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# Opportunity knocks – Investing cash in China:

## The risks and challenges facing institutional cash investors in China

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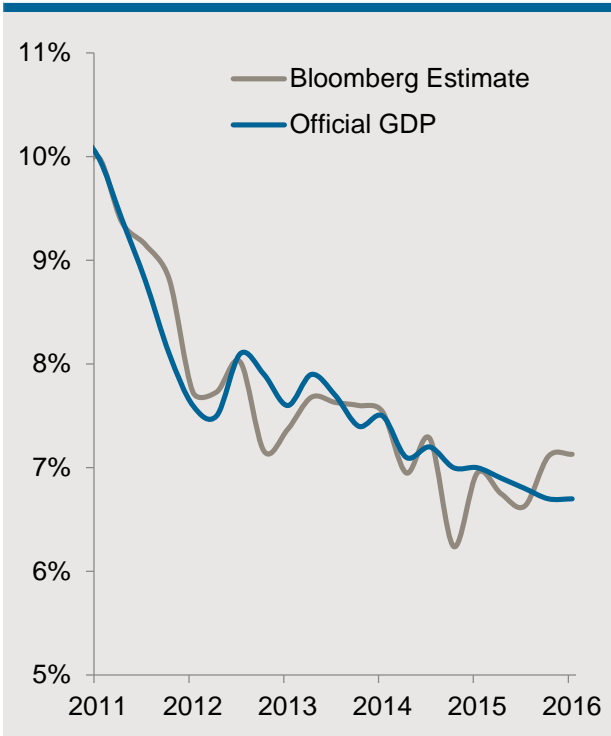
**ACT Asia Treasury Leaders' Forum 2016 | Hong Kong**

**Mr. Aidan Shevlin**, CFA, Head of Asia Pacific Liquidity Fund Management, J.P. Morgan Asset Management

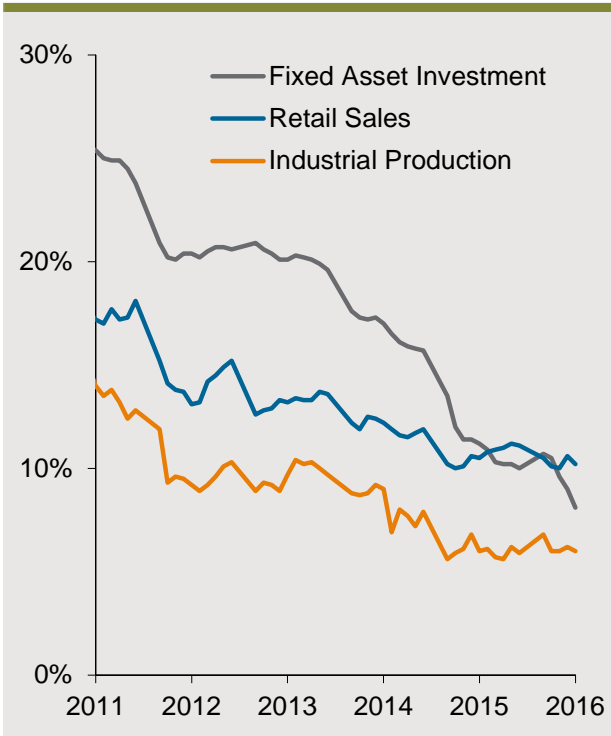
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# RISK #1: Negative headlines regarding slowing growth and increasing volatility, weighted on investor sentiment

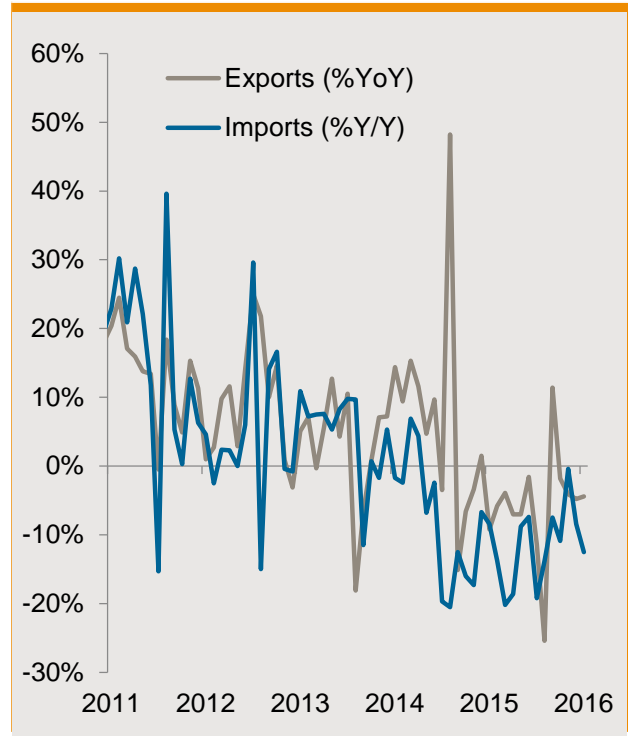
## GDP (%YoY)



## Key Domestic Indicators (% YoY)



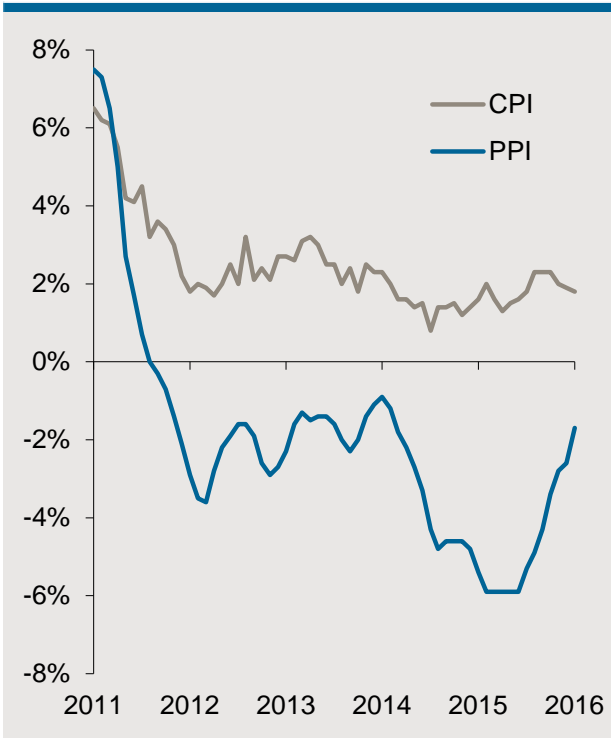
## Exports & Imports (%YoY)



