Insights

FTSE Russell

China Onshore Bonds

China's bond market is the third largest in the world after the U.S. and Japan. There have been positive recent developments to open up the onshore Chinese bond market – The IMF approved the Renminbi (RMB) as global reserve currency in November 2015 alongside the EUR, USD, JPY, and GBP. A few months later the RMB bond market was opened to foreign investors (February 2016).[1]

This allows investors to penetrate a new market with particular traits – In many cases, higher relative yield and lower duration than domestic markets providing a portfolio diversifier and yields in a yield starved environment, especially in continental Europe. It also allows Chinese local issuers to tap international bond investors.

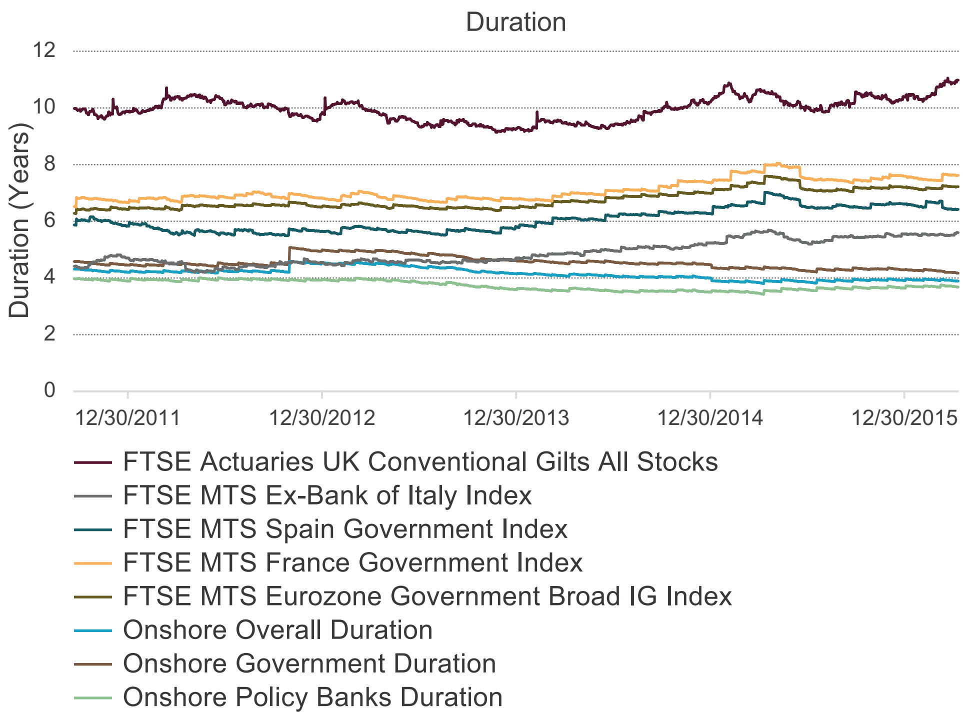
The market, being relatively new to most international investors, requires tools for research, and benchmarking. FTSE Russell launched the FTSE China Onshore Bond Index Series in March 2015 with history back to 30 December 2011 to provide an independent benchmark on the Chinese onshore RMB bond markets. The index series offers data on both the sovereign bond market representing a market value of 5.3 trillion RMB (approximately $820 billion) as of February 29 2016, as well as the Policy Bank bond market representing a market value of 7.5 trill ion RMB (approximately $1.1 trillion).

The following document intends to highlight and compare characteristics of the onshore China bond market by comparing characteristics of the FTSE Onshore China Bond Index Series and European government bond markets represented by the FTSE Actuaries UK Conventional Gilts, FTSE MTS Eurozone Government Bond IG Index, FTSE MTS France, FTSE MTS Spain, and FTSE MTS Italy indexes.

