



NATIXIS China Bond Monitor

Offshore bond issuance doubled in 2017 and more to come in 2018, especial for financials and tech companies



January 2018
Monthly publication

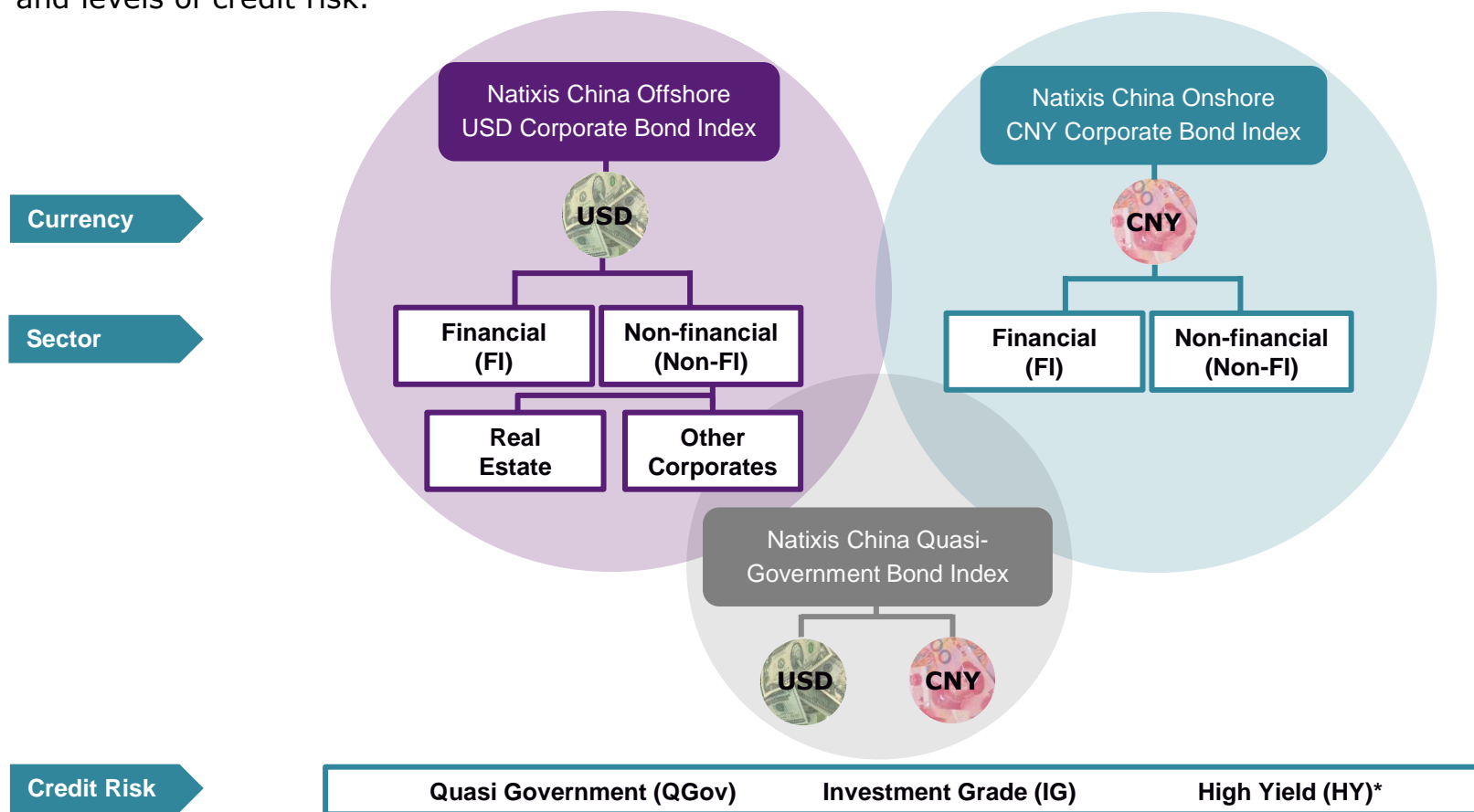
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- The amount of offshore USD corporate bonds issued by Chinese corporates doubled in 2017, to 211 USD billion, in deep contrast to the shrinking onshore market. The offshore-onshore yield differentials have widened further in favor of issuing in USD. Offshore funding cost remained stable but onshore funding cost increased across all credit ratings and sectors in December. This makes offshore issuance clearly preferred for quasi government agencies and financials.
- With such quick pace of surging onshore funding cost, the exchange rate adjusted offshore-onshore spread for financials will soon head towards parity and turn positive. This means it could be cheaper to issue offshore even taking into account any expectation of RMB depreciation (which of course also shrinking given the recent RMB rally).
- Going forward, we expect the offshore market to continue to grow faster than the onshore. Another reason for this is the ongoing push for deleveraging, which should tighten domestic funding conditions even further. The bright prospects for the RMB also push in favor of offshore issuance.

A quick overview to the world of Natixis China bond indexes

Natixis China Bond Indexes make the financial conditions of offshore and onshore corporate bonds comparable. We aim to offer insights for issuers and investors interested in comparing both markets, with focus on funding cost (with and without adjustment for exchange rate expectations), and compare the conditions for different sectors and levels of credit risk.



Methodology in [Appendix A](#)

Source: Natixis * Not rated bonds are classified as high yield.

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1 China Corporate Bond Market, Monetary and Financial Conditions

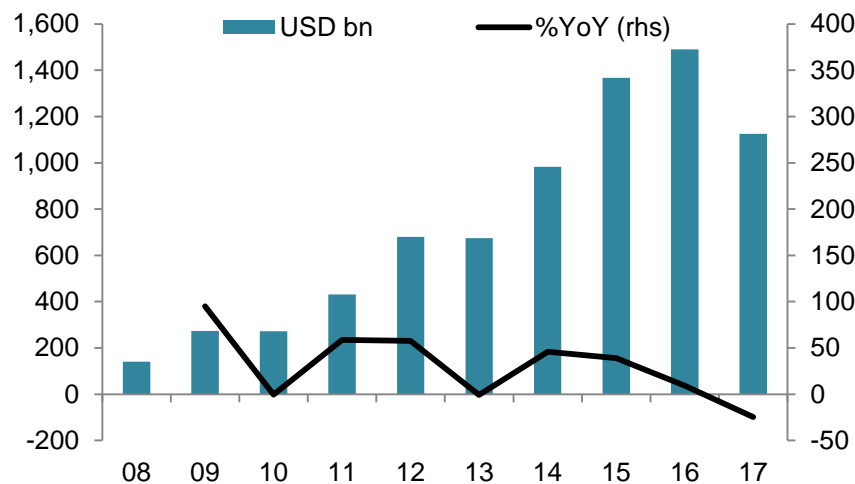
Offshore bond issuance doubled in 2017

1a China corporate bond issuance

As we expected, China's offshore bond issuance in 2017 has doubled, amounting to 211 USD billion, in deep contrast to the shrinking onshore market

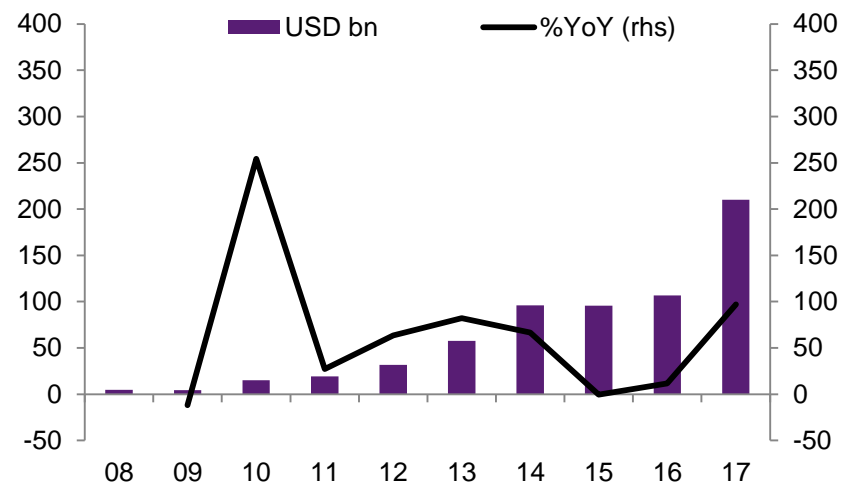


Onshore CNY Bond Issuance (USD bn)



N.B. Both non-financial corporates and financial institutions are included
Source: Natixis, Bloomberg *Data as of 31 Dec 2017

