

Market Summaries

People's Republic of China

Yield Movements

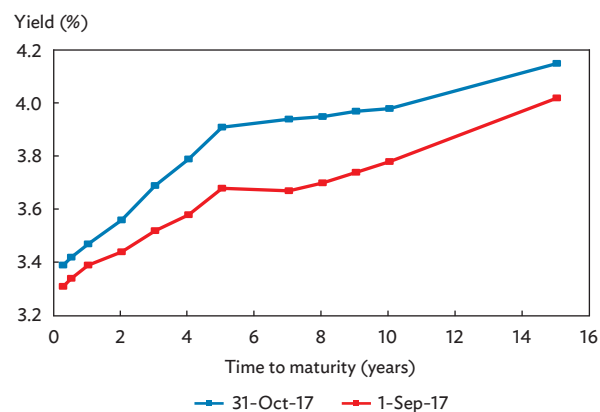
The government bond yield curve of the People's Republic of China (PRC) shifted upward for all tenors between 1 September and 31 October (**Figure 1**). Excluding the 15-year tenor, the pick-up in yields was most pronounced at the long-end of the curve. Yields for tenors of 3 years or less rose an average of 11 basis points (bps), while yields rose an average of 23 bps for the 4-year through 10-year tenor. The 15-year tenor rose 13 bps.

The rise in the PRC's yields has been largely driven by concerns over the ongoing deleveraging campaign being conducted by the government to reduce debt levels. As a result of the bigger gains at the long-end of the curve, the 2-year versus 10-year yield spread rose to 42 bps on 31 October from 34 bps on 1 September.

There was a temporary inversion in the PRC's yield curve as the government's deleveraging campaign pushed yields at the short-end to levels higher than those at the long-end. Yields at the long-end, such as the 10-year yield, declined in September after economic data releases showed weaker growth. For example, August industrial production (released in September) grew 6.0% year-on-year (y-o-y) after gaining 6.4% y-o-y in July. Growth in investment in fixed assets slowed to 7.8% y-o-y in January–August from 8.3% y-o-y in January–July.

Data on economic growth released since September indicate that the PRC will continue its relatively modest economic growth. The PRC's gross domestic product grew 6.8% y-o-y in the third quarter (Q3) of 2017, marginally down from second quarter (Q2) growth of 6.9% y-o-y. Industrial profits grew 22.8% y-o-y in January–September after gaining 21.6% y-o-y in January–August. Industrial production growth also picked up to 6.6% y-o-y in September from 6.0% y-o-y in August. In addition, while consumer price inflation remains benign, slowing to 1.6% y-o-y in September from 1.8% y-o-y in August, producer prices rose 6.9% y-o-y in September after climbing 6.3% y-o-y in August, reflecting strengthening in the manufacturing sector.

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



Source: Based on data from Bloomberg LP.

Yields at the long-end of the curve trended upward in October more rapidly than yields at the short-end. In addition to better economic data, the market was also concerned that the Government of the PRC would impose additional deleveraging measures. On 15 October, the People's Bank of China (PBOC) Governor Zhou Xiaochuan said that corporate debt remains too high and that there was a need to focus more effort on deleveraging and policies that promote financial stability.

Size and Composition

The PRC's local currency (LCY) bonds outstanding rose 5.3% quarter-on-quarter (q-o-q) and 14.2% y-o-y in Q3 2017 to reach CNY54.7 trillion at the end of September. The q-o-q growth rate accelerated from 4.1% in the previous quarter due to faster increases in the amount of both government and corporate bonds outstanding (**Table 1**).

Government bonds. Growth in the PRC's bond market was driven by increases in the government bond segment. Government bonds outstanding increased 6.1% q-o-q in Q3 2017, up from 5.8% q-o-q growth in the previous quarter, mainly led by local government bonds

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q3 2016		Q2 2017		Q3 2017		Q3 2016		Q3 2017	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	47,980	7,178	51,931	7,658	54,693	8,221	4.2	113.3	5.3	14.2
Government	33,154	4,969	37,159	5,480	39,438	5,928	6.0	35.1	6.1	19.0
Treasury Bonds and Local Government Bonds	20,912	3,134	24,405	3,599	26,340	3,959	10.3	57.7	7.93	26.0
Central Bank Bonds	27	4	0	0	0	0	(93.6)	(93.6)	0.0	(100.0)
Policy Bank Bonds	12,215	1,831	12,755	1,881	13,098	1,969	2.6	12.5	2.7	7.2
Corporate	14,736	2,209	14,771	2,178	15,255	2,293	0.3	256.0	3.3	3.5
Policy Bank Bonds										
China Development Bank	7,051	1,057	7,183	1,059	7,331	1,102	1.1	6.7	2.1	4.0
Export-Import Bank of China	2,028	304	2,217	327	2,280	343	2.0	11.6	2.9	12.4
Agricultural Devt. Bank of China	3,136	470	3,355	495	3,488	524	6.7	29.1	4.0	11.2

(-) = negative, CNY = Chinese yuan, LCY = local currency, 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 LCY-USD rates are used.
4. Growth rates are calculated from an LCY base and do not include currency effects.

