

27 November 2017
Article

Early China bond market concerns unjustified

Chinese sovereign bond yields have increased. But that is not alarming - for us, it is more a combined result of financial deleveraging and the usual year-end liquidity tightness.

Contents

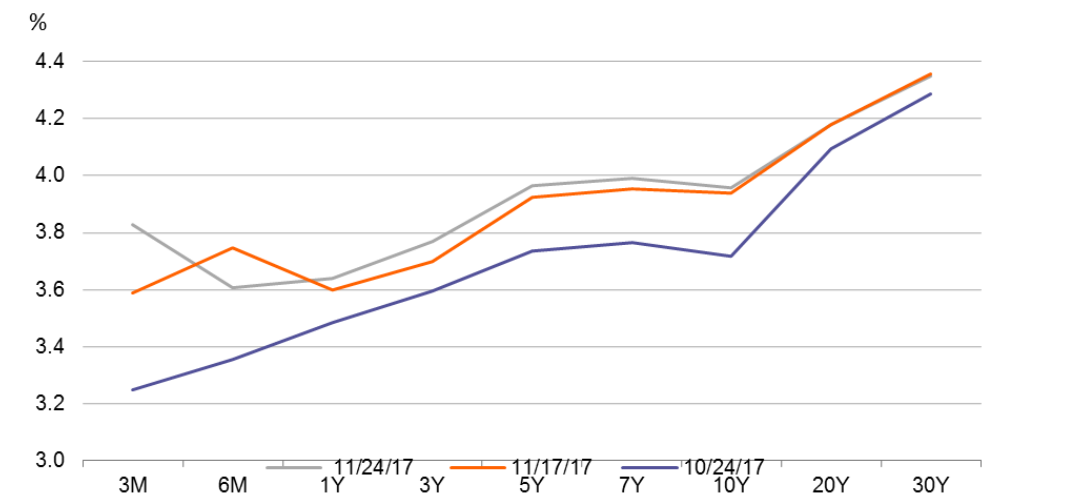
- Rising interest rates would become a norm under financial deleveraging
- No whistle blowing
- It could also due to positive factor from bonds to stocks
-

Rising interest rates would become a norm under financial deleveraging

Financial deleveraging has pushed up interest rates in the interbank from short rates in the money market to long rates in the sovereign bond market. However, we need to have evidence that there has been quick sales of assets before we conclude that recession is coming. But we could not locate them. First of all, financial deleveraging has just begun from cleaning off the Negotiable Certificate of Deposits in the interbank market. Progressing to clean up the financial sector further, especially wealth management products traded in interbank market, would push up interest rates.

Don't worry, the central bank is always there to calm the market

The pace of the rising sovereign yield has stagnated since 17 Nov 2017, an effort by the central bank.



Source: ING, Bloomberg

No whistle blowing

The whole financial deleveraging exercise has just kicked off, not even in the middle of the progress. If there are financial institutions that need to prepare for more cash rather than investing in longer term bonds at this beginning stage then it may hint cash tightness in some financial

institutions.

Some may argue that investors are forward-looking enough to leave the interbank market by selling government bonds. This could be true for financial institutions that fulfill liquidity ratios at the end of the month, and this phenomenon would be more intense when it comes closer to the end of the year.

Is this alarming? We don't think it is the right time for whistle blowing because the pace of sovereign curve shift has stagnated since last week. The central bank has injected liquidity whenever bond yield rises to the central bank's threshold. This means the central bank is in control of liquidity as well as the shape of the curve.

It could also due to positive factor from bonds to stocks

Market's reallocation of asset from bond to stocks also adds shift-up of the sovereign curve. Then in fact, market participants are looking for higher profits from corporates, which should read as a positive sign of the economy.

After all financial deleveraging would only be mild and gradual. The central bank is very mindful that it should avoid systemic risk as stated in the 19th Congress.

Iris Pang

Economist, Greater China

+85 22 848 8071

iris.pang@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group NV and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. The producing legal entity ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is subject to limited regulation by the Financial Conduct Authority (FCA). ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.