



COLCHESTER[®]
GLOBAL INVESTORS

Chinese Sovereign Bonds:

Balancing Challenges with Opportunities

26 November 2020

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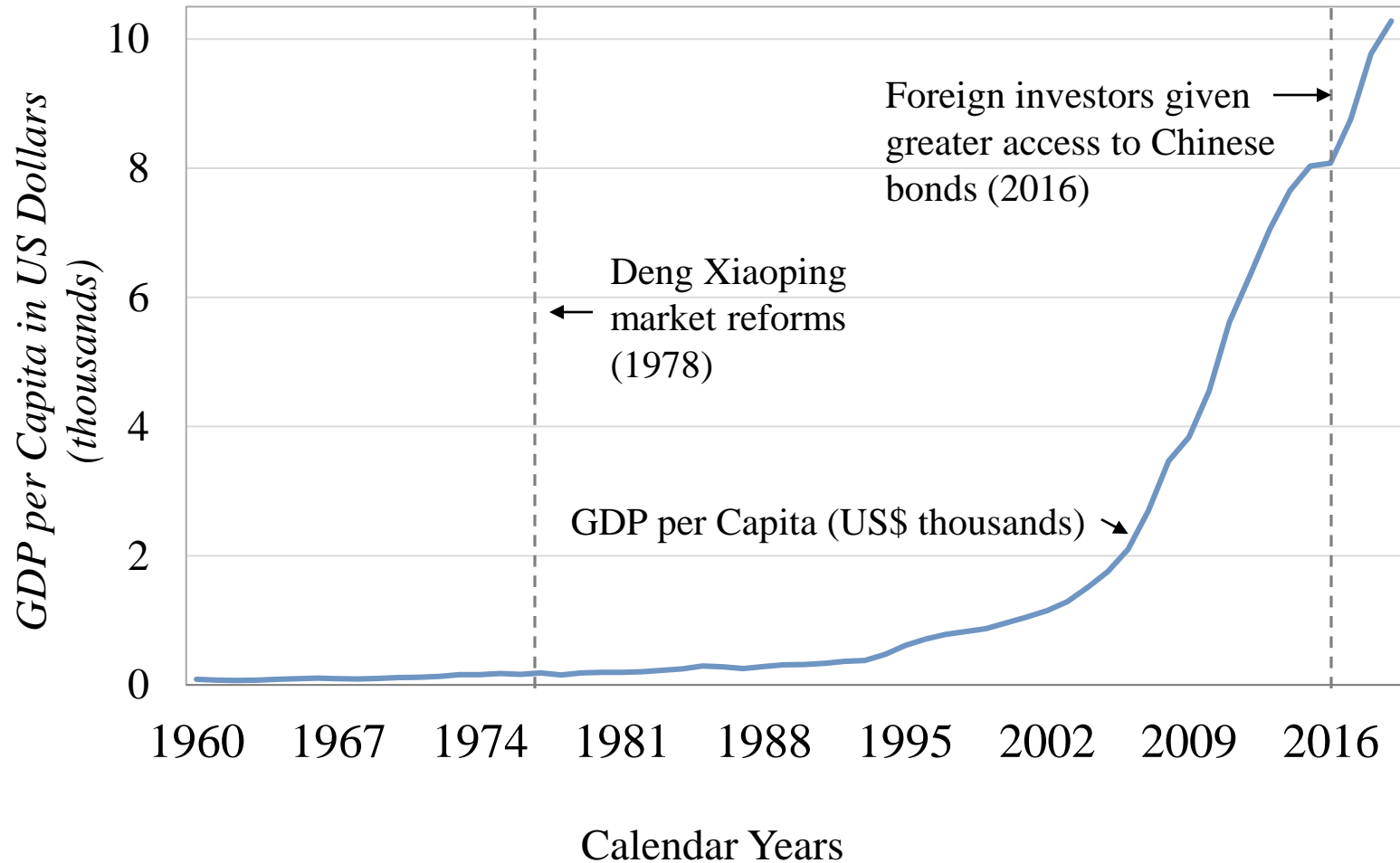
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1. Introduction

CHINA: ECONOMIC GROWTH

The Chinese Economic Miracle:



Source: World Bank, Colchester Global Investors.

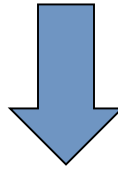
CHINESE GOVERNMENT BONDS: MARKET DEVELOPMENT

- Chinese authorities have taken a number of recent steps to de-regulate their domestic bond market and partially open the capital account to allow foreign investor inflows.
- China's government bond market now ranks as the second-largest government bond market in the world.
- Dealing in Chinese Government Bonds has remaining challenges, but there are opportunities for international investors.
- We will show that China is a credible addition to the local currency Emerging Market and Global Bond opportunity sets.

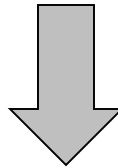
Source: Bloomberg, Colchester Global Investors.

CHINESE GOVERNMENT BONDS: INDEX INCLUSION

Bloomberg Barclays Global Aggregate Bond Index added in April 2019.
Current benchmark weight: 6%.



JP Morgan GBI Emerging Markets Index added in February 2020.
Maximum benchmark weight: 10%.



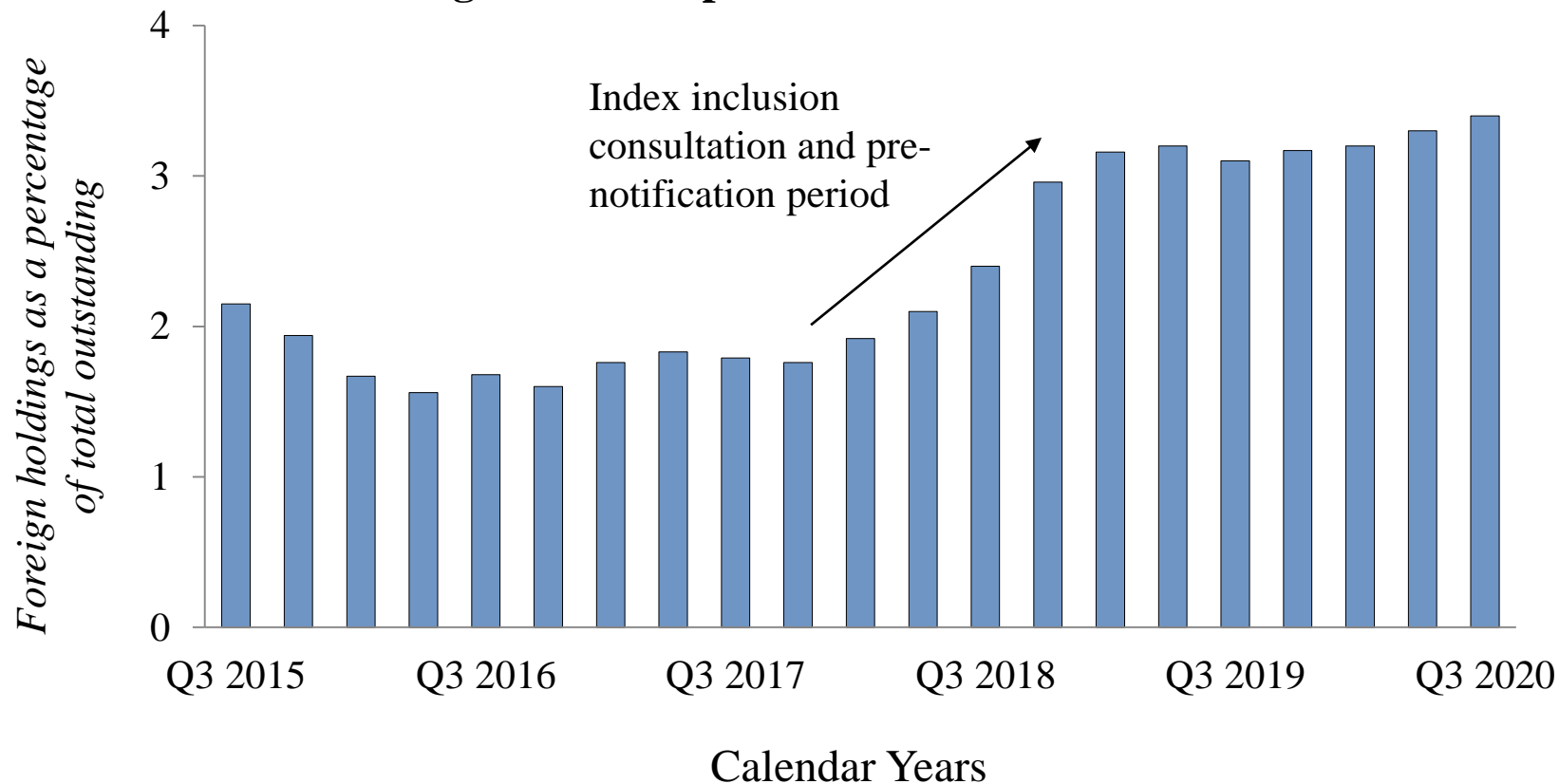
FTSE World Government Bond Index expected to be added in October 2021.
Expected benchmark weight: 5.6%.

