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Weekly Credit Brief Oct 09 - Oct 15

China's 'new energy' vehicles take off amid economic slowdown

by Zheng Chencheng

In China, the second largest automobile market in the world, the car sales growth has fallen for 3 straight months from 4.7% on June to -11.6% on September YoY, amid a worsening trade environment and slowing economic growth. The heightened trade tension between US and China has seen import tariffs levied on automobile imports and experts are expecting that this will further damp consumer confidence. Gauges of activity in China's manufacturing sector also worsened in September 2018 as the official manufacturing purchasing managers index fell to 50.8 from 51.3 in August. However, the new energy vehicle (NEV) industry in China is performing well. NEV sales went up 81.05% YoY to 721,500 units in the first nine months of this year, while production rose 73.05% to 734,600 units, according to the China Association of Automobile Manufacturers (CAAM). The RMI-CRI 1-year aggregate PD for the China-domiciled automotive industry from October 2017 to October 2018 shows that China's NEVs sector has the lowest PD compared with both China and the global auto-industry, implying that the NEV sector has a stronger credit profile.

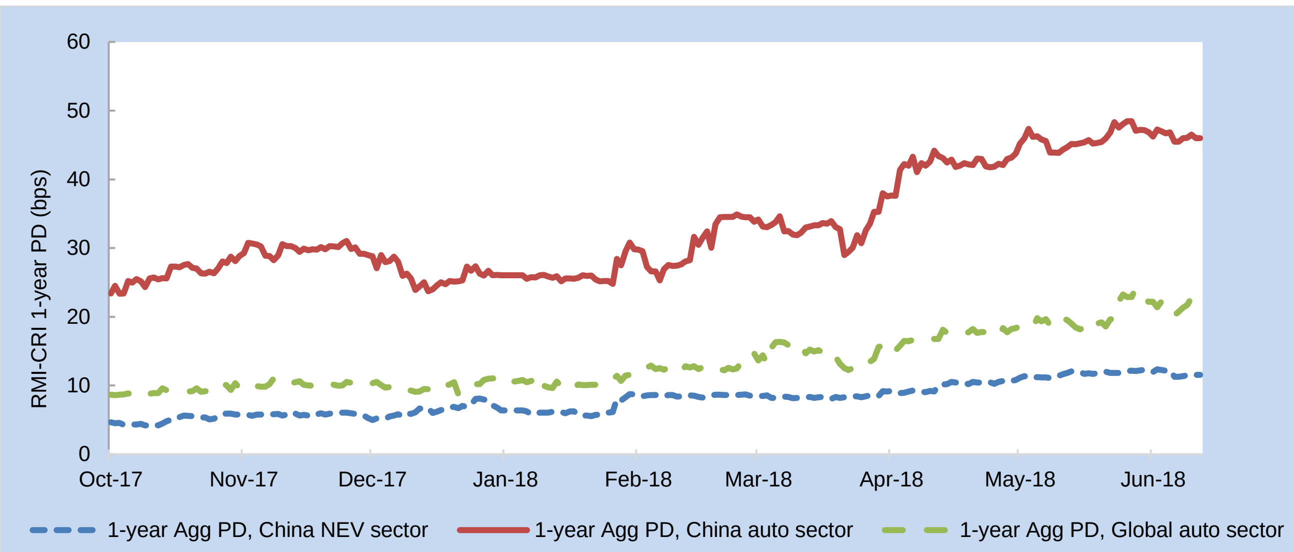


Figure 1: RMI-CRI 1-year Aggregate PDs for China NEV, automotive and global automotive sectors. *Source: RMI-CRI*

