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TRADE WAR AND HIGHER US RATES - KEY RISKS FOR CHINA'S CORPORATE HEALTH

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FOR TRADE

Trade war and higher US rates key risks for China's corporate health

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1 **Deleverage? Not for Chinese corporate sector**

2 **No expectation of deleveraging in 2018 thanks to fiscal and monetary policy**

3 **But risks increase due to trade war and higher US rates**

1. Deleverage? Not for Chinese corporate sector

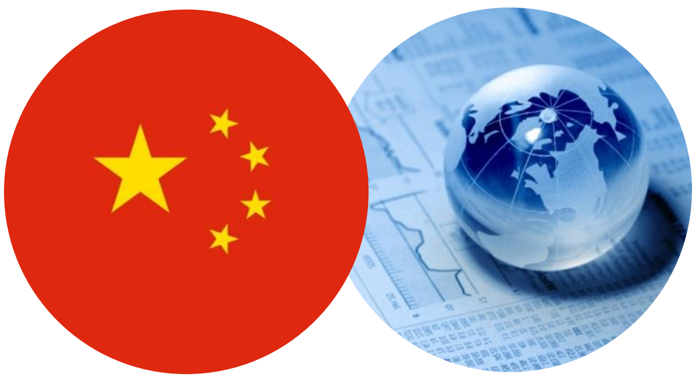
Deleverage? Not for Chinese corporate sector

- Deleverage was the buzzword until the PBoC started cutting RRR
- However, the deleverage was more financial than real:
  - Crackdown on shadow banking but limited progress in corporates
  - Continuous leveraging in Chinese firms especially private ones (mostly real estate developers)
  - Improved repayment ability thanks to stronger revenue growth, but still slow and well below global peers
  - Some sectors do better, such as health care and utilities, but much less so for real estate

Natixis China Corporate Monitor

Natixis China Corporate Monitor offers a bottom-up analysis of the health of the 3,000 largest listed corporates in China in 2017. Beyond evolution over time, the report also looks into the relative financial health of Chinese corporates compared to their global peers. Our analysis compares aggregate corporate health, sectoral differences (old versus new economy) and those driven by corporate ownership and size. The report has two key objectives: (i) achieve a better informed (micro-based) outlook for China's economy; (ii) understand sectoral developments and offer ideas for asset allocation for Chinese corporates across versus their global peers

Coverage (by asset size)



China	**Global**
3000 Non-FIs	**3000 Non-FIs**

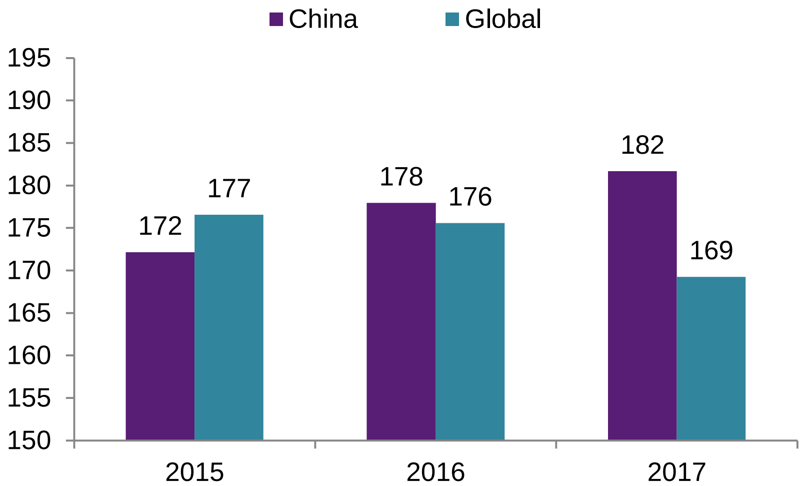
Industry

- Airlines
- Consumer
- Health Care
- Infrastructure
- Real Estate
- Renewables & Environment
- Utilities
- Chemicals
- Energy
- ICT
- Industrial
- Materials & Metals

In contrast with the global peers whose leverage ratio has declined in 2017, Chinese corporates continued to leverage, especially for the private sector

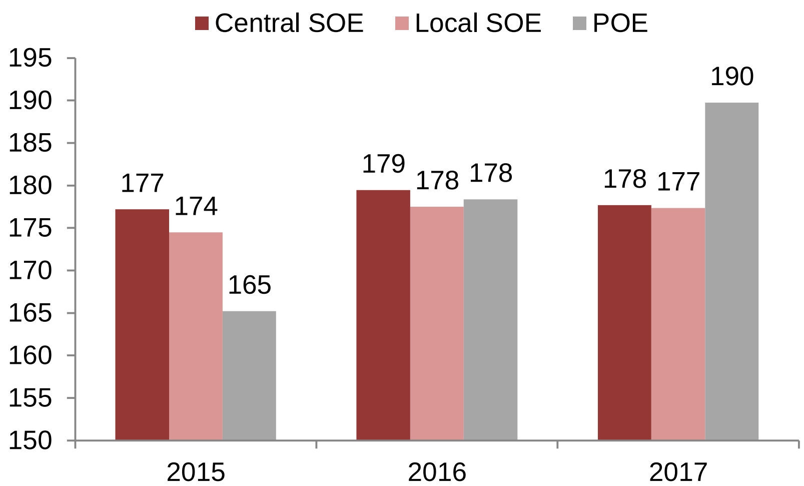
Leverage
Total Liabilities/Common Equity (%)

