

Market Summaries

People's Republic of China

Yield Movements

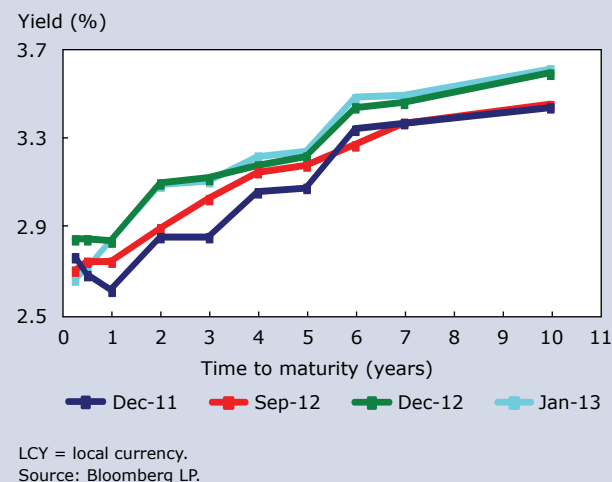
The government bond yield curve of the People's Republic of China (PRC) shifted upward from end-September to end-December, particularly at the shorter-end. Yields rose in 4Q12 between 9 basis points (bps) and 14 bps for tenors of 1-year or less. Meanwhile, yields rose 3 bps–17 bps between the 2- and 6-year tenors, and 9 bps–14 bps between the 7- and 10-year tenors (**Figure 1**). As a result of the rise in interest rates, particularly at the shorter-end of the curve, the yield curve flattened in 4Q12

The rise in yields in 4Q12 was primarily due to a rise in inflationary expectations. Inflation accelerated to 2.5% year-on-year (y-o-y) in December from 2.0% in November. Inflation was 1.7% in October. Inflation was 2.0% in January, but was tempered by a high base due to the Lunar New Year falling in January.

Seasonal factors also contributed to the rise in yields as banks hoarded cash in anticipation of increasing customer demand at year's end. In addition, economic data suggest improvement in the PRC's economy, putting further upward pressure on yields. In 4Q12, gross domestic product (GDP) growth moderately improved to 7.9% y-o-y from 7.4% in 3Q12.

In January, rates declined at the shorter-end of the curve amid improved liquidity as demand among bank customers eased. Interest rates also declined following the central bank's announcement that it would implement a new liquidity management tool using repurchase (repo) and reverse repo agreements of less than 7 days. Interest rates fell 13 bps–18 bps in January on tenors of less than 1 year. Meanwhile, between the belly and longer-

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



end of the curve, interest rates rose marginally between 2 bps and 4 bps. As a result, the yield curve steepened slightly, with the spread between the 2- and 10-year tenors rising to 52 bps at end-January from 49 bps at end-December.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC market reached CNY23.7 trillion (US\$3.8 trillion) at end-December, an increase of 11.2% y-o-y and 3.0% quarter-on-quarter (q-o-q), largely driven by growth in policy bank and corporate bonds (**Table 1**).

Government Bonds. LCY government bonds outstanding grew 8.0% y-o-y and 0.9% q-o-q in 4Q12, largely driven by the growth in policy bank bonds, which expanded 21.3% y-o-y and 3.3% q-o-q. Central bank bonds continued to act as a drag on government bond growth, falling 37.2% y-o-y and 16.2% q-o-q as a result of fewer

