March 2016

PANORAMA
CHINA CORPORATE PAYMENT SURVEY

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economist

Since 2003, Coface has been conducting annual surveys on business payment experience in China. In 2015, the average credit terms offered by China-based firms decreased again, reflecting a more prudent approach to granting credit facilities to customers. The overall payment experience in China deteriorated and remained very challenging in 2015. This can be seen from the over 80% of the survey respondents reporting overdue experiences, 58.1% with an increase in overdue amounts over the past year and 17.9% with ultra-long overdue amounts (over 180 days) exceeding 5% of their annual turnover. This is in line with the rise of non-performing bank loans, an increasing number of corporate defaults and the deterioration of business and investor confidence. Furthermore, private debt is still growing faster than GDP, with outstanding debts held by the private non-financial sector at 201% in June 2015.

There are growing concerns about the future trajectory of the Chinese economy, as reflected by the volatility in stock markets, capital outflows and pressures on the foreign exchange rate. A growing number of companies (57.9% in 2015, vs 48.4% in 2014) believe that the Chinese economic slowdown will affect their buyers' payment defaults in 2016. China's 6.9% GDP growth in 2015 was the lowest in 25 years, while Coface's forecast of 6.5% in 2016 would be another record. Momentum is on a downwards trend, due to the rebalancing process and low global demand. At the same time, businesses in China are facing increasing challenges, such as high leverage with steep costs of financing (despite monetary easing), low profitability driven by large overcapacities in certain sectors and volatility on the FX and stock markets. Monetary measures have not been very effective in 2015 and Coface expects more stimulus packages in 2016, as the Chinese authorities endeavour to avoid a *hard landing*.

The construction sector appears to be the most at risk and the situation is deteriorating rapidly. 28.3% of its credit sales in overdue are over by more than 150 days and 57% of the sector's respondents have more than 2% of their turnover impacted by overdues of more than 6 months[1]. Metals and IT report, respectively, 13% and 15.2% of overdue credit sales of more than 150 days – while telecoms are also under pressure. Some sectors are in better shape but even household spending related sectors, such as the retail and automotive sectors, are seeing a deterioration in their payment experiences.

[1] Coface considers collection of overdues that are '6-months and beyond' doubtful. Coface's experience shows that roughly 80% of these overdues are not repaid at all, if they are not paid after being overdue for 6 months. When the amount of these lengthy overdues exceeds 2% of a company's total annual turnover, the liquidity of these companies can be an issue and their ability to repay suppliers could be questioned.

MARCH 2016

CHINA CORPORATE PAYMENT SURVEY: ONLY A FEW SPARED

BY OUR ECONOMIST

CHARLIE CARRÉ
Economist
Based in Paris

« Corporate payment experience in China remained weak in 2015. Chinese firms suffering from overcapacity and low profits have a higher probability of default. »

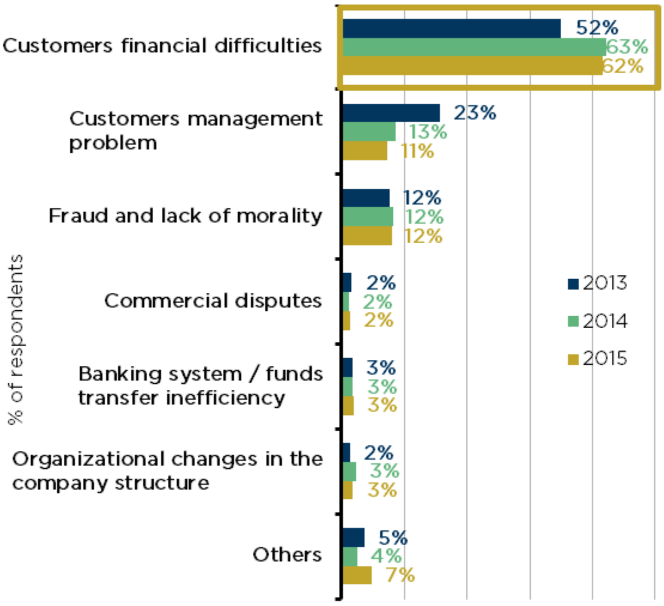
1 PAYMENT SURVEY BACKGROUND

With a primary focus on credit environment and risk management in business practice, the questionnaire was circulated to companies during October and November 2015. We received valid responses from 1,000 China-based companies that are engaged in either manufacturing (75.6%) or trade (24.4%) businesses. These companies are involved in a range of industries. The industrial machinery & electronics and chemicals sectors, which represent, respectively some 27.9% and 11.8%, are the most represented in the survey (see appendices 1).

As the majority of surveyed companies (89.2%) shared that they have adopted credit sales in their business practices, overdues and default payments are key risk factors that could potentially influence their profits. As in previous years, the situation of overdue payments is primarily driven by "customer financial difficulties" (62.4% of respondents) which are in turn increasingly led by "fierce competition impacting margins" (46.9%) and "lack of financing resources" (18.1%). A growing number of companies (57.9% in 2015, vs 48.4% in 2014) believe that the Chinese economic slowdown will affect their buyers' payment defaults in 2016.

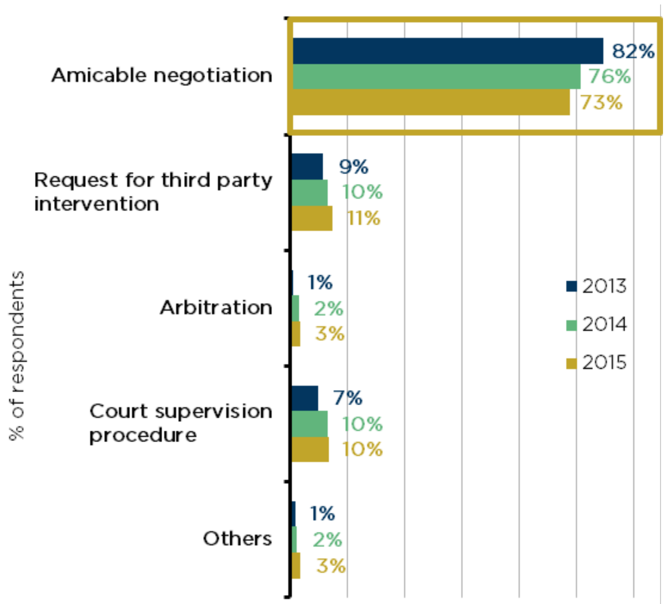
As concerns solutions for non-payments, the majority of surveyed companies (73.4%) continue to believe that amicable negotiation is the most effective tool. It is, however, noteworthy that there is a growing trend of recourse to other procedures, including those relating to the legal system. 43.9% of the survey's respondents consider that the legal environment in China has improved over the last year (37.3% answered "unchanged"). These responses may indicate that the efforts made by top policymakers to address legal reforms have seen positive results.

