

Chinese local governments' creditworthiness shows improvement in 2021 despite headwinds

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Summary

Strong consumption and steady FAI expansion of wealthy regions have led the nation-wide economic recovery in 2021, but sporadic pandemic lockdowns and power shortages are having adverse impact on some regions' economies. The vigorous revival of consumption has propelled the economic growth in some wealthy provincial regions this year with steady fixed-asset investment (FAI) expansion. Regions such as Beijing, Zhejiang and Jiangsu registered higher economic growth than their peers in the first three quarters. On the flip side, some investment-driven economies with obsolete economic structure have seen relatively slower growth this year, such as the provinces of Qinghai, Shaanxi and Henan. We believe the world-wide power inadequacy has casted a shadow over some energy-inefficient economies such as Qinghai, Ningxia and Inner Mongolia which are also grappling with the resurgence of pandemic upon entering the winter.

Dwindling deficits, surging budgetary revenue and expenditure expansion resumption reinforce local governments' fiscal strength. In general, less proactive fiscal policy makes the fiscal expansion no longer an urgent and imperative task for most local governments in 2021. The national general public budgetary expenditure grew 3.6% year on year as of the end of August while the national general public budgetary revenue surged 18.4% with nearly a dozen provincial-regions' year on year revenue growth rising over 20%. Although the revenue and expenditure growth tend to even out somewhat into the rest of this year, the decrease in most regions' deficit level is expected to be significant.

Some poorer regions' budgetary revenue could be hindered by the central government's crackdown on real estate. The stringent restrictions on real estate have rendered a sweeping turbulence in the property market which spills over to the land markets in provincial regions, resulting in slumping land sales. In our opinion, although the provinces of Zhejiang, Jiangsu and Fujian have relied heavily on land sales to fuel their budgetary revenue over the past few years, their land markets will not collapse on the back of their developed economies and strong domestic consumption power. However, regions such as Guizhou, Guangxi and Hebei should come under greater pressure due to their relatively large scale of land sales as well as their low per capita disposal income.

Governmental debt grew slower versus in 2020, with most governments seeing relatively sufficient leeway for debt raises. We estimate only a few provincial regions' direct debt to debt ceiling ratio surpassed 90% at the end of September, meaning that most governments have sufficient capacity for potential liquidity needs or fiscal stimulus in the fourth quarter.

Local governments' overall creditworthiness improves. Negative elements are accumulating and the weaker-than-expected economic performance in the third quarter is likely to prompt the policy makers to contemplate reinforcing the fiscal expansion. Nevertheless, recovering economies and narrowing deficits have strengthened local governments' credit profiles in order to tackle economic or fiscal challenges. In addition, meeting aggressive economic targets would not be the primary goals for most provincial regions as they need to keep their deficit and debt levels in check.

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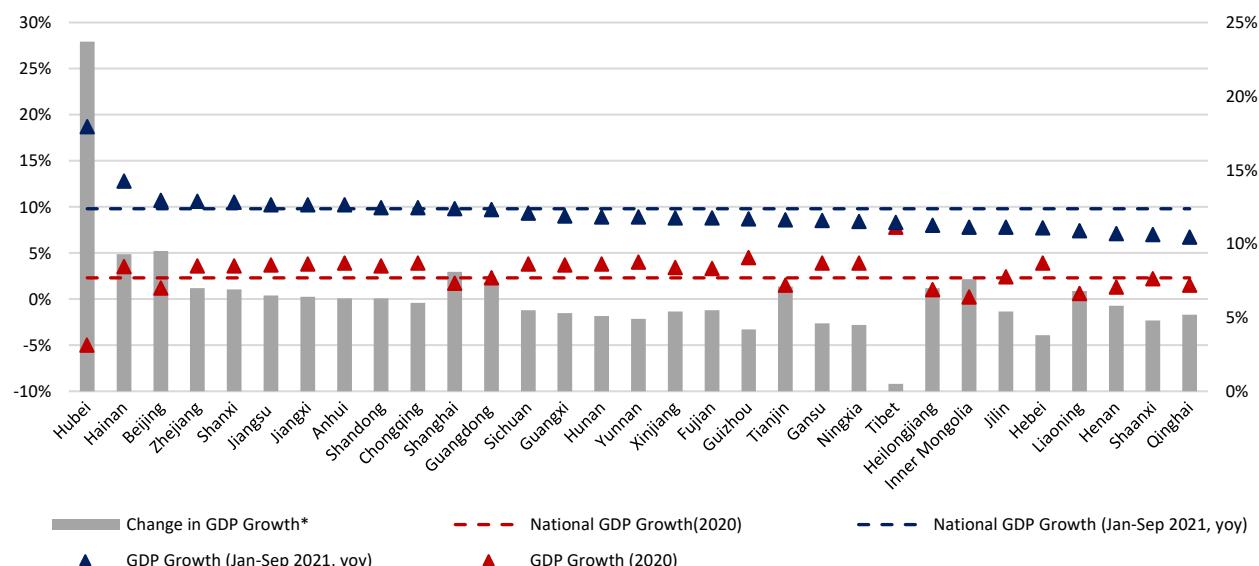
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Wealthy regions are taking the lead in the nation-wide economic recovery

