News Release

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Unlocking opportunities in China's bond market

The world's third-largest bond market is now open to foreign investment, providing an important channel for diversification and the potential for higher returns.

China is accelerating the opening of its financial markets, with foreign investors now enjoying an unprecedented level of access to stocks and bonds in the world's second largest economy. As the country becomes increasingly integrated into the global financial system, Chinese securities are set to become a mainstream addition to international portfolios.

The most dramatic changes have occurred in the equities market, in the form of two programmes that linked the onshore exchanges in China with the offshore market in Hong Kong. The launch of Stock Connect schemes – Shanghai in 2014 and Shenzhen in 2016 - were big bang moments that immediately granted foreign capital easy access to two of the world's largest stock markets. This new route into China is a convenient alternative to the longstanding license-based system known as QFII – the Qualified Foreign Institutional Investor system and its younger sibling RQFII - RMB Qualified Foreign Institutional Investor system.

Late November 2015, China granted Malaysia a RMB50 billion quota under the RQFII program emphasising the financial commitment between the two countries and enabling Malaysian institutional investors to access China's capital markets.

The further capital market liberalisation was extended to the bond market. In 2010, the People's Bank of China launched a pilot programme that allowed a limited range of foreign institutions to invest in China's interbank bond market (CIBM) – primarily foreign central banks, monetary authorities, renminbi (RMB) clearing banks and settlement banks in Hong Kong and Macau. This is followed by further relaxation to allow QFII or RQFII participating in CIBM in 2012-13.

In 2015, the People's Bank of China (PBoC) changed the application process for overseas central banks/ sovereign wealth funds interested in China's interbank market from an approval system to a registration system. This might sound like a minor administrative point, but it is an important step in streamlining market entry into the country.

The most recent major development in the interbank bond market came in May 2016, when PBoC broadened the scheme to all types of financial institutions with a medium to long-term investment horizon. In effect, it provided straightforward access to banks, insurers, and asset managers from all over the world.

By unlocking the world's third largest bond market to global financial institutions, China has created an opportunity to diversify into an asset that offers relatively higher yield than most developed market bonds.

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Progress in making the RMB an international currency suggests that foreign investors will start to own a larger share of China's RMB55 trillion interbank bond market. In October 2016, the International Monetary Fund added the RMB to the basket of currencies that forms the Special Drawing Rights (SDR) – effectively granting the Chinese currency the status of a global reserve currency. Central banks will likely adjust their holdings over the coming years to hold more RMB-denominated assets, which will in turn increase the demand for onshore bonds.

Higher yields, SDR inclusion, and a new route to invest in one of the world's fastest growing economies, are all factors that suggest greater foreign investment in Chinese bonds. HSBC expects the proportion of the onshore government bond market owned by foreigners to increase from the current 2 per cent to 10 per cent over the next two years – a shift that equates to as much as USD100 billion of inflows to the market.

International investors that do decide to allocate capital to Chinese bonds will be entering a highly dynamic market. China, despite its size, is still an emerging economy, and its financial system has yet to reach the level of sophistication found in more mature markets.

There are widespread concerns over the growth of corporate debt since the Global Finance Crisis, which has pushed the corporate debt-to-GDP ratio to 169%. State-owned companies are at the forefront of this trend, and the long-anticipated reform of this sector has yet to materialise. Furthermore, policymakers are dedicated to stabilise property prices, after two years of substantial gains in the country's largest cities.

A mature capital market will help address all of these issues, as it will enhance the country's ability to allocate and price capital – in a way that will both strengthen the economy and provide attractive yield opportunities. Global investors that are looking to take part in China's next wave of growth should therefore be paying close attention to the country's bond market. Major global fixed income index providers have already started reviewing for CIBM inclusion with the opening up of the world's third largest bond market.

Given the vital role China plays in Malaysia and ASEAN's economic future, HSBC Malaysia will be hosting the Asian & RMB Forum in Kuala Lumpur on 27 February 2017 – the Forum will review recent developments and provide strategic perspectives of the prospects for the economies and markets, and touch on the importance of China to a country like Malaysia.

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