

CCXI & CCXAP – Research & Commentary

Special Bonds Create Innovative Synergies to Stabilize Economic Growth, Debt-dissolution Funds Help Many Places Prevent Risks

Hong Kong, 6 November 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") issued a report entitled "Special Bonds Create Innovative Synergies to Stabilize Economic Growth, Debt-dissolution Funds Help Many Places Prevent Risks: Q3 Review and Outlook of Local Government Bonds and Urban Investment Industry – Policies", systematically reviewing the policies that came out in Q3 2020 on the urban investment industry and local government bonds and envisioning the possible future policies. According to the report, as the Chinese economy recovered at a steady pace, macro policies returned to normal gradually in Q3. Local governments adjusted their pace at which bonds were issued flexibly, and special bonds stepped up support for the new infrastructure and new urbanization initiatives and major projects, and were allowed to help small and medium-sized banks replenish their capital. In addition to policies aiming to stabilize economic growth, risk control policies also came out successively, with those on the central level continuing to regulate the management of special bonds, and those on the local levels trying to dissolve debts through multiple measures. Moreover, the reform of financial powers assigned to central and local governments kept going on. The newly revised *Regulations on the Implementation of the Budget Law* was issued formally, and bond markets saw their opening up policies optimized constantly, all of which signaled that reform measures were continuously yielding more dividends.

As the report pointed out, local government bonds in Q3 focused on two missions: expanding domestic demand and adjusting related structure, and got issued at a more flexible pace. While primarily supporting the new infrastructure and new urbanization initiatives and major projects, these bonds were allowed to be used for capital replenishment by small and medium-sized banks. At the same time, special corporate bonds made further innovation, to assist counties in making up for their infrastructure shortage. Local government bonds continued to expand in scale, as stipulated by the Ministry of Finance in its *Notice on Accelerating the Issuance and Use of Special Local Government Bonds*. As at the end of October, the remaining of new special bonds to be issued this year accounted for about 5% of the total annual limit, which means the target of new bond issuance for the year has been basically completed. Meanwhile, local governments flexibly adjusted the pace at which special bonds were issued. Specifically, they preferentially issued special government bonds for COVID-19 control, strove to avoid centralized supply, a source of additional pressure, prioritized the support for the new infrastructure and new urbanization initiatives and major projects, which concerned people's livelihood and structural adjustment, and commenced helping small and medium-sized banks replenish their capital officially. Furthermore, the release of the *Notice on Promoting County-based Industrial Platforms to Bolster up their Weak Links in Public Facilities* and the *Guidelines on the Issuance of Special Corporate Bonds for New Urbanization in Counties* was expected to improve the financing environment facing urban investment enterprises on the district and county levels, or enable them to conduct key projects and boost their credit strength.

Macro policies have gradually returned to normal, as the COVID-19 pandemic is brought under effective control in China. More policy emphasis was therefore diverted to risk control in Q3, while maintaining the efforts to stabilize economic growth at a necessary level. Seen from the central level, the National Development and Reform Commission (NDRC) issued a notice in early September, requiring local governments to issue, use and dispatch their special bonds with reference to the list of key national projects on a monthly basis. This move might help regulators to get promptly informed of actual progress of projects, use of funds, and other aspects of information, which is a prerequisite for ensuring special bond funds could be used for desired purposes. In the same month, the *Opinions on Adjusting and Improving the Scope of Use of Land Transfer Income to Prioritize Support for Rural Revitalization* was released, to limit the use of land income for repaying special bonds. This document might reduce the reliance of special bonds on land transfer income, thus making it possible for new special bond projects to continuously improve the composition of income sources. **From a local perspective,** Hubei, Heilongjiang, Guizhou and many other provinces have now established their debt risk mitigation funds. Hebei Province even succeeded in creating the first provincial credit guarantee fund targeting state-owned enterprises (SOEs) across China in Q3. In the meantime, to reduce their debt risks, many places have continued to roll out a diversity of debt dissolution measures, which included figuring out exact amounts of debts, actively applying for refinancing bonds to repay existing government debts, and assembling the lists of positive and negative lists of government debt financing programs.

More notably, in addition to the successive introduction of policies to stabilize growth and prevent risks, the reform of financial powers assigned to central and local governments kept going on in the fields of emergency response in Q3. Besides, the newly revised *Regulations on the Implementation of the Budget Law* and a series of policies aimed to further open up bond markets also came out successively. The reform to define the respective financial powers and expenditure responsibilities of central and local government was advanced continuously, with the pace significantly accelerated since 2018. This year, emergency response was added as a new field to the reform define the respective financial powers and expenditure responsibilities of central and local government, with a view to allocating funds appropriately and taking emergency response efficiently on the central and local levels. At the same time, the newly revised *Regulations for the Implementation of the Budget Law* was released so that local governments could refine their debt management mechanism, and establish a more complete and well-convicted fiscal capital management regime. Moreover, the policies to enhance bond market opening up were optimized through constant upgrades, which would enable local bond markets to increase their openness and enhance the investor structure while gaining more liquidity.

Looking into the next stage, the report concludes that, to achieve high-quality development, local government bonds still need to push forward the reform on fiscal and taxation systems continuously, by exercising a stricter grip on “fund borrowing, use, management, and repayment”, and preferentially preventing such risks as special bond funds lying idle. As to the urban investment industry, future policies will continue to be refined through such measures as advancing debt dissolution, strengthening debt integration and reorganization, supporting the participation in the new infrastructure and new urbanization initiatives and major projects, and improving internal governance mechanisms. From the perspective of local government bonds, their high-quality

development still hinges on the continued advancement in the reform on fiscal and taxation systems, the establishment of a budget system which features transparent norms, well-convinced standards, and effective restrictions, and the further efficiency enhancement of fiscal funds. For the short-to-medium term, to prevent potential risks that arise from the fast development of local government bonds, it is important to bring the “fund borrowing, spending, management and repayment” process into comprehensively meticulous management. With respect to the current risks of special bond projects such as idle funds and lower-than-expected returns, local governments and regulators still need to prevent special bond-related risks throughout the full life cycle. At the same time, they shall strengthen the supervision and management of special bonds used to supplement the capital of small and medium-sized banks, and put in place a market-oriented bond maturity and exit mechanism at a steady pace. When it comes to the combination of special bonds with PPP, more detailed policies may be issued to further regulate the use of bond funds in the future. In addition, as the Executive Meeting of the State Council required building a regular, directly-connected fiscal fund mechanism, relevant specific policies may be introduced in the next stage. **From the perspective of urban investment industry**, there may be a larger number of diversified and localized policies to dissolve implicit debts. Debt dissolution efforts will be stepped up through replacement, clearing, exit, and other methods, so as to help alleviate liquidity risks and reduce debt pressure facing the industry. Following the introduction of a refined plan for the integration and reorganization of urban investments by Shaanxi Province, more regions are expected to roll out similar policies which are aimed to optimize the overall asset structure and improve asset quality. At the same time, as further progress is achieved in the field of new infrastructure and new urbanization initiatives and major projects, more supporting incentive policies may be released in the next period of time, which will enable urban investment enterprises to participate in the aforesaid initiatives and projects, expand business size, increase the amount and stability of income, and transform themselves towards market-oriented operation.

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

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