

China Offshore Bond Market 2023 Mid-Year Update: Seeking Financing Alternatives and Policy Support as a Way Out

Summary

The China offshore USD bond new issuance declined to USD25.3 billion in 1H2023, representing a year-on-year decrease of 59.2%, mainly due to the USD interest rate hikes, more volatile exchange rate and the exit of weaker issuers. On the contrary, the China offshore RMB bond new issuance showed remarkable growth both in issuance amount and number of issues in 1H2023, mainly supported by the boom in Free Trade Zone (“FTZ”) bonds issuance.

The new issuance of China local investment and development company (“LIDC”) offshore USD bonds amounted to USD3.1 billion in 1H2023, decreased by 80.2% compared to that of 1H2022. In spite of strong refinancing needs, LIDCs slowed down their offshore USD bonds issuance given increasingly tightened regulations conveyed from the central government. Also, many LIDC issuers turned to the FTZ bond market, given the fading interest rate advantage and lower exchange rate risk compared with offshore USD bonds.

We anticipate that the refinancing needs will continue to support the LIDC offshore issuance, especially given the peak of bond maturing in 2024-2025. Some LIDCs may continue to turn their focus on the offshore RMB bond market. Having said that, we are concerned that the decline in land transfer income will widen the fiscal deficits for some local governments and expect the credit profiles of local governments and LIDCs to be increasingly diverse in the next 12 months. Indeed, a series of credit events led to the growing worries about potential defaults in the LIDC bond market.

The FTZ bond market expanded rapidly, as the issuance amount of FTZ bonds increased substantially to USD12.3 billion in 1H2023 from USD0.5 billion in 1H2022. As mentioned, many LIDC issuers turned to FTZ bonds as a substitute for other financing vehicles. LIDC issuers contributed 61% and 46% of the total FTZ bond new issuances in 2022 and 1H2023, respectively. The financial and real estate FTZ bond issuances also contributed to the growth. While the development of the FTZ bond market continues, the tightening regulations on issuance, particularly requiring issuers to have business operations in FTZ, may slow down the growth of new issuance.

The new issuance of offshore USD bonds by Chinese property developers further declined by 32% year-on-year to USD5.6 billion in 1H2023. Most of the real estate offshore USD bond new issuances were issued under exchange offers. Market sentiment remained weak towards the real estate industry, as the contracted sales rebound remained slow and some property developers with relatively strong fundamentals were also exposed to liquidity risk and earnings pressure. In view of the enhanced policy support, contracted sales may experience a recovery. Nevertheless, property developers still need to actively search for ways to solve their long-term capital pressure.

Review of the China Offshore Bond Market

The USD Bond New Issuance Amount Declined Further, while the RMB Bond New Issuance Amount Increased Considerably

The China offshore USD bond new issuance declined to USD25.3 billion in 1H2023, representing a year-on-year decrease of 59.2% (EXHIBIT 1), although the number of new issues increased to 1,218 in 1H2023, from 451 new issues in 1H2022 (EXHIBIT 2). On the contrary, the China offshore RMB bond new issuance showed remarkable growth both in issuance amount and number of issues in 1H2023, mainly supported by the boom in FTZ bonds issuance. The new issuance amount of China offshore RMB bonds climbed to USD12.3 billion in 1H2023, which exceeded the full-year issuance amount in previous years and hit a record high. The number of China offshore RMB bond new issuance was 216 in 1H2023, more than triple the number of 1H2022.

As the Fed had raised interest rates to the highest level since 2006, the financing cost of offshore USD bonds increased substantially compared with previous years, which inhibited some issuers' willingness to issue USD bonds. Meanwhile, the USD appreciation not only induced more exchange rate risk, but also led to a higher cost to service the USD-denominated debts for Chinese issuers. With tightened regulations in the offshore USD bond new issuance, the development of the FTZ bond market attracted a large number of LIDCs to issue offshore RMB bonds in 1H2023, which also reduced the offshore USD bond new issuance. Moreover, the continued defaults in the offshore bond market dampened investors' confidence, and more issuers with weaker credit profiles exited from the market, although the amount of Chinese offshore bond defaults showed a downward trend in 1H2023 (EXHIBIT 3). The amount of Chinese offshore bond defaults totaled USD12.4 billion in 1H2023, compared with USD48.1 billion in 2022.

