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,[1] has been particularly hard hit. It is down 7.3% month to date and -42.41% year to date.[1]
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.[2] 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.

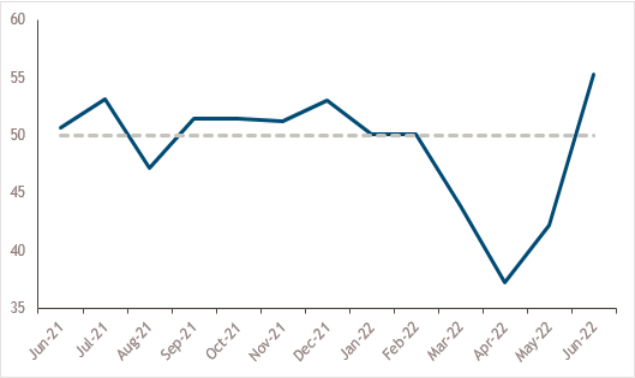
3. Overall macro sentiment remains poor, and investors are more likely to be reducing rather than adding risk, soured by fears of Russia cutting gas supplies from the eurozone and the continued US dollar appreciation tightening financial conditions.

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,[3] with an increase in the M2 (broad money supply) from 11.1 to 11.4% [4]
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[5]

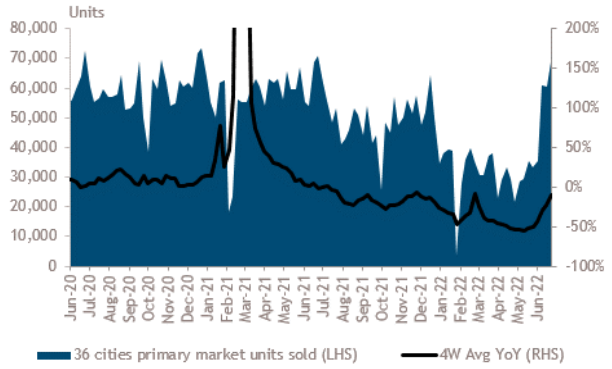
We therefore believe the weak performance of the China high yield market is due to a weak technical situation and it is not a true reflection of the underlying improving fundamentals of the economic backdrop.

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.

Fig. 2 - Chinese Property Sales Normalise*



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

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 12th 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 6th July 2022.

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.

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