

China's Macro-economy & Opening-Up

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October 21, 2019

Catalogue



China's macroeconomic performance

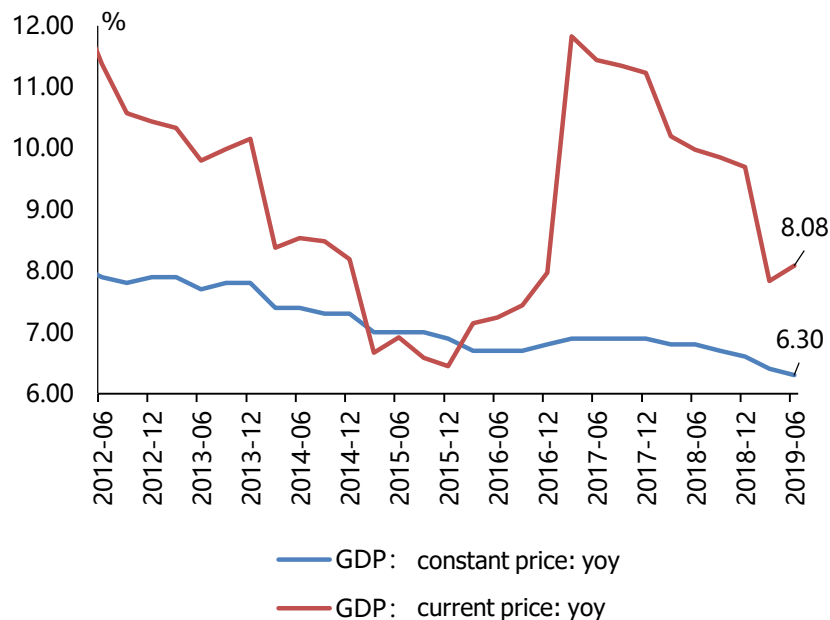
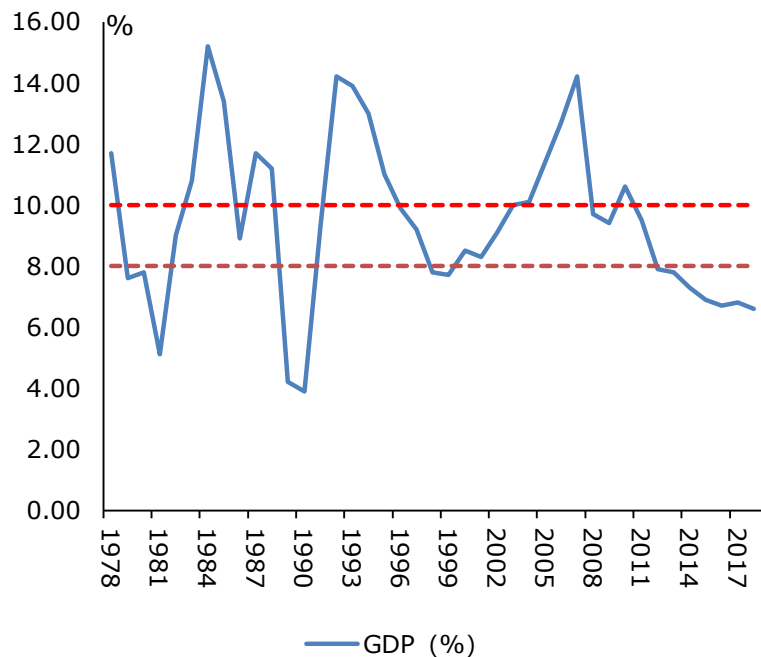


FDI & the opening up of China's capital market

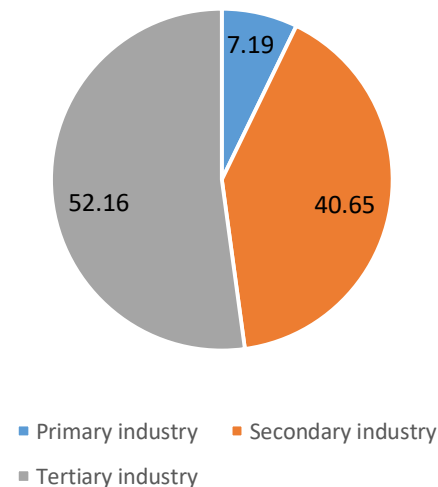
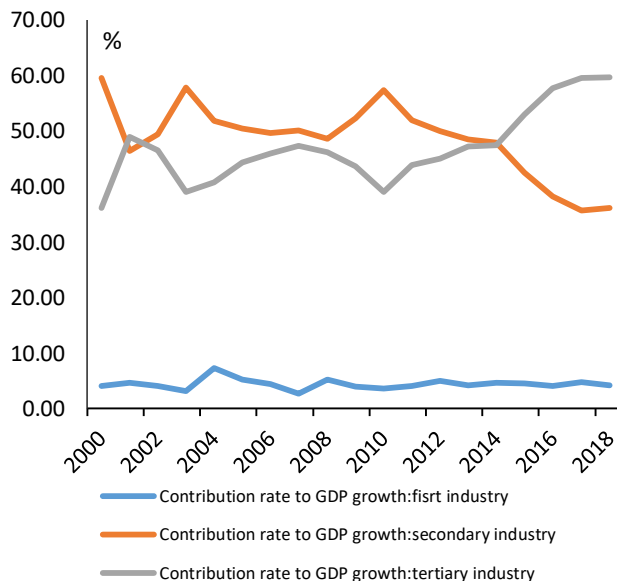
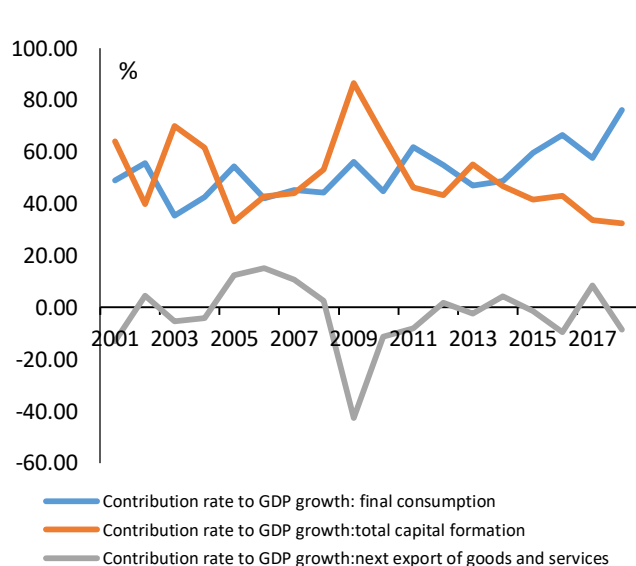


