

China's key risk is financial, and growing

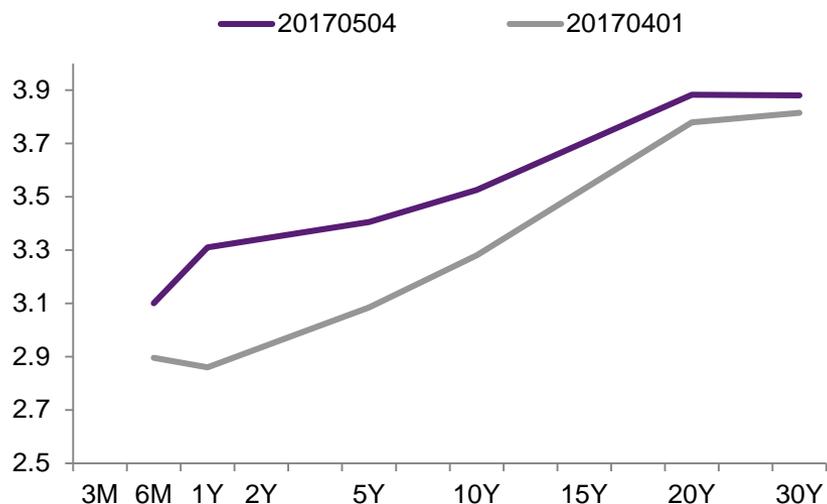
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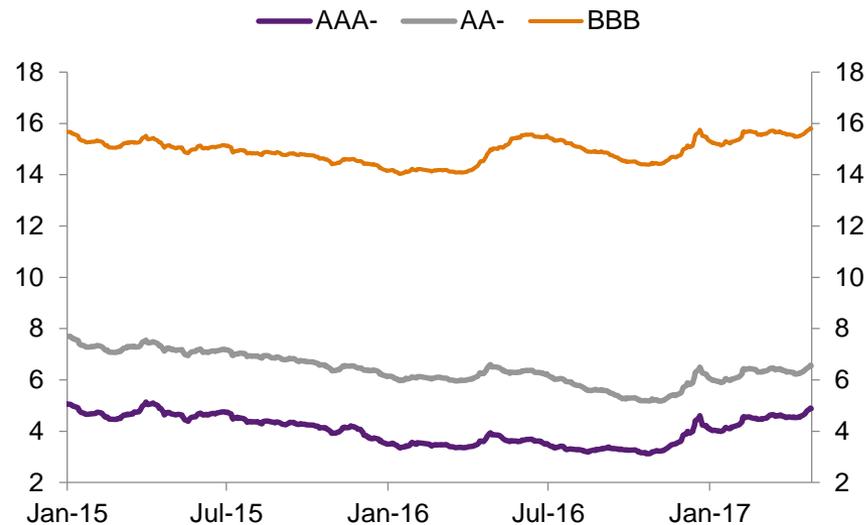
2016 bonanza year over: Growing financial risk pushing State Council/PBoC towards more restraint: cost of funding rising

China Sovereign Yield (%)



Source: Natixis, Bloomberg

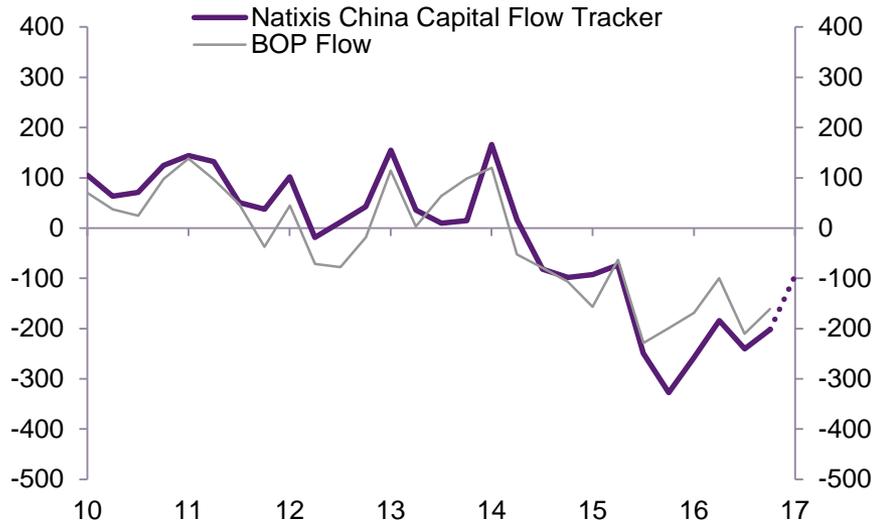
China onshore corporate bond yield: (5Y, %)