The vigorous revival of consumption has propelled the economic growth in some wealthy provincial regions in 2021, as projected in our report "[Is the Creditworthiness of Chinese Local Governments Raising Concerns in 2021?](#)" in February. As the coronavirus pandemic has subsided as a result of the government's draconian controlling measures, China's economy has recovered rapidly and businesses are rejuvenated (Exhibit 1). Among the provincial regions, Hubei's GDP rebounded 18.7% in the first three quarters from a low base of 2020 as its economy was devastated significantly by the pandemic as a hub of the outbreak. In addition, Hainan's economy continues to be boosted by the 'Free Trade Port' policy which rakes in tourists, investment and consumption. As the national economic activities have resumed normalcy and the pent-up consumption power has been unleashed, the economies of some of the wealthiest regions in the country are the major beneficiaries, such as the cities of Beijing and Shanghai and the provinces of Zhejiang, Jiangsu and Guangdong. The burgeoning export this year has also fueled the economies of these regions to a great extent, as they are typically identified as international trade hubs in the country.

However, the complex and fluctuated economic environment reveals the structural defects in some regions' economies. The provinces with high debt burden and investment-driven economic patterns have lagged behind their peers in terms of economic recovery, such as Shaanxi and Qinghai. The coronavirus resurgence in Hebei and the flood disaster in Henan in the first half of 2021 bogged down their economic recovery. They have already been striving to revamp their economic structure and upgrade the traditional industries in recent years, while the outcome is yet to be seen. Liaoning, Jilin and Heilongjiang are the three provinces in the northeastern region which have seen lacklustre economic rebound due to their obsolete economic composition and continuous contraction in population.

Exhibit 1: Provincial regions' GDP rebounded strongly in 2021

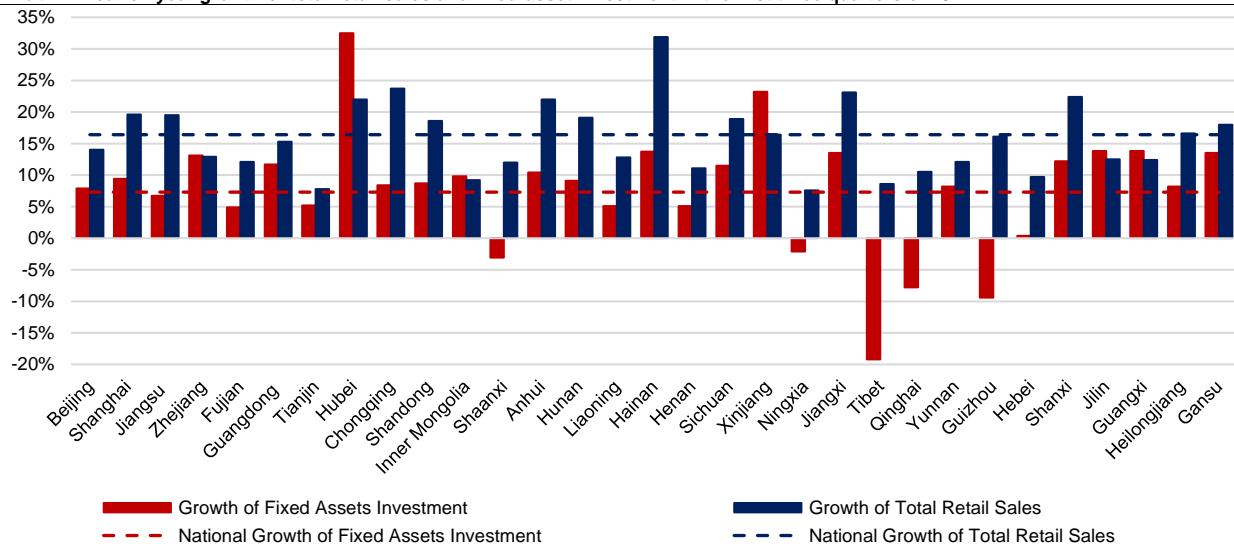


Note: * Change in GDP growth is the difference between the YOY GDP growth of as of the end of Sep 2021 and the GDP growth in 2020.
Sources: Bureau of Statistics, Pengyuan International

