HUTONG RESEARCH

China Economy
Beijing Targets Provinces with High Debt Risks

January 25, 2024

Hutong Team
HQ@hutongresearch.com

What happened

- A document titled "Rules in Enhancing Management by Category over Government Investment Projects in Key Provinces," issued by the State Council General Office, has been circulating in China's social media this week. The document was released at the end of December.

- 12 provinces—Tianjin, Chongqing, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Guangxi, Guizhou, Yunnan, Gansu, Qinghai, and Ningxia—are singled out for high local government debt risks. Consequently, these provinces are subject to stringent rules over government investment projects.

- Within these provinces, only projects with over 50% investment completion and with follow-up fundings secured are permitted to proceed. Projects with less than 50% investment completion can only continue after rigorous feasibility assessments.

- New projects in transportation, social welfare, city management, industrial parks, new infrastructure, large mansions, and shantytown renovation are strictly prohibited with few exceptions.

- The National Development and Reform Commission (NDRC) will take the lead in evaluating the debt levels of these provinces. It will also collaborate with the Ministry of Finance (MOF), the People's Bank of China (PBOC), and the National Administration for Financial Regulation to strengthen oversight of government investment projects.

Analysis

- The document will significantly constrain fixed asset investment (FAI) growth in the 12 provinces. Key projects that usually involve more government support will face more risks, especially those that primarily depend on government funding. New projects will face more risks than existing ones, and infrastructure and real estate projects will face more risks than industrial ones.

- The 12 provinces collectively contribute to 30% of China's total FAI. Key projects make up 20-50% of these provinces' FAI, and 20% of such projects primarily depend on government funding. The share of new projects varies significantly, ranging from 14% in Guangxi to 80% in Heilongjiang. Infrastructure and real estate typically account for 30-50% of key projects by investment. **Depending on how strict the rules are enforced, the document could reduce China's total FAI by 0.1-6%.**

- Most of the 12 provinces have already announced their 2024 growth targets, including those on FAI. In light of the document, however, it is very difficult to see how they could hit the targets. In fact, all 12 provinces except for Inner Mongolia markedly undershot their 2023 FAI growth targets, even with overdelivered investments in key projects.

© Hutong Research. Redistribution prohibited without prior consent. This report has been prepared for distribution to Hutong Research clients. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. For more information and research archive, visit: **www.hutongresearch.com**

- As such, other provinces and the central government must take additional measures to ensure China's FAI growth. Last December at the Central Economic Work Conference, top leaders urged wealthy provinces to contribute more to China's economy. Yesterday, the PBOC pledged more easing to support government bond issuance and investment projects, and immediately announced 50bp cut to banks' reserve ratio requirements, effective 5 February, as well as 25bp cut to interest rate of rediscount for loans to the agricultural sector and small enterprises.

The 12 provinces already missed their investment growth targets in 2023

RMB trn	2023 FAI	% of key projects	2023 Target	2023 Actual	2024 Target
Yunnan	2.41	N/A	~9%	-10.6%	N/A
Guangxi	2.29	18%	8%	-15.5%	>3%
Chongqing	2.28	19%	10%	4.3%	4%
Inner Mongolia	1.61	51%	>10%	19.8%	N/A
Guizhou	1.6	50%	N/A	-5.7%	~4.5%
Jilin	1.31	35%	~7	0.3%	>3%
Heilongjiang	1.06	28%	>8	-14.8%	>7%
Tianjin	0.99	24%	~3	-16.4%	>0%
Gansu	0.81	31%	10	5.9%	~6%
Liaoning	0.76	52%	>10	4.0%	10%
Ningxia	0.33	47%	10	5.5%	~6%
Qinghai	0.31	37%	N/A	-7.5%	N/A

(Source: media reports, Hutong Research)

- The latest document represents Beijing's second stride in resolving local government debt risks. There was another State Council document dated last October circulated, which aimed to control local government debt growth, especially in the same 12 provinces identified as high risks.