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

	Outstanding Amount (billion)						Growth Rates (%)									
	Sep-12		Oct-12		Nov-12		Dec-12		Sep-12		Oct-12		Nov-12		Dec-12	
	CNY	US\$	CNY	US\$	CNY	US\$	CNY	US\$	q-o-q	y-o-y	m-o-m	m-o-m	m-o-m	m-o-m	q-o-q	y-o-y
Total	23,046	3,667	23,263	3,730	23,462	3,768	3,811	3,811	4.6	11.2	0.9	0.9	0.9	1.2	3.0	11.2
Government	17,119	2,724	17,176	2,754	17,222	2,766	2,772	2,772	4.4	8.4	0.3	0.3	0.3	0.3	0.9	8.0
Treasury Bonds	7,915	1,259	7,980	1,279	8,017	1,288	8,074	1,296	5.5	8.8	0.8	0.5	0.5	0.7	2.0	9.3
Central Bank Bonds	1,597	254	1,564	251	1,462	235	1,338	215	(3.2)	(24.5)	(2.1)	(6.5)	(8.5)	(8.5)	(16.2)	(37.2)
Policy Bank Bonds	7,606	1,210	7,632	1,224	7,743	1,243	7,858	1,261	4.9	18.9	0.3	1.4	1.4	1.5	3.3	21.3
Corporate	5,927	943	6,086	976	6,240	1,002	6,477	1,040	5.0	20.2	2.7	2.5	2.5	3.8	9.3	20.8
Policy Bank Bonds																
China Development Bank	5,142	818	5,149	825	5,214	837	5,270	846	4.5	15.4	0.1	1.3	1.3	1.1	2.5	18.6
Export-Import Bank of China	1,008	160	1,026	165	1,078	173	1,112	178	8.4	29.2	1.8	5.1	5.1	3.1	10.3	33.4
Agricultural Devt. Bank of China	1,457	232	1,457	234	1,450	233	1,476	237	4.1	25.4	0.0	(0.5)	(0.5)	1.8	1.3	22.9

() = negative, 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.
5. The balance of outstanding commercial paper at end-December was zero as of 4Q12 based on *ChinaBond* data and CNY1.3 trillion on *Wind*.

Source: *ChinaBond* and Bloomberg LP.

sterilization activities and additional monetary easing by the People's Bank of China (PBOC). Meanwhile, treasury bonds increased 9.3% y-o-y and 2.0% q-o-q in 4Q12.

Corporate Bonds. Corporate bonds outstanding grew 20.8% y-o-y and 9.3% q-o-q in 4Q12 (**Table 2**). Growth was driven mainly by an increase in outstanding local corporate bonds. Commercial bank bonds grew 36.9% y-o-y in 4Q12, due largely to the carryover of issuance of subordinated notes in 2Q12 as banks sought to bolster their capital bases in advance of the PRC's implementation of Basel III capital adequacy requirements. While state-owned enterprise (SOE) bonds rose a modest 11.0% y-o-y in 4Q12, local corporate bonds and medium-term notes (MTNs) expanded significantly by 66.8% y-o-y and 26.2% y-o-y, respectively, during the same period. Also in 4Q12, asset-backed securities (ABS) continued to decline, falling 19.9% y-o-y due to a lack of issuance linked to a government decision to temporarily halt new issuance in 2008. In 4Q12, however, the ABS issuance program was resumed. On a q-o-q basis, local corporate bonds also showed the strongest growth among all types of corporate bonds in 4Q12 at 18.3%.

Overall issuance of corporate bonds was up in 4Q12 from 3Q12 levels (**Figure 2**), with the exception of MTNs. Issuance of commercial bank bonds was strong, matching its peak level reached in 4Q11.

A relatively small number of issuers dominate the PRC's corporate bond market (**Table 3**). At end-December, the top 30 corporate bond issuers accounted for CNY3.8 trillion worth of corporate bonds outstanding, or about 60% of the market. Among the top 30 corporate issuers, the 10 largest accounted for CNY2.5 trillion worth of bonds outstanding.

State-owned companies—defined as majority-owned by the government—continue to dominate the corporate bond market in the PRC. Among the top 30 corporate issuers at end-December, 23 were state-owned, with a total of CNY3.3 trillion worth of bonds outstanding.