Reviving consumption is the pivotal driver in the economic recovery in 2021, outperforming the investment in fixed assets. The national total retail sales surged 16.4% while the FAI grew 7.3% year on year in the first three quarters of 2021. The FAI expansion slowed materially in August and September, ascribing to the weakening intensity of infrastructure investment and slackening real estate investment in our opinion.

Most provincial regions' growth of total retail sales outpaced the growth of the FAI with many of which seeing total retail sales growth above 20% year on year in the first three quarters (Exhibit 2). FAI is also increasing steadfastly in most provinces. However, some western provincial regions registered year on year decline in their FAI in the first three quarters, namely Shaanxi, Ningxia, Tibet, Qinghai and Guizhou, whose economic growth should have been hindered this year. Nevertheless, the slowdown in FAI might not be a negative implication to these regions' credit profiles in the long-term, as we believe these regions might have reined in their fiscal investment expansion so as to alleviate their relatively high debt and deficit pressure.

Exhibit 2: Year on year growth of total retail sales and fixed-asset investment in the first three quarters of 2021

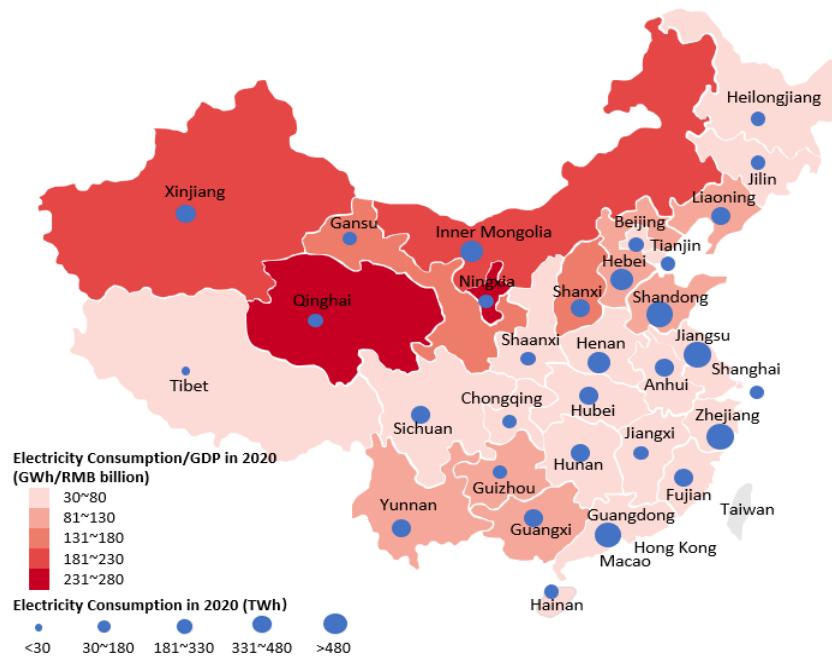


Sources: Bureau of Statistics, Pengyuan International

As a precautionary remark, uncertainties are mounting in China's economy in the last quarter this year, which should exert pressure on some provincial regions' economies. Sporadic coronavirus pandemic outbreak in northern China upon entering the winter is hampering some regions' economic recovery, for instance Inner Mongolia, Gansu and Ningxia. They would have to introduce rigorous lockdown measures and travel restrictions which will wreck the local businesses and economic activities.

The unprecedented world-wide power shortage is suppressing the production of high-energy-consuming industries, which should put pressure on the energy-inefficient economies in the country. To figure out the energy-efficiency of different provincial regions in China, the electricity consumption to GDP ratio is adopted in our analysis to reflect the amount of electricity consumed to produce RMB1 billion of GDP (Exhibit 3). Although the provinces of Jiangsu, Zhejiang and Guangdong have higher electricity consumption than their peers, they are considered energy-efficient based on their large economic scale. However, some regions such as Qinghai, Ningxia, Inner Mongolia and Xinjiang are energy-inefficient as they need more electronic power to fuel the same amount of GDP than their peers. We believe these regions' economies should be more exposed to the impact of power shortage.

