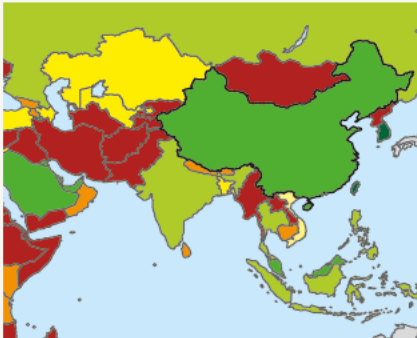


Basic facts (2020)

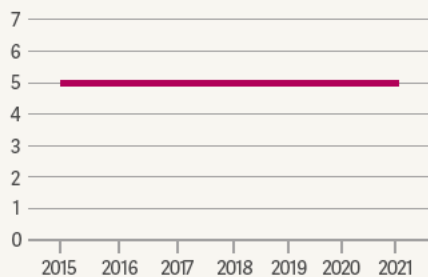
Population: 1 404 million

GDP, nominal: USD 14 723 billion

GDP/capita: USD 10 484



The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the country's creditworthiness

Country classification history

Source: EKN

Strengths

- + Large diversified economy
- + Robust growth potential
- + High national savings rate
- + Strong external position with low external debt and large reserves
- + The regime has a history of navigating difficult policy challenges
- + Capital controls

Weaknesses

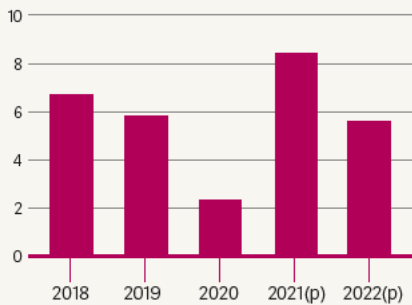
- Credit-intensive growth creates domestic financial imbalances and high public sector debt.
- Growing trade and geopolitical tensions
- Lack of data transparency.

Large diversified economy and strong external balances

A large diversified economy (the world's second largest), strong external balances, and regulated capital flows, provide resilience to external disruptions. The economy has a large, diversified and increasingly advanced manufacturing and export sectors (31% and 22% of GDP, respectively). As a global production hub, China is both the world's largest exporter and importer of raw materials, and China's integration into global production flows is high. The country's financial integration is steadily increasing. However, capital flows are gradually and asymmetrically being liberalized in order to safeguard financial stability. The openness to portfolio inflows has increased significantly in recent years, while domestic outflows are surrounded by regulation. China's now moderate current account surplus comes from structural trade surpluses offsetting the service balance deficit widened by increased foreign travel. For many years now, China has been a net creditor to the rest of the world. While international reserves are not as large relative to the economy as before they still exceed the low external debt (about 16% of GDP). Instead, over the past decade, China has emerged as the largest official bilateral creditor and a leading investor in emerging and developing countries.

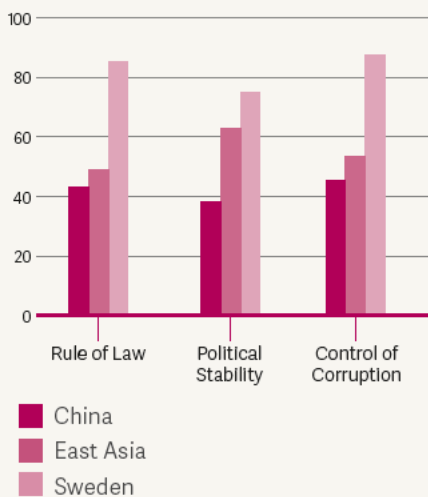
From a credit and macro stability perspective, China's challenges are primarily domestic. According to most estimates, the potential growth of the economy remains robust, around 5-6%, but is in a structural decline. The trend is driven by demographics and the decline of previous growth impulses from globalisation, technology transfer, and expansion in the property and infrastructure sectors. At the same time, the pace of reform seems to have slowed with regard to state-owned enterprises (SOEs) and reforms designed to unlock new growth dynamics in the private sector. Instead, financial imbalances have emerged and productivity growth has slowed since the 2008 financial crisis, when the growth model shifted from an export-intensive to a more investment and credit intensive model. Domestic indebtedness has risen sharply, primarily driven by local governments and SOEs. Overcapacity has been built up in capital-intensive industrial sectors and recurring overheating tendencies are visible in the property sector. Therefore, the 2016-20 Five-Year Plan was characterised by initiatives to promote the transition to more sustainable growth driven by domestic consumption, the service sector and where environmental considerations and increased value added by means of high technology play a growing role. In addition, measures to curb financial imbalances were intensified. The policy was successful to some extent. Household consumption expenditures remain low relative to GDP (a bit under 40%) but is now one of the most important growth engines driven by a growing urban middle class. Relative to GDP, investment in research and development is on track to reach levels in leading Western nations and China is climbing the Global Innovation Index, GII (14th place 2020, 25th 2016). The importance of the services sector is steadily increasing (55% of GDP). However, despite declining marginal returns, public stimulus and lending have remained the primary tools to ensure that growth targets are achieved, and investment's share of GDP remains very high (over 40% of GDP).

