CCXI & CCXAP – Research & Commentary

10-year Government Bond Yields Might Fluctuate at Around 3.0%

Hong Kong, 21 July 2021 -- A report titled “Across-the-Board RRR Cuts was Implemented under Normalized Monetary Policy, and the Yield might Fluctuate Around 3.0%——Review and Outlook of Interest Bonds in H1 of Year 2021” has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. (“CCXI Research Institute”). According to the report, the monetary policy will remain prudent against the backdrop of marginally weakening recovery of the economy but still-resilient growth in the year, and that it is unlikely to see any further easing operations from “quantity” to “price”. The yield of 10-year government bonds might fluctuate around 3.0% which is below the H1 level, and the fluctuation range may not exceed the 30-bps recorded in H1.

The report holds that the monetary policy and interest rate bond market mainly showed the following three characteristics in 2021H1: First, the monetary policy gradually returned to normal, remaining prudent in general. PBOC attached greater importance to the effectiveness and precision of policy operations. In January and February, the monetary policy was in a transition from “easy” to “prudent” that started in 2020H2. PBOC marginally tightened its operations, leading to a net liquidity withdrawal of over RMB500 billion from open markets, a higher level than expected. Starting from March, the monetary policy stayed prudent and neutral. PBOC created an operational mechanism to offer a fixed number of reverse repos daily, boosting the precision of open market operations. The net liquidity injection amounted to RMB63.9 billion from March to June. In terms of money market rates, money market rates moved higher year-on-year in H1 in general. Money market rates for all terms surged in late January, followed by a rapid downturn before they started a stable run. The R007-DR007 spread widened near the end of June, with liquidity layering worsened. Second, government bonds and policy financial bonds continued to expand, with a slow pace of local government bond issuance. New special-purpose local government bonds were issued at a slow pace in H1 due to late granting of additional quotas and strict examination of issues this year, resulting in a year-on-year decline in the special-purpose local government bond issues. The issuance of government bonds and policy bank bonds gained pace, driving up the total scale of interest rate bond issues, which grew by 4.33% year-on-year to RMB9.19 trillion. Third, yield of 10-year government bonds showed a mild overall decline, with an upward start to the year followed by a pullback. The yield remained range-bound early this year amid COVID-19 resurgence and tight interbank liquidity. Later the yield staged a bumpy upturn amid tightening liquidity and rising commodity prices. Starting from late February, the bond yields trended downwards in general as the liquidity situation stabilized, coupled by slow issuance of local government bonds and the interbank liquidity relaxed by PBOC’s prudent operations.

Looking forward the rest of the year, CCXI Research Institute expects the monetary policy to maintain an appropriate aggregate supply with well-targeted operations, putting “prudent” first. Given such a prudent policy stance, it is unlikely to see further easing from “quantity” to “price”. Currently the overseas environment still has a relatively limited impact on China, the monetary policy will retain the domestic orientation through the rest of the year and put “prudent” first amid the marginally weakening recovery of domestic economic fundamentals, yet with sustained resilience of growth. Though the recovery will soften marginally, China’s economy maintains growth resilience with a low probability of worse-than-expected deterioration in fundamentals. The report tends to believe that the monetary policy will remain prudent and PBOC may conduct open market operations to smooth the volatility at some moments of major liquidity turbulence. Thus, there is low necessity of further adopting easing operations at the price level, such as reducing MLF rates, following the July reserve requirement reduction. But vigilance is still required against any possible policy shift triggered by worse-than-expected economic decline and growing pressure on business operations.

The report estimates that interest rate bond issues will total nearly RMB19 trillion, with about RMB10 trillion to be issued by the end of the year. Thus, Q3 may see a peak of supply due to acceleration in new special-purpose local government bonds and government bonds. According to the report estimates, the interest rate bond issues in the year may total RMB18.78 trillion. Specifically, the annual government bond issuance may reach RMB6.73 trillion, with RMB3.91 trillion to be issued in the rest of the year. The annual issuance of policy financial bonds may be RMB5.23 trillion, with a remainder of RMB2.2 trillion to be issued. The annual issuance of local government bonds may amount to RMB6.67 trillion, with a remainder of RMB3.95 trillion to be issued, if only the new bonds and the refinancing bonds earmarked for repaying matured bonds are considered. As for pace of issuance, given the cold weather unsuitable for the starts of some infrastructure projects in November and December, Q3 may see a relatively high issuance of new special-purpose local government bonds. Moreover, as a relatively large size of government bonds will mature in Q3, interest rate bonds are expected hit a peak of supply in Q3 with a total issuance of nearly RMB5 trillion.

The report expects the 10-year government bonds yield to fluctuate around 3.0% within a range of 30 bps, pulling back from H1 in general. PBOC’s across-the-board reserve requirement reduction has opened up the room for a yield decline (mild in general) in the short run. As for the yield trend going forward, ongoing attention should be paid to the economic recovery and the future monetary policy orientation. The yield hike may lack momentum amid a marginally slowing recovery of economic fundamentals. Despite the liquidity turbulence, liquidity pressure is not quite a concern as the required reserve ratio got reduced across the board and the monetary policy remains prudent. Moreover, China’s economy is still resilient and the fundamentals are unlikely to deteriorate beyond expectations, the yield is unlikely to decline continuously, it might fluctuate around 3.0% which is below the H1 level. Without any worse-than-expected developments in the fundamentals and unexpected monetary policy, the fluctuation range may be about 30 bps, not wider than in H1.

To obtain the full report, please call our Customer Service Hotline +852-2860 7111.

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