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Chinese airlines and property developers are heavily hit by the 2019-nCov

by [Luo Weixiao]

2020 is off to a rough start. It has been one month since the Hubei lockdown, the province where the first Novel Coronavirus related case was reported last Dec. In other cities outside Hubei, factories are under unscheduled shutdown and people are highly encouraged to stay at home during the much longer-than-expected Chinese New Year holiday. Consequently, businesses are heavily shocked by the containment. In this gloomy Chinese New Year shopping malls are empty and restaurants are closed. Family trips are cancelled and people only go out once in several days to buy necessities. Till now, more than 2,000 deaths have been reported since the outbreak and the economic toll of the virus weighs on the credit profile of some Chinese companies, who are facing debts maturing amid tight liquidity.

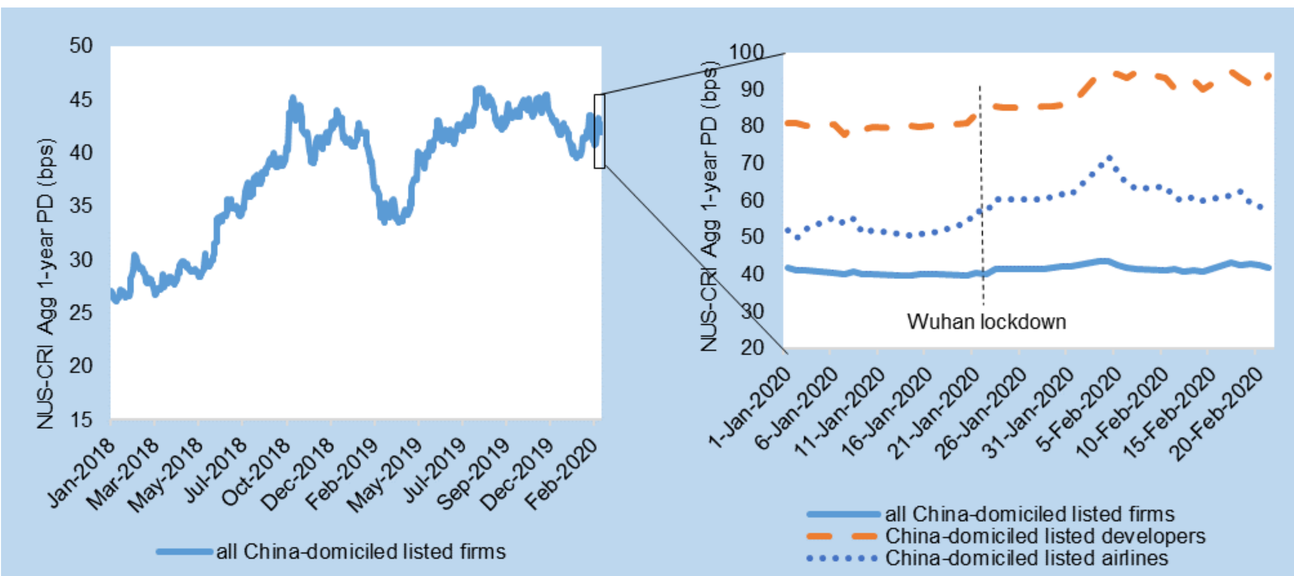

Figure 1a (LHS): NUS-CRI Agg 1-year PD for China-domiciled listed firms. Figure 1b (RHS): NUS-CRI Agg 1-year PD for China-domiciled listed developers and China-domiciled listed airlines. Source: NUS-CRI

Looking into each industry, airlines and developers are among the most negatively affected sectors in China. Tracked by NUS-CRI Aggregate 1-year Probability of Default (Agg PD), Agg PDs for China-domiciled listed airlines and real estate developers have increased 8bps and 13bps respectively since the 2019-nCov outbreak. This is not surprising given their business model.