Prospects of China's economy and bond market

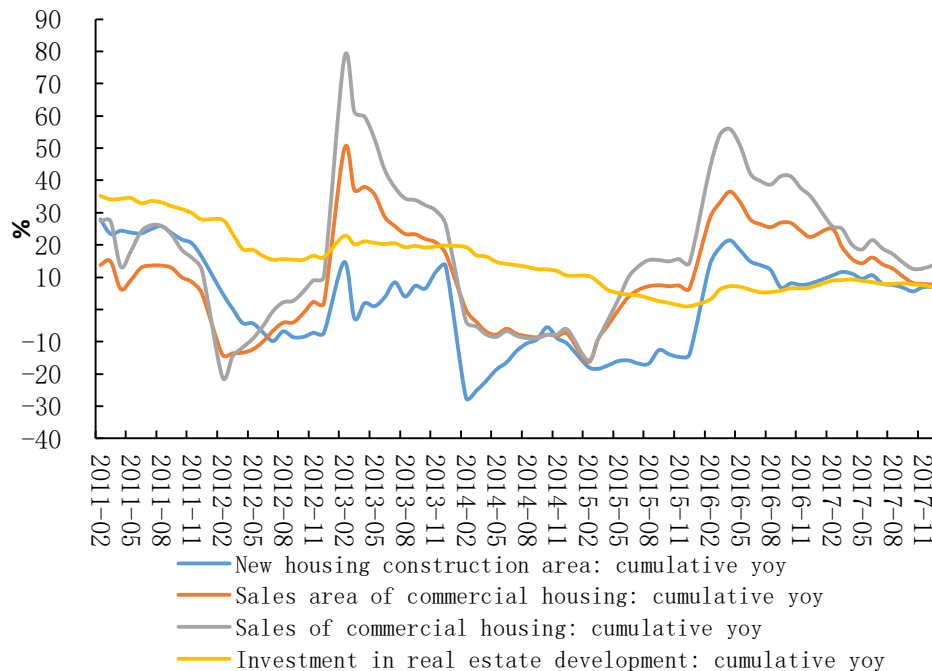
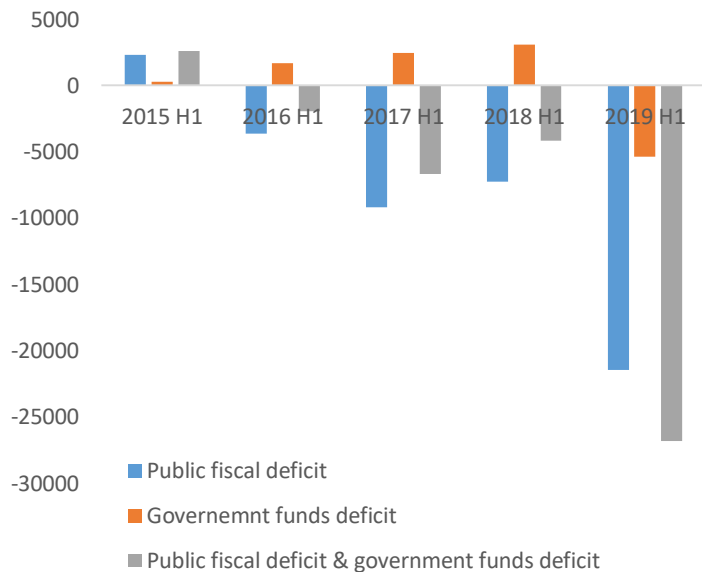
- China's economy has shifted from high-speed growth over the past three decades to medium- and high-speed growth, and has continued to decline so far this year.



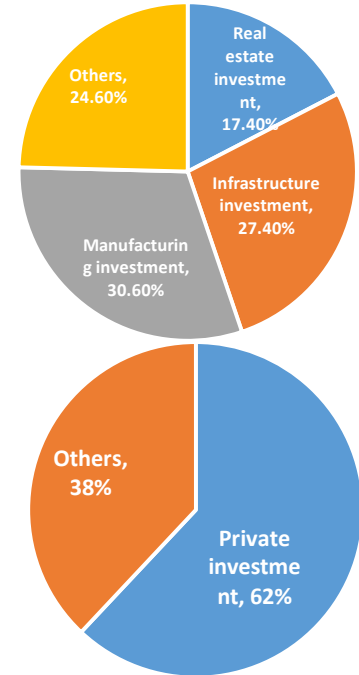
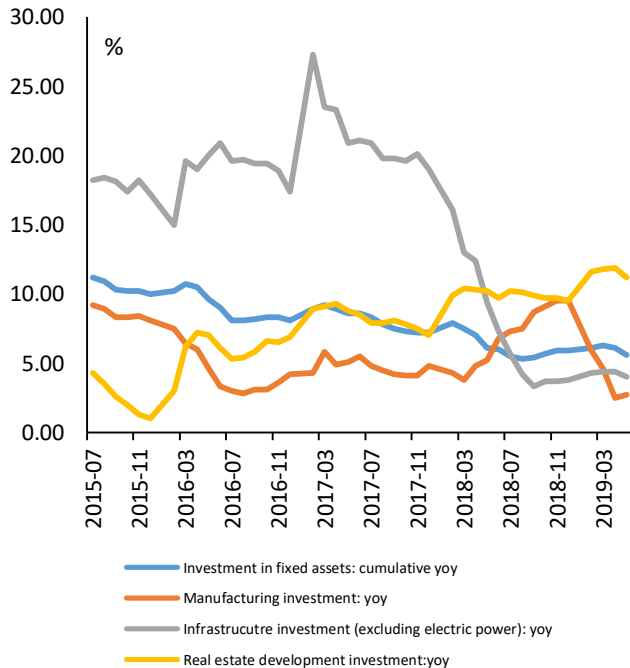
- China's economy has changed from external-demand-driven to domestic-demand-driven, and the service industry has become the main driving force of economic growth.



Investment growth will remain at a low rate.