Table 2: Corporate Bonds Outstanding in Key Sectors

	Outstanding Amount (CNY billion)						Growth Rates (%)					
							q-o-q				y-o-y	
	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	4Q11	1Q12	2Q12	3Q12	4Q12	4Q12
Commercial Bank Bonds	755	924	1,028	1,100	1,106	1,265	22.4	11.2	7.0	0.6	14.4	36.9
State-Owned Corporate Bonds	876	894	953	992	991	993	2.1	6.6	4.1	(0.1)	0.2	11.0
Local Corporate Bonds	727	782	876	987	1,103	1,305	7.5	12.0	12.6	11.8	18.3	66.8
Asset- and Mortgage-Backed Securities	10	10	9	8	8	8	(3.5)	(9.6)	(4.3)	-	(7.4)	(19.9)
Medium-Term Notes	1,769	1,974	2,030	2,129	2,340	2,492	11.6	2.8	4.9	9.9	6.5	26.2

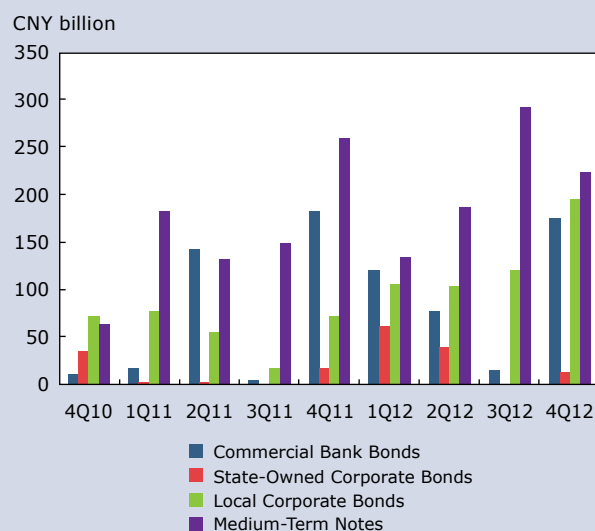
- = not available, () = negative, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Source: ChinaBond.

Investor Profile

Treasury Bonds. Banks remained the largest category of investors in the PRC's treasury bond market, holding a slightly larger share of these bonds at end-December 2012 (68%) than at end-December 2011 (66%) (**Figure 3a**). The shares held by special members fell to 22% from 24% during the same period. 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.

Policy Bank Bonds. Banks are also a significant holder of policy bank bonds (**Figure 3b**). At end-December, banks held 85% of outstanding policy bank bonds, up slightly from 84% a year earlier. Meanwhile, insurance institutions' holdings dropped slightly to 7% from 9% during the same time period.

Corporate Bonds. Banks were also the largest holder of corporate bonds at end-December, albeit with a comparatively smaller share than their holdings of treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 43% at end-December from 49% at end-December 2011 (**Figure 4**). The second largest holder of corporate bonds was insurance companies, with a 20% share at end-December, slightly lower than their 21% share at end-December 2011.

Figure 2: Corporate Bond Issuance in Key Sectors

Source: ChinaBond.

Figure 5 presents the investor profile across different bond categories. Banks were the largest holders of MTNs and policy bank bonds at end-December. Specifically, they held more than 80% of policy bank bonds outstanding. Meanwhile, insurance companies were the largest holder of commercial bank bonds.

Liquidity

Figure 6 presents the turnover ratio for government bonds, including both spot trading and repo trading volumes. The volume of repo trading is

