



P R E S S R E L E A S E

Thailand, 18 September 2014

## **Carrot-and-stick : Challenges ahead for the Chinese economy**

Since the beginning of the year, the Chinese government has continued its effort to carry out various items on the reform agenda, particularly on fine-tuning the structure of the Chinese economy. As domestic demand remains subdued, property market continues to be sluggish and over-capacity in some sectors remains unsolved, it would be unlikely China will achieve the 7.5% growth target. Coface expects the GDP growth of China could reach 7.4% in 2014, given more policy support in sight.

### **Rising non-performing loan and cost of financing**

On the credit quality side, in-line with the findings of our China corporate payment survey report issued early this year, non-performing loan (NPL) has been rising in China, as the absolute amount of NPL soared 28.7% YoY in 1H2014. (Appendix 1). The macro trends observed during the 1H2014 is in-line with our expectation on the Chinese economy. On one hand, we see growth stabilizing, and on the other hand, we see industry participants – particularly smaller companies – facing mounting pressure, from the cost of financing side to the slowdown in demand growth.

*“The growing NPL is leading to concerns over lending qualities, while the cost of financing remains to be a concern to various sectors and smaller companies that lack access to credit facilities. Hence, with inflation figure highly under control, a broad-based interest rate cut could help ease financing pressure of companies and bring growth closer to the government’s 7.5% target,”* said Rocky Tung, Economist of the Asia-Pacific Region.

### **Sluggish property market and over-capacity issues**

A low-light of the Chinese economy in 1H2014 was the property sector, as it faced significant headwinds during 1H2014 and it is not expected to see dramatic reversal in the second half. *“The price pressure and the debt level of property developers are increasingly worrying, and with the high level of inventory to-be-digested, the near-term outlook of the sector remains bleak,”* said Rocky Tung.

Nonetheless, the importance of the property sector to the Chinese economy is significant and a collapse in the sector should be avoided. The medium-term demand will continue to be led by the government’s urbanization plan, which will focus more on quality instead of the volume of investment.

The metals industry continues to be underwhelmed by overcapacity issue and the weaker-than-usual demand growth is hurting profitability further. Energy sector, using coal as a proxy, is also experiencing lower demand growth as the overall economic momentum slows; further

weakness of the price trend should lead to a rise in risk level going forward as it erodes profitability and brings financial difficulties. While it has seen optimism earlier in the year, the wood-paper sector saw weak price trends as end-demands saw softening growth; but as government's determination to carry out industry consolidation and production elimination move forward, supply-demand dynamics could see improvement in 2015 and beyond.

China Sector Barometer			
Sectors	Risk level	Sectors	Risk level
Automotive		Metals	
Construction		Retail	
Electronics & IT		Textile	
Energy		Wood Paper	

Source: Datastream data, Coface

 Moderate risk    Medium risk    High risk    Very high risk

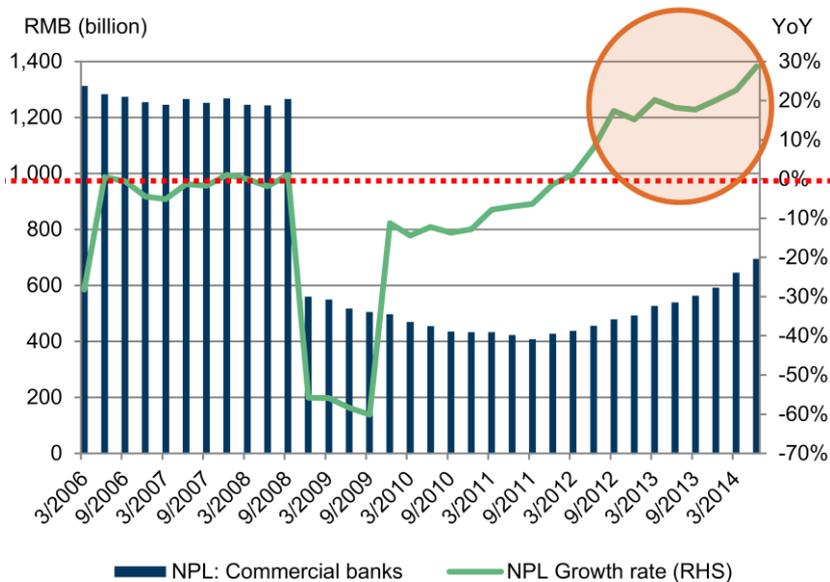
## Slow growth in consumer goods market

Similarly for the consumers sector in China, the medium-term outlook continues to be bright, but near-term challenges are not neglected. Riding on the rising middle-class, the higher number of people in the working-age category, rising living standards, and improving retail channels, the consumers market in China will continue to gain pace as a growth driver of the economy in the medium-term. However, together with the anticorruption scheme, the weakened income growth rate would cast a ceiling for the potentials of the market in the near-term, which is in-line with our view that economic growth is moderating in China.

While various aspects of reform are underway, growth is by no means forgotten. With plenty of signs showing lacklustre growth momentum in this year, it is believed that the government is likely to introduce stronger stimulus to sustain economic growth. More specifically, the continuation of targeted-stimuli is expected. Moreover, a possible interest rate cut would directly lower the cost financing and stimulate consumption. Nevertheless, the PBoC would have to balance the potential credit risk brought by such loosened monetary situation.

## Appendix 1

NPL continued to rise rapidly in 1H2014



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