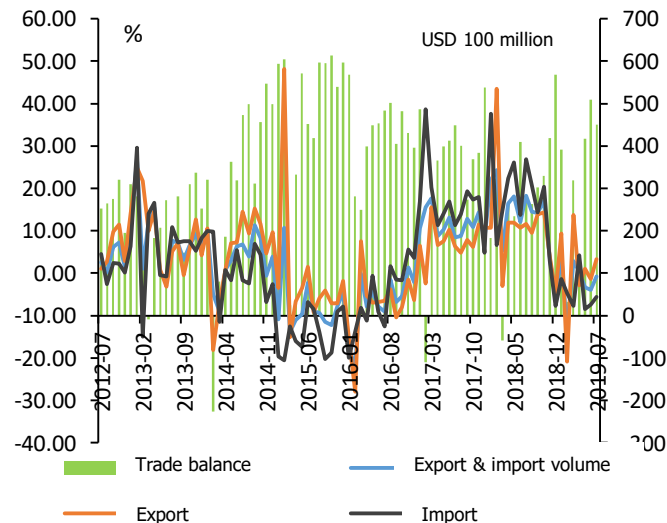
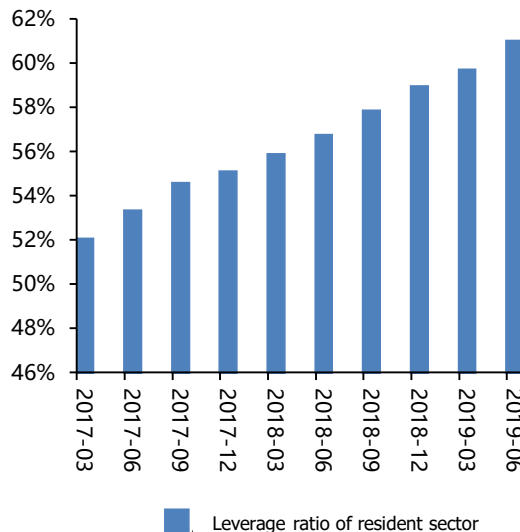
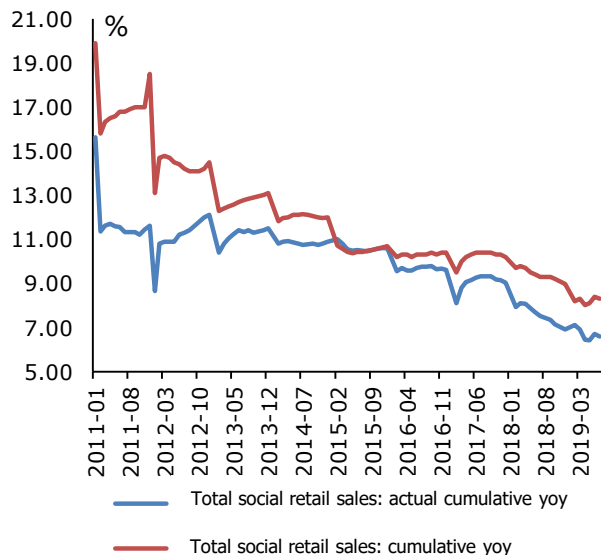
- Real estate and infrastructure investment bring certain support to total investment, while private investment and manufacturing investment are weak.



Note: 2017 data, in 2019, real estate investment increased 20%, and the proportion of infrastructure investment declined

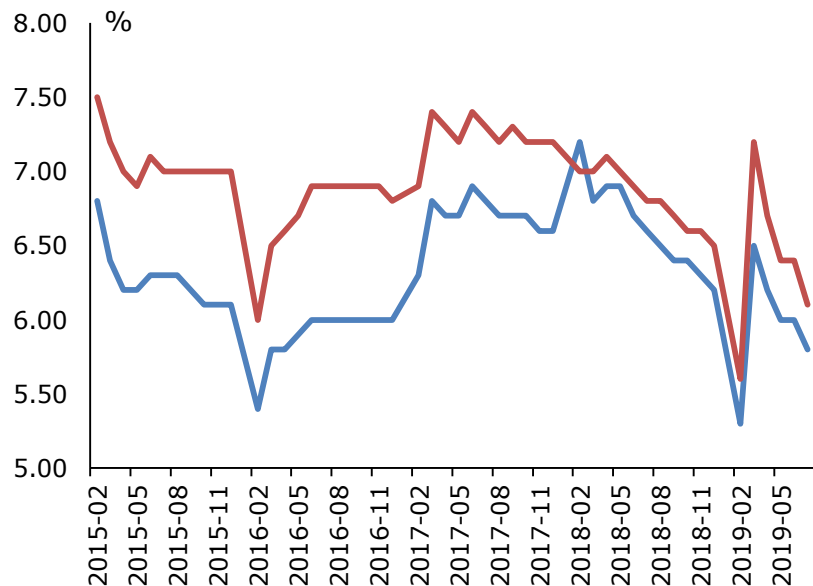
■ Household consumption is relatively low, and exports still face uncertainty.

- Significant improvement in consumption will be hard to record with leverage of the household sector remains high
- Although Sino-US trade friction showed signs of easing recently, in the short run, exports will remain sluggish because external demand stays weak and big power conflicts persist.

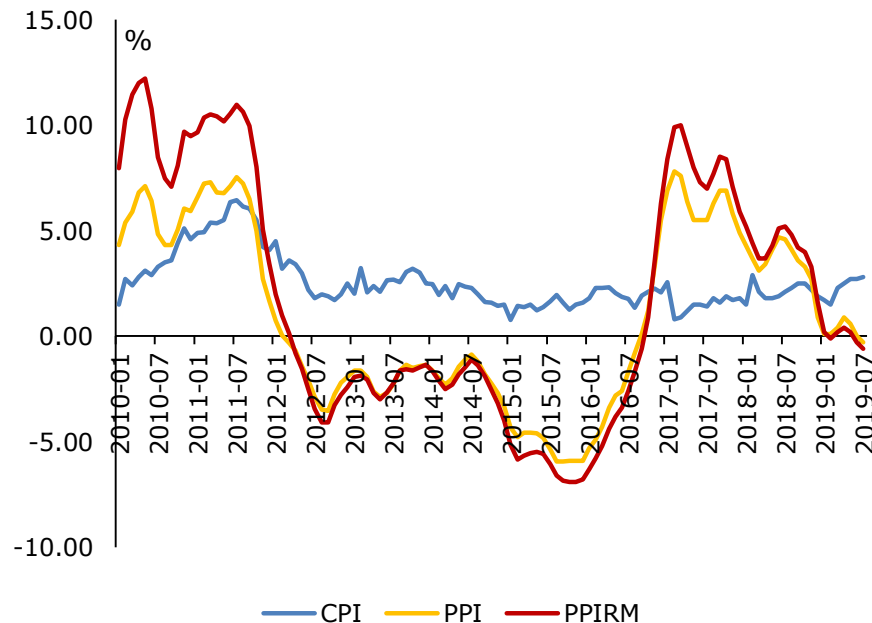
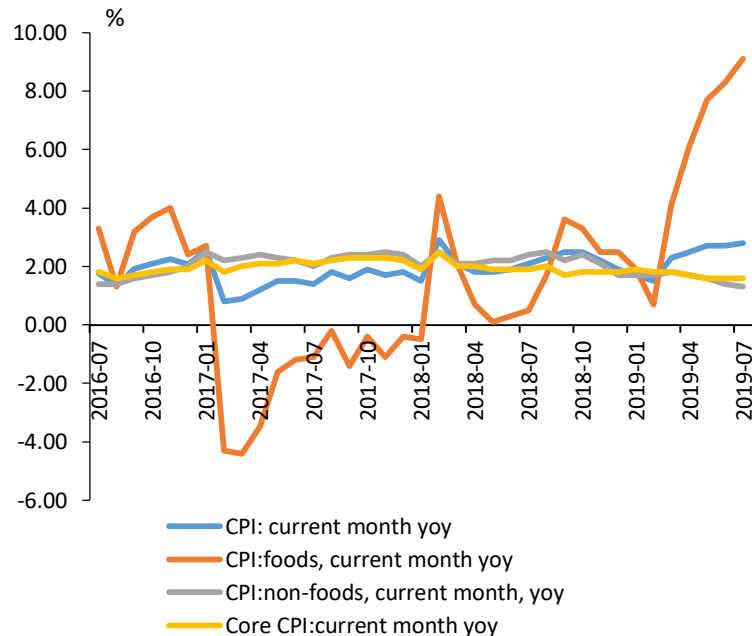




■ In the face of insufficient demand, production continues to slow down.



