

Is the creditworthiness of Chinese local governments raising concerns in 2021?

Contents

Summary	1
Strong economic recovery is underway despite the sporadic outbreak of pandemic	2
After widening in 2020, fiscal deficit of local governments will stabilise in 2021	3
Great discrepancies persist among local governments' debt level	5
Stable outlook for Chinese local governments' creditworthiness	6

Summary

A positive outlook for an economic recovery of China is set for 2021, depicted by a GDP growth rate surpassing 8% registered by many provincial regions in 2021. Since China has well contained the coronavirus pandemic, coupled with the fiscal stimulus, the country's economy recovered rapidly with more than half of provincial regions reported a GDP growth of over 3% in 2020. Although the coronavirus confirmed cases increased marginally at the beginning of 2021, the impact should be modest with the government's draconian measures and strict control in place. We expect the reviving consumption will lead to vibrant economic growth in some wealthy provincial regions this year. Also, as provinces such as Guizhou, Yunnan and Jiangxi have successfully cultivated their fast-growing clusters of industries and sustainable progress pattern, they should manage to record strong growth in 2021. However, the economic growth in regions such as Heilongjiang, Liaoning and Inner Mongolia is likely to fare worse than the average level in 2021 due to the revival in the number of confirmed coronavirus cases and the ingrained structural defects in their economies.

Deficit level of local governments (LGs) in China will generally stabilise in 2021 when the proactive fiscal strategy is toned down and budgetary revenue increases. Local governments' deficit surged in 2020 as a result of the intensified budgetary expenditure. Since the coronavirus pandemic has subsided and the country's economic growth has got back on track, the fiscal expansion should no longer be an urgent and imperative task for most local governments in 2021. On top of that, we believe the general public budgetary revenue of most governments will grow nicely and the land sales will not be significantly dampened by the new policies on debt financing of the real estate industry. Moreover, we believe the reinforced fiscal help from the central government will not abate sharply but will likely to gradually resume normalcy in 2021.

LGs' debt burden is expected to remain heavy with wide gaps depicted. We estimate the average debt-to-revenue ratio of provincial governments of China to have risen by 15 percentage point in 2020. Gaps were widened quickly among local government's debt level due to their uneven impact by the pandemic and various extents of fiscal stimulus. Based on our analysis, the debt-to-revenue ratio of Shaanxi province and Tianjin city exceeded 400% whereas that of Guangdong, Tibet and Beijing was below 150% by the end of 2020. We believe most local governments will be more conscientious with a focus on increasing their debt when their fiscal expansion slows in 2021.

Outlook of LGs' creditworthiness remains stable in 2021. Most LGs will have decent liquidity condition albeit the financing channels for LGs will not be as loose as they were in 2020. Some credit events of a few state-owned enterprises and local government financing vehicles last year have struck a nerve in the financial market. The normalising fiscal policies and financing condition will expose the risk in a few lower-level local governments with vulnerable credit profile. As such, we believe the creditworthiness of local governments will generally remain stable but become more dispersed this year. The tail risk appears to be a concern.

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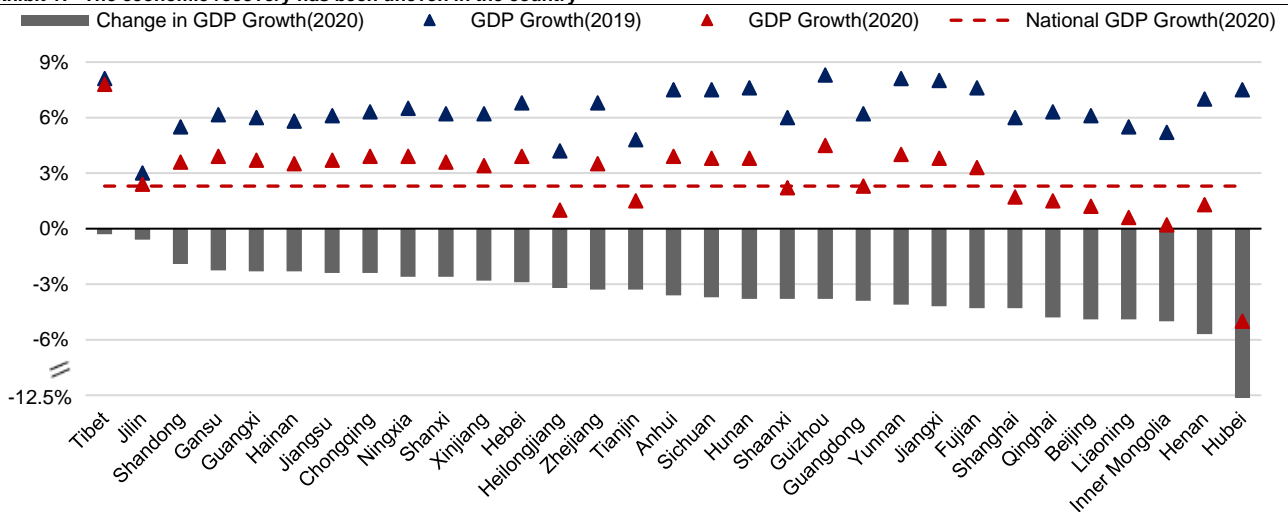
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Strong economic recovery is underway despite the sporadic outbreak of pandemic