Graph 1:
Main reason for overdue account



Source: Coface Survey 2015

Graph 2:
Most effective action in case of non-payment



Source: Coface Survey 2015

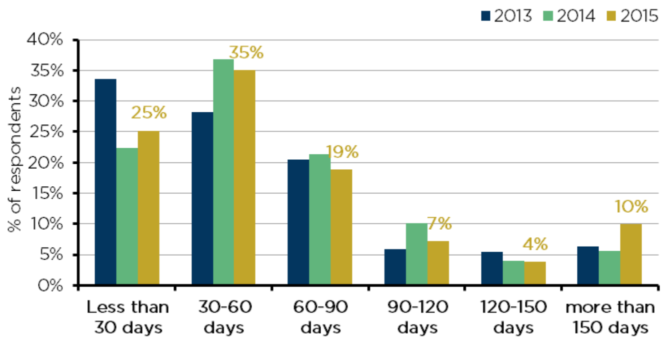
2 CORPORATE PAYMENT EXPERIENCE IN 2015

Companies have again been more prudent in 2015 but risks have continued to increase

In 2015, the average credit terms offered by China-based firms decreased again, reflecting a more prudent approach to granting credit facilities to customers. This is most probably the combined result of weak payment experience in recent years, deterioration of confidence and slower growth expectations.

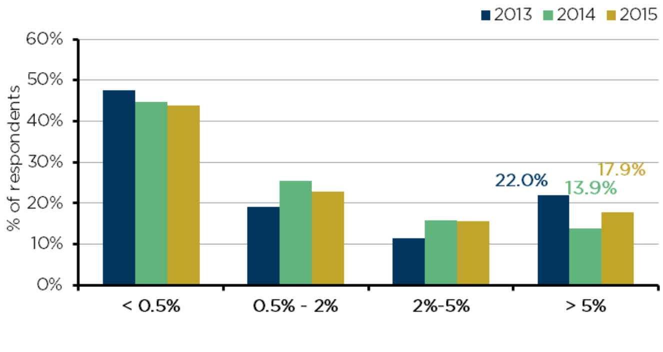
Nevertheless risks have increased, with 80.6% of respondent companies experiencing overdues in 2015 (vs 79.8% in 2014). 58.1% of these firms have also reported an increase in the amount of overdues. A higher percentage of respondents (+4 percentage points, i.e. 10% of total) said that average overdue periods have been longer than 150 days. 17.9% of surveyed companies have had to deal with ultra-long overdue amounts (of more than 180 days) exceeding 5% of their annual turnover. The rise of ultra-long payments is putting increasing pressure on company financials.

Graph 3:
Average overdue days of domestic / export sales



Source: Coface Survey 2015

Graph 4:
Percentage of ultra-long overdue amounts (more than 180 days) in domestic/export annual turnover



Source: Coface Survey 2015

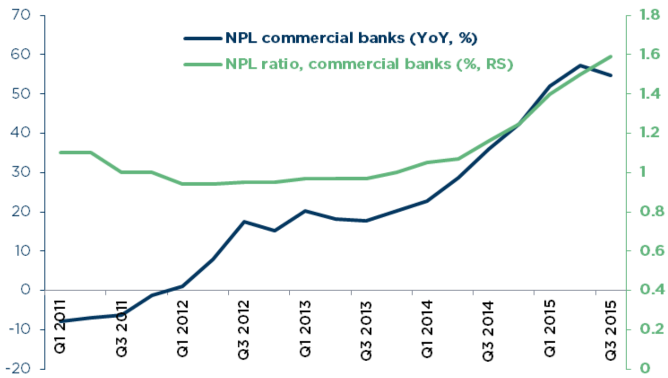
Corporates facing rising challenges

Despite more prudent credit extension practices in 2015, payment experience remained weak and corporates continued to face challenges. As in 2014, this results from the lack of financing resources and the high cost of financing for small-and-medium enterprises (SMEs) - as reduced profitability within the banking sector is tightening liquidity for the weakest corporates. Low profitability (led by the oversupply situation in certain industries), is also negatively affecting payment experience and the current slowdown has hurt the cash flows of Chinese companies.

Beyond the results of this survey, the Chinese economy as a whole is being affected by a deterioration in credit risk - as expressed by the decisions of the three main credit rating agencies, in January 2016[2], to add more Chinese companies to their watch lists for downgrades.

This is in-line with the non-performing loan (NPL) figures released by the China Banking Regulatory Commission. The NPL ratio reached 1.59%, as of the end of 2015, its highest level since 2009 (compared to 1% in 2013). NPLs rose by more than 50% in the first three quarter of 2015. In this context, the risk of rising non-payments should not be underestimated.

Graph 5:
Non-performing loans are rising



Source: CBRC

[2] In January 2016, S&P placed 15% (up from 8% last year) of its rated portfolio on watch for downgrade (240 Chinese companies are rated). Fitch placed 12% of its portfolio on watch (up from 7.4% a year ago).

Bond finance is developing rapidly in China, while bank lending is slowing. Despite the introduction of a real risk of bankruptcy, with significant defaults since 2014, China's bond default level is still low by international standards. There is a system of implicit state guarantees covering financial corporates and big corporates (especially, but not exclusively, SOEs). Given the goal of maintaining social stability, all companies that are sufficiently important for the local economy (and in particular for employment) can benefit from this type of implicit support and receive "mispriced" funds.

