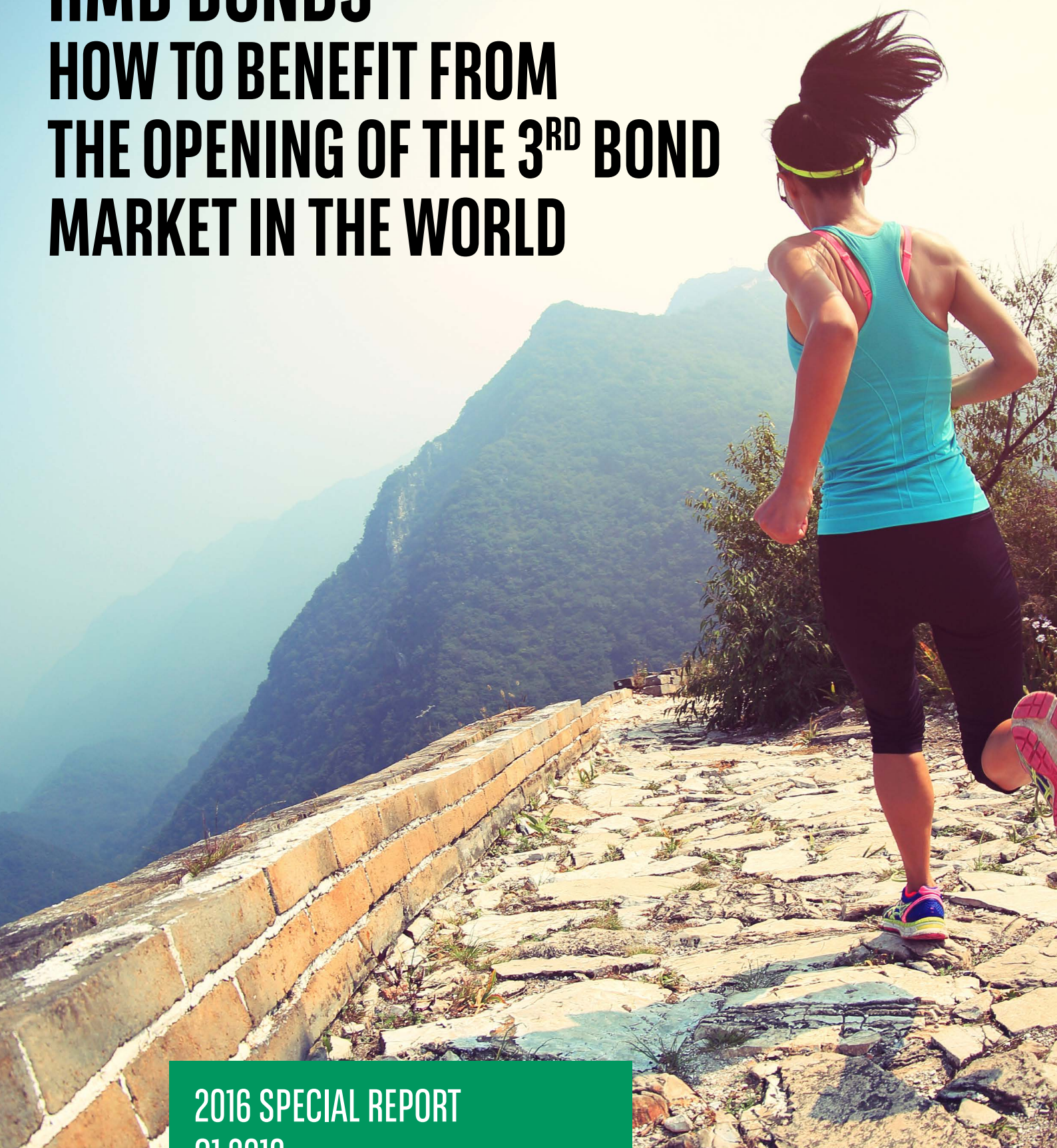


For professional and institutional investors only

# RMB BONDS HOW TO BENEFIT FROM THE OPENING OF THE 3<sup>RD</sup> BOND MARKET IN THE WORLD



2016 SPECIAL REPORT  
Q1 2016



**BNP PARIBAS**  
**INVESTMENT PARTNERS**

The asset manager  
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❖ **“DO NOT FEAR GOING FORWARD SLOWLY;  
FEAR ONLY TO STAND STILL.”**