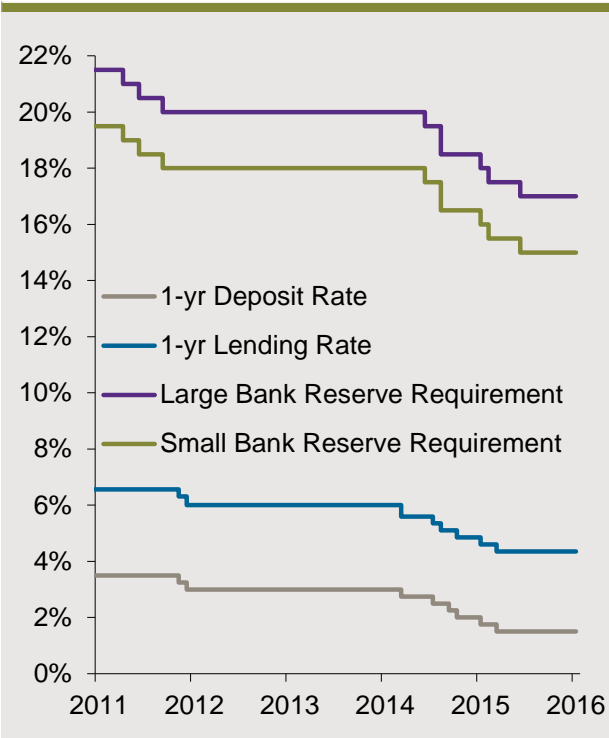
Source: Bloomberg & J.P. Morgan; as at 31 August 2016.

# Inflation remains close to a 5-year low, however in recent months the PBoC has refrained from cutting policy rates, instead favoring open market operations

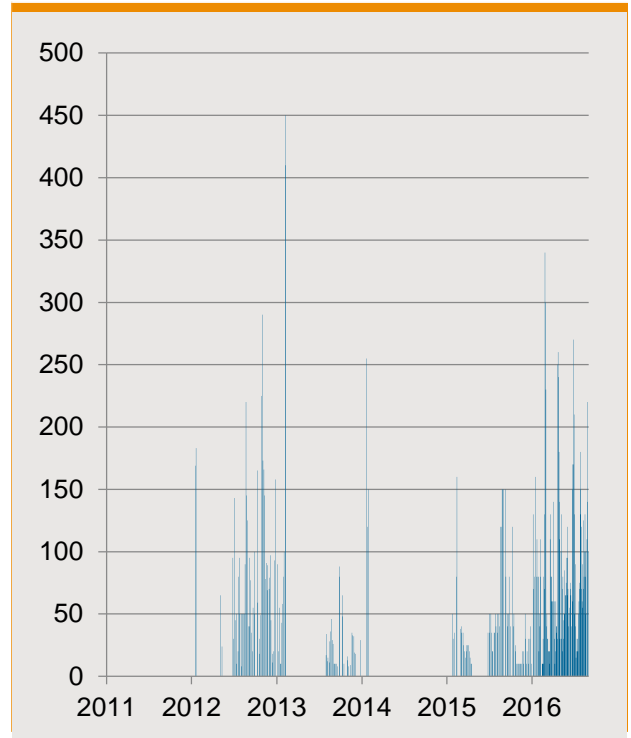
## CPI & PPI (%YoY)



## PBoC Policy Rates (%)



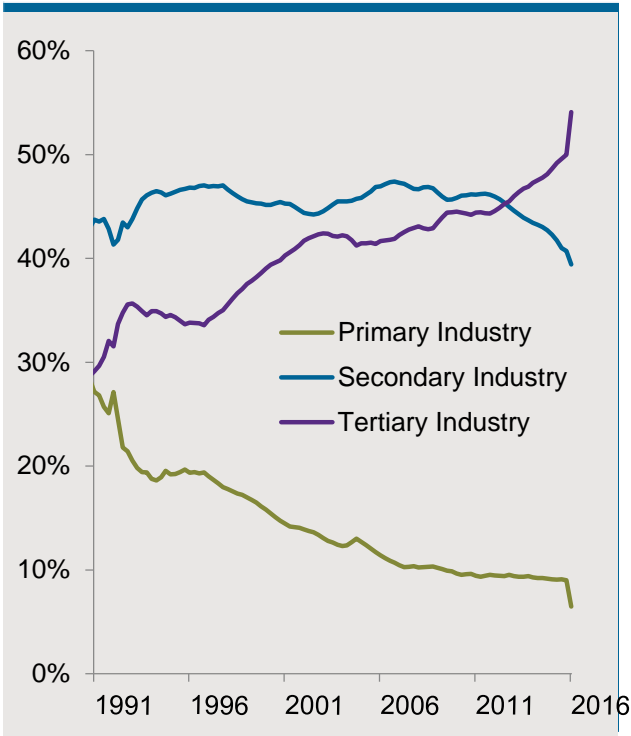
## PBoC OMO Volumes (CNY bn)



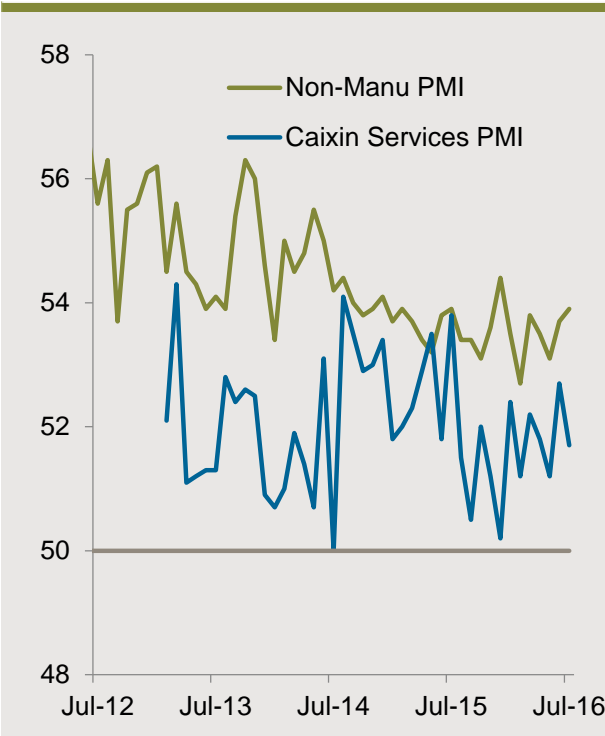
Source: Bloomberg , J.P. Morgan Asset Management & People's Bank of China; as at 31 August 2016.

