

China Offshore Bond Market 1H2022 Review and 2H2022 Outlook: Embracing the Paradigm Shift

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.

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