Credit Research Initiative
National University of Singapore
transforming big data into smart data
NUS National University of Singapore | Asian Institute of Digital Finance
Weekly Credit Brief Feb 02 - Feb 08 2021

Tightening liquidity measures by PBOC increases credit risk for Chinese corporates

by NUS-CRI Market Monitoring Team

- **Signs of tightening monetary policy pose liquidity risk to China domiciled corporates as they try to refinance their debt**
- **Agg 1-year forward PD indicates a deteriorating credit outlook for China domiciled corporates in early 2021, when compared to the end of 2020**

China became the world's first major economy to recover from the COVID-19 pandemic with its economy growing at 2.3% YoY in 2020. The government's 2020 fiscal stimulus and People Bank of China's (PBOC) expansionary monetary policy helped the country weather the initial pandemic-induced economic slowdown. However, these same measures have led to Chinese companies becoming increasingly levered by the end of 2020, with the Total Debt/GDP ratio for the country increasing by 30 percentage points to over 270%. To stem the growth in leverage and to mitigate the excessive liquidity in the financial markets, PBOC has commenced 2021 with a tighter policy stance. Concurrently, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[1]) (see Figure 1a) indicates that the credit outlook for China domiciled corporates based on Feb 2021 data-feed deteriorated compared to the one based on Dec 2020 data-feed.

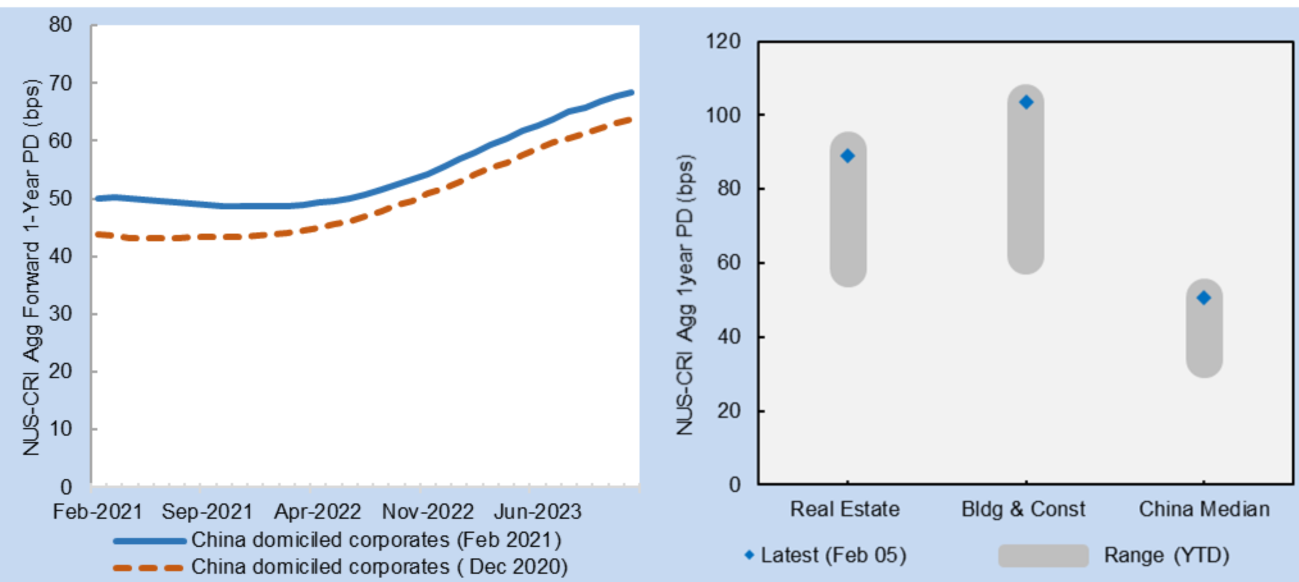

Figure 1a (LHS): NUS-CRI Agg 1-Year Forward PD of publicly listed corporates in China based on Dec 2020 and Feb 2021 data-feeds
Figure 1b (RHS): NUS-CRI Agg 1-year PD for industry groups with the highest default risks in China as of Feb 2021. *Source: NUS-CRI*

After excess liquidity pushed interbank borrowing cost to an all-time low by the end of 2020, PBOC withdrew cash from the financial system for the first time in 6 months. The 1-day overnight interbank rate (SHIBOR) at the end of January was at 3.34%, 247bps higher than at the start of the year. The net drainage of CNY 40.5bn from the domestic financial system in January was contrary to market expectations of a CNY 230bn net injection. Furthermore, the central bank also kept its policy interest rate unchanged at 2.95%. Not loosening monetary

[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.

policy, especially prior to the Chinese New Year holiday period, by PBOC is unusual and may raise concerns of further tightening in 2021.