Offshore USD Bond Issuance (USD bn)

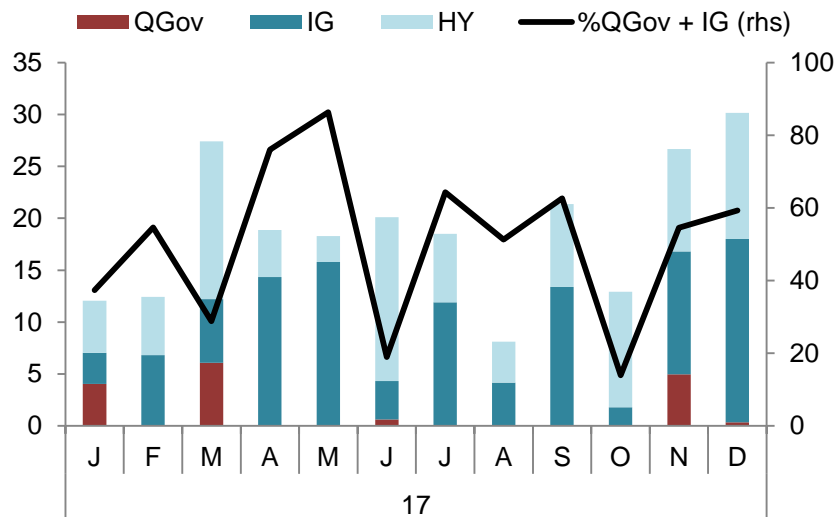


N.B. Both non-financial corporates and financial institutions are included
Source: Natixis, Bloomberg *Data as of 31 Dec 2017

China corporate bond issuance

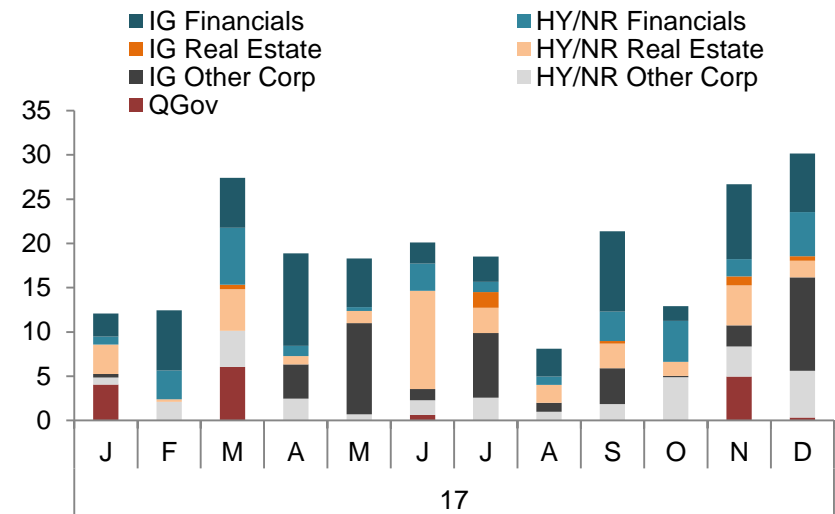
Financials and tech companies are the key drivers in December

Offshore USD Bond Issuance by Issuer (USD bn)



If S&P Rating is not available, Moody's is used followed by Fitch.
Source: Natixis, Bloomberg

Offshore USD Bond Issuance by Industry (USD bn)

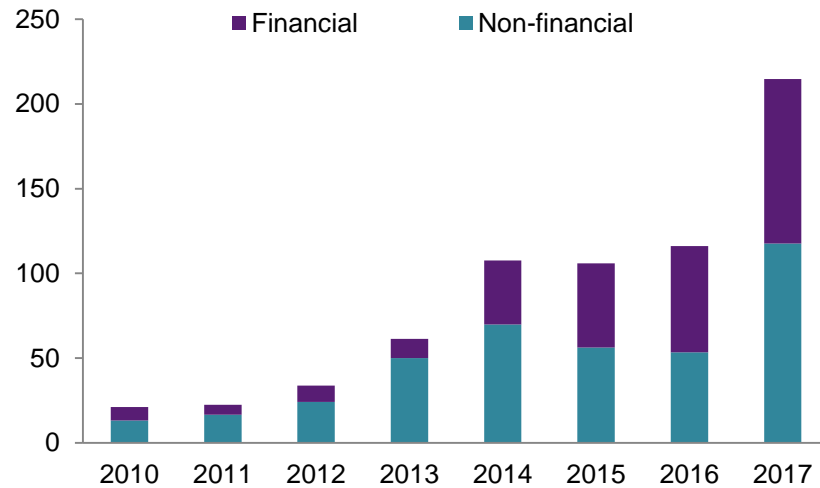


If S&P Rating is not available, Moody's is used followed by Fitch.
Source: Natixis, Bloomberg

However, offshore issuance is much more short-term

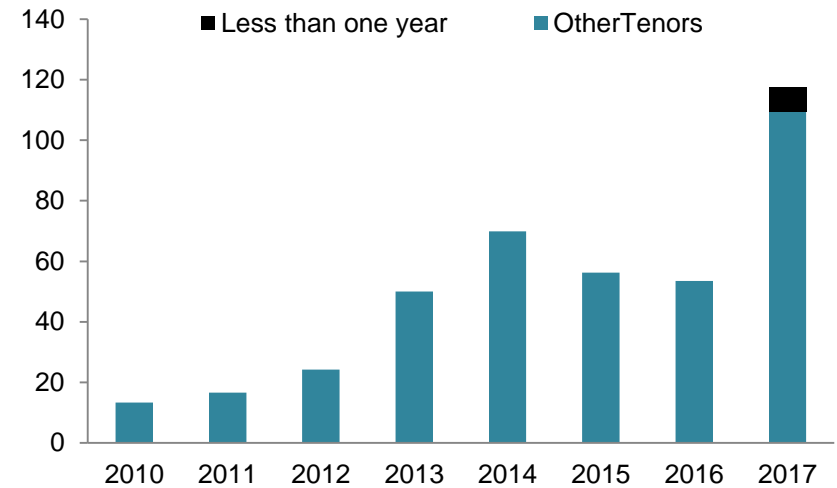
Short term funding by non-financial corporates grew from 0% to 8% of total issuance in 2017

China Offshore USD Corporate Bond Issuance (USD bn)



Source: Natixis, Bloomberg

China Offshore USD Non-Financial Bond Issuance (USD bn)

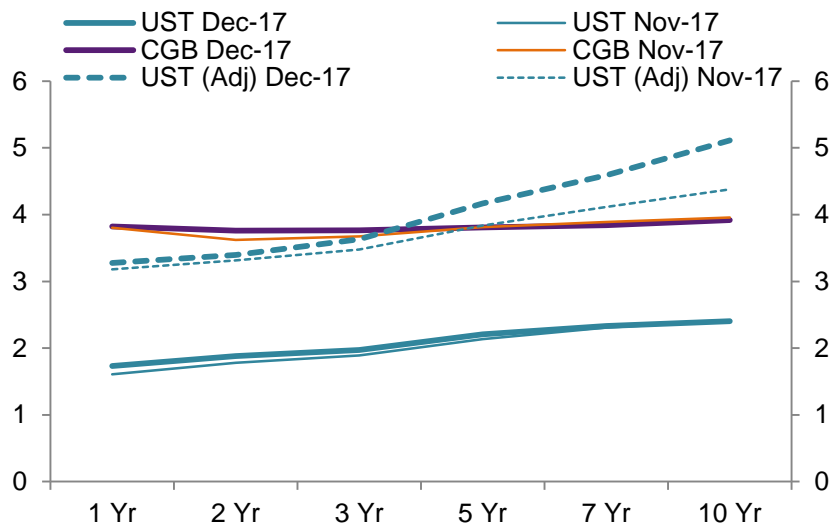


Source: Natixis, Bloomberg

1b Monetary and financial conditions

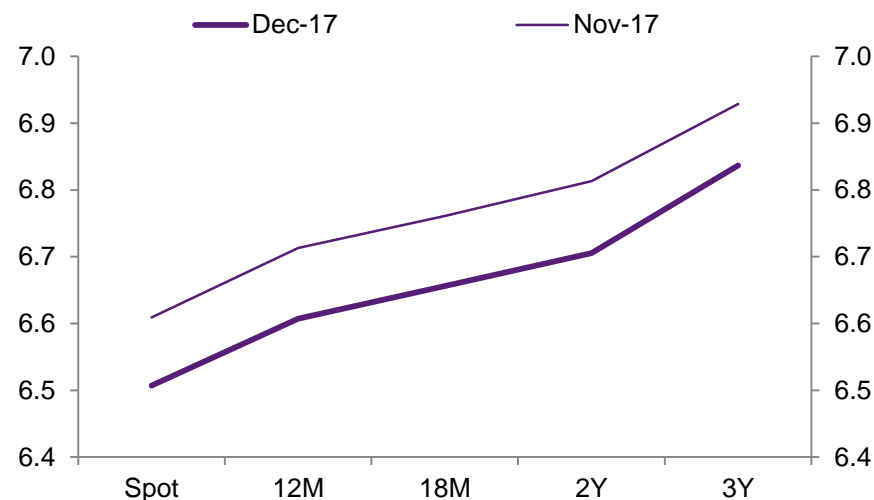
The forward market shows the depreciation expectation at the current level has eased slightly in a short run, but it has not changed the longer term direction

Sovereign Yield Curve



Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation
 UST and CGB are the abbreviation for US Treasury and China Government Bond respectively. Adj stands for rate adjusted by exchange rate expectation.

