

# China's Contagion Risks Rise

**Charles Chang**  
Greater China Country Lead  
Corporate Ratings

Turbulence, Impact, And Transmission Channels

November 2021



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**S&P Global**  
Ratings

*This report does not constitute a rating action.*

# Credit Market

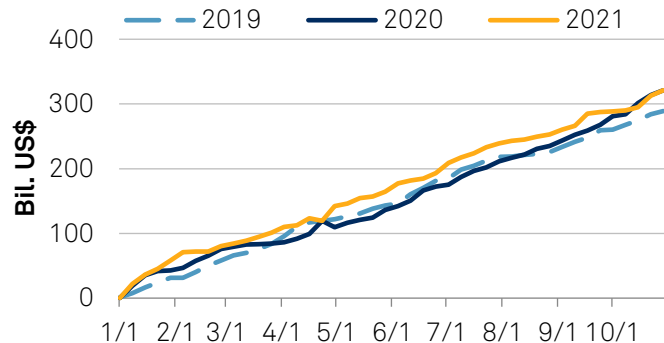
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**S&P Global**  
Ratings

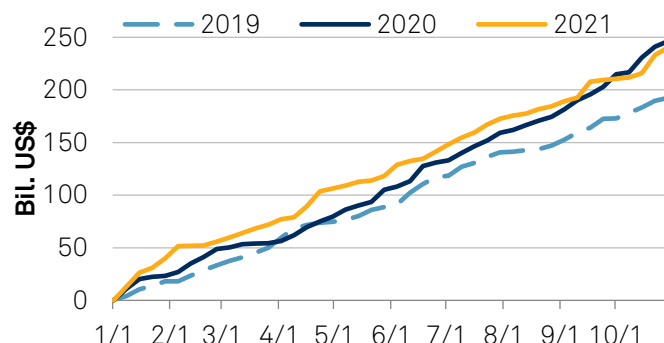
# China Has Dragged On Asia's Issuance Boom

- Issuance of global bonds have boomed across Asia ex-China, but China's volumes have dropped, pulling down the region's investment grade and speculative grade totals to below last year's levels.

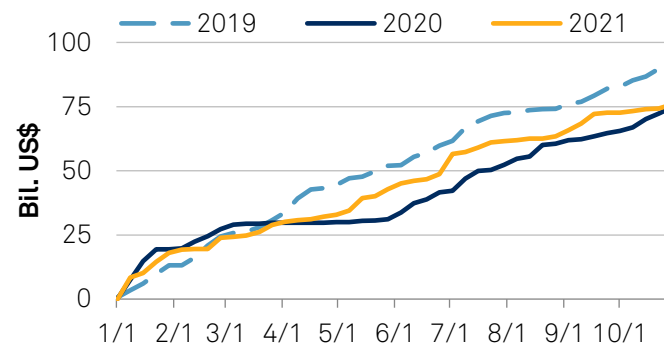
**Asia Total**



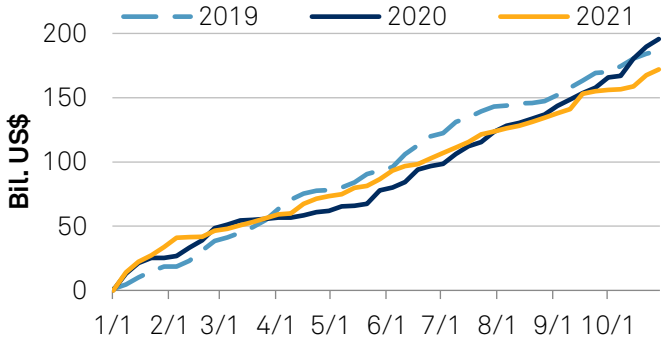
**Asia IG**



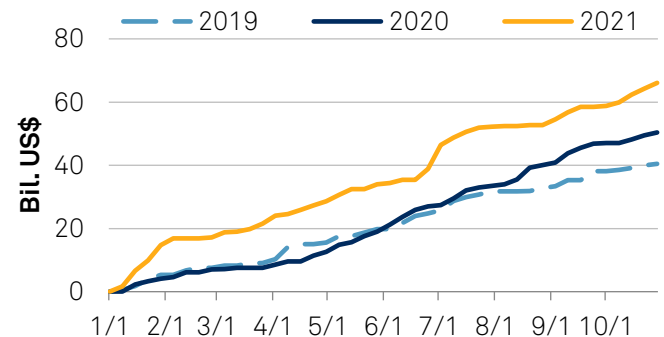
**Asia SG**



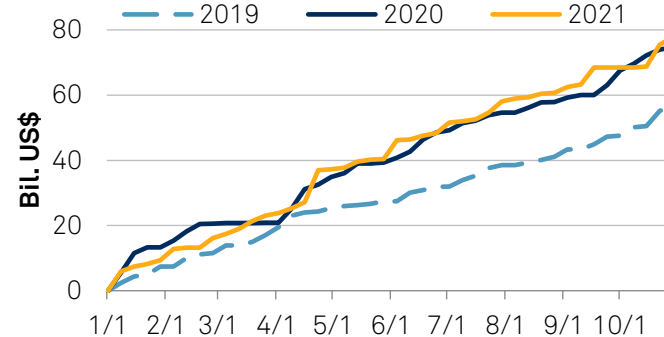
**China Total**



**North Asia Total**



**SSEA Total**

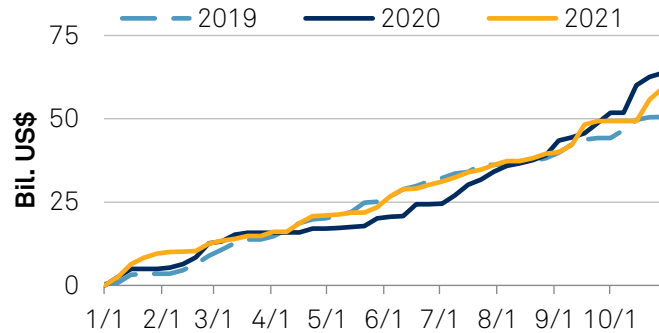


S&P Global Ratings. Note: Cumulative new issues of global bonds. Data as of Oct. 15, 2021. Bil--Billion. IG--Investment grade. SG--Speculative grade. SSEA--South and Southeast Asia. Source: Bloomberg.

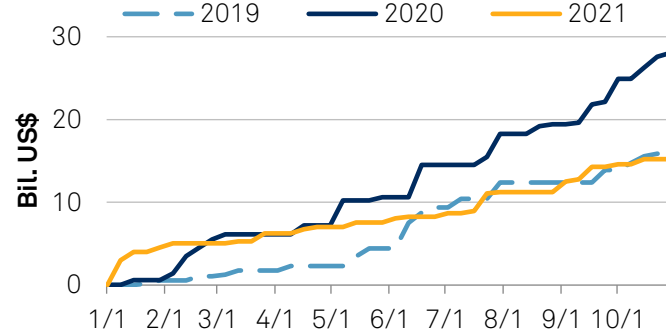
# Leverage Control Will Keep A Lid On Issuance

- China's property sector is facing the most severe policy tightening and has slowed the most, followed by central SOEs.

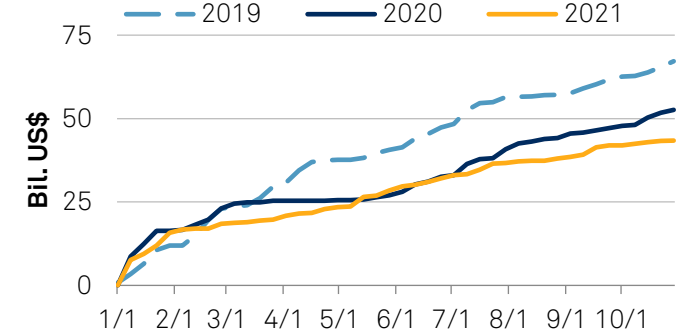
## China Quasi-sov, Banks, Financials



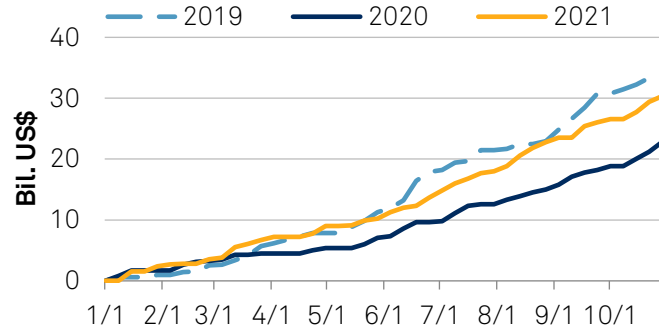
## China Central SOEs



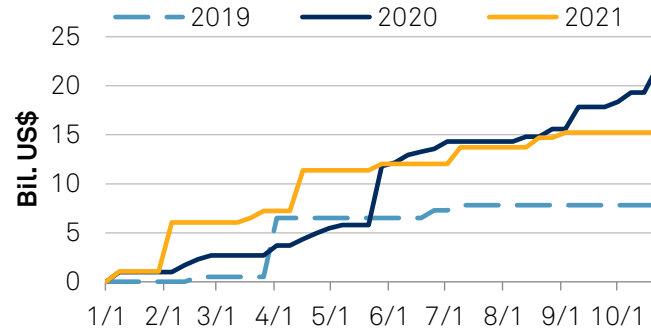
## China Property



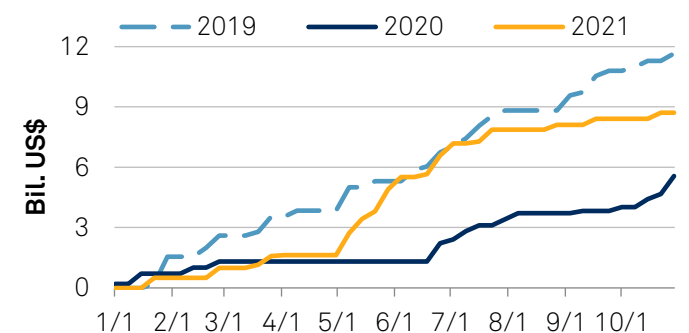
## China Local SOEs



## China Non-SOE IG



## China Non-Property SG



Note: Cumulative new issues of global bonds. Data as of Oct. 15, 2021. Billion--Billion. IG--Investment grade. SG--Speculative grade. Quasi-sov--Quasi-sovereign. SOE--State-owned enterprise. Source: Bloomberg, S&P Global Ratings.

