

Market Summaries

People's Republic of China

Yield Movements

The People's Republic of China's (PRC) local currency (LCY) government bond yield curve moved upward between 31 October and 18 November except for yields for the 2-year, 4-year, and 6-year maturities (**Figure 1**). The largest declines occurred at the longer end, with the 5-year tenor rising 21 bps and the 7-year and 10-year tenors rising 18 bps and 16 bps, respectively. The remaining tenors rose between 7 bps and 11 bps, except for the aforementioned 2-year, 4-year, and 6-year tenors. The 2-year and 6-year tenors were unchanged, while the 4-year tenor fell 7 bps. As a result, the 2-year versus 10-year yield spread rose from 35 bps on 31 October to 50 bps on 18 November. The rise in the yield curve was driven by increasing volatility in markets outside of the United States as a result of its presidential election.

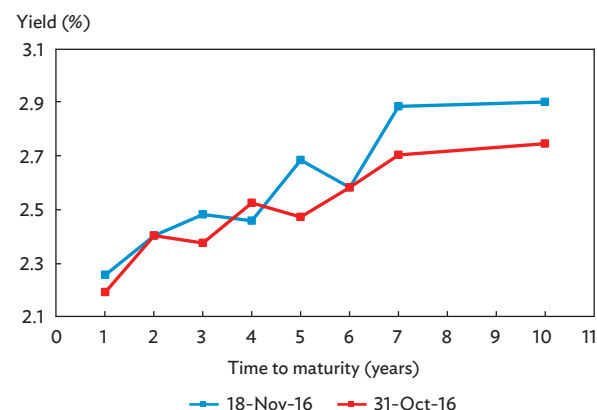
For the third quarter (Q3) of 2016, the PRC reported gross domestic product growth of 6.7% year-on-year (y-o-y), the same pace as in the previous 2 quarters and down from 6.8% y-o-y growth in the fourth quarter of 2015.

Exports from the PRC remained weak in Q3 2016. In renminbi-denominated terms, exports only grew 2.9% y-o-y in July before expanding 5.9% y-o-y in August and then plunging 5.6% y-o-y in September.

The PRC's consumer price inflation has remained manageable. After July's 1.8% y-o-y rise in consumer prices, inflation fell to 1.3% y-o-y in August before accelerating to 1.9% in September, mostly due to a rise in food prices. In October, inflation picked up to 2.1% y-o-y.

Concerns over the direction of the US economy pushed yields up despite increased risk aversion in the PRC's credit markets after a number of corporate bond defaults this year. The central bank governor of the People's Bank of China (PBOC) said during the recent G20 Finance Ministers and Central Bank Governors Meeting that the PRC would take steps to control debt growth.

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



Source: Based on data from Bloomberg LP.

Size and Composition

LCY bonds outstanding in the PRC rose 4.2% quarter-on-quarter (q-o-q) and 26.0% y-o-y to CNY47.9 trillion (USD7.2 trillion) (**Table 1**).

Government Bonds. Outstanding LCY government bonds grew 6.0% q-o-q and 35.1% y-o-y in Q3 2016 to reach CNY33.2 trillion, with all three government bond categories included in Table 1 exhibiting slower growth. Treasury and other governments bonds grew 10.3% q-o-q in Q3 2016, down from 19.6% q-o-q in the second quarter (Q2) of 2016, on the back of slower but still substantial growth in local government bonds. Local government bonds grew 17.2% q-o-q in Q3 2016 after rising 45.5% in Q2 2016. The slowdown in local government bond growth was partially due the quota limits imposed by the central government being approached.

Central bank bonds continued to decline in Q3 2016 as the PBOC ceased issuance in 2013. In Q3 2016, most central bank bonds came due, resulting in a decline of 93.6% q-o-q.

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q3 2015		Q2 2016		Q3 2016		Q3 2015		Q3 2016	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	37,998	5,978	45,980	6,916	47,890	7,178	8.0	19.2	4.2	26.0
Government	24,547	3,862	31,286	4,706	33,154	4,969	9.9	20.6	6.0	35.1
Treasury Bonds	13,263	2,087	18,955	2,851	20,912	3,134	17.5	32.4	10.32	57.7
Central Bank Bonds	428	67	428	64	27	4	0.0	(8.5)	(93.6)	(93.6)
Policy Bank Bonds	10,855	1,708	11,902	1,790	12,215	1,831	2.1	10.0	2.6	12.5
Corporate	13,451	2,116	14,694	2,210	14,736	2,209	4.7	16.8	0.3	9.5
Policy Bank Bonds										
China Development Bank	6,610	1,040	6,976	1,049	7,051	1,057	4.3	6.3	1.1	6.7
Export-Import Bank of China	1,817	286	1,988	299	2,028	304	7.2	22.7	2.0	11.6
Agricultural Devt. Bank of China	2,429	382	2,939	442	3,136	470	11.8	22.8	6.7	29.1

() = negative, CNY = Chinese renminbi, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third quarter, USD = United States dollar, 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 local currency-USD rate is used.
 4. Growth rates are calculated from local currency base and do not include currency effects.
- Sources: ChinaBond, Wind Info, and Bloomberg LP.

