

# Market Summaries

## People's Republic of China—Update

### Yield Movements

The People's Republic of China's (PRC) government bond yield curve shifted downward in October, reflecting expectations of an end to the monetary tightening efforts of the People's Bank of China (PBOC) (**Figure 1**). Yields declined the most on the shorter-end of the curve, falling between 34 basis points (bps) and 47 bps on all tenors of 1 year or less. For tenors longer than 2 years, yields fell 17 bps–30 bps.

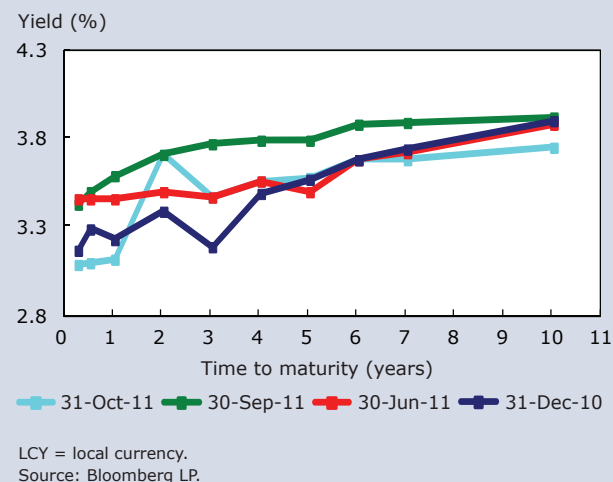
Due to a spike in the 2-year rate, the spread between 2- and 10-year government bonds narrowed to 4 bps at end-October. Excluding the 2-year rate, the yield curve exhibited overall steepening due to a much larger drop in shorter-term yields.

Inflation remained at elevated levels in the third quarter, with a slight tapering off in August and September. After hitting a high of 6.5% year-on-year (y-o-y) in July, inflation fell to 6.2% in August and 6.1% in September. Due to this slowdown in the inflation rate, the PBOC took measures to tighten the money supply only once in 3Q11, expanding the reserve requirement coverage to include margin deposits. Market expectations are for the PBOC to hold off on any further tightening measures given concerns over the eurozone's sovereign debt crisis and continued weakness in developed markets.

The PRC's gross domestic product (GDP) growth rate slowed to 9.1% y-o-y in 3Q11 from 9.5% in 2Q11. In addition, the trade surplus fell in August to US\$17.8 billion from US\$31.5 billion in July. The cumulative trade surplus for January–August fell 10.0% y-o-y to US\$92.7 billion.

New loans granted in July totaled CNY492.6 billion, down CNY25.2 billion from the same month last year.

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



New loans, however, were up in August compared with August 2010, reaching CNY548.5 billion for an annual increase of CNY9.3 billion. Meanwhile, liquidity growth also slowed in August. The M2 money supply expanded 13.5% y-o-y in August following 14.7% growth in July. The PBOC's money supply growth target for the year is 16.0%.

Risk aversion due to a possible Greek default caused turmoil in the financial markets. Central Huijin Investment, the PRC's investment arm, was forced to purchase shares in various PRC banks in October to mitigate the fall in stock market valuations.

### Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC market reached CNY20.7 trillion (US\$3.3 trillion) at end-September, representing a y-o-y increase of 3.5% and a quarter-on-quarter (q-o-q) rise of 0.5% (**Table 1**).