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*Bloomberg is the source for all data in this document as at  
end December 2015, unless otherwise specified*

# ❖ CNY BOND OUTLOOK: THE ONE-INCH PUNCH: WATCH FOR THE INCH TO AVOID THE PUNCH

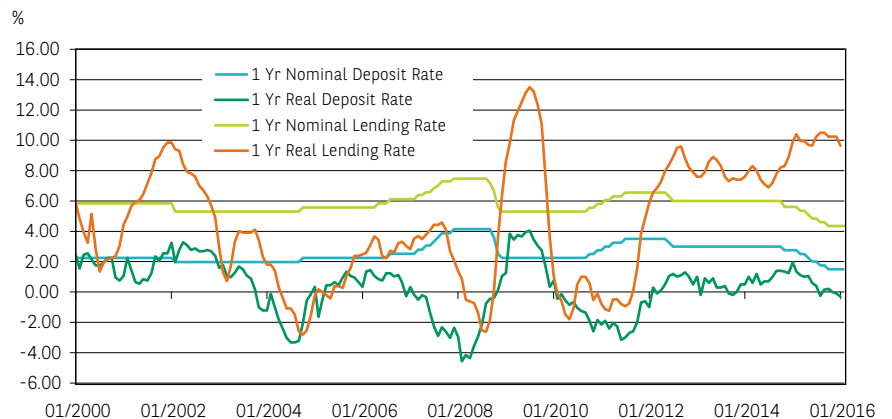
*All reference to credit ratings in this article refer to credit ratings provided by Chinese onshore credit rating agencies, and aggregated by Wind.*

Just as kung-fu is an art, so predicting the bond market for 2016 starts to be one, too. In kung-fu the one-inch punch can be severe when mastered, as it involves being able to strike hard from only one inch away when fighting close to the opponent. For investors in Chinese bonds, we believe that watching out for the inch to avoid the punch will be critical in 2016.

## First round: win with monetary easing

Chinese growth continues to slow and as we expect further downward pressure on inflation, renminbi bonds aren't likely to be supported by economic fundamentals in 2016, but rather by further monetary easing. We expect additional monetary policy moves, especially through reserve requirement ratio cuts, to facilitate liquidity injection into the economy. The People's Bank of China (PBoC) has already cut the interest rate six times since November 2014, and real interest rates have not fallen much since then.

## Nominal and real rates in China: Lending rates still at 10% on the back of PPI deflation



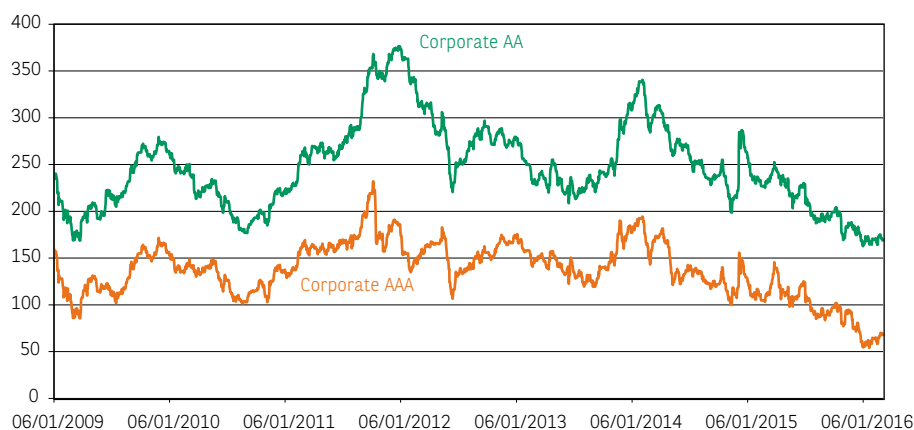
Source: Bloomberg, 29 February 2016

In particular, money-market interest rates may move downward to reduce real interest rates, and this downward movement would create room for the yield curve to decline.

## Second round: avoid the one-inch punch, invest in the "Bruce Lees" of this world

There have been about 10 cases of defaults in China over 2015. We believe these have not yet impacted on credit spreads, which have stayed more or less flat across the year. In fact, credit spreads for AA rated corporate bonds actually hit their lowest level in November. In 2016, we expect the Chinese bond market to see more defaults and spread to adjust.

