

# The Growth of China's Inter-Bank Corporate Bond Market<sup>1</sup>

## I. Overview of China's Corporate Bond Market

After more than 20 years in development, the China's bond market has developed into a multi-layered market, comprising of three segments: the national inter-bank market, the exchange market and the bank counters, among which the inter-bank market plays the dominant role. The inter-bank market accounts for more than 95% of the trading volume in China's bond market (Table 1). China's bond investors now enjoy a broad array of fixed-income securities with different risk and return profiles. The major investors in the China's bond market are commercial banks, insurance companies, mutual funds and securities companies etc., among which commercial banks are the dominant players in the inter-bank market. From Table 2 we can see that the inter-bank market accounts for nearly 70% of bond depository balance in China's bond market,

**Table 1 Trading Activities in Chinese Bond Market (billion RMB)**

	2010.1Q		2009.4Q	
	Trading Volume	Percentage	Trading Volume	Percentage
Inter-bank Market	<b>29797.6</b>	<b>95.88%</b>	<b>29111.3</b>	<b>96.17%</b>
Exchange Market	1280.4	4.12%	1158.5	3.83%
Bank Counter Market	0.99	0.003%	0.91	0.003%
Total	31078.9	100%	30270.7	100%

Source:NAFMII

**Table 2 Bond Depository Balance in CGSDTC (billion RMB)**

	2010.1Q		2009.4Q	
	Balance	Percentage	Balance	Percentage
Commercial Banks	<b>12730.7</b>	<b>70.41%</b>	<b>12149.6</b>	<b>69.31%</b>
Special Members*	1826.4	10.10%	1863.3	10.63%
Insurance Companies	1654.7	9.15%	1576.7	8.99%
Mutual Funds	851.8	4.71%	795.9	4.54%
Total	18081.3	100%	17529.5	100%

**CGSDTC: China Government Securities Depository Trust & Clearing co., Ltd**

<sup>1</sup> Part of this paper is presented at the Workshop on Developing Corporate Bond Market, jointly organized by Asia-Pacific Finance and Development Center (AFDC) and Asian Development Bank (ADB), July 26-28, Shanghai, People's Republic of China.

**\*: Special Members include PBOC, Ministry of Finance and policy banks etc.**

Source:NAFMII

Currently, in China, there are six types of non-financial corporation bonds regulated by different authorities and traded in different markets (Table 3). Short-term corporate financing bills (CPs). Medium-term notes (MTNs) and SME Collective Notes are regulated by PBOC (People’s Bank of China) and NAFMII (National Association of Financial Market Institutional Investors). They are traded in the inter-bank market. Enterprise bonds are regulated by NDRC (National Development and Reform Commission) and traded in both inter-bank and exchange markets. While corporate bonds (also called Listed company bonds) and convertible bonds are regulated by CSRC and traded in the exchange market. Quite different from the situations in overseas countries, China’s corporate bond market includes not only the enterprise bonds or listed company bonds but also non-financial corporate debt-financing instruments, comprising of six types of non-financial corporation bonds. The inter-bank corporate bond market has four instruments: CPs, MTNs, enterprise bonds and SME collective notes.

**Table 3 Instruments in China’s Corporate Bond Market**

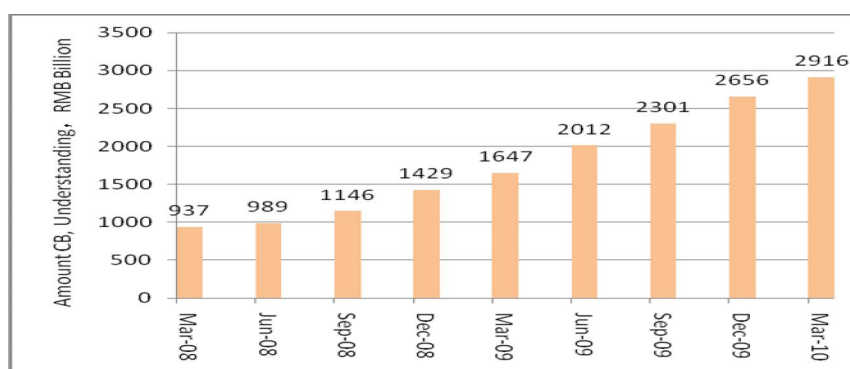
	Regulated by	Traded in
<b>Short-term Corporate Financing Bills (CPs)</b>	PBOC and NAFMII	the inter-bank market
<b>Medium-Term Notes (MTNs)</b>	PBOC and NAFMII	the inter-bank market
<b>SME Collective Notes</b>	PBOC and NAFMII	the inter-bank market
<b>Enterprise Bonds</b>	NDRC	the inter-bank and exchange markets
<b>Corporate Bonds (Listed Company Bonds)</b>	CSRC	the exchange market
<b>Convertible Bonds</b>	CSRC	the exchange market