Source: Bloomberg, JP Morgan, FTSE and Colchester Global Investors.

CHINESE GOVERNMENT BONDS: FOREIGN OWNERSHIP

Index Inclusion Is Attracting Investment:

Foreign Ownership of Chinese Government Bonds



Source: Asian Development Bank, Colchester Global Investors.

2. Legal Process for Accessing China

ROUTES INTO CHINA

- CIBM or Bond Connect?
 - Bond Connect:
 - Existing Global Custodian Structure.
 - Admission time.
 - CIBM:
 - Transaction costs.
 - Bond Settlement Agent.
 - Set-up time and complexity.
- QFII and RQFII.

Note: CIBM is the China Interbank Bond Market; QFII is a Qualified Foreign Institutional Investor; and RQFII is a Renminbi Qualified Foreign Institutional Investor.

CHINA: BOND CONNECT ADMISSION

- Trading Platform: Tradeweb or Bloomberg?
- Bond Connect Application Forms:
 - Content.
 - Submission Process – the Bond Connect E-Filing System.
 - Timing.
- Bond Connect Linkage Participant – the local custodian.

3. Dealing Platforms, Currency and Liquidity Considerations

CHINESE GOVERNMENT BONDS – ACCESS & LIQUIDITY

Accessing Chinese Government Bonds:

- Onshore – CIBM Direct (China Interbank Bond Market).
- Offshore – China Bond Connect.
- Platforms, Settlement Cycles, Trading Hours.

CGB Liquidity:

- Market/Issuance Size.
- Benchmark Issues.
- Participants.

CHINA: CURRENCY CONSIDERATIONS & LIQUIDITY

CNY:

- Onshore CNY Spot.
- Onshore CNY Forward.
- Offshore CNY NDF.

CNH:

- Offshore CNH Spot.
- Offshore CNH Forward.

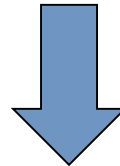
4. Settlement of Chinese Government Bonds (CGBs)

CGB SETTLEMENTS: Overview

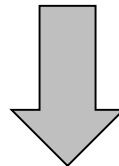
- China Central Depository & Clearing Co (“**CCDC**”) is the depositary.
- The Central Moneymarket Unit of the Hong Kong Monetary Authority (“**CMU**”) acts as the single nominee of all Bond Connect investors and holds one omnibus bond account with the CCDC, when trading and settling using Bond Connect.
- China Foreign Exchange Trade System (“**CFETS**”) is the system that trades are booked on to - this is where the “CFETS ID” is generated.
- The Bank Settlement Agent (“**BSA**”) is responsible for overseeing the whole settlement process after receiving the trade instruction from the Global Custodian when using the China Interbank Bond Market (“**CIBM**”) trading and settlement process.

CGB SETTLEMENTS: Bond Connect settlement process #1

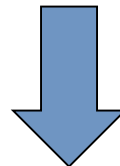
Investment Manager instructs Global Custodian - the counterparty inputs the trade into the CFETS system.



Global Custodian passes the trade instruction to the local Sub-Custodian.



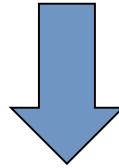
Sub-Custodian enters the trade instruction into the CMU system.



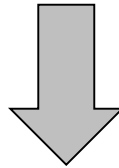
CMU passes the trade instruction and CFETS ID to the CCDC.

CGB SETTLEMENTS: Bond Connect settlement process #2

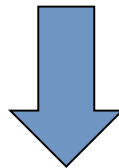
CCDC confirms the CFETS ID and trade details are correct (matching with the counterparty trade instruction which is already in CFETS).



CCDC affirms the trade.



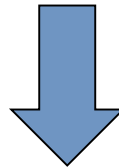
Sufficient CNH must be available by 5pm local time on settlement date (this is the CCDC cut-off, custodians have earlier funding cut-offs).



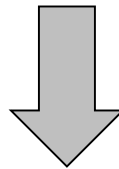
Trade settles on settlement date and the Delivery Versus Payment (“DVP”) exchange of bonds and cash takes place simultaneously.

CGB SETTLEMENTS: CIBM settlement process #1

Investment Manager instructs Global Custodian - the Counterparty inputs the trade into the CFETS system.



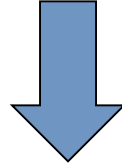
Global Custodian passes the trade instruction to the BSA.



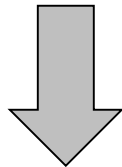
BSA manually verifies the trade details are correct in the CCDC (matching with the counterparty trade instruction which is already in CFETS).

CGB SETTLEMENTS: CIBM settlement process #2

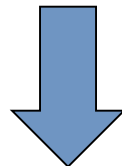
Sufficient CNY must be available by 5pm local time on settlement date (this is the CCDC cut-off, custodians have earlier funding cut-offs).



BSA affirms the trade instruction with the CCDC.



Trade settles on settlement date and DVP exchange of bonds and cash takes place simultaneously.

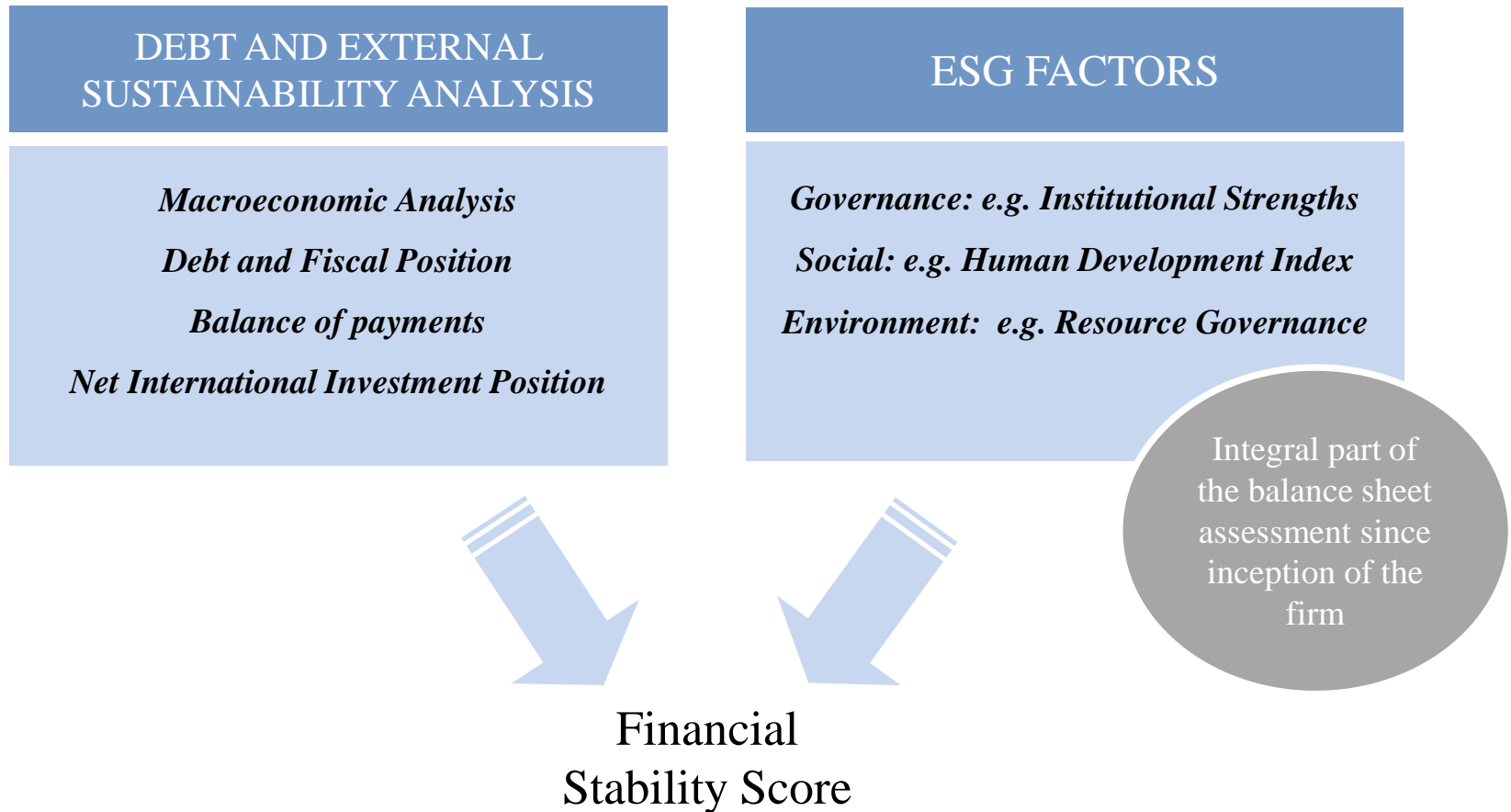


BSA verifies trade settlement status in CCDC.

