People's Republic of China
Rating Report

STABLE OUTLOOK

A

Credit strengths

- Large, diversified economy with strong growth potential
- High external resilience and large foreign exchange reserves
- Government control in some sectors may facilitate effective reforms

Credit challenges

- Large public sector deficits and rising public debt
- Financial imbalances, including high levels of non-financial sector debt

Rating rationale:

Large, diversified economy: China's rating is supported by its large, highly diversified, competitive economy. Despite a gradual decline towards more sustainable growth potential, near-term growth expectations remain high compared with similarly rated peer countries.

High external resilience: The country's high external resilience is underpinned by high foreign exchange reserves, low external debt and consistent current account surpluses.

Government's scope to implement reforms: China's central government exerts a significant degree of control in some sectors. This can support the implementation of effective reforms, including extraordinary macroprudential measures. While this increases the ability to bring about fundamental reform when tackling high levels of leverage, it can also have credit-negative implications if it leads to lower quality of governance and policymaking.

Rating challenges include: i) large structural public sector deficits and an increasing public sector debt stock over the long run; and ii) financial imbalances, including high levels of total non-financial sector debt since 2008.

China's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aa	CNY [+1]	+3/3	A
Public Finance Risk		20%	b+		0	
External Economic Risk		10%	aa+		+3/3	
Financial Stability Risk		10%	bb+		0	
ESG Risk	Environmental Factors	5%	cc		-1/3	
	Social Factors	7.5%	a-		0	
	Governance Factors	12.5%	c		0	
Indicative outcome		**bbb+**			**+2**	
Additional considerations					**0**	

Note: For details, please see Scope's 'Sovereign Ratings' methodology. In line with the methodology, movements between indicative ratings are not immediate but executed after analyst review of the core variable scorecard results. The rating committee approved an indicative rating of 'bbb+'. The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Public finances strengthen, resulting in an improving public debt trajectory
- Strengthened financial stability and/or sustainability of the economic growth outlook thanks to economic and financial reforms
- The renminbi makes substantive gains as a reserve currency

Negative rating-change drivers

- Materialisation of financial or economic shock, impairing medium-term economic growth
- Weakening fiscal outlook and continued rise in the debt trajectory due to a protracted fiscal deterioration and/or crystallisation of contingent liabilities
- Material weakening of external resilience

Ratings and Outlook

Foreign currency

Long-term issuer rating	A/Stable
Senior unsecured debt	A/Stable
Short-term issuer rating	S-1/Stable

Local currency

Long-term issuer rating	A/Stable
Senior unsecured debt	A/Stable
Short-term issuer rating	S-1/Stable