# On an optimistic note: China remains one of the fastest growing countries and the economy is rebalancing towards more stable growth

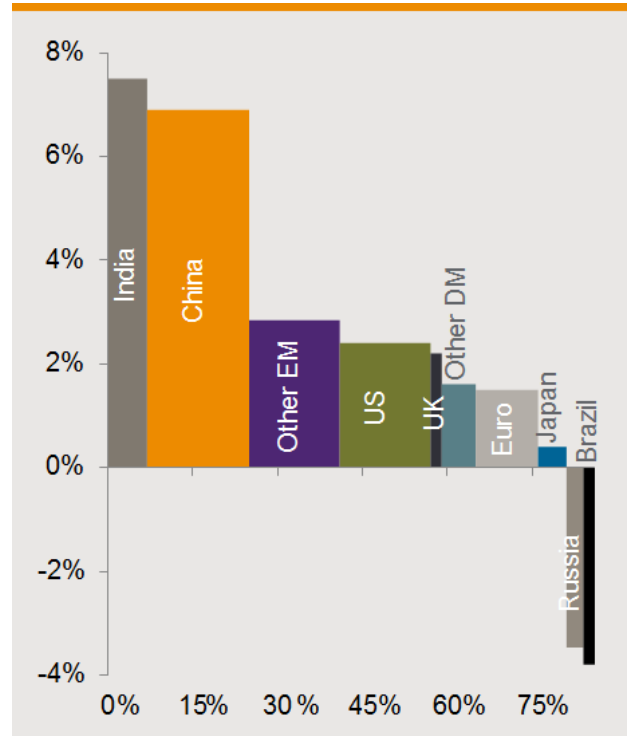
## Share of Nominal GDP (% ann)



## Markit PMI



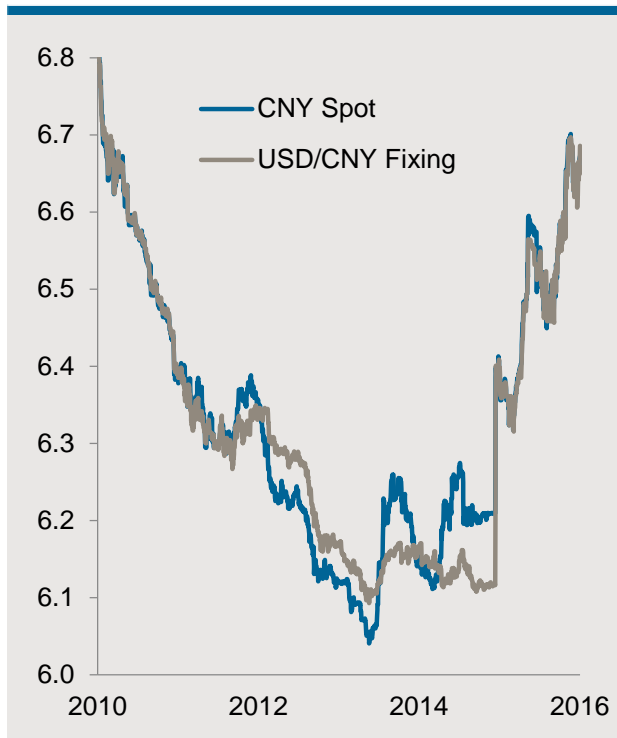
## Growth vs. Global Country Weight



Source: Bloomberg, CLSA, Goldman Sachs & J.P. Morgan; as at 31 August 2016.

## RISK #2: CNY is no longer a one-way bet: SDR inclusion and the focus on managing vs. a basket suggests increased usage but also more two way volatility

