Proactive Fiscal Policy Is Still Expectable, and Mitigation of Local Debt Risks May Be Further Ramped up

Hong Kong, 1 February 2021 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") issued a report entitled "*Scale Expansion and Variety Innovation Aim to Stabilize Growth; Multiple Measures and Diversified Efforts Devoted to Risk Mitigation: 2020 Review and 2021 Outlook of the Local Government Bond and Urban Construction Investment Bond Industry (Policy Chapter)"*.

As indicated by the report, in 2020 when macroeconomic policies intensified counter-cyclical adjustments in response to the pandemic-inflicted impacts, local government bonds expanded in scale rapidly and rolled out innovative varieties, and the urban construction investment bond enterprises embraced a significantly improved financing environment. At the same time, to act on the intensified risk prevention and control policies, different places adopted multiple measures to strengthen their local debt management. Additionally, various reforms continued to advance. As a result, there came out a host of official documents, including the reform plan for the division of central and local powers and responsibilities in the field of emergency response, the new "*Regulations for the Implementation of the Budget Law"*, and the "*Administrative Measures for the Issuance of Local Government Bonds"*. As the proactive fiscal policy is expected to become more sustainable, efforts to stabilize growth still need to be maintained at a necessary level in 2021. In the meantime, the policy will also pay more attention to risk prevention, especially the mitigation of local debt risks.

The report pointed out that to withstand the shocks of the pandemic, macroeconomic policies continued to increase counter-cyclical adjustments and play an important role in stabilizing growth in 2020. **The proactive fiscal policy was intensified to take better effect, local government bonds expanded sharply in an effort to fuel stable growth, and innovative varieties of bonds were rolled out to make up for weak links constantly.** Throughout 2020, the upper limit of new local government bonds was raised to RMB4.73 trillion, representing a substantial increase of RMB1.65 trillion over 2019. Of these, the quota for new special debts was significantly increased to RMB3.75 trillion, and the majority of the raised funds were channeled to the weak links and fields with poor infrastructure, which had been exposed by the pandemic, the new infrastructure and new urbanization initiatives as well as major projects, and the small and medium-sized banks for replenishing their capital funds to meet new purposes. **In the meantime, a series of loose credit policies were introduced to continuously improve the financing environment for urban construction investment bond enterprises.** In February, the National Association of Financial Market Institutional Investors simplified the issuance process of debt financing instruments used for the COVID-19 control, and launched the anti-pandemic bonds for the first time. After the revised *Securities Law* was promulgated in March, the National Development and Reform Commission (NDRC), China Securities Regulatory Commission (CSRC), Shanghai Stock Exchange, and Shenzhen Stock Exchange steadily promoted the registration system for public issuance of securities as required. In the third quarter, the *Guidelines for the Issuance of Special Corporate Bonds for the New*

Urbanization of Counties came out, with an aim to facilitate financing activities of the enterprises at some districts and counties, and thus further alleviate the revenue-and-expenditure contradiction facing these local governments.

In addition to the policy for stabilizing growth, an array of risk prevention policies were also introduced with an aim to strengthen the prevention/control of major risks and firmly hold the bottom line of incurring no systemic risks. In order to guard against and resolve the potential risks accumulated due to the rapid expansion of special bonds, local governments started to use the information disclosure template designed for their new special bond projects in April, a move to further improve the special bond project-related information disclosure mechanism. In August, the NDRC issued a notice requiring local governments to inspect the issuance and use of special bonds every month through the national major construction project library, so as to better supervision measures and forestall the risk of leaving special bond funds idled. At the same time, different localities adopted multiple measures to standardize local debt management. Many places such as Shanxi, Anhui, and Sichuan introduced local debt management measures successively, to boost local debt risk prevention and control. Hidden debts were disposed of through more diverse measures, with many sophisticated measures such as bond swaps and loan swaps used in a wider range. Great progress was made in the application of innovative measures, including debt resolution funds and share transfers from local state-owned enterprises.

Additionally, various reform policies came out to improve related systems continuously. Central and local governments continued to push forward their fiscal and taxation reforms, by further dividing their respective fiscal powers and expenditure responsibilities in the field of emergency response. The newly revised *Regulations for the Implementation of the Budget Law* further broke down the local debt management mechanism, enabling the public fiscal funds to be managed in a more scientific, standardized, efficient way. The *Administrative Measures for the Issuance of Local Government Bonds* was issued to bring local government bonds under unified and standardized administration. According to the *2020 Government Work Report*, there would be a deficit increase of RMB1 trillion, RMB1 trillion of government bonds for COVID-19 control would be issued, and a special transfer payment mechanism would be set up to ensure that funds could go straight to prefecture and county governments. Relevant regular supervision mechanisms came in place gradually. In addition, the bond market managed to optimize its opening-up policies constantly, a prerequisite for local bond markets to open wider to the outside and better their investor structure.

As the proactive fiscal policy is expected to become more sustainable, a highlight made at the Central Economic Work Conference, the report believes that efforts to stabilize growth still need to be maintained at a necessary level in 2021. In the meantime, the policy will also pay more attention to risk prevention, especially the mitigation of local debt risks. From the perspective of local debts, as the economy continues to recover, the large-scale policy tools will exit gradually. According to requirements for risk prevention, the follow-up policies may somewhat limit the further expansion of local debts. However, under the pressure from stabilizing growth, it is still necessary to focus on making up for weak links in the infrastructure sector, especially in the new infrastructure and new urbanization initiatives as well as major projects. Meanwhile, to further expand the size of local debts still needs to strengthen the standardized operation of the whole process that consisted of "borrowing, use, management, and repayment”. Particular attention should be paid to the prevention of idle funds, less-than-expected returns, and other risks arising from the investment of special bonds. In addition, it is worth noting that at a time when overseas economies face great uncertainty, China’s government bonds still hold a certain level of appeal to investors due to the global risk aversion. The opportunity may be seized to accelerate the implementation of the opening-up measures, thus enabling local debts to improve their investor structure. **Seen from the urban construction investment bond industry**, the enterprises as important carriers of hidden debts will possibly take multiple measures to dissolve debts continuously. In order to mitigate the risks of existing debts, a host of conventional measures such as loan swaps with financial institutions and hidden debt-to-local debt swaps by counties will be applied in a wider range. New methods including share transfers by state-owned enterprises and debt resolution funds will continue to be implemented, along with the integration, reorganization and transformation of the enterprises. With respect to the prevention of incremental debt risks, the regions with high debt risks may face some restrictions in the subsequent issuance of urban construction investment bonds, and a part of weak-qualified enterprises will possibly have to deal with the tightened financing supply, both of which can prevent the risk of incremental hidden debts to a certain extent. Even so, it is still necessary to remain vigilant against the aggregated exposure of credit risk due to the restricted refinancing capacity.

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