Insolvencies

Extensive reading

Insolvency in China, Q2

- **Insolvency outlook**
- **Macro data updates with expected further eased monetary policy**
- **Automotive and automotive suppliers: negative sales growth**
- **Improving direct financing for private owned enterprise**

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EXECUTIVE SUMMARY

- In 2019, the number of insolvency cases in China is expected to keep growing but at lower pace (+~20%).
- Not strong enough economic date in 1H2019, further eased monetary policy is expected.
- In Q2 2019, automotive and automotive suppliers sectors downgraded from “Medium” to “Sensitive” due to declining sales volume and weaker assessments on the profitability and liquidity outlook.
- The trade disputes between U.S. and China increase the uncertainty of economic recovery and the dispute is expected to last until the end of this year.
- Improving direct financing for private companies with pick-up in IPO and establishment of Sci-Tech Innovation Board (STAR Market) at the Shanghai Stock Exchange in June 2019.

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INSOLVENCY OUTLOOK

In 2019, the number of insolvency cases in China is expected to keep growing but at lower pace (+~20%) considering 1) not strong economic growth especially in some sector such as automobile 2) U.S. - China trade dispute 3) expected further eased monetary policy 4) Improving direct financing for private companies with the establishment of Sci-Tech Innovation Board (STAR Market) at the Shanghai Stock Exchange in June 2019. During previous years, number of insolvency cases in China increased greatly in 2017(+74%) and 2018 (+50%) mainly due to the acceleration of clean-up zombie companies, slowdown on GDP growth and tightened financing conditions especially for the private owned enterprises.

Macro data updates with expected further eased monetary policy

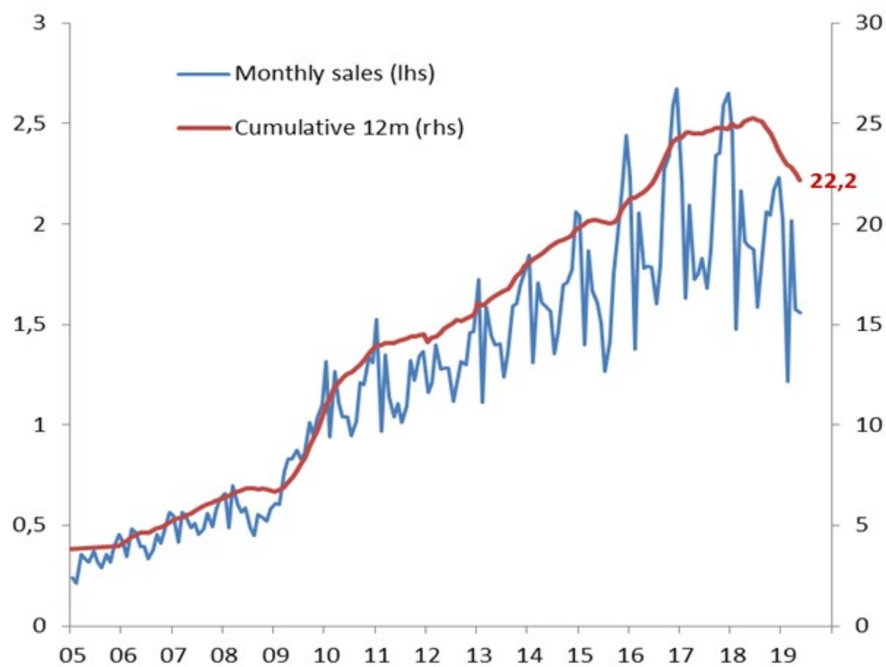
In Q2 2019, China's y/y GDP growth further slowed down to 6.2%, while China's q/q GDP growth for Q2 accelerated to +1.6%, after a 3-quarter long deceleration. Despite data in Q2 2019 and June showed recovery to some extent, economic growth still faced pressure for the incoming two quarters from unfavorable export conditions, slowdown of government consumption and some industrial growth. The official manufacturing PMI was in contraction territory in June at 49.5, the same as in May, while the nonmanufacturing PMI declined to 54.2 in June (from 54.3 in May). Considering currently monetary and financial conditions did not significantly improve, the PBOC is likely to implement additional cuts of the deposit reserves (3 before year-end) and additional targeted medium-term lending facility operations, while the government is likely to launch new measures to support consumption.

