RAM RATINGS

Media Release

China's $_{g}AA_{3}$(pi) rating reaffirmed on economic resilience and continuous reforms despite external challenges

RAM Ratings has reaffirmed China's respective $_{g}AA_{3}$(pi)/Stable and $_{sea}AAA$(pi)/Stable ratings on the global and ASEAN scales. The ratings are premised on the country's resilient economic performance, superior external strength and continued market reforms and liberalisation. These positives are, however, moderated by a highly leveraged economy, stretched government finances given China's accommodative fiscal stance to weather economic challenges, as well as substantial contingent liabilities. "While China's economy faces pressure from US trade protectionism, the government's strong policy capacity and firm commitment to growth will cushion potential shocks to the economy," notes Esther Lai, RAM's Head of Sovereign Ratings.

The country registered steady y-o-y GDP growth of 6.4% in 1Q 2019 amid ongoing trade tension that weighs on its exports performance and dampens domestic sentiments and economic activities. Economic growth weakened slightly to 6.2% in 2Q 2019 following long drawn-out China-US trade negotiations coupled with an escalation of tariff and non-tariff measures by both countries in May. This was evident in the marginally lower readings of leading indicators such as fixed asset investment, industrial production and retail sales during the April-May period, despite a minor pick-up in economic activity in June, backed by increased investment in infrastructure and advanced manufacturing. We expect additional policy support from the government to be forthcoming in stabilising GDP growth (1H 2019: 6.3%) within the official targeted range of 6.0%-6.5% for 2019 (IMF forecast: 6.2%), should trade friction persist or heighten.

China's current account surplus had narrowed to 0.4% of GDP in 2018 owing to economic rebalancing and trade protectionism. The country's current account performance faces downside risks this year, greatly hinging on the progress of trade negotiations which remain protracted. Nonetheless, hefty foreign reserves (the world's largest at USD3.1 tril or 22.9% of GDP in 2018) serve as a solid buffer against potential external deterioration, providing robust financing of 14 months of current account purchases and 2 times coverage of short-term external debts.

The country's total outstanding credit amounting to 224.5% of GDP in 2018 is still elevated compared to major developing peers'. That said, China's broader financial deleveraging objective, entailing more stringent supervision of financing activities, had slowed aggregate financing growth to 9.8% in 2018 (2017: 12.0%) and reduced total outstanding shadow financing to 27.0% of GDP as at end-2018 (end-2017: 32.9%). We view sustained measures to curb excessive credit growth and shadow financing activities as critical in alleviating financial risks.

The government's fiscal deficit is projected by the IMF to widen to 6.0% in 2019, with its debt level rising further to 55.4% of GDP owing to expansionary policies and ongoing reforms. China's light interest servicing burden and domestic funding flexibility accord considerable policy space and underpin fiscal sustainability. While government-linked entity (GLE) liabilities (134.1% of GDP as at end-2018) make up the bulk of the government's contingent exposure, the financial performance of most GLEs is healthy, exhibiting gradually declining debt ratios. Notwithstanding the difficulty in assessing contingent risks from local government (LG) off-balance sheet liabilities, the central government continues to restrict unconventional financing activities by LGs.

The following factors are deemed credit positive for China's ratings: sustained economic rebalancing that reduces the country's reliance on credit expansion for growth, continuous fiscal reforms to contain contingent risks by paring down GLE debts, and further improvement in LG fiscal management. Conversely, any exacerbation of China-US trade tension, which severely disrupts economic performance and rebalancing efforts, would be credit negative. Persistent fiscal deterioration and/or abrupt crystallisation of contingent exposures that substantially worsen government finances will also warrant a reassessment of the ratings, as would rapid credit growth which heightens financial risks.

Analytical contact
Cheong Kah Weng
(603) 3385 2617
kahweng@ram.com.my

Media contact
Padthma Subbiah
(603) 3385 2577
padthma@ram.com.my

Date of release: 18 July 2019

Media Release

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Published by RAM Rating Services Berhad

RAM Rating Services Berhad
(763588-T)

Level 8, Mercu 2
KL Eco City
No. 3, Jalan Bangsar
59200 Kuala Lumpur
Malaysia

T + 603 3385 2488
F + 603 3385 2582
E ramratings@ram.com.my
www.ram.com.my