Source: Natixis, Bloomberg,

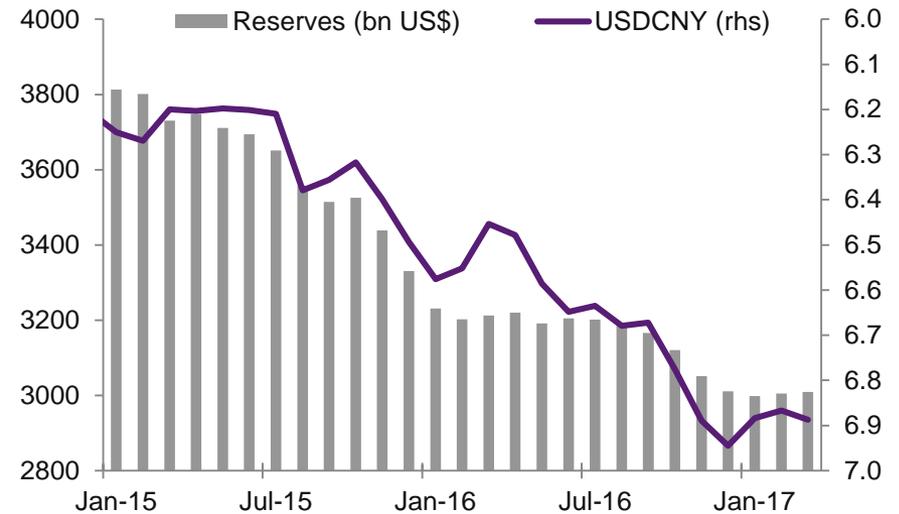
Better externally: capital outflows stabilizing although not yet totally out of the woods