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Bloomberg: RESP SCOP

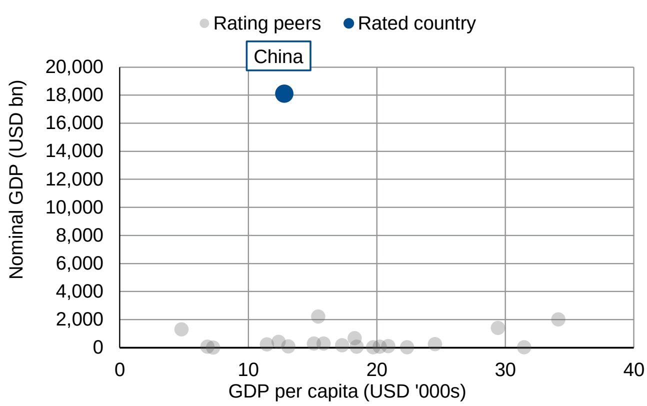
Domestic Economic Risks

- **Growth outlook:** After a strong rebound in 2021 following the initial phase of the Covid-19 pandemic, with economic output growing by 8.4%, GDP growth slowed more than expected to 3.0% in 2022. The decline was driven by the implementation of China’s zero-Covid policy which led to large-scale lockdowns and weaker domestic demand, a prolonged contraction in the real estate sector, as well as a slowdown in exports amid weaker global growth. The rapid easing of Covid restrictions and government intervention to ease pressures in the real estate market are supporting a faster-than-expected recovery in domestic economic activity with GDP growth of 4.5% YoY in Q1 2023. We expect China’s economy to grow by 5.5% in 2023 with an uneven recovery driven by the services sector as retail sales and spending on services rebound after prolonged lockdowns, with weaker growth in the manufacturing sector. Growth is then expected to slow to 4.7% in 2024 and gradually fall to around 4% by 2026.
- **Inflation and monetary policy:** CPI inflation peaked at 2.7% in September 2022 on the back of higher food and energy prices, remaining below the government's 3% inflation target. It has since declined, averaging 1.9% in 2022 and reaching 0.8% in March 2023. Core inflation (excluding food and energy prices) stayed below 1% since early-2022, falling to 0.5% in March. Amid the correction in real estate markets and the recent economic rebound, the People’s Bank of China kept the benchmark five-year and one-year loan prime rates (LPR) unchanged since September 2022 at 4.3% and 3.65%, respectively. The five-year LPR is used as the reference rate for housing loans. To support lending, the reserve requirement ratio for financial institutions was cut by 25 bps and there could be room for policymakers to take further steps in supporting the uneven economic recovery. However, we expect only targeted support measures as authorities remain concerned about rising financial imbalances.
- **Labour markets:** The official survey-based national urban unemployment rate declined to 5.3% in March, down from its 6.1% peak in April 2022. The recent decrease was driven by a falling unemployment rate of the population aged 25-59, while those aged 16-24 saw an increase to near record highs. The unemployment rate in the 31 largest cities also declined from 6.7% in November 2022 to 5.5% in March. We expect the unemployment rate to average 5.4% in 2023 and remain stable in 2024.

Overview of Scope’s qualitative assessments for China’s *Domestic Economic Risks*

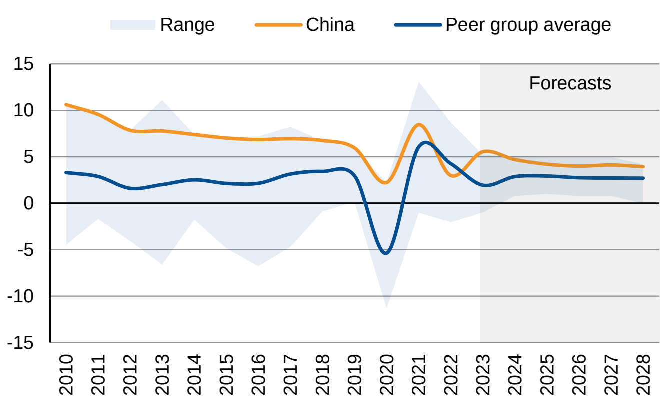
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Growth potential of the economy	Strong	+1/3	Growth potential is still high despite structural decline
	Monetary policy framework	Strong	+1/3	Effective monetary policy and exchange-rate policy, focus on maintaining financial stability
	Macro-economic stability and sustainability	Strong	+1/3	Highly diversified, competitive economy, significant economic size, labour market rigidities

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

Public Finance Risks

- **Fiscal outlook:** The general government deficit as measured by the IMF (which includes some off-budget spending by local governments) fell from 9.7% of GDP in 2020 to 6.0% in 2021 driven by lower levels of public investment but rose back to 7.5% in 2022 as a result of China's zero-Covid policy and the worsening outlook in the real estate sector. Large-scale support measures amounted to RMB 4.2trn in 2022 (3.4% of GDP) and included tax cuts and fee rebates for businesses, particularly for small and medium-sized firms. Local government finances have been significantly impaired by the sharp decline in land sale revenues amid the real estate market downturn. As a result, the central government is making large transfers to support local governments. Transfers increased by around 17% in 2022 and are expected to rise further by 3.6% in 2023, reaching just over RMB 10trn (8.2% of GDP). We expect fiscal deficits to remain above pre-pandemic levels at around 7% over the next years due to higher expenditure on public services such as healthcare, education and defence.