Sources: *ChinaBond*, *Wind Info*, and Bloomberg LP.

outstanding, which grew 11.9% q-o-q in Q3 2017 versus 13.0% q-o-q in Q2 2017.

Local government bonds again registered the highest growth rate among all government bond categories as local governments continued their debt swap program and issued new debt amid the setting of 2017 issuance quotas by the Government of the PRC. Total local government debt has been capped at CNY18.8 trillion. However, as part of the deleveraging efforts of the PRC, local government bond growth in Q3 2017 was not as strong as it was in 2016. Local government bonds grew 43.2% y-o-y in Q3 2017 versus 50.0% y-o-y growth in the same period last year.

Issuance of local government bonds in Q3 2017 grew 20.5% q-o-q as local governments sought to fill their respective quotas. For 2017, the PRC set quotas of CNY1.6 trillion for the issuance of local government bonds and CNY3.0 trillion for debt swaps. The target completion date for the local government debt swap program is in 2018.

Treasury bonds outstanding grew only 3.9% q-o-q in spite of an 83.1% q-o-q increase in issuance as the new bonds mostly replaced maturing bonds. In particular, CNY600 billion of special Treasury bonds were issued in August as part of the refinancing program.

There were no central bank bonds outstanding in Q3 2017 as the PBOC no longer issues such bonds.

Corporate bonds. The PRC's corporate bonds outstanding grew 3.3% q-o-q in Q3 2017 after declining 0.1% q-o-q in the previous quarter. Growth was driven by the capital-raising efforts of banks as outstanding commercial bank bonds and Tier 2 notes gained 7.4% q-o-q (**Table 2**). Local corporate bonds and medium-term notes also showed stronger growth, rising 4.4% q-o-q and 3.3% q-o-q, respectively. The deleveraging efforts and subsequent rise in interest rates at the short-end of the curve discouraged the issuance of short-term debt, leading to a 6.5% q-o-q decline in outstanding commercial paper. State-owned enterprise bonds also fell 2.1% q-o-q.

Total issuance of corporate bonds increased 45.1% q-o-q in Q3 2017 to CNY1.6 trillion, largely to finance maturing bonds as corporate bonds outstanding grew only 3.3% q-o-q. By category, the fastest growth came from local corporate bonds, which more than doubled, followed by medium-term notes, which grew 68.4% q-o-q (**Figure 2**).

The PRC's corporate bond market continues to be dominated by a few big issuers (**Table 3**). At the end of Q3 2017, the top 30 corporate bond issuers accounted for CNY6.1 trillion worth of corporate bonds outstanding, or about 40.2% of the total market. Of the top 30, the 10 largest issuers accounted for CNY3.9 trillion. China Railway, the top issuer, has more than three times the outstanding amount of bonds as State Grid Corporation of China, the second largest

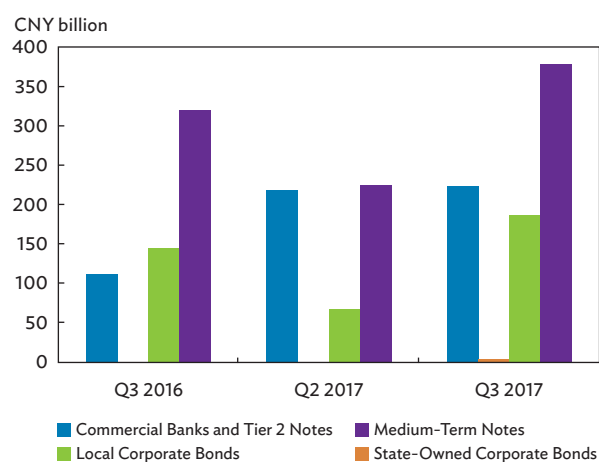
Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q3 2016	Q2 2017	Q3 2017	Q3 2016		Q3 2017	
				q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	2,372	2,713	2,915	1.0	27.6	7.4	22.9
SOE Bonds	560	519	508	1.0	(3.7)	(2.1)	(9.2)
Local Corporate Bonds	2,911	2,932	3,060	1.0	16.8	4.4	5.1
Commercial Paper	2,380	1,657	1,549	0.9	(4.8)	(6.5)	(34.9)
Medium-Term Notes	4,604	4,662	4,816	1.0	7.4	3.3	4.6

() = negative, CNY = Chinese yuan, 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.

