

Market Summaries

People's Republic of China

Yield Movements

From 1 September to 15 October, the local currency (LCY) government bond yield curve in the People's Republic of China (PRC) fell between 5 basis points (bps) and 31 bps for all tenors of 3 years or longer (**Figure 1**). On the other hand, yields for the 1-year and 2-year tenors rose 9 bps and 13 bps, respectively. The 2-year versus 10-year yield spread fell to 38 bps from 82 bps as a result.

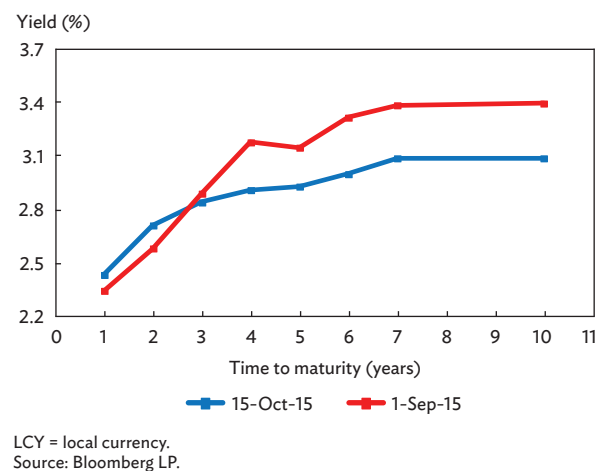
The PRC's yield curve shifted downward at the long-end due to weaker economic growth. Gross domestic product growth fell to 6.9% year-on-year (y-o-y) in 3Q15, compared with growth of 7.0% y-o-y in 2Q15 and 7.4% in full-year 2014. Profits among large industries fell 0.1% y-o-y in September. Investor sentiment has also been affected by the weakening economy, with the growth of private investment in fixed assets falling to 10.3% y-o-y in January–September from 10.9% in January–August.

External demand continues to remain weak. Exports fell 3.7% y-o-y in September after declining 5.5% y-o-y in August. Imports also remain weak, falling 20.4% y-o-y in September after dipping 13.8% y-o-y in August.

Continued weak demand has led the People's Bank of China (PBOC) to implement additional easing measures. In October, the PBOC reduced policy rates by 25 bps, taking the 1-year lending rate to 4.35% and the 1-year deposit rate to 1.50%. The PBOC has also sought to liberalize interest rates by removing the ceiling on deposit rates. In addition, the PBOC reduced the reserve requirement ratios of financial institutions by 50 bps to 17.5% for large banks (See Policy, Institutional, and Regulatory Developments at the end of this Market Summary for more details.)

In contrast to declining yields at the long-end of the curve, yields for the 1-year and 2-year tenors rose on tightened liquidity resulting from large issuances by local government seeking to refinance existing debt obligations.

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



Size and Composition

The amount of outstanding LCY bonds in the PRC reached CNY37.4 trillion (US\$5.9 trillion) at the end of September, an increase of 8.0% quarter-on-quarter (q-o-q) and 18.6% y-o-y, largely driven by growth in Treasury bonds and local corporate bonds (**Table 1**).

Government Bonds. LCY government bonds outstanding grew 9.9% q-o-q and 20.6% y-o-y in 3Q15, driven by growth in Treasury bonds, which have grown rapidly in 2015 on account of the fundraising requirements of local governments. Local government bonds outstanding have risen 84.4% q-o-q in 3Q15, driven by refinancing requirements due to maturing debt. The weaker economy has negatively impacted revenue collection, putting additional strain on local government funding. Initiatives to increase debt transparency and ease the debt burden of local governments also contributed to rising issuance in 3Q15.

