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Credit Research
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#chinadebt

Asia Credit Strategy

China onshore: drip, dribble, drizzle

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- **We look at China's onshore bond market to gauge the state of credit conditions for Chinese corporates. Our observations suggest that funding conditions have stabilized or improved modestly in terms of:**
  - Onshore non-AAA rated companies appear to have slightly better access to the onshore bond market;
  - The total amount of approved quota for bond issuance has increased;
  - Approved quota for MTN issuance bounced back, suggests potential for more longer-tenor issues; private companies started to receive MTN quota again; and
  - The length of time required for bond issuance quota to be approved has shortened.
- **However, SOEs and LGFVs still dominate the onshore bond market.**

Onshore bond market: A gauge of funding conditions

Issuance and maturities: Bond market, trust products, WMPs

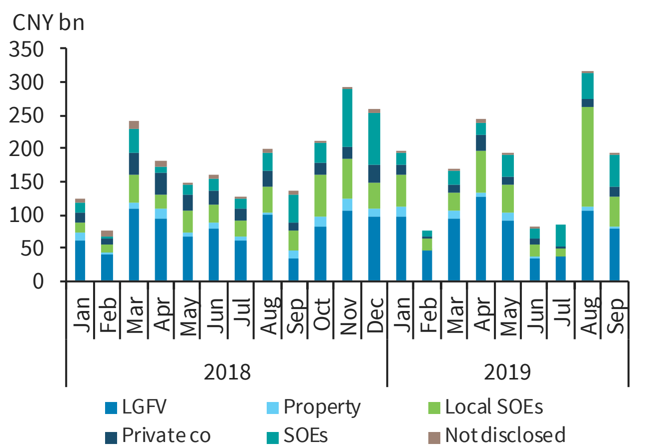
We monitor onshore credit conditions by tracking issuance and maturities in the bond market, and sales of trust products and wealth management products (WMPs). Recently, we detected some signs of improvement or stabilization in high-frequency data (see details in Appendix):

1. WMP issuance shows early signs of picking up – average weekly issuance (number of products) at end September was up 16%, to 1,599, from 1,375 between July and August (Figure 9);
2. Bond issuance by onshore non-AAA rated companies' rose in terms of both gross and net issuance, suggesting that non-AAA rated companies appear to have slightly better access to the onshore bond market (Figure 12).

The People's Bank of China (PBOC)[1] released a draft rule on 12 October that provided further details of the definitions of standard credit assets (which mostly refer to fixed-income securities, including government bonds, central bank bills, corporate bonds). The final version of the rule will be released later and will take effect by the end of 2020. This new regulation is intended to complement the new asset management rule, which will restrict investments in non-standard credit instruments (which were widely recognized as "shadow lending" in the industry, but previously were not stated clearly in regulations). For instance, under the new rule, bank investments in non-standard credit will be capped at 35% of the net assets of their WMPs.

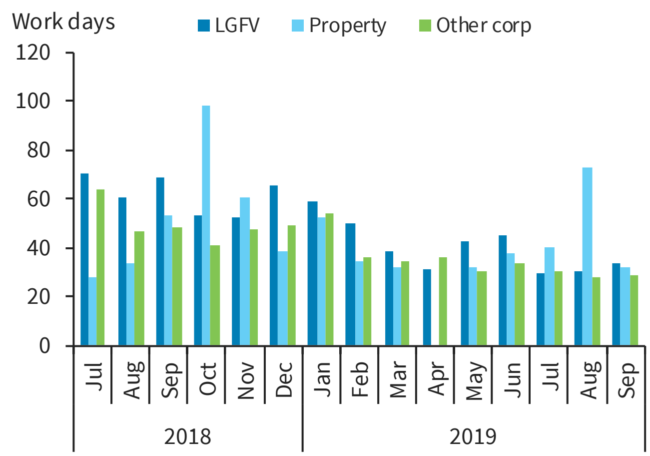
These rules will likely affect banks' and asset managers' portfolio allocation decisions in the long term. As a result, we think a part of the investment in the non-standard credit might be replaced by standard credit tools such as corporate bonds. These changes should also make the onshore bond market a better indicator of corporates' access to domestic funding.

