CCXI

Local Government Bond and Financing Vehicles

Special Research

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Issuance of New Special Bonds Accelerated to Strengthen Weak Areas, and the Scale Leveraged by Stabilizing Investment Expected to Double

——Review of Special Local Government Bonds in the First Quarter and Prospect

Key points of the report

✧ **Issuance characteristics of local bonds in Q1: Considerable YOY expansion in scale, terms tending to become longer and dominated by new bonds**

➢ **Scale of issuance:** Considerable YOY expansion in scale, and much earlier than planned

➢ **Term of issuance:** Terms tending to become longer, with medium and long-term bonds accounting for more than 90%

➢ **Structure of issuance:** Dominated by new bonds and no bonds issued to replace local government outstanding debts temporarily

➢ **Interest rate of issuance:** Slight fall of issuance interest rate and interest spread on the increase after drops

✧ **The characteristics of special bond issuance in Q1: new special bonds account for more than 90% and relatively few issuances in the regions with high debt pressure**

➢ **Scale of issuance:** Continuing to increase capacity substantially with higher proportion than general bonds

➢ **Structure of issuance:** New special bonds account for over 90% and zero issuance of special bonds to replace local government outstanding debts

➢ **Regional distribution:** Fewer issuances and less use of debt limits in the regions with high debt pressure

✧ **Role of special bond: make fiscal policies more active, shore up weak spots and stabilize investment**

➢ **Making fiscal policies more active**

Taking the special bond limit (RMB2.15 trillion) into consideration, this year's broader deficit-to-GDP ratio [(fiscal deficit + special bond limit)/GDP] will hit 4.98%, up 0.84 percentage point over 2018. Therefore, special bonds will make fiscal policies more active.

➢ **Playing an important role in stabilizing infrastructure development and shoring up weak spots**

The government's work report once again emphasized the "reasonable expansion of the scope of use of special bonds", and the funds raised by special bonds will be more used to support major projects in progress and shore up weak spots. By the types of project revenue bonds, the proportion of project income special bonds invested in key weak areas has been rising, and the current issuance scale has greatly exceeded that of toll road special bonds.

➢ **Playing an increasing role in driving investment**

As estimated by CCXI, among new special bonds (RMB666 billion) issued in Q1, about RMB403.5 billion was invested in infrastructure projects to attract infrastructure investment of RMB0.6-1.33 trillion and total investment of RMB2.4-5.32 trillion, exceeding the investment throughout 2018 by 50%.

✧ **Prospect for special bond: Speeding up advancement of key weak areas with investment projected to be doubled**

➢ **Development trend:** Faster capacity increase of project revenue bonds, more diverse varieties and development of key weak areas expected to be accelerated

➢ **Scale forecast:** New special bonds will continue to see accelerated issuance, and the issuable scale will be greatly increased taking into account retained limits

1. **Special bond to replace local government outstanding debts:** No issuance in Q1, and the largest scale of the year was RMB315.1 billion.
2. **Special bond for refinancing:** The largest scale of the year was RMB0.6 trillion and the balance was RMB0.55 trillion within the year
3. **New special bond:** The annual limit was RMB2.15 trillion and the balance was RMB1.48 trillion within the year; if the retained limit (RMB1.23 trillion) of previous year is to be used, RMB2.71 trillion can still be issued within the year

➢ **Investment leverage estimation:** Total investment leverage for the whole year is expected to double that of last year

1. **Excluding the special bond limit retained from last year:** The annual infrastructure investment leveraged is RMB1.9-4.3 trillion, and the total investment leveraged is about RMB7.8-17 trillion
2. **Including the special bond limit retained from last year:** The annual infrastructure investment leveraged is RMB3-6.7 trillion, and the total investment leveraged is about RMB12.2-26.8 trillion

It was put forward in the *Report on the Work of the Government in 2019* that, we will make effective use of local government bonds, provide funding for key projects, create conditions for better forestalling and defusing local governments' debt risks and moderately expand the scope of use for special local government bonds. As an important part of proactive fiscal policies, special local government bonds are an important source of funds to support infrastructure, shore up weak spots and stabilize investment. Against the backdrop that the economic downturn has not been fundamentally reversed, the scale of special local government bonds, especially new special bonds, is expected to continue to expand rapidly, and the types will become increasingly diversified, so as to make the proactive fiscal policies more effective. This paper outlines the issuance of special local government bonds in Q1 2019, analyses in detail the important role of special bonds in stabilizing infrastructure, shoring up weak spots and stabilizing investment, and forecasts and estimates the development trend, issuing scale and investment scale leveraged of special local government bonds in the year.

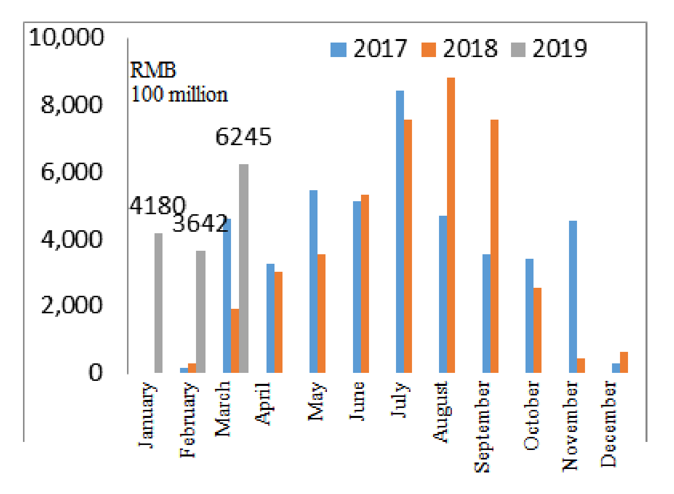
I. Issuance characteristics of local bonds in Q1: Considerable YOY expansion in scale, terms tending to become longer, and being dominated by new bonds with issuance interest rate moving downward

Against the backdrop of stabilizing growth and preventing risks since 2019, local government debt management has followed the principle of "supporting legitimate debt financing and blocking illegal practice" and local government bonds have been increased substantially. In Q1, the issuance is far larger than the same period last year. In addition, the issuance was much earlier than planned, breaking the record of zero issuance in each January of past years. Such features as longer bond terms, large proportion of new bonds and unbalanced regional distribution emerged.

i. Scale of issuance: Considerable YOY expansion in scale and much earlier than planned