1 http://www.kwm.com/en/knowledge/insights/the-pboc-has-further-opened-up-chinas-inter-bank-bond-market-20160225

Yield and duration

Average duration in the China onshore bond market has remained stable at around the last four years (see the graph below), while the UK and continental government bond markets duration has increased over the period from December 30, 2011 to today.



Source: FTSE Russell. Data as of December 30, 2015.

This should make China onshore bonds an instrument to consider for investors with a lower duration exposure and a complement to a European portfolio.

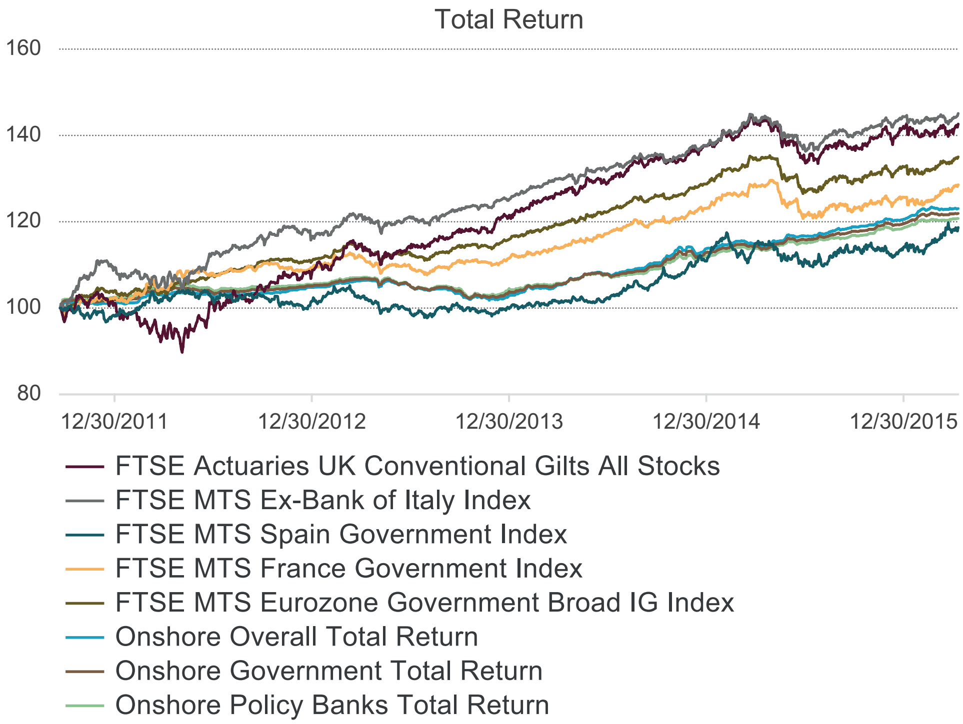
Furthermore, data reveals that the yield on the onshore China bond market, at 2.92% (Feb 29, 2016) is higher than 1.55% for Spain, 1.43% for Italy and the higher rated countries of France with 0.67% and the UK with 1.84%.

Another trend has been the consistent and significant decrease of yields in the UK and the Eurozone countries over the last 4 years, whilst the yield of the onshore China bond market is marginally lower than at the end of 2011.

It is to be noted that the spread in the yield between Policy Banks and Sovereign bonds in China has also shrunk from 0.6% to 0.4% between December 2011 and February 2015 indicating that Policy Banks are backed by the central government and the perceived difference between them and Sovereign bonds has diminished.

