

Market Summaries

People's Republic of China

Yield Movements

The People's Republic of China's (PRC) yield curve for local currency (LCY) bonds shifted downward for all tenors except short-dated tenors between 1 June and 15 August (**Figure 1**). For tenors of 1 year or longer, yields fell an average of 21 basis points (bps). In contrast, yields for tenors less than 1 year rose an average of 10 bps. The 2-year versus 10-year yield spread fell between 1 June and 15 August from 49 bps to 32 bps.

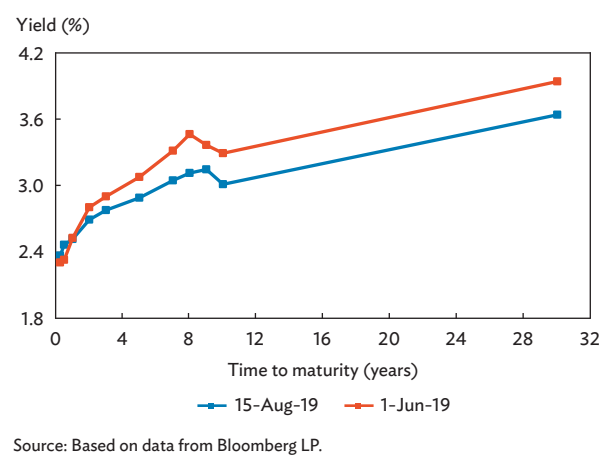
Yields for longer-dated tenors declined largely due to ongoing economic challenges facing the PRC, both domestic and external. On the domestic front, the PRC's economy continued to show signs of weakening. The gross domestic product (GDP) growth rate decelerated to 6.2% year-on-year (y-o-y) in the second quarter (Q2) of 2019 from 6.4% y-o-y in the first quarter (Q1). Industrial production weakened, with growth falling to 4.8% y-o-y in July from 6.3% y-o-y in June. Retail sales growth also declined to 7.6% y-o-y in July from 9.8% y-o-y in the previous month.

The external environment has also proved to be challenging to the PRC amid the ongoing trade dispute with the United States (US). Exports have been relatively weak, with the PRC reporting export growth of 3.3% y-o-y in July after a 1.3% y-o-y contraction in June.

The PRC's inflation rate has remained stable. Consumer prices grew 2.8% y-o-y in July after rising 2.7% y-o-y in June. Inflation has been largely supply-side driven, with food prices leading the increases mainly due to supply shocks impacting pork prices over the outbreak of swine flu.

While longer-term yields generally reflect economic conditions, shorter-term interest rates in the PRC follow funding conditions as demand increased in June before easing toward the end of the month due to corporate cash needs driven by end-of-period balance sheet reporting, before spiking again in July due to corporate tax

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



payments. In addition, funding difficulties were noted for smaller lenders due to heightened risk aversion following the government takeover of Baoshang Bank on 24 May to control credit risks.

Size and Composition

LCY bonds outstanding in the PRC rose 4.0% quarter-on-quarter (q-o-q) in Q2 2019, an acceleration from 3.0% q-o-q growth in Q1 2019. On an annual basis, LCY bonds grew 16.7% y-o-y (**Table 1**).

Government bonds. The government bond market continued to expand in Q2 2019, with growth accelerating to 4.2% q-o-q from 2.5% q-o-q in Q1 2019. A rapid increase in government bonds outstanding was largely due to government efforts to mitigate the headwinds facing the PRC economy. As a result, local government bonds continued their strong growth, expanding 5.4% q-o-q in Q2 2019 after rising 5.2% in Q1 2019, driven by an increase in the local government bond quota in March. In addition, local governments have been instructed to complete their 2019 bond issuance by the end of September.