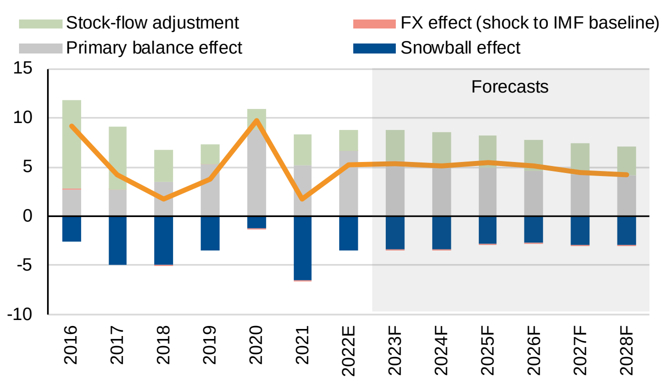
- **Debt trajectory:** Debt levels were on a rising trajectory in the decade before the pandemic. While central government debt remains low at 21.4% of GDP as of Q4 2022, China's general government debt increased from 34% of GDP in 2010 to 77% in 2022. This public debt estimate by the IMF includes central government debt as reported by the Ministry of Finance, explicit local government debt, and shares of contingent liabilities the government may incur based on estimates from the national audit office. The fiscal stimulus in response to the Covid-19 pandemic and the slowdown in real estate markets has continued to push up debt levels, which are expected to reach 82% this year. We expect the trend from recent years to continue, with debt exceeding 100% of GDP by 2027.

- **Debt profile and market access:** China's benchmark 10-year yield has been stable at around 2.8% since 2022, staying below pre-crisis levels. The average maturity of central government debt has also remained stable over the past two years and stood at 6.2 years in March 2023, up from around 5 years before the pandemic. The country issues mainly in renminbi, although there has been increasing foreign-currency issuance (US dollars, euros, Hong Kong dollars and Japanese yen). These include more significant dollar issuances in recent years by local authorities and local government financing vehicles, often with shorter remaining maturities. Local government financing vehicles will face a peak in debt maturing in 2023 at USD 5.5trn. The central government has planned to increase regular bond issuance this year by 20% to RMB 3.16trn to finance a slightly bigger deficit and help to partially reduce pressures on local government debt.

Overview of Scope's qualitative assessments for China's *Public Finance Risks*

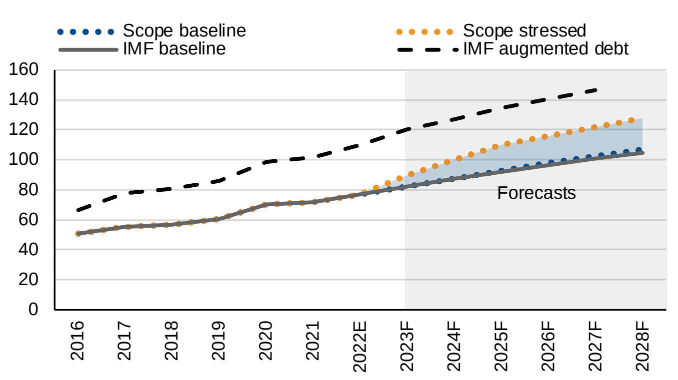
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b+	Fiscal policy framework	Weak	-1/3	Significant structural deficits, wider augmented budget deficits with inclusion of off-balance sheet spending
	Debt sustainability	Neutral	0	Rising public debt ratio, significant off-balance sheet debt, but moderate explicit central government debt
	Debt profile and market access	Strong	+1/3	High government financing needs but most issuance in local currency, significant government assets, development of domestic bond market