USDCNY Forward Curve



Source: Natixis, Bloomberg

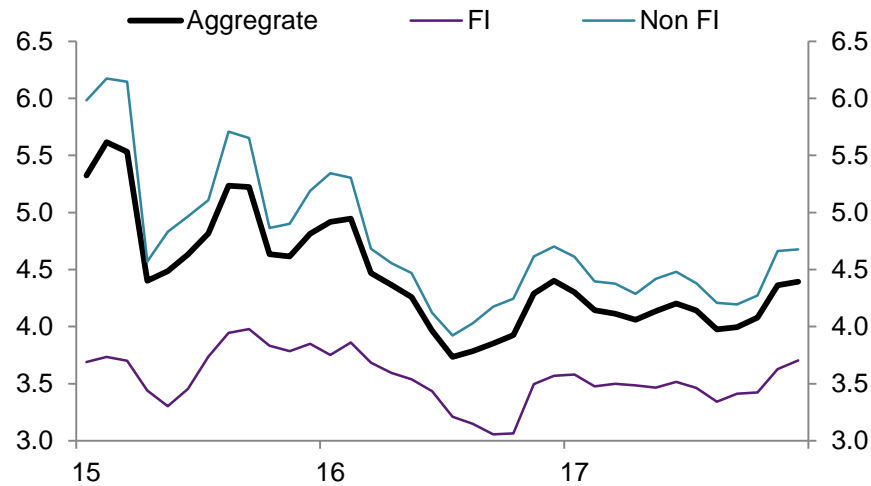
2 Natixis China Offshore USD Corporate Bond Index

A stable offshore funding costs to conclude 2017

2a Aggregate index – By sector

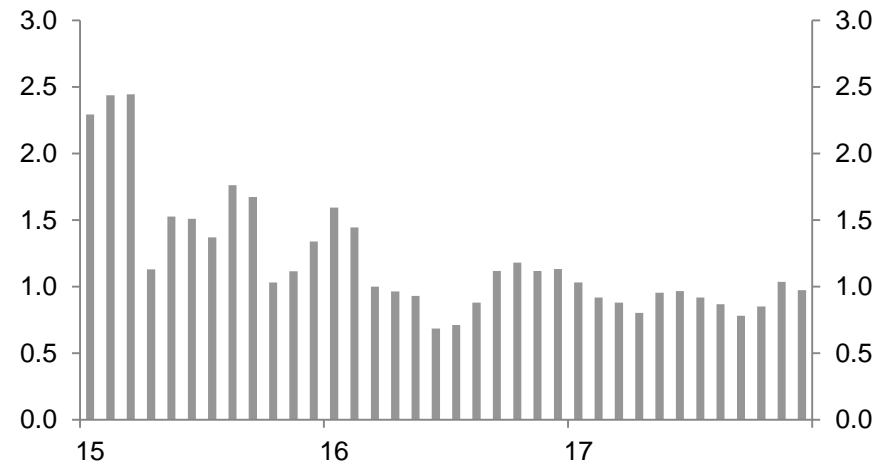
Overall offshore funding costs have remained fairly stable at 4.5% in December, with financials seeing a higher increase

By Sector



Source: Natixis, Bloomberg, WIND

Spread (Non FI – FI)

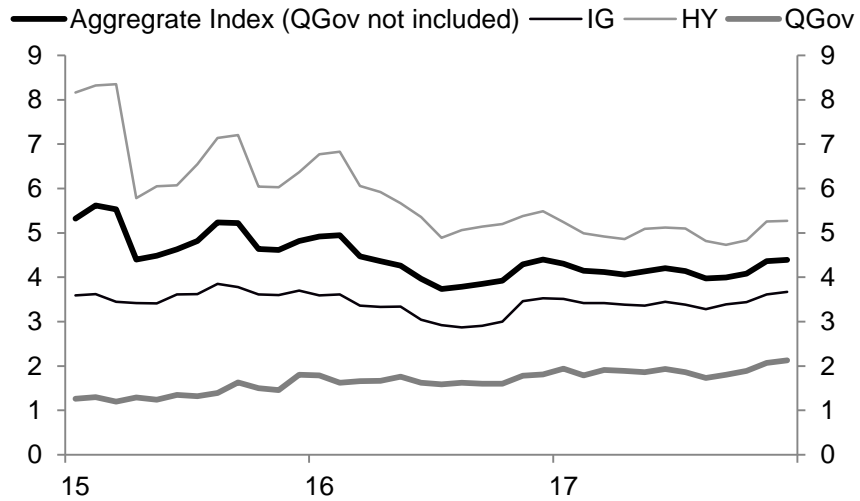


Source: Natixis, Bloomberg, WIND

Aggregate index – By credit rating

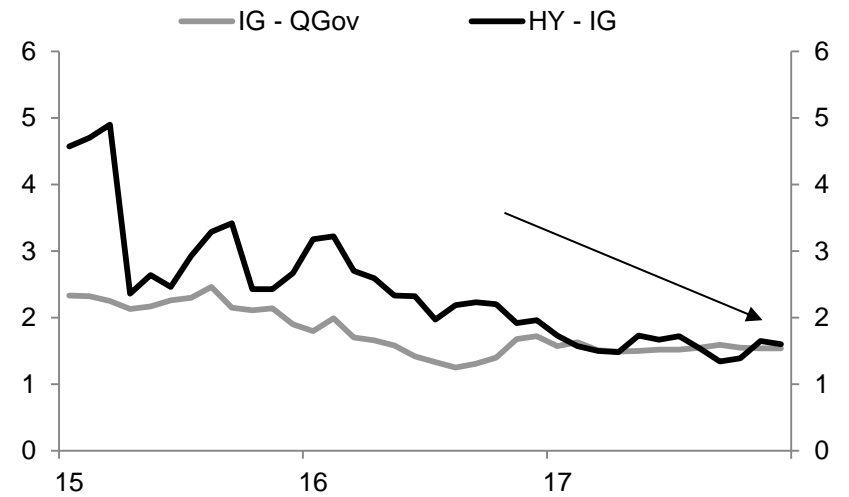
There is no obvious change across credit quality

