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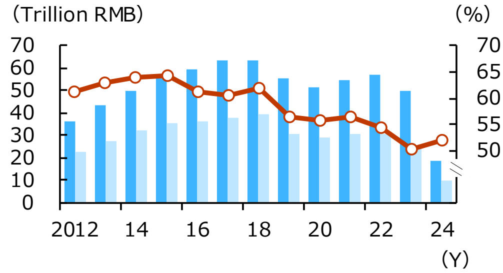
Topics Can China bring about a recovery in private investment?

The Xi Jinping administration has launched measures to promote private enterprises, but they have had little effect. To bring about a recovery in private investment, it will be necessary to raise expectations for an improvement in the business environment surrounding private enterprises going forward.

■ Measures to promote private enterprises have been given an "upgrade"

In China, there has been a marked decline in investment by private enterprises (private investment). The growth rate of investment in 2023 was -0.4% year over year (YoY), registering the first negative figure since statistics began to be compiled. The share of private investment in fixed asset investment reached 64.2% in 2015, two years after Xi Jinping took the helm in 2013, but has since gradually fallen to 50.4% in 2023. Nevertheless, private investment still accounts for a high proportion of fixed asset investment, and its decline will seriously impact the economy.

<Share of Private Investment in Fixed Asset Investment in China>

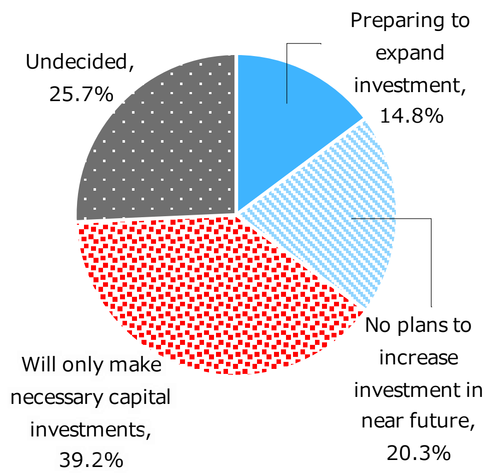


Source: Prepared by JRI based on data from CEIC
Note: Data for 2024 are for January-May.

The Xi Jinping administration is thus actively publicizing the fact that it is taking action to promote private enterprises in order to stimulate private investment. At the core of the measures to promote private enterprises is a policy document entitled "Opinions on Promoting the Development and Growth of the Private Economy" (commonly referred to as the "31 measures for the private economy"), which was released in July 2023. It included a variety of support measures, including 1) improving market access, 2) enforcing fair competition policies, 3) expanding financial support measures, 4) preventing delays in payments by local governments, 5) protecting property rights, and 6) establishing a fair supervisory structure.

The most distinctive feature of the "31 measures for the private economy" is that for the first time the slogan "stronger, better, and bigger" was used for private enterprises. The phrase "stronger, better, and bigger" was first used by General Secretary Xi Jinping when referring to state-owned enterprises (SOEs) at a national meeting held at the end of 2016 on building the role of the Chinese Communist Party within SOEs. Thus, the expression is viewed as symbolic of the administration's emphasis on SOEs in China. The use of this phrase for private enterprises means that the administration has "upgraded" its measures to promote such companies, and signaled a policy commitment to initiatives for private-enterprise promotion that exhibits a different level of enthusiasm from that shown in the past.

<Investment Plans of Private Enterprises>



Source: Prepared by JRI based on data from Jiemian News
Note: Survey period was September-October 2023, and 413 companies were surveyed.

However, there are no signs of a recovery in private investment. Shanghai-based news outlet Jiemian investigated the situation surrounding private enterprises by surveying 413 companies in September-October 2023. When asked about their future investment plans, only 14.8% of the respondents said they were preparing to expand their investments, while 60% answered that they either had no plans to increase their investments in the near future (20.3%) or would only make necessary capital investments (39.2%). Private investment also remained sluggish in January-May 2024, turning positive but growing at a rate of just 0.1% YoY.