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

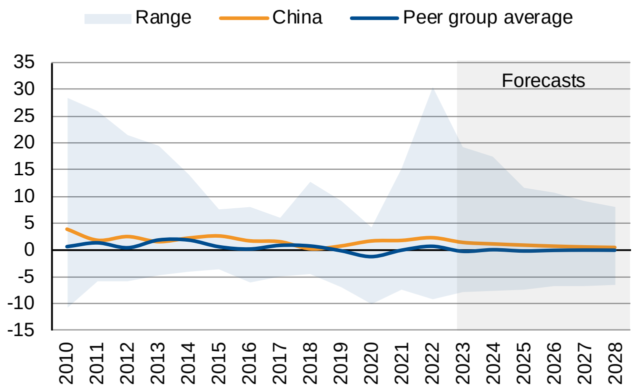
External Economic Risks

- **Current account:** China's current account surplus increased significantly at the onset of the pandemic, rising from 0.7% in 2019 to 2.3% in 2022. Pandemic-related factors contributed to the higher surpluses and included increased medical exports, subdued outbound tourism and a rapid shift in consumption patterns towards goods rather than services among households abroad. Annual export growth has slowed since mid-2022 as a result of weaker global demand, although the trade surplus was supported by weaker imports driven by the domestic economic slowdown with the real estate crisis reducing commodity imports. We expect the current account surplus to narrow over the coming years as higher commodity and energy prices raise import costs and China's economy continues to rebalance towards more consumption-driven growth.
- **External position:** China's net international investment position (NIIP) gradually fell over the past 10 years from 24.5% of GDP in 2010 to 14.0% of GDP in 2022. The decline reflects higher inward direct investment and securities investment received amid relatively robust GDP growth. The NIIP is expected to remain positive but decline over the medium term, although it is still expected to be above the peer group average. FDI inflows reached an all-time high of USD 334bn in 2021 (1.8% of GDP) as the impact of Covid-19 on GDP growth faded and the authorities implemented initiatives to liberalise the economy for foreign firms. However, inflows slowed during 2022, reflecting the impact of continued Covid lockdowns, slowing economic growth and a weaker renminbi due to monetary policy divergence.
- **Resilience to shocks:** Resilience to short-term shocks is bolstered by the country's sizeable and stable foreign exchange reserves, which amounted to around USD 3.2trn in March 2023, and its low external debt of USD 2.5trn (13.6% of GDP) as of Q4 2022. Russian sanctions over the Ukraine invasion and hikes in US interest rates have fuelled discussions on a faster reduction of China's reliance on the US dollar. Anticipated long-run gains by the renminbi as a global reserve currency are expected to increase the government's capacity to manage higher debt stocks. It would also enhance the currency's resilience and China's external-sector stability, such as reducing vulnerabilities to periods of capital outflows. In March 2023, the renminbi became the most widely used currency for cross-border transactions in China reaching 48.4% of transactions compared with 46.7% of USD-denominated transactions. However, wider global adoption will be gradual as the currency still accounts for just 4.5% of global currency transactions compared with 83.7% for USD transactions.

Overview of Scope's qualitative assessments for China's *External Economic Risks*

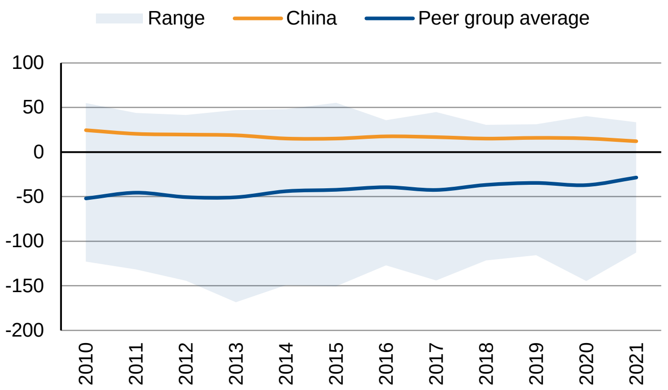
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Current account resilience	Strong	+1/3	Diversified, competitive export base, current account surpluses, risk from periods of capital outflows
	External debt structure	Strong	+1/3	Very low external debt, public and financial sectors have strong liquid external assets
	Resilience to short-term external shocks	Strong	+1/3	Sizeable foreign-exchange reserves, rising international use of the renminbi and foreign investment in domestic assets

