Market Summaries

People's Republic of China

Yield Movements

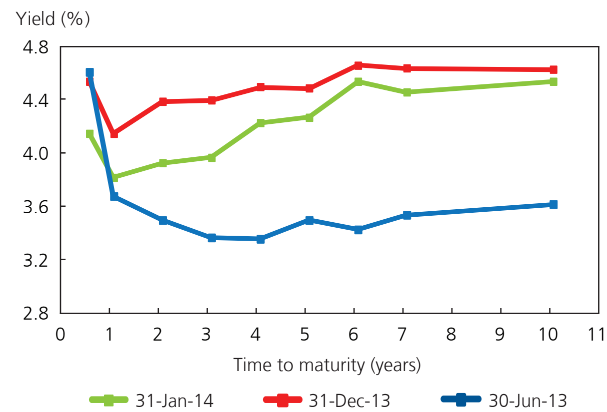
The government bond yield curve for the People's Republic of China (PRC) dramatically shifted upward between end-June and end-December 2013, with the exception of tenors of less than 1 year **(Figure 1)**. At the shorter-end of the curve, yields fell 187 basis points (bps) for the 3-month tenor and 7 bps for the 6-month tenor. Yields rose between 47 bps and 123 bps for tenors of 1 year or longer.

The steep rise in yields between end-June and end-December was the result of both external and domestic factors. Announcements by the United States (US) Federal Reserve that it was considering tapering its monthly bond buying program were made in May. By December, the Federal Reserve signaled its intention to begin tapering asset purchases by US$10 billion per month starting in January.

Domestic liquidity also tightened in the PRC as evidenced by rising interbank repo rates in mid-June in response to the SHIBOR shock. While repo rates had recovered by end-June, tight liquidity conditions still prevailed, causing interbank rates to rise again later in the year. The People's Bank of China (PBOC) suspended reverse repo auctions on 17 October. With corporate tax payments due, the 7-day repo rate rose from 4.56% at the start of August to 4.93% on 28 October. The PBOC was then forced to inject liquidity via short-term liquidity operations from 28 October to 30 December, and to conduct two additional reverse repo auctions.

Liquidity tightened again in the first half of December when the PBOC once more halted reverse repo auctions. The 7-day repo rate rose to 8.84% on 23 December. The PBOC was then forced to intervene via short-term liquidity operations and to extend interbank trading hours by 30 minutes. The liquidity injection helped calm markets, with the 7-day repo rate falling to 5.25% by end-December. These developments and the PBOC's response were the reasons for the decline in short-term rates in the second half of 2013.

Figure 1: The People's Republic of China's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

In early January, yields began to rise on liquidity concerns as the Chinese New Year holiday approached and the PBOC chose not to conduct any reverse repo auctions in the first half of the month. However, market concerns were allayed when the PBOC injected liquidity via reverse repos from 21 January to 28 January. As a result, by end-January yields had fallen between zero and 46 bps from end-December levels. The PBOC again began issuing repo agreements in February, draining some liquidity from the market.

The PBOC has largely been silent in the past regarding its liquidity decisions. But in the PBOC's 4Q13 monetary policy report, the central bank hinted that it will manage liquidity to control credit expansion. In various news reports, market participants were cited as saying that the PBOC appears to be targeting the shadow banking system.

In January, a trust marketed by Industrial and Commercial Bank of China (ICBC) was at risk of default as it had provided funds to the Shanxi Zhengfu Energy Group, which had subsequently gone bankrupt. However, ICBC opted to protect investor principal. In February,

Table 1: Size and Composition of the LCY Bond Market in the People's Republic of China

	Outstanding Amount (billion)						Growth Rates (%)			
	4Q12		3Q13		4Q13		4Q12		4Q13	
	CNY	US$	CNY	US$	CNY	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**23,747**	**3,811**	**26,364**	**4,307**	**26,968**	**4,454**	**3.0**	**11.2**	**2.3**	**13.6**
Government	17,270	2,772	18,117	2,960	18,463	3,050	0.9	8.0	1.9	6.9
Treasury Bonds	8,074	1,296	8,895	1,453	9,109	1,505	2.0	9.3	2.40	12.8
Central Bank Bonds	1,338	215	564	92	552	91	(16.2)	(37.2)	(2.1)	(58.7)
Policy Bank Bonds	7,858	1,261	8,658	1,415	8,802	1,454	3.3	21.3	1.7	12.0
Corporate	6,477	1,040	8,247	1,347	8,505	1,405	9.3	20.8	3.1	31.3
Policy Bank Bonds										
China Development Bank	5,270	846	5,525	903	5,672	937	2.5	18.6	2.7	7.6
Export–Import Bank of China	1,112	178	1,268	207	1,357	224	10.3	33.4	7.0	22.1
Agricultural Devt. Bank of China	1,476	237	1,604	262	1,772	293	1.3	22.9	10.5	20.1