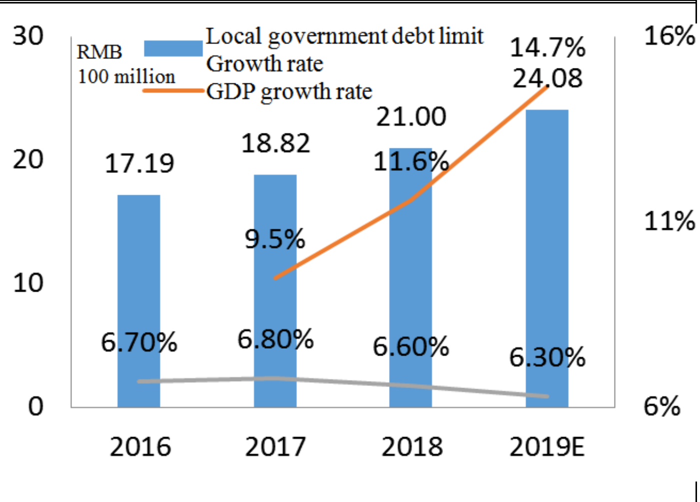
In 2019, local government bonds were issued much earlier than last year. A total of RMB1406.6 billion of local government bonds were issued in Q1, much bigger than the same period of last year and the year before last. Monthly issuance broke the record of zero issuance in each January of past years. RMB418 billion, 364.2 billion and 624.5 billion of bonds were issued in January, February and March, respectively, much bigger than the monthly average scale of last two years. **Faster issuance of local government bonds was related to both earlier issuance of partial local government debt limits this year and stronger support for legitimate debt financing by local governments in the context of loose credit policies.** The 7th session of the 13th National People's Congress authorized the State Council to issue new bond limit (RMB1.39 trillion) of local governments ahead of schedule, including RMB580 billion of new general bonds and RMB810 billion of special bonds. This move made the overall issuance of local government bonds far earlier than planned. Since H2 of 2018, to stabilize infrastructure investment and meet local fund demand, policies have been continuously introduced to accelerate the issuance of local government bonds. It was proposed in the *Report on the Work of the Government in 2019* that, effective use should be made of local government bonds. This year's new special debt limit is RMB2.15 trillion, an increase of RMB800 billion over last year. New general debt limit is RMB930 billion. The total new debt limit of local governments is RMB3.08 trillion this year, an increase of RMB0.9 trillion or 14.7% over last year. Local government bonds continued to expand rapidly.

Figure 1: Monthly issuance scale of local government bonds



Data source: Compiled by CCXI

Figure 2: Local government debt limit and growth rate



Data source: Compiled by CCXI

ii. Term of issuance: Terms tending to become longer, with medium and long-term bonds accounting for more than 90%

Based on the terms of local government bonds issued in Q1, most of local government bonds were still of medium or long-term (5-10 years). However, the terms tend to become longer. Compared with the same period last year, medium and long-term bonds (5-year, 7-year and 10-year) surged to 92% in Q1 2019 from 70%. 10-year local government bonds soared to 38% (No. 1 place) from 15%. 15-year or longer-term local government bonds accounted for 4%. Short and medium-term varieties were sharply decreased. 3-year or shorter-term local government bonds dropped to 4% this year from 30% in the same period last year.

iii. Structure of issuance: Dominated by new bonds and no bonds issued to replace local government outstanding debts temporarily

According to the issuance structure of local government bonds in Q1, most local government bonds were newly issued, totaling RMB1,184.7 billion and accounting for 84.2%; refinancing bonds amounted to RMB222 billion, accounting for 15.8%; bonds to replace local government outstanding debts were not issued temporarily. Because of the expiry of debt replacement last year, most local government bonds were for replacing local government debts in H1 of last year. After the replacement was basically ended in August, bonds to replace outstanding debts were substantially cut. In the context of loose credit policies, the proportion of new bonds climbed rapidly. In terms of debt limit use, new bonds issued in Q1 accounted for 82.2% of the new debt limit (RMB1.39 trillion) issued by the State Council ahead of schedule under authorization of the 7th session of the 13th National People's Congress and 38.5% of the year's new debt limit (RMB3.08 trillion).

Figure 3: Proportions of local government bonds with different terms issued in Q1

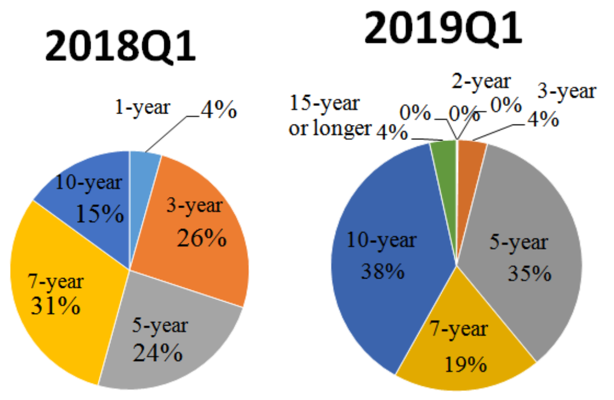


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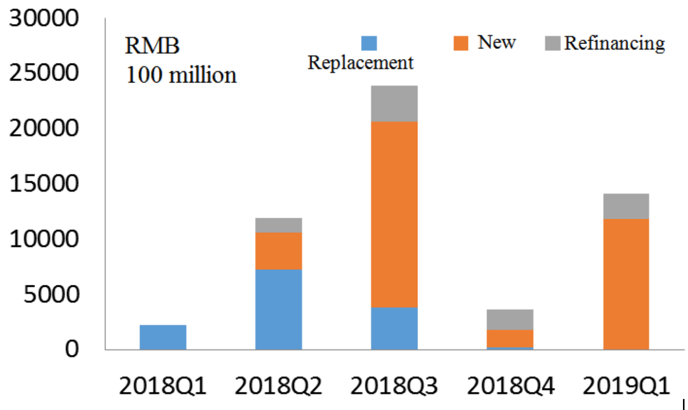
Figure 4: Structure of local government bonds issued in Q1

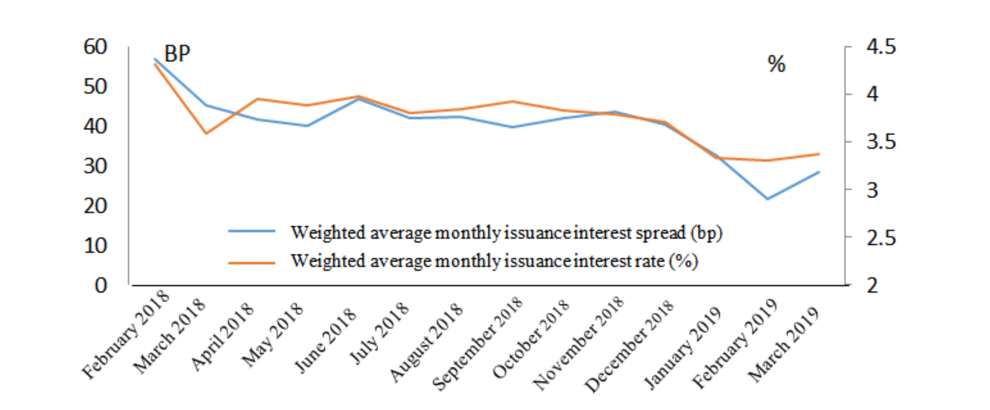


Data source: Compiled by CCXI

iv. Interest rate of issuance: Slight fall of issuance interest rate and interest spread on the increase after drops