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

|                                  | Amount (billion) |       |        |       |        |       | Growth Rates (%) |       |        |       |        |        |        |       |        |        |        |
|----------------------------------|------------------|-------|--------|-------|--------|-------|------------------|-------|--------|-------|--------|--------|--------|-------|--------|--------|--------|
|                                  | Jun-11           |       | Jul-11 |       | Aug-11 |       | Sep-11           |       | Jun-11 |       | Jul-11 |        | Aug-11 |       | Sep-11 |        |        |
|                                  | CNY              | US\$  | CNY    | US\$  | CNY    | US\$  | CNY              | US\$  | y-o-y  | q-o-q | m-o-m  | y-o-y  | q-o-q  | m-o-m | y-o-y  | q-o-q  | m-o-m  |
| Total                            | 20,619           | 3,190 | 20,726 | 3,220 | 20,813 | 3,263 | 20,720           | 3,247 | 6.7    | 1.9   | 0.5    | 3.5    | 0.5    | 0.4   | 3.5    | 0.5    | 0.4    |
| Government                       | 15,773           | 2,440 | 15,811 | 2,456 | 15,871 | 2,488 | 15,788           | 2,474 | 1.0    | 1.0   | 0.2    | 0.4    | 0.1    | 0.4   | (0.7)  | 0.1    | (0.5)  |
| Treasury Bonds                   | 6,943            | 1,074 | 7,050  | 1,095 | 7,179  | 1,126 | 7,276            | 1,140 | 14.4   | 3.1   | 1.5    | 13.7   | 4.8    | 1.8   | 13.7   | 4.8    | 1.4    |
| Central Bank Bonds               | 2,785            | 431   | 2,550  | 396   | 2,385  | 374   | 2,116            | 331   | (41.3) | (7.2) | (8.4)  | (52.4) | (24.0) | (6.5) | (52.4) | (24.0) | (11.3) |
| Policy Bank Bonds                | 6,045            | 935   | 6,211  | 965   | 6,307  | 989   | 6,396            | 1,002 | 25.9   | 2.8   | 2.7    | 26.3   | 5.8    | 1.5   | 26.3   | 5.8    | 1.4    |
| Corporate                        | 4,846            | 750   | 4,916  | 764   | 4,942  | 775   | 4,932            | 773   | 30.8   | 4.7   | 1.4    | 20.0   | 1.8    | 0.5   | 20.0   | 1.8    | (0.2)  |
| <b>Policy Bank Bonds</b>         |                  |       |        |       |        |       |                  |       |        |       |        |        |        |       |        |        |        |
| China Development Bank           | 4,285            | 663   | 4,340  | 674   | 4,396  | 689   | 4,455            | 698   | 23.8   | 2.4   | 1.3    | 21.6   | 4.0    | 1.3   | 21.6   | 4.0    | 1.3    |
| Export-Import Bank of China      | 684              | 106   | 750    | 116   | 775    | 121   | 780              | 122   | 42.3   | 5.6   | 9.7    | 53.2   | 14.0   | 3.3   | 53.2   | 14.0   | 0.6    |
| Agricultural Devt. Bank of China | 1,077            | 167   | 1,122  | 174   | 1,137  | 178   | 1,162            | 182   | 25.6   | 2.8   | 4.2    | 30.2   | 7.9    | 1.3   | 30.2   | 7.9    | 2.2    |

LCY = local currency, m-o-m = month-on-month, 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.

Source: ChinaBond and Bloomberg LP.

LCY government bonds outstanding fell 0.7% y-o-y and grew only 0.1% q-o-q in 3Q11, while corporate bonds rose 20.0% y-o-y and 1.8% q-o-q. In the government sector, the y-o-y decline was due to a drop in central bank bonds outstanding, which fell 52.4% y-o-y and 24.0% q-o-q. In contrast, treasury bonds grew 13.7% y-o-y and 4.8% q-o-q, while policy bank bonds grew 26.3% y-o-y and 5.8% q-o-q.

The reduction in central bank bonds reflected the rise in commercial bank reserve requirements, which has forced the PBOC to reduce its repurchase (repo) sales. Also, demand for central bank bonds fell in 3Q11 in anticipation of monetary tightening.

## Corporate Bonds

Local corporate bonds grew 45.1% y-o-y and medium-term notes (MTNs) grew 37.2% in 3Q11, while state-owned corporate bonds grew only 4.0% (**Table 2**). Commercial paper outstanding fell 8.1% y-o-y and asset- and mortgage-backed securities outstanding fell 54.9% due to a lack of issuance since 4Q08.

On a q-o-q basis, most categories of outstanding corporate bonds fell with the exception of MTNs and local corporate bonds. Commercial paper fell 10.3% q-o-q, while commercial bank bonds fell 0.5% and state-owned corporate bonds fell 0.1%.

