

COVID-19 Is Not Destructive to Chinese LGs' Creditworthiness Yet, but Downside Risk Is Mounting

Contents

Summary	1
Economic and social impacts are felt unevenly across the nation	2
Fiscal policies have been rolled out to support local communities and economies	3

Summary

The COVID-19 epidemic is likely to hurt some provinces' economies more than others, but Hubei is definitely hit the hardest.

Our recent report "[March Marks a Critical Point for China's Economy](#)" summarized three possible scenarios of the epidemic's impact on China's economy. In our base-case scenario, we expect China's 2020 GDP growth to fall 50 basis points to 5.5%, as a result of the COVID-19 outbreak. We also believe economic losses will be felt unevenly among different provinces and regions, with Hubei being the most negatively impacted. Guangdong and Zhejiang are two provinces with more infected cases than other regions, but their well-diversified and developed economies are sufficiently resilient to absorb such an external shock, in our view. By contrast, some other more infected but less-developed provinces – such as Henan, Anhui, Jiangxi and Hunan – may see their economies come under significant pressure. More importantly, if our pessimistic and severe case scenarios materialize, we believe the economic impact will soon be felt across the entire country. On a more positive note, we believe the policy responses by both the central and local governments have been timely and effective and will mitigate some of the downside economic risks.

Chinese local governments (LGs)' budgetary deficits are likely to rise to an all-time high in 2020 amid slower economic growth and additional fiscal stimulus measures.

We expect the local governments' tax and non-tax revenue growth will be subdued in 2020 due to slower economic growth as well as tax and other economic incentives to support local enterprises. Fiscal expenditures directly associated with the containment of COVID-19 may not be a substantial burden to the governments' fiscal balances, but the stimulus packages that are needed to boost the local economies will definitely weigh heavily on the governments' budgetary performance. We estimate some provincial-level governments' deficit to revenue ratios will increase by up to four percentage points in 2020.

With the aid of the central government, provincial-level governments may maintain their creditworthiness in the near-term. But if our pessimistic or severe assumptions materialize, there may be pressure on their ratings in 2020-2021.

Even though we believe the impact of the COVID-19 epidemic on Chinese LGs' fiscal performance is manageable, its mounting pressure on local economies should not be taken lightly, in our opinion. We expect the central government will significantly increase its revenue transfers to support LGs in 2020, but its own fiscal capacity may also be constrained especially if our pessimistic and severe case scenarios become reality. However, given Chinese LGs' relatively high creditworthiness among all domestic issuers, their access to the local bond market has remained uninterrupted. This should limit liquidity risks, in our view.

