Non-rating Action Commentary: Chinese credit rating agencies deepen penetration in the Chinese offshore USD bond market

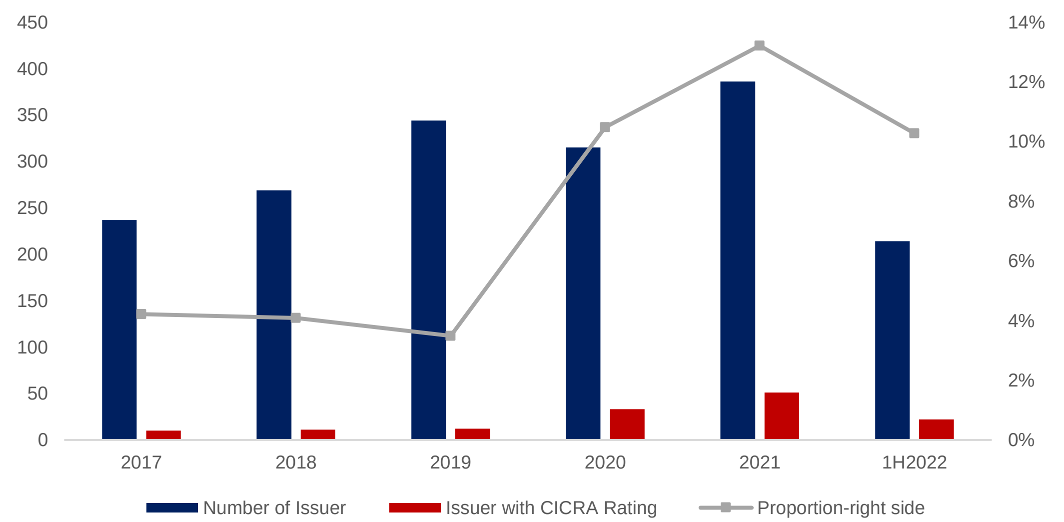
China's central bank supports the local credit rating agencies' international business development

On 28 June 2022, the central bank issued an announcement encouraging Beijing to take the lead in piloting the use of rating services from local credit rating agencies to bond issuers within its jurisdiction when raising funds offshore. This gradually enhances the influence of local credit rating agencies in the international capital market. We believe this initiative is expected to help Chinese international credit rating agencies (CICRA) gain ground and influence in the international bond market while providing international markets with a more diverse perspective on the creditworthiness of Chinese assets.

CICRAs still have a relatively low market share in the Chinese offshore USD bond market

After more than ten years of development, Chinese offshore USD bonds have become an important asset class in the global bond market, and continue to grow with the opening-up of China's capital market and foreign exchange market. The offshore bond market has also become an important channel for Chinese enterprises to raise funds overseas and with the development of the bond market, CICRAs have gradually expanded their influence in overseas bond markets based on their understanding of Chinese assets and international credit rating philosophy and methodologies. According to our statistics, only 4% of the Chinese offshore USD bond issuers in 2017 had ratings assigned by CICRAs. This proportion rose to 13% in 2021 and remained above 10% in the first half of 2022 (Exhibit 1). This indicates that the coverage ratio of CICRAs in the offshore bond market has increased, but it is still at a relatively low level.

Exhibit 1: There is an increase in the number of issuers using CICRA ratings in recent years



Sources：DMI，Bloomberg, Pengyuan International

By breaking down the issuers into different sectors, the real estate and financial sectors have a higher proportion of issuers with ratings than those in other industries in the past two years. Over 70% of real estate issuers have international ratings. In contrast, in the first half of 2022, only 33% of local government financing vehicles (LGFVs) issuers have international ratings. Most LGFVs chose to issue offshore bonds without ratings (Table 1).

Table 1: Overview of Chinese offshore USD bond issuers from different industries in 2021 and the first half of 2022

		Issuer Number	Issuer with Rating	Percentage	Issuer with CICRA Rating	Percentage
LGFV	2021	158	80	51%	14	9%
	1H2022	124	40	32%	10	8%
Real Estate	2021	78	63	81%	25	32%
	1H2022	24	19	79%	9	38%
Finance	2021	64	53	83%	5	8%
	1H2022	29	23	79%	2	7%
Others	2021	86	59	69%	7	8%
	1H2022	37	20	54%	1	3%

