

Market Summaries

People's Republic of China

Yield Movements

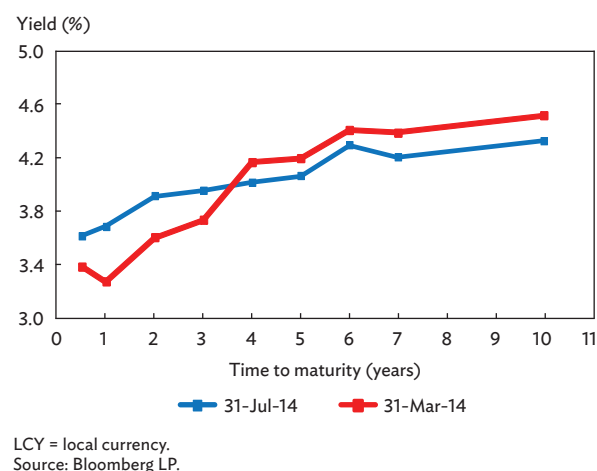
The government bond yield curve for the People's Republic of China (PRC) showed a mixed pattern between end-March and end-July (**Figure 1**). Yields at the shorter-end of the curve rose. Yields for tenors of 3-years or less rose between 22 basis points (bps) and 41 bps. Yields for longer tenors fell 11 bps–19 bps.

The rise in yields at the shorter-end was driven mostly by volatility in the PRC's money market. In 2Q14, the 7-day repo rate peaked on 30 April at 4.18% as a result of seasonal liquidity driven by the payment of taxes. Rates then fell and were relatively stable until rising again from end-June to end-July. The 7-day repo rates rose to 3.85% at end-June and further to 4.02% at end-July. The rate rise was due to a combination of increased demand for liquidity toward the middle of 2014 as well as market concerns over a repeat of the June 2013 SHIBOR shock event. In July, a number of initial public offerings also increased demand for liquidity.

At the longer-end of the curve, the decline in yields was driven by data indicating that the PRC's economic growth might be slowing. Gross domestic product (GDP) growth in 2Q14 was up marginally at 7.5% year-on-year (y-o-y) from 7.4% in 1Q14. In contrast, the PRC's GDP growth for full-year 2013 was 7.7%. Inflation in the PRC has also been modest. In July, the PRC reported consumer price inflation of 2.3%, the same rate as in June, but down from May's 2.5%.

While concerns over the PRC's economic growth exist, the government seems focused on rebalancing the economy and is concerned with potential asset bubbles in the real estate market and rising credit risk. Thus, the PRC has not yet engaged in any full-blown stimulus measures, but has preferred to use targeted stimulus measures to promote development of the agricultural sector and small- and medium-sized enterprises (SMEs). On 31 May, the PRC expanded reserve requirement cuts, which were originally targeted to rural banks and rural cooperatives, to include

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



other types of banks whose lending to the agricultural sector and SMEs reaches a certain level. Previously, on 22 April, the People's Bank of China (PBOC) cut the reserve requirement rate of rural banks and rural cooperatives by 200 bps and 50 bps, respectively. On 27 August, the PBOC increased relending quotas to the agricultural sector by CNY20 billion and decreased the relending rate by 100 bps.

There are also concerns regarding a slowdown in the country's property markets. In July, 64 out of 70 medium- and large-sized cities reported declines in the prices of newly constructed residential buildings. Also, 65 cities reported declines in prices of second-hand residential buildings.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC reached CNY30.2 trillion (US\$4.9 trillion) at end-June, an increase of 3.4% quarter-on-quarter (q-o-q) and 10.8% y-o-y, largely driven by growth in policy bank and local corporate bonds (**Table 1**).

