Chinese Dollar Bond Market Report

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2020H1 Chinese Dollar Bond Market Report

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- **Issuance amount of Chinese dollar bonds fell compared with 2019H1 but May issuance started to recover upon improved market sentiment.** In 2020H1, 161 Chinese issuers issued a total of 264 dollar bonds with a total amount of USD93.2 billion, a YoY decrease of 11.0%. Net financing amount was USD29.6 billion, a YoY decrease of 57.0%.

- **Investment grade issuers remained active while high-yield bond issuance was under pressure.** In 2020H1, 65 investment grade issuers issued USD55.9 billion bonds, accounting for 60.0% of the total issuance. It shows that under lower US dollar benchmark interest rates, large corporations with good credit quality intended to issue long-term dollar bonds. In addition, 48 high-yield issuers issued USD25.7 billion dollar bonds. The sharp decrease in issuance amount by high-yield issuers in the second quarter to USD4.8 billion is attributed to the more cautious approach by investors who require a higher risk premium on bonds, and fluctuations in the offshore bond market.

- **The proportion of new issuance of Chinese real estate and Chengtou dollar bonds declined, while the proportion of the bank and energy sectors increased.** In 2020H1, Chinese real estate and Chengtou dollar bonds accounted for 33.8% and 6.9% of the total issuance, a significant drop compared with 40.0% and 9.3% in 2019H1. Real estate companies remained the major issuers, while Chengtou issuers were mainly first-time issuers, and county- and development zone-level issuers.

- With the decline of US dollar benchmark interest rate, average tenor of Chinese dollar bonds increased to 4.02 years in 2020H1 from 3.88 years in 2019H2, among which the issuance of bonds over 5 years showed an increase.

- Because the proportion of high-yield bond issuance decreased and the US treasury yield declined, average coupon rate of Chinese dollar bonds declined from 5.91% in 2020Q1 to 4.76% in 2020Q2.

- **With improved dollar liquidity and investor sentiment, the prices of Chinese dollar bonds in the secondary market gradually recovered, of which real estate sector rebounded significantly, and non-financial high-yield bonds performed the worst.**

Rating Actions and Credit Events

- **Credit quality of Chinese dollar bond issuers were weakened amid the COVID-19 outbreak and the downward pressure on the economy, especially in real estate and consumer discretionary sectors.** In 2020H1, the three international rating agencies revised the ratings of 43 Chinese issuers, with 6 upgrades and 38 downgrades. Among them, real estate and consumer discretionary sectors each accounted for 10 of downgrades.

- **Significant increase in the defaults on Chinese offshore bonds while most of them have shown signs of credit risk before.** According to Bloomberg, the scale of default in the Chinese offshore bond market was approximately USD4.0 billion in 2020H1, a significant increase from USD1.6 billion in 2019H1.

Outlook

- **Risk of economic downturn remains as the COVID-19 pandemic has not been fully controlled, coupled with the geopolitical risk from the ongoing China-US trade conflicts. The Chinese dollar bond market will remain volatile. We believe that the current credit risk of bond market is manageable, and large-scale default is unlikely to happen in 2020. However, considering that the downward pressure on the economy is still large, and that risk adverse remained amid the pandemic, it is anticipated credit risk divergence will become more intensified. Low credit issuers who have weak competitiveness and financial capability within the industry or the region will face greater clearing pressure. At the same time, with the tightened credit link between onshore and offshore markets, the increase in credit risk events in the onshore market would mean the offshore market can never stand alone, and attention needs to be paid to the debt repayment of domestic affiliates.**

Introduction

Global asset prices plunged in early 2020 amid COVID-19 pandemic across the globe. The shock triggered dollar liquidity crisis, halted the issuance of Chinese dollar bonds in the primary market and exerted downward pressure on the prices in the secondary market. To alleviate the economic instability brought by the pandemic, the Federal Reserve lowered interest rates to near zero and launched a large-scale quantitative easing plan, which caused US Treasury yields to fall and dollar liquidity pressure to ease. Thanks to the improved market liquidity and risk sentiment, the secondary market prices of Chinese dollar bonds rapidly rebounded while the year-to-date return of major bond indexes turned positive. However, the performance of offshore bond market diverged, in particular for the high-yield bond market, so the new issuance of Chinese dollar bonds declined in 2020H1 on YoY basis. The pandemic led to increased downward pressure on the economy, and some issuers experienced deterioration of operating conditions and liquidity profile. As a result, onshore credit risk spread to offshore market, resulting in a substantial increase in the defaults in the Chinese offshore bond market.