**Natixis China Capital Flow Tracker
(Quarterly, USD bn)**



Source: Natixis

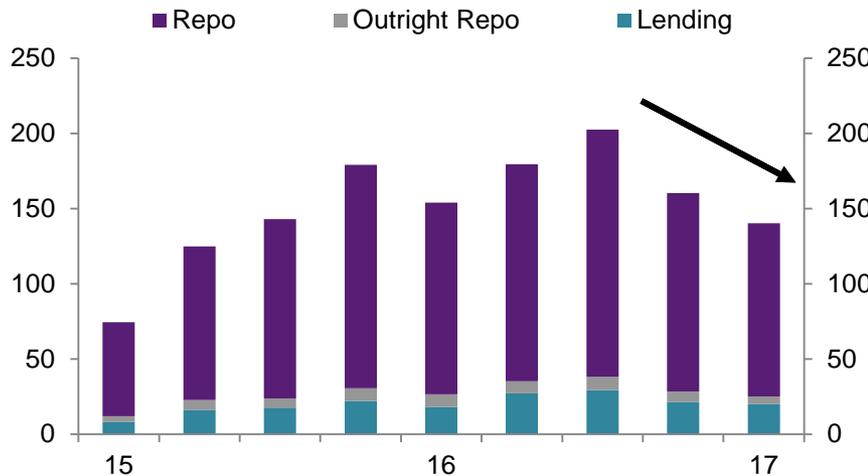
FX Reserves



Source: Natixis, SAFE

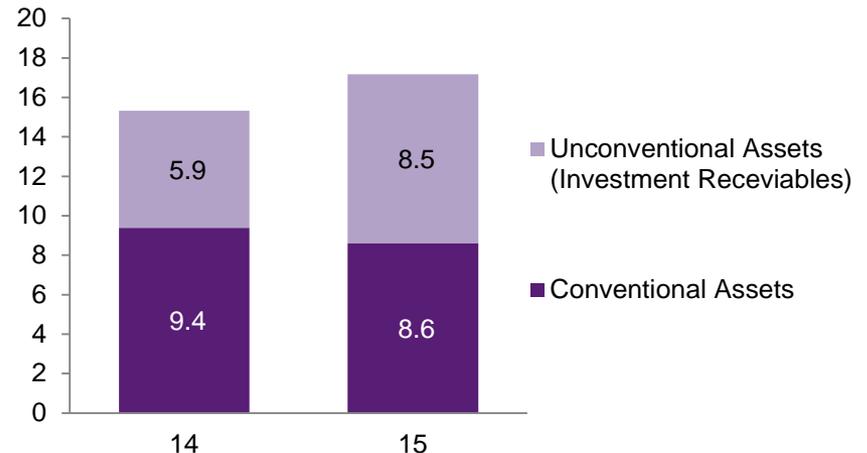
But with increasing risks in the financial sector: shrinking conventional interbank market and more bank-to-bank financing through non-standard collateral

Interbank Activities (Quarterly, RMB tr)



Source: Natixis, WIND

Conventional and unconventional interbank assets (% of total assets)

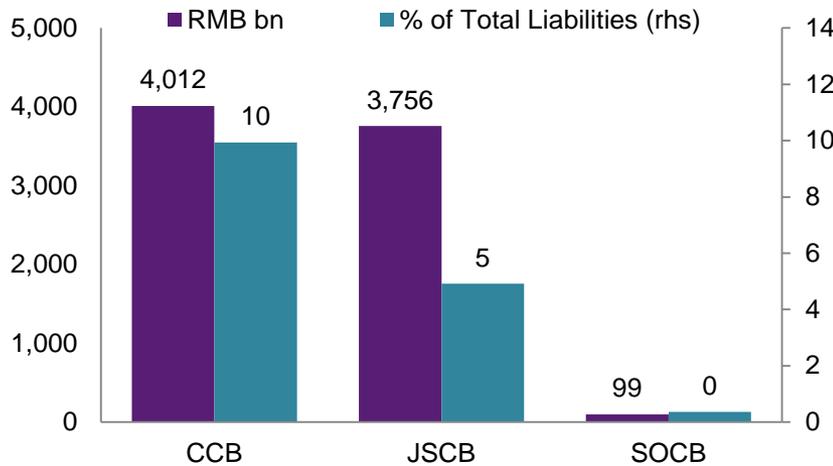


Source: Natixis, Company Data

Related Research:
 Natixis China Banking Monitor 2016: From lending to investing in order to survive
 ([Annual Report](#), [Executive Summary](#))

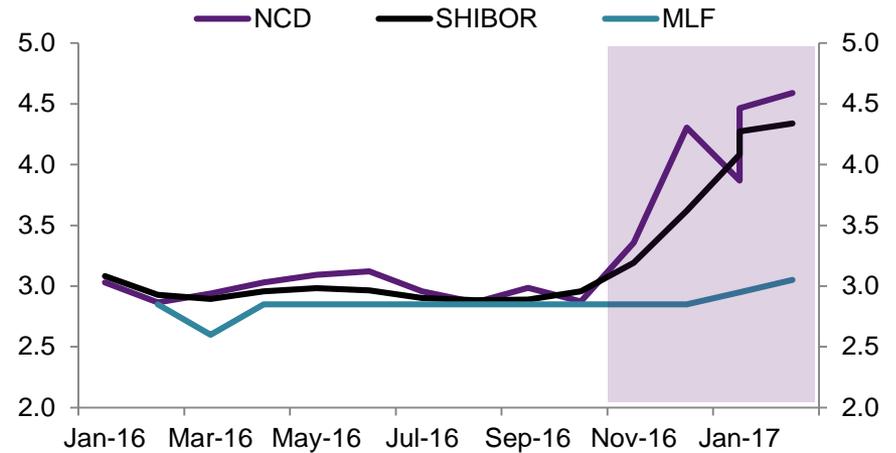
Also increasing recourse to non-collateralized market funding, specially non-negotiable certificates of deposit (NCD) but at a higher cost

