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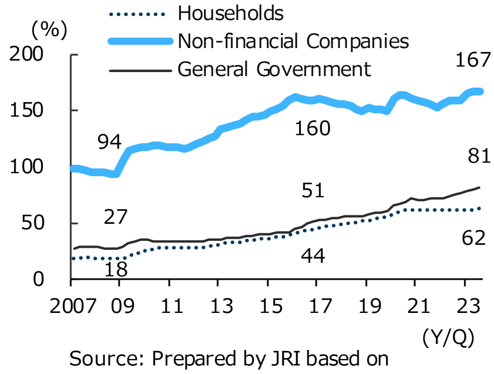
# *Topics* *Debt woes of large Chinese companies easing*

While there has been no significant change overall in the excessive indebtedness of Chinese firms, the debt woes of large enterprises appear to be easing. A background factor has been government controls on corporate debt. It remains to be seen whether the improvement will be sustained going forward.

## ■ Debt ratios of large companies are improving, albeit with fluctuations

While there has been no significant change overall in the excessive indebtedness of Chinese firms, the debt woes of large enterprises have been easing over the past ten years. In contrast, the debt headaches of small enterprises are worsening. First, a look at Chinese debt by sector based on statistics from the Bank for International Settlements (BIS) reveals that the ratio of outstanding debt to GDP increased from 44% at the end of 2016 to 62% at the end of September 2023 in the household sector. Meanwhile, the ratio jumped from 51% to 81% during the same period in the government sector. However, the non-financial corporate sector saw its ratio rise only slightly, from 160% to 167%.

<Outstanding Debt as Percentage of GDP by Sector in China>

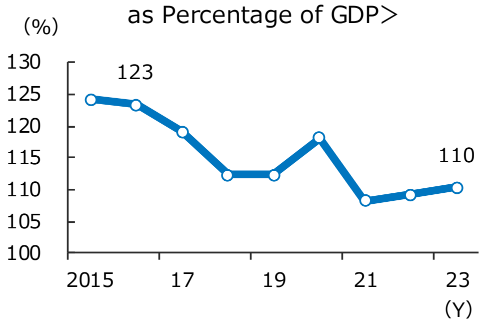



Source: Prepared by JRI based on data from BIS

Next, estimates of debt by company size based on data from the BIS and the Chinese financial authorities indicate that the debt-to-GDP ratio of large and medium-sized enterprises declined from 123% at the end of 2016 to 110% at the end of September 2023, though with some fluctuations along the way. On the other hand, the debt-to-GDP ratio of small/micro enterprises climbed from 36% to 55%.

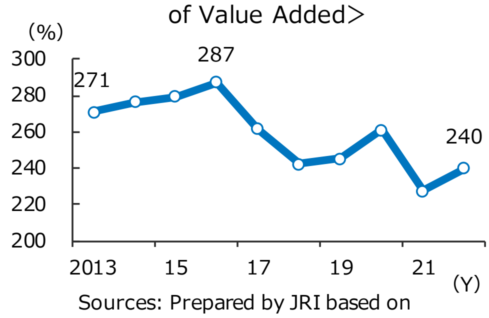
Debt ratios estimated using financial data from more than 5,000 non-financial listed companies have also improved. Although the outstanding debt of all non-financial listed companies increased continuously from RMB12.4 trillion at the end of 2016 to RMB21.4 trillion at the end of 2022, the debt-to-value-added ratio fell from 287% in 2016 to 240% in 2022 due to a faster rise in the value added, i.e., the denominator, which climbed from RMB4.3 trillion to RMB8.9 trillion.

<Outstanding Debt of Large and Medium-sized Enterprises as Percentage of GDP>




Sources: Prepared by JRI based on data from BIS and National Financial Regulatory Administration

<Outstanding Debt of Non-Financial Listed Companies as Percentage of Value Added>




Sources: Prepared by JRI based on financial data from 5,220 non-financial listed companies and Wind
Note: Value added
= total value added x domestic sales ratio

## ■ Government controls on corporate debt

The improvement in the debt ratios of large Chinese companies is partly due to government controls on corporate debt.

