聯合評級國際 Lianhe Ratings Global

Non-Rating Commentary
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China Offshore Bond Market 2024 Outlook: Probable Recovery of New Issuance amid Supportive Policies and Strong Refinancing Needs

Summary

The China offshore USD bond new issuance met a plummet in 2023, with the issuance amount falling to USD62.3 billion from USD102.5 billion in 2022, representing a year-on-year decrease of 39.2%. This was mainly due to the interest rate hikes, more tightened regulation on mid- and long-term offshore bond issuance, and lower investor confidence due to sustained credit events in the offshore bond market. On the contrary, the China offshore RMB bond new issuance achieved considerable growth in 2023, and the issuance amount hit a record high of USD40.8 billion.

The new issuance of China local investment and development company ("LIDC") offshore USD bonds declined to USD11.6 billion in 2023, downed by 67.9% compared to that of 2022. The new and more restrictive regulations on corporate's mid- and long-term offshore bond issuance released by the National Development and Reform Commission ("NDRC"), central government's insistence on curbing local governments' implicit debts and the rising offshore financing cost led to a slump of the LIDC offshore USD bonds issuance.

Unlike the LIDC, the new issuance of offshore USD bonds by Chinese property developers increased to USD17.9 billion in 2023, up by 16.4% from that in 2022 (USD15.4 billion), as many property developers successfully exchanged their bonds for longer maturities and some debt restructuring plans of defaulted property developers with a large amount of debts went into effect. The market sentiment on the real estate industry remained weak, as some top private enterprises defaulted and the contracted sales remained stagnant.

Both the Free Trade Zone ("FTZ") bonds and dim sum bonds issuance amount rose sharply in 2023, as the tightened financing conditions and policies constrained most of the LIDCs, especially those with weaker credit profiles, to raise funds in the offshore USD bond market. As an alternative financing channel for some LIDCs, the issuance amount of FTZ bonds surged to USD12.3 billion in 2023, more than doubled compared with 2022 (USD5.1 billion). The issuance amount of dim sum bonds also surged to USD28.5 billion in 2023 from USD9.1 billion in 2022, following the tightened requirements on the FTZ bond issuance were introduced in mid-2023.

We anticipate the new issuance of China offshore USD bond market will bounce back in 2024, as the approaching rate cut by the Federal Reserve ("Fed") may ease the financing conditions of offshore USD bond issuance. With around USD140 billion of offshore USD bonds maturing in 2024, the strong refinancing needs will also play an important role in boosting the new issuance. Moreover, the Chinese government is expected to introduce more supportive policies for the recovery of the real estate industry and debt settlement of the LIDCs. These may help to revive the market confidence, which can also be conducive to the new offshore USD bond issuance.

A) China Offshore Bond Market: Review in 2023

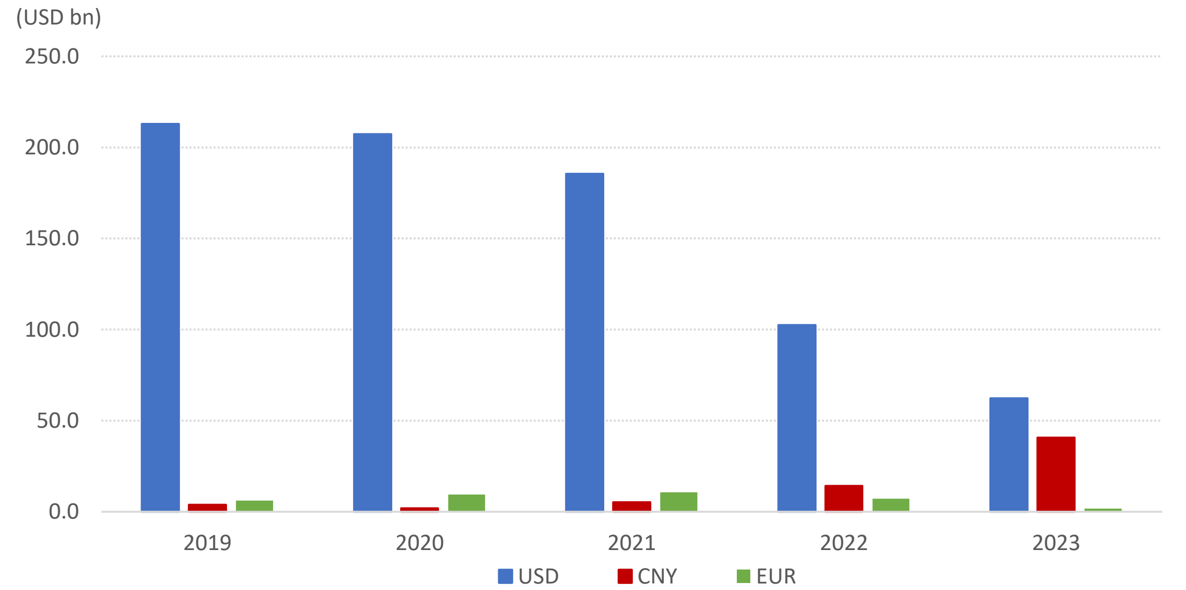
The USD Bonds New Issuance Amount Declined to a 10-year Low, while the RMB Bond Issuance Amount Surged to a Record High

