The FTSE China Onshore Bond Index Series
China is now the world’s largest economy (when measured by purchasing power parity (PPP)) and the largest trading nation. The country's domestic currency bond market is the third-largest in the world, following the United States and Japan, and has been growing rapidly in recent years.

The FTSE China Onshore Bond Index Series, launched in March 2015, offers investors a comprehensive set of benchmarks to measure the performance of the renminbi-denominated bond market. The index series includes fixed-rate and zero-coupon debt issued by the Chinese central government and policy banks.

The primary price source for the FTSE China Onshore Bond Index Series is the electronic trading platform operated by the China Foreign Exchange Trade System (CFETS), ensuring that the indexes accurately represent transactions in China’s interbank bond market, the dominant location for fixed income trading.

**Offshore and onshore renminbi bond markets**

Because of a long-standing government policy of foreign exchange controls, China’s domestic currency bond market has historically been divided into offshore and onshore segments.

Renminbi (RMB)-denominated bonds issued and settled outside the People’s Republic of China (PRC) are known as offshore bonds. These bonds are denominated in the offshore version of the renminbi (the currency code CNH is frequently used to refer to renminbi traded and settled in Hong Kong). This bond market is freely accessible to international investors.

Onshore RMB bonds are bonds issued and settled within the PRC. These bonds are denominated in the onshore version of the renminbi (CNY) and are accessible to mainland investors and licensed international investors (see below for a description of the quota and licence systems used by international investors to obtain exposure to securities within the PRC).

The onshore Chinese bond market is substantially larger than the offshore market. As at end-February 2016, the nominal value of bonds issued offshore was RMB867 billion, while the nominal value of fixed income securities issued onshore was RMB50,374 billion.4

Between 2006 and 2015, China's local currency bond market grew more than six-fold in size, bringing the country to third in a ranking of global domestic debt markets by amount in issuance (see the charts).

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4 Source: WIND and Bloomberg.
China domestic debt market size

Source: Bank for International Settlements (BIS), data captured in Q2 of each year, as at Q2 2015

Domestic debt market size by country

Source: Bank for International Settlements (BIS), data captured in Q2 of each year, as at Q2 2015.

Market composition

China’s domestic debt market consists of the following principal issuer categories:

- **Government (sovereign) bonds**, issued by the Ministry of Finance to fund the central government’s budget deficit;
- **PBoC bills**, issued by the China’s central bank, the People’s Bank of China, to help manage money market liquidity;
- **Local government bonds**, issued by certain Chinese local governments under a quota system approved by the State Council, China’s chief administrative body;
- **Financial bonds issued by state policy banks** (China Development Bank, the Agricultural Development Bank of China, and the Export-Import Bank of China), which have historically received credit support from China’s central government;
- Other financial bonds, issued by commercial banks and non-bank financial companies; and
- Non-financial corporate bonds, issued by non-financial companies, including bonds issued by state-owned and state-controlled enterprises without an explicit or implicit government guarantee.

The levels of issuance of these different bond categories since the first quarter of 2001 are shown in the chart below. Until 2005 sovereign and government-related bonds were the predominant types of onshore Chinese bonds; since 2008 then there has been a rise in the issuance of corporate bonds, both financial and non-financial.

**China onshore bonds issued by quarter and type**

![Chart showing issuance of bonds](chart.png)


**Growth in foreign investor access**

Currently, foreign investors can invest in China’s domestic bond market via one of three access schemes.

Under the PBoC’s interbank investment programme, launched in 2010, investors in one of six categories (foreign central banks, sovereign wealth funds, supranationals, renminbi clearing banks, renminbi settlement banks and insurance companies) may apply for a quota to invest in renminbi bonds.

The Qualified Foreign Institutional Investor (QFII) and the Renminbi Qualified Foreign Institutional Investor (RQFII) schemes were launched in 2002 and 2011, respectively.

QFII and RQFII quotas are awarded by the State Administration of Foreign Exchange (SAFE) to individual foreign institutions and subject to a range of eligibility criteria set by China’s domestic securities market regulator, the Securities Regulatory Commission (CSRC).
QFII licence holders were first allowed to purchase domestic bonds in 2012, while RQFII holders gained access in 2013 (see the diagram).

