



P R E S S R E L E A S E

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## **China in 2014: stable growth with risks of financing and overcapacities**

### **Risks remain in several sectors**

**2014 is a year of divergence for the Chinese economy, representing the diverging trends of macro and micro environments. While expectations are that there will be many reforms following the Third Plenary Session of the 18th Communist Party of China Central Committee (CPC), attention must be paid to the potential negative impacts on the real economy as a result of the reform efforts as well as the credit risks associated with the rising cost of funds.**

### **Focus of 2014: rising cost of funds**

Real GDP growth in China in 2014 will remain stable but slow slightly to 7.2% YoY, partly due to higher inflation. The lower government GDP growth target for 2014 is representative of the government's intention to accelerate reform efforts. Export and investment are expected to improve in light of the global recovery.

Acceleration of urbanization and better local government debt (LGD) management were two key themes highlighted in communication on the Central Economic Work Conference. It is expected that the government will continue to encourage private sector infrastructure investment – particularly in building “networks of cities” in the mid-western and north-eastern regions.. Since the government has already indicated that fiscal policy will remain stable, the private sector is expected to fund these projects.









The rising cost of funds will be a key indicator to follow in 2014. With lending rate liberalization introduced in July 2013, banks' lending may become more market-based and tightness in the interbank market could translate into higher lending rates. Liquidity could become even tighter as many corporate bonds and local government debt will be required to meet repayment obligations in 2014. The weighted-average lending rate in China picked up slowly in 2013, and this trend should continue into 2014, given market conditions (appendix 1). This should be particularly worrying for small and medium enterprises (SMEs) that, traditionally, have not received abundant credit facilities from banks.

**Steel and Coal: risks remain amid government efforts to ease overcapacity**

As a result of the government’s efforts to tackle overcapacity issues, smaller and inefficient participants in these industries will be facing pressure on rising costs and policy uncertainties.

**Steel:** The steel industry utilization rate remained low in 2013. Moreover, the liability/equity ratio of the large and medium steel mills has remained at around the peak level (i.e. 231%) since November 2013. A ratio at this level shows that steel mills are now operating under higher leverage. With profit margins staying at the current level and given the difficulty of generating cash flow, Coface posits that a rise in the ratio will mean that these companies are at a higher risk of insolvency and non-payment.

**Coal:** Risk linked to coal demand is on the decline, due mainly to a reduction in capacity and the introduction of new environmental standards in various industries. With the abundance of supply – both locally and internationally – and relatively flat demand from the steel and cement sectors, the growth momentum seen in late-2013 may not be sustainable and pricing of coal should remain relatively flat in 2014 and beyond.

China Sector Barometer			
Sectors	Risk level	Sectors	Risk level
Automotive		Construction	
Retail		Metals	
Electronics & IT		Textile	
Energy		Wood Paper	

 Moderate risk    Medium risk    High risk    Very high risk   *Source: Datastream, Coface*

**Auto, Retail and Electronics: moderate to medium risk as demand are strong**

**Automotive:** The implementation of measures to control the number of cars in various major cities in China should counterbalance the government’s support of greener vehicles. A strengthening of the Sino-Japan relationship may have a negative impact on on Japanese car manufacturers.

**Retail:** This sector continues to perform well in terms of credit risk, but the outlook is clouded by various factors, including government efforts to tackle corruption, slowing income and capital expenditure growth, import duties and VAT, and RMB appreciation which is driving consumption abroad.

**Electronics and IT:** While domestic demand remained fairly healthy, in the export market mid-sized domestic appliances experienced recessionary pressure in 2013, most notably in Europe and the US. Demand for these appliances could pick up in 2014 in line with these regions’ economic recovery.



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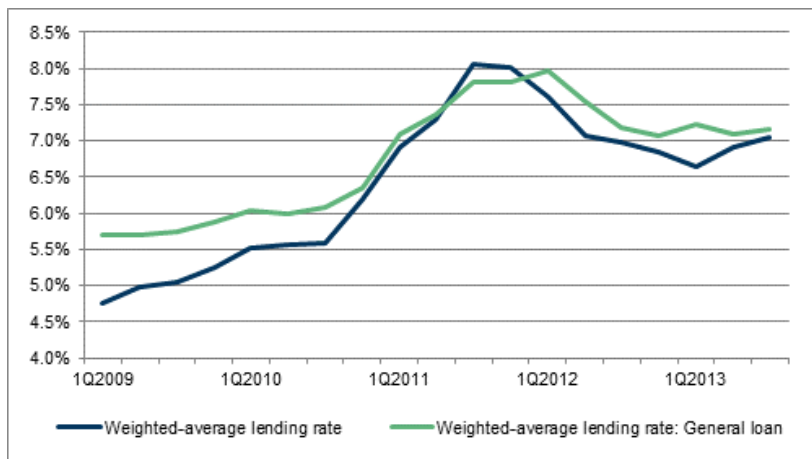
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## Appendix

### Trend of weighted lending rate in China



Source: CEIC, Coface