The growth of policy bank bonds slowed in Q3 2016, with an increase of 2.6% q-o-q compared with 3.4% q-o-q in Q2 2016.

Corporate Bonds. LCY corporate bonds outstanding rose a marginal 0.3% q-o-q in Q3 2016, following a decline of 0.6% q-o-q in the prior quarter, to reach CNY14.7 trillion at the end of September. Growth was driven by a 4.5% q-o-q increase in commercial bank bonds and Tier 2 notes, and a 4.4% q-o-q increase in local corporate bonds (**Table 2**). Outstanding commercial paper continued to decline, falling 10.2% q-o-q.

The rise in LCY corporate bonds outstanding corresponded with an increase in corporate bond issuance. In Q3 2016, total corporate bond issuance reached CNY1.5 trillion, up from CNY1.4 trillion in the prior quarter (**Figure 2**).

Figure 2: Corporate Bond Issuance in Key Sectors

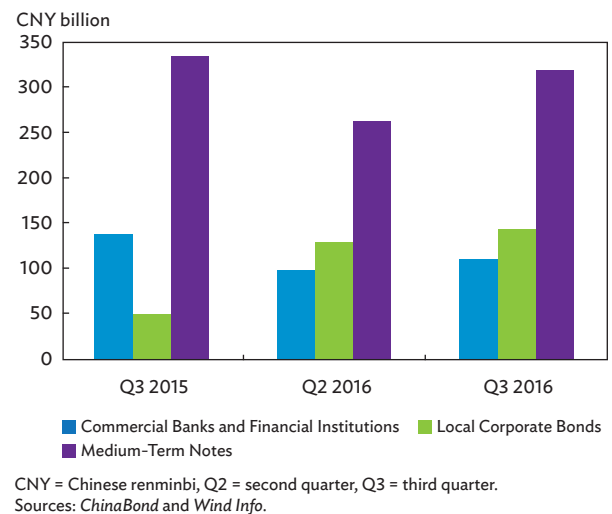


Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q3 2015	Q2 2016	Q3 2016	Q3 2015		Q3 2016	
				q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	1,860	2,271	2,372	1.1	21.1	4.5	27.6
SOE Bonds	581	575	560	0.9	(7.7)	(2.6)	(3.7)
Local Corporate Bonds	2,492	2,787	2,911	1.0	11.7	4.4	16.8
Commercial Paper	2,501	2,652	2,380	1.1	29.2	(10.2)	(4.8)
Medium-Term Notes	4,287	4,559	4,604	1.0	10.8	1.0	7.4

() = negative, CNY = Chinese renminbi, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third quarter, SOE = state-owned enterprise, y-o-y = year-on-year.

Sources: ChinaBond and Wind Info.

Increases were noted in nearly all major corporate bond categories.

Overall corporate bond issuance has remained weak in 2016 because of continued risk aversion among investors following a number of defaults in the corporate bond market. For comparison, corporate bond issuance was CNY1.8 trillion in both the first quarter of 2016 and the fourth quarter of 2015.

Due to increasing concerns over corporate bond defaults, the PRC announced on 10 October measures to reduce risk by encouraging mergers and debt for equity swaps.

The PRC's corporate bond market is dominated by a few big issuers (**Table 3**). At the end of Q3 2016, the top 30 corporate bond issuers accounted for CNY5.6 trillion worth of corporate bonds outstanding, or about 38.2% of