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

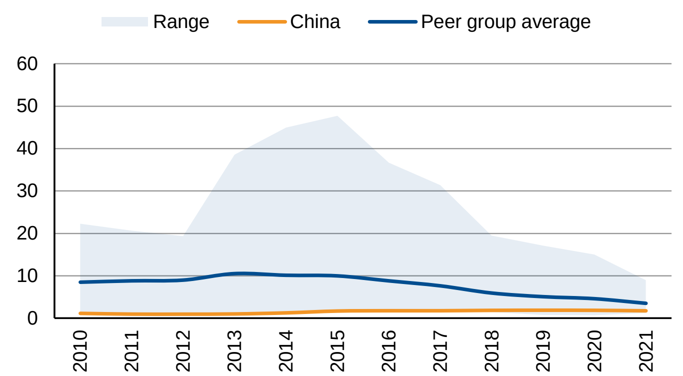
Financial Stability Risks

- **Banking sector:** On average, the banking sector has maintained stable Tier 1 capital levels of around 12% throughout the pandemic crisis and the real estate sector turmoil to date. Reported non-performing loans have also remained below the peer group average at less than 2%. However, balance sheet pressures may emerge for smaller banks and non-bank lenders given their real-estate exposures and limited capital buffers. The new Financial Stability Law which may be introduced this year could help mitigating systemic shocks from potential failures of smaller banks. Aggregate social financing, a broad measure of credit and liquidity in the economy, increased by 9.6% YoY in March 2023, steadily accelerating from the 9% average increase in 2022. This reflects the actions taken by authorities over the past months to sustain credit lending amid the economic slowdown, including support for small businesses, and for stable growth of property loans to help cushion the downturn in real estate markets.
- **Private debt:** Total credit to private non-financial sectors steadily increased and stood at 220% of GDP in Q3 2022, close to all-time highs reached in mid-2020. Private sector debt levels in China therefore remain well above average levels in emerging economies (149%) and advanced economies (157%). Most of this debt relates to non-financial corporations where the debt-to-GDP ratio stood at 161% at the end of 2022, while household debt levels have remained elevated but stable at 62% of GDP. Credit growth is likely to continue increasing over the coming months as authorities ease restrictive measures previously introduced with a view to cushion the sharp correction in real estate markets.
- **Financial imbalances:** Previous policies introduced to reduce borrowing of highly indebted property developers resulted in several prominent developers defaulting and a correction in real estate prices. Prices for existing house sales fell sharply throughout 2022 and have only started to stabilise in March 2023 due to significant intervention by authorities. The pace of restructuring real estate developers has been slow, partially to avoid very large losses from materialising for pre-sale homebuyers. A 16-point plan was announced in November 2022 in an attempt to soften the correction in the real estate market. This includes measures by the central and local governments to support homebuyer demand by introducing mortgage repayment moratoria, protecting homebuyer's credit scores, introducing a central government-funded mechanism to finance the completion of unfinished housing projects and allowing borrowers to renegotiate repayment schedules. In addition, developers and construction firms have been able to extend their loans and restrictions on bank lending to developers have been eased. While the policies are helping to cushion the immediate impact on the real estate market, they also raise already high levels of leverage while the need to restructure developers remains.

Overview of Scope's qualitative assessments for China's *Financial Stability Risks*

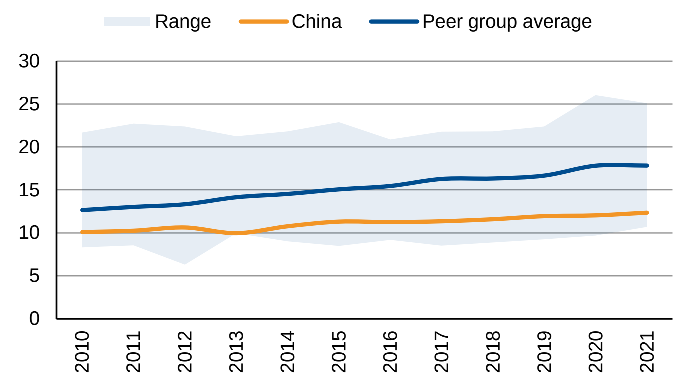
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Banking sector performance	Neutral	0	Low (reported) non-performing loans
	Banking sector oversight	Strong	+1/3	Significant commitment and ability to counteract financial system risks, improvements in financial supervisory regime
	Financial imbalances	Weak	-1/3	High non-financial sector debt, gradually improving credit growth

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG Risks

- **Environment:** China is vulnerable to natural disaster risk, particularly the country's low-lying coastal cities which are home to around one-fifth of China's population and contribute around one-third of GDP. The country is the world's largest emitter of carbon dioxide, accounting for around 27% of global CO_2 emissions. While meaningful progress is being made in cutting the carbon intensity of the economy, the World Bank notes that significant policy and regulatory reform will be needed for China to meet its target of stopping the growth in emissions by 2030. Successful reform will require private sector participation and includes increasing the wind and solar power generation capacity, accelerating electrification of transport, reskilling workers in affected sectors, supporting low-carbon land use in the agricultural sector, and expanding the current emissions trading system. The 14th five-year plan set specific targets regarding the energy system and green development, which are broadly in line with China's current climate commitments to carbon neutrality by 2060. China is also becoming a leader in green finance with a steady increase in green bond issuance, which more than doubled in 2022.