By Credit Risk



Source: Natixis, Bloomberg, WIND

Spread

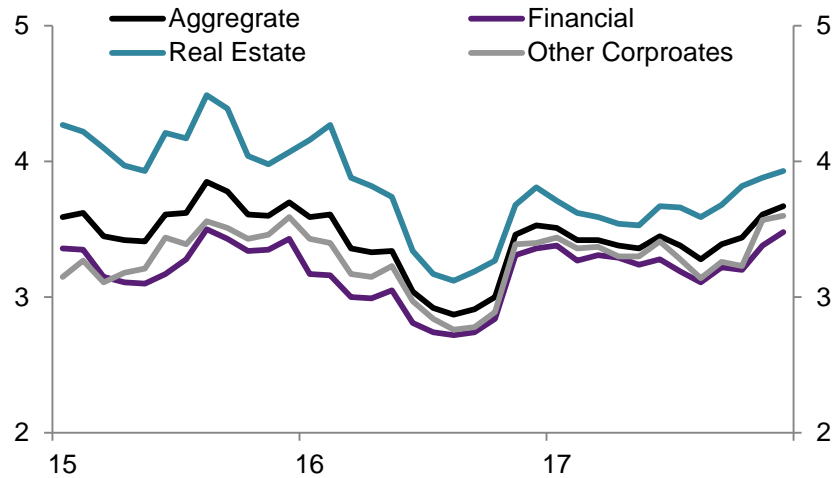


Source: Natixis, Bloomberg, WIND

2a Sectoral index – By credit rating

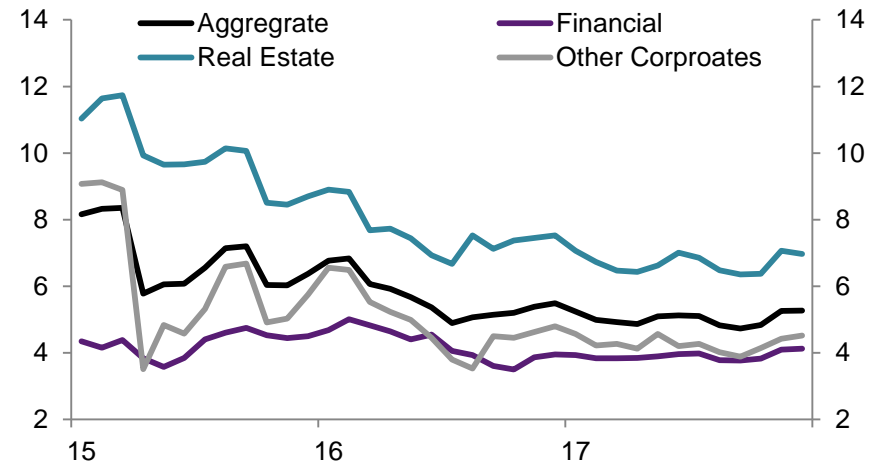
Offshore funding costs for investment grade have moved up for all sectors. The picture is relatively mixed for high yield with lower costs for real estate probably due to better earnings

Investment Grade



Source: Natixis, Bloomberg, WIND

High Yield

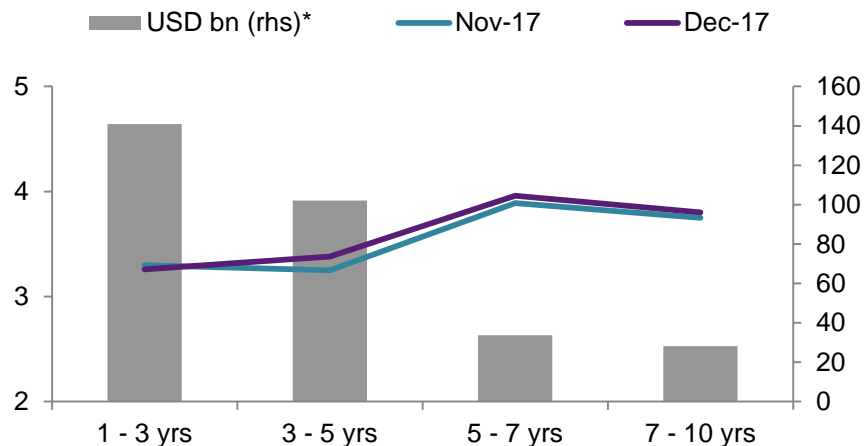


Source: Natixis, Bloomberg, WIND

2c Corporate bond yield curve – By credit rating

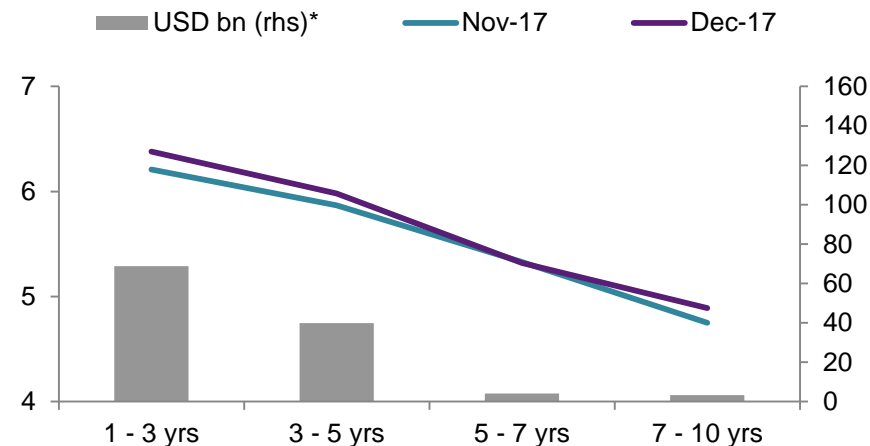
Investment grade has experienced a surge across all tenors, while the increase is mainly on short term funding cost for high yields issuers

Investment Grade



*Latest outstanding value
Source: Natixis, Bloomberg, WIND

High Yield

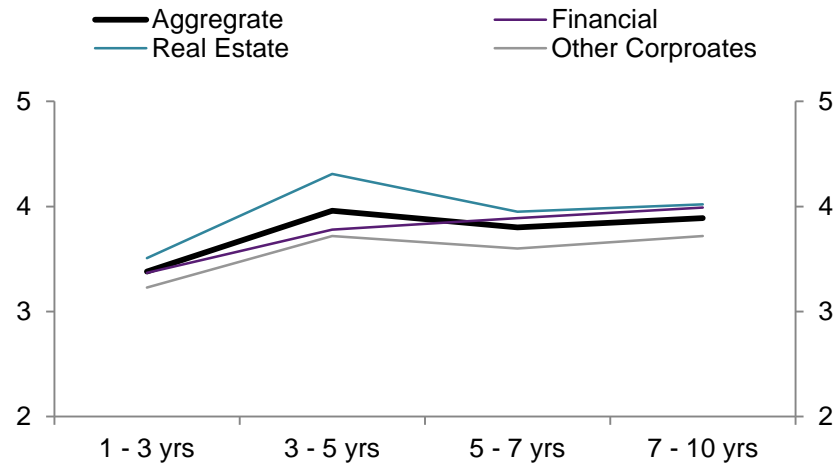


*Latest outstanding value
Source: Natixis, Bloomberg, WIND

Corporate bond yield curve – By sector and credit rating

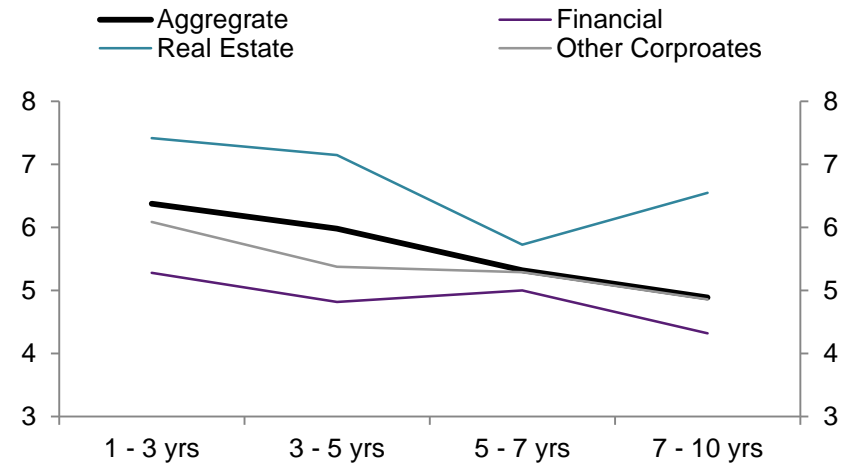
Real estate continues to have the highest funding costs

Investment Grade by Sector



Source: Natixis, Bloomberg, WIND

High Yield by Sector



Source: Natixis, Bloomberg, WIND

3 Onshore-Offshore Yield Differential for issuers

Onshore funding cost has increased in contrast to the stable offshore market

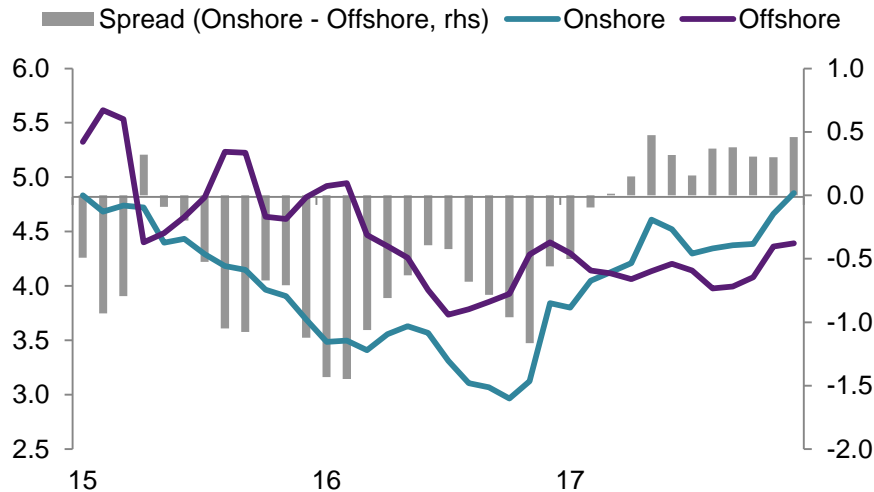
Onshore costs increased while the offshore yields barely moved, widening the differentials in favour of overseas issuance

