The SOE Premium and Government Support in China's Credit Market

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Abstract

Studying China's credit market using a structural default model that integrates credit risk, liquidity, and bailout, we document improved price discovery and a deepening divide between state-owned enterprises (SOEs) and non-SOEs. Amidst liquidity deterioration, the presence of government bailout helps alleviate the heightened liquidity-driven default, making SOE bonds more valuable and widening the SOE premium. Meanwhile, the increased importance of government support makes SOEs more sensitive to bailout, while the heightened default risk increases non-SOEs' sensitivity to credit quality. Examining the real impact, we find severe performance deteriorations of non-SOEs relative to SOEs, reversing the long-standing trend of non-SOEs outperforming SOEs.