中証鵬元國際 CSPI Ratings

2024 Outlook for Chinese Local Government Creditworthiness

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Summary

Anticipated Modest Rise in Asset Prices in 2024 Set to Enhance Nominal GDP Growth Rates Across Chinese Provinces

In the past year, China grappled with relatively subdued domestic and external demand, leading to a decline in economic output prices. Consequently, the national nominal GDP growth rate stood at 4.6%, an uncommon occurrence where it lagged behind the real GDP growth rate by 0.6 percentage points. Insufficient demand directly contributed to the widening disparity in nominal GDP growth rates among provinces. Notably, only seven provincial-level regions, including Tibet, Hainan, Xinjiang, Shanghai, Guangdong, Zhejiang, and Beijing, managed to surpass the real GDP growth rate in terms of nominal GDP growth. These economies are either driven by tourism, agricultural sectors, or are well-developed, consumption-driven economies. Conversely, provinces heavily reliant on resources or heavy industries, such as Shanxi, Jiangxi, and Jilin, experienced significant disparities between nominal and real GDP growth rates. The decline in prices of key commodities and industrial products exerted downward pressure on their nominal GDP growth rates, subsequently impacting local residents' incomes and governments' tax revenues.

Looking ahead to 2024, a continued recovery in consumer spending, intensified infrastructure investment, effective implementation of policies supporting industrial economic growth, and the industrial enterprises of developed economies such as the US and Europe entering the restocking phase are expected to stimulate overall demand. This, in turn, may bolster China's producer price index (PPI) and provide an uplift to the economies of industrialized provinces. It is projected that in 2024, most provinces will regain nominal GDP growth rates surpassing real GDP growth rates, fostering a stronger sense of economic expansion.

Anticipated Fiscal Expansion in 2024 to Bolster Local Government Debt Ratios on an Upward Trajectory

In 2023, the sluggish land market led to a mediocre fiscal revenue recovery for local governments. However, sustained financial support from the central government, coupled with controlled fiscal expenditures, allowed most local governments to achieve a level of fiscal stability and witness a decline in the deficit-to-budgetary revenue ratio. Our estimations indicate that the average deficit-to-budgetary revenue ratio (deficit as a percentage of fiscal budgetary revenue)[1] for local governments decreased from 17% in 2022 to 15% in 2023. Notably, provinces such as Gansu, Jilin, Heilongjiang, and Xinjiang experienced a more pronounced narrowing of their deficits. These regions benefitted from continuous increases in central government financial support while being relatively less affected by the subdued performance of the land market.

Looking ahead to 2024, local governments are expected to face continued challenges in augmenting their fiscal revenues, as government fund revenues may persistently encounter constraints from the real estate market.

Consequently, leveraging further by the central government to support local finances will play a pivotal role in this year's proactive fiscal policies. It is projected

Note:1. Deficit=budgetary expenditure-revenue; Budgetary revenue=general public budgetary revenue + transfer payments + government fund revenue
This research report is written in Chinese. In case of any discrepancies between the English version and the Chinese version, the Chinese version shall prevail.

that local government fiscal initiatives will result in an overall expansion of deficit, thereby further elevating their debt burdens. The implementation of the “Debt Resolution Package' in 2023 led to a substantial increase in direct debt for local governments. However, the issuance of special refinancing bonds has helped local governments reduce the average interest rate of their broad debt and optimize their debt structure. It is anticipated that in 2024, local governments may continue to issue a certain volume of special refinancing bonds.

We Anticipate a Stable Outlook for the Overall Credit Profile of Chinese Local Governments

In 2023, a subdued nominal GDP growth led to an amplified divergence in regional economic development, however prudent fiscal management, augmented financial support from the central government, and the implementation of the “Debt Resolution Package” contributed to a modest decline in fiscal deficit level and an improvement in liquidity condition for local governments. This consequently fostered a solidification of the overall credit profiles of local governments.

Moving into 2024, as marginal recovery in aggregate demand takes hold and asset prices exhibit a potential moderate rebound, it is expected to uplift the nominal economic growth rates across various regions. The growth trajectory of fiscal and tax revenues of local governments is anticipated to sustain stability. However, the persistently sluggish land market and amplified fiscal expenditure intensity may escalate fiscal pressures at the local government level. Projections indicate a continued ascent in local government debt levels, yet the decline in government bond interest rates resulting from accommodative monetary policies is likely to maintain a reasonable level of interest payment burden for local governments.