The economic recovery is right underway

China's GDP growth is accelerating with more than half of provincial regions recording GDP growth of over 3% in 2020 (Exhibit 1). Most fast developing provinces over the past few years such as Guizhou, Yunnan and Anhui continued to have their economic growth exceeded their peers in 2020. However, the recovery has been uneven across the provincial regions. For instance, Tibet's GDP growth was hardly affected by the pandemic because of its deep inland location. The economy of the cities of Beijing and Shanghai has taken a hit more severely by the pandemic than their peers, as their economies have been mainly fueled by consumption which recovered rather slowly in 2020 as China's total retail sales contracted 3.9%. Looking forward, the provincial regions' economic growth will gradually resume their original growth path in the long term.

Exhibit 1: The economic recovery has been uneven in the country



Source: Bureau of Statistics, Pengyuan International estimates

The sporadic pandemic outbreak will have little impact on most provincial regions

The sporadic pandemic outbreak at the beginning of 2021 could dampen the economic recovery in some provincial regions in a short period, namely the provinces of Hebei, Heilongjiang, Jilin and Liaoning, as well as the Beijing city. As the confirmed cases revive, these regions have introduced draconian measures to counter the spread of pandemic including travel restrictions, closure of scenic spots, banning mass gatherings. In particular, the Hebei province's economy would have taken a harder hit than its peers with existing confirmed cases surpassing 800 as of 20 January 2021.

The flow of population will be restrained during the upcoming Chinese New Year rush with the rigorous isolation approaches and travel restrictions in place. On the other hand, when a large amount of population chooses to stay at the cities they work for holiday, the resumption of work and production after the festival will likely to be quicker than the normal years. This could favour the economy of provinces and cities in the Pearl River Delta and Yangtze River Delta, which have large amount of immigrant workers. Generally speaking, the rise in the sporadic confirmed cases will not affect most regions' economic recovery as the governments are now more sophisticated and effective in controlling the pandemic than before.

