

Market Summaries

People's Republic of China

Yield Movements

The entire government bond yield curve of the People's Republic of China (PRC) shifted downward between 1 March and 15 May (**Figure 1**). The yield curve fell an average of 28 basis points (bps), with the largest declines at the shorter-end. Yields fell from 31 bps to 39 bps for tenors of 3 years or less, while falling from 20 bps to 28 bps for the remaining tenors.

Yields for the PRC's government bonds followed a general downward trend beginning in March, stemming largely from expectations that the domestic economy would slow down this year. While the PRC reported a gross domestic product (GDP) growth rate of 6.8% year-on-year (y-o-y) for the first quarter (Q1) of 2018, the same rate as in the fourth quarter (Q4) of 2017, it was lower than full-year 2017's GDP growth.

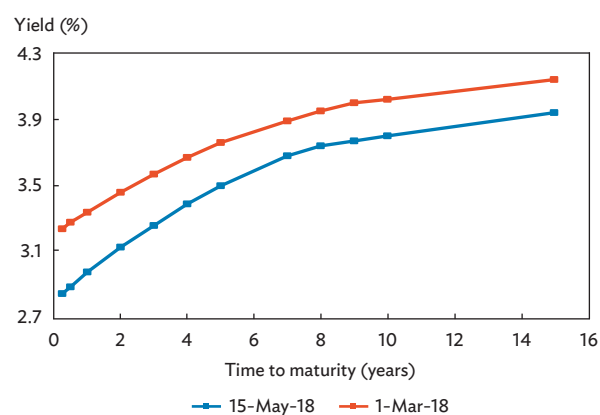
The International Monetary Fund in January forecast the PRC's full-year 2018 GDP growth rate at 6.6%; in March, the PRC set a target of 6.5%.

In addition to expectations of moderating GDP growth, inflation has shown signs of trending downward. In February, consumer prices rose 2.9% y-o-y. This slowed to 2.1% in March and declined further to 1.8% y-o-y in April.

The weaker economic data has also led to increased risk aversion, with the PRC's stock market contracting 3.5% year-to-date through 15 May. In addition, there have been a number of corporate bond defaults. On 14 May, it was reported that more than 10 companies had defaulted on bond payments in 2018 with a total value of CNY12.8 billion. The increased risk aversion has led investors to favor government bonds and AAA-rated bonds.

The People's Bank of China (PBOC) on 17 April reduced by 100 bps the reserve requirement ratio of banks. Funds released by the reserve requirement ratio cut were required to be used by banks to pay outstanding Medium-

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



Source: Based on data from Bloomberg LP.

Term Lending Facility obligations and to support small and micro enterprises. The market interpreted the move by the PBOC as a slight easing from the deleveraging campaign that is being conducted. The move caused a significant 1-day drop in yields, with the PRC's 10-year yield falling 20 bps by the end of the following day.

Size and Composition

The PRC's local currency (LCY) bonds outstanding rose 0.7% quarter-on-quarter (q-o-q) and 14.8% y-o-y in Q1 2018 to reach CNY57.3 trillion (USD9.1 trillion) at the end of March (**Table 1**). The PRC bond market's q-o-q growth slowed from 4.0% in the previous quarter. The slower rate was due to declines in the growth rates of both government and corporate bonds.

Government bonds. The PRC's government bond market grew 0.8% q-o-q in Q1 2018, down from 4.4% q-o-q in the previous quarter. The slowdown was driven by the 0.1% q-o-q contraction in the PRC's outstanding Treasury bonds and only 1.5% q-o-q growth in outstanding local government bonds. In the previous quarter, local government bonds grew 5.9% q-o-q. The slowdown in

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q1 2017		Q4 2017		Q1 2018		Q1 2017		Q1 2018	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	49,895	7,245	56,866	8,739	57,272	9,126	0.8	17.2	0.7	14.8
Government	35,113	5,098	41,167	6,327	41,516	6,616	1.6	26.3	0.8	18.2
Treasury Bonds and Local Government Bonds	22,510	3,268	27,712	4,259	27,916	4,448	1.7	42.0	0.7	24.0
Central Bank Bonds	0	0	0	0	0	0	(100.0)	(100.0)	0.0	0.0
Policy Bank Bonds	12,604	1,830	13,454	2,068	13,600	2,167	1.7	9.5	1.1	7.9
Corporate	14,782	2,146	15,700	2,413	15,756	2,511	(1.2)	0.03	0.4	6.6
Policy Bank Bonds										
China Development Bank	7,185	1,043	7,540	1,159	7,571	1,206	1.5	5.4	0.4	5.4
Export-Import Bank of China	2,190	318	2,296	353	2,329	371	2.7	14.5	1.4	6.4
Agricultural Devt. Bank of China	3,229	469	3,617	556	3,700	590	1.4	16.2	2.3	14.6