Exhibit 1: Total Amount of China Offshore Bond New Issuance

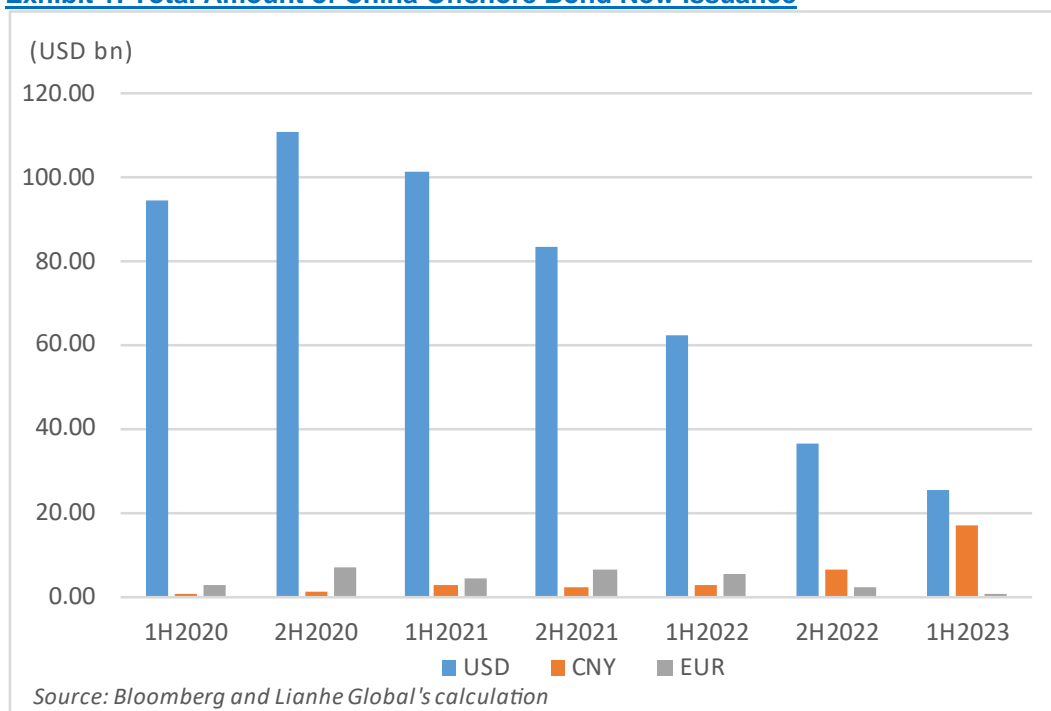


Exhibit 2: Number of China Offshore Bond New Issuance

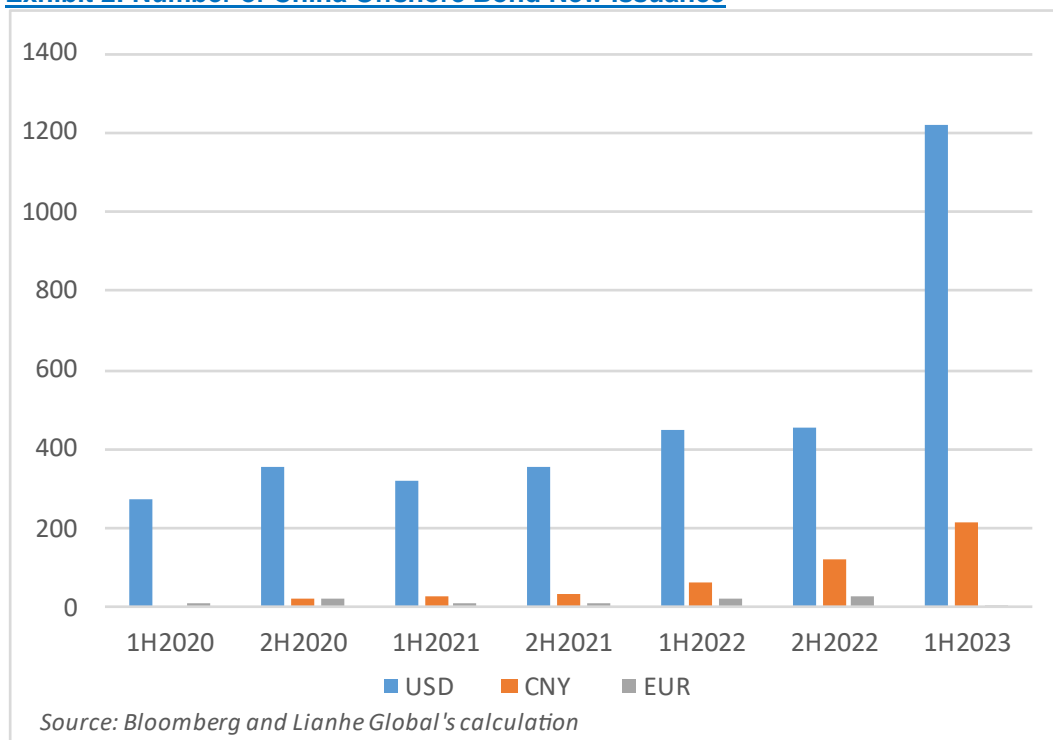
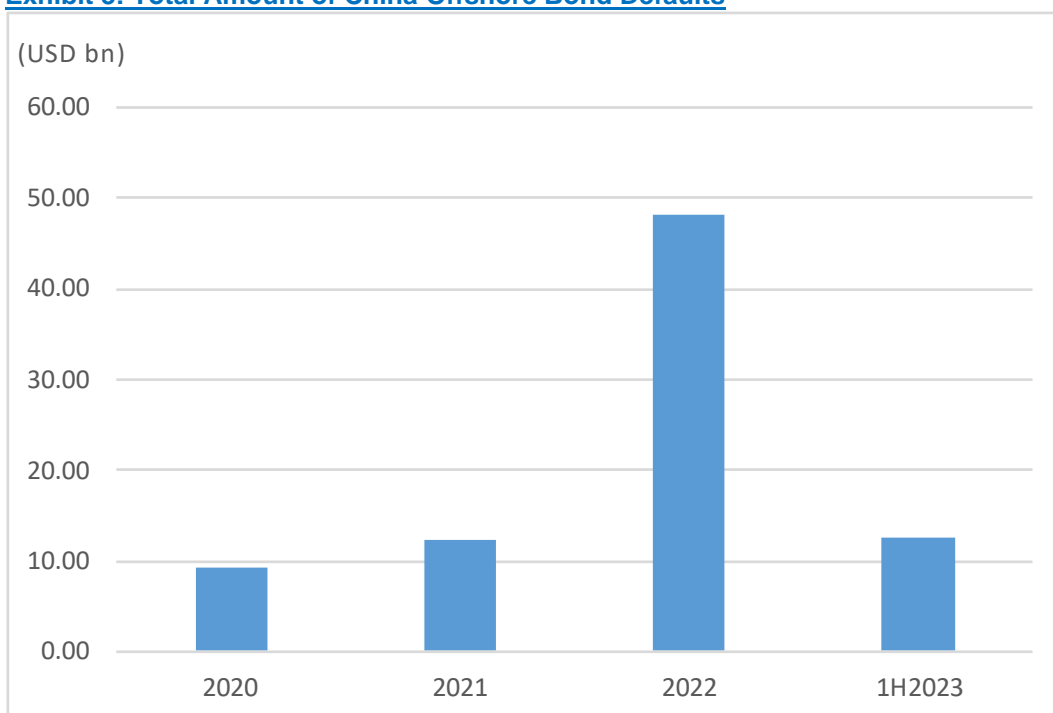


Exhibit 3: Total Amount of China Offshore Bond Defaults



Short Tenor Still Dominated, Upcoming Maturity Peak in 2024-2025

The short tenor issuance (1-5 years) still dominated with 71% of the total offshore USD bond new issuance in 1H2023 (EXHIBIT 4). The short-term bonds with a maturity of less than 1 year accounted for 16.8% of the total offshore USD bond new issuance in 1H2023, and bonds with a maturity of 1-3 years and of 3-5 years contributed 11.7% and 42.6%, respectively.

The total outstanding amount of offshore USD bonds was USD655.6 billion (EXHIBIT 5) at end-June 2023, of which 44.7% (around USD292.8 billion) will mature in 2024-2025. Separately, USD57.5 billion of offshore USD bonds will mature in 2H2023, which was equivalent to 227.0% of the new issuance amount in 1H2023. There is a peak for debt servicing in September and October 2023.

