Credit Research Initiative
Risk Management Institute, National University of Singapore
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Near-term credit outlook on China NEV manufacturers' remains resilient amid government support

by Luo Weixiao

China's automobile manufacturing industry is experiencing a deep downturn after 30 years of sustained growth. Weak domestic demand due to the country's economic slowdown and muted export growth amid the US-China trade war led to consecutive declining car sales in 2018 and 2019. As part of the automobile industry, while Chinese New Energy Vehicle (NEV) manufacturers also face the abovementioned headwinds as other automakers do, they also benefit from favorable government policies. Tracked by NUS-CRI Aggregate (median) Probability of Default (Agg PD), credit risk for both Chinese NEV makers and all Chinese automakers are higher in early 2020 compared to in early 2018. However, it is noteworthy to see that the NEV manufacturers' credit profile remains stronger than the industry aggregate level.

Apart from the temporary relief fuelled mainly by the loosened monetary policies, the Agg PD of the 52 publicly listed Chinese automakers has been trending upwards since Jan 2018, reaching 70bps in Jan 2020. However, the Agg PD of the 15 automakers that have NEV production business stays well below that of the whole industry. Furthermore, the Agg PD of the NEV makers stays within the lower double-digit range and the gap between the NEV makers and the industry has been widening since Apr 2019, suggesting a better credit profile of the NEV manufacturers.

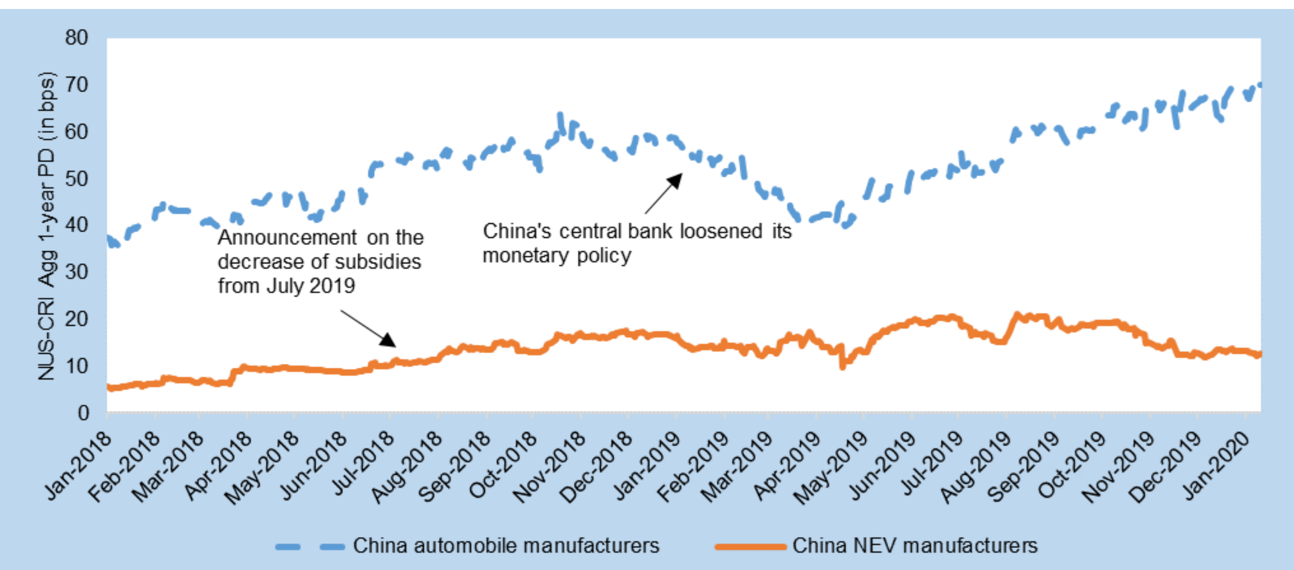

Figure 1: NUS-CRI Aggregate 1-year PD for publicly-listed China domiciled automobile manufacturers and NEV manufacturers. *Source: NUS-CRI*

The Chinese government has implemented favorable policies for the NEV sector. The vehicle registration plate for NEVs is much easier to get compared with that for oil-fuelled automobiles[1]. Also, NEVs are exempt from the

[1] For some cities such as Shanghai, consumers need to draw lots to get a license plate in order to purchase an oil-fuelled automobile and the win rate is extremely low – 5.6% in Shanghai in Apr 2019. However, for NEVs, the vehicle registration plate is free and not applicable to the lots drawing process, which means consumers who want to purchase NEV can get the license easily and free of charge.