Last year, the central government barred local governments from raising debt through the use of

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

	Outstanding Amount (billion)						Growth Rates (%)			
	3Q14		2Q15		3Q15		3Q14		3Q15	
	CNY	US\$	CNY	US\$	CNY	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	31,578	5,143	34,666	5,590	37,444	5,891	3.7	13.4	8.0	18.6
Government	20,354	3,315	22,344	3,603	24,547	3,862	3.7	12.3	9.9	20.6
Treasury Bonds	10,015	1,631	11,284	1,820	13,263	2,087	5.9	12.6	17.54	32.4
Central Bank Bonds	468	76	428	69	428	67	(4.3)	(17.0)	0.0	(8.5)
Policy Bank Bonds	9,870	1,608	10,632	1,715	10,855	1,708	2.0	14.0	2.1	10.0
Corporate	11,224	1,828	12,322	1,987	12,897	2,029	3.6	15.3	4.7	14.9
Policy Bank Bonds										
China Development Bank	6,240	1,016	6,538	1,054	6,610	1,040	0.4	9.9	1.1	5.9
Export-Import Bank of China	1,542	251	1,797	290	1,817	286	4.2	20.8	1.1	17.8
Agricultural Devt. Bank of China	2,088	340	2,297	370	2,429	382	5.6	22.6	5.7	16.3

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

1. Calculated using data from national sources.
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*, *Wind*, and Bloomberg LP

state-owned corporations. This year, the PRC launched a local government debt swap program to exchange local government debt for local government bonds.

The amount of central bank bonds was steady on a q-o-q basis in 3Q15, but fell on a y-o-y basis, as the PBOC continued using other tools to manage liquidity such as reverse repurchases. The PBOC has not issued central bank bonds since December 2013.

Corporate Bonds. Corporate bonds outstanding grew 4.7% q-o-q and 14.9% y-o-y in 3Q15 to reach CNY12.9 trillion (**Table 2**). The types of bonds with strong q-o-q growth rates were those issued by banks

and insurance companies (6.4%), and commercial paper (13.0%). Medium-term notes outstanding rose 2.9% q-o-q due to maturing debt and accounted for the largest issuances in 3Q15 among longer-term corporate bonds.

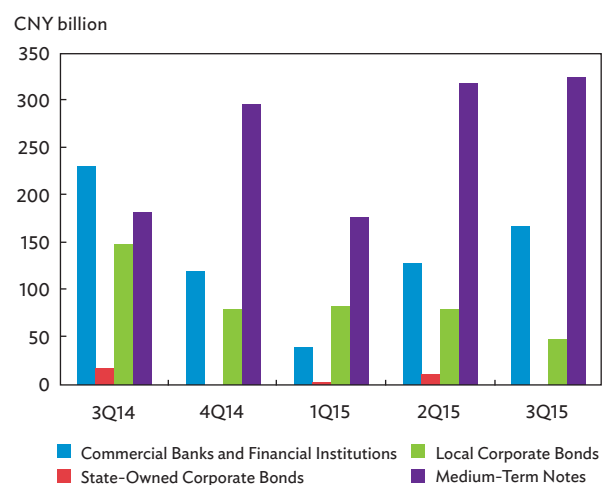
The rise in bonds issued by commercial banks and insurance companies was due to a resurgence in the issuance of subordinated debt that started in 2Q15 and continued in 3Q15 (**Figure 2**).

A relatively small number of issuers dominate the PRC's corporate bond market (**Table 3**). At the end of 3Q15, the top 30 corporate bond issuers accounted for

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)				Growth Rate (%)				
	4Q14	1Q15	2Q15	3Q15	q-o-q				y-o-y
					4Q14	1Q15	2Q15	3Q15	3Q15
Commercial Bank Bonds and Tier 2 Notes	1,612	1,639	1,748	1,860	24.0	1.7	6.6	6.4	43.1
SOE Bonds	622	612	612	581	(3.9)	(1.5)	(0.1)	(5.0)	(10.2)
Local Corporate Bonds	2,306	2,377	2,456	2,492	41.9	3.1	3.3	1.5	53.3
Commercial Paper	1,738	1,866	2,038	2,302	18.0	7.3	9.2	13.0	56.3
Medium-Term Notes	4,179	4,227	4,342	4,470	12.3	1.2	2.7	2.9	20.1

() = 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 and Wind.

CNY5.1 trillion worth of corporate bonds outstanding, or about 40% of the market. The 10 largest issuers accounted for CNY3.4 trillion worth of bonds outstanding.

