Credit Research Initiative
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Credit profile of Chinese rare earth industry improved amid trade war

by Luo Weixiao

Rare earths, a group of 17 metals with a variety of high-tech applications, are widely used in high-tech consumer electronics and military equipment. China dominates the global supply of rare earths, due to the largest portion of rare earth deposits in the world and domination in processing. Over 80% of US imports of the group of 17 minerals are from China and this makes rare earths a strategic weapon for China to retaliate in the trade war.

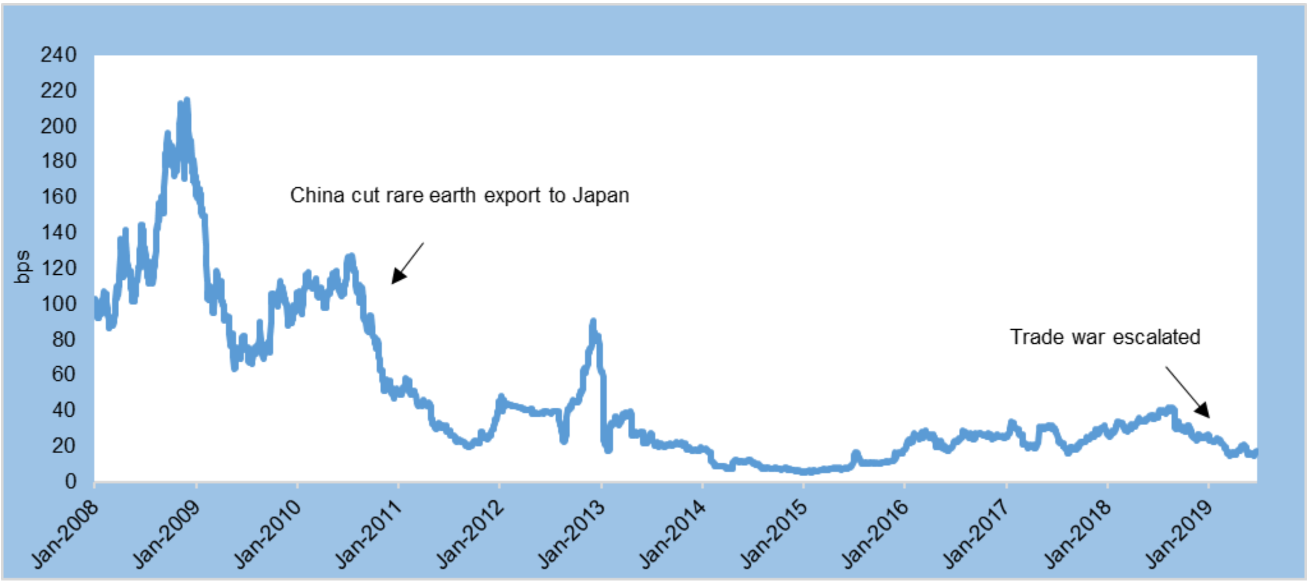

Figure1: NUS-CRI Aggregate 1-year PD for Chinese rare earth industry. *Source: NUS-CRI*

The largest listed rare earths mining and processing companies backed by the government, China Northern Rare Earth Group High-Tech, China Minmetals Rare Earth, Xiamen Tungsten Co Ltd and Shenghe Resources Holding Co Ltd, dominate the supply of rare earths in the country. When China cut rare earths exports to Japan last time in 2010 after Tokyo detained a Chinese fishing trawler captain, together with the idea of luring processing technology to the country to take advantage of China's lower costs and the realization of environmental benefits of curbs on mining, price of rare earths soared to record high and led to a significant improvement on the industry's credit profile. The declined credit risk of the industry was reflected in NUS-CRI aggregate 1-year probability of default (Agg PD). Agg PD of Chinese rate earth industry plunged by 53%, from 106bps in January to 50bps at the end of the year.

