Chinese bonds

The long march to global inclusion

The China bond market continues to grow, as issuers tap the country’s vast pool of savings to fund their operations. The third largest global bond market after the U.S. and Japan, the value of China’s onshore debt reached nearly RMB 56.3 trillion at the end of 2016, while UBS believes the market might double in size over the next five years.

No place like home
While domestic institutional investors — mostly banks — dominate the market, global investors have gradually increased their exposure to China’s domestic bonds, attracted by the market’s mix of liquidity, high yields, varied duration and diversified pool of issuers.

As of the end of 2016, foreign investors were holding RMB 852.6 billion in domestic bonds, already exceeding their exposure to so-called “dim sum” bonds, or RMB bonds issued offshore. While investors generally perceive “dim sum” bonds as less risky than domestic debt instruments, the offshore market’s limited diversity and lack of depth impair its overall attractiveness.

The recent emergence of RMB-denominated instruments issued in China by foreign entities, dubbed panda bonds, further enhances the domestic bond market for issuers and investors alike. Companies planning to use bond proceeds in China incur no currency risk when issuing panda bonds, while investors have taken notice of the profile of panda bonds issuers, which include entities like the Asian Development Bank, HSBC, the Republic of Korea, the National Bank of Canada and Daimler. Issuers raised RMB 130 billion by issuing panda bonds in 2016, an amount expected to increase by 50% this year as per JP Morgan data.

Open door policy…for some
While China’s regulatory authorities appear committed to opening up the country’s financial system, the pace of reform remains uncertain. Still, regulators have made it easier for foreign investors to access the interbank bond market. In addition to the quota schemes, known as Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII), certain institutional investors are now free to invest in the Chinese Interbank Bond Market (“CIBM”) with few restrictions. This gradual shift to a registration-based, quota-free system for the CIBM is another sign that the market may be opening faster than anticipated, at least for institutional investors deemed “mid-term or long-term” by regulators.

Premier Li Keqiang also announced on March 15 China’s intention to let investors buy onshore debt via Hong Kong, presumably through a “bond connect” scheme modeled on the stock connects already linking the HKEX with bourses in Shanghai and Shenzhen. While details remain sketchy, the scheme, to be launched this year, would provide both institutional and retail investors with a new channel to invest in Chinese bonds.

Keeping an eye on the RMB
The status of the currency is crucial. The recent inclusion of the RMB in the IMF’s SDR basket was perceived as a significant milestone in the internationalization of the yuan. While the progressive opening of the PRC’s capital account is likely to be slow as China seeks to manage capital flows, the country remains keen to attract and retain funds. In this respect, operating a domestic bond market that is appealing to both domestic and foreign investors is an important component of this complex transition.
The case for indices

As the accessibility of the Chinese domestic bond market increases, so is the need for relevant indices that can properly capture its diversity while providing global investors with the sort of dynamic, evolving benchmarks they need in order to make the best of these opportunities. While the ultimate goal of Chinese domestic bond inclusion in global indices remains elusive, there is still ample demand for China-related debt indices.

Bloomberg Professional subscribers can now access a total of thirteen China indices, including the Bloomberg Barclays China Treasury + Policy Bank Index, the Bloomberg Barclays China Aggregate Index, and the Bloomberg Barclays China Treasury Index.

Following the recommendations emerging from its ongoing global index review and governance process, Bloomberg recently implemented a number of changes to the Bloomberg Barclays Fixed Income indices and Currency indices. These changes, effective from March 2017, include:

- The lifting of the minimum amount outstanding for inclusion in the China Aggregate Index from RMB 1 billion to RMB 5 billion for government securities and from RMB 1 billion to RMB 1.5 billion for corporate securities. Additionally, all eligible securities should be traded in the China Interbank Bond Market.

- The creation of a new index combining the Global Aggregate Index and the government and policy bank components of the China Aggregate Index, as RMB-denominated securities are not currently eligible for inclusion in the Global Aggregate Index.

- The introduction of the EM Local Currency Government + China Index in two versions — market capitalization-weighted and 10% country-capped.

Additional details can be found in “Changes to Bloomberg Barclays Benchmark Fixed Income Indices,” which is available to Bloomberg Professional subscribers at NH BIP <GO>.

Other indices that may be relevant in this context include the Bloomberg Barclays EM Local Currency Government + China Index and the Bloomberg Barclays Global Aggregate + China Index, which are the first hybrid China indices being introduced globally.

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