CHINA

Population : 1 401 295 763 (2019)
GDP per capita : US$14.3 trillion (2019)
Country risk assessment : B (2019)
Business Climate : B

STRENGTHS

- Sovereign risk contained as public debt remains mainly domestic and denominated in local currency
- Reduced risk of external over indebtedness thanks to the high level of foreign exchange reserves and to the maintenance of a current account surplus
- Gradual move upmarket as part of China 2025 strategy to boost high-value added output
- Services and infrastructure developments

WEAKNESSES

- Credit risks remain a cause of concern. High corporate indebtedness to impact growth potential
- Overcapacity concerns in certain industrial sectors will continue to drag on profits
- Exposure of banks to rising corporate debt levels and deterioration in asset quality
- Government's strategy is ambiguous on arbitrating between reform and growth
- Environmental issues
- Ageing population and gradual depletion of cheap labour pool

RISK ASSESSMENT

ECONOMY

China is the second largest global economy, the largest exporter and has the largest exchange reserves in the world. The global recession of 2009 interrupted its double figure growth and revealed the limits of an export-based growth strategy. However, China still has one of the fastest growing GDPs in the world, and in 2018 the economy grew 6.6%. Resilient external demand and robust domestic household consumption bolstered this growth, despite rising concerns about financial risks amid an economic restructuring led by the Communist government. New sectors like e-commerce and online financial services are gaining momentum in an economy dominated by export-oriented sectors. The trade tensions between the United States and China, however, are expected to start to affect growth in 2019. Therefore, GDP is likely to slightly decrease in 2019 and 2020, to 6.2%, according to IMF estimates.

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By the end of 2018, inflation reached 2.2%, slightly higher than it was in 2017 (1.6%). For the next couple of years, inflation should remain stable, at 2.4% and 2.7%, in 2019 and 2020 respectively. Public debt is a reason for concern in China. Although the official figure for 2018 was 50.1%, the real number is thought to be much higher and is expected to rise in coming years. It it estimated that China's debt to GDP ratio is actually 300%, which Forbes deems as the country's biggest problem. Chinese credit level is high by international levels: corporate debt has reached 165% of GDP, and household debt - though still low - has risen by 15% of GDP over the past five years. In the past year, the government has been targeting spending cuts in its budget and Presindent Xi Jinping has said that curbing loans to bloated state-owned enterprises is "the priority of priorities". The trade war between China and the United States, as well as policies to curb leverage and shadow banking, had been making it harder for companies to get funding in 2018. However, this prompted the authorities to introduce monetary-easing measures, such as freeing up banks to offer more loans to smaller businesses. Government Budget reached a record low of -4.2 percent of GDP in 2018, a trend that is expected to continue in 2019, when it's estimated to reach -4.5%. China's policymakers are expected to increase the budget deficit in the coming year, as a slowing economy and the downdraft from the trade war with the U.S. raise the need for a more active fiscal policy. In May 2017, for the first time since 1998, Moody's Investors Service downgraded China's sovereign credit rating. On the other hand, China still has large reserves of foreign currencies (estimated at USD 3 trillion) which could serve as a buffer to external sovereign volatility, together with a current account surplus of USD 200 billion.

China still has to face many challenges: an ageing population and shrinking workforce, the lack of openness of its political system and issues of competitiveness in an economy dependent on high capital spending and the expansion of credit. A large gap remains between the living standard of the cities and the countryside, between urban zones on the Chinese coast and the interior and western parts of the country, as well as between the urban middle classes and those who have not been able to profit from the growth of recent decades. These inequalities are becoming increasingly worrisome for both Chinese authorities and investors. Poverty has largely decreased in China and unemployment remains stable, at 4%. That rate is expected to remain unchanged in 2019 and 2020. According to the Minister of Human Resources and Social Security Yin Weimin, the low unemployment rate is largely due to the new digital economy and entrepreneurship. Many analysts say, however, that the government figure is an unreliable indicator of national employment levels, as it takes into account only employment in urban areas and does not measure the millions of migrant workers that arrive in the country every year. Finally, around 43 million people continue to live on less than USD 1 per day, which is the poverty line set by the government (according to official statistics, five years ago about 100 million people lived below that line).

