Lianhe Ratings Global

Non-Rating Commentary
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China Offshore Bond Market 1H2022 Review and 2H2022 Outlook: Embracing the Paradigm Shift

Summary

The China offshore USD bond new issuance dropped by 37.3% year-on-year to USD64 billion in 1H2022. The offshore bond issuance was supported by the refinancing needs of LGFVs, but it was hit by the defaults and credit events of Chinese property developers and the Fed rate hike of USD during the period.

China LGFVs' offshore USD bond new issuance decreased moderately in 1H2022 when compared with that in 2H2021, but it still grew considerably in comparison to 1H2021. Investment grades and unrated issuances continued to dominate LGFVs' offshore USD bond market. Also, we notice the increasing participation of issuers from the district or county level and use of credit-enhanced issuances backed by stand-by letter of credit ("SBLC") in LGFVs' offshore bond issuances. Besides, the business model of Chinese LGFVs has become more diversified, such as financial holdings platforms, industrial investment platforms, energy investment platforms, water utilities enterprises and transportation investment etc.

We believe the credit polarization and consolidation of LGFVs to continue and intensify in 2H2022. Regions and provinces with high levels of implicit debts and high proportion of government fund income in their fiscal revenue will face challenges on their credit profiles and refinancing capabilities. On the other hand, the use of special purpose bonds quota will help boost investment and stabilize the economy. Other than this, we believe various policies towards LGFVs are unlikely to be loosened substantially in the near term.

The offshore real estate USD bond new issuance dropped by 77.2% year-on-year in 1H2022. Many property developers resorted to exchange offers or defaulted on their maturing bonds. Given the declining contracted sales and narrowed refinancing channels, we believe property developers may still face tight liquidity and repayment pressure in the near to medium term.

We believe the impact on financial institutions from the real estate market downturn is limited at this stage, given the manageable proportion of non-performing loans and the various exposure caps on Chinese banks limiting their risks to the real estate market. Also, most of the banks providing SBLCs to first-time or small LGFV issuers are limited to joint-stock and regional/local banks with small or limited footprints.

The offshore green and sustainable USD bond new issuance continued to grow rapidly and almost doubled year-on-year and contributed 24.2% to the total China offshore USD new issuance in 1H2022. The HKSAR government launched the inaugural retail green bond in 1H2022. We believe the HKSAR government will continue to issue green bonds regularly to promote the development of green and sustainable bond markets in Hong Kong.

Last but not least, we believe that the PBOC's recent announcement encouraging the use of Chinese rating agencies in the Chinese offshore USD bond issuance is conducive to Chinese rating agencies in expanding rating business overseas and raising their influence in the international capital markets.

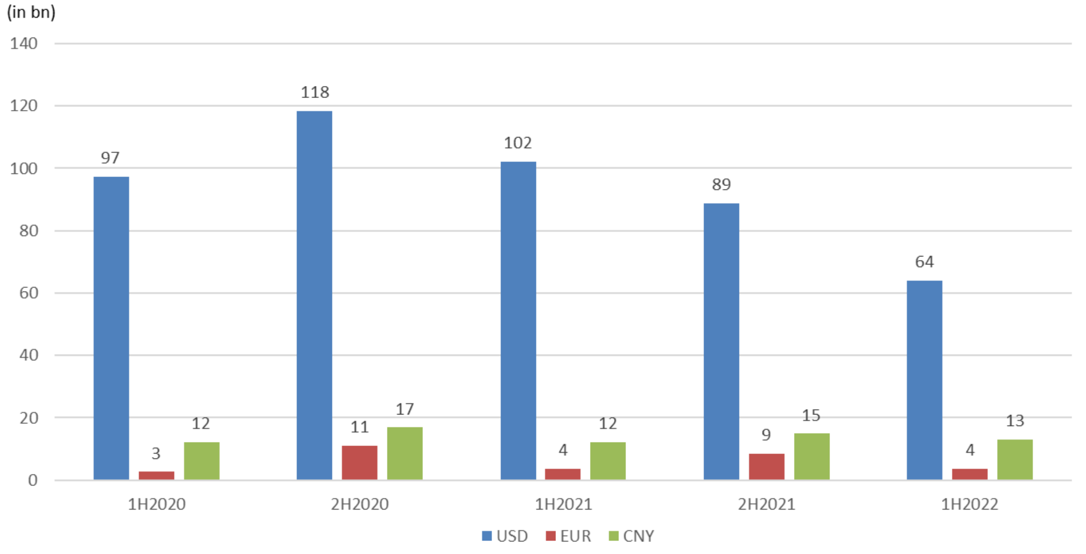
A. Review of China Offshore Bond Market and China Economy in 1H2022

New Issuance Amount Declined, Despite Higher Number of New Issues

The China offshore USD bond new issuance dropped by 37.3% year-on-year to USD64 billion in 1H2022, compared with USD102.1 billion issued during the same period in 2021 (EXHIBIT 1). Having said that, the number of new issues increased to 462 in 1H2022, compared with 322 in 1H2021 (EXHIBIT 2).

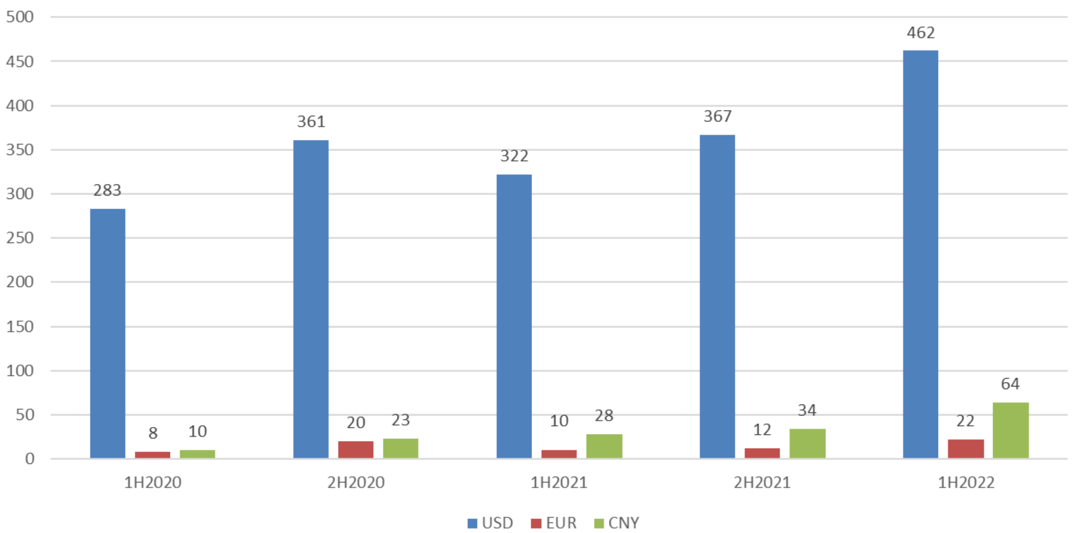
The refinancing needs of LGFVs continued to support the total offshore new issuance in 1H2022. However, investors' sentiment and risk appetite were hit by the defaults and credit events of Chinese property developers. Moreover, the interest rate hike of USD in 1H2022 lifted the financing costs of offshore USD bond issuance.