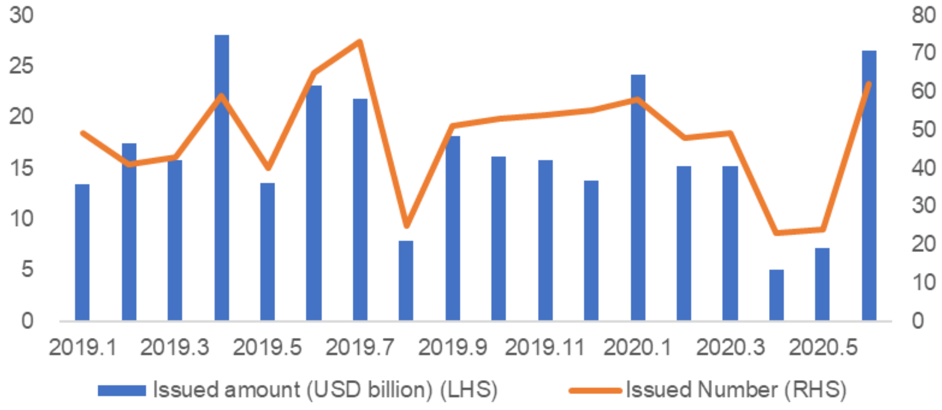
2020H1 China Dollar Bond Market Review

Primary market

Issuance amount of Chinese dollar bonds fell compared with 2019H1 but May issuance started to recover upon improved market sentiment. In 2020H1[1], 161 Chinese issuers issued a total of 264 dollar bonds with a total amount of USD93.2 billion, a 11.0% YoY decrease. Net financing amount was USD29.6 billion, a YoY decrease of 57.0%. With improvement of financing environment as well as refinancing need of offshore bonds, Chinese dollar bond issuance thrived in January with total issued amount of USD24.1 billion, a YoY increase of 80.7%. In February, due to the COVID-19 outbreak, the new issuance of Chinese bonds declined. From March to April, the epidemic led to a slump in global asset prices and a decline in market risk appetite, triggering a liquidity crisis in the US dollar, causing the new issuance of Chinese dollar bonds to shrink. Only USD5.1 billion of new bond issuance was recorded in April. In May, thanks to the Fed’s interest rate cut and its expansionary monetary policy, market sentiment restored and dollar liquidity gradually improved, which led to a rebound in dollar bond issuance. New issuances rebounded to USD26.7 billion in June, a month-on-month increase of 272.9% and the largest monthly new issuance in the first half of 2020.

[1] By issuing date

Exhibit 1： Issuance amount and number of Chinese dollar bonds in 2019 to 2020H1



Source: Bloomberg, CCXAP research

Investment grade issuers remained active while high-yield bond issuance was under pressure. The first half of 2020 featured a total of 161 Chinese dollar bond issuers, of which 113 of them have obtained the ratings of the three major international rating agencies[2]. During the period, 65 investment grade issuers issued USD55.9 billion bonds, accounting for 60.0% of the total issuance. It shows that under lower US dollar benchmark interest rates, large corporations with good credit quality intended to issue long-term dollar bonds. These companies include state-owned enterprises like China Petrochemical Corporation or IT companies like Tencent Holdings Limited, Baidu Inc. and Lenovo Group Limited. In addition, 48 high-yield issuers issued a total of USD25.7 billion in dollar bonds, accounting for 27.5% of the total issuance amount. The amount in 2020H1, compared with USD48.8 billion last year, represents a 40.4% drop. The sharp decrease in issuance amount by high-yield issuers in the second quarter to USD4.8 billion is attributed to the more cautious approach by investors who require a higher risk premium on bonds, and fluctuations in the offshore bond market.

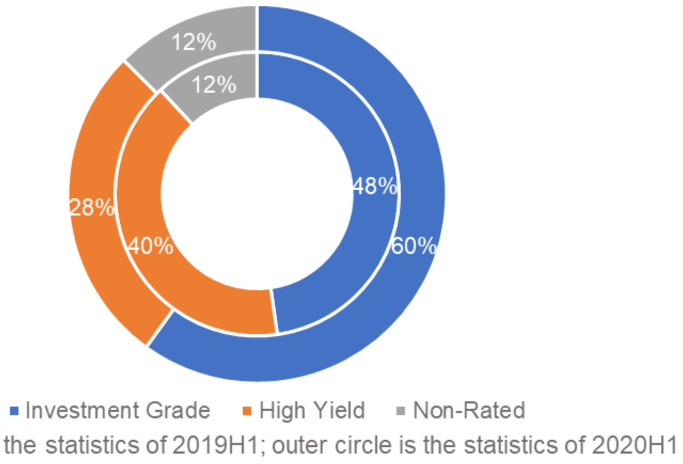
In terms of distribution of issuers by industry, real estate (57), Chengtou companies (30) and financial institutions (20) remained the major issuers of Chinese dollar bonds. In 2020H1, the issuance of financial institutions was similar to that of 2019H1. There were 22 financial institutions issued dollar bonds in 2020H1, which were mainly financial leasing, asset management and securities companies with good credit quality. The majority of real estate issuers had weak credit quality, of which 44 of them were non-investment grade. Thus, real estate issuance dropped significantly as Chinese dollar bond market experienced downward pressure in March and April. In the first half of the year, Chengtou issuers demonstrated three key characteristics. First, Chengtou issuers were mainly first-time issuers, 19 of which accounted for 63.3% of all Chengtou issuers in 2020H1, increased as compared to that of 17 issuers and 47.2% in 2019H1. Second, unrated phenomenon remained, as 19 Chengtou issuers, two third of the total, did not obtain a rating from the three international rating agencies. Third, lower-tier issuers were active. There are 16

