

Asia FI & FX Strategy Watch

China rates – waiting for more duration supply

China government bonds issuance outlook

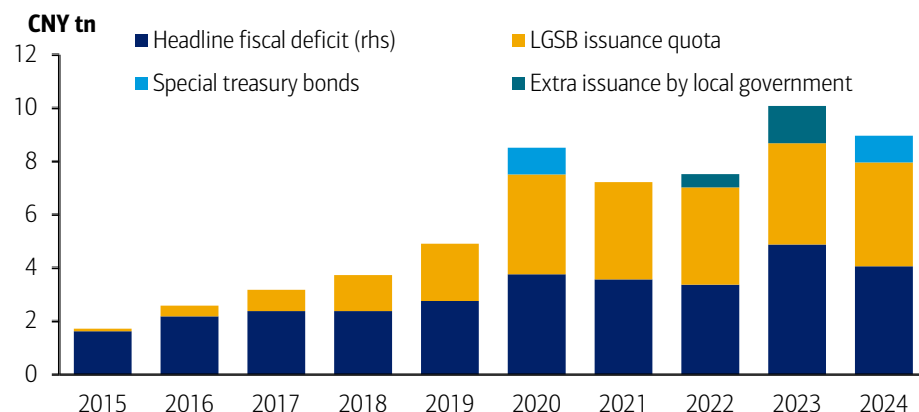
We update our government bonds supply estimates for 2024 based on the fiscal plan unveiled in the Government Work Report (GWR). There are three components when it comes to calculating the aggregate borrowing needs by the governments: 1) a 3% headline fiscal deficit ratio; 2) an annual issuance quota of CNY3.9tn for LGSBs; and 3) another CNY1tn issuance of super-long tenor special treasury bonds.

The first component – the headline fiscal deficit, will be funded by issuing CNY3.34tn CGBs and CNY0.72tn LGGBs (Exhibit 2). The deficit ratio of 3% was probably on the lower end of market expectations heading into the NPC, but it was to some extent offset by the usage of special treasury bonds (SCGB) to fund national strategic projects, not only in 2024, but also in the next few years.

Incorporating all three fiscal ingredients, the net supply of central and local government bonds would be around CNY9tn, 10% lower than that of 2023 (Exhibit 1). However, there are still uncertainties on potential additional issuance by local governments. In 4Q last year, local governments got the green light to issue about CNY1.4tn special refinancing bonds to replace non-standard, high-interest rates debt obligations, as an effort to defuse debt risks. If that continues to play out this year, it would impose upside risk to our baseline estimate, but overall, we think net supply will not deviate much from 2023.

Exhibit 1: Government bonds net supply estimate for 2024

The net supply of central and local government bonds would be around CNY9tn, less than 2023



Source: Wind, China MoF, BofA Global Research

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GEM FI & FX Strategy
Asia

Janice Xue
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 8587
janice.xue@bofa.com

Asia FI Strategy & Economics
Merrill Lynch (Hong Kong)

GEMs FI Strategy & Economics
BofAS

CGB – China central government bonds

GWR – Government Work Report

LGSB – Local government special purpose bonds

LGGB – Local government general purpose bonds

LPR – Loan prime rate

MoF – Ministry of Finance

PBoC – People's Bank of China

RRR – Required reserve ratio

SCGB – Special China government bonds

YTD – year-to-date

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Too much demand, not enough supply

China rates rally continued this week, suggesting little change in sentiment and limited concern about the bond supply pressure. Even though it remains unclear when the CNY1tn super-long tenor SCGB will be issued and at which exact tenors, we think it makes a lot of sense for the government to extend duration given the rising debt level, strong market demand, and prevailing curve-flattening pressure.

Exhibit 3 shows the central government's gross issuance of bonds and bills in recent years. For each particular month, the auction sizes for 1y, 2y, 3y, 5y, 7y, and 10y are more or less the same, while those for 30y have been much smaller. Since 2021, the MoF has also started auctioning larger bill sizes, especially during the 2H. In 2023, the supply of 30y and 50y CGB made up only 3.4% of the total supply, or 5% of the bonds supply, which looks relatively small compared to other major EM Asia countries. For instance, nearly 30% of India government bonds (IGB) were issued at the 20y+ segment during FY2022-2023. In Korea's case, 20-50y Korea treasury bonds (KTBs) account for 38% of gross bond issuances in 2023.