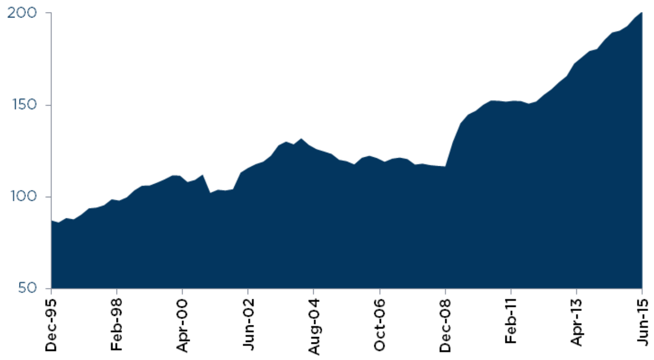
Nevertheless, firms that are suffering from overcapacity and low profits now have a higher probability of default, since the government has decided to tackle overcapacity and 'zombie' companies[3]. Reforms of SOEs[4] will also add pressure to credit risks, although according to the IMF[5], they may raise potential growth. The IMF has measured the combined effect of liberalising deposit interest rates and removing implicit guarantees (which has, so far, been partial). This would lead to a more efficient allocation of capital and higher GDP growth, by reducing the role played by less efficient companies in the economy. GDP would rise by around 1% and Total Factor Productivity by 3%. Such reforms would also make it possible for SMEs to obtain cheaper funds.

No deleveraging so far

Even though credit growth is slowing, private debt is continuing to grow faster than GDP. China has not yet entered a deleveraging process and the risks are increasing. Outstanding debt held by the private non-financial sector reached 201% of GDP in June 2015, compared to 114% in June 2008 and 176% in June 2013.

In January 2016, *Total Social Financing*[6] and new RMB loans both reached all-time highs. Nevertheless, private debt to GDP ratio is now growing at a slower pace.

Graph 6:
Debt to Chinese private non - financial sector (% GDP)



Source: BIS

According to credit rating agency Standard&Poor's, the credit risk China faces is generating a systemic risk[7]. The market has priced this risk with CDS (Credit Default Swaps[8]) surging to a 4 year high, highlighting investors' fears.

Graph 7:
China's sovereign 5Y Credit Default Swap

Source: Thomson Reuters CDS

[3] According to the official Xinhua News Agency (January 2016), China's top state-owned asset administrator has vowed to clean-up the country's so-called 'zombie' companies, which are unproductive and usurp resources, by 2020 (these companies are mainly state-owned).

[4] Important reforms include accelerating the increase in dividend payments, ensuring dividend flows to the budget (rather than being recycled to other SOEs), eliminating direct and indirect subsidies for factor costs (land, energy, and capital), strengthening governance and improving commercial strategy.

[5] Financial Distortions in China: A General Equilibrium Approach - Anzoategui, Chivakul, and Maliszewski, IMF Working Paper, December 2015

[6] Since 2011, the PBoC has defined Total Social Financing (TSF) as an overall indicator of financing. It includes bank loans (in FX and RMB), trust and entrust loans, bank acceptance, corporate bonds and stocks of non-financial corporations.

[7] "While corporate financial risks are not as high as the leverage level suggests - as companies tend to hold a lot of liquid assets - the increase in the debt-to-GDP ratio still poses a systemic risk, which could potentially add pressure to ratings" said Mr Kim Eng Tan, senior director of Asia-Pacific sovereign ratings at S&P, during an interview.

[8] A credit default swap is a particular type of swap designed to transfer the credit exposure of fixed income products between two or more parties. CDS prices are a good measure of the probability of default.

3 2016 – ADJUSTMENT PROCESS IS STILL UNDERWAY

Coface assessments	Country risk A4 (downgraded from A3 in June 2015)	Business climate B

Main economic indicators	2013	2014	2015(f)	2016(f)
GDP growth (%)	7.7	7.3	6.9	6.5
Inflation (yearly average) (%)	2.6	2.0	1.5	1.8
Budget balance (%GDP)	-1.1	-2.1	-2.3	-3.0
Current account balance (%GDP)	2.5	1.7	2.4	3.3
Public debt (%GDP)	39.4	41.1	43.2	46.0

(f) : forecast

"New normal" = rebalancing + slowdown of the economy + tough challenges

There are growing concerns about the future trajectory of the Chinese economy - as reflected by the volatility in stock markets, capital outflows and pressure on the foreign exchange rate (see box 1). China is experiencing a slowdown in key pillars of its economy, such as construction and manufacturing. Slower growth is necessary to rebalance the economy towards consumption and services, and to reduce vulnerabilities. Chinese policy makers acknowledge that this rebalancing is much-needed in order to reinvent the Chinese model. China is thus now adjusting to a 'new normal[9]' of slower growth, in a context of sluggish world demand[10]. Potential growth is declining[11] and the 'old China' model has created imbalances (notably a high level of debt and zombie companies with large overcapacities).

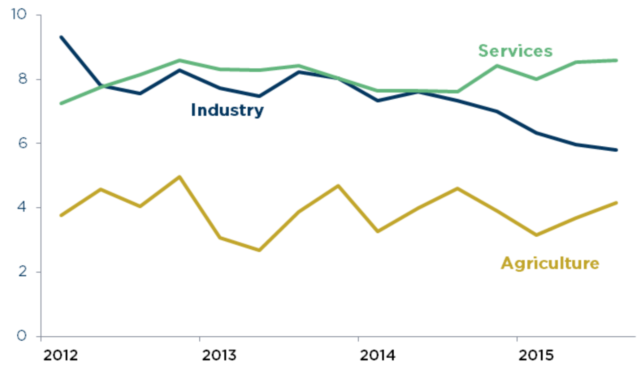
The authorities are implementing reforms needed to rebalance growth in favour of consumption and services. Despite the positive effect in the medium term, this rebalancing has had some short-term negative effects and generated tough challenges for companies, by hitting profits and exacerbating credit risk. Prime Minister Li has acknowledged that "downwards pressure on China's economy is intensifying"[12].