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

Issuers	Outstanding Amount		State-Owned	Privately Owned	Listed Company	Type of Industry
	LCY Bonds (CNY billion)	LCY Bonds (US\$ billion)				
1. Ministry of Railways	742.0	119.1	Yes	No	No	Transportation
2. China National Petroleum	320.0	51.4	Yes	No	No	Energy
3. State Grid Corporation of China	309.5	49.7	Yes	No	No	Public Utilities
4. Industrial and Commercial Bank of China	230.0	36.9	Yes	No	Yes	Banking
5. Bank of China	219.9	35.3	Yes	No	Yes	Banking
6. China Construction Bank	200.0	32.1	Yes	No	Yes	Banking
7. China Petroleum & Chemical	154.7	24.8	Yes	No	Yes	Energy
8. Agricultural Bank of China	150.0	24.1	Yes	No	Yes	Banking
9. Central Huijin Investment	109.0	17.5	Yes	No	No	Diversified Financial
10. Shenhua Group	97.0	15.6	Yes	No	No	Energy
11. China Guodian	95.2	15.3	Yes	No	No	Public Utilities
12. Petrochina	87.5	14.0	Yes	No	Yes	Energy
13. China Minsheng Bank	82.3	13.2	No	Yes	Yes	Banking
14. Shanghai Pudong Development Bank	79.2	12.7	No	Yes	Yes	Banking
15. Bank of Communications	76.0	12.2	No	Yes	Yes	Banking
16. Industrial Bank	72.1	11.6	No	Yes	Yes	Banking
17. China Three Gorges Project	70.5	11.3	Yes	No	No	Public Utilities
18. China Life	68.0	10.9	Yes	No	Yes	Insurance
19. China Power Investment	61.8	9.9	Yes	No	No	Public Utilities
20. China Merchants Bank	61.7	9.9	No	Yes	Yes	Banking
21. State-Owned Capital Operation and Management Center of Beijing	58.5	9.4	Yes	No	No	Diversified Financial
22. Huaneng Power International	58.0	9.3	Yes	No	Yes	Public Utilities
23. China Southern Power Grid	54.0	8.7	Yes	No	No	Public Utilities
24. Citic Group	53.5	8.6	Yes	No	No	Diversified Financial
25. China United Network Communications	53.0	8.5	Yes	No	Yes	Telecommunications
26. China Everbright Bank	52.7	8.5	No	Yes	Yes	Banking
27. China Huaneng Group	52.2	8.4	Yes	No	No	Public Utilities
28. China Citic Bank	42.5	6.8	No	Yes	Yes	Banking
29. Shougang Group	42.0	6.7	Yes	No	No	Raw Materials
30. Metallurgical Corporation of China	39.6	6.4	Yes	No	Yes	Capital Goods
Total Top 30 LCY Corporate Issuers	3,792.4	608.7				
Total LCY Corporate Bonds	6,477.1	1,039.6				
Top 30 as % of Total LCY Corporate Bonds	58.6%	58.6%				

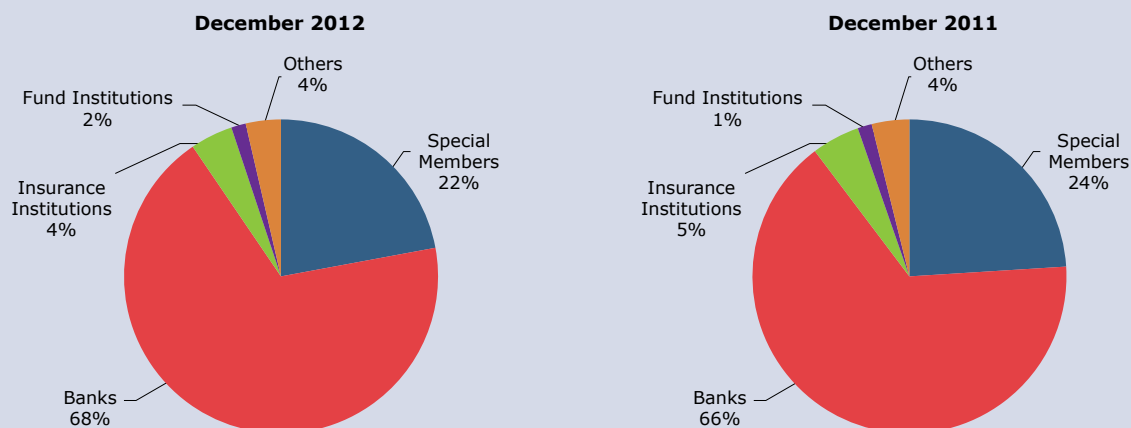
LCY = local currency.