# Secondary Market Volatility To Continue Into 2022

- 2021 began with large defaults in the first quarter, followed by events involving large issuers in the second quarter (Huarong, with RMB72 billion onshore and US\$21 billion offshore bonds) and the third quarter (Evergrande, with RMB56 billion onshore and US\$19 billion offshore bonds).
- This hit investor sentiment and amplified the volatility of events that followed.

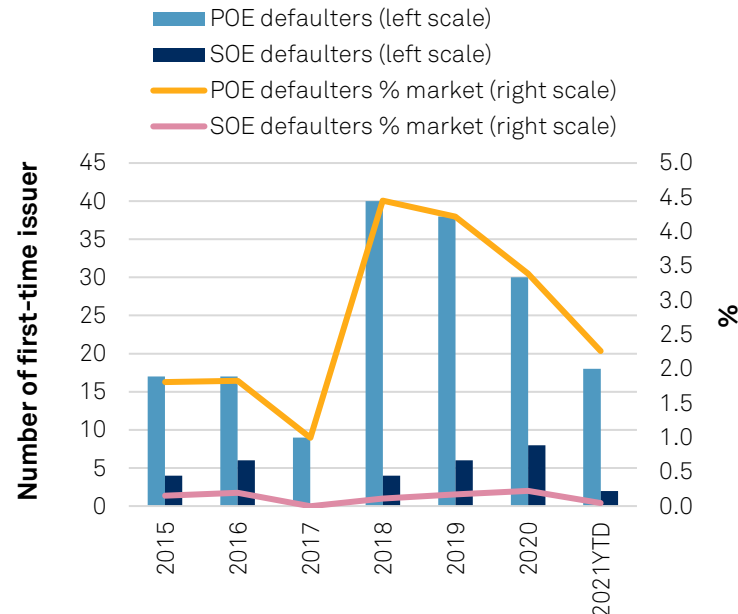
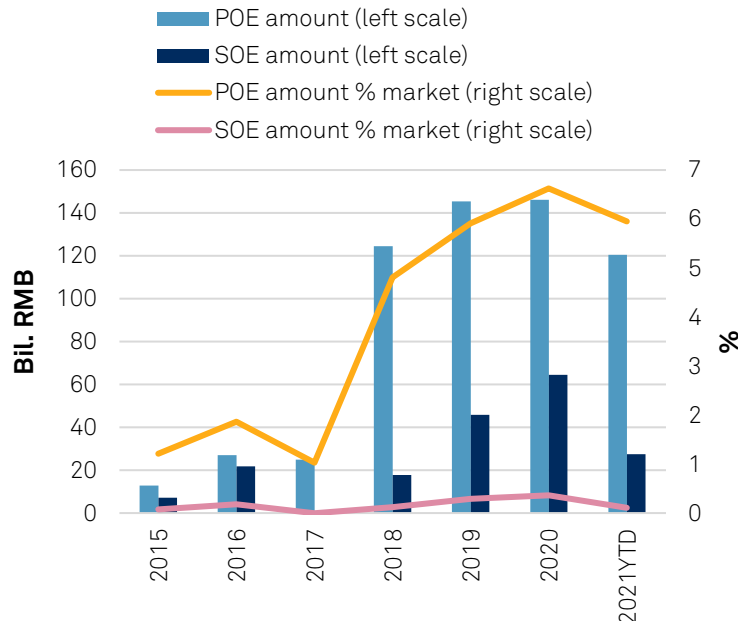
Issuer	Event date	Bonds on/offshore (Bil. RMB/US\$)	Home province/government	Event description, significance
Huachen Automotive Group Holdings Co. Ltd.	23-Oct-20	17.2 / 0.0	Liaoning	Famous car firm failed to repay a private RMB1 billion bond, shaking investor confidence in local government support of “strategic” SOEs
Tsinghua Unigroup Co. Ltd.	16-Nov-20	17.7 / 2.45	Central	Defaulted on a RMB1.3 billion bond, hitting confidence in central government support of university-backed SOEs
Yongcheng Coal & Electricity Holding Group Co. Ltd.	10-Nov-20	17.9 / 0.0	Henan	One of Henan’s largest SOEs defaulted on a RMB1 billion bond, shaking confidence in the Henan government and local government support
Henan Energy & Chemical Industry Group Co. Ltd.	31-Dec-20	22.3 / 0.0	Henan	Yongcheng’s parent. Did not repay half of a US\$62.5 million private bond, shaking confidence in Henan government local government support
China Fortune Land Development Co. Ltd.	29-Feb-21	20.6 / 4.56	Hebei	Largest China property bond defaulter in history, defaulted on US\$530 million bond after hopes of Ping An/Hebei government rescue failed
Jizhong Energy Group Co. Ltd.	7-Mar-21	13.2 / 0.0	Hebei	One of Hebei’s largest listed SOEs, repaid two private bonds totaling RMB1.5 billion, two days later than their put and maturity dates
Chongqing Sincere Property Group Co. Ltd.	9-Mar-21	1.9 / 0.0	Chongqing	Defaulted on a RMB482 million bond, adding to default worries of property developers
Chongqing Energy Investment Group Co. Ltd.	10-Mar-21	0.5 / 0.5	Chongqing	Produces most of Chongqing’s coal, supplies a third of its coal use, defaulted on a letter of credit and a bank draft of RMB915 million, shaking confidence in local government support of “strategic” SOEs

All defaulted RMB bonds referenced in the table are domestic bonds. Data as of June 2, 2021. Bil.—Billion. RMB—Chinese renminbi. SOEs—State-owned enterprises. Source: Wind, Bloomberg, S&P Global Ratings.

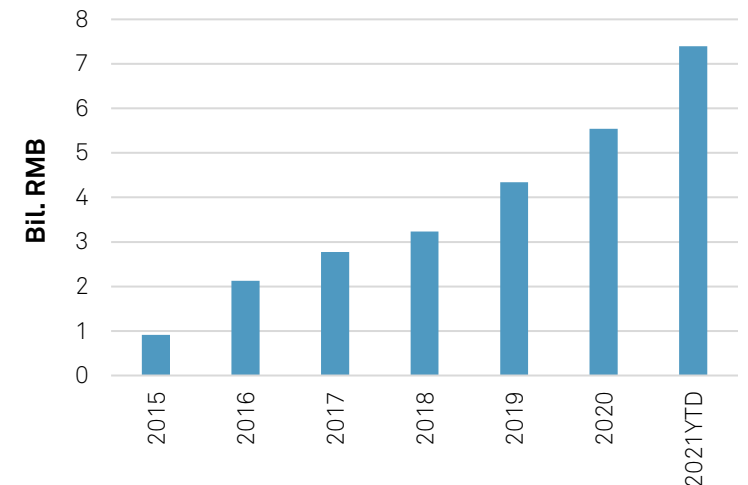
# Defaults Rates Still Low, But Cases Bigger And More Impactful

- Domestic bond defaults of privately owned enterprises spiked five times by amount, four times by number in 2018, but slowed after. SOEs are the opposite--defaults are up 3.6 times by amount, and 2.3 times by number in just three years.
- In 2021, each defaulter has RMB7.4 billion of onshore bonds, 2.6 times that of 2017, eight times that of 2015, and with more contagion potential.

## China SOEs' Domestic Bond Defaults Accelerate As That Of POEs' Slow



## Average Defaulters' Onshore Bonds Outstanding

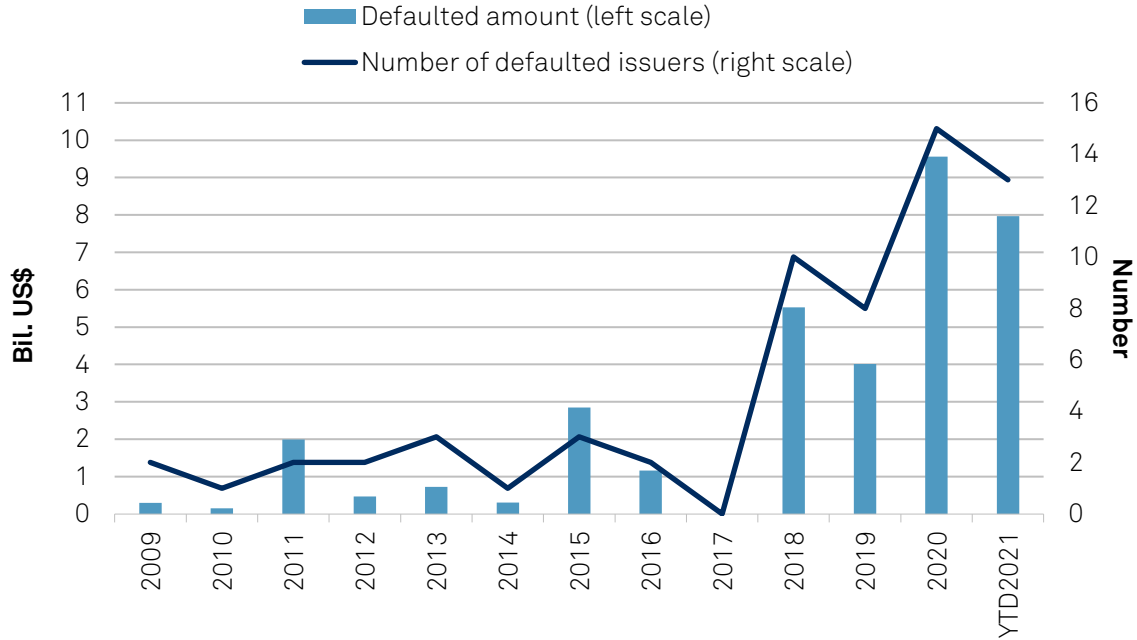


Note: Data as of Nov. 4, 2021, includes all nonfinancial corporates in China's domestic bond market. Defaults are failures to pay interest or principal in full and on time, including maturity extensions and other distressed restructurings. Default amount is defaulters' bonds outstanding on the date of first default, defaulter number is the number of first-time defaulters. Market is total bonds outstanding or number of issuers in the market. Bil.--Billion. RMB--Chinese renminbi. SOE--State-owned enterprises. POE--Privately owned enterprises. YTD--Year-to-date. Source: Wind, S&P Global Ratings.