Figure 2: Corporate Bond Issuance in Key Sectors



CNY = Chinese yuan, Q2 = second quarter, Q3 = third quarter.
Sources: ChinaBond and Wind Info.

issuer. The top 30 issuer includes 14 banks, which continue to dominate the list as they generate funding in order to beef up their capital bases and liquidity, and lengthen their maturity profiles.

Table 4 lists the largest corporate bond issuances in Q3 2017. All of the companies on the list are financial firms except for China Railway Corporation.

Investor Profile

Treasury bonds and policy bank bonds. Banks were the single largest holder of Treasury bonds and policy bank bonds at the end of September, though this share had declined to 66.8% from 68.4% a year earlier (**Figure 3**).

In contrast, the share held by funds institutions rose to 16.2% from 13.6% in the same period.

Corporate bonds. Funds institutions were the largest holders of corporate bonds at the end of September with a share of 48.2% of outstanding corporate bonds, up from a 44.9% share at the end of September 2016 (**Figure 4**). The share held by banks declined to 15.8% from 18.1% during the review period. **Figure 5** presents investor profiles across different corporate bond categories at the end of September. Funds institutions are the dominant buyers in the PRC of both local corporate bonds and medium-term notes, while banks and insurance companies are the dominant holders of commercial bank bonds.

Liquidity

The volume of interest rate swaps declined 9.7% q-o-q in Q3 2017. The 7-day repurchase remained the most used interest rate swap, comprising a 73.6% share of the total interest rate swap volume during the quarter (**Table 5**).

The trading volume of government bonds rose in Q3 2017; however, turnover ratios were still lower than in Q3 2016, owing to the ongoing deleveraging of the government (**Figure 6**).

Ratings Update

In September, S&P Global downgraded the PRC's long-term foreign currency rating to A+ from AA- with a stable outlook. In its decision, S&P Global cited the PRC's rising debt levels as a reason for the downgrade.

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	1,456.5	218.93	Yes	No	Transportation
2.	State Grid Corporation of China	401.8	60.40	Yes	No	Public Utilities
3.	China National Petroleum	325.0	48.85	Yes	No	Energy
4.	Bank of China	288.9	43.42	Yes	Yes	Banking
5.	Agricultural Bank of China	278.0	41.79	Yes	Yes	Banking
6.	Industrial and Commercial Bank of China	268.0	40.28	Yes	Yes	Banking
7.	Bank of Communications	245.0	36.83	Yes	Yes	Banking
8.	China Construction Bank	212.0	31.87	Yes	Yes	Banking
9.	Shanghai Pudong Development Bank	204.6	30.75	No	Yes	Banking
10.	China Everbright Bank	188.9	28.39	Yes	Yes	Banking
11.	Industrial Bank	185.0	27.81	No	Yes	Banking
12.	China Minsheng Banking	170.1	25.57	No	Yes	Banking
13.	China CITIC Bank	157.5	23.67	No	Yes	Banking
14.	State Power Investment	142.0	21.35	Yes	Yes	Energy
15.	Bank of Beijing	137.9	20.73	Yes	Yes	Banking
16.	PetroChina	137.0	20.59	Yes	Yes	Energy
17.	Huaxia Bank	130.4	19.60	Yes	Yes	Banking
18.	Central Huijin Investment	109.0	16.38	Yes	Yes	Asset Management
19.	China Huarong Asset Management	106.0	15.93	Yes	Yes	Asset Management
20.	Tianjin Infrastructure Construction and Investment Group	96.3	14.48	Yes	No	Construction
21.	China Three Gorges	95.5	14.35	Yes	Yes	Public Utilities
22.	CITIC Securities	95.3	14.32	Yes	Yes	Brokerage
23.	Dalian Wanda Commercial Properties	93.0	13.98	No	Yes	Real Estate
24.	China Cinda Asset Management	91.0	13.68	Yes	Yes	Asset Management
25.	China Merchants Bank	89.0	13.38	Yes	Yes	Banking
26.	Guotai Junan Securities	87.3	13.12	No	Yes	Brokerage
27.	Haitong Securities	87.1	13.09	No	Yes	Brokerage
28.	China Guangfa Bank	86.5	13.00	Yes	Yes	Banking
29.	Shenhua Group	82.5	12.40	Yes	Yes	Mining
30.	China Datang Corporation	79.7	11.98	Yes	Yes	Energy
Total Top 30 LCY Corporate Issuers		6,126.79	920.93			
Total LCY Corporate Bonds		15,254.99	2,293.02			
Top 30 as % of Total LCY Corporate Bonds		40.2%	40.2%			