Corporate bonds spreads (in basis points) at their lowest historical levels (local ratings – 5 years)



Source: Bloomberg, onshore Chinese credit rating agencies, 8th March 2016

The PBoC's monetary easing has triggered a hunt for yield in onshore China, which is not used to a low yield environment, and we believe as a result that corporate spreads have not properly priced in the embedded risk. Looking ahead, a strong priority for the government is to implement supply-side measures to combat overcapacity issues. The government's willingness to pursue this was reaffirmed during the Central Economic Work Conference, the annual meeting held in December to set the objectives for China's economy, as well as the National People's Congress in March. This will likely force further defaults, which in turn implies more volatility in spreads for lower quality bonds. Corporate leverage has increased, especially for lower quality bonds.

For AAA-rated bonds, we are seeing the opposite trend, with increasing cash positions and greater reimbursement of short-term debt. As a result, we believe that as 2016 progresses, we will see even more differentiation in quality and spreads. To achieve a stable return, we believe investors should concentrate on what we call "Bruce Lees", meaning government-backed bonds, or bonds issued by high quality state-owned enterprises. These should continue to see further gains throughout the year, backed by sound financials. On average they are currently yielding between 2.7% and 3.5% on 3-year maturities. Policy bank bonds should be favoured, in our view, and their issuance should increase since policy banks are a major financing tool for Beijing in the implementation of the One Belt-One road policy.

### The show must go on? Increasing issuance in 2016, to be met by further demand

Bond issuance has risen sharply in 2015 and, given low corporate spreads, this has worried investors. What the market has misunderstood in our view is the fact that the issuance has been mostly of local government bonds, not corporate bonds, due to the implementation of the local government bond swap. Treasury issuance has also expanded. We believe the government clearly wants to limit further leverage in the corporate world.



In 2016, we expect the Chinese bond market to see more defaults and spread to adjust.



Gross issuance (in renminbi, billions): the major increase in issuance has been in local government bonds



Source: Wind, 30 December 2015

We expect bond supply to at least meet, if not exceed, the government's target for 2016. As to local government debt, we estimate that total 2016 gross issuance will come in at around RMB 3.5 trillion. We assume all local government direct debt maturing in 2016 (around RMB 2.7-3.0 trillion) will be swapped into local government bonds.

The spread between Treasury and AAA-rated bonds should remain quite stable or even continue to fall on the back of healthy demand for such high quality assets. This is likely to be further supported by rising demand from foreign investors who – especially given the recently relaxed regulations and the impending inclusion of the renminbi in the IMF's Special Drawing Rights (see article on page 15) – should in our view consider investing in Treasury and policy bank bonds as well as in high quality AAA-rated bonds .

## ❖ TO RM-BE OR NOT TO RM-BE: THAT IS THE QUESTION FOR 2016

### 2015: to RM-Be for the IMF but not to RM-Be for investors

2015 was an eventful year in the internationalisation of the renminbi, with greater usage of the renminbi for trade and for wealth/reserve management purposes. Unfortunately, it did not pay off for investors, who became 'collateral damage' resulting from the strong drive by the Chinese authorities to include the currency into the International Monetary Fund's (IMF) Special Drawing Rights (SDR) basket. Both onshore and offshore renminbi fell by 4.42% and 5.41%, respectively, over the year versus the US dollar.

Still, the renminbi became the fifth most used currency for international payments in 2015, according to SWIFT, which indicates its rapidly increasing usage - it had been the seventh most used in 2014 and only the thirteenth in 2013. Aiming both for greater currency flexibility and for the renminbi's eligibility for the SDR basket, the People's Bank of China had to pursue further liberalisation and reform to establish the midpoint rate (the reference rate) determination mechanism. As this happened earlier than the market expected, it caused a sudden depreciation, contributing to most of the overall depreciation during the year.

However, by further liberalising the currency market - in September, for example, the authorities gave free access for official institutions to the foreign exchange market - the likelihood of the renminbi's inclusion in the SDR basket rose, confounding the pessimistic consensus forecasts in early 2015. In late November, the IMF announced that the renminbi is to be included within the SDR basket in 2016 with a weight of more than 10%. IMF Managing Director Christine Lagarde said: "[We recognise] the progress that the Chinese authorities have made in reforming China's monetary and financial systems. The continuation and deepening of these efforts will bring about a more robust international monetary and financial system, which in turn will support the growth and stability of China and the global economy."

