taxes as well as utility overheads bring only negligible benefits to most of firms.

• Payment period extensions

Deadlines of tax and fee payments were generally negotiable and extended; the STA extended February's statutory tax filing deadline to February 28, and these deadlines could be further extended by local tax authorities (and most of them have been extended). Additionally, firms were allowed to defer their social security payments by 6 months, and the due date for contributing to the "housing provident fund" was extended to June 30.

4. Discussions

In summary, thanks to coordinated efforts from many government agencies, China's economic and financial policies during the epidemic period were aggressive and targeted to help infected entrepreneurs/individuals, smaller firms, regions in trouble, and firms directly involved in providing supplies to the battle. But are there any concerns about these polices, and are the policies effective? How do they compare to international counterparts?

• The impacts on the banking sector

Commercial banks played an important role in executing the liquidity and financing policies against the outbreak. However, it seems that these policies may hurt bank profitability and in turn the stability of the entire banking sector, because

i. Deferred repayments, loan term extensions, and rollovers may disturb the banks' operation cycles and require additional effort for liquidity and asset management;

ii. Exemptions for penalty interests hurt revenues; and

iii. Borrowers will be influenced by national or local authorities in many cases (e.g., the shortlisted firms in the special relending program).

We believe these policy-driven initiatives have reasonable economic motivations. The value of bank assets depends on borrowers' survivals and future earnings. Facing the unprecedented liquidity shock due to the coronavirus, banks would find it in their own interest to scarify some short-term profits to help their temporarily troubled clients survive the crisis—banks can collect deferred repayments once their client firms resume their normal operations. In fact, similar exemptions by banks are also observed in the U.S. without too many policy interventions.

More importantly, top policy makers in Beijing are aware of this issue, and we have mentioned several such policy supports received by commercial banks. Along this line, banks were also encouraged by the PBOC to issue perpetual bonds to raise capital. To boost the perpetual bonds' liquidity, the PBOC conducted central bank bills swaps of 21 billion yuan from February to April, with which dealers in the open market could exchange perpetual bonds for more liquid central bank bills.

• Policy effectiveness and challenges on unemployment

Tsinghua PBCSF and the CSRC just conducted a joint survey in late February 2020, which covered all 3,801 listed firms and 605 representative private firms. From the survey, the top five supporting policies favored by these firms are i) tax cuts and deferrals; ii) looser monetary policies; iii) loan term extensions and rollovers; iv) cutting and deferring social security payments; and v) cutting interest and deferring payments. We note that all these preferences are exactly what the top authorities in Beijing are doing. Furthermore, more than 70% of surveyed firms mentioned that they had received some help (e.g., a tax cut) from local governments, suggesting an effective and timely enforcement of the aforementioned policies.

Looking forward, though the spread of the coronavirus has been effectively contained inside China, China's economic recovery faces a mounting challenge, let alone the deteriorating pandemic situation across the globe. The statistics on the macro economy in China show that on a year-to-year basis, the industrial value-added dropped by 4.3% and 25.9% in January and February, respectively. In contrast, the unemployment rate increased by 1% from 5.2% to 6.2% in February 2020 compared to December 2019.

These numbers seem to suggest that Chinese firms were largely paralyzed during the first quarter in 2020, but did not cut their labor forces. However, the joint Tsinghua PBCSF-CSRC survey showed that 60.1% firms have cash to sustain operation for three months or more. That is, they are able to maintain the current level of employment for about three months before exhausting their financial resources. If the pandemic continues for more than three months, and if there is not enough follow-on policy support, these firms may get into trouble, causing a more severe economic downturn.

• An international comparison

Many policies tools used by major economies to battle against the pandemic are similar to those adopted by the Chinese authorities in nature. Generally, more funds are injected to the economy to support firms and households. For example, in the U.S., besides loosening money supply, the Federal Reserve and Department of Treasury jointly established programs to provide 300 billion dollars in new financing. A forgivable loan program of 350 billion dollars was also designed to help small enterprises' payroll for their employees. On April 21, the U.S. Senate passed a $484 billion interim relief package as replenishment. Germany set up a 600 billion-euro rescue fund to support troubled firms with loans, guarantees and equity investments.

Fiscal policies in terms of tax cuts or deferrals are also widely used, and tax deferrals are often preferred. For instance, the U.S. government postponed the April 15 tax payments for 90 days for individuals and firms. The U.K. exempted business property taxes for 12 months for the retail, leisure, and tourism sectors, and deferred 30 billion pounds in Value-Added-Tax payments to June 30.

Last but not least, outside China, governments are more engaged in providing direct subsidies to workers. The U.S. government sent one-time 1,200-dollar direct payments to adults making up to 75,000 dollars. Britain gave 25,000 pounds to each firm hit hard by the coronavirus, and 10,000 pounds each to small businesses. Japan gave firms 8,330 yen per employee to retain workers from February 27 to May 6. The Danish government promised that firms hit by the pandemic could get aid to pay 75% of salaries, lasting for three months.

The lack of massive worker-favored polices in Beijing' s responses have been criticized by many economists, but these criticisms overlook the fact that State-Owned-Enterprises in China are providing a financial safety-net for (a significant fraction of) Chinese workers. And, workers of privately owned enterprises are paid with some legally binding minimum furlough wage, as the employers face hefty severance penalties during that period. From this perspective, Beijing' s aggressive firm-favored subsidy polices mentioned above also help workers, in the same spirit as the Pay-Check Protection Program in the United States. Just like their counterparts in other countries around the world, small entrepreneurs and self-employed workers in the small- and micro-business sector are the biggest losers during this pandemic lockdown.

Another interesting point, which is specific to China, is that households tend to have savings for unexpected rainy days; this effectively buys some time for Chinese government to launch a bigger wave of subsidies during its recovery phase starting in April. This fact also helps explain that, instead of subsidies in cash like other western governments do, a few local governments have been partnering with private companies to send coupons to residents to boost consumption. By April 27, there are 42 cities sending 6.5 billion yuan in coupons to local residents. The reason is simple: Given the relatively high propensity of saving in China, it is more effective to encourage consumption and hence stimulate the economy in a more direct way.

• Looking forward

China just recorded its worst quarterly GDP growth of -6.8% in 2020 Q1 since quarterly data were made available in 1992. The economic impact of COVID-19 on China is large, severe, and is still mounting despite various massive economic and financial policies that have been rolled out by top authorities in Beijing in a timely fashion. The situation seems to be recovering inside China, to some extent. Another more recent Tsinghua PBCSF - CSRC joint survey conducted on March 27 showed 71.4% of the listed firms had resumed more than 80% of their production capacities by then. The official unemployment rate went down by 0.3% to 5.9% at the end of March, although it is widely acknowledged that actual unemployment in China is likely to be worse than the official statistics suggest.

However, China is still facing a daunting challenge for its economic recovery at this point, especially because the deteriorating pandemic situation across the globe is bringing an almost complete halt to the export sector in China (according to the March 27 survey, 43.5% of the listed firms expect declines in 2020 oversea revenues), and could make it difficult for Chinese firms to access critical inputs provided by firms outside of China. As expected, on March 27th, Beijing has decided to roll out a multi-trillion yuan stimulus package, with a refreshed focus on “new infrastructure,” with much uncertainty going forward.