The Chinese Government to Maintain Adequate Market Liquidity for Infrastructure Investments to Stimulate Economic Growth

Major Policy Announcements:

The Chinese government is unlikely to roll out any massive stimulus plan but instead, it will use available tools to fine-tune its policy goals to maintain economic growth with a particular focus on investing in infrastructure projects, according to the July 23 State Council Executive Conference. The central government encourages the deployment of unencumbered cash under a market-orientated approach to funding infrastructure projects under construction to ensure their completions to maintain economic growth.

According to a guideline released by Finance Bureau of Lueyang County, Shaanxi Province, governments' contingent liabilities refer to any direct or indirect commitments, made by the governments between January 2015 and August 2018, to borrow, guarantee, buyback, purchase, and plus any unpaid construction costs of infrastructure projects etc. It is expected that these contingent liabilities would not be eligible for the debt-swap program. Viable solutions to resolve these contingent liabilities include using proceeds from disposal of government-owned equity interests and for-profit commercial enterprises, deployment of unencumbered cash and designated transfer payments, and sales of idle assets.

On 14 August 2018, the Ministry of Finance announced a directive encouraging finance departments at various administrative levels to use stacked debt issuance to match the funding needs of their planned infrastructure projects. Local government financings are no longer subject to quarterly quota thresholds after the new measure.

On 14 September 2018, the General Offices of the Communist Party of China Central Committee and the State Council announced a directive supporting the lawful and proper liquidation of any dilapidated subsidiaries of state-owned enterprise ("SOE") to balance the interests of all stakeholders and redeploy encumbered capitals more effectively. Any remaining subsidiary with potentially viable business plans should be considered for reorganization. No heavily indebted local government financing vehicles ("LGFVs") are "Too-Big-To-Fail" in order to avoid systemic risk.

Investors Favour High Grade LGFV Bonds

Investors still maintain their preference for LGFV bonds with onshore ratings of 'AA+' and 'AAA'. LGFVs incurred higher funding costs as a result of investors' risk aversion. The median coupon rate for bonds issued in 3Q18 by issuers with 'AA-' onshore rating increased by 1.05 percentage points to 7.55% (compared with the median coupon rate of bonds issued in 3Q17), much higher than the 4.39% for issuers with 'AAA' rating. The median coupon rate for 'AAA' rated LGFVs decreased by 0.3% during the same period.

The bonds issued by issuers with 'AAA' and 'AA+' onshore ratings accounted for 50.2% and 32.9%, respectively, of the total new issuances in 3Q18. The amount issued by issuers with 'AAA' rating increased by 46.2% year-on-year to CNY300 billion from CNY205 billion.

Whereas, bonds issued by issuers with ‘AA’ rating notably decreased by 67.9% year-on-year to CNY95 billion from CNY297 billion.

Issuers Focus on Short- and Medium-term Bonds

Investors’ risk aversion resulted in the decrease in the total issuance size by 20.5% year-on-year to CNY597 billion in 3Q18, with 64.5% being short- and medium-term bonds (maturities shorter than 3 years). Bonds with maturities within one year and between 1-3 years accounted for 35.2% and 29.3% of the total issuances, respectively. The high liquidity and short duration made these bonds more attractive for investors.

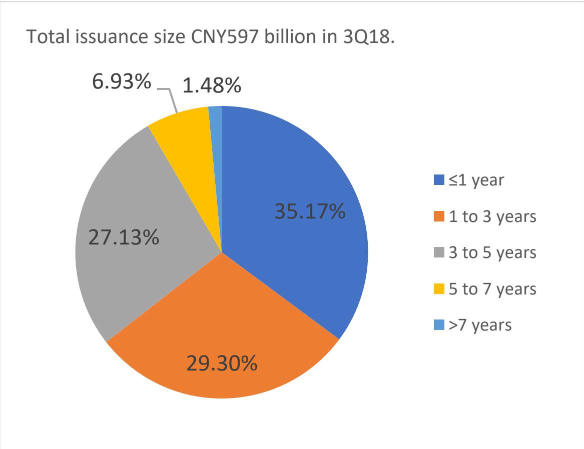
The issuance amount in some economically developed regions with higher fiscal revenue still maintained high growth in 3Q18 (compared with 3Q17), although more than half of the 29 provinces/cities slowed down in issuing new bonds. Jiangsu province had the largest issuance amount of CNY122 billion or 20.4% of the total issuance in 3Q18, significantly higher than the second largest issuance amount of Beijing which accounted for 8.3% of the total.

