

August 15, 2019

Panda bonds have become popular among overseas issuers.....2

Daimler auto group is the leading issuer of panda bonds.....3

Key drivers encouraging panda bond issuers.....4

YTM spread on panda bonds shrank last year.....5

RUSAL has been the sole Russian issuer of panda bonds to date.....7

High YTM's hinder a stronger growth in the panda-bond market.....7

Panda-bond market is becoming more attractive to foreign issuers

Higher offering volumes indicate that the debt instrument is gaining popularity

- **The panda-bond market began to develop rapidly in 2015, and over the past five years, the total volume of debt securities placed by foreign borrowers amounted to RMB 350 bln.** To date, the size of the panda-bond market is comparable with that of the markets of debt securities denominated in other Asian currencies.
- **The largest issuers of panda bonds include Daimler auto group, foreign governments, and financial institutions.** Most foreign issuers in the panda-bond market have an extensive issuing experience; their share has reached about 30% over the past five years.
- **Today, the main objectives pursued by panda-bond issuers are of a non-price nature, as they aim to diversify their debt base and settlements within China and to promote their image in the country.** Others reasons include financing large government projects, including those related to the One Belt & One Road Initiative, debt refinancing, supporting national companies, etc.
- **Unlike other issuers, the Philippines issued panda bonds largely because of their lower YTM compared to debt securities denominated in the local currency.** This may be explained, among other reasons, by the low volatility of the PHP/RMB exchange rate compared with the PHP/USD or PHP/EUR rate.
- **The yield-to-maturity on panda bonds varied significantly up to September 2018, but it became more stable later.** Moreover, the yields to maturity on panda bonds and dim sum bonds are tending to converge at around 3.5%.
- **RUSAL has been the sole Russian company that issued panda bonds to date.** VEB.RF was another Russian company that looked into options for an offering, but it abandoned the idea eventually, as it considered it inappropriate in the circumstances.
- **High YTM's hinder a stronger growth in the panda-bond market.** Other restraining factors may include a complicated issue approval procedure by Chinese regulators and a relatively low liquidity of panda bonds.

Rostislav Erzin
Junior Analyst
Sovereign Ratings and
Macroeconomic Analysis Group
+7(495) 139-0492
rostislav.erzin@acra-ratings.ru

Media contact

Alexey Churilov
Manager for External
Communications
+7 (495) 139-0480, ext. 169
media@acra-ratings.ru

Panda bonds have become popular among overseas issuers

Panda bond is a type of debt instrument offered in the mainland China by overseas registered companies only. Unlike panda bonds, dim sum bonds may only be offered outside the mainland China.

Overseas companies include non-Chinese companies registered outside China. Those Chinese companies that are registered outside China (a.k.a. "red chips") are mentioned separately.

Overseas companies not registered in China may borrow funds denominated in RMB through public offerings of panda bonds and dim sum bonds mainly. The key difference between these debt instruments is that panda bonds may be offered in the mainland China, while dim sum bonds are offshore RMB bonds (see *Table 1*).