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Treasury bonds include savings bonds and local government bonds.
3. Bloomberg LP end-of-period LCY–US$ rate is used.
4. Growth rates are calculated from LCY base and do not include currency effects.
5. The balance of outstanding commercial paper as of 4Q13 was CNY1.5 trillion based on data from *Wind*.
Sources*:* Bloomberg LP, *ChinaBond,* and *Wind*.

another trust product marketed by China Construction Bank (CCB) raised concerns over loans made to Shanxi Liansheng Energy.

Declining yields in January also reflected concerns that the PRC's growth might slow. Growth in 4Q13 was relatively stable at 7.7% y-o-y following a 7.8% expansion in 3Q13. For full-year 2013, GDP grew 7.7%. However, more recent data has raised concerns. Both the manufacturing and non-manufacturing Purchasing Managers' Index (PMI) fell in January. The manufacturing PMI fell to 50.5 in January from 51.0 in December, while the non-manufacturing PMI fell to 53.4 from 54.6. The PRC's industrial production growth has also been on the decline, with December's growth slipping to 9.7% y-o-y from 10.0% in November. Meanwhile, inflation has been stable, with January's consumer price inflation at 2.5% y-o-y, the same rate as in December.

As a result of the much larger decline in short-term yields compared with long-term yields, the 2- versus 10-year spread rose to 61 bps at end-January from 24 bps at end-December.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC market reached CNY27 trillion (US$4.5 trillion) at end-December, an increase of 2.3% quarter-on-quarter (q-o-q) and 13.6% y-o-y, largely driven by growth in treasury, policy bank, and corporate bonds **(Table 1)**.

Government Bonds. LCY government bonds outstanding grew 1.9% q-o-q and 6.9% y-o-y in 4Q13, driven by growth in policy bank bonds. Central bank bonds continued to decline as the PBOC opted to use other tools to manage liquidity (e.g., reverse repos).

Corporate Bonds. Corporate bonds outstanding grew 3.1% q-o-q and 31.3% y-o-y in 4Q13 **(Table 2)**. The bonds with relatively higher q-o-q growth rates were medium-term notes and local corporate bonds at 3.9% and 3.6%, respectively. Outstanding commercial bank bonds were relatively unchanged in 4Q13 as banks had completed most of their capital-raising requirements before the start of the quarter.

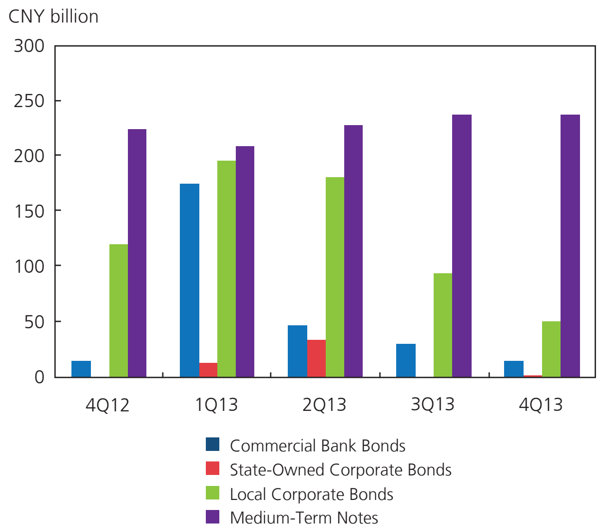
The growth of corporate bonds outstanding is reflected in the issuance data presented in **Figure 2**, with corporate bond issuance levels for some bond types having been affected by tight liquidity conditions in the market. Yet, there were some issuers who opted to lock in the low borrowing costs in anticipation of rising yields as the US Federal Reserve tapers its monthly asset purchases.

Table 2: Corporate Bonds Outstanding in Key Sectors

	Outstanding Amount (CNY billion)				Growth Rates (%)				
					q-o-q				y-o-y
	1Q13	2Q13	3Q13	4Q13	1Q13	2Q13	3Q13	4Q13	4Q13
Commercial Bank Bonds	1,304	1,329	1,299	1,311	3.1	1.9	(2.2)	0.9	3.6
State-Owned Corporate Bonds	1,024	653	647	646	3.2	(36.3)	(0.9)	(0.1)	(34.9)
Local Corporate Bonds	1,484	1,580	1,626	1,684	13.7	6.4	2.9	3.6	29.0
Medium-Term Notes	3,194	3,509	3,705	3,848	10.2	9.9	5.6	3.9	32.8

( ) = negative, – = not available, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Source: *ChinaBond.*

Figure 2: Corporate Bond Issuance in Key Sectors



Source: *ChinaBond.*

A relatively small number of issuers dominate the PRC's corporate bond market **(Table 3)**. As of 4Q13, the top 30 corporate bond issuers accounted for CNY4.1 trillion worth of corporate bonds outstanding, or about 49% of the market. Among the top 30 corporate issuers, the 10 largest accounted for CNY2.8 trillion worth of bonds outstanding.