## **II. Growth of China’s Corporate Bond Market**

By the end of March 2010, the total amount of bonds outstanding was RMB 18,475 billion, among which government bonds, central bank bills, financial institution bonds and non-financial corporate debt-financing instruments represented 31.78%, 23.71%, 28.63% and 15.79% of the total market respectively.

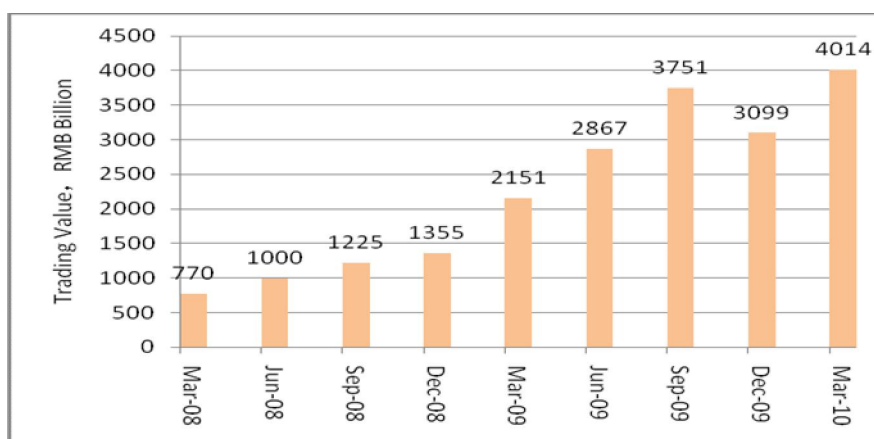
If we look at corporate bond market, it's obvious to see that the market has been expanding remarkably, The amount of corporate bonds outstanding has tripled in the past 2 years, up from 937 billion RMB in first quarter of 2008 to 2916 billion RMB in first quarter of 2010 (Figure 1). The quarterly trading volume of the inter-bank corporate market has increased by more than 5 times in the recent 2 years, from 770 billion RMB in first quarter of 2008 to 4014 billion RMB in first quarter of 2010 (Figure 2). Corporate bonds' share of bonds outstanding amount is nearly 15 percent in first quarter of 2010 compared with 7 percent in first quarter of 2008. Corporate bonds' percentage of quarterly trading volume has increased from less than 10 percent in first quarter of 2008 to nearly 35 percent in first quarter of 2010.