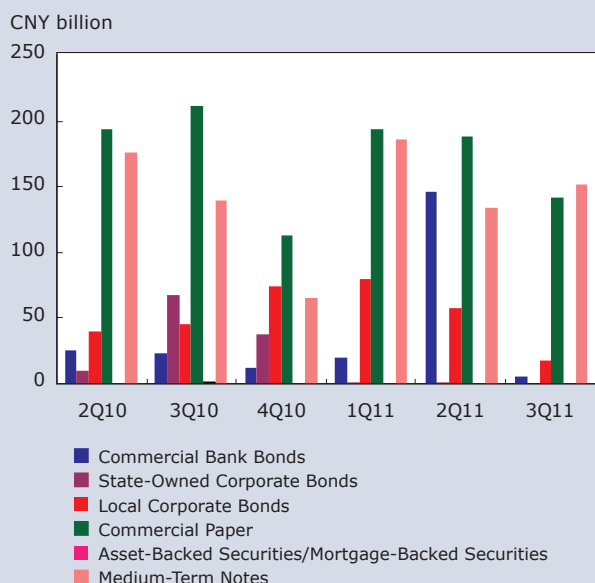
The amount of MTNs outstanding continued to grow rapidly in 3Q11 due to their ease of issuance and quick approval process compared to other forms of debt. In fact, MTNs consistently enjoyed double-digit q-o-q growth rates for several quarters prior to 4Q10. The decline in 3Q11 in amounts outstanding for most corporate bonds is likely the result of expectations of monetary tightening as well as the financial turmoil caused by concerns over a Greek default.

Issuance of corporate bonds slowed in 3Q11 from 2Q11 (**Figure 2**), with the exception of MTNs, due to market volatility. In particular, commercial bank

**Table 2: Corporate Bonds Outstanding in Key Sectors**

|                                   | Amount<br>(CNY billion) |         |         |         |         |         | Growth Rates (%) |        |        |       |        |        |
|-----------------------------------|-------------------------|---------|---------|---------|---------|---------|------------------|--------|--------|-------|--------|--------|
|                                   |                         |         |         |         |         |         | q-o-q            |        |        | y-o-y |        |        |
|                                   | 2Q10                    | 3Q10    | 4Q10    | 1Q11    | 2Q11    | 3Q11    | 3Q10             | 4Q10   | 1Q11   | 2Q11  | 3Q11   | 3Q11   |
| Commercial Bank Bonds             | 608.5                   | 609.0   | 609.5   | 625.0   | 758.8   | 755.2   | 0.1              | 0.1    | 2.5    | 21.4  | (0.5)  | 24.0   |
| State-Owned Corporate Bonds       | 781.1                   | 842.6   | 879.6   | 879.6   | 877.1   | 876.4   | 7.9              | 4.4    | –      | (0.3) | (0.1)  | 4.0    |
| Local Corporate Bonds             | 461.7                   | 501.3   | 569.4   | 653.1   | 714.1   | 727.3   | 8.6              | 13.6   | 14.7   | 9.3   | 1.9    | 45.1   |
| Commercial Paper                  | 615.4                   | 670.6   | 653.0   | 683.3   | 687.1   | 616.5   | 9.0              | (2.6)  | 4.6    | 0.6   | (10.3) | (8.1)  |
| Asset-/Mortgage-Backed Securities | 26.5                    | 21.9    | 18.2    | 10.8    | 10.1    | 9.9     | (17.2)           | (16.8) | (41.0) | (6.1) | (2.2)  | (54.9) |
| Medium-Term Notes                 | 1,151.2                 | 1,289.5 | 1,353.6 | 1,532.5 | 1,621.4 | 1,768.6 | 12.0             | 5.0    | 13.2   | 5.8   | 9.1    | 37.2   |

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

**Figure 2: Corporate Bond Issuance in Key Sectors, 2Q10–3Q11**

Source: *ChinaBond*.

bond issuances fell dramatically from 2Q11. In 2Q11, the bulk of commercial bank bond issuance was for capital raising efforts in anticipation of Basel III.

Only a handful of issuers dominate the PRC’s corporate bond market (**Table 3**). At end-October, the top 30 corporate bond issuers accounted for CNY2.85 trillion, or about 56%, of total corporate bonds outstanding.

Furthermore, the 10 largest corporate issuers accounted for CNY1.97 trillion, or nearly 69%, of this total.