Many of China's top airlines slashed their profit forecasts for 2019 before the virus outbreak as softer travel demand pressures passenger yields, a measure of average fare per kilometre flown, and a weakening yuan currency inflates costs. Their exposure to the 2019-nCov makes the situation worse. According to aviation data provider OAG, regional demand for flights has collapsed due to travel restrictions and cancelation of nonessential travel, forcing carriers to cancel over 25,000 flights a week in total. OAG said the number of seats available on domestic Chinese flights fell 63% year-over-year to 5.4 million in the second week of February and according to the Civil Aviation Administration of China (CAAC), daily passenger numbers down 91% on the year as of last Monday. As of Feb 14, Chinese airlines had refunded over USD 2.85bn to passengers unable to take cancelled flights, according to CAAC and the industry is estimated to lose USD 5bn in revenues in the first quarter by the International Civil Aviation Organization. The weak revenue and tight cash flow pressure the highly leveraged carriers especially the ones that are already in trouble. Chinese authority is planning to take over the HNA Group and sell off its airline assets amid the economic damage of the deadly virus. The indebted conglomerate was once eye-catching for its debt-fuelled aggressive overseas acquisition spree in 2016-2017 and is one of the leading shareholders of Hilton and Deutsche Bank. HNA has reported several defaults entering 2018 and the outbreak could be the last straw for the group.

Similarly, Chinese property developers are also facing pressure from tight cash flow and maturing debts. Property sales offices have been closed for one month since the outbreak and online transactions are few because most people prefer an onsite house viewing. According to a report from E-House, during the first week of Feb fewer than four homes a day were sold in Beijing, at a time when hundreds of homes would usually be sold every day. However, the sales hit is not expected to end soon since in 2019, 61.78% of the home sales in the nation came from 10 provinces with the most confirmed cases and the recovery of business in those provinces will be slow. Moreover, the virus outbreak delays the expected delivery date of properties and further pressures the liquidity of the developers. In such a situation, Chinese developers are facing heightened refinancing risk and the pressure on small developers is especially severe. As presented in a previous NUS-CRI Weekly Credit Report, credit profiles for Chinese small-to-median size developers are generally weaker and these developers have limited access to several credit channels such as bank loans and offshore bonds. The sector is facing around USD 23bn of bonds maturing this year and despite the recent easing monetary policies, small developers might still face liquidity problems.

Issuer	Issue Date	Maturity (years)	Coupon rate	Issue Amount (USD)
Xiamen Airlines	Feb 17, 2020	0.45	2.3%	600mn
Jointown Pharmaceutical Group	Feb 7, 2020	0.74	3.0%	500mn
Shenzhen Airlines	Feb 13, 2020	0.49	2.0%	600mn

Table 1: A selection of virus prevention and control bonds. *Source: bond.jrj.com.cn*

Chinese regulators have used financial instrument innovation to keep the economy afloat. A fast-track regulatory process in the interbank market was built for virus prevention and control bonds (virus bonds) and the proceeds will be mainly used to replenish working capital and repay interest-bearing debt. 26 companies have tapped the virus bonds to raise funds quickly and 37 virus bonds have been issued by Feb 18, with issuing amount exceeding CNY 30bn (USD 4.3bn). As new issues are few during the virus containment, the virus bond demand is quickly filled by investors and the coupon rates are generally lower than the YTM of the issuer's outstanding bonds with a similar maturity date (as shown in Table 1). Air carriers and pharmaceutical companies issued the most, with 10 bonds and 7 bonds respectively. It is also worthy to note that out of the 37 virus bonds issued, 27 came from state-owned enterprises, 9 from private enterprises and 1 from a foreign-invested enterprise. The fast-track process helps bolster corporates' balance sheets without any doubt but access to the process can be exclusive and selective. Businesses, especially the smaller ones are still facing mounting pressure from the 2019-nCov outbreak, which might not end in the foreseeable future.

Credit News

Millions of Chinese firms face collapse if banks don't act

Feb 23. The outbreak of coronavirus has put millions of small businesses at risk. Many of China's businesses have already suffered from the trade war and lending crackdown in China. Support from China's banking giants in response to the outbreak is mostly earmarked for directly combating the virus. While China's government has cut interest rates, ordered banks to boost lending and loosened criteria for companies to restart operations, many of the nation's private businesses have been unable to get enough cash to meet upcoming deadlines for debt and salary payments. Without more financial support from banks or a sudden rebound in the economy, Chinese firms may face collapse. (Bloomberg)