Outstanding NCD by Issuer



Source: Natixis, WIND N.B. Data as of 5 Apr 2017

Funding Cost of Different Instruments (6M , monthly average , %)

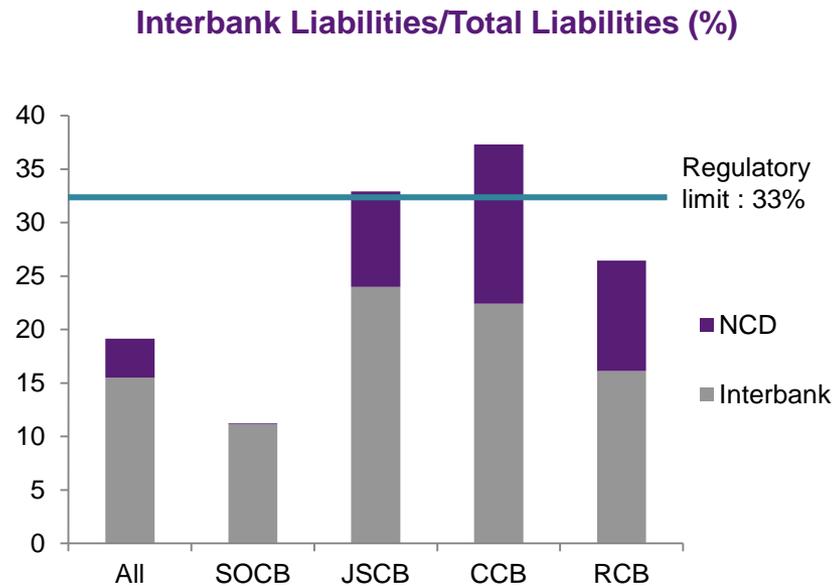


Source: Natixis, WIND

Related Research:

[Chinese banks liquidity problem: Regulation and lack of collateral as key culprits](#)

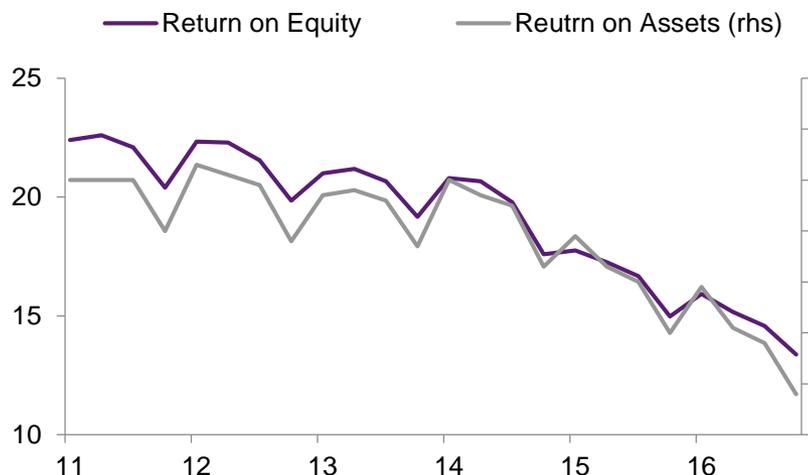
Liquidity not an issue for big five, only for city commercial banks and some joint stock commercial banks, but some have the size of a G-SIFIs!



