



## UBS Investment Research

# China: Outlook and Pressure Points

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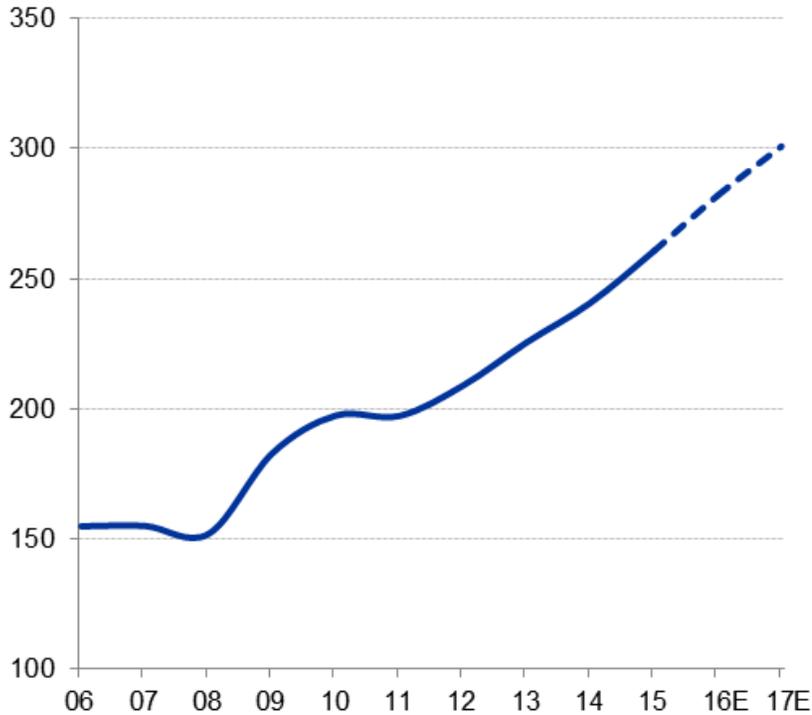
# Three main points

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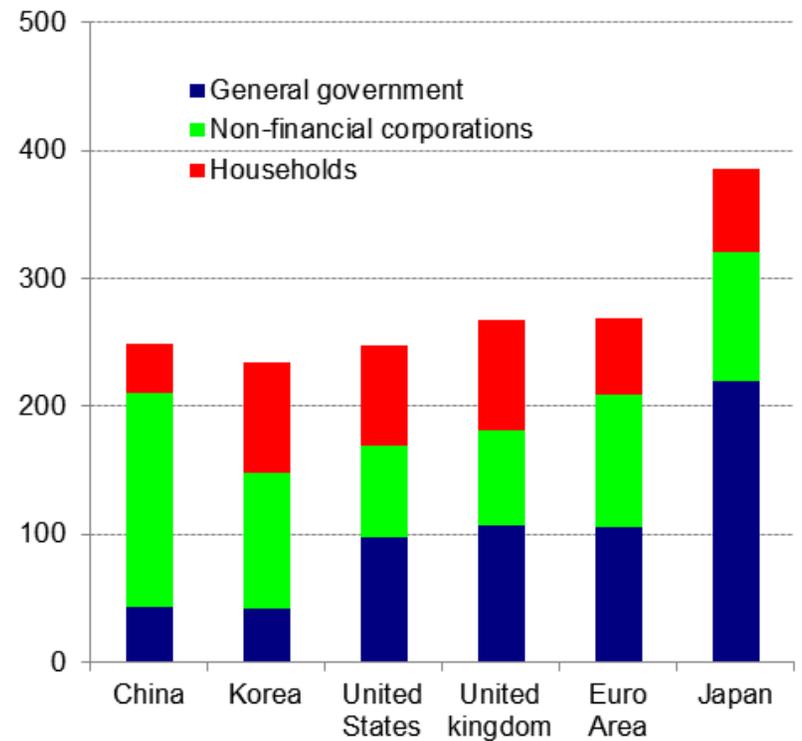
- China's long-term growth potential remains good
  - Potential for labour transfer and productivity gains remain
- Resources being allocated to inefficient and non-productive sectors is the biggest challenge to realizing growth potential
- Pressure points to financial stability are rising shadow market and large capital outflows. Restructuring and rising inequality a risk to social stability

# China's rapidly rising leverage...

Total non-financial sector debt/GDP (% , UBSe)