[2] As of June 30, 2020, the highest rating is used if more than one ratings are available.

county- or development zone-level issuers in 2020H1, accounting for half of the total.

Exhibit 2：Chinese dollar bond issuance amount in 2019H1 and 2020H1

(by issuer rating)



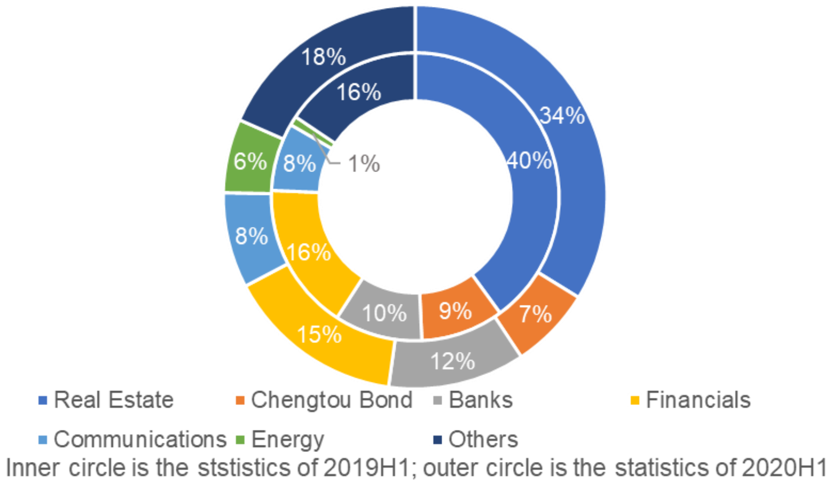
Source: Bloomberg, CCXAP research

The proportion of new issuance of Chinese real estate and Chengtou dollar bonds declined, while the proportion of the bank and energy sectors increased. In 2020H1, Chinese real estate and Chengtou dollar bonds accounted for 33.8% and 6.9% of the total new issuance, a significant drop compared with 40.0% and 9.3% in 2019H1. There were a total of 57 real estate issuers issuing 87 dollar bonds in 2020H1, with the issuance amount of USD31.5 billion, a YoY decrease of 29.2%. However, real estate companies remained the major issuers of Chinese dollar bonds. Real estate dollar bond issuance demonstrated a V-shape trend. Early this year, real estate companies had a strong refinancing demand as January's monthly issuance reached recorded high of USD16.5 billion. Affected by the fall in risk appetite and the pressure on dollar liquidity, the new issuance of high-yield bond declined, and the scale of real estate dollar bond issuance recorded a low of USD87 million in April. As market showed marginal improvement, real estate dollar bond issuance gradually recovered. In the first half of 2020, 34 dollar bonds were issued by 30 Chengtou issuers, with an issued amount of USD6.4 billion, a 37.9% decrease from last year. Since February, with the increased support on refinancing policies by the Chinese government, onshore financing channels became smooth and financing cost fell continuously. Chengtou companies were less motivated to issue dollar bonds, resulting in a significant contraction in new issuance.

The issuance amount of dollar bonds by Chinese banks remained stable. Due to their good credit qualities, banks are the first to recover from the volatile market. In 2020H1, Chinese banks issued dollar bonds of USD10.8 billion, a 2.2% decrease compared with 2019H1, while the proportion increased from 9.9% to 11.5%. In addition, as energy companies issued several bonds of large denomination, its proportion in new issuance increased.

