

The Financing of Local Government in China Stimulus Loan Wanes and Shadow Banking Waxes

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Discussion by

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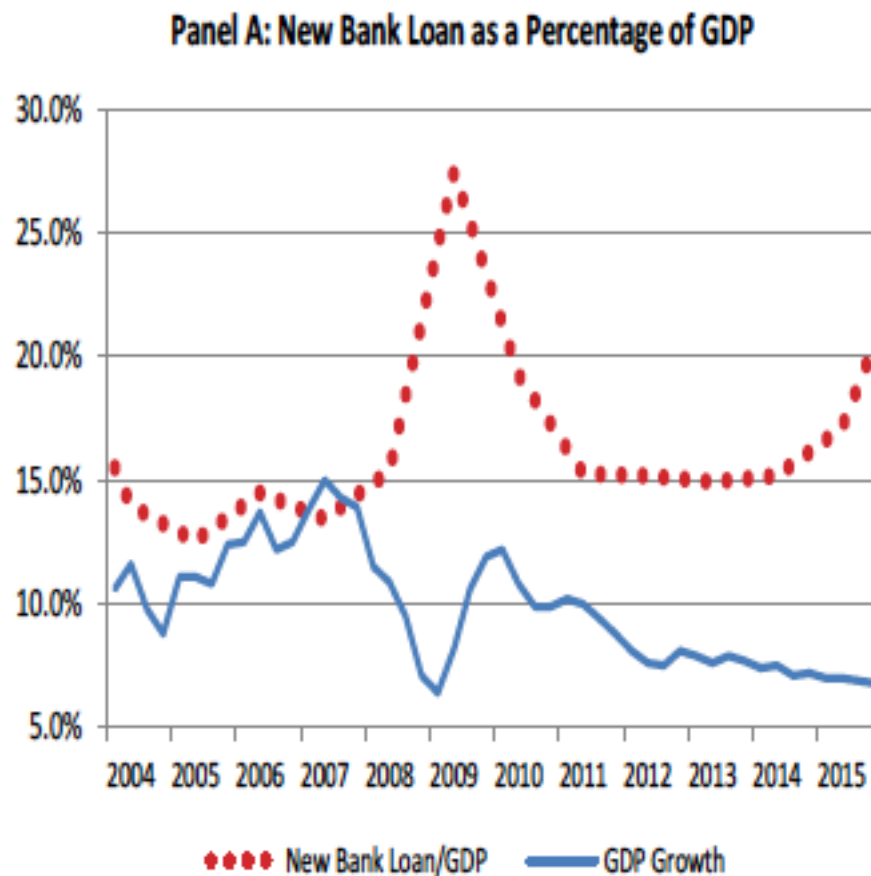
Singapore May 24, 2017, ABFER

1) What the paper does

- Mini boom on china (local) debt
- Contributes to our understanding of “what the heck is going on in Chinas local government finances”
- Provides date and extensive institutional background on the stimulus, on LGFVs, shadow banking instruments, municipal corporate bonds
- points to another angle to “the long shadow of China's fiscal expansion”(Bai et al. 2016), i.e. the 2009 fiscal stimulus
- by focusing on the liability side, specifically the structure of liabilities
- Useful and well written

2) Why do we care about the government financing in China?

