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The coronavirus outbreak that began last December sharply curtailed economic activities across China. In response to this sudden, countrywide, 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 are designed to support small- and medium-sized firms, and industries and regions hit hard by the outbreak. We finally discuss the effectiveness of the policy intervention based on a recent survey which covers a representative sample of public and private firms.

1. <u>Liquidity Policies</u>

- *Loan term extension and debt rollover*

For firms that have trouble repaying debts on time due to the 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. 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 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,

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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.[2]

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 before March 22, based on the statistics released by CBIRC.

- *The increased relending and rediscount quota*

Soon after establishing the 300-billion-yuan special relending program, in an effort to help firms resume operation, 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 130 billion yuan with average borrowing cost below 4.55% have been extended as of March 22.

- *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

[2] For instance, on February 7, via this relending program, Shanghai Rural and Commercial Bank issued a 19-million-yuan loan to Shanghai Kinfo, a privately owned company specializing in producing some critical materials for facial masks; and the China Construction Bank and the Industrial and Commercial Bank of China jointly issued a 15-million-yuan loan to Guangdong Huisheng Technologies, a privately owned firm producing facial masks. https://m.chinanews.com/wap/detail/zw/cj/2020/02-18/9096286.shtml.

restrictions on private placement of SEOs (e.g., pricing, lockup periods, number of investors) were also partially lifted.

3. Fiscal Policies

- *Tax and fee 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. 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.
ii. Social security paid by firms was exempted for up to 5 months for micro-, small-, and medium-sized firms, firms in Hubei, and self-employed business owners. Payments by large firms were cut by half.
iii. Tariffs were exempted for the import of medicines, medical supplies, and other vehicles used to fight against the outbreak.
iv. 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%.

- *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. 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 massive 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?

- *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 to be 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. And the penalty interest exemptions are restricted to small firms, suggesting that the profit loss is limited.

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 a central bank bills swap of 5 billion yuan at the end of February, 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 are largely paralyzed but have not cut their labor forces yet. If that is indeed the case, then it can be attributed to the above mentioned well-executed supportive policies. However, the joint Tsinghua PBCSF-CSRC survey shows 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 greater economic downturn.