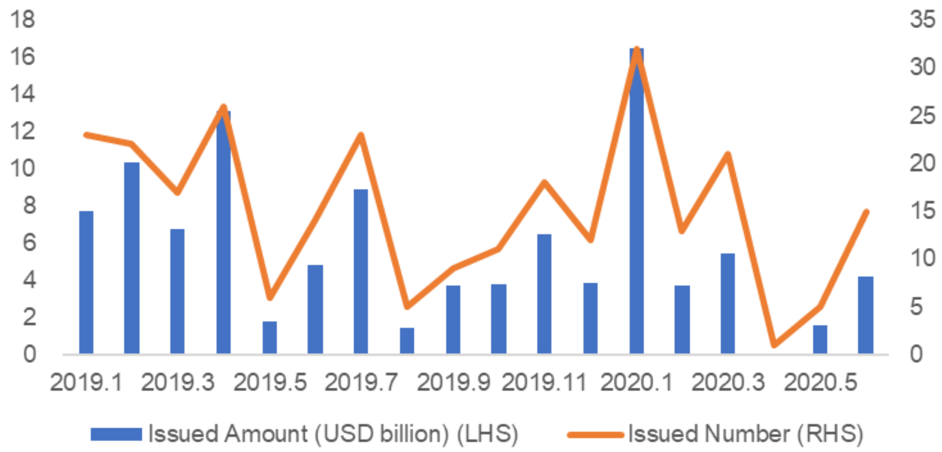
Chinese energy issuers were all state-owned enterprises, including Sinopec, CNPC and COSL. In 2020H1, Chinese energy companies issued dollar bonds totaling USD5.8 billion, a substantial increase by 405.1% YoY, and the proportion increased from 1.0% to 6.2%.

Exhibit 3： Chinese dollar bond issuance amount in 2019H1 and 2020H1 (by industry)



Source: Bloomberg, CCXAP research

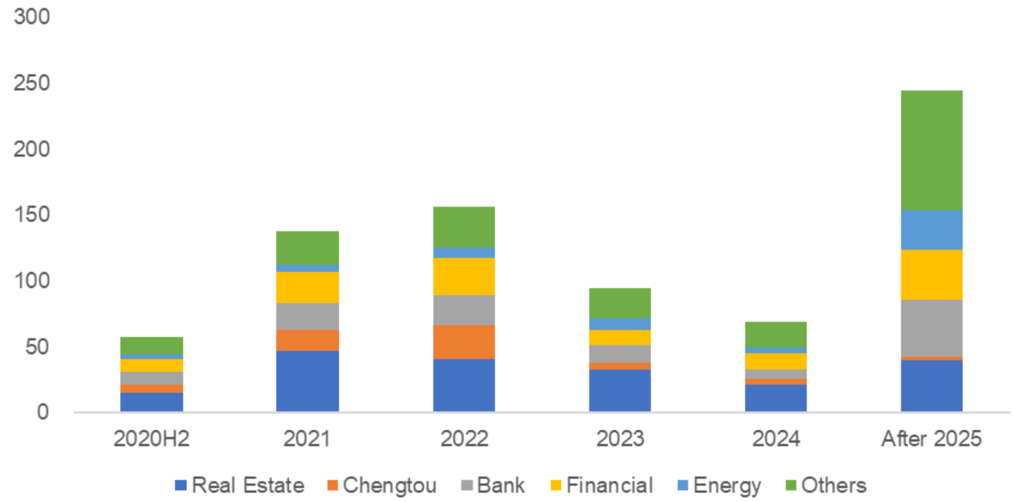
Exhibit 4: Issuance of Chinese real estate dollar bonds in 2019 to 2020H1



Source: Bloomberg, CCXAP research

As of June 30, 2020, outstanding Chinese dollar bond from about 600 Chinese issuers stood at USD759.5 billion. The scale of bond mature in 2020H2, 2021 and 2022 will be USD57.2 billion, USD137.5 billion and USD156.3 billion, respectively. For real estate issuers, 2020H2 and 2021 will be the peak season for bond repayment with a total of USD14.9 billion and USD47.1 billion, respectively. Against the background of slowing growth and increasing market concentration, property developers with weak credit profiles may face more intense refinancing pressure.

Exhibit 5： Distribution of maturity date of outstanding Chinese dollar bonds as of June 30, 2020 (USD billion)