By Country



Source: Natixis

By Ownership

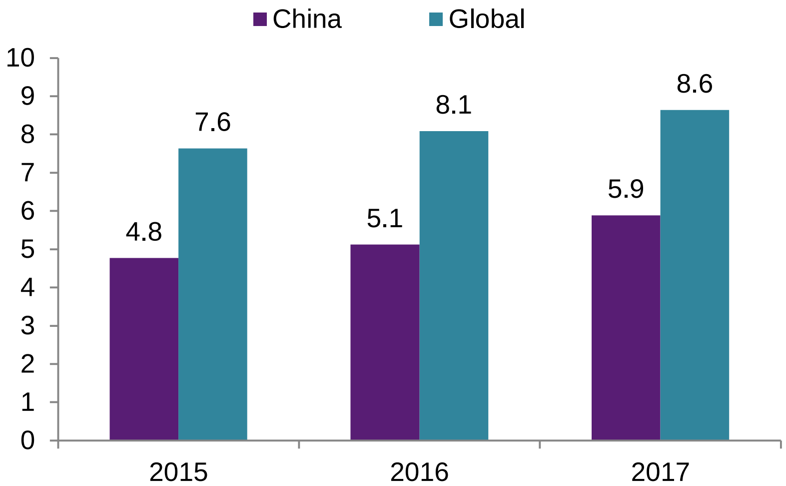


Source: Natixis

Therefore, Chinese corporates improved their repayment ability but still lower than their global peers

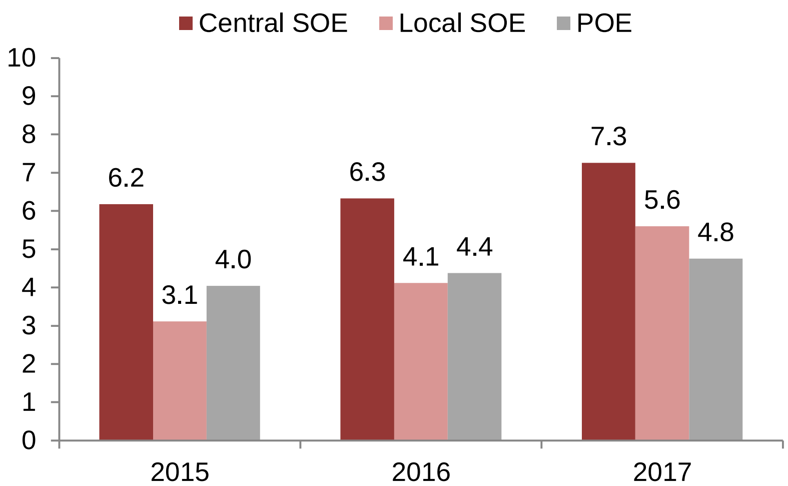
Repayment
EBITDA/Interest Expense

By Country



Source: Natixis

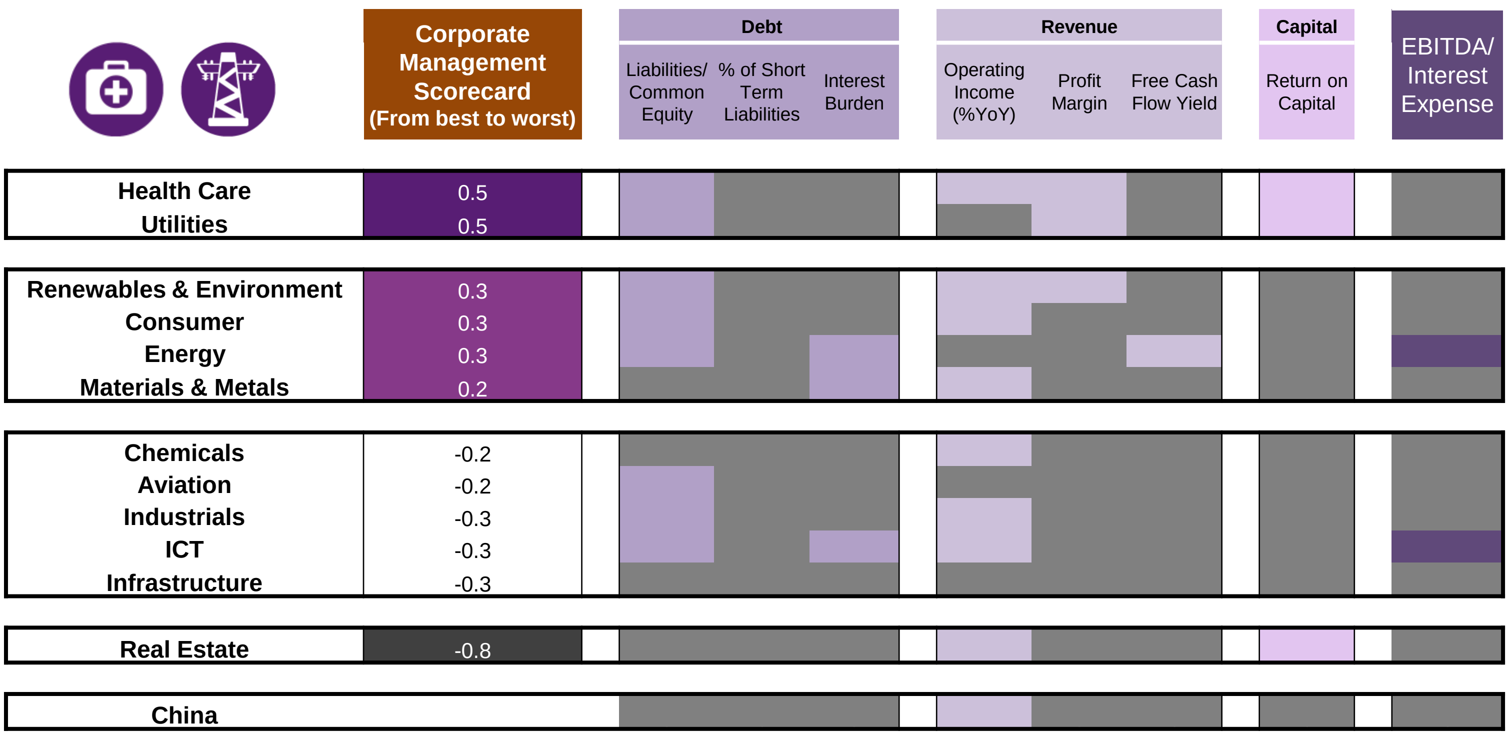
By Ownership



Source: Natixis

When compared to global peers, the new economy is clearly performing better. Health care and utilities are the very rare sectors with better corporate health than global average