Since H2 of 2018, theissuance interest rate in the bond market moved downward and the issuance cost of local government bond dropped slightly in the context of stable regulation and loose credit. Based on the weighted average issuance interest rate of local government bonds, the interest rate of local government bonds issued in Q1 showed an obvious decline trend compared with last year. It was 3.33% in January, down 38 percentage points over the end of last year (3.71%). In February, it dropped slightly to 3.31%. In March, it rose slightly to 3.38%. **Based on the weighted average issuance interest spread of local government bonds**, the lower limit of interest rate of local government bonds over Treasury bond yield was adjusted to 25bps from 40bps in Q1. As a result, the bid-to-cover ratio of local government bonds was rapidly reduced to one-digit level from 50 times and their liquidity dropped somewhat. However, after the Ministry of Finance issued the *Notice on Launching the Issuance of Local Government Bonds through the Over-the-Counter Market of Commercial Banks*, the scope of local government bond investors was widened to include individuals and small and medium institutions. The investors tend to become diverse, providing certain liquidity support for increasing local government bonds.

Figure 5: Interest rate and spread of local government bonds issued in Q1



Data source: Compiled by CCXI

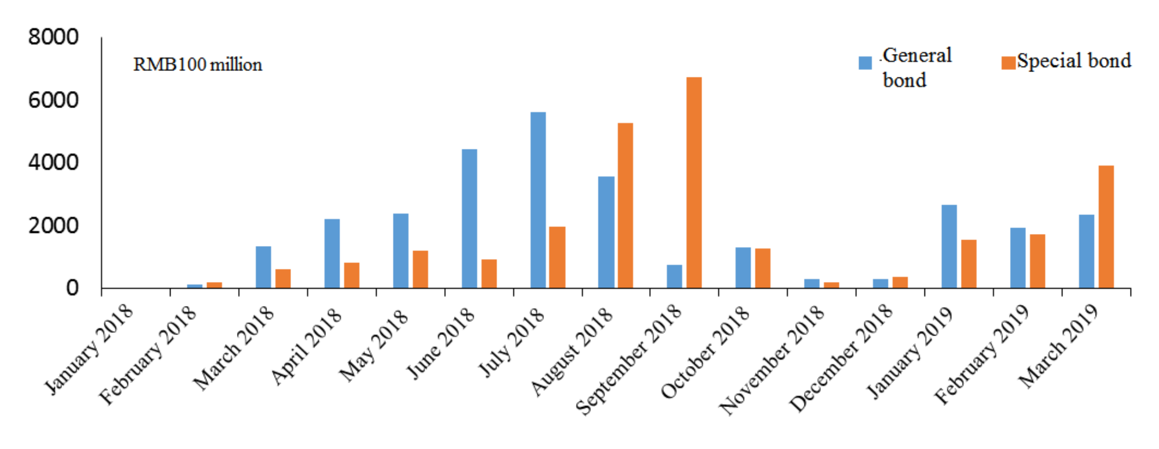
II. The characteristics of special bond issuance in Q1: New special bonds accounting for more than 90% and fewer issuances in the regions with high debt pressure

Local government bonds in China can be divided into general and special bonds. The former is issued by local governments to alleviate the shortage of funds or solve temporary shortage of funds, and the latter is issued by local governments to raise funds for a specific project. From the variety of local government bonds issued over the years, the general bonds take a large proportion. Since 2019, under the requirements of further implementing the proactive fiscal policy, special bonds have continued to expand rapidly. The proportion of special bonds in Q1 has surpassed that of general bonds. New special bonds exceeded 90%.

i. Scale of issuance: Continue to increase substantially and higher proportion than general bonds

Proactive fiscal policies have produced remarkable results, and special local government bonds have been greatly expanded. Since H2 of last year, the *Opinions on the Issuance of Special Bonds of Local Government* (C. K. [2018] No. 72) issued by the Ministry of Finance in August further lifted the quarterly balance requirement on the issuance of local government bonds. Special bonds were concentrated in Q3, worth RMB1396.5 billion, a surge of 80% over the same period of last year (RMB776.6 billion), and accounting for 72% of the year's total and far larger than general bonds. Starting from the end of last year, the National Conference on Finance and Central Economic Work Conference put forward requirements including "substantially expanding special local government bonds". As a result, the substantial expansion of special bond insurance continued in 2019. It was proposed in the *Report on the Work of the Government* in March that, it was planned to issue RMB2.15 trillion of special local government bonds this year, an increase of RMB800 billion over last year. With the support of proactive fiscal policies, special bonds continued to be increased substantially. Special bonds of RMB717.2 billion were issued in Q1, accounting for 51% of total local government bonds, exceeding the size of general bond with a striking increase of RMB640 billion over the same period of last year (RMB77 billion). New special bonds of RMB666 billion accounted for 56.2% of new bonds.

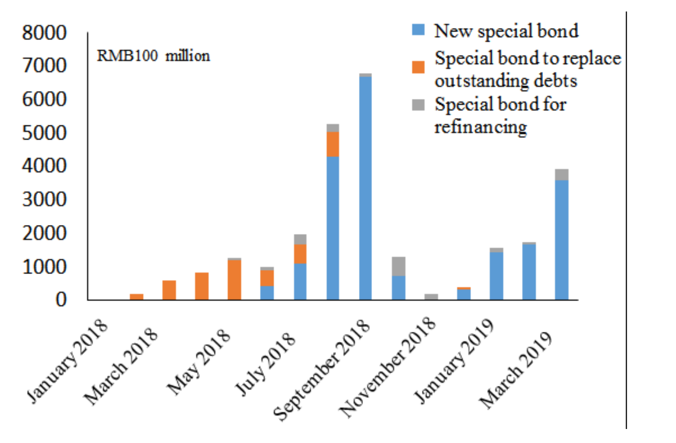
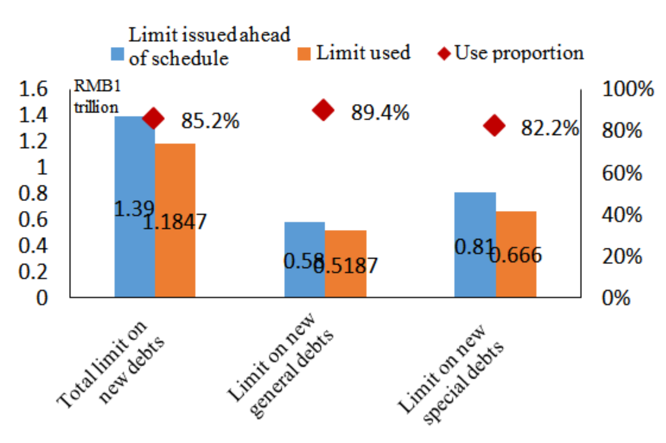
Figure 6: Comparison between general and special bonds in terms of monthly issuance size



