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## Research Update:

# China Ratings Affirmed At 'AA-/A-1+'; Outlook Stable

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## Research Update:

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## Overview

- China's robust growth prospects, strong net external asset position, and modest government indebtedness are key supporting factors for the government's creditworthiness.
- These strengths offset weaknesses related to China's low middle-income economy, restricted information flows, and continued reliance on direct administrative tools to manage the economy.
- We are affirming our sovereign credit rating on China at 'AA-/A-1+'. In line with this, we are affirming our Greater China regional scale rating at 'cnAAA/cnA-1+'.
- The stable outlook on the global scale long-term rating reflects our view that economic and political developments in the next two to three years are likely to support the rating.

## Rating Action

On Nov. 29, 2013, Standard & Poor's Ratings Services affirmed the 'AA-' long-term and 'A-1+' short-term sovereign credit rating on the People's Republic of China. The outlook on the long-term rating is stable. In line with this, we are affirming our Greater China regional scale rating at 'cnAAA/cnA-1+'. Our transfer and convertibility (T&C) assessment is 'AA-'.

## Rationale

The ratings on China reflect the country's strong economic growth potential, robust external position, and the government's relatively healthy fiscal position. We weigh these strengths against credit factors that are weaker than normally seen in similarly rated peers. These include China's lower average income, lesser transparency, and more restricted information flows. An economic policy framework that is still evolving to suit its largely market-based economy is yet another sovereign credit weakness for China.

Efforts toward deepening structural and fiscal reforms are likely to continue, given the government's recent policy announcements. While growth could decelerate from the historical trend rate, we expect the Chinese economy to continue to perform relatively strongly and maintain its large external creditor position.

We project per capita real GDP growth in 2013-2016 at 6.7%, less than the 8.6% average rate of the previous five years. We expect China's high domestic

savings to be more than sufficient to fund strong investment spending in the near future. Standard & Poor's projects that the associated current account surpluses will keep the country's external debt well below official reserves and financial sector external assets, with net external non-equity assets exceeding 100% of current account receipts throughout 2013-2016.

In our base-case scenario, we project general government debt to increase by an average amount equal to 1.3% of GDP each year over 2013-2016. General government debt should remain largely unchanged relative to GDP, and we forecast net general government debt at 13%-14% of GDP during the period. However, we believe China's fiscal position to be somewhat weaker than these indicators suggest. Local governments in the country owe significant off-budget debt. Much of these debts belong to enterprises that these lower-level governments own. The lack of timely and regularly available data, as well as questions regarding the legal responsibilities of local governments for these debts, makes external monitoring of such debts extremely difficult.

The restricted flow of information and transparency problems in China lessen support for the government's credit standing. Analysts outside China are less likely to be able to detect early developments that materially affect the ability of the sovereign to service debt. This makes future trends in key factors affecting sovereign creditworthiness more unpredictable. It is also difficult to gauge the appropriateness of direct government intervention in the economy, which policymakers rely on for managing the economy. The lack of transparency could also increase the risks of policy mistakes as the Chinese economy increases in complexity.

China's average income remains lower than similarly rated sovereigns, a credit weakness that may exacerbate the impact of errors in economic policies. Standard & Poor's estimates the Chinese per capita GDP in 2013 at close to US\$7,000. This measure signals significant inefficiency in the Chinese economy, making it less resilient to a major shock than a high-income economy. Large adverse developments in the economic or financial sectors, including those related to policy errors, could cause more significant and prolonged damage to growth prospects than in a more efficient economy.

We equalize the T&C assessment for China with the sovereign foreign currency rating. This reflects Standard & Poor's opinion that the likelihood of the sovereign restricting access to foreign exchange needed by China-based non-sovereign issuers for debt servicing is similar to the likelihood of the sovereign defaulting on its foreign currency obligations. The interventionist nature of government policies and the existing foreign exchange restrictions underlie this opinion.

