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2020H1 China's Onshore Credit Bond Market Review and Outlook: Credit Bonds Are Expected to Issue RMB7.5 Trillion in 2020H2, with Yields Lingering around Lows

Hong Kong, 16 July 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") issued the *Credit Bonds Are Expected to Issue RMB7.5 Trillion in 2020H2, with Yields Lingering around Lows - 2020H1 Credit Bond Market Review and Outlook*. The Report reviews the performance of the credit bond market in 2020H1 and forecasts the credit bond issuance and interest rate trends in the next phase, taking into account the macro-economy, monetary policy and financing environment.

CCXI notes that the issue size and net proceeds of credit bonds increased substantially year-on-year or quarter-on-quarter under the accommodative credit and money supply and the financing policies that can directly boost the real economy. The credit bond trading activity improved, with a V-shaped yield curve. The yield generally declined from the end of last year, while credit spread mostly widened. In the future, market liquidity will not be as easy as seen in H1 as the Chinese economy recovers gradually. About RMB7.5 trillion of credit bonds will be issued in H2. The bond market yield may linger around lows after a short run of adjustments. The inter-rating credit spread may become divergent.

China's Onshore Credit Bond Market Performance in 2020H1

Bond issues expanded sharply in size in 2020H1 as the financing policy was loosened across the board in response to the COVID-19 epidemic, as part of the strengthened effort to ensure stable growth of the macro-economy. From January to June 2020, credit bond issues totaled RMB7.43 trillion, showing a YoY expansion for all major types of bonds. SCPs and privately placed corporate bonds recorded bigger growth in issue size. **All industries showed improvements in financing in the context of corporate financing conditions crackdown, with divergence seen across types of business and geographical areas.** Bond proceeds still mainly flowed to state-owned enterprises (SOEs), with 90% of bonds issued by SOEs. Bonds issued by private enterprises accounted for merely 2%, but the financing conditions improved and net financing proceeds turned from negative to positive. By industry, except the IT industry with negative net proceeds in H1, all non-financial industries issued more bonds than matured bonds, i.e. with positive net financing. By geography, Beijing, Guangdong, Jiangsu, Shanghai and Zhejiang active in bond issuance still recorded large issue sizes, while Heilongjiang, Inner Mongolia and Qinghai inactive in bond issuance experienced further contraction in issue size. By rating, most new bonds were rated high. 59% and 27% of new bonds had a rating of AAA and AA+ respectively, basically flat with one year ago. AA bonds accounted for 13%, down 0.8 percentage point. AA- and A+ bonds accounted for a slightly bigger percentage of 0.6% and 0.4% respectively. **The issue cost of all bonds declined from the end of 2019. Short-term and high-rating bonds registered greater fall in interest rates.** Specifically, by the end of June, one-year commercial papers were issued at an interest rate of

2.60% to 4.23% on average, down 70 bps to 100 bps from the end of 2019. As for medium- and long-term interest rates, except 3Y AA MTNs and 5Y AA+ corporate bonds saw their issue rates up 59 bps to 61bps from the end of 2019, the issue rates fell between 3.55% and 4.06% for other terms of bonds rated AAA and AA+ respectively, down 15 bps to 63 bps. **Given the low bond issue rates, issuers chose to lower coupon rates upon bond sale-back in most cases in H1.** The center of gravity of interest rates dropped after sale-back, with about half of bonds seeing their interest rates down by more than 100 bps.

Credit bond trading and investment gained traction in 2020H1, with the trade volume expanding markedly year-on-year and representing a higher proportion of total bond trading. Spot bond trading totaled RMB101.08 trillion in H1 (excluding interbank certificates of deposit), a significant rise over one year ago. Of them, the trading in credit bonds amounted to RMB19.41 billion, accounting for 19% of total. **The credit bond yield moved in a V-shaped pattern in general, down by 2 bps to 44 bps from the end of last year. In terms of credit spread, the trends in credit spread between ratings were mixed.** The credit spread for AAA, AA+ and AA- ratings expanded mostly, by 4bps to 22 bps, while that for AA rating shrank in most cases. In terms of grade spread, the spread between AAA and AA+ was flat with the end of last year, that between AA+ and AA shrank by 6 bps and that between AA and AA- expanded by 12 bps. **In terms of industry spread, the spread narrowed notably for pharmaceuticals and electronics but widened for coals.**

China's Onshore Credit Bond Market Outlook in 2020H2

Looking into the future, CCXI expects the overall liquidity situation to be less easy than in H1 as the COVID-19 containment efforts has yielded positive results and the economy has been reopening to stage a progressive recovery since Q2. In addition, the net financing proceeds of corporate credit bonds reached RMB3.2 trillion in H1, comparable to the annual total of last year. As the Executive Meeting of the State Council called for “guiding the net proceeds of corporate credit bonds to grow by RMB1 trillion more than last year”, **the net proceeds of credit bonds are expected to be RMB1 trillion or so in H2, a marked contraction from H1. Considering the rising pressure from maturing credit bonds in H2, however, the issue size may be flat with H1.** According to CCXI estimates, nearly RMB4.7 trillion of credit bonds will mature naturally in 2020H2. Considering that the future risk aversion may make investors more willing to sell back, we project the total sale-back will be about RMB0.3 trillion to RMB0.7 trillion in H2 assuming a sale-back ratio of 30%, 50% and 70% respectively. In addition, taking into account the size of newly issued SCPs to be redeemed upon or before maturity, about RMB6.0 trillion to RMB6.3 trillion of credit bonds are expected to mature in H2. In terms of issue size, if the net proceeds of corporate credit bonds grows by RMB1 trillion more than last year, coupled by the incremental net proceeds of asset-backed securitization products, **RMB7.3 trillion to RMB7.7 trillion of credit bonds are expected to be issued in H2. Given the quarterly issuance characteristics and maturity pressure, the issue size is estimated to be RMB3.3 trillion to RMB3.5 trillion in Q3 and rise to RMB4 trillion to RMB4.2 trillion in Q4.**

In the secondary market, as the producer activity gradually recovered and economic data improved, the monetary policy turned from loose to marginally tightening in Q2. Moreover, the stock-bond “seesaw” effect has taken hold as the stock market has picked up in July. The bond

market ushered in a quick correction in July. The government bond yield rose back to the beginning level of the year on July 10, with most credit bonds seeing their yields above the year's beginning level. **As the market environment has changed, the economic pressure and the liquidity easiness may have already touched their peak. The bond market is unlikely to see any trendsetting opportunity in H2.** But there is no need to be too pessimistic. The economic growth slope may slow down from Q2 due to the continuing overseas spread of the coronavirus and stressed foreign demand. The monetary policy is unlikely to embrace a turnaround in the near future due to the necessity of creating a pro-recovery climate and guiding down the financing costs for the real economy. As the yield retreats, the bonds will become more worth investing in. As the China-US interest rate spread remains at all-time high now, more overseas funds are expected to flow into the stock market. In addition, whether the stock market will remain bullish in H2 on strong results of listed companies remains to be observed. The market sentiments are likely to be restored if the monetary policy loosens and the stock market cools down gradually. **The average 10Y government bond yield may be adjusted to 2.9% to 3.0% in H2, with the 5Y AAA corporate bond yield to stand at 3.5% to 3.6%. As for credit spread, the credit spread for high ratings is likely to narrow, while the credit spread for medium and low ratings might widen.**

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