Insolvencies

Extensive reading

Insolvency in China, 2020 Q2

- **Insolvency outlook**
- **Review of bond default in 2019 and 2020 H1**
- **Macro data updates**
- **Easing monetary policy and corporate credit to support economic recovery**

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EXECUTIVE SUMMARY

- Compared with the past 3 years (+74% for 2017, +50% for 2018,+c.20% for 2019), the number of insolvency cases in China is expected to keep growing at a relatively high pace in 2020 (+c.21%, up from +c.15% in previous expectation considering COVID-19 impact).
- The number of new bond default companies in Chinese market decreased from 44 in 2018 to 39 in 2019, and recorded 8 in 1H2020. The downward trend in 1H2020 is due to increasing liquidity injected by central government to fight against COVID-19.
- The official manufacturing PMI in March shows the overall manufacturing industry is gradually recovering with large enterprises showing relatively better performance than small and medium-sized enterprises (SMEs).
- New RMB loans from financial institutions totaled RMB 12.09 trillion / EUR 1.52 trillion in 1H 2020, a large increase from RMB 9.67 trillion / EUR 1.22 trillion for the same period last year.
- On April 3, 2020, PBOC, the central bank of China, announced to release around RMB 400 billion / EUR 50 billion via cutting the reserve requirement ratio (RRR) for small and mid-sized banks by 1% in two equal steps, the first effective as of April 15 and the second as of May 15.
- With COVID-19 sweeping across the globe, full recovery could take longer.

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INSOLVENCY OUTLOOK

Compared with the past 3 years (+74% for 2017, +50% for 2018,+c.20% for 2019), the number of insolvency cases in China is expected to keep growing at a relatively high pace in 2020 (+c.21%, up from +c.15% in previous expectation considering COVID-19 impact). The situation might continue in 2021 (+c.16%).

During previous years, number of insolvency cases in China increased greatly in 2017(+74%) and 2018 (+50%) mainly due to the acceleration of clean-up zombie companies, slowdown on GDP and tightened financing conditions especially for the private owned enterprises.

The insolvency growth rate in 2020 is expected to be slightly higher than 2019 and was revised up from +c.15% to +c.21% considering

1) Global economic slowdown due to COVID-19 impact

2) Uncertain U.S.-China trade tensions

3) Eased monetary policy and corporate credit

4) Improving direct financing for innovative private companies with the establishment of SCI-Tech Innovation Board (STAR Market) at the Shanghai Stock Exchange in June 2019 and reform of Second-board Market.

As the COVID-19 pandemic outbreak in overseas in 2020 Q2, transportation, automotive and textile are most at risk.

Review of bond default in 2019 and 2020 H1

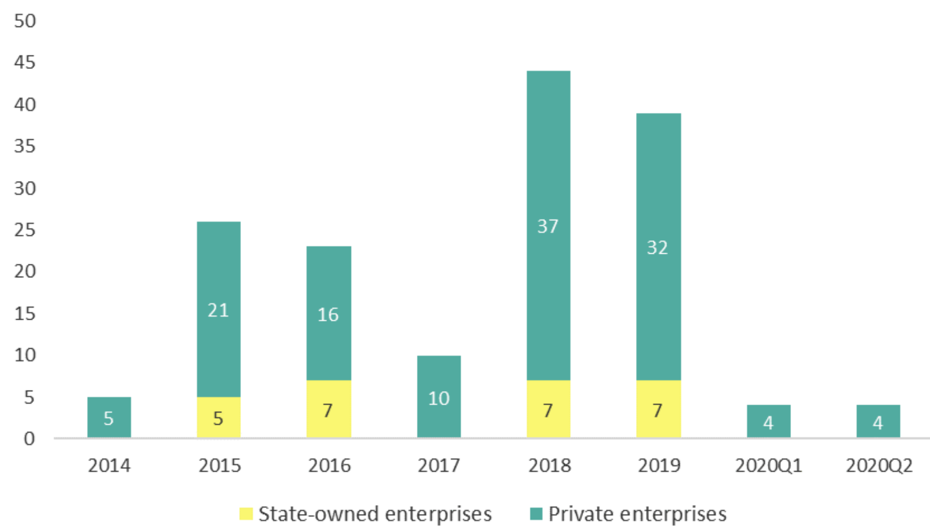
The number of new bond default enterprises in Chinese market decreased from 44 in 2018 to 39 companies in 2019. The defaulters still concentrated in private enterprises in 2019 and the situation will not change in 2020. Both the regions and sectors of the bond default companies were relatively scattered in 2019.

The reasons of default for the private companies included

1) Aggressive capital expenditure and M&A
2) Failure in new business, main business in downturn
3) Long-term use of short loans
4) Poor cash flow of main business
5) Unclear ownership structure
6) Poor internal control
7) Large shareholders or actual controllers misappropriating funds or irregular guarantees
8) Excessive amount of related parties
9) Inadequate disclosure of financial statements, financial fraud
10) Tightened external financing condition

There were 4 new bond defaulters in 2020 Q2 and all were private enterprises who had been suffering from bad financial situation. The outbreak of COVID-19 accelerated their default process.