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

	Outstanding Amount (billion)						Growth Rates (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	CNY	US\$	CNY	US\$	CNY	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	27,283	4,445	29,233	4,702	30,223	4,872	3.1	18.1	3.4	10.8
Government	17,830	2,905	19,002	3,056	19,625	3,164	1.5	8.7	3.3	10.1
Treasury Bonds	8,438	1,375	9,136	1,470	9,461	1,525	4.5	12.5	3.56	12.1
Central Bank Bonds	995	162	552	89	489	79	(26.0)	(39.7)	(11.4)	(50.8)
Policy Bank Bonds	8,397	1,368	9,313	1,498	9,675	1,560	3.1	15.8	3.9	15.2
Corporate	9,453	1,540	10,231	1,646	10,598	1,708	6.3	41.1	3.6	12.1
Policy Bank Bonds										
China Development Bank	5,525	900	5,988	963	6,217	1,002	1.9	12.3	3.8	12.5
Export-Import Bank of China	1,268	207	1,458	235	1,480	239	7.2	36.4	1.5	16.7
Agricultural Devt. Bank of China	1,604	261	1,867	300	1,978	319	4.1	14.5	5.9	23.3

() = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources. 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates.

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.

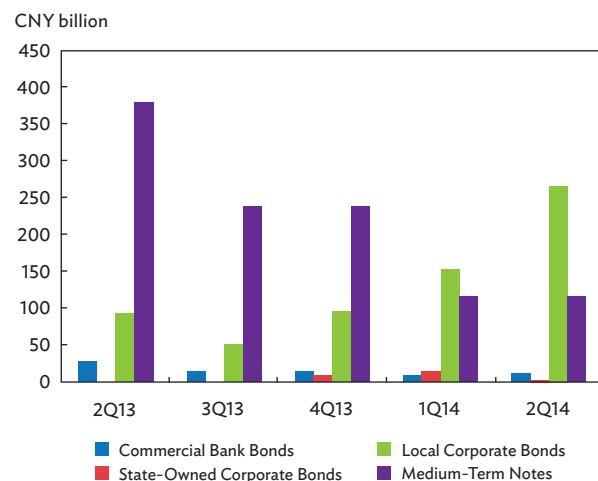
Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *AsianBondsOnline* estimates.

Government Bonds. LCY government bonds outstanding grew 3.3% q-o-q and 10.1% y-o-y in 2Q14, driven by growth in policy bank bonds. Central bank bonds continued to decline as the PBOC opted to use other tools, such as reverse repos, to manage liquidity.

Corporate Bonds. Corporate bonds outstanding grew 3.6% q-o-q and 12.1% y-o-y in 2Q14 to reach CNY10.6 trillion (Table 2). The bonds with positive growth rates were medium-term notes and local corporate bonds at 9.8% and 32.0% y-o-y, respectively. Outstanding commercial bank bonds were slightly lower in 2Q14 than in 1Q14, despite slightly higher issuance, due to more commercial bank bonds maturing.

LCY corporate bond issuance was the highest among the major corporate bond types in 2Q14 (Figure 2). However, overall issuance levels were lower compared to 2013 owing to the uncertainty in money markets.

Figure 2: Corporate Bond Issuance in Key Sectors



LCY = local currency.

Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *AsianBondsOnline* estimates.

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)				Growth Rate (%)				
	3Q13	4Q13	1Q14	2Q14	q-o-q				y-o-y
					3Q13	4Q13	1Q14	2Q14	2Q14
Commercial Bank Bonds	1,299	1,294	1,287	1,264	(2.2)	(0.4)	(0.5)	(1.8)	(4.9)
SOE Bonds	647	630	635	618	(0.9)	(2.6)	0.8	(2.7)	(5.3)
Local Corporate Bonds	1,626	1,702	1,833	2,085	2.9	4.7	7.7	13.7	32.0
Medium Term Notes	3,721	3,848	3,841	3,867	5.7	3.4	(0.2)	0.7	9.8

() = negative, -- = not applicable, q-o-q = quarter-on-quarter, SOE = state-owned enterprise, y-o-y = year-on-year.

Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *AsianBondsOnline* estimates.

At the end of 2Q14, the top 30 corporate bond issuers accounted for CNY4.1 trillion worth of corporate bonds outstanding, or about 39% of the market (**Table 3**). 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 2Q14. Among the top 30 corporate issuers at end-June, 21 were state-owned.

