China Offshore Bond Market 2021 Review and 2022 Outlook: There is Light at the End of the Natural Selection Process

The China offshore bond market was severely hit by a series of defaults and credit events caused by Chinese property developers in the second half of 2021 (2H2021). Developers were virtually facing a shutdown of bond financing channel due to the significant surge in bond yields and the widening spread in coupon rates. As such, China offshore USD bond new issuance dropped by 11.9% to USD165.5 billion for the first ten months in 2021 (10M2021). In particular, the new issuance amount decreased by 30% for the four months ended October in 2H2021, compared with the same period in 2020.

The Chinese property developers' offshore USD bond new issuance dropped by 51.4% year-on-year and contributed only 18% of the total offshore USD new issuance for the four months ended October in 2H2021. Developers' default risk was heightened when most of their cash were held in project companies instead of holding companies, and when some covenants of early repayment for some non-traditional financings were triggered. In the operation aspect, developers' contracted sales shrank in 2H2021, and most of them rapidly reduced their land purchase spending to safeguard their liquidity conditions.

The LGFVs' offshore USD bond issuance rebounded by 17.9% for the four months ended October in 2H2021, compared with the same period in 2020. Investors' risk aversion favored IG LGFVs' bond issuance. The central government urged local governments to resolve the risks arising from implicit debt and escalating debt burden. Also, the fiscal conditions of provinces vary across different regions.

Green and sustainable bond issuance continued to grow rapidly in 2021. There were 60 Chinese offshore green and sustainable issuances for 10M2021, compared with the total of 18 issuances for 2020. In November 2021, the HKSAR government sold c. USD3 billion equivalent of USD and Euro-denominated and RMB5 billion of RMB-denominated green bonds, which helped to set a yield curve for the green bond markets.

The virtual shutdown of the USD public bond financings for most Chinese property developers will probably last at least into the first half of 2022, as offshore investors suffered huge losses in their high yield bond investments. We expect investors to become more cautious on scrutinizing developers' liquidity and financial positions in evaluating their credit and liquidity profiles. Bondholders will also pay more attention to bond issuance terms stated in the offering circular. IG issuers were relatively less affected by the credit events, though their refinancing capabilities were also being undermined.

Chinese property developers will prioritize the soundness of their financial conditions over scale expansion. We expect contracted sales will drop by 10-20% in 2022, which is a major business risk for developers. It will hit developers' financial and cash positions, and heighten the risk of their interest coverage slippage. If there is no positive action from the government to ease the current situation, the risk of liquidity stress may spread to highly-rated developers.

On the LGFVs front, credit polarization among LGFVs will continue in 2022. LGFVs with lesser roles in core policy functions and lower visibility of government support are under higher risk of being consolidated. In addition, LGFVs in regions with weaker economic and fiscal conditions will face more challenges in terms of financing and cash flow sustainability. The restrictions on land premium ceiling and the centralized land sales revenue collection may weaken local governments' flexibility in their fiscal conditions.

Analysts

Stan Ho
Chief Executive Officer
(852) 3462 9568
stan.ho@lhratingsglobal.com

Alex Kung
Senior Director
(852) 3462 9577
alex.kung@lhratingsglobal.com

Ben Yau
Director
(852) 3462 9586
ben.yau@lhratingsglobal.com

Toni Ho
Director
(852) 3462 9578
toni.ho@lhratingsglobal.com

Business Development Contact

Joyce Chi
Managing Director
(852) 3462 9569
joyce.chi@lhratingsglobal.com

Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited ("Lianhe Global" or "the Company" or "us") are subject to certain terms and conditions. Please read these terms and conditions at the Company's website: www.lhratingsglobal.com

A credit rating is an opinion which addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrades or downgrades or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by a credit committee vesting process. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstances shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fees in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entities nor its related parties participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relying on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or part, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of Lianhe Credit Information Service Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company's independent credit ratings and research.