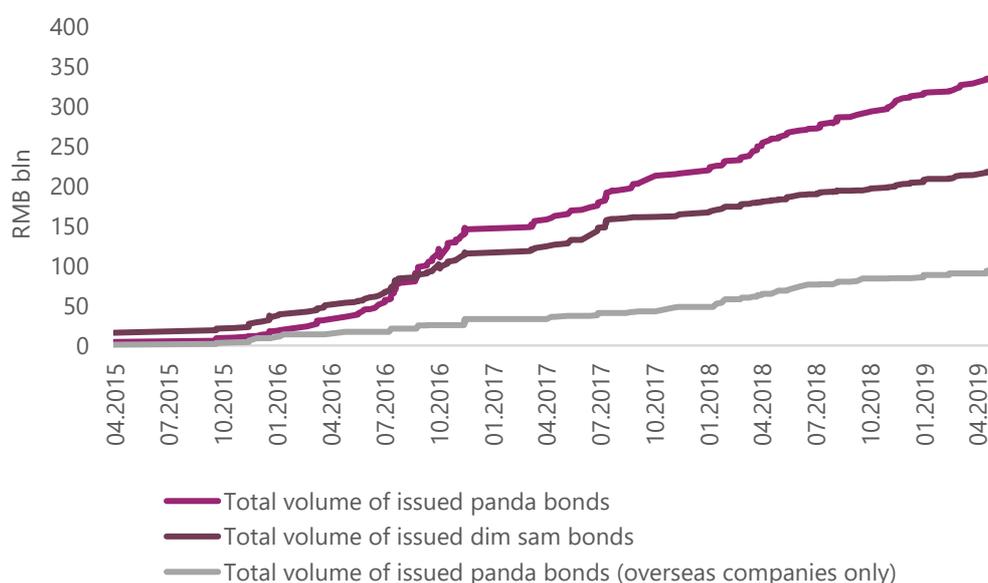
Table 1. Panda bonds vs dim sum bonds

	Panda bonds	Dim Sum bonds
Currency	RMB	RMB
Market	Mainland China	Rest of the world
Average duration	2.0 years	2.0 years
Average maturity	3.9 years	3.7 years

Source: Wind, Bloomberg

The panda-bond market was established in 2005, but its explosive growth began no sooner than in 2015. In terms of the historical volume of public offerings (including redeemed bonds), the panda bond market outperforms the dim sum bond market (see *Fig. 1*), but it lags behind in terms of total current liabilities (about USD 40 bln vs USD 78 bln, respectively).

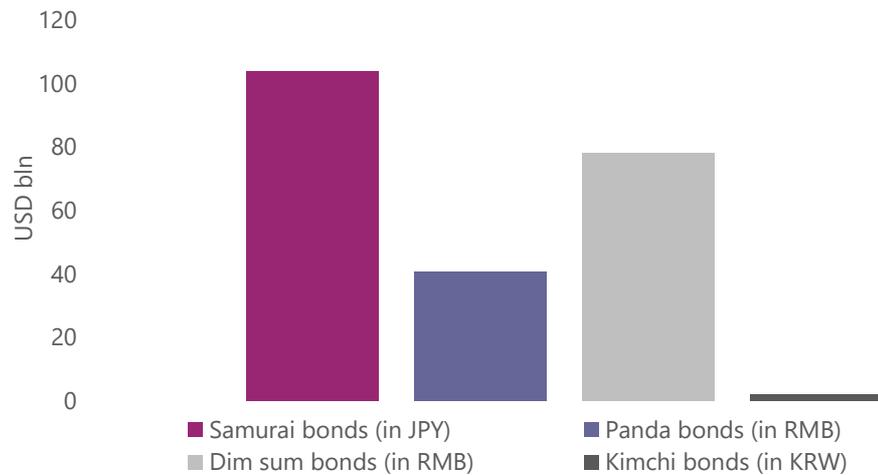
Figure 1. The historical volume of issued panda bonds is 50% higher than that of issued dim sum bonds



Source: Wind

Of course, the volumes of panda bond and dim sum bond markets are incomparable with that of the markets of debt securities denominated in US dollars (USD 16 trln) or in euro (USD 6.75 trln), but they are comparable to bond markets in other Asian currencies (see *Fig. 2*).

Figure 2. The total volume of current obligations in the panda bond market is lower than that in the samurai bond and dim sum bond markets, but higher than in the kimchi bonds market

