

CCXI & CCXAP – Research & Commentary

Credit Divergence May Continue as Trends in the Debenture Market Are Hard to Spot in Q4

Hong Kong, 3 November 2021 -- A report titled “Credit Divergence May Continue as Net Financing Contracts, Innovative Products Come out Faster, and Trends in the Debenture Market Are Hard to Spot: A Review of the Debenture Market the First Three Quarters of 2021 as well as the Outlook for the Next Phase” 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 operations of China’s debenture market in the first three quarters of 2021 and then presents an outlook for future trends of the primary and secondary segments in the debenture market in the upcoming fourth quarter. Given that it’s hardly possible for debenture investment to show clear trends in the fourth quarter, the Report suggests that investors lower their yield expectations, reduce leverage and duration at the right time, rack up profits and cash out, and pay attention to investing in the bonds of some real estate companies that have sound fundamentals but have been “wrongly affected” by the ongoing massive industry crackdown.

The Report summarizes the following five characteristics of the primary debenture market in the first three quarters of 2021. First, debentures were issued in a record-high size but at a slowed growth rate, with the net financing volume contracted year-on-year. According to CCXI’s statistics, the gross corporate debentures issued in the first three quarters of 2021 stood at about RMB9.76 trillion, posting a net financing of RMB2.15 trillion. Due to the large issuance scale, the net financing in the third quarter reached RMB0.79 trillion, which was a rebound from the first two quarters. **Secondly, securitization products became more popular among issuers, with the bond terms being short and the average rating of new bonds edging up.** By the issuance scale, short-term commercial papers, securitization products, and medium-term notes were still the top three, of which the issued securitization products exceeded RMB2 trillion, with the proportion exceeding that of medium-term notes. Of the issued products, short-term ones still made the majority. Specifically, the bonds that would mature within three years accounted for nearly 70% of the total. Different types of short-term bonds all saw their percentages on the year-on-year rise, while the proportion of perpetual bonds decreased. Of the rated bonds, the average rating of new bonds went up slightly compared with the same period of a year earlier. **Third, product innovation accelerated and guided the flow of funds to key areas.** Regulators promoted the innovation in bond products. As a result, carbon neutrality-themed, rural revitalization-themed, sustainability-linked, high-growth, equity-funded, and other bonds continued to grow in issuance size. The old revolutionary base areas development bond was launched in the third quarter of the year. As of the end of September, the above innovative bond varieties recorded a total issuance scale of over RMB300 billion. **Fourth, the interest rates of bonds issued took on a V-shaped movement, but still stayed lower than the level at the end of last year.** The issuance interest rates dropped and then increased in the first three quarter of 2021. As of the end of

September, there was a widespread increase in the costs of the entities with various ratings when issuing major types of bonds, compared with the end of the second quarter. The rise ranged between 7-34bps. Even so, the average coupon rate of most bonds was still lower than that at the end of a year before. **Fifth, financing diverged by different types of companies, industries, and regions.** Most funds of the bond market still flowed to state-owned enterprises (SOEs), and the net financing of private enterprises continued to fall short of expectation. A host of sectors including real estate, steel, coal, non-ferrous metals, light manufacturing, medicine, information technology (IT), and automobile all saw their net financing in the negative territory. Over 30% of regions suffered from negative net financing. With respect to the net financing of debentures, there was an under-performance in some western provinces including Xinjiang, Ningxia, and Qinghai, northeastern region, and many places in northern regions like Tianjin, Shanxi, and Hebei.

The Report summarizes the operating characteristics of the secondary bond market in terms of spot bond turnover, yield curve, interest spreads trend, and other aspects as follows. As to the spot bond turnover, the Report indicates that the ratio of debenture turnover to total spot bond turnover increased further in the first three quarters of 2021. Of which, convertible bonds were traded actively, replacing medium-term notes as the largest bond variety by turnover volume in the first three quarters of the year. **With respect to the yield curve,** the debenture yields declined slowly from late February, experienced a slight pullback in June as local government bonds were issued at a faster pace, started to dip again in July and August against the backdrop of natural disasters and sporadic COVID-19 cases, and then rebounded slightly in September under the pressure of the contracted supply in the bond market. As of the end of September, all grades of short- and medium-term notes saw their yields all falling (between 21-62bps) from the end of the previous year. There was an extensive downturn, compared with the end of June. **When it came to the interest spreads trend,** the medium and high-graded debentures saw their spreads narrowed overall, while the low-grade debentures posted the slightly expanded spreads. For inter-rating spreads, the spreads between different ratings of bonds diverged in the first three quarters. To be specific, spreads of medium and high-graded bonds narrowed, while those of medium and low-graded bonds expanded. By industries, the agriculture, forestry, animal husbandry & fishery industry and the automobile industry saw their interest spreads expanded to different extents compared with the end of last year. Other industries all showed a narrowing trend as a whole.