Most provinces will see their GDP growth above 8% in 2021

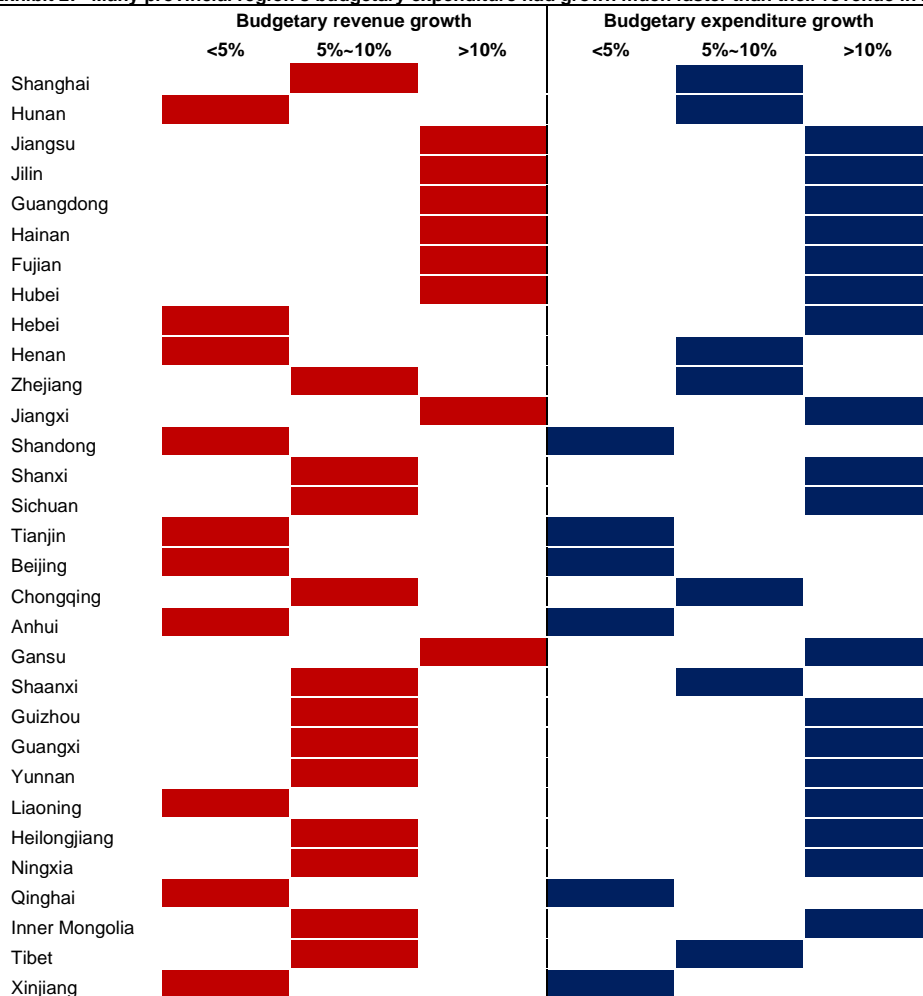
The investment in the country will keep surging in the first half of 2021 with consumption catching up. The pace of consumption has recovered slower than that of investment and foreign trade in 2020 due to its laggard effect in respective to the stimulus approaches. We expect the reviving consumption will lead to vibrant economic growth of some wealthy provinces this year. Also, some regions that have successfully cultivated a cluster of fast-growing industries and healthy progress pattern will also see strong economic performance, namely the provinces of Guizhou, Yunnan and Jiangxi. In the opposite, the regions such as Heilongjiang, Liaoning and Inner Mongolia are expected to recover slower and softer than their peers in 2021 as they are not only striving to rein in the rebound in the number of confirmed coronavirus cases, but also struggling with the ingrained structural defects in their economy. In general, we project most province's GDP growth will range from 10% to 20% year on year in the first quarter of 2021 due to a lower base in 2020, then gradually shift down to their normal growth range in the fourth quarter. More than half of provincial regions will register economic growth of over 8% in 2021, in our view.

After widening in 2020, fiscal deficit of local governments will stabilise in 2021

Exacerbated fiscal imbalance

Even though the tax and fee collection of local governments has been hindered severely by the pandemic, the central government's increased fiscal help has underpinned local governments' budgetary revenue growth. Based on our estimation, most provincial regions' budgetary revenue growth in 2020 were between 0% to 10% with the Tianjin city being the slowest (Exhibit 2). However, the budgetary expenditure of most provincial regions surged in 2020 in a bid to counter the pandemic and its aftermath. As such, only half of provincial regions managed to keep their budgetary revenue and expenditure increasing in a similar range of speed while others' budgetary expenditure growth significantly outpaced their revenue growth, such as Hebei and Liaoning provinces.