Risks build in world's largest bond funds

Feb 23. Due to high amounts of debt issuance by US companies as well as low interest rates, some of the world's largest bond funds have become riskier by holding the accumulated risk. The US 10-year Treasury bond reached its all-time low of 1.47 percent in September and the average yield across US investment grade bonds having a record low of 2.57 percent. Concerning the Bloomberg Barclays US Aggregate bond index (Agg), the most important benchmark in fixed income markets globally, its real yields fell to nearly zero which increases the risk of losses in case of rising interest rates. Furthermore, the weakening capacity of US companies to service their debt from earnings has led to quality deterioration of the Agg's corporate bonds. (FT)

Banks risk being caught off-guard by climate change

Feb 21. Climate change is creating substantial risk in the financial system as banks are failing to prepare for green regulation and carbon taxes that will have an impact on the companies they lend to. According to the Rainforest Action Network, in 2018, banks provided about USD 654bn in financing to fossil fuel companies, which were already under pressure from low fuel prices and would be more likely to default if the countries signed up to the Paris climate accord institute a USD 50 a tonne carbon tax. Analysts of Oliver Wyman reported that they had yet to find a single bank that has developed a way to embed the outcomes of climate-risk scenario analysis across the loan book. (FT)

Bankruptcy risks rise for US shale

Feb 19. Bankruptcy risks in the US shale sector are rising, with weak oil prices and tightening access to credit worsening the outlook for some producers as a total of USD 86bn of debt maturities start to come due. Amid the global oversupply exacerbated by the coronavirus outbreak and the recent unseasonably warm weather, oil prices have fallen more than 15% since January 2020, and the front-month US natural gas prices have plunged to their lowest February close in 20 years last week. Speculative-grade debt makes up more than 60% of the industry's total debt to be repaid between now and 2024. The average interest rate paid by shale producers for highly speculative corporate debt was 400-500bps above the average for all sectors, implying a higher degree of default risk for the industry. (FT)

Cost of corporate debt protection sinks to post-crisis low

Feb 19. Several important credit default swap (CDS) indices, which reflect the cost of default protection on bonds, dropped to their minimum since the second half of 2007. For instance, the CDX North American Investment Grade index dropped from its peak of 279.6bp during the 2008 crisis to 43.81bp at the beginning of February 2020. CDSs serve the purpose to help investors protect against a company failing to pay back its debt by offering to make them whole in case of a default event. Currently, investors bet that support from central banks continues to be strong and thereby keeping credit markets afloat. A trader explains the significant fall of CSDs markets can be attributed to the investors' large demand for corporate bonds. If there are not enough corporate bonds, investors could sell CDX as they can also profit when the company does not default. (FT)

The bond rally in emerging markets may not be all that it seems (Bloomberg)

Chinese companies sell "coronavirus bonds" to boost balance sheets (FT)

Investors fume as China develops new playbook for state-backed bonds (WSJ)

Regulatory Updates

China reopens bond futures market to big local banks

Feb 21. The five largest Chinese state-owned commercial banks and qualifying insurers have been given the permission to trade in domestic bond futures, a landmark in the reopening of Treasury derivatives market that was shut down in the 1990s. The reform is part of a multiyear plan by Chinese regulators to broaden participation in its bond market. Policymakers hope the introduction of new hedging instruments for Chinese banks can boost liquidity and help with the price discovery for bonds, which might attract more foreign investors. Concerns remain on the regulation and the potential liquidity shocks but analysts are optimistic on the long-term prospects for Chinese bond market. (FT)

Bank Indonesia cuts rate, revises down growth target amid virus outbreak

Feb 20. The Indonesian central bank lowers its benchmark interest rate by 25bps to 4.75 percent to help mitigate potential impacts of the coronavirus outbreak by stimulating bank lending and supporting economic growth. Therefore, the central bank also reduces its deposit facility and its lending facility rate to 4 and 5.5 percent respectively. Economists have projected that the virus could lower China's economic growth by up to one percentage point which results in a drop of 0.3 to 0.6 percentage points in Indonesia's growth since China is one of Indonesia's major trading partners and the world's second largest economy. Bank Indonesia lowers Indonesia's economic growth projection from between 5.1 and 5.5 percent to 5 and 5.4 percent, whereby the magnitude of the impact depends on the length of outbreak and the economic policy responses. (Jakarta Post)

China benchmark loan rate drops after PBOC eases policy (Business Times)

Turkey lowers borrowing costs again in push to reboot growth (FT)

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