Data source: Compiled by CCXI

ii. Structure of issuance: New special bonds account for 90% and zero issuance of special bonds to replace local government outstanding debts

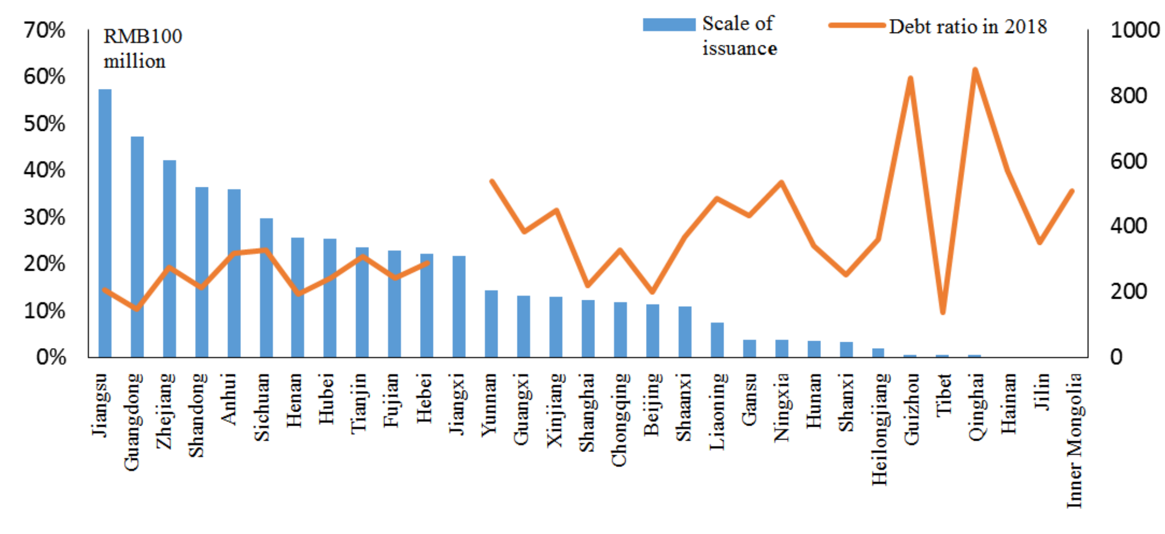
With respect to special bond issuance structure, in order to further raise the implementation efficiency of proactive fiscal policies, the issuance of new special bonds has been constantly accelerated with proportion in total special bonds keeping rising since H2 of last year. New special bonds of RMB666 were issued in Q1 of this year, marking a big breakthrough compared with the same period of last year (zero issuance) and accounting for more than 90% of total special bonds. After the deadline of debt replacement in last August, special bonds to replace local government outstanding debts were only issued in a small amount (RMB4.1 billion) in December, with zero issuance in Q1 of this year. Special bonds for refinancing remained on a small scale, with RMB51.2 billion in Q1, only accounting for 7%. **In terms of special debt limit use,** new special bonds issued in Q1 accounted for 82.2% of the new special debt limit (RMB810 billion) issued by the State Council ahead of schedule under authorization of the 7th session of the 13th National People's Congress and 31% of the year's new special debt limit (RMB2.15 trillion), leaving a big room for further issuance.

Figure 7: Monthly issuance structure of special bonds	Figure 8: Use of limit issued in advance in Q1
	
Data source: Compiled by CCXI	*Data source: Compiled by CCXI*

iii. Regional distribution: Fewer issuances and less use of debt limits in the regions with high debt pressure

Regarding regional distribution of local government bonds, there is a certain relationship between the issuance of provincial and municipal local government bonds and their debt pressure. Smaller new debt limits were allocated to the regions with high debt pressure. So, special bond issuance was reduced accordingly in Q1. As estimated by CCXI, in some regions of China, the debt level is too high and there is a high debt risk. In 2018, the debt ratio (debt/GDP) exceeded the EU’s warning line of 60% in Qinghai and Guizhou, while this figure was low in Guangdong, Henan and Jiangsu. **Based on the issuance of special bonds by provinces and cities in Q1,** regional divergence was relatively obvious. Jiangsu, Guangdong, Zhejiang, Shandong and Anhui issued more than RMB50 billion of special bonds, with low debt pressure. Jiangsu topped other provinces (cities) by RMB81.8 billion. Shanxi, Heilongjiang, Guizhou, Tibet and Qinghai, however, issued less than RMB5 billion of special bonds, and Jilin, Inner Mongolia and Hainan issued no special bond, those regions have higher debt risks.

Figure 9: Regional distribution of special bonds in Q1[1]