State-owned companies—defined as majority-owned by the government—continued to dominate the corporate bond market in 4Q13. Among the top 30 corporate issuers at end-December, 22 were state-owned.

Table 4 presents the most significant issuances of 4Q13.

Investor Profile

Treasury Bonds. Banks remained the largest category of investors in the PRC's treasury bond market, which includes policy bank bonds, holding a slightly smaller share of these bonds at the end of 4Q13 (77.0%) than at the end of 4Q12 (77.2%) **(Figure 3)**.

Corporate Bonds. Banks were also the largest holders of corporate bonds at the end of 4Q13, albeit with a comparatively smaller share than their holdings of treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 29.5% at the end of 4Q13 from 36.7% a year earlier **(Figure 4)**. The second largest holders of corporate bonds were insurance companies, with a 14.7% share at the end of 4Q13, down from a 21.0% share a year earlier.

Figure 5 presents investor profiles across corporate bond categories. Based on the latest data available, banks were the largest holders of medium-term notes at end-December with more than 50% of the total. Meanwhile, insurance companies were the largest holders of commercial bank bonds.

Liquidity

Figure 6 presents the turnover ratios for government bonds, which have seen a significant decline since June, reflecting both tight liqudity conditions as well as the crackdown on illegal bond trading in May.

Interest Rate Swaps

In 4Q13, the total notional amount of signed interest rate swap agreements in the PRC reached

Table 3: Top 30 Issuers of LCY Corporate Bonds in the People's Republic of China

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (CNY billion)	LCY Bonds (US$ billion)			
1. China Railway	896.0	147.99	Yes	No	Transportation
2. State Grid Corporation of China	354.5	58.55	Yes	No	Public Utilities
3. China National Petroleum	340.0	56.16	Yes	No	Energy
4. Industrial and Commercial Bank of China	233.0	38.49	Yes	Yes	Banking
5. Bank of China	224.9	37.15	Yes	Yes	Banking
6. China Construction Bank	205.0	33.86	Yes	Yes	Banking
7. Agricultural Bank of China	153.0	25.27	Yes	Yes	Banking
8. China Petroleum & Chemical	134.7	22.25	Yes	Yes	Energy
9. China Guodian	112.3	18.55	Yes	No	Public Utilities
10. Central Huijin Investment	109.0	18.00	Yes	No	Diversified Financial
11. Petrochina	106.0	17.51	Yes	Yes	Energy
12. China Minsheng Bank	102.3	16.90	No	Yes	Banking
13. Shenhua Group	97.0	16.02	Yes	No	Energy
14. China Power Investment	89.6	14.80	Yes	No	Public Utilities
15. Bank of Communications	89.0	14.70	No	Yes	Banking
16. Shanghai Pudong Development Bank	82.2	13.58	No	Yes	Banking
17. China Three Gorges Project	77.5	12.80	Yes	No	Public Utilities
18. Industrial Bank	71.0	11.73	No	Yes	Banking
19. China Southern Power Grid	68.5	11.31	Yes	No	Public Utilities
20. China Life	68.0	11.23	Yes	Yes	Insurance
21. China Merchants Bank	64.7	10.69	No	Yes	Banking
22. China Citic Bank	60.5	9.99	No	Yes	Banking
23. China Huaneng Group	60.0	9.91	Yes	No	Public Utilities
24. State-Owned Capital Operation and Management Center of Beijing	55.0	9.08	Yes	No	Diversified Financial
25. China Everbright Bank	52.7	8.70	No	Yes	Banking
26. Citic Group	49.5	8.18	Yes	No	Diversified Financial
27. Tianjin Infrastructure Investment Group	47.8	7.90	Yes	No	Capital Goods
28. China Datang	44.7	7.38	Yes	No	Public Utilities
29. Bank of Beijing	43.5	7.18	No	Yes	Banking
30. Huaneng Power International	43.0	7.10	Yes	Yes	Public Utilities
Total Top 30 LCY Corporate Issuers	**4,134.94**	**682.98**			
Total LCY Corporate Bonds	**8,505.36**	**1,404.85**			
Top 30 as % of Total LCY Corporate Bonds	**49%**	**49%**			

LCY = local currency.
Notes:
1. Data as of end-December 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on *Wind* data.

