

Market Summaries

People's Republic of China

Yield Movements

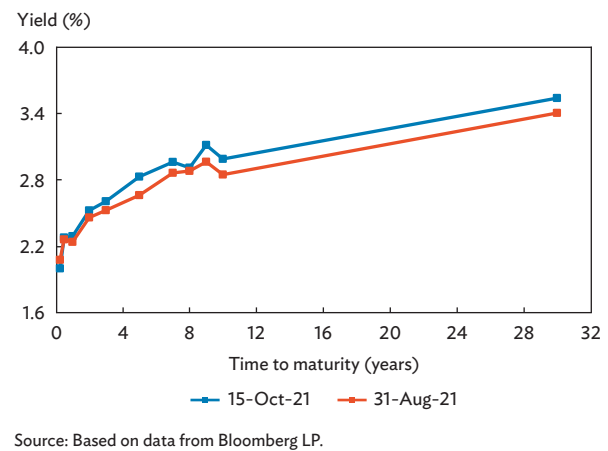
The People's Republic of China's (PRC) yield curve shifted upward for all tenors except the 3-month tenor, which fell 8 basis points (bps), between 31 August and 15 October (Figure 1). The remaining tenors rose an average of 9 bps, with the steepest increases seen for the 5-year tenor at 17 bps and for the 9-year to 30-year tenors, which rose between 13 and 15 bps. As a result of the rise in yields, particularly for the longer-dated maturities, the 2-year versus 10-year yield spread rose 8 bps from the end of August to 15 October.

The PRC's yield curve rose despite economic indicators showing that the domestic economy was slowing down. The PRC's gross domestic product growth fell to 4.9% year-on-year (y-o-y) in the third quarter (Q3) of 2021 from 7.9% y-o-y in the second (Q2) quarter. Economic growth fell largely due to a deceleration in the secondary sector, where growth declined from 7.5% in Q2 2021 to 3.6% in Q3 2021, and in the tertiary sector, in which growth fell from 8.3% to 5.4%. The growth rate in the primary sector fell to 7.1% from 7.5% in the same period.

The growth rate of industrial production has also been steadily declining from a high of 35.1% y-o-y in the first 2 months of 2021 to 3.1% y-o-y in September. Consumer demand, as measured by retail sales, also weakened with double-digit growth rates posted from January through June before falling to 8.5% in July and 2.5% in August, and rising to 4.4% in September.

Several reasons abound for the rise in yields despite softening growth. Following the reserve requirement rate reduction by the People's Bank of China (PBOC) in July, markets expected either a reduction in its loan prime rate or additional reserve requirement rate cuts. However, the PBOC so far has done neither, disappointing market expectations. In addition, despite economic weakness and turmoil in the property sector with several real estate companies at the brink of default, the Government of the PRC has not strongly shifted from its risk control focus.

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



Inflationary concerns also manifest. While consumer price inflation has been tame, with the inflation rate trending downward from 1.3% y-o-y in May to 0.7% y-o-y in September, producer price inflation has been rising strongly. September producer price inflation rose to 10.7% y-o-y from 9.5% y-o-y in August. The inflation rate was at 0.3% y-o-y in January. There are concerns that high producer prices will eventually make their way to consumer prices as the cost increases get passed on.

Size and Composition

Growth in the PRC's local currency (LCY) bond market accelerated to 3.8% quarter-on-quarter (q-o-q) in Q3 2021 from 3.0% q-o-q in Q2 2021, with bonds outstanding at the end of September reaching CNY110.6 trillion (USD17.2 trillion) (Table 1). However, the growth rate fell on a y-o-y basis to 12.6% in Q3 2021 from 14.4% in the preceding quarter.

Government bonds. Government bonds outstanding in the PRC grew 4.0% q-o-q to CNY71.1 trillion, accelerating from a 3.3% q-o-q gain in the previous quarter. Treasury and other government bonds and bank bonds all showed

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q3 2020		Q2 2021		Q3 2021		Q3 2020		Q3 2021	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	98,178	14,457	106,590	16,507	110,589	17,159	5.4	19.9	3.8	12.6
Government	62,747	9,240	68,384	10,591	71,129	11,037	6.6	18.6	4.0	13.4
Treasury Bonds and Other Government Bonds	19,327	2,846	21,548	3,337	22,342	3,467	8.7	21.1	3.7	15.6
Central Bank Bonds	15	2	15	2	15	2	0.0	0.0	0.0	0.0
Policy Bank Bonds	17,489	2,575	18,658	2,890	19,253	2,987	5.0	13.2	3.2	10.1
Local Government Bonds	25,915	3,816	28,163	4,362	29,519	4,580	6.1	20.6	4.8	13.9
Corporate	35,432	5,217	38,207	5,917	39,460	6,123	3.2	22.2	3.3	11.4

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

Sources: CEIC Data Company and Bloomberg LP.

an acceleration in growth rates, while the outstanding amount of central bank bonds remained unchanged.