- Price trends are divided. CPI is affected by the price of vegetables and pork, while PPI is negatively growing.
- Overall inflation is still under control.



■ Current macro-economic policy: focusing on stable growth, but still paying attention to the balance of stable growth and risk prevention

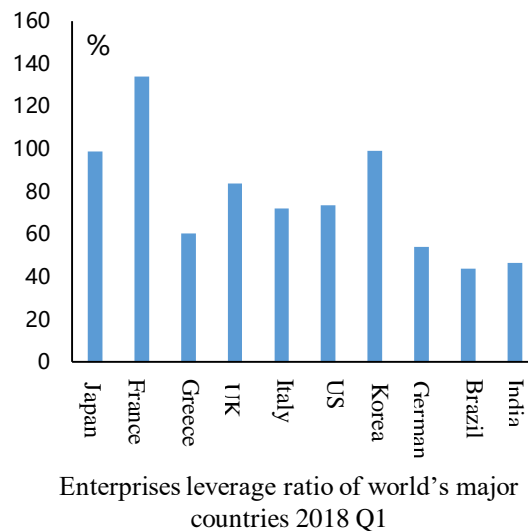
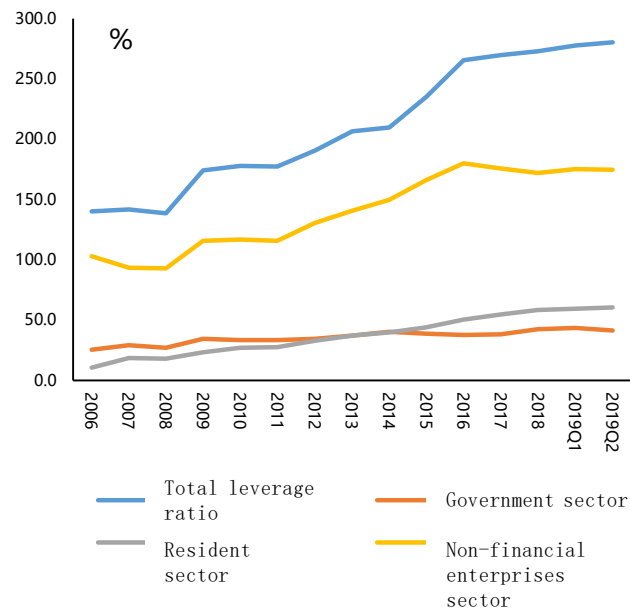
- Maintaining **prudent monetary policy** while keeping **marginal loose**, and strengthening **support to private enterprises**.
 - ✓ There have been six interest rate cuts since 2018, four of which have been structural, mainly to improve the financing problems of small and medium-sized enterprises.
 - ✓ Pump cash into the financial system through open market operations.
- Implementing more **proactive and effective fiscal policy**, and further reducing taxes and fees.
 - ✓ In 2019, on the basis of the tax reduction of about 1.3 trillion yuan last year, a further 2 trillion yuan tax reduction plan was put forward.
 - ✓ The amount of local special bonds increased to 2.15 trillion yuan in 2019 from 1.35 trillion yuan in 2018, and the broad fiscal deficit ratio (including special bonds) exceeded 5%.
- **Financial supervision** policy remains stable.
- Regulation on **real estate** remains strict, and won't use real estate as a means of economic stimulus.

■ As the economy slows, short-term risks shall not be ignored

- **Global economy** continues to weaken.
- **Sino-U.S. frictions** aggravate the external uncertainty of China's economic growth.
- IMF downgrades world economic growth forecast for 2019.

	Growth rate in 2019 (October forecast)	Growth rate in 2019 (April forecast)	Growth rate in 2018 (Real)
Global economy	3.0 ✓✓	3.3 ✓✓	3.6
Global trade	1.1 ✓✓	3.4 ✓✓	3.8
US economy	2.4 ✓✓	2.3 ✓✓	2.9
EU economy	1.2 ✓✓	1.3 ✓✓	1.9
German economy	0.5 ✓✓	0.8 ✓✓	1.5
Italian economy	0.0 ✓✓	0.1 ✓✓	0.9
France economy	1.2 ✓✓	1.3 ✓✓	1.7
UK economy	1.2 ✓✓	1.2 ✓✓	1.4
Japanese economy	0.9 ✓	1.0 ✓	0.8

- **Debt risk** remains, and the policy to support steady growth has led to another rapid **rise in macro leverage**.
- The leverage ratio of **non-financial enterprises** is highest globally, leverage of the **residential sector** continues to rise, and the **hidden debt risk of local governments** is prominent.