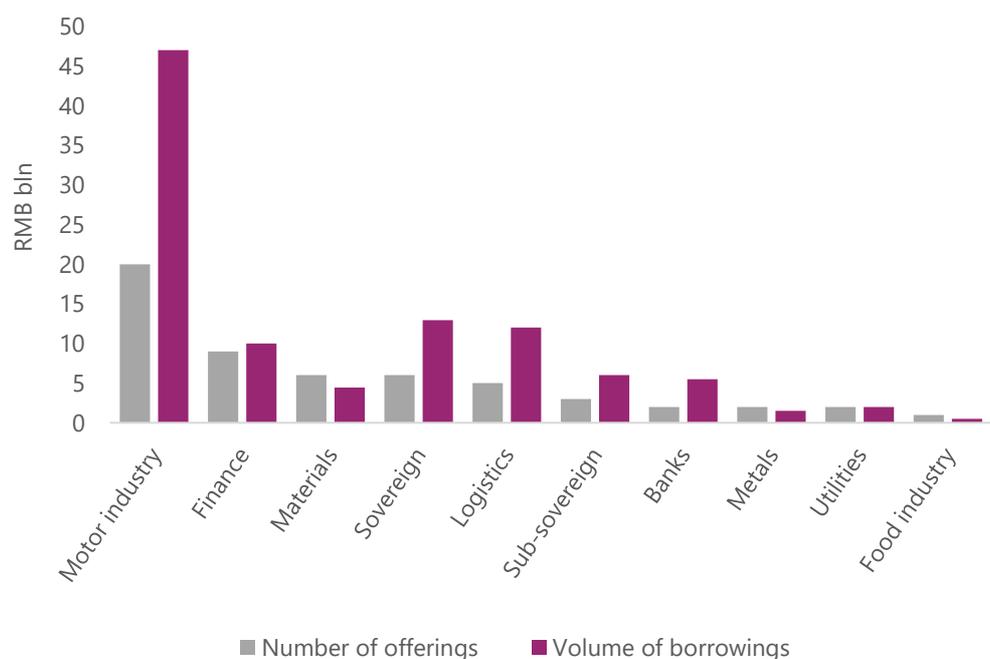


Source: Bloomberg

Daimler auto group is the leading issuer of panda bonds

The leading issuers are the so-called "red chips," the share of which in the total volume of bonds issued over the past five years amounted to 70%. Overseas issuers have been also active in the market, increasing the volume of offerings year by year: their share in the total volume of offerings was 28.5% in 2017, and it became as high as 49.2% in 2019. The largest issuers are Daimler and foreign governments, including Poland, Hungary and Philippines (see Fig. 3).

Figure 3. Daimler has been the leader among overseas issuers over the last five years



Source: Wind

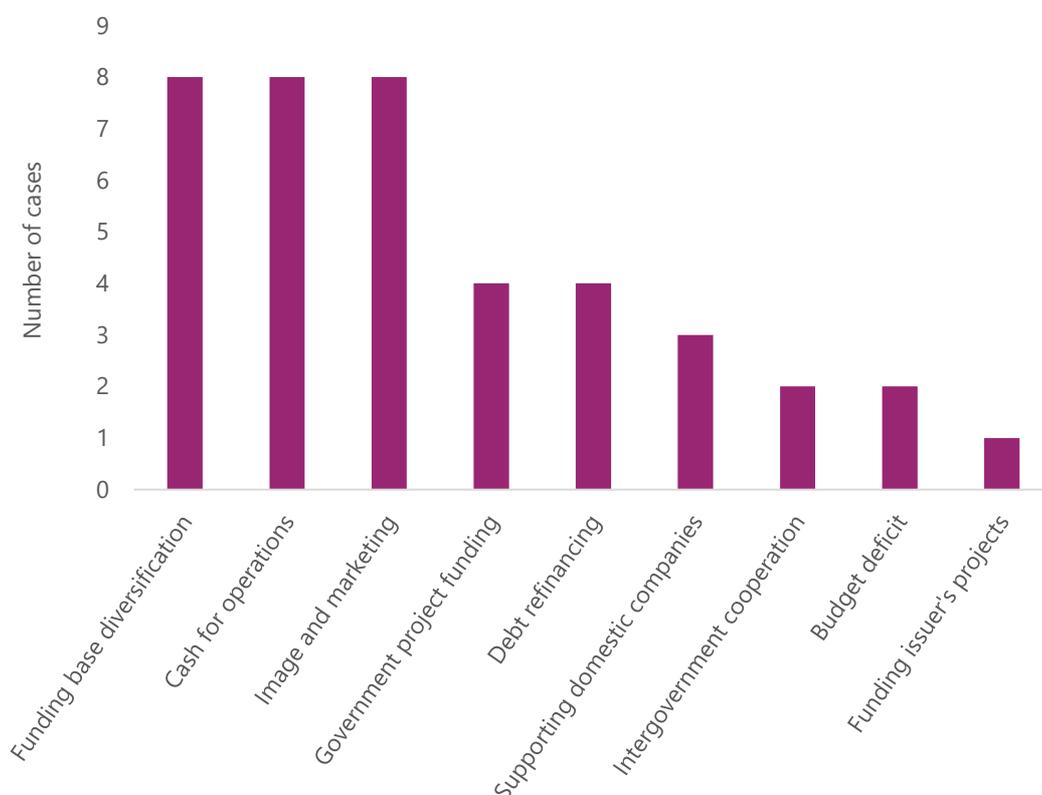
Red chips include companies that were established and registered overseas (mainly in Cayman Islands, Bermuda Islands or British Virgin Islands) and listed and offered their bonds outside their home jurisdictions (generally, in Hong Kong, New York, London, Frankfurt or Singapore), while their manufacturing assets and businesses are located in the mainland China.