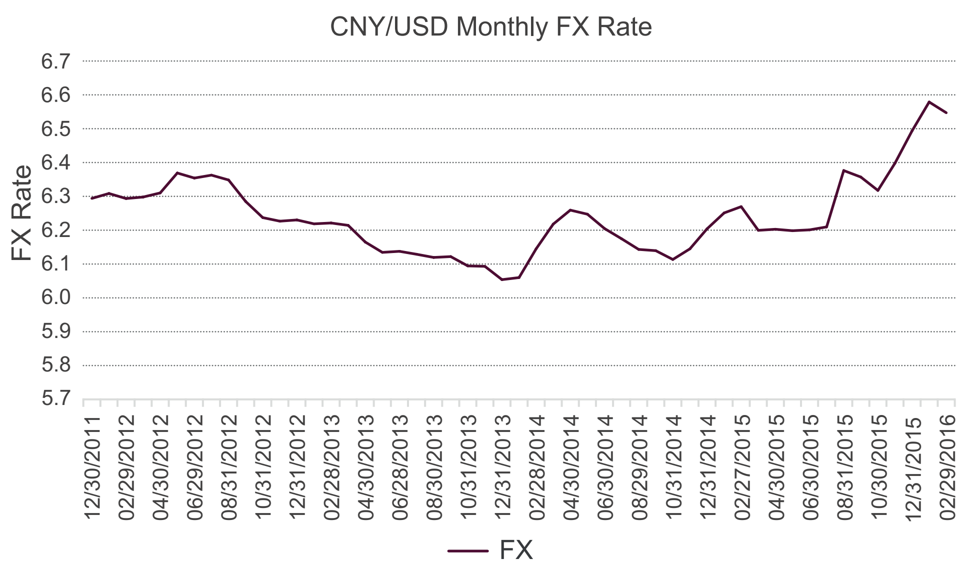
Performance and FX Rates

The data demonstrates that total return from the onshore China bond market has been higher over the relevant period compared to France and the UK. Compared to Italy and Spain, total returns for the onshore China bond market have been lower, although the prices of the Spanish and Italian government bonds were depressed at the beginning of the period measured as a result of the government bond crisis in those countries. From 2013 onwards, the performance of these markets improved after the respective governments stabilized their policies and economies.



Source: FTSE Russell. Data as of December 30, 2015. Total return is in local currency. Past performance is no guarantee of future results. Please see the end for important legal disclosures.

Currency exposure is a key component of risk/return and although not significantly different from the beginning of the period there has been recently more uncertainty as to the direction of the CNY/USD rate, especially with the devaluation of 1.9% on August 11, 2015, and 0.51% on Jan 7, 2016.[2]

