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Hong Kong S.A.R., 26 May 2021

China: rising payment risks in construction and energy sectors despite stronger economic outlook

"Coface China Corporate Payment Survey 2021 : shorter credit terms for most sectors except construction, food and automotive"

Overall, the Chinese economy expanded by 2.3% in 2020, being the only major economy to record growth, and Coface expects the GDP to accelerate to a 7.5% growth in 2021.This would be the fastest pace since 2013, and comfortably above the minimum of 6% set by the authorities.

In normal times, higher economic growth should translate into fewer incidents of payment delays, but the recovery has been uneven across sectors.Thus, Coface's 2021 China Corporate Payment Survey[1] shows that payment terms shortened by 11 days on average in 2020, falling to 75 days, while the distribution of credit terms leaned towards a shorter rather than longer period.

Finally, firms also benefited from greater fiscal and monetary support measures last year, which are expected to be further tapered this year. Coface expects an increase in bond defaults and insolvencies in 2021, especially among sectors that accumulated higher cash-flow risks in 2020 amid a slowdown in credit growth.

Bernard Aw, Economist for Asia Pacific at Coface, said:

"Coface's latest China Payment Survey showed Chinese companies taking the necessary step to strengthen credit management in 2020 due to the Covid-19 pandemic. Credit terms were shortened in many sectors, and more credit management tools were deployed, including the use of credit insurance and credit reports, alongside debt collection and factoring services. As a result, fewer companies experienced payment delays in 2020 compared to the previous year.

"While the path of the pandemic remains uncertain and a sustained economic recovery is far from guaranteed, Chinese firms are optimistic about China's economic prospects, with 73% of respondents expecting growth to improve this year, up significantly from 44% in 2020. This coincided with more firms anticipating better sales performance and improved cash flows this year.

"Nevertheless, the survey indicated that credit risks are building up in specific sectors, which warrant close monitoring in the coming months. The proportion of firms in the construction and energy sectors that reported ultra-long payment delays (ULPDs, over 180 days) amounting to more than 10% of annual turnover doubled in 2020 to over 60%, hinting at heightened cash flow risks. This development overlapped with rising bond defaults in mainland China, especially in the construction and real estate sector.

"Looking ahead, Coface expects corporate bond defaults and insolvencies in China to increase in 2021, especially among sectors that accumulated higher cash flow risks in 2020 due to the pandemic."

[1] This 2021 China Corporate Payment Survey was conducted between February and April this year, and surveyed over 600 companies across 13 broad sectors located in mainland China.

Payment delays [2]: Most sectors experienced shorter delays, except construction

Fewer companies experienced payment delays in 2020, with **57% of respondents reporting overdue payments, down from 66% in 2019**. The drop in payment delays reflected a strong government policy response to soften the impact of the pandemic on business activity, which included tax relief, loan guarantees and loan interest waivers. According **to Coface survey, firms in 11 out of 13 sectors reported a decline in payment delays, despite the difficult context.** Among them, wood, pharmaceuticals, transport and ICT reported the largest drops.**There was no change in retail, while construction saw an increase in overdue payments**.

Customers' financial difficulties were the main reason for payment delays. The lack of financing resources was the second most common reason - after fierce competition - suggesting that pockets of the economy may not have access to government support.

Upturn boosts optimism, but higher prices remain key concerns

With China being the only major economy to see GDP growth in 2020, and recent economic data pointing to a steady expansion in the first quarter of 2021, firms are overall optimistic about economic conditions, according to the survey. Over 70% of respondents expect growth to improve in 2021, up considerably from 44% in 2020. **This optimism was accompanied by a greater share of firms anticipating higher sales and cash-flows over the next 12 months**. **Consequently, a majority (62%) of respondents expects their business to return to pre-COVID-19 levels in less than a year**, while nearly a quarter estimates this period between one and two years. **Higher prices was the most common impact mentioned by respondents**, where almost two-thirds stated that the pandemic led to an increase in commodity prices, as governments' public health measures disrupted global supply chains.

Despite the pandemic, 47% of respondents admitted not using any credit management tool to mitigate cash-flow risks in 2020, after 40% in 2019. At the same time, a greater proportion deployed more than one credit management tool. The percentage of firms using credit insurance increased from 17% in 2019 to 27% in 2020, while those using credit reports were at 31% in 2020, up significantly from 19%. Both factoring and debt collection also saw an increase compared to the previous year, reaching 10% and 13%, respectively.

Bond defaults and insolvencies set to rise in 2021

At first glance, our survey's findings may not seem to illustrate the connection between cash-flow risks and corporate bonds defaults, but **a sectoral breakdown shows a strengthening of the link**. The trend in China's corporate bond defaults has been on the rise since the first case in 2014, rising from less than USD 1 billion in 2015 to a record USD 27 billion in 2020, according to data compiled by Bloomberg. **In the first four months of 2021, bond defaults surged by over 70% to USD 18 billion, mostly in real estate, aviation and electronics**. A **significant proportion of the defaults (37%) was linked to HNA Group, a Chinese conglomerate involved in various industries including aviation, real estate, financial services, tourism and others**. Our survey suggested that **many of these sectors also had high cash-flow risks, with 67% of respondents in construction reporting over 10% of annual turnover tied up in ULPDs (Ultra Long Payment Delays), alongside 29% in ICT and 19% in transport**.

[2] Payment delay – the period between the due date of payment and the date the payment is actually made.

Looking ahead, **Coface expects corporate bond defaults and insolvencies to increase in 2021, especially in sectors that accumulated higher cash-flow risks in 2020**, as indicated in our 2021 China Corporate Payment Survey. These are the sectors with the highest proportion of ULPDs amounting to over 10% of annual turnover, including construction (67%), energy (62%) and retail (30%).

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Coface: for trade

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ISIN Code: FR0010667147 / Mnemonic: COFA

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