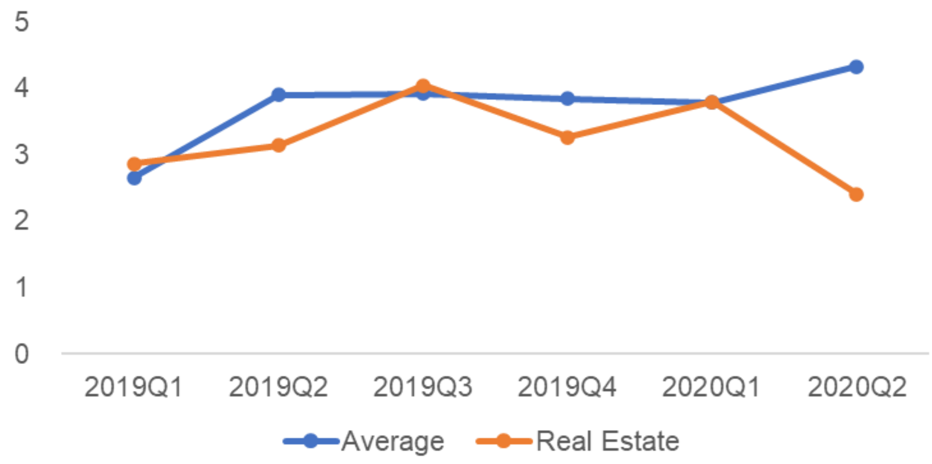


Source: Bloomberg, CCXAP research

Issuance amount for bonds over 5 years of tenor increased substantially and average tenor extended amid fall of US interest rate. In 2020H1, the average tenor[3] of Chinese dollar bond was 4.02 years, which was longer than 3.88 years in 2019H2. Because of the impact of downward adjustment on US benchmark rate, Chinese companies are more willing to issue dollar bonds of longer maturity. A total of 54 dollar bonds with tenor more than 5 years were issued in the first six months of the year, totaling USD30.5 billion. It represented 32.8% of the total issuance scale, and was much higher than the USD13.8 billion in 2019H2. On the other hand, short-term dollar bonds with less than one year of maturity soared from USD5.6 billion in 2019H2 to USD7.6 billion in 2020H1, of which the issuance of real estate dollar bonds rose to USD4.4 billion. Chinese real estate issuers sought for liquidity from short-term dollar bond given deferred cash payments amid COVID-19 outbreak and ease of issuance for offshore bonds with less than one year of maturity.

[3] Not include perpetual bonds

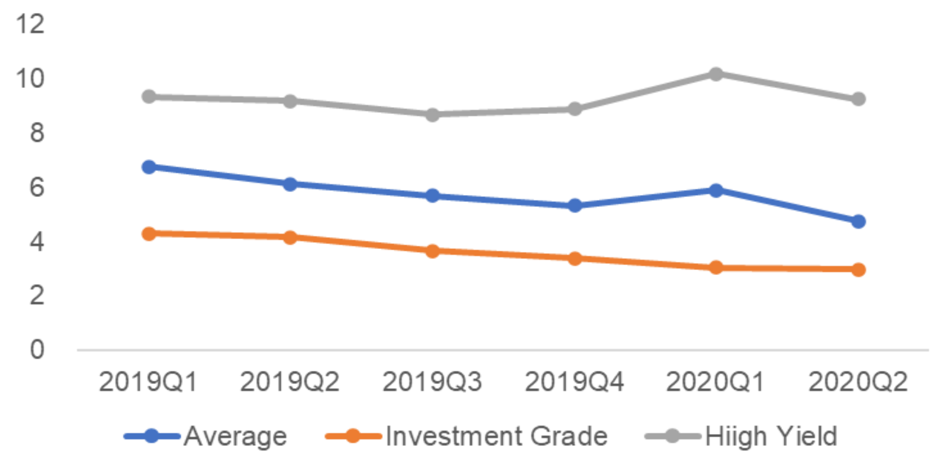
Exhibit 6: Average issue tenor in 2019Q1 to 2020Q2



Source: Bloomberg, CCXAP research

The proportion of high-yield bond issuance decreased while US Treasury yields dropped, and thus average coupon rate dropped. The average coupon rate of Chinese dollar bond declined from 5.91% in 2020Q1 to 4.76% in 2020Q2. In terms of issue rating, the average coupon rate of high-yield dollar bond dropped by 94bp to 9.27%. Given a more conservative risk preference, high-yield bonds from relatively weak credit quality issuers were difficult to issue, causing the average coupon rate to fall. However, if compared with the rate from dollar bonds of the same issuer, the average coupon rate increased. In addition, there were a total of 10 bonds issued through SBLC with a size of USD1.5 billion in 2020Q2, a large increase from 3 tranches of bond issued amounting to USD0.6 billion dollar in 2020Q1. Issuers used SBLC for credit enhancement so as to reduce the issuing yield, with bond coupon rate usually ranging between 2.9% and 4.3%.

