China Halts Trading in Key Bond Futures as Panicky Investors Sell Securities

Slowing growth, capital outflows fuel concerns that bull market is coming to an end

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SHANGHAI—Chinese authorities halted trading in key bond futures for the first time on Thursday, as panicky investors sold the securities on concern that a long, credit-fueled bull market was coming to an end amid slowing growth, capital outflows and heightened government concern about asset bubbles.

China's 10-year and 5-year Treasury bond futures recorded their biggest ever drops in early trading, falling by 2% and 1.2%, respectively, prompting exchange authorities here to suspend the securities. Trading resumed only after China's central bank injected around $22 billion into the short-term money market. The 10-year government bond yield, which rises when prices fall, meanwhile hit a 16-month high of 3.4%, extending a selloff in Chinese bond markets that began in late November and has accelerated this week.

In recent years, China has unleashed a wave of easy credit and fiscal stimulus to keep its slowing economy aloft. Chinese investors were able to benefit by borrowing cheap money and siphoning it into assets from bonds to housing to commodities, producing what some economists have described as a series of unsustainable bubbles.

Some of these bubbles have burst dramatically over the last 18 months, with the crash in China's stock markets last summer the most notable example. On Thursday, the pain spread to China's $9 trillion bond market, which remains overwhelmingly driven by domestic investors, despite some opening up to foreigners this year. The yield on 10-year government bonds had reached as low as 2.6% in August.

Trading in key bond futures resumed Thursday only after China's central bank injected around $22 billion into the short-term money market. ENLARGE

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"People woke up to the fact that the bond bubble is too large," said Hao Hong, co-head of research at Bocom International, which is owned by Hong Kong's Bank of Communications. "The bond market in China is under severe pressure, across the board."

The U.S. Federal Reserve's decision to raise interest rates helped trigger the selloff. Chinese investors believe it increases the chance China will guide its own rates higher to stem the yuan's recent decline against the dollar and heavy capital outflows from the country.

But the bond market slump also exacerbates the policy dilemma facing China's central bank. It has tightened short-term lending in recent weeks in an effort to make it harder for speculative investors to borrow money. The problem is that such tightening moves—along with any future rate rises—could provoke market plunges and panics as liquidity dries up.

"The Chinese bond bull market is over, as we have seen a turning point in money market rates this year," said Yang Delong, chief economist at Shenzhen-based First Seafront Fund Management Co., with $6 billion under management, referring to a tightening of liquidity in China that began this autumn and has recently gathered pace.

Underscoring the skittish feeling among investors, Thursday's selling pressure was also driven by rumors spreading through the markets. A midsize Chinese brokerage denied a report in a major Chinese newspaper that it had defaulted on a large bond payment. One of the country's biggest fund managers, meanwhile, denied a rumor circulating on cellphone chat groups that it was facing large redemptions.

Analysts said such rumors carried weight because many fund managers are heavily in debt, making them vulnerable to declining bond prices.

"The market is very sensitive to rumors now," said Ke Congwei, a fixed-income analyst at Guosen Securities, based in Shenzhen.

The bond selloff adds to broader concerns about the Chinese economy, which likely grew at its slowest pace in more than 25 years in 2016, weighed down by a growing debt load and money-losing state-owned industries.

China is also grappling with large-scale capital outflows. The country has lost around $1.2 trillion of its foreign reserves, or around a quarter of its total, in the last two years as billionaires and average citizens transfer savings to the safety of overseas markets. To stem the outflows, authorities are using measures such as restricting overseas company acquisitions—transactions that could be fronts for spiriting money out of the country.

—Yifan Xie and John Lyons