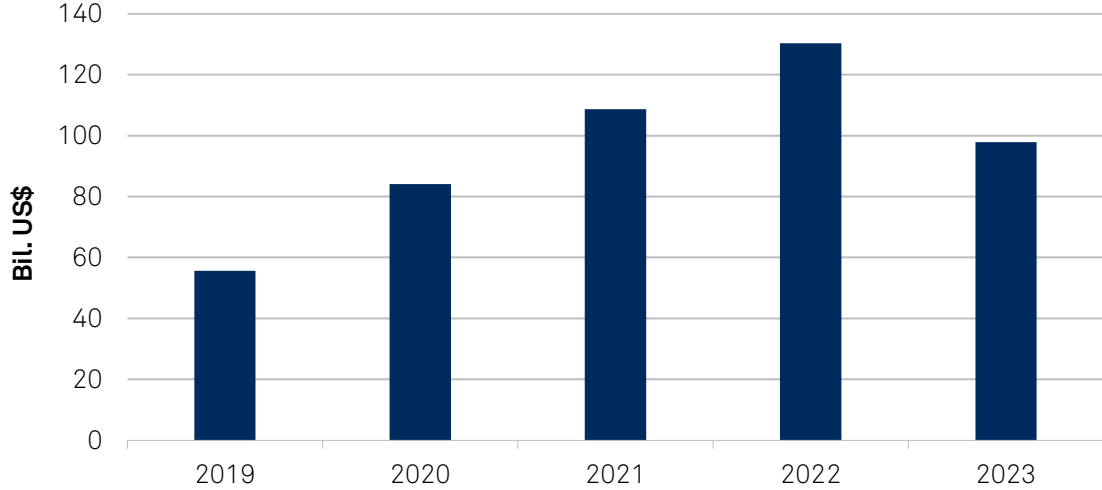
# High Maturity Walls Could Push Offshore Defaults

- 2020 offshore defaults reached a historic high, driven by QPIG, PUFG, and Tahoe Group.
- 2021 offshore defaults remain elevated, and have already reached double the full-year 2019 level (that is, pre-COVID)
- Maturities will total US\$239 billion in 2021 and 2022, versus the 2020 maturity of US\$84 billion.

## Offshore Default Remain Elevated



## Maturities Will Peak In 2022

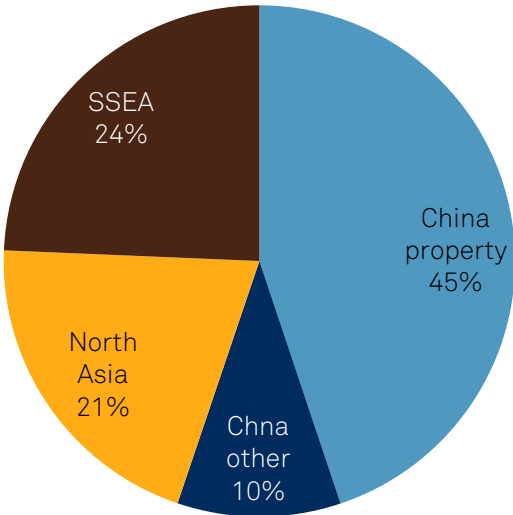


*Note: Data as of Nov. 3, 2021. Offshore defaults amount include only the defaulted bond (e.g., not other debt by the same issuer). Matured amount includes bonds with puttable rights. Bil.--Billion. QPIG--Qinghai Provincial Investment Group. PUFG--Peking University Founder Group. YTD--Year to date. Source: Bloomberg, S&P Global Ratings.*

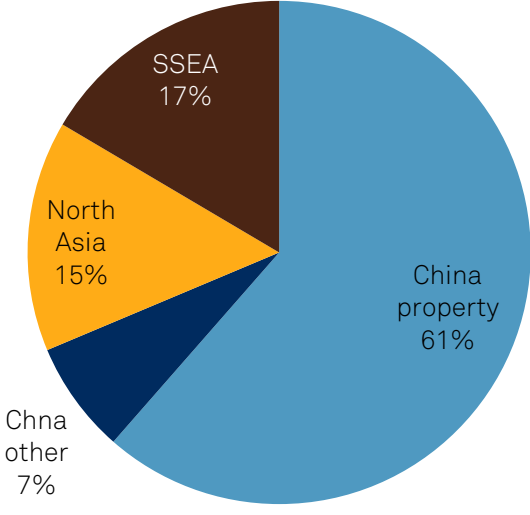
# Investors' Exposure To China Debt Has Grown Under COVID

– In 2020, China made up two-thirds of speculative grade and about 60% of investment grade global bond issuance in Asia.

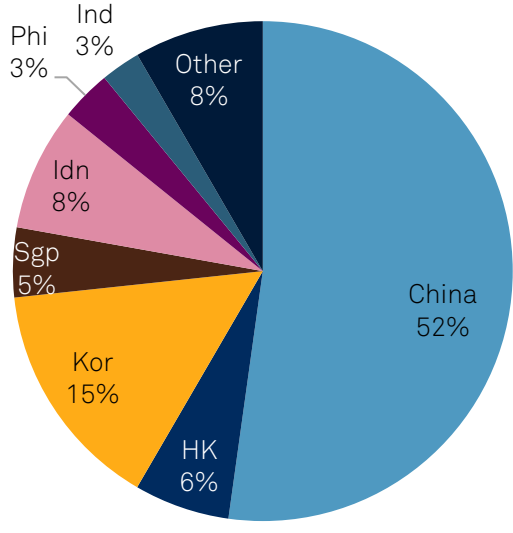
Asia SG YTD 2021: \$79 Billion



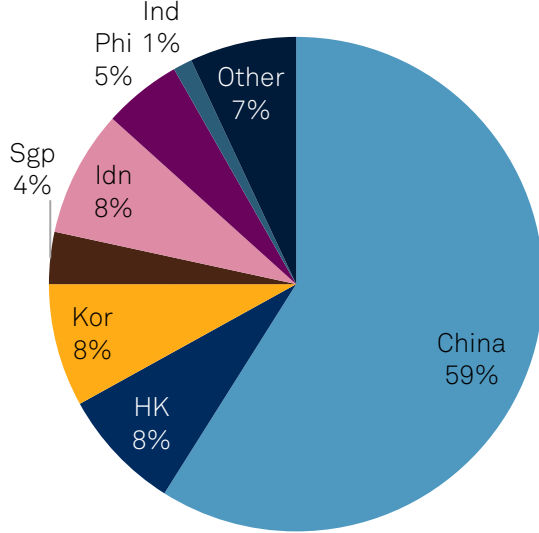
Asia SG 2020: \$86 Billion



Asia IG 2021: \$231 Billion



Asia IG 2020: \$269 Billion

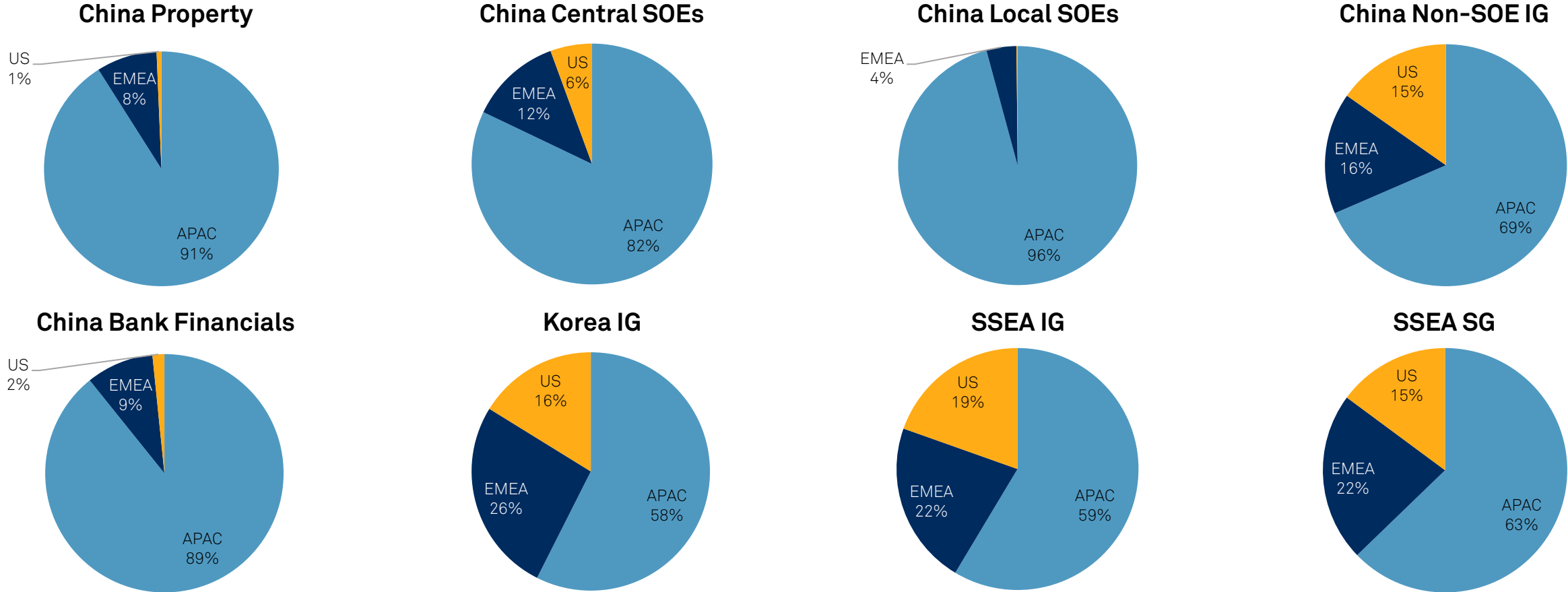


Note: Cumulative new issues of international bonds. Data as of Oct. 15, 2021. HK--Hong Kong. Kor--Korea. Sgp--Singapore. Idn--Indonesia. Phi--Philippines. Ind--India. YTD--Year-to-date. IG--Investment grade. SG--Speculative grade. SSEA--South and Southeast Asia. Source: Bloomberg, S&P Global Ratings.