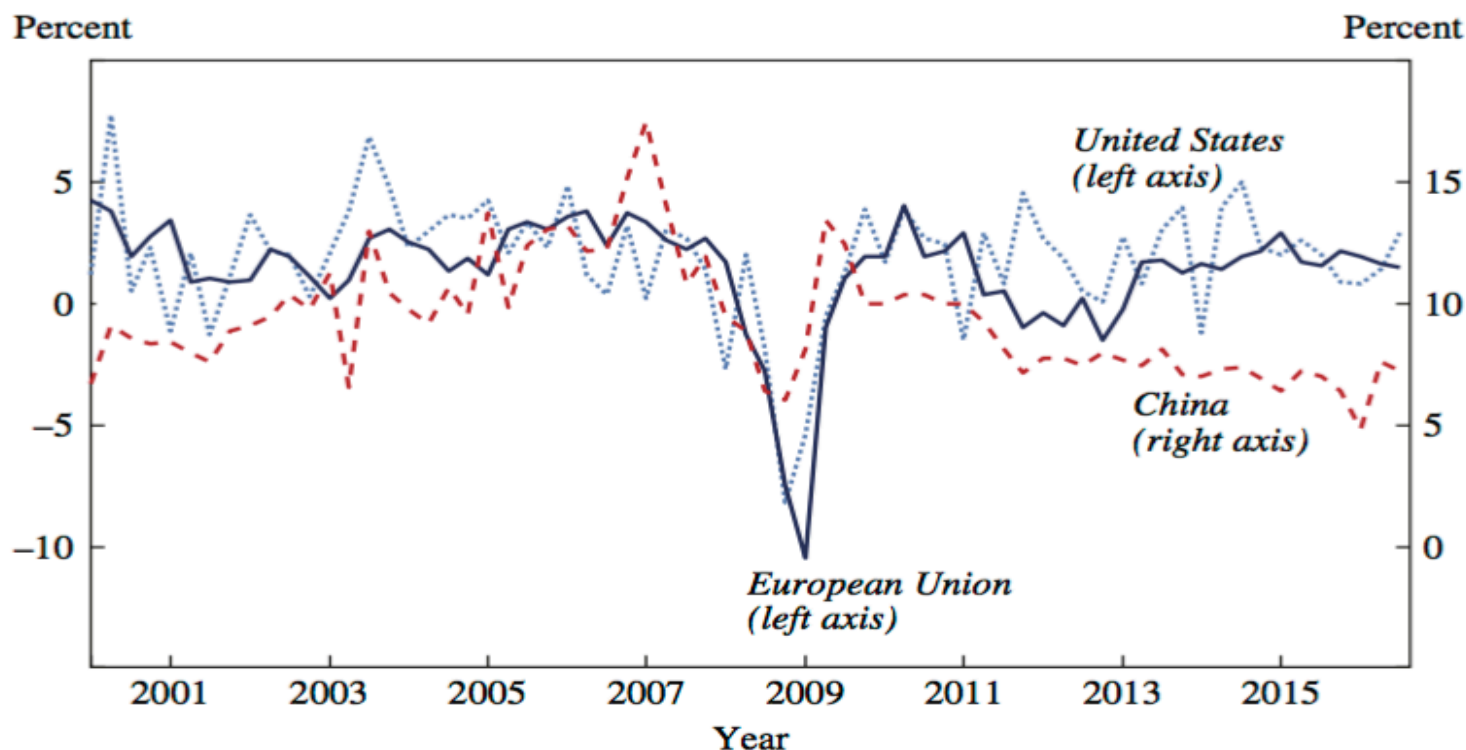
- **Because the 2009 stimulus was massive and because since then Chinas growth performance was not...**



2) Why do we care about the government financing in China?

- Even when compared to the EU or US... (relative scale)

Figure 1. Real GDP Growth, 2000–16^a



Sources: Federal Reserve Economic Data; Chang and others (2016).

a. Real GDP growth is measured as the percent change over the preceding quarter, seasonally adjusted, at annual rates.

Source : Tesar (2016), comments on Bai et al (2016)

2) Why do we care about local financing in China?

- ... because it was massive
- because it had a long (and shady) tail
- because the growth trend afterwards declined
- because there might be a causal connection
- i.e. misallocation of resources
- White elephants