Exhibit 2: Many provincial region's budgetary expenditure had grown much faster than their revenue in 2020



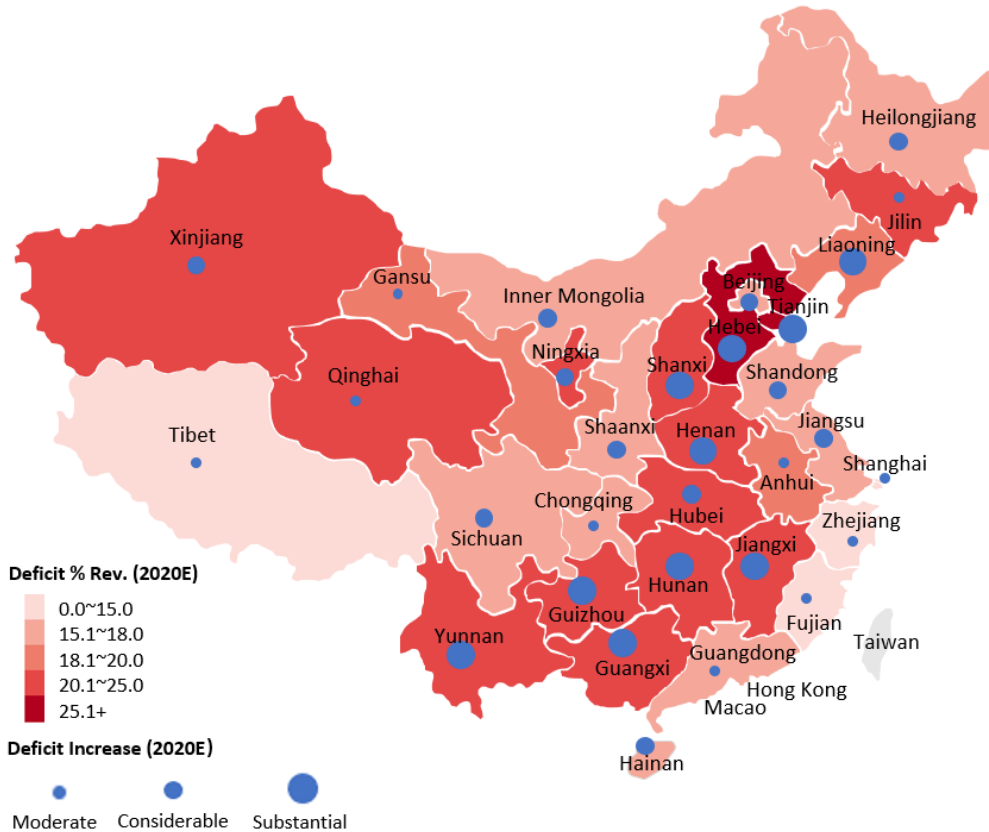
Note: 1, The budgetary figures are estimated. 2, The budgetary revenue includes general public budgetary revenue, refunds and transfers from the central government and government fund revenue. 3, The budgetary expenditure includes the general public budgetary expenditure and government fund expenditure.

Source: Local governments' bureaus, Wind, Pengyuan International estimates

Deficit level reached to an all-time high

The abnormal fiscal approaches in 2020 have lifted the deficit level of nearly all provinces but also increased discrepancies among them (Exhibit 3). The wealthy provinces such as Guangdong, Zhejiang and Fujian, leveraging on their solid economic resilience and exuberant land market, managed to keep their deficit increment in a modest scope while some provinces and regions' budgetary deficit surged. The expansion of fiscal expenditure also varied greatly across different local governments in China. Some provinces boosted their fiscal expenditure substantially to mitigate the economic downside risk while some others adopted relatively conservative fiscal expense approaches.

Exhibit 3: Wealthy regions' deficit level tended to increase moderately

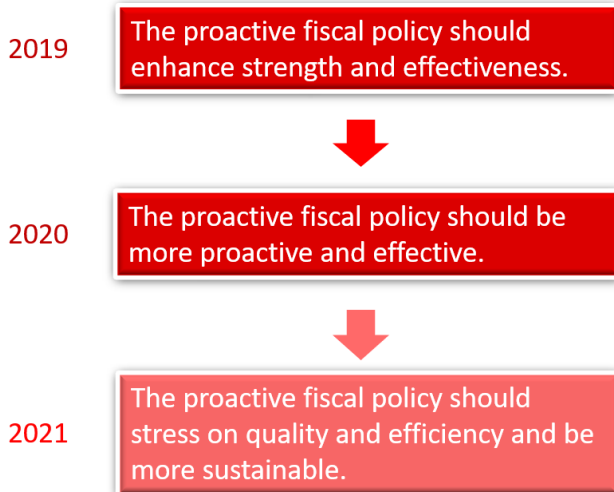


Note: 1, The data of 2020 are estimated. 2, The deficit increase is relative to the regions' budgetary revenue
Source: Local governments' bureaus, Wind, Pengyuan International estimates