Table 4: Notable LCY Corporate Bond Issuance in 4Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
Hubei Provincial Communications Investment		
15-year bonds	6.18	2.5
Wuhan Metro Group		
5-year bonds	Floating	2.3
Wuulanchabu Urban Investment and Development		
7-year bonds	7.7	2
China Shenhua Energy		
5-year bonds	5.49	5
Henan Energy and Chemical Group		
5-year bonds	6.40	5
Hunan Provincial Express Highway Construction and Development		
3-year bonds	7.30	5

LCY = local currency.
Source: *Wind*.

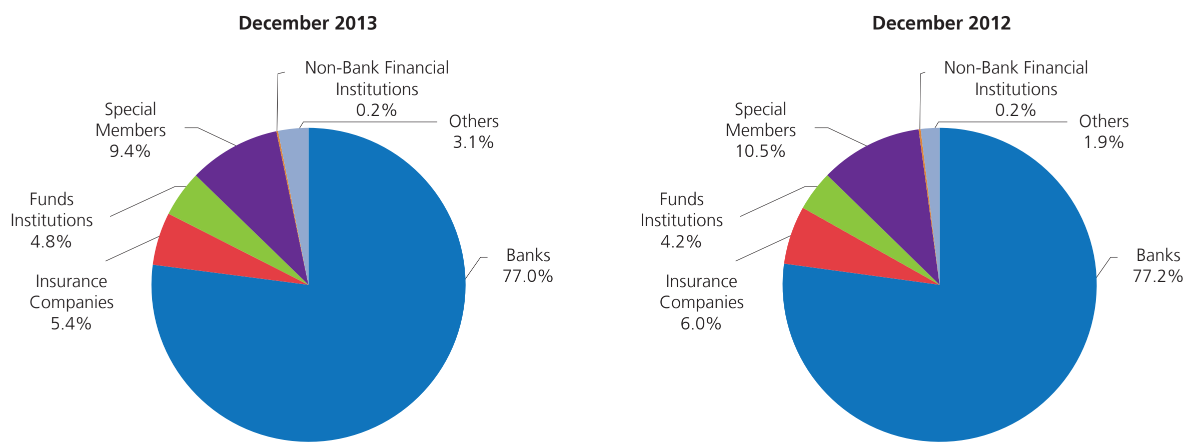
CNY606 billion on 6,021 transactions **(Table 5)**. The most popular benchmark was the 7-day repo, which accounted for 69% of all transactions.

Policy, Institutional, and Regulatory Developments

Shanghai Free Trade Zone Processes Cross-Border Renminbi Payments

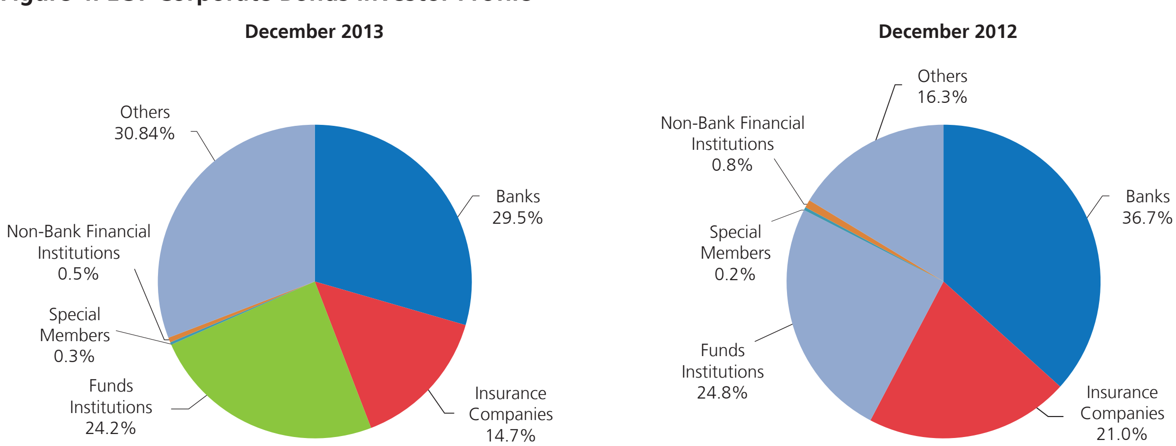
On 18 February, the PBOC announced it would allow five payment companies to process cross-border renminbi payments in the Shanghai Free Trade Zone: Allinpay, 99Bill, ChinaPay, Dongfang Electronics, and Shengpay. The five companies will open accounts with the Shanghai branches of