The China offshore USD bond new issuance slumped to USD62.3 billion in 2023 from USD102.5 billion in 2022, representing a year-on-year decrease of 39.2% (EXHIBIT 1). In contrast, the new issuance of China offshore RMB bonds hit a record high in 2023, bolstered by the growth of both the FTZ bond and the dim sum bond issuance. The issuance amount totaled USD40.8 billion in 2023, nearly tripled compared with that in 2022 (USD14.2 billion) and hitting a record high.

As the Fed continued interest rate hike in 2023, it became more expensive for Chinese issuers to finance through the USD bonds, and the higher financing cost induced by USD appreciation restrained many entities from issuing new offshore USD bonds. Additionally, the new regulation on mid- and long-term offshore bond issuance that went into force in February 2023 and the banking crisis in March 2023 also dampened the offshore USD bond issuance. Constrained by the tightened financing conditions of offshore USD bonds, the issuers turned to the FTZ bond market and dim sum bond market to satisfy their financing needs, especially those with limited access to finance and desperately needed offshore capital to roll over their debts.

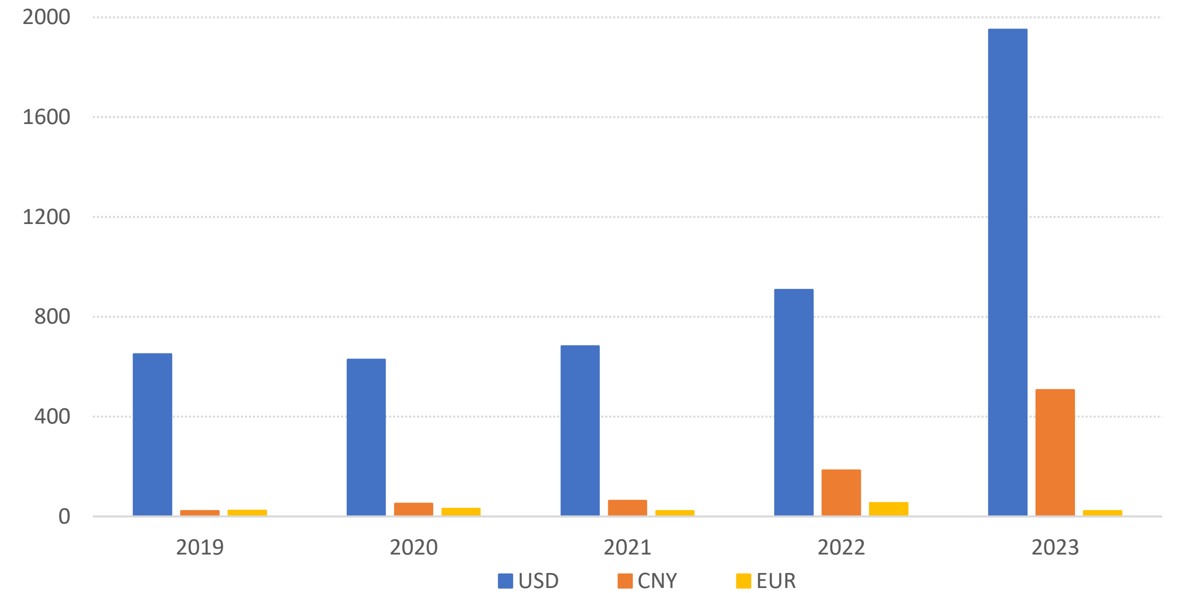
The defaulted offshore USD bonds fell to USD29.6 billion in 2023 (EXHIBIT 3), downed by 39.0% from USD48.5 billion in 2022, but still at a high level. Some Chinese property developers with large amount of maturing debts failed to meet their obligations. Although the defaults showed a downward trend, the market confidence was still at a trough. The sustained defaults of Chinese property developers in the offshore USD bond market and the slow recovery of the real estate industry depressed investors' expectations on the industry's performance. Also, the defaults of some top private real estate enterprises added to the woes.