Exhibit 1: Total Amount of China Offshore Bond New Issuance



Source: Bloomberg and Lianhe Global's calculation

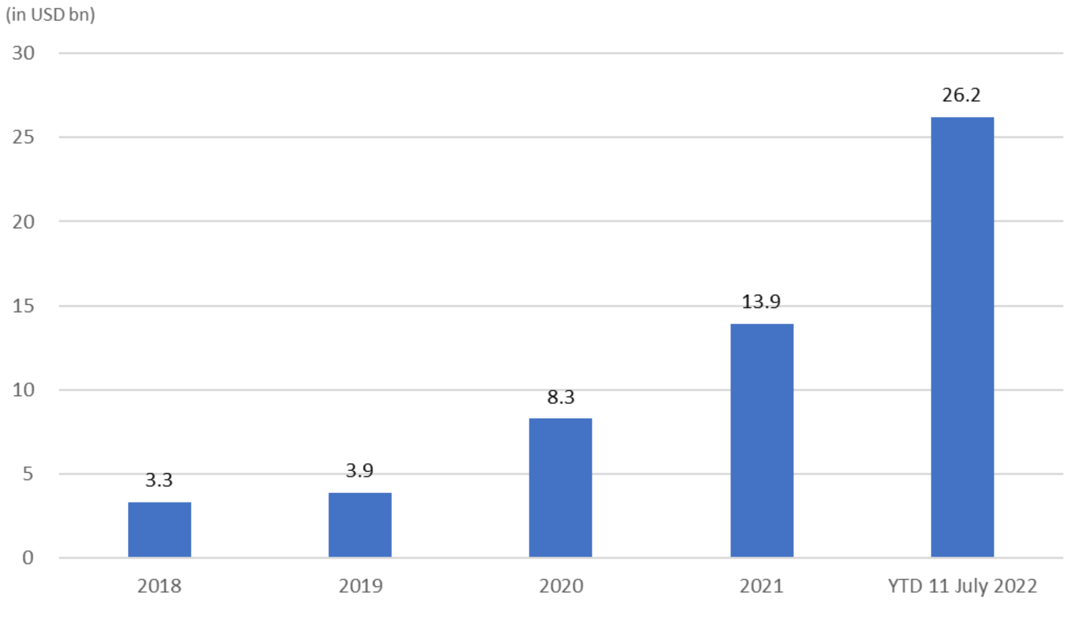
Exhibit 2: Number of China Offshore Bond New Issuance



Source: Bloomberg and Lianhe Global's calculation

The total amount of Chinese offshore bonds defaults increased to USD26.2 billion as of 11 July 2022 (EXHIBIT 3). According to Bloomberg, the offshore bond defaults reached a record high of 85% of all Chinese bond defaults as of 11 July 2022, as measured by the issuance amount. In other words, the proportion of onshore bond defaults to the total Chinese bond defaults were at the lowest point since 2018.

Exhibit 3: Total Amount of China Offshore Bond Defaults



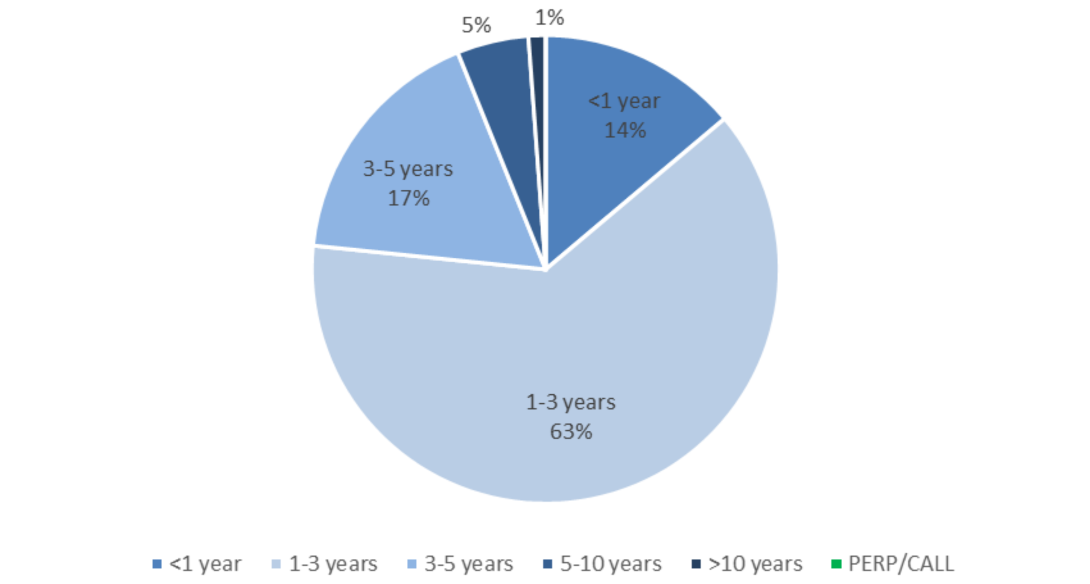
Source: Bloomberg and Lianhe Global's calculation

Short Tenor Dominated New Issuance, Upcoming Maturity Wall in 2H2022 and 2023

Given investors' risk aversion stance and the refinancing purpose for most of the new bond issuance by both developers and LGFVs, bonds with short tenors (1-5 years) accounted for the majority (94%) of the total offshore USD bond new issuance in 1H2022 (EXHIBIT 4). Short-term bonds with maturity of less than 1 year contributed 13.9% of the new issuance in 1H2022. Bonds with maturity of 1-3 years accounted for 62.8% of the new issuance during the same period, followed by bonds with maturity of 3-5 years (17.2%).

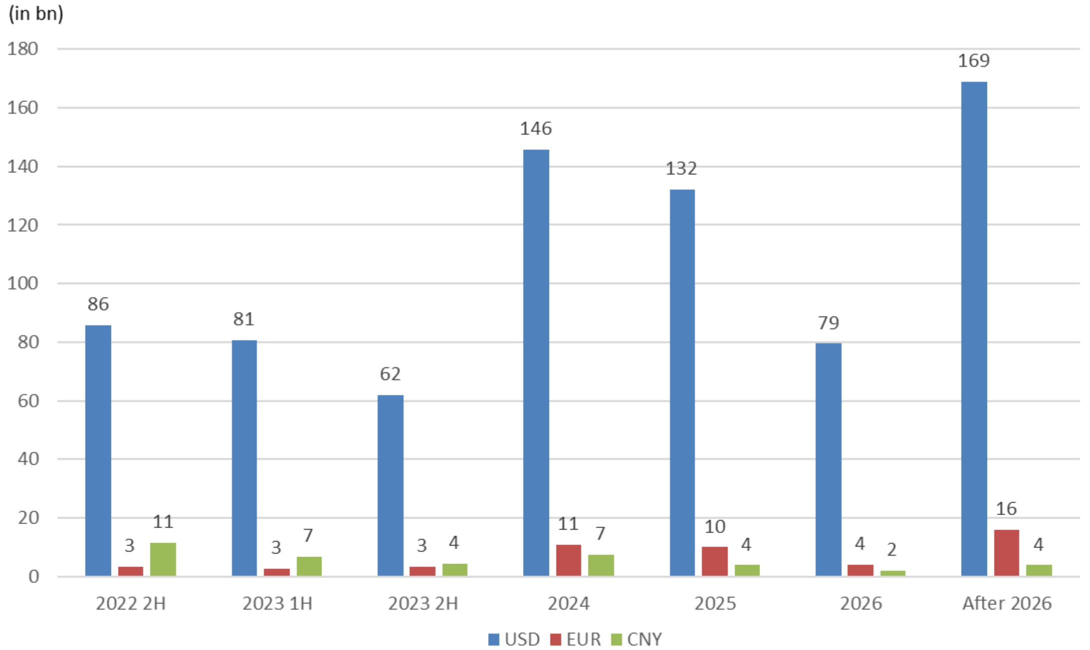
At end-June 2022, the outstanding amount of offshore USD bond was USD754 billion of which USD228 billion will mature in either 2H2022 or 2023 accounting for 30.3% of the total outstanding amount (EXHIBIT 5). Therefore, we expect the refinancing demand from issuers remains intact and it will partly support the new issuance volume going into 2H2022, especially for LGFVs.

Exhibit 4: Tenor Distribution of China Offshore USD Bond New Issuance in 1H2022



Source: Bloomberg and Lianhe Global's calculation

Exhibit 5: Maturity Profile of China Offshore Bond at end-June 2022



Source: Bloomberg and Lianhe Global's calculation

China's Economy Retreated in 2Q2022, Mild Signal of Recovery since June

According to the National Bureau of Statistics of China, China's GDP grew at a tepid rate of 0.4% year-on-year in the second quarter of 2022 (2Q2022), the lowest since the first quarter of 2020 that retreated from the moderate growth rate of 4.8% in 1Q2022. The slowdown of the economic growth in 2Q2022 was largely due to the lockdown and mass quarantines caused by the resurgence of COVID cases in various provinces and cities. As a result, China's 1H2022

GDP growth rate slowed to 2.5% dragging down by the tepid growth in 2Q2022, compared with the annual economic growth target of 5.5% for 2022.

Fixed asset investment was relatively strong with a 6.1% growth rate in 1H2022, of which the investment in infrastructure increased by 7.1%, as the Chinese government ramped up infrastructure spending to boost the overall economic growth. On the contrary, investment in real estate deteriorated with a 5.4% decline in 1H2022, compared with the same period in 2021.