Notes:

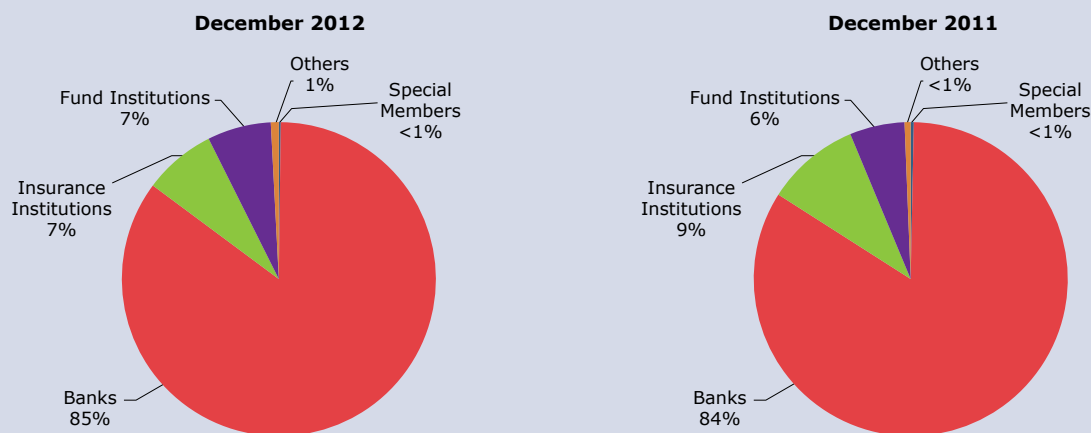
1. Data as of 31 December 2012.

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.

Figure 3a: LCY Treasury Bonds Investor Profile

LCY = local currency.
Source: ChinaBond.

Figure 3b: LCY Policy Bank Bonds Investor Profile

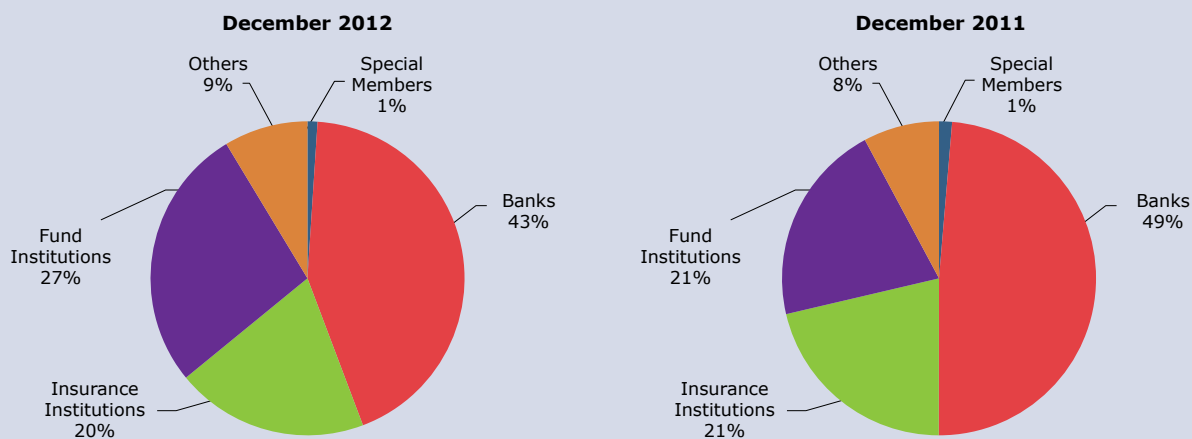
LCY = local currency.
Source: ChinaBond.

larger than that of spot trading in the PRC bond market, and the repo market is also the more active of the two. As of end-December, repo transactions for central bank bonds had the highest turnover rate among all government bonds outstanding. Turnover, however, for central bank bonds declined in 2012 with the lack of new issuance of central bank bonds and bills.

