Euler Hermes Economic Research

Country Report

China

Growth remains solid despite higher corporate risk

General Information

GDP	USD9240.27bn (World ranking 2, World Bank 2013)
Population	1357mn (World ranking 1, World Bank 2013)
Form of state	Communist State
Head of government	LI Keqiang
Next elections	2018, presidential and legislative

Strengths

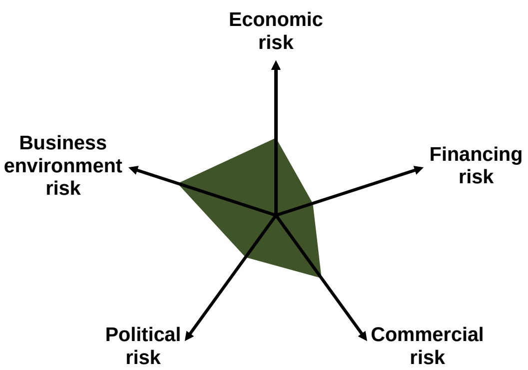
- Strong FX reserves and external surpluses
- Large domestic market
- Huge industrial base
- Solid growth prospects
- Low public and external debt
- Improvement in macro-prudential management
- Increasing market orientation

Weaknesses

- Ageing population
- Difficult business environment, lack of transparency
- Rising share of non-standard financing
- High indebtedness on regional and local level
- High inequality, low share of private consumption to GDP regarding the economic performance
- Competitiveness erosion
- Key sectors with overcapacities especially steel and solar
- Continued geopolitical tensions with key countries in the region

Country Rating

B1



Source: Euler Hermes

Trade Structure

By destination / origin (% of total)

Exports		Rank		Imports
United States	17%	1	10%	South Korea
Hong Kong	16%	2	8%	Japan
Japan	6%	3	8%	United States
South Korea	4%	4	8%	Taiwan
Germany	3%	5	5%	Germany

By product (% of total)

Exports		Rank		Imports
Telecom. Equipment	12%	1	14%	Crude Oil
Computer Equipment	11%	2	9%	Electronic Components
Electrical Apparatus	6%	3	6%	Iron Ores
Leather	5%	4	4%	Basic Organic Chemicals
Misc. Hardware	4%	5	4%	Plastic Articles

Sources : ITC, Chelem

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Economic Overview

Economic growth to slow to +7.0% in 2015, insolvencies up 8%

EH expects insolvencies to accelerate in 2015 (+8% from 2% in 2014), economic growth to decelerate (7%). In H1, activity proved to be sluggish and downward price pressures remain evident. Going forward, activity is set to stabilize at 7% by Q4. Outside of China, demand in advanced economies is set to strengthen supporting a gradual improvement in Chinese exports. In China, even if business surveys in the manufacturing still points to a weak outlook, non-manufacturing sector continue to show resilience and activity in "non-traditional sectors" (such as on-line sales, new-tech industries) is getting momentum. Policy makers will likely intensify accommodative measures (i) to ease credit conditions for most vulnerable domestic entities (SME, rural sectors) and (ii) to support industrial upgrading. Risks to the baseline scenario, stem from a slower than expected global recovery, higher credit risk for companies and uncertainty regarding private consumption, all of these are tilted to the downside.

Financial risks: firm's debt is the main issue

Systemic risk is largely contained due to the strong government financial position however credit risk should be watched carefully. Non-bank lending has decreased as a part of total credit flows (38% in 2014 from 45% in 2013) reflecting a more stringent regulatory framework as authorities made it clear they wanted to reduce shadow banking activities. Meanwhile bank credit has increased to support economic activity raising fears of higher corporate risk. Corporate debt has soared since the Global Financial Crisis as a result of various stimulus packages. Non-financial corporate debt was 157% GDP in 2014 up dramatically from around 100% GDP in 2007. Although the level remains manageable, the pace of credit supply growth (21% p.a. over 2007-2014) should be adjusted downward to more sustainable range in the medium term. In the current context, such efforts are tough as slower than expected economic activity and ongoing disinflationary pressures led the authorities to move from targeted measures (targeted rate cuts in H1 2014) to more conventional accommodative measures (universal rate cuts since H2 2014). Accordingly, corporate debt will likely continue to rise and go above 160% GDP in 2015, increasing risk of non-payment further.

External position remains strong

The current account is set to increase in 2015 (3.0% from 2.1% GDP in 2014), while the trade surplus remains large in H1 2015 reflecting a sharp decrease of imports (-17.6% y/y in May) compared to exports (-2.5% in May). In H2, we expect a trade surplus normalization with increasing exports due to advanced economies, improving imports thanks to pro-consumption measures (e.g.: -50% decrease in imports tariff for selected consumption goods). External liquidity ratios remain sounds with large FX reserves and low external debt (close to 9% GDP). On the currency front, RMB "flexibility" has increased with a trading band expansion in 2014, the IMF said the currency is no longer overvalued.

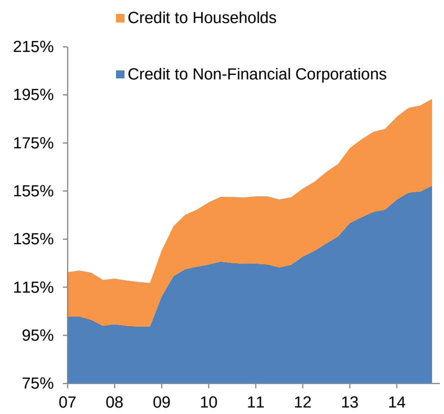
Economic forecasts

	2013	2014	2015	2016
GDP growth (% change)	7.7	7.4	7.0	6.8
Inflation (%, yearly average)	2.5	1.5	1.6	1.7
Fiscal balance* (% of GDP)	-2.5	-2.2	-2.4	-2.6
Public debt* (% of GDP)	26.5	39.4	41.2	44.0
Current account (% of GDP)	2.1	1.9	2.1	3.0
External debt (% of GDP)	9.7	8.6	8.4	8.3

*Government balance and debt according IMF definition

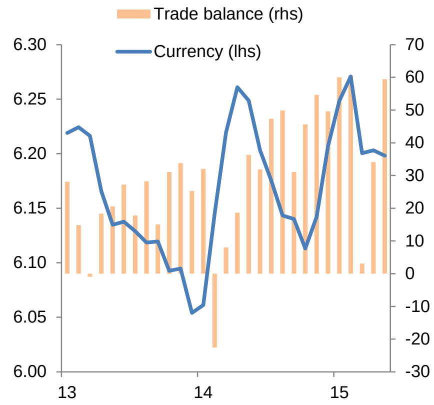
Sources: IIF, national sources, Euler Hermes, IMF

Outstanding credit to the private non-financial sectors (% GDP)



Sources: BIS, Euler Hermes

RMB per USD and trade balance (USD bn)



Sources: IHS, Euler Hermes

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