Exhibit 7: Average coupon rate in 2019Q1 to 2020Q2



Source: Bloomberg, CCXAP research

Table 1： Examples of high-yield Chinese dollar bonds in 2020H1

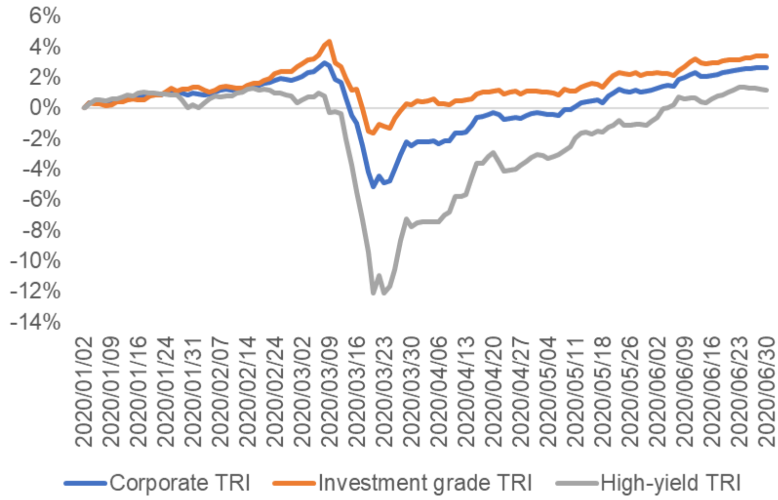
Subject of Credit	Issued date	Issued size (USD million)	Coupon	Tenor
Kaisa Group Holdings Ltd.	2020/2/20	400	6.75%	364 days
Kaisa Group Holdings Ltd.	2020/6/10	300	7.875%	364 days
Fantasia Holdings Group Co., Ltd.	2020/1/9	450	10.875%	3 years
Fantasia Holdings Group Co., Ltd.	2020/6/1	300	11.875%	3 years
China Fortune Land Development Co., Ltd.	2020/1/13	500	6.9%	3 years
China Fortune Land Development Co., Ltd.	2020/6/16	300	6.92%	2 years

Source: Bloomberg, CCXAP research

Secondary market

With improved dollar liquidity and investor sentiment, the prices of Chinese dollar bonds in the secondary market gradually recovered. At the beginning of 2020, supported by abundant liquidity and positive market sentiment, Chinese dollar bond price in the secondary market went up. But the pandemic caused the global major asset prices to plummet, leading to the dollar liquidity crisis. Chinese dollar bonds, especially high-yield bonds with higher credit risk, was under pressure. The year-to-date return of high-yield bond index once fell to the low point of -12.08%. Subsequently, with a view to maintaining market stability and preventing excessive systemic risk, governments and central banks introduced expansionary monetary policies to stimulate economic recovery. With the restoration of market liquidity and investor sentiment, there was a rising demand for risky assets, causing the Chinese dollar bond prices in secondary market to rebound. As of June 30, 2020, Chinese dollar bond index recorded a year-to-date return of 2.62%. Investment grade bond index had a return of 3.38%, higher than that of high-yield bond index (1.19%), reflecting investment grade bonds were more welcome under uncertain market conditions.

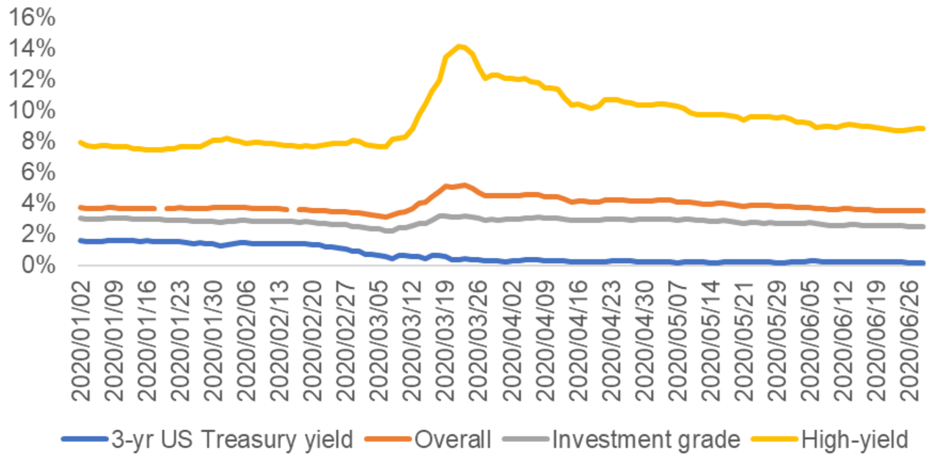
Exhibit 8：Markit iBoxx index's Chinese dollar bond rate of return in 2020H1



Source: Bloomberg, CCXAP research

As of June 30, 2020, the yield-to-worst of Chinese dollar bonds was 3.52%, down 25bp from the beginning of the year. Among them, investment-grade bonds performed better that the yield-to-worst dropped by 55bp to 2.52%. On the other hand, the yield-to-worst for high-yield bond increased by 92bp to 8.85%, reflecting the uncertainties in the global market and a relatively conservative risk appetite.