FIGURE 1
Monthly bond quota approved by NAFMII



Source: WIND, Barclays Research

FIGURE 2
Shanghai/Shenzhen Exchange's quota approval cycle*



*Work days between application and approval. Source: WIND, Barclays Research

[1] China's PBOC Clarifies Standard Assets as New Regulations Loom, Bloomberg, 12 October 2019

Onshore bond quota: Approvals and pipeline

We track filings of quota applications to National Association of Financial Market Institutional Investors (NAFMII) and the Shanghai and Shenzhen Stock Exchanges for the past two to three months and observe that:

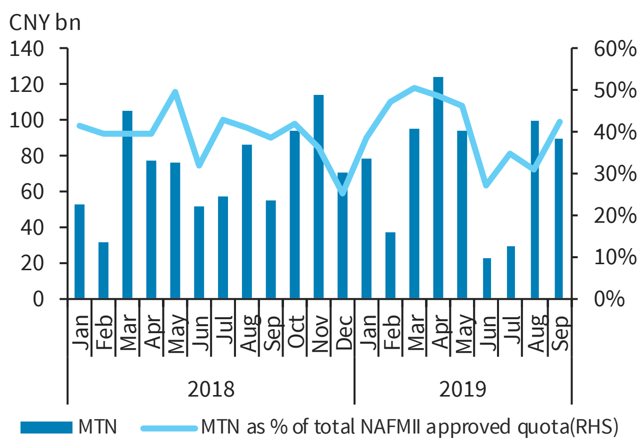
Total approved quota picked up, SOEs and LGFVs got most of the approved quota

- The total amount of approved quota has picked up during the past few months.
  - The amount of quota approved per month by NAFMII rose to CNY265bn on average in August-September from an average of CNY156bn a month during January-July (Figure 1).
  - The total amount of quota approved by the Shanghai and Shenzhen Exchanges has increased gradually since June, with the monthly approvals averaging CNY484bn during July-September versus ~CNY380bn a month in 1H19 (excludes a surge March).
- SOEs and LGFVs received most of the increased quota – ~85% of the total quota approved by NAFMII YTD and ~80% of total quota approved by the exchanges during August and September.

More MTN quota and faster approval process

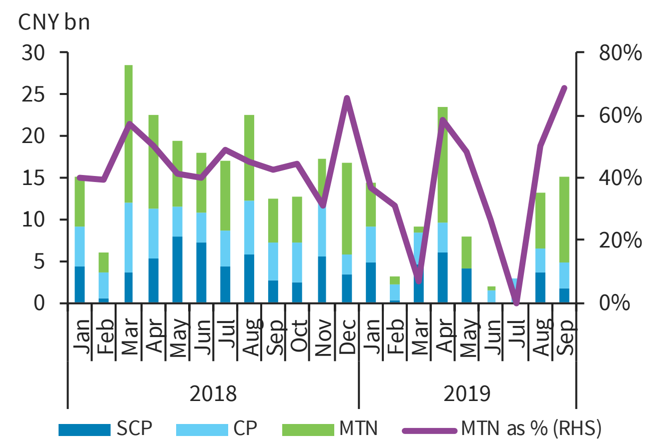
- NAFMII's increase in approvals of quota for medium-term notes (MTNs) suggests potential for more longer-tenor issues (Figure 3).
  - The monthly average MTN quota approved in August and September was CNY95bn, up from an average of CNY85bn from January to May and CNY26bn during June-July.
  - MTN quota as a percentage of total NAFMII approved quota rebounded to 42% in September from 31% during June-August.
- Private companies started to receive quota approval for MTN issuance again in August, after July approvals fell to zero. CNY8.5bn of MTN quota was approved in both August and September, compared with the monthly average of ~CNY4bn in 1H19 (Figure 4).

FIGURE 3
Monthly total MTN quota approved by NAFMII



Source: WIND, Barclays Research

FIGURE 4
Monthly approved NAFMII quota to private companies by bond type



Source: WIND, Barclays Research

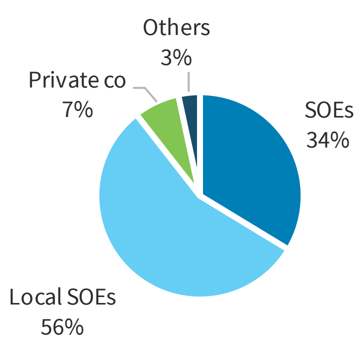
- Data from the Shanghai and Shenzhen exchanges show that the time required for quota approvals for non-property sectors (including SOEs, LGFVs and private companies) has shortened since July (Figure 2). We counted the number of working days between the day a quota application was received and the day the approval was recorded. We found that average approval cycle in 1H19 was ~40 days and that it has shortened to ~30 days since July. However, data for the property sector are volatile, therefore the trend is not clear at this stage.