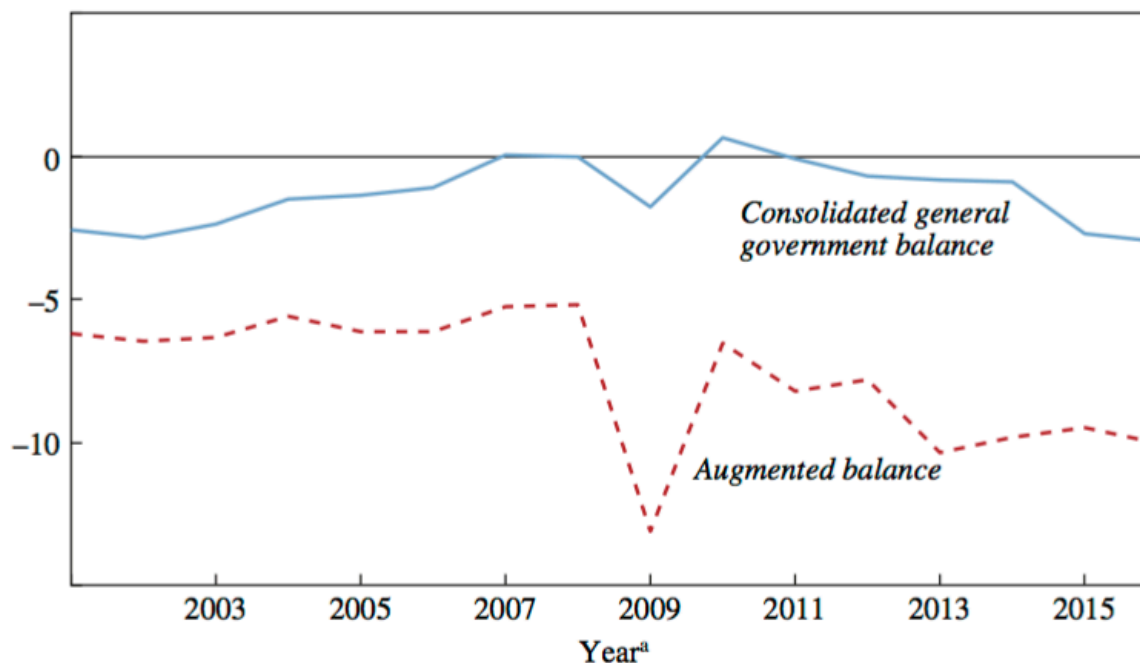
Source : Obstfeld (2016), comments on Bai et al (2016)

2) Why do we care about local government financing in China?

- **Because they are large and in transparent ..
From shadow banks and off balance**

Figure 2. China's Fiscal Balances, 2001–16

Percent of GDP



Sources: CEIC Data; IMF staff estimates.

a. Data for 2016 are a projection as of October 2016.

Source : Obstfeld (2016), comments on Bai et al (2016)

2) Why do we care about local government financing in China?

- ... and may create problem of financial stability?
- Risk of the borrower and of the financial intermediary?
- Who bears the ultimate risk?
- Can there be a run?
- Central government guarantees?
- Debt crisis, currency crises, capital outflows.

Source : Obstfeld (2016), comments on Bai et al (2016)

3) Back to, What the paper does:

- **“bank loans from the 2009 stimulus to local governments where replaced by MCBs”**
- **“the refinancing need also stimulated trust loan growth”**
- **“this modernized the financial market in China”**
- **Provide data on the liability side of local government balance sheet, bank loans, MCB, WMP, trust loans**
- **Collected from **multiple** sources , instrument level, entity level, speeches, “estimated”**

3) Back to, What the paper does:

Panel A: 2009 bank loan and 2012-2015 MCB issuance, regional

	(1)	(2)	(3)	(4)
	MCB ₂₀₁₂	MCB ₂₀₁₃	MCB ₂₀₁₄	MCB ₂₀₁₅
2009 BL/GDP	0.11*** (2.66)	0.11** (2.24)	0.22*** (3.29)	0.24** (2.52)
Constant	0.00 (-0.46)	0.00 (-0.47)	-0.01 (-0.65)	-0.02 (-0.99)
Observations	7	7	7	7
Adj. R ²	0.42	0.35	0.44	0.46