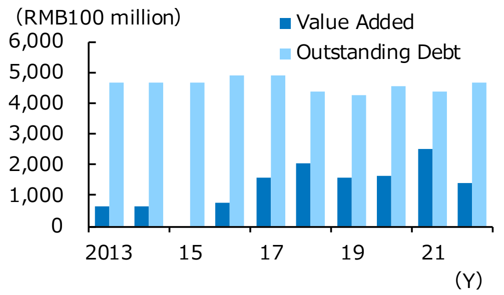
In 2015, the government adopted the slogan "three eliminations, one reduction, and one improvement," articulating a commitment to eliminating the three excesses of production capacity, housing inventory, and debt, as well as reducing production costs and improving weak sectors. However, there was initially little concrete explanation of how excess debt and capacity would be eliminated, how production costs would be reduced, or what the weak sectors were. It was not until the following year that the action that would be taken to bring corporate debt, which had surged, down to sustainable levels (de-leveraging) became clear. For example, in October 2016, the State Council issued its "Opinions on Vigorously, Steadily and Properly Reducing Corporate Leverage Ratios," which comprised seven measures, including promotion of mergers and restructuring of enterprises, optimization of debt composition (debt restructuring), and bankruptcy proceedings in accordance with laws and regulations.

Taking the steel industry as an example, the government has set targets for reducing crude steel production capacity and has moved forward with debt restructuring since 2016. And in recent years, it has used its promotion of decarbonization policies as a reason to curb increases in annual crude steel output and production capacity.

As a result, the supply-demand balance of steel products has improved, and China's composite steel price index has picked up since 2016. In addition, Chinese steelmakers are focusing their investments on production facilities for high-grade steel products such as cold-rolled steel sheets and electromagnetic steel sheets, which require advanced processing technology.

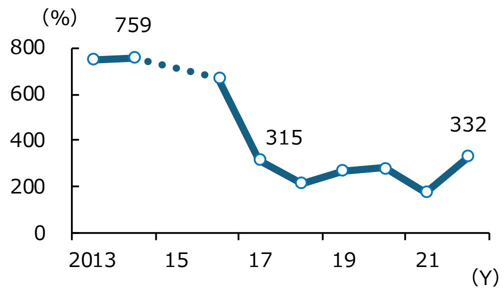
With the rise in steel prices and the upgrading of products, the value added of 32 major steelmakers increased from RMB61.7 billion in 2014 to RMB155 billion in 2017. At the same time, their debt ratio fell sharply from 759% in 2014 to 315% in 2017 as their outstanding debt remained constant, edging up from RMB469 billion to RMB489.1 billion over the same period. Since then, both their outstanding debt and value added have stayed more or less flat, so their debt ratio has been largely unchanged.

<Steel Industry's Outstanding Debt and Value Added>




Sources: Prepared by JRI based on financial data from 32 steelmakers and Wind
Note: Value added = total value added x domestic sales ratio. In 2015, the steel industry's value added was negative.

<Outstanding Debt of Steel Industry as Percentage of Value Added>




Source: Prepared by JRI based on above figure
Note: In 2015, the steel industry's value added was negative, so the debt ratio was also negative.

## ■ Whether the improvement will be sustained going forward remains to be seen

A surge in debt in China's non-financial corporate sector was observed between 2008 and 2016, as shown in the upper right figure on the previous page. The debt ratio of the non-financial corporate sector increased by 66 percentage points from 94% at the end of 2008 to 160% at the end of 2016.

Massive overinvestment triggered by the RMB4 trillion economic stimulus package that followed the global financial crisis can be pointed to as the reason for this. Firms kept borrowing more money than they needed as funding costs declined due to large-scale monetary easing. They used the cash to build infrastructure and pursue real-estate development projects, investing in production facilities for construction materials such as steel and cement.