In December, the China Foreign Exchange Trade System (CFETS) started publishing a new trade-weighted exchange rate index (TWI) which measures the strength of the renminbi against a broader basket of 13 currencies (as shown in Table 1). Targeting the TWI is a way to allow more flexible renminbi movement by severing its tie with the US dollar and should in our view, definitely be helpful in 2016 and beyond.

Table 1. The weight of each currency in the Trade-Weighted Index basket

CURRENCY	WEIGHT	CURRENCY	WEIGHT
USD	26.40	GBP	3.68
EUR	21.39	MYR	4.67
JPY	14.68	CAD	2.53
SGD	3.82	THB	3.33
RUB	4.36	HKD	6.55
AUD	6.27	CHF	1.52
		NZD	0.65

Source: CFETS, December 2015



The renminbi became the fifth most used currency for international payments in 2015, according to SWIFT, which indicates its rapidly increasing usage.



Despite the possibility of China's currency weakening against the US dollar, we believe the renminbi will eventually stabilise over the long run.

## RMB: 2015 major events for the RMB



Source: Bloomberg, BNPP IP, January 2016

Overall the year was eventful for the renminbi, and we are expecting the same in 2016. However, as investing purely in the currency did not pay off in 2015, the question remains for 2016: To RM-Be or not to RM-Be?

## 2016, our answer to the dilemma: the hibernation of RMB

For 2016, we expect a potential depreciation. Short-term, we believe the RMB might continue to soften against the US dollar because the Chinese economy has not yet bottomed. Additionally, the RMB/USD cross rate will largely depend on federal fund rate movements. The prevailing expectation that the US Federal Reserve (the Fed) will make four rate hikes in 2016 might place more downward pressure on the Chinese currency. Nonetheless, Beijing is clearly seeking to stabilise its currency. Since August the central bank has introduced measures designed to deflect attention from the RMB/USD rate, such as the launch of the TWI in December, and the extended onshore trading hours of the RMB starting in January 2016. When necessary, the central bank could also resort to direct market intervention.

## The after-life of the renminbi

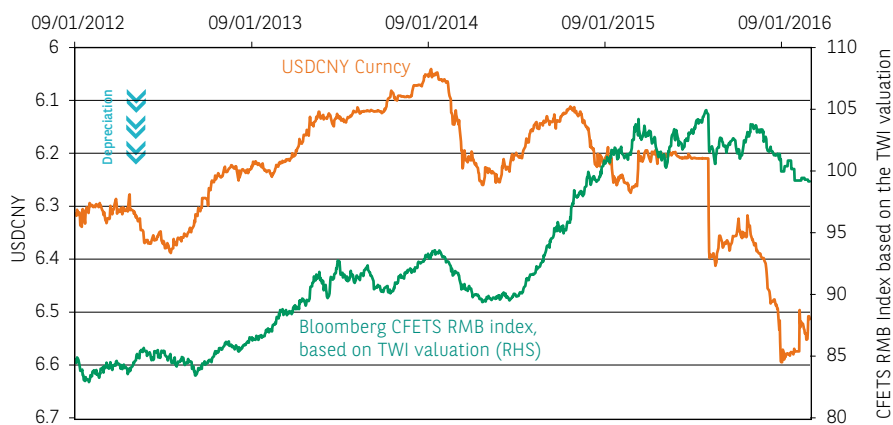
Despite the possibility of China's currency weakening against the US dollar, we believe the renminbi will eventually stabilise over the long run. The launch of TWI is not a sign of major devaluation, although in our view, it is a risk. Targeting a stable TWI means when other currencies weaken against the US dollar, the renminbi would also weaken against it. In the same way, when the dollar weakens against other major currencies, the renminbi would strengthen against it.

Moreover, the central bank has not declared that it would manage the renminbi strictly in accordance with the TWI. Presumably, its announcement of the TWI only suggests that a currency basket would be a crucial reference for the renminbi's movement. Investors will need to look across the whole TWI basket rather than just the narrow RMB/US dollar rate.



The renminbi was actually reasonably stable versus the basket of currencies during 2015, and even during the USD depreciation events of early 2016.