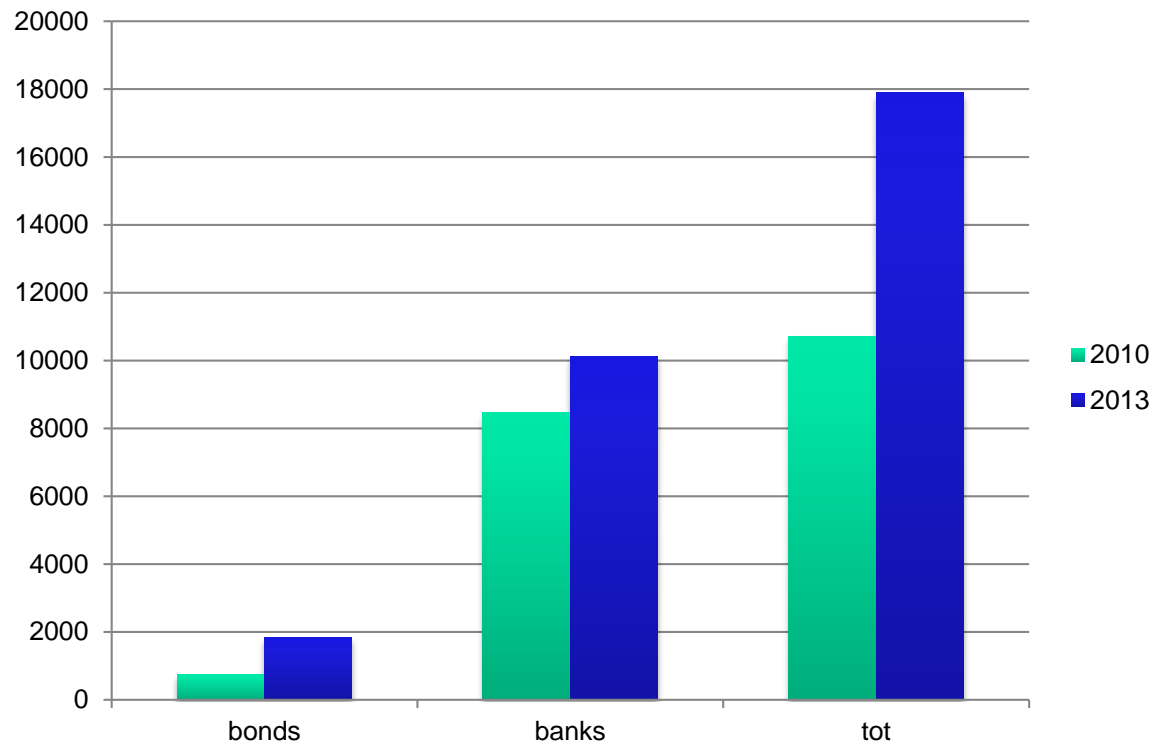
Panel B: 2009 bank loan and 2012-2015 MCB issuance, provincial

	(1)	(2)	(3)	(4)
	MCB ₂₀₁₂	MCB ₂₀₁₃	MCB ₂₀₁₄	MCB ₂₀₁₅
2009 BL/GDP	0.11 (1.55)	0.13*** (2.61)	0.20*** (3.45)	0.15* (2.05)
Constant	0.00 (-0.15)	-0.01 (-0.89)	0.00 (-0.50)	0.00 (0.01)
Observations	30	30	30	30
Adj. R ²	0.10	0.31	0.34	0.17

- Drop 7 obs.
- Go to panel, with fixed effects
- with controls for borrower characteristics
- endogeneity , “abnormal”

