

A Discussion of Chinese Bond Market

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Abstracts: *in Chinese capital market system, the bond market plays an indispensable role. The bond market plays a positive role in supporting the national infrastructure construction, promoting the marketing of interest rate and improving the capital market. At the same time, there also have a lot of problems in the development of Chinese bond market. This paper analyzes the current situation of the development of Chinese bond market, summarizes the risks and problems existing in the development of it, and put forward some Suggestions on perfecting and developing Chinese bond market.*

Keywords: *the bond market, the development, problems and risk prevention*

1. INTRODUCTION OF BOND MARKET

1.1 The Bond

Bonds are obligations issued by government, financial institutions, or institutions such as industrial and commercial enterprises to investors, the main purpose of them are to raise funds to the society and they promised to repay the principal according to the agreed terms and conditions. Bond is essentially a kind of financial contracts, and has the force of law. Purchasers and the issuers of bond have a relation of debt. The bond issuers are debtors and investors or bondholders are creditors. They are also a kind of negotiable securities. As a result of the bond interest is often decided in advance, so the bond is a kind of fixed-interest securities. In developed countries and regions, bonds may be listed in financial markets. In China, typically government bonds are Treasury bills.

1.2 The Bond Market

The bond market is a place where bonds are issued and traded. It is an important part of financial market and an indispensable part in a country's financial system. A unified and matured bond market can be used as low risk financing tools in the whole society by investors and raisers. The bond yield curve is a benchmark for all financial products in the society. Also, it is an important carrier of conducting central bank monetary policy. We can say that a unified and matured bond market constitute the foundation of a nation's financial markets.

There have a developed bond market in all matured financial markets across the world. The bond market occupies such an important position in the social economy, because it has the following several important functions:

Financing:

As an important part of financial market, the bond market has a function of removing money from the remainders to the demanders. This is a function of raising funds to those who are short of

money. Chinese government has issued many batches of bonds to raise money in order to make up national budget deficit and many national key construction projects. In the eighth "five-year" period, many enterprise raise 82 billion Yuan through the issuance of bonds. Those funds are used to support construction of the three gorges project, Shanghai Pudong new area, Beijing-Kowloon railway, Huning highway, Jilin chemical industry, the Beijing subway, Beijing West railway station and other important constructions such as energy, transportation, key construction projects and the construction of urban public facilities.

Cash Flow Guidance:

Bonds issued by well-operated corporate is generally popular in investors. Those bonds have low interest rates and low cost in issuing. Conversely, corporate bonds issued by bad-operated corporate may be risky and unpopular. They may have high issuing cost. Therefore, through the bond market, funds can be concentrated to dominant enterprises, which is beneficial to the optimal allocation of resources.

Macroeconomic Regulation and Control:

As a monetary policymaker and implementer, the central bank control macro economy by reserve requirement, rediscount, interest rate and open market operations. Open market operation is buying and selling securities on the stock market by the central bank. By this way, the central bank can regulate the money supply and realize macroeconomic regulation. When the economy is overheating, money supply is large, the central bank will sell bonds, withdraw money from financial institutions or public, in order to curb economic overheating. When the economy is in recession, it is low in money supply, the central Banks will buy bonds which may increase money supply.

2. THE DEVELOPMENT OF CHINA'S BOND MARKET

Different bonds occupy different market share, and the proportion of various bonds also reflects a country's bond market development status. This article separately discusses government bonds, financial bonds and corporate bonds, on the basis of collecting the relevant market data; it analyzes the present situation of bond market in our country.

2.1 Financial Bonds

New issuance of policy oriented financial bonds increased each year since 1992, and remained a high increasing rate annually from 2005 to 2007. The annual growth rate is 41.06% in 2005, and 48% in 2006. In 2008, new issuance increasing rate is the same as 2007. After 2008, the issuance continues to maintain rapid growth after. In 2010, New issuance increase to 1.3192 trillion Yuan. The growth rate and honor rate of financial bonds are both lower than its new issuance, which led to continuous increase of bond balance every year. In 1992, balance of financial bonds is 143.12 billion. In 2014, the balance reached 11.1368 trillion, which increased by 778 times.

2.2 Government Bonds

Government bonds are often used to make up the country's fiscal deficit or to raise funds for some large projects as well as some special economic policies. Government bonds are less risky with high liquidity. Although interest rates of government bonds are correspondingly low, they are still higher than bank's rates. The characteristics of the government bonds influence its market size. Because government bonds are often used to control macro economy, the size of them is largely dependt on the country's financial policy.

As for the issuance size, China's government bonds remained steady in growth. In 2007 the ministry of finance issued 1.55 trillion special national bonds, to buy about \$200 billion foreign exchange. The foreign exchange is used as capitals of new funded Foreign Exchange Investment Company. The circulation of government bonds increase rapidly in recent years. Until April 2014, the government bond increased to 1040 trillion.

2.3 Corporate Bonds

In 2008, the national development and reform commission issued "Notice about promoting the development of corporate bonds and simplifying approval procedures". Since then, the issue system of corporate bonds changed greatly. The notice changed the approval procedures from the double procedure "approve scale first" into a simplified one- "directly approve issuance". The Notice greatly simplify the approval schedule, and at the same time reduces the threshold of corporate bonds. The issuance of corporate bonds has greatly increased because of the Notice. According to statistics data, in 2009, 190 corporate bonds are issued, with the amount of 425.233 billion Yuan, Respectively increased 270.42% and 79.66% than previous years. At the same time, scales and periods create a high record than in history. In 2010, the total issuance of corporate bonds is 182 which amount to 362.703 billion Yuan. It is a second peak year of corporate bonds issuance.