China versus global in 2017



N.B. Score computed by Principal Component Analysis with 34.9% in debt dynamics, 31.6% in revenue generation and 33.6% in capital management.
Source: Natixis

2. No expectation of deleveraging in 2018 thanks to fiscal and monetary policy

In 2018, stimulus should help but there are looming uncertainties

Monetary and Fiscal Stimulus

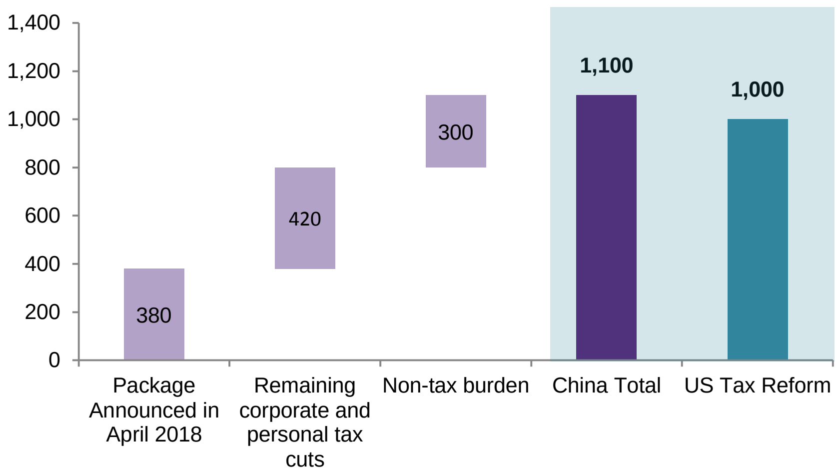
Key uncertainties

US-China Trade war
(Supply chain and
access to technologies)

The FED
(Higher rates)

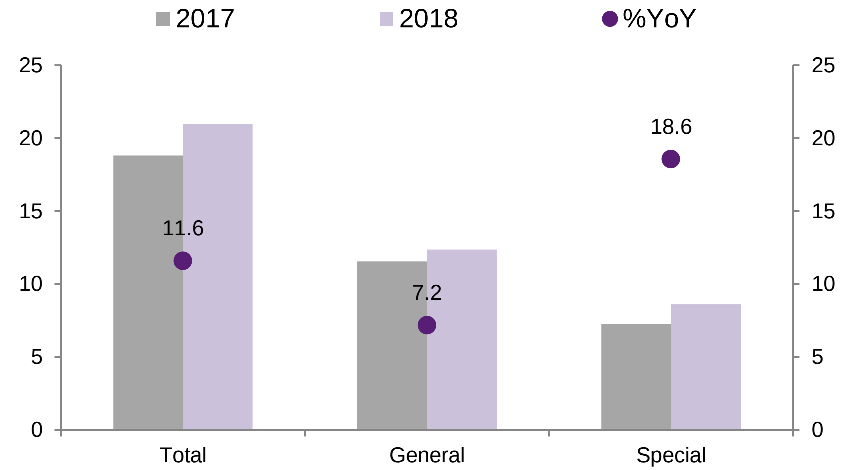
Tax cuts and additional local government bond financing to fight against the economic impact of US-led trade war

Reduction in tax and non tax burden in 2018 (RMB bn)



Source: Natixis

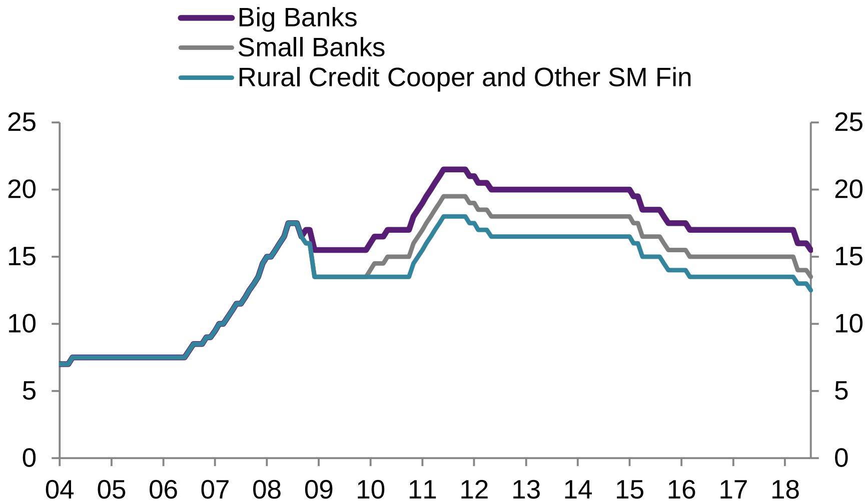
Local Government Debt Limit (RMB tr)