While retail sales dropped by 0.7% in 1H2022, it rebounded by 3.1% in June from a 6.7% decrease in May. Similarly, the industrial production growth accelerated to 3.9% in June, compared with a 0.7% growth in May. Most of the major cities have resumed normal business activities since June, and the Chinese government also announced the loosening of quarantine requirements in June. Therefore, there are likely some recovery prospects for China's economy in 2H2022.

B. Review of LGFVs in 1H2022

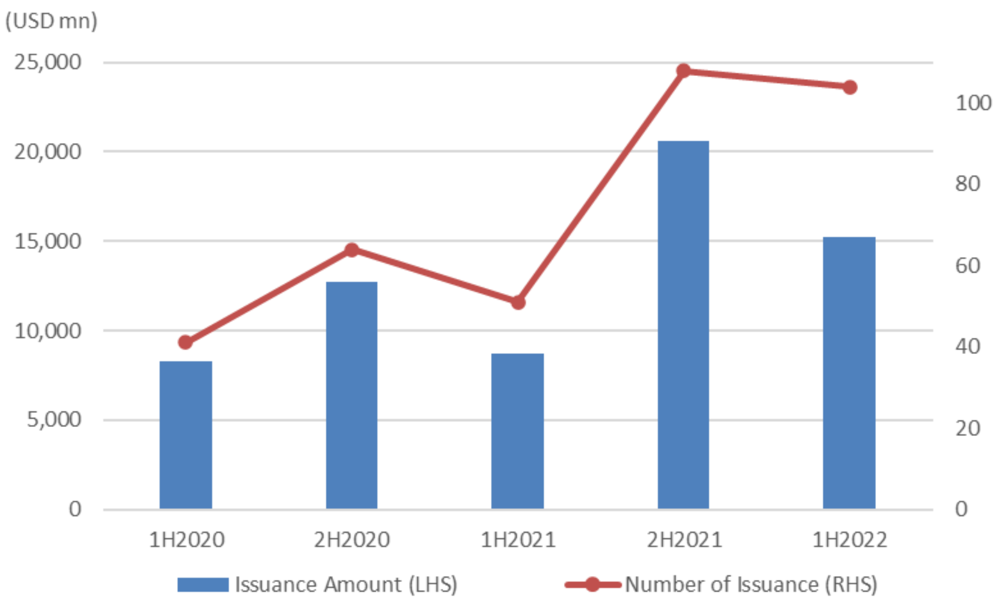
Growth of LGFVs' Offshore USD Bond Issuance Slowed Down in 1H2022

China LGFVs' offshore bond issuance amount decreased moderately in 1H2022 when compared with that in 2H2021, but still showed a considerable growth in comparison to the same period in 2021. The credit events in the Chinese property sector have lowered investors' risk appetites for the sector, which coupling with the tightened financing policies onshore for LGFVs, have in turn favored LGFVs' offshore bond issuance since 2H2021. Some new issuances came out for LGFVs with lower credit quality having to rely on SBLCs for tapping the offshore USD bond market.

However, the increasing financing cost in the offshore USD bond caused by the Fed rate hike and the tightening policies and regulations offshore partly constrained the growth of LGFVs' offshore bond issuance in 1H2022. LGFVs' pent-up refinancing demand due to their maturity wall in 2022-2024 could continue providing some support to the issuance volume in the offshore USD bond market.

As a whole, China LGFVs' offshore USD new bond issuance reached USD15.2 billion in 1H2022, representing an increase of 74.5% as compared with the same period in 2021 (EXHIBIT 6).

[Exhibit 6: Offshore LGFV USD Bond New Issuance Amount and Number of Issuances]()



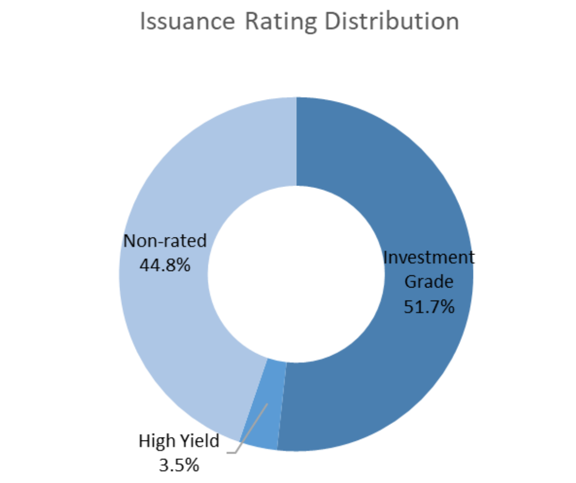
Source: Bloomberg and Lianhe Global's calculation

Developing Trend in Issuance Landscape

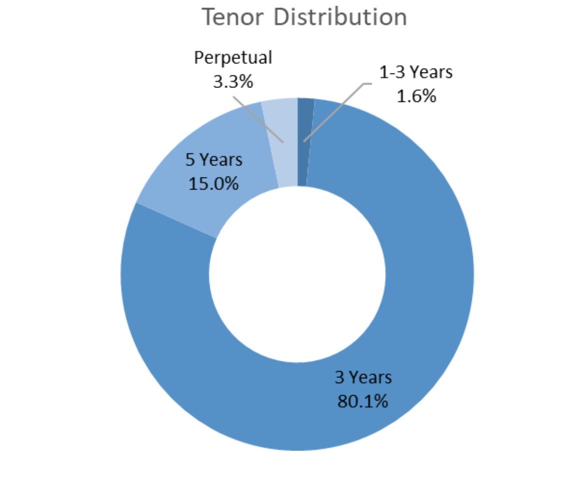
Investment grades and unrated issuances continued to dominate the LGFVs' offshore USD bond market over the past two to three years. Key issuer regions of domicile remained to be the major provinces such as Zhejiang, Jiangsu, Guangdong, and Shandong. Remarkably, the proportion of issuers at the district or county level also increased significantly from c. 17% in 2020 to c. 26% in 2021 and c. 49% in the 1H2022, as some of these issuers faced increasing difficulty in raising funds onshore.

[Exhibit 7: Change of Structure in China Offshore LGFVs' Bond Issuance]()

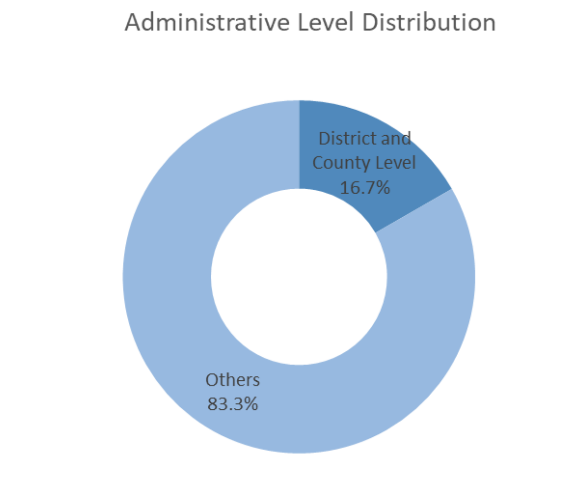
2020:



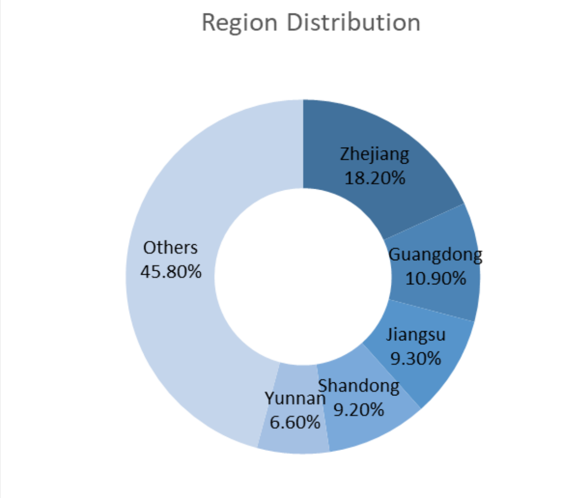
Source: DMI and Lianhe Global's calculations