Table 3: Top 30 Issuers of Local Currency 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 (USD billion)			
1.	China Railway	1,263.5	189.38	Yes	No	Transportation
2.	State Grid Corp of China	437.1	65.51	Yes	No	Public Utilities
3.	China National Petroleum	365.0	54.71	Yes	No	Energy
4.	Agricultural Bank of China	260.0	38.97	Yes	Yes	Banking
5.	Bank of China	258.9	38.80	Yes	Yes	Banking
6.	Industrial and Commercial Bank of China	258.0	38.67	Yes	Yes	Banking
7.	China Construction Bank	212.0	31.78	Yes	Yes	Banking
8.	Industrial Bank	196.0	29.38	No	Yes	Banking
9.	Bank of Communications	194.0	29.08	No	Yes	Banking
10.	Shanghai Pudong Development Bank	184.6	27.67	No	Yes	Banking
11.	PetroChina	181.0	27.13	Yes	Yes	Energy
12.	China Minsheng Banking	155.1	23.25	No	Yes	Banking
13.	State Power Investment	145.2	21.77	Yes	No	Energy
14.	Bank of Beijing	122.9	18.42	Yes	Yes	Banking
15.	Central Huijin Investment	109.0	16.34	Yes	No	Asset Management
16.	China CITIC Bank	107.5	16.11	No	Yes	Banking
17.	Shenhua Group	104.5	15.66	Yes	No	Energy
18.	China Petroleum & Chemical	94.5	14.16	Yes	Yes	Energy
19.	China Everbright Bank	88.9	13.32	Yes	Yes	Banking
20.	China Datang	86.7	12.99	Yes	Yes	Energy
21.	China Three Gorges	86.5	12.97	Yes	No	Public Utilities
22.	China Guangfa Bank	84.5	12.67	No	Yes	Banking
23.	Tianjin Infrastructure Construction & Investment Group	83.4	12.50	Yes	No	Industrial
24.	Shaanxi Coal and Chemical Industry Group	80.5	12.07	Yes	Yes	Energy
25.	Huaxia Bank	80.4	12.05	Yes	No	Banking
26.	China Merchants Bank	79.0	11.84	No	Yes	Banking
27.	Haitong Securities	78.0	11.69	Yes	Yes	Brokerage
28.	China United Network Communications	77.0	11.54	Yes	Yes	Telecommunications
29.	China Huarong Asset Management	77.0	11.54	Yes	Yes	Asset Management
30.	Beijing State-Owned Capital Operation and Management Center	73.5	11.02	Yes	No	Asset Management
Total Top 30 LCY Corporate Issuers		5,624.20	842.98			
Total LCY Corporate Bonds		14,735.71	2,208.66			
Top 30 as % of Total LCY Corporate Bonds		38.2%	38.2%			

CNY = Chinese renminbi, LCY = local currency, USD = United States dollar.

Notes:

1. Data as of end-September 2016.

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.

the total market. Out of the top 30, the 10 largest issuers accounted for CNY3.6 trillion.

The top 30 issuer list is dominated by banks, owing to the continued issuance of commercial bank bonds as banks accelerate their fund-raising. Among the top 30 corporate issuers at the end of September, 14 were in the banking industry.

Table 4 lists the most notable corporate bond issuances in Q3 2016. Most companies on the list are from capital-intensive industries such as oil, infrastructure, and power. One bank, China Guangfa Bank, was on the list.

Investor Profile

Treasury Bonds and Policy Bank Bonds. The share of bank holdings of Treasury bonds, including policy bank bonds, continued to fall in Q3 2016, declining to 68.4% at the end of September from a 73.3% share a year earlier (**Figure 3**). There was a corresponding rise in the holdings of funds institutions such as mutual funds during the same period, with the share of funds institutions rising to 13.6% from 8.2%.

Corporate Bonds. Similar to Treasury bonds, banks' share of local corporate bonds continued to decline in Q3 2016, falling to 18.1% at the end of September from 24.1% a year earlier. Banks were no longer the largest holder of corporate bonds at the end of September (**Figure 4**). Fund institutions became the dominant holders in Q3 2016, with their share rising to 44.9% at the end of September from 29.8% a year earlier.

Figure 5 presents investor profiles across corporate bond categories at the end of September. Funds institutions continued to be the dominant buyer of both local corporate bonds and medium-term notes, with the share of banks' holdings declining from a year earlier. Banks and insurance companies were the dominant holders of commercial bank bonds at the end of September.