Source: Natixis, WIND

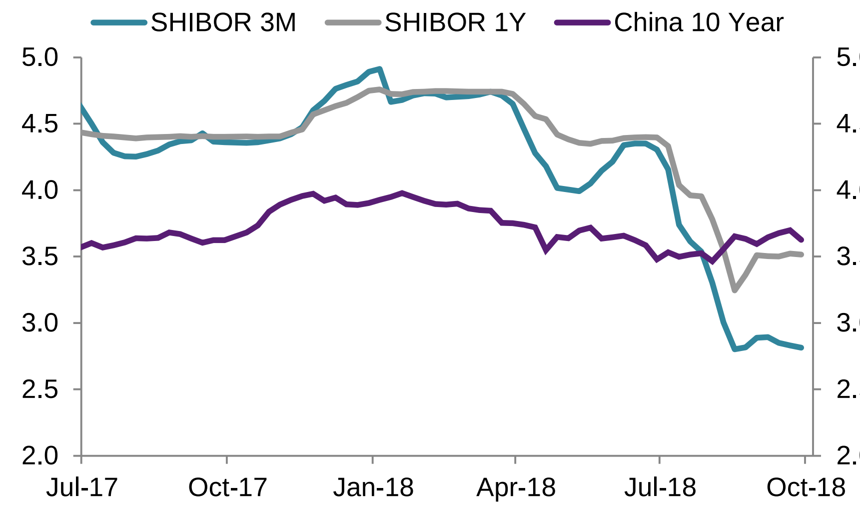
Same with monetary policy through 250 basis points reduction in RRR cuts in 2018, pushing down cost of funding at the short end

Required Reserve Ratio (%)



Source: Datastream, PBoC, Natixis

China's Rates (%)



Source: Natixis, Bloomberg

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3. But risks increase due to trade war and higher US rates

GROUPE BPCE

In front of a trade war, the good news is that China's reliance on trade for growth seems reduced

Source: Natixis, Bloomberg

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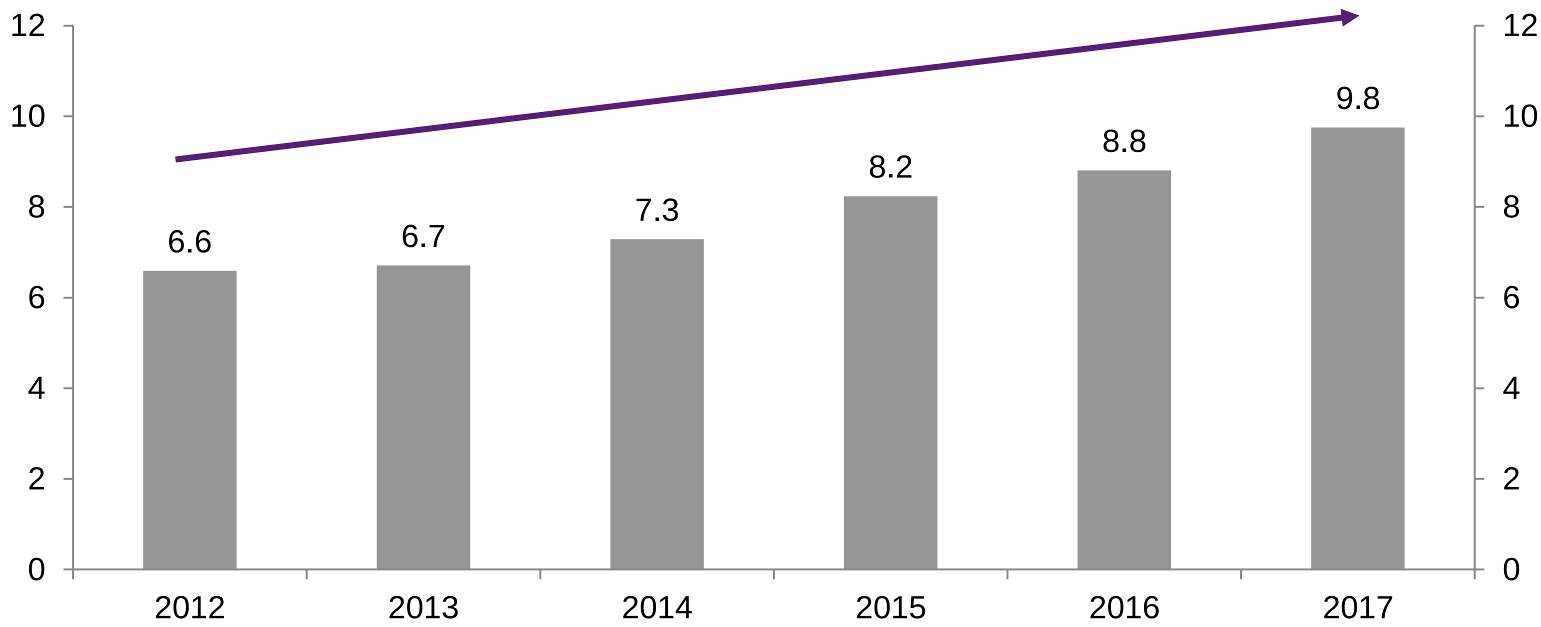
..but Chinese corporates are more and more dependent on overseas revenue

Proportion of overseas revenue (%)