Source: DMI and Lianhe Global's calculations

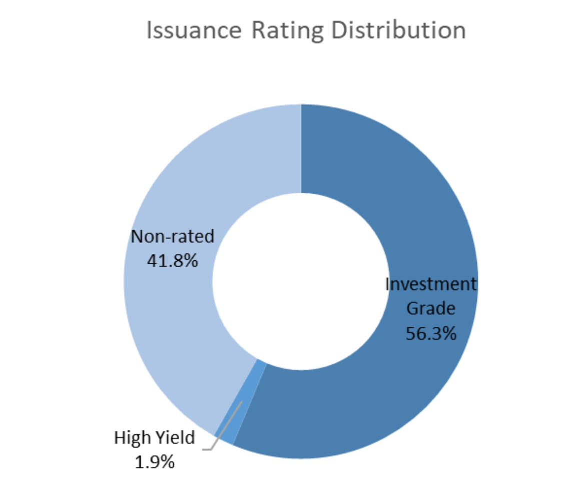


Source: DMI and Lianhe Global's calculations

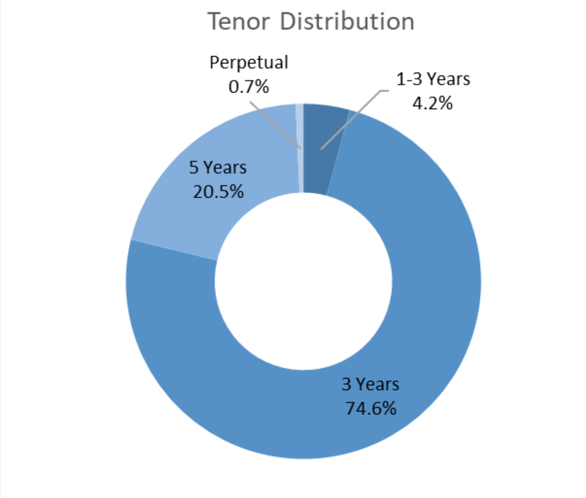


Source: DMI and Lianhe Global's calculations

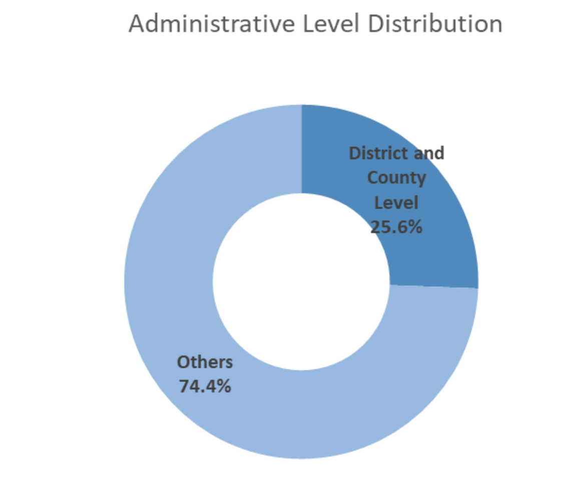
<u>2021:</u>



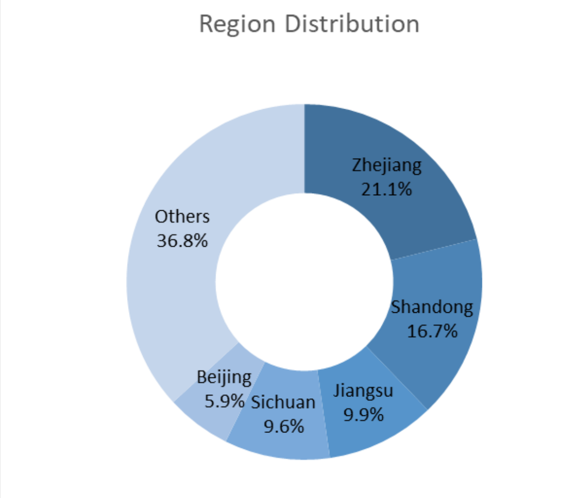
Source: DMI and Lianhe Global's calculations



Source: DMI and Lianhe Global's calculations

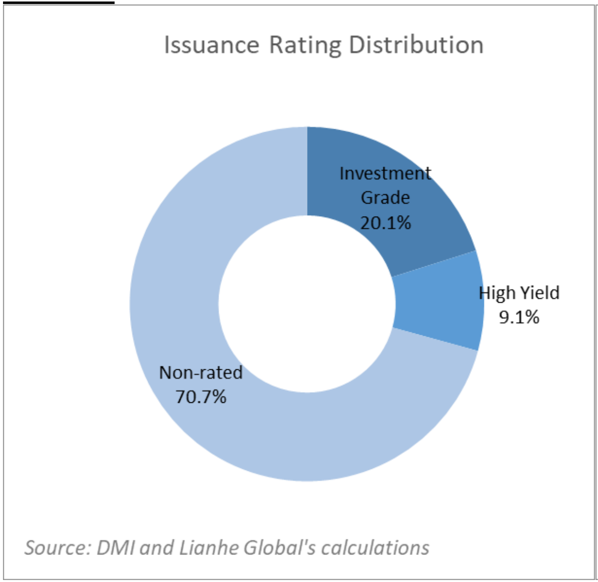


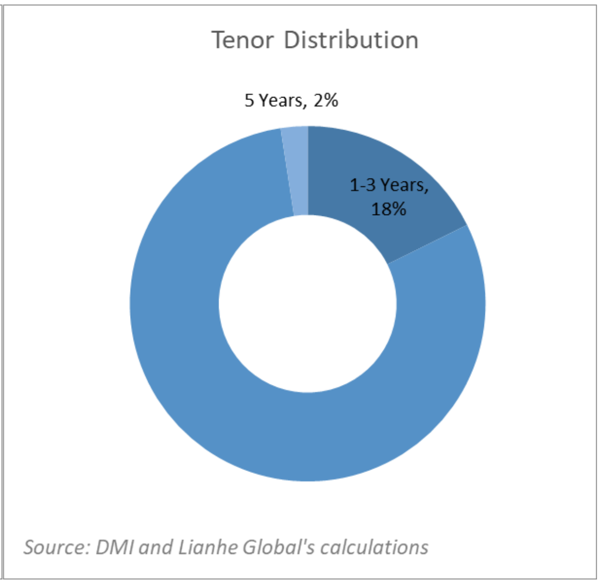
Source: DMI and Lianhe Global's calculations

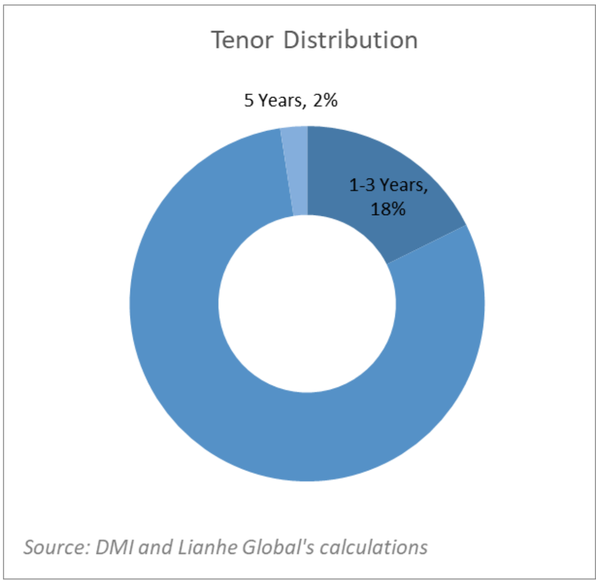


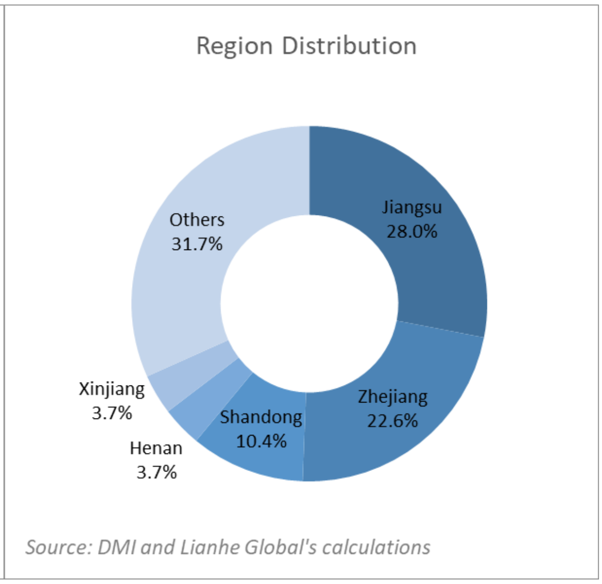
Source: DMI and Lianhe Global's calculations