Since 2016, the debt ratio of the non-financial corporate sector has remained more or less flat, and the debt ratios of large companies have been improving, albeit with fluctuations, which is good news for the Chinese economy as it will help the Chinese economy to achieve sustainable growth. However, the Chinese government has recently been encouraging companies to upgrade their facilities to support the economy, and state-owned enterprises are actively moving to expand fixed asset investment. Going forward, it is necessary to pay close attention to whether the Chinese government will be able to control corporate debt to keep it at an appropriate level.

**(Shinichi Seki)**

# *Topics* *Trump risks for Asian economies*

If Donald Trump is re-elected, his tough policies toward China will accelerate the relocation of production bases from China to other Asian countries. However, there is also a risk that Trump will take issue with the huge trade surpluses that several Asian countries/territories have with the U.S.

## ■ Re-election of Trump will put China in extremely difficult corners, while Asian countries other than China may benefit

The U.S. presidential election scheduled for November 5 this year looks set to pit former President Donald Trump as the Republican nominee against current President Joe Biden as the Democratic nominee. Although the gap in the polls between the two candidates has narrowed, Trump is still polling higher than President Biden.

If Trump is re-elected, he is expected to adopt more protectionist policies than his previous term, especially toward China. Trump has pledged to impose tariffs of more than 60% on imports from China and to revoke China's "most-favored-nation" status. If these policies are implemented, the Chinese economy will inevitably take a major hit as its exports to the U.S. decline.

The hard line toward China, which targeted trade, was instituted under the Trump administration, which was in power for four years from 2017. In 2018 and 2019, the U.S. significantly ramped up tariffs on numerous Chinese products to protect U.S. domestic industry, imposing additional duties of up to 25% on imports from China, for example. This approach to tariffs drastically changed the nature of business with China and resulted in global companies reviewing their China-centered supply chains and stepping up the relocation of production facilities elsewhere. After that, under the Biden administration, economic security centered on high-tech industries came to occupy the center stage of trade policy, building momentum to decouple China from Western economies. As a result, the move to restructure supply chains that began under the Trump administration has accelerated.

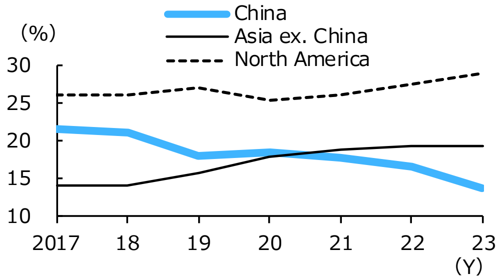
In response to these trends, the U.S. trade structure is changing. China's share of total U.S. imports plunged from 21.6% in 2017 to 13.9% in 2023. Conversely, the shares of Asia excluding China and of North America have risen significantly, with Mexico seeing the largest increase, though South Korea, Taiwan, Canada, and Vietnam have also seen their shares expand. As background factors to this, Chinese products have been being exported via these countries/territories, and production bases have been

< Trump's Current Policy Proposals>

| |
|---|
| **Tariffs of more than 60% on goods imported from China** |
| **Revocation of China's most favored nation (MFN) status**<br>Products imported from MFNs are generally subject to the same tariff rate. If China is stripped of MFN status, it would be treated as an enemy state, like North Korea or Russia, making it possible to impose high duties on goods imported from China. |
| **100% tariff on automobiles made in Mexico by Chinese manufacturers** |
| **Introduction of flat 10% tariff on all imported goods** |
| **Building of success under the United States-Mexico-Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA)**<br>Under NAFTA, production and jobs were lost to Mexico. The USMCA tightens rules of origin, and is aimed at increasing the percentage of components produced in North America and boosting investment in U.S. manufacturing. |

Source: Prepared by JRI based on various media reports

<Share of U.S. Imports by Country/Territory>




Source: Prepared by JRI based on data from USA Trade Online
Note: Asia ex. China means South Korea, Taiwan, India, and the ASEAN5. North America means Canada and Mexico.

being relocated to them from China. If protectionism intensifies as a result of a Trump re-election, global companies can be expected to shun China further, and to become even more interested not only in North America but also in Asia excluding China as a potential destination for production relocation.