State-owned companies—defined as majority-owned by the government—continued to dominate the corporate bond market in 3Q15. Among the top 30 corporate issuers, 23 were state-owned. By industry, seven of the top 10 corporate issuers were banks, largely as a result of their capital-raising efforts this year.

Table 4 presents the most notable corporate bond issuances in 3Q15.

Investor Profile

Treasury Bonds and Policy Bank Bonds. Banks remained the investor category comprising the largest share of

the PRC's Treasury bond market, which includes policy bank bonds, accounting for a slightly smaller share of the market at the end of September (73.3%) than in the same month a year earlier (76.2%) (**Figure 3**).

Corporate Bonds. Banks were also the largest holders of corporate bonds at the end of 3Q15, albeit with a comparatively smaller share than their holdings of Treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 24.1% at the end of 3Q15 from 27.5% a year earlier (**Figure 4**). The second largest holders of corporate bonds were funds institutions, with a 29.8% share at the end of September, up from a 22.8% share a year earlier.

Figure 5 presents investor profiles across corporate bond categories at the end of September. Banks were the largest holders of medium-term notes with almost 50% of the total. Insurance companies were the largest holders of commercial bank bonds.

Liquidity

Demand for liquidity increased in 3Q15, driven by local government bond issuances and stock market initial public offerings. As a result, the use of interest rate swaps also increased in 3Q15, with the total volume of swaps rising 16.3% q-o-q. The bulk of interest rate swaps involved the 7-day repurchase rate, which accounted for 92.6% of all volume traded (**Table 5**).

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 caused by the June 2013 Shanghai Interbank Offered Rate shock and a crackdown on illegal bond trades. However, 3Q15 saw a massive uptick in the trading for government bonds due to a continued decline in interest rates as the economy slowed.

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	1,183.5	186.20	Yes	No	Transportation
2.	State Grid Corporation of China	429.1	67.51	Yes	No	Public Utilities
3.	China National Petroleum	350.0	55.07	Yes	No	Energy
4.	Bank of China	298.9	47.02	Yes	Yes	Banking
5.	Agricultural Bank of China	260.0	40.91	Yes	Yes	Banking
6.	Industrial and Commercial Bank of China	238.0	37.44	Yes	Yes	Banking
7.	China Construction Bank	188.0	29.58	Yes	Yes	Banking
8.	Shanghai Pudong Development Bank	139.2	21.90	No	Yes	Banking
9.	China Minsheng Bank	136.5	21.48	No	Yes	Banking
10.	Industrial Bank	136.0	21.40	No	Yes	Banking
11.	Petrochina	131.0	20.61	Yes	Yes	Energy
12.	State Power Investment	128.4	20.21	Yes	No	Energy
13.	Bank of Communications	119.0	18.72	No	Yes	Banking
14.	Central Huijin Investment	109.0	17.15	Yes	No	Diversified Financial
15.	Senhua Group	104.0	16.36	Yes	No	Energy
16.	China Citic Bank	103.5	16.28	No	Yes	Banking
17.	China Petroleum and Chemical	98.5	15.50	Yes	Yes	Energy
18.	China Everbright Bank	88.9	13.99	Yes	Yes	Banking
19.	China Three Gorges Project	81.5	12.82	Yes	No	Public Utilities
20.	China Southern Power Grid	80.0	12.59	Yes	No	Public Utilities
21.	China Merchants Bank	79.0	12.43	No	Yes	Banking
22.	Shaanxi Coal and Chemical Industry Group	74.0	11.64	Yes	No	Energy
23.	Beijing State-Owned Assets Operation & Management Center	72.5	11.41	Yes	No	Diversified Financial
24.	China Datang	71.2	11.20	Yes	No	Energy
25.	China Guodian	71.1	11.18	Yes	No	Public Utilities
26.	Haitong Securities	71.0	11.17	No	Yes	Financial Services
27.	China Life	68.0	10.70	Yes	Yes	Insurance
28.	China Huarong Asset Management	67.0	10.54	Yes	Yes	Asset Management
29.	China Cinda Asset Management	66.0	10.38	Yes	Yes	Asset Management
30.	Tianjin Infrastructure Investment Group	64.9	10.21	Yes	No	Capital Goods
Total Top 30 LCY Corporate Issuers		5,107.63	803.59			
Total LCY Corporate Bonds		12,896.91	2,029.09			
Top 30 as % of Total LCY Corporate Bonds		39.6%	39.6%			

LCY = local currency.