Exhibit 4: Tenor Distribution of China Offshore USD Bond New Issuance in 1H2023

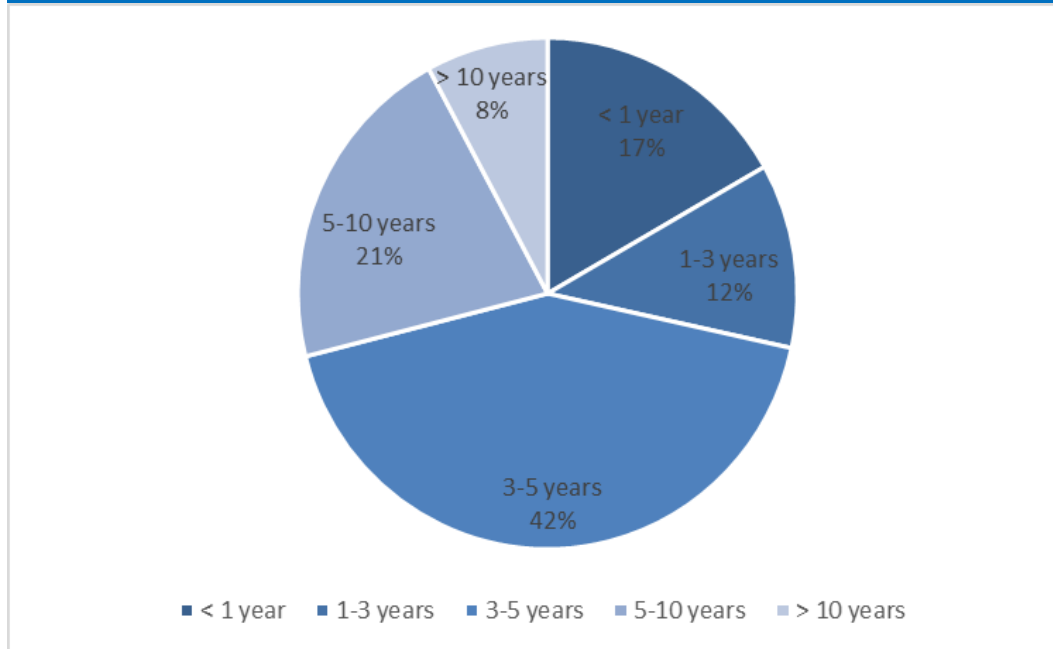
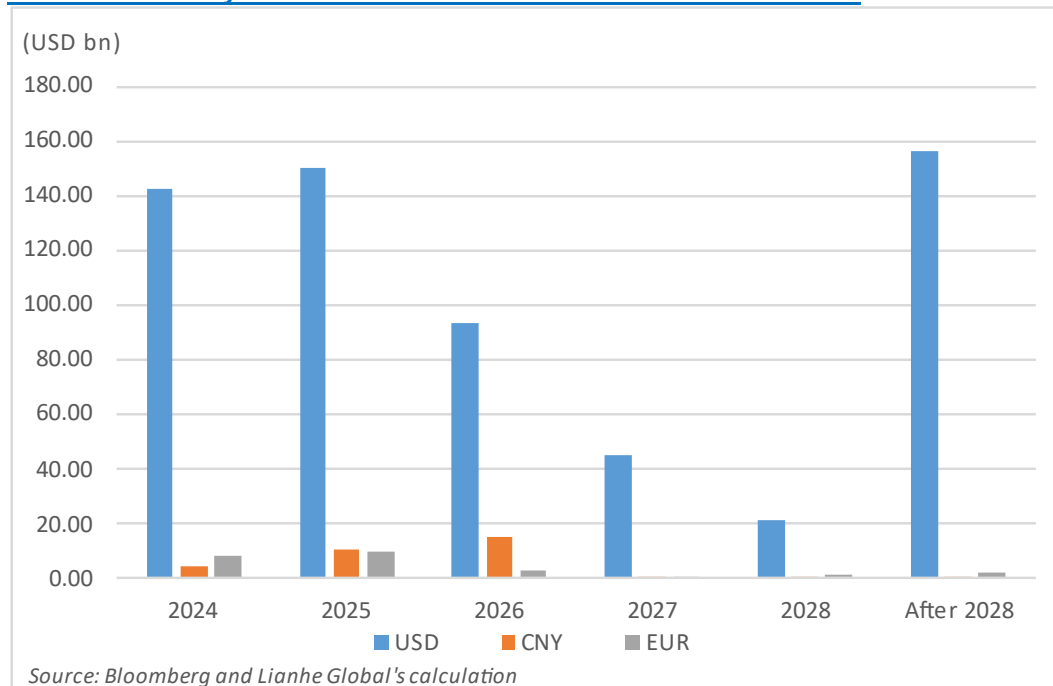