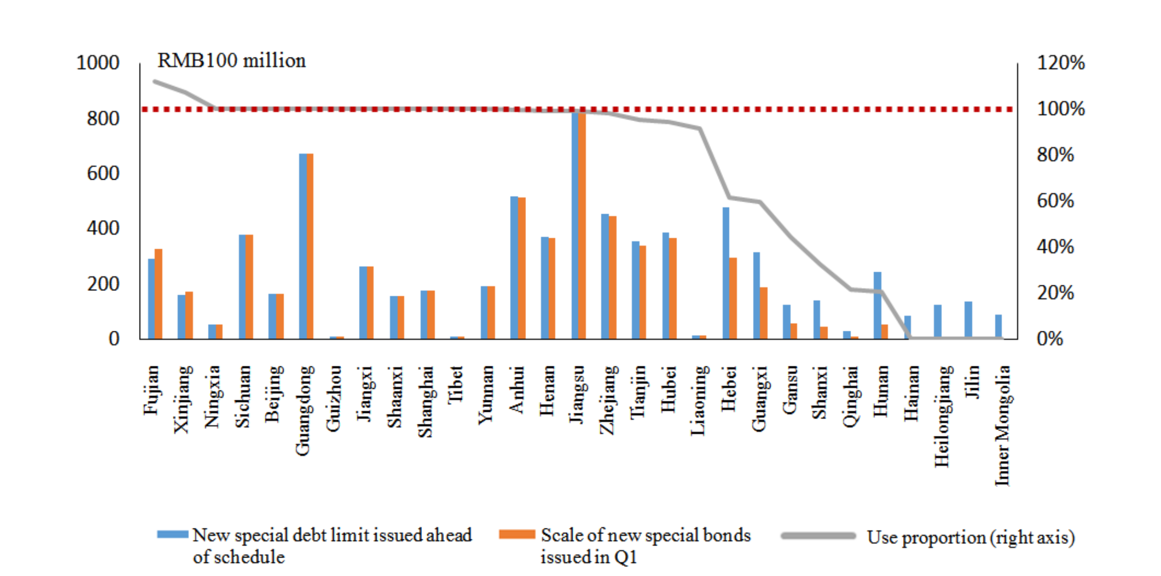


Data source: Compiled by CCXI

In terms of special debt limit use by provinces and cities, the proportion of early-issued new special debt limits used by in different regions differed greatly. Most provinces with low use proportion are in the regions with relatively high debt risk. By the end of Q1, 12 provinces (including Fujian, Xinjiang, Ningxia and Sichuan) used up special debt limits issued in advance. Among them, new special bonds of Fujian and Xinjiang exceeded the new special debt limits, with a high use proportion. Eight provinces (including Gansu, Shanxi and Qinghai) used less than half of new special debt limits. Hainan, Heilongjiang, Jilin and Inner Mongolia have not issued special bonds, with low use efficiency of special debt limits.

[1] As Jiangxi Province has not disclosed the balance of local government debt in 2018, it is impossible to calculate the debt ratio.

Figure 10: Use of new special debt limits issued in advance for local governments in 2019[2]



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III. Role of special bond: Make fiscal policies more active, shore up weak spots and stabilize investment

At present, the economy is still facing downward pressure. As an important part of proactive fiscal policies, special local government bonds are the direct force to bolster areas of weakness and stabilize investment, and has gradually become the necessary focus of stabilizing economic growth. Accelerating the issuance of special bonds is conducive to alleviating the financial pressure of local governments, guaranteeing the financial needs of key projects, and further playing the role of infrastructure in supporting economic growth, so as to enhance the implementation efficiency of fiscal policies, which is an important manifestation of more active fiscal policies.

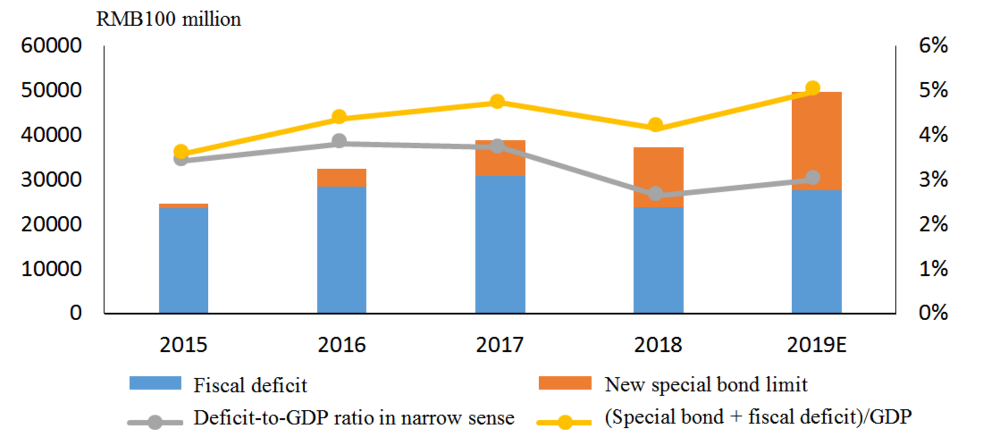
i. Making fiscal policies more active

In respect of the broad deficit-to-GDP ratio, special local government bonds make proactive fiscal policies more positive. Fiscal deficit-to-GDP ratio is an important indicator of fiscal policy expansion. In the *Report on the Work of the Government* this year, the ratio is set at 2.8%, up 0.2 percentage point from last year. The fiscal deficit is set as RMB2.76 trillion, up RMB380 billion over last year's objective and actual deficit. The fiscal deficit of Central Government and local governments were RMB1.83 trillion and RMB930 billion respectively. The above deficit-to-GDP ratio is only for general public budget, and the revenue and expenditure of local governments' special debt are reflected in their fund budget. The issuance of special bonds can be regarded as an integral part of proactive fiscal policies. The funds raised through special bonds are used for expanding investment

[2] As Shandong and Chongqing have not disclosed the new special debt limits issued ahead of schedule for 2019, the use of limits by such two provinces are not considered in this figure.

and expenditure, which is also a manifestation of fiscal expansibility. Therefore, the narrow fiscal deficit-to-GDP ratio underestimates the expansion of current fiscal policies. Taking the special bond limit (RMB2.15 trillion) into consideration, this year's broader deficit-to-GDP ratio [(fiscal deficit + special bond limit)/GDP] will hit 4.98%, up 0.84 percentage point over 2018. Therefore, special bonds will make fiscal policies more active.

Figure 11: Deficit-to-GDP ratio of nearly 5% (including new special bonds)



Data source: Compiled by CCXI

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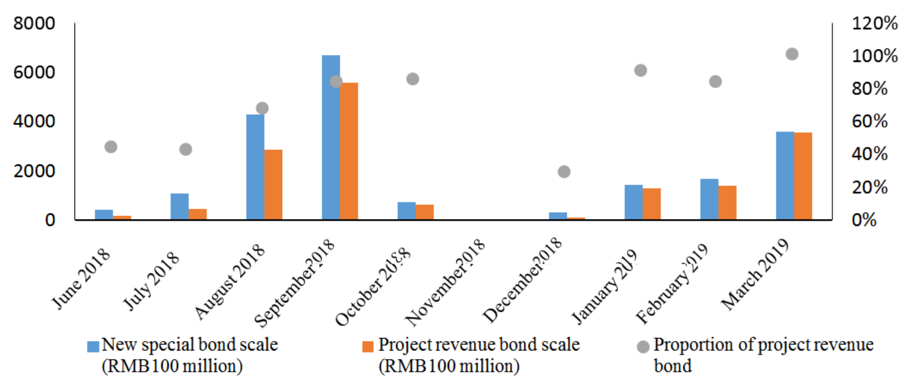
ii. Playing an important role in stabilizing infrastructure development and shoring up weak spots