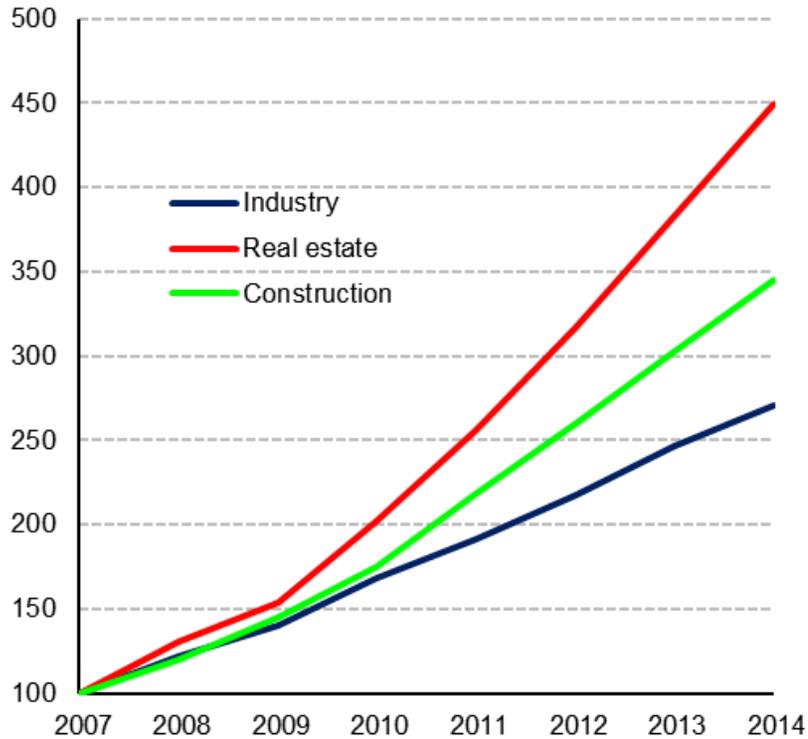
Non-financial debt (% of GDP, 2015)



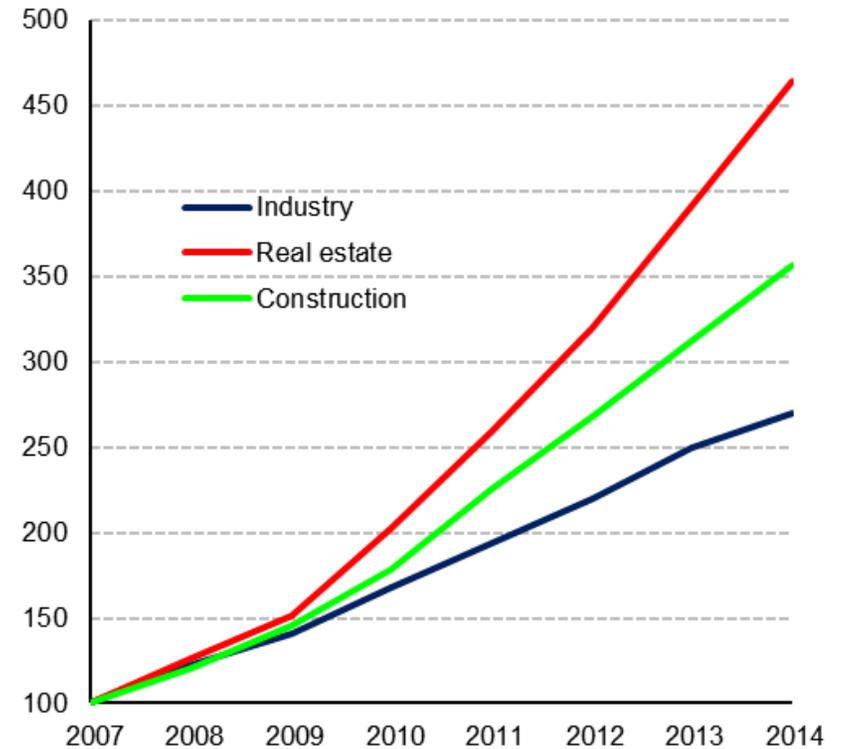
Source: BIS, CEIC, UBS estimates

# Helped to finance the build-up of "non-productive" real estate assets...

Assets of above-sized enterprises (2007=100)