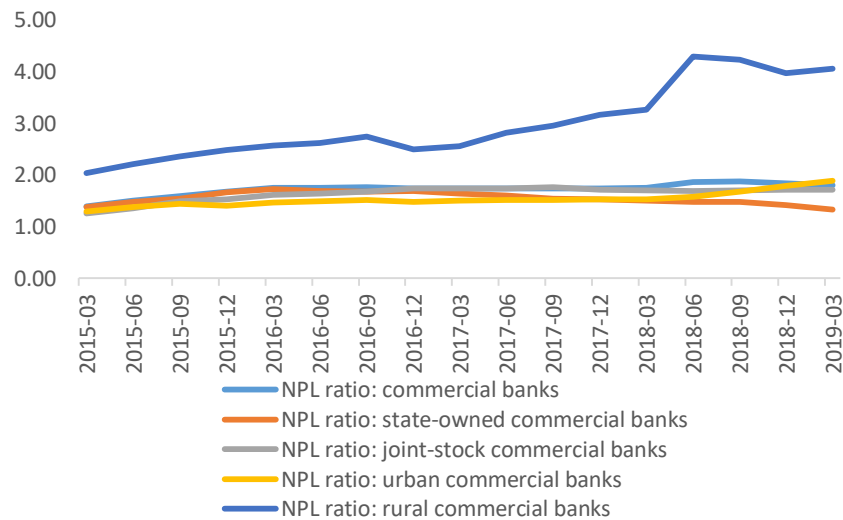


Implicit gov debt scale

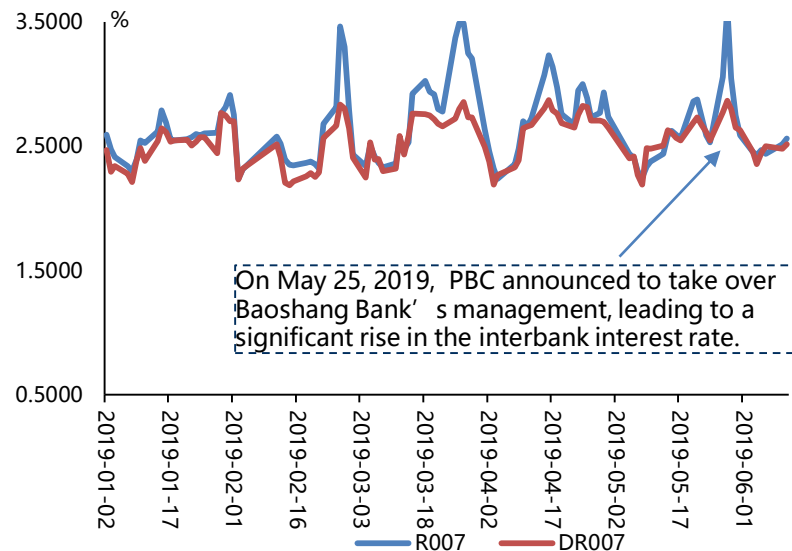
2018	Direct debt (trillion yuan)	Implicit debt (trillion yuan)	Implicit debt/direct debt
Statistical method I	18.39	40.11	2.18
Statistical method II	18.39	41.65	2.26
Statistical method III	18.39	31.85	1.73

- The quality of bank assets is divided, and the asset quality of **small and medium-sized banks** has deteriorated.

The risk of regional small and medium banks is prominent



Baoshang Bank's take-over increased the financial market fluctuations



Catalogue



China's macroeconomic performance



FDI & the opening up of China's capital market



Prospects of China's economy and bond market



■ Opening-up dividends contributed in a profound way.

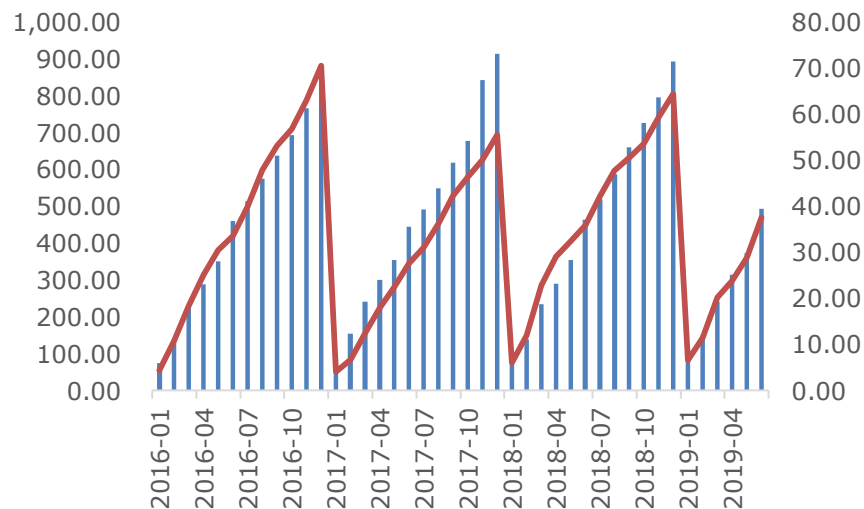
■ Foreign investment law is to be implemented soon.

- Starting from 2020, a new fundamental law will be enforced —— the “ **Foreign Investment Law**”.
- Employ the “pre-entry national treatment + negative list” system for foreign investment.
- Stipulate that foreign-invested enterprises can finance through public offering of shares and corporate bonds .
- Emphasis on the protection of intellectual property rights.

Comparison of Negative Lists in Version 2019 vs 2018

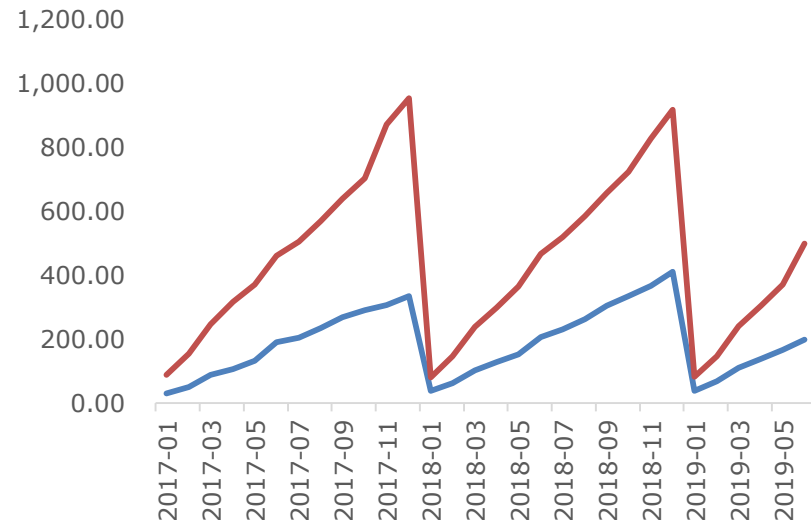
Sector	Changes in 2019 Version
Transportation	Removing the restriction of domestic shipping agents shall be controlled by the Chinese side
Culture	Removing the restriction of the construction and operation of cinemas shall be controlled by the Chinese side
	Removing the restriction of performance brokerage institutions shall be controlled by the Chinese side
Value-added telecommunications	Removing restrictions on domestic multi-party communications, store-and-forward, and call center business foreign investment stocks ratio of no more than 50%
Mining	Lifting restrictions on foreign investment in the exploration and exploitation of molybdenum, tin, antimony and fluorite
Manufacturing	Removing the ban on investment in the production of rice paper and ink ingots
Production and supply of electricity, heat, gas and water	Removing the restriction that the construction and operation of urban gas and thermal pipe networks shall be controlled by the Chinese side

➤ Under the guidance of Chinese government, **foreign capital inflows** gradually went to **high value-added economic areas**.



Amount of foreign capital actually used: FDI: cumulative value (left).