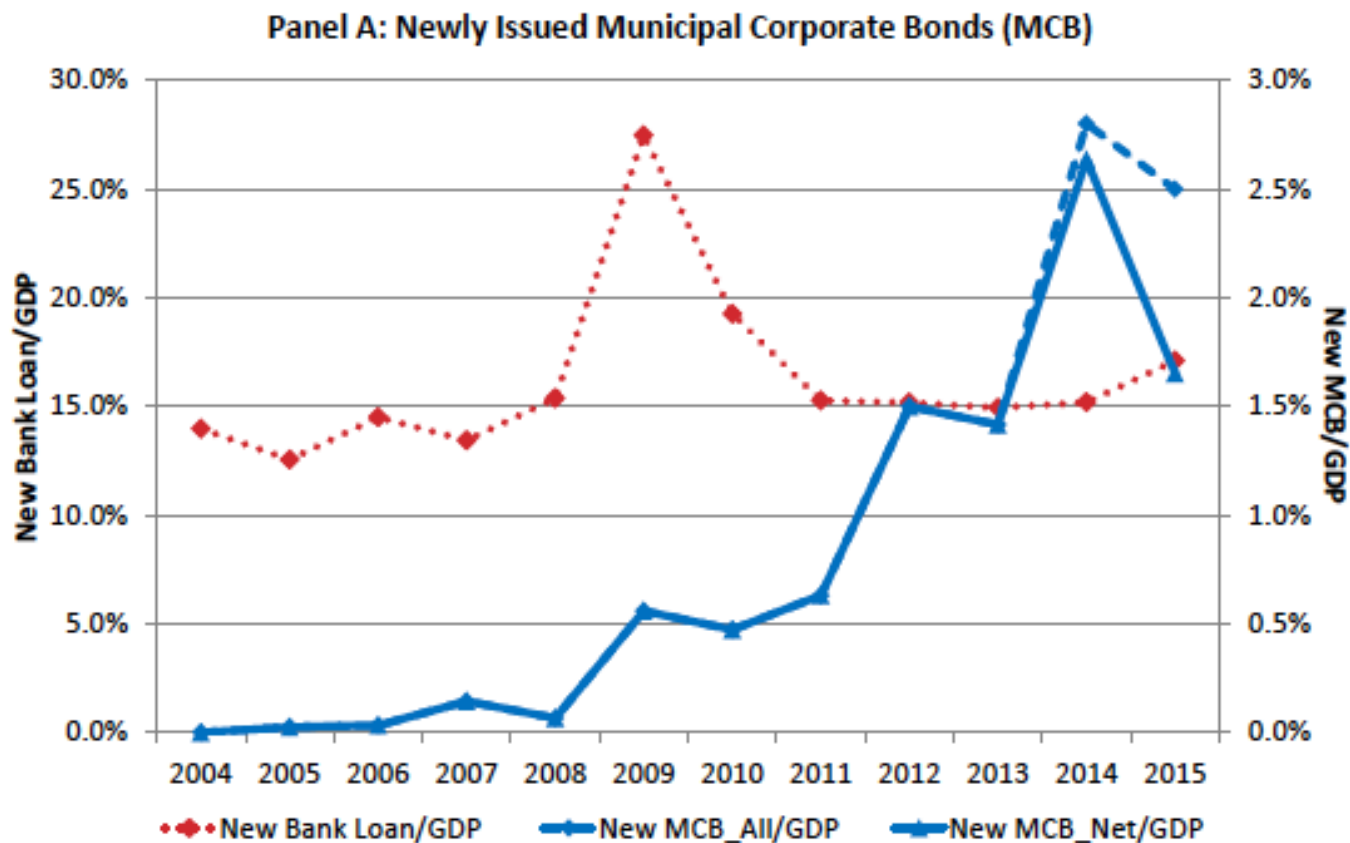
Comment on message : Are bank loans really **waning**?

- Bank lending only wanes in relative terms , bonds still small and there is a lot of "other" local gov. financing
- Economic magnitude of the rollover effect seems small (15 cent additional MCB issuance for repayment of stimulus loans)



Composition of Local gov. debt 2010 , 2013 in bn of RMB, Source Table 1, Panel A and B, Data form NAO

Is this big? From 0 to 1.5 % of GDP in 10 years?



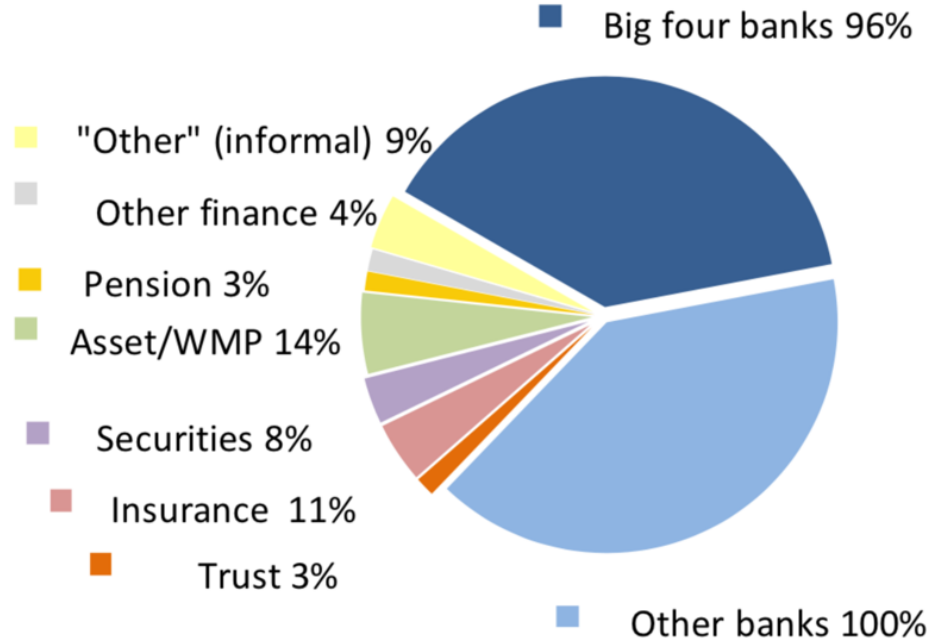
, Source figure 5 Panel A

Interpretation

- **Convince the reader that this is a **modernization** of china's financial system :**
- **Why are MCB better than bank loans?**
- **Any way you can say something about riskiness ?**
- **Macro: fiscal deficit, debt level, defaults, sovereign ratings?
Political: connectedness to gov., to lender
Instrument level : spreads, volatility?
Intermediary : (e.g. LGFV, WMP) rating?**