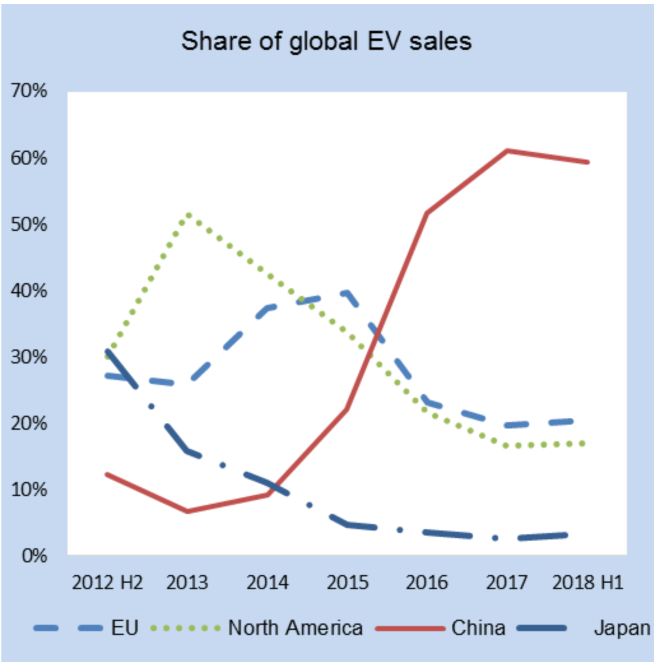
Fundamentally, most NEV industrial leaders performed better than other automotive companies in terms of credit, liquidity and growth. Other than having a lower debt ratio, NEV companies' revenue are increasing as it continues to show substantial expansion in production and sales.

	Revenue growth YoY(%)		Profit Margin(%)		Debt Ratio(%)		Current Ratio(X)	
	2018 H1	2017 H2	2018 H1	2017 H2	2018 H1	2017 H2	2018 H1	2017 H2
BYD	17.28	2.10	3.96	4.96	36.00	31.73	0.94	0.98
BAIC	15.23	0.39	1.88	3.67	18.33	18.90	0.96	0.91
SAIC	17.27	17.13	3.93	4.12	23.84	23.34	1.06	1.01
Auto Sector	7.60	4.90	2.80	4.70	30.90	30.70	1.10	1.10

Table 1: Financial figures of China NEV companies and auto sector. *Source: Bloomberg*

The development of NEVs plays a strategic role for China. Not only the increasing use of NEVs help reduce pollution, China also regarded NEV as a chance for industrial development. The development of NEV is a chance for domestic car manufacturers to grab more market share which have been tilting towards the foreign giants. NEV development also boosts the Made in China 2025 initiative, a national strategic plan to upgrade Chinese industry and move domestic manufacturing up the global value chain. In the past, China has taken the advantage of huge labor forces and relied on manufacturing and exporting lower add-on value basic consumer goods such as clothing, shoes and household appliance. However, to escape the middle-income trap, China is planning to move towards high-tech industries.

Made in China 2025 sets market-share targets for domestic companies across ten industries. The government expects annual NEV output to hit 2 million in 2020, and for NEV sales to make up 20 percent of the overall auto market by 2025. At least two of the top ten global NEV participators are expected to be Chinese-owned by 2025. China's NEV market has been in the golden age over the past five years. From around 12,791 in 2012, NEV sales rose to almost 777,000 in 2017, according to official statistics. In the pure EV field, China contributed about 42 percent of the world total sales since 2012, and almost twice the size of the second-biggest EV market, the EU. By promoting NEVs sales, the Chinese government also supports its lithium-ion battery makers, a sector valued USD 40bn before 2025 by Goldman Sachs. Chinese companies already control roughly 60 percent of the world's lithium-ion-battery manufacturing capacity, compared with about 50 percent in 2013, and are planning to control a majority of future capacity as well.



