

Market Summaries

People's Republic of China

Yield Movements

The People's Republic of China's (PRC) government bond yield curve fell between 1 June and 15 August (**Figure 1**). The entire yield curve shifted downward by an average of 18 basis points (bps), with the shorter-end declining by a much larger amount. Yields fell from 13 bps to 53 bps for tenors of 3 years or less, while yields fell between 5 bps and 9 bps for longer tenors. The spread between the 2-year and 10-year tenors widened from 49 bps on 1 June to 65 bps on 15 August.

Yields in the PRC declined on weaker economic data. The PRC's gross domestic product (GDP) growth fell to 6.7% year-on-year (y-o-y) in the second quarter (Q2) of 2018 from 6.8% y-o-y in the first quarter (Q1) of 2018. On 29 May, the International Monetary Fund announced that it was maintaining its GDP growth forecast of 6.6% for full-year 2018, down from 6.9% in 2017.

Yields have been driven lower by increased risk aversion and uncertainty arising from the PRC's ongoing trade tensions with the United States (US), which has led to uncertainty regarding the PRC's economic outlook.

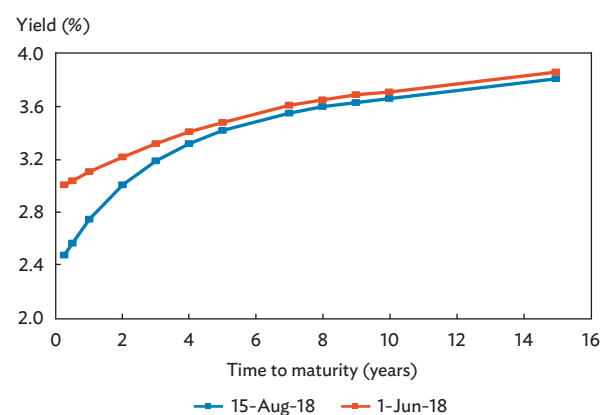
The PRC's government bond market has also benefited from increased demand from investors moving funds out of the stock market, largely due to the ongoing trade tensions. The PRC's equity market fell 11.4% between 1 June and 15 August.

In response, the People's Bank of China (PBOC) reduced the reserve requirement ratio of some banks by 50 bps to mitigate the impact of the ongoing trade tensions with the US. The PBOC is requiring larger banks to use the funds freed up for debt-equity swaps, while for smaller banks the funds are to be used for lending to small- and micro-sized enterprises.

Size and Composition

The PRC's local currency (LCY) bonds outstanding rose 3.8% quarter-on-quarter (q-o-q) and 15.1% y-o-y to

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



Source: Based on data from Bloomberg LP.

reach CNY59.8 trillion (USD 9.0 trillion). The PRC's bond market q-o-q growth rate quickened from the previous quarter's 1.3% (**Table 1**).

Government bonds. The PRC's government bond market's growth rate accelerated to 4.4% q-o-q in Q2 2018 from 0.8% q-o-q in Q1 2018. The faster growth rate was largely due to gains in the category of "Treasury Bonds and Other Government Bonds," which expanded 5.1% q-o-q in Q2 2018, up from 0.7% q-o-q in the previous quarter. Within this category, the primary growth driver was an increase in local government bonds outstanding.

Local government bonds grew 6.9% q-o-q in Q2 2018, up from 1.5% q-o-q in Q1 2018, largely due to an increase in issuance, which rebounded in Q2 2018 ahead of the scheduled end of the local government debt swap program in August, leading to a rush in issuance during the quarter in order to fully utilize the quotas set by the central government. For full-year 2018, local governments were given a total debt ceiling of CNY21.0 trillion. A report released on 14 June said that the current cumulative debt of local governments was CNY16.6 trillion in May, well below the ceiling set by the central government.