### Renminbi against the TWI basket of currencies, and versus the US dollar



Source: Bloomberg, BNPPPI, March 2016

Another factor to consider is China's ongoing reform of its exchange rate regime. When Beijing eventually establishes a more market-oriented exchange rate mechanism to replace its current system, the renminbi exchange rate is likely to stabilise due to less uncertainty and regulatory risk. Most importantly, the long-term currency outlook ties back to the relative strength of economic fundamentals. In our view, the Chinese economy might regain its momentum as domestic consumption recovers, especially as demand for education, sports, and tourism picks up. In addition, Beijing still has some tools at its disposal to boost the economy. China could, for example, cut taxes to stimulate demand and introduce further supply-side and state-owned enterprise reforms to optimise resource allocation. The combined effect of such measures should help to support healthy economic growth. Last but not least, the renminbi will benefit from its inclusion in the IMF's SDR basket and its increased versatility as a result of China's efforts to establish the renminbi as a global currency.

So to RM-Be-or not to RM-Be? The volatility of the renminbi remains low compared to that of A-shares, and the return offered by renminbi bonds. As a result, long-term renminbi-denominated asset holders should keep an eye on the currency's movements but more importantly focus on the broader factors that could influence their investment's performance.



# ❖ RMB MONEY MARKET STRATEGIES: THE FIRST SAFE-HAVEN IN CHOPPY CHINESE MARKETS



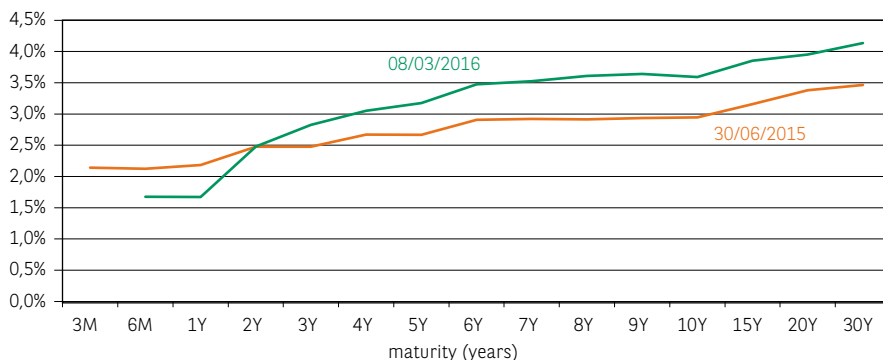
By investing in short-term debt instruments with high credit ratings, MMFs can be a relatively safe and highly liquid investment vehicle to park money with in such times of uncertainty.

Despite the recent interest-rate cuts by the People's Bank of China (PBoC), the renminbi (RMB) money market is an asset class on the move. With credit risk mounting in China sector allocation in the fixed income, money market strategies stand to gain importance. New issues should further impact the ever-changing fixed-income landscape this year, with bonds expected to be a popular means for the (re) financing for companies.

## The flattening of the treasury yield curve makes the short end of the fixed-income high-grade universe more attractive

Since 30 June 2015, the RMB treasury bond yield curve (see chart below) has flattened notably with the 2-10 year spread dropping from 70bp to 35bp. Flattening usually occurs in economic downturns. As the central bank cuts interest rates, bond market yields may continue to drop as well. As such, companies are likely to finance themselves via bond issues at the longer end of the curve. A new dynamic to the market this year is that as of January, those companies which have the credit qualification (usually a AA local rating or above) can lower the financing cost by as much as 100bp by choosing to issue bonds instead of taking out bank loans.

### RMB treasury bond yield curve- flattening



Source: Bloomberg, March 2016

## Choppy equity markets

Recent sharp declines in the A-shares market following the roller coaster ride of 2015 have left many investors quite cautious, if not nervous. At the same time, bond prices are unlikely to rise much further after the bull run of 2014 and 2015. Furthermore, we believe more credit issues could come to light in 2016, given China's slower economic growth. By investing in short-term debt instruments with high credit ratings, MMFs (Money Market Funds) can be a relatively safe and highly liquid investment vehicle to park money with in such times of uncertainty.

## Mitigating rising credit risk by cherry-picking in demand-driven sectors

Given the expectations of more credit events this year, we will cautiously limit our investments to short-term securities with the best credit outlook only, making use of the depth of the broad onshore money market. Does this mean a money market

strategy has to focus on government-backed issues only? Not just yet. Favouring commercial paper is key over policy bank issues. The (local) AAA rated commercial paper market is liquid and has the highest credit rating (as illustrated by the fact that commercial paper cannot have additional credit guarantees from third parties). Policy bank bonds, despite their state-level rating, are less attractive since their yields can be 50-60bp lower. Sector-wise, public utilities and consumption-related companies with the highest market share need to be favoured, i.e., the largest state-owned companies that belong to a solid industry and have the most stable profit outlook. These sectors tend to have issuers with the most stable revenue outlook and are least likely to have credit issues. Specifically, we like national electricity groups, airports and highways in the most developed areas. The sectors to avoid are mostly industries suffering from over-capacity that may eventually be overcome by competition. These include coal mining, steel and iron, and non-precious metals.