10% vehicle purchase tax and purchase price is subsidized according to the type of the vehicle as shown in Table 1 below. According to the Ministry of Industry and Information Technology of People's Republic of China, the total subsidies for NEV sales in 2018 amounted to CNY 13.8bn (USD 2bn).

	Mileage on one charge (R in km)	2018 (in 1,000 RMB)	2019 (in 1,000 RMB)
Pure Electric Vehicle	150 ≤ R < 200	15	Not Applicable
	200 ≤ R < 250	24	Not Applicable
	250 ≤ R < 300	34	18
	300 ≤ R < 400	45	
	R ≥ 400	50	25
Hybrid Electric Vehicle	R ≥ 50	22	10

Table 1: Chinese Government's subsidy policy for NEV purchase in 2018 and 2019. *Source: Ministry of Industry and Information Technology of the People's Republic of China*

The incentives have boosted NEV sales and improved the NEV makers' fundamental performance. Thanks to the subsidies, NEV manufacturers are less affected when the automotive industry is struggling amid the weak economic environment. The median leverage ratio (measured by total debt to total assets) for the NEV makers is lower than the industry median since Q1 2017.

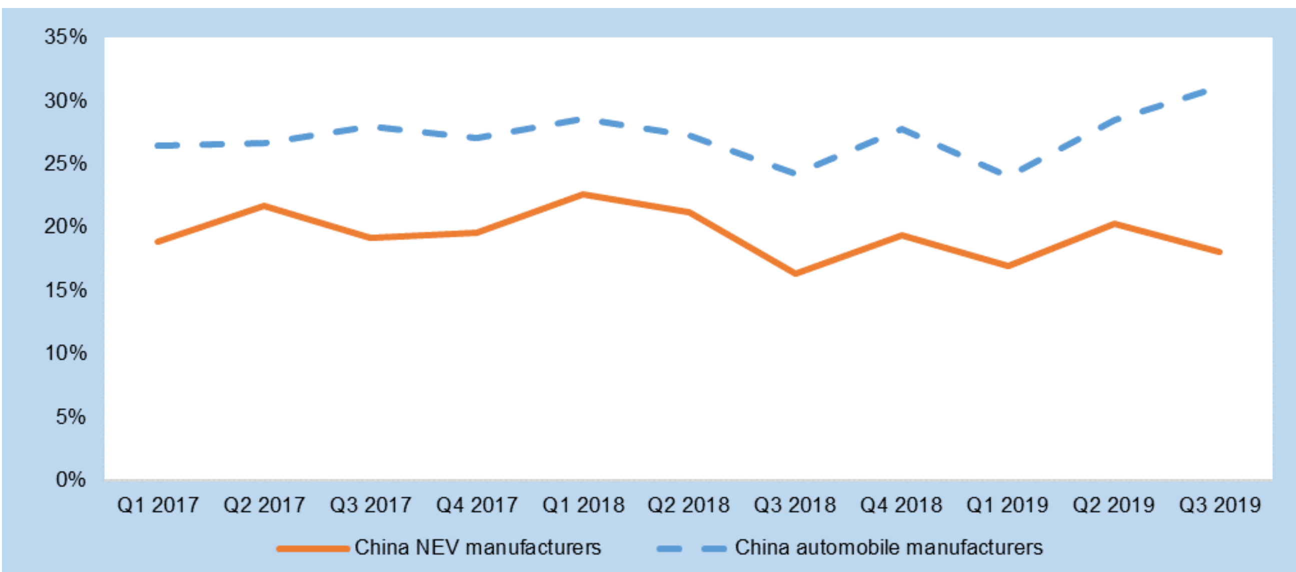

Figure 2: Median leverage ratio (measured by total debt to total assets) for China NEV makers and China automobile manufacturers from 2017 Q1 to 2019 Q3. *Source: Bloomberg*