Notes:

1. Data as of end-September 2015.

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

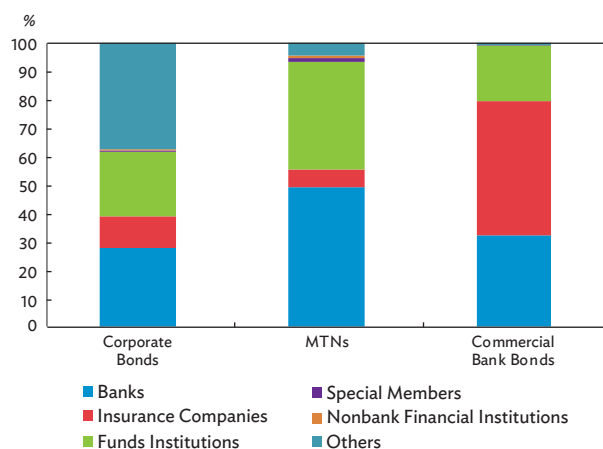
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Table 4: Notable LCY Corporate Bond Issuance in 3Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Huarong Asset Management		
3-year bond	4.01	17.50
5-year bond	4.21	17.50
China Railway Corp.		
1-year bond	3.10	10.00
10-year bond	4.32	15.00
10-year bond	4.23	10.00
Shanghai Pudong Development Bank		
10-year bond	4.50	30.00
Central Huijin Investment		
3-year bond	3.32	13.00
5-year bond	3.55	13.00
Postal Savings Bank		
10-year bond	4.50	25.00
Dalian Wanda Commercial Properties		
5-year bond	4.60	10.00

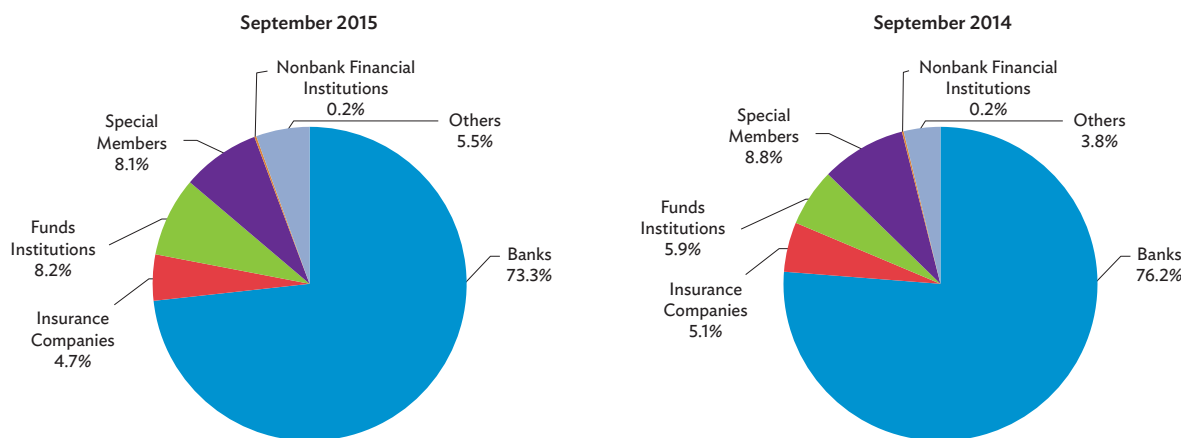
LCY = local currency.
Source: Bloomberg LP.

