

CCXI & CCXAP – Research & Commentary

Issuance of Next Year's New Special Bonds May Fall Back, and Risks of Special Bonds Need to Be Forestalled in Promoting Economic Circulation

Hong Kong, 23 October 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") has recently released the report, *Proportion of "Two New & One Major" has been Improved to Shore up for Weak Spots, and Risk Prevention of Special Bonds still Needed to Promote Circulation — Review and Outlook on Local Government Special Bonds in First Three Quarters of 2020*. This report holds that as an important source of funds for infrastructure construction, special bond is a major tool to stabilize economic growth and shore up weak spots in "domestic economic circulation". **According to this report, with China's gradual economic recovery and saturation of local infrastructure construction, the issuance of new special bonds next year may be reduced to RMB2.4 trillion-2.6 trillion; under the requirements of stabilizing growth and shoring up weak spots, special bonds will continue to support new infrastructure, new urbanization initiatives and major projects which not only boost consumption and benefit the people, but also facilitate structural adjustments and enhance the sustainability of growth; however, efforts need also to be made to forestall risks to help better put policies into effect.**

The report points out that this year, under the increasing economic downward pressure brought by the pandemic, China has implemented a series of proactive fiscal policies, including issuing nearly RMB4 trillion of special bonds with more reasonable terms. **Of these bonds, a significantly larger proportion have been used as project capital, compared with that in the previous year.** In the first three quarters, a total of RMB3.70 trillion of special bonds were issued, greatly increasing by RMB1.18 trillion year on year and approximating twice the size of general bonds issued. **The special bonds issued tended to have long terms.** 83% of these special bonds have a term of 10 years and above. Compared from the same period of last year, the long-term special bonds issued this year have sharply increased by over 40 percentage points and better matched with the fund demand and duration of projects. **In terms of issuing costs,** earlier this year, against the background of easing credit, fiscal, and monetary policies, the issuing rates of special bonds declined month by month. Since April, the issuing rates have kept rising and have now basically returned to the same period of last year. The issuing rates vary greatly with the terms of bonds and those of short-term bonds dropped significantly year on year. **More importantly,** compared with last year, a greatly larger proportion of special bonds were used as project capital. From January to August, a total of more than RMB150 billion of such special bonds were invested in over 400 projects as capital; the investment scope has also been further expanded to focus on railways and other transportation sectors. Meanwhile, the structure of project income sources has improved, with less dependence on land transfer income. That conduces to alleviating the pressure on local finance and allowing special bonds to keep playing the important role of stabilizing infrastructure construction.

While rapidly expanding the size, the issuing structure of special bonds was continuously optimized, keeping giving priority to infrastructure construction with more

diversified varieties. Against the background of stabilizing growth and addressing inadequacies, more special bonds have been issued to support “Two New and One Major” area. In the first three quarters, a total of RMB3.37 trillion of new special bonds were issued, greatly increasing by RMB1.24 trillion from the same period of last year, accounting for over 90% of the total size of special bonds; a total of RMB190.2 billion of refinancing special bonds were issued, and no special replacement bonds were issued. **In terms of regions**, the size of special bonds issued in the provinces like Shandong and Guangdong were relatively larger, while that in other provinces like Ningxia and Qinghai were smaller; in terms of the issuing structure, new special bonds accounted for the majority in most provinces, while the refinancing special bonds occupied a higher proportion in Liaoning, Jiangsu and other provinces. That may be related to the higher rolling pressure from the maturing local government bonds in these provinces. **In terms of varieties**, special bonds have been continuously allocated to infrastructure construction with more diversified varieties. These special bonds were issued to mainly support traditional infrastructure, people’s wellbeing, and medical care, as well as new infrastructure, new urbanization initiatives, emergency medical services, cold chain logistics, and other sectors added based on policy requirements. According to the summary in the report, from January to August, nearly 40% of these special bonds were issued to new infrastructure, new urbanization initiatives and major projects, among which, 70% were used in transportation, mainly in railway-related construction. And still, a small proportion were used in new infrastructure, especially information infrastructure. It is worth noting that after suspension in the first half of the year, the special bonds for shanty town renovation were issued intensively in Q3, accounting for 30% of the new special bonds in the quarter.

Looking ahead, the report expects that the issuance of new special bonds next year may be reduced to RMB2.4 trillion-2.6 trillion as the domestic epidemic has been under control, the economy has been gradually recovering and infrastructure construction has been becoming saturated. The report holds that under the requirements of stabilizing growth and addressing inadequacies, special bonds will continue to support new infrastructure, new urbanization initiatives and major projects. In terms of bond issuance, the report forecasts the issuing structure of special bonds in Q4 and 2021: the maximum size of special replacement bonds will be RMB191.5 billion, while there is a high probability that none of them will be issued; the remaining quota of refinancing special bonds in Q4 is RMB0.17 trillion, and nearly RMB100 billion of such bonds may be issued in 2021; the remaining quota of new special bonds this year is less than RMB400 billion, and next year’s quota may be reduced to RMB2.4 trillion-2.6 trillion, of which, RMB800 billion may be issued as the advanced batch. **In terms of investment areas**, special bonds will continue to support new infrastructure, new urbanization initiatives and major projects which not only boost consumption and benefit the people, but also facilitate structural adjustments and enhance the sustainability of growth. Among these sectors, the new infrastructure and new urbanization initiatives are the priority. Meanwhile, to further keep business operations stable and support market entities, local governments will accelerate the work of supplementing the capital funds of small and medium-sized banks with special bonds and help resolve SMEs’ business risks as fast as possible. As the pandemic impacts have been gradually subsiding and some areas are seeing recovering demand, the investment structure of raised special bonds may return to the normal state before the pandemic. **Besides**, basing on the issuing size and investment areas, this report estimates that this year’s new special bonds can theoretically drive an annual infrastructure investment

of roughly RMB5.6 trillion and a nominal GDP growth of about 4 percentage points. However, the actual effects remain constrained by such factors as the proportion of special bonds used as capital, the availability of project funds, and the construction progress of projects and their supporting facilities.

At the end, the report suggests that there remain some problems in the vigorous issuance of special bonds, such as insufficient leverage due to low capital ratio, idle project funds, lower-than-expected returns, and financial risks in supplementing the capital funds of small and medium-sized banks. The report recommends that against the background of stabilizing growth and promoting circulation, efforts need to be made to optimize the issuing and using quality of these special bonds and forestall risks, in a bid to accelerate the high-quality development pattern of “domestic economic circulation”.

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

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