(-) = negative, CNY = Chinese yuan, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth 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 Information*, and Bloomberg LP.

Q1 2018 reflected the approaching end of the PRC's local government debt swap program and other efforts to limit the debt risk of local governments.

The PRC's local government debt swap program is set to end in August 2018. For full-year 2018, the Government of the PRC set a ceiling for local governments of CNY21.0 trillion worth of debt, up from the previous limit of CNY18.8 trillion in 2017. Local government bond issuance is expected to increase in the remaining months of the debt swap program as an estimated CNY1.9 trillion worth of local government debt remains to be swapped under the ceiling.

There were no central bank bonds outstanding in Q1 2018 as the PBOC no longer issues such bonds.

Corporate bonds. The PRC's corporate bonds outstanding grew 0.4% q-o-q in Q1 2018 after rising 2.9% q-o-q in Q4 2017. With the exception of medium-term notes, all other major categories of corporate bonds showed q-o-q declines (**Table 2**). State-owned enterprise bonds, local corporate bonds, and commercial papers all registered y-o-y declines in Q1 2018.

The weaker corporate bond growth was largely a result of increased risk aversion due to the PRC's deleveraging campaign, which led to corporates being reluctant to issue more debt. A string of defaults in January–May also led investors to prefer government bonds and

investment grade corporates. These factors contributed to a 9.0% q-o-q contraction in corporate bond issuance in Q1 2018 to CNY1.4 trillion. Other than medium-term notes, all major categories of corporate bonds had lower issuance levels in Q1 2018 than in the previous quarter (**Figure 2**).

The PRC's corporate bond market continues to be dominated by a few big issuers (**Table 3**). At the end of Q1 2018, the top 30 corporate bond issuers accounted for CNY6.5 trillion worth of corporate bonds outstanding, or about 41.3% of the total market. Of the top 30, the 10 largest issuers accounted for CNY4.1 trillion. China Railway, the top issuer, has more than three times the outstanding amount of bonds as Industrial and Commercial Bank, the second-largest 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 Q1 2018.

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 March, though their share declined to 66.0% from 67.9% a year earlier (**Figure 3**). In contrast,

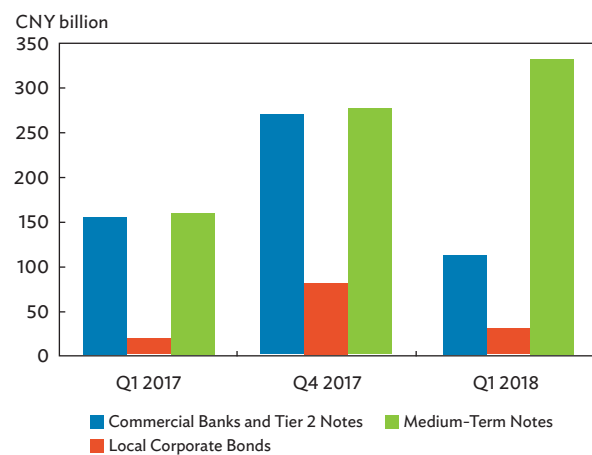
Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q1 2017	Q4 2017	Q1 2018	Q1 2017		Q1 2018	
				q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	2,534	3,143	3,125	1.0	15.4	(0.6)	23.3
SOE Bonds	542	485	465	1.0	(7.0)	(4.2)	(14.3)
Local Corporate Bonds	2,912	3,005	2,911	1.0	8.3	(3.2)	(0.1)
Commercial Papers	1,912	1,536	1,477	0.9	(32.7)	(3.9)	(22.8)
Medium-Term Notes	4,701	4,905	5,049	1.0	2.8	2.9	7.4

() = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth quarter, SOE = state-owned enterprise, y-o-y = year-on-year.