Exhibit 5: Maturity Profile of China Offshore Bond at end-June 2023



Review of LIDC Offshore USD Bond Issuance

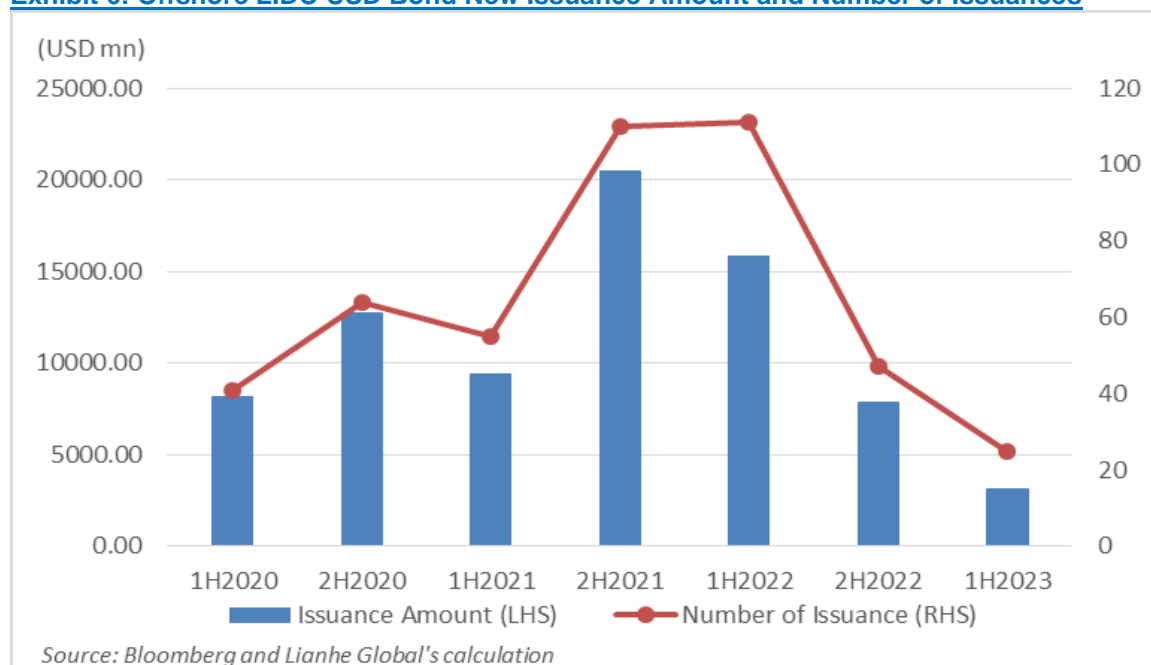
New Issuance Fell Sharply, Tightened Regulatory Policies Continued

The new issuance of China LIDC offshore USD bonds amounted to USD3.1 billion in 1H2023, decreased by 80.2% compared with 1H2022 (EXHIBIT 6). Particularly, the monthly new issuance was below USD1 billion in each of the first five months in 2023, due to the rising USD interest rates, continued signals from the central government indicating to strengthen local governments' debt regulation and the emergence of the FTZ bond market. Nevertheless, the issuance amount in June rebounded to a record high since the beginning of 2023.

In spite of strong refinancing needs, LIDCs slowed down their offshore USD bonds issuance in 1H2023 given increasingly tightened regulations conveyed from the central government. Some LIDCs strived to find other financing channels to fulfil their financing needs, such as the FTZ bond market. Moreover, the fading interest rate advantage compared to the onshore market also prevented some LIDCs with weaker credit profiles from issuing new offshore USD bonds.