See ACRA's research [A brief introduction to China's bond market](#) published on February 28, 2019.

Key drivers encouraging panda bond issuers

According to publicly available data and statements made by representatives of the issuers, some financial institutions, including the Asian Development Bank, the National Bank of Canada and Mizuho, offered panda bonds to diversify their funding sources; governments of Poland, Japan, etc. intended to improve their image in China and establish bilateral relations; manufacturing companies (like Daimler, Trafigura) needed cash for their operations in China. Other equally important considerations include the need to finance major projects, including those related to the One Belt & One Road initiative, supporting domestic companies and promoting intergovernmental cooperation (see *Fig. 4*).

Figure 4. Key drivers encouraging panda bond issuers

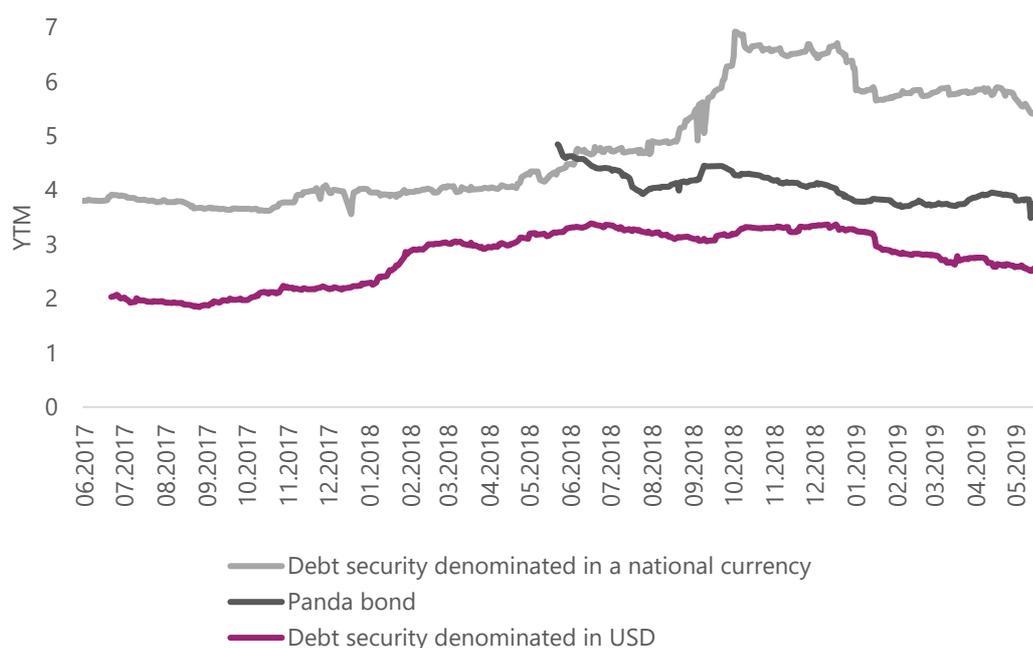


Source: Wind, mass media

In this context, we note the Government of the Philippines that issued panda bonds primarily because of their attractive YTM compared to the borrowing costs of loans denominated in the local currency.

The Philippine Government has issued panda bonds twice since mid-2018. The YTM on those bonds is lower than that of debt securities denominated in the national currency, which is only slightly higher than the YTM on USD-denominated bonds (see *Fig. 5*). This may also be due to the low volatility of the PHP/RMB exchange rate (the annual standard deviation is 1.3 over the past 30 years), unlike the PHP/USD (11.6) and PHP/EUR (7.9) exchange rates (see *Fig. 5*). Other considerations taken into account by panda bond issuers include the desire to diversify their funding bases and raise the prestige of their countries in China. We do not exclude that, in the foreseeable future, other potential issuers may also be attracted by the low yield-to-maturity of panda bonds, which is due to, among other things, lower currency risk.