■ Market expectations for private enterprises are also fading

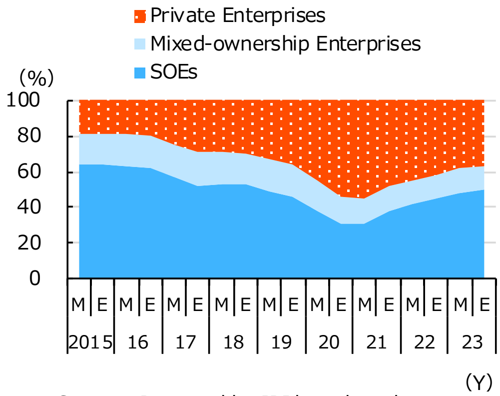
One of the reasons for the lack of recovery in private investment is the widely-held belief that the environment surrounding private enterprises will not change easily. For example, the protection of property rights, which was included in the "31 measures for the private economy," was already enshrined in the Constitution following an amendment made at the end of 1982. Yet the fact that now, almost 40 years later, it has been articulated as one of the measures to promote private enterprises shows just how fragile the position of such firms is.

Another matter that should not be overlooked is that the "31 measures for the private economy" contain an element that could discourage private enterprises. This element is the declared aim of promoting the growth of sound private enterprises through more widespread political and ideological education. Although the "31 measures for the private economy" list a raft of support measures, the beneficiaries will be companies that demonstrate excellence not only economically but also politically. Whether a private enterprise embodies the goals of political and ideological education is now a more important factor than ever in determining the fate of such firms.

Anxiety about the future of private enterprises is shared by market participants. The Peterson Institute for International Economics (PIIE) grouped the 100 Chinese companies with the largest market capitalizations on the Hong Kong, Shanghai, and Shenzhen stock exchanges based on their form of ownership, and calculated the share of each group in total market capitalization. They discovered that the share of private enterprises had declined from a peak of 55.4% at the end of June 2021 to 36.8% at the end of 2023, indicating diminishing market expectations for such companies.

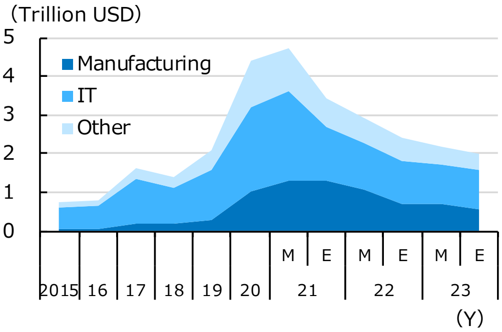
Breaking down the change in the market capitalization of private enterprises before and after the peak at the end of June 2021 by industry, we find that it was the manufacturing and IT sectors that drove the overall share of private enterprises to the peak, yet it was also these same two sectors that lowered the overall level after that. The year 2021, when the market capitalization of private enterprises began to decline, coincided with a period in which the Xi Jinping administration tightened the screws on cram schools and the IT industry under the banner of "common prosperity," a slogan that refers to the ideal of society's affluence being felt by all.

<Breakdown of Market Cap of Top 100 Chinese Listed Companies>



Source: Prepared by JRI based on data from PIIE
Note: M: end of June, E: end of December. SOEs are those where the state owns 50% or more of the paid-in capital. Mixed-ownership enterprises are those where this ratio is 10-50%, and private enterprises are those where this ratio is under 10%. The companies are Chinese firms listed on stock exchanges in the cities of Shanghai, Hong Kong, and Shenzhen.

<Market Cap of Private Enterprises by Industry>



Source: Prepared by JRI based on data from PIIE
Note: Same as for previous figure.