Exhibit 1: Total Amount of China Offshore Bond New Issuance



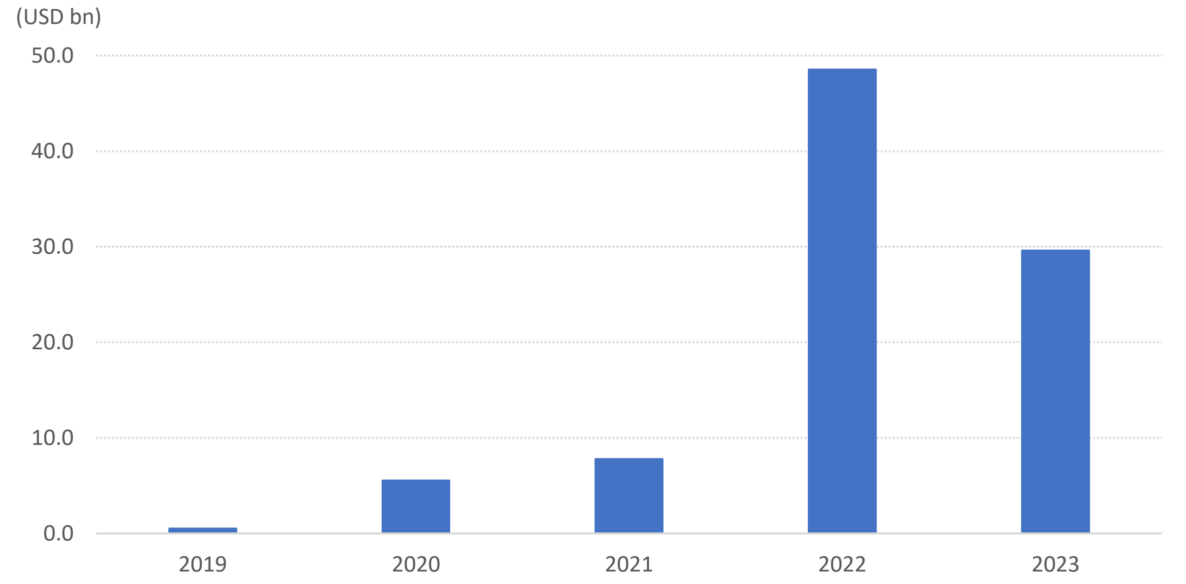
Source: Bloomberg and Lianhe Global's calculation

Exhibit 2: Number of China Offshore Bond New Issuance



Source: Bloomberg and Lianhe Global's calculation

Exhibit 3: Total Amount of China Offshore Bond Defaults



Source: Bloomberg and Lianhe Global's calculation

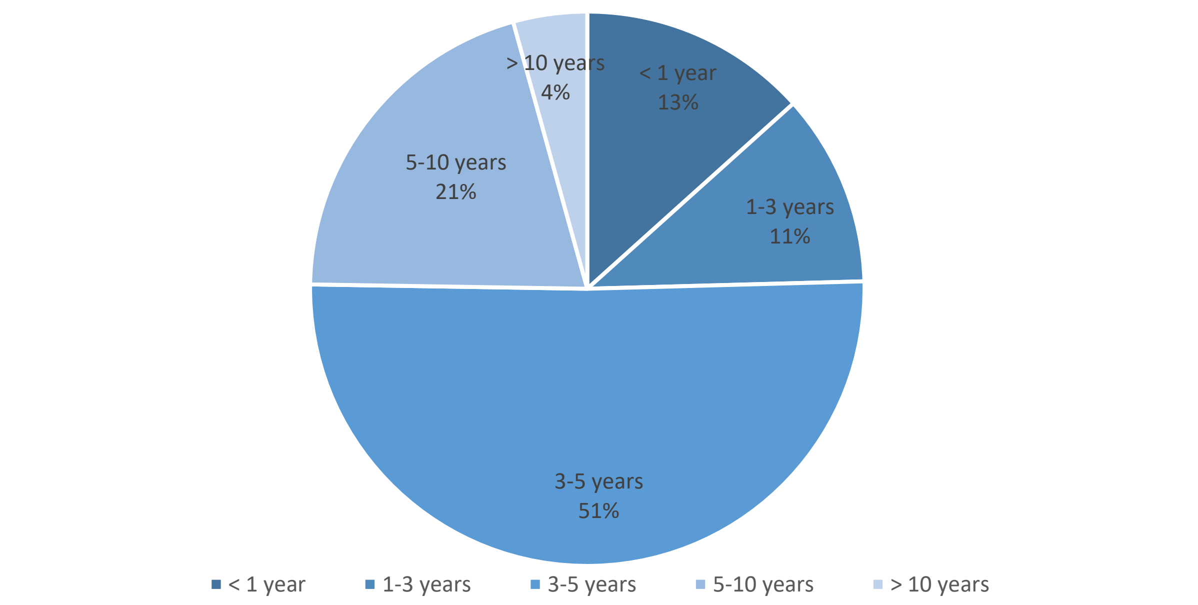
Short Tenor Still Dominated, Maturity Peak in 2024-2025

