Rating-Agentur Expert RA GmbH assigned 'AA-' ratings to China

Rating-Agentur Expert RA GmbH assigned 'AA-' sovereign government credit rating (SGC) to China in national currency (Very high level of creditworthiness of the government) and 'AA-' in foreign currency (Very high level of creditworthiness of the government).

Rating-Agentur Expert RA GmbH assigned 'AA-' country credit environment rating (CCE) to China in national currency (Very high quality of credit environment of the country) and 'AA-' in foreign currency (Very high quality of credit environment of the country).

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- China has the second largest economy in the world. The economy is highly diversified, industrialized and dynamic. It is export-oriented and highly competitive with stable trade surpluses (3,7% of GDP in 2014);
- China enjoys a long track record of solid and stable economic growth. Real GDP growth was 6,9% in annualized terms in 3Q 2015. Albeit slower than the historical average, contribution from consumption to the GDP growth has been rising, a clear indication of rebalancing of the economy from the investment-driven model;
- Very strong sovereign balance sheet with foreign exchange reserves at USD 3,5tn as of 3Q 2015 equivalent to more than 83% of total government debt. The reserves have been gradually declining since 2013, but they still provide deep buffers against most possible risks and place China among the top net creditor nations of the world;
- General government debt is moderate at 41,1% of GDP and 144,2% of budget revenues as of end-2014. Concerns on nontransparent contingent liabilities, including debt of local governments and state-owned enterprises (SOE), are being addressed by the central government and are largely mitigated by strong sovereign reserves and high share of liquid assets in SOEs;
- Central government short-term debt is low at 1,5% of GDP as of 2014 and is well covered by FX reserves (22x);
- The fiscal performance is sound with officially reported deficit of 1,14% of GDP in 2014. However fiscal balance might be worse if possible off-budget spending is included as estimated by the IMF;
- Full liberalization of lending rates and partial liberalization of deposit and CNY exchange rates demonstrate improving monetary policy and commitment of the authorities to make the financial system more open and competitive. These steps were among the factors that led the IMF to include CNY in the SDR basket paving the way for CNY to become a global reserve currency in the long term;
- The banking system is profitable (ROA of 1,2% in 2014) and fairly diversified with 30,1% of the total assets concentrated in the three largest banks as of end-2014;
- The official reported figure of non-performing loans (NPLs) remains low at 1,1% in 2014. However the credit risk stemming from bad assets of shadow lenders is hard to estimate;
- A long track record of low and nonvolatile inflation (1,5% in 2014);
- Unemployment is historically low (4,1% in 2014).

Restricting factors:

- Ongoing fiscal reforms led to a new budget law allowing local governments to issue their own bonds, while setting limit for local government debt at CNY 16tn (USD 2,5tn) in 2015. However a longer time frame is necessary to assess success of the reforms;
- High ratio of banks´ assets to GDP at 270% and private credit to GDP at 169% (excluding shadow banking) in 2014. Both ratios might be indicating excessive leverage of the Chinese economy. However, credit growth has slowed down substantially in 2015.

Negative factors:

- High local government debt mostly issued through special purpose vehicles. These contingent liabilities grew by 23% from mid-2013 until end-2014 alongside debt incurred by SOEs. Nonetheless, reforms and the recently imposed cap on local government debt should add more transparency and limit growth of contingent obligations;
- The banking sector is mostly state-owned and the government has a substantial influence on it. However, the elimination of the lending rate floor and gradual lift of the deposit rate ceiling, demonstrate progress in liberalization of the banking system;
- Environmental issues such as water and air pollution.

Support factors:

- High level of foreign exchange reserves (USD 3,5tn in 3Q 2015 including a substantial amount of US government debt) (weak support-factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Low deposit-lending rate spread at 2,8% in 2014;
- Real interest rates (4,1% in 2014) have been stable for the past three years.

Negative factors:

- Recent volatility and sharp correction of the Chinese stock markets expose structural risks and the early stages of stock market development;
- Numerous government restrictions on free flow of capitals and operation of capital markets;
- Low quality of investor's protection – China is ranked 134th out of 180 in protecting interests of minority investors according to the WB Doing Business 2016 report.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Consolidation of the CYN as a reserve currency;
- Sustained gradual reduction in private credit, especially in the shadow banking sector, without hampering the economic growth.

The following developments could lead to a downgrade:

- Further material leveraging of the economy and the general government combined with increase in off-budget and shadow banking activities.

"China's SGC and CCE ratings reflect the stability of its general government debt level and its outstanding external position. In addition, macroeconomic indicators such as inflation, unemployment and real GDP growth continue to be solid and their volatility is almost negligible.

In our opinion, current and planned reforms will aid to alleviate public finances and gradually liberalize the economy which will help improve transmission mechanism of the monetary policy. Finally, the addition of the CNY to the SDR basket will increase the possibilities for the currency to receive reserve status in the long-term and further strengthen its creditworthiness." – clarified Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH.

Responsible expert: Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

Research report on China is available at:

http://raexpert.eu/reports/Research_report_China_11.12.2015.pdf

Next scheduled rating publication: TBD in December 2015. Approximate date of the next scheduled rating publication is 3 June 2016.

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Minute's summary

The rating committee for China was held on 8 December 2015. 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 and Country Credit Environment Ratings. Short Public Version (from April 2015) can be found under the following link: (http://raexpert.eu/files/methodology/MethodologyShort_Credit_Ratings_Sovereign_2015.pdf). Descriptions and definitions of all rating categories can be found within the aforementioned methodology. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

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.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information which 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.

Despite similar methodologies, credit ratings of China from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

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 no conflicts of interests before initiation of the rating assessment.

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 Research Reports.

This Report 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.