With the introduction of proactive fiscal policies, special bonds have become the main force of stabilizing infrastructure construction and strengthening points of weakness. On October 31 of last year, the *Guiding Opinions of the General Office of the State Council on Maintaining Efforts to Remedy Shortcomings in Infrastructure* proposed focusing on weaknesses of key fields (such as poverty alleviation, railway, highway, water transportation, airport, water conservancy, energy, agriculture, rural areas, ecological and environmental protection and people's livelihood) and speeding up major projects included in the planning. This year's *Report on the Work of the Government* reemphasized moderately expanding the scope of use for special local government bonds and allocating more special bond funds for supporting major projects in progress and shoring up weak fields. First, supporting three critical battles, including poverty alleviation projects in extremely poor areas (such as "three regions and three prefectures") and pollution prevention and control projects; second, supporting major development strategies such as the construction of Xiongan New Area, development of Yangtze Economic Zone, development of Belt and Road and Guangdong-Hong Kong-Macau Greater Bay Area; third, supporting major project, including shanty town renovation, railway, highway and other transport infrastructure, major water conservancy facilities and public-good project construction (such as rural revitalization), with the focus on the subsequent construction of projects in progress. In order to promote proactive fiscal policies, special local government bonds will expand infrastructure investment and strengthen shortcomings, thus creating an important foundation for sustained economic growth.

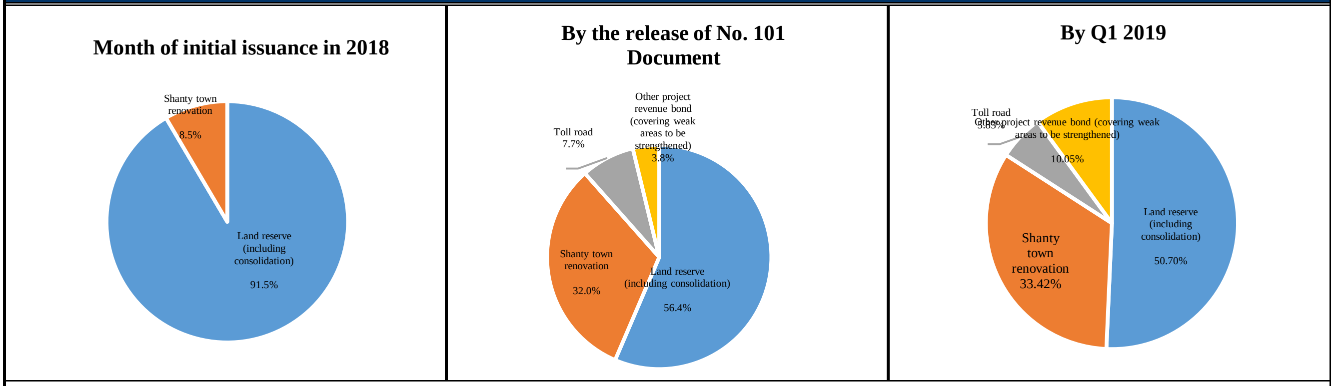
Project revenue bonds were dominant in new special bonds. The issuance of varieties in weak areas gathered pace. Compared with ordinary special bonds, special project revenue bonds are more closed and independent and all issued as new bonds. Projects supported by such bonds will generate continuous and stable cash flow incomes and cover principal and interest. The statistics of CCXI show that, by the end of March, special project revenue bonds of RMB1.6 trillion were issued in total. RMB623.6 billion was issued in Q1, accounting for 86.9% of special bonds issued in Q1 and 93.6% of new special bonds in Q1. By project type[3], since the month of initial issuance, project revenue bonds relating to land reserve were the largest in scale, exceeding RMB800 billion up to now. However, the proportion continued to drop to current 50.7% from 91.5% in the month of initial issuance. It is notable that, **special project revenue bonds in key weak areas continuously climbed. As of the end of Q1, the proportion of other project revenue bonds covering weak areas was 6.25 percentage points higher than before the release of No. 101 document at the end of last October. The current issuance scale is far bigger than special bonds of toll roads ranking No. 3 previously.**

Figure 12: Monthly project revenue bond and new special bond scale



Data source: Compiled by CCXI

Figure 13: Proportion changes of special project revenue bond varieties



Data source: Compiled by CCXI

[3]As projects relating to ordinary special bonds have not been disclosed in detail, only invested fields of special project revenue bonds are considered in this document.

iii. Playing an increasing role in driving investment

With the support of policies, special bond issuance was accelerated substantially, playing an increasing role in bolstering and boosting stable investment. Special bonds are included in governmental fund budget management. Expenditures excluding land transfer fees and involving transport facilities, water conservancy facilities and ecological progress are all related to infrastructure development. Thus, new special bonds are an important source of infrastructure development funds. As projects relating to ordinary special bonds have not been disclosed in detail, fund investment direction and scale of special project revenue bonds are temporarily used to estimate the scale of infrastructure investment promoted by special bonds. **Their role in driving current infrastructure investment is estimated as follows:**

First of all, according to the scope of investment of fixed assets, the early operation (i.e., primary land development) of land development is not included in fixed asset investment. Thus, special land reserve bonds with the largest stock scale cannot become the main force of driving infrastructure development for the time being and won't be included in estimation. The remaining funds are mainly allocated to infrastructure-related fields such as shanty town renovation, toll road and rail transit. **Based on such estimation, about RMB403.5 billion out of RMB666 billion (new special bonds in Q1 2019) was invested in infrastructure projects.**

Second, regarding another two major varieties of special project revenue bond, a relatively small amount of funds were allocated to shanty town renovation projects, and most of new projects were dependent on special bonds (15%-70%). Toll road projects basically adopted the operation mode combining project capital and special bond (45%-60%). Based on these two special bonds with larger stocks, special bonds are roughly estimated as 25%-70% of project investment. Based on the above proportion, the multiplier of promoting infrastructure development is estimated to be 1.5-3.3 times. **Therefore, infrastructure investment that can be promoted by special bonds is roughly RMB0.6-1.33 trillion in Q1 2019.** If the average infrastructure investment is estimated to be 25% of fixed asset investment in recent five years, **the investment that can be promoted by special bonds is around RMB2.4-5.32 trillion in Q1,** exceeding 50% of the amount that can be promoted by the investment made throughout 2018. **Along with constantly substantial increase of special bonds, an increasingly big role will be played in stabilizing investment.**

Table 1: Investment promoted by special project revenue bonds[4] (2018 & Q1 2019)

	Issuance scale in 2018 (RMB100 million)	Issuance scale in Q1 2019 (RMB100 million)	Special bond/total project investment	Times of infrastructure investment promoted	Scale of infrastructure investment promoted in 2018 (RMB trillion)	Scale of investment promoted in 2018 (RMB trillion)	Scale of infrastructure investment promoted in Q1 2019 (RMB trillion)	Scale of investment promoted in Q1 2019 (RMB trillion)
Land reserve	5496	2625	/	/	/	/	/	/
Shanty town renovation	3155.8997	2195	15%-70%	1.4-6.7	/	/	/	/
Toll road	749.6	185	45%-60%	1.7-2.2	/	/	/	/
New special bond (excluding land reserve)	7762.7317	4035.2723	30%-65%	1.5-3.3	1.16-2.56	4.46-9.85	**0.6-1.33**	**2.4-5.32**

[4] This table is based on estimated fund proportion of specific projects relating to special project revenue bond.