1H2022:





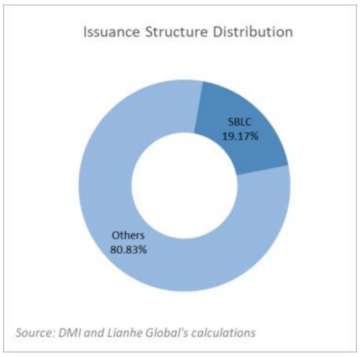




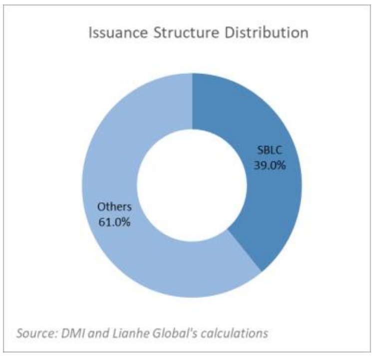
From the structure side, the proportion of credit-enhanced issuances backed by SBLCs increased from c.19.2% in 2020 to c. 47.6% in 1H2022 (EXHIBIT 8). The proportion of credit-enhanced issuance backed by SBLCs continued to rise since this structure emerged gradually from 2018. Normally, issuers may have to pay 1-2% handling fee and certain portions of their credit lines may be countered as utilized.

Exhibit 8: The Proportion of China Offshore LGFV Bond Issuance Backed by SBLC

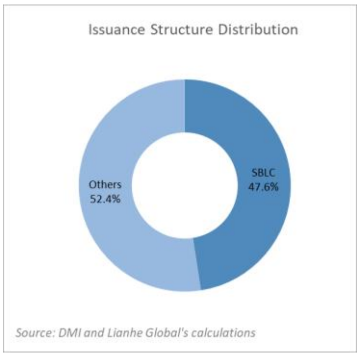
2020:



2021:



1H2022:



Increasing Participations from a Variety of Chinese LGFV Sub-sectors Continue

The business model of Chinese LGFVs has become more and more diversified. Traditionally, LGFVs are mainly engaged in infrastructure construction, land development and consolidation, public housing construction, transportation construction and operation, public utilities and cultural tourism, etc. Having said that, LGFVs with businesses that are not focused on the aforesaid sub-sectors have gradually become more active in the offshore USD bond market. Examples of such include financial holdings platforms, industrial investment platforms, energy investment platforms, water utilities enterprises, etc. From the perspective of credit rating, these LGFVs have their own unique characteristics and credit features, but they are often time regarded as the same as or as a part of the broadly defined LGFVs by international investors.

Examples of the Variety of LGFV Sub-sectors

- Financial Holding Platforms

Financial holding platforms are usually set up serving the regional economic development by mobilizing, integrating, or expanding financial resources as their most important mission. From a financial resource perspective, the number of licenses held, especially the four traditional key licenses (banking, securities, insurance, and trust), represents the strength of a financial holding platform and the willingness of support from its government. Financial holding platforms often hold shares in the form of equity investment in entities in possession of the four key licenses, most of which, especially commercial banks, are not included in the scope of consolidation. Some financial holding platforms who do not hold the four key licenses would be involved in other quasi financial services and may be engaged in local asset management company ("AMC") business.

The establishment of provincial financial holding platforms has been basically completed. However, that of financial holding platforms at municipal and county level are still at the stage of formation and consolidation.

- Industrial Investment Platforms

Industrial investment platforms mainly refer to LGFVs that integrate or restructure state-owned assets according to local development requirements and aim to maintain and increase their values. Compared with regional urban construction- or resources utilization-related LGFVs, linkages between industrial investment platforms and their governments may not be so direct.

Industries which are strategic or fall under state planning initiatives would likely get more government supports and would have a higher degree of linkage to their governments. Support history or prospect such as subsidies, asset injections or whether an LGFV acts as the manager of regional industrial investment fund could also show the strength of linkage of an LGFV to its government.

- Energy Investment Platforms

In general, energy investment platforms often invest in different types of energy assets in the form of equity participation to integrate and utilize local energy resources, in addition to carrying out some of their operations via subsidiaries. Analyzing these LGFVs is similar to that for industrial investment platforms, but the industries they invest in are more concentrated, mostly regional strategic resources.

- Water Utility Enterprises

Quasi-public water utility enterprises have both economic and social mandates. The water industry has a low cyclicality with stable income. Regional economic development and structure (proportion of residential vs. industrial users) have a direct impact on the demand for water utility enterprises. Support history or prospect such as subsidies or asset injections could also show the strength of linkage of these LGFVs to their governments.

- Transportation investment

Highway transportation continues to occupy a dominant position in China's transportation system, accounting for c. 75% and c. 63% of the total domestic commercial cargo transportation and passenger transportation, respectively, in 2021. Transportation infrastructures play an important role in promoting commodity logistics, improving urbanization level, and driving regional economic development, which could be deemed as a relatively stronger aspect in terms of strategic importance to their governments.

C. Review of China’s Property Market in 1H2022

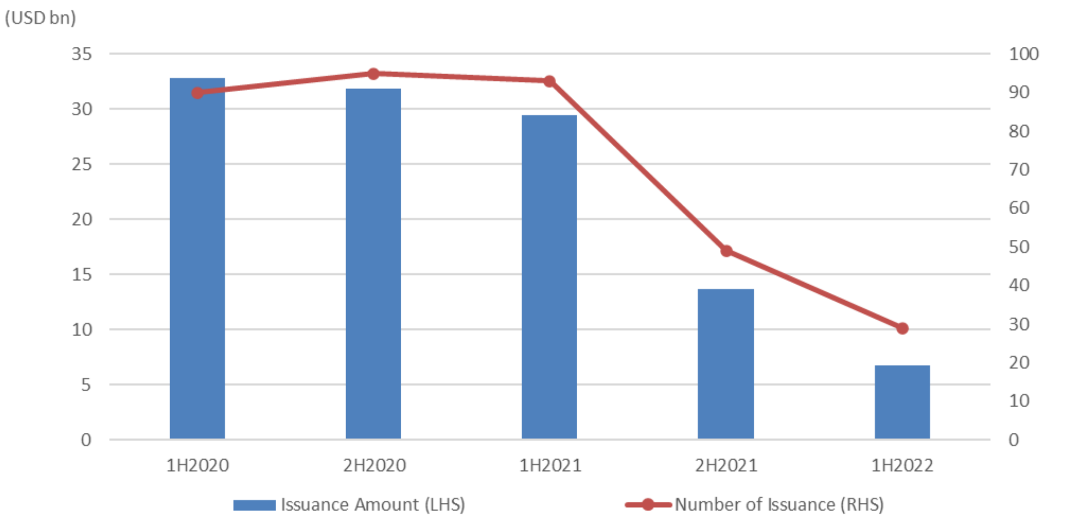
Weak Demand for Property Developers’ Offshore USD Issuance

The offshore bond issuance by Chinese property developers deteriorated in 1H2022 continuing the decline trend since 2H2021. Many property developers resorted to exchange offers or even defaulted on their maturing bonds, as they generally faced heightened liquidity pressure given their declining contracted sales and narrowed financing channels. These credit events hurt investors’ confidence and caused fluctuation of bond prices across the sector. The significant decline of bond prices in the secondary market undermined refinancing capability and halted refinancing activities in the primary market for most of the property developers, which in turn further intensified their liquidity risk. Overall, most of the property developers were shut out from the offshore public bond market. Only a few high-quality and IG property developers were still able to execute their refinancing activities.

As a result, the offshore real estate USD bond new issuance dropped significantly by 77.2% year-on-year to USD6.7 billion in 1H2022, compared with USD29.5 billion in 1H2021 (EXHIBIT 9). On a half-year comparison basis, the new issuance amount in 1H2022 was also 51.0% lower than the USD13.7 billion in 2H2021. There were 29 new issuances in 1H2022, down from 93 and 49 new issuances in 1H2021 and 2H2021, respectively. Also, the real estate bond issuance contributed only 10.5% to the total offshore USD bond issuance in 1H2022, compared with 28.9% and 15.4% in 1H2021 and 2H2021, respectively.

