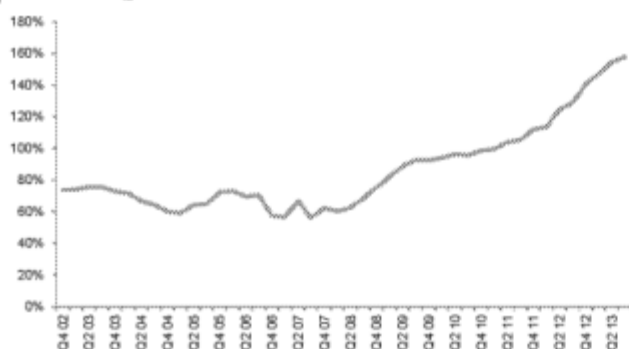




Debt situation is becoming critical for materials and industrials sectors

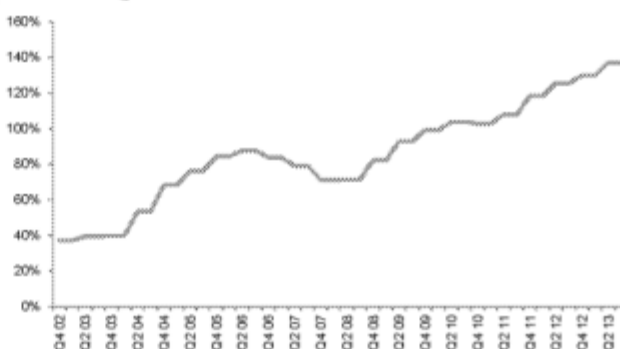
The debt levels of the Industrials and Materials sectors reveal how close the entire system is to reaching a tipping point. The balance sheet leverage of both sectors has risen sharply since 2008 (Figure 34 and Figure 35) despite a level of capital expenditure which has generally been falling relative to sales (Figure 36 and Figure 37). The implication is that whilst the listed companies have in general been behaving in a rational manner, the widespread provision of cost subsidies especially to A- or non-listed enterprises creates a level of overcapacity which drives returns far below the real cost of capital for entire industries. The situation is becoming increasingly critical in our view, since these enterprises are leveraging into an economy which is itself increasing leverage by a considerable amount, led by the local government financing vehicles, many of which offer direct support to the enterprise sector. There is no definitive figure for the extent of LGFV debt – the National Audit Office has been conducting an investigation, the results of which were supposedly going to be released in the lead up to the Plenum, but have failed to appear as yet for some reason. Our best guess is that the level is some way ahead of RMB20trn compared with the RMB10trn in 2010, which was the last official estimate.

Figure 34: Chinese Materials – Debt/Equity (%), rolling 12m average



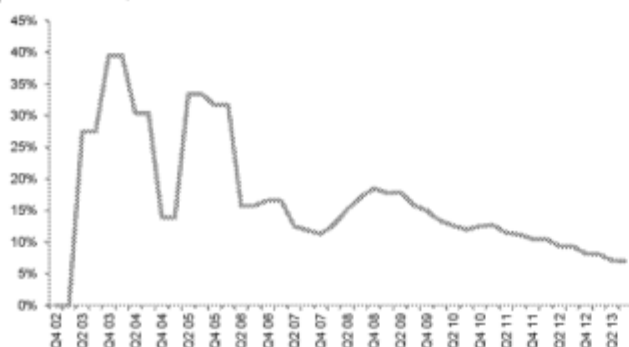
(1) Bottom-up aggregation of relevant stocks in MSCI EM index.
Source: Deutsche Bank, Bloomberg Finance LP

Figure 35: Chinese Industrials – Debt/Equity (%), rolling 12m average



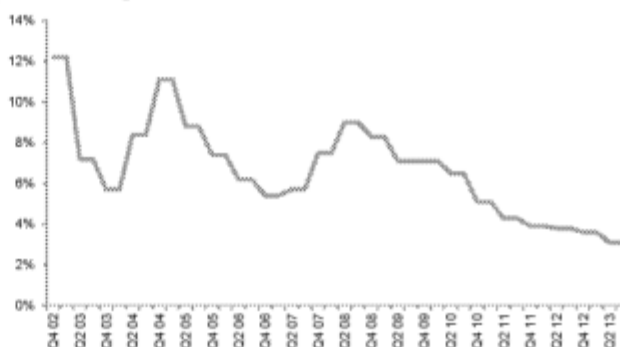
(1) Bottom-up aggregation of relevant stocks in MSCI EM index.
Source: Deutsche Bank, Bloomberg Finance LP

Figure 36: Chinese Materials – Capex/Sales (%), rolling 12m average



(1) Bottom-up aggregation of relevant stocks in MSCI EM index.
Source: Deutsche Bank, Bloomberg Finance LP

Figure 37: Chinese Industrials – Capex/Sales (%), rolling 12m average



(1) Bottom-up aggregation of relevant stocks in MSCI EM index.
Source: Deutsche Bank, Bloomberg Finance LP