Looking to the future, the Report believes that the bond issuance in the primary market will remain stable throughout the year. The debentures issued in the fourth quarter would be around RMB3.7 trillion, with the issuance of innovative varieties expected to grow further and the financing divergence to continue. In the view of the Report, the medium-term lending facilities (MLFs) will mature at a fairly large scale in the fourth quarter. Coupled with the tremendous supply pressure in the bond market, liquidity may show a marginal tightening. At the same time, the fundamentals are weak on the whole. However, considering that market players are generally expecting a weakening economy, the positive impact brought by the weakened fundamentals is limited, and the Sino-US interest spreads may further narrow. Taken as a whole, the yields in the secondary market are likely to edge up in the fourth quarter. Seen from credit spreads, medium and high-graded bonds may post the slightly expanded credit spreads, while credit spreads of low-graded bonds are now close to the record high and may fluctuate in the current position against the backdrop of credit divergence.

In conclusion, the Report proposes the following strategy for debenture investment in the fourth quarter. Given that it's hardly possible for debenture investment to show clear trends in the quarter, it suggests that investors lower their yield expectations, reduce leverage and duration at the right time, and rack up profits and cash out. Besides, investors may pay attention to the bonds of some real estate companies that have sound fundamentals but have been affected by the ongoing massive industry crackdown in the country. In the primary market, it is recommended to increase the allotments of innovative bonds and preferentially select the entities with sound fundamentals to obtain a stable coupon yield.

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

Copyright

Copyright © 2021 China Chengxin (Asia Pacific) Credit Ratings Company Limited, China Chengxin (Asia Pacific) Credit Ratings Company Limited and/or their affiliates (collectively, "CCX"). All rights reserved. All information contained herein is protected by law. None of such information may be copied or otherwise reproduced, repackaged, further transmitted, transferred, redaction, interception, resold or redistributed, or stored for subsequent use for any such purpose, by any person without CCX's prior written consent.

Important Information

All information contained herein is obtained by CCX from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "as is" without warranty of any kind. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any commercial purpose of such information is given or made by CCX in any form or manner whatsoever.

To the extent permitted by law, CCX and its directors, officers, employees, agents and representatives disclaim liability to any person or entity (a) for any direct or compensatory losses or damages, including but not limited to by any negligence on the part of, or any contingency within or beyond the control of, CCX or any of its directors, officers, employees, agents or representatives, arising from or in connection with the information contained herein or the use of or inability to use any such information; or (b) for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if CCX or any of its directors, officers, employees, agents or representatives is advised in advance of the possibility of such losses or damages.



中诚信国际信用评级有限责任公司

地址：北京市东城区朝阳门内大街
南竹竿胡同2号银河SOHO6号楼
邮编：100020
电话：(8610) 6642 8877
传真：(8610) 6642 6100
网址：<http://www.ccxi.com.cn>

China Chengxin International Credit Rating Co., Ltd

Address: Building 6, Galaxy SOHO,
No.2 Nanzhugan hutong, Chaoyangmennei Avenue,
Dongcheng district, Beijing, 100020
Tel: (8610) 6642 8877
Fax: (8610) 6642 6100
Website: <http://www.ccxi.com.cn>



中国诚信(亚太)信用评级有限公司

地址：香港中环康乐广场1号
怡和大厦19楼1904-1909室
电话：(852) 2860 7111
传真：(852) 2868 0656
网址：<http://www.ccxap.com>

China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House, 1 Connaught Place,
Central, Hong Kong
Tel: (852) 2860 7111
Fax: (852) 2868 0656
Website: <http://www.ccxap.com>