Exhibit 3: The energy-efficiency provincial regions

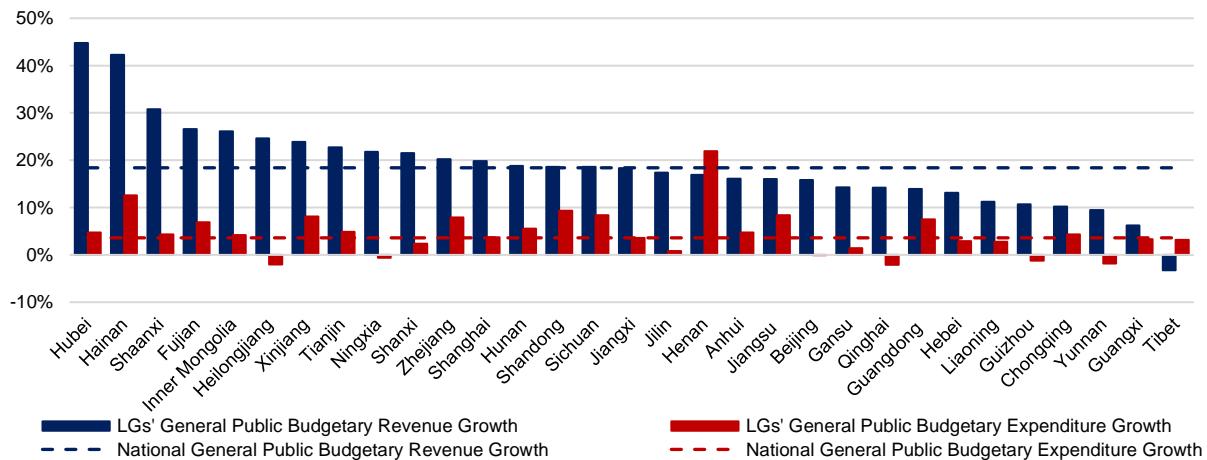


Sources: Bureau of Statistics, Pengyuan International

Surging budgetary revenues in local governments attenuate their deficit pressure

Most provincial regions' deficit level reached to an all-time high in 2020 owing to the intensified fiscal stimulus in an effort to counter the pandemic and its aftermath. As of the end of August 2021, the national general public budgetary revenue grew 18.4% year on year and most provincial regions' general public budgetary revenue surged along with the strong economic recovery (Exhibit 4). In the contrast, since the nation-wide proactive fiscal approaches have been toned down, the intensity of fiscal expenditure have resumed to normalcy. Nearly all provincial regions' general public budgetary revenue outstripped their expenditure as of the end of August except the Henan province, which had grappled with the heavy rainfall and flood disaster since July.

Exhibit 4: The year-on-year growth of general public budgetary revenue and expenditure of provincial regions as of the end of Aug 2021

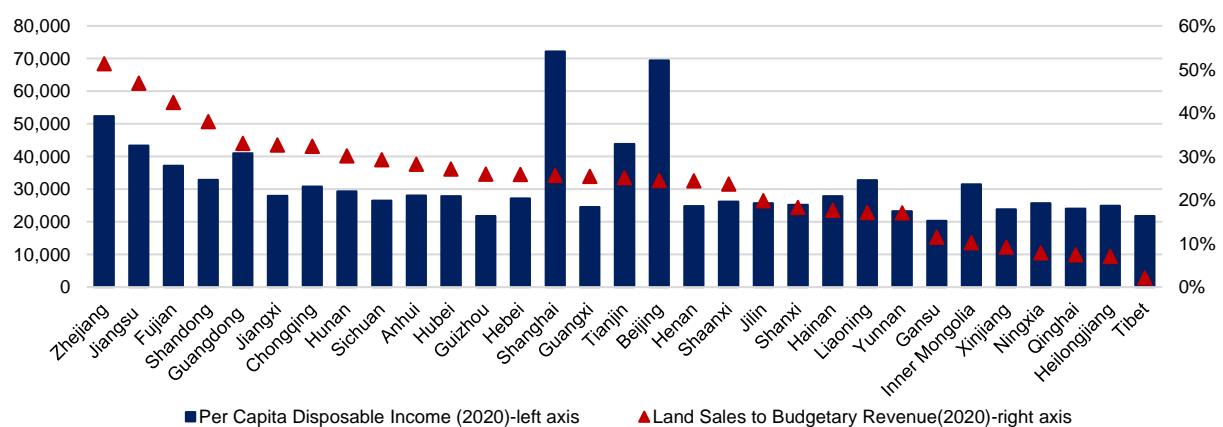


Note: data of Heilongjiang is estimated based on the budget implementation as of the end of July 2021.