The short tenor issuance (1-5 years) remained dominant in 2023 (EXHIBIT 4), with more than 75% of total offshore USD bond new issuance having a maturity of less than 5 years. The short-term bonds with a maturity of less than 1 year accounted for 13.3% of the total offshore USD bonds new issuance in 2023, bonds with a maturity of 1-3 years made up 11.2% of the new issuance, and the proportion of bonds with a maturity of 3-5 years was 50.7% over the same period.

At end-2023, the total outstanding amount of offshore USD bonds reached USD788.0 billion (EXHIBIT 5), of which 17.8% (USD140.0 billion) and 18.8% (USD148.1 billion) will mature in

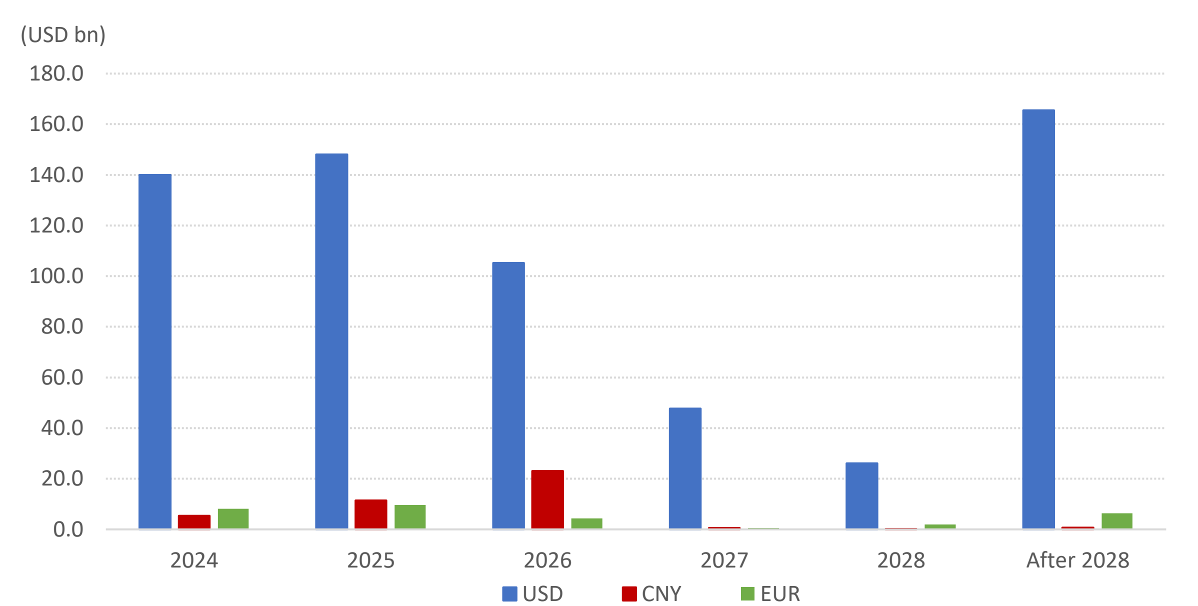
2024 and 2025, respectively. Specifically, the maturing amounts of offshore USD debts in each quarter of 2024 are rather evenly distributed. There will be a peak of debt repayment in the second quarter of 2024 (USD41.8 billion).