Amongst all industries in the country, we see that the real estate and building and construction corporates struggled disproportionately, as per the NUS-CRI Aggregate (Median) 1-year PD (Agg PD) in Figure 1b. With the implementation of new policy changes, mortgage financing from the government has slowed dramatically, effectively cooling down the red-hot property market. This could in turn depress prices for housing should demand fall, inadvertently affecting the top-line of property developers. At the same time, developers are hard hit by "Three Red Lines" policy measures, which would add to the liquidity issues faced by these firms. In essence, if corporates were to break three different leverage metrics in a certain year, they would not be able to increase its debt levels the following year, thereby crippling its liquidity buffers. This could lead to a trickle-down effect to the building and construction sector, as the fall in property development projects would limit the need for construction services. The China New Orders Index for the construction sector fell by 4.6% in Jan 2021 as compared to Dec 2020.

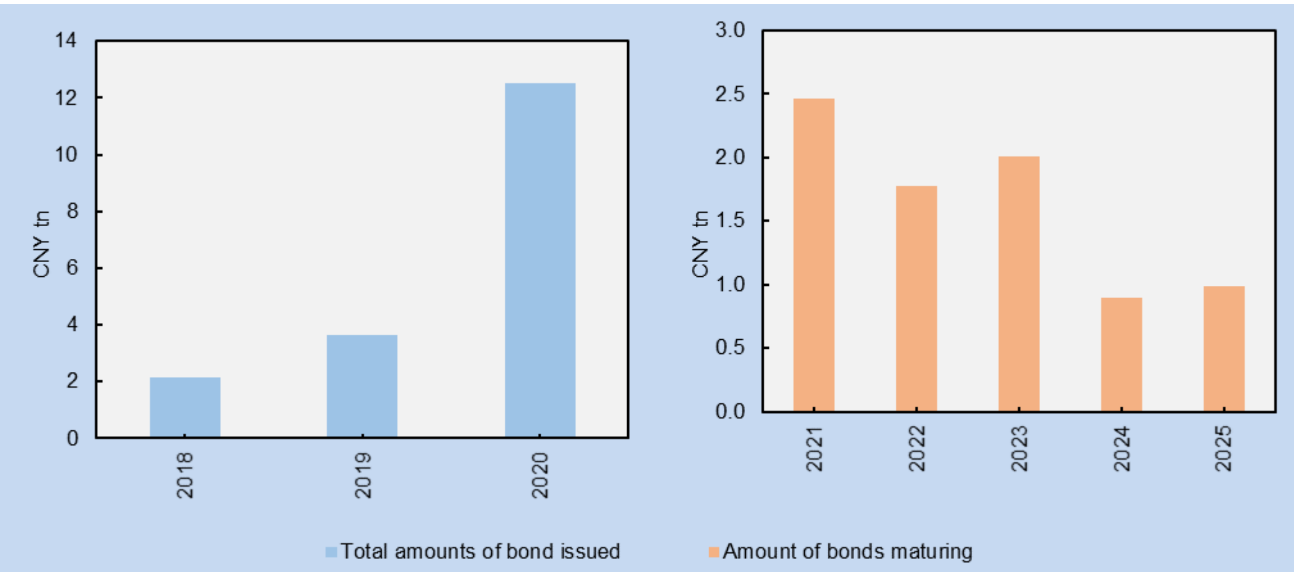

Figure 2a (LHS): Total amounts of bonds issued between 2018 and 2020 by listed China domiciled corporates. Figure 2b (RHS): Amount of bonds maturing over the next 5 years by the same sample in Figure 2a. Source: *Bloomberg*

In 2020, China's capital markets saw an increase in re-financing efforts by domestic corporates amid the low interest rate environment. The onshore bond market also saw a record amount of bond issuance in the second half of the year. Around CNY 12.5tn of bonds were issued last year (see Figure 2a), 64% of which were issued in the Q3 and Q4 of last year. In Jan 2021, the issuance spree continued with Chinese corporations issuing another CNY 2tn, marking a 13.6% increase YoY and 142% increase from two years ago. Furthermore, we also see that 16% of bonds outstanding are maturing in 2021. However, we may see the trend conclude in the near term due to PBOC's potential tightening of monetary policy, which not only reduces the amount of liquidity being pumped into the system, but also increases the cost of financing. This effectively makes it harder for corporates to access the debt markets.

PBOC's policy stance is consistent given the fact that the country is currently facing significant regulatory adjustments in its financial markets. This is partially driven by the potential asset bubbles that are occurring in the Chinese property and financial markets. Overall, this could be considered the lesser of two evils, as the PBOC aims to improve China's credit market. While these moves may increase the risk of default of Chinese corporates, as shown by the rising term structure in Figure 1a, they may go a long way in preventing leverage from rising out of hand, and posing a risk to the country's financial system.

