Media Release

RAM Ratings reaffirms China's $_{g}AA_{3}$(pi) rating on stable economic rebalancing and sustained reforms

RAM Ratings has reaffirmed China's respective $_{g}AA_{3}$(pi)/stable and $_{sea}AAA$(pi)/stable global- and ASEAN-scale sovereign ratings. The ratings are premised on China's strong economic fundamentals and resilience amid structural rebalancing, superior external strength, and commitment to market reforms and liberalisation. These positives are, however, moderated by the country's highly leveraged economy, weakened fiscal performance with substantial sovereign contingent liabilities, and risks arising from uneven property sector recovery.

"While China's economic rebalancing remains on track with further improvement in the quality of growth, consistently rapid credit expansion and sluggish progress of reforms could erode the country's capacity to contain financial risks," notes Esther Lai, RAM's Head of Sovereign Ratings. China's GDP growth had decelerated to a more sustainable pace of 6.7% in 2016 (RAM's estimation: 6.6%), as its economy is gradually shifting towards a consumption-driven growth path with less reliance on large-scale state-led investments. Financial risks stemming from government-linked entities (GLE) and local government financing vehicles (LGFV) have so far been kept under control, owing to the strong links between these borrowing entities and state-controlled banks.

The country maintained a healthy net external creditor position of 14.3% of GDP as at end-2015, supported by adequate foreign reserve holdings of 26.4% of GDP as at end-2016, which provide robust financing of 20 months of current-account purchases and up to 3 times coverage of short-term external debts. China's external position is expected to remain sturdy despite rising capital volatility from further capital account liberalisation, given the government's cautious stance on managing the easing of capital restrictions.

While China's officially reported fiscal indicators are still manageable, with an estimated fiscal deficit of 3.1% of GDP and debt level of 47.5% of GDP in 2016, its augmented deficit and debt positions (after accounting for local governments' off-balance sheet position) are projected by the IMF to remain stretched in 2017 at a respective 8.2% and 64.5%, owing to the government's pro-growth fiscal stance. That said, ample domestic surpluses and liquidity still accord the government strong funding flexibility with a low interest burden. The interlinkages between state-

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owned banks, GLE and LGFV pose substantial contingent risks to the sovereign balance sheet in view of the entrenched perception that the liabilities of these entities are either directly or implicitly guaranteed by the central government. While appropriate reform policies have been introduced to manage fiscal vulnerabilities on this front, we expect the progress of initial implementation to be slow given considerable underlying challenges.

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