INTERNATIONAL TRADE

Thanks to its enormous trade surplus over the past few years, China has become the world's largest exporter and ranks second among the world's largest importers. Despite its strict policies, the country is fairly open to foreign trade, which represents 37.8% of its GDP. China's main exports include transmission apparatus for radio-telephony (7.7%), automatic data processing machines and units (7%), electronic integrated circuits and microassemblies (3%), electrical apparatus for line telephony (2.4%), and parts and accessories for machines and vehicles (2.9%). On the other hand, the country mainly imports electronic integrated circuits and microassemblies (14.2%), petroleum oils (8.9%), iron ores (4.1%), gold (2.8%), and motor vehicles (2.7%).

The country's main partners are the United States, Hong Kong, Japan, South Korea, Vietnam, and Germany. Increasing tensions in the U.S. – China economic relationship have heightened business uncertainties, given that the US is the country's main trade partner (China's 2017 trade surplus with the U.S. was USD 275.81 billion, an all-time record). However, the Chinese government has been adopting looser economic policies to mitigate mounting risks to future growth.

Trade has become an increasingly important part of China's overall economy, and it has been a significant tool used for economic modernization. According to a statement by the General Administration of Customs, China reported a 7.9% increase in exports and 15.9% rise in imports for 2017. According to the World Bank, China's overall trade surplus for 2017 was USD 476.1 billion, a decline from USD 488,8 billion in 2016.

Main International Economic Cooperation

China is a member of the following organisations/agreements: Asia-Pacific economic cooperation Organisation (APEC), Bilateral Treaties and Accords, AFTA and ASEAN - China Free Trade Area.

INVESTMENT

According to the 2019 World Investment Report published by UNCTAD, China was ranked the world's second largest FDI recipient after United States and before Hong Kong. The country is the largest recipient in Asia. China's economy was ranked the second most attractive to multinational companies for 2017-2019, only behind the U.S. With steady growth for several years, FDI inflows continued to increase between 2017 and 2018, from USD 136 billion to 139 billion (+3.7%, all-time high). This growth is favored by liberalization plans, the rapid development of the high-tech sector and the establishment of free trade zones. Despite trade tensions with the United States, more than 60 000 companies were established by foreign investors in 2018, a 70% increase compare to 2017. The country continued absorbing flows from developing Asia and developed countries (UK and Germany), thanks to M&A megadeals. Main deals were the acquisition of a majority stake in Sichuan Swellfun by Diageo ($9 billion), an investment of $4 billion by BMW in the country. However, inflows from the US decreased from $10 to $ 6 billion in 2018. Stocks increased by 9%, reaching 1 627 billion (12.1% of the GDP). Forecasts are positive for 2019: a series a projects in automotive manufacturing and electrical and electronic equipment in East Asia boosted the value of announced projects in China. In 2017, Hong Kong was the largest investor in China. Singapore, the Virgin Islands, South Korea, Japan, the United States, the Cayman Islands, the Netherlands, Taiwan, and Germany were other major investors. Investments were mainly oriented towards manufacturing, computer services, real estate, leasing business and services, wholesale and retail trade, financial intermediation, scientific research, transport, electricity, and construction.

China was ranked 46th out of 190 countries in the World Bank's 2019 Doing Business report, a major improvement from 2018, when it was ranked 78th out of 190. China was one of the top 10 economies to improve the most between the 2018 and the 2019 reports, and it was the only economy from East Asia and the Pacific on the list of top

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improvers. The country demonstrated reform agendas that aim to improve the business regulatory environment in the country over the course of several years. The reforms mainly focus on increasing the efficiency of business processes. In order to attract further foreign investment, the country has introduced mechanisms to improve the delivery of major foreign investment projects, reduce import tariffs, streamline customs clearance, and establish an online filing system to regulate FDI. Given that trade frictions with the US show no signs of abating, more measures to bolster the country's economy can be expected in 2019. And as a result of recently announced liberalization plans, inflows to China could see continued growth over the next few years. With a wealth of employees and potential partners eager to learn and evolve, the country is a base for low cost production, which makes it an attractive market for investors. Nevertheless, certain factors can hinder investments, such as China's lack of transparency, legal uncertainty, low level of protection of intellectual property rights, corruption or protectionist measures which favour local businesses. FDI inflows to the high-tech sector have been rising significantly and currently account for almost a third of total inflows. For instance, Samsung is investing USD 7.2 billion to expand its production line of memory chips in Xi'an. In 2016, Apple made a USD 1 billion fundiang deal with Didi Chuxing, and in 2017 Japan's Soft Bank, along with other companies, contributed to a USD 5.5 billion funding round for Didi Chuxing as well.

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