

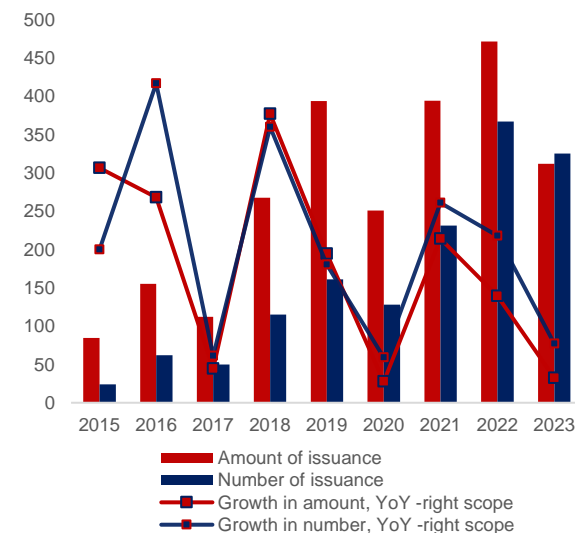
Non-rating Action Commentary: Reviewing the Offshore Bond Issuance of Chinese LGFVs in 2023

Contraction in Chinese Offshore Local Government Financing Vehicles (LGFVs) Bond Issuance in 2023 Was Accompanied by a Continued Downward Shift in Issuers' Administrative Levels

In recent years, the offshore LGFV bond market has exhibited a fluctuating upward trend in overall issuance volume. However, the year 2023 witnessed a significant decline in issuance activity, primarily due to the US Federal Reserve's sustained interest rate hikes and stricter controls on offshore financing for LGFVs. The total issuance volume of offshore LGFV bonds in 2023 reached approximately USD 31.2 billion, marking a substantial year-on-year decline of 34%. Concurrently, the number of issuances amounted to 325, reflecting an 11% decrease compared to the previous year (Exhibit 1). Notably, the decline in issuance volume surpassed the decrease in the number of issuances, indicating a reduction in the average size of individual bond offerings. This trend is believed to be correlated with changes in the structure of LGFV issuers. In 2023, county-level or industrial park-level LGFVs emerged as the predominant issuer in the offshore market, representing nearly 59% of the total issuance amount (Exhibit 2). This notable shift underscores a discernible downward movement in the administrative levels of offshore LGFV issuers in recent years.

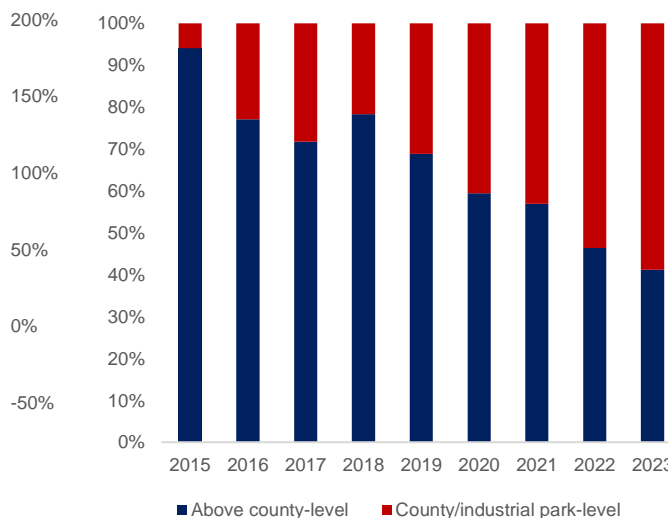
On one hand, China's urbanization has been steadily advancing in recent years, with a deepening focus on local infrastructure development driven by grassroots governments. This has resulted in a heightened demand for funding among lower-level LGFVs. On the other hand, there has been an enhanced regulatory oversight on domestic financing for these LGFVs, prompting them to seek increased offshore financing opportunities. Simultaneously, facilitating overseas funding channels and attracting foreign investment for local projects also contributes to the positive development of LGFVs and regional economies. We anticipate that this trend will persist over the next two years, as an increasing number of lower-level LGFVs venture into or expand their engagement in offshore financing initiatives.

Exhibit 1: LGFV offshore bond issuance amount (USD10 mil.)



Sources: DMI, CSPI ratings

Exhibit 2: The proportion of issuance amount of LGFVs at different levels



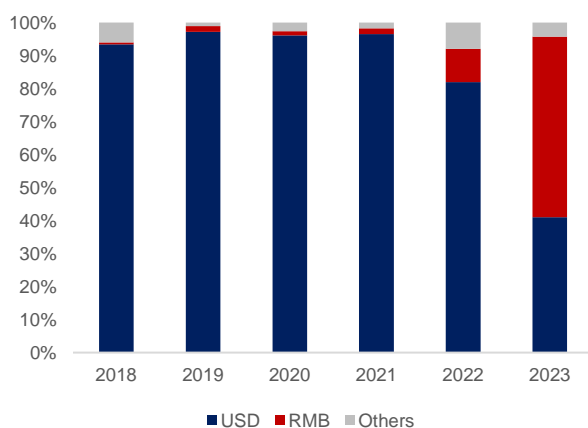
Sources: DMI, CSPI ratings

The offshore RMB interest rate advantage has become increasingly pronounced, leading to a significant surge in RMB-denominated bond issuance