5. Analysing China

CHINA: BALANCE SHEET ANALYSIS

Financial Stability Score a function of Macro Balance and ESG factors:



CHINA: GOVERNMENT FINANCIAL ANALYSIS

Debt Characteristics:

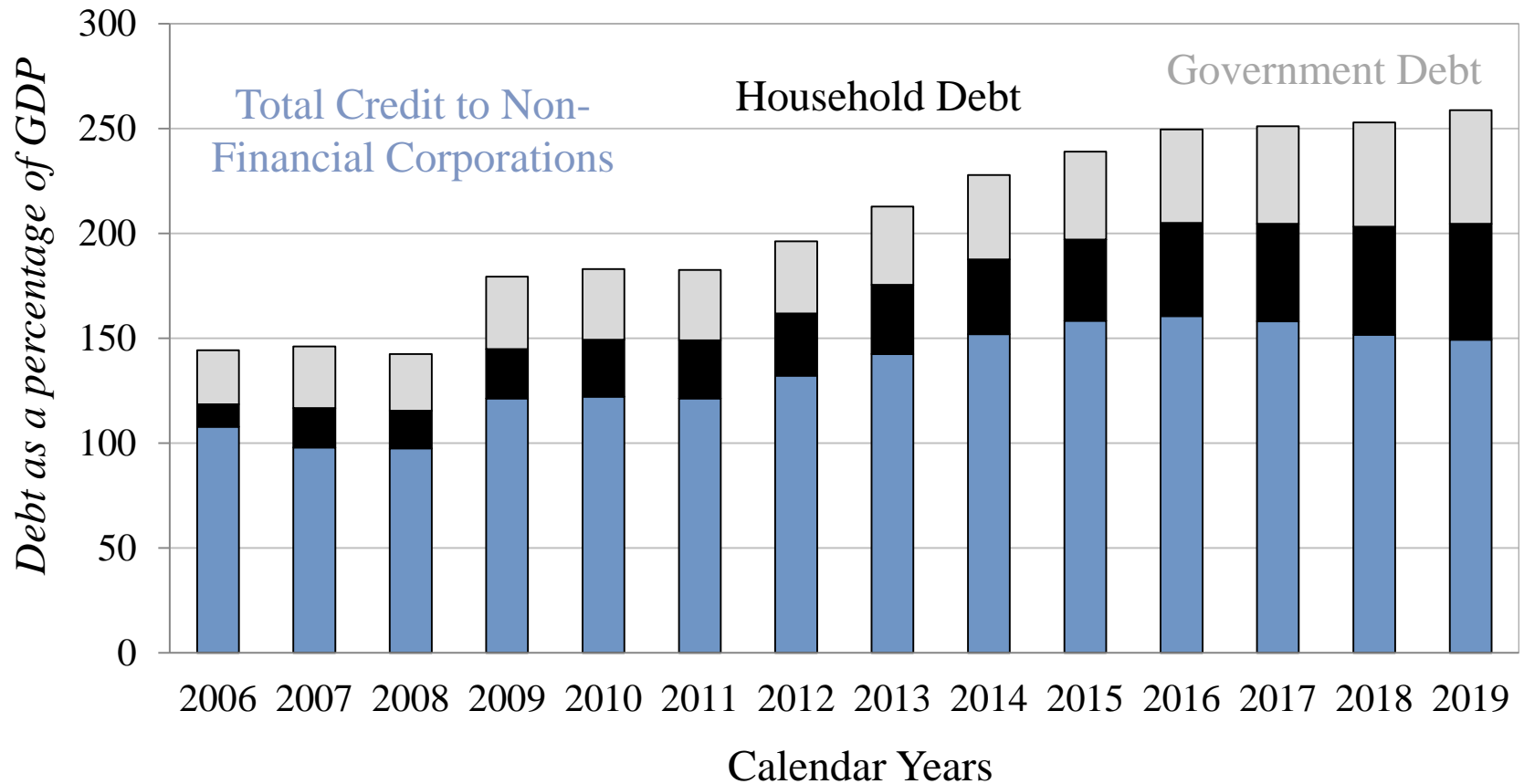
- China Credit Rating is ‘Stable’: A+ (S&P), A1 (Moody’s), A+ (Fitch).
- Government and Household debt to GDP are relatively low at around 55% each but corporate debt is high at 149% of GDP. Total non-financial sector debt is 259% of GDP at the end of 2019.
- Dominated by corporate and quasi-sovereign bonds. The government bond market amounts to US\$13 trillion.
- Commercial banks are the main holders of Chinese government bonds.

Credit ratings sources: ratings are the long-term local currency ratings from Standard and Poor’s, Moody’s Investor Service and Fitch Ratings. Bond and GDP data sources: Institute of International Finance, as of end 2019.

CHINA: BREAKDOWN OF TOTAL DEBT STOCK

Total Debt increasing, whilst Non-Financial Corporate Debt starting to Reduce:

Breakdown of Total China Debt to GDP



Source: Bank for International Settlements (BIS) data to end 2019.

CHINA: BREAKDOWN OF CORPORATE DEBT BALANCES

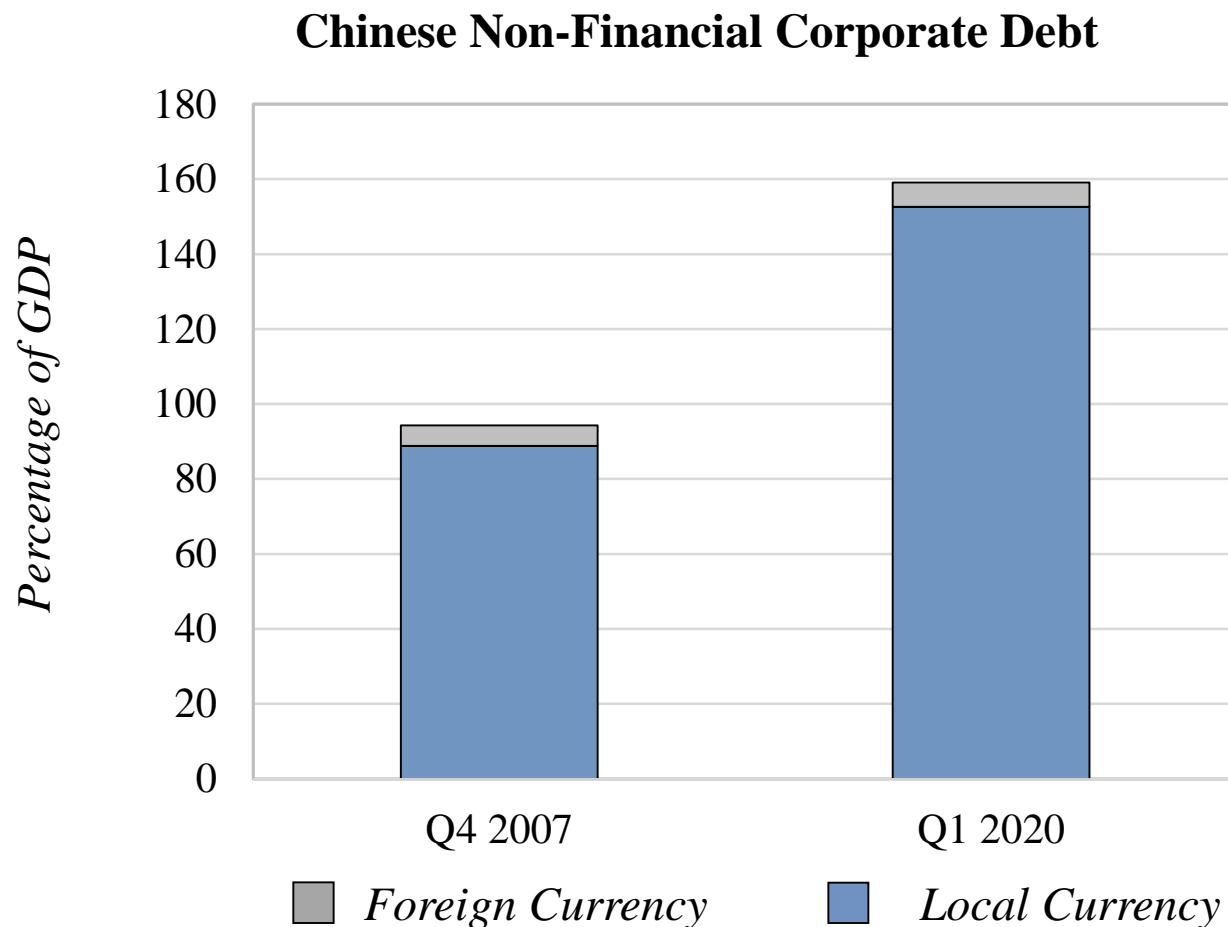
Total Debt Stock is Dominated by one Sector:



Source: Institute of International Finance. Note 1: Developed markets are the Group of Seven (G7) countries. Note 2: Emerging markets are defined as those markets in the JPM GBI-EM Global Diversified Index, where data is available. Further details available on request. Data to end of March 2020.

