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China's developers facing refinancing pressure

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China's developers have been through a tough 2018 amid slowing economic growth, tight credit environment and strict regulations on real estate sector. The mounting pressure in the housing market has been reflected in the sector's NUS-CRI 1-year aggregate Probability of Default (Agg PD) in 2018, from 66.92bps in January to 105.65bps at the end of the year. The 1-year Aggregate PD for smaller developers is even higher, increasing 39% from 132.1bps in January to 183.53bps in December. With the wall of debts maturing soon, there are concerns on property developers' inability to repay its debts.

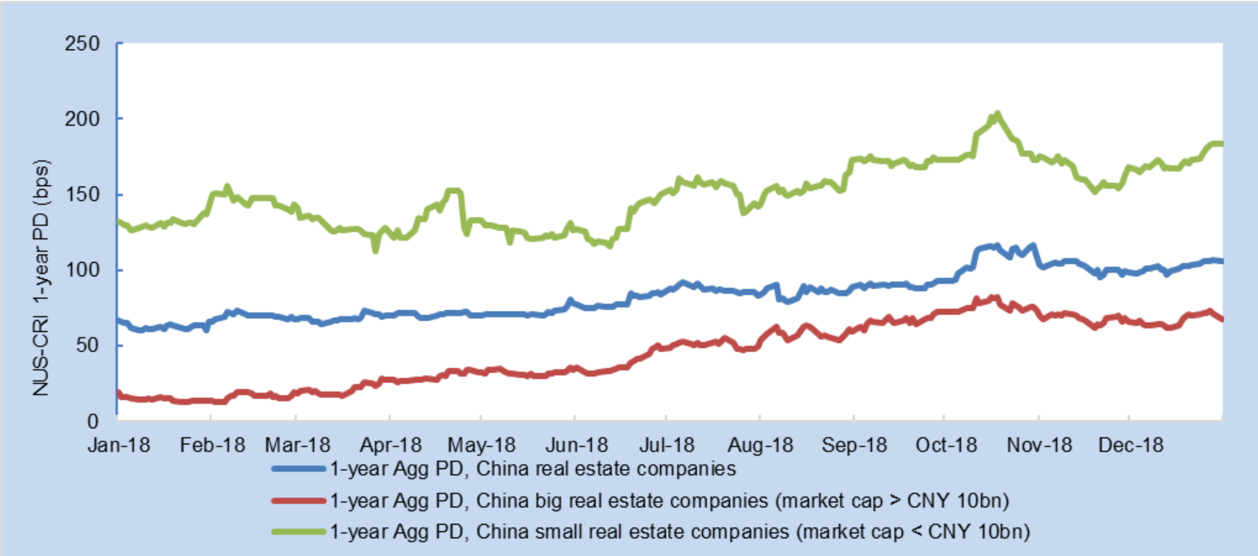
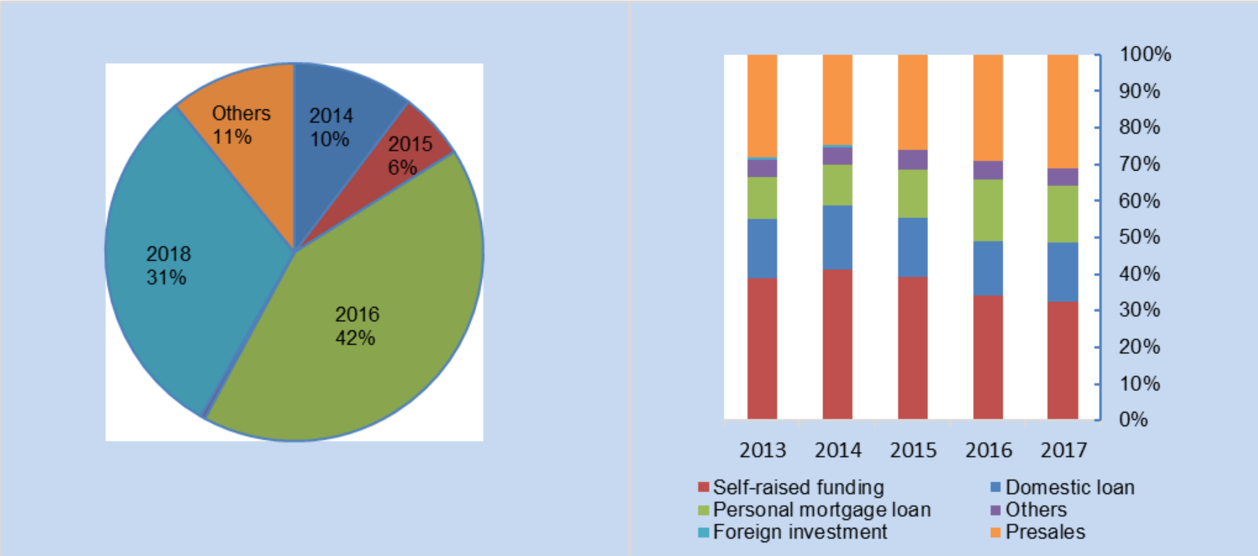