Sources: ChinaBond and Wind Information.

Figure 2: Corporate Bond Issuance in Key Sectors



CNY = Chinese yuan, Q1 = first quarter, Q4 = fourth quarter.
Sources: ChinaBond and Wind Information.

the share held by funds institutions rose to 16.1% from 13.6% in the same period.

Corporate bonds. Funds institutions were the largest holders of corporate bonds at the end of March with a share of 48.0% of outstanding corporate bonds, up from 47.5% at the end of March 2017 (Figure 4). The share held by banks declined to 15.8% from 15.9% during the review period.

Figure 5 presents investor profiles across different corporate bond categories at the end of March. Funds institutions are the dominant buyers of local corporate bonds while banks are the dominant holders of commercial bank bonds.

Liquidity

The volume of interest rate swaps rose 2.5% q-o-q in Q1 2018. The 7-day repurchase rate remained the most used interest rate swap, comprising an 84.2% share of the total interest rate swap volume during the quarter (Table 5).

Government bond turnover ratios fell in Q1 2018 despite lower interest rates due to some investors adopting a wait-and-see attitude (Figure 6).

Policy, Institutional, and Regulatory Developments

PBOC Reduces Reserve Requirement Ratio

On 16 April, the PBOC reduced the reserve requirement ratio of banks by 100 basis points, effective 25 April. The PBOC placed restrictions on the funds freed by the reduction, stipulating that they must be used to repay loans from the PBOC's Medium-Term Lending Facility. Leftover funds must be used for lending to small and micro enterprises.

Government Issues New Rules on Local Government Bond Issuance

On 8 May, the PRC issued new rules governing the issuance of bonds by local governments. The new rules allow local governments to issue bonds with longer tenors, such as 15-year to 20-year bonds, and to allow bond issuances for the purpose of rolling over maturing obligations.

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	1575.5	251.06	Yes	No	Transportation
2.	Industrial and Commercial Bank of China	356.0	56.73	Yes	Yes	Banking
3.	State Grid Corporation of China	326.8	52.08	Yes	No	Public Utilities
4.	China National Petroleum	325.0	51.79	Yes	No	Energy
5.	Bank of China	318.9	50.81	Yes	Yes	Banking
6.	Agricultural Bank of China	318.0	50.67	Yes	Yes	Banking
7.	China Construction Bank	272.0	43.34	Yes	Yes	Banking
8.	Bank of Communications	265.0	42.23	No	Yes	Banking
9.	Shanghai Pudong Development Bank	198.6	31.65	No	Yes	Banking
10.	China CITIC Bank	192.5	30.67	No	Yes	Banking
11.	China Everbright Bank	188.9	30.10	Yes	Yes	Banking
12.	China Minsheng Banking	185.1	29.50	No	Yes	Banking
13.	Industrial Bank	155.0	24.70	No	Yes	Banking
14.	Central Huijin Investment	154.0	24.54	Yes	No	Asset Management
15.	State Power Investment	135.8	21.65	Yes	No	Energy
16.	Bank of Beijing	130.4	20.78	Yes	Yes	Banking
17.	Huaxia Bank	128.8	20.52	Yes	No	Banking
18.	Tianjin Infrastructure Construction and Investment Group	122.9	19.58	Yes	No	Industrial
19.	CITIC Securities	117.5	18.72	Yes	Yes	Brokerage
20.	China Cinda Asset Management	112.0	17.85	Yes	Yes	Asset Management
21.	PetroChina	105.0	16.73	Yes	Yes	Energy
22.	China Datang	97.2	15.49	Yes	Yes	Energy
23.	China Huarong Asset Management	96.0	15.30	Yes	Yes	Asset Management
24.	China Three Gorges	95.0	15.14	Yes	No	Public Utilities
25.	Haitong Securities	93.6	14.91	Yes	Yes	Brokerage
26.	Dalian Wanda Commercial Properties	93.0	14.82	No	Yes	Real Estate
27.	Guotai Junan Securities	89.8	14.31	Yes	Yes	Brokerage
28.	China Merchants Bank	89.0	14.18	Yes	Yes	Banking
29.	China Guangfa Bank	86.5	13.78	No	Yes	Banking
30.	Huatai Securities	85.9	13.69	Yes	No	Energy
Total Top 30 LCY Corporate Issuers		6,509.70	1,037.32			
Total LCY Corporate Bonds		15,756.08	2,510.73			
Top 30 as % of Total LCY Corporate Bonds		41.3%	41.3%			

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

Notes:

1. Data as of 31 March 2018.

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.