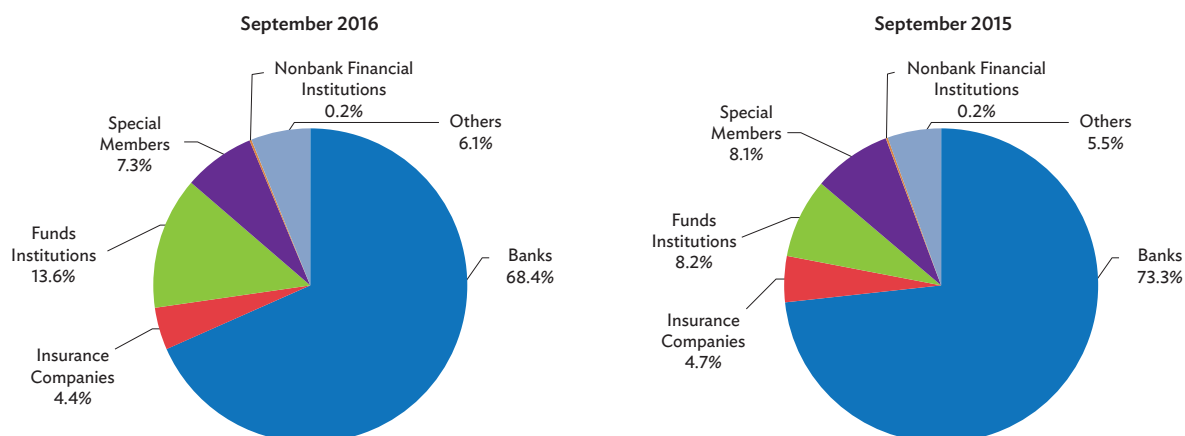
Liquidity

Interest rate swap volumes rose 9.0% q-o-q, driven by a large increase in trading volumes for the 3-month SHIBOR swap. The 7-day repurchase interest rate swap remains the most popular among all swap categories, accounting for 85.8% of the total transaction volume in Q3 2016 (**Table 5**).

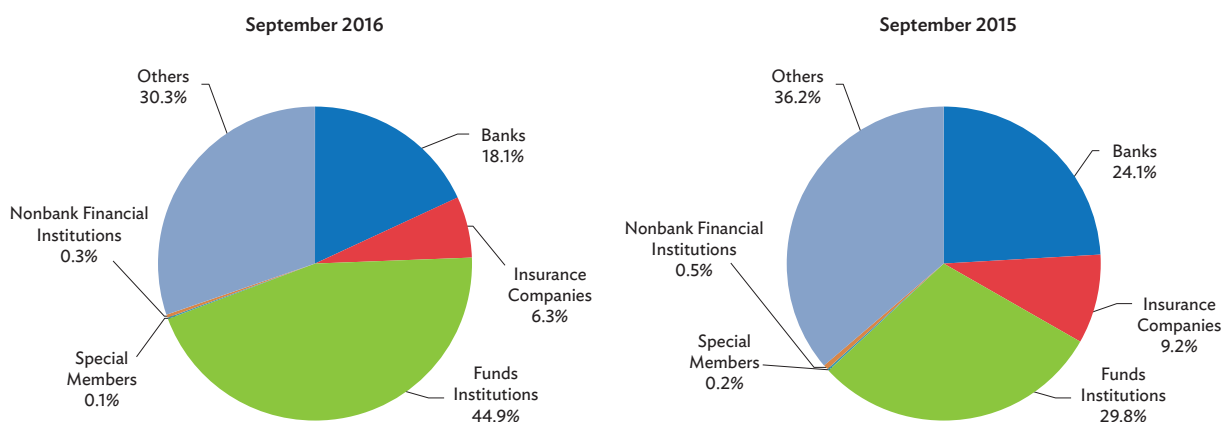
Table 4: Notable Local Currency Corporate Bond Issuance in Q3 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway			China Petrochemical		
270-day bond	2.45	15.0	270-day bond	2.50	10.0
10-year bond	3.09	15.0	5-year bond	2.83	13.0
10-year bond	3.15	15.0	7-year bond	3.02	4.3
20-year bond	3.38	5.0	10-year bond	3.30	0.8
20-year bond	3.43	5.0	China Guangfa Bank		
China Huadian			180-day bond	2.50	2.5
270-day bond	2.50	4.0	210-day bond	2.53	5.0
270-day bond	2.57	4.0	240-day bond	2.57	4.0
270-day bond	2.50	4.0	270-day bond	2.72	3.5
270-day bond	2.69	3.5	270-day bond	2.78	3.5
270-day bond	2.48	3.5	3-year bond	2.88	5.0
270-day bond	2.50	3.0	5-year bond	2.94	4.0
270-day bond	2.50	3.0			
3-year bond	2.99	4.0			
5-year bond	2.95	3.0			
5-year bond	3.25	3.0			

