

# Market Summaries

## People's Republic of China

### Yield Movements

Between 31 August and 15 October, the People's Republic of China's (PRC) yield curve shifted slightly downward by an average of 2.3 basis points (bps) (**Figure 1**). The largest shift was for the 15-year tenor, with the yield falling 8 bps. All other tenors fell between 1 bp and 2 bps.

For much of 2018, the PRC's yields have been trending downward, largely due to the weakening of the domestic economy. In addition, the PRC has been beset by numerous corporate bond defaults and increased economic uncertainty as a result of the ongoing trade war with the United States (US).

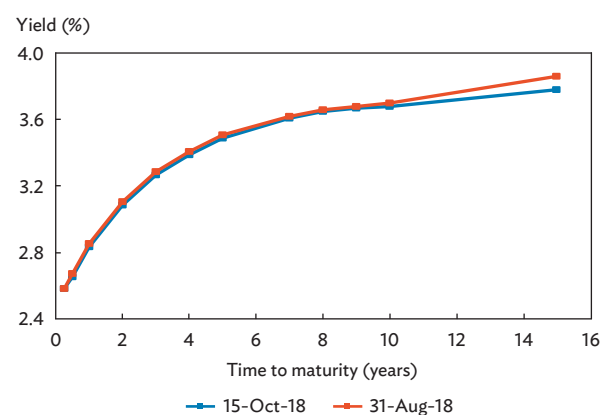
These concerns largely continued in the third quarter (Q3) of 2018, leading to a decline of 5.8% between 31 August and 15 October in the PRC's equity markets. The PRC's currency also depreciated 1.2% versus the US dollar in the same period.

In an effort to help stabilize the economy, the PRC has ceased or slowed its deleveraging activities. On the monetary side, the People's Bank of China (PBOC) released the China Monetary Policy Report Quarter Two, 2018, which reiterated that the PBOC will continue its sound and neutral monetary policy while maintaining total financing at an appropriate level. The report said that the PBOC would "strike a balance between steady growth, structural adjustments, and risk prevention," replacing the term "deleveraging" used in the first quarter report with "structural adjustments."<sup>14</sup>

In order to help promote liquidity, the PBOC also has made a number of reserve requirement ratio cuts, with the latest cut of 100 bps coming on 7 October.

The Government of the PRC has engaged in various stimulus measures in 2018. On 23 July, the State Council announced measures to help boost economic growth, including the increase of a previous CNY1.1 trillion tax

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



Source: Based on data from Bloomberg LP.

cut to CNY1.165 trillion. The cuts for R&D expenses were expanded from applying to technology companies only to all enterprises. The government also announced that it would accelerate issuance of CNY1.35 trillion in "special bonds" by local governments.

While the yield curve of the PRC largely shifted downward during the review period, the overall decrease in the yield curve was small due to volatility over the course of Q3 2018. Yields in the PRC rose in August and September, following an increase in inflation in August when consumer prices rose 2.3% year-on-year (y-o-y) after gaining 2.1% y-o-y in July. Inflation further accelerated to 2.5% y-o-y in September.

There were initial concerns that the PRC's stimulus measures such as the increased issuance of special bonds would affect liquidity in the market. In September, interbank liquidity was strained due to cash withdrawals in preparation for the long holiday in October as well as some corporate tax payments. Nevertheless, the PRC's yields saw an overall decline during the review period.

<sup>14</sup> People's Bank of China. 2018. *China Monetary Policy Report Quarter Two, 2018*. <http://www.pbc.gov.cn/english/resource/cms/2018/09/2018091310133940652.docx>.

Ongoing trade tensions with the US have affected economic sentiment and the PRC economy continues to slow. Gross domestic product growth fell to 6.5% y-o-y in the third quarter (Q3) of 2018 from 6.7% y-o-y in the second quarter (Q2) of 2018.

## Size and Composition

The PRC's local currency (LCY) bonds outstanding rose 5.7% quarter-on-quarter (q-o-q) and 15.5% y-o-y to reach CNY63.2 trillion (USD 9.2 trillion). The PRC's bond market q-o-q growth rate quickened from the previous quarter's 3.8% expansion (**Table 1**).

**Government bonds.** The PRC's government bond market grew 6.3% q-o-q in Q3 2018 after expanding 4.4% q-o-q in Q2 2018. The faster growth rate was driven by the rapid increase in Treasury bonds and other government bonds, which grew 8.7% q-o-q in Q3 2018, up from 5.1% q-o-q in the previous quarter.

