

# Asia Credit - A Crisis in Confidence, Not Fundamentals

## July 2022

### What is causing the current weakness in the Chinese high yield credit markets?

Asia credit markets have continued to sell off during a turbulent year. The China high yield market, which comprises 44% real estate,<sup>1</sup> has been particularly hard hit. It is down 7.3% month to date and -42.41% year to date.<sup>1</sup>

We believe the abnormal drawdown can largely be attributed to three events:

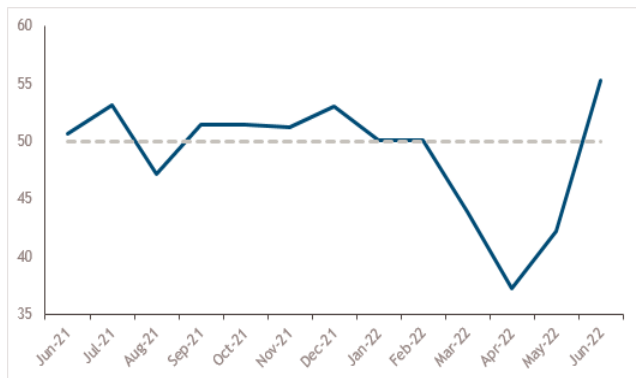
1. Concern has risen that Shanghai will move back into full lockdown. On Monday 11th July, the number of new COVID cases in Shanghai reached 59 - the 4th day in a row they measured above 50.<sup>2</sup> This in turn has triggered a mass testing event, although so far authorities have not enforced strict lockdown conditions.
2. The China Evergrande Group suffered its first rejection from local creditors to extend a bond payment, a development that may result in a landmark onshore default.
3. Overall macro sentiment remains poor, and investors are more likely to be reducing rather than adding risk, soured by fears of Russia cutting gas supplies from the eurozone and the continued US dollar appreciation tightening financial conditions.

This negative technical picture is, however, in sharp contrast to the recent release of very strong economic data and supportive macro policy:

- A. The Caixin China PMI composite increased from 42.2 to 55.3 in June (Fig. 1)
- B. We have witnessed robust monthly credit growth,<sup>3</sup> with an increase in the M2 (broad money supply) from 11.1 to 11.4%<sup>4</sup>
- C. There has been a strong recovery in property sales where the top 36 cities increased sales in June by 78% month-on-month (Fig. 2)
- D. China continues to push forward with its pro-growth policy<sup>5</sup>

We therefore believe the weak performance of the China high yield market is due to a weak technical situation and it is not a true reflection of the underlying improving fundamentals of the economic backdrop.

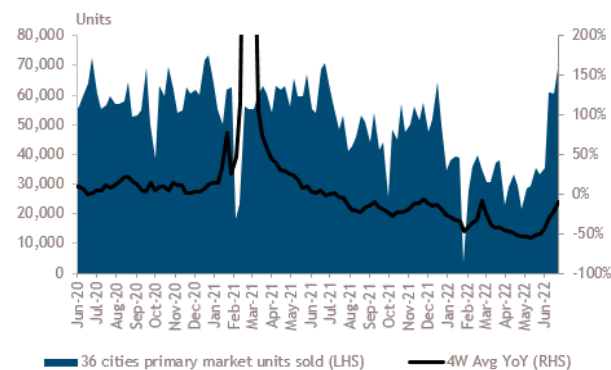
Fig. 1 - Chinese Economic Activity



Source: Bloomberg, Caixin China General Composite Purchasing Managers Index, as of 30th June 2022. Grey line highlights 50 level; any moves above 50 indicate economic expansion. For illustrative purposes only.

\* 36 cities include: 4 Tier-1 cities: Beijing, Shanghai, Shenzhen, Guangzhou, 15 Tier-2 cities: Chongqing, Hangzhou, Nanjing, Wuhan, Chengdu, Suzhou, Dalian, Xi'an, Changsha, Fuzhou, Shenyang, Qingdao, Jinan, Changchun, Nanning, 17 Tier-3/4 cities: Wenzhou, Dongguan, Zhenjiang, Yangzhou, Lianyungang, Shantou, Jilin, Shaoguan, Zhoushan, Taian, Jiangyin, Huaian, Wuhu, Shaoxing, Zhaoqing, Suzhou (Anhui), Haimen

Fig. 2 - Chinese Property Sales Normalise\*



Source: China Real Estate Index System (CREIS), Citi Research, as of 8th July 2022. For illustrative purposes only.