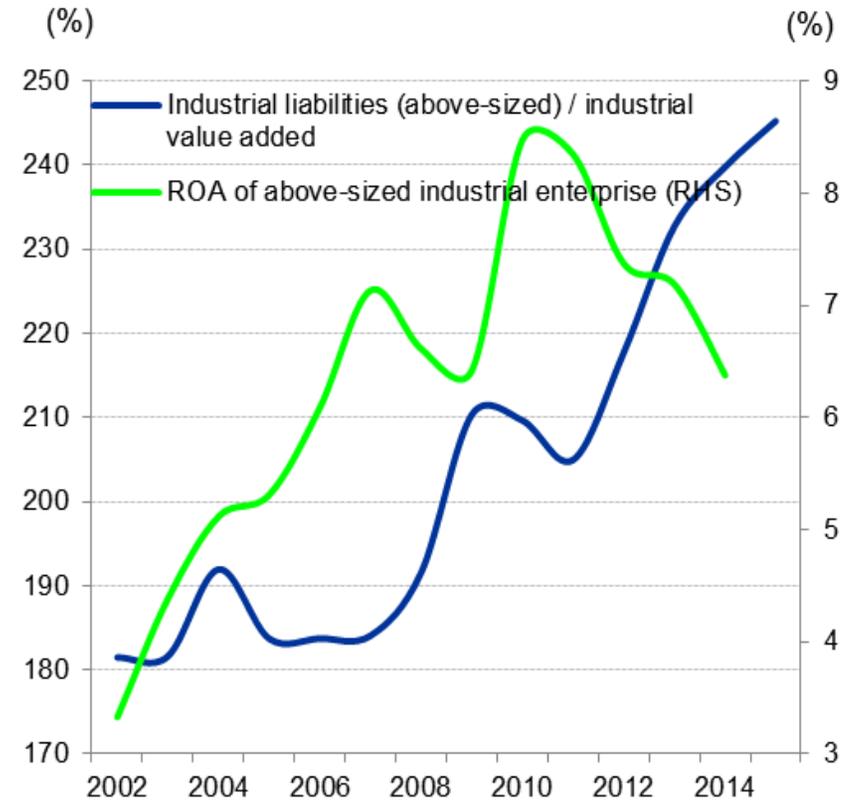
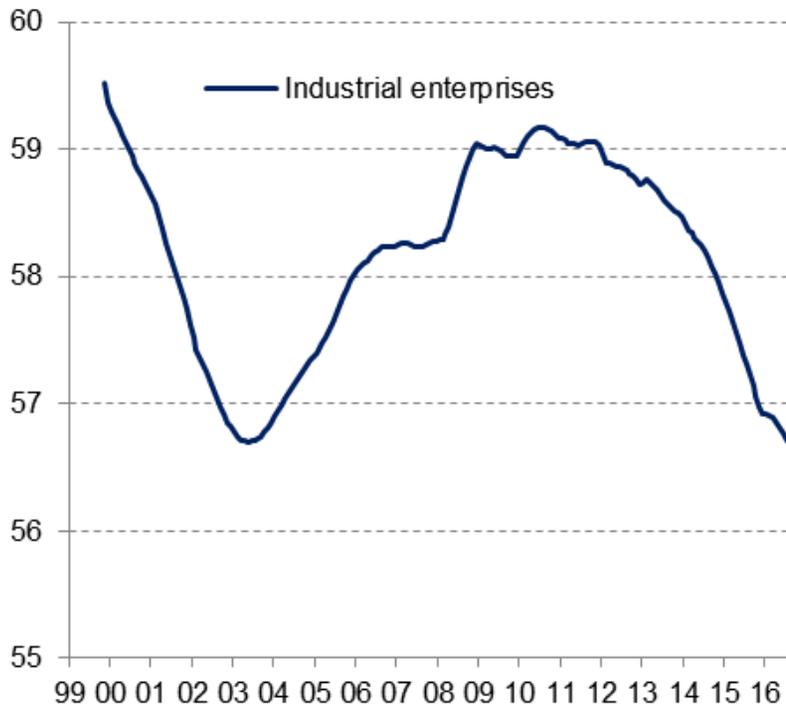
Liabilities of above-sized enterprises (2007=100)



Source: CEIC, UBS estimates

# While industrial sector asset also rose, ROA is declining...

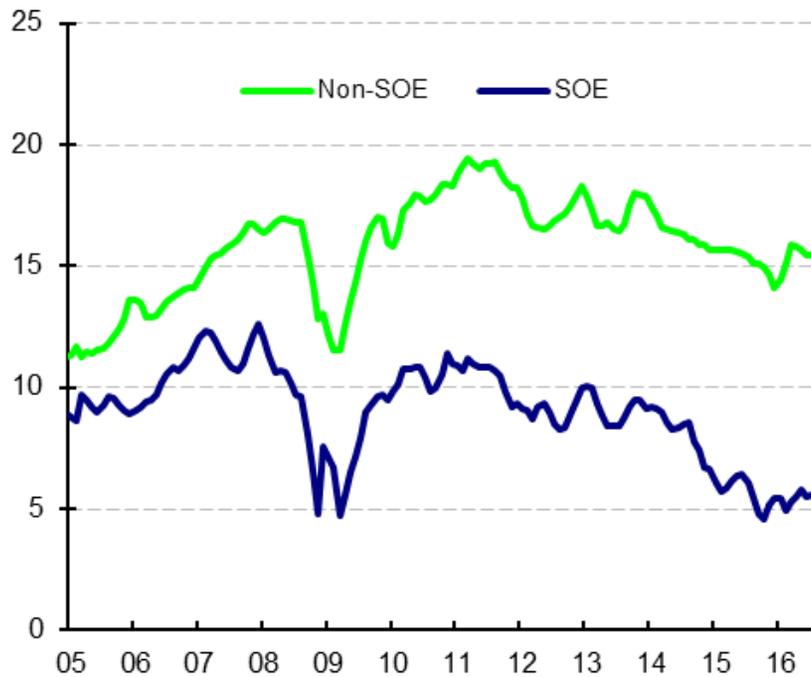
Liability/asset (% 12mma)