Local government bonds, which grew 12.5% q-o-q in Q3 2018 compared with 6.9% q-o-q in Q2 2018, also contributed to the gains. More of the local government bonds issued during this period were special bonds, which are a type of project bond for local governments. Proceeds from the bonds can be used for various local government projects and earnings from the projects can

be used to repay the bond, as opposed to the general revenue measures of the local government.

This type of issuance is part of the Government of the PRC's stimulus measures, which include a 2018 issuance quota of CNY1.35 trillion for local governments. However, local governments were slow to issue special bonds earlier in the year, selling only CNY360.9 billion in the first half of 2018. The government then later issued guidelines stating that local governments needed to meet 80% of their annual special bond quota by the end of September and the remainder in October. In response, local governments issued a total of CNY2.4 trillion in local government bonds in Q3 2018, of which CNY1.3 trillion were special bonds. The remainder came largely from the local government debt-swap program, which ended in August.

There were no central bank bonds outstanding in Q3 2018 as the PBOC no longer issues such bonds.

**Corporate bonds.** The PRC's corporate bonds outstanding grew 4.1% q-o-q in Q3 2018, up from Q2 2018's growth of 2.1% q-o-q. While all bond categories except for state-owned enterprise bonds and local corporate bonds showed strong positive growth rates, the growth was driven primarily by capital-raising efforts by banks as well as issuances of medium-term notes, as companies took advantage of lower interest rates (**Table 2**).

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>54,693</b>	<b>8,221</b>	<b>59,762</b>	<b>9,026</b>	<b>63,160</b>	<b>9,195</b>	<b>5.3</b>	<b>14.2</b>	<b>5.7</b>	<b>15.5</b>
<b>Government</b>	<b>39,438</b>	<b>5,928</b>	<b>43,352</b>	<b>6,548</b>	<b>46,072</b>	<b>6,707</b>	<b>6.1</b>	<b>19.0</b>	<b>6.3</b>	<b>16.8</b>
Treasury Bonds and Local Government Bonds	26,340	3,959	29,347	4,432	31,888	4,642	7.9	26.0	8.7	21.1
Central Bank Bonds	0	0	0	0	0	0	0.0	(100.0)	0.0	0.0
Policy Bank Bonds	13,098	1,969	14,005	2,115	14,184	2,065	2.7	7.2	1.3	8.3
<b>Corporate</b>	<b>15,255</b>	<b>2,293</b>	<b>16,410</b>	<b>2,479</b>	<b>17,088</b>	<b>2,488</b>	<b>3.3</b>	<b>3.5</b>	<b>4.1</b>	<b>12.0</b>
<b>Policy Bank Bonds</b>										
China Development Bank	7,331	1,102	7,743	1,169	7,979	1,162	2.1	4.0	3.0	8.8
Export-Import Bank of China	2,280	343	2,366	357	2,299	335	2.9	12.4	(2.9)	0.8
Agricultural Devt. Bank of China	3,488	524	3,895	588	3,907	569	4.0	11.2	0.3	12.0

(-) = 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 Information, and Bloomberg LP.

**Table 2: Corporate Bonds Outstanding in Key Categories**

	Amount (CNY billion)			Growth Rate (%)			
	Q3 2017	Q2 2018	Q3 2018	Q3 2017		Q3 2018	
				q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	2,915	3,226	3,449	1.1	22.9	6.9	18.4
SOE Bonds	508	468	443	1.0	(9.2)	(5.4)	(12.9)
Local Corporate Bonds	3,060	2,771	2,591	1.0	5.1	(6.5)	(15.3)
Commercial Paper	1,549	1,715	1,886	0.9	(34.9)	9.9	21.8
Asset-Backed Securities	672	1,020	1,184	1.1	43.3	16.1	76.1
Medium-Term Notes	4,816	5,222	5,464	1.0	4.6	4.6	13.4

( ) = 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 Information.

While the PRC has eased its deleveraging stance, it continues to remain guarded against risks and is focusing on debt reduction among state-owned enterprises. On 13 September, the State Council announced that by 2020 state-owned enterprises needed to cut their debt ratios by 2 percentage points from end-2017 levels.