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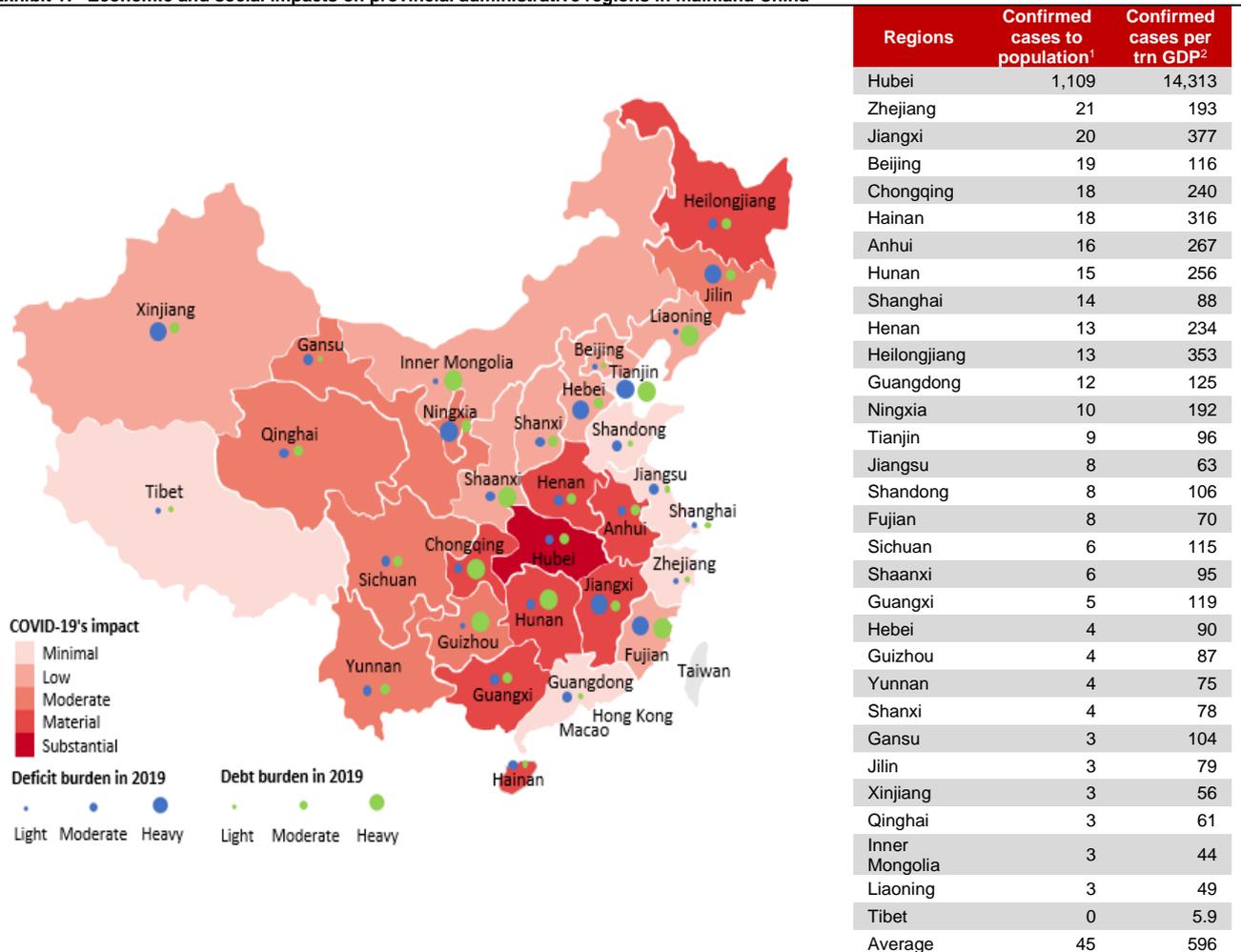
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Economic and social impacts are felt unevenly across the nation

The COVID-19 epidemic's impacts manifest in almost all economic and social aspects, which are difficult to quantify precisely. Some provinces may report more absolute number of confirmed infection cases, but they may also have larger populations and more advanced economies. We present two relative measures below, including confirmed cases per million local population and confirmed cases per trillion GDP, to show the epidemic's impacts on local communities and economies (Exhibit 1). The local governments' deficit and debt burden measures also shed some light on their ability to handle post-epidemic rebuilding.

Exhibit 1: Economic and social impacts on provincial administrative regions in mainland China