**Milestones in the development of the China onshore bond market**

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>1950</td>
<td>First Issuance of Chinese government bonds by Ministry of Finance</td>
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<tr>
<td>1990</td>
<td>Bonds listed and traded on the Shanghai Stock Exchange</td>
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<tr>
<td>1997</td>
<td>Commercial banks were stopped from trading bonds in the exchange market, leading to the introduction of the interbank bond market</td>
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<tr>
<td>2010</td>
<td>PBOC allowed renminbi-clearing banks in Hong Kong and Macau, foreign central banks involved in currency swap deals with Beijing, and international banks participating in renminbi settlements to trade on the mainland interbank market</td>
</tr>
<tr>
<td>2012</td>
<td>CSRC permitted QFII licence holders to trade in the interbank bond market</td>
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<tr>
<td>H1 2013</td>
<td>PBOC granted RQFIIs the right to invest in the China interbank bond market</td>
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<tr>
<td>H2 2013</td>
<td>Launch of 5 year China Government bond futures</td>
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<tr>
<td>2014</td>
<td>First Chinese bond ETF launched in Hong Kong</td>
</tr>
</tbody>
</table>

Source: FTSE Russell

**Market structure and index price source**

The majority (around 95%) of trading in onshore renminbi bonds takes place in the interbank market (i.e., on a bilateral basis), using the electronic order-matching system operated by the China Foreign Exchange Trading System (CFETS). Trades are cleared and settled via a central counterparty, either the Shanghai Clearing House (SHCH) or the China Central Depository and Clearing Company (CCDC).

A limited amount of interbank trading takes place away from this CFETS platform. The interbank market is regulated by China's central bank, the PBoC. Around 5% of onshore renminbi bond trading takes place on the Shanghai or Shenzhen stock exchanges, cleared and settled by the China Securities Depository and Clearing Company (CSDCC) and regulated by the China Securities Regulatory Commission.

The secondary market trading structure is described in the diagram.
The FTSE China Onshore Bond Index Series

The objective of the FTSE China Onshore Bond Index Series is to provide a series of indexes that track the performance of renminbi-denominated bonds. As a starting set, the index series includes all fixed-rate or zero coupon bonds issued and settled in the People’s Republic of China.

The series currently includes the following three indexes:

- The FTSE China Onshore Sovereign Bond Index
- The FTSE China Onshore Policy Bank Bond Index
- The FTSE China Onshore Sovereign and Policy Bank Bond Index

Each index includes sub-indexes for bonds falling into predefined maturity segments (see the diagram). The index series also includes price and total return versions, as well as standard fixed income analytics at the index or individual constituent level.

FTSE screens out less liquid bonds by setting a minimum amount outstanding of RMB20 billion for sovereign bonds and RMB10 billion for policy bank bonds.
The issuer and maturity compositions of the FTSE China Onshore Sovereign and Policy Bank Bond 1-10Y Index are shown in the pie charts below. As at end-February 2016, around 42% of the index consisted of Chinese government bonds, with the remainder in bonds issued by the three Chinese policy banks.

FTSE China Onshore Sovereign and Policy Bank Bond 1-10Y Index: Issuer & maturity composition

Source: FTSE Russell, as at 29 February 2016
**Bond pricing**

To ensure that the indexes within the FTSE China Onshore Bond Index Series reflect accurately the quotations in the secondary bond market, bond prices are valued at the mid price, using quotes from market makers in the electronic trading platform operated by the China Foreign Exchange Trade System (CFETS). In this way, the indexes accurately reflect the information on executable quotes in China’s interbank bond market, the dominant location for fixed income trading.

The evaluated mid price from the Shenzhen Securities Information Co., Limited, is used as a secondary price source for bonds included in the index series. The secondary price source is used if there is no primary price for a bond on any day, or in case prices are stale or considered off-market (if bond prices from the primary source deviate by more than a pre-determined threshold from the level determined by the secondary source).

**Yield and performance history**

A comparison of ten year government bond yields in China, the U.S., Germany, Japan and Australia between December 2006 and February 2016 is given in the following chart. Over the period, ten-year yields in China have remained predominantly in the 3-5% range. Although they have fallen to below 3% in recent months, they were still among the highest compared to the other four markets.

**Ten year government bond yields (%)**

The chart below shows the price performance from end-2011 to February 2016 of the 1-10 year segments of the three principal indexes within the index series. Over the period, the FTSE China Onshore Policy Bank Bond 1-10 Year Index gave a higher return than the FTSE China Onshore Sovereign Bond 1-10 Year Index.

Price Performance: 1-10 Year China Onshore Bond Indexes

Uses of the FTSE China Onshore Bond Index Series

The FTSE China Onshore Bond index series is designed to provide comprehensive coverage of the domestic renminbi bond market. The index series will be of use to investors seeking to benchmark the performance of China’s onshore bond market and to creators of financial products based on onshore bonds, including index-tracking products and exchange-traded funds (ETFs).
For more information about our indexes, please visit ftserussell.com.
About FTSE Russell

FTSE Russell is a leading global provider of benchmarking, analytics and data solutions for investors, giving them a precise view of the market relevant to their investment process. A comprehensive range of reliable and accurate indexes provides investors worldwide with the tools they require to measure and benchmark markets across asset classes, styles or strategies.

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