Figure 1: NUS-CRI 1-year Aggregate PDs for real estate companies, including large and small firms. *Source NUS-CRI*

A record CNY 437.1bn of onshore bonds and USD 10bn offshore bonds in the sector will mature in 2019. 42% of these maturing bonds were issued in 2016 due to easy financing policy at that time and 31% are commercial papers issued in the second half of 2018, to meet the refinancing need of earlier bonds.

According to National Bureau of Statistics of China, presales, loans, and self-raised fund, including issuing bonds, accounted for around 80% of financing. The proportion of presales increased steadily to 31% in 2017 after the government started cracking down on risky borrowing.



Figures 2a and 2b: Issue dates of bonds maturing in 2019 and Source of Financing. *Source: Bloomberg, National Bureau of Statistics of China*

Developers in China can apply a presale permit from the local government after securing around 25% of the planned funding for the project. The permit allows developers to sell apartments and receive some proceeds before its completion. Pre-sold value of properties has exceeded 80% of total property sales since the start of 2018 and has been increasing in the year. Homebuilders are rushing to sell newly started apartments and some have extended delivery date of the property in order to hold more cash in hand, while waiting for credit conditions to improve. The completed construction declined in Nov 2017, first time declining since 2016 and has kept declining for 13 consecutive months, from -1.0% in Nov 2017 to -7.8% in Dec 2018, peaking in Oct 2018 at -12.5%.

However, property sales have weakened though developers rely heavily on it. 2018 has seen a slower pace of average sales price growth and contracted sales volume due to bearish market sentiment as well as property curbs, such as minimum down payment. More investors are holding a wait-and-see attitude amid the economic slowdown and trade war. At the same time, the strong housing price growth since 2015 is largely underpinned by the housing rebuild monetarization program in tier 2 and tier 3 cities. With the program gradually phasing out, the housing market is expected to cool down further.