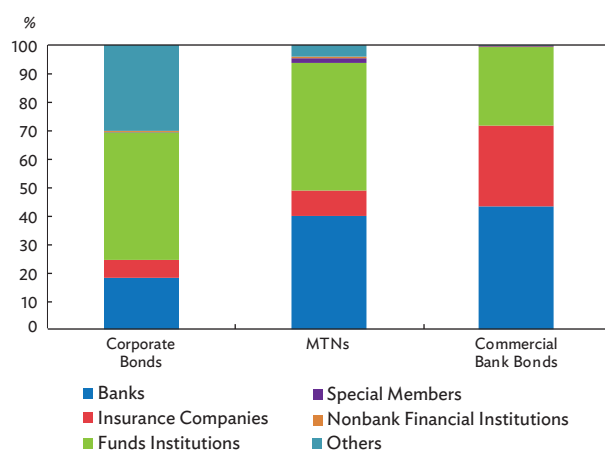
CNY = Chinese renminbi, Q3 = third quarter.
Source: Based on data from Bloomberg LP.

Figure 3: Local Currency Treasury Bonds and Policy Bank Bonds Investor Profile


Source: ChinaBond.

Figure 4: Local Currency Corporate Bonds Investor Profile


Source: ChinaBond.

Figure 5: Investor Profile across Bond Categories


MTNs = medium-term notes.
 Note: Data as of end-September 2016.
 Source: ChinaBond.

Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in Q3 2016

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Percentage of Total Notional Amount (%)	
		Q2 2016	q-o-q
7-Day Repo Rate	2,217.0	85.8	3.3
Overnight SHIBOR	9.6	0.4	(82.0)
3-Month SHIBOR	348.4	13.5	125.3
1-Year Term Deposit Rate	1.3	0.05	(82.5)
1-Year Lending Rate	5.4	0.2	(32.1)
3-Year Lending Rate	0.1	0.0	0.0
5-Year Lending Rate	1.0	0.04	70.4
Total	2,582.7	100.0	9.0

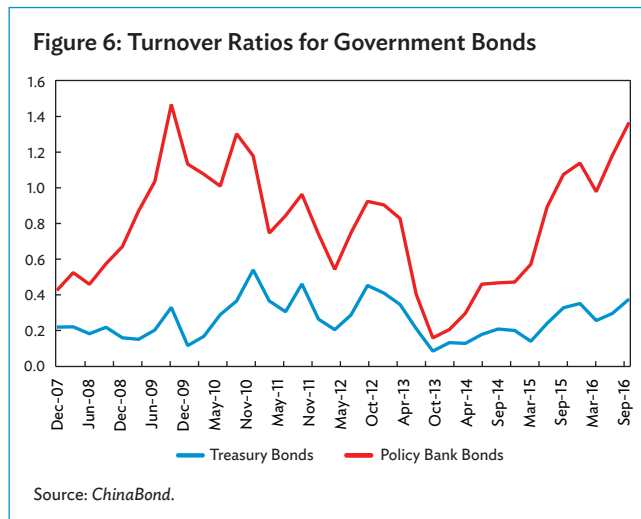
() = negative, CNY = Chinese renminbi, q-o-q = quarter-on-quarter, Q3 = third quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.

Notes:

- Growth rate computed based on notional amounts.
- London Interbank Offered Rate and 1-Year Loan Prime Rate had no transaction for Q3 2016.

Sources: AsianBondsOnline and ChinaMoney.

Consistent with the decline in interest rates, trading activity in government bonds rose on increased demand, driven by demand for safe assets on credit market concerns as well as expectations of higher government bond prices due to lower interest rates amid slowing economic growth (**Figure 6**).



Policy, Institutional, and Regulatory Developments

People's Bank of China Renews Currency Swap with European Central Bank

On 27 September, the PBOC renewed its currency swap agreement with European Central Bank for an additional 3 years. Under the swap agreement, the PBOC can exchange up to CNY350 billion with the European Central Bank for EUR45 billion.

International Monetary Fund Includes Renminbi in Special Drawing Rights Basket

On 30 September, the International Monetary Fund (IMF) announced that it would include the Chinese renminbi in its Special Drawing Rights basket effective 1 October. The IMF said that the renminbi's inclusion is due to the currency's increasing role in the international monetary system. Other currencies included in the IMF's Special Drawing Rights are the US dollar, euro, Japanese yen, and pound sterling.

Trading in Credit Default Swaps Allowed

On 31 October, the PRC allowed banks to begin trading credit default swaps as part of efforts to help hedge credit risks amid increasing concerns in the PRC's corporate bond market. The credit default swaps that are being traded in the PRC are similar to those traded in international markets. In the past, the PRC launched credit risk mitigation warrants to hedge against credit risk, but they were not well received by market participants.