Total approved quota broadly in line with maturities, but private companies have a gap

- The total approved quota in Q3 (~CNY1,865bn) is broadly in line with the total amount of maturities of onshore bonds in Q4 (~CNY1,851bn).
- The LGFV sector received 41% of the total approved quota in Q3, more than its share of Q4 onshore corporate bond maturities of 35%.
- The property sector accounts for very small part of the onshore market (~3% of both Q4 maturities and recently approved quota).
- Among other corporates (excluding LGFVs and property), there appears to be a mismatch between maturities over the next three month and quotas approved over the past two months:
  - In August and September, local SOEs' approved quota exceeded their Q4 maturities (CNY444bn of approved quota versus ~CNY286bn of maturities). In addition, data in percentage terms – 56% of the other corporates sector's quota versus 25% of the sector's maturities, possibly implies that the sector benefits from a favorable stance by regulators.
  - In contrast, private companies' approved quotas fell short of their maturities in both absolute and percentage term – they received CNY57bn (7%) of the sector's approved quota versus CNY170 (15%) of the sector's maturities.
  - SOEs received 34% of the other corporates' approved quota (CNY268bn) during the past two months, but the sector accounts for 58% of the maturities (CNY659bn) in

FIGURE 5

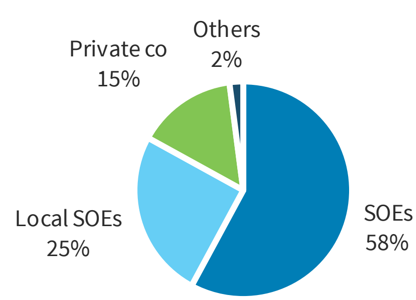
Other corporates' approved onshore bond quota Aug-Sep by segment



Source: WIND, Barclays Research

FIGURE 6

Other corporates' onshore bond Q4 maturities by segment



Source: WIND, Barclays Research

the next three months. However, we are less concerned about this gap, because we believe most SOEs usually have solid relationships with Chinese banks, as well as other onshore funding channels.

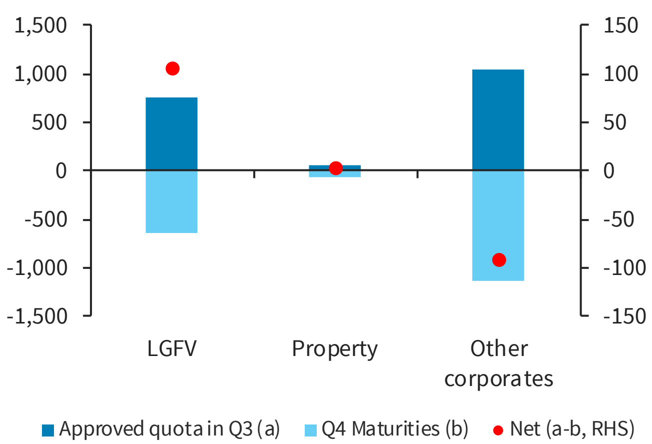
More quota on the way

We also examine the "quota applications" that are still in progress (i.e. not yet approved):

- Of "in progress" quota applications, 90% is from Local SOEs and SOEs.
- Although private companies account for a small portion (7%) of the "in progress" quota applications, their applications would largely cover their maturities if most are approved and are translated into real credit (Figure 8). We believe this is an important factor to monitor, as this could imply whether the sector has the access to the onshore market and could indicate the regulators' preference for this sector.

FIGURE 7

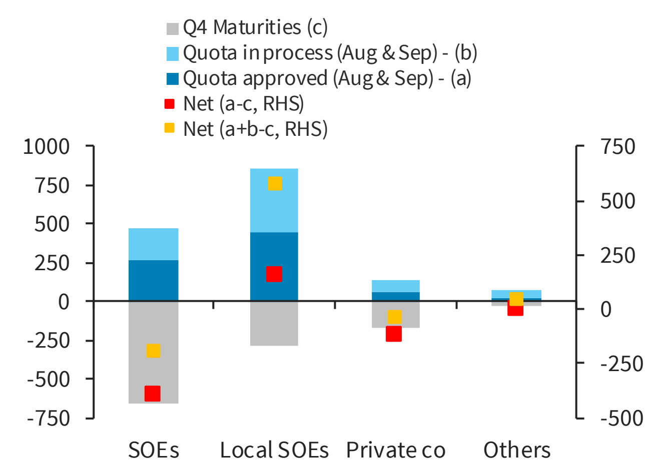
Onshore bond maturities and quotas by sector (CNY bn)



