



China's reopening provides a marginal reprieve to the credit outlook for Chinese corporates, albeit not a silver bullet

by [Lee Wei Qi](#)

- **NUS-CRI Agg Forward PD term structures reflect a slight improvement in the short-term credit outlook of Chinese corporate amidst news of the country's reopening**
- **Longer-term recovery remains challenging amid risks pertaining to limited credit uptake, uncertainty with the reopening rollout and rising input costs**

China had strictly and continuously maintained a rolling series of lockdowns. When the nation experienced its second wave of COVID-19 infections, consumer confidence hit lows while unemployment crept higher. As of [Aug 2022](#), there were 31 cities, contributing up to 18% of China's economic activity, under full or partial lockdowns. Today, the tides have seemingly turned. Following the announcement by the Chinese government of some [relaxation in curbs](#), market participants are increasingly convinced that the nation's rhetoric on its battle against COVID-19 moving forward will coalesce around a softer tone. Though the immediate impact of the reopening on the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) has remained relatively [stable](#) for China-domiciled corporates (Chinese corporates), a downward shift of the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD¹) term structures as of Dec 2022 relative to Sep 2022, as seen in Figure 1a, suggests a short-term improvement in Chinese corporates' credit profile. With hopes of reopening revitalized and easing of curbs set in motion, the possibility of an impending cyclical upturn following China's reopening could prop up sectors that were hit by mobility restrictions and poor consumer sentiments. This slight improvement in the aggregate credit outlook of Chinese corporates is accompanied by a tilt towards a more risk-on mandate in the Chinese financial markets where equities have noted [a historical rally](#) while investment-grade credit recorded [its largest outflows since 2017](#).²

¹ The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months – this is conditional on the firm's survival in the next 6 months.

² This short-term optimistic euphoric reaction can be largely reconciled when taking the former consensus into account that China would reopen [no earlier than Q2 2023](#). With the easing coming earlier and greater than expected, foreign-domiciled fund managers have recorded over [US\\$8.5bn of net purchases](#) in Nov 2022 with more bids to come closing the year.

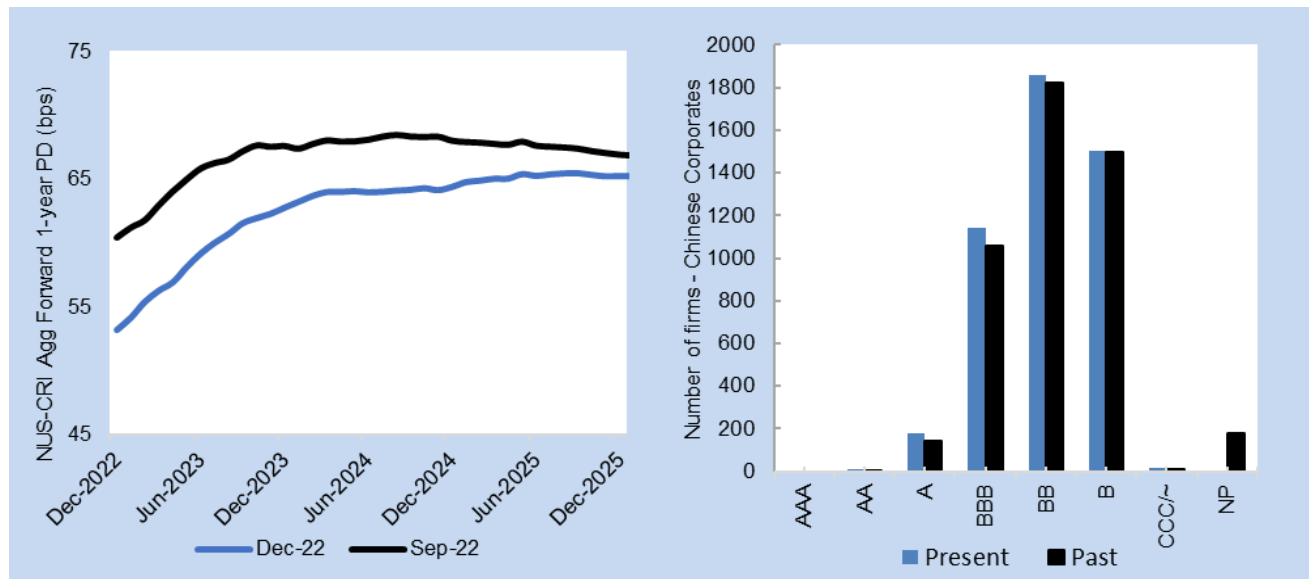


Figure 1a (LHS): NUS-CRI Agg Forward 1-Year PD of Chinese corporates as of Sep 2022 and Dec 2022. Figure 1b (RHS): Current and Past (3 month ago) PDiR rating distributions of Chinese corporates as of Dec 2022. Source: NUS-CRI and iRAP