Rebalancing, really?

The rebalancing from industry towards services is underway. As of 2015, services now represent over 50% of GDP. The growth of the services sector is much higher than that of industry (8.6% vs 5.8% in Q3 2015). This is partly due to the growing contribution of financial services up until Q1 2015. Since June 2015, the stock market correction has had an impact on the development of financial services (notably "margin finance"[13]). The growth of financial services is likely to moderate in the quarter ahead. Interest rate liberalisation means that bank revenues are also under pressure. However, growth of services should remain dynamic in 2016 thanks mainly to the development of leisure services, e-commerce, and healthcare services. This will sustain GDP growth, with FDI inflows increasingly directed towards services.

Graph 8:

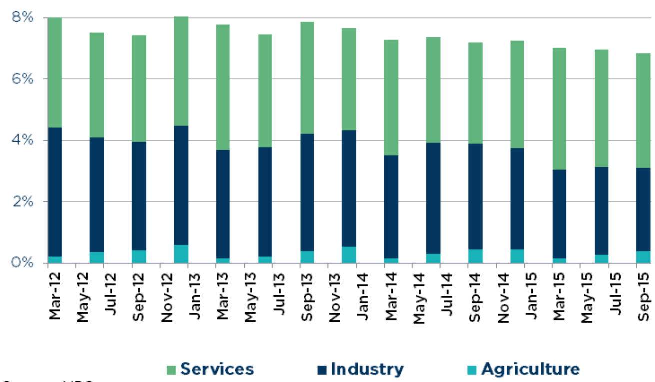
Quarterly GDP growth by sectors (%, YoY)



Source: NBS

Graph 9:

Quarterly sectorial contribution to growth



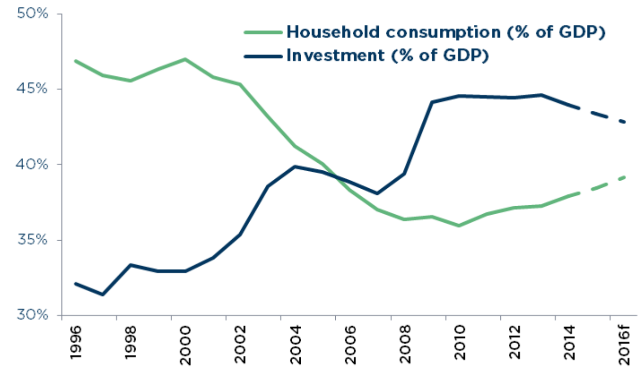
Source: NBS

9 The concept of 'new normal' was expressed for the first time by the PM, Li, during a speech in Davos in February 2015. He stated that the country had "entered the stage of the new normal, shifting from high speed to medium-to-high speed"
10 Coface forecasts that world GDP will grow by 2.7% in 2016 (vs 2.5% in 2015)
11 "Asia challenged by Chinese slowdown", M. Albert, C. Carré, J. Marcilly, P. Raso, September 2015, Coface panorama
12 Li Keqiang's speech at the opening of the annual session of the National People's Congress (March 5, 2015)
13 According to Goldman Sachs, margin financing (investors borrowing money to buy shares) in the market was equivalent to 3.5% of GDP in June 2015, "easily the highest in the history of global equity markets"

This structural rebalancing is also visible on the demand side toward household consumption. The process is underway but overall progress is relatively slow. Household purchasing power has greatly increased since 2010, with per capita disposable income for urban households doubled, thanks to wage increases. Household consumption, as a share of GDP, was on a downwards trend until 2010. Since then, it has gained 2.5 GDP points. Constraints can be seen with the deterioration of consumer confidence and high saving rates related to a lack of social protection but loans to households are dynamic (+21% in 2015). Overall, growth in household consumption will continue and the rebalancing process will go on, albeit very gradually. Even if household consumption slows down, its share of GDP would still rise, as investments will decelerate faster.

Graph 10:

Consumption and investment



Sources: NBS, IIF

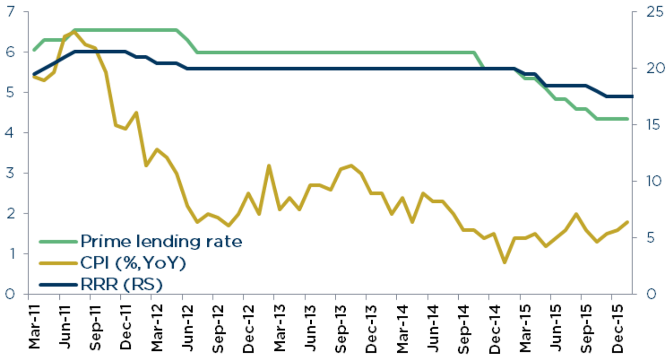
Economic policy is caught between two fires

The government's strategy is ambiguous and the authorities are caught between two fires. They need to find a balance between, on one side, supporting GDP growth to prevent a 'hard landing' and to protect jobs, while on the other side managing the debt bubble risk. This is complex, as the Chinese economy is suffering from a combination of excess capacity and high debt, within an environment where GDP growth has slowed markedly. Risks are more from policy errors and inconsistencies, rather than policy inaction.

On the monetary side, the People's Bank of China (PBoC) initiated an easing cycle in November 2014 and has since cut the prime lending rate 6 times (165 bp), lowered banks' required reserve ratio (RRR) 5 times (-300bp) and injected liquidity into the economy (1.5 trillion RMB in January 2016, via different tools). Nevertheless, monetary easing measures have not been very effective thus far. Chinese corporates are already highly indebted and are still experiencing rising financing costs, in real terms, as inflation slows below the central bank's target (3%). In 2015, fewer companies considered that "Tightening monetary policy and access to credit" would affect their buyers' payment defaults over the coming year (see appendice 2). Further easing episodes are expected in 2016, but the PBoC will be careful to avoid adding incentives for capital outflows, given the downward pressures on the currency. Beijing will most probably use budgetary tools and there are expectations and announcements related to development of public investments. The 13th Five Year Plan (FYP / 2016-2020), announced in November 2015, was finalised in March 2016. The government aims to double GDP and per capita income by 2020 (compared to the 2010 level). The Five Year Plan prioritises the growth of household consumption to attain a "moderately prosperous society". Xinhua (the official Chinese press agency) has announced that the budget deficit will again increase in 2016, to reach 3% of GDP (up from 2.3% in 2015), due to the country's proactive fiscal policy. Following the debt-funded stimulus of 2008-2009, China is no longer a low-debt economy. The country still has fiscal space, but less so than before. Public debt (including local government debt) will reach 43.2% of GDP in 2015, compared to 26.9% in 2010.