■ The key is to create expectations of an improved business environment

Since private enterprises account for 60% of GDP, 70% of technological innovation, and 80% of urban employment, the recovery of private investment is essential to return the Chinese economy to a stable growth path. The Xi Jinping administration has launched a series of new measures to promote private enterprises, including the establishment in September 2023 of a new private economic development bureau within the National Development and Reform Commission and the announcement in February 2024 that it will begin preparing legislation to provide a level playing field so that private enterprises are not put at a disadvantage compared to SOEs. However, given that the "31 measures for the private economy" proved largely ineffective in bringing about a recovery in private investment, it is unclear whether the recent series of measures to promote private enterprises will lead to such a recovery. The Xi Jinping administration will need to steadily implement the measures to promote private enterprises and be tenacious in taking action to raise expectations among private enterprises of an improvement in their business environment.

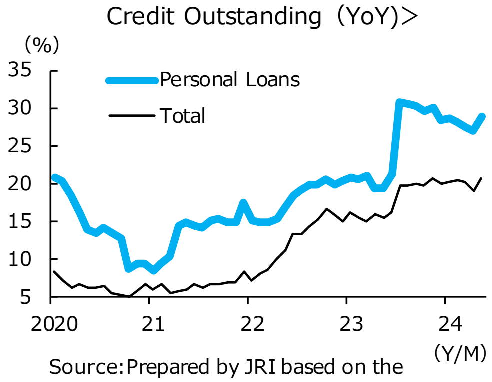
(Yuji Miura)

Topics *Lending to individuals by Indian financial institutions is soaring*

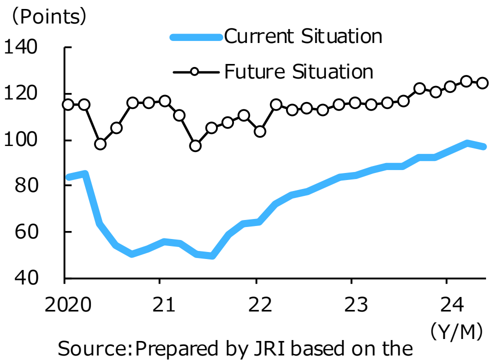
Lending by financial institutions in India, particularly to individuals, has been increasing rapidly. Against this backdrop, the Reserve Bank of India (RBI), the country's central bank, has been stepping up its efforts to tighten lending regulations in order to curb potential financial risks.

■ Financial institutions' loans to individuals have risen sharply

Lending by Indian financial institutions is skyrocketing. The rise is being driven by lending to individuals, mainly in the form of mortgages and auto loans, and recently the amount of outstanding loans from commercial banks to individuals has been increasing by nearly 30% annually. In addition, lending to individuals by financial institutions specializing in auto loans or mortgages, as well as by non-banks in such forms as consumer loans, is rising at a rapid clip. This can be attributed to the two background factors detailed below:



Source: Prepared by JRI based on the Reserve Bank of India



Source: Prepared by JRI based on the Reserve Bank of India

The first is an increase in the capacity of households to bear debt due to an improvement in the employment environment. With economic and social activities getting back to normal in the wake of the COVID pandemic, the employment situation has continued to get better, especially in the face-to-face service sector. In urban areas for which short-term labor statistics are available, the unemployment rate, which briefly exceeded 20% in 2020, has recently fallen to the 6% level. Youth unemployment remains high, at just under 20%, but is still down significantly from the 30% level recorded at the peak of the pandemic. In addition, according to a questionnaire survey conducted by a private research organization, nominal wages have been rising at an annual pace of around 10% for the past few years. As consumer confidence continues to improve, middle-income earners, in anticipation of future increases in their incomes, are increasingly willing to purchase homes, cars, appliances, and other goods on credit.

The second is improved access to financial services for low-income groups. As economic and societal digitalization accelerated in response to the pandemic, many financial institutions started offering personal loans for which all procedures could be completed quickly using smartphones thanks to identity verification via India's "Aadhaar" national ID system and PAN (permanent account number) and AI-driven loan screening models. This has led to an improvement in access to financial services for households living in rural areas where there are few financial institution branches, and sparked a rapid increase in small-scale borrowing by low-income households.