# U.S. And EMEA Based Investors May Have Less Exposure

– New issue allocation of global bonds suggest U.S. and EMEA-based investors may have limited exposure to most sectors in China, particularly that issued by property firms and local SOEs.

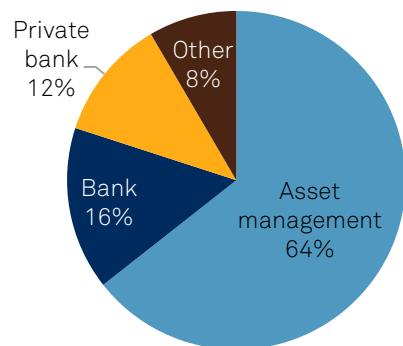


Note: Average allocation of global bond issuance, January 2019 to October 2021. IG--Investment grade. SG--Speculative grade. SOE--State-owned enterprises. APAC--Asia pacific. SSEA--South and Southeast Asia. EMEA--Europe, Middle East, Africa. Source: Bloomberg, S&P Global Ratings.

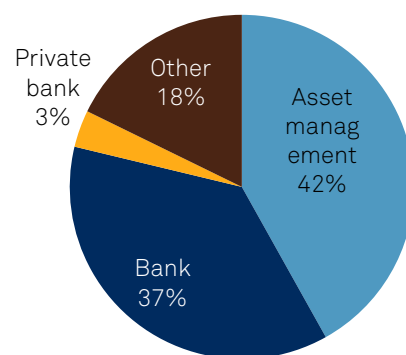
# Asset Managers And Private Banks May Have More Exposure

- New issue allocation of global bonds suggest two-thirds of China property bonds may be held by fund managers, with relatively large holdings by private bank clients compared with other sectors.

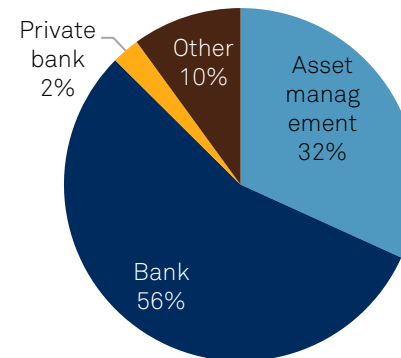
**China Property**



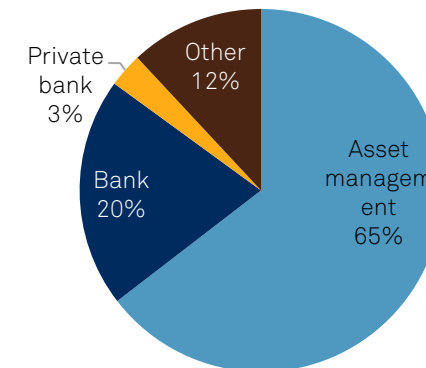
**China Central SOEs**



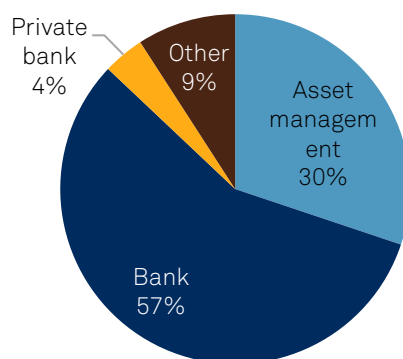
**China Local SOEs**



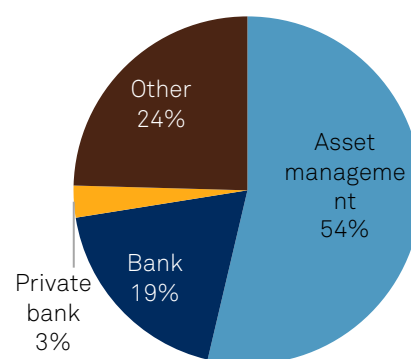
**China Non-SOE IG**



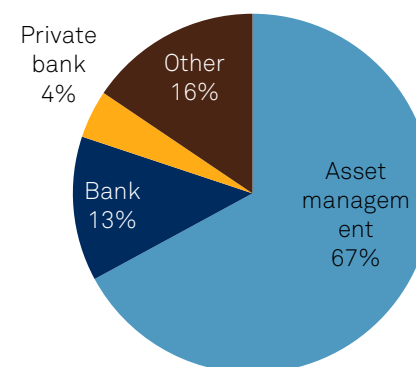
**China Bank Financials**



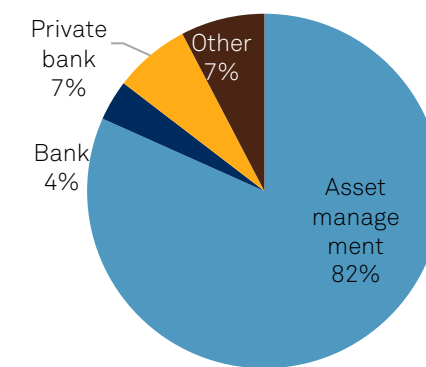
**Korea IG**



**SSEA IG**



**SSEA SG**

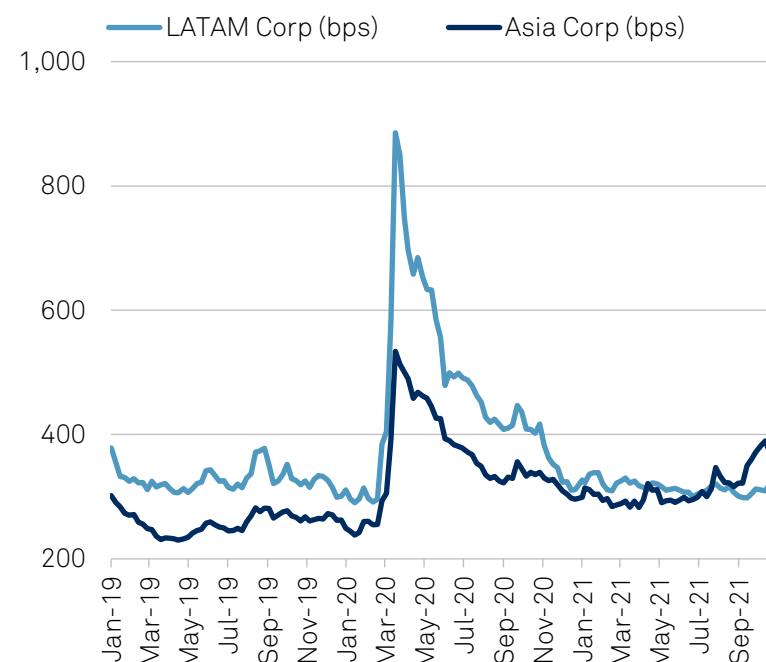


Note: Average allocation of global bond issuance, January 2019 to October 2021. IG--Investment grade. SG--Speculative grade. SOE--State-owned enterprises. SSEA--South and Southeast Asia. Source: Bloomberg, S&P Global Ratings.

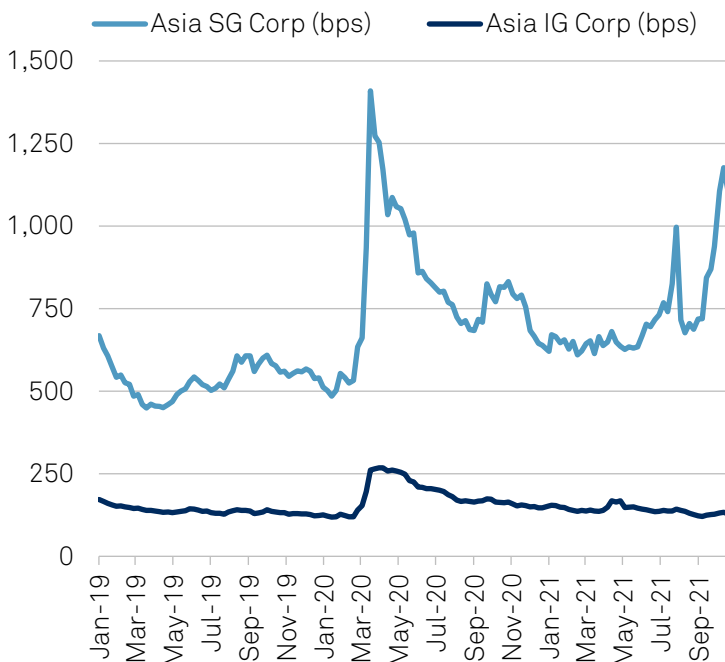
# Contagion So Far Mostly Local, Not Yet Global

- 2021 hits not as bad as COVID downturn in 2020 but Asian corporate spreads have widened to LATAM--an effect not seen for three years.
- So far, the impact has been largely confined in Asia to speculative grade, particularly to 'B' category issuers.

