HKEX
香港交易所

June 2022

ETF Focus

Navigating China's Onshore Bond Market: A Quick Primer

While the Chinese bond market seems complex, it is becoming an essential part of China portfolios today. In this issue of ETF Focus, we will provide an overview of the Chinese bond market, starting with a look at the different types of bonds trading onshore.

Dominance of government bonds

China's bond market is the second largest in the world. By the end of 2021, the outstanding amount of bonds in China's onshore markets exceeded RMB130 trillion, achieving a compound annual growth rate of 19.6% from 2012 to 2021. The top 3 bond types in China's onshore bond market include: [1]

Data as of end-2021	Outstanding value (RMB trillion)	% of China's bond market
Municipal bond	30.30	23.24%
Central government bond	23.03	17.66%
Policy bank bond	20.46	15.69%

The largest segment of China's bond market is **municipal bond** (or local government bond), which has seen explosive growth since 2014 after China allowed provincial governments to issue bonds in a bid to rein in the formation of hidden debts and make local government borrowing more transparent. By the end of 2021, the size of outstanding municipal bonds has expanded to over RMB30 trillion. Municipal bond yields at issuance averaged 3.36% in 2021, with average maturity of 11.9 years, offering local governments a low-cost, long-term financing vehicle. [2]

Central government bonds (CGBs), the second largest bond type in China, are issued by the Ministry of Finance to fund large-scale infrastructure projects. With low correlation to other major bond markets, and supported by China's strong fiscal position, CGBs are widely recognised as portfolio diversifiers that come with attractive risk-adjusted returns.

The third largest bond type, **policy bank bonds**, accounted for the majority of turnover in China's bond market. In 2021, their trading value reached RMB83 trillion, more than double that of CGBs. Policy bank bonds are issued by the three policy banks of China to fund China's infrastructure development. The average yield of policy bank bonds was 2.70% in March 2022, slightly higher than the average yield of 2.53% in CGBs.[3]

In addition to the "rates" market that includes the three types of bonds mentioned above, the onshore "credit" market, which includes corporate bonds, enterprise bonds, financial bonds, and asset-backed securities and so on, is another important pillar of the Chinese bond market, accounting for around 43% of outstanding bond value at the end of 2021.[4]

[1] Source: Wind. Data as of end-December 2021
[2] Source: Ministry of Finance
[3] Source: CCDC. Average yields of key maturities (excluding the overnight yield)
[4] Source: Wind

Benefits of investing in Chinese bonds

One of the major advantages of investing in Chinese bonds is their superior risk-return profile compared to bonds issued in other major economies. We compared the ratio of index return to annualized volatility of selective bond indexes in the Bloomberg Barclays USD Aggregate Index series and found that the China index has the highest return-to-volatility ratio among major bond markets during 2011 to September 2021 (see table below). Furthermore, the low correlation of Chinese bonds with other asset classes make them an ideal instrument for spreading risk.

Correlation coefficients and risk-return profile of selected bond indices (2011 – Sep 2021) [5]

	Global	US	Europe	Japan	UK	China
Correlation coefficients of daily returns						
Global	—	0.60	0.44	0.24	0.75	0.18
US	0.60	—	0.48	0.15	0.42	0.02
Europe	0.44	0.48	—	0.15	0.40	0.04
Japan	0.24	0.15	0.15	—	0.11	0.05
UK	0.75	0.42	0.40	0.11	—	0.17
China	0.18	0.02	0.04	0.05	0.17	—
Average correlation coefficient	**0.44**	**0.33**	**0.30**	**0.14**	**0.37**	**0.09**
Risk-return profile						
10-year period return (%) (A)	27%	43%	48%	17%	43%	63%
10-year annualised return volatility (%) (B)	4.5%	3.3%	3.0%	2.0%	8.7%	3.2%
Return-to-volatility ratio **[(A)/(B)]**	**6.0**	**13.2**	**16.2**	**8.5**	**4.9**	**19.6**

Source: HKEX, **"Broadening International Investor Participation in the Mainland Bond Market"**, February 2022.

The wide range of bond types in China's onshore market creates diverse income opportunities for investors. With HK$12.0 billion of AUM in China fixed income ETFs by the end of May 2022, Hong Kong's ETF market provides international investors with a low-cost platform for accessing income opportunities in Chinese bonds.

Learn more: www.hkex.com.hk/etp

[5] 10-year annualised return volatility is calculated as the standard deviation of daily returns times the square root of 252 (the assumed number of trading days in a year). Global — Bloomberg Barclays Global Aggregate Index (USD unhedged); US — Bloomberg Barclays US Aggregate Index (USD unhedged); Europe — Bloomberg Barclays Euro Aggregate Index (USD unhedged); Japan — Bloomberg Barclays Japan Aggregate Index (USD unhedged); UK — Bloomberg Barclays UK Aggregate Index (USD unhedged); China — Bloomberg Barclays China Aggregate Index (USD unhedged)

Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square, 8 Connaught Place, Central, Hong Kong
info@hkex.com.hk (t) +852 2522 1122 I (f) +852 2295 3106 hkexgroup.com I hkex.com.hk