Among major corporate bond types, issuance in Q3 2018 grew for medium-term notes and commercial bank bonds, driven by capital-raising efforts designed to strengthen balance sheets amid uncertainty and rising debt defaults (**Figure 2**). While comprising a relatively small portion of the PRC's corporate bonds, asset-backed securities

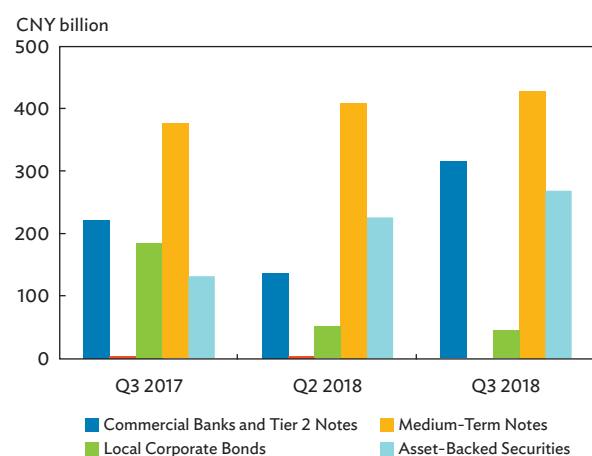
have been making a comeback and their issuance and outstanding amounts have risen rapidly since the asset-backed market was restarted in 2012. While banks have issued asset-backed securities to offload nonperforming assets, the majority of the issuances were consumer-based loans from financing companies seeking ways to free up liquidity and raise additional funds.

The PRC's LCY corporate bond market continues to be dominated by a few big issuers (**Table 3**). At the end of Q3 2018, the top 30 corporate bond issuers accounted for CNY7.1 trillion worth of corporate bonds outstanding, or about 41.4% of the total market. Of the top 30, the 10 largest issuers accounted for CNY4.6 trillion. China Railway, the top issuer, had more than five times the outstanding amount of bonds as the 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 the largest corporate bond issuances in Q3 2018. The top issuers consisted largely of banks and state-owned enterprises.

## Investor Profile

**Treasury bonds and policy bank bonds.** Banks were the single-largest holders of Treasury bonds and policy bank bonds at the end of September, though their share declined to 64.9% from 66.8% a year earlier (**Figure 3**). In contrast, the share held by funds institutions was roughly unchanged at 16.4% versus 16.2% a year earlier.

**Figure 2: Corporate Bond Issuance in Key Sectors**

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

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	1840.5	267.95	Yes	No	Transportation
2.	Bank of China	358.9	52.25	Yes	Yes	Banking
3.	Agricultural Bank of China	358.0	52.12	Yes	Yes	Banking
4.	Industrial and Commercial Bank of China	356.0	51.83	Yes	Yes	Banking
5.	State Grid Corporation of China	336.7	49.02	Yes	No	Public Utilities
6.	China National Petroleum	320.0	46.59	Yes	No	Energy
7.	China Construction Bank	315.0	45.86	Yes	Yes	Banking
8.	Bank of Communications	255.0	37.12	No	Yes	Banking
9.	Central Huijin Investment	252.0	36.69	Yes	No	Asset Management
10.	Shanghai Pudong Development Bank	238.6	34.74	No	Yes	Banking
11.	China CITIC Bank	222.5	32.39	No	Yes	Banking
12.	China Minsheng Banking	185.1	26.95	No	Yes	Banking
13.	China Everbright Bank	180.9	26.34	Yes	Yes	Banking
14.	Industrial Bank	155.0	22.57	No	Yes	Banking
15.	State Power Investment	154.7	22.53	Yes	No	Energy
16.	Huaxia Bank	148.4	21.60	Yes	No	Banking
17.	Tianjin Infrastructure Construction and Investment Group	137.3	19.99	Yes	No	Industrial
18.	CITIC Securities	123.3	17.95	Yes	Yes	Brokerage
19.	Bank of Beijing	122.9	17.89	Yes	Yes	Banking
20.	PetroChina	105.0	15.29	Yes	Yes	Energy
21.	China Cinda Asset Management	100.0	14.56	Yes	Yes	Asset Management
22.	China Merchants Securities	98.4	14.33	No	Yes	Brokerage
23.	China Merchants Bank	96.0	13.98	Yes	Yes	Banking
24.	Datong Coal Mine Group	93.5	13.61	Yes	No	Coal
25.	Dalian Wanda Commercial Properties	93.0	13.54	No	Yes	Real Estate
26.	China Datang	88.7	12.91	Yes	Yes	Energy
27.	Shaanxi Coal and Chemical Industry Group	88.5	12.88	Yes	No	Energy
28.	China Southern Power Grid	85.5	12.45	Yes	No	Power
29.	Haitong Securities	84.6	12.32	No	Yes	Brokerage
30.	China Three Gorges	83.0	12.08	Yes	No	Public Utilities
<b>Total Top 30 LCY Corporate Issuers</b>		<b>7,076.98</b>	<b>1,030.31</b>			
<b>Total LCY Corporate Bonds</b>		<b>17,088.45</b>	<b>2,487.84</b>			
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>41.4%</b>	<b>41.4%</b>			

