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Tail Risks Get Increasingly Exposed in the Context of Credit Stratification and the Annual Default Rate in the Public Offering Bond Market Is Expected to Reach 0.70%-0.80%

Hong Kong, 6 August 2021 -- A report titled “Tail Risks Get Increasingly Exposed in the Context of Credit Stratification and the Annual Default Rate in the Public Offering Bond Market Is Expected to Reach 0.70%-0.80%” has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. (“CCXI Research Institute”). The report has review and Outlook of Credit Risks in the Bond Market throughout the First Half of 2021. The report takes a look back at the credit risk performance of China’s bond market in the first half of 2021 and then presents an outlook for future trends of credit risks by taking into account the current monetary policy, financing environment and maturity pressure. According to the Report, **it is necessary to remain vigilant about the possibility that entities at the tail get their credit risks exposed at a faster pace in the second half of the year. Thanks to the tough regulatory stance on stability maintenance, the negative impact that default events pass on to the financing end of the bond market through the market sentiment is probable to go weaker, with credit risks remaining under control overall. The default rate in the public offering bond market may range between 0.70% and 0.80% throughout the year of 2021.**

A look back at the credit risk performance that the bond market released default risks faster in the first half of 2021, with the number of defaulted issuers and the scale of defaulted bonds both on the rise year-on-year. According to the statistics from CCXI, there were a total of 37 defaulted issuers, of which 16 defaulted for the first time, an increase of three year-on-year. Furthermore, most of the newly defaulted issuers came from Hainan Airlines (HNA), a feature that highlighted credit risks of group-affiliated enterprises. Defaulted bonds numbered 103 and totaled RMB124.685 billion, nearly doubling on a year-on-year basis. **The six-month rolling default rate rose first and then descended in the public offering bond market.** The rolling default rate in January continued the falling trend at the end of 2020. However, it rebounded to around 0.76% in February and March, then kept falling slightly to 0.72% in April and May, and edged up to 0.74% in June. **As defaults become more market-based and frequent, their impact on market sentiment is gradually weakening.** This change can be attributed to two reasons. On the one hand, most of the newly defaulted issuers in the bond market this year are entities that are in the spotlight or have triggered credit incidents and been hit with multiple rating downgrades before defaulting. Therefore, these default events are not entirely unexpected. On the other hand, the regulatory authorities have in recent years attached great importance to risk prevention. They have mentioned in many important meetings that it is necessary to improve the credit risk disposal mechanism, forestall or mitigate various types of financial risks, and never overstep the bottom line of incurring no systemic risks. Therefore, the regulatory stance on credit risk management and control has also played an important role in ironing out market sentiment swings and in maintaining credit risks within a reasonable range.

The Report reviews the renewal events that happened in the first half of the year. According to the statistics from CCXI, a total of 10 issuers extended the redemption periods for 17 bonds

over the period. The bonds confirmed for extension involved the principal and interest of RMB10.441 billion, a figure equal to 1.83 times in the same period of a year earlier. It is worth noting that seven of the extension entities are defaulted entities or enterprises related to defaulted entities, and three other issuers have triggered multiple bond renewal events during the year and suffer low credit ratings. There is still uncertainty about whether the extended bonds can be redeemed as agreed. So, attention needs to be paid to the possibility of delays in credit risk exposure of related issuers.

As indicated by the Report, the cumulative defaults in the bond market amounted to RMB557.009 billion at the end of June, which involved 204 issuers. According to public information, the default amount already paid totaled RMB46.525 billion, accounting for less than 9%. The follow-up disposal of defaulted bonds still proceeds at a slow pace. However, the redeemed bonds posted an average principal recovery rate up to 89.6%, a fairly high level of recovery.

Looking to the future, the Chinese economy will remain in the stage of continuous recovery from the COVID-19 pandemic. In the second half of the year, the economic growth will marginally slow down, as the low base effect weakens. The structural imbalance of economic recovery still exists, and the divergence of operating conditions will continue among different industries and within an industry. Some issuers will still face profit pressure and limited sources of internal funds. At the same time, the prudent monetary policy will continue in the second half of the year. It is expected that the funding environment will be broadly stable. However, it is hardly possible that the financing environment will be significantly improved and the structural tightening of financing supply will continue. Considering the great maturity pressure from credit bonds in the next five months and the structurally different sources of funds of issuers for debt repayment, **it is still necessary to be alert about the possibility that entities at the tail get their credit risks exposed at a faster pace.**

However, CCXI Research Institute holds that credit risks remain under control overall. On the one hand, the regulatory agencies have significantly stepped-up credit risk control and supervision and repeatedly emphasized the requirement for never overstepping the bottom line of incurring no systemic risks. Many provincial and municipal governments have undertaken to ensure that local state-owned enterprises (SOEs) won't default. All of these will help keep credit risks under control. On the other hand, market investors have adopted a rational attitude towards credit risks over time and become significantly less worried compared to the fourth quarter of last year. The negative impact that default events pass on to the financing end of the bond market through the market sentiment is probable to grow weaker in the future. **The Report predicts that the default rate of the public offering bond market may be 0.70%-0.80% throughout the year of 2021. At the same time, it reminds the focus should be put on the following four major categories of credit risks in the future. Firstly**, it is necessary to track the redemption risk of entities at the tail in the industries with poor financing records and mounting maturity pressure, especially for the possibility that real estate companies at the tail have no access to debt repayment funds. **Secondly**, the urban construction investment bond industry incurs the increasingly divergent risks at a time of "reducing stocks and controlling increments", which requires particular attention to the rise in refinancing risks of urban investment companies that come from weak areas and with weak qualifications. **Thirdly**, it is important to look out the possibility that there are delays in credit risk exposure of the issuers

that have been granted bond extension. **Fourthly**, attention should be paid to the internal linkage of enterprise groups in terms of credit risk.

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