**Figure 1 Amount of corporate bonds outstanding (billion RMB).**



Source:NAFMII

**Figure 2 Trading volume of corporate bond in inter-bank market (billion RMB).**



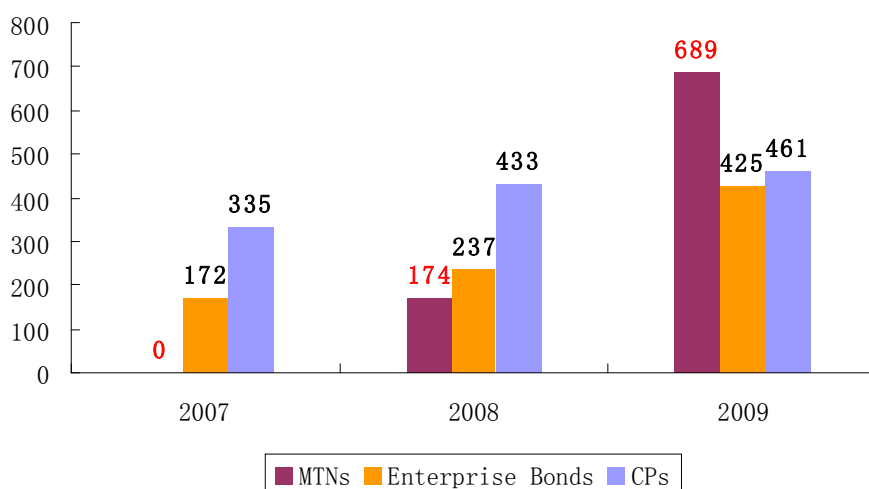
Source:NAFMII

The dramatic growth in China's corporate bond market is attributed to the following three aspects: issuance supply and demand (Figure 3). From the perspective of issuance, we can find that product innovation (that is introduction of MTNs) leads to more corporate bond issuance. But product innovation alone can't lead to the growth of corporate bond market. Thus we should dig deep to figure out why corporations are attempted to use the new instrument for financing needs and why investors are willing to buy and trade. The above three aspects are the factors behind high liquidity of China's inter-bank corporate bond market.

### III. Decoding The Growth of China's Inter-bank Corporate Bond Market

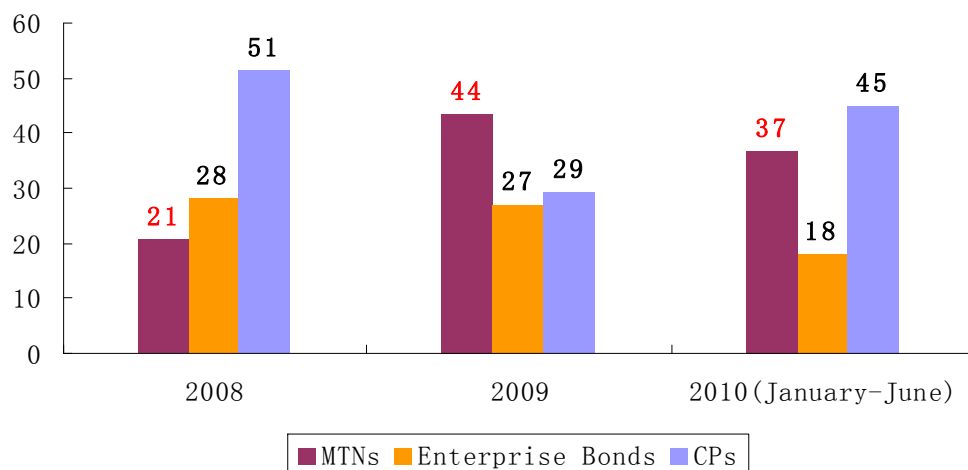
Firstly, since the issuance of the first MTN in April 2008, the issuance volume of MTNs have grown dramatically, with volume of 689 billion RMB in 2009, more than 300% higher in the previous year (Figure 3). The share of MTNs in terms of total corporate bond issuance volume has increased from 21% in 2008 to 44% in 2009 (Figure 4). Last year near half of corporate bond issuance volume came from MTNs. The introduction of MTNs contributes greatly to the rapid growth of Chinese corporate bond market. And if we further look at the supply side and demand side of MTNs, we will find out what drives the rise of MTNs.

**Figure 3 Corporate Bond Issuance Volume (billion RMB)**



Source: [www.chinabond.com.cn](http://www.chinabond.com.cn)

**Figure 4 Share of Corporate Bond Issuance Volume (%)**



Source: [www.chinabond.com.cn](http://www.chinabond.com.cn)

To corporations or issuers, MTNs came with much less rigid issuance requirements than enterprise bonds with more flexibility in bond issuance. After completion of the registration, the enterprises may issue MTNs in small amounts, consecutive or cyclical mode and have great flexibilities in offering amount, maturity and issuance time. Enterprises may even capitalize on the fluctuation of market interest rates and seek to launch the MTNs issuance during the most advantageous time.