## **Outlook**

The stable outlook reflects our view that economic and political developments in the next two to three years are likely to support the current rating, with structural economic reforms potentially allowing financial sector risks to

ease. In this scenario, China can sustain its real per capita GDP growth at well above the average for economies of its income level. At the same time, we expect policy settings to continue to rein in credit risks in the financial system by restricting the growth of credit to commercially unviable projects.

We may raise the ratings if structural reforms lead to a more vibrant domestic debt market, a greater reliance on market-based macroeconomic management tools, and a more flexible exchange rate. Conversely, we may lower the ratings if reform efforts falter, lowering per capita real GDP growth below 4% annually or causing policymakers to respond with growth-supporting measures that increase risks to financial sector stability.

## Key Statistics

Table 1

China--Selected Indicators											
	2006	2007	2008	2009	2010	2011	2012	2013e	2014f	2015f	2016f
Nominal GDP (US\$ bil.)	2,793	3,504	4,547	5,106	5,950	7,314	8,384	9,533	10,914	12,545	14,392
GDP per capita (US\$)	2,106	2,626	3,387	3,778	4,375	5,345	6,088	6,890	7,852	8,983	10,257
Real GDP growth (%)	12.7	14.2	9.6	9.2	10.5	9.3	7.7	7.3	7.3	7.1	7.0
Real GDP per capita growth (%)	12.0	13.5	9.0	8.5	9.8	8.6	7.0	6.8	6.8	6.6	6.5
Change in general government debt/GDP (%)	1.1	6.4	0.4	2.0	1.8	1.0	1.0	1.5	1.3	1.3	1.3
General government balance/GDP (%)	(0.5)	0.8	(0.3)	(2.2)	(1.7)	(1.1)	(1.6)	(1.5)	(1.3)	(1.3)	(1.3)
General government debt/GDP (%)	22.1	24.9	21.4	21.4	20.3	18.3	17.4	17.1	16.7	16.2	15.8
Net general government debt/GDP (%)	17.6	18.5	16.0	15.3	14.3	13.5	13.4	13.5	13.5	13.4	13.3
General government interest expenditure/revenues (%)	2.2	1.8	1.9	2.0	1.8	1.8	1.8	2.1	2.0	2.0	1.9
Oth dc claims on resident non-govt. sector/GDP (%)	107.5	107.2	103.1	124.3	129.5	127.1	132.2	138.0	139.2	139.8	140.7
CPI growth (%)	1.5	4.8	5.9	(0.7)	3.3	5.4	2.6	2.5	3.2	3.4	3.5
Gross external financing needs/CARs +use. res (%)	60.9	56.8	52.4	47.1	48.6	52.6	53.3	51.4	51.6	53.9	55.8
Current account balance/GDP (%)	8.3	10.1	9.3	4.8	4.0	1.9	2.3	3.2	2.9	2.6	2.5
Current account balance/CARs (%)	20.2	24.1	24.1	16.4	12.3	5.9	7.9	11.6	10.6	9.9	9.7
Narrow net external debt/CARs (%)	(91.2)	(96.7)	(109.8)	(154.0)	(136.6)	(128.6)	(126.4)	(125.1)	(116.1)	(110.8)	(104.4)
Net external liabilities/CARs (%)	(57.7)	(80.7)	(86.8)	(102.3)	(92.7)	(83.9)	(82.0)	(86.3)	(85.5)	(85.5)	(85.9)

**Table 1**

**China--Selected Indicators (cont.)**

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. The data and ratios above result from S&P's own calculations, drawing on national as well as international sources, reflecting S&P's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

**Related Criteria**

- Sovereign Government Rating Methodology and Assumptions, June 24, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance And Sovereign Issuers, May 7, 2013
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

**Ratings List**

Ratings Affirmed

China (People's Republic of )	
Sovereign Credit Rating	AA-/Stable/A-1+
Greater China Regional Scale	cnAAA/--/cnA-1+
Senior Unsecured	AA-
Senior Unsecured	cnAAA

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