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

Notes:

1. Data as of 30 September 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 Third Quarter of 2018**

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
Central Huijin Investment		
1-year bond	3.43	9
1-year bond	3.60	11
1-year bond	4.00	9
3-year bond	3.86	7
3-year bond	4.05	7
3-year bond	4.24	7
5-year bond	4.23	2
5-year bond	4.12	13
China Railway Corporation		
5-year bond	4.09	7
5-year bond	4.15	10
5-year bond	4.18	7
10-year bond	4.53	10
20-year bond	4.65	13
20-year bond	4.65	13
China Construction Bank		
10-year bond	4.86	43
Bank of China		
10-year bond	4.86	40
Shanghai Pudong Development Bank		
10-year bond	4.96	20
10-year bond	4.96	20

CNY = Chinese yuan.

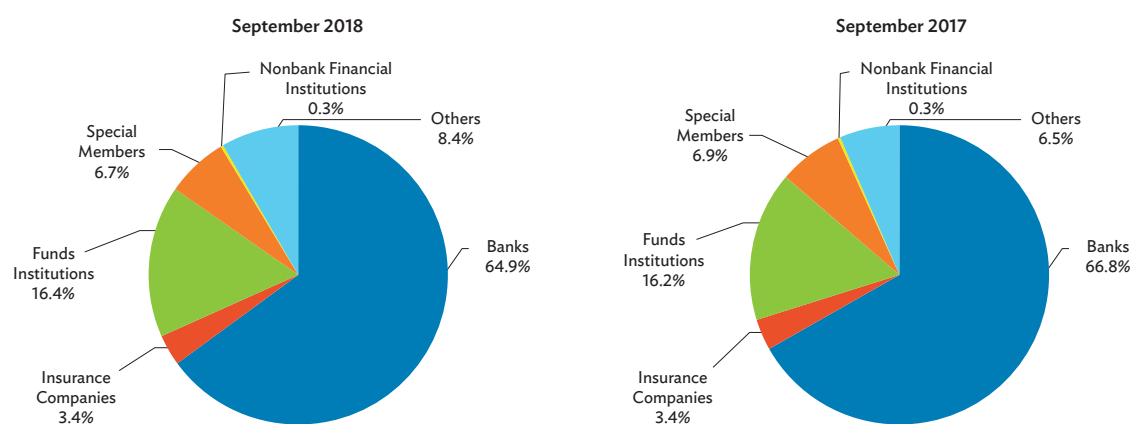
Source: Based on data from Bloomberg LP.

**Corporate bonds.** Funds institutions were the largest holders of LCY corporate bonds at the end of September with a share of 46.6% of total outstanding corporate bonds, down from 48.2% at the end of September 2017 (Figure 4). The share held by banks rose to 17.7% from 15.8% during the review period.