State-owned companies (defined as majority-owned by the government) dominate the corporate bond market in the PRC. Among the top 30 corporate bond issuers, 24 are state-owned, with a total of CNY2.57 trillion worth of bonds outstanding.

## Investor Profile

**Treasury bonds.** Banks remain the largest category of investors in the PRC’s treasury bond market, holding a slightly larger share of these bonds at end-September (65%) than at end-June (64%) (**Figure 3**). The share held by the second largest group of holders, special members, dropped to 25% in September from 26% in June. Special members comprise the PBOC, Ministry of Finance, policy banks, China Government Securities Depository Trust and Clearing Co., and China Securities Depository and Clearing Corporation.

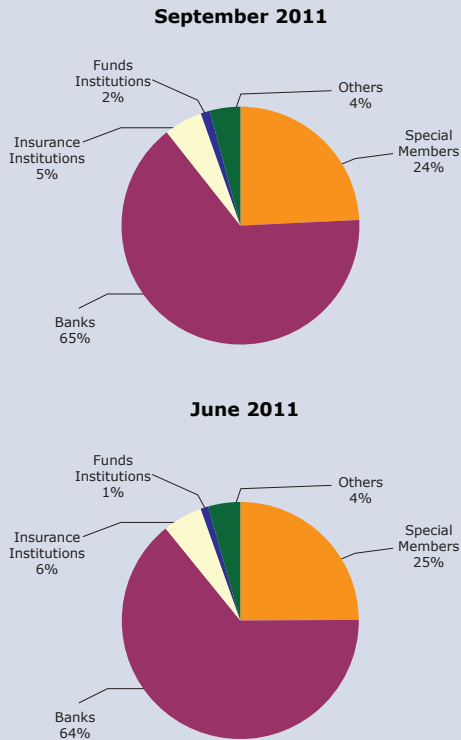
**Corporate bonds.** Banks remained the largest holder of corporate bonds in September (**Figure 4**). The share of most major investors remained unchanged with the exception of fund institutions, whose share of ownership increased to 20% in September from 19% in June, and insurance institutions, whose share declined to 21% from 22%.