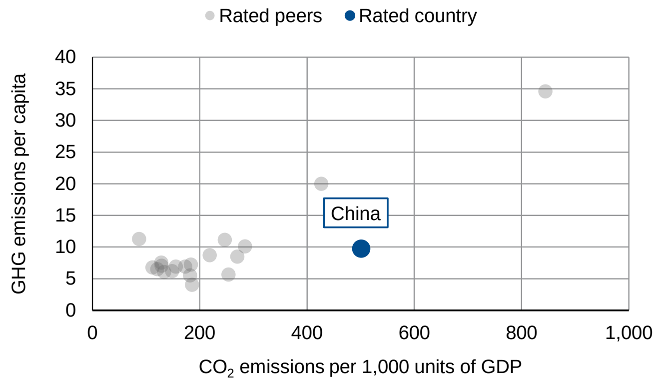
- **Social:** Significant social progress has been achieved over the past decade, including improvements in poverty, education and health. Moreover, the current five-year plan places greater focus on the quality and efficiency of economic growth and citizens' lives (including concentrating on GDP per capita). Priorities include boosting social safety nets, reducing urban-rural inequality and on property rights reform. Social safety nets remain inadequate given that less than half of urban employees are ordinarily covered by unemployment insurance, with much lower rates for rural households. China's health expenditure of about 5.3% of GDP is below other upper middle-income countries (5.8%), although the gap has narrowed in recent years. While China's old-age dependency ratio is still more favourable than those of advanced economies, its rapidly ageing population will pose challenges for the social security system. The US and other Western nations have repeatedly accused China of human rights violations, which China has disputed.

- **Governance:** The 18th Communist Party Congress allowed President Xi Jinping to solidify his power, securing a third term for the first time in the history of the People's Republic of China. The politburo's standing committee mainly consists of loyal allies of the president. While such power consolidation can simplify the implementation of some reforms, it has credit-negative implications over the longer run. We believe it may undermine the delicate collective leadership structure underpinning China's decades-long economic miracle and reduce the quality of governance and policymaking in the long term. Rising geopolitical tensions with the US may have repercussions on economic and trade practices.

Overview of Scope's qualitative assessments for China's *ESG Risks*

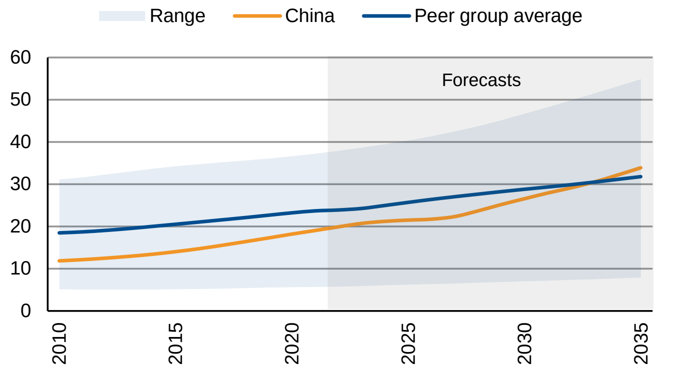
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Environmental factors	Weak	-1/3	Significant transition risks in greening the economy but progress made has been substantive and objectives are ambitious
	Social factors	Neutral	0	High income and urban-rural inequalities, declining working age population, but strong educational attainment and reduction of poverty
	Governance factors	Neutral	0	Improved government effectiveness, President Xi's power consolidation poses long-term governance risks