Graph 11:

Policy rates and inflation



Source: PBoC

Nevertheless the cabinet is trying to avoid the economic policy mistakes made in 2008-2009. In the wake of the Lehman crisis, it decided upon massive stimulus measures. As a result, growth was very resilient in 2009 and 2010 (at 9.2% and 10.4% respectively). However, this huge monetary stimulus also resulted in the strong acceleration of credit growth, the build-up of asset bubbles and high amounts of corporate debts.

Today, Chinese policy makers are communicating on reforms and emphasising the need to tackle overcapacity. President Xi Jinping has announced that China aims to cut overcapacity in the steel industry. By 2020, they plan to reduce crude steel capacity between 100 and 150 million metric tons (13% of existing capacity[14]). Cuts of this scale are likely to have a massive impact on employment, even though one of Beijing's goals is to protect jobs.

In the meantime, the authorities are supporting growth through monetary and budgetary policies. Rebalancing could mean finding the equilibrium between growth support and reforms. This will require fine tuning.

[14] China Iron & Steel Association

4 SECTORIAL ANALYSIS : NO ONE SPARED

Sector	Overdue experience* vs. 2014	Coface barometer**
Automotive and transportation	Stabilised	🟠
Chemicals	Deteriorated	na
Construction	Deteriorated	🔴
Household electronics	Deteriorated	🟠
Industrial electronics	Deteriorated	🟠
IT-telecoms	Deteriorated	🟠
Metals	Deteriorated	⚫
Paper-wood	Improved	🟠
Pharmaceuticals	Improved	🟢
Retails	Deteriorated	🟢
Textile clothing	Deteriorated	🔴 ↘
Total	Deteriorated	

*Lengh of overdue of more than 150 days (in % of total credit sales)

**Coface's assessments are based on the financial data published by listed companies. Our statistical credit risk indicator simultaneously summarises changes in 4 financial indicators: turnover, profitability, net indebtedness and cash flow, completed by the claims recorded though our network. This barometer refers to Emerging Asia but China is overrepresented in the indicator

🟢 Low risk 🟠 Medium risk 🔴 High risk ⚫ Very high risk

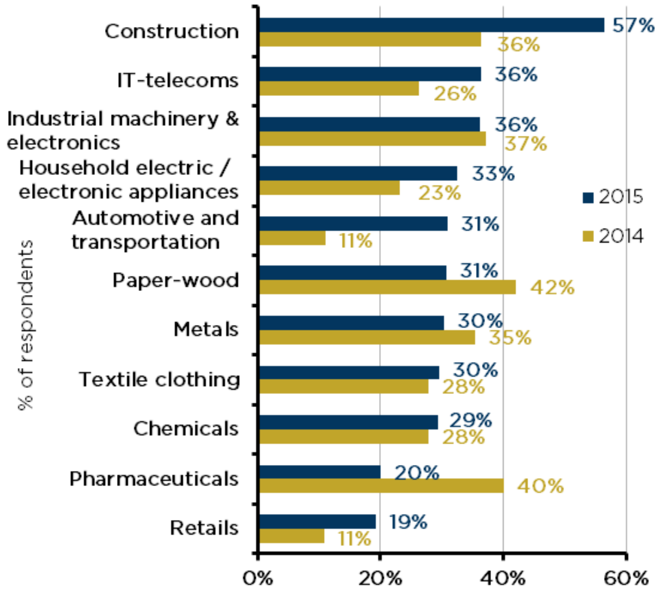
↗ The risk has improved ↘ The risk has deteriorated

Growing risks in the construction sector

With 57% of the respondents from the construction industry having more than 2% of their turnover impacted by overdues of more than 6 months[15], this sector appears to be the most at risk. The situation has deteriorated significantly, as only 36% of respondents were in the same situation in 2014 (42% in 2013). In addition, 72% of the respondents from the construction sector saw an increase in the amount of overdues in 2015 and 28.5% of their credit sales are overdue by more than 150 days (vs 11.4% in 2014).

[15] Coface considers collection of overdues that are "6 months and beyond", doubtful. According to Coface's experience, roughly 80% of overdues are not repaid at all if they are not paid after being overdue for 6 months. When the amount of these lengthy overdues exceeds 2% of the total annual turnover of a company, its liquidity could become an issue, as could its ability to repay suppliers.

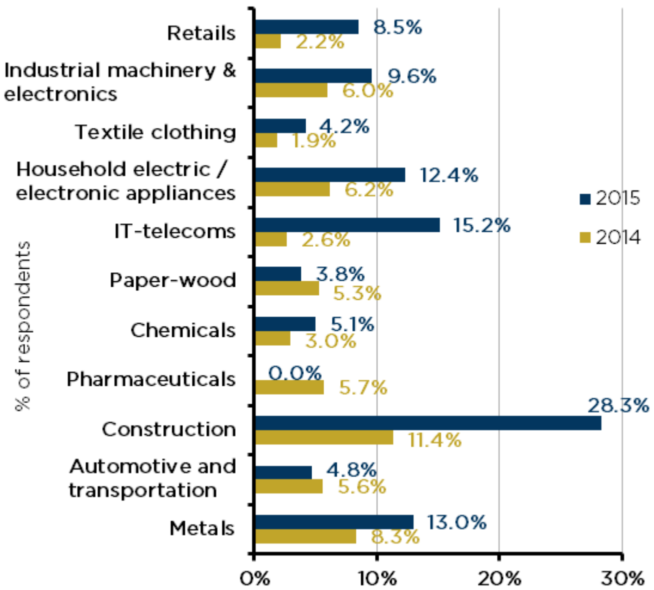
Graph 12:
Companies having more than 2% of their total sales in overdues of over 6 months, per sector