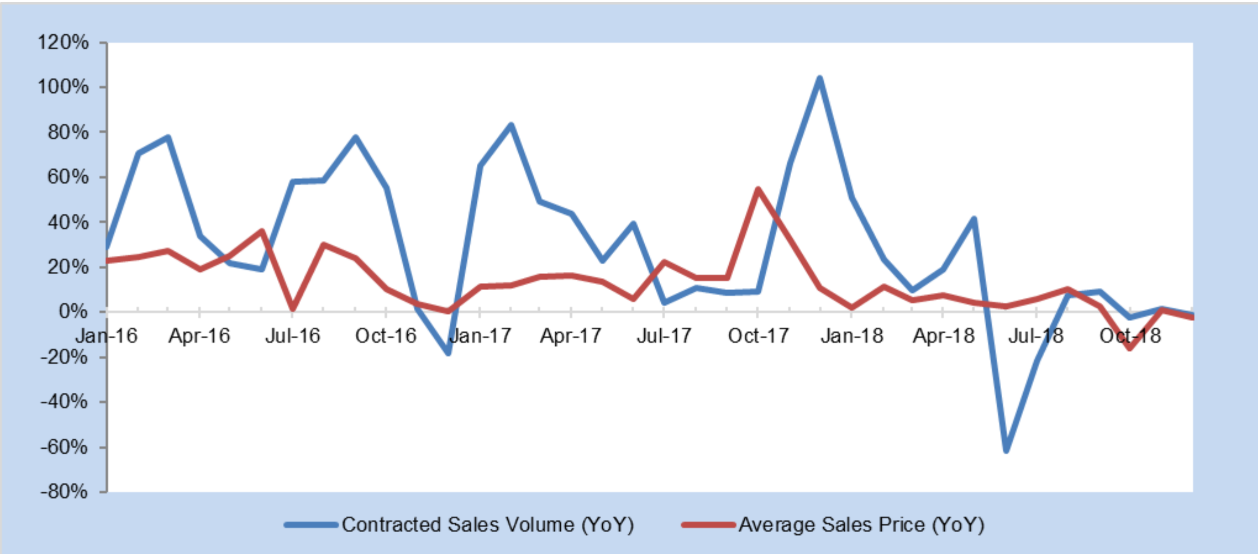


Figure 3: YoY change in Contracted sales volume and Average sales price. *Source: Bloomberg*

Developers with diversified external financing channels have better access to funding given the cooling housing market. Most firms would raise money from a bank loan but banks are more cautious in 2018 as the NPL ratio in the real estate sector is going up. Agricultural Bank of China reported a 1.45% NPL ratio in real estate sector in Jun 2018, rising from 1.13% in Dec 2017. Shadow banking is also important for property developers to get credit, especially for medium to small firms. But a crackdown on shadow banking has made companies much more reliant on the public capital markets, where funding is hard to get. The China Securities Regulatory Commission (CSRC) imposed tight regulations on real estate corporate bonds in 2016 and new issues have been declining since then. Successful issues are mostly from top ranked developers including SOEs and some issues are even halted, such as bonds issued by Guangzhou R&F Properties and Seazen Holdings Co Ltd. Some firms tapped into offshore bonds but the borrowing cost is rising. The recent multibillion-dollar bond offerings of Evergrande, China's third-largest property developer by sales, have unusually high interest rate up to 13.75%. Chairman Hui Ka Yan bought more than half of the overall issue to boost investor confidence. Looking ahead, there is no clear sign of an easier credit environment or any cancelation of property curbs. China's property developers are facing refinancing pressure in 2019.

Credit News

US companies turn to junk bonds over loans to fund deals

Jan 31. The US bond market has staged a stronger recovery than the loan market as US companies look to junk bonds rather than leveraged loans for long-term debt financing needs. Back in December, the US witnessed a drop in sales of both high-yield bonds and leveraged loans due to concerns of slowing global growth. However, high-yield bond funds have benefitted as USD 4bn has been injected since the start of 2019 as compared to loan funds which have seen a withdrawal of USD 2.2bn. The more attractive borrowing costs in the bond market have also lured companies away from loans. The slower growth out of China and Europe as well as the recent US government shutdown had weakened the case of Fed raising rates. With the lower interest rate expectations, investors turn to the high-yield market. (FT)

Indonesia banks warn of liquidity squeeze from govt bond issuance

Jan 31. Two of Indonesia's largest banks have cautioned that a government strategy of frontloading bond issuance and selling more debt to retail investors is draining cash in the economy, undermining efforts to boost bank lending. Bank Central Asia (BCA), Indonesia's largest bank by market value, reported that the industry's loan-to-funding ratio (LFR) is at 93%, above Bank Indonesia's (BI) recommended range within 80-92%. Furthermore, BCA argued that assistance by banks in government bond sales to investors this year and bonds' higher return than banks' term deposits have cannibalized saving deposits. Indonesia's finance minister said on Tuesday that although the bond strategy would adapt to local market conditions and take into account the rise in US interest rate, it would not deepen competition with private sector due to a lower projection of budget deficit for the whole year. (Reuters)