### Riding the liquidity waves

We expect liquidity risk generally to be more pronounced this year as the central bank's easing tools are dulled by the depreciation pressure on the renminbi. We are focusing on an average duration of 60 to 90 days to maintain enough liquidity (the higher the maturity, the better the liquidity for short-term paper). We seek to benefit from the short-end of the curve (curve flattening favours the short-end). Meanwhile, as the opportunity occurs, we aim to get the most out of our investments in offshore underlying to take advantage of possible hikes in the offshore yields.

### Going H or Y? The battle between CNH & CNY

Among all the events surrounding the offshore CNH and onshore CNY exchange rates and the attractiveness of renminbi money market investments, the most remarkable may be the spike in CNH offshore deposit rates. The offshore yield's sudden increase is a result of Chinese government intervention to slow down the depreciation of the currency. In early January, the CNH HIBOR rate hit the highest level since the benchmark was launched in 2013 and short-term fixed deposits followed suit. Despite this appearing to be an investment opportunity that CNH investors have jumped on for as long as it lasts, the rates soon retraced from the record high. Similarly, the CNH offshore yield's higher return relative to the onshore CNY yield may reverse as the currency stabilises. Investors should be aware of the low liquidity nature of the CNH offshore deposits when they choose between CNY and CNH assets. For those who have the risk appetite to enter the CNY onshore capital markets, money market funds that can benefit from both markets could be the solution.

In summary, for high credit quality issues, the flattening of the yield curve is driving investors to the shorter end of the market. In addition, money market funds can provide safety and flexibility for Chinese investors facing a volatile equity market. Strategy-wise, we prefer the highest credit underlying to minimise credit risk, mainly in the form of the largest state-owned companies in consumption-driven sectors. We would avoid industries suffering from overcapacity. Among the highest grade instruments, we prefer commercial paper to policy bank bonds for the higher yield. As the discrepancy between CNY and CNY rates persists, so the need for flexible allocations remains.

### Key points

- Current yield curve flattening is pushing investors to the short-end of the fixed income market for the highest credit quality issues.
- The need for a safe haven as well as the flexibility and liquidity of money market solutions should boost demand, but supply should be adequate.
- Picking big names in consumption-driven sectors over industries suffering from over-capacity.
- Expect a run to highest credit quality and a preference for commercial paper yields over policy bank bonds.
- The gap between onshore and offshore rates calls for flexible solutions.

# ❖ CHINA HIGH-YIELD BOND STRATEGIES: HOW TO PICK UP ADDITIONAL YIELD WITHOUT INVESTING IN HIGH YIELD BONDS

## Key points

- High-yield bonds in China by international standards are not the same as local high-yield bonds for Chinese investors.
- Picking' the gold out of the sand' such as municipal bonds and bonds issued by property developers.
- 2016 should bring more vibrancy to the Chinese bond market with supply-side reforms and CSRC measures.

Investor confidence in the high-yield bond market in China has been put to the test by the recent rise in defaults. This calls for a closer assessment of the asset class, especially of the differences between international ratings and local ratings. Ongoing reforms to improve market maturity and transparency along with a wave of companies leveraging on bond financing should add dynamism to the market in 2016.

## High-yield bonds by international standard do not equal high-yield bonds

For international investors, high-yield (or 'junk') bonds have credit ratings of BB or below, as defined by Standard & Poor (or BBB and below from S&P and below Baa from Moody's). The lower the rating, the greater the likelihood the issuer defaults, hence the higher yield. These investment characteristics are straightforward enough, but how does this translate to the Chinese fixed-income market?

There are a number of dissimilarities between international markets and the China onshore market that shine a different light on what is high yield in China and how to manage a high-yield portfolio for international investors in China (among others):

- Rating differences between local rating agencies and international ratings
- Until recently, there were few defaults in the Chinese fixed-income universe.