From bank based

Assets of the financial system , end-2008 (% GDP)

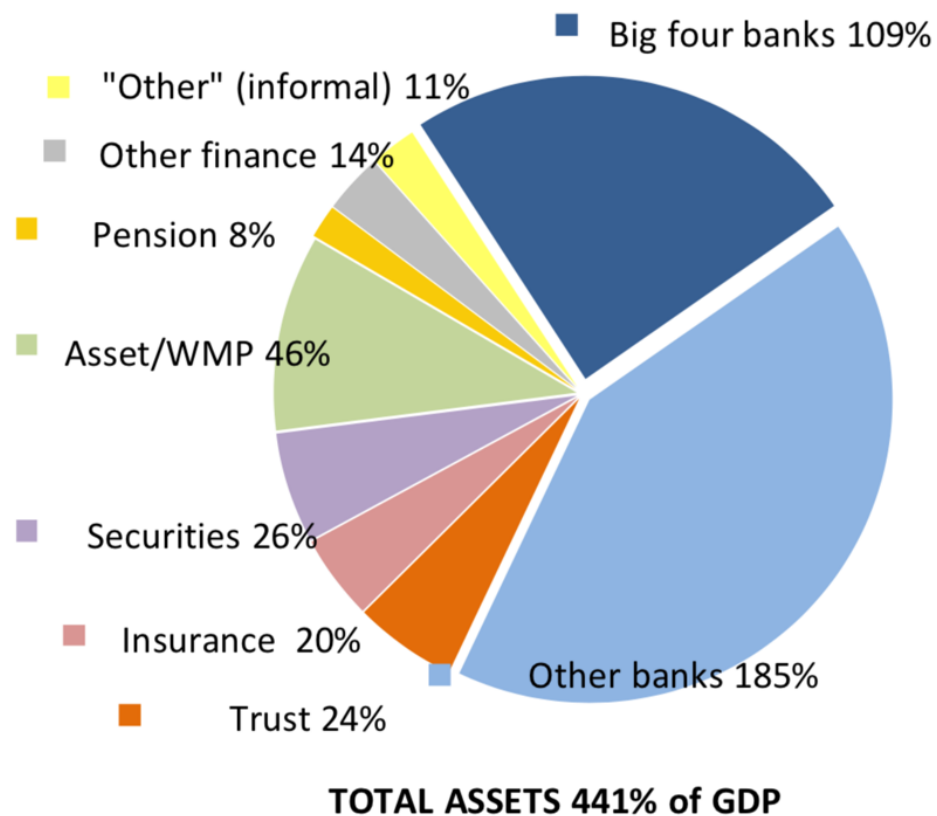


TOTAL ASSETS 248% of GDP

Source: Anderson (2017) Emerging Market Advisors

