CCXI & CCXAP – Research & Commentary

2020H1 China's Onshore Bond Market Credit Risk Review and Outlook: Bond Default Risk May Rise in 2020H2, with Default Rate to Rebound to Around 0.75%

Hong Kong, 16 July 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") issued the *Bond Default Risk May Rise in 2020H2, with Default Rate to Rebound to around 0.75% - 2020H1 Bond Market Credit Risk Review and Outlook*. The Report reviews the credit risk performance of the bond market in 2020H1 and provides an outlook on the credit risk trends in the next phase, taking into account the financing environment and industry-wide risk performance.

CCXI holds that the marginal slowdown in the bond-market credit risk in H1 mainly benefited from the notable improvements in financing environment and various risk mitigations (including extension) by some issuers. Looking forward to H2, however, the best time for financing environment of the bond market might have elapsed, and issuers will face a higher risk of refinancing. The public offering market is expected to see the default rate rising to about 0.75%. Given continued divergence in credit risk developments, extra attention should be paid to credit risks of bottom players with weak qualifications in some industries.

China's Onshore Bond Market Credit Risk Review in 2020H1

The COVID-19 pandemic disrupted business activity and put enterprises under liquidity stress in H1. However, regulators took various measures to guide market interest rates downward while keeping liquidity reasonably sufficient, creating an easy financing environment for enterprises. In addition, some issuers also mitigated risks by diverse means to ease the bond default pressure and pursue marginal slowdown in credit risk. **In terms of re-rating actions, there were obviously fewer negative rating actions than the same period of last year.** According to CCXI data, there were 65 issuer rating downgrades, 133 facility rating downgrades and 19 outlook downgrades in H1, all showing a decline from one year ago. More specifically, 40 industrial entities had their issuer ratings downgraded, partially due to the negative business shock from the COVID-19 outbreak. Two infrastructure financing and investment entities had their issuer ratings downgraded mainly due to estimated negative net profit, rising overdue loans and uncertainty in asset reorganization, which posed a contingent liability risk. Two financial institutions saw their issuer ratings downgraded due to weaker shareholder support, deterioration in asset quality and uncertainty in capital increase.

As for bond default, the default risk eruption slowed down in H1, as shown by a sharp fall in number of new issuers in default. According to CCXI data, 57 bonds were defaulted in H1 involving a total value of RMB56.661 billion, up 12% year on year, mainly due to accelerated maturity of close to RMB38 billion of bonds following the bankruptcy reorganization of Founder Group. As for number of defaulters, 22 issuers went into default in H1, including 11 new defaulters, a decline of 9 from one year ago. Moreover, the first-time defaulters were mainly companies reliant heavily on debt financing for radical expansion but weak in corporate governance or management. Most of these new defaulters showed prominent credit risk before 2019. **Some issuers mitigated the default risk in H1 through extension, issuance of replacement bonds, off-exchange redemption and not-to-sell advice.** Extension involved obviously more issuers and bonds than one year ago. **As of the end of H1, the trailing 12-month default rate in the public offering market fell to 0.68%, down 0.08 percentage point from the end of 2019.**

As for the follow-up actions on defaults, the public offering market saw a material progress in disposal for seven defaulting issuers. Specifically, Xiwang Group and Shanshui Cement reached debt settlement with creditors in H1. The former adopted settlement by judicial means, while the latter turned to settlement through negotiation and cancelled a few defaulted bonds. The *Reorganization Plans* of QingHai Salt Lake and Shandong SNTON and the *Draft Reorganization Plans* of BOCO and Baoding Tianwei were approved by the court. Sichuan Coal's application for bankruptcy reorganization was accepted by the court. **As of the end of June 2020, a total of 469 bonds had been defaulted in the bond market, involving a total value of RMB354.508 billion and 164 issuers. Only 62 bonds were completely redeemed. Defaulted bonds still showed tardy progress of subsequent disposal.** The PBOC, NDRC and CSRC jointly issued the *Notice on Disposal of Defaulted Corporate Credit Bonds* at the end of H1, reiterating the core role of the meeting of bond trustees and holders. **As more accountability mechanisms and diverse disposal rules are put in place, the disposal efficiency of defaulted bonds is likely to improve.**

Market Outlook in 2020H2

Looking into H2, CCXI believes that whether micro non-financial entities can improve their business performance will remain an uncertainty in spite of the gradual recovery of China's economy and improvements on both demand and supply sides in Q2. As to maturity pressure, some issuers postponed the debt maturity pressure in H1 to H2 through refinancing and short-term bond issuance. If these issuers have weak liquidity, some refinancing risks are likely to erupt in H2. **According to CCXI estimates, about RMB6 trillion to RMB6.3 trillion of credit bonds will mature or be sold back in H2, much higher than one year ago.** As the COVID-19 epidemic situation stabilizes, the policy tools issued earlier in response to the virus will be phased out and put an end to the best financing environment of the bond market. **The issuers' refinancing risk is expected to rise in H2 and trigger a rally in bond market default rate. The public offering market may see the default rate to reach about 0.75% for the year, above the current level and generally flat with the 2019 level.**

Given the continued industry-wide or regional divergence in credit risk developments, extra attention should be paid to the credit risk of bottom players in some industries. By industry, particular **attention should be paid to the credit risk of bottom players in real estate, construction, wholesale and retail, selected service sectors and export-oriented industries.** In terms of local government financing vehicles (LGFVs), **the infrastructure companies have shown divergent credit standing due to the combined effect of epidemic and flood. Due attention should be paid to the investment and financing pressure and debt service stress of regional LGFVs at lower administrative levels.**

To obtain the full report, please call our Customer Service Hotline +852-2860 7111.

中诚信国际
CCXI

中诚信国际信用评级有限责任公司

地址：北京市东城区朝阳门内大街
南竹竿胡同 2 号银河 SOHO6 号楼
邮编：100020
电话：(8610) 6642 8877
传真：(8610) 6642 6100
网址：http://www.ccxi.com.cn

China Chengxin International Credit Rating Co., Ltd
Address: Building 6, Galaxy SOHO,
No.2 Nanzhugan hutong, Chaoyangmennei Avenue,
Dongcheng district, Beijing, 100020
Tel: (8610) 6642 8877
Fax: (8610) 6642 6100
Website: http://www.ccxi.com.cn

中誠信亞太
CCXAP

中国诚信(亚太)信用评级有限公司

地址：香港中环康乐广场 1 号
怡和大厦 8 楼 805-808 室
电话：(852) 2860 7111
传真：(852) 2868 0656
网址：http://www.ccxap.com

China Chengxin (Asia Pacific) Credit Ratings Company Limited
Address: Suites 805-808, Jardine House, 1 Connaught Place,
Central, Hong Kong
Tel: (852) 2860 7111
Fax: (852) 2868 0656
Website: http://www.ccxap.com