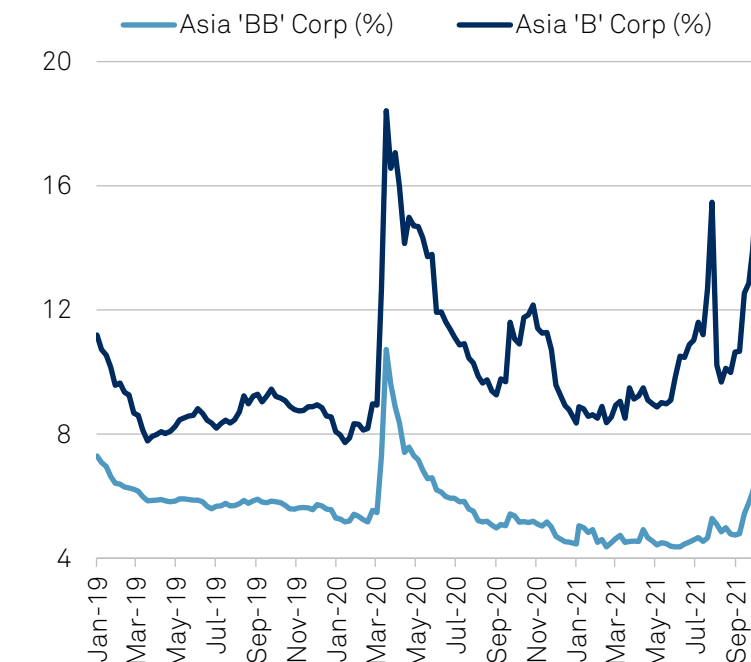
## Asia vs. LATAM Benchmark Spreads



## Asia IG vs. SG Benchmark Spreads



## Asia 'BB' vs. 'B' Yield To Maturity

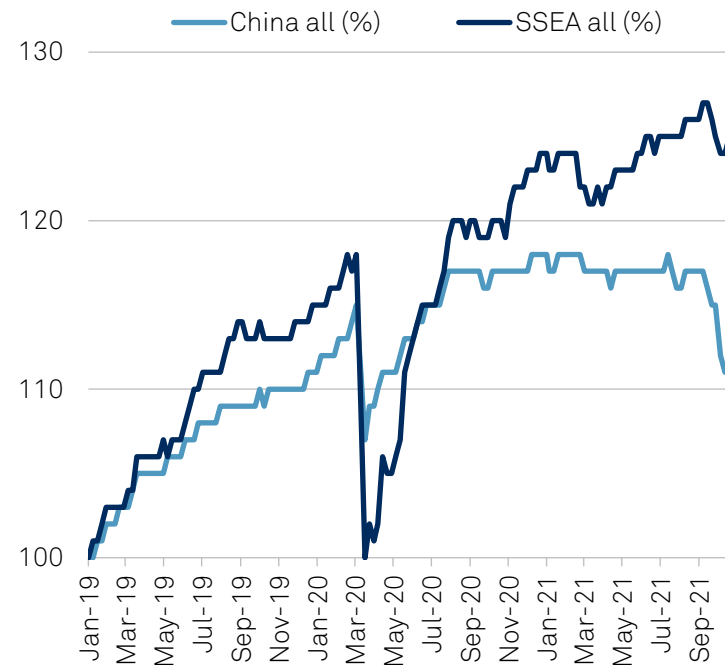


Note: Data as of Oct. 15, 2021. IG--Investment grade. SG--Speculative grade. LATAM--Latin America. Corp--Corporates. Bps--Basis points. Source: Credit Suisse Asia Bond and Latin America Credit Indices, S&P Global Ratings.

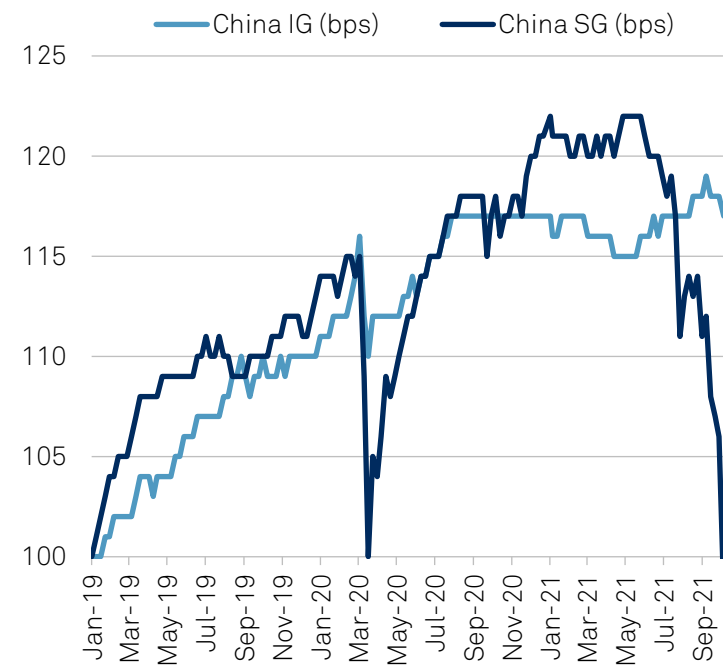
# Contagion Effects Contained Mostly Within China Speculative Grade

- China Fortune Land, Huarong, Evergrande effects have been mainly contained within China.
- China investment grade was helped by low rates and a haven effect, while speculative grade took most of the hits.

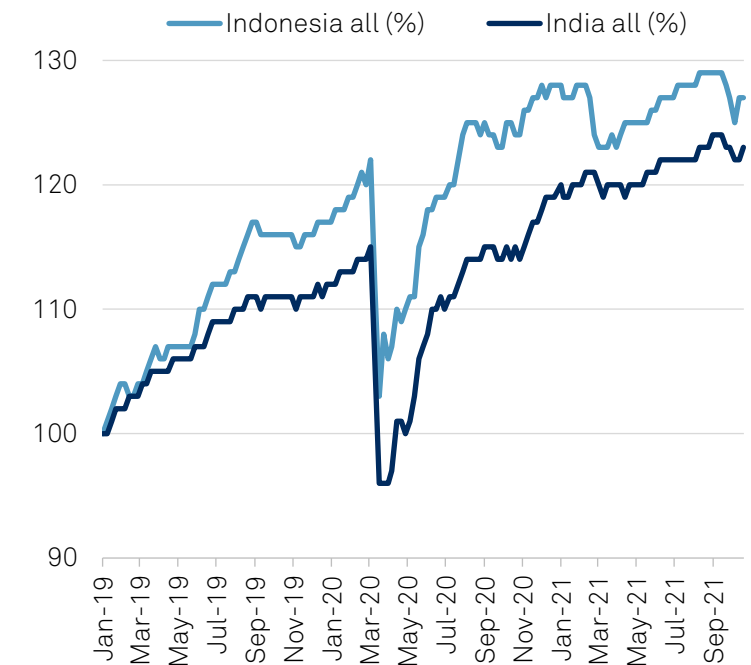
## China vs. SSEA Total Returns



## China IG vs. China SG Total Returns



## Indonesia vs. India Total Returns



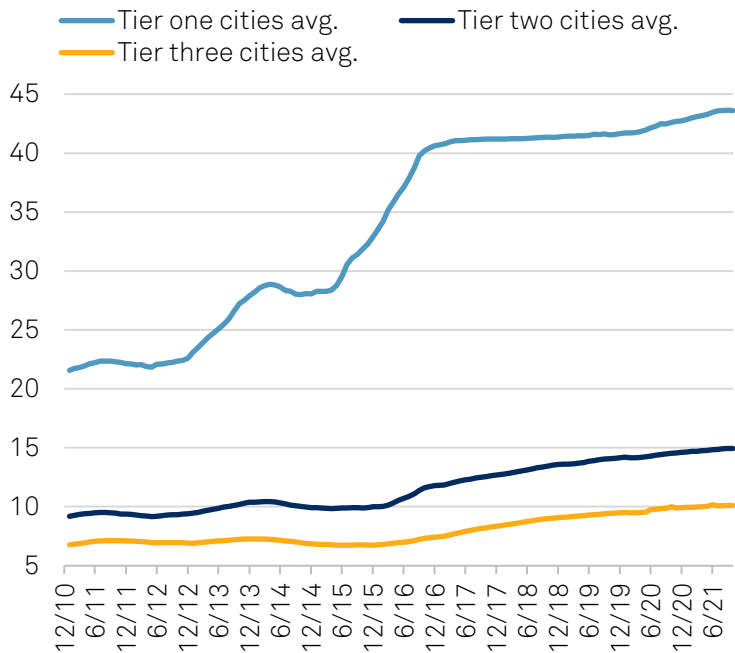
Note: Data as of Oct. 15, 2021. IG--Investment grade. SG--Speculative grade. SSEA--South and Southeast Asia. Bps--Basis points. Source: Bloomberg Barclays Asia Ex-Japan USD Credit Indices, S&P Global Ratings.

# Property Market

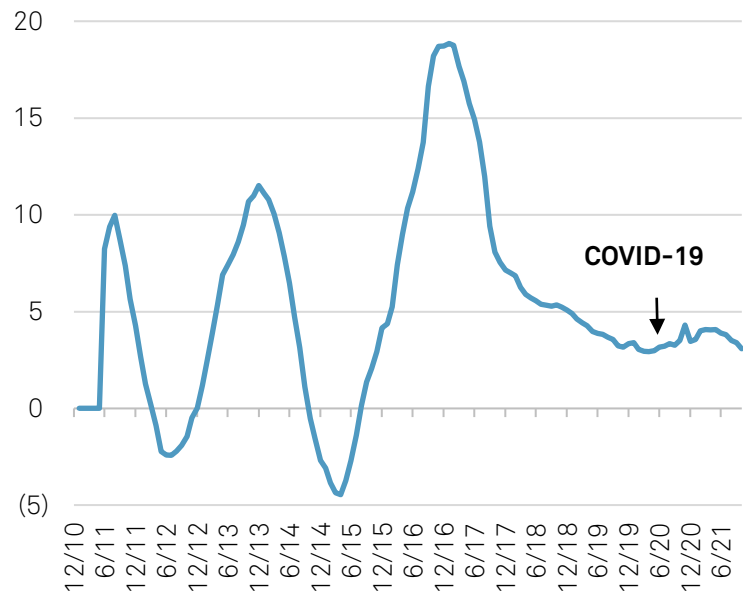
# Rising Home Prices To Drive Tightening Policies

- The government's COVID stimulus indirectly drove home prices to accelerate, particularly in tier-one cities.
- Prices have not fallen year on year since 2014; COVID only caused a month-on-month blip.
- The need to cool buying and slow prices will drive tightening policies and keep any loosening temporary and marginal.