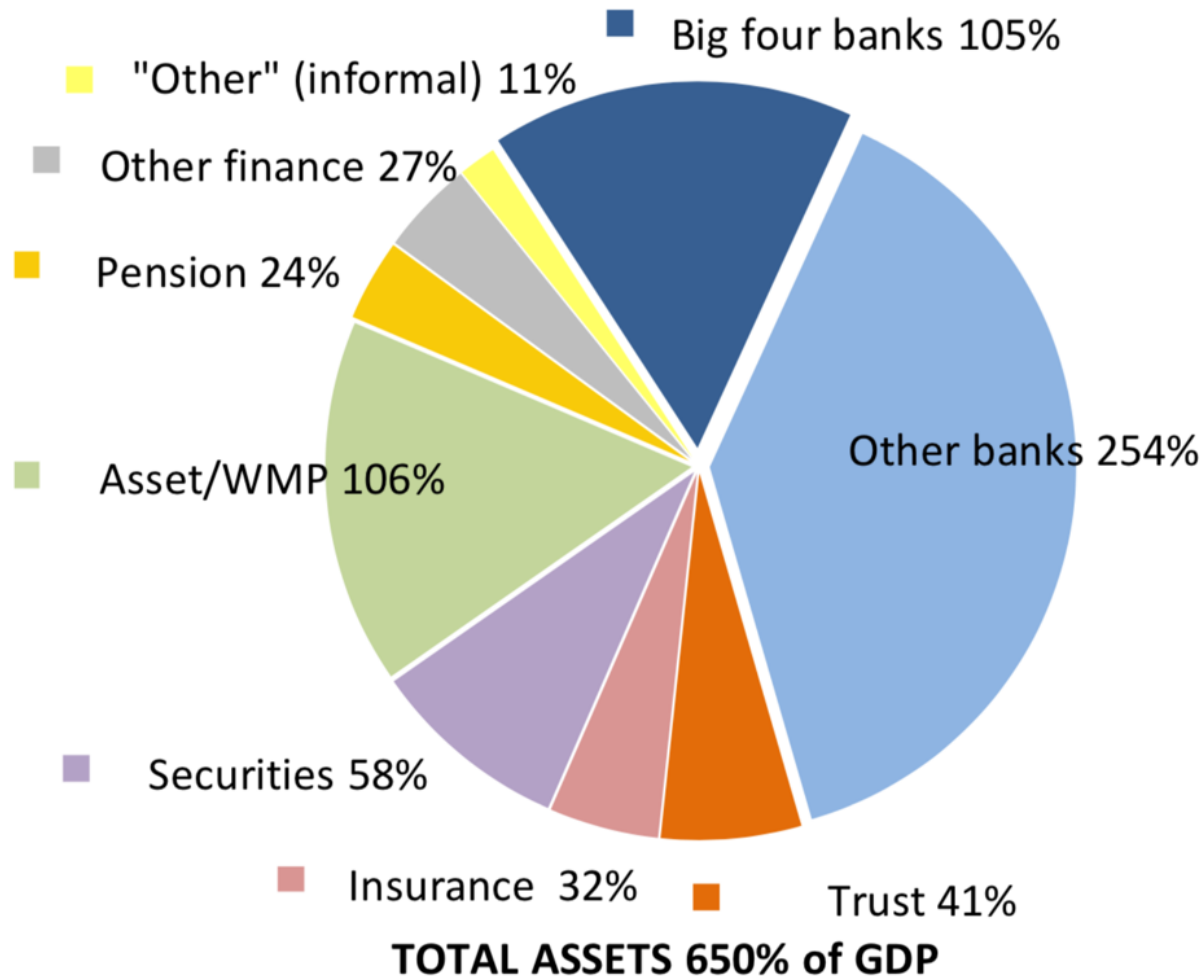
To less so ..

Assets of the financial system , end-June 2016 (% GDP)



Source: Anderson (2017) Emerging Market Advisors

Assets of the financial system , end-2020 (% GDP)



