

China's Ratings Affirmed

05 Mar 2009 3:42PM

Fitch Ratings-Hong Kong/Singapore-05 March 2009: Fitch Ratings has today affirmed the People's Republic of China's Long-term foreign currency and local currency Issuer Default Ratings (IDRs) at 'A+' and 'AA-' (AA minus), respectively. The Outlook on the ratings is Stable. At the same time, the agency has affirmed China's Short-term foreign currency IDR at 'F1' and Country Ceiling at 'A+'.

"While China's economy is decelerating markedly amid recessionary conditions across advanced economies and emerging markets, the Chinese sovereign retains an exceptionally strong external balance sheet," notes James McCormack, Head of Asia Sovereigns. "In addition, the central government's fiscal position is sufficiently robust to allow for an aggressive counter-cyclical policy response to what is clearly an economic hard landing," adds Mr. McCormack. Fitch forecasts real GDP growth will slow to 5.6% in 2009, the lowest growth rate since 1990, from 9.0 in 2008.

In November 2008, the Chinese government announced a two-year, CNY4tn fiscal stimulus package, equivalent to 13% of forecast 2009 GDP. In Fitch's view, the scale of the package confirms the authorities' commitment to supporting economic growth; further fiscal and monetary policy measures are likely to be undertaken during the course of the downturn. The agency notes, however, that there are several qualifications and risks associated with both the economic outlook and the government's policy response.

In terms of the growth outlook, Fitch does not believe that stimulus measures can fully offset the downward momentum that is evident across the economy. Indeed, the agency suggests that China's economic recovery depends primarily on the timing of the recovery in major trading partners. Fitch projects a 12% decline in exports this year, in the most abrupt contraction of the trade sector since economic reforms began 30 years ago.

Fitch estimates central government debt was 21.9% of GDP at end-2008, well below the 'A' peer group median of 42%. The relatively low debt burden certainly provides Chinese policymakers with some flexibility regarding the adoption of additional debt-financed stimulus programme, but it also underscores the fact that Chinese fiscal data are incomplete. Local governments are not allowed to incur any debt - and thus do not report any outstanding obligations - but they are widely known to have borrowed indirectly through state enterprises. Moreover, local governments have a significant role in implementing the CNY4tn stimulus plan, implying their financial positions are likely to be under additional strain as they roll out large projects to support economic growth. Fitch considers local government debt and local government guarantees on borrowing by state enterprise to be contingent liabilities of the sovereign.

The agency identifies Chinese banks as another contingent sovereign liability, and they too are active in the current stimulus programme, with massive increases in lending since November 2008. Fitch believes the surge in lending is based largely on the understanding that projects included in the stimulus plan are state-sponsored. Any problems the banks experience with the new projects - and any consequent sovereign support for the banks - may not materialise for some time, however, as about one-half of the CNY4tn stimulus is directed at infrastructure investment, where excess capacity and inadequate returns on investment would not be immediately evident.

China's relatively weak short-term economic outlook and the risks surrounding the policy response to the slowdown do not undermine support for sovereign creditworthiness derived from the country's balance of payments performance and net external credit position. In 2009, Fitch forecasts a current account surplus of USD299bn (6.4% of GDP) and net external credit of USD2.4tn. The agency expects China to continue to add to its official foreign exchange reserves, albeit by a much smaller amount than in recent years.

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