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Tail Risks Continue to Be Exposed amid the Weakened Economic Recovery and the Still Mounting Maturity Pressure Raises Credit Risks Marginally

Hong Kong, 1 November 2021 -- A report titled "Tail Risks Continue to Be Exposed amid the Weakened Economic Recovery and the Still Mounting Maturity Pressure Raises Credit Risks Marginally: A Review of Credit Risks in the Bond Market throughout the First Three Quarters of 2021 and An Outlook for the Next Stage" has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. ("CCXI Research Institute"). The Report takes a look back at the credit risk performance of China's bond market in the first three quarters of 2021 and then presents an outlook for future trends of credit risks by taking into account the current macroeconomic trends, financing conditions, and maturity pressure. **Against the backdrop of the slowing macroeconomic, micro-entities face pressure from market demand and operating costs; and for some issuers, there will be a certain amount of uncertainty about the recovery of their profitability and cashability,** according to the Report. **At the same time, the foremost purpose of the monetary policy is to stabilize growth, with more focus put on precious supply. There is little possibility of subsequent easing. Coupled with the policy limitations such as the prevention of "highly-leveraged" enterprises from over-financing, some issuers may face the further elevated refinancing pressure. Given the massive debts that will mature within the year, credit risks are likely to rise marginally. We maintain the forecast that the default rate in the public offering bond market may range between 0.70% and 0.80% throughout the year of 2021.**

According to the Report, the credit risks of the Chinese bond market demonstrate the following three characteristics, given the specific risk performance in the first three quarters of 2021. First, the bond market continues to release default risks, with the number of defaulted bonds and the scale of defaulted bonds both on the rise year-on-year. But the number of new defaulted issuers shows a quarter-on-quarter decrease. According to the statistics from CCXI, there were 142 defaulted bonds in the year, which amounted to RMB168.78 billion, representing a year-on-year increase of 95% and exceeding the total defaulted amount in 2019. These defaulted bonds involved 43 issuers, of which 19 defaulted for the first time, a decline of three year-on-year. **The monthly rolling default rate rose first and then descended amid fluctuations 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, due to a spate of default among groups and enterprises. The rate kept falling amid fluctuations from April and fell to 0.68% in September. **Second, credit risks of private enterprises are further highlighted, especially the accelerated exposure of debt risks among real estate firms.** Most new defaulted issuers in the year are private enterprises, accounting for nearly 80%. By industry distribution, the real estate industry ranked the second place in terms of the number of defaulted companies, affected by the tightened regulation since this year and the ensuing financing contraction. **Third,**

the number of bond rollover agreements between issuers and holders has increased significantly during the year, and the rollover periods grow longer over time. According to the incomplete statistics from CCXI, a total of 15 issuers extended the redemption periods for 30 bonds in the first nine months of 2021. The bonds confirmed for extension involved the principal and interest of RMB21.405 billion, a figure surging 88% over the same period of a year earlier. The third quarter witnessed the intensive occurrence of bond rollover events. A total of 16 bonds were rolled over in the single quarter, posting a scale of RMB10.964 billion and representing an increase of more than 90% compared with both last year and last quarter. **Seen from the length of rollover period**, the number of bonds with the rollover period lasting one year and above has increased significantly. According to the statistics of CCXI, the average annual rollover period was 0.55 year in 2019 and 0.93 year in 2020, respectively. However, the average rollover period in the first three quarters of 2021 was up to 1.65 years. In this context, it is important to guard against the possibility of delayed credit risk exposure among the relevant issuers in the future.

With respect to the progress in the subsequent disposal of defaults, there were 16 defaulted entities in the public offering market having made substantial progress over disposal of defaulted bonds in the first three quarters of 2021. The cumulative defaults in the bond market amounted to RMB601.104 billion at the end of September, which involved 207 issuers. According to public information, the default amount already paid totaled RMB47.557 billion, accounting for less than 8%. **The follow-up disposal of defaulted bonds proceeds at a fairly slow pace.** However, the redeemed bonds posted an average principal recovery rate up to 90.54%, a quite high level.

Looking to the future, micro-entities will face pressure from both market demand and operating costs, and deliver a weaker performance in self-restoration against the backdrop of the uncertain economic recovery and the weakened production and demand pickup. Enterprises in some industries will see their profitability and cashability experiencing a weaker recovery, in addition to some uncertainty about the recovery of their endogenous funding ability. Concerning the monetary policy, the foremost purpose of the follow-up policy is to stabilize growth, and more focus will be put on precision orientation. At the same time, it will give greater support for key areas and weak links. An overall easing monetary policy is less likely to come out in the fourth quarter of the year. It is expected that some issuers will have to deal with a restricted external financing environment. Especially for highly-leveraged enterprises, refinancing pressure may further deteriorate. Given the still massive credit bonds that will mature in the fourth quarter, **it is necessary to be vigilant against the possibility that credit risks of tail issuers and highly-leveraged enterprises get exposed. Overall, the bond market will still face some pressure from credit risk release in the fourth quarter.** We, therefore, maintain the forecast that the default rate in the public offering bond market may range between 0.70% and 0.80% throughout the year of 2021, after a slight increase over a year earlier.

The Report also points out that attention should be paid to the following three aspects of credit risk in the future. First, it is important to follow with high interest the credit risks of tail issuers and highly-leveraged enterprises, especially the upcoming maturity of the tail issuers in the coal, real estate, and air transportation industries. **Second**, the credit ratings of enterprises in the urban construction investment industry may get further divergent, with focus on the negative impact of the tightened financing supply in the real estate industry on the urban construction investment enterprises. **Third**, it is necessary to guard against the delayed exposure credit risks and the risks of serial bond defaults that may arise from the bond rollover.

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

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