However, the credit profile for the NEV manufacturers is sensitive to policy reversals. In H2 2018, the government implied a gradual decrease of the subsidies starting from July 2019. Correspondingly, the Agg PD of the sector entered the double-digit range in Jul 2018 and remains in the range since then. When the new policy started to take effect in Jul 2019, the Agg PD reached its highest level at 20bps – twice as high as the level during the same period one year ago.

As shown in Figure 3, NEV sales also experienced a slump after Jul 2019 because of the change of the policy. Since the gradual decrease of the subsidies in July 2019, NEV sales dropped for six consecutive months compared with NEV sales in the same period last year. It's noteworthy that NEV sales from Jan 2019 to Jun 2019 was higher than it in the previous year despite a lower sales of all types of vehicles through 2019.

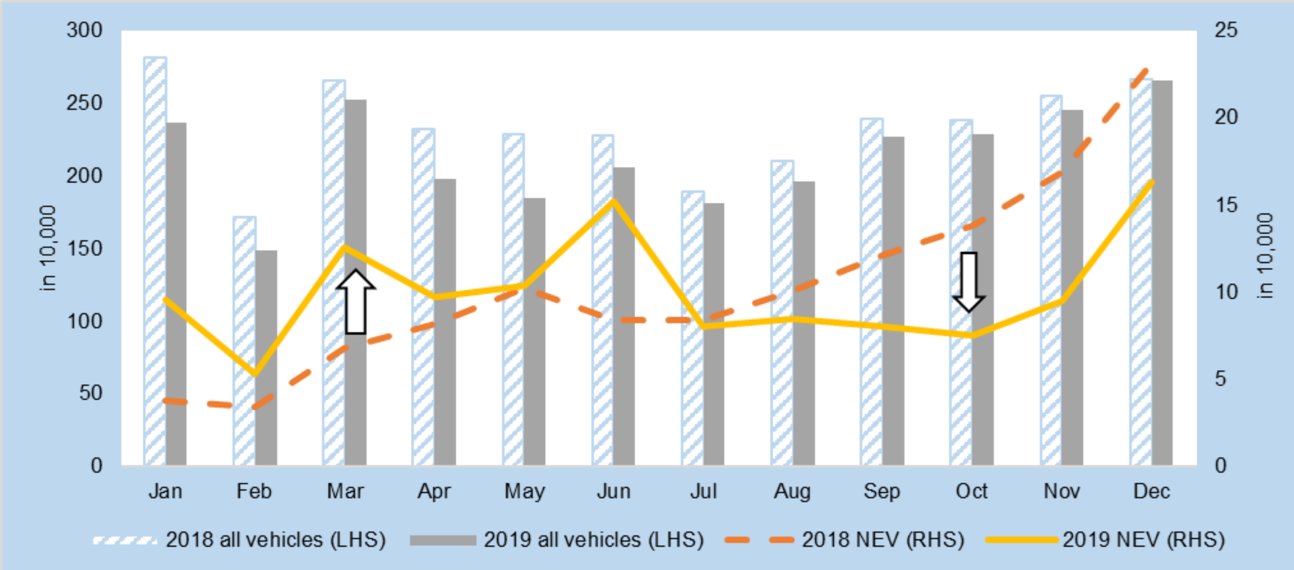

Figure 3: All types of vehicles and NEV sales in China in 2018 and 2019. *Source: Ministry of Industry and Information Technology of the People's Republic of China*

Moving forward, the government announced that new subsidies for the sector in 2020 will not be lower than the level in 2019. With government support, the credit outlook for the sector remains positive. Based on the information in Jan 2020 when the policy was announced, the NUS-CRI Aggregate (median) Forward 1-year PD[2] (Forward PD) of the NEV sector stays safely within the lower double-digit zone while at the same time the Forward PD of the automotive industry stays above 50bps. It's also worth noting that though staying in the safe lower double-digit zone, the Forward PD of NEV sector increases in the future one year. This might be due to the fierce competition from other automotive manufacturers. For instance, Tesla built its Gigafactory in Shanghai last year and cut the selling price days after its first deliveries of Model 3 sedan in Jan 2020. The price for one Tesla Shanghai-made Model 3 sedan was cut to USD 46,400, which is even cheaper than ES8 from Nio, a newly listed domestic NEV manufacturer.