Interest Rate Swaps

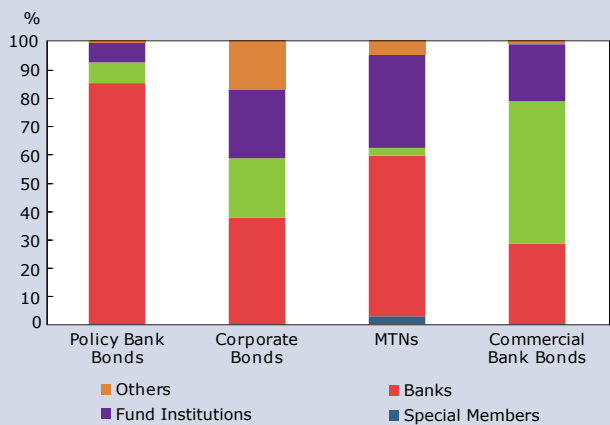
In 4Q12, the total notional amount of signed interest rate swap (IRS) agreements in the PRC reached CNY927.5 billion on 4,807 transactions (**Table 4**). Also during the quarter, the most popular benchmark switched from the 7-day repo rate, which accounted for 31.0% of the notional amount of signed IRS agreements, to the overnight Shanghai Interbank Offered Rate (SHIBOR), which accounted for 57.1% of the notional amount signed.

Figure 4: LCY Corporate Bonds Investor Profile



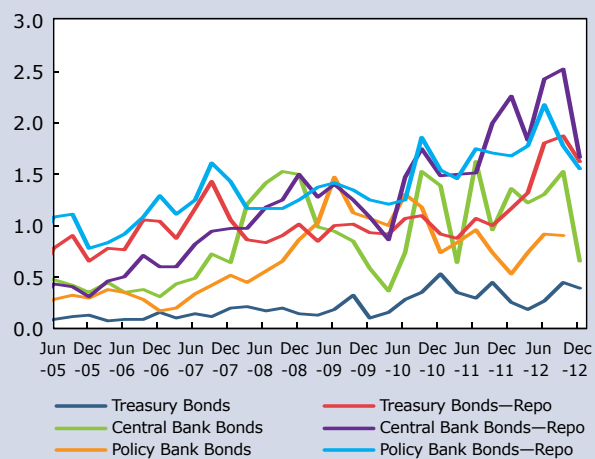
LCY = local currency.
Source: *ChinaBond*.

Figure 5: Investor Profile across Bond Categories



bps = basis points, MTNs = medium-term notes.
Note: Data as of 31 December 2012.
Source: *ChinaBond*.

Figure 6: Turnover Ratios for Government Bonds



Repo = repurchase.
Source: *ChinaBond*.

Policy, Institutional, and Regulatory Developments

The PRC to Implement Pilot Capital Monitoring System

On 5 December, the PRC announced that it would implement a pilot data system in the city of Dalian and the provinces of Liaoning, Zhejiang (except Ningbo), and Shaanxi that would update the government’s data collection system for capital

transactions. The program will cover capital account business processed by foreign exchange regulators and banks.

The PRC Mulls Increasing QFII and RQFII Quotas

On 15 January, the Chairman of the China Securities Regulatory Commission, Guo Shuqing, announced that the PRC plans to increase the quotas for Qualified Foreign Institutional

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

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions
7-Day Repo Rate	287.8	31.0	2,508
Overnight SHIBOR	529.2	57.1	1,092
3-Month SHIBOR	88.8	9.6	895
1-Year Term Deposit Rate	7.2	0.8	94
6-Month Lending Rate	0.04	0.0	4
1-Year Lending Rate	9.8	1.1	190
3-Year Lending Rate	3.8	0.4	16
5-Year Lending Rate	0.3	0.0	5
Above 5-Year Lending Rate	0.6	0.1	3
Total	927.5	100.0	4,807

- = 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.

Note: Data as of 31 December 2012.

Source: *AsianBondsOnline* and *ChinaMoney*.

Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII). The quotas could possibly be increased tenfold in the future, he said. Guo also said that the PRC will support two-way balanced portfolio investment, which would allow non-residents to diversify existing investments in the PRC.

PBOC to Use Short-Term Liquidity Operations to Manage Money Supply

On 21 January, the PBOC announced that it will begin using short-term liquidity operations as an additional tool to manage the money supply. The main tools will be repo and reverse repo agreements with maturities of less than 7 days.