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q2 2018		Q1 2019		Q2 2019		Q2 2018		Q2 2019	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	67,720	10,228	76,012	11,325	79,049	11,512	3.9	15.4	4.0	16.7
Government	44,114	6,663	49,061	7,309	51,135	7,447	4.4	16.0	4.2	15.9
Treasury Bonds and Other Government Bonds	13,841	2,091	14,882	2,217	15,461	2,252	2.8	10.1	3.9	11.7
Central Bank Bonds	0	0	2	0	4	1	0.0	0.0	166.7	0.0
Policy Bank Bonds	14,005	2,115	14,776	2,201	15,213	2,215	3.0	9.8	3.0	8.6
Local Government Bonds	16,268	2,457	19,401	2,890	20,457	2,979	7.0	28.0	5.4	25.7
Corporate	23,606	3,565	26,951	4,015	27,914	4,065	3.1	14.2	3.6	18.3
Policy Bank Bonds										
China Development Bank	7,743	1,169	8,328	1,241	8,580	1,250	2.3	7.8	3.0	10.8
Export-Import Bank of China	2,366	357	2,444	364	2,533	369	1.6	6.8	3.6	7.0
Agricultural Devt. Bank of China	3,895	588	4,005	597	4,100	597	5.3	16.1	2.4	5.3

() = negative, CNY = Chinese yuan, 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 local currency-USD rates are used.
 4. Growth rates are calculated from local currency base and do not include currency effects.
- Sources: CEIC and Bloomberg LP.

The issuance of local government bonds is mostly designed to finance local infrastructure projects. However, in June, regulators relaxed rules governing special bonds issued by local governments, allowing the use of proceeds in lieu of equity capital for some projects.

Treasury bond issuance also increased in Q2 2019, growing 159.9% q-o-q in Q2 2019 after contracting 52.2% q-o-q in Q1.

Corporate bonds. The corporate bond market grew 3.6% q-o-q in Q2 2019, down from 4.1% q-o-q growth in the previous quarter. Growth in corporate bonds slowed over concerns about the PRC's economy as well as corporate bond defaults (**Table 2**).

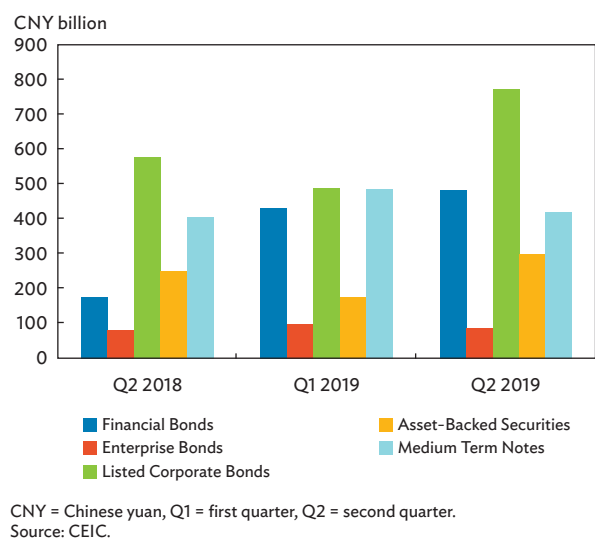
Increased issuance was noted for financial bonds, listed corporate bonds, and asset-backed securities in Q2 2019 versus Q1 2019 (**Figure 2**).

The PRC's LCY corporate bond market continued to be dominated by a few big issuers (**Table 3**). At the end of Q2 2019, the top 30 corporate bond issuers accounted for CNY7.7 trillion worth of corporate bonds outstanding, or about 27.5% of the total market. Of the top 30, the 10 largest issuers accounted for CNY4.8 trillion. China Railway, the top issuer, had more than four times the outstanding amount of bonds as the second-largest issuer, Industrial Commercial Bank

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q2 2018	Q1 2019	Q2 2019	Q2 2018		Q2 2019	
				q-o-q	y-o-y	q-o-q	y-o-y
Financial Bonds	3,854	4,744	5,042	1.0	21.0	6.3	30.8
Enterprise Bonds	4,205	3,872	3,834	1.0	(6.4)	(1.0)	(8.8)
Listed Corporated Bonds	5,759	6,608	7,024	1.1	25.5	6.3	22.0
Commercial Papers	1,741	2,240	2,197	1.0	2.6	(1.9)	26.2
Medium Term Notes	5,056	5,813	5,919	1.0	12.2	1.8	17.1
Asset-Backed Securities	1,164	1,728	1,924	1.2	67.1	11.3	65.3

() = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, y-o-y = year-on-year.
Source: CEIC.