**Table 3: Top 30 Issuers of LCY Corporate Bonds in the People's Republic of China** (as of October 2011)

| Issuers  | Outstanding Amount      |                          | State-Owned | Privately-Owned | Listed Company | Type of Industry      |
|--|-------------------------|--------------------------|-------------|-----------------|----------------|-----------------------|
|  | LCY Bonds (CNY billion) | LCY Bonds (US\$ billion) |             |                 |                |                       |
| 1. Ministry of Railways  | 593.0                   | 93.3                     | Yes         | No              | No             | Transportation        |
| 2. State Grid Corporation of China                                 | 259.5                   | 40.8                     | Yes         | No              | No             | Public Utilities      |
| 3. China National Petroleum  | 206.0                   | 32.4                     | Yes         | No              | No             | Energy                |
| 4. Bank of China   | 196.9                   | 31.0                     | Yes         | No              | Yes            | Banking               |
| 5. Industrial and Commercial Bank of China                         | 160.0                   | 25.2                     | Yes         | No              | Yes            | Banking               |
| 6. China Petroleum & Chemical                                      | 131.5                   | 20.7                     | Yes         | No              | Yes            | Energy                |
| 7. China Construction Bank   | 120.0                   | 18.9                     | Yes         | No              | Yes            | Banking               |
| 8. Central Huijin Investment                                       | 109.0                   | 17.2                     | Yes         | No              | No             | Diversified Financial |
| 9. Agricultural Bank of China                                      | 100.0                   | 15.7                     | Yes         | No              | Yes            | Banking               |
| 10. Petrochina   | 97.5                    | 15.3                     | Yes         | No              | Yes            | Energy                |
| 11. Bank of Communications   | 76.0                    | 12.0                     | No          | Yes             | Yes            | Banking               |
| 12. China Guodian  | 65.6                    | 10.3                     | Yes         | No              | No             | Public Utilities      |
| 13. Industrial Bank  | 62.1                    | 9.8                      | No          | Yes             | Yes            | Banking               |
| 14. China Three Gorges Project                                     | 51.5                    | 8.1                      | Yes         | No              | No             | Public Utilities      |
| 15. China Southern Power Grid                                      | 51.0                    | 8.0                      | Yes         | No              | No             | Public Utilities      |
| 16. Shenhua Group  | 48.4                    | 7.6                      | Yes         | No              | No             | Energy                |
| 17. China Huaneng Group  | 44.2                    | 7.0                      | Yes         | No              | No             | Public Utilities      |
| 18. China Telecom  | 40.0                    | 6.3                      | Yes         | No              | Yes            | Telecommunications    |
| 19. Citic Group  | 40.0                    | 6.3                      | Yes         | No              | No             | Diversified Financial |
| 20. State-Owned Capital Operation and Management Center of Beijing | 40.0                    | 6.3                      | Yes         | No              | No             | Diversified Financial |
| 21. Metallurgical Corporation of China                             | 39.6                    | 6.2                      | Yes         | No              | Yes            | Capital Goods         |
| 22. China Power Investment   | 39.1                    | 6.2                      | Yes         | No              | No             | Public Utilities      |
| 23. China Minsheng Bank  | 38.3                    | 6.0                      | No          | Yes             | Yes            | Banking               |
| 24. China United Network Communications                            | 38.0                    | 6.0                      | No          | Yes             | Yes            | Telecommunications    |
| 25. Shanghai Pudong Development Bank                               | 37.2                    | 5.9                      | No          | Yes             | Yes            | Banking               |
| 26. Shougang Group   | 37.0                    | 5.8                      | Yes         | No              | No             | Raw Materials         |
| 27. China Guangdong Nuclear Power Holding                          | 32.7                    | 5.1                      | Yes         | No              | No             | Public Utilities      |
| 28. COFCO  | 31.6                    | 5.0                      | Yes         | No              | No             | Retail                |
| 29. Aluminum Corporation of China                                  | 31.0                    | 4.9                      | Yes         | No              | Yes            | Raw Materials         |
| 30. China Merchants Bank   | 30.0                    | 4.7                      | No          | Yes             | Yes            | Banking               |
| <b>Total Top 30 LCY Corporate Issuers</b>                          | <b>2846.7</b>           | <b>448.0</b>             |             |                 |                |                       |
| <b>Total LCY Corporate Bonds</b>                                   | <b>5074.2</b>           | <b>772.9</b>             |             |                 |                |                       |
| <b>Top 30 as % of Total LCY Corporate Bonds</b>                    | <b>56%</b>              | <b>58%</b>               |             |                 |                |                       |

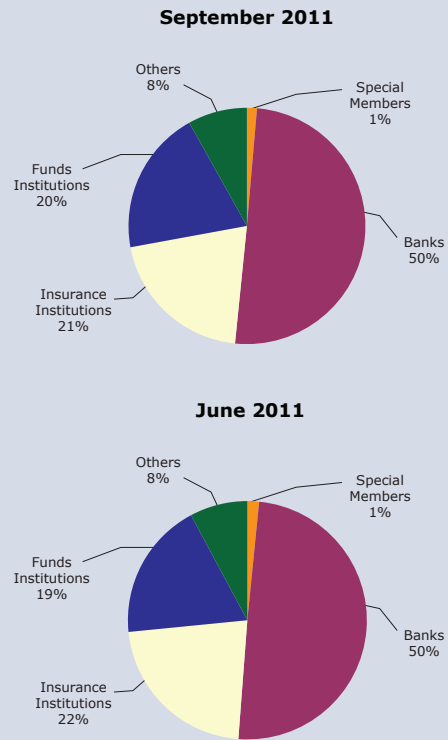
LCY = local currency.  
Source: Bloomberg LP and Wind.

**Figure 3: Treasury Bonds Investor Profile**



Source: ChinaBond.