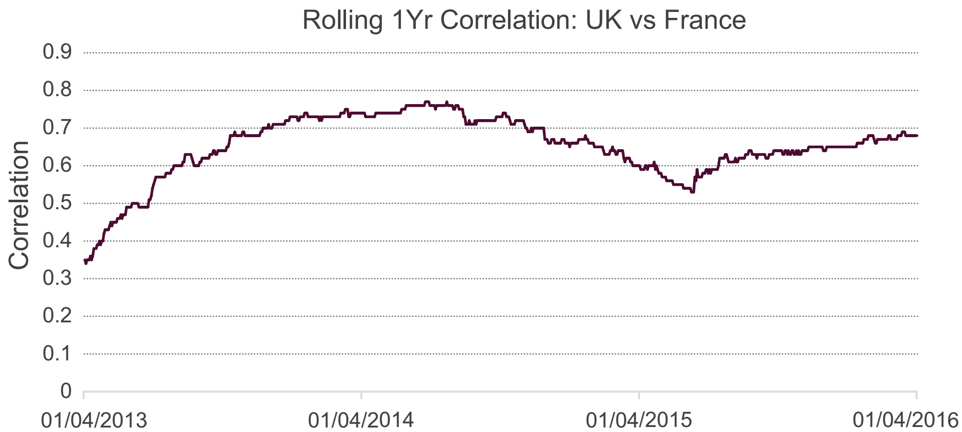


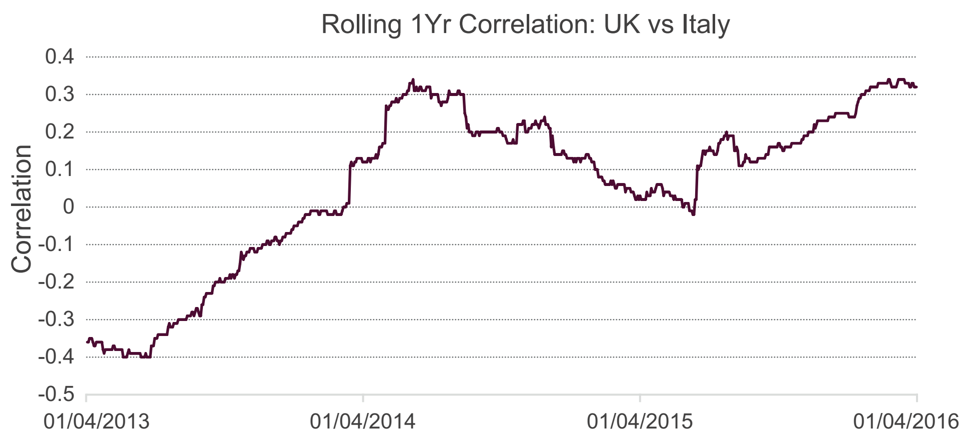
Source: FTSE Russell. Data as of February 29, 2016.

[2] http://www.ftse.com/Analytics/FactSheets/Home/DownloadSingleIssue?issueName=BOCHKQR&IsManual=True

Correlation

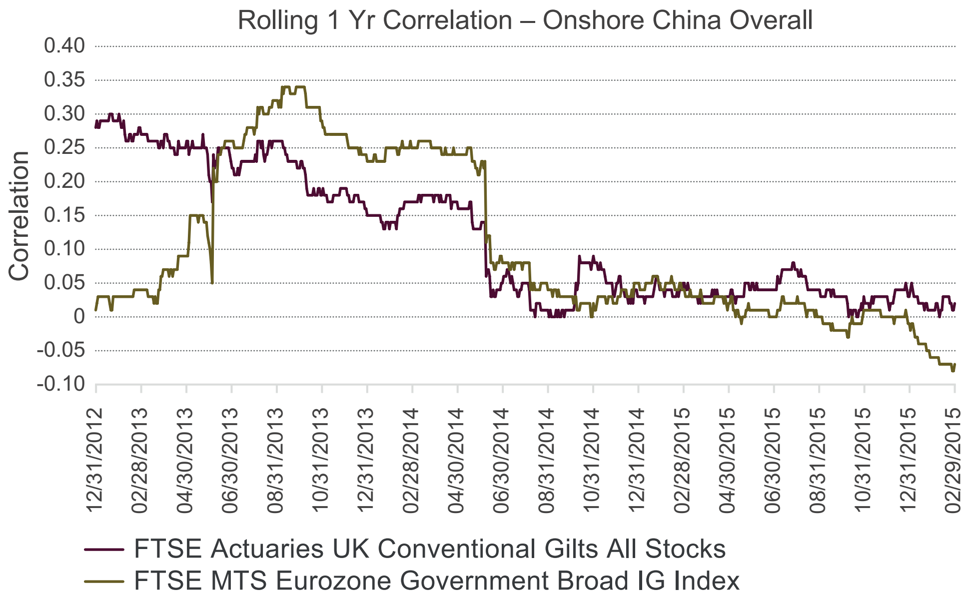
Correlations within European markets is relatively high and has increased over the last three years.





Source: FTSE Russell. Data as of January 4, 2016. Past performance is no guarantee of future results. Returns shown may reflect hypothetical historical performance. Please see the end for important legal disclosures.

However the correlation of the FTSE Onshore China bond index series to the Gilts market and Eurozone indexes has decreased and is hovering around zero.



Source: FTSE Russell. Data as at February 29, 2016. Past performance is no guarantee of future results. Returns shown may reflect hypothetical historical performance. Please see the end for important legal disclosures.

Conclusion

The Chinese onshore bond market is still new to many investors and carries FX exposure, but the low correlation to European markets, shorter duration and higher yield as highlighted may interest certain market participants.

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