Hong Kong's tourism industry facing multi-faceted downward pressures

by Li Mengyan

Tourism, as one of Hong Kong's four traditional key industries, is now facing downward pressures from the recent local unrest, the US-China trade tension, and an overall weak global economy. Figure 1 below exhibits the NUS-CRI Aggregated (median) 1-year Probability of Default (Agg PD) for publicly listed Hong Kong domiciled firms and its tourism industry from January 2018 to October 2019. Tourism-related sectors in this article include passenger transportation, transit services, entertainment facilities, leisure and travel facilities, transport support services, commercial vehicle, and restaurants.

In general, Hong Kong domiciled firms in the tourism industry has a lower Agg PD than their peers before July 2019. However, as a re-export hub between China and the US, Hong Kong's business is vulnerable and inevitably affected by the trade tensions between the two parties. Although Hong Kong has been an attractive place for companies seeking to escape high tariffs under the First-Sale Rule, both mainland China and the US governments are now taking note of the tariff avoidance via routes such as Hong Kong, making its tariff advantage less attractive as before. Amid an overall weak global economy, Hong Kong's Agg PD started to increase since January 2018 when the US-China trade war began. While the Agg PD of Hong Kong domiciled firms in the tourism sector is also in an upward trend this year, it has a steeper hike compared to Hong Kong firms in all sectors, finally surpassing globally listed firms and Hong Kong domiciled firms' Agg PD level in April and October 2019 respectively.

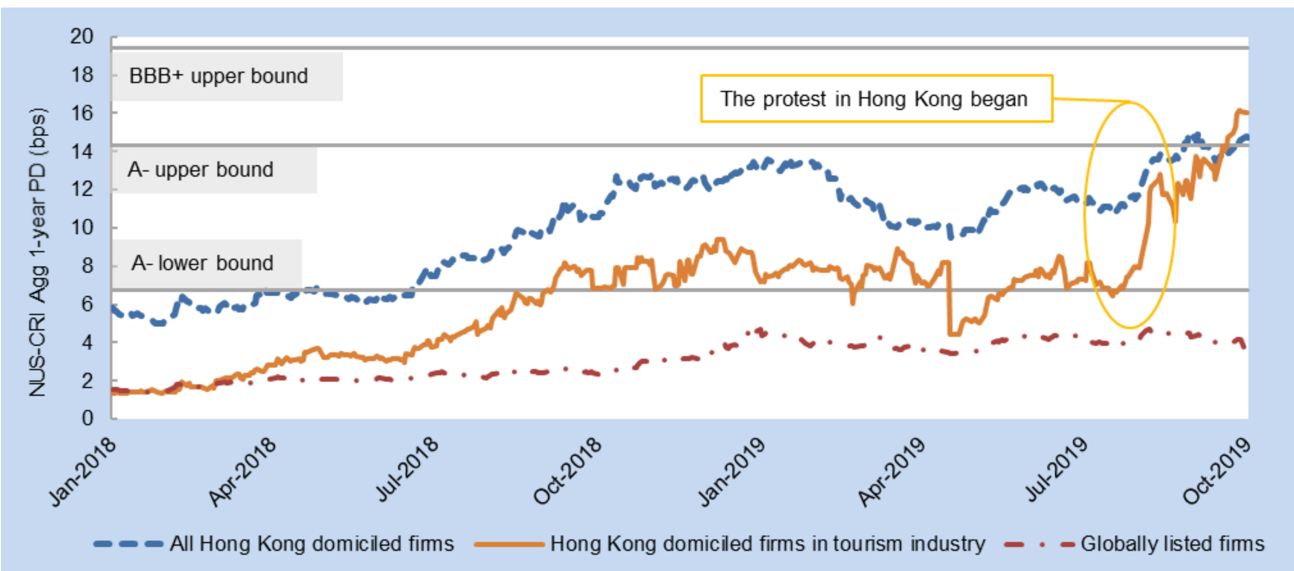

Figure 1: NUS-CRI Aggregate 1-year PD for all Hong Kong domiciled firms, Hong Kong domiciled firms in tourism industry and globally listed firms from 2018, NUS-CRI PD implied rating boundaries[1] *Source: NUS-CRI*

Hong Kong domiciled firms in the tourism industry are getting more leveraged in 2019. Figure 2a shows that while Hong Kong domiciled firms in the tourism industry saw a relatively stable debt to equity ratio in 2018, their ratio soared to 83% in the second quarter of 2019. Overall, their free cash flow in 2019 are also negative in general. On top of that, considering over 70% of the bonds issued by Hong Kong domiciled firms in the tourism industry will mature within 5 years (see Figure 2b), they are facing a potentially higher credit risk.

