Corporate Default Risk and Loan Pricing Behaviour in China

Hongyi Chen
Hong Kong Institute for Monetary Research

Jianghui Chen
Chinese University of Hong Kong

Gaofeng Han
Hong Kong Institute for Monetary Research

October 2017

Summary

This paper studies banks' loan pricing behaviour in mainland China from 2003-2013 by applying panel regressions to firm-level loan data and the estimated default likelihood for listed companies. We find that, with the progress of market-oriented financial reforms, banks generally require compensation for their exposure to borrowers' default risks. More so if the borrower is a non-state-owned enterprise (non-SOE), mainly due to the pricing behaviour of the Big Four banks. On the other hand, bank lending rates are less sensitive to the default risks of state-owned enterprises (SOEs). Our results also reveal that banks priced in firm default risks before 2008 financial crisis, but not necessarily after the crisis. As for industries, we find that, after the 2008 Global Financial Crisis, the real estate sector and other government-supported industries tended to enjoy better terms on loan pricing in terms of default risks. We believe the main reason is that government stimulus policies tilted towards those industries that played crucial roles in China's economic growth.