HONG KONG, 3 September 2019. Pengyuan International has assigned the global scale foreign-currency issuer credit rating (ICR) and local-currency ICR to five provincial level local governments (LG) in China, including the municipality of Shanghai, the provinces of Jiangsu, Henan, Jilin and Shandong. The outlooks for these ratings are stable. Relative ICRs are as following:

Local Government	Foreign-currency ICR	Local-currency ICR
Shanghai	AA-	AA
Jiangsu	A+	AA-
Jilin	A	A+
Henan	A	A+
Shandong	A+	AA-

China's administrative system mainly involves four-level of governments: central government, provincial-level governments, prefecture-level city governments, and county-level governments. Counties are then further divided into townships and villages. In China, provincial level LGs are highest level local governments that are under central government's direct supervision and their credit profiles are closely linked to China's sovereign rating (AA/AA+, stable), in our view. We examine Chinese LGs' creditworthiness on five aspects: economic strength, budgetary strength, debt burden, liquidity, governance and financial management. Each of these five major credit factors is assessed on relative basis by comparing a particular LG's credit strength to its relevant peer group, and then a weighted average score is derived to determine the LG's credit linkage with its higher level government. Some additional adjustment may be applied to address a unique credit characteristic of a LG.

Given China's centralized governing system, we believe Chinese central government would generally keep the creditworthiness of the provincial level LGs within a closer distance to its own creditworthiness. Even though the central government has offloaded most of economic and social responsibilities down to the LGs over the last decades, it still deeply influences the LGs' economics and financials through a tax-sharing and reallocation system. In addition, the appointment and promotion of the local government officials are very much centralized in China through a vertically managed system controlled by the ruling party.

In our view, the provincial level LGs' credit ratings are no more than three notches below China's sovereign rating, with only a few provinces and centrally-supervised municipalities outperforming the peers and establishing their credit profiles to be one notch away from the sovereign rating. We believe most of the provincial level LGs' credit ratings will fall into two to three notches below the sovereign rating given their current credit strength.

CREDIT SUMMARY

Our ratings on Shanghai municipal government reflect the city's superior economic strength, solid budgetary performance, light debt burden and abundant liquidity. Shanghai's rating also benefited from its friendly business environment and government's excellent budgetary management as well as its superior ability to access external financial resources. However, given the development phase of Shanghai, we do not believe its economy and budgetary revenue growth would be able to outrun its peers in the future.

Jiangsu provincial government's ratings reflect the province's strong economic strength, moderate debt burden, weakening budgetary performance and tightening liquidity condition. The province's budgetary deficit rose sharply in recent years and is expected to grow further in the next few years. Even though Jiangsu general government has the biggest absolute amount of debt outstanding among all peers, its debt burden is only moderate if assessed relative to its government revenue and GDP. Jiangsu has strong economic fundamentals but its liquidity is much weaker than most of its peers.

Our ratings on Jilin provincial government reflect the province's poor economic strength, weak budgetary performance, moderate debt burden and tighter-than-peers liquidity condition. In addition to the weaker performance on most of per-capita based credit indicators, Jilin is also facing challenges like outflowing population and inefficient economic structure. We also believe Jilin general government's liquid assets are not sufficient to meet its short-term debt payments and potential deficit without seeking more debt funding. On a brighter side, Jilin general government's absolute debt is smaller, resulting in a moderate debt pressure.

Henan provincial government's ratings reflect the province's below-average economic strength, moderate budgetary performance and debt burden, as well as its very weak liquidity. Henan has shown some decent GDP gains in recent years, but the province depends heavily on investment to achieve economic growth. Due to Henan's large population, some of its per-capita indicators underperformed national average, and the Henan general government's liquidity risk is also noticeably higher than that of peers.

Our ratings on Shandong provincial government reflect the province's strong economic strength and relatively small debt burden, as well as its deteriorating budgetary performance and very tight liquidity condition. The province has a good foundation for the development of heavy industries and its economic fundamentals remain strong, which provide the credit support to its rating. However the Shandong general government 's hiking budgetary deficits and tightening liquidity are two major credit weakness overhanging its ratings.

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Additional information is available on www.pyrating.com

Related Criteria

Chinese Local Government Rating Criteria (28 June 2019)

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Unsolicited ratings - non-participative rating

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