[1] The NUS-CRI Probability of Default Implied Rating (PDiR) provides a more conventional interpretation of PDs – it translates NUS-CRI 1year PDs to letter ratings by taking reference from the historical observed default rates of S&P's rating categories.

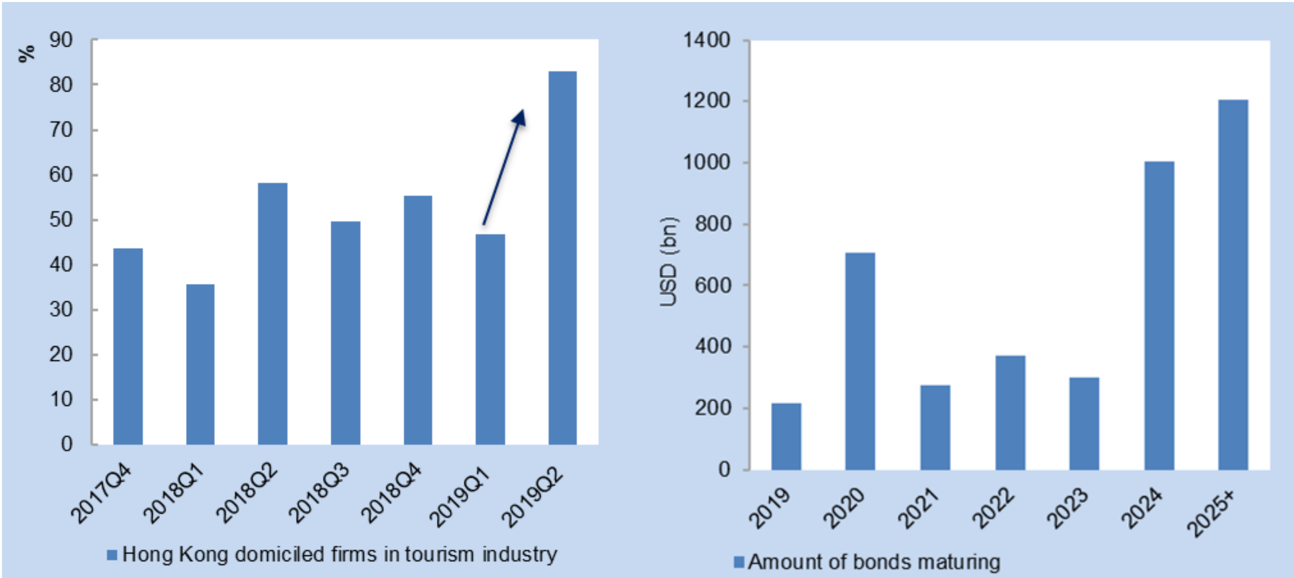

Figure 2a (LHS): Median total debt over total equity ratio of Hong Kong domiciled firms in tourism industry. Figure 2b (RHS): Outstanding amount of Hong Kong domiciled firms in the tourism sectors' bonds. *Source: Bloomberg*

Presently, the low free cash flow in the tourism industry might be partially caused by its poor profitability. Revenue from tourism shrank significantly in 2019, induced by a noticeable drop in visitor arrivals from 6.8 million in January 2019 down to 3.6 million in August 2019. As shown in Figure 3 below, tourist arrivals from all major market areas decreased, with the Mainland China market bearing the greatest hit. The drop was mainly due to the recent intensive local social unrest which caused 31 countries to issue travel advisories or alerts on Hong Kong since June 2019. Facing a weakening RMB and the local unrest, mainlanders are discouraged to travel to Hong Kong, since Hong Kong, regarded as a shopping paradise for mainlanders, would be more expensive when the Chinese yuan is depreciated and this has offset Hong Kong's previous advantage on its prices of luxuries products. The occupancy rate of Hong Kong's hotel room dripped from 92% to 66% from March to August 2019, hitting lowest since 2010. Retail sales in August dropped 23%, the deepest decrease since February 2016, with retail sales of jewellery and watches dropped by 47.4%. During the 2019 Golden Week, Chinese group tours to Hong Kong plunged by 86% compared to the same period last year. Flight prices from Shanghai to Hong Kong are 38% cheaper than last year's fares and only 30% of hotel rooms are booked for the holiday period, compared to the usual 70%.