Since 2022, the continuous rise in USD financing costs has pushed up the overall interest rates for offshore LGFV financing and prompted a growing number of issuers to opt for RMB-denominated bonds. In 2023, the issuance volume of offshore RMB bonds for LGFV reached approximately USD 17 billion, marking an impressive year-on-year increase of 259%. RMB bonds accounted for a substantial 55% share of the total offshore LGFV bond issuance in 2023, establishing itself as the primary financing currency for the year (Exhibit 3). It is evident that since 2022, the average issue yield for offshore RMB bonds by LGFVs has been slightly lower than that of USD bonds. In 2023, the average issue yield for offshore RMB bonds

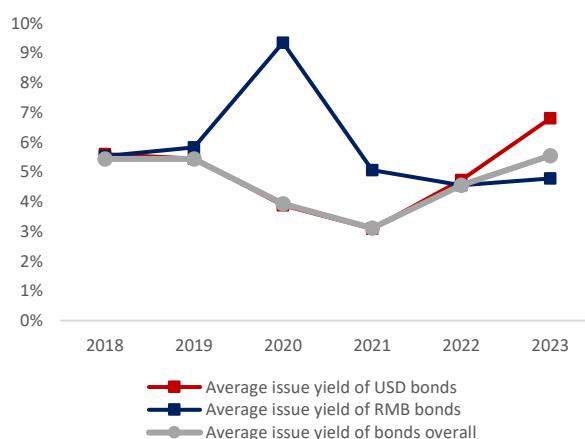
was around 4.8%, while USD bonds exhibited an average issue yield of 6.8%, resulting in a notable 2-percentage-point difference. This discrepancy highlights the cost advantage of RMB financing (Exhibit 4). Moreover, the significant volume of offshore RMB bond issuances also reflects the fruitful development of RMB internationalization and the offshore RMB market in recent years. From a long-term perspective, as the US Federal Reserve concludes its interest rate hike cycle, the USD is expected to remain the dominant currency for offshore financing by Chinese entities. However, it is worth acknowledging that RMB's offshore progress is irreversible. Therefore, offshore RMB will continue to be a vital choice for LGFV financing in the future.

Exhibit 3: The currency structure of offshore LGFV bond issuances



Sources: DMI, CSPI ratings

Exhibit 4: The average issue yield of LGFV offshore bonds

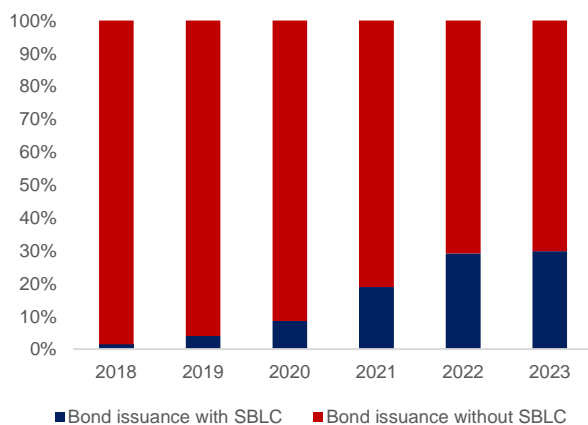


Sources: DMI, CSPI ratings

The proportion of LGFV offshore bond issuances guaranteed by Standby Letters of Credit (SBLC) has reached a stable level, while the interest advantage has notably increased

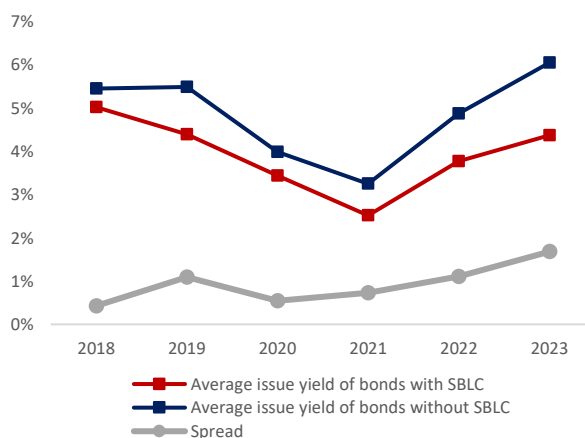
Since 2022, there has been a significant increase in the issuance volume of offshore LGFV bonds backed by SBLC from banks. In 2022 and 2023, the issuance amount of SBLC-backed offshore LGFV bonds amounted to approximately USD 13.7 billion and USD 9.3 billion, respectively, constituting around 30% of the total issuance amount (Exhibit 5). The provision of SBLC by banks effectively reduces the costs of offshore LGFV financing. In 2023, the average issue yield for SBLC-backed offshore LGFV bonds stood at 4.4%, compared to 6% for those without SBLC, resulting in a widened yield spread of 1.6 percentage points (Exhibit 6). This development may be attributed to the overall weakened trend in the stand-alone credit profiles of the offshore LGFV bond issuers, thereby highlighting the credit enhancement provided by SBLC. However, it is important to note that the issuance of SBLC by banks is subject to various factors, including banks' risk appetites, financial regulations, and foreign exchange controls. Consequently, we anticipate that the SBLC-backed bond issuance volume is unlikely to persist in its rapid expansion. Ultimately, the stand-alone credit profiles of LGFVs will remain a crucial determinant in their bond issuances in the future.

Exhibit 5: Proportion of SBLC-backed issuance stabilizes



Sources: DMI, CSPI ratings

Exhibit 6: The interest rate advantage of financing with SBLC expands



Sources: DMI, CSPI ratings

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