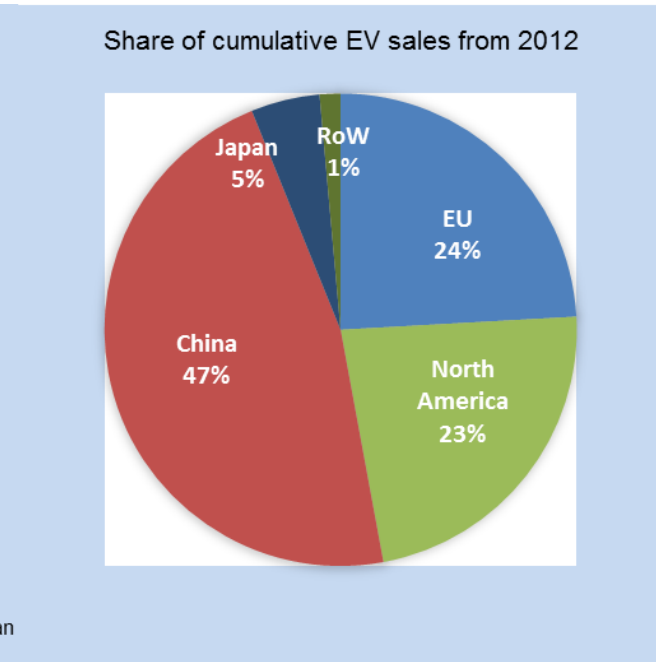


Figure 2a (LHS): Share of global EV sales. Figure 2b (RHS) Share of cumulative EV sales from 2012 to 2018. *Source: Bloomberg*

Some early winners in Made in China 2025 game are already global industry leaders. Given the support from Chinese government, BYD went through an unprecedented transformation to become the biggest NEV company in the world. BYD sold around 110,000 units globally in 2017, compared with Tesla, a US electric-vehicle maker, which sold 103,181 vehicles over the same period. BYD recently opened a new battery manufacturing facility; when it reaches full capacity, it will be the world's largest. Another beneficiary is Contemporary Amperex Technology Ltd (CATL), China's largest lithium battery maker. CATL has strategic agreements with carmakers including SAIC Motor Corp, Geely, BMW and Volkswagen and plans to build its first European production site in Germany.

To assist the NEV industry, the government has been given generous subsidies to boost the sales. China's Central Government provides tax exemptions and subsidies to consumers who purchase NEVs from CNY 15,000 to CNY 50,000(USD 2.500 to USD 7,000) per vehicle, depending upon NEV's range. In addition, local governments will add about 15% to 50% to that amount. For example, to buy a BYD Qin in Shanghai, the pre-subsidy price is about CNY 220,000, and the new energy subsidy is more than CNY 50,000. In addition, Shanghai New Energy Vehicles can obtain a car plate free of charge, while the auction price of an internal combustion engine car plate in Shanghai is about RMB 80,000. At an average subsidy of USD 10,000 per vehicle, China's central and local government spent USD 7.7bn on NEV subsidies in 2017.

However, the China government support is slowing down, and the NEV sector needs to face the fact of total subsidies removal by 2020. Announced in Feb 2018 in a "Notice on Adjusting and Improving the Financial Subsidy Policy for the Promotion and Application of New Energy Vehicles," subsidies ended for NEVs with a driving range less than 150 kilometers, while subsidies continue for NEVs with range more than 150 kilometers.

"Government policy has a huge impact over the NEV sector and every adjustment made on the policy front will result in tremendous changes in the industry," said Li Yixiu, sales chief for Beijing Electric Vehicle Co., China's biggest maker of pure EV.

Besides, announcements by the global giants such as Benz, BMW and Volvo in China to develop NEVs starting from the second half of 2018, the domestic NEVs industry will face more competition. The future of China's NEV industry will depend on whether the authorities can provide a viable and scalable business model that creates an ecosystem for NEV industry to thrive, including enough market demand to replace the policy-led growth.