The proactive fiscal strategy has been toned down in 2021

The pandemic outbreak in 2020 has led to a more proactive approach in fiscal strategy compared to 2019, when the central government rolled out a nationwide tax and fee cuts initiative to propel the slowing economic growth (Exhibit 4). However, this is unsustainable as the deficit of local governments has widened greatly and many have seen unprecedented fiscal pressure. Since the pandemic is under control and economy is reviving smoothly, the proactive fiscal strategy has been toned down in 2021 and budgetary expenditure is expected to be more conservative than the previous two years.

Exhibit 4: Fiscal policies shifted over time



Source: MOF

Deficit level of most local government will stabilize

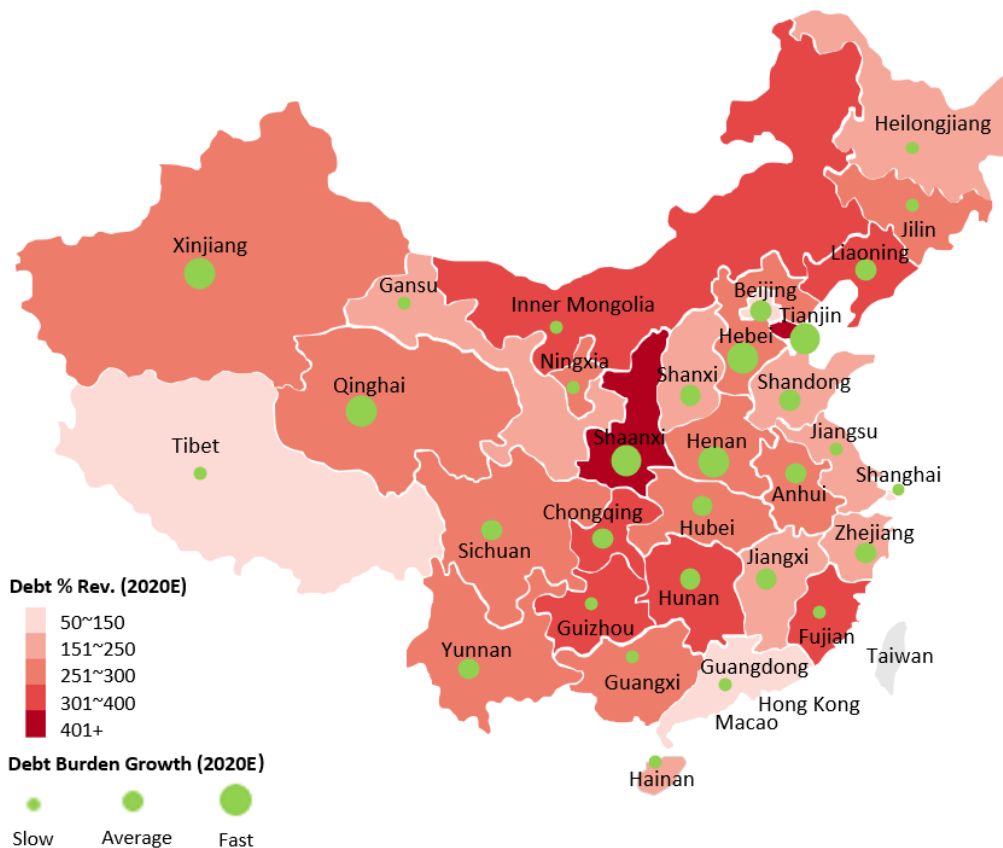
As the economy continues to revive in 2021, the tax and non-tax fee income of provincial governments will also revive. In addition, we believe the reinforced fiscal help from the central government will not abate sharply, instead, it will likely to gradually resume normal position and become more focused on bolstering the provinces or regions which are facing the economic downside risk and fiscal troubles. Therefore, we expect that most provincial governments' general public budgetary revenue growth will be in a spectrum of 6% to 12% in 2021. The rigorous financing restrictions on the real estate segment may cause some uncertainties in land sales of local governments in 2021. That said, we hold a relatively positive view for most provinces' land market this year in the wake of the strong recovering economy and businesses. On the other hand, the fiscal expenditure of most provincial governments would not increase greatly according to the softened proactive fiscal strategy. As a result, we believe the provincial governments' deficit pressure will generally remain stable in 2021.