Countries along the Belt and Road : actual amount of foreign investment: cumulative value (right)

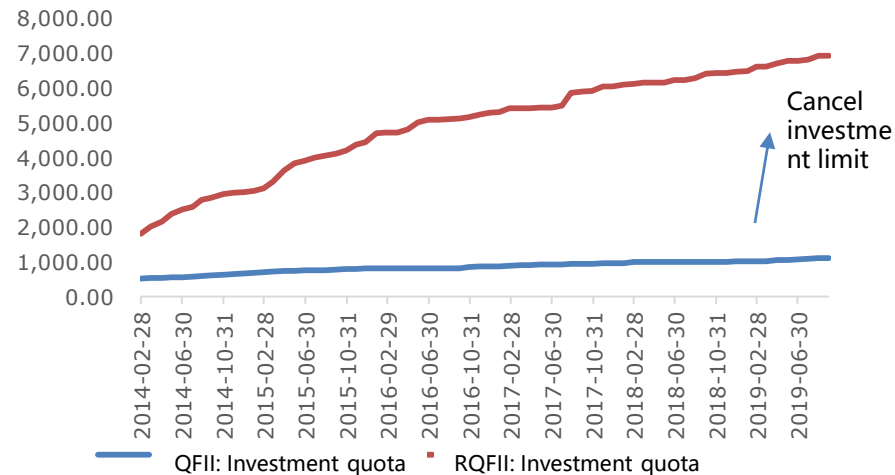
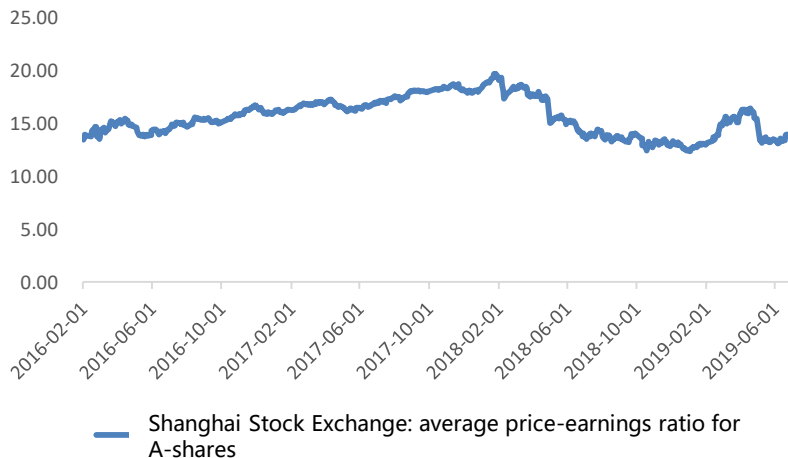


Manufacturing: actually used fdi: cumulative value

Service industry: actual use of fdi: cumulative value

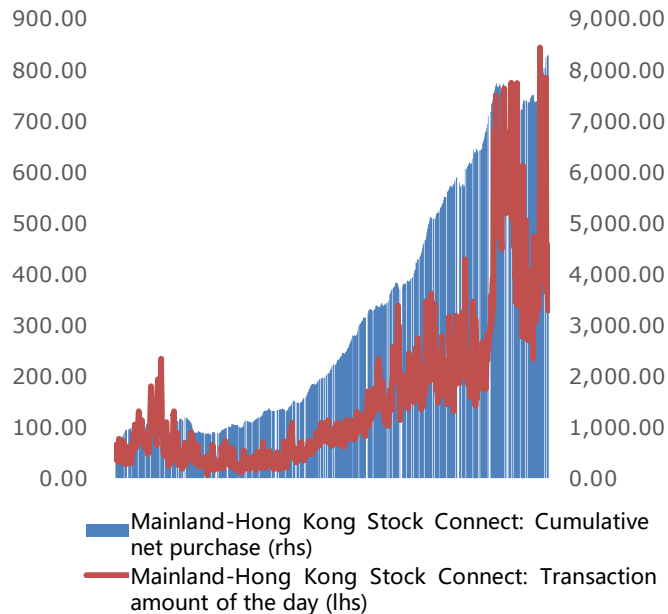
■ Foreign institutions actively participate in Chinese stock market

- China's A-share market has relatively low P/E and risk.
- Foreign capital's investment channels mainly includes Mainland-Hong Kong Stock Connect (Shanghai and Shenzhen) and QFII/RQFII.
- International index companies have been throwing olive branches to the A-share market. On September 10, SAFE lifted the limit on investment quota for QFII and RQFII, which echoes with their inclusion of A-shares.



➤ Each investment channel has its own advantages.

Mainland-Hong Kong Stock Connect trading is becoming increasingly active



Features of Channels for Overseas Investment in China's Stock Market

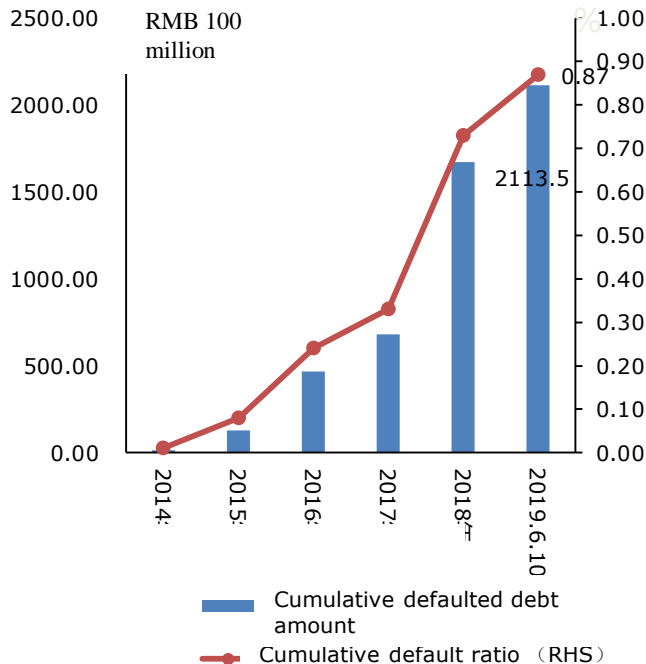
	Mainland-Hong Kong Stock Connect	QFII	RQFII
Investors	Institutional investors and individual investors in the Mainland and Hong Kong	Overseas fund management organizations, insurance companies, securities companies and other asset management organizations	Mainland-based subsidiaries of Hong Kong/Singapore financial institutions and local financial institutions
Currency	RMB	USD	RMB
Investment restrictions	Only spot stocks traded on exchanges	Participation in the IPOs and secondary share offerings, investment in stock index futures	Participation in the IPOs and secondary share offerings, investment in stock index futures
Cross-border fund management	Retained funds return along the original route without a lock-up period	Retainable in the Chinese market, without a lock-up period	Retainable in the Chinese market, without a lock-up period

China has become the world's second largest bond market

The current balance of China's bond market is only about one third of that of the United States, accounting for about 96% of GDP, rendering a large gap as compared to the ratio of over 200% of GDP of the United States and other developed countries.