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q2 2017		Q1 2018		Q2 2018		Q2 2017		Q2 2018	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	51,931	7,658	57,591	9,177	59,762	9,026	4.1	12.9	3.8	15.1
Government	37,159	5,480	41,516	6,616	43,352	6,548	5.8	18.8	4.4	16.7
Treasury Bonds and Local Government Bonds	24,405	3,599	27,916	4,448	29,347	4,432	8.4	28.7	5.1	20.3
Central Bank Bonds	0	0	0	0	0	0	0.0	(100.0)	0.0	0.0
Policy Bank Bonds	12,755	1,881	13,600	2,167	14,005	2,115	1.2	7.2	3.0	9.8
Corporate	14,771	2,178	16,075	2,562	16,410	2,479	(0.1)	0.5	2.1	11.1
Policy Bank Bonds										
China Development Bank	7,183	1,059	7,571	1,206	7,743	1,169	(0.03)	3.0	2.3	7.8
Export-Import Bank of China	2,217	327	2,329	371	2,366	357	1.2	11.5	1.6	6.8
Agricultural Devt. Bank of China	3,355	495	3,700	590	3,895	588	3.9	14.1	5.3	16.1

() = negative, CNY = Chinese yuan, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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.

There were no central bank bonds outstanding in Q2 2018 as the PBOC no longer issues such bonds.

Corporate bonds. The PRC's corporate bonds outstanding grew 2.1% q-o-q in Q2 2018, down from Q1 2018's growth of 2.4%. Medium-term notes, state-owned enterprise bonds, and financial bonds increased on a q-o-q basis in Q2 2018, while the outstanding amounts of local corporate bonds and commercial paper declined (Table 2).

The weaker corporate bond growth was largely a result of increased risk aversion due to ongoing uncertainties in the PRC's financial markets due to trade tensions with the US and rising corporate bond defaults. This led to a 1.0% q-o-q contraction in corporate bond issuance in Q2 2018 to CNY1.4 trillion. Other than local corporate bonds, all major categories of corporate bonds had lower issuance levels in Q2 2018 than in the previous quarter (Figure 2).

The PRC's LCY corporate bond market continues to be dominated by a few big issuers (Table 3). At the end of Q2 2018, the top 30 corporate bond issuers accounted for CNY6.7 trillion worth of corporate bonds outstanding, or about 40.9% of the total market. Of the top 30, the 10 largest issuers accounted for CNY4.3 trillion. China Railway, the top issuer, had more than four times the outstanding amount of bonds as the Agricultural Bank

of China, the second-largest issuer. The top 30 issuers include 13 banks, which continue to dominate the list as they generate funding to strengthen their capital bases, improve liquidity, and lengthen their maturity profiles.

Table 4 lists some of the largest corporate bond issuances in Q2 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 June, though this share declined to 65.1% from 67.3% a year earlier (Figure 3). In contrast, the share held by funds institutions rose to 16.2% from 14.8% in the same period.

Corporate bonds. Funds institutions were the largest holders in the LCY corporate bond market at the end of June with a share of 46.3% of total outstanding corporate bonds, down from 47.5% at the end of June 2017 (Figure 4). The share held by banks rose to 16.9% from 15.9% during the review period.

Figure 5 presents investor profiles across different corporate bond categories at the end of June. Funds institutions were the dominant buyers in the PRC local corporate bonds, while banks were the dominant holders of medium-term notes and commercial bank bonds.