There is no defined rule on how to 'convert' ratings provided by local rating agencies to international ratings. According to our proprietary credit rating system, Chinese bonds with AA + or a lower local rating may be matched roughly to an international rating of BBB or lower, or high-yield bonds by international standards. However, for Chinese investors, the local definition of high-yield bonds refers to bonds with AA local ratings or below. These bonds can have annualised yields of 10% and higher. They are concentrated in sectors viewed as deteriorating and linked to 'old economy' industries such as steel, coal and non-precious metals. The few credit events or defaults seen recently have been linked to these local high-yield bonds.

## Rising credit risk requires greater selectivity

Managing high-yield bond strategies for international investors, especially with the recent increase of credit defaults is a challenge.

First, we need to determine what rating bracket our high-yield strategy is actually aiming at. For the purpose of China high-yield strategies for international investors, we stick to the international ratings to determine the investment universe. This translates into a universe with an estimated average local rating of AA or higher (we match the universe roughly to B international ratings or better). In other words, the credit quality of the universe for these strategies is distinctively higher than what locally would be classified as high yield.

Within this bond universe, our portfolio manager targets 'the gold out of the sand' opportunities, i.e., bonds that are undervalued, but have a decent outlook and can therefore provide a good source of fixed income. This may sound like platitudinous investment wisdom, but applying it in the reality of today's onshore fixed-income market may involve making distinct choices.



There are a number of dissimilarities between international markets and the China onshore market that shine a different light on what is high yield in China and how to manage a high-yield portfolio for international investors in China

## Favour municipal bonds and property development issuers

First of all, it favours specific types of bonds and sectors: municipal bonds and bonds issued by property developers.

Chinese municipal issuers may not have the best credit ratings, especially small municipalities. Neither do the bonds have guarantors as some Western municipal bonds do (e.g., US natural gas bonds guaranteed by large investment banks). Such guarantors stand by for repayment of the principal and coupons in the case that the issuer defaults. However, the ongoing local debt swap programme in China enables provincial governments with higher credit ratings to issue bonds that may help smaller municipalities pay off outstanding debt. The programme has boosted investor confidence in the credit outlook of municipal bonds issued by small towns or local jurisdictions. We have found municipal bonds attractive as they generate higher returns at marginally higher credit risk.

Another example of an under-priced sector is bonds issued by property developers. With the industry at a turning point, double-digit rates of growth are unlikely to be seen again in the real estate sector. The industry, however, has been recovering slowly since 2015 when the central and local governments introduced stimulus policies. The central government is seeking to reduce housing inventories and has lifted the restriction on buying for second and third-tier cities. Immigrant workers are encouraged to buy property and permanently settle in cities. More importantly, the real estate market in the first-tier cities such as Beijing, Shanghai and Shenzhen has remained strong and prices have continued to increase with demand. We favour large real estate developers with exposure in the biggest cities. We focus on bonds with a three-to-five-year duration as we are optimistic about the short-term outlook.

## Growing pains to subside

In 2016, we expect the credit spread between the highest grade and the lowest grade to further expand. More credit problems may come to light as economic growth slows. We will continue to focus on medium to high-quality bonds for reliable income while minimising credit risk.

For 2016 and beyond, we expect a more sophisticated and vibrant credit market as the bond market matures and moves closer to international standards. First, supply-side reforms are conducive to a healthier and more competitive credit market and to the economy as a whole. As part of the reform, bonds issued by state-owned-enterprises (SOEs) may no longer enjoy implicit guarantees from local governments. In the short term, it might imply more credit defaults, but this also helps to build a more solid and robust base for economic recovery in the long run as only SOEs with sound fundamentals can survive in a more competitive market. The success of the reforms will also show the true credit risk of the underlying bonds, making the market more transparent for all investors.

Second, the China Securities Regulatory Commission (CSRC) has adopted new policies aimed at re-energising the bond market. It has added private companies to the list of possible issuers. In addition, it is making the procedure of issuing privately placed notes (PPNs) easier and faster. This has significantly increased



**A high yield strategy favours specific types of bonds and sectors: municipal bonds and bonds issued by property developers.**



**For 2016 and beyond, we expect a more sophisticated and vibrant credit market as the bond market matures and moves closer to international standards.**



supply, while the additional yields on the PPNs are particularly attractive to investors focused more on returns than liquidity. The CSRC has divided investors into qualified investors (mostly institutional investors) and non-qualified investors (mostly retail investors) to align issues and investor risk profiles and to protect their interests. Qualified investors can access a wider range of bonds than non-qualified investors.