The rapid development of MTNs benefits from the close bank-enterprise relationship, especially the interaction between large central SOEs and large commercial banks. China's financial system is featured by banks being the dominant player and banking system is the main source of external corporate financing. As China's credit rating agencies are not mature, commercial banks are the ones with the best knowledge of the corporations. Commercial banks' role in underwriting and buying MTNs alleviates the problems associated with underdevelopment of credit rating system and facilitates MTNs' issuance. From Table 4 we can see that the 7 issuers with the largest issuance volume are either large central SOEs such as State Grid, PetroChina, Sinopec, China Telecom, Shenhua Group, or central governmental agencies such as Ministry of Railway. The big 7 issued 321 billion RMB MTNs in 2009, making up for 46.52%,

nearly half of the total MTNs issuance volume. The largest MTN issuance in 2009 were all underwritten by large State-owned commercial banks such as ICBC (Industrial and Commercial Bank of China), BOC(Bank of China) , CCB(China Construction Bank), ABC(Agricultural Bank of China) and BCM (Bank of Communications) (Table 5). The close relationship between large central SOEs and large commercial banks contributes greatly to the explosive growth of MTNs market.

**Table 4 Issuance Volume of MTNs in 2009 (billon RMB)**

Issuer	Issuance Volume	Percentage (%)
State Grid	90	13.04
PetroChina	86	12.46
Ministry of Railways	40	5.80
Sinopec	30	4.35
China Telecom Corporation	30	4.35
Beijing State-owned Assets Operation Center	25	3.62
Shenhua Group	20	2.90
Big 7 Combined	321	46.52
Total	690.00	100

Source: Wind, www.chinabond.com.cn

**Table 5 Top MTNs Issuance in 2009 (billon RMB)**

MTNs Issued	Issuance Volume	Underwriters
PetroChinaMTN1	20	ICBC
State Grid MTN1	30	China Development Bank, BCM
Sinopec MTN2	20	ICBC, CCB
Ministry of Railways MTN3	20	BOC, ABC
State Grid MTN2	30	ABC, BOC
PetroChinaMTN2	30	ICBC
Shenhua MTN1	20	CEB, ICBC
State Grid MTN3	30	ICBC, CCB

Source: Wind, www.chinabond.com.cn

Why are commercial banks, the dominant investor in the inter-bank corporate bond market, willing to buy and trade MTNs? Because no bank guarantee is required for the issuance of MTN which are real credit bonds and have credit spread. When interest rates stay, low commercial banks are willing to take more risk for higher

return. Recently China has cut rate amid concerns about the impact of sub-prime crisis and keeps the level of interest rates low until now. During the past 1 and a half years the yield-to-maturity of 5 year policy bank bond and the yield-to-maturity of 5 year treasury bond have remained between 2 to 3 percent. The credit spread between 5 year triple-A MTN and 5 year policy bank bond has remained from 60 to 100 basis points during the past 1 and a half years, with the one between 5 year triple-A MTN and 5 year treasury bond from 100 to 160 basis points during the same period . Unlike insurance companies and mutual funds which can invest both bonds and stocks, Chinese commercial banks' investment -portfolio are restricted to fixed-income instruments only, including government bonds, policy bank bonds, high-grade enterprise bonds, commercial bank subordinate bonds, CPs and MTNs. Restrictions are imposed on the investment of low-grade corporate bonds and other credit products. Thus the credit spread and good credit rating attract commercial banks to hold and trade MTN actively.

#### **IV. Conclusions**

Firstly, It is through the introduction of MTNs product innovation that leads to more corporate bond issuance. Secondly, commercial banks' role in underwriting and buying MTNs the bank-enterprise relationship has made MTNs' issuance flexible and efficient and MTNs' growth benefits from banks' dominant role in the financial system. Last but not least, faced with low level of interest rates , commercial banks' holding and trading MTNs has increased the liquidity of inter-bank corporate bond market.

(Edited by Ji Rui and Wu Ningqin)