■ The surge in lending by financial institutions will impact the Indian economy, both positively and negatively

The jump in lending by financial institutions, particularly to individuals, will have both positive and negative ramifications for the Indian economy. On the plus side, the increase in lending to households will give the economy a short-term lift by boosting consumption and housing investment. In addition, the expansion of loans by financial institutions and the more favorable economic environment surrounding borrowers will make the financial system more stable as it will improve the financial condition of financial institutions. Alongside the ongoing virtuous cycle of increased lending and economic expansion, commercial banks' return on assets (ROA), nonperforming loan ratios, and capital adequacy ratios have all improved recently, partly thanks to initiatives such as the restructuring of state-owned banks with weak balance sheets and the transfer of nonperforming loans to National Asset Reconstruction Co., Ltd., the so-called "bad bank" set up to buy legacy stressed loans. Furthermore, the ratio of household debt to GDP and the rate of increase in housing prices are both stable, suggesting that the financial system is becoming healthier.

However, attention needs to be paid to the fact that the surge in lending by financial institutions increases the risk of debt repayment delays in the event of an unexpected economic downturn. Although the Indian economy is expected to see robust growth over the medium to long term, the risk of a sudden economic downturn is by no means zero for these reasons: 1) about 40% of the workforce is engaged in agriculture, which is susceptible to the effects of weather factors, 2) the economic structure means that the economy is vulnerable to the effects of resource prices and the monetary policies of developed countries, and 3) India has experienced temporary economic and social turmoil following bold institutional changes on numerous occasions in the past.

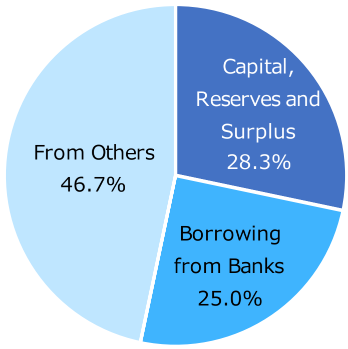
Furthermore, given that 1) more than 20% of non-bank loans to individuals are unsecured, 2) non-banks fund about 70% of their lending by borrowing from financial institutions and issuing corporate bonds, and 3) lending to non-banks accounts for around 10% of total lending by commercial banks, if non-banks for which unsecured loans make up a large proportion of their loan books run into financial difficulties, adverse effects could be felt across the entire financial sector. Looking back at past examples, when major non-bank IL&FS defaulted on multiple debts in 2018, it set off a cascade of credit uncertainty that led to financial institutions adopting stricter attitudes toward lending, which resulted in a dip in durable goods consumption and investment.

<Commercial Banks' Soundness Indicators (2021→2024) >

	2021	2024
Gross Advances (Trillion Rupee)	105.3	161.1
Return on Asset (%)	0.7	1.3
Gross Non-Performing Assets (% of Total Loan)	7.4	2.8
Net Non-Performing Assets (% of Total Loan)	2.4	0.6
Capital Adequacy Ratio (%)	16.2	16.8
Liquidity Coverage Ratio (%)	158.9	130.3

Source: Prepared by JRI based on the Reserve Bank of India

<NBFC's Sources of Funds>
(as of March 2024)



Source: Prepared by JRI based on the Reserve Bank of India

■ Regulations on lending are being tightened

The RBI, wary of such heightened potential financial risks, has stepped up moves to make lending regulations more stringent. In November 2023, the RBI raised the risk weight (required ratio of provisions to assets at risk of default) of financial institutions' loans to individuals. And in January this year, it ordered the banking subsidiary of electronic payment giant Paytm to suspend operations following a system audit aimed at curbing cyber risks. Later, in March, it barred major non-bank IIFL from making gold-backed loans, citing supervisory concerns.

In response to this series of actions, the rate of increase in commercial banks' lending to individuals has slowed recently, though it is still high compared to the past few years. Eyes are now focused on whether the RBI will increase risk weights and liquidity coverage ratios and tighten rules on mortgage LTVs (loan-to-value ratios).

(Shotaro Kumagai)