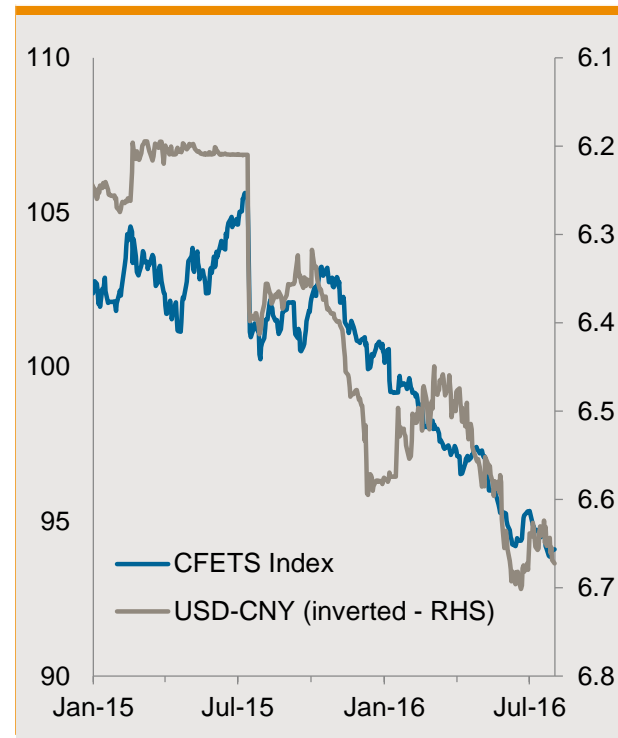
### CNY Spot & Fixing



### China FX Trade Weighted Index

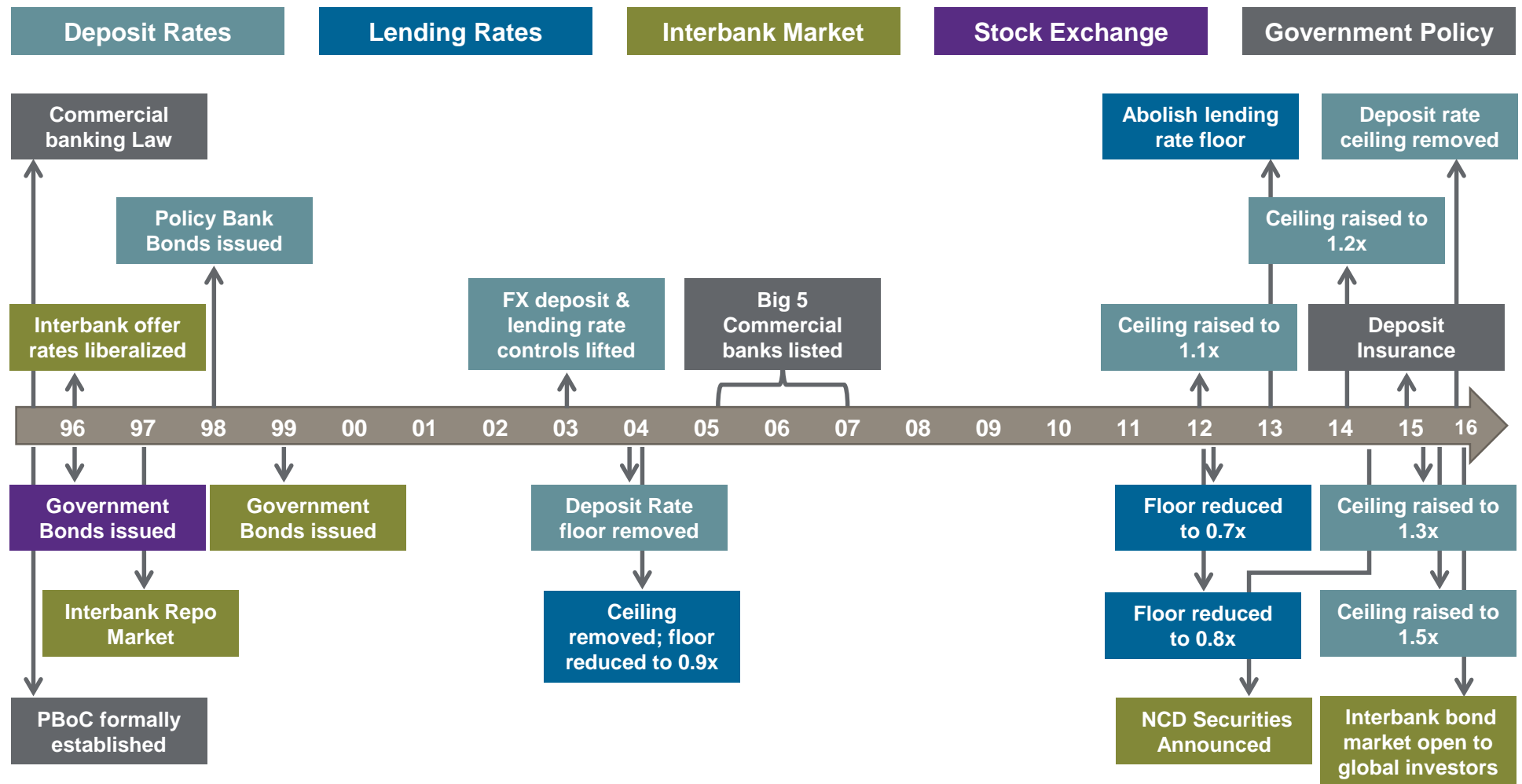


### CFETS Index vs. USD/CNY



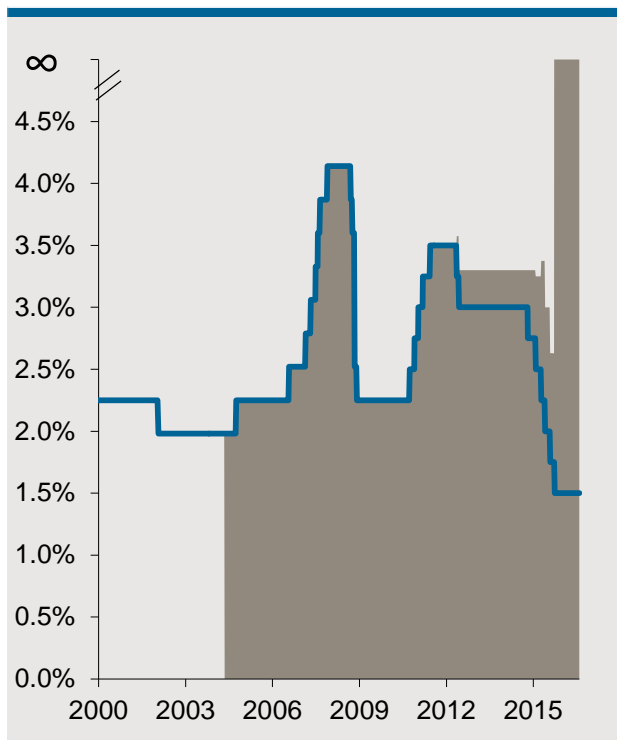
Source: IMF, CFETS, Bloomberg, SCB & J.P. Morgan; as at 31 August 2016.