The outstanding local government bonds growth rate dipped slightly to 4.8% q-o-q in Q3 2021 from 5.2% q-o-q in Q2 2021 due to base effects. After tepid issuance in the first quarter of 2021, local government bond issuance rose 173.5% q-o-q in Q2 2021 as local governments sought to complete their bond quotas. Local government bond issuance dipped slightly in Q3 2021, falling 7.0% q-o-q. Local government bond issuance is still expected to remain strong for the year, as net issuance for the first 9 months was only 61.0% of the allotted quota for 2021.

Growth in Treasury and other bonds outstanding accelerated to 3.7% q-o-q, to reach CNY22.3 trillion, from 2.5% q-o-q in the previous quarter, driven by a 37.6% q-o-q jump in issuance. Policy bank bonds also gained 3.2% q-o-q to reach CNY19.3 trillion, up from 1.5% q-o-q growth in Q2 2021. However, issuance of policy bank bonds in Q3 2021 was roughly comparable to Q2 2021.

Corporate bonds. The PRC's corporate bonds outstanding rose 3.3% q-o-q to CNY39.5 trillion after gaining 2.3% q-o-q in the previous quarter. While overall corporate bond growth accelerated, corporate bond issuance was significantly higher in Q3 2021, rising 17.1% q-o-q as a number of companies issued bonds to refinance maturing obligations.

Growth in outstanding corporate bonds was mainly from financial bonds, with a number of financial institutions issuing tier 2 bonds to raise capital, resulting in a

5.1% q-o-q gain in financial bonds outstanding (**Table 2**). Regulators have encouraged financial institutions to bolster their capital bases in the wake of a potential economic slowdown as well as rising corporate bond defaults. Asset-backed securities were the second-biggest gainer, with such bonds expanding 4.9% q-o-q. Demand for listed corporate bonds only gained 3.2% q-o-q but grew 17.9% y-o-y. Given rising interest rates, interest in commercial paper waned; while commercial paper outstanding gained 2.4% q-o-q, it declined 13.4% y-o-y.

Issuance amounts of financial bonds remained strong with levels in Q3 2021 similar to Q2 2021 (**Figure 2**). Issuance of commercial paper showed an increase as companies rolled over their existing maturities. Issuance of listed corporate bonds was the highest among all the major bond categories, driving the overall increase in the y-o-y growth rate of corporate bonds outstanding.

The top 30 issuers' share of total LCY corporate bonds outstanding stood at 28.3% at end of September (**Table 3**). The total amount of the top 30 was at CNY11.1 trillion and the 10 largest issuers accounted for CNY7.3 trillion. China Railway remained the largest issuer, accounting for 24.5% of the total bonds outstanding of the top 30 issuers. Due to capital-raising efforts, 14 banks were among the top 30 list of top issuers.

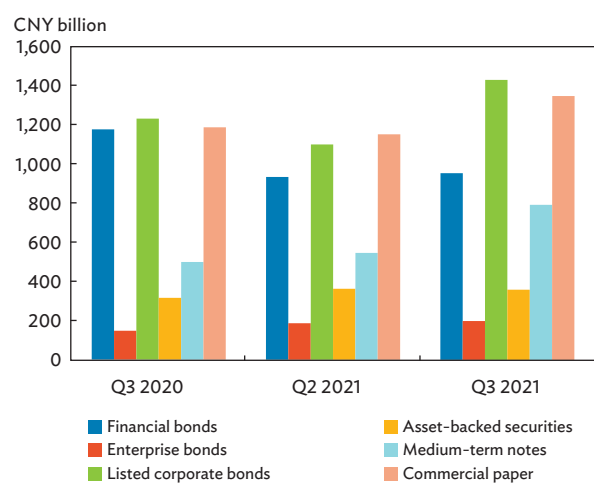
Table 4 lists the largest corporate bond issuances in Q3 2021. Of the five top issuers, four were financial institutions that sought to bolster their capital bases. China State Railway Group was the sole nonfinancial issuer among the top five issuances for Q3 2021.