IV. Prospect for special bond: Speeding up advancement of key weak areas with investment projected to be doubled

In order to further implement proactive fiscal policies, mitigate infrastructure development fund pressure on local governments, and continuously play the role of special bonds in strengthening points of weakness, special bonds will continue to be rapidly increased within the year. In the meantime, the issuance of project revenue bonds in key weak areas will be accelerated. The year's special bond issuance goal may be accelerated for completion by Q3. The issuance of special bonds will be sped up in the future two quarters, which will play an increasingly big role in boosting infrastructure and total investments.

i. Development trend: Faster capacity increase of project income bonds, more diverse varieties and development of key weak areas expected to be accelerated

The introduction of new *Budget Law* (2014 version) and No. 43 Document signaled that local government debt management entered the period of standardization and financing platforms were gradually separated from governmental credit. With local government financing further standardized, expanding statutory debt is a necessary way to effectively prevent and defuse hidden debts. To implement the policy of "supporting legitimate debt financing and blocking illegal practice" to mitigate high hidden debt pressure on local governments, new special bonds mainly containing special project revenue bonds will surge. All special bonds have clear sources to repay. All initialization, issuance and repayment processes are included in the current statement of budget receipts and payments, so that risks can be isolated more effectively. **With continuous prevention and control of hidden debt risks, special bonds will gradually replace the local government financing function performed by the financing platforms in infrastructure development, public service and other fields in the past and will be of great significance to mitigating hidden debt risks of local governments.**

Current special project revenue bonds are mostly related to land reserve. By distribution of project revenue bond varieties, project revenue bonds related to land reserve issued in Q1 accounted for 42.09%. Although other varieties relating to weak fields (such as rural revitalization and poverty alleviation, infrastructure in municipal development in urban and rural areas, environmental protection, community construction and support for people's livelihood) continued to increase, their absolute proportion remained low at 11.64%. With vigorous advancement of special bond issuance by the state, the overall scale and varieties of special bonds can no longer fully meet the fund demand of infrastructure investment, people's livelihood improvement and other areas. To further carry out proactive fiscal policies, other policies have been successively released to vigorously promote special bond issuance to ease infrastructure fund pressure on local governments and continuously play the role of special bonds in strengthening points of weakness. On October 31 of last year, the *Guiding Opinions of the General Office of the State Council on Maintaining Efforts to Remedy Shortcomings in Infrastructure* proposed focusing on weaknesses of key fields (such as poverty alleviation, railway, highway, water transportation, airport, water conservancy, energy, agriculture, rural areas, ecological and environmental protection and people's livelihood) and speeding up major projects included in the planning. The *Report on the Work of the Government in 2019* pointed out that, China will make effective use of local government bonds, provide funding for key projects and moderately expand the scope of use for special bonds. **In the environment of loose credit policies, innovative special project revenue bonds will be constantly released. The issuance scale and pilot scope are expected to be expanded in the year. In particular, advancement in key weak areas will be sped up.**

ii. Scale forecast: New special bonds will continue to see accelerated issuance, and the issuable scale will be greatly increased taking into account retained limits

Since 2019, the issuance of local government bonds will be continuously accelerated. Most of early-issued new limit was used in Q1. Only 60% of new limit of the year has not been used. New general bonds were 55% of annual limit. New special bonds were 31% of annual limit. According to the deployment made at the Executive Meeting of the State Council on January 9 for accelerating the issuance of special local government bonds, great efforts should be made to strive for completion of issuance by the end of September and avoid financing difficulties in key projects. **The annual issuance goal of special bonds may be completed ahead of schedule in Q3. Hence, special bonds will be issued more quickly in the coming two quarters, with the speed and scale far higher and bigger than general bonds.** By categories:

1. Special bond to replace outstanding debts: No issuance in Q1, and the largest scale of the year was RMB315.1 billion

The latest data released by the Ministry of Finance reveals that, by the end of March 2019, the existing governmental debt balance in the non-governmental bond form was RMB315.1 billion. The *Report on the Work of the Government in 2019* proposed "continuing the issuance of some local government bonds to replace outstanding debts in order to reduce the interest payment burdens of local governments". Such existing government debts may be entirely replaced within the year. So, RMB315.1 billion of bonds to replace outstanding debts are **expected to be issued in the year. If all of them will be issued in the special bond form, the maximum scale of special bonds to replace outstanding debts will be RMB315.1 billion.**

2. Special bond for refinancing: The largest scale of the year was RMB0.6 trillion and the balance was RMB0.55 trillion within the year

According to the *Opinions on the Issuance of Local Government Bonds in 2018* (C. K. [2018] No. 61) issued by the Ministry of Finance, refinancing bonds should be mostly used for repaying partial due local government bond principals. Hence, the issuance scale of refinancing bonds is forecast based on the amount of local government bonds to be due in the year. RMB1,315.187 billion of local government bonds will be due throughout 2019, including 712.709 billion of general bonds and RMB428.05 billion of special bonds. Before 2015, the bonds (not classified as general and special) of RMB174.43 billion became due. Thus, **the maximum scale of special refinancing bonds will be RMB0.6 trillion all the year round. RMB51.2 billion was issued in Q1. The remaining issuance of special refinancing bonds is expected to be about RMB0.55 trillion in the year.**

3. New special bond: The remaining limit is RMB1.484 trillion. If the retained limit of last year is included, another RMB2.71 trillion can be issued in the year

New bonds can be divided into general bonds and special bonds. As limited by budget deficit, the new general bond limit for 2019 is RMB0.93 trillion. RMB518.7 billion was issued in Q1, leaving RMB411.3 billion in the year. New general bond issuance is expected to slow down at the next stage.