As for local government financing vehicles (LGFVs), the steady government credit and effective implementation of the “Debt Resolution Package” are poised to support the creditworthiness of LGFVs in the medium to short term. Conversely, the reinforcement of financing control policies may restrict additional financing for certain regions with high debt burdens and lower administrative levels. As we navigate through 2024, it remains crucial to closely monitor potential tail risk.

Notable Disparities Among Provincial Nominal GDP Growth Rates in 2023

In 2023, provinces heavily reliant on resource-intensive and heavy-industry sectors exhibited a lacklustre performance in terms of nominal GDP growth rates

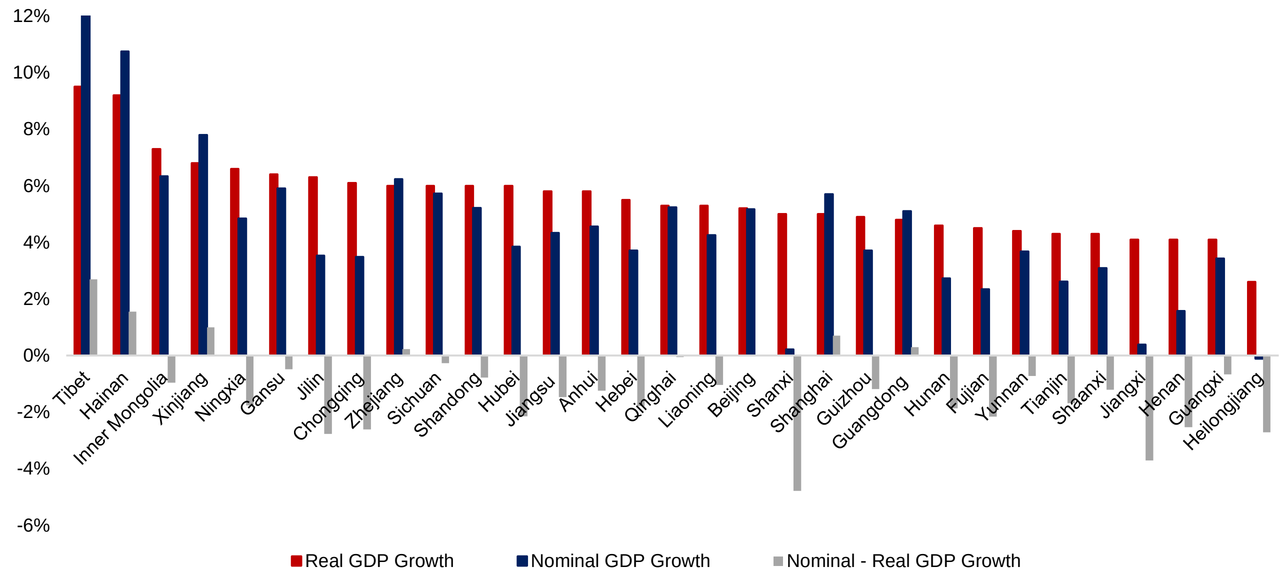
In 2023, the national GDP reached RMB126 trillion, representing a 5.2% year-on-year growth in constant prices. However, the nominal GDP growth rate stood at 4.6%, resulting in a rare occurrence of nominal GDP trailing behind real GDP growth—an unprecedented phenomenon in the past two decades. This inversion between nominal and real GDP growth rates can be attributed to a decline in output prices and overall sluggishness in demand.

Examining the provincial landscape, 17 provinces outperformed the national average in terms of real GDP growth. Tibet, Hainan, Inner Mongolia, and Xinjiang emerged as frontrunners, benefiting from the impetus generated by industries such as tourism, agriculture, and fixed asset investments. Conversely, Heilongjiang, Guangxi, and Henan reported relatively lower GDP growth rates, reflecting the challenges encountered during their ongoing industrial transformation and upgrade processes.

Furthermore, a significant divergence in nominal GDP growth rates was observed among provinces. Tibet recorded an impressive nominal GDP growth rate of 12.2%, while Heilongjiang experienced a contraction of -0.1%. Only seven provincial-level regions—Tibet, Hainan, Xinjiang, Shanghai, Guangdong, Zhejiang, and Beijing—witnessed nominal GDP growth rates surpassing their real GDP growth rates. These regions are predominantly driven by tourism, agriculture-based economies, or thriving consumer-driven industries.