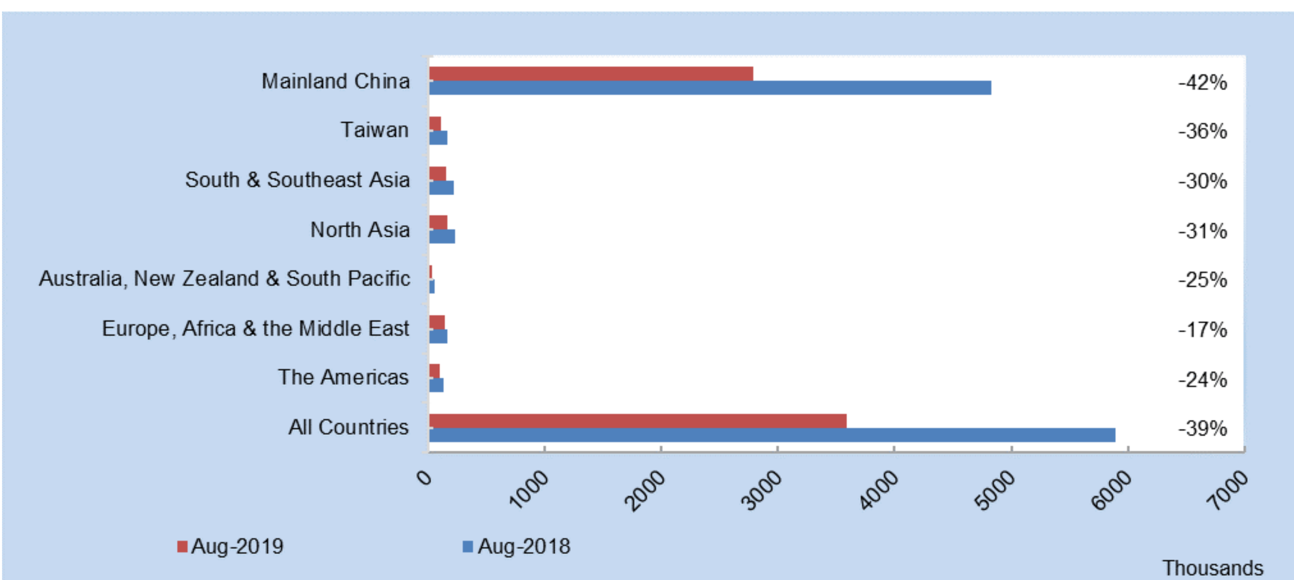

Figure 3: Tourist arrival in Hong Kong from major market areas on August of 2018 and 2019, and 2019 YoY growth rate. *Source: Census and Statistics Department of Hong Kong*

The NUS-CRI Aggregate (median) Forward 1-year PD[2] (Forward PD) illustrates a direct comparison between the credit outlooks of Hong Kong domiciled firms in the tourism industry and all Hong Kong domiciled firms.

[2] The Forward PD computes the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 12-month Forward 1-year PD is the probability that the firm defaults during the period from 12 months onwards to 1 year plus

Figure 4a plots the Forward PD based on information available on July 2019 and there is a noticeable gap between the Forward PD curves for firms in the tourism industry and all Hong Kong domiciled firms, indicating that Hong Kong domiciled firms in the tourism industry had a better credit outlook compared to all Hong Kong domiciled firms. However, as the global economic slowdown progresses, the credit outlook for Hong Kong domiciled firms in the tourism sector is now slightly worse compared to Hong Kong domiciled firms, which indicates that Hong Kong domiciled firms in the tourism sector are more exposed to the slowdown and recent events.