Also, some property developers issued credit-enhanced offshore USD bond backed by SBLCs in 1H2022, such as Greentown China Holdings Limited, Shenzhen Excellence Business Management Co., Ltd. and Sino-Ocean Group Holdings Limited, etc. The credit-enhanced issuances backed by SBLCs may strengthen their attractiveness to bondholders given the guarantee provided by commercial banks. However, property developers may need to take into account the higher cost and the more stringent terms when considering to obtain SBLCs for their bond issuances.

Exhibit 9: Offshore Real Estate USD Bond New Issuance Amount and Number of Issuance



Source: Bloomberg and Lianhe Global's calculation

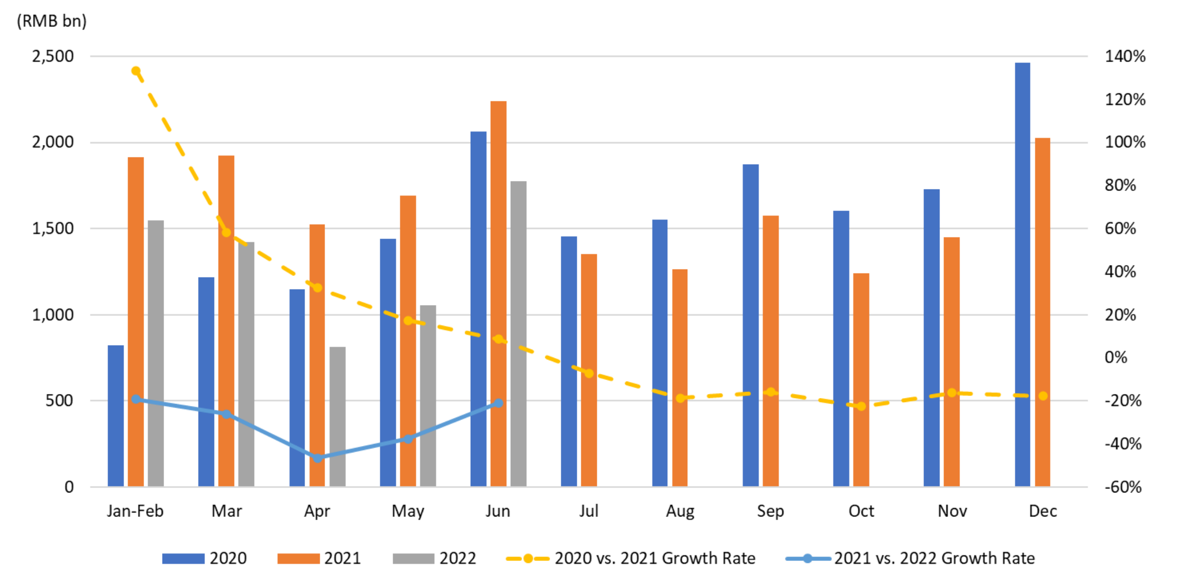
Weak Contracted Sales in 1H2022

Contracted sales remained weak in 1H2022 because of 1) homebuyers' concern on property developers' financial positions and their capability of project delivery, 2) homebuyers' weakening expectation on property prices, 3) lower income and purchasing power of homebuyers, and 4) the lockdowns in individual provinces and cities caused by COVID-19, especially in 2Q2022.

According to the National Bureau of Statistics of China, the total contracted sales and GFA dropped by 28.9% and 22.2% year-on-year in 1H2022, respectively (EXHIBIT 10). In particular, the monthly contracted sales hit the near-term bottom in April with a 46.6% decrease year-on-year, probably due to the COVID 19-related lockdowns. The decline of monthly contracted sales narrowed to 37.7% and 20.8% year-on-year in May and June, respectively.

Some cities (mainly low-tier cities) have introduced policy relaxations and stimuli since 1H2022, such as relief on purchase restriction and loosening the use of provident fund for property purchase. Banks also introduced loosening policies to encourage property purchase, such as lowering of the down payment for first-time purchase, mortgage rate cut and acceleration of mortgage loan approval. Also, there were modest measures to ease the liquidity pressure of property developers, such as introducing vouchers as compensation for residents involved in urban renewal projects and easing the access to presales proceeds in escrow accounts. More positive impact on contracted sales from these supportive policies may be seen in 2H2022.

Exhibit 10: Monthly Contracted Sales Amount and Year-on-year Change



Source: National Bureau of Statistics of China, Lianhe Global's calculations

Profit Margin and Liquidity Under Pressure

Most of the property developers encountered gross margin squeeze and earning decline in 2021. At the same time, given the tight liquidity with lower cash on hand and weakening refinancing channels, many property developers cut their dividends in 2021.

As property developers need to accelerate contracted sales by offering price cuts and discounts, we expect their profit margins to continue the declining trend in 2H2022. Also, given the challenging refinancing channels in both the onshore and offshore markets, most of the property developers may have to settle their debts with internal resources or resort to exchange offers. Therefore, we expect property developers will likely face tightened liquidity and heightened repayment pressure in 2H2022.

Potential Risks from Homebuyers' Mortgage Boycott

Driven by the slowdown or even halt in construction progress of some property projects, homebuyers' refusal to continue honoring their mortgage payments emerged as a major event in both the Chinese property and banking industries. According to E-House Research and Training Institute, there have been at least 271 loan suspension notices across China as of 16 July 2022, with most cases in Henan, Hunan and Hubei provinces. We believe some property developers are facing tight liquidity as they fail to obligate their payables to suppliers and find it difficult to continue allocating fund for the construction progress.

Meanwhile, there is a growing concern over the contagion risk if it were to spread to financial institutions. While Chinese banks are inundating to handle the default and delinquency risks arising from property developers' tight liquidity, homebuyers' threats to stop making mortgage payments will exacerbate the risk undertaken by these banks.

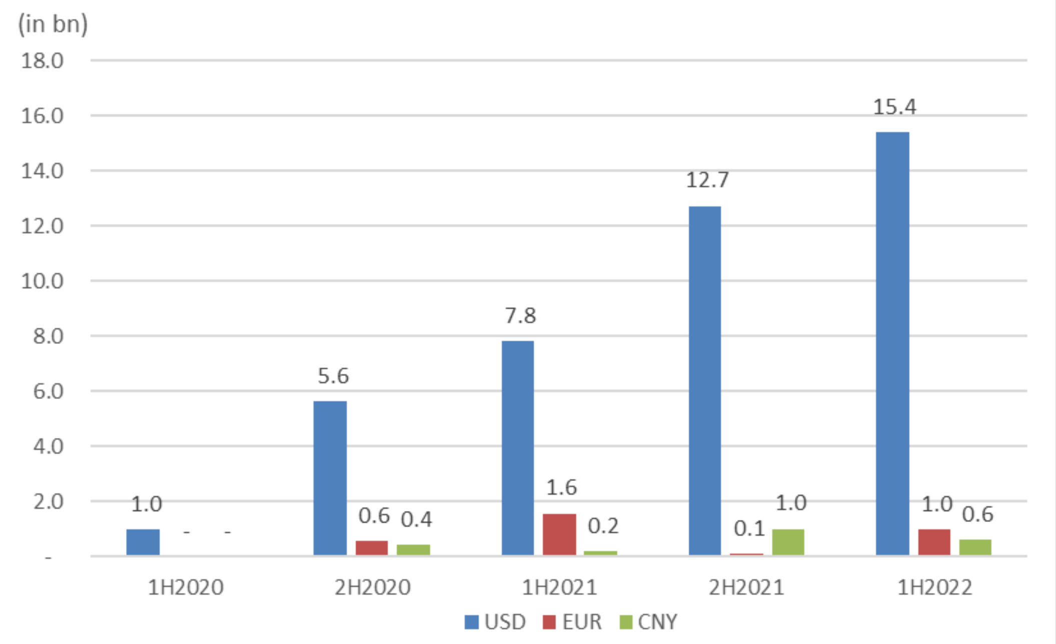
The China Banking and Insurance Regulatory Commission (CBIRC) expressed concerns on this incident and would strengthen coordination with housing and construction departments and the People's Bank of China (PBOC) to support local governments in guaranteeing the property project delivery. CBIRC also urges banks to provide sufficient financial liquidity to property developers wherever reasonable for their property project completions.