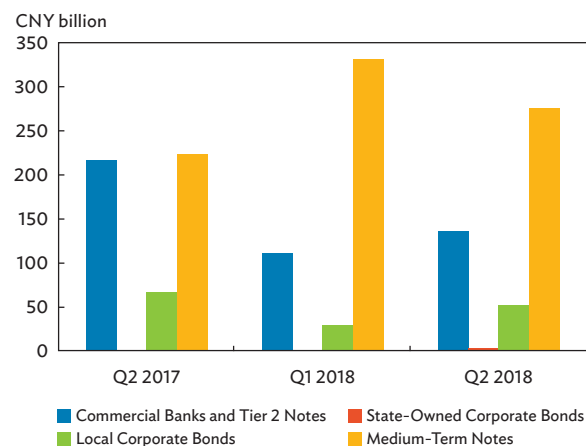
Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q2 2017	Q1 2018	Q2 2018	Q2 2017		Q2 2018	
				q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	2,713	3,125	3,226	1.1	23.5	3.2	18.9
SOE Bonds	519	465	468	1.0	(11.0)	0.6	(9.9)
Local Corporate Bonds	2,932	2,911	2,771	1.0	9.0	(4.8)	(5.5)
Commercial Paper	1,657	1,796	1,715	0.8	(41.7)	(4.5)	3.5
Medium-Term Notes	4,662	5,049	5,222	1.0	1.9	3.4	12.0

() = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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, Q2 = second quarter.
Sources: ChinaBond and Wind Information.

Liquidity

The volume of interest rate swaps rose 2.5% q-o-q in Q2 2018. The 7-day repurchase remained the most used interest rate swap, comprising an 83.3% share of the total interest rate swap volume during the quarter (Table 5).

Policy, Institutional, and Regulatory Developments

People's Bank of China Expands Collateral Usage

On 1 June, the PBOC issued guidelines expanding the types of collateral that banks can use for the central bank's medium-term lending facility. The expanded collateral coverage will include bonds issued by small- and micro-sized institutions, green and agricultural financial bonds rated AA and above, corporate bonds rated AA+ or AA, and high-quality small- and micro-sized loans and green loans.

People's Bank of China Reduces Reserve Requirement Ratio

On 24 June, the PBOC reduced the reserve requirement ratio of some banks by 50 bps. Specifically, the following larger banks, and 12 joint-stock commercial banks, must use freed-up funds to carry out debt-equity swap programs: Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, and Bank of Communications. In addition, Postal Savings Bank of China, city commercial banks, non-county rural banks, and foreign-funded banks must use funds freed up by the reduction to support lending to small- and micro-sized enterprises.

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	1,675.5	253.06	Yes	No	Transportation
2.	Agricultural Bank of China	358.0	54.07	Yes	Yes	Banking
3.	Industrial and Commercial Bank of China	356.0	53.77	Yes	Yes	Banking
4.	State Grid Corporation of China	331.8	50.11	Yes	No	Public Utilities
5.	China National Petroleum	325.0	49.09	Yes	No	Energy
6.	Bank of China	318.9	48.16	Yes	Yes	Banking
7.	China Construction Bank	272.0	41.08	Yes	Yes	Banking
8.	Bank of Communications	265.0	40.02	No	Yes	Banking
9.	Central Huijin Investment	200.0	30.21	Yes	No	Asset Management
10.	Shanghai Pudong Development Bank	198.6	30.00	No	Yes	Banking
11.	China CITIC Bank	192.5	29.07	No	Yes	Banking
12.	China Minsheng Banking	185.1	27.96	No	Yes	Banking
13.	China Everbright Bank	180.9	27.32	Yes	Yes	Banking
14.	Industrial Bank	155.0	23.41	No	Yes	Banking
15.	Huaxia Bank	148.4	22.41	Yes	No	Banking
16.	State Power Investment	147.4	22.27	Yes	No	Energy
17.	Tianjin Infrastructure Construction and Investment Group	137.3	20.74	Yes	No	Industrial
18.	CITIC Securities	126.8	19.15	Yes	Yes	Brokerage
19.	Bank of Beijing	122.9	18.56	Yes	Yes	Banking
20.	China Cinda Asset Management	102.0	15.41	Yes	Yes	Asset Management
21.	China Huarong Asset Management	96.0	14.50	Yes	Yes	Asset Management
22.	PetroChina	95.0	14.35	Yes	Yes	Energy
23.	China Datang	93.2	14.08	Yes	Yes	Energy
24.	China Merchants Securities	93.1	14.05	No	Yes	Brokerage
25.	Dalian Wanda Commercial Properties	93.0	14.05	No	Yes	Real Estate
26.	China Three Gorges	89.5	13.52	Yes	No	Public Utilities
27.	Shaanxi Coal and Chemical Industry Group	89.0	13.44	Yes	No	Energy
28.	China Merchants Bank	89.0	13.44	Yes	Yes	Banking
29.	China Southern Power Grid	88.0	13.29	Yes	No	Power
30.	Guotai Junan Securities	86.5	13.06	Yes	Yes	Brokerage
Total Top 30 LCY Corporate Issuers		6,711.36	1,013.65			
Total LCY Corporate Bonds		16,410.31	2,478.52			
Top 30 as % of Total LCY Corporate Bonds		40.9%	40.9%			