Figure 5. YTM on panda bonds vs other bonds



Source: Bloomberg

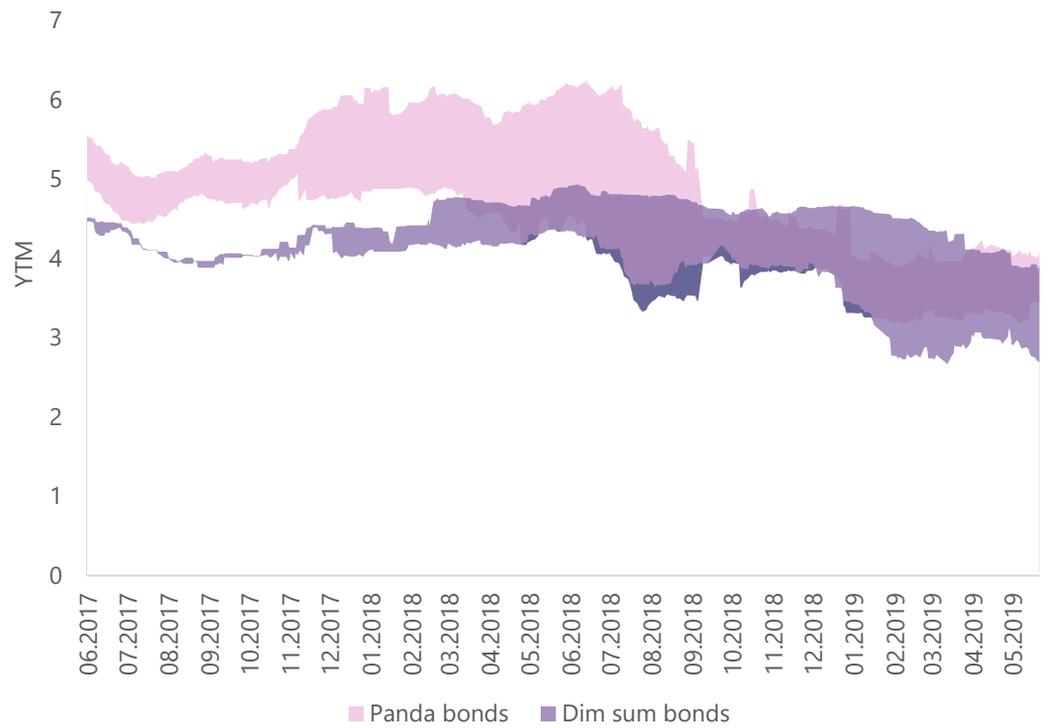
YTM spread on panda bonds shrank last year

Our analysis of panda bonds with the three-year tenor showed a significant YTM spread in the period from December 2017 to September 2018. The panda bond yields have since stabilized relatively, and the spread has started to gradually decrease. Our analysis of dim sum bonds with the five-year maturity showed an inverse trend: the YTM spread began to increase in July 2018. Such narrow spreads can be explained by the fact that the major foreign issuers of both types of bonds had floated their bonds in the international markets many times, so that the Chinese markets assessed their risks as low. In addition, most issuers have high credit ratings assigned to them by Chinese rating agencies. The maturity date for the main volume of the bonds has not yet occurred (see Fig. 7), and there have been no defaults to date.

Currently, there is a trend towards convergence in the yields to maturity demonstrated by both types of bonds, as they are approaching 3.5% (see Fig. 6). This may be explained by growing liquidity and openness of the Chinese financial market for foreign players. In this context, it is indicative that foreign rating agencies have been admitted to China's domestic rating market.