EXHIBIT 1: Comparison of Coupon Rate for Bonds Issued in 3Q18 and 3Q17

Onshore Credit Rating	3Q2018		3Q2017	
	Range of Coupon Rate	Median	Range of Coupon Rate	Median
AAA	2.75~6.80	4.39	3.95~6.00	4.69
AA+	3.70~7.80	5.68	4.25~6.90	5.49
AA	4.40~8.80	7.00	4.65~8.48	6.30
AA-	7.50~8.20	7.55	5.80~7.50	6.50

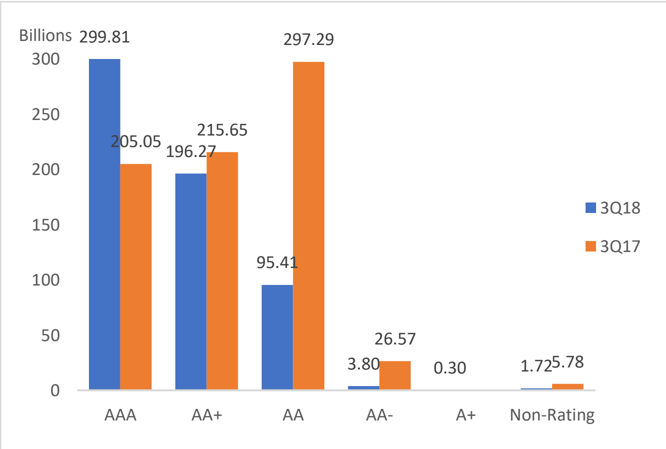
Source: Wind; *LGFV report in 3Q18*, United Credit Ratings Co., Ltd.

EXHIBIT 2: Breakdown of Bonds Issued in 3Q18 by Maturity



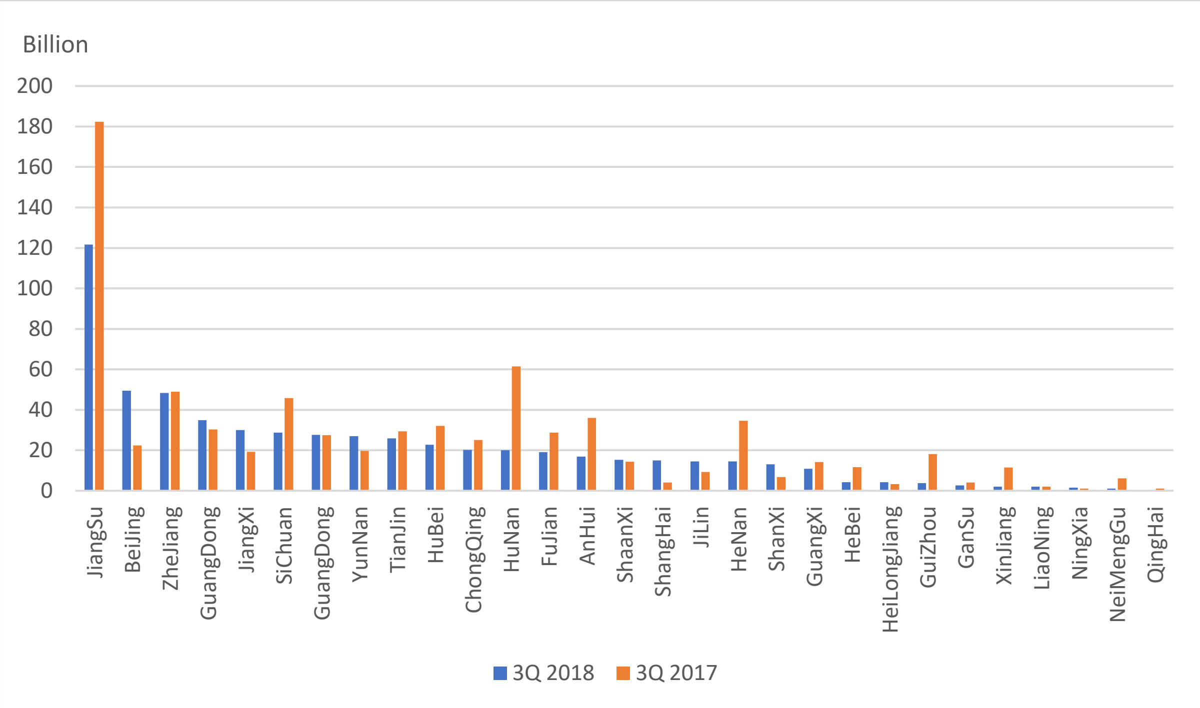
Source: Wind; *LGFV report in 3Q18*, United Credit Ratings Co., Ltd.

EXHIBIT 3: Breakdown of Bonds Issued in 3Q18 and 3Q17 by Issuer Rating



Source: Wind; *LGFV report in 3Q18*, United Credit Ratings Co., Ltd.

Exhibit 4: Bond Issuance Amount in 3Q18 and 3Q17 by Province



Source: Wind; *LGFV report in 3Q18*, United Credit Ratings Co., Ltd.

Improved Regional Economy, Financial Conditions or Standalone Performance Drove Rating Upgrades

Onshore rating agencies upgraded 12 and downgraded 1 LGFVs in 3Q18. The upgraded issuers are mainly domiciled in regions with more advanced economic development. These areas' strong economic growth and financial strength supported LGFVs' development. The only issuer rating downgrade was the rating of Xinjiang Production and Construction Corps Sixth Division State-Owned Asset Management Co Ltd to 'C' from 'AA' due to its missed payment at maturity date.

For more details, please refer to the Chinese report:
《联合信用评级有限公司 2018 年第三季度城投行业报告》
http://www.lianhecreditrating.com.cn/News.aspx?m=20140627100707687840&n=20181023180036337310

Source: Wind; *LGFV report in 3Q18*, United Credit Ratings Co., Ltd, published on 23 October 2018.
Note: In case of any discrepancies between the English version and the Chinese version, the Chinese version shall prevail.

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