Automotive and automotive suppliers: negative sales growth

According to China Automobile Association, automotive sales volume decreased by 12.4% y/y in 1H2019 in China. The sales drop was mainly due to high volume in previous period, lack of new stimulus, economic slowdown, deleverage and trade disputes. Although authorities launched new stimulus and data in June showed slightly recovery, the response of consumers remained unclear. In Q2 2019, automotive and automotive suppliers sectors downgraded from "Medium" to "Sensitive" due to declining sales volume and weaker assessments on the profitability and liquidity outlook.

Figure 1 : Sales of Passenger Cars

(in number of vehicles)



Sources: China Association of Automobile Manufacturers, Euler Hermes, Allianz Research

Uncertainty- U.S.- China trade dispute

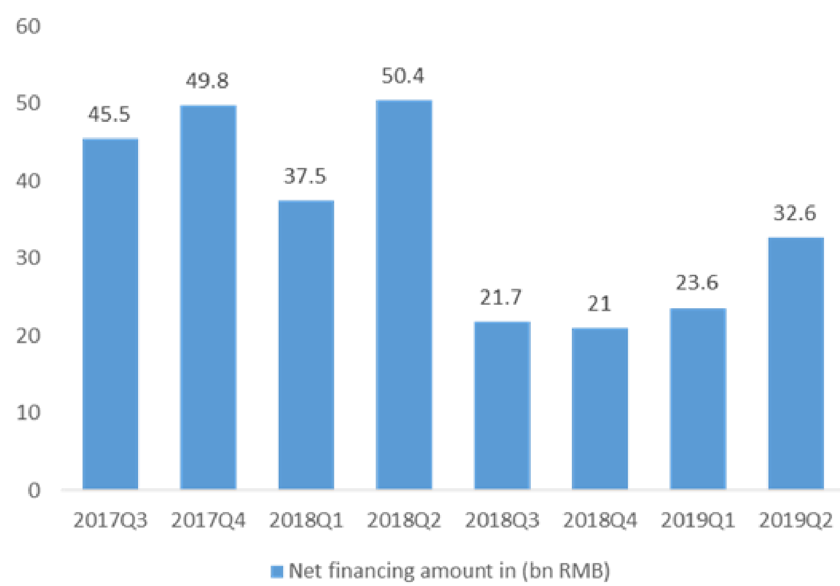
The trade dispute between U.S. and China increase the uncertainty of economic recovery. In May 2019, President Trump announced a new round of tariffs as well as new sanctions on Huawei. President Trump decided to hike the average level of tariffs on USD 200 bn of imports from China to 25% from 10%. Then, at the end of June 2019, during the last G20 summit in Japan, China and the U.S. agreed to resume talks for a new agreement, putting on hold the interdiction on U.S. companies selling products to Huawei against the promise by the Chinese authority of buying more U.S. agricultural products. Despite these slight improvements, the decision of imposing a 25% tariff on USD 200 bn of U.S. imports from China was not backtracked, while the uncertainty surrounding USD 325 bn of remaining U.S. imports from China will persist in the coming month. U.S.- China trade dispute is expected to last until the end of the year.

IMPROVING DIRECT FINANCING FOR PRIVATE OWNED ENTERPRISE

A. Direct financing of private owned companies- pick up in IPO

The private enterprise IPO slowed down in 2H 2018 and the marginal improvement in 1H2019. IPO issuance has a "V" shape trend. In 1H 2019, the number of IPOs and the net amount of IPO funds raised increased, but there is still a certain gap from the previous high.

Figure 2 : Fund raising from IPO for private owned companies



Sources: Wind

B. New direct financing channel-establishment of Sci-Tech Innovation Board (STAR Market)

On June 13th 2019, Sic-Tech Innovation Board (STAR Market) was established at Shanghai Stock Exchange. First batch of registered 25 companies which are most SME got listed on July 22th 2019.The first batch of companies raised RMB37 billion, and the amount of funds raised by single companies was concentrated in the range of 5-1 billion yuan. STAR Market is designed to help growth-oriented technology innovation enterprises with their finances.

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