Euler Hermes Economic Research

Country Report

China

Slowing growth and eroding policy buffers

General Information

GDP	USD10360.1bn (World ranking 2, World Bank 2014)
Population	1364.3bn (World ranking 1, World Bank 2014)
Form of state	Communist State
Head of government	Li KEQIANG
Next elections	2018, presidential and legislative

Strengths

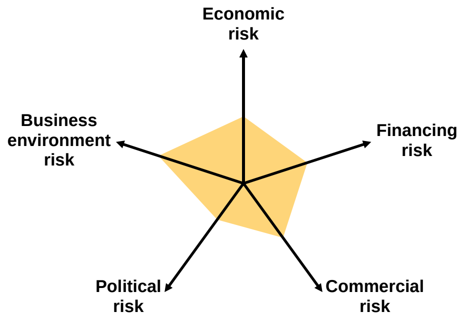
- Strong FX reserves and external surpluses
- Large domestic market
- Huge industrial base
- Solid growth prospects
- Low public and external debt
- Improvement in macro-prudential management
- Increasing market orientation

Weaknesses

- Ageing population
- Difficult business environment, lack of transparency
- High corporate debt
- 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

B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	17%	1	10%	Korea, Republic of
Hong Kong	16%	2	8%	Japan
Japan	6%	3	8%	United States
Korea, Republic of	4%	4	8%	Taiwan
Germany	3%	5	7%	China

By product (% of total)

Exports		Rank		Imports
Electrical machinery, apparatus and	12%	1	18%	Electrical machinery, apparatus and
Telecommunication and sound recording apparatus	12%	2	13%	Petroleum, petroleum products and related materials
Office machines and automatic data	10%	3	8%	Metalliferous ores and metal scrap
Articles of apparel & clothing	8%	4	5%	Road vehicles
Miscellaneous manufactured articles	7%	5	4%	Professional and scientific instruments

Source: UNCTAD

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GDP growth to slow to +6.5% in 2016

GDP growth is set to decelerate to +6.5% in 2016. Exports would remain a drag on growth this year with a modest demand expansion in the U.S., the European Union and weak new orders from large emerging markets. Private investment will grow at a slower pace limited by a high corporate debt and ongoing overcapacity reduction.

Against this background, policy support is set to accelerate in the form of a large fiscal stimulus. The monetary stance will also be supportive but more cautious in order to contain credit risk. After a slight slowdown in H1, private consumption is expected to pick up gradually thanks to higher purchasing power and improved confidence.

Non-payment risk will likely remain elevated. Insolvencies are expected to grow by +20% in 2016 (from +24% in 2015). Risks are tilted to the downside in the short run and stem from both external and domestic sources. Externally, a prolonged slowdown in exports will weigh on economic activity. Internally, higher credit risks and delayed reforms should reduce overcapacity while restructured SOEs will undermine the long-term growth outlook.

Strong stimulus erodes policy buffers

The policy stance is very accommodative with elevated risks of creating unintended consequences. Since 2014, monetary policy has been relaxed significantly to avert a sharp slowdown of the economy and curb deflationary pressures. The results were twofold. The economy has proved resilient and deflationary pressures started to decrease. However, stimulus efficiency has diminished and credit risk has increased rapidly. The NPL ratio for banks increased from 2014 (1.25%) to Q1 2016 (1.75%), corporate debt rose to 171% GDP in 2015 (from 157% in 2014). Against this background, the monetary stance will have to be more cautious. On the fiscal side, public debt is set to increase. The government has decided to expand its support, targeting a fiscal deficit of -3% GDP this year (compared to a target of -2.3% GDP last year).

External position shows signs of weaknesses but remains strong overall

The current account surplus is large due to a robust trade surplus. Despite a strong fall in reserves since H2 2015, external vulnerabilities remain under control with large import cover and low external debt. On the currency front, downward pressures persist due to diverging monetary policy with the United States and investors' concerns.

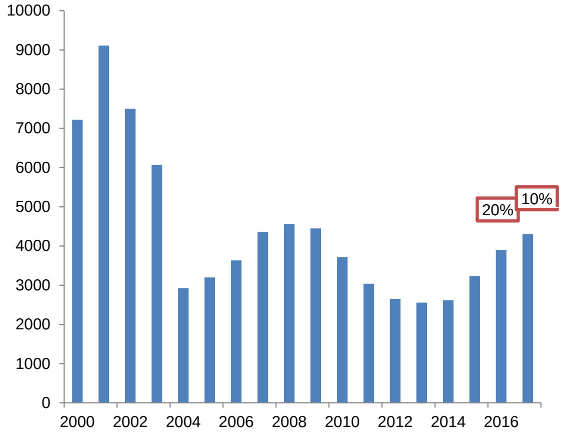
Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	7.3	6.9	6.5	6.4
Inflation (%, year average)	2.0	1.4	2.3	2.4
Fiscal balance (% of GDP)*	-0.9	-2.7	-3.5	-3.5
Public debt (% of GDP)*	41.1	43.9	47.2	49.8
Current account (% of GDP)	2.7	3.1	2.5	2.3
External debt (% of GDP)	8.7	13.2	12.7	12.1

* Fiscal indicators includes: Central Government; Local Government; adjustments of stabilization fund, social security fund, and government-managed funds.

Sources: IMF, Euler Hermes

Figure 1 – Insolvencies (number and growth rate)



Sources: national sources, Euler Hermes

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