In 2018, the excess return of RMB-denominated bonds was as high as 500bp, highlighting a significant premium advantage.

According to the calculation of CCXI, as at June 10, 2019, the cumulative default rate of China's bond market was 0.87%, still far below the international level, and the overall credit risk of the bond market was under control.



- China's bond market is becoming more open to the outside world, and foreign investors continue to buy Chinese bonds

Features of Channels for Overseas Investment in China's Bond Market

	QFII	RQFII	CIBM	Bond Connect
Investment scope	Exchange-traded bonds, fixed-income products in the interbank bond market		All spot bonds in the interbank bond market	All spot bonds in the interbank bond market
Trading currency	Foreign currency	RMB	RMB	Foreign currency or RMB
Trading mode	Broker			Market maker
Regulatory authorities	CSRC, SAFE		Macro-prudential supervision by PBOC	PBOC, SAFE, HKMA and other relevant national and regional regulatory authorities

Northbound



- Interest rate bonds are still the main choice for foreign investments in mainland bond market, and the credit bond market exhibits great potential

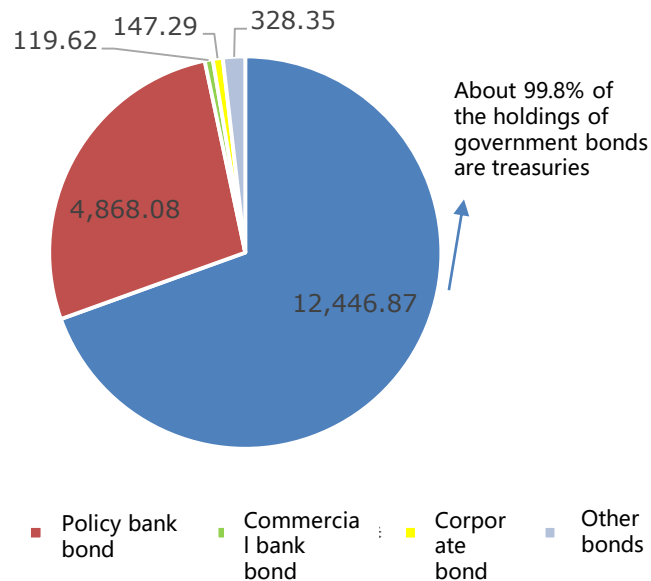


China's 5-year and 10-year government bond yields are all above 3%, while that in Germany, Japan and other developed countries are almost zero, while US 5-year and 10-year government bond have yields level at around 2%.



As of the end of May, the size of credit bonds held by foreign investors was only 74.6 billion yuan, accounting for less than 4% of the total size of Chinese bonds of their holdings.

Securities investment of overseas institutions



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China's macroeconomic performance



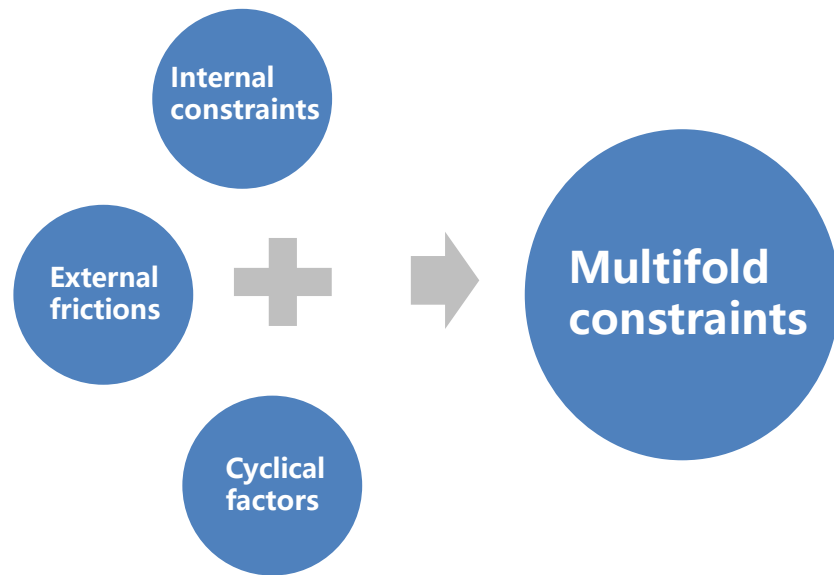
FDI & China's capital market opening up



Prospect of China's economy and bond market

■ Although the policy has been re-adjusted to stabilize growth, short-term economy still faces downward pressure under multifold constraints

- Internal : depend on policy
 - ✓ Household consumption: high leverage ratio
 - ✓ Infrastructure investment: control of LGFV debt
 - ✓ Real estate investment: policy control and regulation
- External: depend on Sino-US game
 - ✓ Export: Although the trade friction has eased in the short term, the possibility of marginal decline in exports remains in the context of the big countries' game along with the still slowing-down global economic growth.
- Cyclical factors
 - ✓ Decline in traditional dividends such as resources, population, environment, etc.



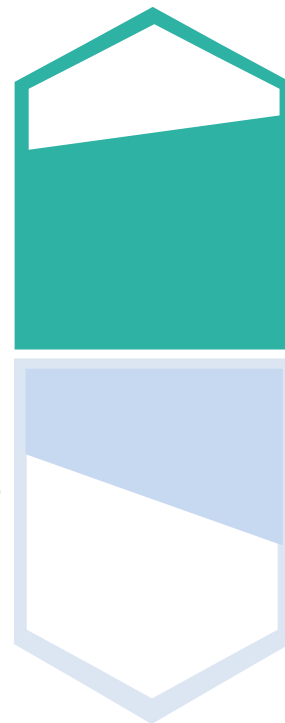
■ In the long run, China' s economic growth still has resilience

Domestic factors

- Great potential for domestic consumer market
- An increasingly mature industrial system based on research and development.
- Continued release of reform dividends based on factor market reform.
- An increasingly perfect macro-control system.

International factors

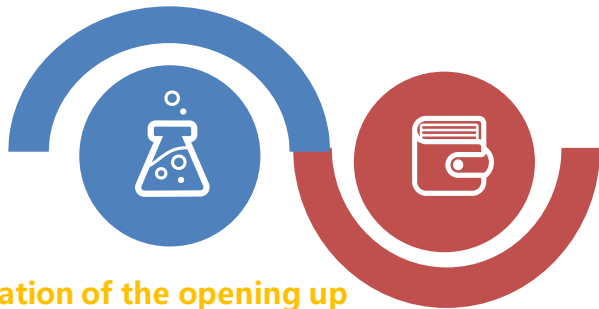
- The inclusive globalization of the "Belt and Road" .
- Digital technology-based data globalization and related services.