## RISK #3: Regulatory changes offer challenges – and also opportunities

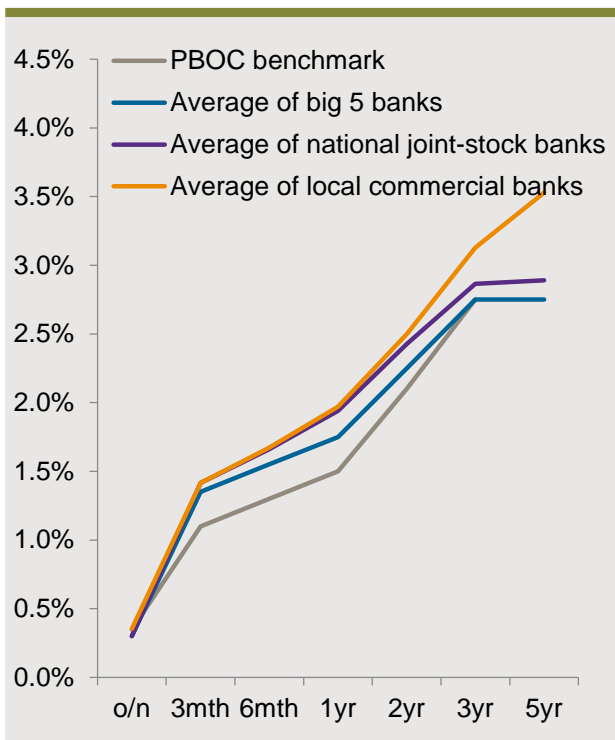


## RISK #4: Interest Rate Liberalization has happened: What's next?

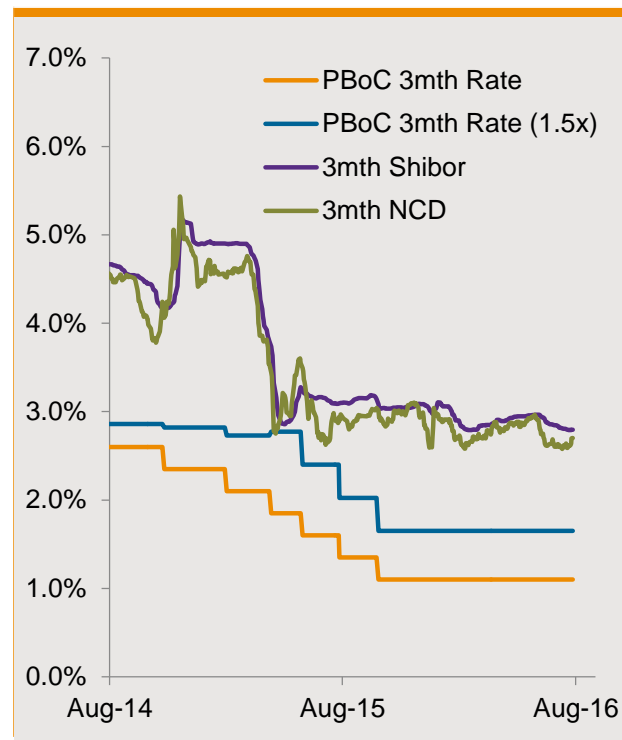
### PBoC 1yr Deposit Rate Range



### Liberalized Deposit Rates



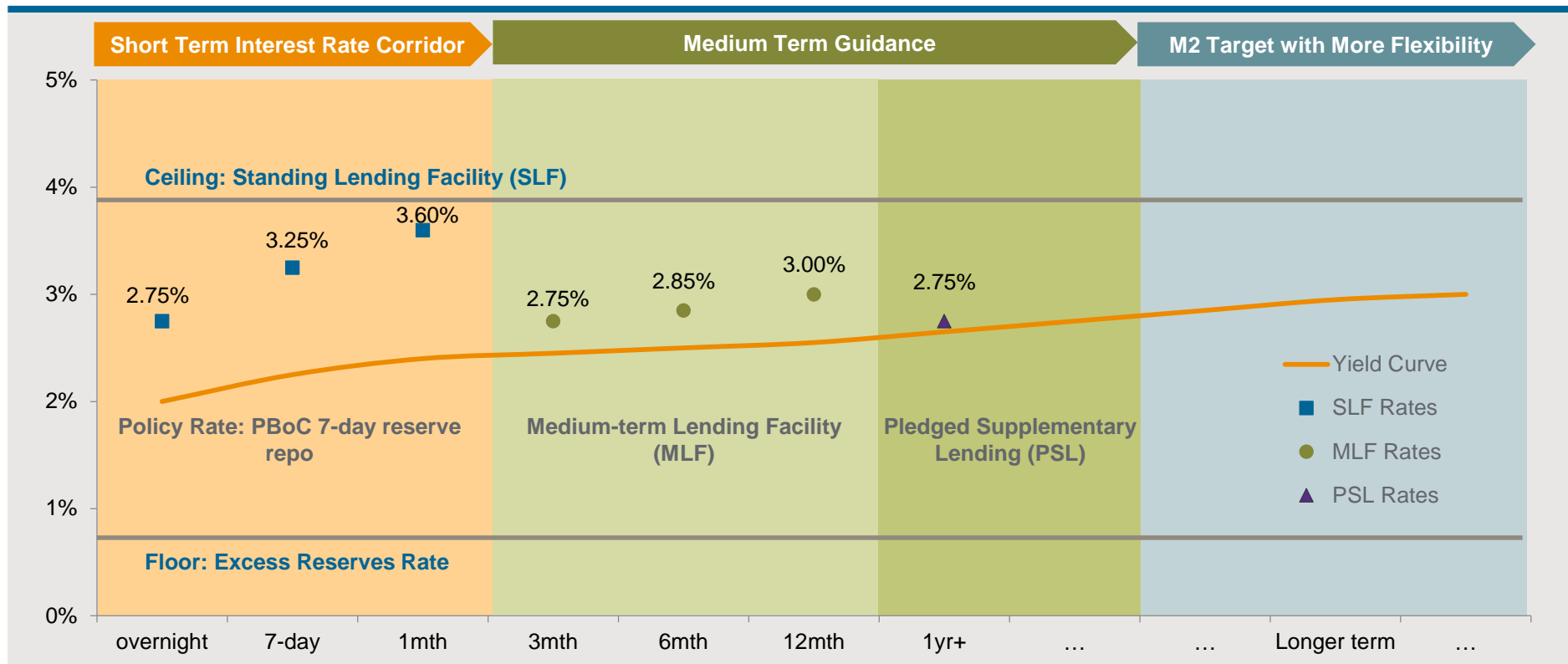
### NCD, Shibor & TD Rates



Source: Bloomberg & J.P. Morgan; as at 31 August 2016.

# Interest Rate Liberalization has happened: What's next?

## China's future policy framework

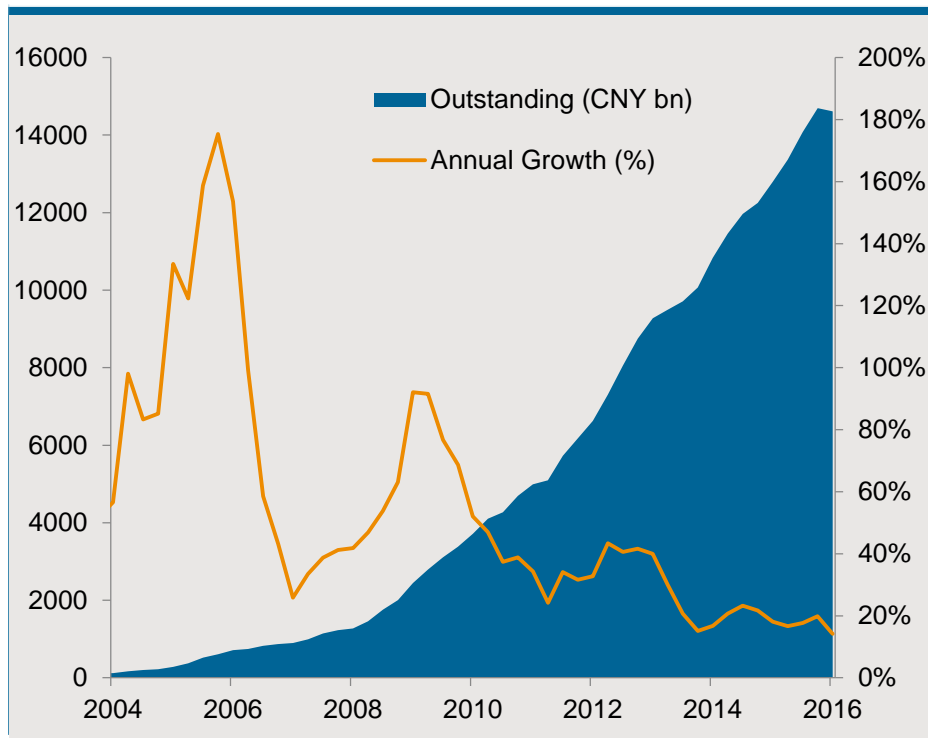


Source: Bloomberg, Wind & J.P. Morgan Asset Management; as at 31 August 2016.