CHINA: CORPORATE DEBT IN LOCAL CURRENCY

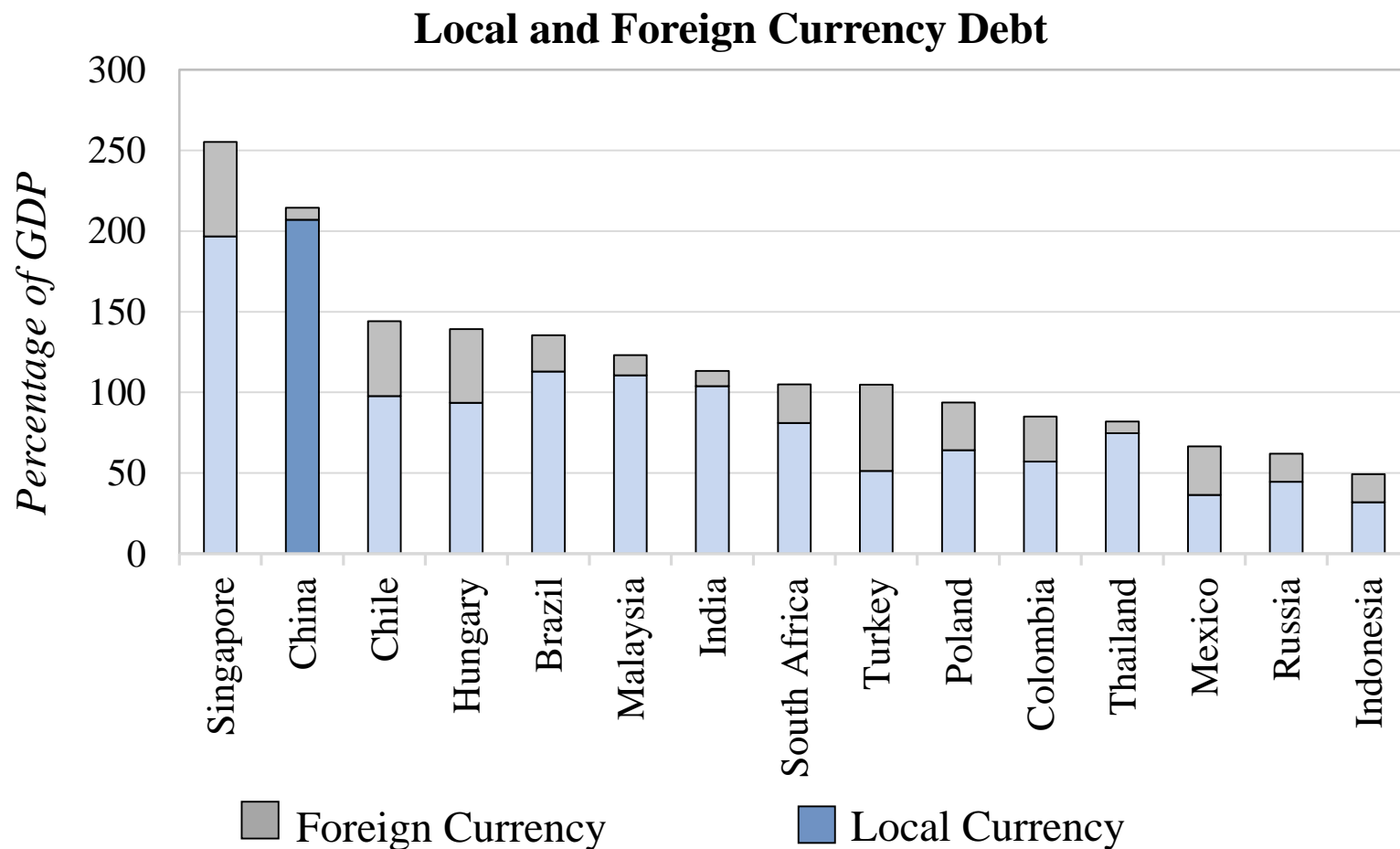
Financial Risk is Reduced by Issuing Local Debt:



Source: Institute of International Finance. Data to end of March 2020.

EMERGING MARKETS: LOCAL AND FOREIGN DEBT

Local Currency Issuance Reduces Financial Risk:

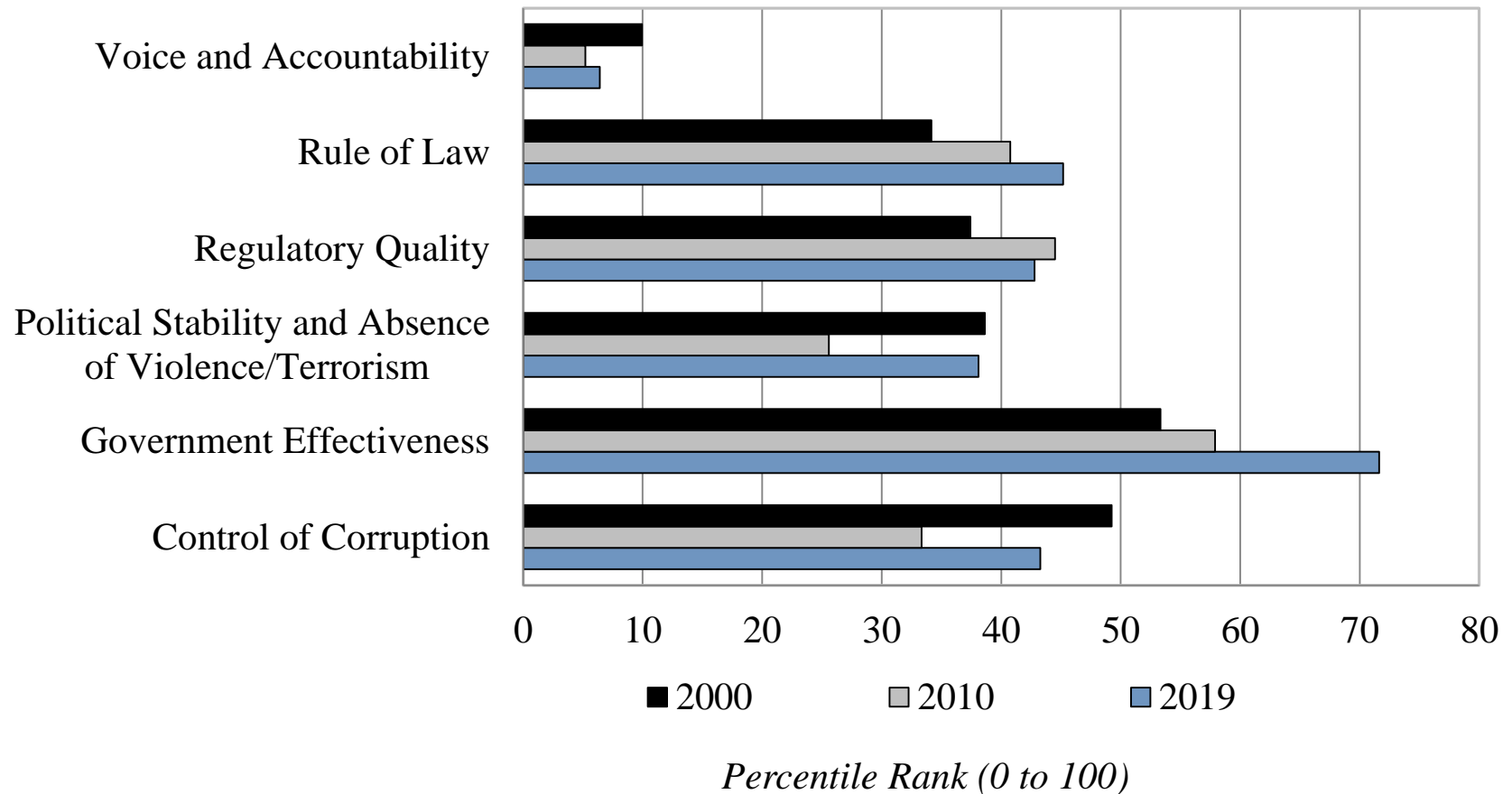


Source: Institute of International Finance. Note: Debt includes both Government and Non-Financial Corporate debt, as at end March 2020.

CHINA: ESG AND GOVERNANCE

Chinese Governance Indicators are Poor but Improving Over Time:

Chinese Governance Indicators



Source: World Bank as of end 2019.