Sources: Bureau of Statistics, local governments' Department of Finance, Pengyuan International

The central government's crackdown on real estate is culminating to a sweeping turbulence in the property market which spills over to the land markets in the provincial regions. Slumping land sales are dragging the budgetary revenue growth of the provinces. The provincial governments' proportion of land sales in their budgetary revenue can shed some light on the impact. In our opinion, although the provinces of Zhejiang, Jiangsu and Fujian have relied heavily on land sales to fuel their budgetary revenue over the past few years, their land markets should not collapse on the back of their more developed economies and stronger domestic consumption power than their peers (Exhibit 5). The enthusiasm and dynamic for the real estate developers to participate in the primary land markets in these wealthy regions should not be weakened materially with the relatively promising profit in place. However, regions such as Guizhou, Guangxi and Hebei would have taken a severer hit as their budgetary revenues have a considerably higher reliance on the land sales (with roughly 26% of land sales income in their budgetary revenue in 2020), and on top of that, with a rather low per capita disposable income. The land sales in these regions could become arduous under the current circumstances when the property developers become more eager to focus on more lucrative projects and wealthier areas.

Exhibit 5: The proportion of land sales in provincial regions' budgetary revenue



Sources: Bureau of Statistics, local governments' Department of Finance, Pengyuan International

Looking forward, the discrepancy between the growth of governments' revenue and expenditure is projected to be dwindled to a certain extent, following an expected slow growth in governments' budgetary revenue and increasing expenditure. Nevertheless, the overall deficit level in the provincial-regions is set to decrease in 2021.

Governments have more leeway for debt raises than 2020

As of the end of September, the debt growth in most provincial regions has been modest compared to that of 2020. We estimate only a few provincial regions' direct debt to debt ceiling ratio surpassed 90% at the end of September while most governments should have sufficient funding capacity in the last quarter (Exhibit 6).

Nation-wide local governments' direct debt grew 13.2% year on year in the first three quarters of 2021, slower than that of last year. We believe the weaker-than-expected economic performance in the third quarter has prompted the policy makers to contemplate reinforcing the proactive fiscal approaches, such as the infrastructure construction expansion. However, the fiscal stimulus should be more prudent and delicate than before as the governments need to discreetly balance the debt increase and economic growth. Achieving aggressive economic targets are unlikely to be the primary goals for most provincial regions, as they need to keep their deficit and debt levels in check.

Exhibit 6: The debt growth and debt to debt ceiling of provincial regions

Region	Direct Debt/Debt Ceiling (30 Sep 2021)	Debt Growth (Jan-Sep 2021, yoy)	Direct Debt/Debt Ceiling (2020)	Debt Growth (2020)
Beijing	56.33%	10.10%	59.06%	22.15%
Shanghai	69.23%	4.39%	70.88%	20.44%
Ningxia	80.11%	3.25%	91.08%	12.33%
Tibet	80.42%	21.65%	82.54%	49.16%
Hebei	80.90%	15.09%	88.54%	25.84%
Shaanxi	82.04%	14.18%	86.76%	13.78%
Jiangxi	82.77%	11.77%	86.14%	33.60%
Guangdong	84.80%	16.07%	87.49%	28.18%
Yunnan	84.85%	10.02%	88.95%	18.30%
Jiangsu	84.99%	10.45%	90.64%	15.79%
Sichuan	85.51%	9.28%	91.11%	20.48%
Henan	85.95%	22.89%	82.82%	24.10%
Qinghai	86.12%	10.88%	90.54%	16.76%
Inner Mongolia	87.00%	8.04%	92.34%	13.18%
Hubei	87.64%	13.56%	95.98%	30.80%
Hainan	87.65%	7.88%	93.29%	17.58%
Shanxi	87.70%	19.95%	95.43%	29.92%
Gansu	87.99%	21.29%	90.58%	26.76%
Zhejiang	88.85%	8.63%	95.20%	18.94%
Liaoning	89.11%	12.09%	87.06%	4.24%
Jilin	89.63%	18.49%	90.30%	20.17%
Shandong	89.85%	17.51%	92.69%	26.39%
Fujian	90.09%	16.30%	86.51%	18.55%
Chongqing	90.23%	16.43%	90.15%	21.35%
Tianjin	90.30%	19.50%	93.09%	28.41%
Heilongjiang	90.69%	15.79%	92.51%	16.91%
Guizhou	91.84%	5.86%	98.65%	13.60%
Guangxi	92.13%	14.03%	95.83%	19.83%
Anhui	92.39%	17.33%	89.80%	20.96%
Hunan	93.29%	10.18%	97.15%	16.11%
Xinjiang	93.52%	24.40%	90.14%	25.18%