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	144.44	Yes	No	Transportation
2.	State Grid Corporation of China	354.5	57.15	Yes	No	Public Utilities
3.	China National Petroleum	340.0	54.81	Yes	No	Energy
4.	Industrial and Commercial Bank of China	233.0	37.56	Yes	Yes	Banking
5.	Bank of China	224.9	36.26	Yes	Yes	Banking
6.	China Construction Bank	205.0	33.05	Yes	Yes	Banking
7.	Agricultural Bank of China	153.0	24.67	Yes	Yes	Banking
8.	China Minsheng Bank	134.7	21.71	No	Yes	Banking
9.	Central Huijin Investment	112.3	18.10	Yes	No	Diversified Financial
10.	Industrial Bank	109.0	17.57	No	Yes	Banking
11.	Senhua Group	106.0	17.09	Yes	No	Energy
12.	China Power Investment	102.3	16.49	Yes	No	Public Utilities
13.	Petrochina	97.0	15.64	Yes	Yes	Energy
14.	China Petroleum & Chemical	89.6	14.44	Yes	Yes	Energy
15.	Shanghai Pudong Development Bank	89.0	14.35	No	Yes	Banking
16.	China Guodian	82.2	13.25	Yes	No	Public Utilities
17.	China Southern Power Grid	77.5	12.49	Yes	No	Public Utilities
18.	China Life	71.0	11.45	Yes	Yes	Insurance
19.	China Merchants Bank	68.5	11.04	No	Yes	Banking
20.	China Three Gorges Project	68.0	10.96	Yes	No	Public Utilities
21.	Bank of Communications	64.7	10.43	No	Yes	Banking
22.	China Citic Bank	60.5	9.75	No	Yes	Banking
23.	Tianjin Infrastructure Investment Group	60.0	9.67	Yes	No	Capital Goods
24.	China Everbright Bank	55.0	8.87	No	Yes	Banking
25.	Shanxi Coal and Chemical Industry Group	52.7	8.50	No	Yes	Energy
26.	Beijing State-owned Assets Operation & Management Center	49.5	7.98	Yes	No	Diversified Financial
27.	Tianjin Binhai New Area Construction & Investment Group	47.8	7.71	Yes	No	Engineering and Construction
28.	China Huaneng Group	44.7	7.21	Yes	No	Public Utilities
29.	Citic Group	43.5	7.01	Yes	No	Diversified Financial
30.	Bank of Beijing	43.0	6.93	No	Yes	Banking
Total Top 30 LCY Corporate Issuers		4,134.94	666.59			
Total LCY Corporate Bonds		10,597.50	1,708.42			
Top 30 as % of Total LCY Corporate Bonds		39.0%	39%			

LCY = local currency.

Notes:

1. Data as of end-June 2014.

2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.

Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 4 presents the most significant issuances of 2Q14.

Table 4: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway		
20-year bond	7.58	20
20-year bond	5.70	20
15-year bond	5.26	15
15-year bond	5.42	15
15-year bond	5.26	15
Shenhua Group		
5-year bond	5.15	20

LCY = local currency.
Source: Bloomberg LP.

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 treasury bonds at end-June (76.7%) than in the same period last year (77.7%) (**Figure 3**).

Corporate Bonds. Banks were also the largest holders of corporate bonds at the end of 2Q14, albeit with a comparatively smaller share than their holdings of treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 28.9% at the end of 2Q14 from 31.3% in 2Q13 (**Figure 4**). The second largest holders of

corporate bonds were insurance companies, with a 13.1% share at the end of 2Q14, down from a 16.1% share in the prior year.

Figure 5 presents investor profiles across corporate bond categories for the latest period for which data are available (2Q14). Banks were the largest holders of medium-term notes at end-June 2014 with more than 50% of the total. Meanwhile, insurance companies were the largest holders of commercial bank bonds.