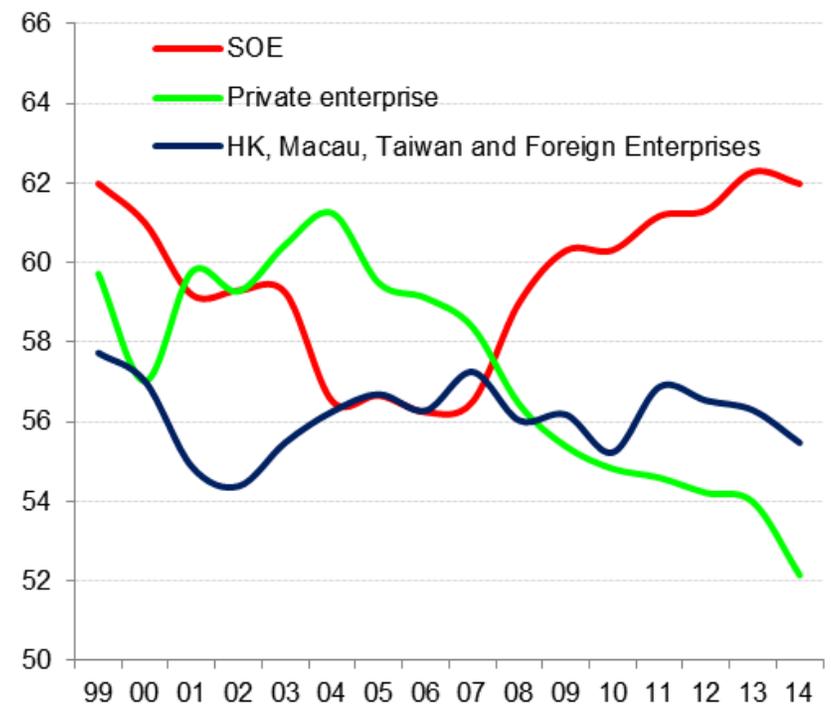
Source: CEIC, UBS estimates

# ...partly due to poor performing SOEs taking up more debt

ROE of above-sized industrial enterprises (% , sa, 3mma)



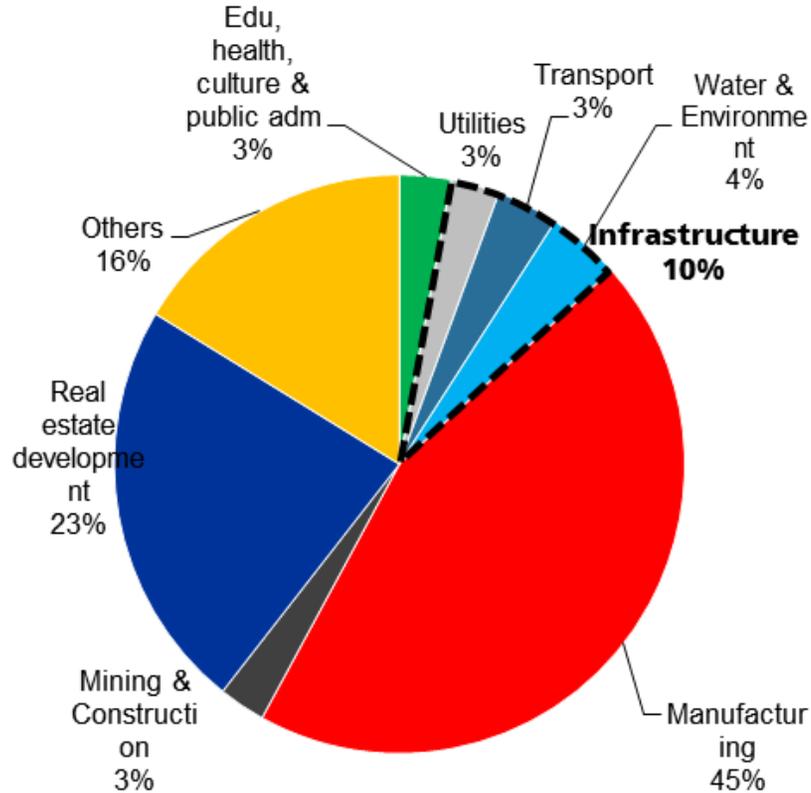
Liability-asset ratio of above-sized industrial enterprises (%)