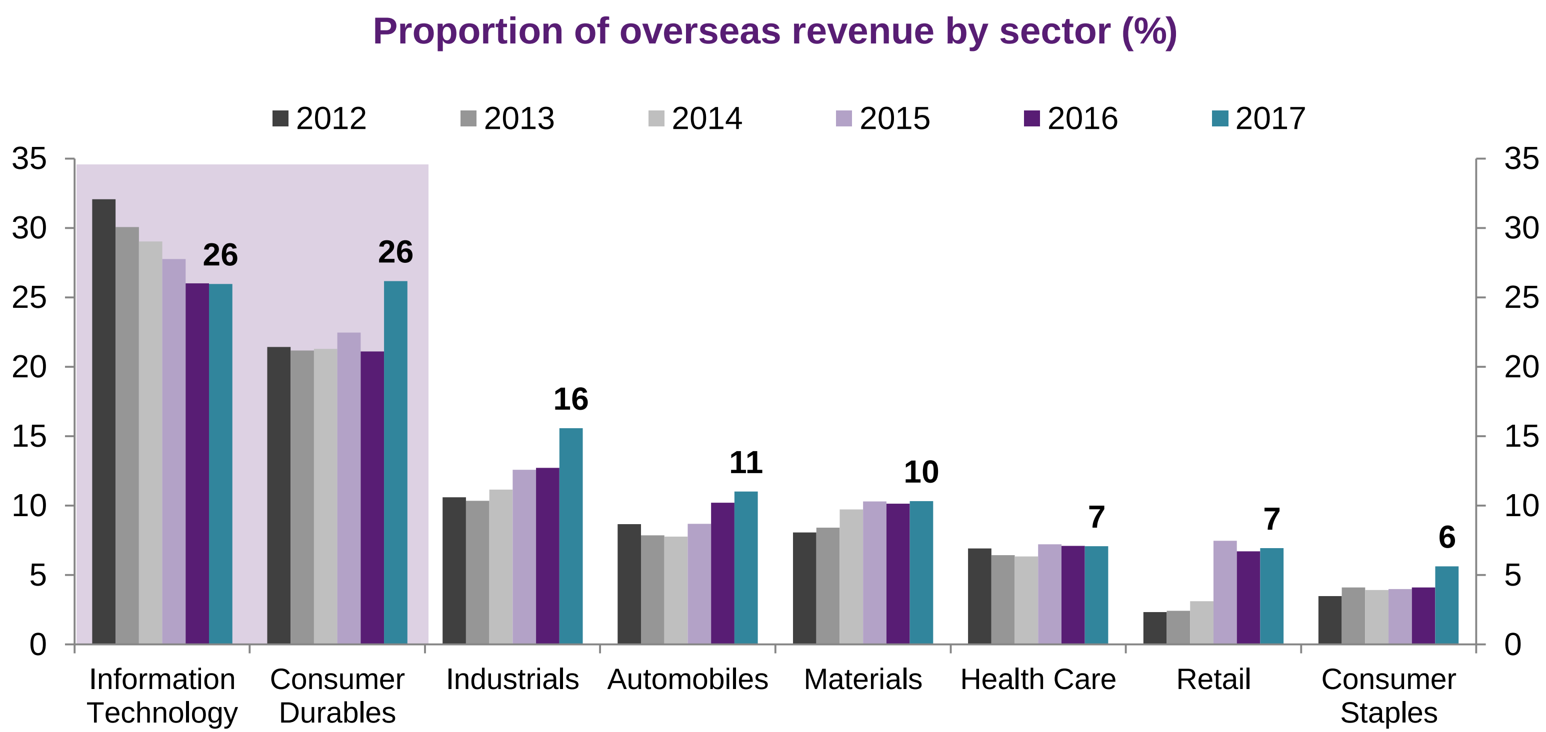


Source: Natixis, WIND N.B. Estimated from A shares

Related Research

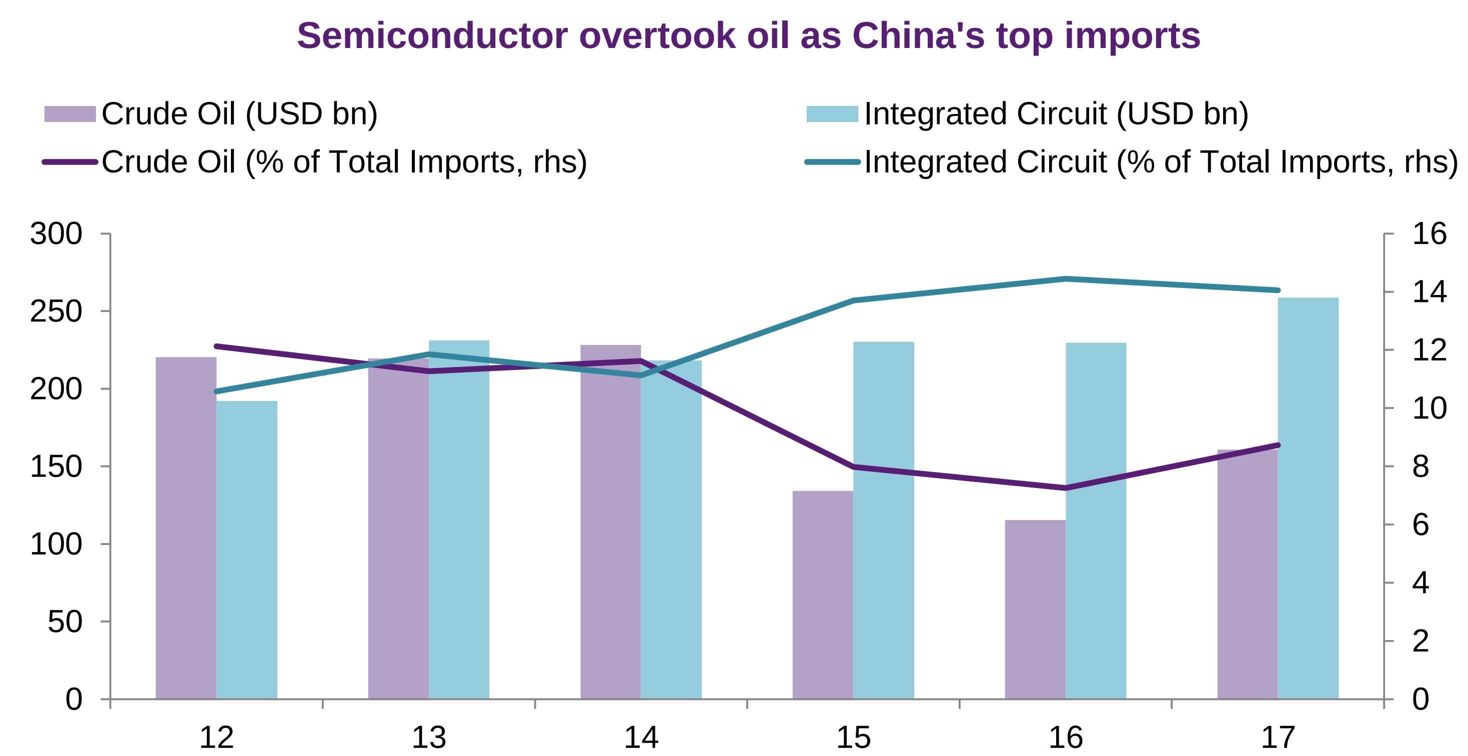
Which Chinese sectors are more exposed to a global trade war?

