

CCXI & CCXAP – Research & Commentary

Focus on Four Risk Points as Credit Risk Release Slows and Real Estate Enterprises Continue to Reduce Risk Exposure

Hong Kong, 29 August 2022 --The Research Institute of China Chengxin International Credit Rating Co., Ltd. (hereinafter referred to as “the CCXI Research Institute”) recently released a report entitled “Focus on Four Risk Points as Credit Risk Release Slows and Real Estate Enterprises Continue to Reduce Risk Exposure: H1 Review and H2 Outlook of Bond Market Credit Risk”. In the report, **we maintain the view that the overall credit risk in 2022 will be flat or slightly lower compared with that in 2021, and the annual default rate in the publicly offered bond market may range between 0.40% and 0.50%, since the overall credit risk in the bond market would remain within a manageable range owing to the macroeconomic restoration and the marginal easing of monetary policy in the second half of the year. However, the weakly qualified enterprises are projected to still face some refinancing pressure and tail credit risk, considering that it takes a long time for micro entities to restore their vitality amid the current complex and severe environment at home and abroad as well as the lingering downward pressure on economy, coupled with the mounting maturity pressure in the second half of the year.**

The report firstly reviews the credit risk conditions in the first half of the year. Despite the complex and volatile environment at home and abroad, the lingering disturbances from the COVID-19 flare-ups and the Russian-Ukrainian conflict, and the further increase in the three-fold pressure on the national economy, China’s macro-control policies made steady progress, with the timing of proactive fiscal policy taking effect further brought forward and the monetary policy remaining prudential and marginally easing in tandem. At the same time, focused on risk prevention as usual, major regulatory departments all put debt risk prevention and disposal in an important position. **The relatively abundant funding supply and the further increased risk prevention efforts underpinned the year-on-year improvement in credit environment, slowing down the pace of credit risk release and making sure the resulting impact didn’t significantly exceed market expectations.** The number of new defaulted bonds, the size of these bonds, and the number of issuers of such bonds in the first half of the year were significantly reduced compared to the same period of last year. According to CCXI’s statistics, there were 46 new defaulted bonds in the first half of 2022, down 57% from the same period of last year; the defaulted bonds amounted to RMB25,578 million, down 80% year on year; and a total of 15 defaulted entities were involved, seven of which were in default for the first time, down nine from the same period of last year. The monthly rolling default rate of the publicly offered bond market got stabilized after a sharp decline in February, which remained at 0.28% by the end of June.

According to the report, the credit risk in the Chinese bond market in the first half of the year had the following four characteristics. **First, new defaulted issuers were mainly private enterprises, and real estate enterprises still incurred high levels of risk.** Among the seven new defaulted entities, five were private enterprises, three of which belonged to the real estate sector. **Second, the new defaulted issuers got their internal problems exposed more**

apparently, due to external environmental factors. New defaulted issuers were generally battered by many external factors such as the downward pressure on macro economy, the declining prosperity of the industries to which they belonged, and the tightened financing environment so severely that they defaulted due to problems including the deteriorative business performance, limited financing capacity, highly-leveraged operations, and liquidity crunch. **Third, the intra-group risk transmission and cross-default events occurred frequently.** Among the seven new defaulted issuers in the first half of the year, four were in two sets of parent-subsidiary relationships, and one was an issuer whose parent company had been in default last year, which attested to the pervasive risk transmission within enterprise groups. At the same time, three of the new defaulted issuers involved other debts overdue, thus triggering cross-default clauses. This situation further aggravated the short-term debt burdens of enterprises and accelerated the outbreak of their credit risk events. **Fourth, more issuers mitigated their redemption risk by rolling over their bonds, most of which were real estate companies.** According to the incomplete statistics of CCXI, a total of 22 issuers extended the redemption periods for 37 bonds in the first six months of 2022. The bonds confirmed for extension involved the principal and interest of RMB41,227 million, a figure exceeding the level for the full year of 2021 and setting an all-time high. The remarkably increased number of rollovers has been mainly attributed to real estate enterprises this year. Of the 11 new issuers who rolled over their bonds in the first half of the year, seven were real estate enterprises. Of the extended bonds, those issued by real estate enterprises accounted for nearly 85%.