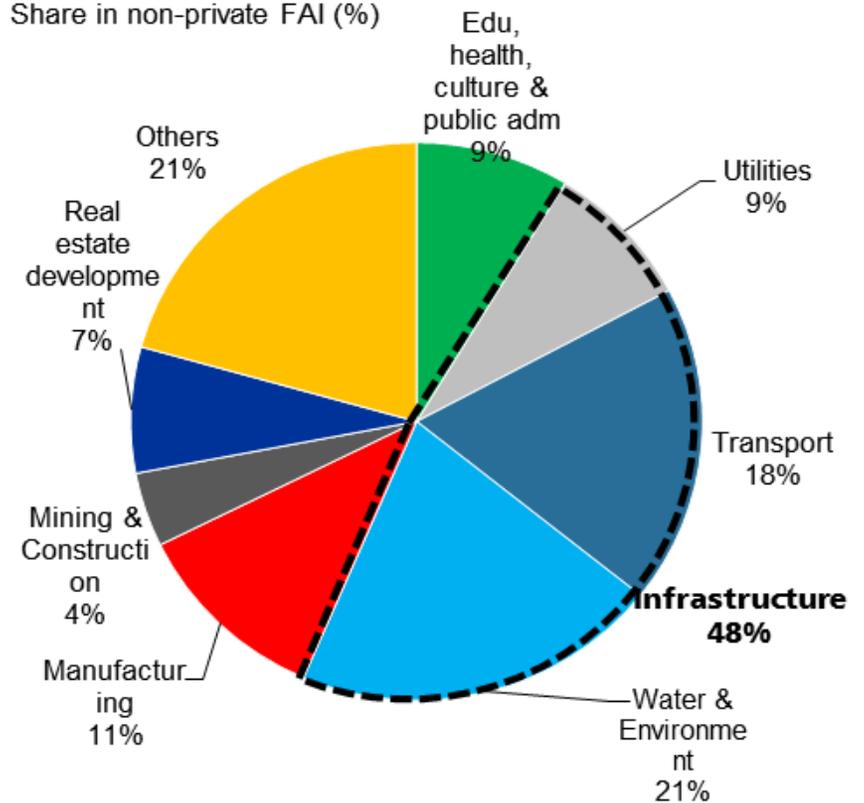
Source: CEIC, UBS estimates

# Why has private investment plunged? – sectors with private dominance have done more poorly

Share in private FAI

