Euler Hermes Economic Research

Country Report

China

Turbulent times

General Information

GDP	USD10360bn (World ranking 2, World Bank 2014)
Population	1364mn (World ranking 1, World Bank 2014)
Form of state	Communist State
Head of government	LI Keqiang
Next elections	2018, presidential and legislative

Strengths

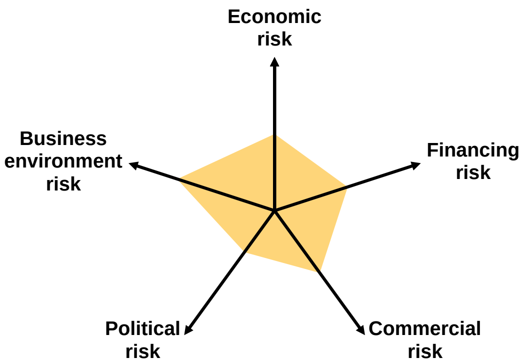
- Strong FX reserves and external surpluses
- Large domestic market
- Huge industrial base
- Solid growth prospects
- Low public and external debt
- Improvement in macro-prudential management
- Increasing market orientation

Weaknesses

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

B2



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

Economic Overview

Economic growth to slow to +6.8% in 2015, insolvencies up +25%

Economic growth is set to decelerate to +6.8% in 2015 and +6.5% in 2016. The performance of export is constrained by weak global demand and investment is expected to slow down further, reflecting a reduction in overcapacity and weak sentiment. Domestic consumption will likely be the main growth driver. Public support is set to step in in the form of higher infrastructure spending, further tax breaks but also better financing conditions. Private consumption is set to show some signs of weakness in Q3 2015 as a result of lower consumer confidence following financial market correction but significant buffers (rising real wages, large savings, state support) should allow a gradual improvement thereafter. We expect insolvencies to grow by +25% in 2015 (from 2014) and +20% in 2016. While the increase is significant, the number of insolvent companies will still be below the 2009-level (-12%). Risks are tilted to the downside in the short run and they stem from both external and domestic sources. Externally, emerging markets demand weakened, financial conditions are volatile ahead of the Fed rate hike and deflationary pressures are still elevated. Internally, the private sector is still adjusting and achieving government targets (7% healthy growth) is getting complicated. Authorities have the difficult task to support growth without creating another surge in corporate debt and convince market players that economic activity is still expanding at a healthy rate.

Financial vulnerabilities: insufficient credit, firm's debt and financial market volatility

Systemic risk is contained as a result of the strong government financial position, however, financing risk has increased somewhat. Credit supply is increasing but the pace is not enough to compensate for the decrease in non-bank lending (especially shadow banking). Corporate debt is at a high level (160% of GDP) and the current context suggests a further increase. In particular, companies' revenues are set to increase moderately as deflationary pressures are still elevated and demand growth is slower. Moreover, financial volatility has increased and it will probably last in the near term. GDP growth is set to slowdown further in H2, market players need time to adapt to the Chinese New Normal (new growth-regime, more market based).

External position shows signs of weaknesses but remains strong overall

The current account surplus is set to increase in 2015. The trade surplus was large in H1 2015 due to a sharp decrease of imports compared to exports. In H2, we expect a gradual normalization with increasing exports due to advanced economies. Despite a significant fall in FX reserves in Q3 2015, external liquidity indicators remain sound: import cover is still significant; and external debt is low. On the currency front, RMB "flexibility" has increased with a change in the exchange rate formation methodology in August 2015. After a sharp depreciation in August, the currency stabilized, but downward pressures still persist including investors' concerns about China's economy and diverging monetary policies.

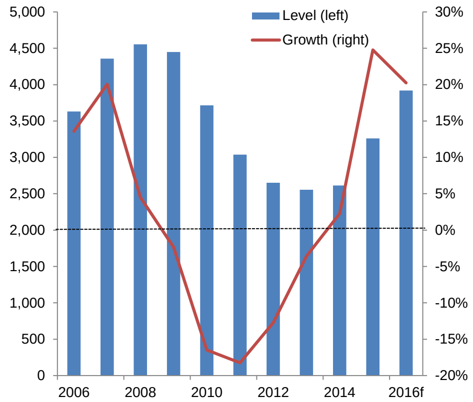
Economic forecasts

	2013	2014	2015	2016
GDP growth (% change)	7.7	7.3	6.8	6.5
Inflation (%, yearly average)	2.6	2.0	1.7	2.0
Fiscal balance* (% of GDP)	-1.1	-1.1	-2.2	-2.6
Public debt** (% of GDP)	39.3	40.7	43.0	47.0
Current account (% of GDP)	1.6	2.1	3.5	3.0
External debt (% of GDP)	9.1	8.6	10.0	11.0

* General Government net lending, IMF definition
** General government debt, IMF definition

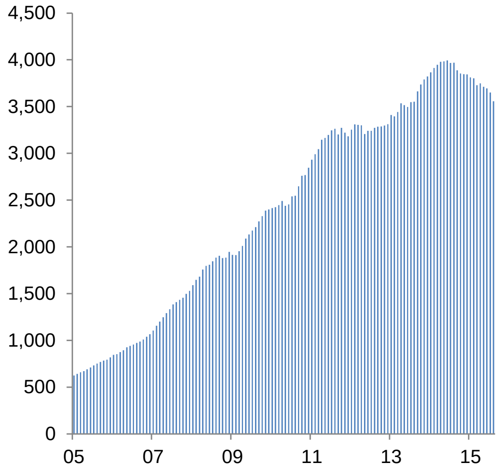
Sources: IIF, national sources, Euler Hermes, IMF

Insolvencies



Sources: national sources, Euler Hermes

FX reserves (USD, bn)



Sources: IHS, Euler Hermes

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