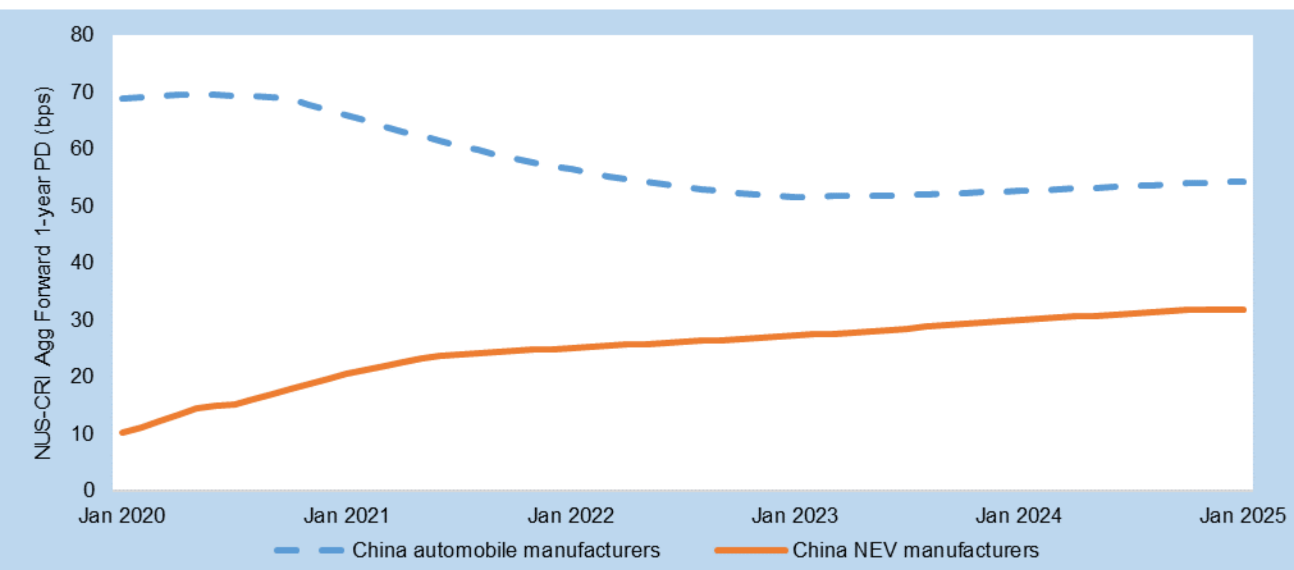

Figure 4: NUS-CRI Aggregate Forward 1-year PD term structure for publicly-listed China domiciled automobile manufacturers and NEV manufacturers. *Source: NUS-CRI*

[2] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm's survival in the next 3 months.

Credit News

Boom in emerging market corporate debt stir fears

Jan 20. The emerging market corporate bond market has expanded nearly fourfold to USD 2.3tn over the past decade, but a lack of liquidity could lead to violent price declines in a crisis according to an emerging markets hedge fund. The risk of sudden dislocations has been increased by a wave of bond buying by mutual and exchange traded funds that allow investors to pull out money quickly. Furthermore, regulatory changes have forced banks' trading desks to scale back their holdings, hampering their ability to cushion any turmoil. While emerging markets corporate bonds are prone to exaggerate sell-offs and developing-world debts are now more vulnerable to sudden evaporation of liquidity, investors agree that "dislocation" events could also offer up large returns if trading is timed correctly. (FT)