GDP growth (fixed prices, % per annum)



Source: IMFWEO April 2021

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

Increased focus on financial imbalances

After the COVID-19 virus began to spread in Wuhan in the autumn of 2019, China was closed in the first quarter of 2020 and a large drop in GDP was noted. With its extraordinary control capabilities, China brought the infection rates down early on and has so far managed to isolate sporadic contagion clusters. The recovery thus started early and China is the only leading economy that was able to end 2020 with annual GDP growth (+2.3%). The recovery has been driven not only by major public stimulus that has boosted the infrastructure and construction sector but also by exports. With its own production capacity, the rate of vaccination has accelerated, which is why “herd immunity” may be within reach as early as in the autumn of 2021. There are signs that the recovery continues to widen in the services sector and private demand. Given that China has managed to keep sporadic COVID-19 outbreaks under control and the situation continues to brighten in the West, forecasts point to a growth rebound in 2021 of around 7-8% before China returns to its previous trajectory with GDP growth of slightly over 5%.

The five-year plan 2021-25 signals a renewed focus on the quality of growth. For the first time in many years, precise growth targets are missing and the focus is on increased domestic consumption and the green transition, while at the same time the dependence on technology from outside the country will decrease and the pace of innovation will increase. China’s rapid recovery has however taken place at the cost of the financial imbalances escalating again, not the least in the form of increased indebtedness of local governments, SOEs and property companies. This also increases vulnerabilities in parts of the financial sector. The debt ratio, measured as total debt relative to GDP in the non-financial sector (public sector, enterprises, households), has increased again sharply in 2019-20 to about 280% in 2020 (249% in 2018). The IMF estimates of total general government debt suggest that it is high (over 90% of GDP) and rising. As public stimulus efforts are reduced, the focus returns to managing these risks. China is assessed to have buffers in place to manage the risks over time and stabilise the debt. The debt issues are domestic, and largely a matter for the wider public sector. This increases the government’s ability to deal with debt in an orderly manner. The central government also has significant assets available and scope to increase revenues. With high domestic savings and capital controls, interest rates are low and the availability of domestic financing is good as long as the domestic savers’ confidence is maintained.

Business environment

China is one of the world’s top destinations for direct investments. Investors are attracted by a growing and increasingly sophisticated consumer market as well as good conditions for large-scale industrial production with expanded infrastructure and logistics, larger industrial clusters of integrated value chains, and China’s growing role as an innovation hub. Chinese public authorities have actively made efforts to improve the conditions for entrepreneurship, for example by using digitalisation to rationalise in processes related to permits, tax payments, etc. This contributes to China climbing in the World Bank’s business climate (Ease of Doing Business, DBI) rankings. In 2020, China reached number 31 (out of 190 countries) (80, 2016). DBI ranks China 56th (5th in Asia) in terms of time and cost of import and export procedures and logistics.

