

Market Summaries

People's Republic of China

Yield Movements

Yields rose for most tenors on the People's Republic of China (PRC) government bond yield curve between end-June and end-September (**Figure 1**). The biggest increase was for the 1-year tenor, with the yield rising 37 basis points (bps). Yields rose between 3 bps and 15 bps for all remaining tenors, with the exception of the 6-year and 10-year tenors, which declined.

The PRC's yield curve actually rose between end-June and end-August, mostly reflecting demand for funds in the PRC's money markets. In July and August, rates were higher because of seasonal demand for cash due to tax payments and a number of large initial public offerings that temporarily locked up liquidity.

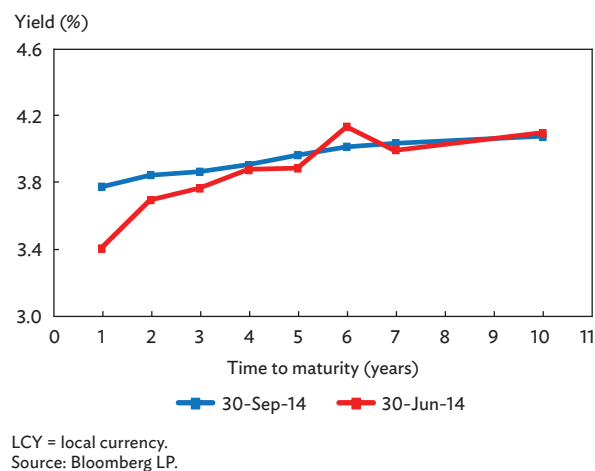
As a measure of funding demand, the 7-day repo rate was 3.40% on 3 July and rose to 3.98% by end-July. The month of August showed some volatility, with the 7-day rate dipping to 3.65% on 5 August before rising again to 3.70% by end-August.

The PRC's bond yield curve shifted downward from end-August to end-September, falling between 3 bps and 28 bps along the length of the curve. The 1-year rate remained somewhat elevated in advance of the holidays in the first week of October.

The downward shifting of the yield curve from end-August to end-September mostly reflected sentiments that the PRC's economy is weakening. The PRC's gross domestic product (GDP) growth in 3Q14 fell to 7.3% year-on-year (y-o-y) from 7.5% in the prior quarter. Inflation in the PRC has been showing a gradual decline as well, with September's inflation rate falling to 1.6% y-o-y from 2.0% in August.

In addition, there are concerns over the PRC's property market. September property data showed that new home prices fell for the fifth consecutive month, with only one out of 70 cities not showing a decline in average prices. The PRC has tried to ease some property market

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



conditions by reducing the down payment required for second-home buyers with no existing mortgages to 30% from 60%.

While the PRC has not engaged in any broad-based stimulus—preferring fine-tuning measures such as providing stimulus to small and medium-sized enterprises, and the agricultural sector—some market participants speculate that the PRC will eventually be forced to adjust interest rates.

More recently, during a State Council executive meeting, Premier Li Keqiang said that the council would focus on boosting the economy's consumption growth. Six areas were identified as particularly important: the Internet, sustainable energy, housing, tourism, education, and social security.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC reached CNY31.6 trillion (US\$4.8 trillion) at end-June, an increase of 3.7% quarter-on-quarter (q-o-q) and 13.4% 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 (%)			
	3Q13		2Q14		3Q14		3Q13		3Q14	
	CNY	US\$	CNY	US\$	CNY	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	27,853	4,550	30,462	4,911	31,578	5,143	2.1	13.6	3.7	13.4
Government	18,117	2,960	19,625	3,164	20,354	3,315	1.6	5.8	3.7	12.3
Treasury Bonds	8,895	1,453	9,461	1,525	10,015	1,631	5.4	12.4	5.86	12.6
Central Bank Bonds	564	92	489	79	468	76	(43.3)	(64.8)	(4.3)	(17.0)
Policy Bank Bonds	8,658	1,415	9,675	1,560	9,870	1,608	3.1	13.8	2.0	14.0
Corporate	9,736	1,591	10,837	1,747	11,224	1,828	3.0	31.7	3.6	15.3
Policy Bank Bonds										
China Development Bank	5,678	928	6,217	1,002	6,240	1,016	2.8	10.4	0.4	9.9
Export-Import Bank of China	1,277	209	1,480	239	1,542	251	0.7	26.7	4.2	20.8
Agricultural Devt. Bank of China	1,703	278	1,978	319	2,088	340	6.2	16.9	5.6	22.6

() = 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.

Sources: *ChinaBond* and *Wind*.