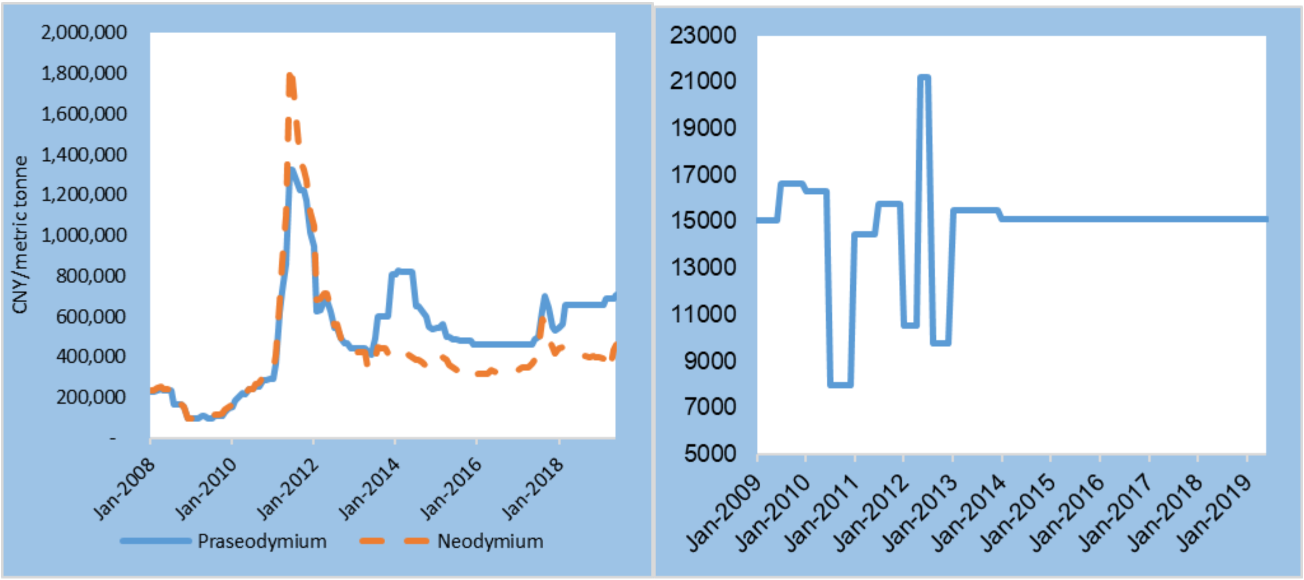

Figure 2a & 2b: China praseodymium and neodymium metal market price Shanghai; China's rare earth element export quota. *Source: Bloomberg*

In the escalation of trade war this year between US and China, the chance of rare earths price rise becomes higher. Chinese president Xi Jinping made a visit to rare earth magnet maker JL Mag Rare-Earth in Jiangxi province in May and state media implied China could limit rare earths sales to US, emphasising its role in the market. As Xi demonstrated with his visit, the country is also a major player in the downstream industrial supply chains that depend on such metals. These materials will be used in the production of consumer products such as smartphones and automobiles, and also military equipment such as fighter planes. The government also implemented policies amid the trade war to support the growth of the industry. A series of environmental regulations has been carried out to make sure an environmental friendly mining and processing system will be put into practice by 2020. A rare earths innovation center was established to develop a world-class rare earth advanced manufacturing cluster in the region. Ministry of Industry and Information Technology of the country has introduced regulation to standardize the packing, transportation and storage of rare earth products.

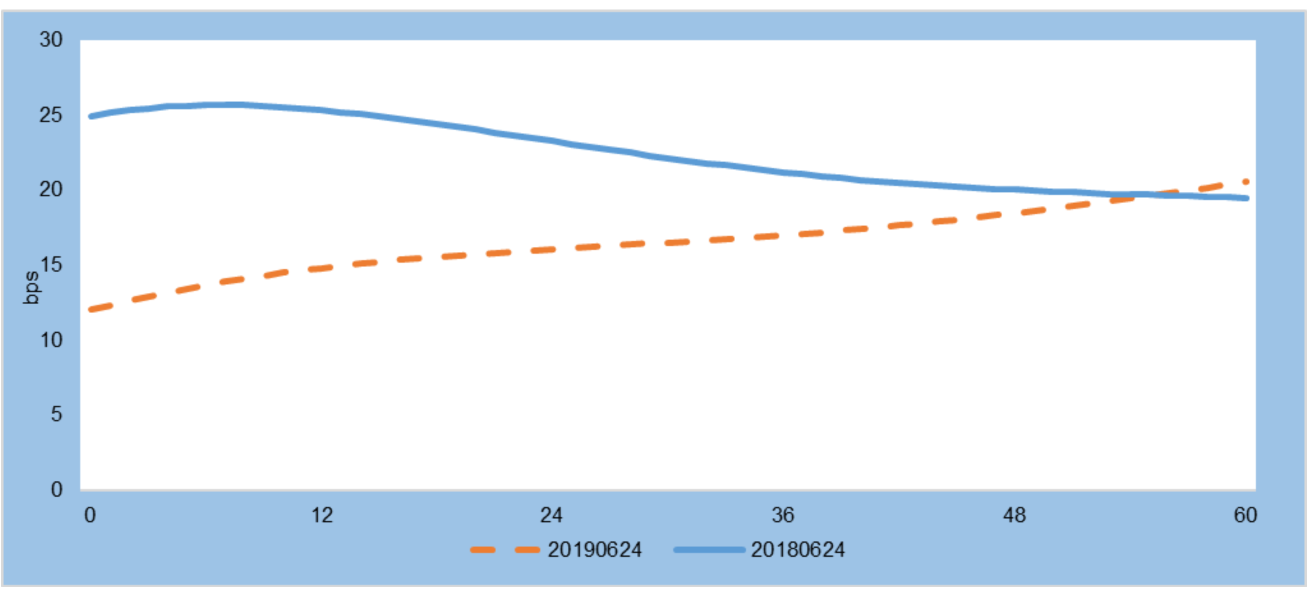

Figure 3: NUS-CRI Aggregate Forward 1-year PD term structure for Chinese rare earth industry as of June 24, 2019 and June 24, 2018. *Source: NUS-CRI*

With higher projected demand from high-tech products and a probable lower supply of rare earths, rare earth price are expected to rise in the future two to three years and thus credit profile of Chinese rare earth industry could improve recently. Neodymium and praseodymium are the two main rare earths used in magnets, which are widely used in electric vehicles (EVs). As the push towards EVs becomes stronger, demand for magnets will be consequently higher and the magnets are almost all reliant on rare earths mined in China. On the supply side, China will likely maintain its dominance on mining and processing rare earths for some years thanks to ampler domestic processing facilities compared to other countries. However, NUS-CRI Aggregate Forward 1-year PD tends to converge to the level before escalated trade tension in the long run.