However, the Forward PD term structure as of Dec-2022 remains elevated, with the long-term credit risk outlook remaining around 65bps. On a more granular level, as seen from CriAT’s iRAP³ PDiR migration tool, more than 70% of Chinese corporates are still considered non-investment grade as of Dec-2022. With China’s reopening timeline potentially [not being swift or linear](#)⁴, domestic consumption and spending could face continued pressures from a [slow](#) reopening plan, a new [surge](#) in COVID-19 cases that leads to reinstating of curbs, and [fading overseas demand](#). Moreover, the financing conditions from global markets, especially for non-investment grade Chinese corporates, remain unfavorable. This can be partially attributed to the persistent contagion effects from the highly geared property sector and risk premia demanded by foreign investors as the government continues to regulate competition in technology and education amongst other sectors. The index yield-to-maturity of the Bloomberg Asia ex-Japan USD Credit for Chinese high-yield firms remains high at 20.87% as of Dec-2022. Although the index’s YTM has fallen from its all-time high of 31.09% in Oct-2022, it is still higher compared to Dec-2021 levels (16.56%) (See Figure 2a). Moreover, domestic financing uptake remains lackluster despite the central bank’s strong and continuous push to provide liquidity. Aggregate financing as of Nov-2022 [marginally missed estimate](#) while precautionary savings continue to pile as consumer pessimism remains. As investors tilt to equities following the news of reopening, [corporate bond issuance has plunged](#) following the sell-off in the bond market.

³ iRAP (intelligent Risk Analysis Platform) is a software developed by [CriAT](#) for conducting both firm-level and portfolio level credit analysis. iRAP utilizes the NUS-CRI Probability of Default (PD) model and links it to the live NUS-CRI database offering PDs on almost 80,000 exchange-listed corporates globally.

⁴ Economics and health experts maintain the expectation that [some restrictions are to stay in place](#) until mid 2023 at least and possibly drag onto 2024