Government Bonds. LCY government bonds outstanding grew 3.7% q-o-q and 12.3% y-o-y in 3Q14, driven by growth in policy bank bonds and Treasury bonds. Central bank bonds continued to decline as the People's Bank of China (PBOC) opted to use other tools to manage liquidity (e.g., reverse repos). Treasury bond growth in 3Q14 received a significant boost due to an increase in local government bonds outstanding, which rose 25.0% q-o-q to CNY1.2 trillion. The increase in local government bonds outstanding was due to a number of factors including a slowdown in local government revenues due to a weakening property market, and the renovation of shantytowns as part of the PRC's urbanization process. In addition, new changes implemented by the PRC allow local governments to issue bonds directly, while limiting the use of local government financing and corporate vehicles.

Corporate Bonds. Corporate bonds outstanding grew 3.6% q-o-q and 15.3% y-o-y in 3Q14 to reach

CNY11.2 trillion (**Table 2**). Bonds with strong positive growth rates were those issued by banks and insurance companies, and local corporates, rising 18.2% and 37.3% y-o-y, respectively. The strong growth in financial bonds was mostly due to issuance of subordinated bonds by banks in 3Q14 to boost capital ratios.

Overall corporate bond issuance was strong in 3Q14. While corporate issuance was lower in 3Q14 versus 2Q14, issuance was still high compared with prior quarters (**Figure 2**). Driving the growth was rise in bonds issued by banks and insurance companies. The primary driver was subordinated debt issued by banks as part of their capital raising efforts in line with Basel III requirements. LCY corporate bond issuance was the highest among the major corporate bond types in 3Q14.

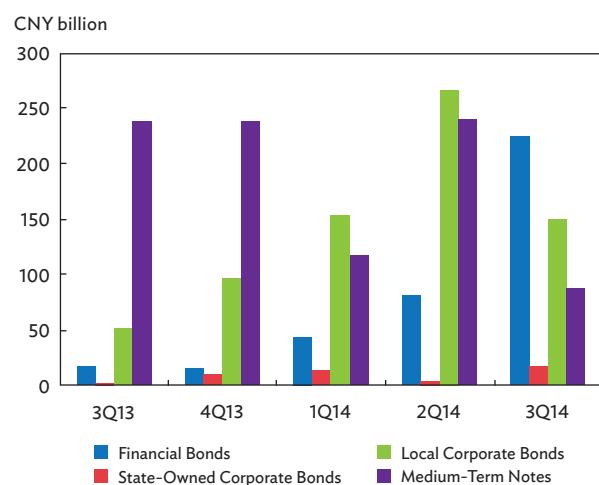
A relatively small number of issuers dominate the PRC's corporate bond market (**Table 3**). At the end of

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)				Growth Rate (%)				
	4Q13	1Q14	2Q14	3Q14	q-o-q				y-o-y
					4Q13	1Q14	2Q14	3Q14	3Q14
Financial Bonds	1,295	1,324	1,369	1,536	(0.3)	2.2	3.4	12.2	18.2
SOE Bonds	630	635	618	630	(2.6)	0.8	(2.7)	1.8	(2.7)
Local Corporate Bonds	1,702	1,833	2,085	2,231	4.7	7.7	13.7	7.0	37.3
Medium Term Notes	3,848	3,841	3,985	4,054	3.4	(0.2)	3.7	1.7	9.0

() = negative, q-o-q = quarter-on-quarter, SOE = state-owned enterprise, y-o-y = year-on-year.

Sources: *ChinaBond* and *Wind*.

Figure 2: Corporate Bond Issuance in Key Sectors

LCY = local currency.
Sources: ChinaBond.

3Q14, the top 30 corporate bond issuers accounted for CNY4.2 trillion worth of corporate bonds outstanding, or about 38% 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 3Q14. Among the top 30 corporate issuers at end-September, 23 were state-owned.

Table 4 presents the most significant issuances of 3Q14. The largest issuances came from banks issuing subordinated debt.

Investor Profile

Treasury Bonds and Policy Bank 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-September (76.2%) than in the same period a year earlier (77.3%) (**Figure 3**).

Corporate Bonds. Banks were also the largest holders of corporate bonds at the end of 3Q14, 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 3Q14 from 30.7% a year earlier (**Figure 4**). The second-largest

holders of corporate bonds were funds institutions, with a 22.9% share at the end of 3Q14, down from a 25.4% share a year earlier.

Figure 5 presents investor profiles across corporate bond categories at end-September. Banks were the largest holders of medium-term notes at end-September 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, 3Q14 showed a slowdown in the increase in the turnover ratios from the prior quarter, mostly due to the volatile interest rates as some traders adopted a wait-and-see attitude regarding the direction of the PRC economy and PBOC actions.

Policy, Institutional, and Regulatory Developments

Property Companies Allowed to Issue Medium-Term Notes

On 3 September, the PRC allowed qualified, listed property companies to issue medium-term notes on the interbank bond market. Funding from the notes can be used for new residential projects, operating cash flows, or bank loan repayment. The funds cannot be used for land purchases.