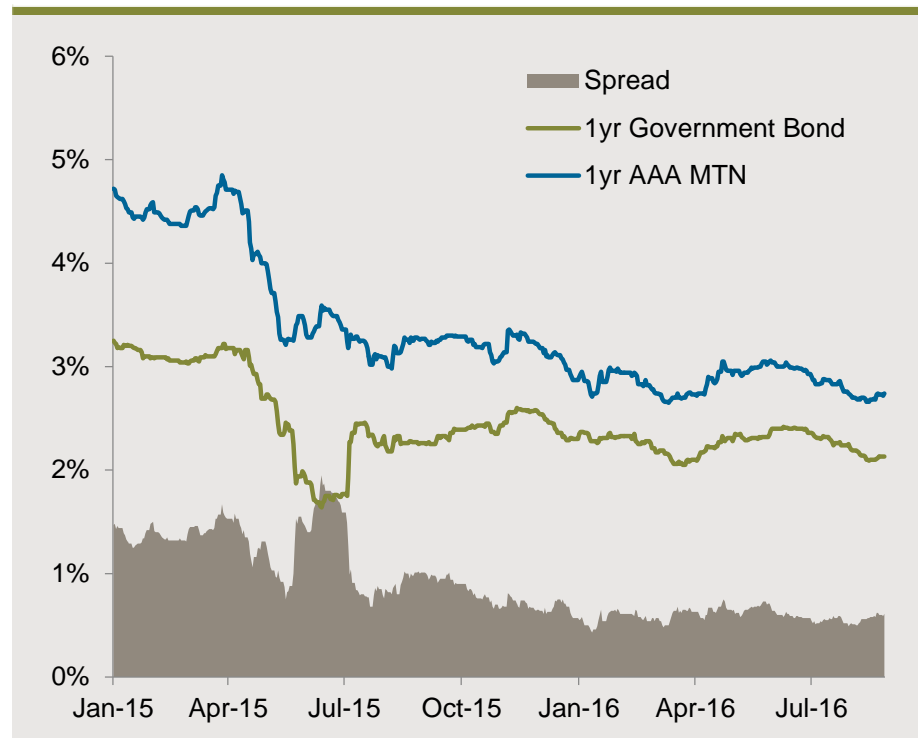


## RISK #5: Credit risks are increasing...

### Chinese Domestic Corporate Debt



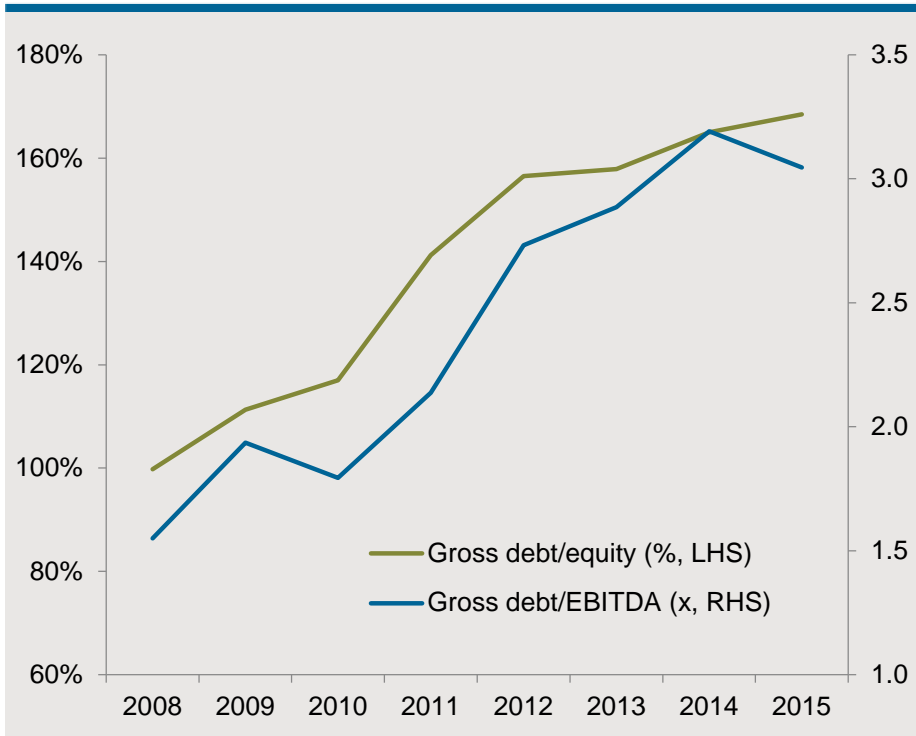
### 1yr Credit Spread - Sovereign and AAA Corps



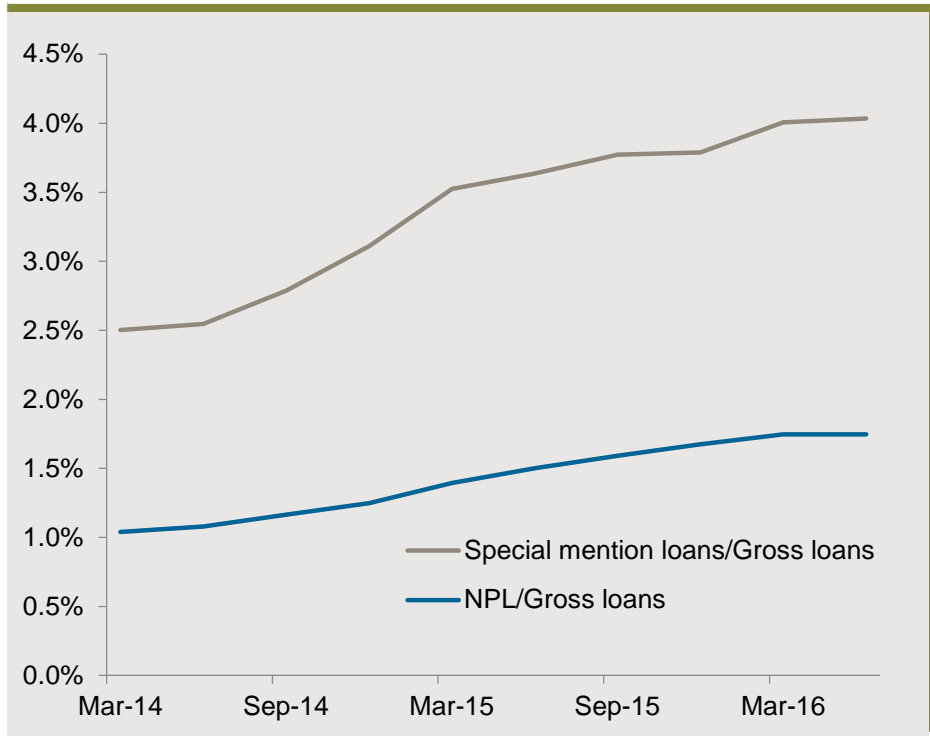
Source: ADB, Bloomberg, Wind; as at 31 August 2016.