Source: Natixis, WIND N.B. Listed banks included

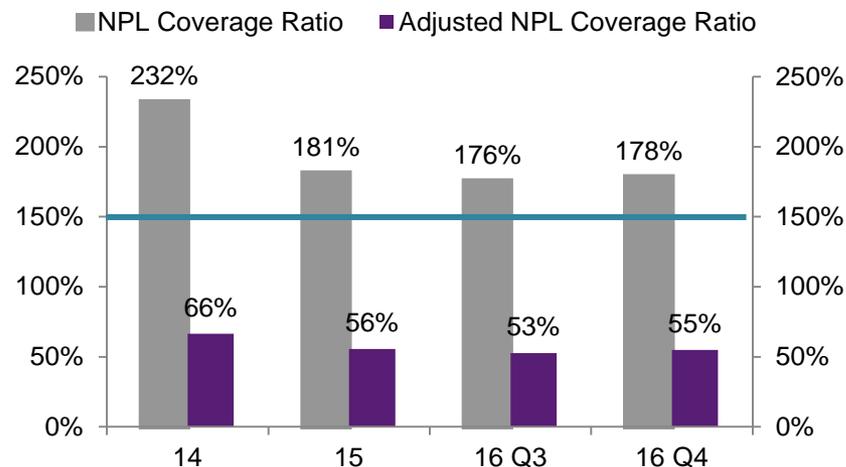
Beyond liquidity, banks' profitability and solvency worsening

Profitability (%)



Source: Natixis, WIND

NPL Coverage Ratio (%)

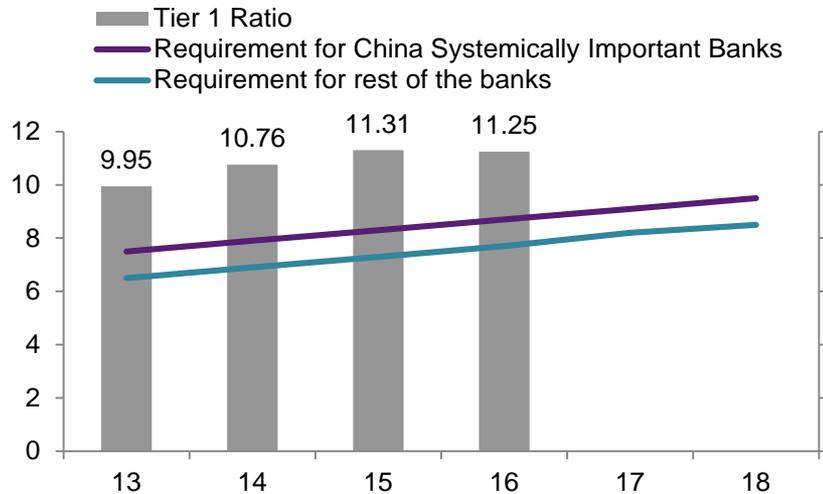


*Adjusted NPL Coverage Ratio is calculated as $NPL\ Provision / (NPL + SML)$
Source: Natixis, CEIC, WIND

Related Research:
[China Banks in 2017: No rebound in sight, rising risks for smaller banks](#)