Some sectors are more exposed than the others (ICT, consumer goods)



Source: Natixis, WIND N.B. Estimated from A shares

Semiconductor overtook oil as China's top imports



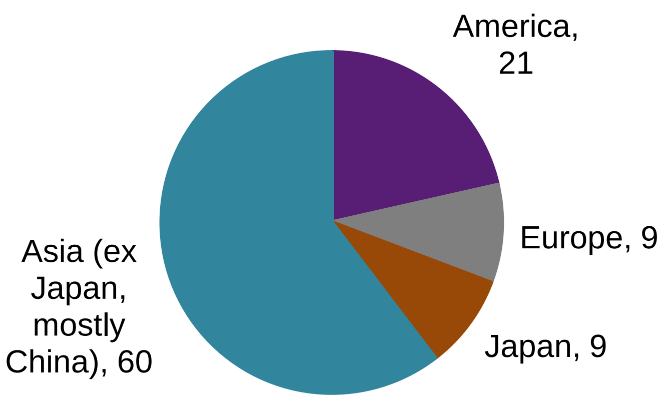
Source: Natixis, CEIC

Related Research

China Semiconductor: Money rain not enough to achieve "Manufacturing 2025"

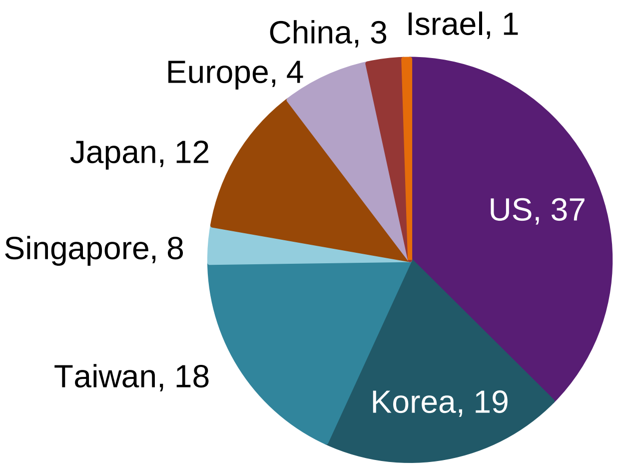
Achilles heel as the biggest market but the smallest supplier

Demand of Semiconductor (2017, %)



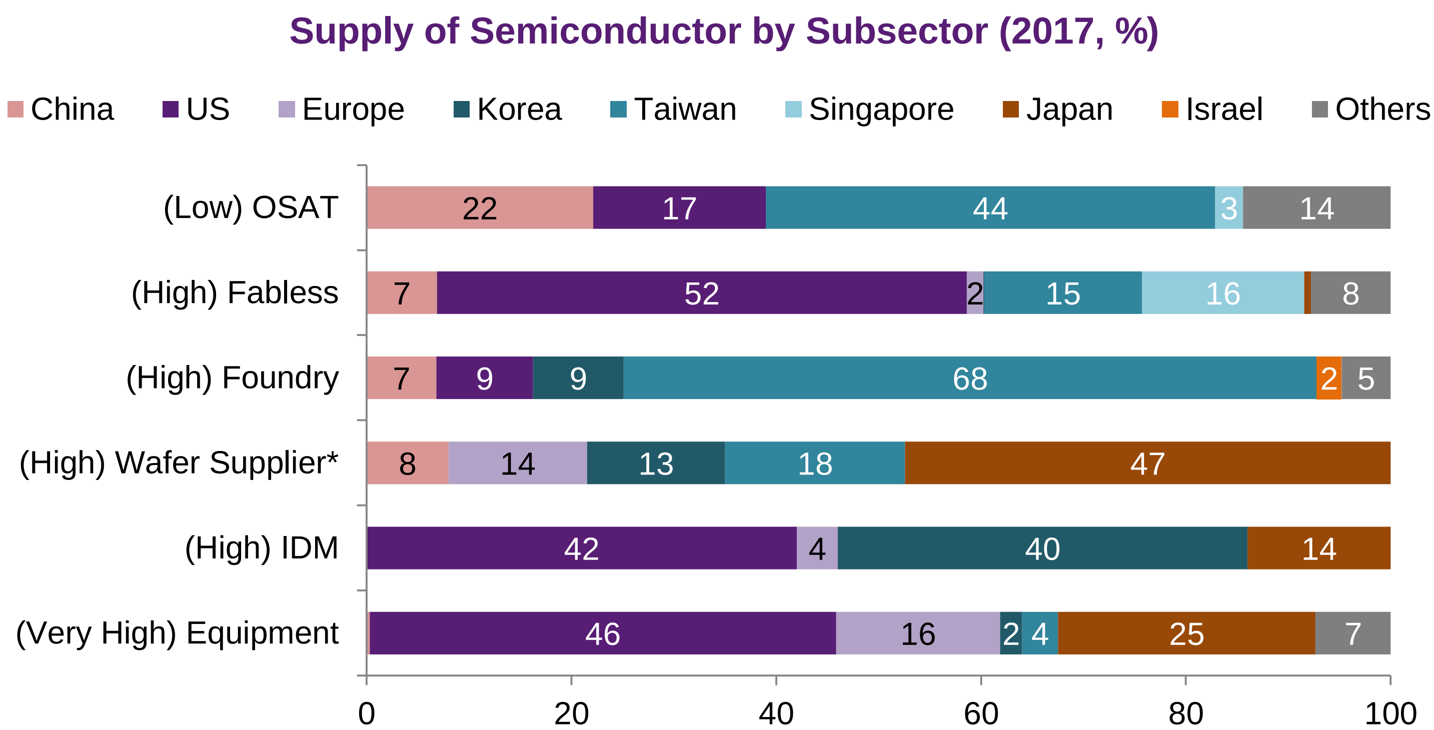
Source: Natixis, SEMI, WIND

Supply of Semiconductor (2017, %)