CHINA: EXTERNAL FINANCIAL ANALYSIS

China has Robust External Balances:

	2014	2015	2016	2017	2018	2019	2020 (f)	2021 (f)
Current Account Surplus	2.2	2.7	1.8	1.6	0.4	1.0	1.3	0.7
Trade Surplus	4.1	5.1	4.3	4.0	2.9	3.1	2.9	2.7
<i>Imports</i>	17.2	14.0	13.4	14.4	15.1	14.5	14.0	13.5
<i>Exports</i>	21.3	19.1	17.7	18.4	18.0	17.6	16.9	16.2
<i>Services Balance</i>	-2.0	-1.9	-2.1	-2.1	-2.2	-2.2	-2.2	-2.2
Net International Investment Position	15.2	14.9	17.4	17.4	15.9	15.6	14.8	13.9
<i>External Debt</i>	17.0	12.3	12.6	14.6	14.8	14.9	14.7	14.4
<i>Short-term external debt</i>	12.5	7.9	7.8	9.1	9.2	9.2	9.0	8.8
Gross International Reserves Position (USDbn)	3,899	3,406	3,098	3,236	3,168	3,167	3,174	3,177
<i>in months of imports</i>	26	26	25	22	19	18	18	17

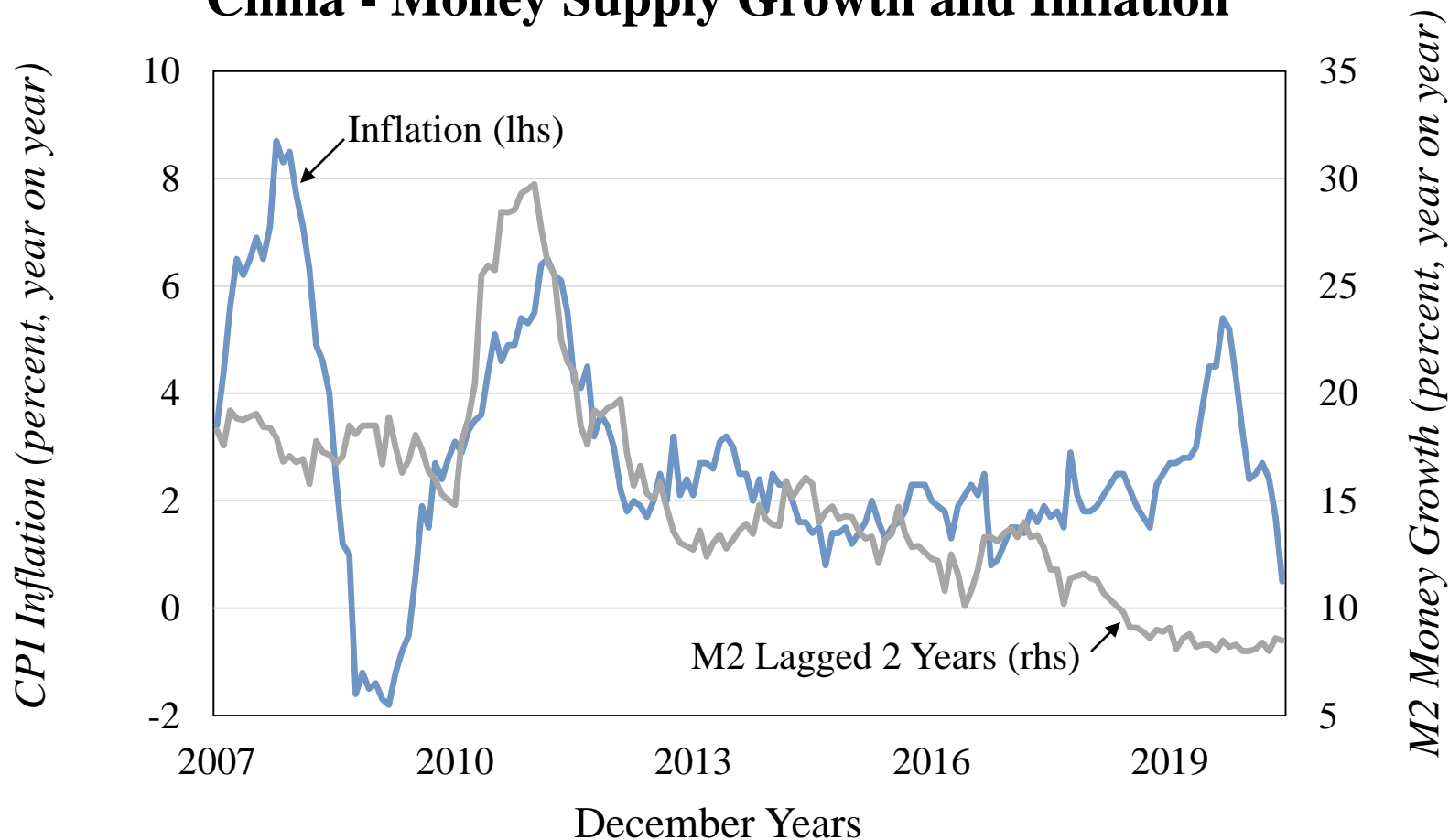
Source: IMF. Note: Percentage of GDP unless stated otherwise. (f) = Forecasts.

6. China Inflation Outlook & Current Valuations

CHINA: INFLATION DETERMINANTS – MONEY SUPPLY

“Lagged Money Supply” Currently Indicates Lower Future Inflation:

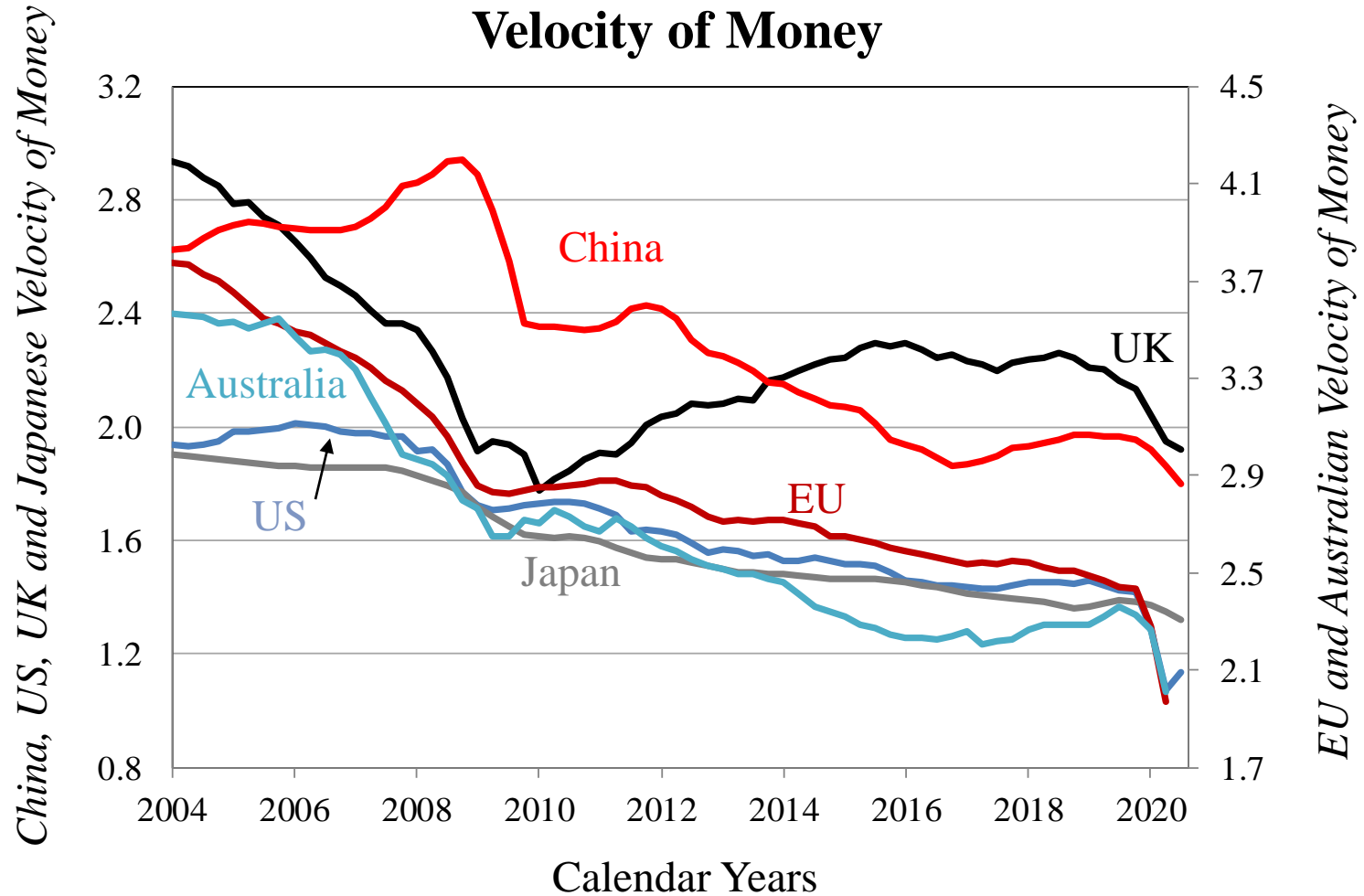
China - Money Supply Growth and Inflation



Source: People's Bank of China (PBoC). Note: Inflation data to end of October 2020 and M2 data is lagged two years.