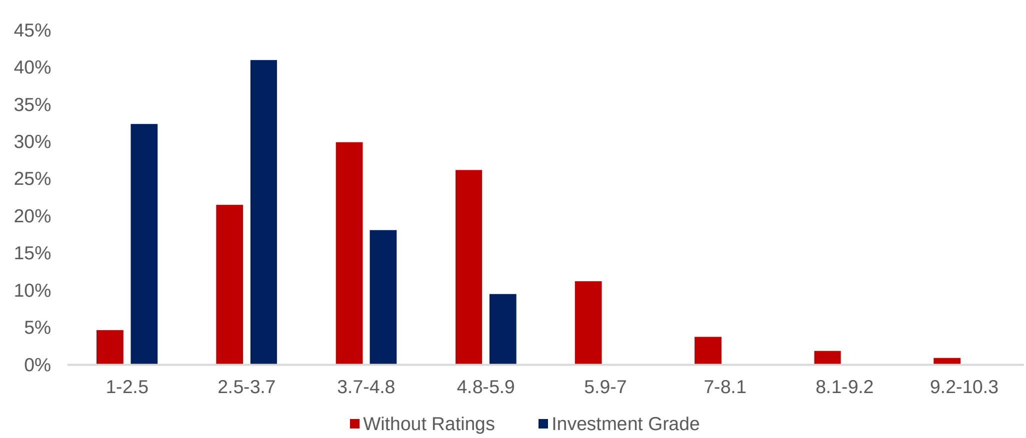
Source：DMI，Bloomberg，Pengyuan International

The high proportion of LGFV issuers without ratings could be attributable to the unique asset features

The LGFVs' offshore bond issuance surged in 2022, accounting for more than half of Chinese offshore USD bond issuers in the first half of 2022, most of which were issued without ratings. In the first half, the issuers without ratings accounted for about 67% of the total LGFV USD bond issuers. LGFV is a special kind of asset with unique characteristics. Its credit rating considerations include the analysis of the creditworthiness of the LGFV itself, the creditworthiness of the relevant local government and the relationship between the two. We believe that the relatively special nature of LGFVs may make it difficult for their credit assessments to be integrated into the traditional analytical frameworks of international rating agencies. In addition, as a government credit-linked asset, LGFV's rating is also bound by the limitations of international rating agencies on China's sovereignty and government ratings. For instance, in 2017, major international rating agencies successively downgraded China's sovereign ratings. These may be the main reasons why LGFVs mostly issue without ratings.

On the other hand, Chinese international rating agencies have a deeper understanding of China's public finance asset category while at the same time adopting international analytical methodologies generally accepted by international investors. This can, to a certain extent, solve the deviation between domestic and foreign understanding of the LGFV credit profile. From the issue yield distribution of investment-grade LGFV USD bonds issued since 2021 (excluding the issuance with standby letters of credit (SBLC) guarantee), it can be seen that the issue yield of investment-grade LGFV is relatively concentrated, with more than 73% distributed between 1% and 3.7%. However, the issue yield of LGFV without ratings is relatively dispersed, with 26% distributed below 3.7%, while more than 40% surpassed 4.8% (Exhibit 2). It can also be noted that international ratings have played an important role in guiding market pricing.

Exhibit 2: The LGFV offshore issuer's issue yield distribution from 2021 to June 2022 (%)



The Voice to be heard

Source：DMI，Bloomberg, Pengyuan International

International investors continue to be significant holders of Chinese offshore USD bonds, and CICRAs confront a challenging task in strengthening their influence

Although the development time of CICRAs' business in overseas markets is limited, the development speed is relatively fast. The central bank's policy support is expected to increase the coverage of CICRA's ratings in the Chinese offshore USD bond market and gradually establish an effective credit risk assessment system while at the same time enhancing the influence of CICRA from point to point. Currently, the proportion of international investors in the structure of Chinese USD bondholders is not low. As of 21 July 2022, the total holding amount of China corporate USD bondholders who have disclosed their holding positions was about $111.2 billion (accounting for about 13% of the overall outstanding Chinese offshore USD bonds), most of which are international asset managers, including Blackstone, Fidelity International, Allianz, and HSBC[1]. Therefore, the healthy development of CICRAs depends on the objectiveness, scientificity, comparability, and stability of their credit ratings methodologies; it depends on whether the ratings can correctly reflect the creditworthiness of the rated entities and can withstand the test of market challenges. Only in this way can the CICRAs gradually gain recognition from the international market and enhance their international influence.

[1] Source: Bloomberg

Note: This Non-rating Action Commentary is written in Chinese. In case of any discrepancies between the English version and the Chinese version, the Chinese version shall prevail.

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