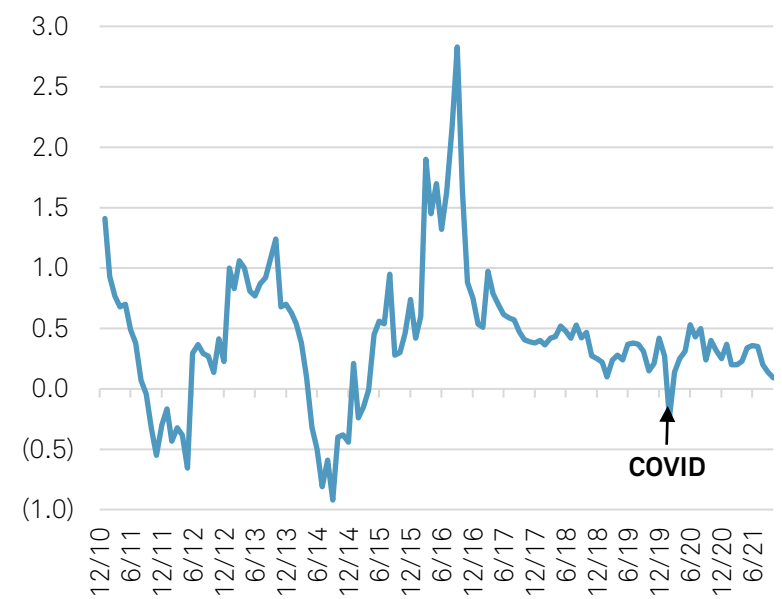
**China Home Prices ('000 RMB Per SQM)**



**China Home Prices (YoY Change, %)**



**China Home Prices (MoM Change, %)**



Avg.--Average. YoY--Year-on-year. MoM--Month-on-month. RMB--Chinese renminbi. SQM—square meter. Source: Wind, S&P Global Ratings.

# Fragmented Market To Limit Default Impact On Sales...

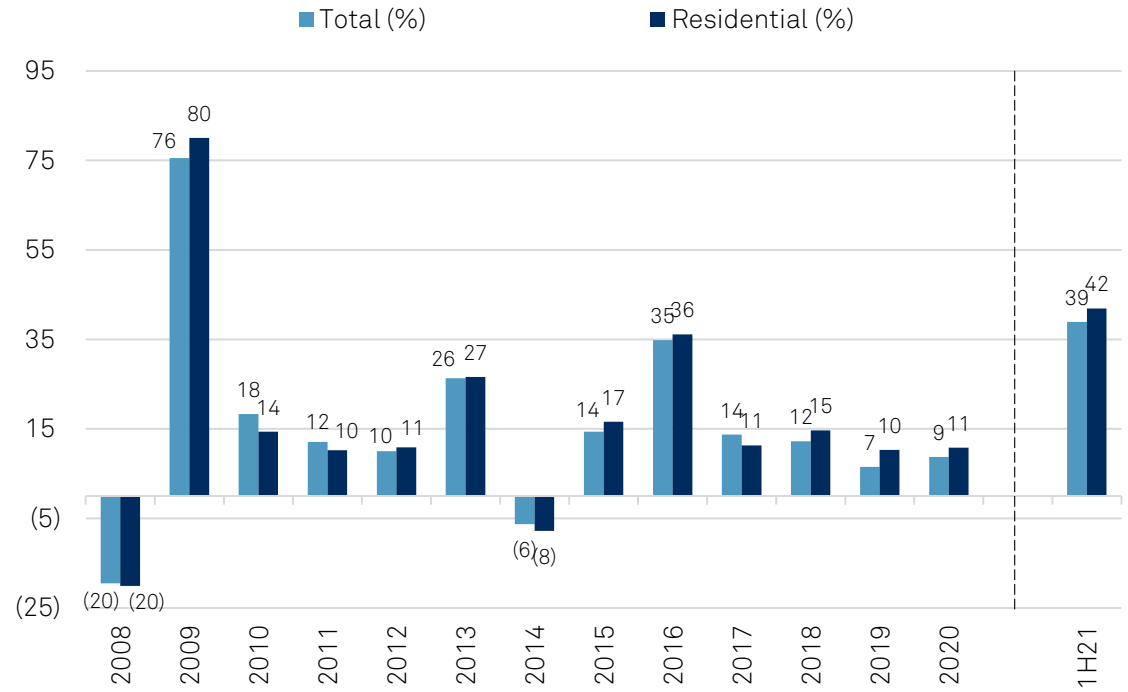
- Evergrande's 2020 sales of RMB723 billion were only 4% of the market; all rated developers' sales of RMB7.1 trillion were only 40%.
- Individual developer defaults will have limited effect on overall sales in China's highly fragmented housing market.

**Total And Residential Real Estate Sales (Tril. RMB)**



RMB--Chinese renminbi. Tril.--Trillion. Source: Wind, S&P Global Ratings.

**Real Estate Sales Value Year-on-Year Change**

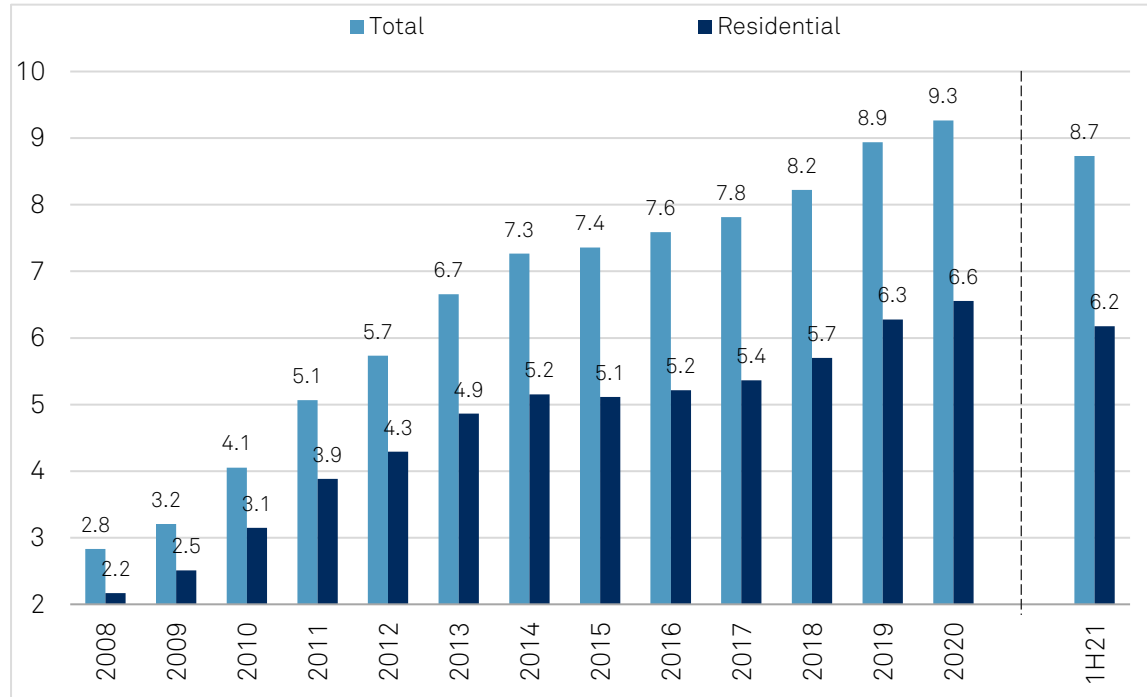


Source: Wind, S&P Global Ratings.

# ...And Construction Activity...

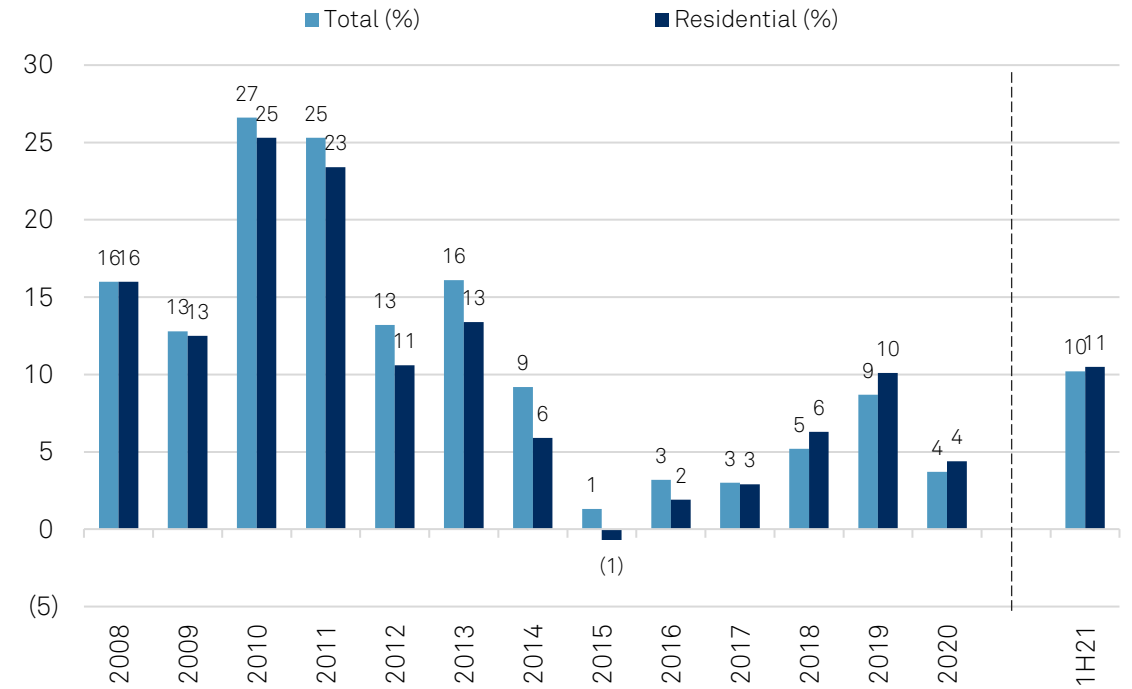
- Evergrande's 2020 GFA under construction of 132 mil. sqm was only 1.4% of the market; all rated developers' 1.5 bil. sqm was only 16%.
- Individual developer defaults will have limited impact on overall construction activities of China's vast housing market.