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

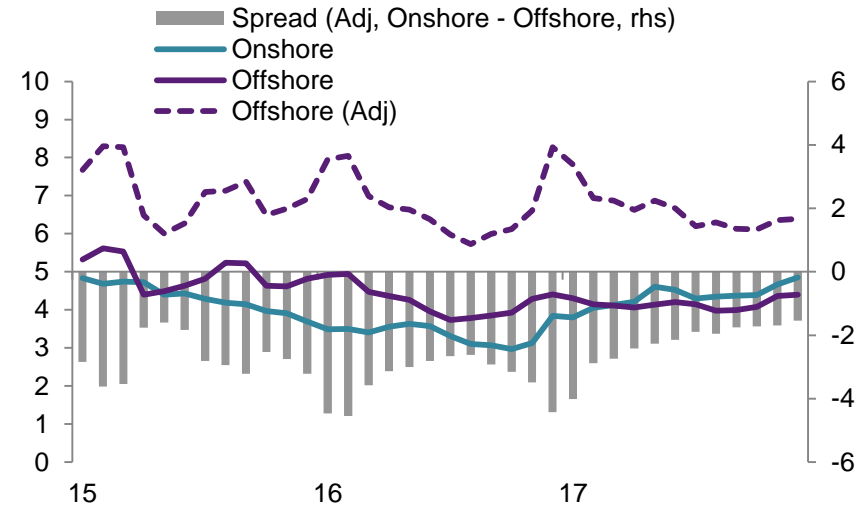
Not so when considering expectation of RMB depreciation

Aggregate



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation



Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

3b By sector – Financial

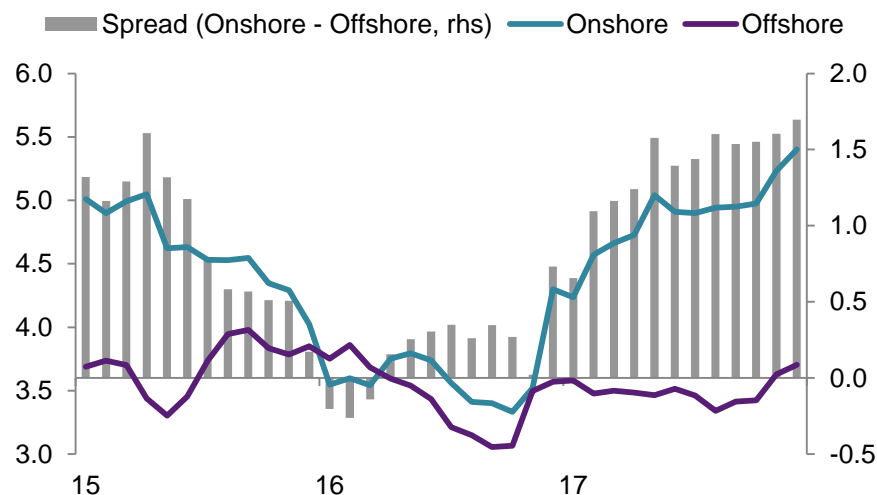
With such quick pace of surging onshore funding cost, the adjusted offshore-onshore spread will soon heading towards parity, also favoring offshore issuance

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

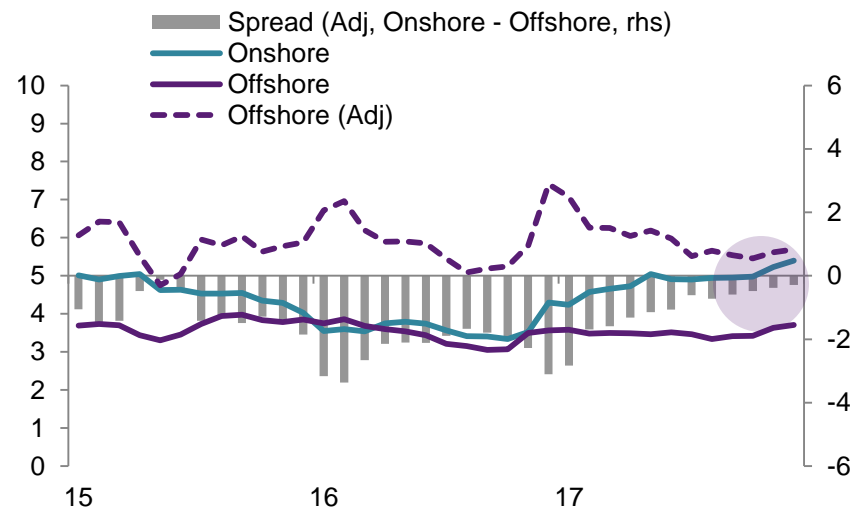
Only 29 bps difference with exchange rate expectations

FI



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation



Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

By sector – Non Financial

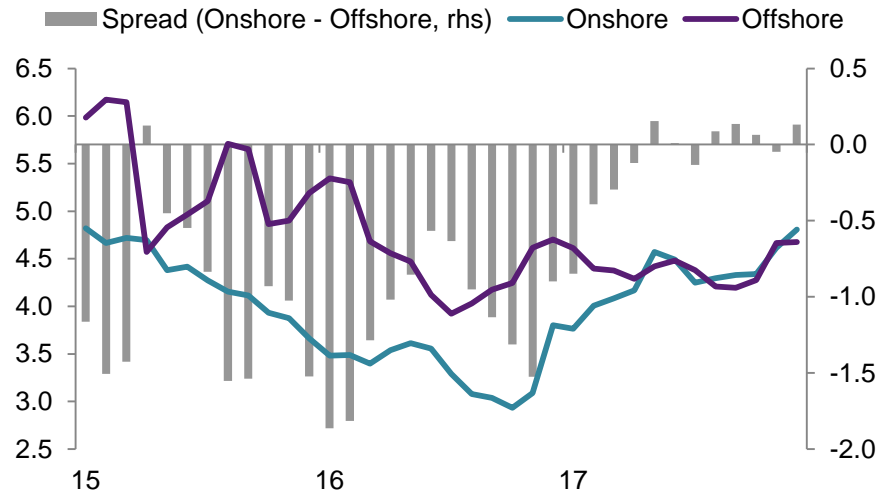
Due to the surge in onshore funding cost, the offshore-onshore spread has turned positive once again

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

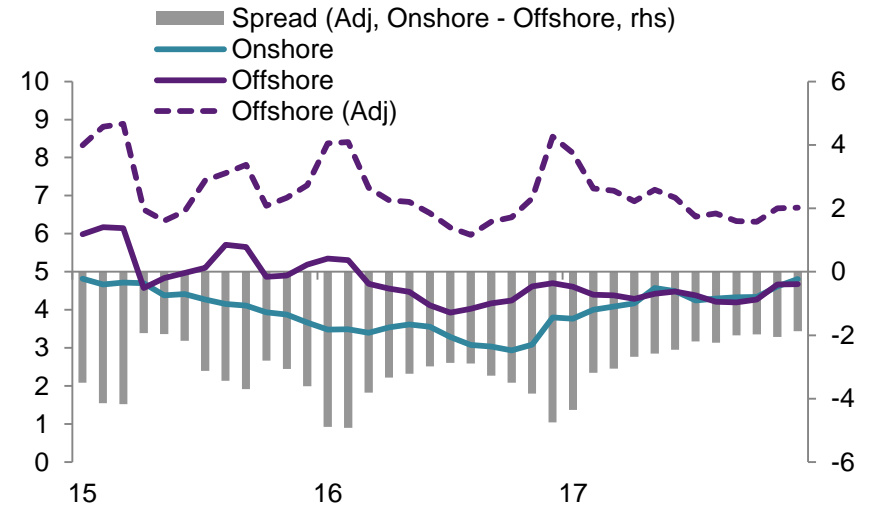
More expensive to fund in USD for onshore usage.