Third, we expect the shift from bank loans to bond financing to continue vigorously. Among the possibilities for corporate financing, debt placement comes with the lowest cost and the fewest strings attached. Issuing bonds has proved to be an easier and more flexible way to raise capital than issuing equity in China, aside from the benefit of not having to give up company ownership. On the other hand, the rates of bank loans are still mainly determined by the government-planned benchmark rates, while the yields of new issued bonds are a result of supply and demand in the fixed-income capital markets. As of January, those companies who have the credit qualification (usually a AA local rating or above) can lower the cost of financing by as much as 100bp by opting to issue bonds rather than taking out bank loans. This has boosted the popularity of bond financing. In fact, we expect more and more companies to issue bonds only to pay off bank loans.

In summary, our high-yield fixed-income strategies use international ratings to find attractive sources of income with relatively good credit quality and sound fundamentals with an average local credit rating of AA, or well above the local high-yield bond rating. We are cautious when it comes to liquidity risk and monitor closely the portfolio's credit and duration risk. In particular, we like municipal bonds and bonds issued by property developers. For 2016 and onwards, we expect the Chinese credit market to become more sophisticated and mature as government-led supply-side reforms and CSRC measures continue to push the market towards greater transparency and openness. Such a development would be welcomed by international investors. We expect bond financing to increase in popularity among Chinese companies as they find it to be the most efficient way of funding.

# ❖ OPENING UP ONSHORE BONDS TO FOREIGN INVESTORS

Despite signs of the People's Bank of China (PBoC) slowing down the process of capital account liberalisation, China has announced that it is opening up the onshore interbank bond market to trading and investment by foreign long-term investors without any restrictions on QFII and RQFII\* quota holders.

## Opening up areas where there is least resistance to change

The move can be seen as part of a strategy of opportunistic liberalisation – i.e. opening up areas where there is least resistance to change and whenever opportunities present themselves. It also honours China's pledge to continue opening up its capital account as the renminbi becomes one of the IMF's Special Drawing Rights (SDR) currencies.

The liberalisation of the interbank bond market for foreign private-sector investment can be seen a structural move to attract foreign participation in the onshore capital market. Since the new policy also applies to existing QFII and RQFII funds, Beijing appears to be trying to make foreign investment in China simpler, more flexible and, presumably, more attractive by extending the range of investable instruments to onshore bonds.

## Eventual support for the Renminbi

In the long run, this should help support the renminbi exchange rate and facilitate renminbi internationalisation by allowing foreign investors to buy more renminbi-denominated assets. However, given the negative market sentiment towards China and the persistent confusion over its foreign exchange policy, the short-term impact is likely to be muted.

Is China worried about more foreign players increasing volatility in the onshore market, which is a key reason for the PBoC making capital account convertibility less of a priority?

Probably not. Firstly, Beijing is only allowing in long-term investors such as commercial banks, pension funds, insurance companies and asset managers. Secondly, Chinese bonds are extremely under-owned by global investors. Currently, total foreign holdings of domestic Chinese bonds is about 1.7%, or USD 120 billion, of the estimated USD 7 trillion domestic bond market. Even if foreigners doubled their holdings following this policy announcement, which is unlikely in the short term, they will still be a drop in the bucket in the onshore bond market.

Thirdly, foreign private investors will only be allowed to invest in or trade cash bonds in the interbank bond market. They have no access to bond instruments such as repos, futures and forwards, interest-rate swaps and bond lending. This is still limited to official institutions such as central banks and sovereign wealth funds.

\*QFII and RQFII: Qualified Foreign Institutional Investors and Renminbi Qualified Foreign Institutional Investors



**The liberalisation of the interbank bond market for foreign private-sector investment can be seen a structural move to attract foreign participation in the onshore capital market.**



**From an internationalisation perspective, broadening foreign participation in the domestic bond market should pave the way for global index service providers to include Chinese bonds in global indices.**

### **Index membership in due course**

From an internationalisation perspective, broadening foreign participation in the domestic bond market should pave the way for global index service providers to include Chinese bonds in global indices as and when more foreigners buy Chinese domestic bonds.

In a nutshell, the opening up of China's domestic bond market to foreign investors is in our view a positive further move, facilitating the internationalisation of the renminbi in the long term and bringing more market discipline to the Chinese system. Ultimately, such structural changes should improve China's growth quality. All told, though, the short-term impact on financial markets is likely to be subdued.

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The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay.





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