# CCXI & CCXAP – Research & Commentary

## Structural Divergence in Urban Construction Investment Expected to Intensify, and Belief in Urban Construction Investment to Shatter amid Growth Control and Dissolution of Implicit Debts

Hong Kong, 19 April 2021 -- A report titled "UCIBs Continue to Expand as Risk Appetite Sinks, and Structural Divergence Aggravates Shattering of Belief in Urban Construction Investment" has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. ("CCXI Research Institute"). According to the report, with the peak of maturity of urban construction investment bonds (UCIBs) approaching, under the pressure of refinancing, UCIBs are expected to be issued on a large scale in the year. The issue volume of UCIBs this year is estimated to be higher than that in the previous year and reach between RMB4.7 trillion and RMB5.0 trillion. Investors should pay close attention to the pressure of principal and interest repayment as debt repayment peaks, the structural divergence in urban construction investment against the backdrop of government efforts to control increase in and dissolve existing implicit debts, expand special-purpose bonds and promote the construction of new infrastructure, new urbanization initiatives and major projects, and watch out for the possibility that belief in urban construction investment will shatter.

**The report has presented the operation status of the UCIB market in Q1. The report points out that as the economy continued to recover, the credit environment was tightened marginally and market risk appetite declined, compared to industrial bonds, UCIBs saw a significant increase in both issue volume and transaction volume in Q1. In the meantime, in the transition to easing credit and easing monetary policy, interest rates in both the primary and second market rose. In the primary market,** the issue volume of UCIBs recorded RMB1.48 trillion, up 32.93% year on year, and its proportion in the issue volume of credit bonds rose 7 percentage points to 38%. Even though the net financing amount of UCIBs fell year on year as the amount of mature debts rose significantly, its proportion in the net financing amount of credit bonds increased substantially to about eighty percent. In terms of issue structure, ultra-short-term bonds had the highest proportion in issue volume and the fastest growth, while the proportion of UCIBs used for refinancing fell slightly but still exceeded seventy percent. **In the secondary market,** the spot trading volume of UCIBs surpassed RMB2.70 trillion, a significant increase both quarter on quarter and year on year. Yield to maturity rose from Q4 2020, and the yield of UCIBs with shorter residual maturity first rose then declined. In the meantime, the credit spread of UCIBs widened on the whole, and it was especially evident in Yunnan Province and Guizhou Province. Moreover, there were abnormal changes in bond transaction prices in urban construction investments with weaker qualifications in provinces with greater debt pressure and provinces with a relatively low administrative level. Investors should pay attention to provinces whose abnormal transaction volume of UCIBs took up a high proportion.

**In terms of urban construction investment enterprises' credit standing, all of their credit ratings for urban construction investment were upgraded in Q1, and credit events decreased.** In Q1, three urban construction investment enterprises' corporate credit ratings were upgraded. Two prefecture-level urban construction investment enterprises saw their corporate credit ratings upgraded from AA to AA+, and one provincial urban construction investment enterprise from AA+ to AAA. The main reason for the upgrades is because the urban construction investment enterprises had excellent development and operation environment, the importance of their status improved, capital strength increased, etc. during the observation period. No urban construction investment enterprise was downgraded. In addition, according to the report, some places hadn't fully recovered their profitability from urban construction investments and solvency. Even though negative credit events decreased year on year, they still emerged. According to public information, there were two trust default events by urban construction investment enterprises in Q1, which occurred in Zunyi of Guizhou Province and Xiangtan of Hunan Province. Compared to the 11 events that occurred in the corresponding period last year, the number declined markedly. However, as the credit environment was marginally tightened, investors should pay attention to the possibility of default of non-standard products by urban construction investment enterprises in provinces with relatively weak economic and financial strength.

**Looking into the next stage, with the change of the credit cycle, the scale of aggregate financing to the real economy (AFRE) is expected to contract this year and the net financing amount of UCIBs is likely to fall significantly from the previous year. However, given that the amount of UCIBs mature within the year is still huge and bond funds are mostly used for refinancing, the issue volume of UCIBs is expected to reach between RMB4.7 trillion and RMB5.0 trillion, slightly higher than that in the previous year.** If the growth in stock of AFRE in 2021 decreases slightly to around 11%, the stock of AFRE may reach RMB316 trillion by the end of 2021. If the proportion of corporate bonds and asset-backed securities issued by deposit financial institutions to the AFRE remains unchanged, with the proportion of UCIBs in existing credit bonds taken into account, existing UCIBs is estimated to be RMB11.5 trillion by the end of 2021, and the net financing amount of the year about RMB1.1 trillion. Moreover, based on the issue volume of UCIBs in Q1 and the refinancing needs in the next stage as well as the proportion of newly issued bonds in 2021 that are mature within the year and different put-back proportions, the report forecasts that the issue volume of UCIBs throughout 2021 will be between RMB4.7 trillion and RMB5.0 trillion, slightly higher than that in the previous year.