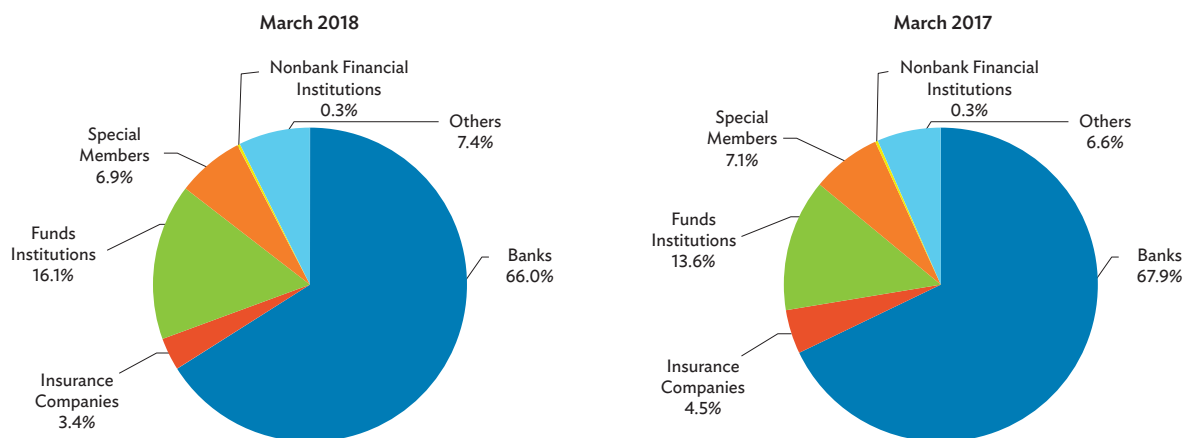
Table 4: Notable Local Currency Corporate Bond Issuance in the First Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway Corp			China Cinda Asset Management		
5-year bond	4.91	15	10-year bond	5.50	15
5-year bond	5.03	15	10-year bond	5.50	10
5-year bond	5.03	15	China National Petroleum		
5-year bond	4.80	13	5-year bond	1.40	20
10-year bond	4.93	7	Tianjin Infrastructure Construction and Investment (Group)		
10-year bond	5.10	5	3-year bond	5.64	3
10-year bond	4.91	5	3-year bond	5.47	3
10-year bond	5.09	5	3-year bond	5.46	2
Central Huijin Investment			3-year bond	5.70	2
1-year bond	4.80	5	3-year bond	5.48	2
1-year bond	4.90	5	3-year bond	5.68	2
3-year bond	5.00	10	3-year bond	5.68	2
3-year bond	5.15	10			

CNY = Chinese yuan.

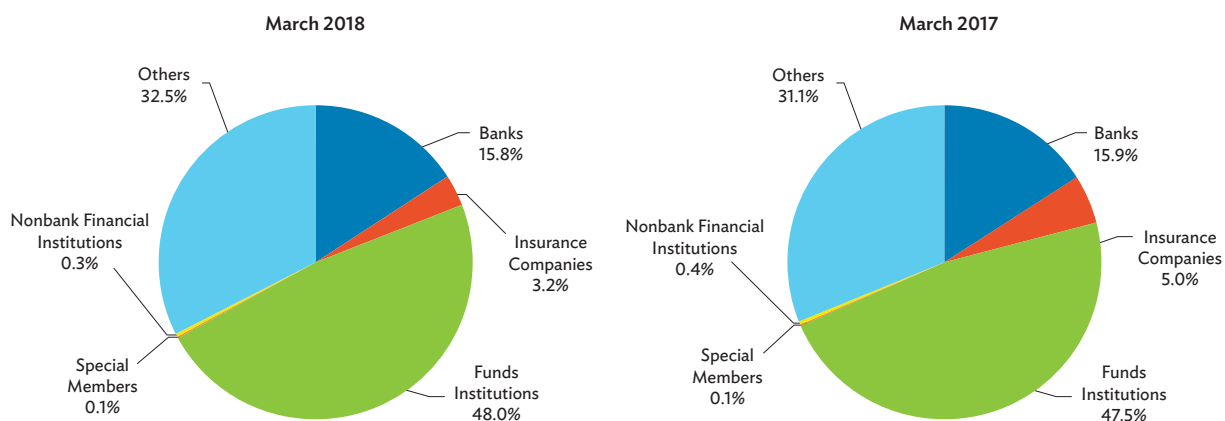
Source: Based on data from Bloomberg LP.