Note: The debt ceilings at 30 Sep 2021 are estimated.

Sources: Local governments' Department of Finance, Wind, Pengyuan International

Chinese local governments' creditworthiness has generally improved

Buoyed by the recovery of economy and budgetary revenue, local governments' deficit pressure has been eased. Less proactive fiscal policy has curbed the expansion of infrastructure construction in many regions and released the strain in their fiscal balancing. Most local governments are possessing more debt raising capacities and better liquidity positions than 2020. We believe the creditworthiness of local governments has generally improved compared to a year ago but the divergence among them has widened. On the flip side, the uncertainties are accumulating since the expected resurgence of pandemic this winter is likely to wreck some provinces' economy, while power shortages are restricting factory production in high power consuming regions, and the depressing real estate market could be insidiously spreading to other economic sectors. The expected enhancement of FAI in the last quarter may weigh on the local government's budgetary balance.

To summarise, despite accumulating negative factors, the entrenched credit profiles as well as prudent and conscientious fiscal and economic measures should provide the local governments with greater capability to withstand the potential downside risk than 2020.

For more research and credit views, the table below lists our published local government ratings.

Table 1: Our published issuer credit ratings for 22 provincial-level governments

Provincial-level governments	Issuer Credit Ratings	Issuer reports
Beijing	AA	Pengyuan International Assigns 'AA' Ratings to Beijing Municipal Government;
Liaoning	A+	Pengyuan International Assigns 'A+' Rating to the Provincial Government of Liaoning;
Heilongjiang	A	Pengyuan International Assigns 'A' Rating to the Provincial Government of Heilongjiang;
Shanghai	AA-	Pengyuan International Affirms 'AA-' Rating to the Municipal Government of Shanghai;
Hainan	A+	Pengyuan International Affirms 'A+' Rating for the Provincial Government of Hainan;
Shaanxi	A+	Pengyuan International Affirms 'A+' Rating to the Provincial Government of Shaanxi;
Hebei	A	Pengyuan International Assigns 'A' Ratings to the Provincial Government of Hebei;
Hunan	A	Pengyuan International Affirms 'A' Ratings for the Provincial Government of Hunan;
Jiangsu	A+	Pengyuan International Affirms 'A+' Rating for the Provincial Government of Jiangsu;
Jilin	A	Pengyuan International Affirms 'A' Rating to the Provincial Government of Jilin;
Guangdong	AA-	Pengyuan International Affirms 'AA-' Ratings for the Provincial Government of Guangdong;
Fujian	A+	Pengyuan International Affirms 'A+' Ratings for the Provincial Government of Fujian;
Henan	A	Pengyuan International Affirms 'A' Rating to the Provincial Government of Henan;
Zhejiang	AA-	Pengyuan International Affirms 'AA-' Ratings for the Provincial Government of Zhejiang;
Jiangxi	A+	Pengyuan International Affirms 'A+' Ratings for the Provincial Government of Jiangxi;
Shandong	A+	Pengyuan International Affirms 'A+' Rating for the Provincial Government of Shandong;
Shanxi	A+	Pengyuan International Affirms 'A+' Ratings for the Provincial Government of Shanxi;
Sichuan	A+	Pengyuan International Affirms 'A+' Ratings for the Provincial Government of Sichuan;
Tianjin	A	Pengyuan International Affirms 'A' Ratings for the Municipal Government of Tianjin;
Guizhou	A	Pengyuan International Affirms 'A' Ratings for the Provincial Government of Guizhou;
Yunnan	A+	Pengyuan International Affirms 'A+' Rating for the Provincial Government of Yunnan;
Guangxi	A	Pengyuan International Affirms 'A' Ratings for the Government of Guangxi Zhuang Autonomous Region;

Note: The credit ratings are global scale long-term foreign currency ratings.

Source: Pengyuan International

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