In addition to the deteriorating macro environment, the increasingly cautious sentiments on LIDCs also shook investors' confidence in LIDCs' capacities for repayment. As the non-standard financing instrument defaults increased greatly since the beginning of 2023, more concerns were focused on potential bond defaults by LIDCs. To comply with the debt management requirements of the central government and resolve debt problems, LIDCs became more cautious about issuing new offshore USD bonds. All these factors led to the plummet of LIDCs' offshore USD bond issuance in 1H2023.

Exhibit 6: Offshore LIDC USD Bond New Issuance Amount and Number of Issuances



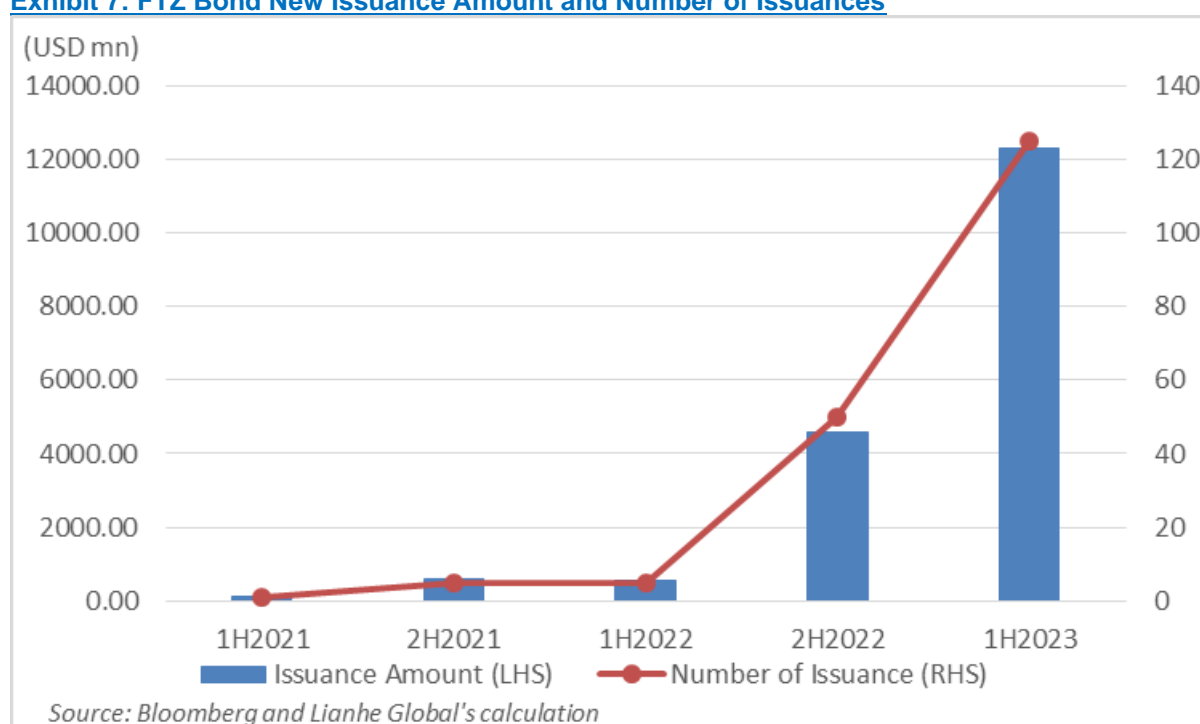
Review of FTZ Bond Issuance

LIDCs' Contribution Led to Historical High New Issuance

The FTZ bonds are bonds issued to global institutional investors who have opened Free Trade Accounts in the Shanghai Free Trade Zone. The issuers can be domestic, FTZ and overseas financial institutions or enterprises. There is no limitation for the currency of bond issuance. In short, FTZ bonds can be regarded as “the offshore bonds issued in the onshore market”.

The FTZ bonds commenced their debut issuance in 2016, followed by a few issuances in the following years. The issuance amount climbed to USD12.3 billion in 1H2023 (EXHIBIT 7), which increased substantially from USD0.5 billion in the same period of 2022 and hit a record high.

