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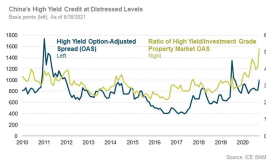


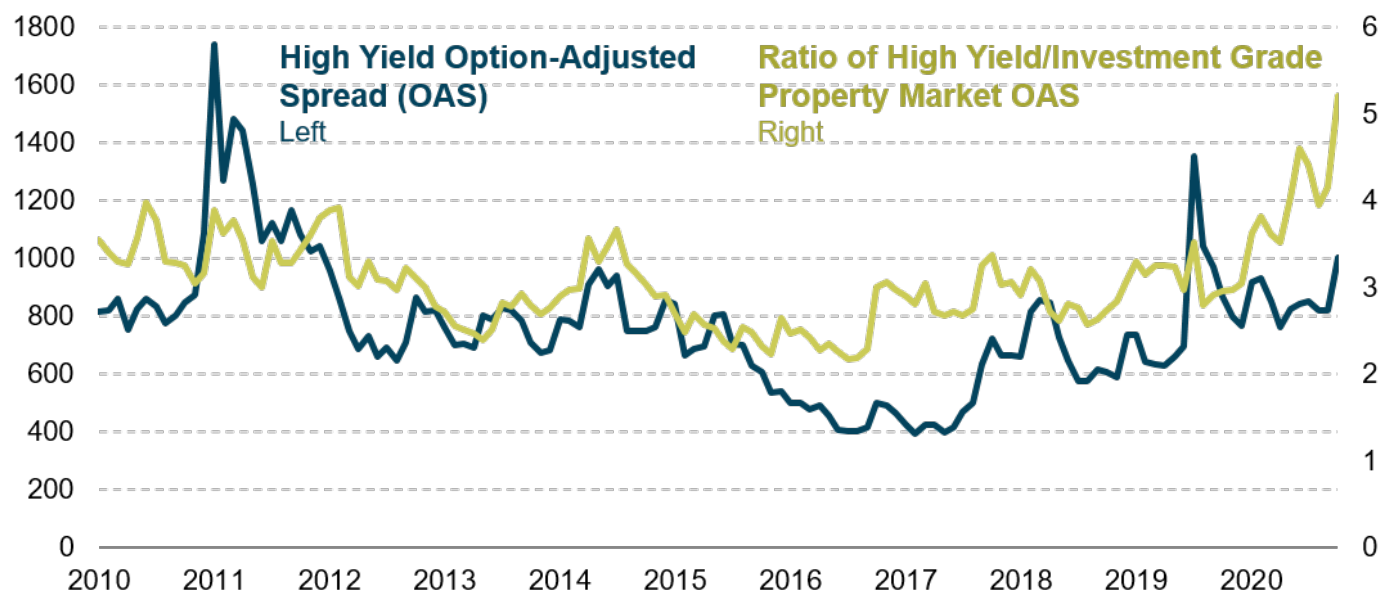
Chart of the Moment: Cracks in China's Great Wall of Debt

Hard currency corporate and sovereign credit valuations continue to trade toward the tighter end of historical ranges. One notable exception is the China high yield bond market, which is facing growing credit and default risks. As a result, Chinese high yield bonds are currently trading at distressed levels with spreads just over 1,000 basis points (bps), while high yield property spreads are 5x that of investment grade property.

In addition to the recent rout in the technology and for-profit education sectors, investors are also following developments around several situations in China's debt markets, including distressed asset management and property market sectors. According to Fitch Ratings, China just saw its highest level of corporate bond defaults for the first six months of a year in nearly seven years, although this number still represents only a fraction of the onshore bond market, and none of the defaults were state-owned enterprises. However, these latest high-profile companies raise challenges to China's "implicit guarantee," and investors are looking for clues on how China will confront its moral hazard. While China is known for its commitment to bailing out government-sponsored companies, the rising default rate signals things may be changing. Policymakers appear to be seeking a balance between retaining control over businesses while allowing some market forces to weed out poorly managed companies. Authorities' end goals may be to improve the quality of the onshore bond market and potentially spur growth through greater competitiveness and industry diversification. At the same time, analysts are watching for signs of how a restructuring of bonds may look in the future for onshore and offshore debt investors. They also must determine how to weigh fundamental analysis against the potential for policy decisions made by senior members of the Chinese government.

China's High Yield Credit at Distressed Levels

Basis points (left), As of 6/30/2021



Source: ICE BAML

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