Conversely, provinces with substantial gaps between nominal and real GDP growth rates tend to rely on resource-intensive or heavy-industry-oriented sectors. For instance, Shanxi, Jiangxi, and Jilin faced challenges as the decline in prices of key commodities and industrial products impacted their nominal GDP growth rates, subsequently affecting residents' income levels and government tax revenue.

Exhibit 1: Real GDP and nominal GDP growth of provincial-level regions in 2023



Source: National Bureau of Statistics, Local governments' bureaus, CSPI Ratings compiles

In 2024, there is optimism for a potential amelioration of the demand deficiency, which is anticipated to boost the nominal GDP growth rates of provinces

In 2023, the economy was impacted by weak exports and a decline in real estate investment, leading to a significant increase in the contribution of consumption to overall economic growth. It is anticipated that in 2024, consumption will continue to be a pivotal driver of economic expansion, with economically developed provinces maintaining a stable growth trajectory. However, fixed asset investment is expected to remain constrained due to the ongoing downturn in real estate development investment. Infrastructure investment will serve as a key pillar of support for fixed asset investment, ensuring that investment levels remain stable across provinces.

In 2023, the national Consumer Price Index (CPI) saw a marginal uptick of 0.2%, while the Producer Price Index (PPI) for industrial production recorded a year-on-year decline of 3%. Looking ahead, the implementation of policies aimed at promoting industrial economic development, coupled with the developed economies' industrial sector entering a restocking phase, is expected to stimulate demand and potentially narrow the decline in PPI. This bodes well for the revitalization of the economies in major industrial provinces.

Moreover, it is projected that in 2024, a majority of provinces will witness nominal GDP growth rates surpassing their real GDP growth rates. This is expected to enhance the perceptible impact of economic growth, thereby accelerating the nominal GDP growth rates of provinces. As for the economic growth targets set for 2024, many provinces are maintaining or revising their targets lower, prioritizing stability in economic expansion. However, the quality of economic development will improve, which will have positive implications for the growth of local government's fiscal revenue.

Fiscal Expansion Is in the Pipeline in 2024

During the latter half of 2023, local governments encountered mounting pressures on their fiscal revenue

The national general public budgetary revenue for the 2023 fiscal year experienced a notable year-on-year growth of 6.4%. However, this growth was primarily driven by a significant increase of 45.3% in value-added tax (VAT) revenue, which was influenced by the low base resulting from the tax rebate initiative from the previous year. Conversely, other major tax categories and non-tax revenue witnessed a decline, thereby impeding the overall recovery momentum of the general public budgetary revenue.

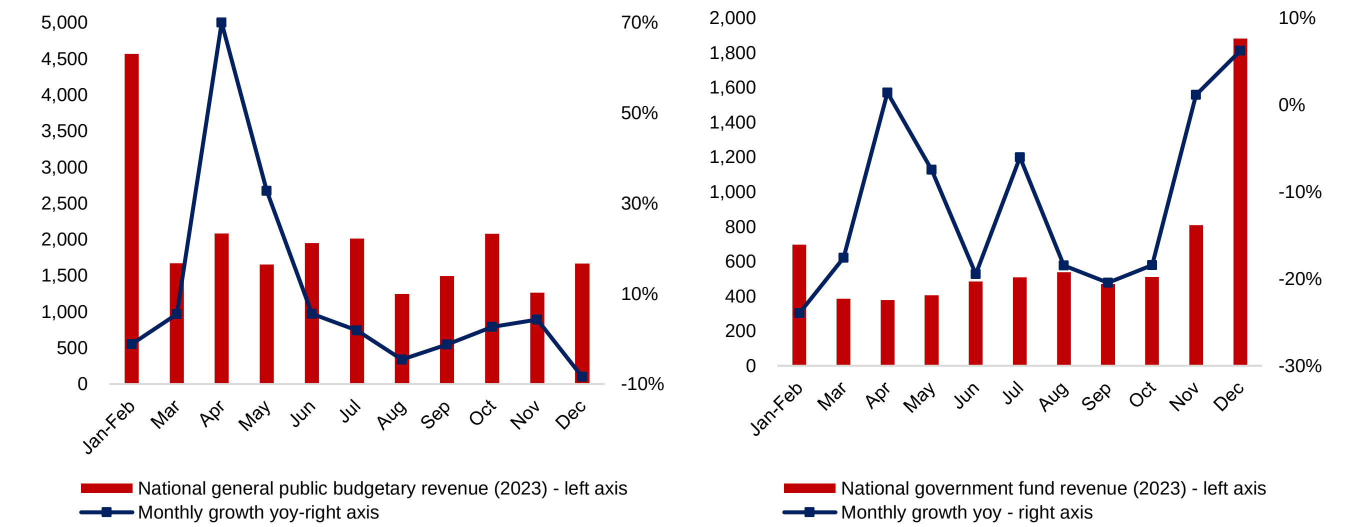
Meanwhile, the general public budgetary expenditure recorded a relatively moderate year-on-year growth of 5.4%, indicating a narrower increase compared to the previous year. The deficit for the general public budget in 2023 remained relatively stable at approximately RMB5.8 trillion, holding a similar level to that of 2022. This suggests a consistent level of fiscal pressure on the general public budget of local governments.

At the national level, the government fund budget experienced a decline in revenue and expenditure of 9.2% and 8.4% respectively. Consequently, the deficit for government fund budget narrowed to RMB3.1 trillion in 2023, compared to RMB3.3 trillion in the previous year. Based on these figures, we estimate that the overall budgetary revenue in China grew by 2.1% year-on-year in 2023, while overall budgetary expenditure increased by 1.3%. These growth rates were significantly lower than the country's economic growth rate, indicating a relatively restrained expansion in the fiscal sector throughout the year.

Looking into the monthly revenue changes, it is noteworthy that national general public budgetary revenue experienced substantial year-on-year growth in April and May, largely influenced by the low base resulting from the implementation of the tax rebate policy in 2022. However, the growth rate started to converge from June onwards. The year-on-year decline of 5.4% in the second half of 2023 for national general public budgetary revenue reflects the notable pressure faced by the fiscal revenue collection during this period, compounded by the relatively weak performance of the economy.

Regarding government-operated funds, revenue remained lacklustre throughout 2023, primarily due to the persistent downturn in the real estate market. However, the decline was relatively less severe compared to the previous year. Notably, the months of November and December experienced a rebound in government fund revenues, potentially attributed to the government's intensified efforts to concentrate land auctions towards the year-end. This initiative contributed to a temporary improvement in government fund revenues during that period. Nonetheless, the sustainability of this growth needs to be closely monitored.

Exhibit 2: Monthly change in nationwide budgetary revenue trend (RMB billion)



Source: Ministry of Finance, CSPI Ratings compiles

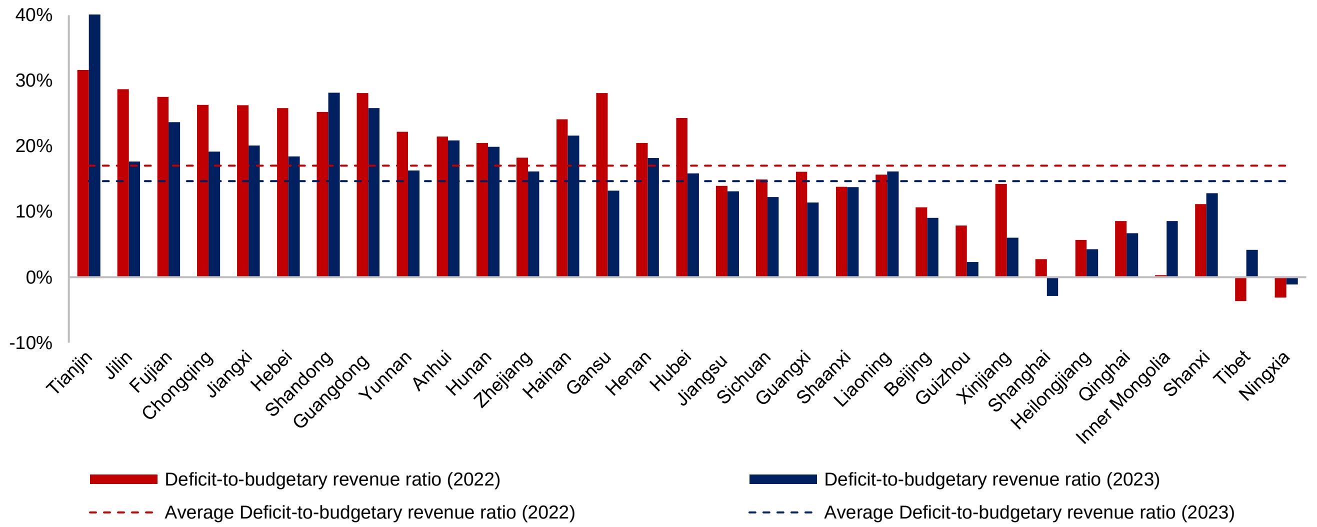
In 2023, the bulk of provincial-level regions in China witnessed a decline in their deficit-to-budgetary revenue ratios

Despite the moderate recovery of local government fiscal revenues due to the impact of the real estate market, the consistent financial support from the central government, coupled with corresponding measures to curtail fiscal expenditure, enabled most local governments to achieve a level of fiscal stability and reduce their deficit-to-budgetary revenue ratios.

Based on our calculations, the average deficit-to-budgetary revenue ratio (deficit/ budgetary revenue) for local governments in 2023 decreased from 17% in 2022 to 15%, indicating a moderate alleviation of fiscal deficit pressure. Notably, provinces such as Gansu, Jilin, Heilongjiang, and Xinjiang experienced a significant narrowing of their deficit. These regions heavily rely on financial subsidies from the central government, while their reliance on land transfer revenue is relatively low. Consequently, they benefited from the continuous increase in central government financial support throughout 2023 and were less affected by the sluggishness in the real estate market, leading to favourable growth in fiscal revenues.

Conversely, regions like Tianjin, Shandong, and Henan, which faced a deeper impact from the real estate market and encountered substantial fiscal expenditure pressures, witnessed a further increase in their deficit levels in 2023.

Exhibit 3: The average deficit-to-budgetary revenue ratio of provincial governments declined in 2023



Note: 1. Deficit-to-budgetary revenue ratio=Deficit/Budgetary revenue 2. Budgetary revenue includes general public budgetary revenue, transfer payments and government fund revenue; 3. Fiscal data of Hebei, Fujian, Shaanxi, Inner Mongolia, Heilongjiang and Gansu in 2023 are based on our estimates.
Source: Ministry of Finance, Local governments' bureaus, CSPI Ratings estimates

In 2024, local governments in China are poised to strengthen their fiscal expansion efforts

Local governments will continue to grapple with significant challenges in generating sufficient revenue. The growth of general public budgetary revenue is expected to remain moderate, in line with the ongoing economic recovery. However, government fund revenue may be constrained by the persistent sluggishness in the real estate market, albeit with a narrower decline projected. Notably, relatively developed regions are anticipated to fare better in terms of land sales revenues compared to their less-developed counterparts.

It is important to note that China's overall economic recovery currently faces notable weaknesses, with the foundation of the recovery yet to solidify. Against this backdrop, a further proactive fiscal approach becomes increasingly crucial. The national fiscal policy for 2024 emphasizes a strategy of "moderate reinforcement and enhanced quality and efficiency," with a focus on increasing balanced transfer payments to local governments. Given the potential ongoing constraints on local fiscal revenue sources, the central government will leverage its fiscal capacity to provide substantial support to local governments, serving as a pivotal mechanism for implementing proactive fiscal policies throughout the year.

In the fourth quarter of 2023, the central government issued RMB1 trillion worth of government bonds, which were allocated to local governments at the beginning of 2024. These funds will provide robust support for local governments' fiscal expenditures during that period. Anticipating a continued commitment to supporting local finances, it is expected that the central government will further enhance its assistance to local governments, elevating the level of financial security. Consequently, regions with a higher degree of reliance on central government transfer payments are likely to experience sustained growth in their income streams.

Turning to expenditure considerations, while China maintained an overall proactive fiscal policy in 2023, the actual extent of fiscal expansion was relatively moderate, with broad fiscal expenditure growing by a mere 1.3% year-on-year. Thus, it was virtually a year of fiscal restraint. In 2024, given the persistent downward pressure on the economy and the imperative to stabilize growth and foster confidence, the government's fiscal expenditure efforts will be further intensified. This may result in an overall increase in deficit for local governments.

LGs' Debt Level Is on a Persistent Upward Trajectory

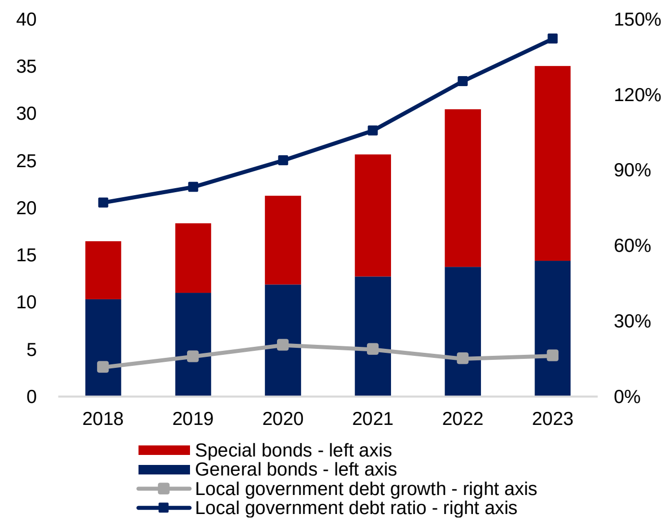
In 2024, local governments in China are expected to persist moderate increase in their overall direct debt ratio, with an issuance pattern characterized by higher issuance in the early part of the year followed by a decrease

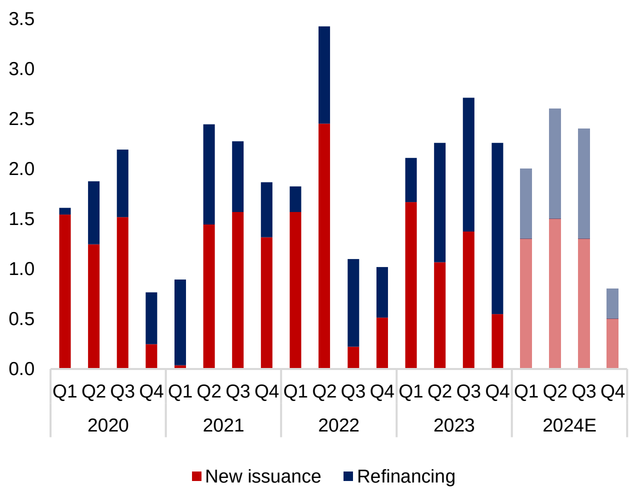
In 2023, the total issuance of local government bonds nationwide reached RMB4.66 trillion, slightly lower than the previous year. However, the substantial growth in special refinancing bonds, which are mainly used to replace hidden debts, led to a significant increase in the direct debt outstanding number of local governments, reaching RMB40.7 trillion by the end of 2023. This represents a year-on-year increase of 16.2%, surpassing the growth rate of the previous year. Meanwhile, the overall budgetary revenue of local governments in 2023 showed only a modest 2.1% increase compared to the previous year.

Based on our estimations, the overall direct debt ratio of local governments reached 142% by the end of 2023, indicating a notable increase compared to the previous year. However, it is important to consider that a significant portion of the debt issued was aimed at replacing hidden debts, the overall debt pressure on local governments has not been exacerbated significantly.

Examining the issuance pace, the total issuance of local government bonds in each quarter of 2023 was relatively balanced, with higher issuance volume observed in the first three quarters. In the fourth quarter, driven by the implementation of the "Debt Resolution Package," there was a significant increase in the issuance of refinancing bonds. For 2024, it is projected that the issuance pace of bonds will maintain a front-loaded pattern, with a higher supply of local government bonds anticipated in the first and second quarters. We estimate that the new local government bond issuance quota in 2024 will be approximately RMB4.6 trillion, with around RMB3.8 trillion allocated for special bonds and approximately RMB800 billion for general bonds.