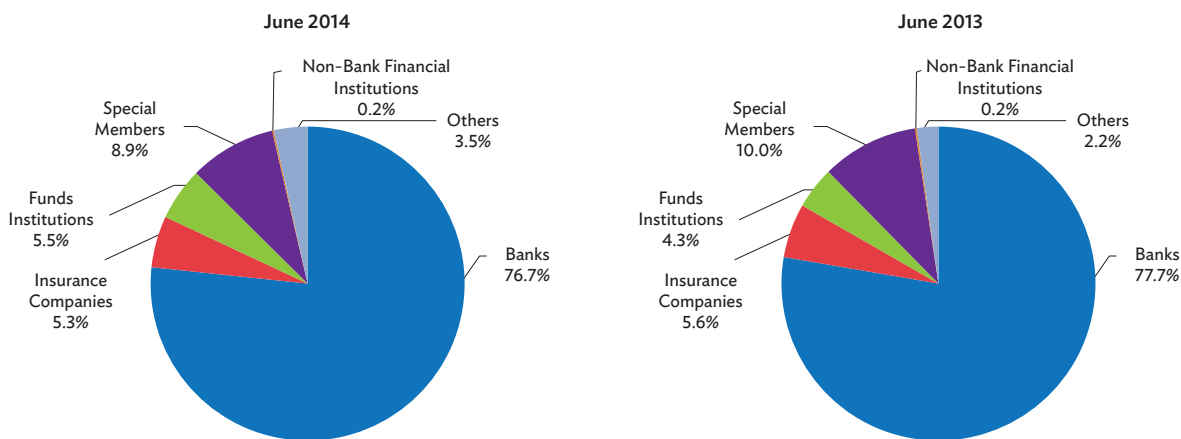
Liquidity

Figure 6 presents the turnover ratios for different categories of government bonds, which have seen a significant decline since 2013 owing to the tight liquidity conditions driven by the June 2013 SHIBOR shock and a crackdown on illegal bond trades. However, 2Q14 saw an increase in turnover ratios from 1Q14 due to increased trading as yields fell, particularly for longer-tenored bonds.

Interest Rate Swaps

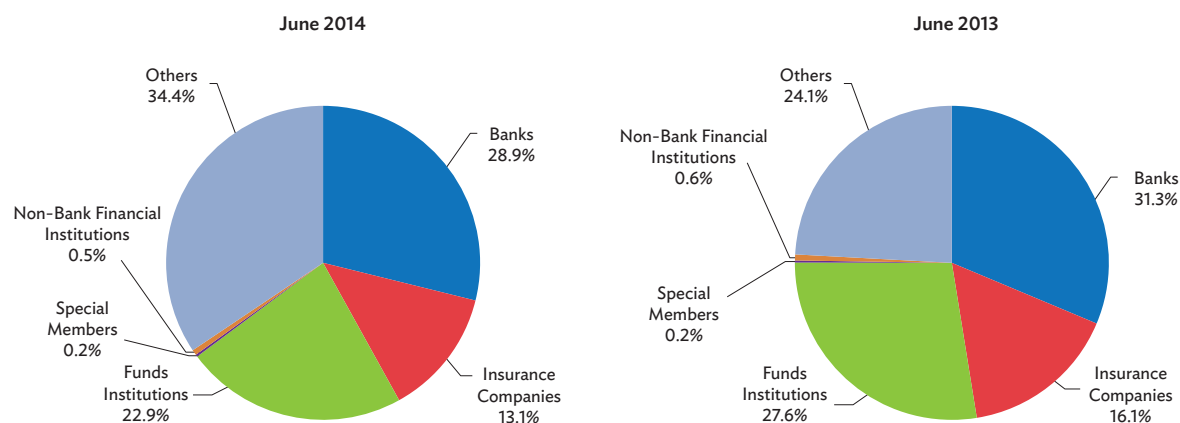
In 2Q14, the total notional amount of signed interest rate swap agreements in the PRC reached CNY894.2 billion on 9,292 transactions (**Table 5**). The most popular benchmark is the 7-day repo, which accounts for 73% of all transactions.

