# CCXI & CCXAP – Research & Commentary

## Credit Risks May Continue to Rise and Default Rate May Rebound to 0.70% in Q4

Hong Kong, 26 October 2020 -- China Chengxin International Credit Rating Co., Ltd. (“CCXI”) has released the report, *Credit Risks May Continue to Rise and Default Rates May Rebound to 0.70% in Q4 — Review and Outlook on Credit Risk in Bond Market for Q3 2020,* reviewing the credit risk performance on the bond market in the third quarter of 2020, and forecasting the credit risk trends in the next stage. **According to the Research Institute of CCXI, impacted by the increasing pressure from maturing credit bonds and the marginally tightened financing environment, the credit risks in Q3 tended to rise after the previous fall; in Q4, as the size of maturing credit bonds will remain large, and the financing environment on the bond market will not be significantly eased, the credit risks are expected to keep rising, and the annual default rate on the public offering bond market may jump to around 0.70%; in Q4, main attention should be paid to the tail risks in some sectors, the risk contagion within enterprise groups, and the risk of increase in serial default events.**

**In terms of credit risk performance, the credit risks in the first three quarters of 2020 were remarkably lower than those in the same period of 2019; however, on a quarter-on-quarter basis, the credit risks in Q3 tended to marginally rise.** According to CCXI’s statistics, the first three quarters saw the default of 79 bonds, with a total size of RMB74.088 billion. Among the issuers, 17 defaulted for the first time, including 6 newcomers in the third quarter; the quantity and size of defaulted bonds as well as the number of new defaulting entities increased quarter on quarter. The rolling default rate on the public offering bond market showed a fall-and-rise trend, slightly going up to 0.65% at the end of September after reaching the low point at the end of July. In terms of industry distribution, more new defaulting issuers come from the real estate sector; nevertheless, on the whole, the default events are still dispersedly distributed in various industries. The reasons for default mainly lie in the poor operation of main businesses, the radical expansion, the defected corporate governance, etc.

**In terms of credit risk mitigation methods, Q3 has seen a significant drop in bond extension, indicating that extension is being less recognized by holders as a means to mitigate risks. In the future, attention should still be paid to the redemption risks of maturing extended bonds.** According to CCXI’s statistics, Q3 only saw the extension of 5 bonds with 5 issuers involved. Among these issuers, 4 are subordinate to the HNA Group, and most have already reached extension agreements. There have been fewer and fewer new entities extending the bonds, which shows to some extent that extension is being less acknowledged by holders as a means for risk mitigation. Thus, negotiations on extension matters become more difficult. The main reason comes from two aspects. On the one hand, as the extended maturity periods of bonds this year are generally so short that issuers can hardly substantively improve their debt solvency, holders face uncertainty on whether they can recover their investment on the extended maturity date; on the other hand, due to the reality where some extended bonds were further extended for multiple times or still defaulted, holders become more cautious about the validity of extension when negotiating with the issuers.

**In terms of subsequent resolutions of default, this year, 13 defaulting issuers on the public offering market have made substantial progress in resolutions through the three methods: judicial channels, debt restructuring and repayment made by issuers themselves.** Judicial channels include the common bankruptcy reorganization and liquidation, as well as judicial reconciliation which has newly emerged in the domestic market this year. In March, Xiwang Group and the holders of its bonds reached an agreement on the debt reconciliation plan. This is the first domestic case where bond default was resolved through a judicial reconciliation procedure. Moreover, Sunnsy Group, Huolinhe Coal Industry Group Co., Ltd. of Inner Mongolia, and Sound Group are paying off the bonds by installment through debt restructuring. Kangmei Pharmaceutical has paid part of bonds through self-raised funds. In addition, **as regulators have been improving the trading mechanism for defaulted bonds in recent years, some defaulted bonds have now been traded on the bond market.** In the first three quarters, the trading volume of defaulted bonds totaled RMB2.55 billion, involving 18 defaulted bonds from 11 issuers including Tahoe Group, CITIC Guoan Group Corporation, and Founder. As such defaulted bonds still account for a small part of all existing defaulted bonds, the trading of defaulted bonds remains to be further activated in the future. As at the end of September 2020, the bond market saw the default of 486 bonds in total, with 170 issuers involved. Among these bonds, only 138 were resolved, accounting for less than 30%, and the recovery rate of defaulted principals on the public offering market approximated 88%. Generally speaking, **currently, the resolution methods for default tend to be diversified, while subsequent resolutions still progress slowly.**

**Looking ahead to Q4, the Research Institute of CCXI expects that in Q4, credit risks will keep rising marginally as the size of maturing credit bonds will remain large and the financing environment on the bond market will not be significantly eased.** The Research Institute of CCXI estimates that this year's **annual default rate on the public offering bond market may jump to around 0.70%, slightly higher than the rolling default rate in June 2020 and lower than last year's annual default rate.**

**The Research Institute of CCXI predicts that in Q4, under the pressure brought by the high probability of rising credit risks, it is hard to avoid the exposure of tail default risks of low-qualified entities. Therefore, the Research Institute of CCXI suggests that main attention should be paid to the tail risks in some sectors, the risk contagion within enterprise groups, and the risk of increases in serial default events due to the maturity of defaulting entities' existing bonds.** Specifically, in terms of industries, the credit risks in the urban investment sector are controllable on the whole, while focus should be placed on the tail risks of the industrial entities that have slow profitability recovery and face high pressure from the maturity of bonds. In recent years, more enterprise groups have been involved in risk interconnections where the size of defaulted bonds is generally large. Therefore, focus should be placed on the credit risk contagion within enterprise groups caused by internal fund transfer and related party transactions. Besides, as a total of 31 defaulted bonds from 20 issuers with a size of nearly RMB35 billion are to mature or to be sold back in Q4, attention still needs to be paid to the serial default risks in the quarter**.**

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

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