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2020H1 China's Monetary Policy and Government-backed Bonds Review and Outlook: Yields Have Hit Lows under the Loose Monetary Environment for Pandemic Control and might Go Up as Monetary Policy Becomes Normalized

Hong Kong, 17 July 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") issued a report entitled "*H1 2020 Review and Outlook of Monetary Policy and Government-backed Bonds: Yields Have Hit Lows Low Yields Have Appeared under the Loose Monetary Environment Policy for Pandemic Control and Higher might Go Up as Monetary Policy Becomes Normalized*". In the Report, CCXI indicated that if the pandemic can be brought under overall control nationwide in the second half of 2020 (H2 2020), the economic fundamentals in China are likely to rally up slightly compared with those in H1.

Accordingly, the monetary policy will return to the normal gradually, the aggregate measures related to pandemic control may exit in good time, and more emphasis will be placed on the implementation of structural instruments, centering on directly stimulating the real economy. **In this context, CCXI holds that there is no serious possibility that the yield of 10-year government bonds will take on a downtrend. Instead, the yield of such bonds is likely to go up somewhat in H2 compared with H1. It is expected to reach the range of 2.9%-3.0%.**

China's Monetary Policy and Government-backed Bonds Review in 2020H1

As the pandemic crisis was brought under control and the economic fundamentals achieved marginal improvement, China shifted the focus of its monetary policy from aggregate easing to directly stimulating the real economy with structural tools in H1 2020. As a result, the money market interest rates bounced back slightly after hitting the periodic low at the end of April, and still went down overall compared with a year earlier. In H1, the central bank of China announced one across-the-board reserve requirement ratio (RRR) cut, two targeted RRR cuts, and two cuts in interest rates of open market operations (by 30BPs in total), lowered the interest rates on excess reserves to 0.35%, and reduced the interest rates of central bank lending and central bank discounts twice (by 0.5 percentage points in total). Under the structural easing monetary policy, the liquidity managed to stay at a reasonably adequate level. The money market interest rates firstly declined compared with a year earlier, and then picked up slightly in May and June, thus taking on an overall V-shaped trend in H1. The loan prime rate (LPR) quotations wend down since the first quotation was made.

Government-backed bonds market: Against the backdrop of stepped-up active fiscal policy, government-backed bonds were issued in a larger size and raised more net proceeds, thanks to a remarkable increase in new special bonds. The yields of government-backed bonds took up a V-shaped trend and went down overall compared with the end of last year. Government-backed bonds issued in H1 2020 grew to RMB8.79 trillion compared with a year earlier, with net proceeds rising to RMB5.08 trillion. Of these, local government bonds issued amounted to RMB3.49 trillion, up 22.88% over a year earlier, new special bonds issued totaled RMB2.23 trillion, representing a year-on-year increase of 60.92% and accounting for 64.00% of the total local government bonds issued in H1. The coupon rate of bonds fell down first and then lifted up, but went down overall compared with the end of prior year. The interest spreads of local government bond issues widened slightly. **In terms of yields,** the yield of 10-year government bonds declined overall compared with the end of last year, but it picked up somewhat in Q2, with a greater rally on the short-term side than the long-term side, hence revealing a V-shaped trend. The interest rate rebound was primarily driven by such factors as weakened influence from the COVID-19 pandemic, re-rise of risk assets under the expectation of economic recovery, normalization of monetary policy, and the marginally tightened liquidity.

China's Monetary Policy and Government-backed Bonds Outlook in 2020H2

Looking to the future, CCXI believes that the continuous recovery of economic fundamentals will push the monetary policy back to the normal state. The tone of the current macro policy enables China to give priority to "ensuring employment and public wellbeing". Against the background, the monetary policy will continue its prudential and flexible stance, and gradually shift from "emergency easing" in response to the pandemic crisis in H1 to "directly stimulating the real economy" in the normal state. In doing so, it aims to reduce financing costs of private firms as well as small and medium enterprises, and meanwhile retains the reasonably adequate liquidity in the interbank market. Given the maturity distribution of assets in the public market within the year and the central bank's special care for cross-year liquidity, one or two more (targeted) RRR cuts can be expected in H2, especially by the end of the year.

In the view of CCXI, there is no serious possibility that the yield will take on a downtrend. Instead, the yield is expected to range between 2.9% and 3.0%. After the yield of 10-year government bonds experienced a V-shape rebound, **CCXI holds that there is no serious possibility for a downtrend within the year** mainly on following grounds: **First**, the monetary policy will be more normalized and focus more on directly stimulating the real economy. This expectation augurs ill for the possibility that massive RRR cuts or interest rate cuts drive down bond yields remarkably. **Second**, the Chinese economy may take on a V- or W-shaped trend throughout the year, with a slight improvement to be expected in H2 compared with H1. Risk assets are likely to outperform safe-haven assets, so the prices of the latter will withstand pressure. **Third**, in consideration of the drop of yields within the previous cycles and the average value of timespans, 2.4824%, the yield of 10-year government bonds this April, is estimated to be the low point of the current cycle, and the likelihood of going further down is small. **With respect to the yield trend, CCXI holds that the marginal recovery of economic fundamentals will largely decide the yield of bonds in H2. If the Chinese economy can continue its marginal recovery and the monetary policy can return to the normal state gradually, the median yield of bonds will go upward in H2 to reach the range of 2.9%-3.0%.**

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