N.B. Calculated by revenue
Source: Natixis, Bloomberg, IC Insights, Trend Force, WIND

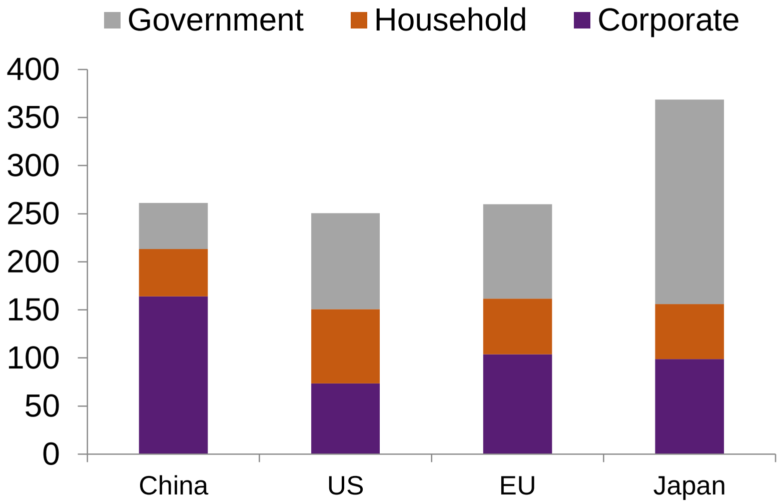
Chinese manufacturers only manage to secure larger market share in the lower end



* Assumed corporates out of the Top 6 are China affiliated corporates
Source: Natixis, Bloomberg, IC Insights, Trend Force, WIND

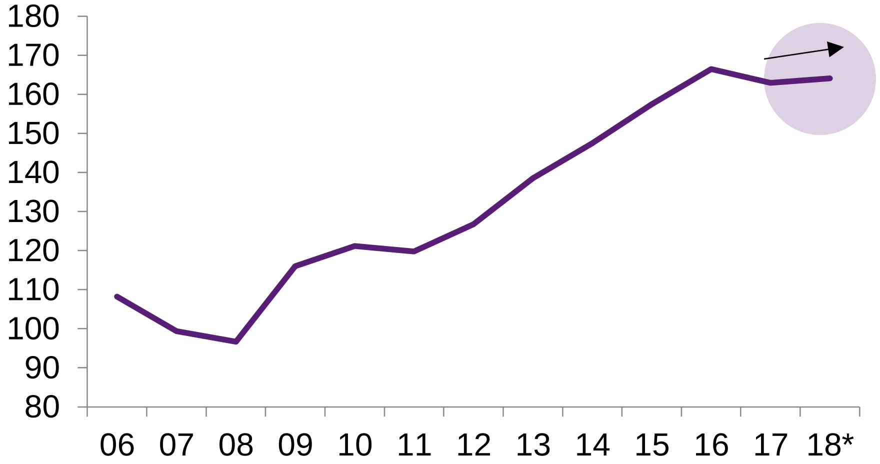
Ballooned corporate leverage in China means risks from higher funding cost

Total debt to GDP (%)



Source: Natixis, BIS

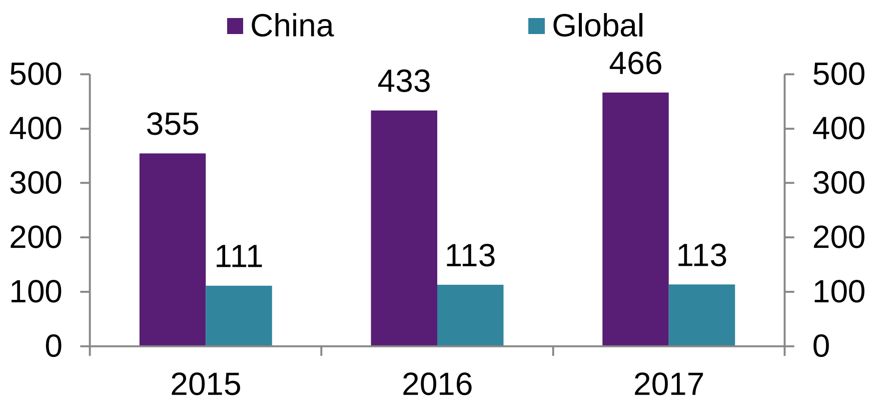
China's Corporate Leverage (% GDP)



*2018 Q1
Source: Natixis, BIS

Real estate sector: the big elephant in the room with massive leverage

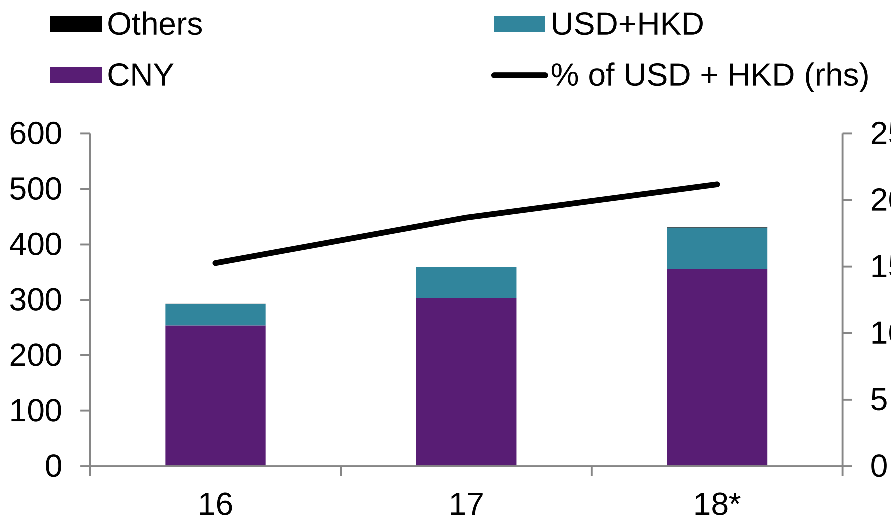
Chinese developers are more leveraged than global peers