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
	Q3 2020	Q2 2021	Q3 2021	Q3 2020		Q3 2021	
				q-o-q	y-o-y	q-o-q	y-o-y
Financial Bonds	7,166	8,038	8,447	1.1	30.2	5.1	17.9
Enterprise Bonds	3,826	3,808	3,876	1.0	(0.3)	1.8	1.3
Listed Corporate Bonds	9,619	10,986	11,341	1.1	32.7	3.2	17.9
Commercial Paper	2,694	2,279	2,334	1.0	25.2	2.4	(13.4)
Medium-Term Notes	7,351	7,457	7,623	1.0	19.7	2.2	3.7
Asset-Backed Securities	2,519	3,075	3,225	1.0	21.1	4.9	28.1

(-) = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third quarter, y-o-y = year-on-year.
Source: CEIC Data Company.

Figure 2: Corporate Bond Issuance in Key Sectors



CNY = Chinese yuan, Q2 = second quarter, Q3 = third quarter.
Source: ChinaBond.

Investor Profile

Government bonds. Commercial banks were still the dominant investor group in government bonds in Q3 2021, but their share of outstanding bonds declined from a year earlier (**Figure 3**). However, banks still have an overwhelming presence in the local government bond market with a share of 86.9%.

Banks are still the major holders of Treasury bonds, with a 65.2% share in Q3 2021. But continued foreign investor interest has led to rapid gains in their share of Treasury bonds, which rose from 9.7% in Q2 2021 to 11.4% in Q3 2021. Foreign investors have also made significant inroads in policy bank bonds, with the foreign investor share rising to 5.5% from 4.8% in the same period.

Liquidity

The volume of interest rate swaps fell 4.6% q-o-q in Q3 2021 (**Table 5**). The 7-day repo rate was the most active instrument, while repo transactions exclusive to banks and other deposit taking institutions have fallen.

Policy, Institutional, and Regulatory Developments

Southbound Trading of Bond Connect Launched

In September, the Hong Kong Monetary Authority and the PBOC jointly announced the opening of the southbound leg of the Bond Connect scheme. This will allow residents in the PRC to buy bonds in Hong Kong, China, thereby facilitating outward investment flows. The PBOC said that total transactions reached CNY4 billion during the first day of the launch.

Tax Incentives for Foreign Investors Extended

In October, the PRC extended tax exemptions for foreign investors in the PRC's domestic bond market, which was set to expire in November. The incentives exempt foreign investors from corporate income taxes and value-added taxes on bond investments. Exemptions were extended until the end of 2025.

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	2,735.5	424.45	Yes	No	Transportation
2. Industrial and Commercial Bank of China	721.4	111.93	Yes	Yes	Banking
3. Bank of China	688.1	106.77	Yes	Yes	Banking
4. Agricultural Bank of China	650.3	100.90	Yes	Yes	Banking
5. Bank of Communications	575.7	89.33	No	Yes	Banking
6. Shanghai Pudong Development Bank	470.6	73.02	Yes	Yes	Banking
7. China Construction Bank	468.1	72.62	Yes	Yes	Banking
8. Central Huijin Investment	416.0	64.55	Yes	No	Asset Management
9. China CITIC Bank	315.0	48.88	No	Yes	Banking
10. Industrial Bank	286.2	44.41	No	Yes	Banking
11. China Minsheng Bank	270.0	41.89	No	Yes	Banking
12. China National Petroleum	269.9	41.88	Yes	No	Energy
13. State Grid Corporation of China	262.5	40.73	Yes	No	Public Utilities
14. State Power Investment	256.5	39.81	Yes	No	Power
15. China Securities Finance	242.0	37.55	Yes	No	Finance
16. Postal Savings Bank of China	220.0	34.14	Yes	Yes	Banking
17. China Everbright Bank	215.9	33.50	No	Yes	Banking
18. China Merchants Bank	209.2	32.46	No	Yes	Banking
19. Ping An Bank	185.0	28.71	No	Yes	Banking
20. CITIC Securities	181.5	28.16	Yes	Yes	Brokerage
21. Huaxia Bank	180.0	27.93	No	Yes	Banking
22. China Southern Power Grid	165.6	25.70	Yes	No	Public Utilities
23. Huatai Securities	163.2	25.32	No	Yes	Brokerage
24. Tianjin Infrastructure Investment Group	157.5	24.44	Yes	No	Capital Goods
25. China Merchants Securities	155.8	24.17	No	No	Brokerage
26. Shaanxi Coal and Chemical Industry Group	155.0	24.05	Yes	Yes	Coal
27. Shenwan Hongyuan Securities	139.0	21.57	No	No	Brokerage
28. GF Securities	134.0	20.79	No	Yes	Brokerage
29. Guotai Junan Securities	131.1	20.35	Yes	Yes	Brokerage
30. Haitong Securities	128.3	19.91	No	Yes	Brokerage
Total Top 30 LCY Corporate Issuers	11,149.0	1,729.9			
Total LCY Corporate Bonds	39,459.6	6,122.7			
Top 30 as % of Total LCY Corporate Bonds	28.3%	28.3%			