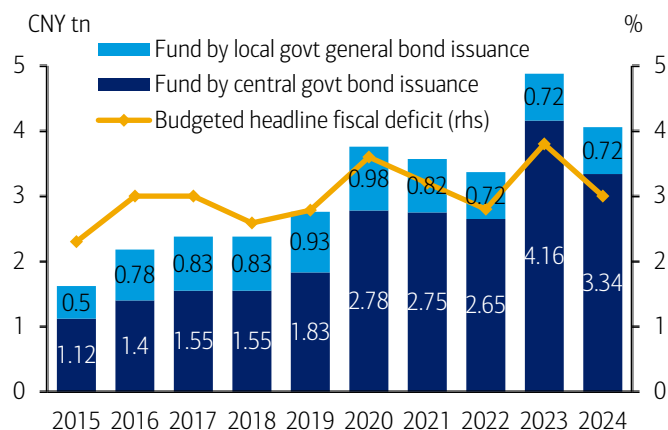
In absolute amounts, China MoF only issued CNY276bn/CNY92bn 30y and 50y CGB in 2023. Of course, besides CGBs, local government bonds also serve as a key source for meeting asset allocation demand from Chinese commercial banks and insurance companies. Exhibit 4 shows the tenor distribution of different types of bonds issued by local governments during 2023. LGGBs, refinancing bonds, and special refinancing bonds have a similar average duration of ~8.5 years. On the other hand, LGSBs issued in 2023 had an average duration of close to 18 years and were the main source of back-end bond supply.

See less favorable policy backdrop for China rates in 2Q

The slow issuance of LGSBs so far this year - around CNY403bn - has also exacerbated the imbalance between duration demand and supply (Exhibit 5). For that dynamic to change, we probably need to see: 1) the issuance rate of local government special bonds accelerates, and/or 2) the central government starts issuing super-long SCGBs. 2Q and 3Q are typically the peak season for government bonds supply. We think that should remain the case this year. In the meantime, after lowering the RRR and cutting the 5y LPR rate, the PBoC may take a pause in broad-based monetary easing, especially given a less favorable external environment of a later Fed cut. In short, the policy backdrop could turn less favorable for China's rates in the next few months.

Exhibit 2: Headline fiscal deficit and associated bonds issuances

Headline fiscal deficit will be funded by the issuance of CNY3.34tn CGBs and CNY0.72tn LGGBs

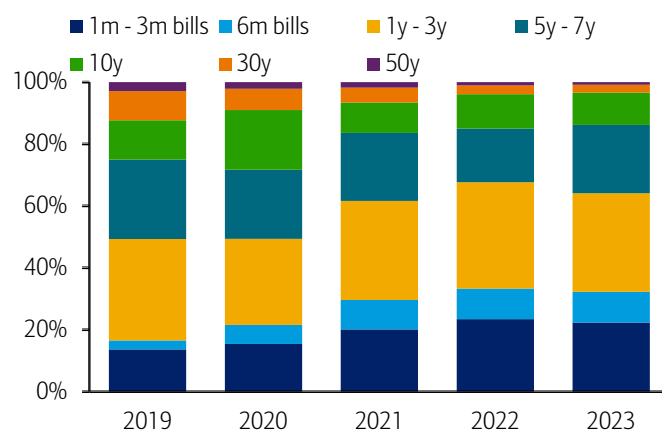


Source: Wind, China MoF, BofA Global Research

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Exhibit 3: Issuance of China government bonds and bills

The supply of 30y and 50y CGB make up only 3.4% of the total supply and 5% of the bonds supply

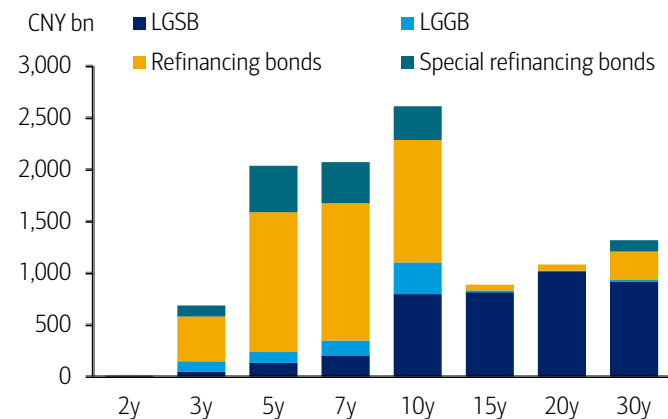


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Exhibit 4: Tenor distribution of local government bonds in 2023

LGSBs have much longer duration comparing to other types of bonds

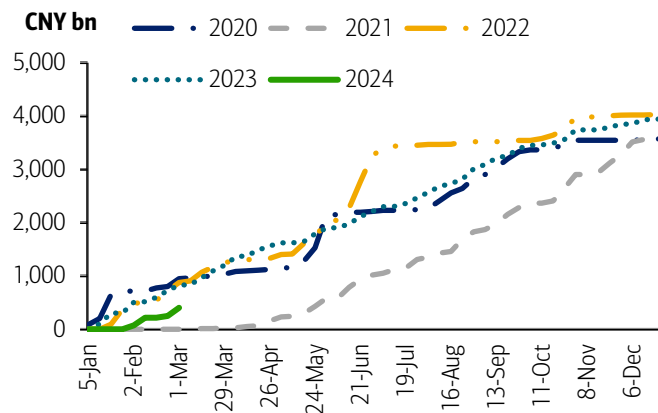


Source: Wind, BofA Global Research

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Exhibit 5: Cumulative issuance of LGSBs

Slow issuance of LGSBs YTD



Source: Wind, BofA Global Research

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