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

Notes:

1. Data as of end-September 2017.

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: Notable Local Currency Corporate Bond Issuance in the Third Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway Corporation		
5-year bond	4.30	13
5-year bond	4.31	15
10-year bond	4.48	5
10-year bond	4.61	7
China Everbright Bank		
3-year bond	4.20	22
10-year bond	4.70	12
Bank of China		
10-year bond	4.45	30
Central Huijin Investment		
5-year bond	4.38	26
Huaxia Bank		
3-year bond	4.30	22

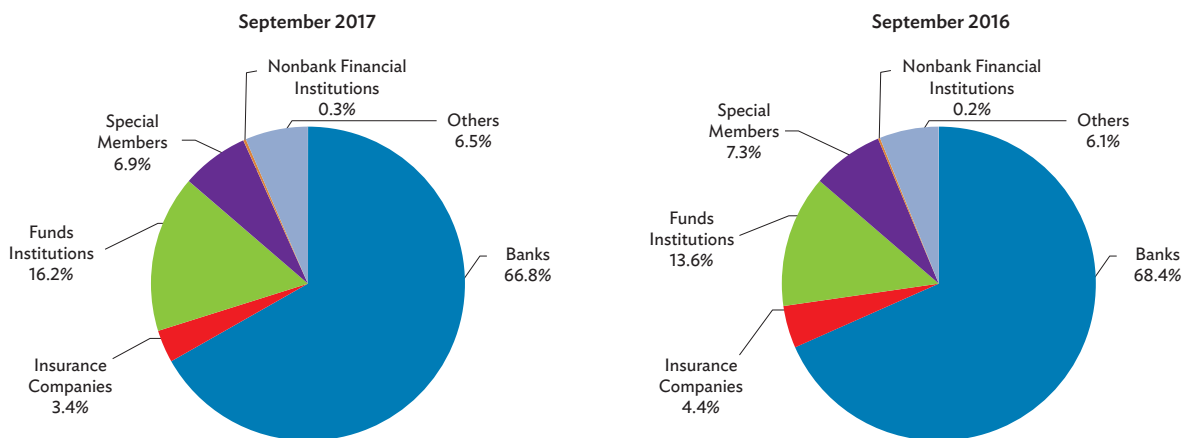
CNY = Chinese yuan.
Source: Based on data from Bloomberg LP.

Policy, Institutional, and Regulatory Developments

People’s Bank of China Reduces Reserve Requirement Ratio for Select Institutions

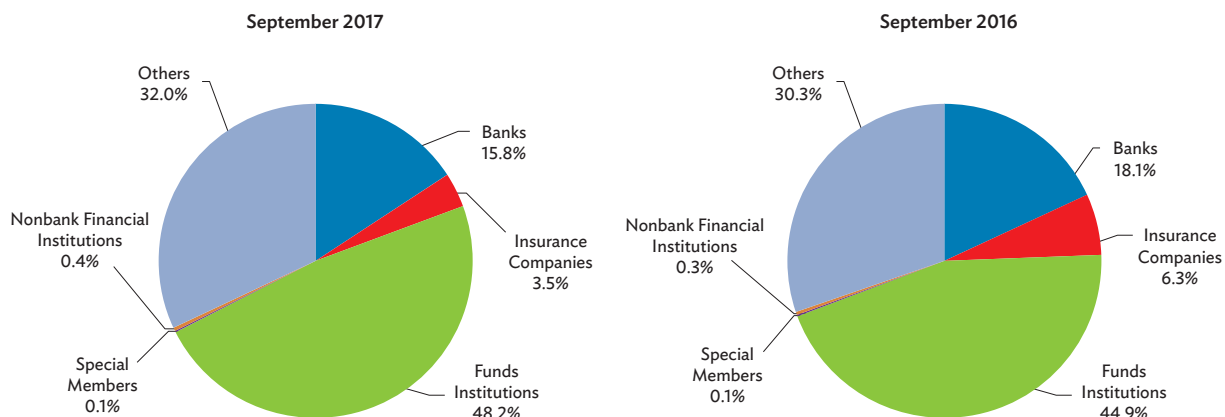
In September, the PBOC announced that it would reduce the reserve requirement ratio for banks that meet established lending metrics to small and medium-sized enterprises, and to the agriculture sector. Banks will receive a 50-bps reduction in their ratio if their loans to the abovementioned sectors meet or exceed either 1.5% of new lending in 2017 or 1.5% of outstanding loans. Banks can receive a 150-bps reduction if the loans to these sectors comprise 10% or more of either new lending in 2017 or outstanding loans. Alternatively, banks will qualify for the 150-bps reduction if 10% or more of their