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



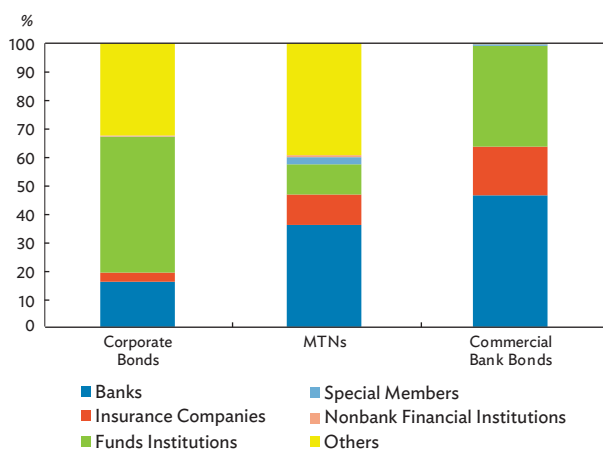
Source: ChinaBond.

Figure 4: Local Currency Corporate Bonds Investor Profile



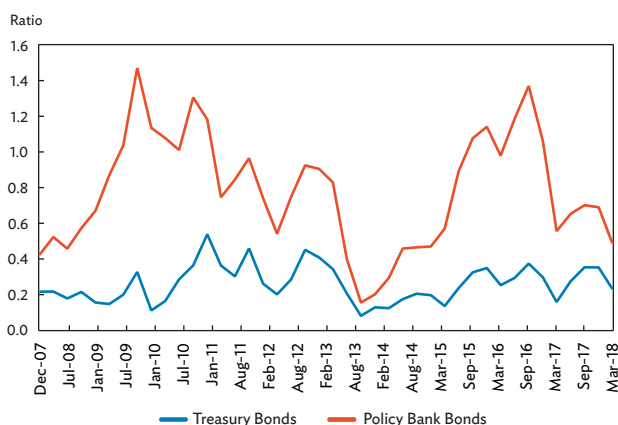
Source: ChinaBond.

Figure 5: Investor Profile across Bond Categories



MTNs = medium-term notes.
 Note: Data as of end-March 2018.
 Source: ChinaBond.

Figure 6: Turnover Ratios for Government Bonds



Source: ChinaBond.

Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in the First Quarter of 2018

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	Growth Rate (%)
		Q1 2018	q-o-q
7-Day Repo Rate	4,455.2	84.22	19.28
Overnight SHIBOR	16.1	0.30	1.20
3-Month SHIBOR	783.1	14.80	(42.65)
1-Year Term Deposit Rate	1.0	0.02	-
LIBOR		-	n.a.
1-Year Lending Rate	0.0	-	(100.00)
LPR1Y	0.0	-	(100.00)
3-Year Lending Rate	1.5	0.03	919.33
5-Year Lending Rate	0.8	0.02	n.a.
Depository Institution 7-Day Repo Rate	2.1	0.04	(16.33)
10-Year Bond Yield	18.5	0.35	(29.69)
10-Year Treasury yield	9.4	0.18	16.77
3-Year AAA Short-Term Notes/ Government Debt	0.2	0.00	(69.23)
10-Year Bond Yield/10-Year Government Bond Yield	0.8	0.02	90.48
Loan Interest Rate—1 Year * 1.10	0.7	0.01	n.a.
Loan Interest Rate—1 Year * 1.05	0.5	0.01	n.a.
Total	5,289.7	100.00	2.51

(-) = negative, CNY = Chinese yuan, LIBOR = London Interbank Offered Rate, LPR1Y = 1-Year Loan Prime Rate, n.a. = not available, q-o-q = quarter-on-quarter, Q1 = first quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
 Note: Growth rate computed based on notional amounts.
 Sources: AsianBondsOnline and ChinaMoney.