N.B. Data extracted from Natixis China Corporate Monitor 2018. Real estate companies within 3000 largest Chinese and global corporates by asset size included respectively. Total Liabilities/Common Equity used as the measure of leverage
Source: Natixis

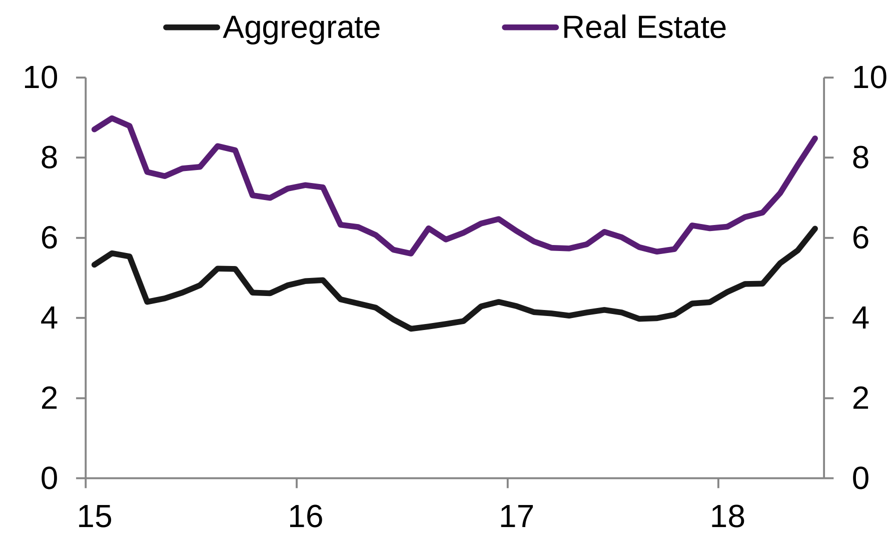
Chinese property developers are increasing their reliance on USD bond funding, which is becoming more expensive

Outstanding Bond of Chinese Developers by Currency (USD bn)



Source: Natixis, Bloomberg *Data as of May 2018

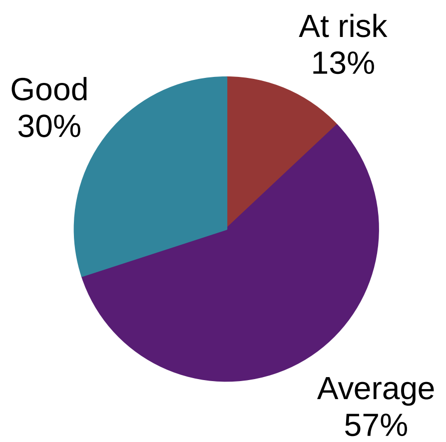
Natixis China Offshore USD Corporate Bond Index (By Sector, Yield-to-maturity)



Source: Natixis, Bloomberg, WIND

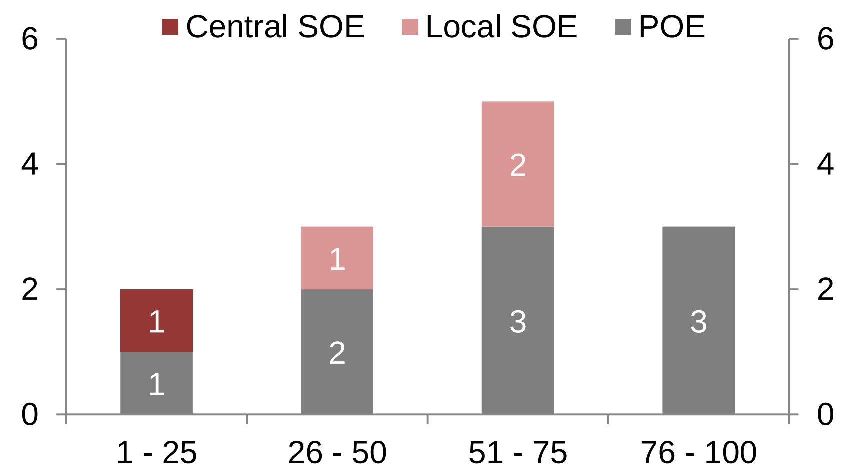
According to our calculations, 13% of Chinese developers are subjected to severe debt repayment difficulties

Repayment Ability of Chinese Developers



Source: Natixis

Number of real estate developers with high repayment risk ordered by asset size



Source: Natixis

N.B. To access the repayment ability of individual Chinese property developers, we look at various metrics, i.e. leverage ratio, liquidity risk, refinancing needs and forex exposure.

For details:
China's Real Estate Developers: A grey rhino in the jungle of financial risks

Conclusion

- Chinese corporate balance sheets have not improved in 2017 especially when compared with those of global corporations.
- Some sectors have been better than others, namely health care and utilities
- As for 2018 prospects, fiscal and monetary stimuli should help increase the stream of income and keep funding costs low.
- However, the trade war will penalize the most export oriented sectors (especially those more integrated in the global value chain). This is especially true for ICT.
- Higher rates in the US will also push up funding costs for Chinese companies, especially those more exposed to external debt.
- The real estate sector, due to massive leverage and increasing dependence on external funding, is the elephant in the room

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