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

Notes:

1. Data as of 30 June 2018.

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

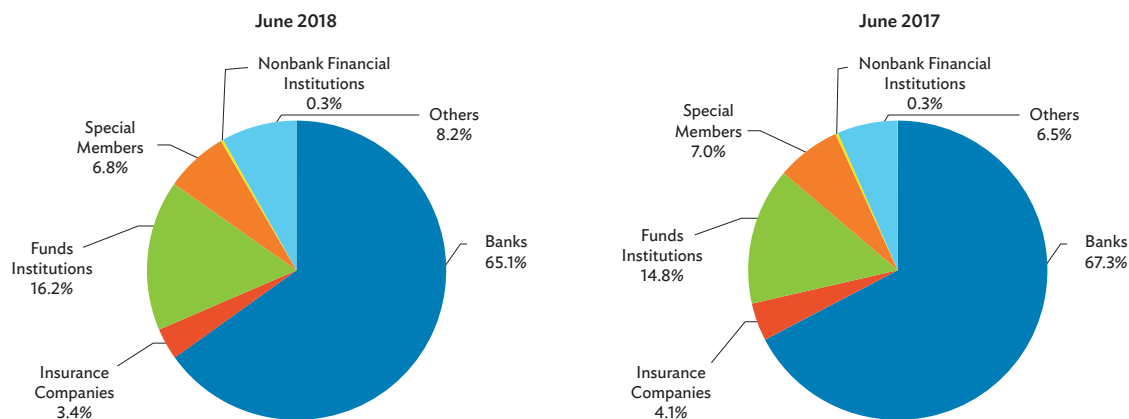
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

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

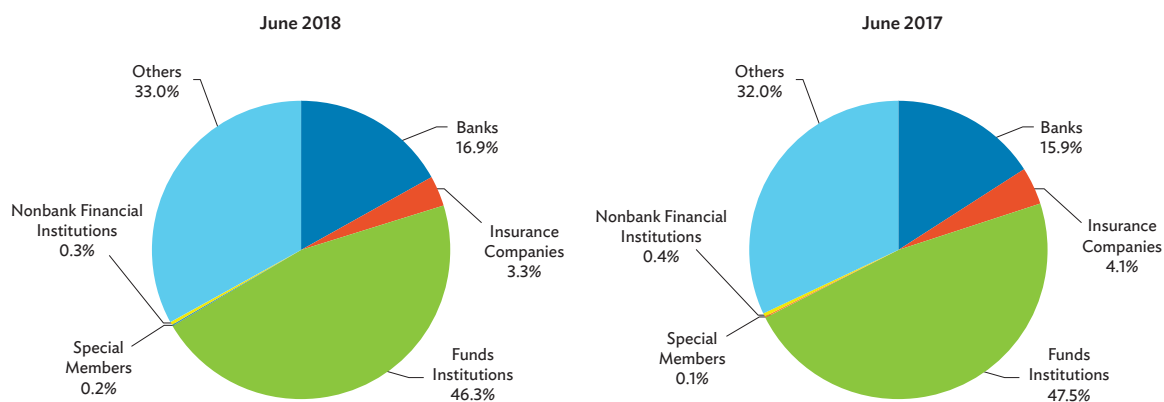
Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway Corp			3-year bond	4.56	7.0
5-year bond	4.15	13.0	3-year bond	4.58	12.0
5-year bond	4.52	10.0	3-year bond	4.55	7.0
5-year bond	4.42	13.0	Agricultural Bank of China		
5-year bond	4.46	10.0	10-year bond	4.45	40.0
5-year bond	4.63	13.0	China CITIC Securities		
5-year bond	4.46	10.0	2-year bond	5.10	3.0
5-year bond	4.46	10.0	2-year bond	5.05	4.8
10-year bond	4.80	10.0	3-year bond	4.90	0.6
10-year bond	4.78	10.0	3-year bond	5.09	2.5
10-year bond	4.74	7.0	3-year bond	4.80	2.4
10-year bond	4.78	7.0	Tianjin Infrastructure Construction and Investment (Group)		
10-year bond	4.73	7.0	3-year bond	5.19	1.8
10-year bond	4.78	10.0	3-year bond	4.55	1.0
10-year bond	4.78	10.0	3-year bond	5.13	1.0
Central Huijin Investment			5-year bond	4.73	2.0
2-year bond	4.52	9.0	5-year bond	5.40	2.0
2-year bond	4.50	3.0	5-year bond	5.48	1.2
2-year bond	4.47	8.0	5-year bond	5.20	3.0