New Regulations to Manage Local Government Debt Risks

On 2 October, the State Council of the PRC passed new regulations governing local government debt. Under the new rules, local governments can now issue bonds directly subject to a quota. There are other restrictions such as the requirement that funding raised from bond issuances by local governments cannot be used to pay for existing government operations. It can only be used to repay debt servicing and to fund public services. In addition, local governments are no longer allowed to issue bonds through special funding vehicles or local-government-owned corporations.

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	1,017.5	165.73	Yes	No	Transportation
2.	State Grid Corporation of China	415.5	67.68	Yes	No	Public Utilities
3.	China National Petroleum	380.0	61.90	Yes	No	Energy
4.	Industrial and Commercial Bank of China	203.4	33.13	Yes	Yes	Banking
5.	Bank of China	182.3	29.70	Yes	Yes	Banking
6.	China Construction Bank	158.0	25.74	Yes	Yes	Banking
7.	Agricultural Bank of China	155.0	25.25	Yes	Yes	Banking
8.	China Minsheng Bank	115.1	18.75	No	Yes	Banking
9.	Central Huijin Investment	109.0	17.75	Yes	No	Diversified Financial
10.	China Power Investment	107.7	17.54	Yes	No	Public Utilities
11.	Senhua Group	101.5	16.53	Yes	No	Energy
12.	Bank of Communications	93.5	15.23	No	Yes	Banking
13.	Petrochina	91.0	14.82	Yes	Yes	Energy
14.	China Citic Bank	90.5	14.74	No	Yes	Banking
15.	China Petroleum & Chemical	87.5	14.25	Yes	Yes	Energy
16.	China Guodian	84.4	13.74	Yes	No	Public Utilities
17.	Industrial Bank	83.0	13.52	No	Yes	Banking
18.	Tianjin Infrastructure Investment Group	69.1	11.26	Yes	No	Capital Goods
19.	China Life	68.0	11.08	Yes	Yes	Insurance
20.	China Southern Power Grid	66.9	10.90	Yes	No	Public Utilities
21.	China Three Gorges Project	62.5	10.18	Yes	No	Public Utilities
22.	Beijing State-owned Assets Operation & Management Center	60.5	9.85	Yes	No	Diversified Financial
23.	Shanghai Pudong Development Bank	60.4	9.84	No	Yes	Banking
24.	China Huaneng Group	56.6	9.22	Yes	No	Public Utilities
25.	China Datang	55.7	9.07	Yes	No	Energy
26.	Shanxi Coal and Chemical Industry Group	54.5	8.88	No	Yes	Energy
27.	China Everbright Bank	52.9	8.62	Yes	Yes	Banking
28.	China Merchants Bank	50.0	8.14	No	Yes	Banking
29.	Tianjin Binhai New Area Construction & Investment Group	49.9	8.13	Yes	No	Engineering and Construction
30.	Beijing Infrastructure Investment	46.6	7.59	Yes	No	Institutional Financial Services
Total Top 30 LCY Corporate Issuers		4,228.39	688.73			
Total LCY Corporate Bonds		11,224.25	1,828.23			
Top 30 as % of Total LCY Corporate Bonds		37.7%	37.7%			

LCY = local currency.

Notes:

1. Data as of end-September 2014.

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

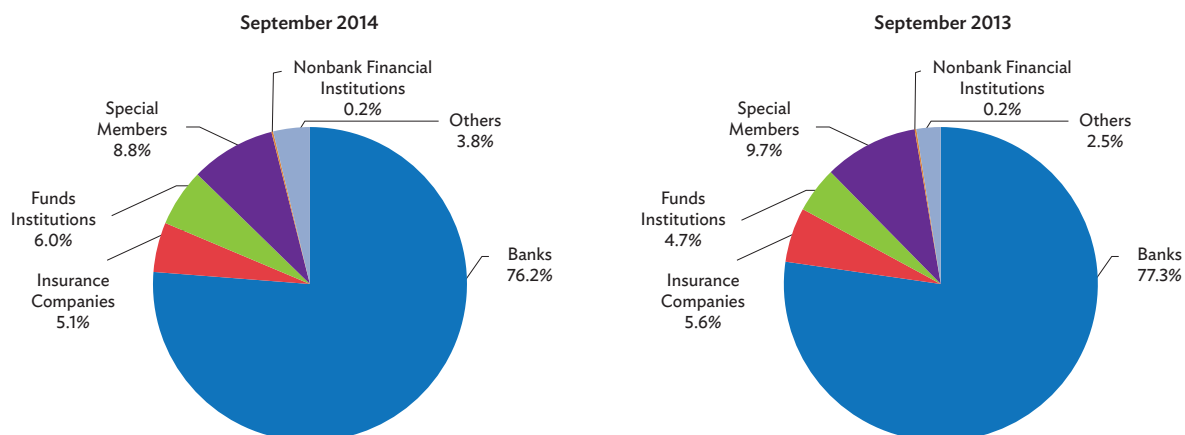
Source: AsianBondsOnline calculations based on Wind data.