Credit News

Danger lurks in global markets transfixed by rising bond yields

Feb 7. Treasury yields are up to an all-time high since Mar 2020. This rise is propelled by the revitalization of growth and inflation in light of the vaccine rollout and coming stimulus deal. Given the zero lower bound and substantial debt level, both the equity and debt capital markets will be left heavily exposed should yields go beyond a justifiable growth break out. A significant proportion of the risks today centers around duration. The negative convexity means that higher yields will lead to a disproportionate increase in duration, tanking prices at greater speed. (Bloomberg)

Money pours into US loan funds as growth and inflation expectations rise

Feb 5. Investors have renewed interest in leveraged loans, as the capital flows into funds specializing in these assets have outpaced outflows for the first time since 2018, consolidating market consensus that interest rates will likely rise soon. With a vaccine rollout and strong stimulus measures, investors are expecting inflation to rise as a result of strong economic growth. As these leveraged loans perform well in a high-interest rate environment, demand for these securities has grown. The average yields of leveraged loans have fallen from 13% in March last year to 3.78% currently, leading private equity firms to increase their funding pool for acquiring new companies, as well as refinance their existing debt. (FT)

Alibaba sells USD 5bn of bonds

Feb 5. Alibaba, which has recently had run-ins with the local authority, has raised USD 5bn by issuing four bonds yielding between 2.14% and 3.25%. These included two bonds of USD 1.5bn each for 10 and 30 years, as well as two bonds of USD 1bn each for 20 and 40 years. The 20-year bond was designated to be a green bond used to fund projects such as greened buildings and energy-efficient data centers. Though there are macroeconomic challenges that the company still faces such as the US-China geopolitical tensions, the underlying credit strength of Alibaba is sound with strong fundamentals such as steady cash-flow generation and a large cash pile. As such, the bonds have rated stellar ratings from all major credit rating agencies, which believe that Alibaba can handle the upcoming regulatory-related liabilities. (WSJ)

Cineworld backs down in dispute with lenders over interest bill

Feb 3. A months-long dispute regarding interest payments between Cineworld and its creditors have culminated with the cinema operator finally backing down this week. The issue, which came about during negotiations with creditors, related to an accidental increase in interest payments on billions of dollars of their outstanding bonds in November. This was a result of a Libor-floor being included in the clauses of the loan agreement, causing the company millions of dollars in additional interest payments each year. Further changes to rectify the mistake hit a dead wall as Barclays, the agent of the loan, asserted that any changes could only be made with the approval of all creditors. The company had been on the brink of bankruptcy before an additional injection of funding gave a lifeline to the ailing company. However, these disputes between creditors and companies have been occurring more often recently, affecting other banks such as Citigroup, as mistakes in the deal-making process have significantly affected both sides of the restructuring. (FT)

Risky borrowers hope to boost green credentials

Feb 2. Issuers are taking advantage of the hunger for yield to prototype papers with green features. The lowering of rates is conditioned on the borrower meeting their stipulated Environmental, Social and Governance (ESG) based targets. European regulators are increasingly concerned with this aggressive learning by these private equity lenders. Today, the aggregate debt to earnings of European debt stands at 6.3 times – a 13 years all-time high. (WSJ)

Luckin Coffee seeks bankruptcy protection under Chapter 15 in US (Reuters)

Peru oil firm Petroperu says issues USD 1bn bond at all-time low 4.65% (Reuters)

Bank of China issues first 'Yulan' bond (Reuters)

Regulatory Updates

RBI holds rates steady, assures markets of liquidity support

Feb 5. Reserve Bank of India (RBI) kept rates steady at record low levels, in line with market expectations. They also promised to maintain liquidity support for the Indian economy, with RBI governor Das highlighting the prospects of recovery to pre-pandemic levels achievable in the upcoming year. The repo rate, RBI's key lending rate, was held at 4% (1.15% decrease since Mar 2020), while the reverse repo rate was left unchanged at 3.35%. The policy aims to ensure that the 'liquidity carpet' backs growth recovery and fiscal financing. Given that inflation has returned to the "tolerance" band, the main driver for the policy stance is to ensure a high growth trajectory, while raising concerns that there are long-term 'disinflation' drivers. (Reuters)

FCA calls for full regulation of 'buy now, pay later' credit

Feb 2. "Buy now, pay later" firms have faced increased scrutiny, as financial regulators in the UK have turned their attention to these consumer lending platforms. These platforms, that provide unsecured consumer lending, have left billions of pounds exposed to credit risk. The payment method became popular, with GBP 2.7bn being lent in 2020 to consumers. However, consumers were not fully aware of the terms of the lending, leading them to accrue significant late payment fees. With the proposed regulations, these businesses would have to operate within FCA credit rules, thus needing consumers to undergo stringent credit checks. This would be supplemented with more support via credit unions and community development finance institutions. Regulation for this sector appears to be the utmost priority in the UK, but estimates place real change to take more than a year to be made, as a careful line must be drawn in order not to stifle innovation and access to cheaper consumer lending services. (FT)

Bank of England keeps rates and bond-buying programme unchanged (Reuters)

China's short-term money rates fall to two-week low as PBOC injects liquidity (Business Times)

Published weekly by Credit Research Initiative – NUS | Disclaimer
Contributing Editors: Yao Xuan, Anthony Prayugo