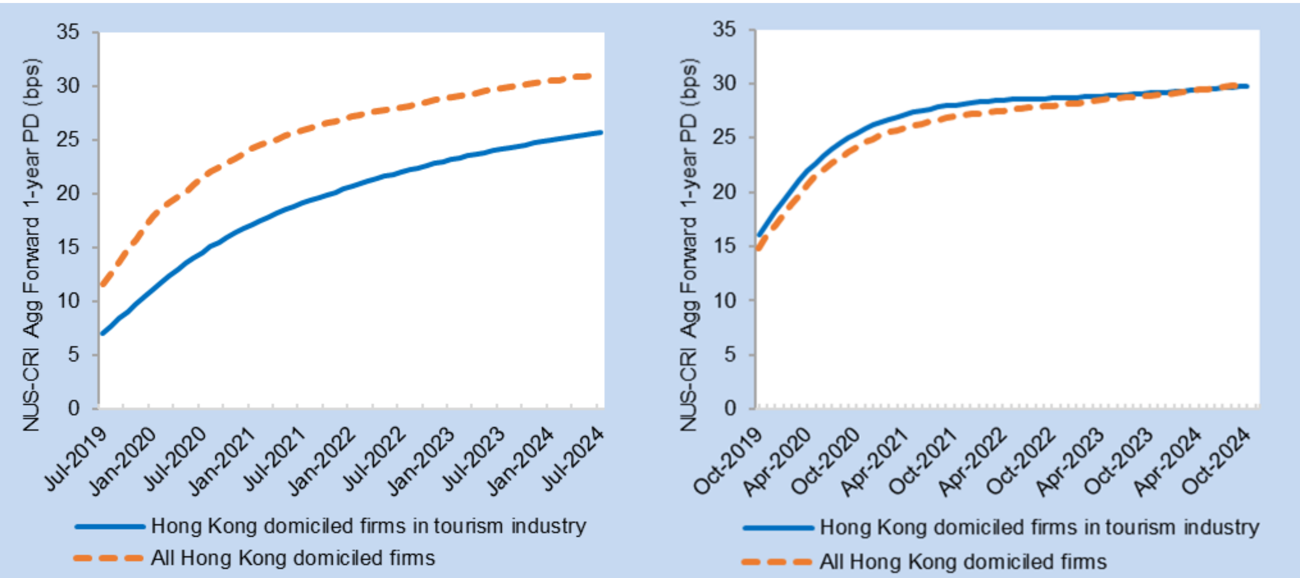

Figure 4a (LHS) & 4b (RHS): NUS-CRI Forward 1-year PD for all Hong Kong domiciled firms and Hong Kong domiciled firms in the tourism industry on Jul 2019 (LHS) & Oct 2019 (RHS). *Source: NUS-CRI*

Looking forward, with a seemingly no end in sight for the US-China trade war and amid an increasingly uncertain domestic environment in Hong Kong, Hong Kong domiciled firms in the tourism sector might face a deteriorating credit outlook. The longer the stand-off continues, the greater the risk that Hong Kong domiciled firms in the tourism sector will likely face.

Credit News

China's riskiest form of state borrowing enjoys a new boom

Oct 6. The investment arms of China's cities and provinces have issued CNY 2.37tn of domestic bonds to fund infrastructure spending this year, which is up 38% from the same period in 2018 and is expected to break the full year record of CNY 2.56tn set in 2016. Despite being viewed as one of China's riskiest categories of bonds, investors are warming to these funding vehicles as the central government has relaxed its stance on debt buildups. The jump in sales is also partly due to the refinancing of a record amount of CNY 2.1tn debt from local government financing vehicles maturing this year. Combined with falling borrowing costs, the continue rise in defaults on corporate bonds this year has boosted the comparative appeal of bonds from local government financing vehicles. (WSJ)

USD 63bn of zombie buildings sound alarm for Indian banks

Oct 4. Indian real estate developers are struggling amid a liquidity crunch in India's shadow-banking sector. Developers have been relying on loans from non-banking financial corporates (NBFCs) to fuel a five-year property boom, until last year when Infrastructure Leasing & Financial Services Ltd, a leading shadow banking lender, defaulted. As banks had boosted overall lending to NBFCs by more than 50% over the past five years to nearly 8% of their total exposure, some have inevitably caught up in the crisis. The Reserve Bank of India (RBI) has taken steps to improve cash flow to shadow lenders, including allowing banks to lend more to the sector, providing partial credit guarantees and easing banks' mandatory liquidity ratios. (Bloomberg)

12 months, conditional on the firm's survival in the next 12 months.