- The October document asks provinces to control their debt growth based on local GDP and total social financing (TSF) growth. For example, provinces may not issue new bonds if their debt levels exceed local GDP and/or growth of their outstanding bonds exceed the growth of local TSF.

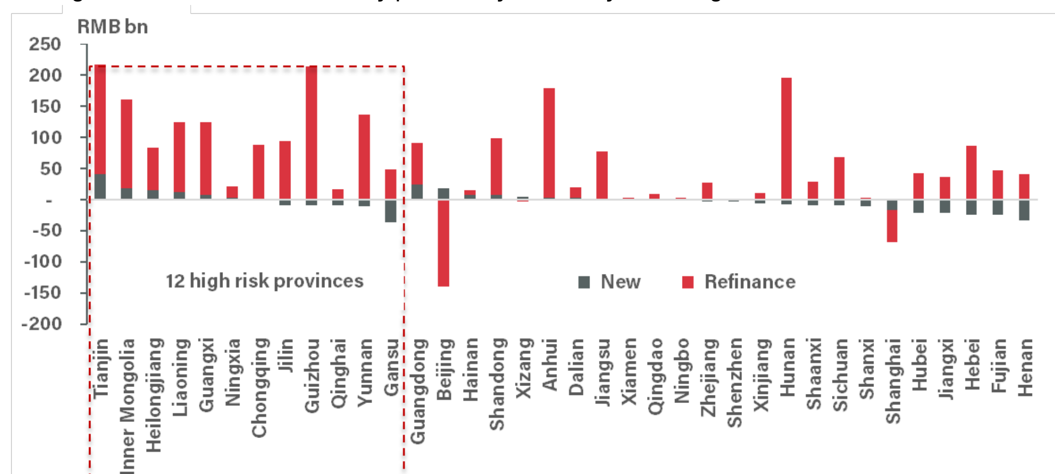
- Special attention was paid to local government financing vehicles (LGFV). The LGFVs that are formally recognized, as well as all LGFVs in the 12 provinces, can only borrow to repay their existing debts. Moreover, financial institutions are required to help the 12 provinces roll over their debts with lower interest rates.

- The October document was already in effect last year. In 2023, provinces issued RMB 4.7trn refinancing bonds, compared to only RMB 2.6trn in 2022. 40% of such bonds were issued in Q4 (i.e. after the October document), compared to only 19% in 2022. 44% of the refinancing bonds were issued by the 12 provinces, compared to 31% in 2022. **We expect the trend to continue in 2024, meaning another RMB 1-2trn bonds to help provinces refinance their debts, including those incurred by LGFVs.**

© Hutong Research. Redistribution prohibited without prior consent. This report has been prepared for distribution to Hutong Research clients. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. For more information and research archive, visit: **www.hutongresearch.com**

Provinces issued a lot more refinancing bonds in 2023

Local government bond issuance by province, year-over-year change



(Source: Wind, Hutong Research)

- The enforcement of both documents is overseen by vice premier He Lifeng, who serves as office director at both the Central Financial and Economic Affairs Commission and the Central Financial Commission. Last summer, He sent over a dozen working groups to inspect local government debt risks, and held meetings with each province to discuss their numbers in depth. **In other words, He should have a good knowledge of the local situation**.

- At the time of the inspections, MOF was headed by He's college classmate Liu Kun, who was succeeded by Lan Fo'an, Liu's former deputy in Guangdong, last October. Concurrently, Zheng Shanjie—He's two-time subordinate—has been at the helm of the NDRC since last March. These personnel arrangements mean that He Lifeng has no room for excuses in the event of a local debt crisis, given that all key decision-makers are aligned with and report to him. **He should also have strong incentives to resolve local government debt risks.**

© Hutong Research. Redistribution prohibited without prior consent. This report has been prepared for distribution to Hutong Research clients. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. For more information and research archive, visit: **www.hutongresearch.com**