CCXI & CCXAP – Research & Commentary

Issuance Expected to Remain Active under Repayment Pressure of Mature Bonds, and Investors May Add New Bonds Issued by Quality Entities into Portfolios

Hong Kong, 27 April 2021 -- A report titled “Issuance Expected to Remain Active under Repayment Pressure of Mature Bonds, and Investors May Add New Bonds Issued by Quality Entities into Portfolios: Overview of the Credit Bond Market in Q1 2021 and Outlook” has been recently published by China Chengxin International Credit Rating Co. Ltd. (“CCXI”). The report has reviewed the operation state of the credit bond market in Q1 2021 and forecasted the issuance and interest rate trends of credit bonds in the next phase in light of the macroeconomy, monetary policy and financing environment. In Q1 2021, as economic fundamentals improved and more Covid-19 vaccines were administered, China’s monetary policy maintained its focus and open market operations attached more importance to “precision irrigation”. Interest rates of operations also remained stable and liquidity was reasonably sufficient on the whole.

Against such backdrop, **in the primary market, the issue volume of credit bonds increased year on year and was basically flat quarter on quarter. However, with a lot of bonds maturing in the quarter, net financing amount decreased significantly year on year, and bond interest rates generally went down from the end of 2020. In the secondary market, the trading and investment activity of credit bonds decreased somewhat. The yield went up from the end of January and fell again after March. As at the end of March, a number of bond varieties saw their yields decrease by 3 bps to 22 bps from the end of 2020. Looking into Q2 2021, CCXI believes that under the leverage stabilizing policy, macro policies will further return to normal, the issue volume of credit bonds may be less than that in Q1, and bond interest rates are likely to rise slightly.** With interest rates rising, spreads expanding and credit risk still under exposure pressure, investors are advised to pay attention to new bonds issued by quality enterprises with good fundamentals.

The report has reviewed the operation state of the credit bond market in Q1 2021. According to the report, the primary market of credit bonds in Q1 had the following characteristics. First, **the issue volume of credit bonds increased year on year, while net financing amount decreased**. In Q1 2021, with a lot of credit bonds maturing in the quarter, the issue volume of credit bonds registered RMB3.9 trillion, basically flat compared to that in Q4 2020 but up nearly 10% year on year. Net financing amount fell 56% year on year to RMB768.91 billion but it’s still higher than that in Q4 2020. Second, **bonds proceeds flowed mostly into state-owned enterprises**. The issue volume of SOE bonds accounted for 92%, with the proportion of bonds issued by local SOEs represented by infrastructure investment rising the fastest. The volume of bonds issued by private enterprises remained basically the same with last year, and bond proceeds generally went to leading enterprises. Third, **bond issue volume still varied greatly region by region**. Beijing, Jiangsu, Guangdong and Zhejiang took up the top five positions in term of bond issue volume. Tianjin, Shanxi, Yunnan, Henan and Hebei saw their net financing amounts turn negative. Liaoning, Hainan, Tibet, Ningxia, Heilongjiang and Qinghai registered an issue volume of less than RMB5 billion. They remained behind in the ranking and all recorded a negative net financing amount. Fourth, **the issue amount is larger than the matured amount in over half of the industries**. However, all industries saw their net financing amounts decline year on year, and the comprehensive, real estate, steel, coal, building, nonferrous metals, information technology and building materials industries registered a negative net financing amount. Fifth, **of the issuers, medium and high-grade issuers were still in the majority**. Sixth, **issue costs declined from the end of 2020**. As at the end of March 2021, the interest rates of major credit bond varieties generally went down from the end of 2020. Seventh, **innovative varieties were active**. Carbon neutrality bonds, rural revitalization notes and high-growth bonds were issued in succession.

With respect to the trading and investment of credit bonds, **in Q1 2021, the trading and investment activity of bonds decreased, and both the trading volume of bonds and that of credit bonds declined year on year.** The trading volume of bonds totaled RMB40.69 trillion (excluding negotiable certificates of deposit), representing a decrease of 1.65% year on year but an increase quarter on quarter. The trading volume of credit bonds recorded RMB7.95 trillion, down 7.90% year on year and 23.15% quarter on quarter. It accounted for 20% of the total trading volume of all bonds, basically flat compared to the same period last year but down 8 percentage points from Q4 2020. **The yield of credit bonds declined in early January, fluctuated upward till March and went down again in March. As at the end of March 2021, the yield of credit bonds generally declined by an amplitude between 1 bp and 22 bps from the end of 2020. Credit spreads narrowed by 2 to 23 bps.** In terms of interest rate spread by rating, the interest rate spread between AAA and AA+ bonds and that between AA and AA- bonds narrowed, while that between AA+ and AA bonds expanded. **In terms of interest rate spread by industry, most industries saw their spreads narrow, while automotive, coal, electronic and steel industries saw their spreads expand from the end of 2020.**

Looking ahead, CCXI believes that as China continues to do well in pandemic prevention and control and its economy continues to recover, macro policies will gradually return to normal and follow the general principle of being continuous, stable and sustainable in Q1, and the "leverage stabilizing" policy orientation will remain unchanged throughout the year. CCXI maintains the judgment that the net financing amount throughout 2021 will be RMB2.9 trillion. Based on different put-back proportions, CCXI estimates that the issue volume of credit bonds will be between RMB14.4 trillion and RMB15.3 trillion throughout 2021, and it will be between RMB3.5 trillion and RMB3.7 trillion in Q2, slightly lower than that in Q1. With money supply marginally shrinking, the interest rate of credit bonds in Q2 is likely to go up from Q1, but the room for rise is limited.

In the secondary market, at the beginning of Q2 2021, all released macroeconomic data show that economic fundamentals have continued to recover but are within expectations and their disturbance of yields is slight. In Q2, money supply is likely to shrink from Q1, which may bring certain upward pressure on yields. In the external environment, as overseas economic recovery continued and US bond yields maintained at a high level, China-US interest rate spread narrowed compared to that before. The attraction of the Chinese bond market to overseas funds decreased, so did the support of foreign investment to the bond market. Besides, a series of policies were issued in Q1, which raised higher requirements on the distinction degree of ratings and emphasized to reduce the impact of external support on credit ratings. With the release of annual reports and possible revision of ratings following that, there is a possibility that more negative rating actions will emerge. On the other hand, as the pressure of repaying mature bonds is expected to remain high in Q2 2021, credit risk will still be under the exposure pressure. The increase in negative rating actions and emergence of default events will probably have certain impact on the bond market. In such internal and external environments, both credit spreads and credit bond yields will be under upward pressure in Q2. As for credit bond investment strategy, with interest rates going up, spread expanding and credit risk still under the pressure of exposure, investors are advised to pay attention to new bonds issued by quality enterprises with good fundamentals. Moreover, a number of targeted policies for local SOE debts were issued in Q1. The *Opinions of the State Council on Further Deepening the Reform of the Budget Management System* issued by the State Council states that local financing platforms shall be streamlined and standardized and stripped of government financing function, and those that have become insolvent shall be subject to bankruptcy reorganization or liquidated according to law. In view of that, CCXI suggests that investors avoid weak SOE bonds with weakened urban construction investment attribute and relatively poor qualifications.

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

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