Figure 1: Number of new bond default enterprise



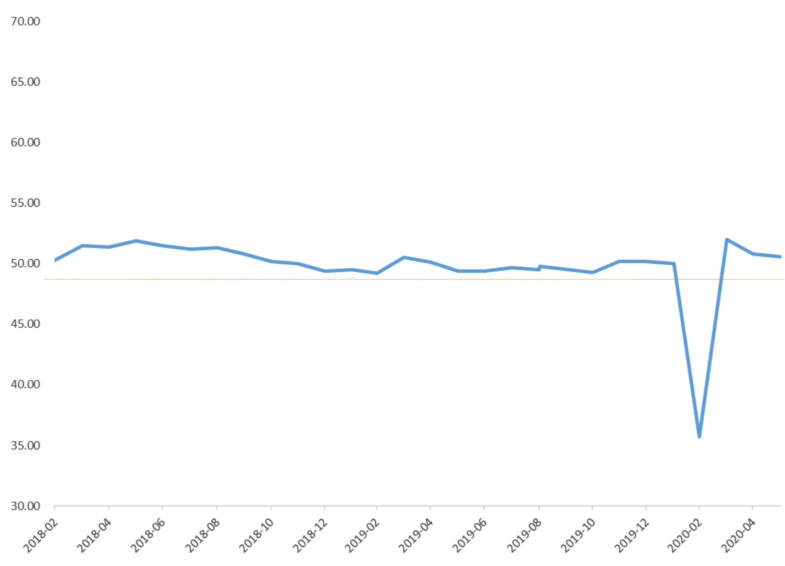
Source: Wind

Macro data updates

China's y/y actual GDP growth expected to be 2.9% in 2020 Q2 as the epidemic situation was eased. The official manufacturing PMI in June recorded 50.9 which stayed in expansionary territory for four months. From the perspective of enterprise scale, the PMI of large enterprises was 52.1 (+0.5), PMI of medium-sized enterprises was 50.2 (+1.4) and the PMI of small enterprises was 48.9 (-1.9). The overall manufacturing industry is gradually recovering amid COVID-19 with large enterprises showing relatively better performance than small and medium-sized enterprises (SMEs).

So far, economic recovery still faces challenges of still weak export and potential second wave of epidemic.

Figure 2: Monthly official manufacturing PMI



Source: National Bureau of Statistics, Wind

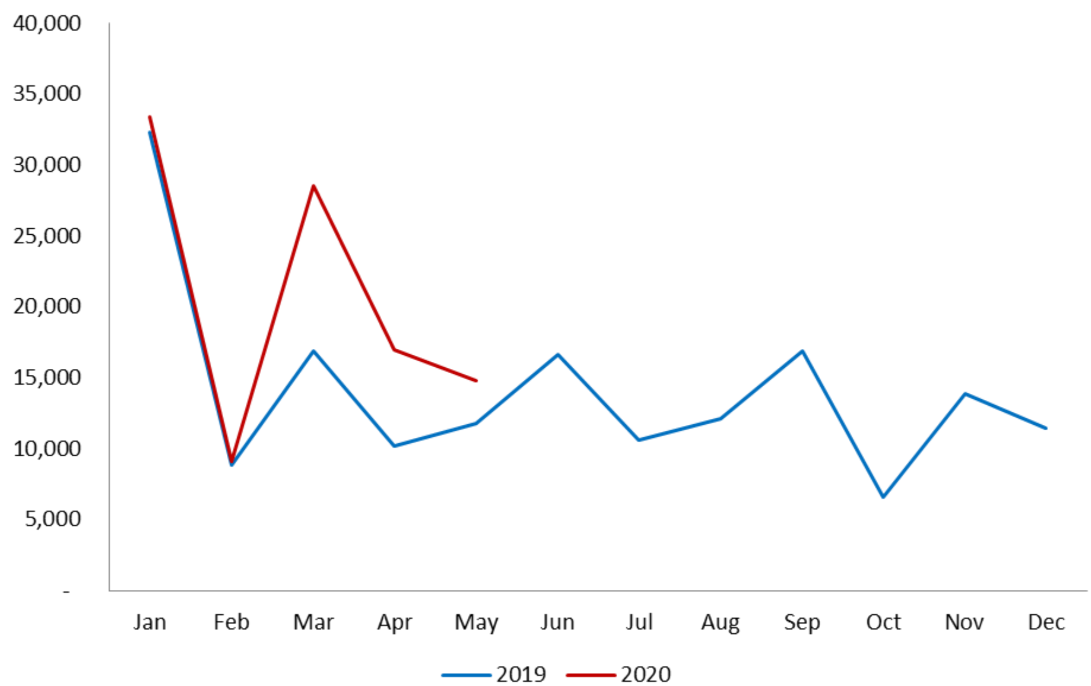
Easing monetary policy and corporate credit to support economic recovery

End of June, M2, the broad measure of money supply, rose by 11.1% year on year (May: 11.1%).

Total social financing, the more broadly defined measure of credit in the economy that includes loans, bonds and other non-traditional financing instruments, jumped to RMB 20.83 trillion / EUR 1.42 trillion in 1H2020, from RMB 14.63 trillion / EUR 1.84 trillion a year earlier.

New RMB loans from financial institutions totaled RMB 12.09 trillion / EUR 1.52 trillion in 1H 2020, a large increase from RMB 9.67 trillion / EUR 1.22 trillion for the same period last year.

Figure 3: New CNY Loans from financial institutions (CNY 100 million)



Source: The People's Bank of China, Wind

On April 3, 2020, PBOC, the central bank of China, announced to release around RMB 400 billion / EUR 50 billion via cutting the reserve requirement ratio (RRR) for small and mid-sized banks by 1% in two equal steps, the first effective as of April15th and the second as of May 15. The RRR cut along with other support measures targets to cushion the economic blow from COVID-19.

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