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

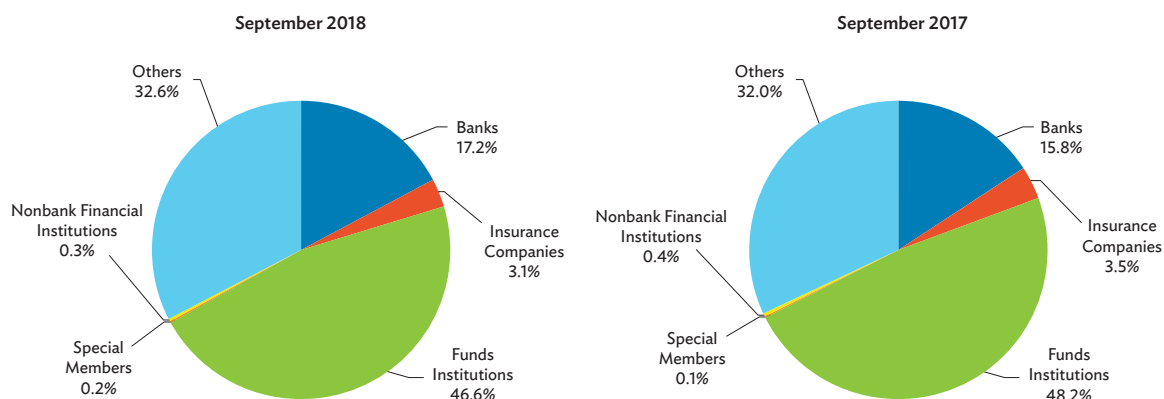
## Liquidity

The volume of interest rate swaps fell 15.1% q-o-q in Q3 2018. The 7-day repurchase rate swaps remained the most used interest rate swap, comprising a 75.8% share of the total interest rate swap volume during the quarter (Table 5).

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

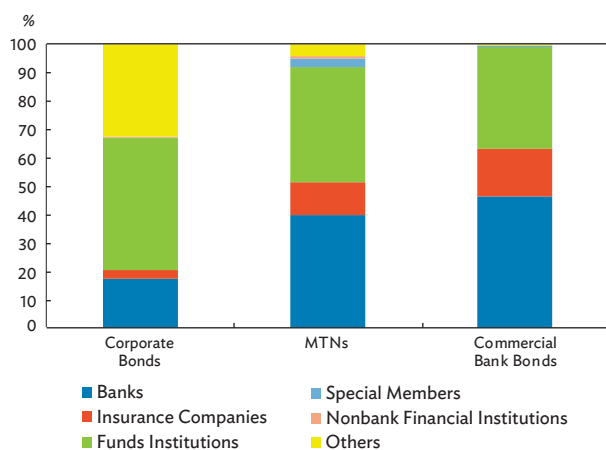
Source: ChinaBond.

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 2018.  
 Source: ChinaBond.

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

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	Growth Rate (%)
7-Day Repo Rate	3,786.5	75.77	(22.77)
Overnight SHIBOR	11.3	0.23	(24.67)
3-Month SHIBOR	1,109.0	22.19	30.60
1-Year Lending Rate	3.9	0.08	1,154.84
LPR1Y	5.4	0.11	126.59
3-Year Lending Rate	2.2	0.04	388.89
5-Year Lending Rate	0.1	0.00	-
10-Year Bond Yield	21.2	0.42	(44.21)
10-Year Treasury Yield	54.7	1.09	(27.76)
3-Year AAA Short-Term Notes/ Government Debt	0.6	0.01	(14.29)
Loan Interest Rate—1 Year * 1.10	2.1	0.04	20.59
Loan Interest Rate—1 Year * 1.05	0.4	0.01	(23.00)
<b>Total</b>	<b>4,997.2</b>	<b>100.00</b>	<b>(15.12)</b>

( ) = negative, - = not applicable, CNY = Chinese yuan, LPR1Y = 1-Year Loan Prime Rate, 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.

## Policy, Institutional, and Regulatory Developments

### The Government Seeks to Reduce State-Owned Debt

On 13 September, the State Council announced that state-owned enterprises must cut their debt ratios by 2 percentage points by 2020 from their levels at the end of 2017. The PRC will also help create an environment to allow firms to reduce their debt. Other measures to be taken include promoting mergers and restructuring state-owned corporations, allowing “zombie” firms to go bankrupt, promoting market-based debt–equity swaps, and banning lending by financial firms to state-owned enterprises being monitored for debt risks.

### People's Bank of China Reduces Reserve Requirement Ratio

On 7 October, the PBOC reduced the reserve requirement ratio of large commercial banks, joint stock commercial banks, city commercial banks, non-country rural commercial banks, and foreign-funded commercial banks by 100 bps. In addition, the PBOC announced that maturing funds from its Medium-Term Lending Facility for that day would not be renewed, effectively using some funds freed by the reserve requirement ratio cut to repay the lending facility. The PBOC said that the net effect would be a release of CNY750 billion of funds into the banking system.

### People's Bank of China to Set Up Facility for Corporate Bond Issuance

On 24 October, the PBOC announced that it would provide guidelines to establish a facility to help promote bond issuance by private companies. Funds for the facility would initially come from a loan from the PBOC. Managers of the facility would use it to provide credit enhancements such as guarantees.