# Corporate issuers' credit profiles are deteriorating and non-performing loans are increasing

## Corporate Debt Affordability



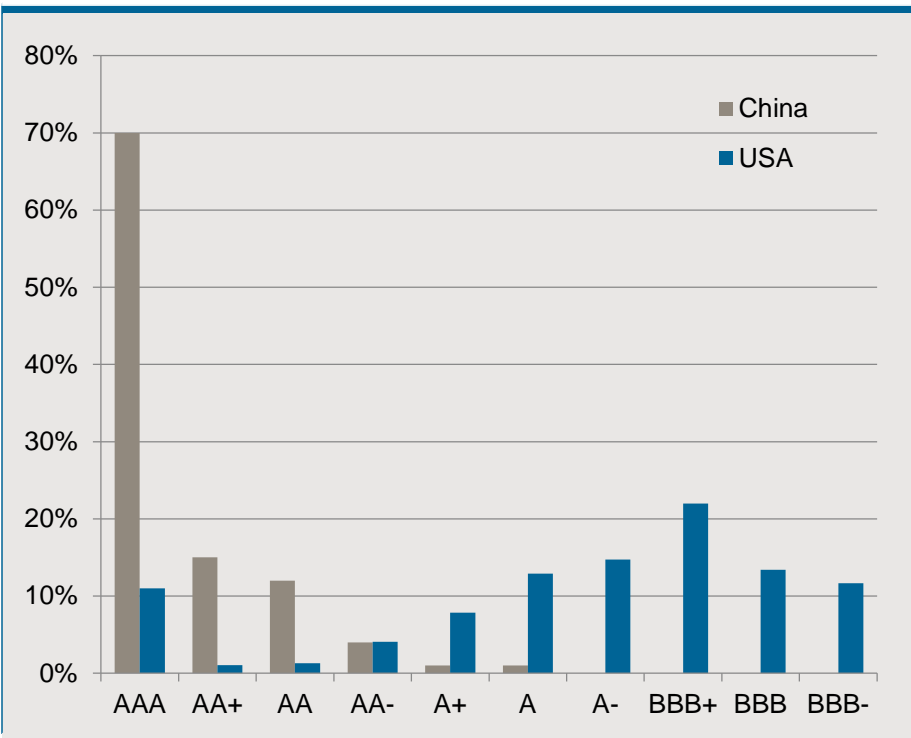
## Commercial Bank Non-Performing Loans



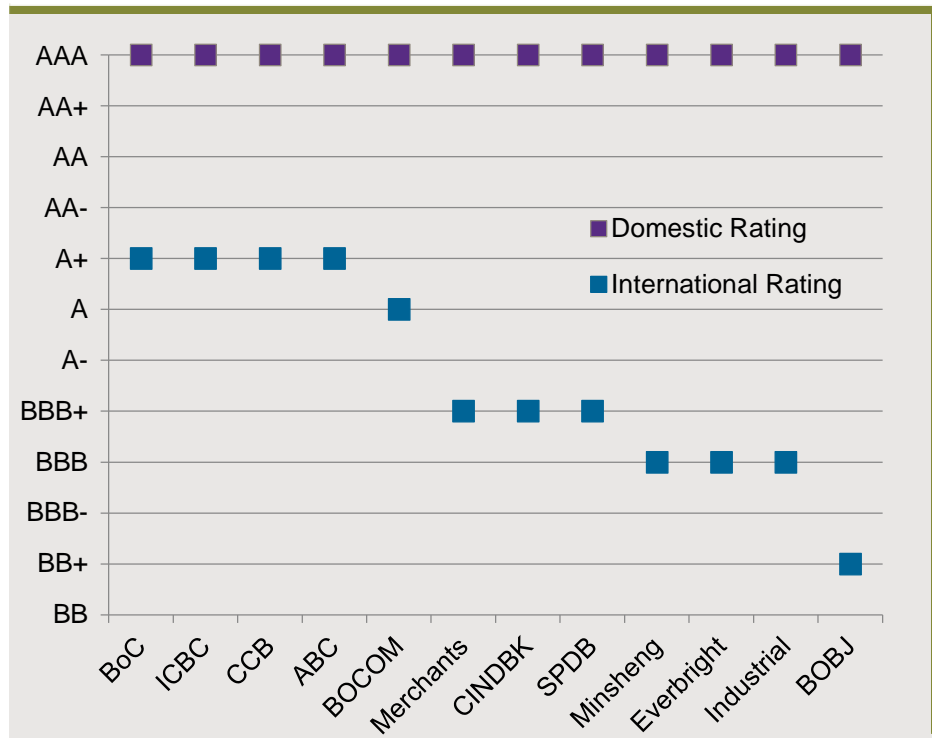
Source: Bloomberg, Wind, J.P. Morgan Asset Management; as at 31 August 2016.

# Credit risks are compounded by inconsistent domestic ratings which have created a false sense of security

## Chinese versus US corporate bond ratings

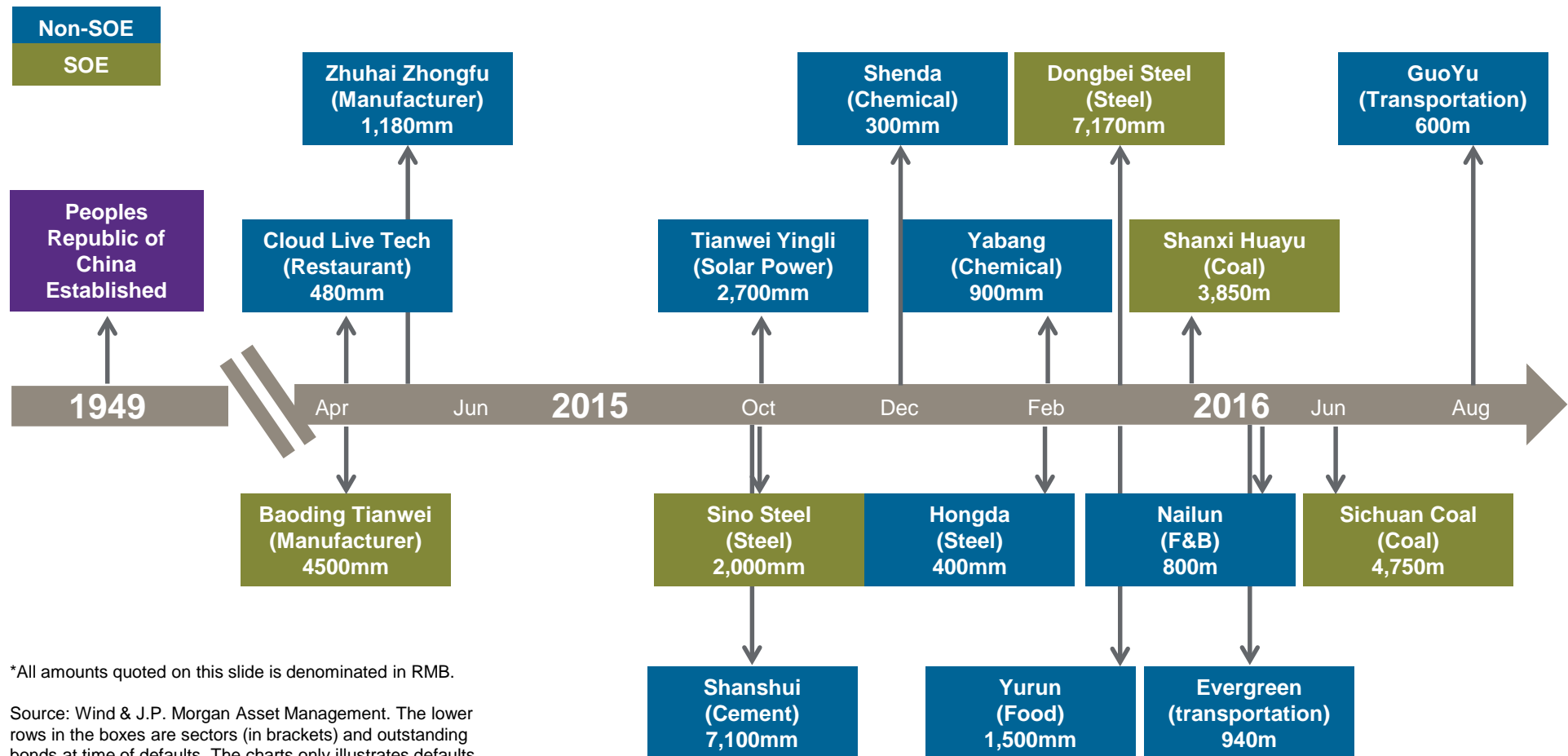


## Domestic versus International ratings - Banking



Source: Bloomberg, Barclays & Wind; as at 31 August 2016.

# The number of defaults has increased as the Government's willingness and capacity to support the system has decreased...



\*All amounts quoted on this slide is denominated in RMB.