CHINA: INFLATION OUTLOOK

“Halt” in Activity has Prompted a Decline in Velocity:

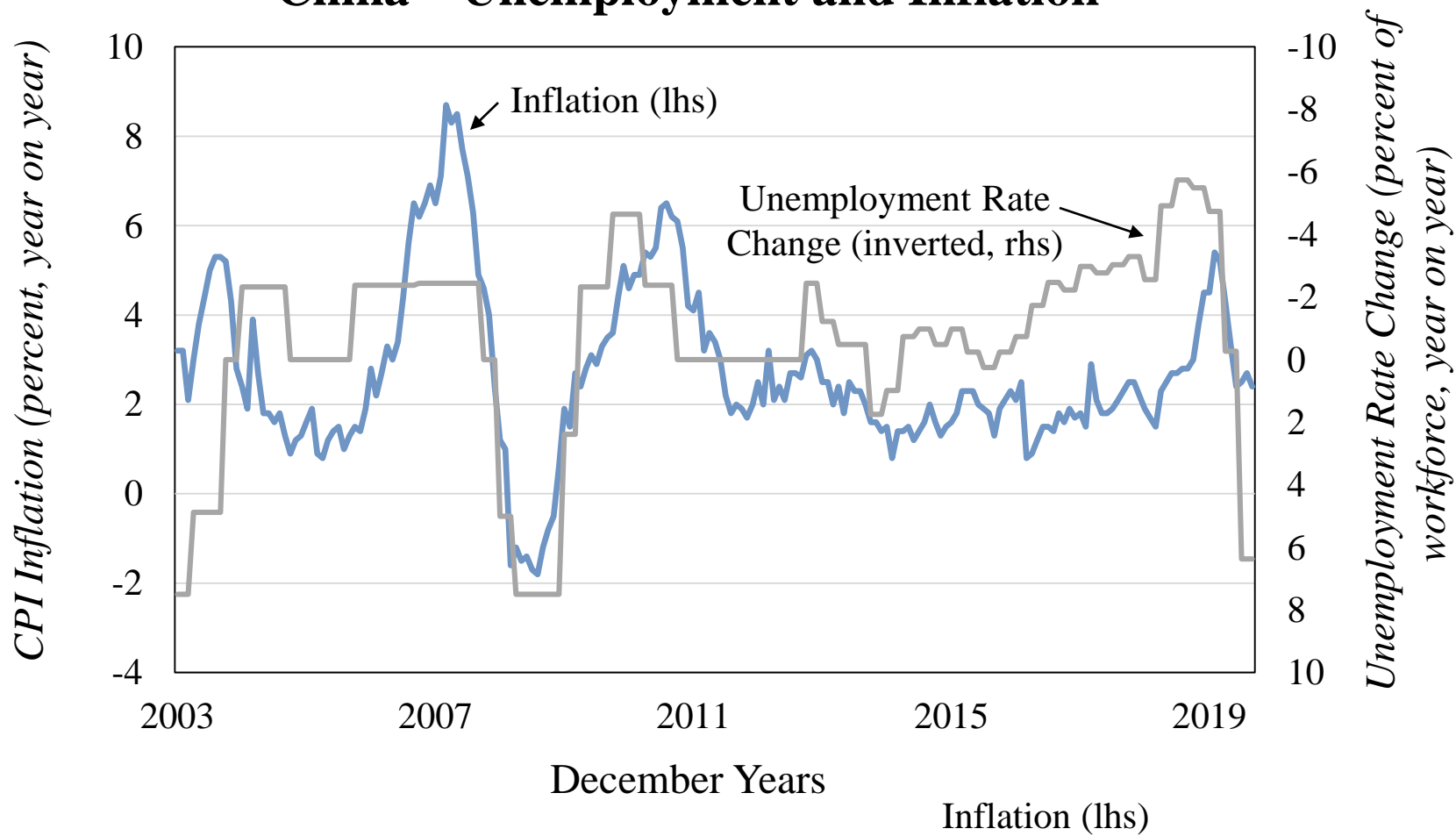


Source: Official data sources. Further details available on request. Data as at end of September 2020.

CHINA: INFLATION DETERMINANTS – CAPACITY

Increase in Unemployment Signals “Slack” in the Economy:

China – Unemployment and Inflation

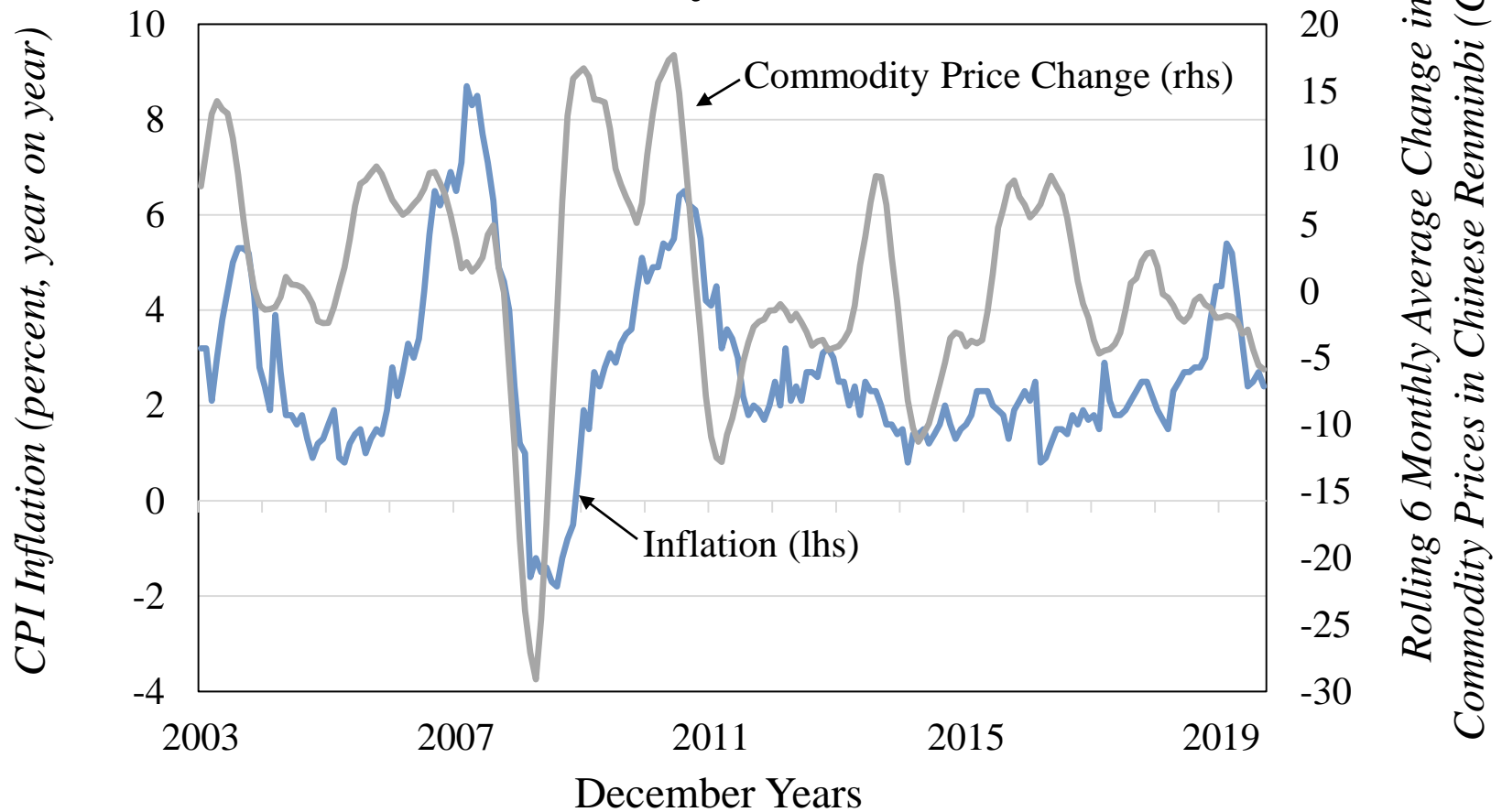


Source: National Bureau of Statistics of China. Data to end of October 2020.