India's largest lender is finding fear can be a potent weapon in recovering loans

Jan 31. Previously used to walking away from debt without any major consequences, business owners in India have been convinced by the recent crackdown on bad debt by policy makers' that they risk losing their companies once the courts become involved. Consequently, the State Bank of India (SBI) found negotiation with business owners to be easier especially when they are genuinely trying to avoid losing their companies. While the bad-debt ratio at India's banks remains among the worst for a major economy, the crackdown managed to help reduce the bad-debt ratio at India's banks to 10.8% in September 2018 from 11.5% 6 months earlier. However, the difficulty in consensus building on the restructuring terms and legal challenges from founders caused some debt resolution processes to be extended beyond the deadline enshrined in the law. (Business Times)

Britain's banks face funding crunch as Brexit looms

Jan 30. The average cost for British banks of issuing secured debt has jumped to its highest since the 2016 EU referendum due to the uncertainty from the disorderly Brexit and the end of cheap cash from the Bank of England. The BoE has ended its GBP 127bn funding scheme to support lending to consumers and businesses after the Brexit vote. The tight funding market will have the most impact on challenger banks such as Metro Bank and Virgin Money which are less able to rely on savers' deposits to finance lending. Banks have been forced to new forms of funding such as issuing debt secured against assets or attract more deposits. These forms of funding tend to be more expensive and analysts are expecting banks' earnings to be affected by 10-20%. (Reuters)

As growth slows, China cuts local government debt costs to spur investment

Jan 29. Facing weaker domestic demand and a trade dispute with the US, China has seen a slowdown in its economic growth. To lower borrowing costs to kick start investments and shore up growth, the China regulators have cut the premium local government must pay to issue debt from a minimum spread of 40 basis points to between 25 and 40 basis points. The change follows the recent oversubscription of local government bonds, underscoring the distorted pricing and the market's demand for high-quality debt. The record pace of issuance of normal and special-purpose bonds means local government will use up 30 percent of the total 2019 quota within two weeks. Analysts expect that the quota could be raised to RMB 2tn for special-purpose bonds from RMB 1.35tn last year, if economic signals remain weak. (Reuters)

Indonesian bankruptcy case against Lippo spooks investors (FT)

Singapore bank lending flat in December: MAS preliminary data (Business Times)

Australia government says credit a priority in bank inquiry response (Business Times)

Regulatory Updates

China steps up opening of capital markets as securities watchdog broadens scope of inbound investments

Feb 01. Amid a slowing economy and trade tensions with the US, China is stepping up the opening of its capital markets o attract more long-term overseas capital. The China Securities Regulatory Commission published draft rules that would combine the Qualified Foreign Institutional Investor (QFII) scheme and its RMB denominated scheme (RQFII) which will lower the threshold for overseas applicants and simplify the vetting process. Under the new scheme, investors will be allowed to buy securities traded over the counter, invest in private funds or conduct bond repurchase transactions. Foreign institutions will also have access to derivatives including financial futures and commodity options. Risk management rules for brokerages would also be adjusted to encourage them to make more long-term equity investments. (SCMP)

Fed keeps interest rate unchanged, will be 'patient'

Jan 31. The Federal Reserve holds the key US lending rate unchanged in a range of 2.25% to 2.5% and said that it would be 'patient' about making further changes. Amid the low inflation and risks to the US economy, Fed chairman Jerome Powell said that the case for raising rates has weakened. The Fed is also prepared to changed the pace of reduction of its securities holdings which stands at USD 4.5tn as markets were concerned that the current process might cause borrowing cost to increase amid a slowing economy. The Fed also cautioned that another government shutdown or protracted trade negotiations with China would hurt the economy by denting business confidence. (Business Times)

Australian regulator vows to tackle 'cosy oligopoly' of big banks (FT)

Italian government plans to separate commercial lenders from investment banks (Reuters)

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