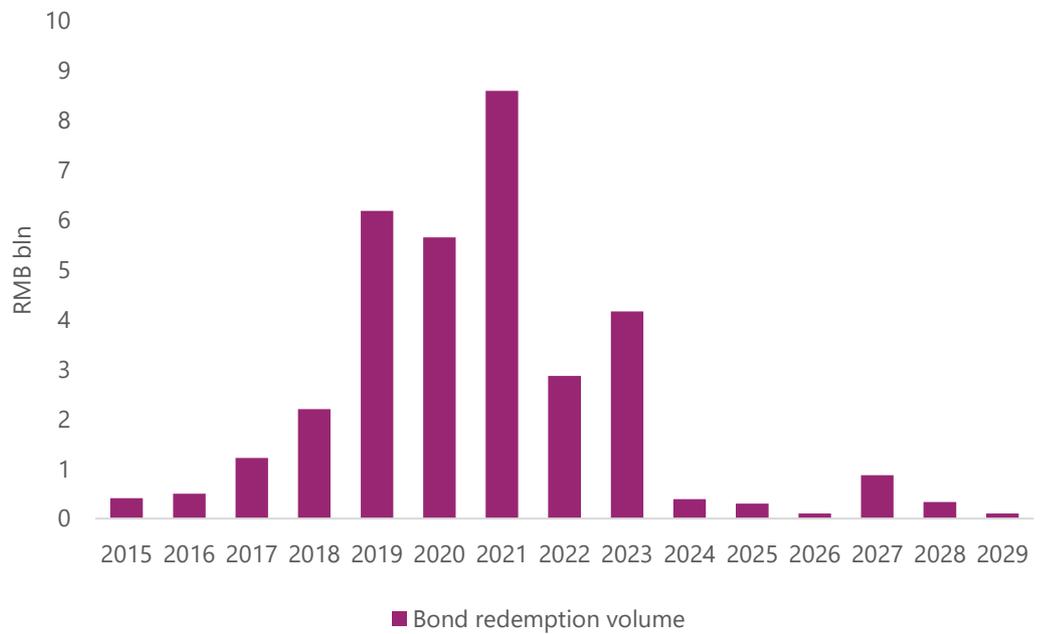
There are two main scenarios for further panda-bond market development. The first one assumes that the variation in the yields and their average values will remain low, provided that there are no defaults on bonds; the second scenario assumes an increase in the variation amid defaults by some borrowers, first of all, red chips.

Figure 6. YTM trends in panda bonds and dim sum bonds issued by foreign companies



Source: Bloomberg

Figure 7. Aggregate panda bond redemptions will peak in 2021



Source: Wind

RUSAL has been the sole Russian issuer of panda bonds to date

In 2017, the Russian aluminum manufacturer UC RUSAL issued panda bonds twice: for RMB 1 bln on March 20, 2017 and for RMB 500 mln on March 4, 2017, which is a relatively insignificant volume compared to other issuers. The bond issues were driven by the company's intentions to strengthen its presence in the Chinese domestic market and to further develop cooperation with Asian partners.

Table 2. Panda bond offerings by RUSAL at Shanghai Stock Exchange

	March 2017	September 2017
Issuer	UC RUSAL	UC RUSAL
Offer	Private offering	Private offering
Rating by Fitch	B+	B+
Rating by China Chengxin	AA+	AA+
Offering volume	RMB 1 bln	RMB 500 mln
Maturity	3 years	3 years
Coupon rate	5.5%	5.5%
Market	Shanghai Stock Exchange	Shanghai Stock Exchange

Source: Bloomberg

High YTM's hinder a stronger growth in the panda-bond market

From the viewpoint of issuers, panda bonds and dim sum bonds are still unable to compete with euro- or dollar-denominated debt obligations that offer much lower yields.

ACRA does not expect that the panda-bond market will become an alternative to dollar and euro denominated loans in the foreseeable future. In addition to high yields, there are other circumstances that hinder more active development of the market, including complicated regulatory approval procedures and low liquidity. According to the market rules, any panda bond may be offered in the market only after it is admitted by Chinese regulators, who mainly look at the issuer's creditworthiness. This, in turn, may prove to be a serious obstacle for those potential issuers who have a modest track record in the international debt market. For well-known issuers, the approval procedure may take only a few months, but for little-known but creditworthy issuers, it can take years.

This may be due to the fact that the Chinese government strives to ensure the high credit quality of borrowers and to prevent defaults in the market. Low liquidity (as the majority of investors are Chinese commercial banks) is another factor that pushes yields up and, consequently, affects the popularity of panda bonds among potential issuers. It is worth noting that the Bloomberg Liquidity Assessment is equal to 45.84 for panda bonds and 31.18 for dim sum bonds, while for debt securities denominated in US dollars and euros, it is equal to 67.92 and 67.06, respectively. Moreover, until recently, potential issuers were to obtain a credit rating from a Chinese rating agency, but this requirement has become optional after certain amendments have been introduced into the relevant regulations.

Bloomberg Liquidity Assessment is a measure of liquidity that includes such parameters as price volatility and securities price indicators.