Non FI



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation



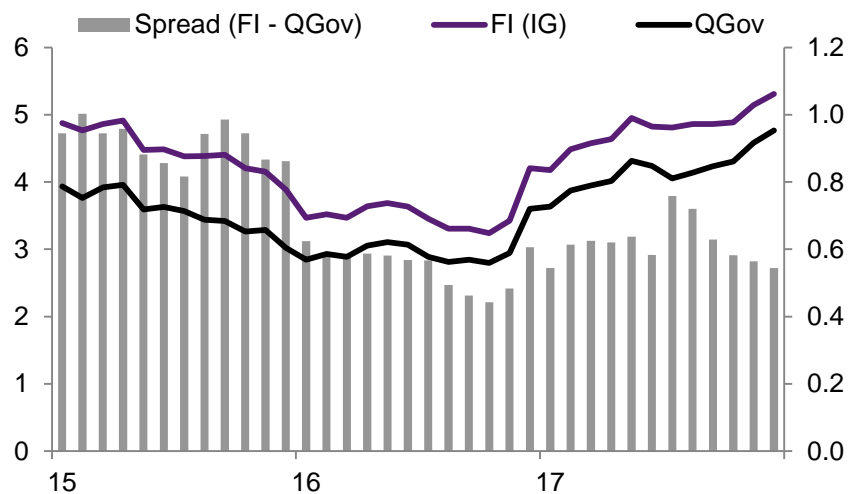
Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

By sector – Financial and Quasi Government

Risk differential between investment grade financials and quasi governments in the onshore market continues to narrow

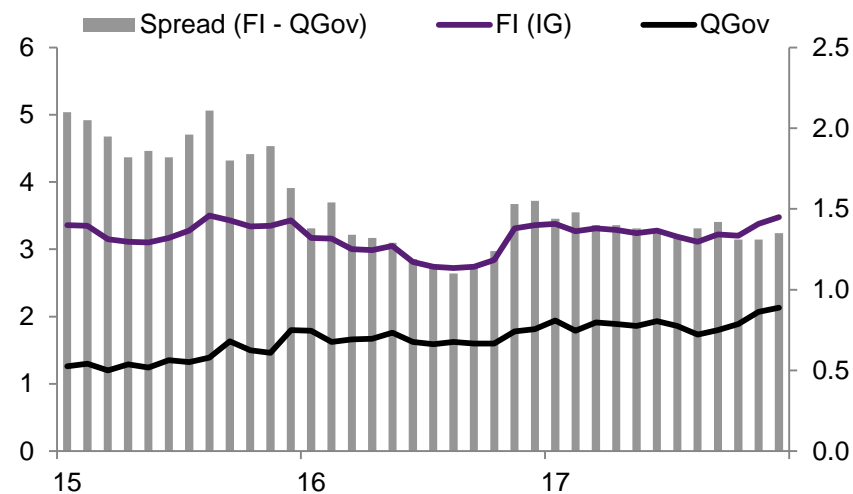
Spreads indicate the risk differentials between FI and quasi government (better rating) bonds

Onshore



Source: Natixis, Bloomberg, WIND

Offshore



Source: Natixis, Bloomberg, WIND

3c By credit rating – Quasi Government

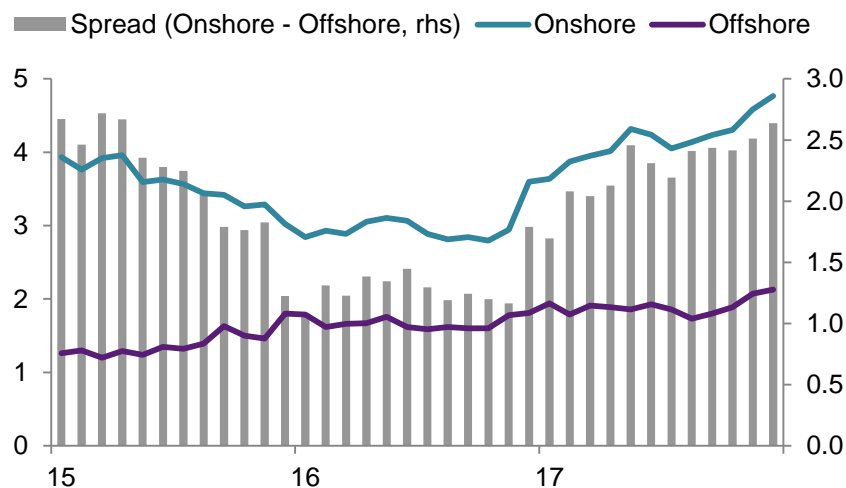
Yield differentials continue to widen slowly, even when exchange rate expectation is considered, indicating offshore issuance is attractive regardless of the RMB depreciation

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

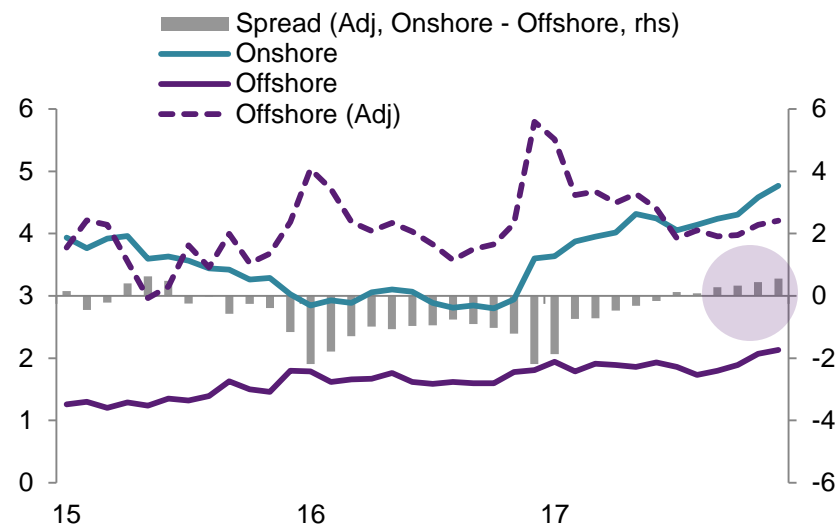
USD issuance is cheaper in any case

Quasi Government



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation



Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

By credit rating – Investment Grade

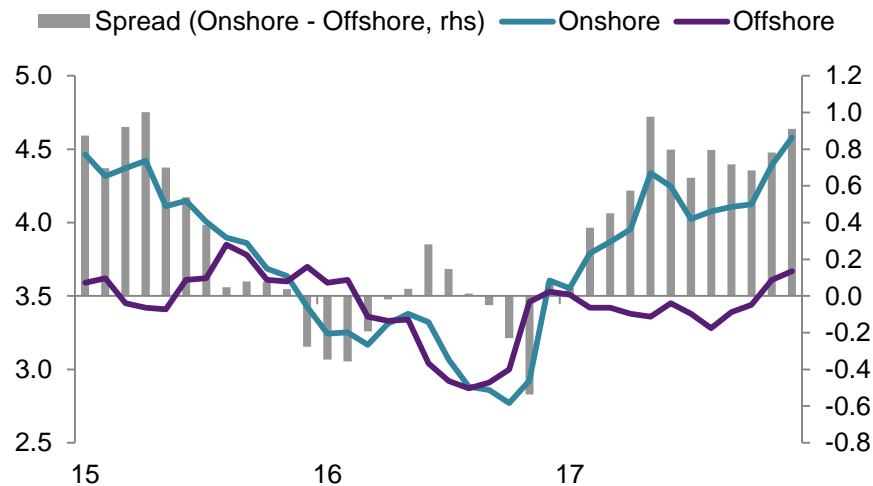
Onshore funding cost has increased much quicker than offshore too

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

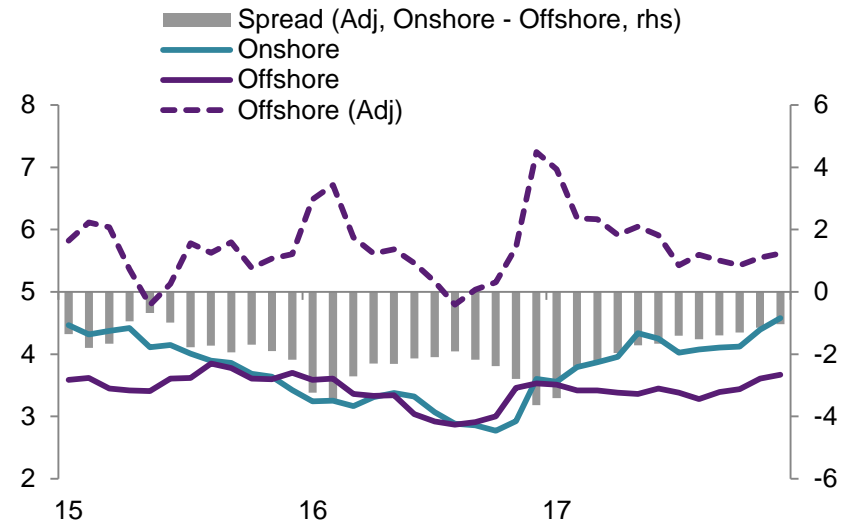
Not so when considering expectation of RMB depreciation