### Housing GFA Under Construction (Bil. SQM)



GFA--Gross floor area. YoY--Year-on-year. SQM--Square meter. mil.--Million. bil.--Billion. 1H--First half.  
Source: Wind, S&P Global Ratings.

### Housing GFA Under Construction YoY Change



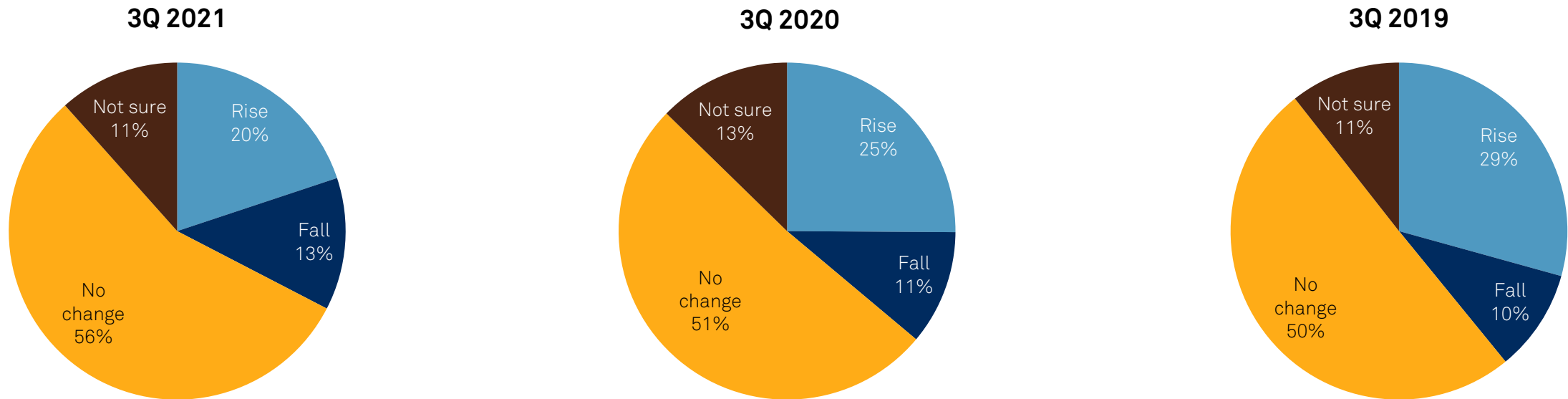
Source: Wind, S&P Global Ratings.



# ...But Headlines Can Hit Sentiment And Drive Contagion

- Default headlines are hitting homebuyer sentiment and spreading contagion to the broader market.
- 13% now expect prices to fall versus 10% in 2019--still a minority, but enough to affect sales volumes.
- Those expecting a rise have dropped 9 percentage points from the level recorded in 2019.

## PBOC Survey Of 20,000 Households In 50 Chinese Cities: How Will Home Prices Change Next Quarter?

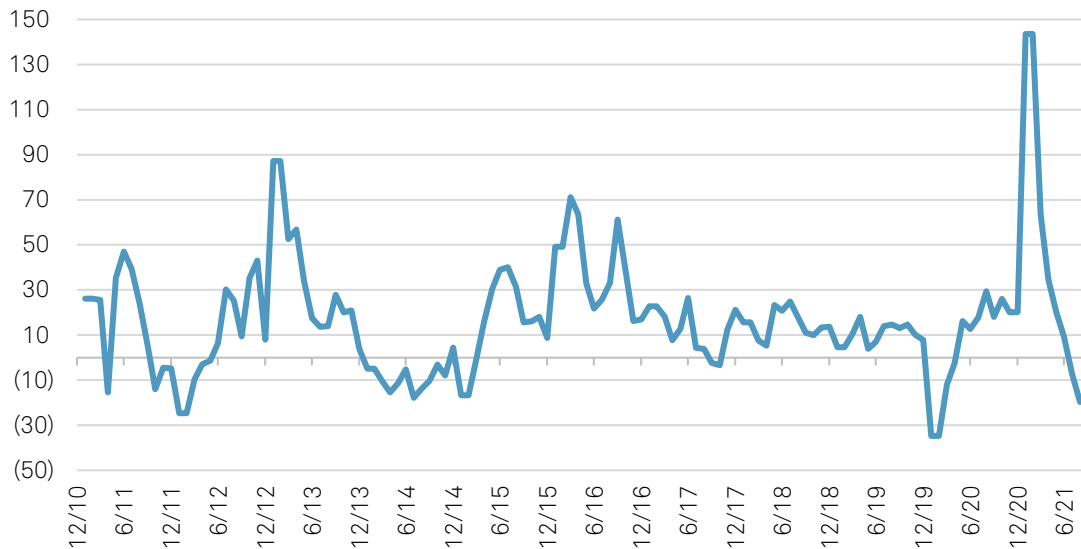


Note: Quarterly survey of 20,000 households across 50 Chinese cities. PBOC--People's Bank of China. 3Q--Third quarter. Source: People's Bank of China, S&P Global Ratings.

# Home Sales Are Falling As Buyers Monitor Headlines, Taxes

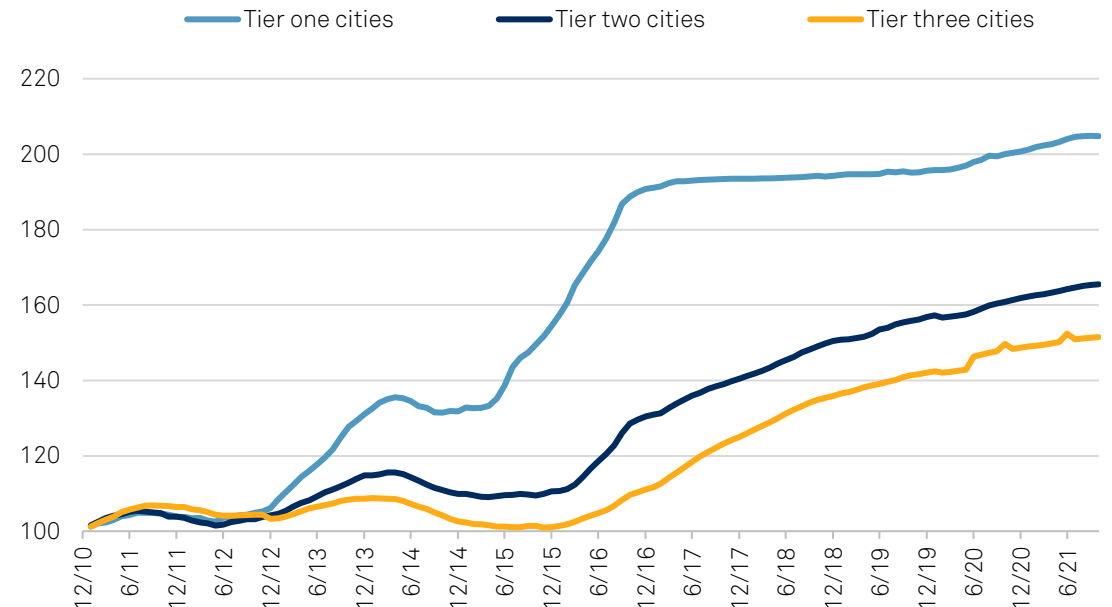
- Homes sales fell 20% year on year in August, and 17% in September, as more buyers monitored default headlines, and trial rollouts of property taxes.
- We expect sales to fall 10% in 2022 and 5%-10% in 2023, with an up-to 3%\* drop in prices.
- This is within range of past weak markets but would be the first multiyear decline in sales.

## Residential Real Estate Sales Value YoY Change (%)



Note: Data as of August 2021. YoY--Year-on-year. \*See, "China Property Watch: Strains In The Key Of 'B'," Oct. 27, 2021. Source: Wind, S&P Global Ratings.

## Home Price Index (2010=100)

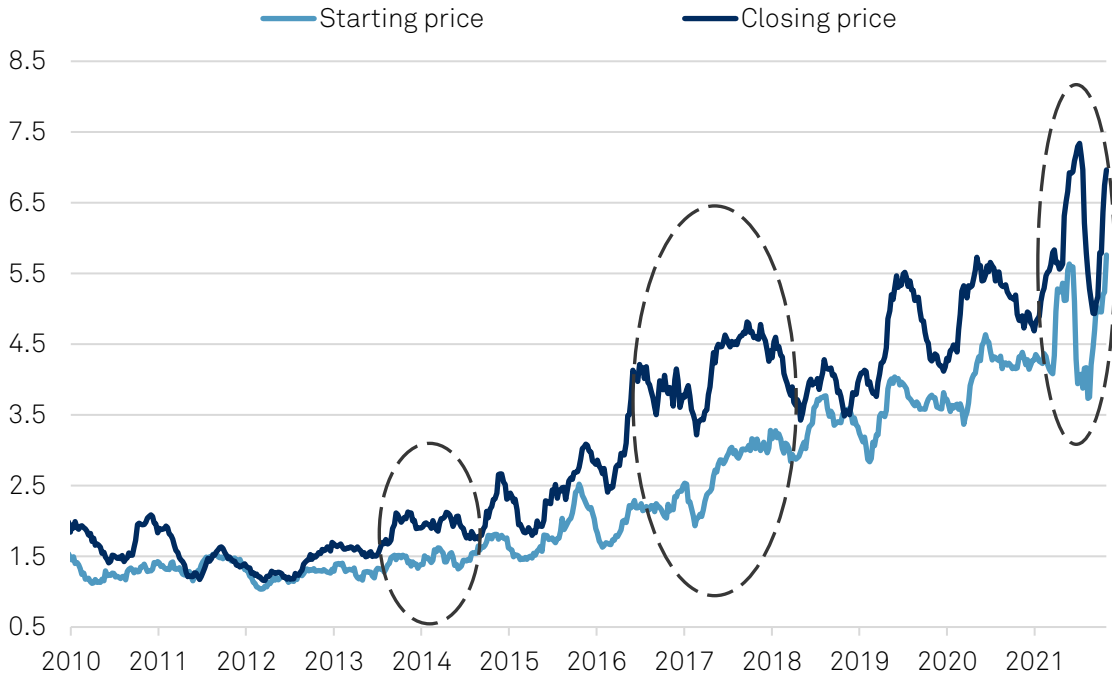


Source: Wind, S&P Global Ratings.