1. ICE Index Platform, ICE BofA Asian Dollar High Yield Corporate Index (ACHY), as of 11th July 2022.
2. Bloomberg News, Shanghai Covid Cases Rising, July 12<sup>th</sup> 2022
3. Bloomberg News, China's Credit Flow Jumps as Government Boosts Economic Stimulus, 11th July 2022.
4. People's Bank of China, as of 30th June 2022.
5. China Daily, China's pro-growth policies may extend into second half, as of 6<sup>th</sup> July 2022.

Muzinich & Co. views and opinions as of July 2022, and subject to change without notice. Muzinich views and opinions, as of July 2022 are for illustrative purposes only and not to be construed as investment advice. Reference to the names of any company mentioned in this communication is merely for explaining the investment strategy and should not be construed as investment advice or investment recommendation of those companies.

## Index Descriptions

ACHY - The ICE BofA Asian Dollar High Yield Corporate Index tracks the performance of sub-investment grade US dollar-denominated securities issued by Asian corporate issuers in the US domestic and eurobond markets.

## Important Information

Muzinich & Co. referenced herein is defined as Muzinich & Co., Inc. and its affiliates. This material has been produced for information purposes only and as such the views contained herein are not to be taken as investment advice. Opinions are as of date of publication and are subject to change without reference or notification to you. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. The value of investments and the income from them may fall as well as rise and is not guaranteed and investors may not get back the full amount invested. Rates of exchange may cause the value of investments to rise or fall. Emerging Markets may be more risky than more developed markets for a variety of reasons, including but not limited to, increased political, social and economic instability; heightened pricing volatility and reduced market liquidity.

This material and the views and opinions expressed should not be construed as an offer to buy or sell or invitation to engage in any investment activity; they are for information purposes only. Opinions and statements of financial market trends that are based on market conditions constitute our judgement as at the date of this document. They are considered to be accurate at the time of writing, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. Certain information contained herein is based on data obtained from third parties and, although believed to be reliable, has not been independently verified by anyone at or affiliated with Muzinich and Co., its accuracy or completeness cannot be guaranteed. Risk management includes an effort to monitor and manage risk but does not imply low or no risk

This discussion material contains forward-looking statements, which give current expectations of the Fund's future activities and future performance. Further, no person undertakes any duty or obligation to revise such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Muzinich makes no representation or warranty (express or implied) with respect to the information contained herein (including, without limitations, information obtained from third parties) and expressly disclaims any and all liability based on or relating to the information contained in, or errors omissions from, these materials; or based on or relating to the recipient's use (or the use by any of its affiliates or representatives or any other person) of these materials; or based on any other written or oral communications transmitted to the recipient or any of its affiliates or representatives in the course or its evaluation of Muzinich.

**United States:** This material is for Institutional Investor use only - not for retail distribution. Muzinich & Co., Inc. is a registered investment adviser with the Securities and Exchange Commission (SEC). Muzinich & Co., Inc.'s being a Registered Investment Adviser with the SEC in no way shall imply a certain level of skill or training or any authorization or approval by the SEC.

Issued in the European Union by Muzinich & Co. (Ireland) Limited, which is authorized and regulated by the Central Bank of Ireland. Registered in Ireland, Company Registration No. 307511. Registered address: 32 Molesworth Street, Dublin 2, D02 Y512, Ireland. Issued in Switzerland by Muzinich & Co. (Switzerland) AG. Registered in Switzerland No. CHE-389.422.108. Registered address: Tödistrasse 5, 8002 Zurich, Switzerland. Issued in Singapore and Hong Kong by Muzinich & Co. (Singapore) Pte. Limited, which is licensed and regulated by the Monetary Authority of Singapore. Registered in Singapore No. 201624477K. Registered address: 6 Battery Road, #26-05, Singapore, 049909. Issued in all other jurisdictions (excluding the U.S.) by Muzinich & Co. Limited. which is authorized and regulated by the Financial Conduct Authority. Registered in England and Wales No. 3852444. Registered address: 8 Hanover Street, London W1S 1YQ, United Kingdom. [2022-07-14-9029](#).