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Topics Debt Soars Among China's Micro and Small Enterprises

In China, debt among micro and small enterprises (MSEs) has risen sharply in recent years due to COVID-19 responses and government guidance to financial institutions that predated the COVID-19 pandemic. This is a new risk for the Chinese economy.

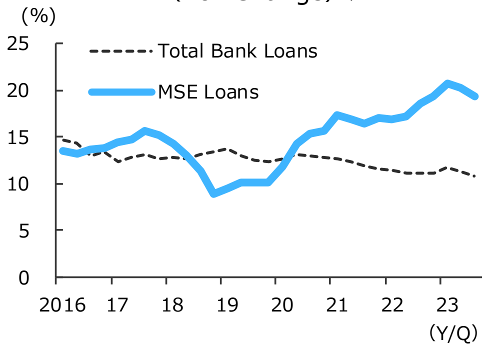
■ Bank Lending to MSEs Rises Sharply

In recent years, debt has been rising sharply among MSEs in China. According to the National Financial Regulatory Administration, the balance of MSE loans was RMB 69.2 trillion at the end of September 2023, up 19.3% year on year. Considering that total outstanding bank loans increased by 10.9% year on year to RMB 234.6 trillion in the same month, banks appear to be very willing to lend to MSEs.

Such a sharp increase in loans is reminiscent of the sharp rise in property loans that occurred between 2015 and 2020. The balance of property loans, which includes loans to property developers and mortgage loans, as a percentage of GDP has increased by as much as 19 percentage points over five years, from 30% to 49%, between the end of 2015 and the end of 2020. Subsequently, the Chinese government's crackdown on developer financing in the fall of 2020 caused this ratio of property loans to GDP to fall, and a string of developers defaulted on their debt. Outstanding MSE loans were 55% of GDP at the end of September 2023, also an increase of 19 points over five years. This implies that the risk of default among MSEs is increasing.

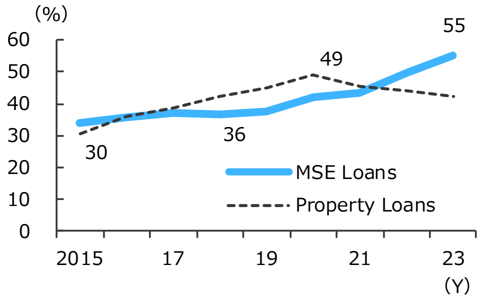
In China, companies are categorized by size into large, medium, small, and micro enterprises based on indicators such as taxable income, number of employees, and total assets, which are established for each sector. MSEs are defined as follows: for the manufacturing sector, enterprises with less than 300 employees and less than RMB 20 million in taxable income; for the retail sector, enterprises with less than 50 employees and less than RMB 5 million in taxable income; and for the real estate sector, enterprises with less than RMB 10 million in taxable income and less than RMB 50 million in total assets.

<Outstanding Bank Loans (YoY Change) >



Source: Prepared by JRI based on the Wind Database

<Outstanding Loans by Borrower Type as a Percentage of GDP>



Source: Prepared by JRI based on the Wind Database
Note: The most recent figure is as of the end of September 2023.

■ Crisis Response to the COVID-19 Pandemic and "Two Increases and Two Controls"

The following two factors can be cited as reasons for the sharp increase in MSE loans. The first is the response to the COVID pandemic. In late January 2020, the government adopted a zero-COVID policy aimed at thoroughly curbing COVID-19 infections, intermittently imposing strict behavioral restrictions until December 2022, while hammering out both monetary and fiscal countermeasures to mitigate the policy's negative impact on the economy. Monetary measures included financial support to companies through the provision of funds to financial markets and re-lending. Fiscal measures included reductions in the value-added tax and reductions/exemptions of corporate social security contributions.

MSE loans increased substantially due in particular to the government's decision at a State Council executive meeting in February 2020 to allow deferral of interest payments and principal repayments on loans to medium-sized enterprises and MSEs and to allow financial institutions not to book those loans as non-performing loans, as well as the government's request to large commercial banks at the National People's Congress in May of that year to increase MSE loans (inclusive finance) by more than 40% year on year. As a result, the balance of MSE loans continued to grow at a high rate (in the high teens) year on year between 2020 and 2022.

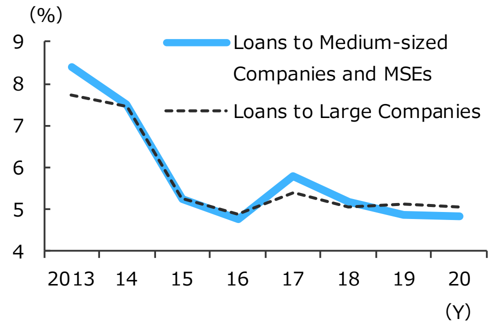
The second factor for the sharp increase in MSE loans is the government's guidance given to financial institutions on lending, which predates the COVID pandemic. At the National People's Congress in March 2015, the government announced its policy to strengthen the development of financial inclusion and to enable all market players to enjoy financial services. Based on this policy, the government created new statistics on inclusive finance, such as MSE loans, agricultural loans, and education loans below a certain credit amount. It encouraged banks to increase inclusive finance by defining loans to MSEs and sole proprietors of less than RMB 5 million credit per borrower (until 2018) or less than RMB 10 million credit per borrower (from 2019) as "inclusive financing for MSEs." At the National People's Congress in March 2017, the government requested large and medium-sized commercial banks to set up inclusive finance departments to address the issue of financing difficulties and high financing costs for medium-sized enterprises and MSEs.