Figure 2: Corporate Bond Issuance in Key Sectors

of China. The top 30 issuers included 13 banks, who continue to generate funding to strengthen their capital bases, improve liquidity, and lengthen their maturity profiles.

Table 4 lists the largest corporate bond issuances in Q2 2019. The top issuers consisted largely of banks and state-owned enterprises.

Investor Profile

Government bonds. Among the major government bond categories, banks were the single-largest holder at the end of June, owning more than 70% of the total outstanding government bonds (**Figure 3**). The concentration of bank holdings is the highest for local government bonds, as banks are asked by the government to support the funding efforts of local governments. Policy banks are the next largest holder of local government bonds.

Unincorporated products were the second largest holder of policy bank bonds after banks.⁷

Liquidity

The volume of interest rate swaps rose 17.6% q-o-q in Q2 2019. The 7-day repurchase remained the most used interest rate swap, comprising a 75.3% share of the total interest rate swap volume during the quarter (**Table 5**).

Policy, Institutional, and Regulatory Developments

The People's Republic of China Relaxes Restrictions on Use of Local Government Bonds Proceeds

On 11 June, the Government of the PRC allowed local governments to use funds raised from the issuance of special bonds for the 20%–25% equity requirement for certain types of infrastructure projects in order to boost infrastructure spending. The central government also said this would encourage local governments to issue special bonds with tenors longer than 10 years and use the proceeds of special bonds for Belt and Road Initiative projects, shanty-town renovations, and urban and rural infrastructure projects.

The People's Bank of China Reduces Reserve Requirement Ratio for Rural Banks

On 20 August, the People's Bank of China (PBOC) announced that it would make changes to how the benchmark loan prime rate is used. The PBOC said that banks are encouraged to use the loan prime rate as the benchmark for loan pricing instead of the existing 1-year benchmark lending rate. In addition, banks will need to link loan prime rate pricing to the rates used for the PBOC's existing medium-term lending facility. The goal of the PBOC is to reduce interest rate costs charged to borrowers.

⁷ Unincorporated products include banks' wealth management products, securities investment funds, trust funds, and insurance products.

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	1,765.5	257.1	Yes	No	Transportation
2.	Industrial and Commercial Bank of China	439.7	64.0	Yes	Yes	Banking
3.	Agricultural Bank of China	418.2	60.9	Yes	Yes	Banking
4.	Bank of China	412.0	60.0	Yes	Yes	Banking
5.	Central Huijin Investment	343.4	50.0	Yes	No	Asset Management
6.	China Construction Bank	327.2	47.6	Yes	Yes	Banking
7.	State Grid Corporation of China	320.0	46.6	Yes	No	Public Utilities
8.	China Minsheng Banking	290.0	42.2	No	Yes	Banking
9.	China CITIC Bank	267.6	39.0	No	Yes	Banking
10.	Bank of Communications	265.9	38.7	No	Yes	Banking
11.	Shanghai Pudong Development Bank	265.3	38.6	No	Yes	Banking
12.	China National Petroleum	260.8	38.0	Yes	No	Energy
13.	Industrial Bank	205.3	29.9	No	Yes	Banking
14.	State Power Investment	173.4	25.3	Yes	No	Energy
15.	Tianjin Infrastructure Construction and Investment Group	163.8	23.9	Yes	No	Industrial
16.	China Everbright Bank	161.5	23.5	Yes	Yes	Banking
17.	Huaxia Bank	143.9	21.0	Yes	No	Banking
18.	Ping An Bank	138.0	20.1	No	Yes	Banking
19.	CITIC Securities	133.4	19.4	Yes	Yes	Brokerage
20.	China Merchants Bank	126.7	18.4	Yes	Yes	Banking
21.	PetroChina	125.0	18.2	Yes	Yes	Energy
22.	Datong Coal Mine Group	120.8	17.6	Yes	No	Coal
23.	China Datang	113.5	16.5	Yes	Yes	Energy
24.	China Southern Power Grid	105.5	15.4	Yes	No	Energy
25.	China Merchants Securities	103.0	15.0	No	Yes	Brokerage
26.	China Three Gorges Corporation	102.1	14.9	Yes	No	Power
27.	China Life Insurance	100.0	14.6	Yes	Yes	Insurance
28.	GF Securities	98.0	14.3	No	Yes	Brokerage
29.	Guotai Junan Securities	93.0	13.5	No	Yes	Financial
30.	Haitong Securities	93.0	13.5	No	Yes	Brokerage
Total Top 30 LCY Corporate Issuers		7,675.3	1,117.7			
Total LCY Corporate Bonds		27,914.1	4,065.1			
Top 30 as % of Total LCY Corporate Bonds		27.5%	27.5%			

