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# PANORAMA

## China's two-speed economy: Sector winners and losers

COFACE ECONOMIC PUBLICATIONS

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**C**hina's ongoing structural reforms have shifted to a greater focus on services and consumption, making the country's two-speed economy even more evident. The divide between winning and losing sectors is linked to their medium and longer term growth potential, relevant government policies and structural demand.

The sector winners and losers indicate the longer term growth prospects, while Coface's updated quarterly sector risk assessments point to the short-term credit risks for Chinese corporates in 12 sectors. In general, sector winners likely to enjoy brighter longer term growth outlooks, such as pharmaceuticals and retail, have been assigned with low or medium risk assessments. The Information communication technologies (ICT) segment is an exception to this, being a sector winner assigned with a high risk rating. This would indicate that the

credit risks of Chinese corporates in the ICT sector are probably high due to keener regional competition, despite the market's strong longer-term growth potential.

Sector losers that are likely to face longer term growth challenges, such as chemicals and metals, are assigned with either high, or very high risk ratings. This indicates that the high to very high short-term credit risks for Chinese corporates in these sectors will probably continue, with challenging business conditions persisting in the longer term. Neutral sectors that do not directly benefit from the government's structural reforms (such as agrofood, paper-wood and textile-clothing), have been assessed as either medium or high risk.

Among the 12 sectors, construction and metals are the only two at very high risk. The risks for these two sectors are somewhat linked to recent hot topics, such as debt problems amid a surge in non-performing loans, a number of corporate bond defaults,

industrial overcapacities and zombie companies. These risks could be somewhat addressed by reforms of state-owned enterprises (SOEs), where measures concerning "Closure", "Reorganisation" and "Public-private-partnerships (PPP)" are likely to be implemented.

The pharmaceutical sector remains the brightest spot and is showing steady profit margins. Besides a clear improvement in corporate payment experience in 2015, pharmaceutical enterprises are less dependent on borrowing for their operations and fixed asset investment expansions. The medium term outlook is positive, with a structural increase in demand backed by the continuing rise of the middle classes and the ageing population.

Against the backdrop of ongoing structural and SOE reforms, the Chinese economy is set to continue its slowdown in 2016 and 2017, with an overall increase in credit risks for Chinese enterprises.

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