Figure 3: LCY Treasury Bonds Investor Profile



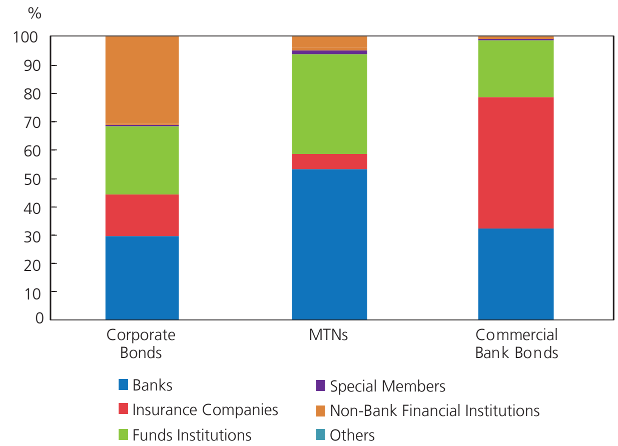
LCY = local currency.
Source: *ChinaBond*.

Figure 4: LCY Corporate Bonds Investor Profile



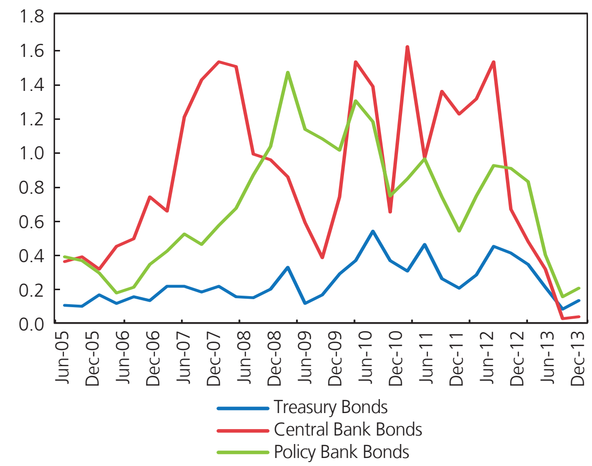
LCY = local currency.
Source: *ChinaBond*.

Figure 5: Investor Profile across Bond Categories



MTNs = medium-term notes.
Note: Data as of end-September 2013.
Source: *ChinaBond*.

Figure 6: Turnover Ratios for Government Bonds



Source: *ChinaBond*.

Table 5: Notional Values of the PRC's Interest Rate Swap Market in 4Q13

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions	Growth Rate (%)	
		4Q13		q-o-q	y-o-y
7-Day Repo Rate	418.4	69.1	4,588	3.6	45.4
Overnight SHIBOR	87.1	14.4	203	10.2	(83.6)
3-Month SHIBOR	89.6	14.8	1,097	11.9	0.9
1-Year Term Deposit Rate	9.1	1.5	116	122.2	26.3
1-Year Lending Rate	1.2	0.2	11	(28.7)	(87.6)
3-Year Lending Rate	0.6	0.1	6	(34.4)	(83.0)
Total	**606.0**	**100.0**	**6,021**	**6.4**	**(34.7)**

( ) = negative, PRC = People's Republic of China, q-o-q = quarter-on-quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate, y-o-y = year on year.
Sources: *AsianBondsOnline* and *ChinaMoney*.

ICBC, Bank of China (BoC), CBC, China Merchants Bank, and China Minsheng Bank to help facilitate the transfers.

PBOC Resumes Repo Auctions

On 18 February, the PBOC conducted its first repo auction in 8 months when it auctioned 14-day repurchase agreements at a rate of 3.8%. The total amount issued was CNY48 billion.

CIRC Relaxes Investment Limits for Insurance Companies

On 19 February, the China Insurance Regulatory Commission (CIRC) released new regulations regarding allowable investments for insurance companies. There will no longer be limits for fixed-income investments. Prior to this, fixed-income investing had some restrictions, such as investments only in corporate bonds with credit ratings of BBB and above, as well as a 40% limit in corporate bonds.

Limits on equity investments were also raised to 30%. Prior to this, the limits were 25% in listed equities, and 10% in unlisted equities and equity investment funds.

Banks Liquidity Coverage Ratio Requirement Increased

On 20 February, the China Banking Regulatory Commission (CBRC) announced new rules requiring banks to maintain a 100% Liquidity Coverage Ratio (LCR) by 2018 compared with the prior requirement of 60%. The LCR requirement will increase by 10% each year until reaching 100% in 2018.