Source: Coface Survey 2015

Graph 13:

Overdues of more than 150 days (% of credit sales)

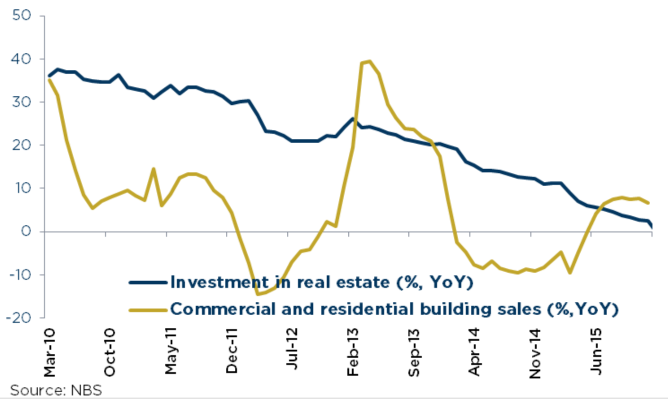


Source: Coface Survey 2015

2015 was, again, a challenging year for the construction sector. The property market faced headwinds, headlined by the slowdown in demand and investment appetite. Following years of massive investments, China's housing market is facing significant overcapacities. In 2015, real estate investment decelerated sharply and sales were also on a declining trend, before rebounding at the end of the year. The relaxation of prudential measures for household loans, in addition to monetary stimulus, may have had a positive impact.

Graph 14:

Difficult path for the real estate sector



Source: NBS

As the construction sector also relies on infrastructure developments, it should benefit from the expansionary measures being taken by the authorities and the *One Belt One Road*[16] *(OBOR)* initiative. Among many other goals, the OBOR initiative is a way to increase infrastructure investments overseas, thus using overcapacities.

In summary, the construction sector will continue to be at risk in 2016, but it should benefit from positive developments.

Metals are still risky

Albeit still risky, the metals sector has seen a decrease (-5 percentage points) in respondents reporting more than 2% of their total sales in overdues of over 6 months. However it is facing increasingly longer payment delays, with overdues of more than 150 days accounting for a growing share of credit sales. This ratio now stands at 13% (vs 8.3% in 2014).

The sector is facing challenges, with subdued demand and significant overcapacities. Many investment projects were initiated after the turn of the century to meet demand from emerging countries, mainly from China. In just 10 years, the country has become the largest global consumer and producer of the main base metals such as nickel, aluminium, zinc and lead. Due to the slowdown in domestic demand (mainly linked to weak investments in real estate and deceleration of growth in car sales), China has been flooding the world with its steel exports since early 2014. This has intensified the downwards pressure on metal prices.

Chinese metals exports should gradually decline in 2016. During the year, the Chinese authorities will reduce their steel production capacities and their refining capacities for copper, zinc and nickel.

IT and telecoms: a difficult path

IT-telecoms is another of the most-at-risk sectors, with increasingly longer payment delays. Overdues of more than 150 days now account for 15.2% of their credit sales (vs 2.6% in 2014).

China's IT sector is facing rising challenges. After years of double digit growth, Smartphones sales are now stagnating. In 2015, smartphone sales (in terms of units) grew by only 0.5% (vs 20% in 2014). The market has reached maturity, or at least an intermediate phase. Beijing-headquartered Xiaomi Inc, the world's 4th largest smartphone manufacturer, missed its 2015 sales target of 100 million, with only 70 million units sold.

The electronics market is becoming increasingly competitive, with new players. In 2016, the electronics industry may be hurt by the depreciation of the RMB, as it relies on imports of microchips.

Some sectors are in a better shape, while the retail and automotive industries are seeing deterioration of their payment experiences

Several sectors saw less respondents reporting more than 2% of their total sales in overdues of over 6

[16] First introduced in late 2013 by President Xi, it aims to build up China's regional and global presence, through outward direct investments in 65 countries.

months. This is the case for paper-wood (-9 points) and pharmaceuticals (-20 points).

The retail sector is still the least risky sector in terms of long overdues, but the situation is deteriorating (+8 points). The automotive and transport sector also shows a rise in the percentage of respondents reporting the same trend (+20 points).

Shorter average credit terms offered in almost all sectors

In 2015, average credit terms offered by China-based firms decreased again. This reflects a more prudent approach in granting credit facilities to customers - most probably the result of weak payment experience in recent years, deterioration of confidence and slower growth expectations. However, these shorter credit terms could generate downside risks for buyers, by weakening their cash positions.

On a sector by sector basis, paper-wood, construction, metals and IT-telecoms are all facing significantly longer average credit terms, with a progression in credit terms of more than 120 days.

Table 1: Average credit term offered

	30 days	Var*	60 days	Var*	90 days	Var*	120 days	Var*	more than 120 days	Var*	Less than 60 days	Var*
Automotive and transportation	20.0%	-0.9%	36%	-10.5%	34%	13.1%	4%	-0.7%	6%	-1.0%	56.0%	-11.4%
Chemicals	33.3%	-2.7%	40.7%	7.4%	17.6%	-5.8%	5.6%	0.2%	2.8%	1.0%	74.1%	4.7%
Construction	20.4%	-19.2%	24.5%	1.6%	32.7%	1.4%	4.1%	2.0%	18.4%	14.2%	44.9%	-17.6%
Household electric / electronic appliances	33.3%	1.3%	38.4%	-1.6%	23.2%	-2.1%	1.0%	-0.3%	4.0%	2.7%	71.7%	-0.3%
Industrial machinery & electronics	21.1%	-9.8%	42.5%	11.2%	24.3%	0.0%	4.5%	-0.1%	7.7%	-1.4%	63.6%	1.4%
IT-telecoms	44.7%	13.8%	15.8%	-17.5%	23.7	-7.3%	5.3%	2.9%	10.5%	8.1%	60.5%	-3.8%
Metals	30.6%	-3.8%	42.9%	1.9%	14.3%	-7.0%	2.0%	0.4%	10.2%	8.6%	73.5%	-1.9%
Paper-wood	15.4%	-4.6%	46.2%	6.2%	26.9%	-13.1%	0.0%	0.0%	11.5%	11.5%	61.5%	1.5%
Pharmaceuticals	29.4%	7.8%	35.3%	2.9%	35.3%	-2.5%	0.0%	-2.7%	0.0%	-5.4%	64.7%	10.7%
Retails	55.8%	-3.9%	25.0%	-4.8%	13.5%	2.9%	1.9%	1.9%	3.8%	3.8%	80.8%	-8.7%
Textile clothing	42.0	-1.4%	35.8%	0.8%	18.5%	1.9%	0.0%	-3.3%	3.7%	2.0%	77.8%	-0.6%
Total	**30.4%**	**-3.9%**	**36.8%**	**2.4%**	**22.6%**	**-1.2%**	**3.1%**	**-0.1%**	**7.1%**	**2.8%**	**67.2%**	**-1.5%**