Exhibit 9：Bloomberg Barclays index's Chinese dollar bond yield-to-worst rate in 2020H1



Source: Bloomberg, CCXAP research

Real estate dollar bond rebounded significantly while non-financial high-yield bond performed the worst. As of June 30, 2020, sovereign bonds which is considered less risky performed the best, with a year-to-date return of 6.37%, followed by non-financial (3.20%), financial (2.21%). Dragged down by the poor performance in the first quarter, real estate dollar bonds had a year-to-date return of 1.97% only. Nonetheless, the return of real estate dollar bond rebounded significantly to 9.21% in the second quarter. Compared with other sectors like trading and manufacturing, real estate sector suffered the least. Coupled with the signs of recovery of the Chinese property sector, the lower valuation of the real estate dollar bonds attracted investors to invest more on, causing prices to jump in the second quarter. On the other hand, the high-yield non-financial dollar bonds performed the worst in 2020H1, with return of -2.49%. This was because countries experienced lockdown due to the COVID-19 outbreak, causing a drop in product demand and a blow to the credit profile of cyclical industries such as energy and industrials, and therefore investors were more risk adverse.

Table 2： Chinese dollar bond rate of return in 2020H1 (by industry)

Markit iBoxx Chinese dollar bond return index	Q1	Q2	H1
Real Estate TRI	-6.76%	9.21%	1.97%
- Investment Grade TRI	-1.96%	4.51%	2.50%
- High-Yield TRI	-8.66%	11.28%	1.83%
Financial TRI	-3.65%	6.01%	2.21%
- Investment Grade TRI	-0.09%	2.69%	2.63%
- High-Yield TRI	-7.25%	9.61%	1.78%
Non-Financial TRI	-0.26%	3.52%	3.20%
- Investment Grade TRI	0.87%	3.15%	3.97%
- High-Yield TRI	-9.30%	7.28%	-2.49%
Sovereign TRI	3.48%	1.94%	6.37%

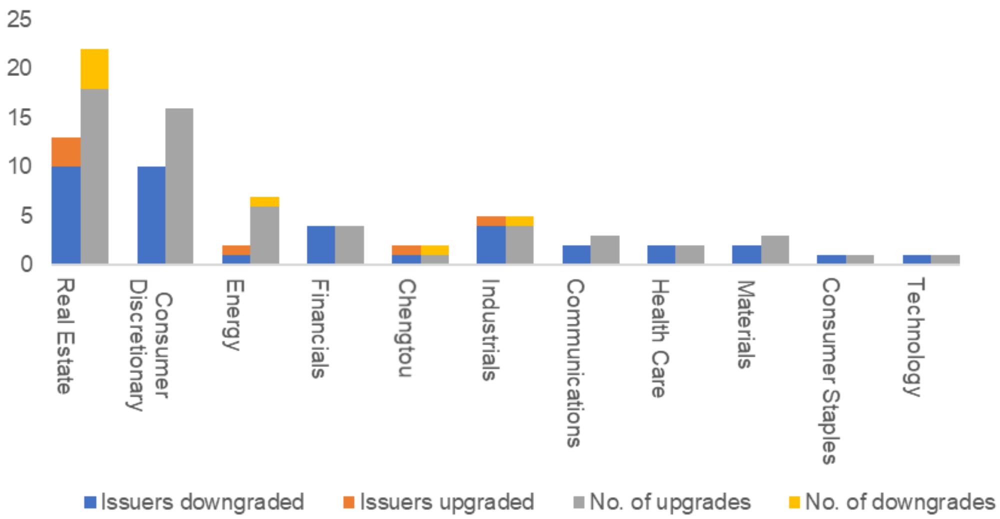
Source: Bloomberg, CCXAP research

Rating Actions and Credit Events

Credit quality of Chinese dollar bond issuers were weakened amid COVID-19 outbreak and the downward pressure on the economy, especially in real estate and consumer discretionary sectors. In 2020H1, the three major international rating agencies revised the ratings on 43 Chinese bond issuers, with 6 upgrades and 38 downgrades[4]. Among them, real estate and consumer discretionary sectors each accounted for 10 of them. Real estate issuers were downgraded mainly because of their high debt leverage. The slow property sales and restricted financing channels tightened their liquidity positions, thus weakening their credit quality. For consumer discretionary sector, the pandemic has restricted outdoor activities and decreased consumers' willingness to purchase luxury goods, which has led to a drop in the revenue of retail and automobile issuers, harming their debt repayment ability. In 2020H1, the three major international rating agencies revised the credit rating outlook of 74 Chinese issuers to "negative" or placed them on the "negative watch list", concentrated on consumer discretionary (19), real estate (13), financial (12) and industrial (8) sectors, driven by adverse impacts of pandemic and the weakening refinancing capabilities of the issuers. If the issuer's credit quality and liquidity conditions deteriorate further, the ratings of more Chinese issuers may be downgraded in the second half of 2020.