**Finally, the report warns investors about the risks of urban construction investment enterprises in four aspects. First, investors should pay attention to urban construction investment enterprises' refinancing risk when government departments are deleveraging and controlling increase in implicit debts.** The executive meeting of the State Council held on March 15 required government departments to lower the leverage ratio. Against the backdrop of government efforts to control increase in and dissolve existing implicit debts and enhance prevention of local state-owned enterprise debt risk, urban construction investment enterprises are likely to face restricted regional and corporate qualifications in financing, and the measure of refinancing adopted by urban construction investment enterprises in weak provinces and/or with weak qualifications is hard to sustain. **Second, investors should pay attention to the repayment pressure on urban construction investment enterprises and spread of contingent risks as maturity of UCIBs peaks and financing is restricted.** 2021 is the peak season of maturity and put-back of UCIBs, while the solvency of entities with mature UCIBs hasn't fully recovered to the level before the pandemic and enterprises with weak qualifications and high debts are restricted in financing, so their repayment pressure is likely to increase. Moreover, support of local governments in provinces with relatively weak economic and financial strength to local urban construction investments is likely to be limited. Investors should continue to pay attention to the redemption pressure on urban construction investment enterprises in provinces with weak debt carrying capacity and the evolution of credit risk. In the meantime, as financing capability and solvency worsen, investors should be alert to the spread of contingent risks caused by default of non-standard products by urban construction investment bond issuers with weak qualifications and compensation by guarantors. **Third, investors should pay attention to divergence in the credit risk of urban construction investment enterprises as existing implicit debts are being dissolved.** In recent years, local governments have defused local government debts through bond swap, swap with loans from financial institutions, establishment of debt dissolution funds, etc. The scope of the pilot project of using local government bonds to defuse local government debts at organizational counties has been gradually expanded. In addition, the *Opinions on Further Deepening the Reform of the Budget Management System* recently issued by the State Council requires insolvent financing platforms to conduct bankruptcy reorganization or liquidation. Some urban construction investment enterprises with weak qualifications may face the risk of bankruptcy because of that, and the belief in urban construction investments may be gradually shattered. As debt risks and debt risk defusing progress vary from province to province, the credit strength of urban construction investment enterprises will remain divergent. **Fourth, investors should pay attention to divergence in the credit strength of urban construction investment enterprises as special-purpose bonds continue to expand to support the construction of new infrastructure, new urbanization initiatives and major projects.** The quota for new special-purpose bonds fell slightly to RMB0.1 trillion this year, however, they will continue to focus on the construction of new infrastructure, new urbanization initiatives and major projects, especially new infrastructure and new urbanization initiatives. The urban construction investment enterprises who participate in the construction are likely to see their credit strength improve, and primary-level urban construction investment enterprises in key regions are expected to obtain more financing because of preferential policies. That will also aggravate the divergence between urban construction investment enterprises supported by policies and other urban construction investment enterprises.

**Important Information**

All information contained herein is obtained by CCX from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "as is" without warranty of any kind. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any commercial purpose of such information is given or made by CCX in any form or manner whatsoever.

To the extent permitted by law, CCX and its directors, officers, employees, agents and representatives disclaim liability to any person or entity (a) for any direct or compensatory losses or damages, including but not limited to by any negligence on the part of, or any contingency within or beyond the control of, CCX or any of its directors, officers, employees, agents or representatives, arising from or in connection with the information contained herein or the use of or inability to use any such information; or (b) for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if CCX or any of its directors, officers, employees, agents or representatives is advised in advance of the possibility of such losses or damages.

CCX's credit ratings, assessments and other opinions contained herein are current opinions and are not statements of current or historical fact and do not constitute or provide investment or financial advice, and do not provide recommendations to purchase, sell, or hold particular securities. CCX's credit rating assessments and other opinions are not intended for use by retail investors when making an investment decision. Any person as investor will, with due care, make its own study and evaluation of each security, issuer, guarantor, and credit supporter that is under consideration for purchase, holding, or selling.

**中诚信国际信用评级有限责任公司**

地址： 北京市东城区朝阳门内大街
南竹竿胡同 2 号银河 SOHO6 号楼
邮编：100020
电话： (8610) 6642 8877
传真： (8610) 6642 6100
网址： http://www.ccxi.com.cn

China Chengxin International Credit Rating Co., Ltd
Address: Building 6, Galaxy SOHO,
No.2 Nanzhugan hutong, Chaoyangmennei Avenue,
Dongcheng district, Beijing, 100020
Tel: (8610) 6642 8877
Fax: (8610) 6642 6100
Website: http://www.ccxi.com.cn

**中国诚信(亚太)信用评级有限公司**

地址:香港中环康乐广场 1 号
怡和大厦 19 楼 1904-1909 室
电话:(852) 2860 7111
传真:(852) 2868 0656
网址:http://www.ccxap.com

China Chengxin (Asia Pacific) Credit Ratings Company Limited
Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong
Tel: (852) 2860 7111
Fax: (852) 2868 0656
Website: http://www.ccxap.com