Exhibit 7: FTZ Bond New Issuance Amount and Number of Issuances



Review of Real Estate Bond Issuance

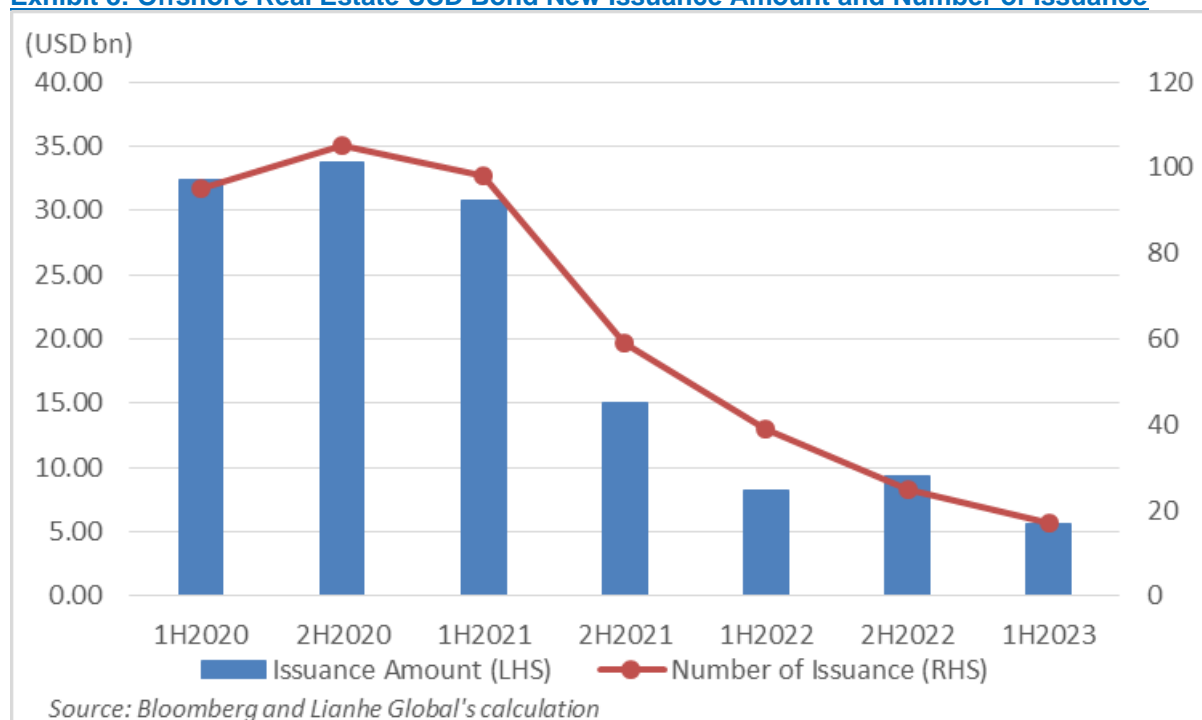
Continued Defaults and Weak Market Confidence Led to a Plummet in Offshore USD Bond New Issuance

The amount of offshore USD bonds issued by Chinese property developers further declined to USD5.6 billion in 1H2023 (EXHIBIT 8), representing a year-on-year decrease of 32.0%. There were 17 new issuances in total in 1H2023, which fell from 25 new issuances in 1H2022. Having said that, the proportion of real estate offshore USD bonds to total offshore USD bond issuance was 22.1% in 1H2023, compared with 13.3% in 1H2022.

As more Chinese property developers failed to meet their obligations in the offshore bond market in 1H2023, it became tougher for real estate issuers to raise funds through issuing offshore USD bonds. Most of the real estate offshore USD bond new issuances were issued under exchange offers.

The real estate offshore USD bonds are losing ground in the offshore bond market, due to more cautiousness of investors on real estate issuers, lower affordability of higher financing costs for most of the property developers, etc. Though the authorities have released many supportive policies and favourable conditions to boost the recovery of the real estate market since late 2022, the ongoing defaults of Chinese property developers and stagnant sentiment of the real estate industry led to weak confidence in the real estate industry. In particular, there were signs that some property developers with relatively strong fundamentals were also exposed to liquidity risk and earnings pressure.

Exhibit 8: Offshore Real Estate USD Bond New Issuance Amount and Number of Issuance



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