Table 4: Notable LCY Corporate Bond Issuance in 3Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China CITIC Bank 10-year bond	6.13	37
Bank of China 10-year bond	5.8	30
Agricultural Bank of China 10-year bond	5.8	30
Bank of Communications 10-year bond	5.8	28
Industrial and Commercial Bank of China 10-year bond	5.8	20

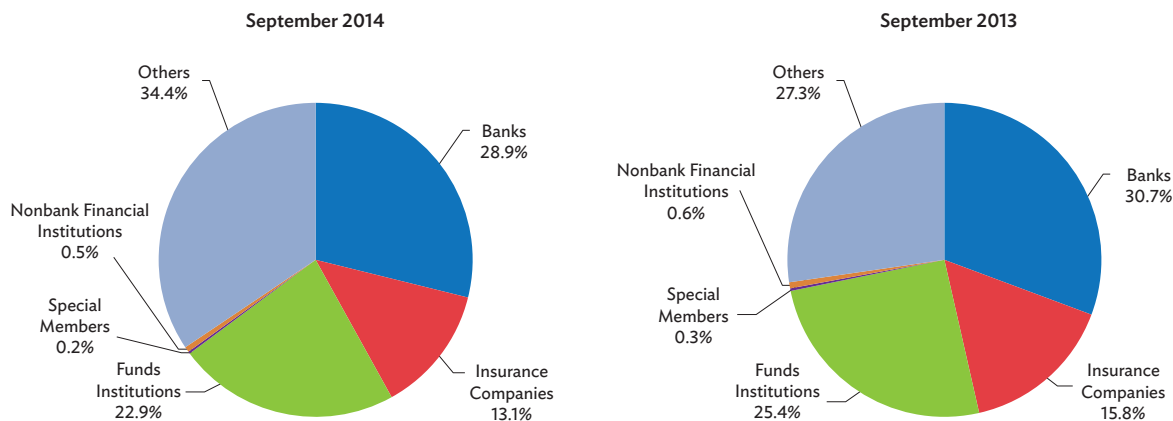
LCY = local currency.
Source: Bloomberg LP.

Figure 3: LCY Treasury Bonds and Policy Bank Bonds Investor Profile



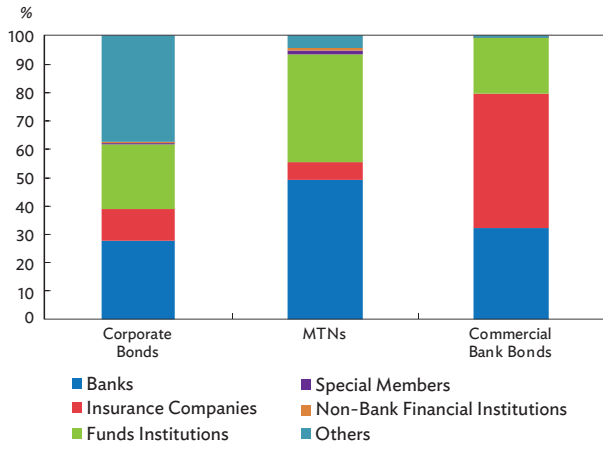
LCY = local currency.
Source: ChinaBond.

Figure 4: LCY Corporate Bonds Investor Profile



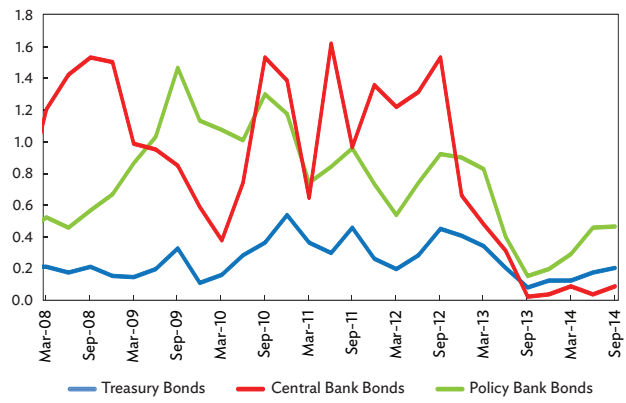
LCY = local currency.
Source: ChinaBond.

Figure 5: Investor Profile across Bond Categories



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

Figure 6: Turnover Ratios for Spot Market



Source: ChinaBond.