*Variation 2015 vs. 2014 (in percentage points)
Source: Coface

Box 1

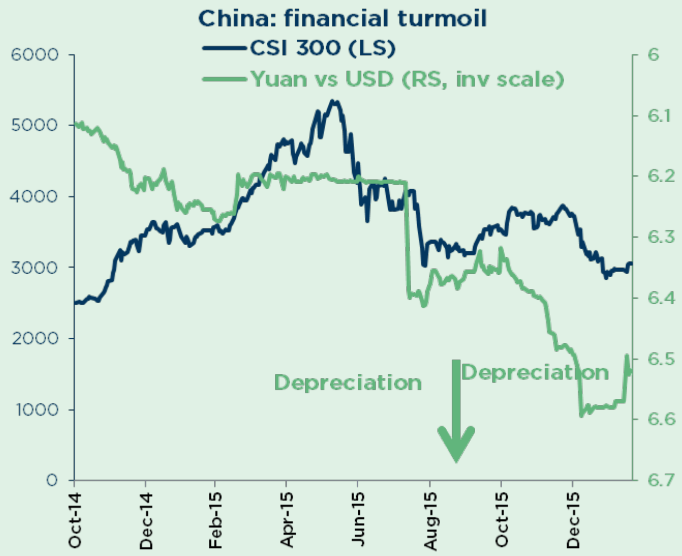
Foreign exchange and stock market volatility

The Chinese stock market has recorded a significant correction since June 2015. Shares were overvalued in a context of slowing growth. The authorities' decision to limit investor ability to buy stocks with borrowed money initiated the fall in share prices, as it was seen as a signal that Beijing's easing cycle was coming to an end. Following a rise of more than 110% between November 2014 (and a peak in June 2015), shares tumbled by more than 40% in less than 3 months, before firming up slightly. Since the beginning of 2016, Chinese markets have been experiencing a new episode of falls (-16% during the first week of January) and volatility.

At the same time, the yuan has recorded an unprecedented drop, to reach a 5-year low against the US dollar during the first week of January, despite interventions by the People's Bank of China.

This volatility is the result of disappointing economic indicators and the deterioration of business and consumer confidence. Uncertainties over government interventions in the FX and stock markets have also exacerbated downward pressures - such as the introduction on Monday 4 January of the controversial 'circuit breaker' mechanism that halts trading for 15 minutes after a 5% decline and closes the market for the day after a plunge of 7%. This mechanism was activated twice in a week, before being suspended on January 8. Markets have also been shaken by the authorities' flip-flop on the 6-month share-sale ban by large shareholders. Admittedly the stock market correction could be seen as a healthy development after such a sharp rally that was disconnected from corporates' fundamentals - but volatility and equity price deflation have generated additional risks. The heavy use of margin finance (investors borrowing money to buy shares) has increased credit risks and could exacerbate the downwards spiral. The impact on real activity has, so far, been limited, but new episodes of falls and volatility could affect household consumption. Unlike other large economies, retail investors (rather than institutional) dominate in China, with 80% of the market. Equities only represent a small portion of households' assets (between 5 and 10%).

Downward pressures on the yuan (-1.3% since the beginning of the year, despite PBoC interventions to keep the currency stable) are intensifying, due to stock market events and mixed messages from the authorities about whether they will be willing to let the yuan depreciate against the US dollar. On top of this, the yuan's valuation is suffering from capital outflows, worsened by worries about the Chinese economic slowdown. In August 2015, the PBoC surprised the market by lowering the benchmark exchange rate (by 1.9%). According to the central bank, this was the result of technical change. The currency continued to fall over the following days, leading to an accumulated depreciation of 3% in 3 days. In the meantime, the PBoC is using its FX reserves to attempt to support the currency (99 billion USD in January 2016). Nevertheless, China's real effective exchange rate has appreciated markedly since the beginning of its liberalisation in 2005 (+58%). In perspective, the Chinese currency has only depreciated by 4.4% in one year, while in comparison the Malaysian Ringgit has fallen by 16.7%, the Indonesian rupiah by 10.7% and the Thai baht by 10.4%. In addition, the country still enjoys comfortable FX reserves of more than 3.2 trillion USD, as of January 2016. According to the IMF's Reserve Adequacy Ratio, China's reserve needs to be between 1.1 and 2.8 trillion USD, depending on the currency regime. Even under the most extreme scenario (no capital control and fixed regime), China's reserves are still 117.5% above the recommended level.