# Land Prices Are Cooling, And May Decelerate More

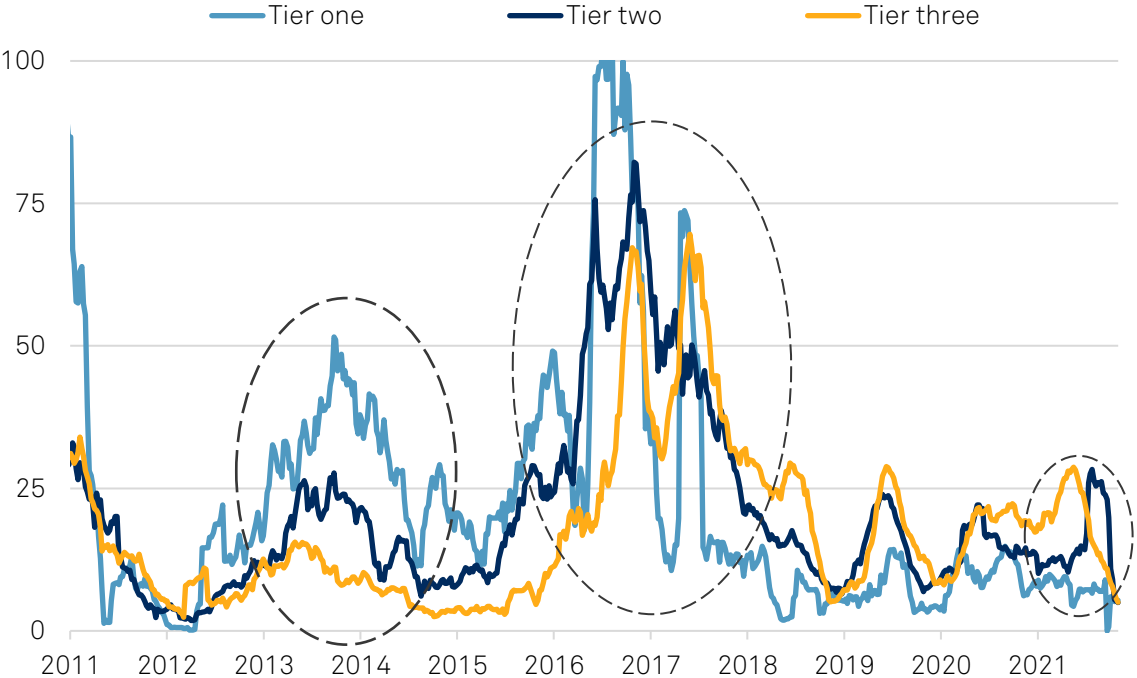
- Residential land prices have been accelerating for nearly a decade, persistently driving up home prices.
- Land price bubbles have formed and deflated every three to four years; they formed again under COVID and are now deflating.

**Residential Land Auctions Starting And Closing Prices ('000 RMB Per SQM)**



SQM--Square meter. RMB -- Chinese renminbi. Source: Wind, S&P Global Ratings.

**Residential Land Auctions Closing Price % Above Starting Price**

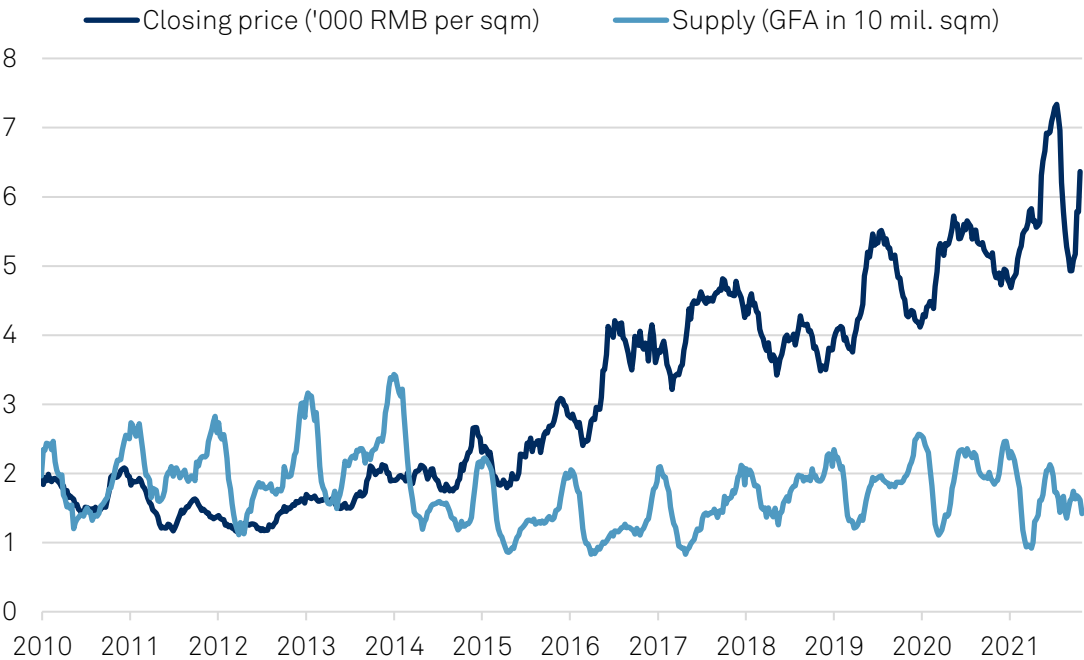


Source: Wind, S&P Global Ratings.

# Reliance on Residential Land May Hit Local Governments

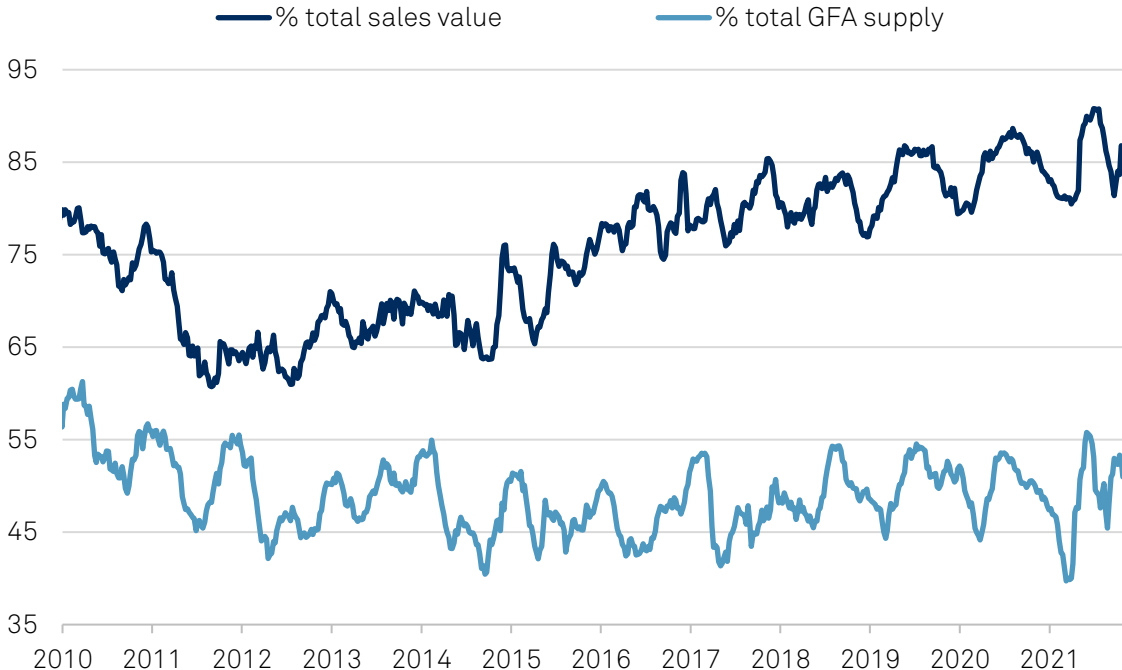
- Local government land revenues have become reliant on prices, as land supply has flattened.
- Residential land now makes up about 85% of land sales revenues, 20 percentage points more than a decade ago.

## Residential Land Auction Closing Price vs. Supply



Sqm--Square meter. GFA--Gross floor area. Mil.—Million. RMB--Chinese renminbi. Source: Wind, S&P Global Ratings.

## Land Auctions: Residential % Of Total Sales



Source: Wind, S&P Global Ratings.

# Takeaways

## Credit market contagion

- China will continue to drag on Asia's new-issue market, as tightening policies are unlikely to be reversed over the near term.
- 2021 has seen significant issuer events, which have hit investor sentiment and will amplify volatility.
- This is exacerbated by exposure that grew under COVID, when China made up two-thirds of speculative-grade issuance, and about 60% of investment-grade issuance.
- New-issue allocation data suggest U.S./EMEA-based investors may have less exposure to Chinese property debt.
- Credit market contagion has been mostly in 'B' category issuers in China, leaving property market contagion as the key risk.

## Property market contagion

- COVID stimulus indirectly drove home prices to accelerate. The government needs to reverse price and sales momentum.
- Fragmentation limits effect of individual defaults; Evergrande makes up 4% of overall sales, 1.4% of GFA under construction.
- However, the recent sales drop shows default headlines can hit buyer sentiment and spread contagion to the broader market.
- We expect sales to fall 10% in 2022, 5%-10% in 2023, with an up-to 3% fall in home prices.
- Higher reliance on residential land sales may lead to contagion to local governments as land prices decelerate.

# Contact



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