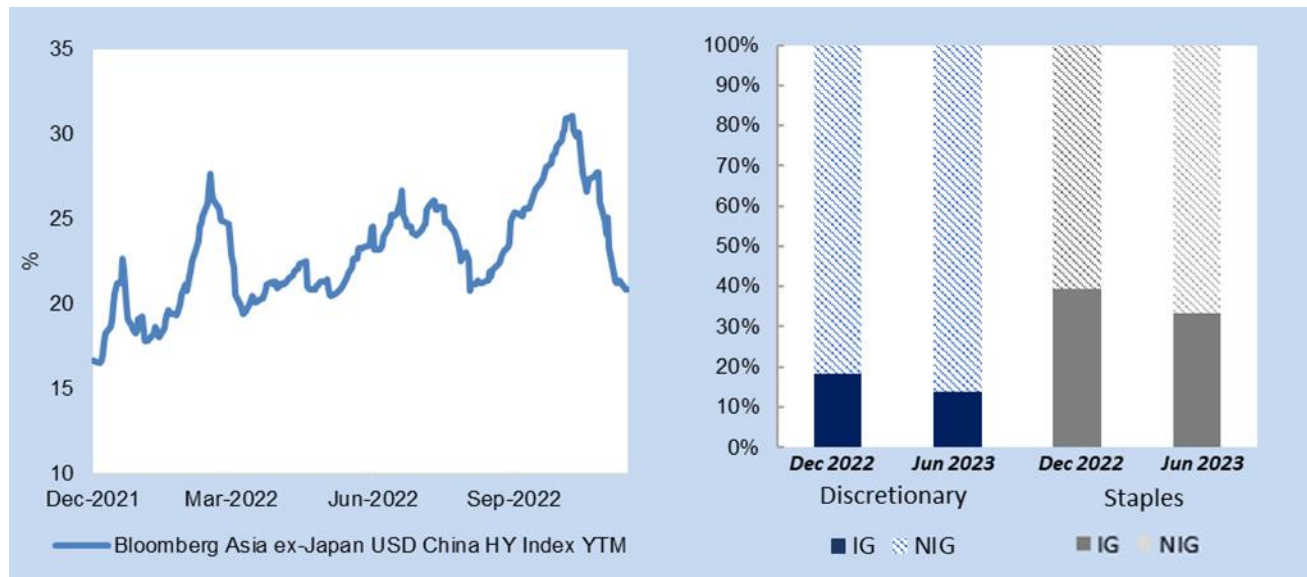


Figure 2a (LHS): Bloomberg Asia ex-Japan USD China HY Index's yield to maturity. Figure 2b (RHS): Current and forecasted (6 months later) PDiR rating distributions of Chinese consumer discretionary and staples sectors as of Dec 2022. Source: Bloomberg, iRAP

Amongst sectors poised to benefit from easing mobility curbs domestically, the consumer discretionary and staples sectors are notable. Interestingly, improvement in credit risk outlook across both sectors remains subdued. According to CriAT's iRAP shown in Figure 2b, there is likely to be an increase in the proportion of non-investment grade firms six months from now. Alongside a possibly slow road to full reopening, inflationary pressure on costs remains a potential challenge for the sector as [oil prices rebounded on reopening hopes](#). Margins and top lines for corporates in the consumer sector are likely to remain under stress, especially for corporates that are unable to capture volume or pass-through costs to buyers.

Within the subgroups, the impact of macroeconomic structural shifts could diverge credit outlooks as well. For instance, brick-and-mortar retailers are subjected to a diminishing total addressable market given the possibly long-lasting [shifts in consumer patterns toward online shopping](#). Amongst discretionary products, luxury goods and [auto sales](#) are likely to see a more subdued recovery as consumers prioritize spending on staples. Specifically in vehicle sales, with fiscal stimulus ending for traditional auto counterparts alongside competition from the electric vehicle manufacturers, woes pertaining to profitability and low inventory turnover could dampen cash flow generating capabilities. Conversely, online retailers, which remained resilient during the stringent pandemic restrictions, are likely to continue to benefit due to sustained changes in spending behavior. For example, one of the big three online shopping platforms, [Pinduoduo](#), continued to record upbeat sales and revenue growth. Similarly, [essential sales](#) such as food and beverages are poised to enjoy steady recovery alongside sportswear and restaurants as higher-priced raw material inputs could enjoy easier pass-throughs to consumers.

Going into 2023, the People's Bank of China is likely to maintain [a loose monetary policy](#). The continued extension of credit to the economy adds much-needed liquidity to the headwinds faced by the property sector and could lead to improved consumer and investor confidence pertaining to government support, which may lead to an improved credit outlook for Chinese corporates. Though current financing conditions remain unfavorable, improving growth prospects may see more capital inflows into the country's bond and equities market, especially as the US and other major economies slow down rate hikes. Though full recovery for Chinese corporates partially hinges on the timeline and eventual full rollout of China's reopening plan, initial signs of the reopening are positive for the short-term credit outlook of Chinese corporates, as suggested by the downward shift in their Forward PD shown in Figure 1a.

Credit News**Bond market points to Fed standing firm in battle against inflation**

Dec 08. The 2-year US Treasury yield traded on Wednesday at 4.2%, and the 10-year yield stood at 3.4%. The US yield curve has been inverted with the short- and long-term difference reaching the largest since 1981. Although the recent economic data suggest the US economy is picking up speed, some investors still worry that it may strengthen the Fed's resolve to continue raising interest rates which could lead to a recession. Though the signs pertaining to the depth and severity of the recession are yet to be seen, persistently high borrowing costs have raised concerns by investors regarding wider economic activity. ([FT](#))

Global ESG bond issuance headed for first full-year decline ever

Dec 07. Global sales of ESG bonds are set to fall this year for the first time. Sales were around USD 635mn YTD till Monday, down 30% compared with last year, during which the sales reached around USD 910bn. Considering the US inflation figures and the Fed's decision next week, it will be difficult to close the sales gap this month, resulting in the first-ever full-year fall in sales. Investment in ESG bonds now faces the harshest test ever, as the criticism came from investors, politicians, and regulators raising the cost for issuers as Greenium, the premium enjoyed by issuers, depletes. ([Bloomberg](#))