D. Green and Sustainable Bonds

The issuance of green and sustainable bonds continued to grow rapidly and played an increasingly important role in the offshore USD bond new issuances in 1H2022. The offshore USD green and sustainable issuance amount almost doubled year-on-year to USD15.4 billion with 38 issuances in 1H2022, compared with USD7.8 billion and 24 issuances in 1H2021 (EXHIBIT 11). Also, the contribution of offshore USD green and sustainable issuance to the total China offshore USD bond new issuance continued its rising trend to 24.1% in 1H2022, compared with 7.7% and 14.3% in 1H2021 and 2H2021, respectively (EXHIBIT 12).

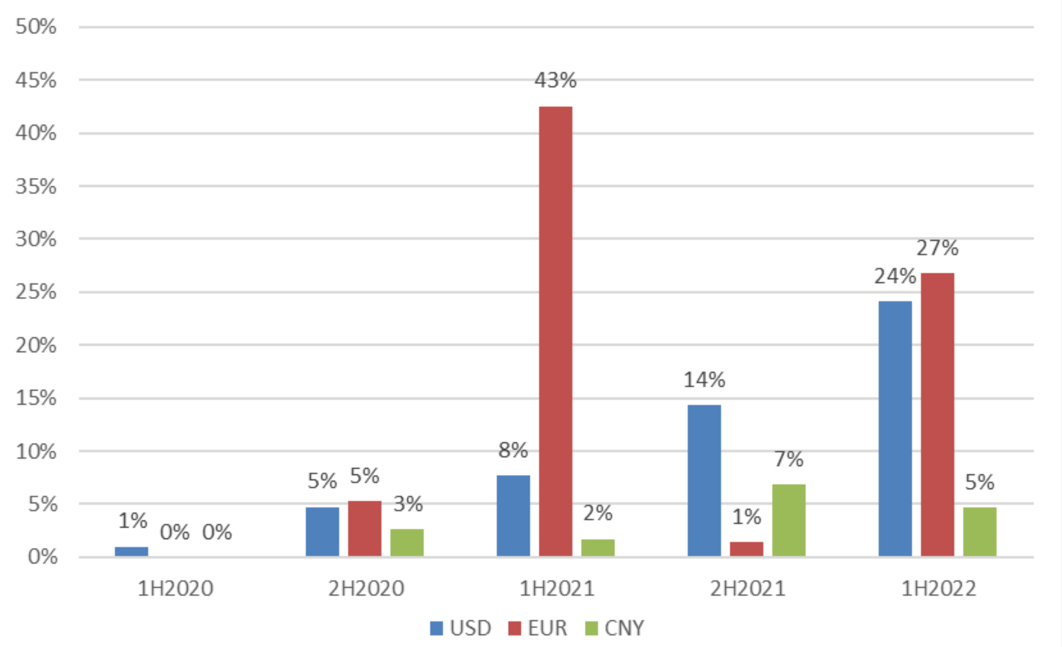
Green and sustainable bonds issued by financial institutions (which are predominantly banks) are still the main type of issuance in the offshore green bond market, accounting for c. 50% of the total issuance. Most of the offshore green and sustainable bonds are denominated in USD (c. 90% of the total issuance), followed by Euro and RMB.

Exhibit 11: Offshore Green and Sustainable Bond New Issuance Amount



Source: Bloomberg and Lianhe Global's calculation

Exhibit 12: Proportion of Green and Sustainable Bond New Issuance Amount to Total Offshore Bond New Issuance Amount



Source: Bloomberg and Lianhe Global's calculation

The HKSAR government continues its effort in promoting the development of green and sustainable bond markets in Hong Kong. The government launched the inaugural retail green bond with the issuance size of HKD20 billion, which was listed on the Stock Exchange of Hong Kong in May 2022. Also, the government has issued a cumulative amount of over USD7 billion equivalent of green bonds targeting global institutional investors at end-May 2022.

On the other hand, Hong Kong Quality Assurance Agency (HKQAA) continues to support the green and sustainable bond issuances in Hong Kong through the Green and Sustainable Finance Certification Scheme, which provides third-party conformity assessments for green bond and green loan issuers. Hong Kong Monetary Authority (HKMA) continues to support the market through the Green and Sustainable Finance Grant Scheme, which provides subsidy for eligible bond issuers and loan borrowers to cover their expenses on bond issuance and external review services.

Meanwhile, the Common Ground Taxonomy unveiled by International Platform on Sustainable Finance (IPSF), which was first published in 2021 and updated on 3 June 2022, will facilitate Chinese entities to issue offshore green bonds. Hong Kong will likely be one of the beneficiaries. Also, the Guangdong Society for Finance and Banking (GSFB) advocates the promotion of more Chinese enterprises to issue offshore green bonds in Hong Kong, in order to strengthen the cooperation and development of green finance in the Greater Bay Area.

E. Credit Outlook for 2H 2022

Credit Polarization to Intensify Between LGFVs

There will be a higher degree of divergence in credit profiles between local governments and specifically LGFVs located in the same region but at various administrative levels. Regions and provinces with high levels of implicit debt may face higher refinancing risks. Regions with lower economic development level and higher debt ratio will also continue to face the challenge of tightened liquidity.

At the same time, land transfer incomes have declined significantly in 2H2021 and 1H2022, resulting from the spill-over effect of the property sector. The budgetary revenue from land transfer of local governments had shrunk significantly as a result of the weakening of real estate sector and the cooling land market. The local government fund income was RMB2,607 billion in 1H2022, representing a decrease of 29.7% over the same period last year, of which the income from the transfer of state-owned land use rights was RMB2,362 billion, representing a year-on-year decrease of 31.4%. Regions with high proportion of government fund income (largely land sales) in their fiscal revenue, such as Guizhou, Hebei, will also continue to experience weakening credit profiles.

Business Nature and Sustainability are Keys to Positioning LGFVs for Government Support; Consolidation among LGFVs to Continue

Under the momentum of LGFV consolidation, larger-scale LGFVs have been integrating smaller-scale LGFVs to improve operating efficiency, control debt, financing costs and monitor non-standardized businesses. In addition, some regions have also utilized a newly set up LGFVs to house all the LGFVs in their respective regions.

From a financial perspective, attention should be paid to indicators such as the amount of account receivables from government related entities, cash collection rates from projects and sustainability or nature of an LGFV's business. Given the current economic and fiscal conditions in China, negative effects from high proportions of non-standard financings to total debt and the existence of maturity concentration are likely to hinder the willingness and ability to support these LGFVs, especially from regions with weaker credit profiles. Attentions should be paid to LGFVs in regions with high proportions of non-standard financing and frequent credit events such as Guizhou, Inner Mongolia Autonomous Region, Jilin, etc.

The outstanding balance of loan portfolio of local banks could indirectly demonstrate the availability of financial resources of a region, which is important for LGFVs to coup with liquidity stress should it occur.

Various Policies Towards LGFVs Unlikely to be Loosened Substantially in the Near Term; Minor Adjustments Expected

The onshore LGFV bond market was impacted by the categorization of regions into a "red, orange, yellow and green" scale according to the Ministry of Finance since 2021, which has played an important role in constraining the issuance of onshore LGFV bonds in regions with higher leverage and financing risk. Some LGFVs with weaker credit profiles or at relatively lower administrative levels, such as those at the district or county levels, turned to the offshore USD bond market to expand their financing channels.

In March 2022, the National Development and Reform Commission (NDRC) emphasized "Optimizing the classification management of enterprises' offshore debt and preventing financing risks in the offshore market continuously". In addition, the NDRC put out guidance on a list of criteria to be met in order for offshore USD bond quota to be granted, such as maximum (in terms of revenue) proportion of land development or construction on behalf of governments, net income to interest expense coverage ratio, etc. We believe that the policies towards LGFVs' offshore USD bond issuance will unlikely be loosened substantially in the near term.

Having said that, the State Council issued the circular known as "No. 20 Document" (国发〔2022〕20 号文) in May 2022, which further delineates more explicitly the financial management and responsibilities between various administrative levels. We believe, by doing that, LGFVs at the district or county levels would have more flexibility in mobilizing financial resources to some extent and could possibly help them reduce reliance on external financing in the medium to long term.