Although corporate bonds has developed rapidly in recent years, the proportion of their scale and total circulation is also growing, but compared with other main kinds of bonds and shares, their issuance scale is still small. In 2010, the score of book-entry treasury bonds and saving bonds is 1.5878 trillion Yuan, while the issuance of corporate bonds only accounts for 23% of the total amount, and accounts for only 3.81% of all bond issue during the year. Compared with those in developed countries, corporate bonds are greatly fall behind.

3. THE EXISTING PROBLEMS IN THE BOND MARKET

3.1 Unreasonable Structures

After years of development, China's bond market has formed a multi-level market lead by inter-bank market. Exchange market is complementary; over the counter bond market is supplement. However it is important to note that with the rapid development of bond market, inter-bank market developed rapidly, the development of exchange market was backward. Segmentation between interbank market and exchange market was becoming more and more large. At the same time, There exists serious distortion of interest rate system in our country, not only in the relationship between interest rates and credit markets but also in the interest rate distortion between the primary market and secondary market, the enterprise. Enterprises cannot estimate financing cost according to market-oriented interest rates. Serious speculation and market volatility between primary and secondary market also caused segmentation between issue market and circulation market.

There are great gap between bond market and the stock market in scale. Although China's bond market and stock market developed with the same speed, but the bond market is far legged behind the stock market in scale. Comparing Chinese bond market with the international bond market (we select nine countries cover three continents of Europe, America, and Asia), we use the bond value percentage of GDP as a reference, the percentage of China is about 41%, which is only the eighth in nine countries. We can see that from the experience of global experience, the bond value of GDP should be relatively high, generally higher than that of the stock. China's bond market still has a long way to go compared with those developed countries.

Although bond market developed so much in recent years, it is still lagged behind the government bonds and financial bonds. The issuance scale between different kinds of bonds differs a lot. Corporate bonds are low in ratio compared with others. As a result, the financial and economic functions of corporate bonds cannot fully exert.

3.2 Defects in Operation Mechanism

At present, China's bond market is divided into inter-bank market and the stock exchange market. Under the current market access system, commercial banks are not allowed to enter the exchange market. Also, non-financial institutions in exchange market cannot enter the interbank market. This kind of trading system caused little traders in the two markets. Demand preference and trading behavior in the two markets are convergence. This destroyed liquidity in the bond market, which decreased efficiency of capital turnover. The market separation hindered the development of China's bond market, and destroyed market-oriented interest rates.

A developed bond market should provide conditions for the country's central bank monetary policy. the development of bond market's is closely related to the central bank's monetary policy implementation effect. high efficiency of monetary calls for a highly developed bond market. The interest rate in the bond market can be important signals in monitoring the effects of monetary policy. The distortion and administrative of bond market will disturb market signal transfer, which will not exert the price discovery mechanism of bond market, and will cause unfavorable central bank's open market operations.

3.3 Low Efficiency in Regulation and Imperfect Laws

Along with the development of the bond market, our country gradually introduced a series of laws and regulations for the bond market supervision. We had improved so much in regulation of bond market. However, there still have some defects in Chinese bond market supervision. Some laws are not match with their operation rules. In addition, some laws and regulations are issued in early days, which can not applicable for the current situation, and will not be able to meet the needs of the development of the market at present. Also, there are evading from laws and inapplicable of laws everywhere.

4. COUNTERMEASURES ON DEVELOPING OF THE BOND MARKET

4.1 Eliminate Segmentation in the Bond Market

Practice shows that market segmentation leads to inefficiency. positive correlation between risks and benefits cannot be reflected because of the same asset has different pricing in different markets. Bond yields have to compensate for the opportunity cost, implementation risk and liquidity risk. If a bond yield between different customers is distorted, the enthusiasm of investors to participate in the bond market development will be severely affected. We should gradually eliminate the division among bond markets, to safeguard investors' demand for bonds and repurchases. The government should no longer limit the same demand of investors in the same market; this can make the relationship between benefits and risks accurately reflected, improve the enthusiasm of investors to participate in the bond market.

4.2 Perfect the Operation Mechanism of Chinese Bond Market

Perfect mechanism is to adhere to the market-oriented reform direction, and fully mobilize the enthusiasm of market participants, makes efforts to build a unified, co-related, security and coordinated system of the bond market. Multi-level bond market should be established to gradually lead commercial banks back to exchange market in order to form a trade system comprises exchange market and OTC trading platform. Bond market in China is developed in a

period changing from planned economy to market economy. The market economy system is not perfect enough and market operation mechanism is not sound. We must improve the market mechanism to promote the development of China's bond market; Promote the unity of the bond market; let securities companies, fund companies enter into the inter-bank bond market; issue bonds across different markets. We should also strengthening the cooperation between exchange bond market and inter-bank bond market, let bonds issuers and investors choose issuing market and investment market freely in order to eliminate bias segmentation, eliminate the difference between the two markets and to further improve the overall development of the bond market.

4.3 Strengthen the Supervision System and Perfect Related Laws

Perfect, reasonable and effective regulation system is essential for the healthy development of the bond market. Bond management in China is a scale, centralized management with decentralized approval. This leads to the bond market fragmented regulation and inefficiency. Therefore coordinating bond regulatory functions and centralized supervision is target of bond market regulation at present stage.

In the process of promoting the bond market, multi-level bond market system should be built. The government should focus on establishment of multi-level legal system, clarify relationship among different legal and regulations in order to match different laws to different policy objectives, to avoid policy absence, offside and mismatch.

Bond market transparency should also be increased; laws should be improve to increase information disclosure. The transparency of the bond market is the basis of enhance the flexibility of the bond market. Bond market transparency including: before trading transparency, allowing large liquidity traders use "sunshine trade" strategy; moderate prolong lag of after transactions transparency.

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