Exhibit 4: Tenor Distribution of China Offshore USD Bond New Issuance in 2023



Source: Bloomberg and Lianhe Global's calculation

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



Source: Bloomberg and Lianhe Global's calculation

B) LIDC

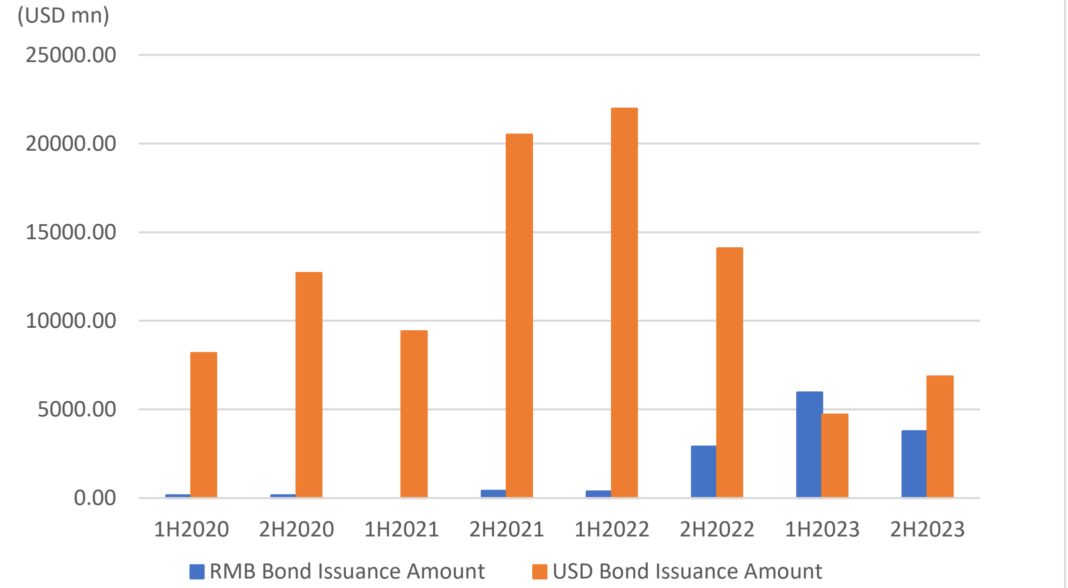
Review of LIDC Bond Issuance in 2023

New USD Bond Issuance Fell Sharply in 2023, while New RMB Bond Issuance Surged

The new issuance of China LIDC offshore USD bonds amounted to USD11.6 billion in 2023, decreased by 67.9% compared to that in 2022 (EXHIBIT 6). Particularly, amid rising USD rates and continued signals from the central government indicating to strengthen local governments' debt regulation, LIDCs slowed down their offshore USD bond issuance in 1H2023 in spite of their strong refinancing needs. Moreover, the fading interest rate advantage compared to the onshore market also prevented some LIDCs with weaker credit profiles from new offshore USD bond issuance. As the USD interest rate almost reached the peak and a package of debt relief measures to resolve local government debt risk was rolled out by the central government, the new USD bond issuance of LIDCs rebounded in 2H2023. Having said that, the amount was still below the average level of the past three years.

On the other hand, some LIDCs tried to find other channels to satisfy their financing needs, such as the FTZ bond market and dim sum bond market. The new issuance of China LIDC offshore RMB bonds amounted to USD9.7 billion in 2023, almost tripled compared to that in 2022. Particularly, the new issuance hit a record high in 1H2023 as a large amount of FTZ bonds were issued by LIDCs. The market focus turned to dim sum bond market in 2H2023 after the regulations on FTZ bond issuance were tightened in mid-2023.