CHINA: INFLATION DETERMINANTS – COMMODITIES

Lower Commodity Prices Indicate Lower Future Inflation:

China – Commodity Prices and Inflation



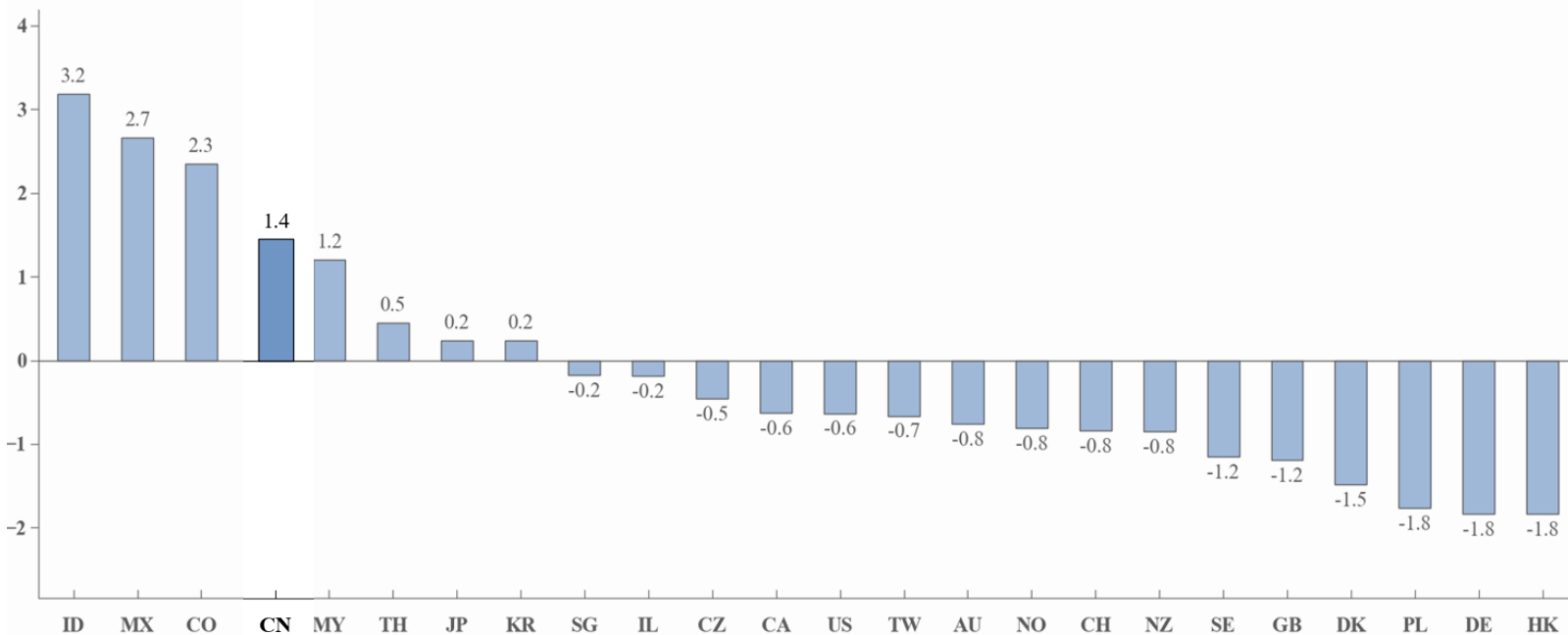
Source: National Bureau of Statistics of China and Bloomberg. Data to end October 2020 respectively. Data is smoothed for presentational purposes, with the CRB commodity price index has been converted into CNY expressed as the average of the past 6 months, 6 monthly changes.

CHINA: REAL YIELD BOND VALUATIONS

Chinese Government Bonds are an Attractive Relative Value Proposition:

Prospective Real Yield - October 2020

Real Yields equal 10 year market yield less Colchester inflation forecasts (%)



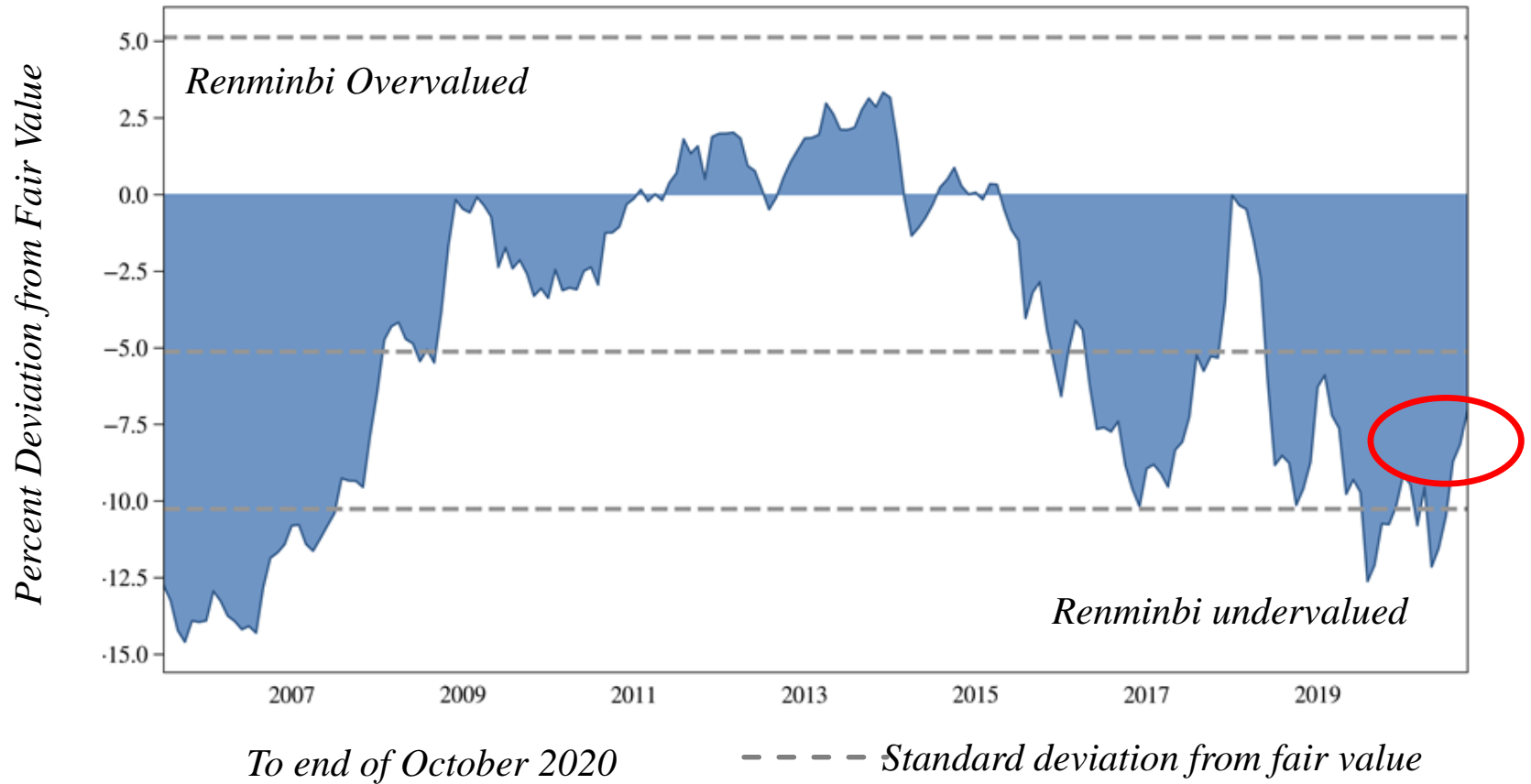
AU Australia	CZ Czech Republic	ID Indonesia	MY Malaysia	SG Singapore
CA Canada	DK Denmark	IL Israel	NO Norway	TH Thailand
CH Switzerland	DE Germany	JP Japan	NZ New Zealand	TW Taiwan
CN China	GB United Kingdom	KR South Korea	PL Poland	US United States
CO Colombia	HK Hong Kong	MX Mexico	SE Sweden	

Notes: 1. The prospective real yield for the 10 year sector is shown here for representational purposes. Colchester values up the 2, 5, 10 and 20 year sectors of the yield curve when valuing a country. The final portfolio reflects the value on offer in these individual yield curve points.