**Figure 4: Corporate Bonds Investor Profile**



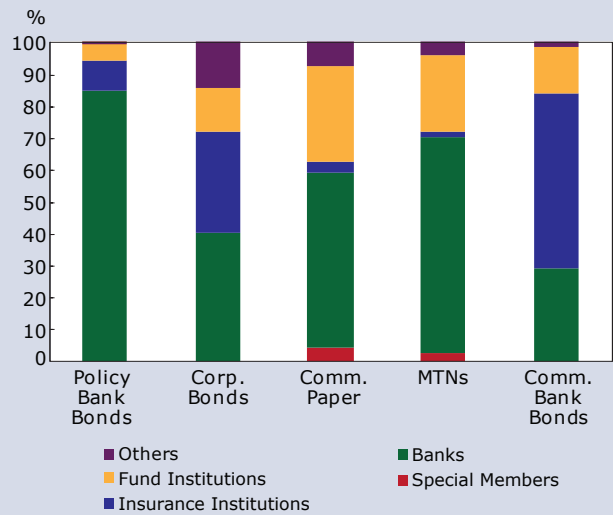
Source: ChinaBond.

**Figure 5** presents the investor profile across different bond categories, with banks as the largest holder of policy bank bonds at end-September, holding more than 80% of outstanding policy bank bonds. Meanwhile, insurance institutions were the largest holder of commercial bank bonds.

### Interest Rate Swaps

The total notional amount traded in the interest rate swap (IRS) market expanded 152.7% y-o-y and 19.5% q-o-q in 3Q11, reaching CNY789.8 billion at end-September on 6,332 transactions (**Table 4**). The 7-day repo rate remained the most widely used benchmark in 3Q11, accounting for 51.4% of the total notional amount traded. The overnight SHIBOR accounted for 35.3% of the total on significant growth of 567.4% y-o-y and 70.1% q-o-q. These two benchmarks advanced the most because the primary participants in the PRC’s onshore

**Figure 5: Investor Profile across Bond Categories** (as of September 2011)



MTNs = medium-term notes.  
 Note: Others includes security companies, non-bank financial institutions, individuals, and exchanges.  
 Source: ChinaBond.

**Table 4: Notional Values of the PRC's Interest Rate Swap Market**

| Interest Rate Swap Benchmarks | Notional Amount<br>(CNY billion) | % of Total Notional Amount | Number of Transactions | Growth Rate (%) |               |
|-------------------------------|----------------------------------|----------------------------|------------------------|-----------------|---------------|
|                               |                                  |                            |                        | 3Q11            |               |
| 7-Day Repo Rate               | 406.3                            | 51.4%                      | 4,163                  | 9.8%            | 101.9%        |
| Overnight SHIBOR              | 278.6                            | 35.3%                      | 1,100                  | 70.1%           | 567.4%        |
| 3-Month SHIBOR                | 81.7                             | 10.3%                      | 936                    | (9.6%)          | 48.4%         |
| 1-Year Term Deposit Rate      | 23.1                             | 2.9%                       | 124                    | (34.6%)         | 60.8%         |
| 6-Month Lending Rate          | 0.0                              | 0.0%                       | 1                      | (20.0%)         | -             |
| 1-Year Lending Rate           | 0.1                              | 0.0%                       | 8                      | 368.4%          | 18.7%         |
| <b>Total</b>                  | <b>789.8</b>                     | <b>100.0%</b>              | <b>6,332</b>           | <b>19.5%</b>    | <b>152.7%</b> |

- = not applicable, 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.  
Source: *ChinaMoney*, *Wind*, and *AsianBondsOnline*.

IRS market are commercial banks with funding exposure mainly in the form of repo transactions. Therefore, banks desire to use the repo rate as the base rate to hedge their funding.

## Policy, Institutional, and Regulatory Developments

### PBOC Expands Deposit Coverage for Reserve Requirement Ratios

On 29 August, the PBOC announced that for the purposes of calculating required reserves, margin deposits, such as those paid for issuing bankers' acceptances; letters of guarantee; and letters of credit would be included. The amount to be set aside as reserves will be divided over

stages to allow banks time to adjust, with the largest banks asked to set aside the reserves over three stages and smaller banks over six stages. The increase in reserves is estimated to be the equivalent of a 100 bps–150 bps hike in the reserve requirement ratio.

### Local Governments Allowed to Issue Bonds

On 20 October, the Ministry of Finance launched a trial program allowing four local governments to issue bonds directly. The four local authorities granted permission are the provinces of Guangdong and Zhejiang, and the municipalities of Shanghai and Shenzhen.