Exhibit 6: Offshore LIDC USD and RMB Bond New Issuance Amount



Source: Bloomberg and Lianhe Global's calculation

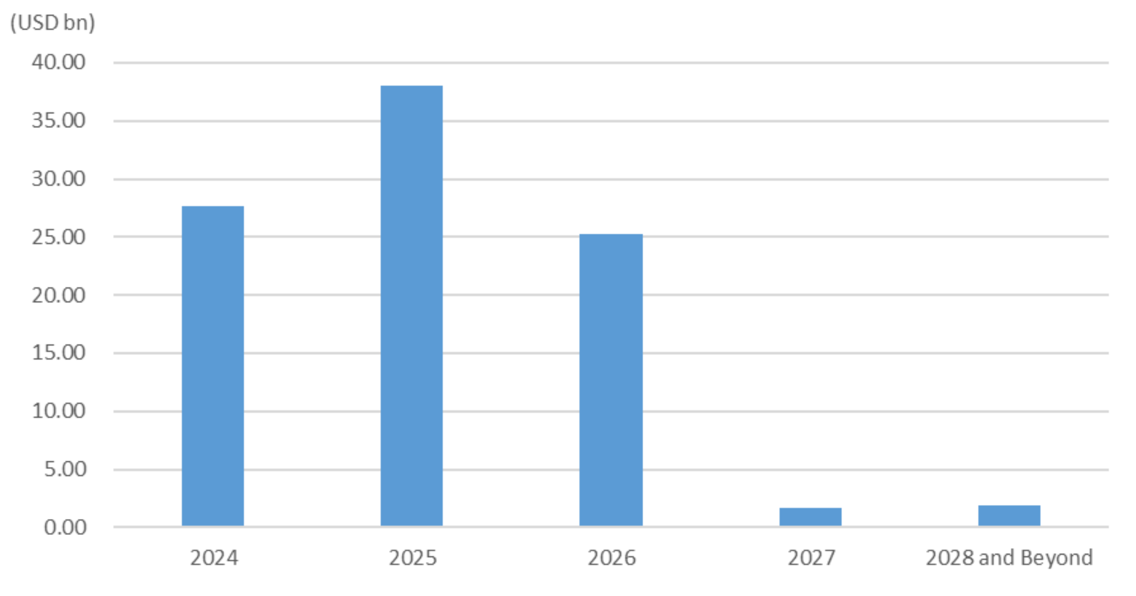
Outlook of LIDC Bond Issuance in 2024

Refinancing Need Continues to Encourage LIDCs Issuance in 2024 and Beyond

We anticipate that the refinancing needs will continue to support the LIDCs offshore issuance in 2024. Around USD27.6 billion of LIDC offshore bonds will mature in 2024, and the debts maturing in 2025 are also high at USD38.0 billion (EXHIBIT 7). The forthcoming debt servicing peak requires a large amount of funds for LIDCs to fulfil their obligations of repayment, thus we expect there will be incremental issuance in LIDC offshore bond market under strong refinancing needs.

Additionally, the Fed is widely expected to commence the interest rate cut cycle in 2024, although the cuts might be slow and gradual. The offshore financing cost is likely to be lowered under this backdrop, which will be conducive to LIDC offshore bond issuance.

Exhibit 7: Maturity Profile of China LIDC Offshore Bonds at end-2023



Source: Bloomberg and Lianhe Global's calculation

C) Real Estate

Review of Real Estate Bond Issuance in 2023

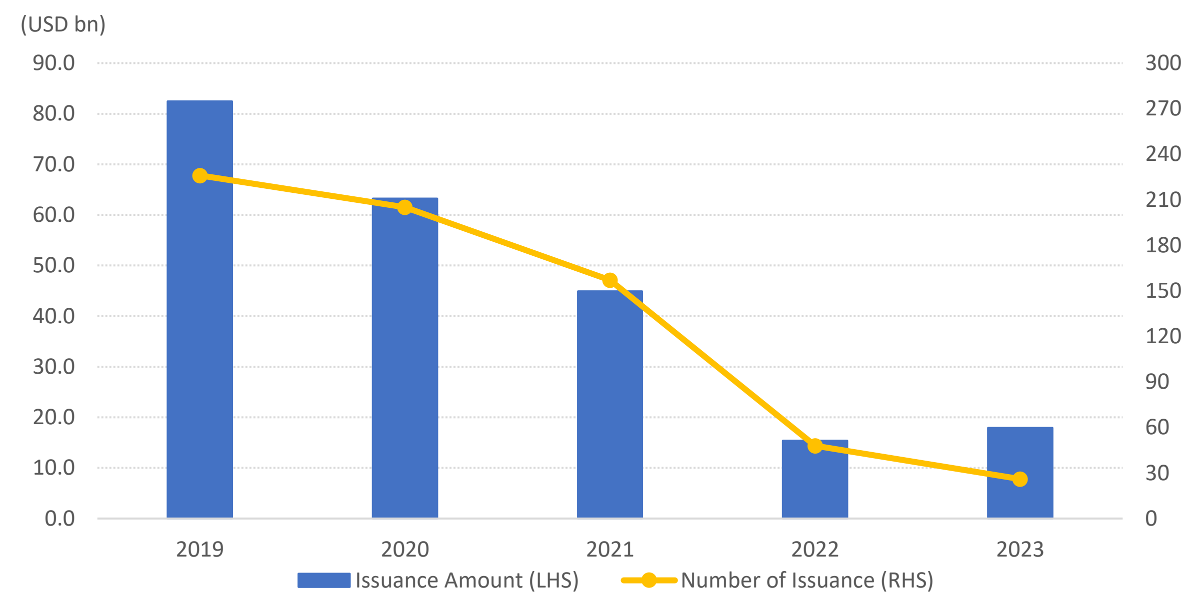
New Issuance in 2023 Dominated by Bonds Issued Under Exchange Offers and Debt Restructuring Plans

Unlike the LIDCs, the new issuance of offshore USD bonds issued by Chinese property developers rallied in 2023, with the issuance amount increasing to USD17.9 billion (EXHIBIT 8), up by 16.4% compared to that in 2022. Moreover, the real estate offshore USD bond issuance accounted for 28.7% of the total issuance in 2023, up by 13.7 percentage points compared with that in 2022.