In March 2018, the government demanded financial institutions to implement "Two Increases and Two Controls." "Two Increases" means that the growth in MSE loans of less than RMB 10 million credit should not be lower than that of total loans and that the number of accounts for such loans should not be lower than that of the previous year; and "Two Controls" means to keep the lending rates on such loans and the non-performing loan ratios low.

As a result of such government guidance, the balance of inclusive financing for MSEs has increased by more than 20% year on year since 2019, reaching RMB 28.4 trillion (23% of GDP) by the end of September 2023.

Due to these policies, the average interest rate on loans to medium-sized enterprises and MSEs has remained lower than that on loans to large enterprises in China since 2019, while lending rates for SMEs in developed countries are typically higher than those for large companies, reflecting credit quality.

<Average Interest Rate on Bank Loans by Company Size>



Source: Prepared by JRI based on OECD, Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard, March 2022

■ MSEs' Debt Problems Pose a New Risk to China's Economy

The fact that MSEs' financing difficulties are being resolved is a positive development for the Chinese economy. However, this raises concerns that it may impede the healthy process of unprofitable companies exiting the market, and that potential non-performing loans will increase due to the growth of inappropriate lending to MSEs.

The International Monetary Fund (IMF) has also begun to sound the alarm about the rapid increase in debt among MSEs in China. In its report on the Article IV consultation with China released in February 2024, the IMF pointed out that the asset quality of financial institutions had deteriorated due to the sluggish property market and deterioration in the earnings of non-manufacturing companies as a result of the COVID pandemic, and that the sharp rise in inclusive financing for MSEs was also a factor for heightened concerns about financial institutions' asset quality. Going forward, we must keep a close eye on MSEs' debt problems as a new risk for the Chinese economy.

(Shinichi Seki)

Topics *South Korea's Widening Intergenerational Employment Gap*

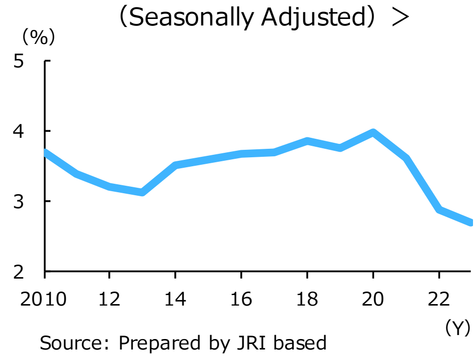
The employment environment in South Korea has improved in general. However, upon a more meticulous examination of the employment landscape, it becomes evident that intergenerational gaps have widened. This disparity stems from government policies that have enhanced the employment environment for the older generation, while inadvertently worsening it for the younger generation.

■ A Significant Decline in Unemployment

The employment environment in South Korea has improved in general. The unemployment rate in 2023 was 2.7%, falling 1.3 percentage points from its peak in 2020. Employment growth is pushing down the unemployment rate, with the number of employed people increasing by 1.32 million from August 2019 before the coronavirus outbreak to August 2023. A background factor for this is economic recovery. Despite a significant downturn due to sluggish domestic and international demand in the wake of the COVID-19 pandemic, the economic growth rate resumed its normal pre-pandemic pace as economic activity returned to normal.

However, a closer look at the increase in the number of employed persons shows that the intergenerational gap has widened. Below, we highlight two issues related to employment and explain the measures taken by the government that were behind them.

<Unemployment Rate (Seasonally Adjusted) >



Source: Prepared by JRI based on data from CEIC

<Change in the Number of Employed Persons by Gender and Type of Employment (10,000 Persons)>

	Total	Male			Female		
			Regular	Regular		Regular	Regular
Total	132.0	50.8	33.0	20.1	81.1	42.4	44.0
Ages 15–29	▲ 5.2	▲ 6.0	▲ 6.3	1.9	0.8	▲ 5.0	4.6
Ages 30–39	▲ 15.6	▲ 19.0	▲ 11.7	▲ 4.0	3.4	12.0	▲ 8.2
Ages 40–49	▲ 24.8	▲ 17.4	1.4	▲ 3.7	▲ 7.4	1.9	0.2
Ages 50–59	25.7	11.1	24.2	▲ 3.4	14.6	16.5	8.8
Age 60 and older	151.8	82.0	25.4	29.5	69.8	17.1	38.6

Source: Prepared by JRI based on data from KOSIS
Note: From August 2019 to August 2023

■ Employment Recovery Skewed Toward the Elderly

The first issue is that the employment recovery is concentrated on the older generation, while the employment situation with regard to the younger generation has worsened. From August 2019 to August 2023, the most significant increase in employment was seen among individuals aged 60 or older (+1.518 million), contrasting with a decrease seen in those aged 49 or younger (-0.456 million). The government's measures to support employment of the elderly have had a strong impact on the gap between the older and younger generations. Specifically, they are (1) an increase in the government employment quota and (2) measures to support job creation in the private sector.