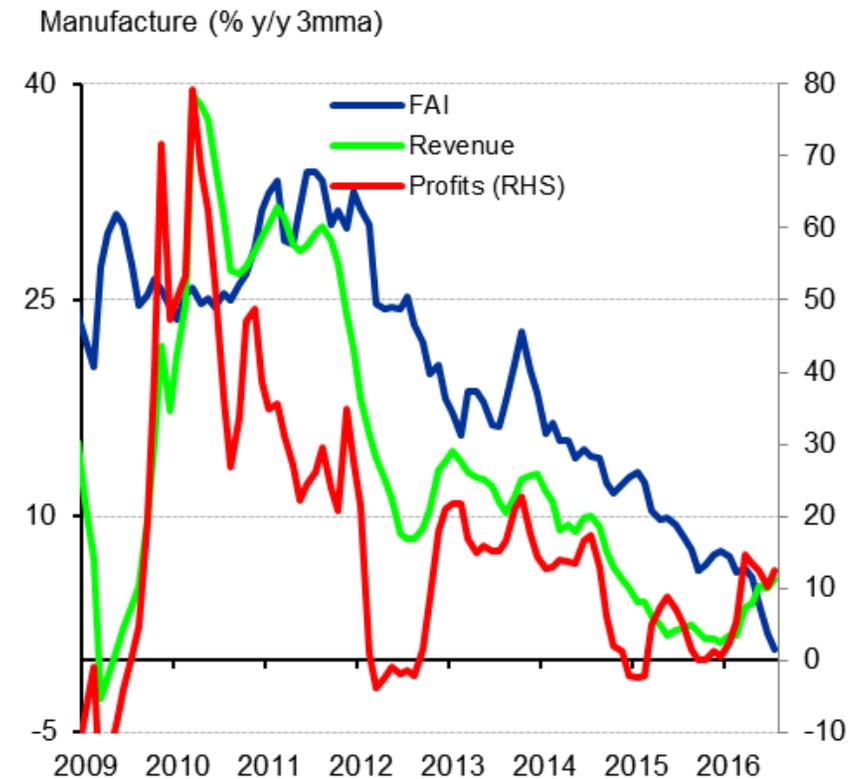
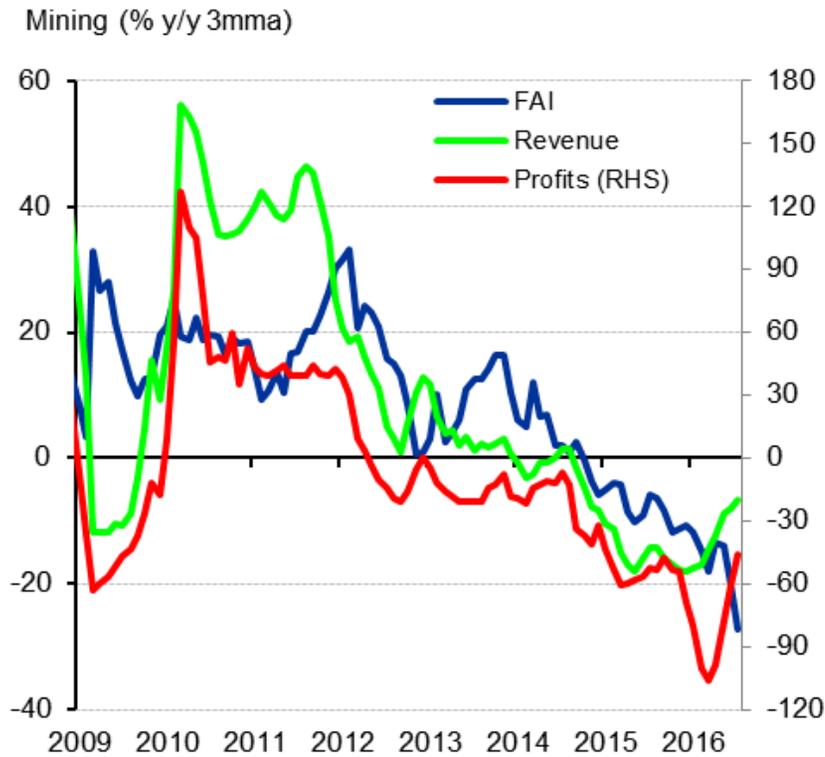


Share in non-private FAI (%)



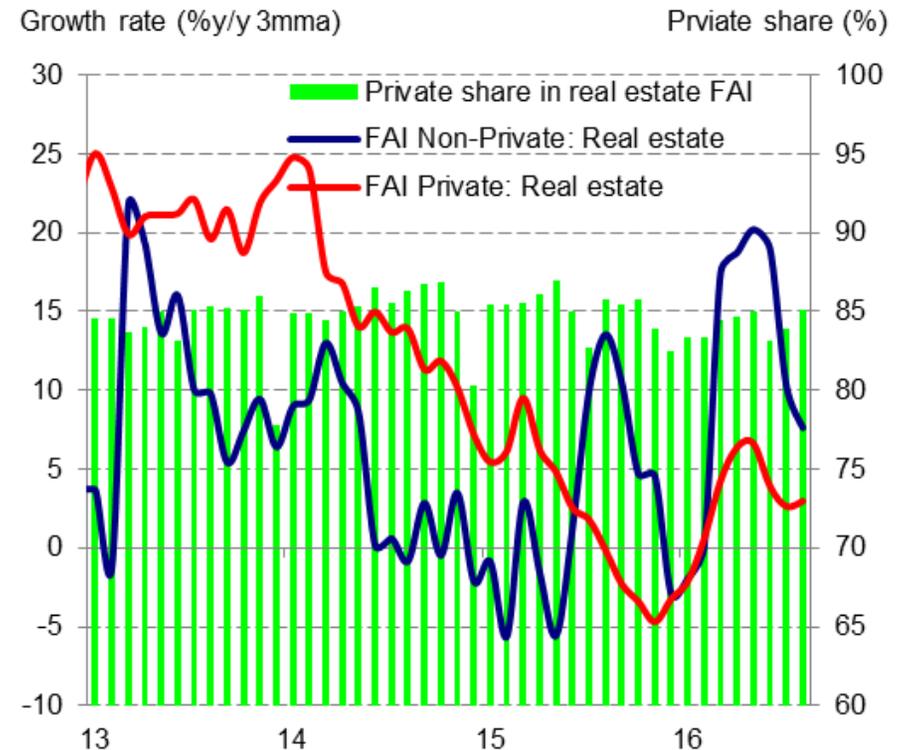
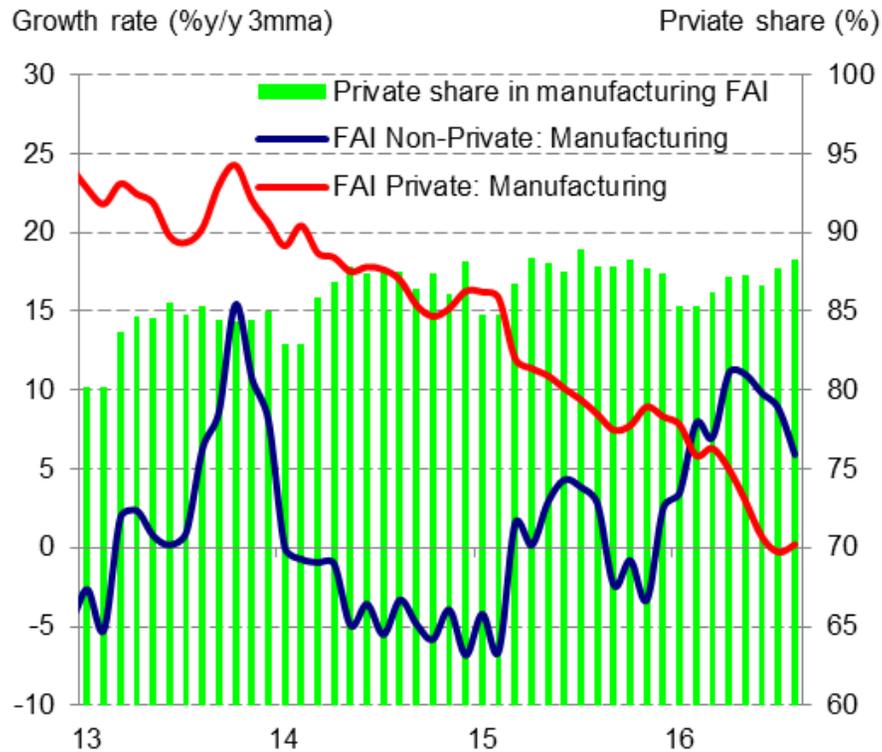
Source: CEIC, UBS estimates