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

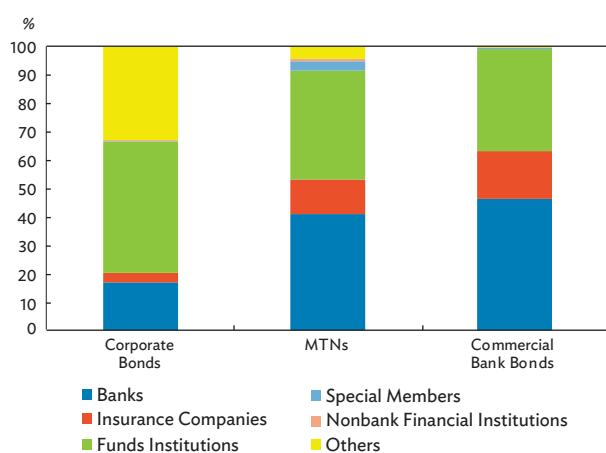
Figure 3: Local Currency Treasury Bonds and Policy Bank Bonds Investor Profile



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-June 2018.
 Source: ChinaBond.

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

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	
		Q2 2018	q-o-q
7-Day Repo Rate	4,903.1	83.28	10.05
Overnight SHIBOR	15.0	0.25	(6.60)
3-Month SHIBOR	849.1	14.42	8.44
1-Year Lending Rate	2.4	0.01	n.a.
LPR1Y	0.5	0.04	n.a.
3-Year Lending Rate	0.1	0.01	(70.57)
5-Year Lending Rate	0.3	0.00	(89.38)
Depository Institution 7-Day Repo Rate	38.0	0.01	(84.62)
10-Year Bond Yield	75.7	0.65	304.26
10-Year Treasury Yield	0.7	1.28	310.03
3-Year AAA Short-Term Notes/ Government Debt	0.3	0.01	250.00
10-Year Bond Yield/10-Year Government Bond Yield	1.7	0.01	(62.50)
Loan Interest Rate—1 Year * 1.10	0.5	0.03	415.15
Loan Interest Rate—1 Year * 1.05	0.5	0.01	-
Total	5,887.7	100.00	2.51

(-) = negative, CNY = Chinese yuan, LPR1Y = 1-Year Loan Prime Rate, n.a. = not available, q-o-q = quarter-on-quarter, Q2 = second quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
 Note: Growth rate computed based on notional amounts.
 Sources: AsianBondsOnline and ChinaMoney.