[4] One of the issuers was first downgraded and then upgraded.

Exhibit 10： Rating actions by international rating agencies in 2020H1 (by industry)



Source: Bloomberg, CCXAP research

Significant increase in the defaults on Chinese offshore bonds while most of them have shown signs of credit risk before. According to Bloomberg, the scale of defaults in the Chinese offshore bond market was approximately USD4.0 billion in 2020H1, a significant increase from USD1.6 billion in 2019H1. Most of the defaults were related to onshore credit risk events, such as Peking University Founder Group Co., Ltd. Since more frequent cross-border capital flows, the correlation between onshore and offshore markets has increased. A change in business or credit risk of domestic affiliates could have ripple effect to the offshore issuers. On the other hand, some dollar bond issuers tried to avoid bond defaults by exchange offer or postponing repayments. But unless these companies improve the liquidity and operating conditions, they still need to face refinancing pressure on interest and principal payments, resulting in a relatively high risk of default.

Table 3： Default and credit events of Chinese issuers in offshore market in 2020H1

Enterprise	Default
Qinghai Provincial Investment Group Co. Ltd.	On January 16, February 21 and April 16, Qinghai Provincial Investment Group Co Ltd. announced that it was unable to repay the principal and interest in 3 tranches of bond, constituting a material default over a size of USD0.85 billion.
Peking University Founder Group Company Limited	On March 4, April 15 and June 22, Peking University Founder Group Company Limited announced that it was unable to repay the principal and interest of 5 tranches of bond, constituting a material default over a size of USD1.65 billion.
China Huiyuan Juice Group Limited	On March 17, China Huiyuan Juice Group Limited announced that it defaulted on interest payments for its USD0.2 billion notes.
Yida China Holdings Ltd.	On April 23, Yida China Holdings Ltd announced that it defaulted on principal and interest payments for its USD52.854 million notes.

MIE Holdings Corporation	On May 11, MIE Holdings Corporation announced that it defaulted on principal payments for its USD52.854 million notes.
Yihua Enterprise (Group) Co., Ltd.	According to Bloomberg, the Bank of New York Mellon (Trustee) announced on June 2 in its Notification to Investors that Yihua Enterprise（Group）Co., Ltd. was unable to repay an interest for its USD0.25 billion on its bond, constituting a material default.
Tunghsu Group Co., Ltd.	On June 15, Tunghsu Group Co., Ltd. announced that it defaulted on principal and interest payments for its USD0.3 billion notes.
Hilong Holding Limited	On June 22, Hilong Holding Limited announced that it defaulted on principal and interest payments for its USD0.165 billion notes.
Shandong Ruyi Technology Group Co., Ltd.	According to Bloomberg News, Shandong Ruyi Technology Group Co., Ltd. was unable to repay interest for its EUR0.25 billion convertible bonds on June 22 or within a grace period of 5 days, constituting a material default.
Century Sunshine Group Holdings Limited	On July 3, Century Sunshine Group Holdings Limited announced that it defaulted on principal and interest payments for its SGD1.0175 million notes.
Credit Events	
Macrolink Group Limited	On March 6, Macrolink Group Limited announced that it defaulted on principal and interest payments for its onshore medium-term notes.
Tahoe Group Co., Ltd.	On July 6, Tahoe Group Co., Ltd. announced that it defaulted on principal and interest payments for its onshore medium-term notes.

Source: CCXAP research

Outlook

Many governments have taken measures to boost the economy. US Treasury yields have fallen, the pressure on US dollar liquidity has eased, and the overall financing environment has improved. Nonetheless, **risk of economic downturn remains as the COVID-19 pandemic has not been fully controlled, coupled with the geopolitical risk from the ongoing China-US trade conflicts. The Chinese dollar bond market will remain volatile.** Although a low level of interest rate would favor Chinese issuers with good credit quality to issue bonds with low cost, those with worse quality would need to pay for a higher risk premium under the background of a more conservative risk appetite and divided credit quality. As such, the cost of issuance for Chinese dollar bond may become further divided. **We believe that, the current credit risk of the bond market is still manageable and a large-scale default is unlikely to happen in 2020.** However, considering that the downward pressure on the economy is still large, and that risk adverse remained amid the pandemic, it is anticipated credit risk divergence will become more intensified. **Low credit issuers who have weak competitiveness or financial capability within the industry or the region will face greater clearing pressure.** At the same time, with the tightened credit link between onshore and offshore markets, the increase in credit risk events in the onshore market would mean the offshore market can never stand alone, and attention needs to be paid to the debt repayment of domestic affiliates.

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