From EKN's credit risk perspective, important aspects of the business environment are related to the degree of predictability, stability and quality both in regulations that affect our obligors' business operations and in the country's legal and institutional environment that affect the position of lenders and creditors. In relation to EKN's strong country risk category of China, the business environment in these respects shows some institutional shortcomings. This is partly related to China's governance model with the significant influence of the State and ultimately the Party on the economy. Neither the judiciary nor regulators can be regarded as being independent. The dividing lines between the state and the banking and business sectors are in many respects blurred, not the least at the regional level. This is reflected in China's performance in the World Bank's Worldwide Governance Indicators on economic institutions that are dragged down by regulatory quality and the assessment of the rule of law. This contributes to China being just below the average for the region in this index, despite a state apparatus that is in many respects effective. One regulatory dimension that is difficult to capture in indices is that foreign companies operating in China are at risk of being caught up in the increasing economic and political tensions between the United States and China. These tensions, affect the two countries' regulations on investments, technology transfer, and sanctions regimes, among other things.

On the legal side, the Bankruptcy Act was modernised in 2007 and reform work is under way to strengthen the credit environment. The average recovery rate (in one transaction with collateral) is estimated by DBI at 37%, which is just below the average in the region (40%, in Sweden 78%). As infrastructure in the form of special courts for bankruptcy and liquidation has begun to reach a critical mass, there is an increasing use of bankruptcy that has long been sparse. Another driver is that bankruptcies have begun to be used to reform SOEs to discipline the credit market, which had tended to lend to SOEs under the assumption of implicit state guarantees. The number of SOEs that have defaulted on the domestic bond market has risen over the past 5 years, albeit from low levels. The public authorities are now signalling a more selective use of rescue operations and an increased tolerance for SOE defaults. This applies primarily to SOEs that are not systemically important or strategic and SOEs controlled by lower levels of the state apparatus, not the least financially weaker provinces. Such counterparties are likely to experience rising financing costs going forward. Credit analysis of SOEs may rely on assumptions about state aid to a lesser and lesser degree. Instead, financial transparency is required. The access to this is varied. In groups of companies and conglomerates, ownership and corporate structures are often complex. In private companies, concentration of ownership in a key individual or family is not uncommon. Financing from outside the formal banking system may hamper transparency. Also, the credit analysis need to consider that companies may have benefited from support measures in response to the pandemic such as deferral of payments, as these measures can be expected to be phased out.

Swedish export to Brazil

	MSEK
2020	10 034
2019	9 473
2018	7 976
2017	7 337
2016	6 791

Source: SCB

EKN:s exposure

	MSEK
Guarantees	53 635
Offers	1 374

EKN:s policy

EKN has placed China in country risk category 2 (of 0 to 7) for more than a decade. Normal risk assessment applies to all debtor categories. This means that there are no predetermined limitations in the issuance of guarantees and that the transactions are assessed on their own merits without specific requirements

or preconditions.

EKN:s commitment and experience

EKN's guarantee commitments amount to SEK 2.4 billion, of which just under SEK 1.2 billion are outstanding guarantees, the rest are pledges. During the period 2016-20, EKN issued guarantees in 223 export transactions for 46 export companies totalling SEK 5.4 billion. The dominant sectors in the flow were transport and construction equipment. SME exporters accounted for 6% of the guarantee volume. Over 95% of the guarantee volume relates to transactions with credit terms up to one year and 40% refers to letter of credit guarantees where EKN shares the risk with banks confirming letters of credit on behalf of the Swedish exporter and where the counterparty risk rests with Chinese banks. The predominance of short-term transactions suggests that demand for longer financing is limited. This may reflect not only a good supply of domestic financing, but also that currency regulation may dampen demand. EKN's payment experience has been good, with few losses due to claims. This can be partly explained by the large element of letter of credit guarantee transactions where losses due to claims is usually low. Delays in payment are common in guarantees for SME exporters. Of the SME guarantees issued during the period 2016-20, payment arrears were notified in 26% until May 2021. The arrears lasted 60 days on average. However few transactions have resulted in a loss due to claims, Over the past 5 years, EKN has settled claims in 3 transactions for a total of SEK 7 million. The recovery rate varies but amounts to a total of about 45 per cent.