In addition, under the premise that the central government has been vigorously promoting infrastructure construction to boost economic development, local governments have accelerated the use and issuance of special purpose bonds quota, whereby the use of proceeds is mainly towards industrial park (health and new energy, etc.) and infrastructure constructions. Local governments altogether have been granted an aggregate quota of RMB3.65 trillion of special purpose bond issuance in 2022, which is roughly the same as 2021, of which, RMB1.45 trillion had already been allocated in advance at end-2021 to boost investment and stabilize the economy. The Ministry of Finance has also published guidance on a number of principles when allowing a slight change in the use of proceeds from special purpose bond issuance for local governments.

Challenge on Liquidity for Property Developers with Modest Contracted Sales Recovery

We believe that the liquidity crunch will remain the major risk to property developers in 2H2022. We believe the liquidity position of property developers will deteriorate if they are short of refinancing alternatives and keep relying on internal resources for debt repayments. Moreover, the contagion risk may cross over to large-scale and IG property developers if the fluctuation of bond prices continues to undermine their refinancing capabilities. It was reported in the media that the State Council considered to establish a real estate fund with the size of c. RMB300 billion. The fund aimed to provide financial support to a number of distressed property developers, including China Evergrande Group, in completing their property projects. We believe the central government may provide some policy loosening on the financing front for property developers and support their property project completions. Having said that, we expect property developers to still face repayment pressure in the near to medium term. We remain cautious on the near-term credit outlook for the Chinese property developer industry.

We believe the contracted sales outlook will be slightly better in 2H2022, compared with the near-term trough in 1H2022. Most of the provinces and cities have resumed normal life and economic activities since the beginning of 2H2022. Also, the supportive measures may start to have impact on contracted sales in 2H2022. Together with the low base given the weak contracted sales since 2H2021, we believe the year-on-year decrease in contracted sales will probably narrow in 2H2022. Nevertheless, we remain cautious on whether a meaningful recovery will happen in 2H2022, given the weak homebuyers' sentiment, possible slowdown on property developers' construction progress and limited life span of their land banks.

Limited Risk on Financial Institutions from Property Market and LGFVs At This Stage

At this stage, the adverse spillover effect from the real estate market downturn has not materially impacted the large-to-medium sized national banks. Based on publicly available information and recent bank announcements, the reported non-performing loans from the real estate sector are still relatively benign at below 1% and thus manageable. Recent policy announcement from the PBOC in mid-July encourages banks to lend to struggling property developers such that they could have sufficient new funds to restart and complete idled projects upholding the interest of homebuyers. We believe this will thwart the risk from spreading if implemented successfully. The PBOC had previously put various caps on Chinese banks in terms of their exposures to the real estate market, and thus we believe the overall risk is under control at this stage. Also, we believe it is a step in the right direction which could serve a stopgap to prevent further deterioration and contagion risk.

In addition, every province in China has at least one local AMC to tackle any potential contagion risk. Furthermore, the central government has introduced a series of supportive policies for the distressed asset management industry since 2016, including the permission for each provincial government to add one more local AMC (i.e., each province was allowed to have up to two local AMCs) and the permission for local AMCs to dispose distressed assets through debt restructuring and external transfer among other methods. By the end of 2021, there were a total of 59 local AMCs in China.

Separately, another risk for financial institutions is the burgeoning exposure to LGFVs. We notice that the use of SBLC has become prevalent by either first-time or small LGFV issuers. At this stage, we notice that most of the banks providing these SBLCs are limited to joint-stock and regional/local banks with small footprints. Chinese provincial governments have a high degree of control over their regional/local banks, and thus arguably provincial governments could potentially instruct their regional/local banks to extend timely credit and/or support to local LGFVs.

Continuous Efforts in Encouraging Offshore Green and Sustainable Bond Issuance

Following the successful green bond issuances in 2021 and 1H2022, we believe the HKSAR government will continue issuing green bonds regularly under the Government Green Bond Programme (GGBP), with the borrowing ceiling of HKD200 billion within the next five financial years from the 2021-22 financial year.

The Stock Exchange of Hong Kong remains the most popular listing place for offshore USD green and sustainable bond issuances. Besides, more green debt instruments and transition finance products are being developed in Hong Kong, such as sustainability-linked bonds, transition bonds, etc. We believe this would further consolidate and strengthen Hong Kong's role as the major international market for offshore green and sustainable bond issuance by Chinese issuers.

PBOC Encourages Chinese Issuers to Issue Offshore Bonds with a Chinese International Rating Agency

The Business Administration Department of PBOC has recently published "Action Plan for Promoting the High-quality Development of Beijing's Credit Information System" ("the Action

Plan”). The Action Plan encourages issuers to choose two or more rating agencies for credit ratings, to achieve dual- or multi-rating in order to prevent information asymmetry. The Action Plan also encourage LGFVs, financial institutions and corporate bond issuers to use the rating services of Chinese rating agencies when issuing offshore bonds. Furthermore, the Action Plan encourage issuers to use at least one Chinese rating agency in the Chinese USD bond market, in order to raise the influence of Chinese rating agencies in the international capital markets.”

We believe the Action Plan proposes some specific measures which are conducive to Chinese rating agencies in expanding rating business overseas, accumulating international rating business experience, and building their competitiveness and reputation in the international markets. We also believe overseas expansion of Chinese rating agencies can help reveal the credit risks of Chinese corporates more accurately, provide more credit information to the market, help foreign investors to better allocate their assets portfolio, and is conducive to the safety and stability of the offshore debt financing channels for Chinese enterprises.

Appendix

List of Lianhe Global's Publicly Rated LGFVs

Issuer Name	Province/City	Issuer Rating /Outlook
Chengdu Airport Xingcheng Investment Group Co., Ltd.	Chengdu	BBB/Positive
Chengdu Dujiangyan Investment Development Group Co., Ltd	Chengdu	BBB-/Stable
Chengdu Wenjiang Xingrongxi City Operation Group Co., Ltd.	Chengdu	BBB-/Stable
Dalian Deta Holding Co., Ltd.	Dalian	BBB+/Stable
Fujian Zhanglong Group Co., Ltd.	Zhangzhou	BBB+/Stable
Huai'an Traffic Holding Company Limited	Huai'an	BBB/Stable
Liangshan Development (Holdings) Group Co., Ltd	Liangshan	BBB-/Stable
Qingdao City Construction Investment (Group) Limited	Qingdao	A/Stable
Shaoxing City Investment Group Limited	Shaoxing	A-/Stable
Shuifa Group Co., Ltd.	Shandong	A/Stable
Taizhou Hailing City Development Group Co., Ltd.	Taizhou	BBB-/Stable
Taizhou Huaxin Pharmaceutical Investment Co., Ltd.	Taizhou	BBB-/Stable
Tianjin Binhai New Area Construction and Investment Group Co., Ltd.	Tianjin	A-/Stable
Wuxi Construction and Development Investment Corporation Limited	Wuxi	A/Stable
Yancheng High-tech Zone Investment Group Corporation Limited	Yancheng	BBB-/Positive
Yancheng Oriental Investment & Development Group Co., Ltd.	Yancheng	BB+/Stable
Yangzhou Economic and Technological Development Zone Development (Group) Co., Ltd	Yangzhou	BBB+/Stable
Zhengzhou Urban Construction Investment Group Co., Ltd.	Zhengzhou	A-/Stable
Zhongyuan Asset Management Co., Ltd.	Henan	A-/Stable
Source: Lianhe Global		

List of Lianhe Global's Publicly Rated Chinese Property Developers

Issuer Name	Long-term Issuer Credit Rating	Outlook
CIFI Holdings (Group) Co. Ltd.	BBB-	Stable
Dexin China Holdings Company Limited	BB-	Stable
Huijing Holdings Company Limited	B+	RWN
Jinke Property Group Co., Ltd.	CCC-	Negative
LVGEM (China) Real Estate Investment Company Limited	BB-	Stable
Source: Lianhe Global		

List of Lianhe Global's Publicly Rated Corporates and Non-Banking Financial Institution (NBFI)

Issuer Name	Long-term Issuer Credit Rating	Outlook
China Hongqiao Group Limited	BB+	Positive
Jiangsu Shagang Group	BBB+	Positive
Lionbridge Capital Co., Ltd.	BB+	Stable
Pujiang International Group Limited	BB-	Negative
Source: Lianhe Global		

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