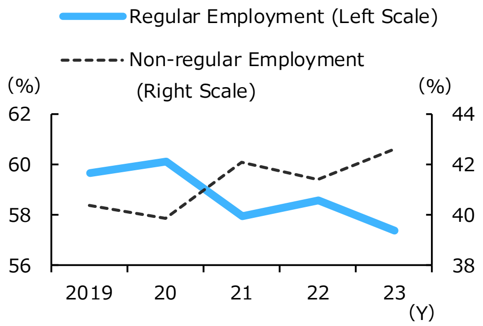
Regarding the increase in the government employment quota, a quota of 706,000 in total was created in 2022, targeting areas including public utilities, utilization of specialized knowledge and skills, and ESG projects. According to a survey by the Korea Labor Force Development Institute for the Aged, the number of jobs created for the elderly has seen steady annual growth, by 0.684 million in 2019, 0.77 million in 2020, 0.836 million in 2021, and 0.882 million in 2022, around 80% of which is assumed to be as a result of the government employment quota. Measures to create jobs for the elderly in the private sector are also believed to have increased employment among the older generation. Specific measures include paying companies KRW 0.9 million per quarter for each senior citizen employed for more than one year who reaches retirement age.

A driving force behind such measures to promote employment among the elderly is the growing issue of poverty among this demographic. As the majority of baby boomers reaches retirement age in 2024, the inadequate functioning of the pension system introduced in 1999 has led to an increase in the number of elderly people living in poverty. The relative poverty rate (the percentage of those whose equivalent disposable income is below the median income) of the elderly in South Korea exceeds 40%, which is the highest among OECD member countries. To address this situation, the government implemented employment support measures targeted at the older generation, but the reality is that this has resulted in a decrease in employment for the young at the expense of an increase in employment for the elderly.

■ Non-Regular Employment Accelerates Among the Younger Generation

The second issue is that employment among young people is shifting from regular to non-regular employment. Between 2019 and 2023, the percentage of regular employment among people aged 15 to 29 declined, although it increased among those aged 30 and older. This is partly due to the government's fiscal austerity measures. As part of its efforts to improve the efficiency of public institutions, the government reviewed the number of civil servants to be hired, causing the number of new hires to fall by almost half, from 41,322 in 2019 to 21,009 in 2023.Furthermore, new hiring by private companies also declined as funds for companies to support youth hiring were reduced significantly after President Yoon took office. As a consequence, younger individuals, who found their opportunities for full-time employment thwarted, turned to industries such as hospitality, where there is a higher prevalence of non-regular job openings.

<Ratio of Regular and Non-Regular Employment (Ages 15–29) >

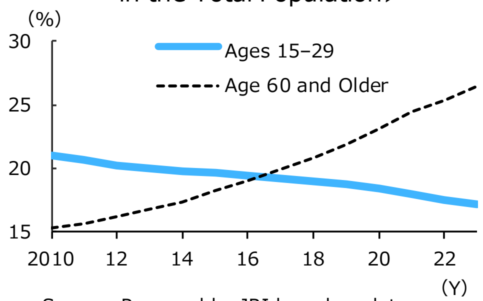


Source: Prepared by JRI based on data from KOSIS
Note: From August 2019 to August 2023

■ Employment Gap to Continue to Widen

A background factor for such policy responses, which benefit the older generation more than the younger generation, is the demographic change in South Korea. Since the proportion of elderly people in the total population exceeded that of young people in the late 2010s, the gap between the two has continued to widen. Since it has become more important than ever for the government to give importance to the opinions of the elderly in running the government, it has adopted policies to benefit the elderly at every election, resulting in an intergenerational imbalance.

<Ratio of Young and Elderly in the Total Population>



Source: Prepared by JRI based on data from CEIC

Employment of the elderly is expected to continue to increase due to various government support measures. The budget for supporting employment and social activities of the elderly increased by 31.6% in 2024 compared to the previous year, and the job creation target has also been raised to 1.03 million jobs. The government is also working to improve the wages of elderly workers, and wages are expected to increase for all government jobs this year.

Meanwhile, the employment environment for the younger generation may continue to deteriorate. As the number of civil servants to be hired is reduced, employment in public institutions is expected to become even more difficult. It is also expected that it will be difficult to increase the employment of the younger generation with limited experience in the private sector due to the recent trend among companies to place more emphasis on work experience, in addition to the continued implementation of policies favoring the elderly. Of course, the government has not stood idly by, and has implemented policies to expand vocational training, including for the younger generation, but it will take time for such policies to translate into actual employment. It is feared that deterioration in the employment situation of the younger generation will not only have an adverse impact on consumption in the short term, but will also further reduce the birth rate, which is already among the lowest in the world, and reduce medium- to long-term growth potential.

(Zijing Wu)