

## CCXI & CCXAP – Research & Commentary

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### Tail Risk Still Exists Amid a Slowing Economy, Watch Five Risks

Hong Kong, 8 February 2022 -- The Research Institute of China Chengxin International Credit Rating Co., Ltd. (“CCXI Research Institute”) has recently issued a report entitled “Tail Risk Still Exists Amid a Slowing Economy, Watch Five Risks: 2021 Review and Next Stage Outlook for Credit Risk in Bond Market”. The report reviews the credit risk performance in the bond market in 2021 and looks forward to credit risk trends ahead in the light of macroeconomic trends, monetary and liquidity environment and maturity pressure. According to the report, **domestic pressure from ensuring stable growth may increase further in 2022. Micro entities are still facing certain pressure on demand and cost. These factors, together with the large size of maturing bonds, pose certain credit risk. With risk handling and resolution gradually implemented, however, it is unlikely to see any concentrated outbreak of credit risk, which will remain under control in general.**

According to the report, China’s economic operation in 2021 still faced the triple pressure of demand contraction, supply shocks and weaker expectations, coupled with sporadic COVID-19 outbreaks. Against the backdrop of a weak macroeconomic recovery, issuers showed divergence in recovery of operations and the tail enterprises had less access to financing. Credit risk erupted from time to time in the bond market. Specifically, credit risk showed the following four characteristics:

**First, credit risk erupted continuously in the bond market with a feature of “one increase, one decrease”.** “One increase” refers to a significant increase in the size of bond market defaults and the number of bonds in default. According to the CCXI statistics, 165 bonds were in default in the year, totaling RMB182,080 million, representing a year-on-year increase of 44%. The main cause was the defaults by many large enterprises and the large default size of individual issuers and continuing risk eruption from chain defaults. “One decrease” refers to a year-on-year decrease in the number of new defaulters. There were a total of 49 defaulting issuers during the year, of which 21 were initial defaulters, representing a year-on-year decrease of 10, the lowest level in four years. As of the end of 2021, the default rate in the public offering market reached 0.49%, down 0.17 percentage point year-on-year.

**Second, efforts to forestall and defuse financial risks were progressing steadily. Due attention should be paid to the delayed eruption of default risk in the bond market. On the one hand, there was a significant increase in extensions in the bond market extension events and the extension periods were longer.** According to non-exhaustive data from CCXI, there was a significant increase in the number of bond extension agreements between issuers and holders in 2021. A total of 28 issuers extended the redemption of 53 bonds in the year, with RMB29.846 billion of principal and interest payment extended, a year-on-year increase of 31%. Compared with previous years, the extension periods of extended bonds became longer in 2021. On the other hand, **some large enterprises took the initiative to defuse credit risk, and the risk mitigation committee mechanism was put into practice. However, the issuers with near-term risk mitigation may still have the possibility of delayed risk eruption. In the future, it is necessary to keep closer follow-up on the**

**operating capability of relevant entities and the financing environment of relevant industries.**

**Third, the risks of private enterprises further erupted and risk outbreak accelerated in the real estate industry.** The new defaulting issuers were still mainly private enterprises, which accounted for 76% of the 21 new defaulters. **In terms of industry,** the transportation industry saw a larger number of new defaulters than other industries due to the impact of the “HNA family” defaults. In addition, real estate developers sank into debt crisis at a faster pace amid tougher property curbs and tightening financing climate. The real estate industry saw the second largest number of defaulting issuers.

**Fourth, the issuer’s own credit risk gradually become prominent amid the industry downturn and the structural tightening of external financing.** In 2021, China witnessed recovery disparities among industries and enterprises of different sizes as the domestic economic come-back was steady but weak. Defaulting issuers generally faced external problems such as weakening of industry prosperity and structural tightening of financing environment. Under this background, some issuers found their credit risk erupting at a faster pace due to weakened operating ability, aggressive business expansion, high debt level, risk contagion from associates and deficiencies in corporate governance.

The report finally points out that the domestic economic momentum may continue to weaken in the first half of 2022 and the pressure on steady growth will further increase. Micro entities are still facing certain pressure on demand and cost. In particular, micro, small and medium-sized enterprises will still face great pressure on production and operation, showing uncertainties in restoration of liquidity generated from within. Meanwhile, given the still-large size of maturing debts in 2022, there is still some pressure of credit risk eruption. **With easier liquidity than in 2021, however, coupled with the gradually stronger risk mitigation and further implementation of related policies, we expect the overall credit risk level in 2022 to be flat or slightly lower than in 2021, and the default rate in the public offering market may range from 0.40% to 0.50%.**

The report brings attention to five major risks: **First, attention should be paid to the refinancing of highly indebted enterprises at the tail of the industry, thereby guarding against the possibility that credit risk in the real estate industry may spread to related industries, regions and even the financial sector.** The general, real estate and transportation industries are under higher pressure to pay debts when due. It is necessary to watch the recovery of profitability and solvency in some industries and the debt service of highly indebted enterprises at the tail of industries. **Second, under “double carbon” background, we should stay alert to the wider credit divergence and rising tail risk in high-carbon industries.** The dual-carbon policy has given certain impetus to the development of high-carbon industries and provided high-carbon enterprises with new ways of financing. Affected by policies such as energy restructuring and dual control of energy consumption, however, high-carbon enterprises will face such risks as capacity constraints, rising costs, declining earnings and rising debts. **Third, the risks still exist in weaker regions and lower-rating LGFVs, with LGFVs likely to become further divergent in credit standing.** Lower-rating LGFVs will see liquidity rising marginally amid tougher regulatory policies and tighter financing. The non-standard default risk spreading through the guarantee chain is a prominent problem. Also, we should guard against

the possible risk contagion from real estate to LGFVs. **Fourth, attention should be paid to the possibility that financial institutions may see further eruption and spread of credit risk.** Indirectly affected by the risks from real estate or controlling shareholders, there will be more negative rating actions for financial institutions and more extension events among non-bank financial institutions such as financial holding platforms and leasing companies. **Fifth, attention should be paid to delayed credit risk eruption of issuers with extensions and serial defaults.** Nearly RMB15 billion of extended bonds will be redeemed in 2022, and more than RMB100 billion of outstanding bonds of defaulting issuers will mature. There is an uncertainty in actual redemption of extended bonds.

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