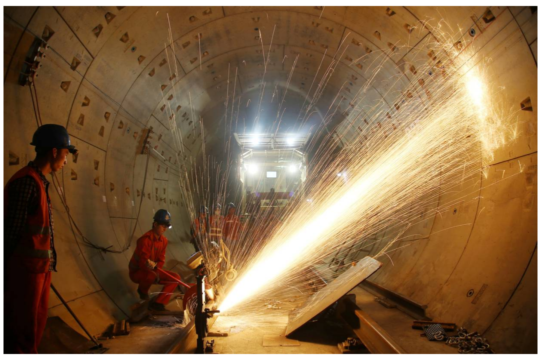
CHINA

China, Seeking Growth, Softens Focus on Cutting Debt

In economic blueprint for 2018, Beijing to dial back emphasis on curbing lending that spurs economy



Workers cut rail tracks in November in the construction of a subway line in Changzhou, one of numerous subway projects under way across China. PHOTO: REUTERS

By Lingling Wei

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BEIJING—As China prepares to unveil its economic blueprint for 2018, people familiar with the plan say it will show that Beijing is finding it hard to cut debt without jeopardizing growth.

In the blueprint to be unveiled on Wednesday, past talk of bringing down debt, the priority for the past two years, is gone in favor of a pledge to just control the rise in borrowing, according to these people.

The softening of the goal, decided earlier this month by the Communist Party's top leadership, is an official acknowledgment of how hard it is for Beijing to wean the economy off debt-driven growth.

"Let's face it," said an official involved in policy discussions, "it's not realistic to reduce leverage when the whole economy relies on banks for financing."

The International Monetary Fund and the World Bank have urged Beijing to tackle debt even if it squeezes economic expansion in the short term.

By tempering the stance on debt, Beijing is signaling it still seeks relatively high rates of growth and that more debt will be tolerated to reach that goal. For the world, that means greater demand from China for oil and other commodities, but also continued worries that Chinese debt could spiral out of control and hurt the global economy.

"The Chinese government is bowing to the complicated reality it faces, recognizing the risks of debt-fueled growth but unable to wean itself from rising debt levels," said Eswar Prasad, a China scholar at Cornell University and the IMF's former top official in China.

For the past two years, deleveraging has been a centerpiece of President Xi Jinping's economic policy. But while regulators reined in borrowing between banks, the kind of practice that

A man cycles past a housing construction site in Beijing in August. More than half of new bank loans in China are flowing into the real-estate market. PHOTO: GREG BAKER/AGENCE FRANCE-PRESSE/GETTY IMAGES

enabled smaller lenders to ramp up risky borrowing, the country's overall debt load continues to climb faster than growth.

China's ruling 25-member Politburo decided on the shift on Dec. 8 as it set the agenda for the annual Central Economic Work Conference this week, where economic priorities are laid out in greater detail.

A statement after the Politburo meeting listed control of the "macro-leverage ratio," or the country's debt-to-GDP ratio, as a major piece of the government's effort to fend off risks next year. That contrasted with its statement ahead of last year's economic conference, which described debt reduction as a key task.

The change followed rounds of discussions by Mr. Xi's economic deputies and financial regulators since the summer, according to the people familiar with the deliberations. An oft-cited issue during those talks, the people said, involved state-owned banks' outsize role in economic activity.

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That led to the conclusion that with businesses lacking easy access to other forms of financing, such as stock sales, tight restrictions on bank loans would hurt growth too much.

A World Bank report issued Tuesday shows outstanding bank loans reached 150% of China's gross domestic product in November, up from 103% a decade ago.

Fresh into his second term, Mr. Xi has talked about the need to focus less on the speed of growth and more on its quality. That has raised expectations that Beijing will take more meaningful steps to curb its debt binge, especially that of state companies. Macquarie Group estimates state firms' debt makes up about two-thirds of Chinese corporate debt.

But with threats of trade penalties against China from Washington and a softening property market at home, authorities have grown more wary about the growth outlook.

"All these things have been declared before, such as less emphasis on GDP target, but there has been no effect," said Anne Stevenson-Yang, co-founder of J Capital Research, which focuses on the Chinese economy.

For 2018, officials don't expect aggressive measures such as large-scale closure of loss-making firms. Instead, authorities likely will try to rein in debt-fueled expansion by state firms, encourage more state companies to turn their debts into equity and clamp down on city halls and townships that borrow for wasteful construction, according to government advisers.

For instance, the central government is calling a halt to new projects in the near-frenzied construction of subway systems all over the country, including two separate, $4 billion subway projects in Inner Mongolia.

In Nanchang, a city of four million in eastern China, streets crisscrossing its downtown area are getting torn up to make way for subway lines. While some commuters applaud the effort, others wonder if the city can afford it.

Local officials estimate that it will cost more than $18 billion, or a third of the city's annual GDP, to build five subway lines. Officials said the city would use a combination of bank lending and bond sales to help finance the projects.

Senior officials who gathered at Beijing's Jingxi Hotel for the economic meeting this week are stressing the need to prevent financial risks, such as rampant borrowing among banks that has made the country's financial system more vulnerable to short-term disruptions.

But they are also wary of taking too-drastic action. Earlier this year, a wave of regulatory measures jolted China's financial markets. Since then, banks and other financial institutions have seen their funding costs rise, causing concerns that the lenders would then make it more expensive for businesses to borrow, thereby hurting growth. Such worries are adding to Beijing's wariness of dealing with debt, officials say.

"The overall direction of deleveraging won't change in the long run," said Zhang Ming, a senior economist at the Chinese Academy of Social Sciences, a government think tank.

Another worry over China's debt buildup: More than half of new bank loans are flowing into the real-estate market, not to areas of the economy that can improve the country's competitiveness. The property market, including construction and home furnishings, accounts for a third of overall growth. Beijing is looking for ways to rein in housing speculation without setting off a housing crash that could torpedo the economy.

The economic plan to be released on Wednesday is expected to outline measures to ward off property bubbles, the people familiar with the plan said. Those will include increasing land supplies, developing home rentals and setting a framework for property taxes.

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