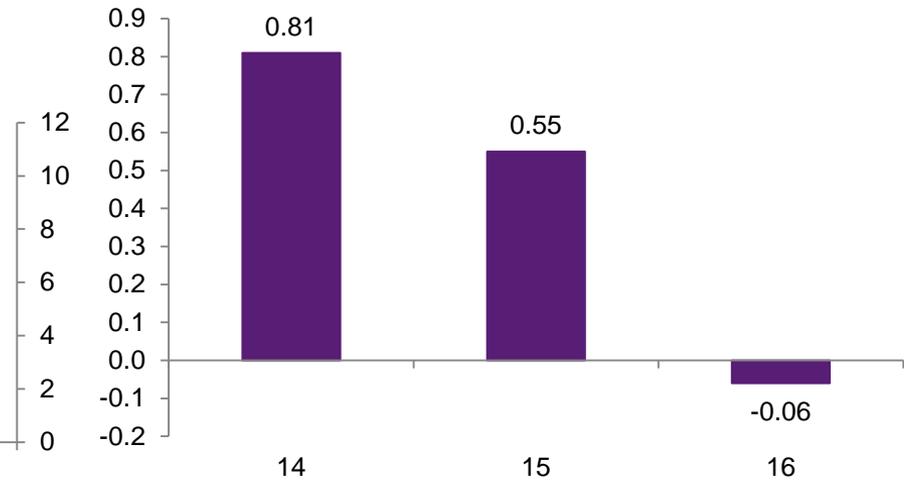
Banks still capable of meeting regulatory requirements, but no organic capital being created

Tier 1 Capital Ratio (%)



Source: Natixis, WIND

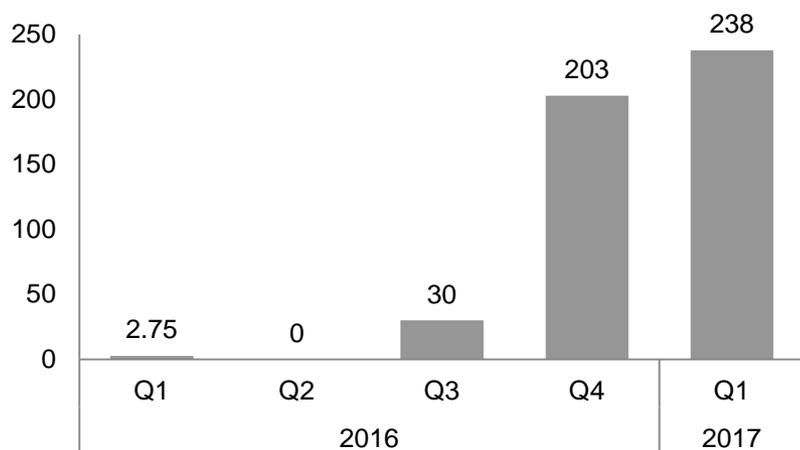
Change in Tier 1 Capital Ratio (%)



Source: Natixis, WIND

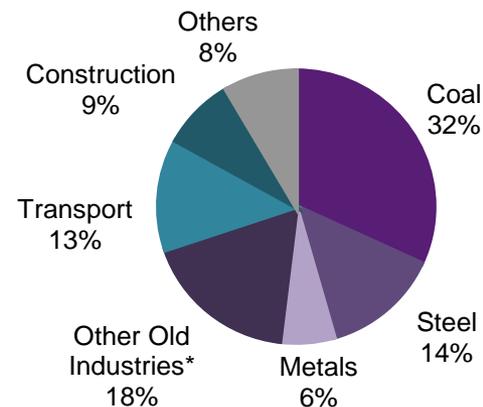
Asset quality improved thanks to the caving out of doubtful loans through debt-to-equity swaps but credit still growing fast so hard to see an improvement in medium term

Debt to Equity Swap (RMB bn)



Source: Natixis NB Based on swap announced date

Debt-to-Equity Swap by Industry



*Some announcements do not have a clear breakdown of several deals, and this includes coal, steel, chemicals, metals.

Source: Natixis

Related Research:

[Debt-to-equity swaps continue at full speed with deferred consequences](#)

All in all

China's real economy doing better but financial risks remain

- External risk stemming from capital outflows easing but...
- Domestic financial risks growing
 - Bank liquidity more immediately but also solvency in the medium term
 - Also increasing risks from shadow banking
 - P2P lending and also entrusted loans
 - And massive securitization as a way to clean up banks

Chinese authorities recent tougher line on financial risk is welcome but hard to maintain. The ball is already too big

- If government gets tougher on moral hazard and losses are allowed, massive capital outflows could resume again

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