Figure 5: Investor Profile across Bond Categories



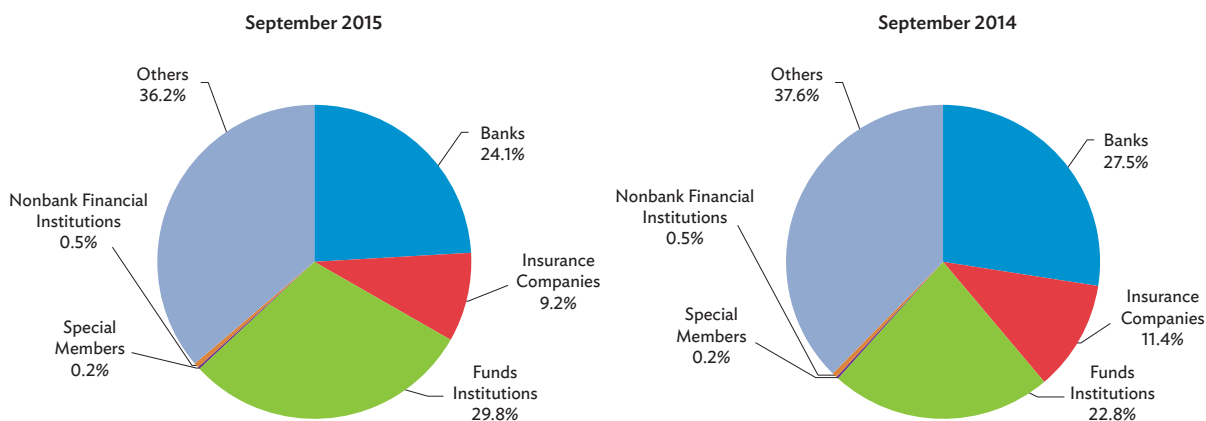
MTNs = medium-term notes.
Note: Data as of end-September 2015.
Source: ChinaBond.

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.

Table 5: Notional Values of the PRC's Interest Rate Swap Market in 3Q15

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions	Growth Rate (%)
				q-o-q
7-Day Repo Rate	2,088.9	92.6	15,488	20.92
Overnight SHIBOR	38.9	1.7	57	(37.20)
3-Month SHIBOR	120.5	5.3	737	(11.75)
1-Year Term Deposit Rate	3.0	0.1	29	(40.34)
LIBOR	0.0	0.0	0	0.00
1-Year Lending Rate	4.3	0.2	6	(48.30)
LPR1Y	0.0	0.0	3	0.00
3-Year Lending Rate	0.0	0.0	0	0.00
5-Year Lending Rate	0.0	0.0	0	0.00
Total	2,255.7	100.00	16,320	16.31

(-) = negative, PRC = People's Republic of China, LIBOR = London Interbank Offered Rate, q-o-q = quarter-on-quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.

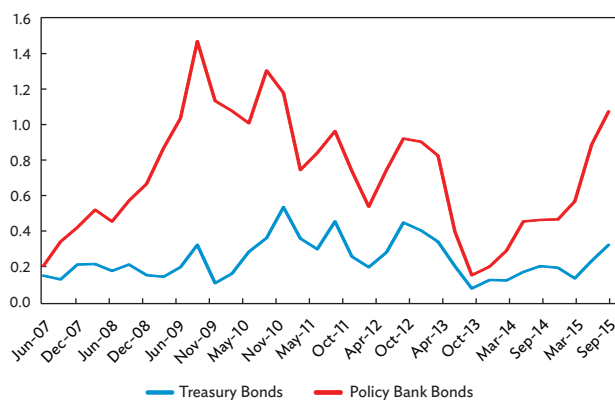
Note: Growth rate computed based on notional amounts.

Sources: ChinaMoney.

Policy, Institutional, and Regulatory Developments

Restrictions Eased on Overseas Funding

On 16 September, the National Development and Reform Commission eased restrictions on corporations seeking funding overseas. The new guidelines streamline the process by which corporations apply for a foreign currency loan and issue offshore renminbi bonds. The

Figure 6: Turnover Ratios for Government Bonds

Source: ChinaBond.

previous process required approval on a per deal basis, but the new regulations only require corporations to register with the National Development and Reform Commission.

PBOC Reduces Reserve Requirement Ratios

On 18 October, the PBOC lowered the reserve requirement ratios of financial institutions by 50 bps. For large banks, the changes resulted in a reserve requirement ratio of 17.5%, while for medium-sized banks the ratio was reduced to 15.5%. Select financial institutions involved in lending to the agricultural sector or to small and medium-sized enterprises will qualify for an additional reduction of 50 bps.