■ Open wider to the outside world, continue to promote globalization and share global growth.

Foreign investment are allowed in SOE reforms

Support foreign investors to participate in mixed reform through investment, acquisition of shares, subscription of convertible bonds, replacement of shares.

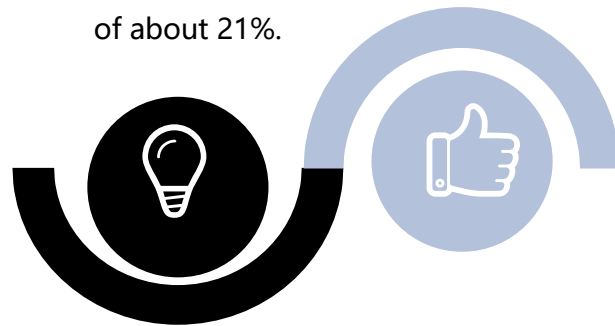


Acceleration of the opening up of the financial industry

In the second half of the year, PBC has three engagements: continue to relax market access; steadily promote RMB capital account opening; promote cross-border use of RMB.

Reduction of tariffs

Vehicle import tariff are reduced, with overall tariff cut from 8.8% to 7.5%; The tax band of import duties has been reduced from 57 to 45, a reduction of about 21%.

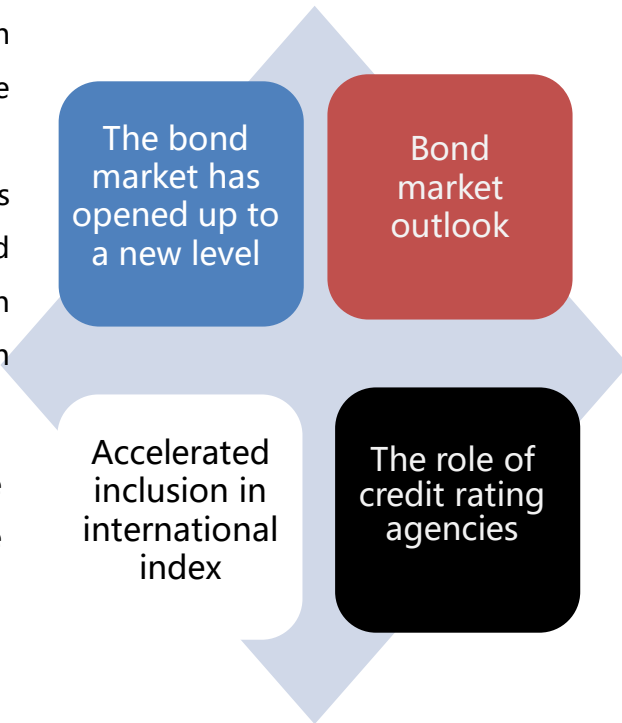


Hosting Import Expo

China has never deliberately pursued a trade surplus Import Expo participated in a total of 156 countries, 3 regions and 13 international organizations in 2018 and would be still held in 2019

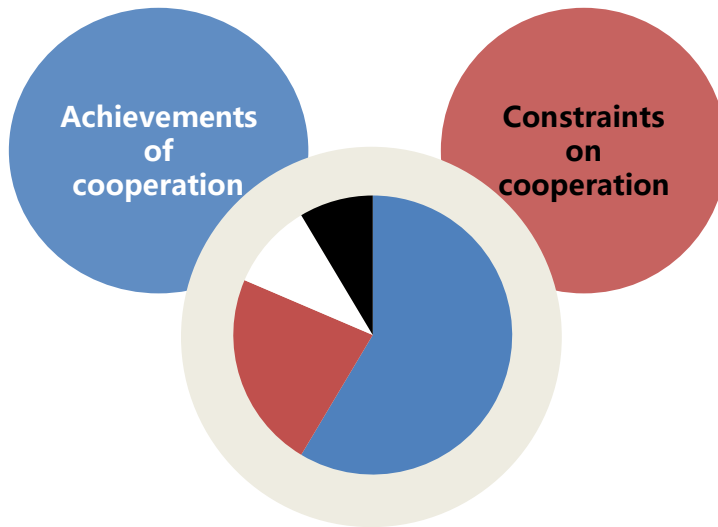
■ Overseas investors' participation in the Chinese bond market is expected to deepen

- Inter-bank bond market opening - allowing foreign institutions to obtain Class A lead underwriting license for the interbank bond market.
- Exchange bond market opening - Banks participating in stock exchange bond trading have been extended to foreign banks in China and other banks listed in China.
- Chinese bonds was included in the Bloomberg Barclays Global Composite Index and JP Morgan Chase GBI-EM Series.



- In accordance with CSRC deployment, the exchange bond market will be opened-up; research and development of exchange management measures for panda bonds will be made to further facilitate bond issuances made by overseas institutions.
- CCXI and Expert RA are in the growth stage, but have rich experiences in local rating and boast inherent information advantages in understanding the economy of China and Russia.

- Sino-Russian trade volume has been growing rapidly in the past five years.
- The Yamal LNG project is the largest economic cooperation project between China and Russia.
- Cooperation between the two sides in local currencies is steadily advancing.



- Both sides are facing the constraints of an increasingly complex global political and economic environment.
- The institutional environment in both countries awaits improvement.
- Information asymmetry.



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Sino-Russian Cooperation

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Advantages of cooperation



- Geographical advantages : the bordering location; China-Mongolia-Russia economic corridor, New Eurasian Land Bridge could benefit the development of regions along the Russian route.
- Trade and investment rules involving bilateral cooperation will be integrated in the smooth progress of the "Belt and Road" .



Prospects for cooperation



- China's energy structure boasts well for a greater demand of energy resources.
- infrastructure construction
- Import of agricultural products
- With financing in the European market being limited, expanding RMB financing channels may become an important strategic choice for Russian companies.





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Ms. Ariel Lei Yang is the Vice President of China Chengxin International Credit Rating Co., Ltd (CCXI).

She is in charge of the company's cross-border rating business, including panda bond, country risks and Belt & Road projects etc.

Ms. Yang joined CCX Group in 2011 as the Chief of Staff to the Chairman, and later as General Manager of International Business Department and Managing Director of CCXI. Previously she was editor and reporter at China's Xinhua News Agency, covering financial markets in New York and writing columns for elite Chinese financial newspapers.

Ms. Yang holds BA in Journalism from Wuhan University and MA in Mass Communication from UK.



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A blue banner featuring a world map in the background. Overlaid on the map are several text elements: 'BB' and 'AAA' in white and light blue, and a stylized 'BB' logo in a blue square. The text 'Thank You!' is prominently displayed in the center in a large, white, sans-serif font. To the right of the map, there are several blue squares of varying sizes, some containing the stylized 'BB' logo and others containing the text 'BB' or 'AAA'.

Thank You!