Asia Credit Research

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Special Drawing Right-Denominated Bond

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Summary

- **The World Bank issued a SDR500mn 3-year bond that was fully settled in Renminbi (RMB), priced at an annual coupon rate of 0.49%**
- **The bond deal was part of the SDR Denominated Issuance Program, approved on 12 August, 2016 by the People's Bank of China (PBoC), amounting to SDR2bn in size (Equivalent to USD2.8bn)**
- **The SDR Denominated Issuance Program aims to support the Chinese government's effort to promote the internationalization of RMB**
- **Although the bond is settled in RMB, the principal and coupon payment is based on the conversion rate of XDRCNY at the date of payment. Effectively, it allows investors to invest in RMB, yet as if holding a basket of currencies contained in the SDR. This allows investors to hedge against a single currency risk without the need to exchange for them. The bond is extremely attractive to Chinese investors, given the current capital restrictions in China to hold sizable foreign assets**
- **Future supply is expected to be significant from the remaining yet-to-be-issued portion of the SDR Issuance Program approved by the PBoC, as well as by Industrial & Commercial Bank of China (Asia) Ltd. and Standard Chartered PLC. who expressed their interests to issue SDR bonds in the China onshore interbank market**
- **Future demand is also expected to be strong, given that the recent issue was 2.5x over-subscribed, fuelled by expectations of future RMB depreciation and the solidification of RMB status as a world's foreign reserve currency following the inclusion of the currency in the SDR's basket**

Background Information

The Special Drawing Rights (SDR) is issued by the International Monetary Fund (IMF) and serves as a form of international-type monetary reserve currency. It is valued and represented by a basket of currencies[1]. With effect from 1st October, 2016, the basket consists of: (1) US Dollar, 42%; (2) Euro, 31%; (3) Yuan, 11% (new inclusion); (4) Yen, 8%; and (5) Pound, 8%. The ownership of the SDR represents a claim to the basket of currencies on the IMF, and also represents the amount of voting power a country holds on IMF's decisions.

SDR-denominated Bond Issue by World Bank

The World Bank issued an SDR500mn (Equivalent to ~USD700mn) 3-year bond on 26th August 2016, priced at an annual coupon rate of 0.49%. The bond was issued by International Bank for Reconstruction and Development ("IBRD", aka World Bank) and was part of the SDR Denominated Issuance Program that was approved on 12 August, 2016 by the People's Bank of China (PBoC), amounting to SDR2bn in size (Equivalent to USD2.8bn). The bond was fully settled in Renminbi (RMB) with regards to the principal amount and coupon payment, and falls under the jurisdiction of the People's Republic of China law. Although investor invest and receive RMB physically, the RMB received is based on the coupon rate of SDR issued, converted to CNY based on the XDRCNY[2] conversion rate on the date of payment. Notably, despite the bond being denominated in SDR, the IBRD does not actually issue SDR

[1] Reviewed every 5 year with the next review scheduled on 30 September, 2021
[2] