

China offshore bond market 2024 outlook

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Summary

China offshore USD-denominated bond issuance to be stagnant. With the backdrop of the US interest rate hike and the appreciation of the US dollar, the financing costs for issuing offshore USD bonds have increased for Chinese issuers. As a result, China offshore USD bond issuance declined 34% year on year to USD61 billion in 2023. With the US interest rate cut remained uncertain and the high interest rate environment may last for some time, we expect USD bond issuance in the offshore market to be stagnant in 2024. Chinese issuers, who have little exposure to overseas business, are likely to turn to the onshore market for financing due to lower funding costs.

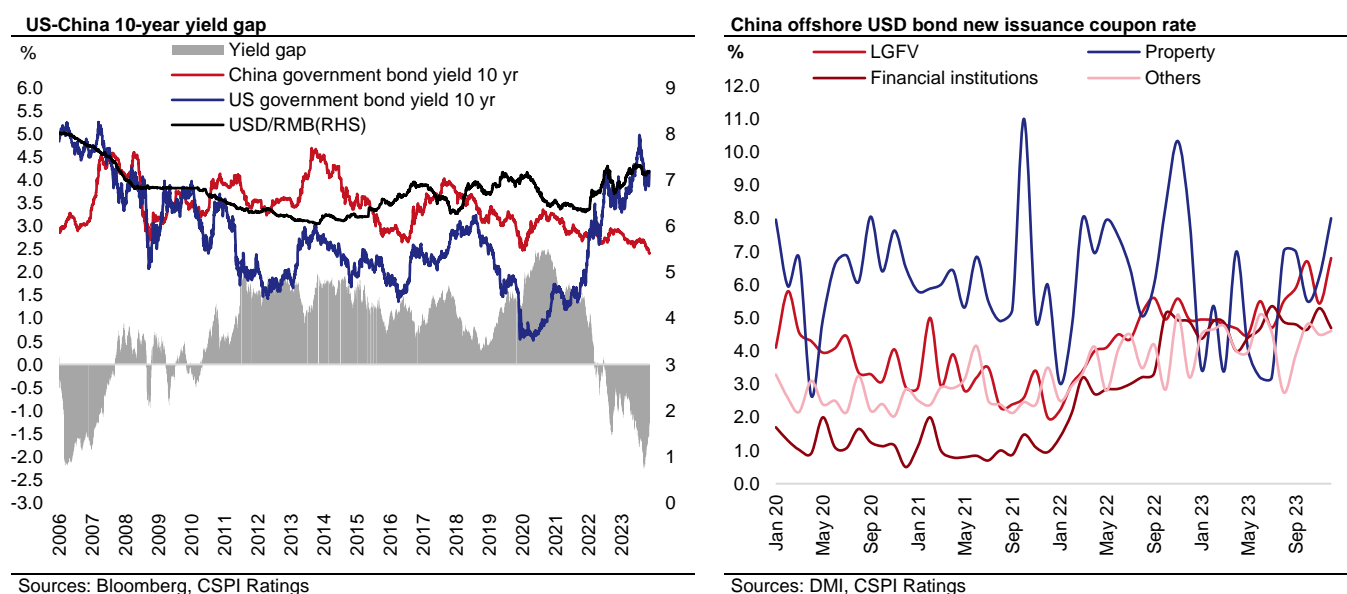
Local government bond issuance influenced by regulatory changes. Local government financing vehicle (LGFV) USD bond issuance has declined by 66% to USD13 billion in 2023. Including offshore RMB bond issuance, the overall LGFV offshore issuance was USD31 billion, dropping 34% year-on-year. The decline was caused by the rigorous restrictions on the offshore issuance approval. In 2024, the refinancing pressure for LGFVs will still exist and we anticipate that offshore LGFV issuance will continue to be heavily influenced by regulatory changes. The Chinese government is determined to set up “a basket of measures” to resolve local debt, which may include additional funding or refinancing channels, debt swaps, asset sales, the central bank’s special purpose vehicles (SPVs), payment extensions, and debt restructurings. By doing these, the government aims to tackle the local government debt by controlling the outstanding balance and reducing the growth of new debt.

Liquidity in the property sector remains constrained. The issuance of property offshore USD bonds increased 19% year-on-year to USD16 billion in 2023, thanks to the debt restructuring or extension. Except for the distressed restructurings, developers were barely able to secure financing in the offshore bond market. The liquidity crisis in the property sector in the past few years has weakened market confidence. Though the Chinese government has introduced a series of measures to stabilize the property market, market confidence remains fragile, with residential property sales falling 12% in 2023. Funding access has been constrained for most market players. In 2024, there will be USD110 billion property bond maturities in the onshore and offshore market. We expect further restructuring and consolidation of the market.

Dim Sum bond and panda bond still offer attractive funding costs to issuers. In contrast to weak USD bond issuance, the issuance of Dim Sum bonds and panda bonds, reached a record size of RMB341 billion and RMB155 billion in 2023, up 57% and 82% year-on-year, respectively. The surge in Dim Sum bond and panda bond issuance is driven by their attractive financing costs, RMB internationalization and continuous improvement of the regulatory framework. In 2024, we expect Dim Sum bond and panda bond issuance will continue to be attractive to the issuers given the lower funding costs. In addition, RMB-denominated bonds would be favored by investors who are interested in diversifying their portfolios.

Offshore issuance declined on the back of expanding US-China interest gap

China offshore USD bond issuance declined 34% year-on-year to USD61 billion in 2023. The high borrowing costs, caused by the widened US-China interest rate spread and a stronger USD, have held back Chinese companies from issuing USD bonds. The average coupon rate of the USD-denominated new issuance with a 3-year tenor increased to 5.1% in 2023 from 4.8% in 2022 and 3.4% in 2021. The coupon rates for Chinese property issuers have been influenced by the default crisis in the property sector, while the coupon rates for LGFV (Local Government Financing Vehicles) and FI (Financial Institutions) issuance have been largely moving with the base rates. We expect USD bond issuance in the offshore market to be stagnant in 2024. Chinese issuers, who have little exposure to overseas business, are likely to turn to the onshore market for financing due to lower funding costs.

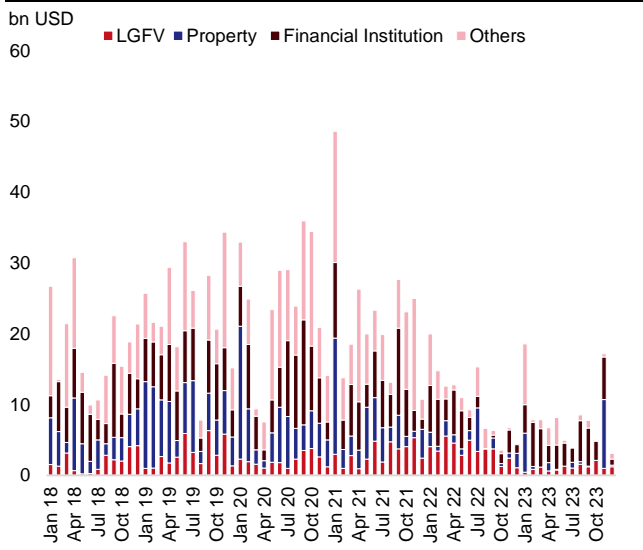


In particular, LGFV USD bond issuance declined 66% to USD13 billion in 2023. Some LGFVs chose to issue free-trade zone (FTZ) bonds or Dim Sum bonds for favorable financing costs. In the fourth quarter of 2023, the 364-day issuance totaled USD1.8 billion, which increased substantially by 190% quarter-on-quarter. Including the FTZ bond and Dim Sum bond, the overall LGFV issuance was USD31 billion in the offshore market, dropping 34% year-on-year. The contraction was caused by the stringent control over the LGFV's offshore financing since late 2022 and curbs on FTZ bonds in the second half of 2023. According to recent press reports, the issuance of 364-day offshore bonds by LGFV was suspended.

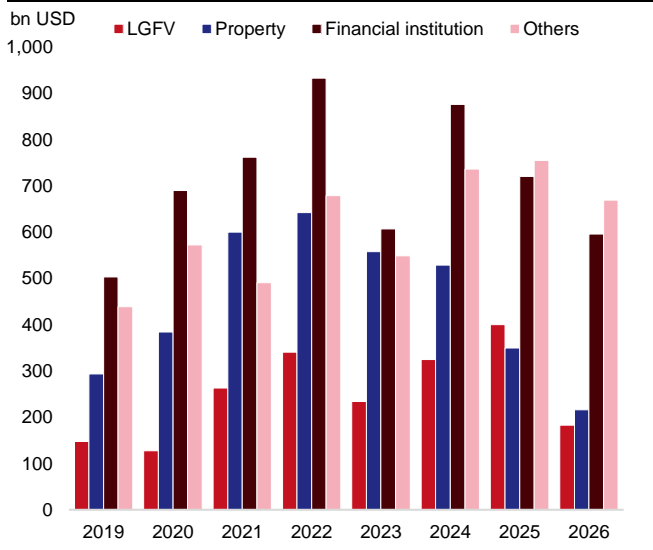
In 2024, the refinancing requirements for LGFV are still high, with USD840 billion and USD32.5 billion maturities in the onshore and offshore bond markets, respectively. We expect offshore LGFV issuance to continue to be heavily influenced by the policy changes. China's government is determined to set up "a basket of measures" to resolve the local debt, which may include additional funding or refinancing channels, debt swaps, asset sales, the central bank's special purpose vehicles (SPVs), payment extensions, and debt restructurings. By doing these, the government aims to tackle the local government debt by controlling the outstanding balance and reducing the growth of new debt.

The issuance of property offshore USD bonds increased 19% year-on-year to USD16 billion thanks to the debt restructuring or extension. Except for the distressed exchanges, Chinese developers were barely able to secure financing in the offshore bond market. Negative credit events in the property sector in the past few years have weakened market confidence. Though the Chinese government introduced a series of measures to stabilize the property market, market confidence remains fragile, with residential property sales declining by 12% in 2023. Property development sources of funds declined remarkably by 14% during the same time. In 2024, Chinese developers will have USD110 billion maturities in the onshore and offshore bond market. We expect Chinese property issuers to continue to face repayment pressure. With the sluggish property sales, liquidity will continue to be constrained for most Chinese developers. We expect China's property market is undergoing further consolidation and restructuring.

China offshore USD bond issuance



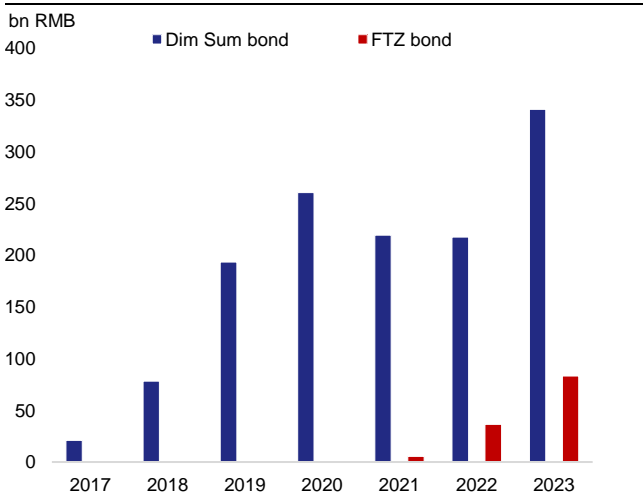
China offshore USD bond maturities



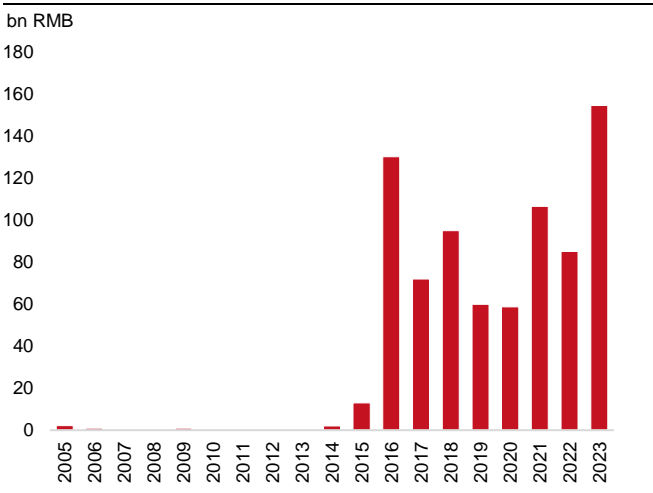
Dim Sum bond and panda bond issuance surged

In contrast to the weak USD bond issuance, the issuance of Dim Sum bonds, offshore bonds denominated in RMB, reached a record size of RMB341 billion in 2023, up 57% year-on-year. The total outstanding Dim Sum bond reached its 10-year high of RMB653 billion by the end of 2023. Since the second half of last year, the financing cost of issuing Dim Sum bonds and swapping them into USD has been lower than that of direct issuance of USD bonds. The issuers of Dim Sum bonds are mainly governments, policy banks, supranational banks, and financial institutions. International issuers leverage Dim Sum bonds to access offshore RMB liquidity, diversify their funding sources, or raise capital to finance their operations in China. The investors of Dim Sum bonds are mostly financial institutions with a Chinese background, or "Southbound Pass" funds.

Issuance of Dim Sum bond and FTZ bond



Issuance of Panda bond

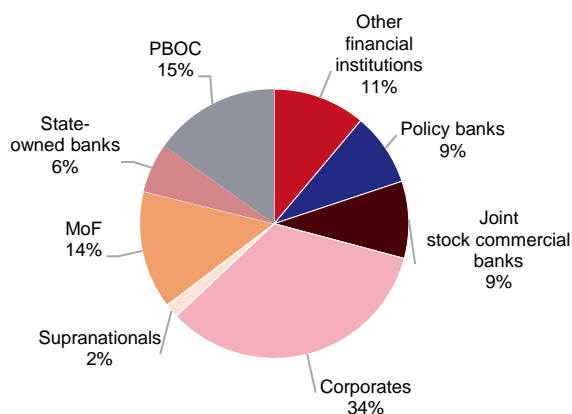


Meanwhile, the issuance of panda bonds, RMB-denominated bonds issued by offshore issuers in China's onshore market, increased substantially by 82% and reached RMB155 billion in 2023. The increase has mainly come from the red-chip companies of China's state-owned enterprises, which recorded a year-on-year 117% increase in panda bond issuance in 2023. Issuance from supranationals, private companies, international banks, and corporates increased 73% year-on-year. Issuance from wholly foreign-owned enterprises (WFOE), companies established in China and wholly owned by international

investors, declined 54% year-on-year as the international companies continued to diversify their operations beyond China. Around 97% of the panda bond issuance was in China’s interbank bond market, with the rest in the exchange-listed market. 95% of the panda bond issued in 2023 had a tenure of less than 3 years. We expect the momentum of panda bond issuance to remain strong in 2024.

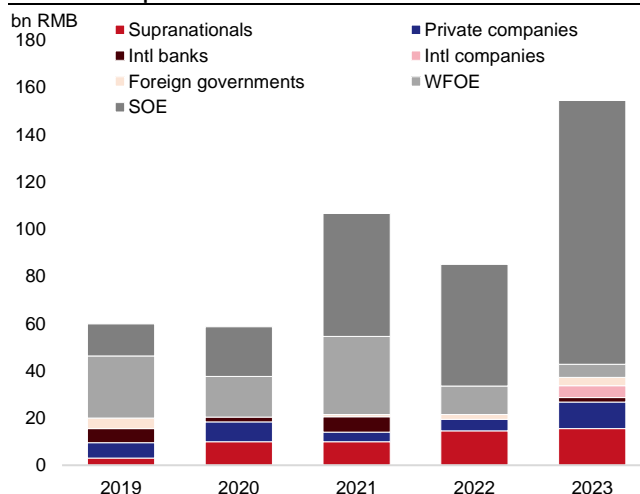
Lower domestic interest rates, together with a weaker RMB, provided a cost advantage to the panda bond issuers and were one of the drivers behind the surge. In 2023, the average coupon rate for panda bonds was 2.9%, in contrast to the average coupon rate for offshore USD-denominated bonds of 5.1%.

Breakdown of Dim Sum bond issuers (2023)



Sources: Wind, CSPI Ratings

Breakdown of panda bond issuers



Sources: Wind, CSPI Ratings

The internationalization of the renminbi has also helped to accelerate the expansion of the Dim Sum bond and panda bond market. The currency’s share in global payments has almost doubled to 4.6% in December 2023, from 1.9% in January 2023, according to Swift, the international payments platform.

In addition, continuous improvement of the regulatory framework has simplified the issuance procedure and made the panda bond more favorable for international issuers. In July 2022, NAFMII (National Association of Financial Market Institutional Investors) launched a pilot program to streamline the panda bond registration and issuance. In December 2022, the People’s Bank of China and the State Administration of Foreign Exchange released new rules for the panda bonds, which allowed proceeds raised domestically in China to be used offshore.

Panda bond issuance was low after its debut in 2005 by the Asian Development Bank and International Finance Corporation. With the ease of regulation after 2015, panda bonds have experienced increasing demand, and their popularity continues to rise. The investor base was predominantly Chinese in the early days. With the development of mechanisms such as Bond Connect, the Qualified Foreign Institutional Investor (QFII) scheme, and the Interbank Market Scheme, the pool of investors for panda bonds became more international and diversified.

Growth in the panda bond market faces a few hurdles, including poor liquidity and a lack of hedging tools in the onshore market. However, the regulators are putting in great efforts to set up more schemes to facilitate the issuers and investors in the panda bond market. In May 2023, “Northbound Trading of Swap Connect” was launched, which provided a channel to trade interest rate swap products in the onshore market through a connection between infrastructure institutions in Hong Kong and Mainland China. We believe the regulators will release more favorable policies to improve the liquidity and accessibility of the panda bond market to international investors.

In 2024, we expect the US-China rate spread will continue to be the key factor that impacts the primary market of the panda bond and Dim Sum bond. Dim Sum bond and panda bond issuance will remain attractive to the issuers given their lower funding costs. In addition, RMB-denominated bonds would be favored by investors who are interested in diversifying their portfolios.

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