The annual limit of new special bonds is RMB2.15 trillion. RMB666 was issued in Q1, with the rest of RMB1.484 trillion unused. According to the deployment made at the Executive Meeting of the State Council on January 9 for accelerating the issuance of special local government bonds, great efforts should be made to strive for completion of issuance by the end of September and avoid financing difficulties in key projects. The annual issuance goal of special bonds may be changed to completion by Q3. **More than RMB700 billion of new special bonds are to be issued in each quarter (Q2 and Q3), far faster than new general bonds.**

If last year's retained limit of special bonds is to be used, new special bonds that can actually be issued will be increased considerably. As special bonds are included in fund budget rather than deficit, its budget management is different from general bonds of local governments. It is possible to use the retained limit. No. 34 Document issued by the Ministry of Finance in 2018 proposed "making active use of the unused special debt limit by the end of last year". By the end of 2018, the remaining special debt limit was RMB1.23 trillion. China's economy remains under downturn pressure. Vigorously promoting the issuance of special bonds is still an important way to underpin infrastructure investment and stabilize economy. Active use of the limit left from last year is conducive to further raising the implementation efficiency of fiscal policies and playing the role of infrastructure development in supporting economic growth. Hence, **if the limit retained from last year is taken into consideration, new special bonds to be issued throughout the year will reach RMB3.38 trillion, an increase of 57% over the limit of RMB2.15 trillion. There RMB2.71 trillion of new special bonds to be issued.**

Table 2: Forecast of issuance structure of local government and special bonds in 2019 (Unit: RMB trillion)

Type		Issuance scale of local government bonds			Maximum issuance scale of general bonds			Maximum issuance scale of special bonds		
		Annual scale	Issuance in Q1	**Unused in the year**	Annual scale	Issuance in Q1	**Unused in the year**	Annual scale	Issuance in Q1	**Unused in the year**
Bonds for debt replacement		0.3151	0	**0.3151**	0.3151	0	0.3151	**0.3151**	0	**0.3151**
Refinancing bonds		1.3152	0.222	**1.0932**	0.8871	0.1708	0.7163	**0.6025**	0.0512	**0.5513**
New bonds	Excluding special bond limit retained from last year	3.08	1.1847	**1.8953**	0.93	0.5187	0.4113	**2.15**	0.666	**1.484**
	Including special bond limit retained from last year	3.08+1.23 =4.31	1.1847	**3.1253**	0.93	0.5187	0.4113	**2.15+1.23 =3.38**	0.666	**2.714**
Total	Excluding special bond limit retained from last year	**4.71**	**1.4067**	**3.3033**	2.1322	0.6895	1.4427	**3.0676**	0.7172	**2.3504**
	Including special bond limit retained from last year	**5.94**	**1.4067**	**4.5333**	2.1322	0.6895	1.4427	**4.2976**	0.7172	**3.5804**

iii. Investment leverage estimation: Total investment leverage for the whole year is expected to double that of last year

Backed by proactive fiscal policies, the issuance of special bonds will continue at a high speed in the year, so as to further play its important role in shoring up weak spots. They will play an even bigger role in driving infrastructure investment. With respect to infrastructure investment scale that can be promoted by special bonds, we take new special bond limit of local governments for 2019 and retained limit of special bonds from 2018 into consideration, and estimate infrastructure and total investment scales from both to use or not use the retained limit. Results are given below:

1. Excluding the special bond limit retained from last year: The annual infrastructure investment is RMB1.9-4.3 trillion, and the total investment leveraged is about RMB7.8-17 trillion

As estimated based on the annual limit of RMB2.15 trillion on new special local government bonds, special project revenue bonds relating to land reserve account for about 40% of current new special bonds, and the rest 60% is the special bonds for infrastructure development. That is, the special bonds to boost infrastructure investment are about RMB1.29 trillion. Given the 1.5-3.3 times of infrastructure investment boosted by special bonds, **a total of RMB1.9-4.3 trillion of infrastructure can be promoted throughout 2019**, nearly twice that of last year. If the average infrastructure investment is estimated to be 25% of fixed asset investment in recent five years, **the investment to be leveraged by special bonds is about RMB7.8-17 trillion all the year round, nearly twice that of last year.**

Table 3: Investment promoted by special project revenue bonds[5] (2018 & Q1 2019) (excluding the limit retained from last year)

Unit: RMB trillion	Issuance scale in 2018	Issuance scale (estimate) in 2019	Special bond/total project investment	Times of infrastructure investment promoted	Scale of infrastructure investment promoted in 2018	Scale of investment promoted in 2018	Scale (estimate) of infrastructure investment promoted in 2019	Scale (estimate) of investment promoted in 2019
Land reserve	0.5496	**0.86E**	/	/	/	/	/	/
Shanty town renovation	0.3156	/	15%-70%	1.4-6.7	/	/	/	/
Toll road	0.075	/	45%-60%	1.7-2.2	/	/	/	/
New special bonds (excluding land reserve)	0.7763	**1.29E**	30%-65%	1.5-3.3	1.16-2.56	4.46-9.85	**1.94-4.26E**	**7.76-17.04E**

2. Including the special bond limit retained from last year: The annual infrastructure investment is RMB3-6.7 trillion, and the total investment leveraged is about RMB12.2-26.8 trillion

If the special bond limit of RMB1.23 trillion from last year is taken into consideration, new special bonds that can actually be issued will be RMB3.38 trillion all year round. Special project revenue bonds relating to land reserve account for about 40% of current new special bonds, and the rest 60% is the special bonds for infrastructure development. That is, the special bonds to boost infrastructure investment are about RMB2.03 trillion. With the same infrastructure investment times of 1.5-3.3, **a total of RMB3-6.7 trillion of infrastructure can be promoted throughout 2019 taking into consideration the retained limit,** 2.6 times that of last year. If the average infrastructure investment is estimated to be 25% of fixed asset investment in recent five years, **the investment to be leveraged by special bonds is about RMB12.2-26.8 trillion all the year round, nearly three times that of last year.**

[5] This table is based on estimated fund proportion of specific projects relating to special project revenue bond.

Table 4: Investment promoted by special project revenue bonds[6] (2018 & 2019) (including the limit retained from last year)

Unit: RMB trillion	Issuance scale in 2018	Issuance scale (estimate) in 2019	Special bond/total project investment	Times of infrastructure investment promoted	Scale of infrastructure investment promoted in 2018	Scale of investment promoted in 2018	Scale (estimate) of infrastructure investment promoted in 2019	Scale (estimate) of investment promoted in 2019
Land reserve	0.5496	**1.35E**	/	/	/	/	/	/
Shanty town renovation	0.3156	/	15%-70%	1.4-6.7	/	/	/	/
Toll road	0.075	/	45%-60%	1.7-2.2	/	/	/	/
New special bond (excluding land reserve)	0.7763	**2.03E**	30%-65%	1.5-3.3	1.16-2.56	4.46-9.85	**3.05-6.70E**	**12.2-26.8E**

[6] This table is based on estimated fund proportion of specific projects relating to special project revenue bond.