Credit News

Trade War Threatens Best Emerging-Market Bond Gain in Decade

Jun 24. The best returns in a decade for emerging-market bonds got a boost as the central banks move toward more easing. The investors are optimistic after the Federal Reserve signalled of cutting interest rates and the European Central Bank indicated more stimulus in the upcoming months. Some of the experts says that in Asia, most investment-grade issuers should be less affected as they are not directly exposed to global trade and will benefit from strong Chinese economic policy support while some fear that with so many geopolitical evets happening there may be some unwanted accidents across the globe. (Bloomberg)

Bond rally sends 10-year Treasury yield below 2%

Jun 21. After the US Federal Reserve (Fed) on June 19 announced its intention to gather additional information before deciding on a potential further rate cut, the country's 10-year treasury yield fell to below 2%. This is its lowest level since 2016. A recent slowing in the global economy and growing trade tensions have overall led to a decrease of 70bps in the benchmark rate in 2019 as investors seek haven in the lower volatility of the bond market. The Fed currently debates the use of another cut in US interest rates as a preliminary measure against an economic downturn. (FT)

China is missing out on huge bond rally taking off globally

Jun 21. China's bonds have dropped 0.02% since April which is the worst performance among the world's biggest debt markets. This is even after the People's Bank of China signalling its readiness to support the economy. Chinese authorities have also repeatedly injected cash into the financial system, boosted liquidity to support smaller banks and ramped up aid to small firms. Concerns regarding the trade war with the US, credit risks after the seizure of a local lender and a flurry of issuance in municipal bonds and a volatile yuan have all led to the situation. China has also not cut its benchmark interest rate since 2015 although it has indulged in other easing measures such as lowering the amount of reserves for banks. However, global investors might still be interested in purchasing Chinese bonds as yields are more attractive than those overseas. (Bloomberg)

'Green bond' market leaves wildlife behind

Jun 21. The World Bank issued the first green bonds in 2008 and the bond issuances are surging since then. But a mere 5-10% of the green-bond proceeds have gone towards the funding of biodiversity conservation projects while the vast majority flows into energy, buildings and transport. Conservation is globally undercapitalised and unlinked to true markets. The main factors holding back the development of this market are the lack of a project pipeline and the regulatory vacuum in which most conservation finance projects operate. A developed and regulated market with proper collaboration could play an important role in restoring the value of nature. (FT)

Value of negative yielding debt hits record USD 12.5tn

Jun 19. Negative yielding bonds hit a record of USD 12.5tn after the European central bank hinted that it could restart its "quantitative easing" programme. The global bond market has been affected by concerns that economic growth is stagnating and that central banks in Europe and Asia will ease monetary policy to prevent a downturn. Trade tensions between the US and China have also increased tensions. With the Federal Reserve expected to cut rates this year, ECB President Mario Draghi has also hinted that the central bank might also trim rates and continue buying bonds if inflation is below 2 per cent. (FT)

Treasury to sell USD203bn in debt (WSJ)

Fitch cuts Mexico's Pemex to below investment grade (WSJ)

Turkish central bank cuts rate for bond dealer banks (FT)

Regulatory Updates

ECB vice president says another bond-buying program could be part of new stimulus

Jun 19. Luis de Guindos, the ECB Vice President, expanded on the dovish stance of ECB President Mario Draghi reported earlier in the week: after a reduction of stabilizing measures aiming at boosting inflation and ensuring price stability in 2018, Draghi had ensured market participants that the ECB's toolbox of monetary policy would remain effective should the "lingering [economic] softness" continue. This toolbox includes a diverse range of measures to be used in conjunction as necessary, explained De Guindos, including targeted longer-term refinancing operations and quantitative easing among others. (CNBC)

Italy finance minister rules out new bonds to pay government debts

Jun 19. Italy's finance minister ruled out the introduction of new treasury bonds and claimed that all the commercial debt can be paid normally with their currency. The Italian government had considerably reduced its arrears to the companies providing goods and services in recent years. Also it is assured that nobody in the government thinks that Italy has to exit from the eurosystem. Italy's problem would be less severe if the other Eurozone countries with fiscal space could cut taxes or raise spending. (FT)

EU TEG on sustainable finance publishes proposal for EU green bond standard (JDSUPRA)

IMF proposes upgrades to EU plan to develop capital market (TNP)

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