Source: Wind & J.P. Morgan Asset Management. The lower rows in the boxes are sectors (in brackets) and outstanding bonds at time of defaults. The charts only illustrates defaults on public bonds, not including private placement bonds, bonds guaranteed by 3<sup>rd</sup> parties, or bonds issued through the SME program.

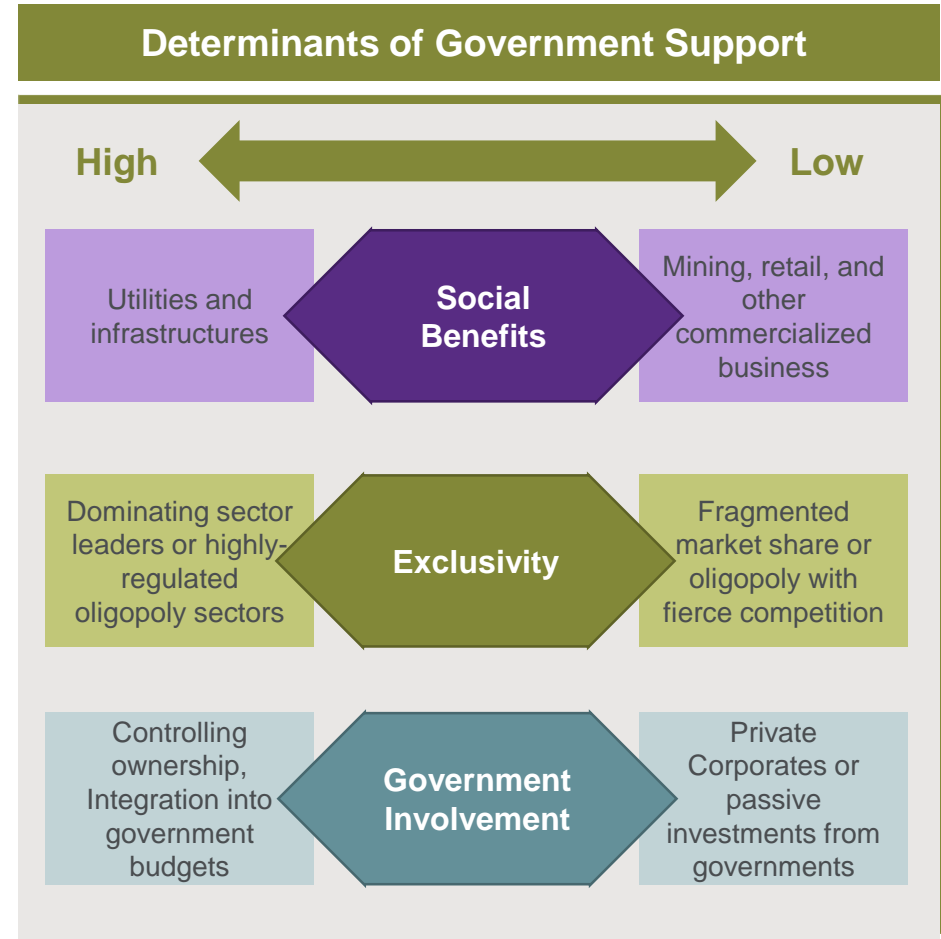
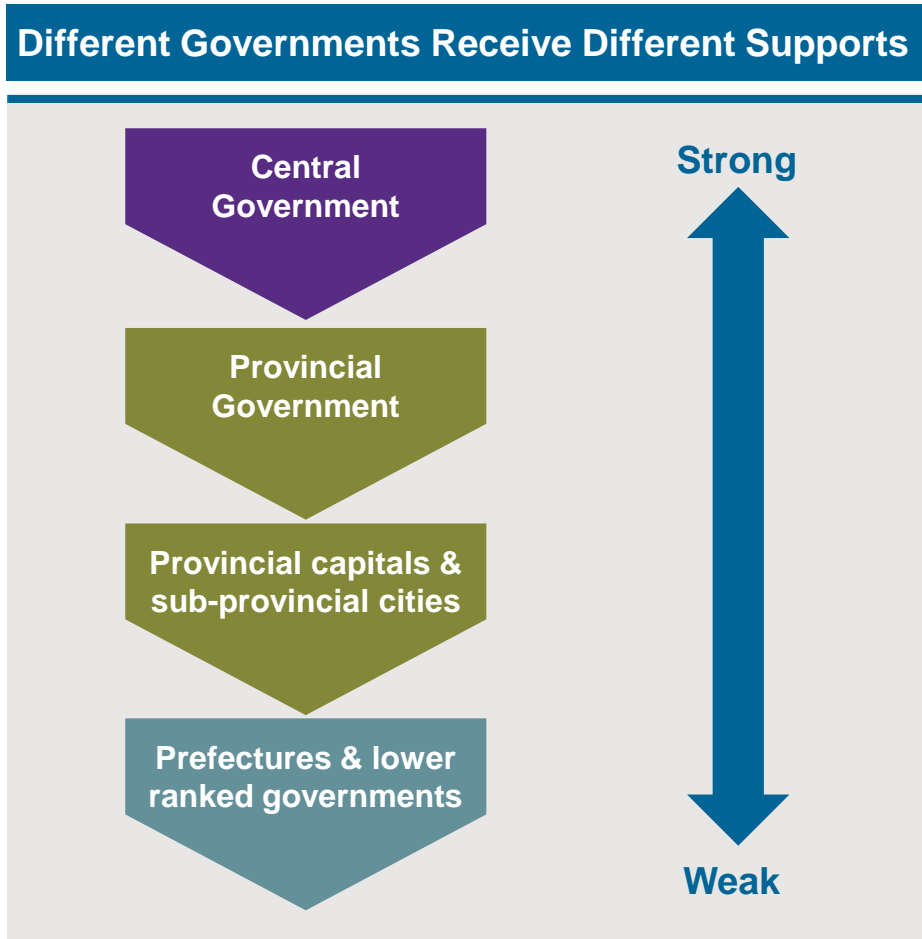
# To minimize credit risk, investors should...

Focus on Standalone Profile	
<b>Capital</b>	<ul style="list-style-type: none"> <li>■ Capital structure (for banks)</li> <li>■ Gross (net) debt to earnings volatility (for corporates)</li> </ul>
<b>Earnings</b>	<ul style="list-style-type: none"> <li>■ Review for resiliency and quality over prolonged time periods</li> </ul>
<b>Liquidity</b>	<ul style="list-style-type: none"> <li>■ Matched funding, stable retail funding base (for banks)</li> <li>■ Cash position, backup credit lines, short-term debt/gross debt (for corporates)</li> </ul>
<b>Market Position</b>	<ul style="list-style-type: none"> <li>■ Market share, brand name, sector competition landscape, bargaining/pricing power, scale</li> </ul>
<b>Management</b>	<ul style="list-style-type: none"> <li>■ Determine consistency and integrity</li> </ul>



Source: J.P. Morgan Asset Management; as at 31 August 2016.

## However, not all government support is equal...



Source: J.P. Morgan Asset Management; as at 31 August 2016.

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