Global banks rush back into repo markets

Jan 19. Global banks' use of funding from the markets rather than from traditional deposits has grown exponentially in recent times, mainly in the form of short-term funding. However, the growth has been distributed unevenly across the world. Banks in the US, UK and Canada have transformed into the largest lenders of short-term markets, while banks in France and Japan have become the biggest borrowers. Short-term market funding is risky as it can suddenly disappear when lenders – such as funds or cash-rich banks – get concerned about the creditworthiness of borrowers, who can then be pushed into a mass sell-off of assets if lenders pull back. (WSJ)

CLO market eyeing tighter spreads to start year

Jan 18. The US Collateralized Loan Obligation (CLO) market is eyeing tighter spreads across tranches to start 2020 after coupons gapped out in 2019 to among the widest levels in two years. Some of the largest and most experienced firms are expected to push spreads on the senior slice of US CLOs into the 120bp range. While spreads have tightened across risky assets, some analysts believe there is still room for the market to tighten. The US CLO market, as the largest buyers of leveraged loans, has recorded the third largest year of volume ever in 2019 but the issuance is forecasted to fall in 2020. Some risks that could weigh on spreads include macroeconomic and political issuers, and any change in loan borrower earnings. (Reuters)

Property giant adds to deluge of Chinese bond deals

Jan 17. China Evergrande Group offers double-digit yields on up to USD 2bn of new dollar debt, becoming the country's latest property developer to tap the international bond market. Chinese property companies have kicked off the year by selling billions of dollars of longer-dated bonds, taking advantage on a hot market to reduce their heavy reliance on short-term funding. However, Evergrande stuck to relatively short-dated bonds and offered higher yields than some peers. The sheer amount of bonds outstanding from this property giant may lead to market indigestion, which may explain why investors demand a higher yield than other Chinese developers with similar ratings. (WSJ)

Crude rebound 'throws lifeline' to debt-laden energy companies

Jan 14. A rebound in commodity prices has "thrown a lifeline" to many troubled US energy companies, which have rushed to issue fresh debt to investors hungry for yield at the start of 2020. Last year, investors backed away from the most distressed companies such as oil and gas firms which experienced a string of debt defaults amid a continuous drop in crude prices. Now, although many energy companies are still suffering from heavy debts, investors have begun to return to the sector due to being encouraged by the rising oil prices. However, there are still reasons to be wary since underwriting risk remains and the flood of bond sales may not be sustainable. (FT)

Investors feast on Delivery Hero convertible bonds (FT)

PG&E bonds jump on settlement talks (WSJ)

Aluminum maker rings in China's first dollar default of 2020 (WSJ)

Regulatory Updates

UK regulators launch fresh push to switch away from Libor

Jan 16. The Bank of England and Financial Conduct Authority told senior managers of firms that it is demanding to see "clear evidence of engagement" from next month that they are ending their Libor addiction. In particular, cash products of firms linked to sterling-denominated Libor must cease by Sep 2020. For the derivatives market, UK regulators also set a March 2 goal to stop the usage of Libor in sterling interest-rate swaps and to start the usage of an overnight alternative rate called Sonia. Despite several warnings, UK regulators are concerned that not enough is being done to meet the 2021 deadline, and therefore, there is a need for more "significant and sustained efforts" made by the official sector and companies to adapt to new benchmarks. (FT)

Chinese companies get to grips with tougher ESG disclosures

Jan 14. In keeping with President Xi Jinping's call for the development of "green finance", Chinese authorities are urging companies to disclose more on their environmental, social and governance (ESG) risks. Following Hong Kong's lead this year, the stock exchanges of Shanghai and Shenzhen are expected to require all issuers to increase ESG disclosures. One company worried that ESG reporting would make the board overloaded by the requirements, while others considered ESG matters were common sense for the management team, and thus, the mandatory disclosure would not motivate companies to improve. However, some foreign investors remained wary as only 40% of green bonds from Chinese issuers were in line with international norms on the use of proceeds. (FT)

China keeps lending benchmark LPR steady for second straight month in January (Reuters)

Fed adds USD 52.6bn to markets as central bank official defends operations (WSJ)

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