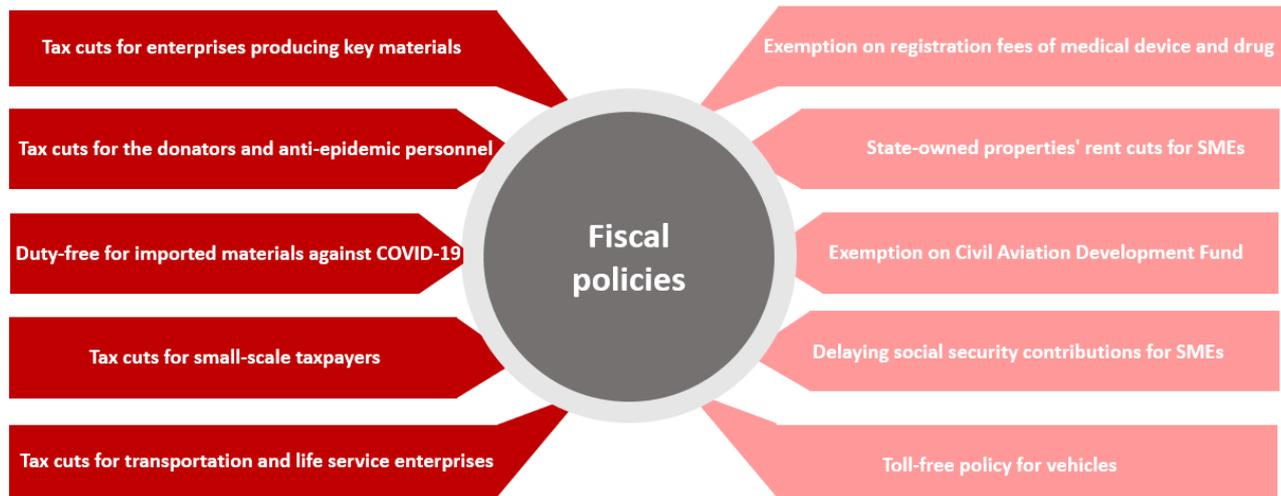
Note: 1, Number of confirmed cases as of 27 Feb per million local population recorded at the end of 2018. 2, GDP in CNY in 2019.

Source: Bureau of Statistics, National and regional Health Commission, Regional Department of Finance, Wind, Pengyuan International estimates

Fiscal policies have been rolled out to support local communities and economies

Several provincial-level governments have followed the Ministry of Finance (MOF)'s policies in launching their own measures to offset the impact of the epidemic. For instance, taxpayers who suffer significant economic losses from COVID-19 could apply for reductions on their urban land use and real estate taxes in provinces like Hubei, Shandong and Chongqing. In addition, Beijing has stopped collecting some administration revenues such as sewage treatment fees from small and medium enterprises (SMEs) during the outbreak. Hainan also has announced measures to support its tourism industry.

Exhibit 2: Fiscal policies against COVID-19 by the MOF and some LGs



Source: MOF

For more research and credit views, please refer to our local government ratings below:

Exhibit 3: Our published issuer credit ratings on 15 provincial-level governments

Provincial-level governments	LT FC Issuer Credit Ratings	LT LC Issuer Credit Ratings	Issuer reports
Shanghai	AA-	AA	https://www.pyrating.com/RatingsActions/10092.html
Hunan	A	A+	https://www.pyrating.com/RatingsActions/10117.html
Jiangsu	A+	AA-	https://www.pyrating.com/RatingsActions/10093.html
Jilin	A	A+	https://www.pyrating.com/RatingsActions/10091.html
Guangdong	AA-	AA	https://www.pyrating.com/RatingsActions/10107.html
Fujian	A+	AA-	https://www.pyrating.com/RatingsActions/10115.html
Henan	A	A+	https://www.pyrating.com/RatingsActions/10094.html
Zhejiang	AA-	AA	https://www.pyrating.com/RatingsActions/10108.html
Jiangxi	A+	AA-	https://www.pyrating.com/RatingsActions/10116.html
Shandong	A+	AA-	https://www.pyrating.com/RatingsActions/10095.html
Shanxi	A+	AA-	https://www.pyrating.com/RatingsActions/10110.html
Sichuan	A+	AA-	https://www.pyrating.com/RatingsActions/10109.html
Tianjin	A	A+	https://www.pyrating.com/RatingsActions/10119.html
Guizhou	A	A+	https://www.pyrating.com/RatingsActions/10111.html
Guangxi	A	A+	https://www.pyrating.com/RatingsActions/10118.html

Source: Pengyuan International

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