Exhibit 4: LGs' debt ratios and bond issuance (RMB billion)





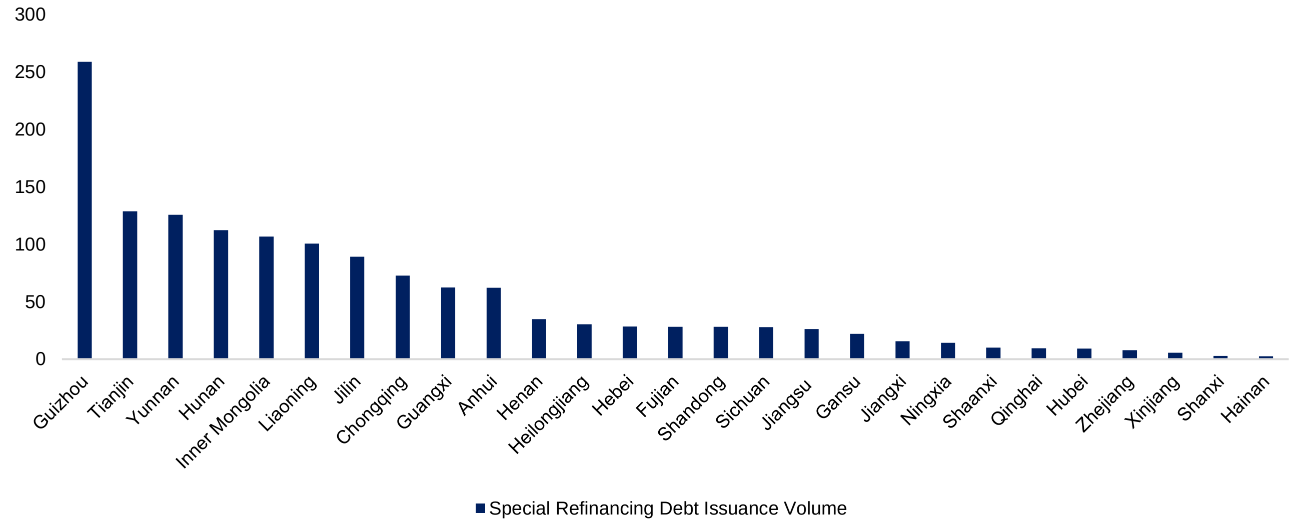
Source: Ministry of Finance, Wind, CSPI Ratings compiles

Regions with substantial debt restructuring efforts have experienced a notable acceleration in the growth of their direct debt

In July 2023, the central government introduced the "Debt Resolution Package" to effectively mitigate and address local government debt risks. This initiative has propelled the resolution of debts within local governments. Starting in October, provincial-level governments commenced the issuance of special refinancing bonds mainly aimed at replacing hidden debts. We contend that this measure serves to optimize the debt structure of local governments, reduce the interest cost of their broad debt, and enhance their overall liquidity. While the debt restructuring plan itself has inherent limitations in terms of alleviating the burden of hidden debts for local governments, the message of central government support conveyed through this initiative has bolstered financial market expectations regarding local government credit outlook.

As of February 2024, the total issuance of special refinancing bonds by local governments has surpassed RMB1.4 trillion. Notably, Guizhou has exhibited the highest issuance scale, reaching RMB258.8 billion, which is double that of the second-ranked Tianjin. The provinces with higher levels of special refinancing bond issuance are predominantly those facing significant debt pressures in recent years. Moreover, the issuance of special refinancing bonds has displayed a degree of concentration, with the top five provinces accounting for over 50% of the total issuance. This concentration underscores the targeted strategy of this debt resolution measure. It is worth noting that local governments still possess approximately RMB1.4 trillion of available debt quota as of the end of 2023, indicating the potential for further issuance of special refinancing bonds in the coming two years.

Exhibit 5: As of February 2024, the issuance scale of special refinancing bonds in various provinces (RMB billion)