At the same time, foreign issuers may find it more advantageous to obtain a rating assigned by a Chinese rating agency, as it reflects their creditworthiness under the national scale in the national currency. It is indicative that, among panda bond issuers, only the government of British Columbia has no rating from a Chinese rating agency.

ACRA expects that the panda bond market will grow further, as more and more companies operating in China and sovereign issuers interested in promoting their image and strengthening ties with the PRC may apply this debt instrument to pursue their goals.

(C) 2019

Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)

75, Sadovnicheskaya embankment, Moscow, Russia

www.acra-ratings.com

Analytical Credit Rating Agency (ACRA) was founded in 2015, with its 27 shareholders representing major Russian corporate and financial institutions and its authorized capital exceeding RUB 3 bn. ACRA's main objective is to provide the Russian financial market with high-quality rating products. Methodologies and internal documents of ACRA are developed in compliance with Russian legislation and with regard to global rating industry best practices.

The provided information, including, without limitation, credit and non-credit ratings, rating assessment factors, detailed credit analysis results, methodologies, models, forecasts, analytical reviews and materials, as well as other information placed on the ACRA website (further referred to as Information), coupled with the ACRA website software and other applications, are intended for information purposes only. Information must not be modified, reproduced or distributed by any means, in any way or form, either in whole, or in part, in marketing materials, as part of public relations events, in news bulletins, in commercial materials or reports without prior written consent from, and reference to, ACRA. Any use of Information in violation of these requirements or the law is prohibited.

ACRA credit ratings reflect ACRA's opinion about the ability of a rated entity to meet its financial obligations or about the credit risk of individual financial obligations and instruments of a rated entity at the time of publication of the relevant Information.

Non-credit ratings reflect ACRA's opinion about certain non-credit risks assumed by interested parties interacting with a rated entity.

The assigned credit and non-credit ratings reflect all material information pertaining to a rated entity and known by ACRA (including the information received from third parties), the quality and reliability of which ACRA considers appropriate. ACRA shall not be responsible for the accuracy of information provided by clients or relevant third parties. ACRA does not audit or otherwise verify the provided data and shall not be held responsible for their accuracy and completeness. ACRA conducts rating analysis of information provided by customers using its own methodologies, with the texts thereof available on ACRA's website – www.acra-ratings.com/criteria.

No credit rating and/or credit rating outlook is regulated by the Central Bank of the Russian Federation, unless distributed so that such credit rating and/or credit rating outlook is in the public domain.

The only source that reflects the latest Information, including the one about credit and non-credit ratings assigned by ACRA, is ACRA's official website – www.acra-ratings.com. Information is provided on an "as is" basis.

Information shall be considered by users exclusively as ACRA's statement of opinion and must not be regarded as advice, recommendation or suggestion to buy, hold or sell securities or other financial instruments of any kind, nor shall it be viewed as an offer or advertisement.

Neither ACRA, nor its employees and persons affiliated with ACRA (further referred to as the ACRA Parties) provide any direct or implied guarantee expressed in any form or by any means regarding the accuracy, timeliness, completeness or applicability of Information for making investment and other decisions. ACRA does not act as a fiduciary, auditor, investment or financial advisor. Information must be regarded solely as one of the factors affecting an investment decision or any other business decision made by any person who uses ACRA's information. It is essential that each of such persons conduct their own research and evaluation of a financial market participant, as well as an issuer and its debt obligations that may be regarded as an object of purchase, sale or possession. Users of Information shall make decisions on their own, involving their own independent advisors, if they deem it necessary.

ACRA Parties shall not be responsible for any action taken by users based on Information provided by ACRA. ACRA Parties shall under no circumstances be responsible for any direct, indirect or consequential damages or losses resulting from interpretations, conclusions, recommendations and other actions taken by third parties and directly or indirectly connected with such information.

Information provided by ACRA is valid only as of the date of preparation and publication of materials and may be amended by ACRA in the future. ACRA shall not be obliged to update, modify or supplement Information or inform anyone about such actions, unless the latter was recorded separately in a written agreement or is required by legislation of the Russian Federation.

ACRA does not provide advisory services. ACRA may provide additional services, if this does not create a conflict of interest with rating activities.

ACRA and its employees take all reasonable measures to protect all confidential and/or material non-public information in their possession from fraud, theft, unlawful use or inadvertent disclosure. ACRA provides protection of confidential information obtained in the course of its business activities as required by legislation of the Russian Federation.