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

Notes:

1. Data as of 30 June 2019.

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

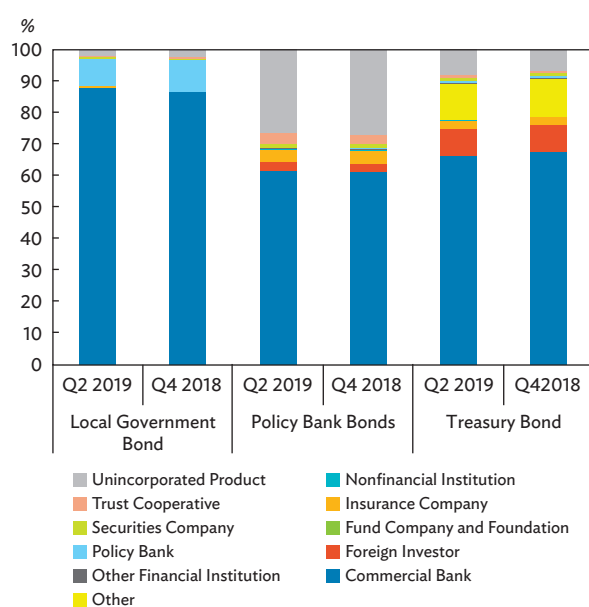
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 4: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2019

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
Central Huijin Investment		
3-year bond	3.40	13.0
3-year bond	3.45	13.0
3-year bond	3.47	10.0
3-year bond	3.74	10.0
5-year bond	3.70	7.0
5-year bond	3.83	7.0
5-year bond	4.06	5.0
5-year bond	3.78	5.0
Agricultural Bank of China		
10-year bond	4.30	40.0
15-year bond	4.63	20.0
Industrial and Commercial Bank of China		
10-year bond	4.40	45.0
15-year bond	4.69	10.0
State Power Investment Corporation		
3-year bond	3.90	2.9
3-year bond	3.85	2.8
3-year bond	4.00	2.3
3-year bond	3.87	2.0
3-year bond	3.77	1.8
3-year bond	3.75	1.7
3-year bond	3.73	1.5
3-year bond	3.73	1.5

CNY = Chinese yuan.

Source: Based on data from Bloomberg LP.

Figure 3: Government Bonds Investor Profile**Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in the Second Quarter of 2019**

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	Growth Rate (%)
		Q2 2019	q-o-q
7-Day Repo Rate	33,894.5	75.3	19.4
Overnight SHIBOR	10,489.7	23.3	14.5
3-Month SHIBOR	339.0	0.8	110.6
1-Year Term Deposit Rate	157.5	0.4	-
1-Year Lending Rate	132.5	0.3	29.3
Loan Interest Rate 1 Year	0.0	-	(100.0)
5-Year Lending Rate	27.5	0.1	192.6
Depository Institution 7-Day Repo Rate	0.5	-	(97.0)
3-Year AAA Short-Term Notes/ Government Debt	0.0	-	(100.0)
Loan Interest Rate—5 Year * 1.05	0.00	-	(100.0)
Total	45,041.2	100.0	17.6

(-) = negative, - = not applicable, CNY = Chinese yuan, 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*.