Following the supportive policies introduced in late 2022, the central and local governments continued to launch policies to stabilize market confidence and boost the development of the real estate industry. The People's Bank of China ("PBOC") and the National Financial Regulatory Administration ("NFRA") lengthened policies aimed at property developers' financing operations, lowered the down payment requirements of housing mortgage loans and imposed mandatory conditions on banks' real estate loan growth to facilitate property developers' funding. As for local governments, all high-tier cities loosened policies on property purchases to stimulate demand from homebuyers and boost the contracted sales, especially in Beijing and Shanghai, which had strict restrictions on property purchases previously. In December 2023, Beijing and Shanghai further optimized mortgage loan requirements, which aimed at attracting more first-time homebuyers. In terms of the financing conditions, PBOC maintained a loosening monetary policy stance, lowering lending rates and the reserve requirement ratio twice to promote financing activities.

Despite intensive support from the governments and regulatory institutions, credit risk of Chinese property developers was further exposed in 2023, which spread to some top private enterprises. In order to have more time to service debts and avoid defaults, many private property developers with large amounts of maturing offshore USD bonds offered debt exchanges and gained their creditors' consent, which boosted the issuance amount. Meanwhile, the successful debt restructuring of large-scale property developers' defaulted debts (about USD9 billion) also partially explained the increase in new issuance.

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



Source: Bloomberg and Lianhe Global's calculation

Outlook of Real Estate Bond Issuance in 2024

More Favorable Policies are Expected to Boost the Recovery of the Real Estate Industry, New Issuance may still Backed by Exchange Offers and Bond Restructuring Plans

In early January 2024, PBOC's published report indicated that it had recommenced the pledged supplementary lending (PSL) program in December 2023, which amounted to RMB350.0 billion. The PSL will mainly be spent on government-subsidized housing, public infrastructure construction and urban village renovation. By using PSL, the financial situation of crash-trapped property developers may be alleviated, and the delivery of projects under construction will be better guaranteed. Overall, we expect more supportive policies will be introduced in 2024.

However, as the financing channels for real estate companies remain constrained and the market sentiment remained weak, the financing and refinancing activities for property developers through offshore USD bonds are still challenging. We expect the majority of new issuance of real estate offshore USD bonds in 2024 may still be dominated by the bonds issued under exchange offers and debt restructuring plans.

D) Free Trade Zone Bonds ("FTZ Bonds") and Dim Sum Bonds

Review of FTZ Bond and Dim Sum Bond Issuance in 2023

LIDCs' Funding Activities Led the New Issuance of Offshore RMB Bonds to Rush to a Historical High

The FTZ bonds are bonds issued to global institutional investors who have opened Free Trade Accounts in the Shanghai Free Trade Zone, and the issuers can be domestic, FTZ and overseas financial institutions or enterprises, and the currency of issuance is not limited.

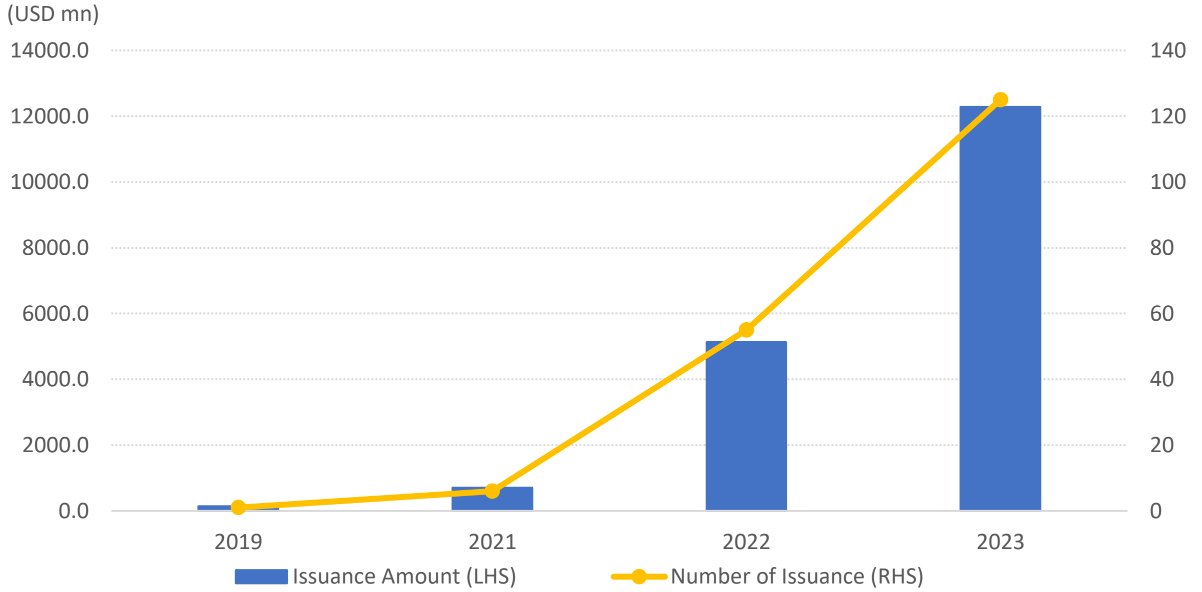
The FTZ bonds commenced their debut in 2016, followed by a few issuances in the following years. The issuance climbed to USD12.3 billion in 2023 (EXHIBIT 9), more than doubled compared with USD5.1 billion recorded in 2022 and hitting a record high.