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

Notes:

1. Data as of 30 September 2021.

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.

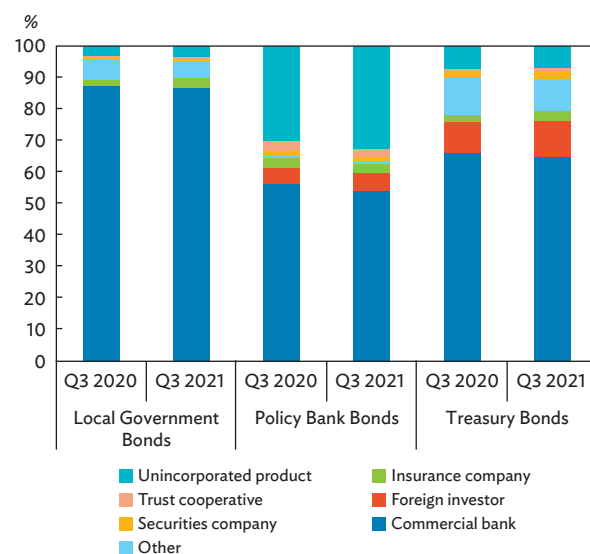
Table 4: Notable Local Currency Corporate Bond Issuances in the Third Quarter of 2021

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
Postal Savings Bank of China		
1-year bond	4.06	41.5
10-year bond	3.44	50.0
China Construction Bank^a		
1-year bond	3.93	20.0
1-year bond	3.87	20.0
10-year bond	3.45	6.0
15-year bond	3.80	15.0
China State Railway Group		
5-year bond	316.00	15.0
10-year bond	3.30	20.0
30-year bond	3.78	5.0
Guotai Junan Securities^a		
1-year bond	2.75	2.0
3-year bond	3.01	2.8
3-year bond	3.09	4.4
3-year bond	3.13	1.9
5-year bond	3.35	4.2
5-year bond	3.48	6.1
10-year bond	3.77	3.0
10-year bond	3.80	3.4
20-year bond	3.80	5.0
20-year bond	3.80	5.0
Shenwan Hongyuan Securities^a		
2-year bond	2.95	2.3
3-year bond	3.04	2.8
3-year bond	3.13	2.0
3-year bond	3.02	3.0
3-year bond	3.05	4.8
3-year bond	3.10	2.3
5-year bond	3.40	1.0
5-year bond	3.38	4.2
10-year bond	3.77	3.0
10-year bond	3.75	3.0
Perpetual bond	3.70	3.3

CNY = Chinese yuan.

^a Multiple issuance of the same tenor indicates issuance on different dates.

Source: Based on data from Bloomberg LP.

Figure 3: Local Currency Treasury Bonds and Policy Bank Bonds Investor Profile**Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in the Third Quarter of 2021**

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Share of Total Notional Amount (%)	Growth Rate (%)
	Q3 2021	Q3 2021	q-o-q
7-Day Repo Rate	4,692.1	86.5	(3.2)
Overnight SHIBOR	7.2	0.1	(29.8)
3-Month SHIBOR	688.3	12.7	(14.0)
1-Year Lending Rate	20.8	0.4	73.7
5-Year Lending Rate	1.5	0.03	(20.5)
10-Year Treasury Yield	5.5	0.1	3.8
China Development Bank 10-Year Bond Yield	5.9	0.1	22.9
10-Year Corporate and Government Bond Yield	5.5	0.1	22.2
Total	5,426.8	100.0	(4.6)

() = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q3 = third quarter, Repo = repurchase agreement, SHIBOR = Shanghai Interbank Offered Rate.

Note: Growth rate computed based on notional amounts.

Sources: AsianBondsOnline and ChinaMoney.