China: a tale of two economies
Asia credit markets in downturn stage

I. EXPANSION
- Credit Growth
- Bad debt recoveries
- NPLs
- Asset prices
- Bank profitability

II. PEAK
- Borrower leverage
- Bank leverage capital stretched
- Bank LDRs, funding constrained

III. DOWNTURN
- NPLs
- Credit growth

IV. REPAIR
- Provisions
- System leverage
- Bank capital

Japan
United States

Other EMs

India
China

Euro Area
Type of financing used

More than half of US and Japan’s financing is comprised of non-bank and bond financing, whereas China’s is largely bank leading.

Total financial markets of selected economies
December 31, 2015 | US$ in trillions

- **US**: $69T
  - Non-Bank Leading: 54%
  - Bond Market: 33%
  - Bank Leading: 16%
  - Equity Market: $21T

- **China**: $34T
  - Non-Bank Leading: 54%
  - Bond Market: 33%
  - Bank Leading: 16%
  - Equity Market: $21T

- **Japan**: $11T
  - Non-Bank Leading: 54%
  - Bond Market: 33%
  - Bank Leading: 16%
  - Equity Market: $21T

- **UK**: $11T
  - Non-Bank Leading: 54%
  - Bond Market: 33%
  - Bank Leading: 16%
  - Equity Market: $21T

2013 – 2015 Total CAGR: 16%

Source: Clearwater research, World Bank, IMF, BIS, FSB, Capital IQ. Reflects data as of December 31, 2015.
Transformation towards broader capital markets

**Total Social Financing** is the broadest measure of capital supply monitored and reported by PBoC. Our analysis here shows the new components of growing financing.

China’s Total Social Financing Outstanding Breakdown

*Note: Non-Bank Lending in the above chart comprises of trust lending, entrusted loans and corporate bonds. It excludes AMCs, securities companies, SLCs, pawnshops, financial guarantees and financial leasing companies. Trust loan amount is partially reflected as many trust loans are reported as equity investments and not reported in PBoC TSF amount.*

Source: PBOC, Clearwater Research

(a) Outstanding amount of total social financing calculated by summing all reported net new credit issuance as reported by PBoC. Reflects data as of December 31, 2015.
Government support of shadow banking

Room for shadow banking to grow

“Shadow banking is a necessary outcome of financial development and innovation, and provides beneficial supplement to the traditional banking system…China’s shadow banking risks are manageable.”


Non-Bank Leading Share of Financial System Assets

Asia NPL formation above global crisis levels

Source: Citi Research estimates, Citi “Where to Hide from Asia’s NPL Cycle?”, November 4, 2015. Clearwater research
China’s onshore bond market has emerged

Dramatic growth in China’s domestic bond market

US$ in billions

Source: PBoC, NBS, Chinabond, Goldman Sachs.
China’s onshore bond market has emerged

Domestic corporate bond market has grown significantly over the past decade

- Third largest in the world
- Over the last decade grown from almost nothing
- Bond market rise and development is inevitable

Overview of China onshore bond market

~7tn
Market Size of Onshore Bonds

~2tn
Market Size of Onshore Corporate Bonds

Source: Clearwater research, news reports, research reports.
Defaults now occurring onshore in China

Rising number of onshore bond default cases

Source: J.P. Morgan, "China Credits, Implications of rising onshore bond defaults", April 21, 2016, Clearwater research
Defaults now occurring onshore in China

Defaults by ownership

- SOE: 7
- Local-SOE: 5
- Non-SOE: 4

Total: 16

Source: J.P. Morgan, “China Credits, Implications of rising onshore bond defaults”, April 21, 2016, Clearwater research
Defaults Now Occurring Onshore in China

2016 number of defaults by sector

- Increasing number of defaults in the onshore corporate bond market in 2016
- Energy, metals and manufacturing sectors have experienced the highest number of defaults
- Ownership type and asset liquidity make a difference when facing default risk

Source: J.P. Morgan, "China Credits, Implications of rising onshore bond defaults", April 21, 2016, Clearwater research.
## China bond market

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Instrument</th>
<th>Outstanding (US$ bn)</th>
<th>As a % of Total</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>MOF</td>
<td>Government Bond</td>
<td>1,642</td>
<td>21%</td>
<td>CIBM/Exchange</td>
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<tr>
<td></td>
<td>Local Government Bond</td>
<td>742</td>
<td>10%</td>
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</tr>
<tr>
<td>PBOC/NAFMII</td>
<td>CP</td>
<td>148</td>
<td>2%</td>
<td>CIBM</td>
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<td></td>
<td>SCP</td>
<td>226</td>
<td>3%</td>
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<tr>
<td></td>
<td>MTN</td>
<td>642</td>
<td>8%</td>
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</tr>
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<td></td>
<td>PPN</td>
<td>332</td>
<td>4%</td>
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<td></td>
<td>Credit ABS/ABN</td>
<td>66</td>
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<td></td>
<td>Financial Bond</td>
<td>2,189</td>
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<td>CD</td>
<td>466</td>
<td>6%</td>
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<td></td>
<td>Central Bank Bill</td>
<td>65</td>
<td>1%</td>
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<tr>
<td>NDRC</td>
<td>Enterprise Bond</td>
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<td></td>
<td>Railway Bond</td>
<td>177</td>
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<tr>
<td>CSRC</td>
<td>Corporate Bond</td>
<td>256</td>
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<td>Exchange</td>
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<td></td>
<td>Convertible/ Exchangeable Bond</td>
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<td>nm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corporate ABS</td>
<td>33</td>
<td>nm</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>7,734</strong></td>
<td>35% CAGR</td>
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</tbody>
</table>