Emissions per GDP and per capita, $mtCO_2e$



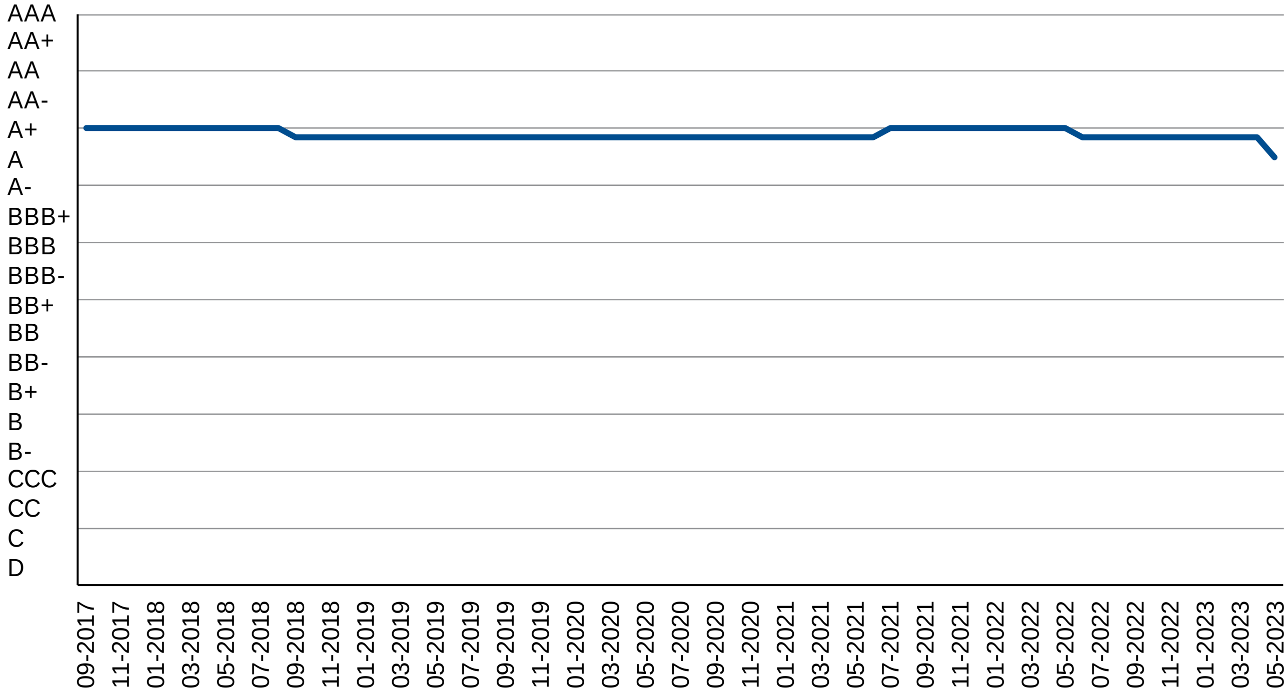
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Bulgaria
Croatia
Cyprus
Hungary
Italy
Latvia
Poland
Portugal
Romania
Slovakia
Spain

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	**GDP per capita, USD '000s**	IMF	9.8	10.2	10.5	12.6	12.8	13.7
	Nominal GDP, USD bn	IMF	13,841.8	14,340.6	14,862.6	17,759.3	18,100.0	19,373.6
	Real growth, %	IMF	6.8	6.0	2.2	8.5	3.0	5.2
	CPI inflation, %	IMF	1.9	2.9	2.5	0.9	1.9	2.0
	Unemployment rate, %	WB	4.3	4.6	5.0	4.6	-	-
Public Finance	**Public debt, % of GDP**	IMF	56.7	60.4	70.1	71.8	77.1	82.4
	Interest payment, % of revenue	IMF	2.8	3.0	3.7	3.4	3.6	4.3
	Primary balance, % of GDP	IMF	-3.5	-5.3	-8.8	-5.1	-6.6	-5.8
External Economic	**Current account balance, % of GDP**	IMF	0.2	0.7	1.7	1.8	2.3	1.4
	Total reserves, months of imports	IMF	13.1	13.8	14.7	11.7	-	-
	NIIP, % of GDP	IMF	15.2	16.0	15.4	11.2	-	-
Financial Stability	**NPL ratio, % of total loans**	IMF	1.8	1.9	1.8	1.7	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	11.1	11.5	11.9	11.9	12.2	-
	Credit to private sector, % of GDP	WB	157.8	165.4	182.9	-	-	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	541.7	523.3	519.6	501.4	-	-
	Income share of bottom 50%, %	WID	14.4	14.4	14.4	14.4	-	-
	Labour-force participation rate, %	WB	76.0	75.9	-	-	-	-
	Old-age dependency ratio, %	UN	16.4	17.2	18.2	19.0	19.9	20.7
	Composite governance indicators*	WB	-0.3	-0.4	-0.3	-0.3	-	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 11 May 2023	73.71

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