Source: WIND, Barclays Research

FIGURE 8

Onshore bond maturities and quota by segment* (CNY bn)

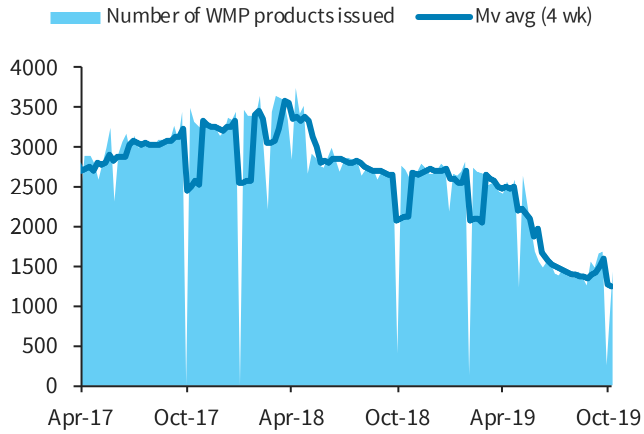


*Within other corporates sector in Figure 7. Source: WIND, Barclays Research

Appendix: Snapshot of China liquidity conditions

FIGURE 9

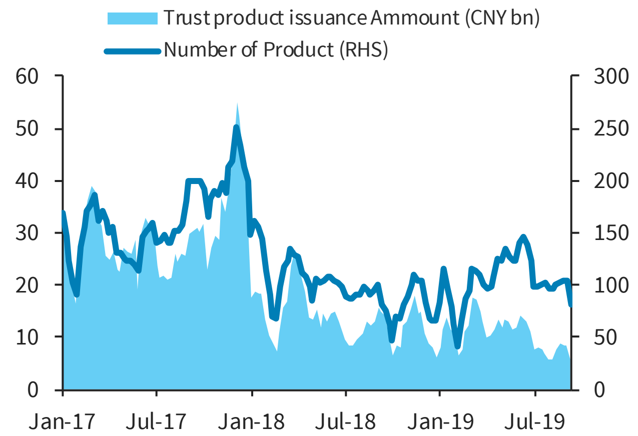
WMP issuance – early signs of bottoming



Note: The sharp drop in the first week of October is due to a national holiday in China. Source: WIND, Barclays Research

FIGURE 10

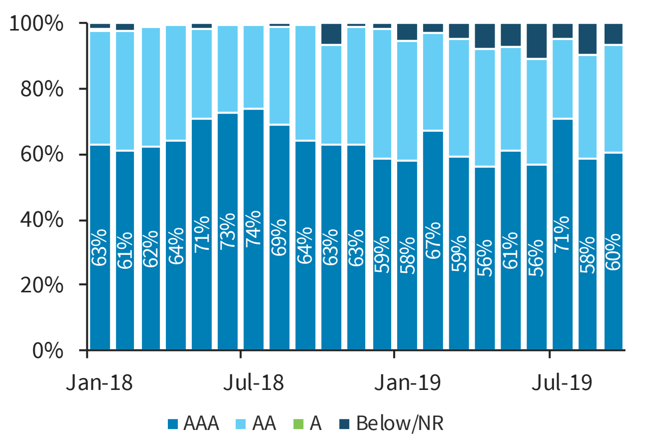
Trust product issuance continues to slow



Source: WIND, Barclays Research

FIGURE 11

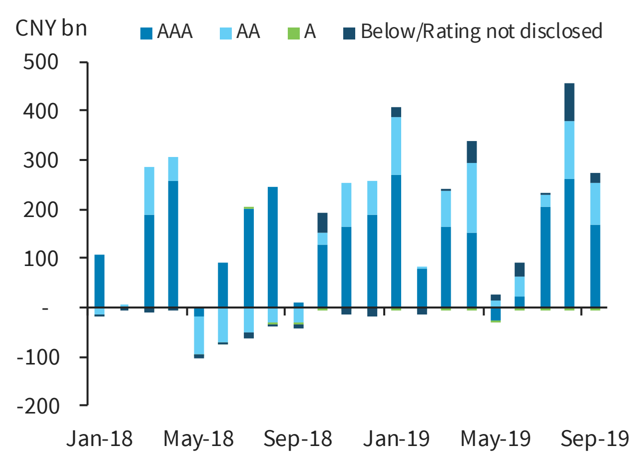
Gross corporate bond issuance by onshore rating bucket – issuance by non-AAA rated companies has bounced back since August



