Rating-Agentur Expert RA confirmed at 'A+' the ratings of China. The rating outlook is stable. The rating was withdrawn.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of China at 'A+' (High level of creditworthiness of the government) in national currency and at 'A+' (High level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The economic competitiveness of China is still a key strength for the creditworthiness assessment. Despite the trade balance having narrowed in 2018 as a result of geopolitical and trade tensions, it was still positive at 1% of GDP showing the economy's resilience to external factors. China is also ranked 22nd out 140 countries according to the 2017-2018 Global Competitiveness Index report prepared by the World Economic Forum;
- The real economy grew at a pace of 6,6% y-o-y in 2018 as a result of the continued economic rebalancing and deleverage efforts from the government, as well as lingering trade tensions with the United States. Even though this is the lowest figure in the last 28 years, it remained solid;
- International reserves resumed an upward trend since November 2018 and, as of March 2019, they reached a level of USD 3,19 tn;
- The inclusion of the CNY in the SDR basket continues to be a positive factor;
- The banking system's core official figures reflect once again a solid sector. The capital adequacy ratio stood at 14,2%, while ROA was once again positive at 0,9% and official NPLs to total loans stood at 1,84%. However, bad debt in small regional banks soared;
- Inflation stood at 1,9% in 2018 and we anticipate the reading to continue to follow the same trend in the following years in order to reach the 3% target set by the government;
- The unemployment rate declined slightly in 2018 and stood at 3,8%.

Restricting factors:

- Official government debt, as we previously anticipated, increased up to 50,5% of GDP in 2018, a 4p.p. hike from a year ago, and debt to budget revenues was around 7p.p. higher and posted a figure of 173%;
- The structure of government debt remains favorable and stable. Short-term debt remained unchanged in 2018 as it stood at around 2% of GDP and external debt was 1,5% of GDP as of the same date. Moreover, external debt is covered by international reserves by around 16x;
- The fiscal policy of the government is expected to remain expansionary as the authorities' efforts to sustain economic growth continue. Tax cuts and new investment projects are the main tools being used to stimulate growth. As a result, the fiscal deficit posted a figure of 4,8% of GDP in 2018 and we expect it to widen further in 2019. However, a consequence of these policies is a potential underfunding of local governments which will be partially mitigated by higher quota of bond issuance, but could increase off-budget borrowing;
- We anticipate the monetary policy to remain prudent along 2019. Back in January, The

People's Bank of China (PBOC) slashed the reserve requirement ratios (RRR) once again down to 14,5% for large institutions and to 12,5% for smaller banks in order to propel the economy. Additionally, the PBOC also recently injected around CNY 267,4 bn through a targeted medium-term lending facility as a measure to expand credit for SMEs. This measure, alongside a highly accommodative fiscal policy, reduces the possibility of further cuts to the RRR. In regard to the exchange rate, we expect it to remain stable and move according to fundamentals;

- China's institutional strength remains neutral, reflected by the moderately low level of the rule of law index and government effectiveness index. Moreover, these indicators could further deteriorate if the authorities do not follow through with the planed reforms.

Negative factors:

- We still consider the materialization of contingent liabilities a key risk for the sovereign's creditworthiness as these remain quite high but have eased moderately. These liabilities mainly stem from SOEs as well as from local governments. Firstly, SOEs posted a ROA of 3,9% in 2018, 0,1p.p. higher than a year before and leverage ratio was 64,7%, a slight reduction of 0,2p.p. Moreover, the government has increased efforts to clean-up the system of the so-called "zombie" companies in order to increase efficiency by letting unprofitable companies go bankrupt. In regard to local governments, even though off-budget financing is still being used, the central government has tightened restrictions on this type of borrowing and has also increased the allowance for formal borrowing through bonds issuance (up to CNY 2,2 tn from CNY 1,4 tn);
- State owned banks continue to dominate the banking sector, which has a direct impact on the amount of the government's contingent liabilities. Despite this, we do not see a risk for these contingent liabilities to materialize in the mid-term perspective;
- Credit to the economy remains elevated in China, but has increased at a slower and more stable pace. Aggregate financing to the real economy (AFRE)[1] was 226% of GDP in 2018 exactly as we predicted in our previous review. Moreover, this indicator grew by 10,7% y-o-y as of March 2019, increasing the growth pace but remaining balanced. We anticipate the overall domestic debt to have finished 2018 at around 222% of GDP. The authorities have also continued with policies to reduce shadow banking which has been subdued. As of March 2019, entrusted and trust loans[2] have declined by 11% and 7,9% y-o-y respectively. However, corporate debt remained high at 153% to GDP 3Q 2018.

Support factors:

- Substantially high level of FX reserves (USD 3,19 tn by March 2019) provides the ability to support the national currency and absorb external shocks.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued deleveraging of the economy by reducing formal credit and shadow banking instruments;
- Improvement in fiscal metrics including total government debt and contingent liabilities.

The following developments could lead to a downgrade:

- Unsustainable increase of credit to the economy;
- Steep slowdown of the economy which could hurt public finances.

[1] Also referred to as "Total social financing" is the overall volume of financing provided by the domestic financial system to the private sector of the economy.
[2] Entrusted loans are loans provided by a corporate lender to a corporate borrower through a commercial bank, while trust loans are loans provided to private enterprises by trust companies.

“The confirmation of China’s rating at ‘A+’ reflects the still solid, albeit slowing, economic performance despite trade tensions with the U.S. and a global economic slowdown. It also shows the outstanding strength of the external position with high levels of international reserves, widely positive net international investment position (NIIP) and positive trade and current account balances, as well as its high level of competitiveness.

Nonetheless, despite the pace of credit growth having slightly declined and shadow banking having reigned in, the economy remains highly leveraged. In addition, the risk of contingent liabilities’ materialization remains in place; however, this has also been reduced as a result of the wipeout of “zombie” companies and the increase in local government bonds issuance quota.” – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on China is available at:

https://raexpert.eu/reports/Research_report_China_03.05.2019.pdf

Next scheduled rating publication: The rating was withdrawn. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

For further information contact:

Responsible expert:
Hector Alvarez, Associate Director of Rating-Agentur Expert RA GmbH
+49 (69) 3085-45-00, ext.1213
alvarez@raexpert.eu

Reviewer:
Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA GmbH
+49 (69) 3085-45-00, ext.1216
kolokolova@raexpert.eu

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
09.11.2018	Scheduled review of both types of ratings for the country	A+	A+	Stable	Stable
11.05.2018	Scheduled review of both types of ratings for the country	A+	A+	NA	NA
17.11.2017	Scheduled review of both types of ratings for the country	A+	A+	NA	NA
19.05.2017	Scheduled review of both types of ratings for the country	AA-	AA-	NA	NA
25.11.2016	Scheduled review of both types of ratings for the country	AA-	AA-	NA	NA
03.06.2016	Scheduled review of both types of ratings for the country	AA-	AA-	NA	NA
11.12.2015	First assignment of both types of ratings for the country	AA-	AA-	NA	NA

Minute's summary

The rating committee for China was held on 2 May 2019. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from April 2019). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, Trading Economics (www.tradingeconomics.com), World Economic Forum, Doing Business, United Nations, Transparency international, People's Bank of China, China Banking Regulatory Commission, State Administration of Foreign Exchange, National Bureau of Statistics of the People's Republic of China, Ministry of Finance of the People's Republic of China, Asia Bonds Online.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.