# CCXI & CCXAP – Research & Commentary

## Credit Risk is Generally under Control but Still under Exposure Pressure, and Three Types of Credit Risk Should be Watched

Hong Kong, 26 April 2021 -- A report titled "Credit Risk is Generally under Control but Still under Exposure Pressure, and Three Types of Credit Risk Should be Watched: Review of Credit Risk in the Bond Market in Q1 2021 and Outlook" has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. ("CCXI Research Institute"). The report has reviewed the credit risk performance of the bond market in Q1 2021 and forecasted the future trend of credit risk based on the financing environment, regulatory policies and the repayment pressure of mature bonds. According to the report, **the domestic economy is currently still recovering on the whole, but the economic losses and gaps caused by the pandemic haven't fully recovered yet. And in the meantime, the recovery was divergent in the economic structure, with some microcosmic entities still facing operation pressure. Meanwhile, the change in the credit cycle under high debt risk has caused money supply to shrink marginally. Given that the repayment pressure of mature credit bonds will remain high within the year, credit risk will still be under exposure pressure. However, with risk prevention measures being gradually put in place, the impact of credit risk on the market is expected to be generally under control.**

**Looking back on the credit risk performance in Q1,** the report says that from the beginning of 2021, the post-pandemic economy gradually recovered, but there was great divergence in performance among economic entities, with some microcosmic entities still facing certain production and operation pressure; moreover, as the overall credit environment was not as easy as it was in 2020, **credit risk in the bond market was exposed faster and the amount of default bonds increased year on year in Q1**. According to CCXI's statistics, a total of 69 bonds defaulted, with a total amount of RMB83.395 billion, up nearly 68% year on year; 28 defaulting issuers were involved, including 12 first defaulters, an increase of 3 year on year. **In terms of the monthly rolling default rate of the publicly offered bond market,** the rolling default rate in January 2021 continued the downward trend at the end of 2020, however, in February and March it slightly rose from January to 0.76%. **In terms of the impact of credit risk on the market,** defaulting bond issuers in Q1 are generally market concerns or entities who previously had credit events. As the exposure of credit risk fell within market expectations, its impact on market sentiment was limited. In the meantime, the orderly handling of default by large enterprises helped stabilize the sentiment of the bond market. The State-owned Assets Supervision and Administration Commission of the State Council released a series of policies and opinions which included strengthening the management of debt risk of SOEs, and it urged screening of central enterprises' debt risk, to ensure debt ratio is largely stable. The government's stand in the risk control work of SOEs has further stabilized market sentiment. **In future, with risk prevention measures gradually put in place, the impact of credit risk on the market is expected to be generally under control.**

In Q1, bond renewal agreements signed between bond issuers and holders increased further from the same period last year. According to CCXI's statistics, a total of seven issuers have rolled over 14 bonds in Q1 2021, which is 2.5 times the same period last year, and the principal and interests of renewal bonds totaled RMB6.284 billion. Among the bonds with known renewal amount and period, nearly 50% or about RMB13.394 billion bonds will mature in the next three quarters, so there is still the possibility that credit risk will be deferred to expose in the short term.

**In terms of default handling progress, in Q1 2021, 13 defaulting entities on the publicly offered bond market made substantial progress.** As at the end of Q1, the cumulative default amount of the bond market was RMB514.869 billion, involving 200 issuers. According to public information, RMB45.07 billion of default amount was repaid, accounting for less than 9%. In terms of redemption of defaulting publicly offered bonds, there were 378 defaulting publicly offered bonds on the whole market, of which only 94 were addressed, accounting for about 25%. The average principal recovery rate of bonds that already completed redemption was 89.5%. The handling progress of defaulting bonds was still slow.

**Looking ahead, even though enterprises' production and operation continued to recover in Q1, the impacts of the pandemic on enterprises haven't been fully eliminated yet.** Micro and small private enterprises and the service sector have suffered serious losses, primary-level microcosmic entities still need time to restore vitality, and some enterprises are still faced such problems as insufficient market demand, great cost pressure and employment difficulty. On the other hand, according to CCXI's estimation, about RMB8.5 trillion to RMB9.3 trillion credit bonds will mature in the next three quarters, slightly higher than that in the same period in 2020. **That will increase the repayment pressure on issuers.** In terms of financing environment, with micro policies gradually changing from adding leverage to stabilizing leverage since the second half of 2020, the net financing amount of credit bonds has fallen somewhat. Meanwhile, according to its Report on the Work of the Government, China will see that increases in money supply and aggregate financing are generally in step with economic growth in nominal terms, and maintain a proper and adequate level of liquidity supply. With monetary policy marginally tightened, there may be still room for increase in aggregate financing to fall within the year. **Against such backdrop, the refinancing pressure of credit bonds will increase in 2021. Given the factors above, credit risk will still be under exposure pressure within the year. However, with the gradual implementation of regulatory policies on risk prevention and advancement of risk prevention work by local governments, the credit risk of the bond market will be generally under control, and the default rate of the publicly offered bond market of the year is expected to be between 0.70% and 0.80%.**

**The report points out that investor should pay close attention to credit risk in the following three respects. First,** against the backdrop that the economic cycle and the credit cycle are staggered and there is "double-gap" pressure, it's unlikely to avoid exposure of credit risk in industries' tail enterprises with low qualifications who are under greater debt repayment pressure. In particular, in industries under greater debt maturity pressure, issuers with a low grade and private enterprise issuers still take up a high proportion, and some downgraded issuers have already had risk events such as overdue debts and debt renewal. As credit marginally shrinks, **investors should pay attention to the debt repayment by tail enterprises with weak qualifications in industrial sectors. Second,** against the backdrop of leverage reduction by the government, divergence in credit risk among urban construction investment enterprises across regions and among urban construction investment enterprises of different qualifications in the same region is expected to increase further. **Investors should pay attention to the bond redemption information and involuntary bankruptcy risk of SOEs in weak regions or with weak qualifications or weak urban construction investment attribute.** Even though there is currently no material default in bonds issued by urban construction investment enterprises, as risk events of non-standard products and bond maturity extension or compensation events have increased in recent years, **investors should still pay attention to the transmission and spreading risk of default of non-standard products and guarantor compensation events to the bond market as the financing of urban construction investment enterprises is restricted and enterprises are under repayment pressure. Third,** in Q1, many risk events involving multiple entities within enterprise groups emerged. Problems such as defects in internal governance and operation management within groups, occupation of related-party funds and concentration of control by parent companies have become prominent. The debt risk that has accumulated in earlier business development will be gradually exposed and transmitted within the group. **Currently, as debt repayment pressure increases and the credit environment marginally shrinks, investors should still pay close attention to the transmission of credit risk within enterprise groups.**

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

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