Short sellers pile into WeWork debt

Oct 3. Since WeWork abandoned its initial public offering earlier this month, its credit ratings had been downgraded 2 notches to CCC+ by Fitch, and traders have been taking a record level of bets against its bonds. WeWork's bonds, which mature in 2025, have been hit hard in recent weeks, trading at a record low 85 cents on the dollar on Wednesday, from a 105 cents high on the dollar when WeWork made public its IPO plans in August. The bonds now offer nearly 12% yield to maturity. Previously, the firm had planned to raise at least $3bn in its IPO and $6bn through syndicated loans but the loans were contingent on the listing. Therefore the company is now negotiating a smaller loan with the syndicate. Credit rating agencies have an increasingly negative outlook on the company and thousands of employees are expected to be laid off in the upcoming weeks. (FT)

Rising corporate debt could spell trouble for Asia's banks if economy falters

Oct 2. Corporate debt levels in Asia-Pacific have been climbing higher as interest rates have remained low, which could result in a greater level of defaults and therefore trouble for the region's banks. With growing geopolitical risk from the US-China trade war, Asian companies could face a more challenging operating environment over 2019 and 2020, weighing in on global economy and supply chains amid already slowing growth. The uncertainty of trade policy has caused a delay in future investments in the region and a shift in the global supply chain away from China to other parts of Asia. Moody's said that corporate debt levels increased by 1% last year in 13 Asia-Pacific regions, but total debt levels remain high in relation to GDP. (South China Morning Post)

September was the busiest month ever for corporate debt issuance

Oct 1. Global bond issuance hit a record amount in September this year due to the cheaper borrowing costs fuelled by investors' frenzied search of yield. While September is usually a busy season for the bond market, the trend was amplified this year by a global rally in government bonds in August which lowered interest costs. By the end of September, close to US$15tn of global debt were negative yielding, pushing investors out of the perceived safety of government bonds in search of higher returns available from corporate issuance. Dollar-denominated debt accounted for the majority of issuance with US$159bn bonds sold. (FT)

France's Société Générale chief rejects call for ECB to buy bank bonds (FT)

Enel ditches green bonds for controversial new format (Reuters)

Argentina sifts through 'fantasy land' bond proposals (FT)

Regulatory updates

Fed officials signal openness to more easing after jobs report

Oct 5. After the data last Friday showed that US job growth slowed in September, two Fed officials signalled that they are open to considering additional easing measures. Nonfarm payrolls increased by 136,000 in September, bringing the 2019 average to 161,000, compared to 2018's 223,000. Average hourly earnings rose 2.9% from a year ago, the lowest since mid-2018 while the unemployment rate declined to a half-century low of 3.5%. Fed Chairman Jerome Powell did not give any clues to whether he would favour another rate cut at upcoming meetings in October and December, but he stressed the importance of continuing the 10-year expansion. Investors still expect the Fed to cut rates again at the end of this month. Boston Fed President Rosengren noted that he is watching consumer spending, alluding two key reports – September retail sales and 3rd quarter GDP. (Bloomberg)

ECB launches new lending benchmark based on overnight deals

Oct 2. European authorities launched ESTR, a new rate intended to replace Eonia, a daily reference rate that reflects unsecured overnight lending between banks in the EU. EUR 24tn worth of derivatives deals will use ESTR as the new benchmark for pricing. On Wednesday, the European Central Bank (ECB) published the ESTR rate for the first time at a rate of minus 0.549% based on Tuesday's trading. The overnight rates of ESTR are closely watched by the market as the "front end" of the European interest rate curves are derived from them; ESTR is a "risk-free" rate and is based on deals concluded the previous day. Eonia will still be published daily as a notional rate until the start of 2022, pegged at ESTR+8.5bps, to allow leeway for older contracts pricing over Eonia to still have economic value. (FT)

MAS to ease policy in October as risk of technical recession lingers (CNA)

India's central bank cuts rates by 25bps as expected (Reuters)

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