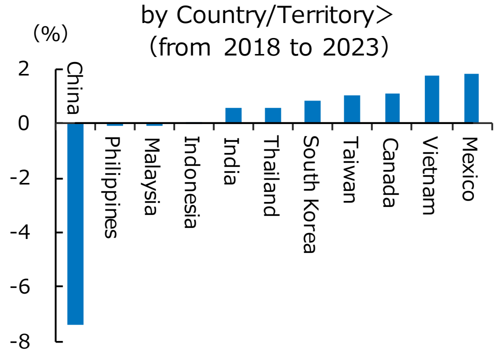
## ■ Major risks to Asian economies other than China as well

However, it must be noted that Trump, who advocates an "America First" approach, is not necessarily friendly toward Asian countries/territories other than China, which exposes them to the following three risks related to trade:

The first is the prospect of higher tariffs. Trump has hinted at a flat 10% levy on imports from all countries, so U.S. domestic industry is expected to be even more coddled than before.

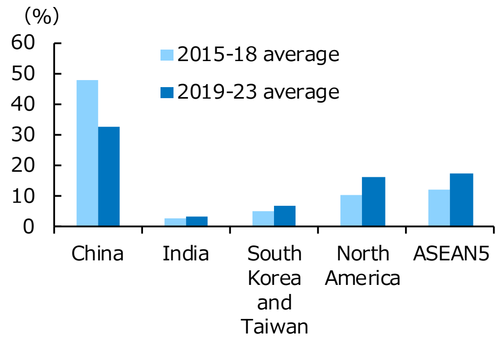
The second is the potential for penalties on countries/territories running trade surpluses with the U.S. The structure of U.S. trade transactions has changed significantly, with China's share of the U.S. trade deficit averaging 32% from 2019 to 2023, well down from an average of 48% from 2015 to 2018. On the other hand, the share of North America, which includes Canada and Mexico, as well as that of the ASEAN5 (five leading ASEAN economies), is rapidly expanding. There is a danger that Trump, who has pressed for a correction of trade imbalances, will exert strong pressure on these economies. In fact, just before leaving office in 2020, Trump floated the possibility of imposing punitive tariffs on products imported from Vietnam.

<Change in Share of U.S. Imports by Country/Territory>
(from 2018 to 2023)




Source: Prepared by JRI based on data from USA Trade Online

<Share of U.S. Trade Deficit>
(Percentage of Total Trade Deficit)




Source: Prepared by JRI based on data from USA Trade Online

The third risk is that of penalties for currency depreciation. Trump, who loathes the strong dollar, may designate Asian countries/territories with weakening currencies as currency manipulators. In its semiannual foreign exchange report, the U.S. Department of the Treasury sets three criteria for determining whether a country is a currency manipulator: 1) an annual trade surplus of at least $15 billion with the U.S., 2) persistent and one-sided foreign exchange intervention (intervention in at least eight of the past 12 months, totaling at least 2% of the economy's GDP), and 3) a current account surplus of at least 3% of GDP. If all three criteria are met, the country is labeled a a currency manipulator, and if two are met, the country is put on the Treasury's "Monitoring List." In Asia, China, Taiwan, Singapore, Malaysia, and Vietnam are currently on the Monitoring List. If a country is recognized as a currency manipulator, it is likely to become subject to punitive tariffs. Given that the Trump administration labeled China as a currency manipulator without warning in August 2019, it is possible that the U.S. will ignore the criteria and designate an Asian country as a currency manipulator in the event of clashes on trade.

As shown by the above, while emphasis is often placed on the benefits to Asian economies, excluding China, from the re-election of Trump, namely that his hard line on China would lead to the relocation of production bases to them, there are also significant negative consequences. In particular, given the changing environment surrounding U.S. trade transactions, there is a risk that several Asian countries/territories will be subject to penalties. Furthermore, a key risk associated with Trump' re-election is that policies will be less predictable, and unexpected events could occur suddenly. It needs to be borne in mind that there are many other potential risks that could adversely affect Asian economies, in addition to those mentioed above.

**(Zijing Wu)**