Source: Anderson (2017) Emerging Market Advisors

- **Clearly more diverse**
- **But is it more stable ?**

- **What is modern?**

Thank you very much for you attention

Smaller comments

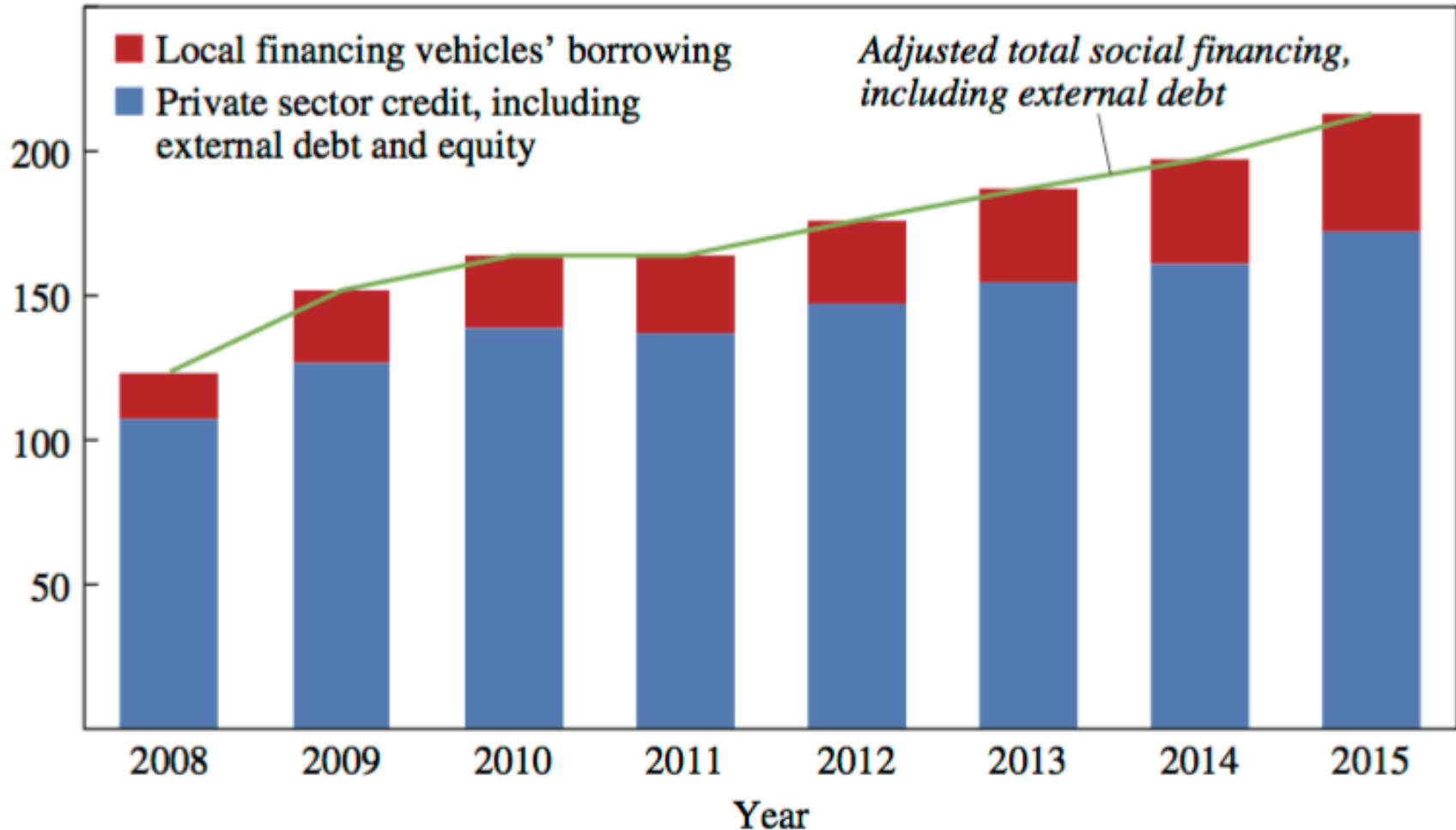
- Get to the core, i.e. the cross section faster. The initial sections raise lot of questions about the data and how it is estimated.
- Section 3.2.2. figure 4 is not ideal as a first evidence, since it most of the “action” is in the part that is not so reliable (“estimated”)
- Section 3.3. uses different data than 3.2.2. ? Confusing.
- Drop the region regressions (7 observations)

Misallocation of Credit is possibly not limited to LFVs

Source : Obstfeld, comments on Bai et al 2016

Figure 4. Domestic Credit in China, 2008–15

Percent of GDP



Multiple reasons for debt increase

Panel B: Local government debt balance as of June 30, 2013

	Full Obligation	Contingent Liability		<i>Total Debt</i>
		Guaranteed Liability	Contingent Bailout Liability	
Bank loan	5,525	1,909	2,685	<i>10,119</i>
Build & Transfer	1,215	47	215	<i>1,476</i>
Bond	1,166	167	512	<i>1,846</i>
MuniBond	615	49	0	<i>664</i>
Corporate bond (MCB)	459	81	343	<i>883</i>
Mid-term note (MCB)	58	34	102	<i>194</i>
Short-term bill (MCB)	12	1	22	<i>36</i>
Accounts payable	778	9	70	<i>857</i>
Trust	762	253	410	<i>1,425</i>
Other entity and individual borrowing	668	55	116	<i>839</i>
Construction loan	327	1	48	<i>376</i>
Other financial institution borrowing	200	31	106	<i>337</i>
Fiscal on-lending	133	171	0	<i>303</i>
Capital lease	75	19	137	<i>232</i>
Other fund raising	37	4	39	<i>80</i>
Total	10,886	2,666	4,339	<i>17,891</i>

Source Table 1, Panel B, Data form NAO