Figure 3: LCY Treasury Bonds Investor Profile



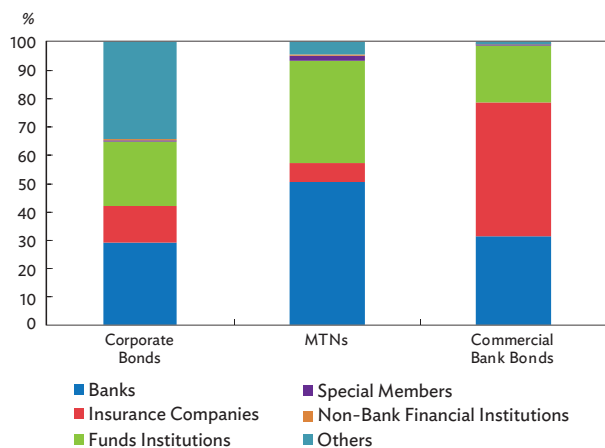
LCY = local currency.
Source: ChinaBond.

Figure 4: LCY Corporate Bonds Investor Profile



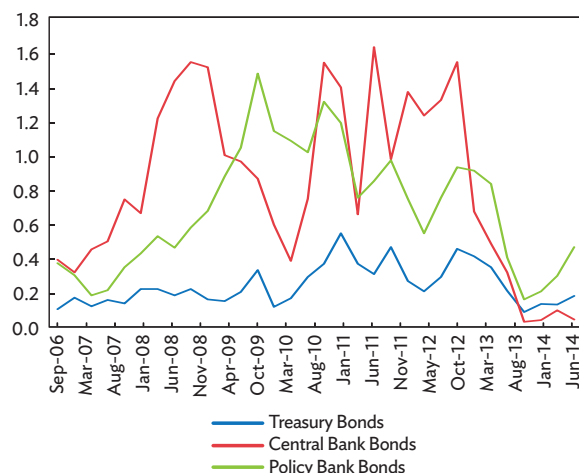
LCY = local currency.
Source: ChinaBond.

Figure 5: Investor Profile across Bond Categories



MTNs = medium-term notes.
Note: Data as of end-June 2014.
Source: ChinaBond.

Figure 6: Turnover Ratios for Government Bonds



Source: ChinaBond.

Policy, Institutional, and Regulatory Developments

Local Government Issuance Program Launched

On 29 May, the PRC launched a pilot program allowing 10 local government units to issue bonds directly. A similar pilot program was to have been launched before, but was scrapped over concerns about mounting local government debt. On 23 June, Guangdong issued the first local government bonds under the pilot program,

auctioning 5-, 7-, and 10-year bonds for an aggregate amount of CNY14.8 billion.

The PRC Expands Coverage of Targeted Ratio Cuts

On 31 May, the PBOC announced that it would extend a reserve requirement ratio cut, originally targeted to state-level rural banks and rural cooperatives, to include other types of banks with a certain level of loans to the agricultural industry and SMEs.

Table 5: Notional Values of the PRC's Interest Rate Swap Market in 2Q14

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions	Growth Rate (%)
				q-o-q
7-Day Repo Rate	656.3	73.4	8,040	(2.7)
Overnight SHIBOR	140.6	15.7	231	243.4
3-Month SHIBOR	87.5	9.8	939	11.2
1-Year Term Deposit Rate	5.1	0.6	74	(22.8)
LIBOR	0.5	0.1	2	(80.6)
1-Year Lending Rate	3.7	0.4	2	96.8
LPR1Y	0.1	0.0	2	(50.0)
3-Year Lending Rate	0.2	0.0	1	-
5-Year Lending Rate	0.2	0.0	1	-
Total	894.2	100.0	9,292	6.4

(-) = negative, - = not available, PRC = People's Republic of China, q-o-q = quarter-on-quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
Note: Growth rate computed based on national amounts.

Sources: *AsianBondsOnline* and *ChinaMoney*.

The PRC Pursues Measures to Promote Agricultural Sector

On 28 August, the PBOC announced an increase in its re-lending quota by CNY20 billion to help support the agricultural industry and rural financial institutions. The relending facility allows financial institutions to provide loans to various sectors from funds provided by the PBOC. In addition, the PBOC said that qualified rural financial institutions availing of the facility will be charged 100 bps less than the preferential rate for agricultural loans.