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

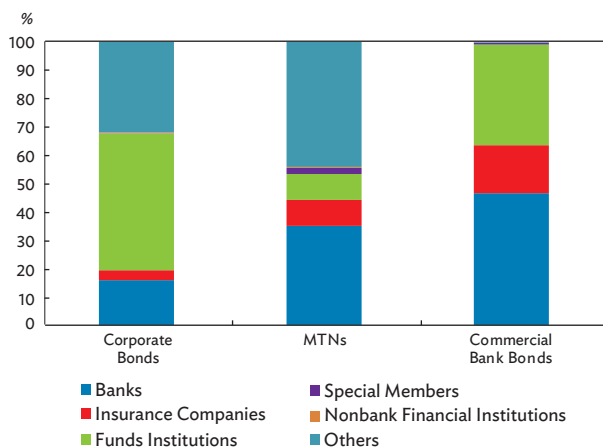


Source: ChinaBond.

Figure 4: Local Currency Corporate Bonds Investor Profile



Source: ChinaBond.

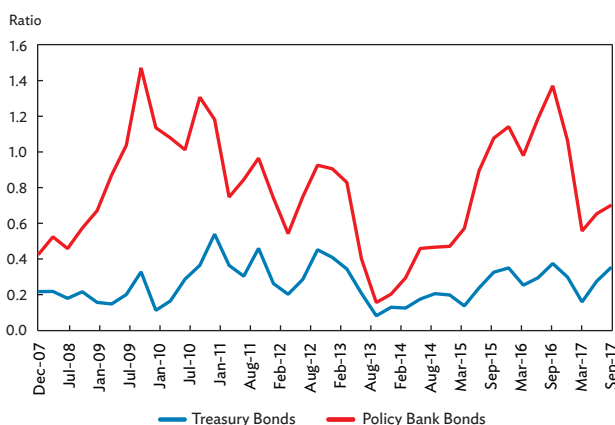
Figure 5: Investor Profile across Bond Categories


MTNs = medium-term notes.
 Note: Data as of end-September 2017.
 Source: ChinaBond.

Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in the Third Quarter of 2017

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	Growth Rate (%)
7-Day Repo Rate	2,690.3	73.64	6.78
Overnight SHIBOR	12.0	0.33	38.34
3-Month SHIBOR	941.9	25.78	201.09
1-Year Lending Rate	1.7	0.05	191.01
3-Year Lending Rate	1.4	0.04	13.45
5-Year Lending Rate	0.1	0.002	0.00
Depository Institution 7-day Repo Rate	6.1	0.17	(75.31)
Total	3,653.5	100.00	(9.71)

(-) = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q3 = third quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
 Note: Growth rate computed based on notional amounts.
 Sources: AsianBondsOnline and ChinaMoney.

Figure 6: Turnover Ratios for Government Bonds


Source: ChinaBond.

outstanding loans are made to the specially designated “inclusive finance” sector. Rural banks can get a 100-bps reduction if 10% or more of new loans are made to local entities. The reductions will take effect in 2018.

People's Bank of China Removes Reserve Requirement Ratio on Forward Transactions

In September, the PBOC removed reserve requirements imposed on the trading of foreign currency forwards. Previously, the ratio was set at 20%.

China Securities Regulatory Commission Imposes Limits on Money Market Funds

The China Securities Regulatory Commission tightened regulations on money market funds in September. Under the new guidelines, money market funds are limited in their lending to a single institution. The rules require money market funds to limit their holdings of deposits, bonds, and other assets from a single bank to no more than 10% of the bank's net assets. Additionally, assets from a single bank cannot exceed 2% of the outstanding assets of the mutual fund. Money market funds also cannot hold investments issued by institutions with a credit rating lower than AAA.