CHINA: CURRENCY VALUATION

Chinese Renminbi is Moderately Undervalued:

Chinese Renminbi versus US Dollar Real Exchange Rate

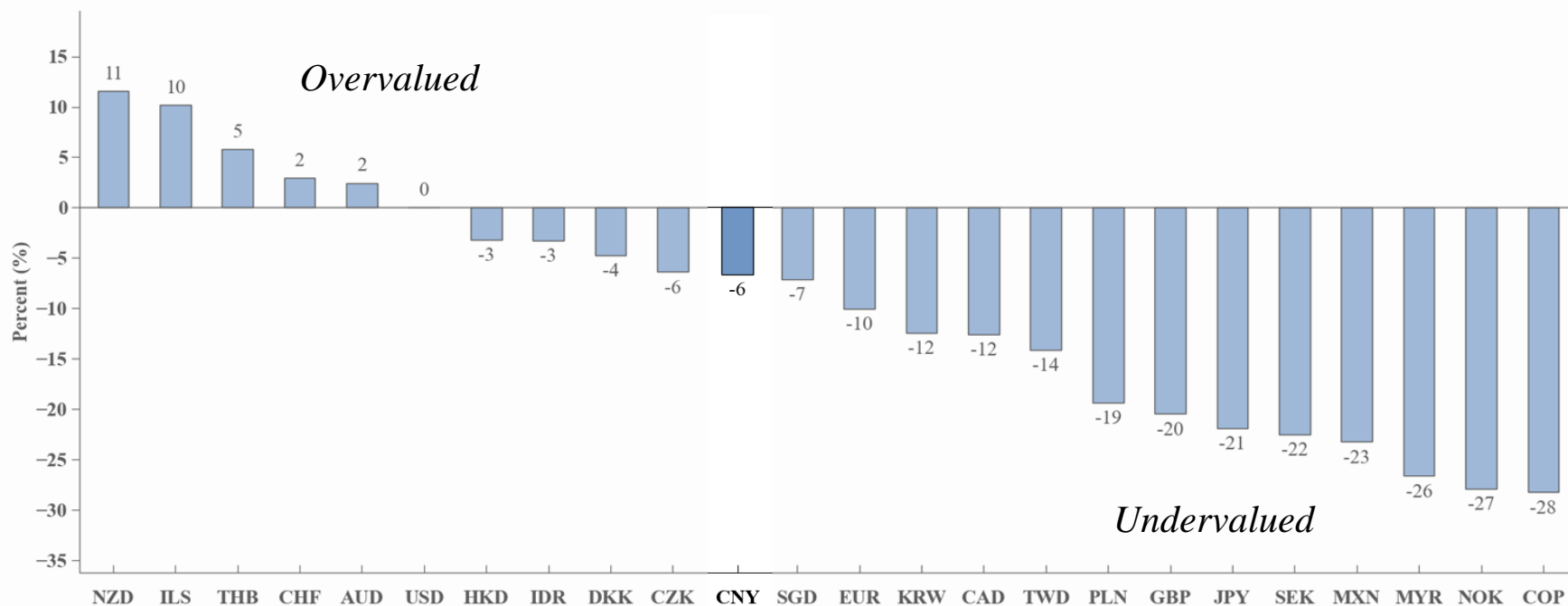


Source: Colchester Global Investors, Central bank CPI and PPI data. Bloomberg and WM Reuters exchange rates.

CHINA: REAL EXCHANGE RATE VALUATIONS

Many other Currencies have Better Value than the Renminbi:

Real FX versus USD - October 2020



AUD	Australian Dollar	CZK	Czech Koruna	IDR	Indonesian Rupiah	MYR	Malaysian Ringgit	SGD	Singapore Dollar
CAD	Canadian Dollar	DKK	Danish Krone	ILS	Israeli New Shekel	NOK	Norwegian Krone	THB	Thai Baht
CHF	Swiss Franc	EUR	Euro	JPY	Japanese Yen	NZD	New Zealand Dollar	TWD	Taiwan Dollar
CNY	Chinese Yuan	GBP	British Pound	KRW	Korean Won	PLN	Polish Zloty	USD	United States Dollar
COP	Colombian Peso	HKD	Hong Kong Dollar	MXN	Mexican Peso	SEK	Swedish Krona		

Source: Colchester Global Investors, Central bank CPI and PPI data, to end of October 2020. Bloomberg and WM Reuters exchange rates.

CHINA: LOW CORRELATION TO GLOBAL BOND MARKETS

China has Low Correlations in the Global Bond Opportunity Set:

- China also has low correlation with the FTSE World Government Bond Index (WGBI) and with other major bond markets.

	China	USA	Eurozone	Japan	UK	Australia	New Zealand	Canada	Norway	Sweden	Switzerland	Malaysia	Singapore	Poland	Mexico	WGBI Index
China	1.00	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
USA	0.29	1.00	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Eurozone	0.12	0.51	1.00	-	-	-	-	-	-	-	-	-	-	-	-	-
Japan	0.25	0.48	0.49	1.00	-	-	-	-	-	-	-	-	-	-	-	-
UK	0.27	0.75	0.54	0.44	1.00	-	-	-	-	-	-	-	-	-	-	-
Australia	0.22	0.71	0.51	0.40	0.65	1.00	-	-	-	-	-	-	-	-	-	-
New Zealand	0.30	0.69	0.46	0.43	0.65	0.77	1.00	-	-	-	-	-	-	-	-	-
Canada	0.31	0.83	0.55	0.45	0.74	0.75	0.70	1.00	-	-	-	-	-	-	-	-
Norway	0.28	0.71	0.37	0.33	0.66	0.61	0.57	0.69	1.00	-	-	-	-	-	-	-
Sweden	0.22	0.70	0.58	0.44	0.71	0.72	0.64	0.68	0.71	1.00	-	-	-	-	-	-
Switzerland	0.16	0.64	0.60	0.48	0.65	0.61	0.57	0.68	0.62	0.76	1.00	-	-	-	-	-
Malaysia	0.21	0.42	0.38	0.32	0.34	0.27	0.45	0.38	0.22	0.26	0.40	1.00	-	-	-	-
Singapore	0.28	0.72	0.45	0.37	0.56	0.44	0.56	0.60	0.53	0.48	0.50	0.60	1.00	-	-	-
Poland	0.22	0.41	0.49	0.17	0.40	0.30	0.39	0.40	0.30	0.30	0.30	0.34	0.54	1.00	-	-
Mexico	0.24	0.43	0.35	0.28	0.34	0.28	0.36	0.38	0.23	0.19	0.25	0.40	0.54	0.52	1.00	-
WGBI Index	0.27	0.87	0.84	0.67	0.80	0.72	0.69	0.81	0.64	0.75	0.73	0.47	0.67	0.50	0.46	1.00

Source: FTSE. Note: the WGBI Index is the FTSE World Government Bond Index (WGBI). Data to end October 2020.

CHINA: LOW CORRELATIONS TO EMERGING MARKETS

China has Low Correlations in the Emerging Market Opportunity Set:

- China exhibits low correlation with the JPM GBI-EM Global Diversified, as well as low correlations with major Emerging Market countries.

	China	Brazil	Mexico	Indonesia	Thailand	Poland	South Africa	Russia	Colombia	Malaysia	Hungary	GBI-EM GD
China	1.00	-	-	-	-	-	-	-	-	-	-	-
Brazil	0.18	1.00	-	-	-	-	-	-	-	-	-	-
Mexico	0.24	0.40	1.00	-	-	-	-	-	-	-	-	-
Indonesia	0.16	0.46	0.51	1.00	-	-	-	-	-	-	-	-
Thailand	0.31	0.38	0.52	0.44	1.00	-	-	-	-	-	-	-
Poland	0.22	0.34	0.52	0.50	0.41	1.00	-	-	-	-	-	-
South Africa	0.07	0.50	0.55	0.57	0.47	0.45	1.00	-	-	-	-	-
Russia	0.06	0.26	0.22	0.17	0.17	0.25	0.25	1.00	-	-	-	-
Colombia	0.09	0.49	0.57	0.62	0.43	0.43	0.64	0.37	1.00	-	-	-
Malaysia	0.21	0.33	0.40	0.50	0.56	0.34	0.46	0.30	0.42	1.00	-	-
Hungary	0.07	0.26	0.44	0.39	0.39	0.50	0.47	0.20	0.37	0.29	1.00	-
GBI-EM GD	0.23	0.68	0.74	0.78	0.63	0.66	0.80	0.43	0.77	0.60	0.59	1.00

Source: JP Morgan. Note: the GBI-EM GD is the JP Morgan GBI-EM Global Diversified Index. Data to end October 2020.

CHINA: A DEFENSIVE MARKET

Chinese Bond Market Surprisingly Defensive to Equities:

Correlation of Monthly Returns: MSCI Equity Index v's Global Bond Markets

	<i>FTSE WGBI</i>	<i>US</i>	<i>Germany</i>	<i>Japan</i>	<i>UK</i>	<i>China</i>
<i>15 years to Oct 2020</i>	-0.26	-0.37	-0.33	-0.20	-0.23	-0.19
<i>5 years to Oct 2020</i>	-0.27	-0.45	-0.19	-0.15	-0.24	-0.24
<i>3 years to Oct 2020</i>	-0.27	-0.46	-0.17	-0.06	-0.30	-0.25

Source: FTSE World Government Bond Index, MSCI All Country World Index and JP Morgan GBI-EM China Index.

7. Conclusions

CHINA: CONCLUSIONS

- China is opening its government bond market to foreign investors.
- Access to the local market has been challenging but is becoming gradually easier for investors to navigate the legal and operational hurdles.
- Once operational and dealing platforms are set up, our dealing experience and market liquidity has been very positive.
- Financial stability and ESG factors are improving in China and bond and currency valuations are moderately attractive.
- China government bonds have low correlations to other government bond markets and are defensive at times of market stress.



Please send your queries to

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Thanks for joining us today.