Investment Grade



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation



Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

By credit rating – High Yield

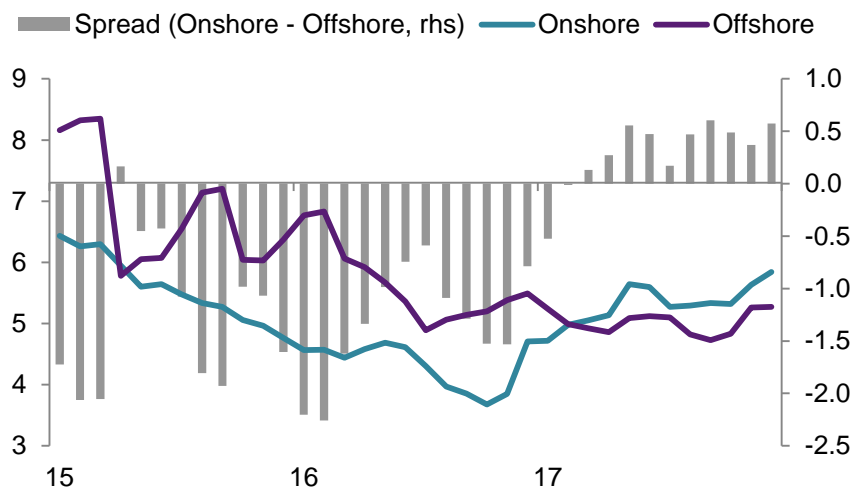
While the onshore funding cost increased, high yield issuers saw a stable funding cost probably due to the demand from offshore investors for higher risk appetite

Positive spreads mean onshore funding cost is more expensive than offshore

If no need to swap back to RMB, USD issuance cheaper

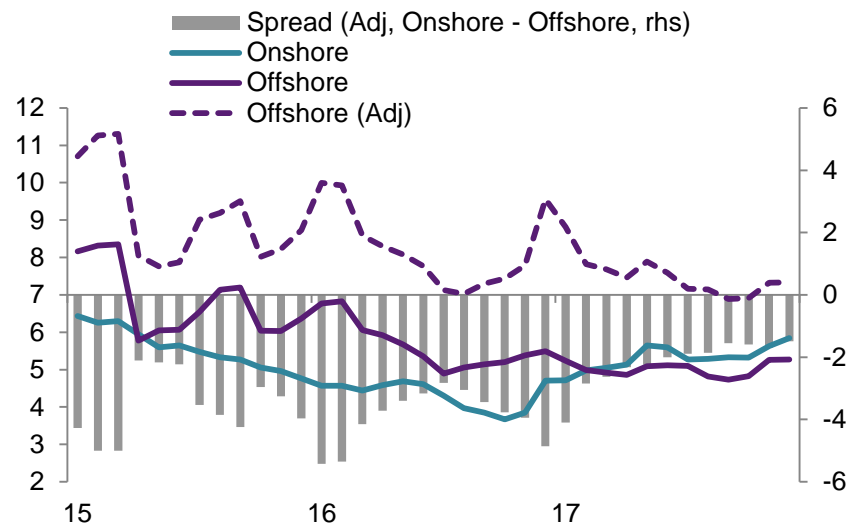
Not so when considering expectation of RMB depreciation

High Yield



Source: Natixis, Bloomberg, WIND

Adjusted by exchange rate expectation

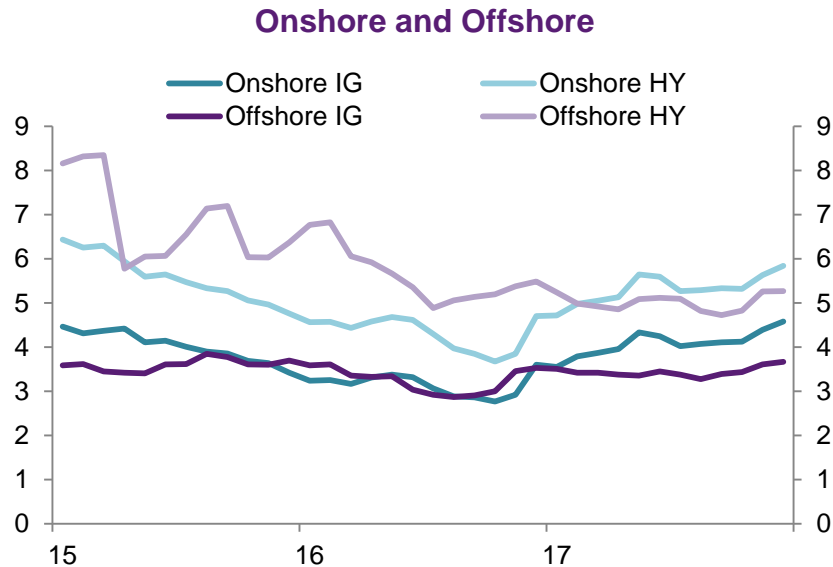


Source: Natixis, Bloomberg, WIND *Adjusted based to CNH expectation

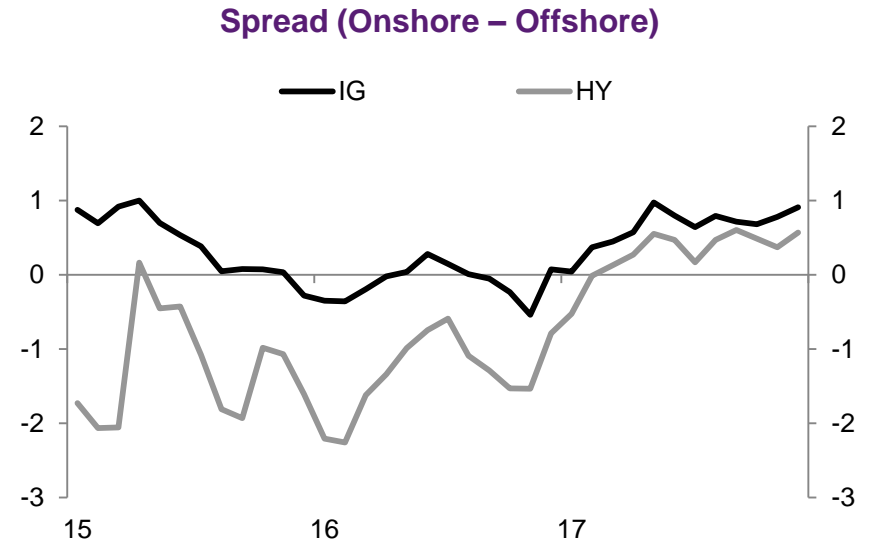
By credit rating - Comparison

The positive onshore-offshore yield differentials should continue to give incentives for corporates to raise funds for overseas investment

Positive spreads mean onshore funding cost is more expensive than offshore



Source: Natixis, Bloomberg, WIND



Source: Natixis, Bloomberg, WIND

APPENDIX A

Methodology

Natixis China Offshore USD Corporate Bond Index

An aggregate index for USD offshore bond issuance by Chinese corporates computed with bottom-up approach by analyzing individual bond data. Sectorial breakdown in financial and corporate (real estate and other corporates) are available for analyzing distinctive differences across industries.

Step 1 Bond Selection Criteria

Maturity:	1 -10 Years
Credit Risk:	Individual bond rating is first used, and issuer rating is used for non-rated bonds. Defaulted bonds excluded.
Industry:	Financial and corporate
Currency:	Denominated in USD
Market:	Offshore

Step 2 Index Computation

Weighting:	Fixed weight by number of bonds
Rebalancing:	Month-end
Start date:	1/1/2015

Step 3 Final Indexes

Total:	Composite
Credit Risk:	Investment Grade, High Yield
Industry:	Financial, Real Estate, Other corporates
Maturity:	1 - 3 Years, 3 - 5 Years, 5 - 7 Years, 7 - 10 Years
Source:	Natixis

Natixis China Onshore CNY Corporate Bond Index

An aggregate index for CNY onshore bond issuance by Chinese corporates computed with bottom-up approach by indexes developed by the series of China Bond indexes developed by China Central Depository & Clearing Company. Ratings are adjusted to international standard based on the average rating distribution of offshore issuance by Chinese corporates for a more comprehensive comparison.