Source: WIND, Barclays Research

FIGURE 12

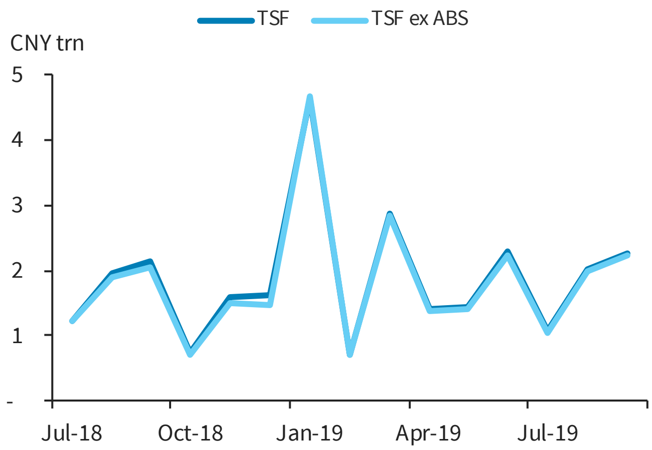
Corp bond net issuance picked up since July, larger proportion issued by non-AAA companies since August



Source: WIND, Barclays Research

FIGURE 13

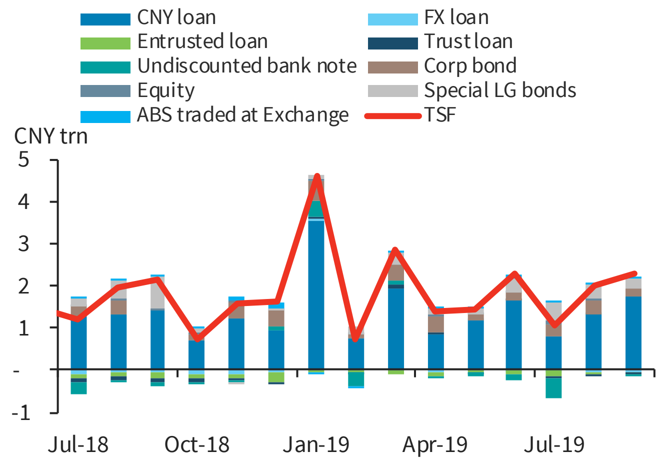
Total social financing stabilized under both the new and old definitions (old definition excludes exchange-traded ABS)



Source: WIND, Barclays Research

FIGURE 14

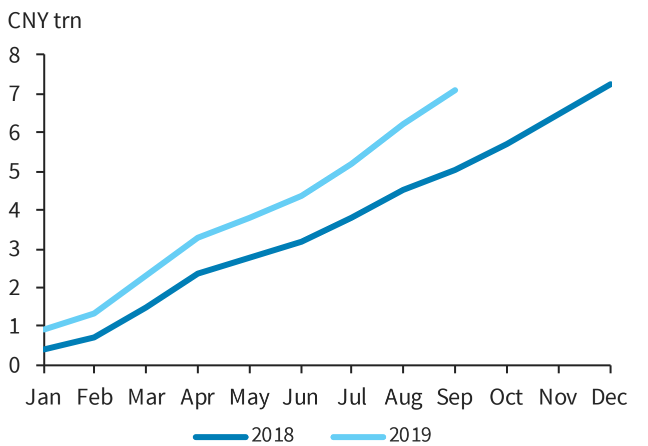
Total social financing breakdown



Source: WIND, Barclays Research

FIGURE 15

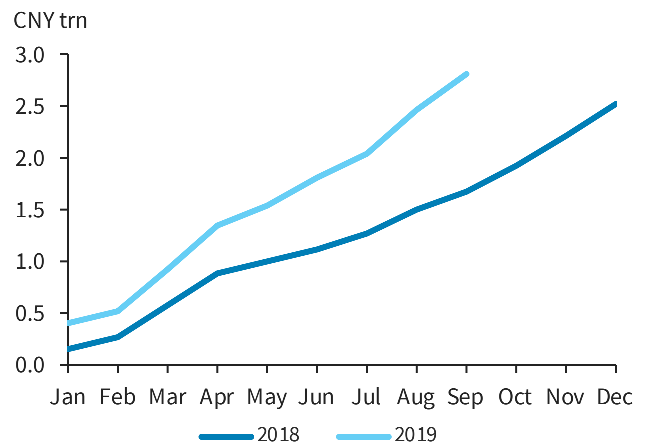
Gross corporate bond issuance – running total



Source: WIND, Barclays Research

FIGURE 16

Gross corporate bond issuance of non-AAA rated companies – running total



Source: WIND, Barclays Research

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