EXECUTIVE BOARD MEETING

SM/16/213
Correction 2

July 26, 2016

To: Members of the Executive Board

From: The Secretary

Subject: **People's Republic of China—Selected Issues**

Board Action:	The attached correction to SM/16/213 (7/8/16) has been provided by the staff:
Evident Ambiguity	**Page 32 (Figure 1)**
Questions:	Mr. Daniel, APD (ext. 39698) Mr. Kang, APD (ext. 37067)

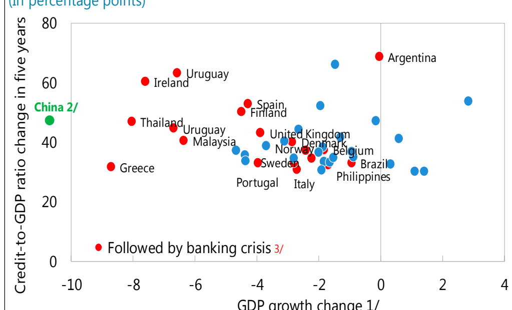
RESOLVING CHINA'S CORPORATE DEBT PROBLEM[1]

- *Corporate credit growth in China has been excessive in recent years. This paper looks at the causes and consequences of this credit boom and outlines a strategy to address the problem of excessive corporate debt.*
- *The credit boom is largely related to the large rise in investment after the global financial crisis. Investment efficiency has fallen and the financial performance of corporates has deteriorated steadily, affecting asset quality in financial institutions.*
- *The corporate debt problem should be addressed urgently with a comprehensive strategy. Key elements: identifying companies in financial difficulties; proactively recognizing losses in the financial system; burden sharing; corporate restructuring and governance reform; removing debt overhang through workouts; and hardening budget constraints.*
- *A proactive strategy would trade off short-term economic pain for larger longer-term gain.*

1. **China's high credit growth points to elevated economic and financial risks**. In response to the Global Financial Crisis (GFC) and collapse in external trade, China deployed policies to boost domestic demand supported by high credit growth, which averaged around 20 percent per year between 2009 and 2015—much higher than nominal GDP growth and the previous trend. The (broadly defined) nonfinancial private credit-to-GDP ratio rose from around 150 percent to over 200 percent over the same period as a result, and 15–25 percentage points above the level consistent with the historical trend at end-2015—a potentially dangerous, high 'credit gap.' The gap is comparable to countries that experienced painful deleveraging (Borio and Drehmann, 2009).

Figure 1. Credit Booms Tend to End Badly

(In percentage points)

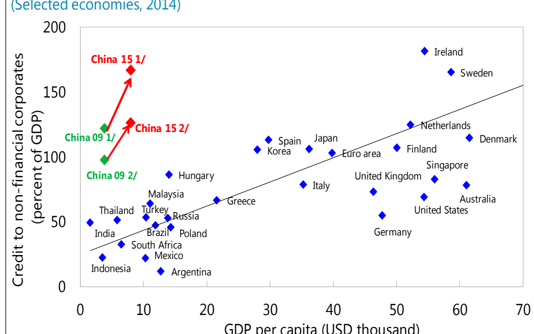


Source: IMF staff estimates.
1/ Average growth differential between 5-year post-boom and 5-year pre-boom periods.
2/ No growth change as China's boom has not ended.
3/ Banking crisis is identified following Laeven and Valencia (2012).

2. **Credit growth in China is concentrated in the corporate sector**. The rapid increase in credit could reflect financial deepening in a fast-growing economy. But the credit-to-GDP ratio for the corporate sector is significantly higher in China than in countries at a similar level of development and exceeded the level typical for

Figure 2. Corporate Credit: High vs. Peers

(Selected economies, 2014)



Sources: Bank for International Settlments (BIS); and IMF staff estimates.
1/ Calculated as total social financing minus equity and household loans.
2/ Calculated as total social financing minus equity, LGFV borrowing and household loans.

---

[1] Prepared by Joong Shik Kang (APD), drawing on a forthcoming paper by W. Maliszewski, S. Arslanalp, J. Caparusso, J. Garrido, S. Guo, J. S. Kang, W. Lam, D. Law, W. Liao, N. Rendak, P. Wingender, J. Yu, and L. Zhang.