Step 1 Bond Selection Criteria

Maturity:	1 to 10 years
Rating:	Onshore rating, BBB+ below neglected
Industry:	Financial and non financial
Currency:	Denominated in CNY
Market:	Onshore

Step 2 Index Computation

Weighting:	Fixed weight by number of bonds
Rebalancing:	Month-end (Rating and maturity distribution rebalanced quarterly before Dec 2016)
Start date:	1/1/2015

Step 3 Final Indexes

Total:	Composite
Credit Risk:	Investment Grade, High Yield (Rating reclassified to international standard)
Industry:	Financial and non financial
Maturity:	1 - 3 Years, 3 - 5 Years, 5 - 7 Years, 7 - 10 Years

Source: Natixis

Natixis China Quasi Government Bond Index

An aggregate index for quasi-government bond issuance (mainly policy banks) in various currencies (USD and CNY) in onshore and offshore market. The USD component is computed from individual bond data. The CNY benchmark is calculated with bottom-up approach by indexes developed by the series of China Bond indexes developed by China Central Depository & Clearing Company.

Step 1 Bond Selection Criteria

Maturity: 1 to 10 years
Agency: China Development Bank, The Export-Import Bank of China, Agricultural Development Bank of China
Currency: Denominated in USD and CNY
Market: Offshore and onshore

Step 2 Index Computation

Weighting: Fixed weight by number of bonds
Rebalancing: Month-end (Rating and maturity distribution rebalanced quarterly before Dec 2016)
Start date: 1/1/2015

Step 3 Final Indexes

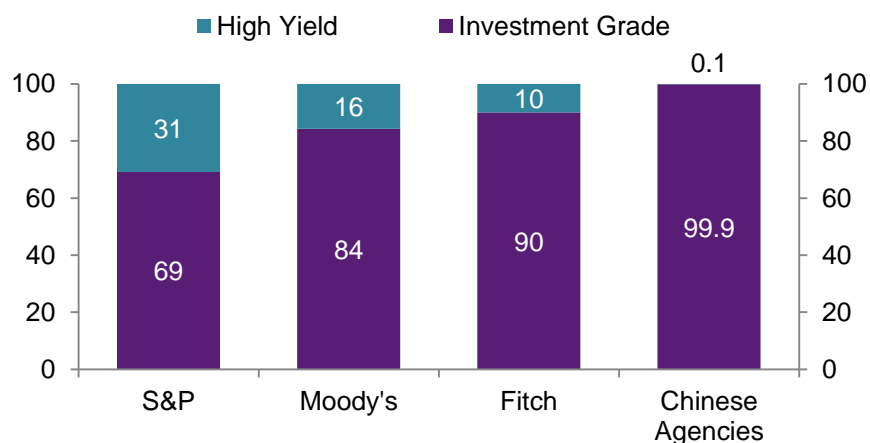
Total: Composite
Maturity: 1 - 3 Years, 3 - 5 Years, 5 - 7 Years, 7 - 10 Years

Source: Natixis

Rating conversion for Natixis China Onshore CNY Corporate Bond Index

Onshore and offshore ratings are not directly comparable. We aim to minimize the difference by using the offshore proportion of investment grade/high yield bonds, and reapply to the onshore sample. In other words, Natixis China Onshore CNY Corporate Bond Index assumes 82% of total bonds are in investment grade. The proportion will be adjusted annually.

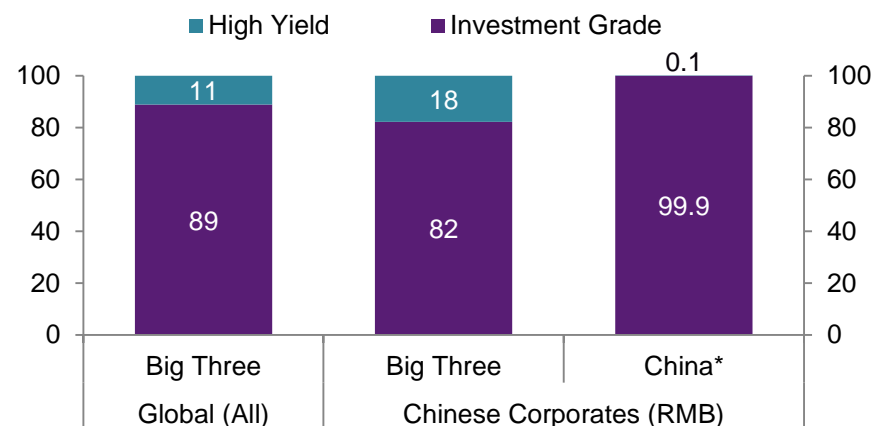
Rating Distribution (Chinese Corporates RMB Bonds, % of rated bonds)



Onshore investment grade classification used for Chinese agencies

Source: Natixis, Bloomberg, WIND N.B. Data as of 24 May 2017

Rating Distribution (% of rated bonds)



Big Three stands for S&P, Moody's and Fitch

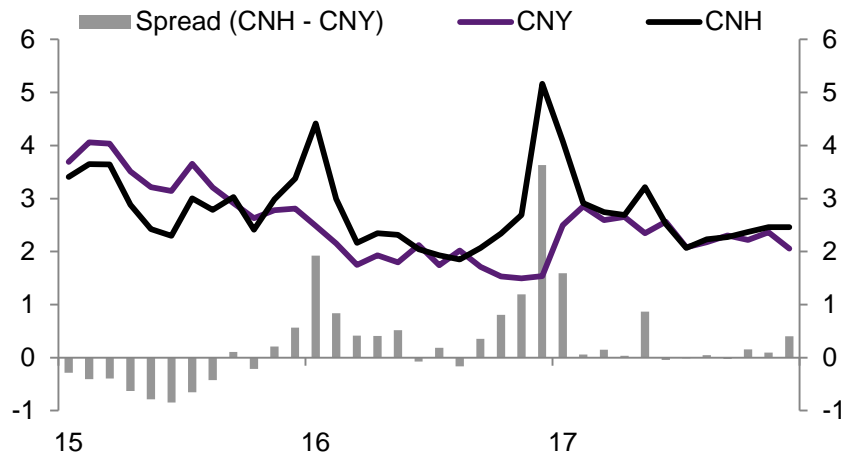
Onshore investment grade classification used for Chinese rating agencies

Source: Natixis, Bloomberg, WIND N.B. Data as of 24 May 2017

Exchange Rate Expectation

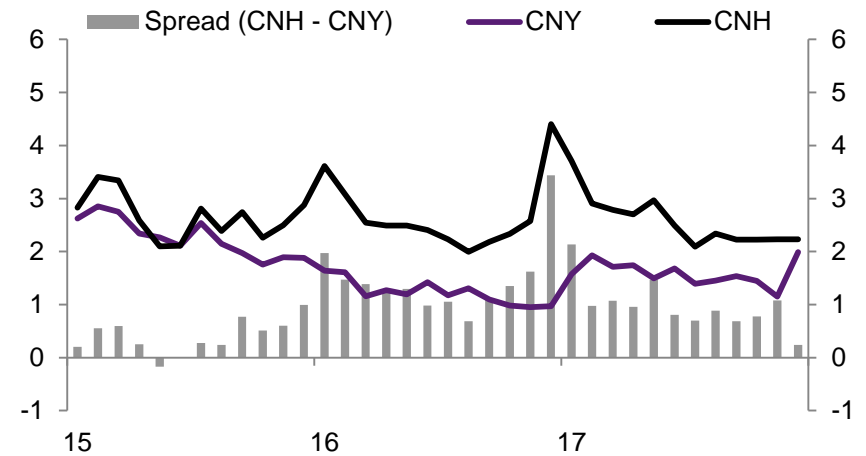
Forward curve is used to estimate the market exchange rate expectation for cross currency comparison. Difference in expectation can be seen among USDCNY and USDCNH, and the offshore rate is used to adjust bond indexes as the hypothesis is that the exchange rate risk is covered offshore.

CNY and CNH Forward (1Y, %YoY)



Source: Natixis, Bloomberg, WIND

CNY and CNH Forward (2Y, %YoY)



Source: Natixis, Bloomberg, WIND

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