As the financing channels for LIDCs in both onshore and offshore markets further tightened, more issuers chose FTZ bonds as an alternative for offshore financing. However, the regulators tightened the requirements on the FTZ bond issuance in June 2023, which stated that issuers with no business operation in the FTZ will not be allowed to finance through the FTZ bonds. As a result, new issuance of FTZ bonds has dropped significantly since July 2023.

The dim sum bonds play as an important role in the offshore RMB bond market traditionally. Boosted by the strong refinancing needs of LIDCs, the dim sum bond new issuance hit a record high in 2023, the issuance amount rose significantly to USD28.5 billion (EXHIBIT 10) from USD9.1 billion in 2022, representing a year-on-year growth rate of 212.8%.

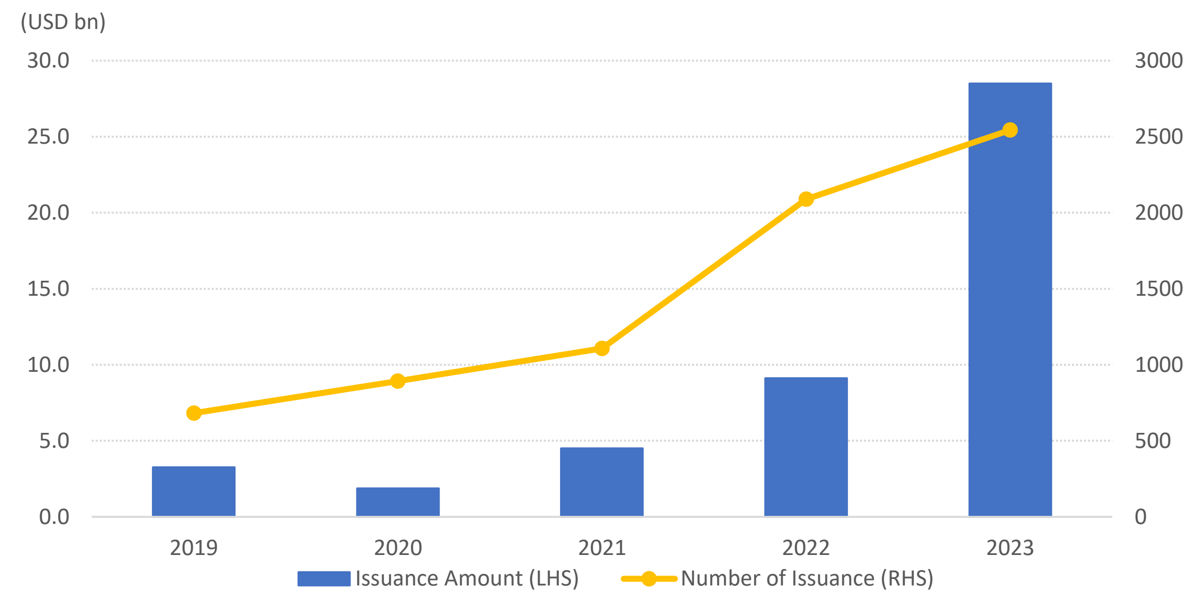
With surging issuances in both FTZ bonds and dim sum bonds, the China offshore RMB bond market showed remarkable growth in 2023, with the new issuance exceeding USD40 billion for the first time.

Exhibit 9: FTZ Bond New Issuance Amount and Number of Issuances



Source: Bloomberg and Lianhe Global's calculation

Exhibit 10: Dim Sum Bond New Issuance Amount and Number of Issuances



Source: Bloomberg and Lianhe Global's calculation

Outlook of FTZ Bond and Dim Sum Bond Issuance in 2024

The strong refinancing needs of LIDCs will continue to support the issuance of dim sum bonds, particularly for those LIDCs with weaker credit profiles and limited subsidy from local governments, and the dim sum bonds may meet a modest growth and continue dominating the offshore RMB bond market in 2024. On the other hand, the new issuance of the FTZ bonds may take a long time to recover without any policy motivation.

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