Credit News
Global financial stability risks rising with trade tensions, IMF says **Oct 15.** IMF said risks to the global financial system could increase sharply if pressures in emerging markets escalate or global trade relations deteriorate further. The easy financial conditions are also building up vulnerabilities such as high debt levels and inflated asset valuations, which may increase the impact of potential shocks to the system. The gap of economic growth between advanced countries and emerging markets is also widening. The normalization of monetary policy in the US, a stronger dollar and escalation in trade tension have already affected emerging market economies. Shown in a new IMF research, emerging market countries excluding China could face debt portfolio outflows of up to USD 100bn. (Reuters)
Once biggest US retailer Sears files for bankruptcy, mired in debt and deserted by shoppers **Oct 15.** The 125-year-old retailer, Sears Holdings Corp, filed for bankruptcy due to its heavy debt and too few shoppers. At the point of bankruptcy, it has listing of more than USD 10bn in debt and USD 1bn in assets. Sears plan to stay open for business with help from USD 600mn in new loans. The company will shut down 142 outlets in addition to the 46 that is slated for closure by November. Sears has been making losses since 2012 and its losses have topped USD 10bn. Parts of Sears have already been through bankruptcy including Sears Canada which was liquidated a year ago. Sears will be run by the CEO office and independent directors will oversee the restructuring. (Straits Times)
Investors bet against Italian debt as budget fears intensify **Oct 14.** Value for Italian bonds out on loan reach the highest level in four months reaching USD 35bn, indicating that Italy's budget proposals have fueled concern about its economic outlook as investors made negative bets on Italian bonds. The investor's short position have become an important indicator to some analysts as it can provide information about the extent to which the outlook is strongly negative. Société Générale warned that holding a short in Italian bonds can be very costly for investors as they need some prospect of volatility to justify a short. If there is no prospect of immediate volatility, underweight investors risked to change their position to neutral for a bond in which they do not have much confidence. (FT)
Higher interest rates boost US bank earnings **Oct 13.** Amid stock losses that were partly caused by the sudden rise in 10-year US Treasury bond yields, large US banks' profits were boosted by the solid US economy and rising interest rates. Big banks have seen a drop in mortgage refinancing due to the higher interest but they have yet to see a big jump in consumer defaults on credit cards. Although JPMorgan welcomed Fed's decisions to raise interest rates in response to the strong growth in the economy, it also expressed concern about the increasing economic and geopolitical uncertainties. The market's mixed reaction to JP Morgan's results also reflected unease over the prospect of higher interest rates and whether it will have a negative effect on the US economy. (Channel NewsAsia)
Boom underway in quiet corner of China's credit market **Oct 12.** Due to the slowdown of China's economy, banks are under pressure to help stimulate growth through new lending which are expected to unleash a boom in China's credit markets. Structured debt sales in China's interbank bond market jumped in Q3 2018 to a record RMB 300bn, with residential mortgage backed

securities currently making up for 60% of issuance this year, up from 6% in 2015. According to Moody's, China's securitization market are expected to maintain its growth momentum. (Business Times)

Uber seeks to raise USD 1.5bn from debt investors (FT)

Construction hit by longest decline in lending since 2011 (FT)

For Pakistan's 13th IMF bailout, expect tougher conditions (Bloomberg)

Regulatory Updates

China plans major expansion of too-big-to-fail rules

Oct 10. China will increase the number of systemically important financial institutions (SIFI) and it plans to shortlist at least 50 lenders. The selected firms will be subject to extra capital requirements, and may face additional rules on leverage, risk exposure and information disclosure. While increasing the list of SIFI may help the government to strengthen oversight of the financial system, tougher capital requirements could make it harder for China's big financial firms to lend, increasing the probability of default and adding pressure on exchange rate and stock market. An economist said the government is unlikely to take the regulation into effect soon as it contradicts with the government's focus in supporting economic growth. (Bloomberg)

Singapore gives bondholders new way to chase default losses

Oct 10. Singapore's new Insolvency, Restructuring and Dissolution Act gave liquidators of insolvent companies a new tool to retrieve funds for bondholders and other creditors after its corporate debt market has been shaken by SGD 1.5bn of defaults in recent years. Under the new framework, court-appointed managers will now be able to seek funding from investors unrelated to the case to pay the cost of pursuing claims, in exchange for part of the proceeds. The legal changes, which was aimed to strengthen the legal framework for debt workout, has attracted litigation-finance professionals to set up operations in Singapore last year as it presented them with new opportunities. (Business Times)

Scrapping Libor leaves USD 500bn of bond contracts in limbo (FT)

PBOC chief sees plenty of room for monetary adjustments (Business Times)

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