# Deterioration of revenue growth and profitability in mining and manufacturing



Source: CEIC, UBS estimates

# Private sectors behaved more logically in recent years



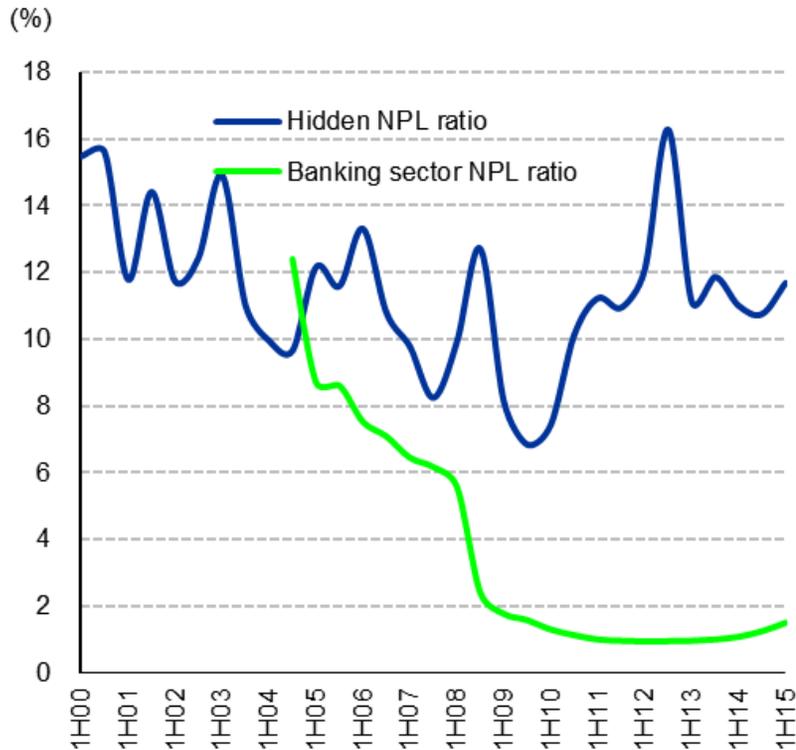
Source: CEIC, UBS estimates

# No imminent hard landing or crisis

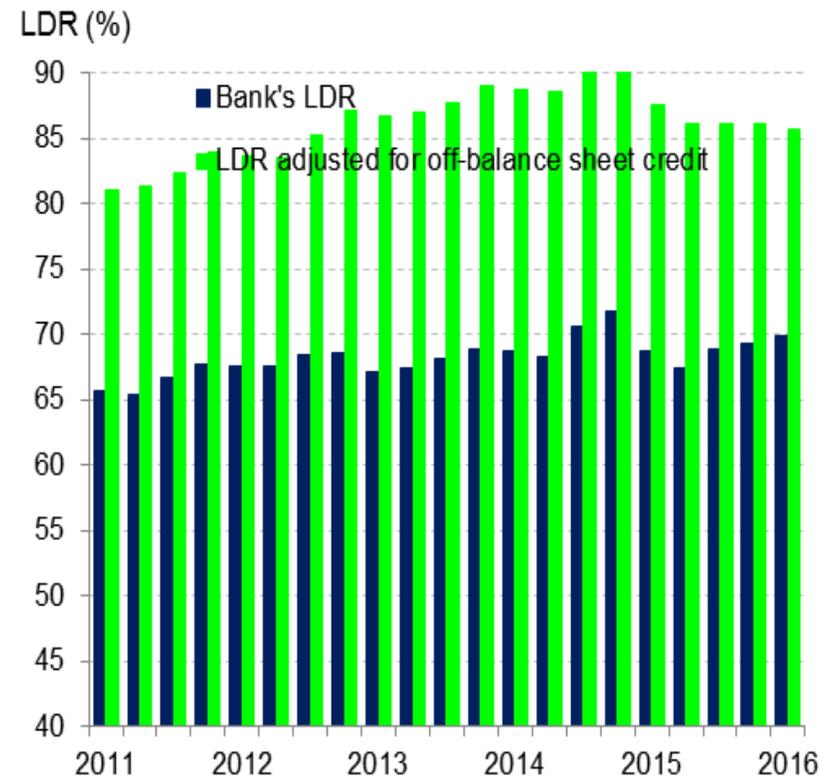
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- The government can use monetary and fiscal policy levers to support growth, though effect is declining
- High savings, capital controls and government ownership make liquidity crisis unlikely
- Corporate and debt restructuring are gradually being implemented

# Bank NPLs will likely rise, but liquidity is not yet an issue



From UBS Bank team. Hidden NPL ratio refers to the percentage of total liabilities of A-share