Great discrepancies persist among local governments' debt level

Debts soared in 2020 as a result of the unprecedented devastation caused by the pandemic

The sharply widened deficit in 2020 has elevated the leverage of nearly all local governments in China with increasing disparities (Exhibit 5). The central government had empowered the provincial governments to load on more debts to fight against the pandemic, and the loose financing market also facilitated the borrowing of local governments. We estimate the average debt-to-revenue ratio of provincial governments of China to have risen by 15 percentage points in 2020. Gaps were widened quickly among local governments' debt level due to their uneven impact by the pandemic and various fiscal stimulus extents. Based on our analysis, the debt-to-revenue ratio of Shaanxi province and Tianjin city was over 400% whereas the debt-to-revenue ratio of Guangdong, Tibet and Beijing was below 150% as of the end of 2020.

Exhibit 5: Debt level rose diversely in 2020



Note: 1, The data are estimated. 2, The debt includes direct debt and hidden debt.
Source: Local governments' bureaus, Wind, Pengyuan International estimates

Debt level will remain stable in 2021 with increasing differentiation among local governments

As the fiscal strategy steps back to normal, the debt growth of provincial governments will be curbed. The local governments will become more conscientious and focus on increasing their debt compared to last year. We project the debt level of local governments in general will increase mildly in 2021 with greater disparities than before. The local governments with high fiscal self-sufficiency will tend to have more flexibility to deleverage than their peers amid the economic recovery in 2021. However, the governments with a bulk of rigid fiscal expense in their budgetary expenditure but inefficient revenue collection will see their debt level shifting even higher this year.

Stable outlook for Chinese local governments' creditworthiness

Overall, the outlook of the creditworthiness of LGs in China will remain stable in 2021 when the economy continues to recover and the governments' fiscal and debt pressure stabilise. The liquidity condition of provincial governments will remain favourable albeit the whole financing tunnels will not be as loose as they were in 2020, however, some lower-level local government's financing position will be dented. In addition, some credit events of a few state-owned enterprises and local government financing vehicles last year have struck a nerve in the financing market. The normalising fiscal policies and financing condition will expose the risks in some lower-level local governments with heavy debt load and lacklustre liquidity position in 2021. Therefore, we believe the creditworthiness of local governments will be more dispersed this year and some lower-level local governments' creditworthiness will be challenged.

For more researches and credit views, the table (Exhibit 6) below lists our published local government ratings.

Exhibit 6: Our published issuer credit ratings for 20 provincial-level governments

Provincial-level governments	Issuer Credit Ratings	Issuer reports
Beijing	AA	https://www.pyrating.com/rating-actions/issuer/Beijing-Municipal-Government-China.html
Shanghai	AA-	https://www.pyrating.com/rating-actions/issuer/Municipal-Government-of-Shanghai-China.html
Hainan	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Hainan-China.html
Shaanxi	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Shaanxi-China.html
Hebei	A	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Hebei-China.html
Hunan	A	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Hunan-China.html
Jiangsu	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Jiangsu-China.html
Jilin	A	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Jilin-China.html
Guangdong	AA-	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Guangdong-China.html
Fujian	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Fujian-China.html
Henan	A	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Henan-China.html
Zhejiang	AA-	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Zhejiang-China.html
Jiangxi	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Jiangxi-China.html
Shandong	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Shandong-China.html
Shanxi	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Shanxi-China.html
Sichuan	A+	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Sichuan-China.html
Tianjin	A	https://www.pyrating.com/rating-actions/issuer/Municipal-Government-of-Tianjin-China.html
Guizhou	A	https://www.pyrating.com/rating-actions/issuer/Provincial-Government-of-Guizhou-China.html
Yunnan	A+	https://www.pyrating.com/rating-actions/issuer/20200818101436501.html
Guangxi	A	https://www.pyrating.com/rating-actions/issuer/Guangxi-Zhuang-Autonomous-Region-Government-China.html

Note: The credit ratings are global scale long-term foreign currency ratings.

Source: Pengyuan International

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