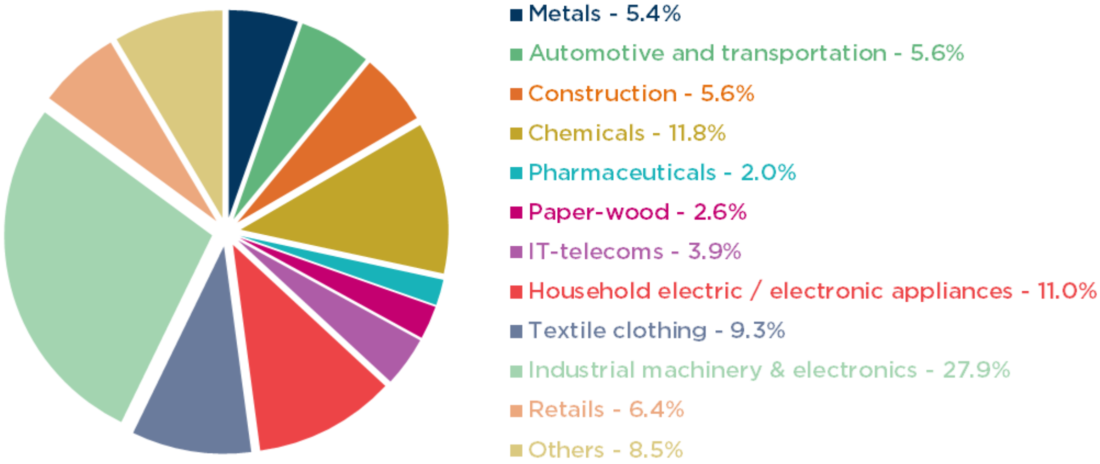


Source: China Securities Index Company, WM / Reuters
Last available data : 19/02/2016

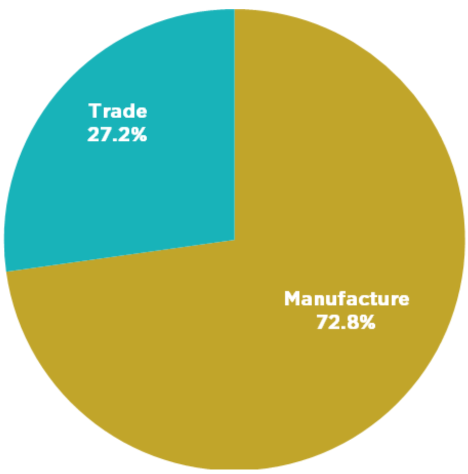
APPENDIX : CHARTS

1. OUR SAMPLE

- **Sectors of companies interviewed**



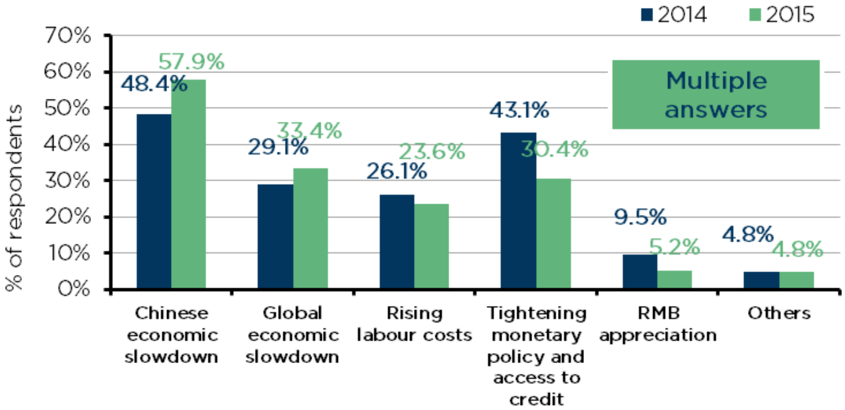
- **Main business activity**



APPENDIX : CHARTS

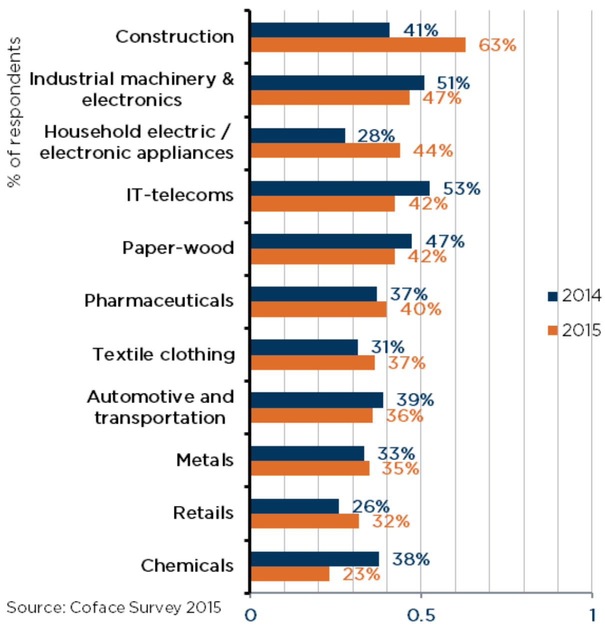
2. CREDIT SALES : OVERDUES

- **Which of the following you expect most affecting your buyers' payment default in the coming year?**



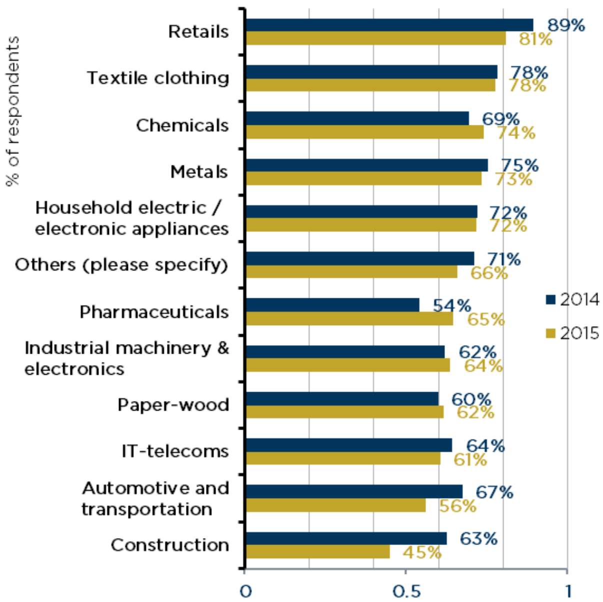
Source: Coface Survey 2015

- **Average overdue more than 60 days by sector**



Source: Coface Survey 2015

- **Average credit term less than 60 days by sector**



Source: Coface Survey 2015

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