non-financial companies of which the ratios of EBITDA/financial costs are <1 or negative to total liabilities of all A-share non-financial companies.



Source: PBC, CEIC, UBS estimates

Source: CEIC, Wind, UBS estimates



# Pressure points to financial stability

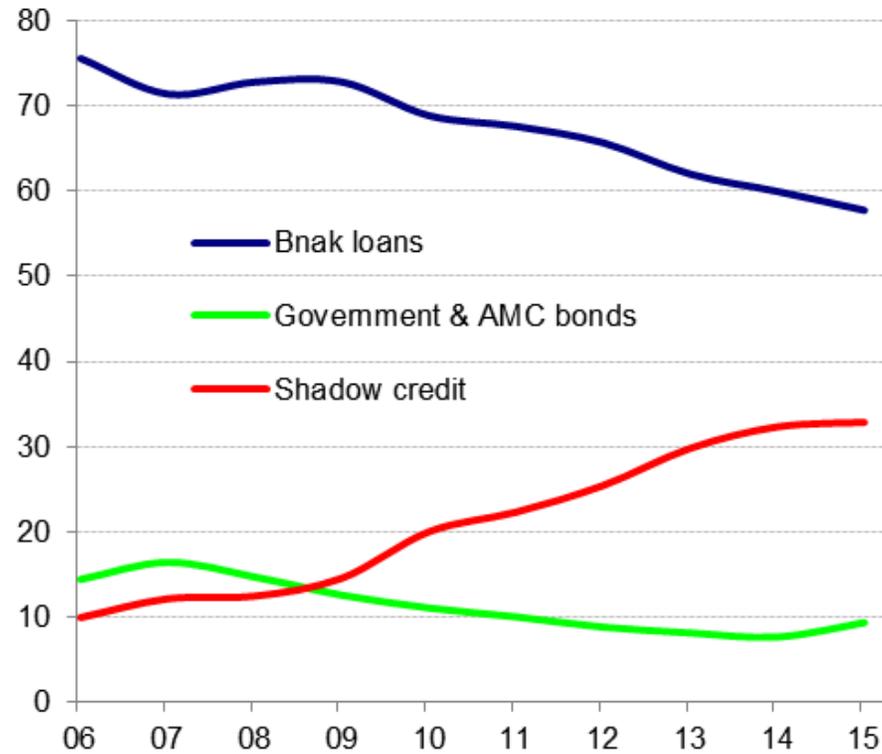
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- **Rapid growth in shadow credit** in the name of financial market development
- **Overly broad Implicit guarantee** encourages excess risk taking
- **Large capital outflows**
- **Lack of oversight on** financial system as a whole

# The rise of shadow credit

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Share in adjusted total credit (% of total)



Source: CEIC, UBS estimates

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