Finally, the report pointed out that the domestic economy continued to recover in the first half of the year, and it is expected to bottom out in the second half of the year, as the policies for stabilizing economic growth are put in place and take effect over time. However, the subsequent economic recovery may be a relatively slow process and take on an “asymmetric W-shaped” trajectory, given that consumption and investment are still weak in China, there is still uncertainty about the COVID-19 resurgence, the Russian-Ukrainian conflict couldn’t end in the short term, and the risks of imported inflation still lingers. In this context, increased credit supply would continue to get financing channels further unimpeded, and monetary policy should also maintain a sound tone. **It is predicted that the overall credit risk in 2022 will be flat or slightly lower compared with that in 2021, and the annual default rate in the publicly offered bond market may range between 0.40% and 0.50%, since the credit risk in the bond market would remain within a manageable range owing to the macroeconomic restoration and the marginal easing of monetary policy in the second half of the year.** However, it takes a long time for micro entities to restore their vitality under the current complex and severe environment at home and abroad as well as the lingering downward pressure on economy. In addition, from the perspective of financial performance, issuers in different industries vary by profitability restoration, thus delivering divergent credit levels. **However, the weakly qualified enterprises are projected to still face some refinancing pressure and tail credit risk,** considering that about RMB7 trillion of debentures will mature in the second half of 2022. **Particular attention should be paid to the following four risk points:**

- **Redemption risk of issuers at the tail of the industries with the weakening profitability and heavy debt pressure.** From 2022, issuers have restored their profitability at a lower pace and became apparently divergent in terms of credit level and debt burden. Most of them have not remarkably repaired their debt servicing

capacities. Considering that real estate, transportation, chemical, and other industries are still under great maturity pressure, particular attention should be paid to the redemption of bonds by issuers at the tail of these industries.

- **Rollover and cross-default risk of real estate enterprises at the tail of the sector.** Credit risk release has continued in the real estate industry since the beginning of 2022. Despite the marginal relaxation of the regulatory policies for real estate enterprises, it still takes more time for these policies to become fully effective. Given that the impact of the uncertainty about the COVID-19 flare-ups still exists, market confidence and financing environment in the real estate industry are yet to be further restored. As the internal credit divergence in the real estate sector will continue in the short term, real estate enterprises at the tail of the sector might face some funding pressure. In short, the risk of the real estate industry is still concentrated in the tail part of the sector.
- **The possibility of divergent credit levels and elevated tail risks in the carbon-intensive industries since the announcement of the goal of peaking carbon emissions and achieving carbon neutrality (hereinafter referred to as “the dual carbon goal”).** Under the pressure of low-carbon transformation and upgrading, enterprises need to increase capital expenditure, a move further aggregating their debt pressure and potential risks and making them more likely to be phased out in the process. For the enterprises not at the forefront of an industry, the inadequate technological/financing strength and the weak risk resistance may further worsen their credit position. Under this circumstance, enterprises in carbon-intensive industries may get their credit levels further divergent.
- **Potentially intensified credit divergence and continued tail risk release among urban construction investment enterprises.** Since this year, urban construction investment enterprises may have got their credit qualifications more notably diverged, driven by the policies such as financing support for urban construction investment enterprises that undertake key projects and the fiscal system reform targeted at the regions below the provincial level. Moreover, considering the continuation of the red line for debt control, zero tolerance to hidden debts, and government re-election, governments of some economically and fiscally weak regions will cut their support for related urban construction investment projects, a change that is expected to further restrict the refinancing of tail urban construction investment enterprises.

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