Chinese property firms get new offshore loans from big banks

Dec 12. Some of China's distressed property firms are getting a much-needed liquidity boost as big banks are now offering offshore loans. Country Garden Holdings is poised to receive a USD 300mn loan from ICBC backed by a domestic guarantee. Bank of China is also set to give Longfor Group holdings an unspecified offshore loan amount backed by the bank's Chongqing branch. Longfor has already tapped into this credit line last week. This policy comes under a larger proposal of big Chinese banks pledging to fund at least USD 179bn towards property developers, especially as the cash-strapped developers raise funds by divesting businesses and share placements. ([Bloomberg](#))

Bond rally tested by wage gains

Dec 06. Signs of easing inflation have driven a rally in the bond markets that saw the 10-year treasury yield curve at its lowest level since Sep-2022. The rally in the bond market follows the clearest signal from the Fed's chairman regarding a slowdown in rate hikes, signaling only a 50bps hike rather than the 75bps hikes seen over the last four meetings of the FOMC, however, the market is still anticipating the impacts of the strong job-market report that signals increased average hourly earnings. The rally in the bond market also indicated to some investors that the Fed has the problem of high inflation under control as the expectation of rate cuts over the next 12 months gathers steam. However, Jerome Powell has cited that the tightness in the job market could be a cause of concern for long-term inflation, as higher employment costs by service-driven industry may be passed onto consumers. ([WSJ](#))

Tokyo's broken bond market needs more than BOJ tweaks to heal

Dec 12. Given the significant liquidity strains felt in the Japanese markets, investors believe that even a "massive" dial-back of bond purchases by the BOJ and a tweak to the yield curve control will not be enough to provide liquidity reprieve in the market. Analysts are calling for an overhaul of the complete framework of policy easing to improve the liquidity concerns present in the Japanese market. The current yield curve cap pegs the 10-year yield to a maximum of 25bps, opening the currency to speculative attacks that have led the BOJ to purchase close to JPY 95tn in Nov-2022. Investor perception of sustainable bond market functioning is also declining to the lowest levels since 2015. Traders and investors are now hoping that the lack of liquidity in the market for government bonds will entice the BOJ to ease its grip on the yield curve cap and stop its daily fixed-rate operations. ([Bloomberg](#))

Emerging-market debt is sliding into distress. just look at Ghana ([Bloomberg](#))

HSBC sees loan availability to drive growth for India M&A deals ([Bloomberg](#))

Poor countries feel sting of local-currency debt ([WSJ](#))

Regulatory Updates

China's credit remains subdued despite PBOC's lending push

Dec 12. Easing lending and loosening restrictions on the property market in China to boost the economy performed less effectively than expected. On the one hand, in anticipation of the end of China's COVID Zero policy, low-risk-profile assets are less favored, making companies less willing to issue debt, which leads to a slowdown in credit market growth. On the other hand, no significant rebound in house-buying intentions has been witnessed. These signs suggest that restoring confidence and vitality in the credit market may require stronger economic measures and a longer recovery period that will boost both investor and consumer confidence in the markets. ([Bloomberg](#))

Banks compete for GBP 6bn of deposits as Nigeria redesigns its banknotes

Dec 12. The Nigerian central bank has announced a plan to replace 200-, 500- and 1000-naira notes. The old bills, amounting to over 80% of the circulating currency, will no longer be legal tender by the end of Jan 2023. Following the announcement in Oct 2022, lenders are now competing to attract up to US\$6bn of deposits amid the 6-week window citizens must replace old currency notes. Banks with large agency networks are likely to attract more liquidity. This, in turn, increases their capacity to create loans at lower rates provided that the central bank does not react with a further hike in the cash reserve ratio. ([Bloomberg](#))

Metro bank fined GBP 10mn for misleading on risk levels ([Bloomberg](#))

India central bank says inflation battle not over, raises rates again ([Reuters](#))

Published weekly by [Credit Research Initiative – NUS](#) | [Disclaimer](#)
Contributing Editors: [Raghav Mathur](#), [Wang Anyi](#)