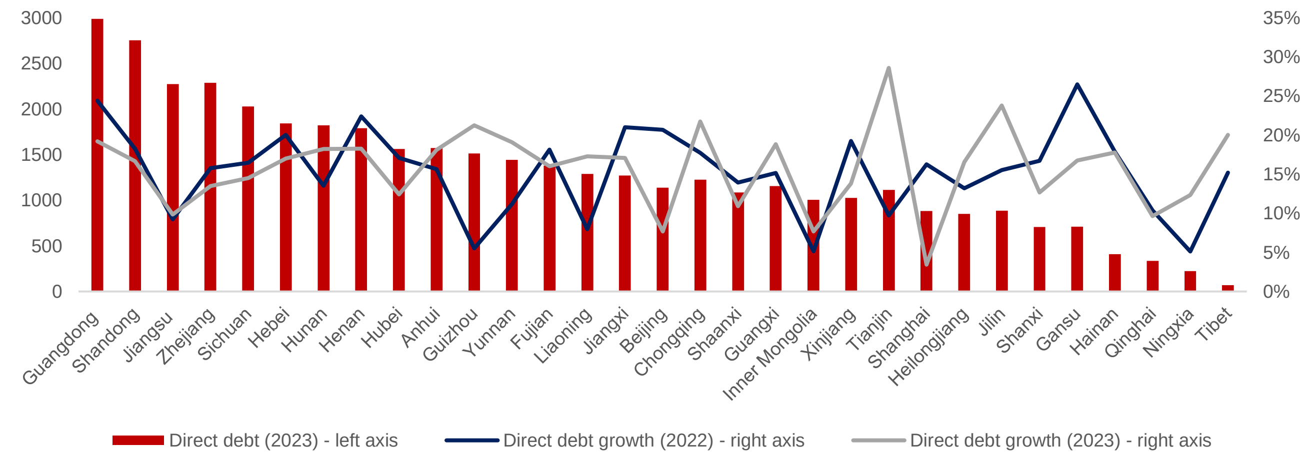


Source: Local governments' bureaus, CSPI Ratings compiles

The implementation of the " Debt Resolution Package" has had an impact on the year-on-year growth of local government's direct debt in 2023, showing a slight increase compared to the overall figure in 2022. Regions that have made significant efforts in debt restructuring have experienced a faster growth rate in their direct debt, exemplified by provinces such as Guizhou, Tianjin, and Hunan. Most other provincial-level areas have maintained the growth momentum in their direct debt observed in recent years. Conversely, developed regions like Beijing, Shanghai, Guangdong, and Zhejiang have seen a decrease in the year-on-year growth rate of their direct debt in 2023 compared to 2022.

Looking ahead to 2024, it is projected that local government debt will continue to exhibit a relatively high growth rate as a result of the proactive fiscal policy.

Exhibit 6: Direct debt growth of provincial governments (RMB billion)



Source: Local governments' bureaus, CSPI Ratings compiles

Outlook of Local Government Creditworthiness

The outlook of the overall creditworthiness of local governments in China will maintain stable in 2024

In 2023, despite the mediocre performance of nominal economic growth and the widening development gap among local governments, prudent fiscal management, increased financial support from the central government, and the implementation of the "Debt Resolution Package" have contributed to a decrease in local government deficit-to-budgetary revenue ratio and a modest improvement in liquidity conditions. As a result, the overall creditworthiness of local governments was reinforced.

In 2024, it is projected that the marginal recovery of overall demand and a potential moderate rebound in asset prices will contribute to a favourable economic outlook. This, in turn, is expected to enhance the quality of economic growth and drive stable increases in fiscal and tax revenues across different regions. However, it is important to note that the subdued real estate market and the intensified fiscal expenditure may amplify fiscal pressures faced by local governments. Consequently, it is expected that the central government will maintain a high level of fiscal support to local governments, facilitating their fiscal expansion and ensuring that fiscal pressures remain within reasonable bounds.

While local government debt levels are projected to continue their upward trajectory in 2024, the decline in government bond interest rates resulting from accommodative monetary policies is expected to help keep interest payment burdens of local governments at a manageable level. This, in turn, will contribute to maintaining stable liquidity for local governments. Overall, we believe the credit outlook of China's local governments will remain stable throughout 2024.

The credit profile of the LGFV sector is expected to maintain an overall stable

The implementation of debt resolution policies has facilitated the replacement of high-interest LGFV debts with low-interest local government bonds. The reinforced expectations of government support have bolstered market confidence in LGFVs, leading to an alleviation of overall refinancing risk. Consequently, financing costs have experienced a certain degree of decline. However, regulatory authorities have concurrently intensified their oversight of new LGFV debt raises, resulting in narrower financing channels and increased difficulty in securing new financing. Thus, it is anticipated that regulatory pressures on LGFV financing will remain high in 2024, maintaining the general debt control method of reducing existing debts while curbing new debts.

While the credit profiles of local governments are expected to remain stable in 2024, it is important to recognize that underdeveloped and lower administrative-level regions, which have experienced a decline in land sales revenues over the past two years, continue to face challenging fundamentals. Particularly, regions with significant debt burdens and limited benefits from the "Debt Resolution Package" may still contend with liquidity risks, given the substantial capital spending made in previous periods to stimulate the economy and stabilize the real estate market.

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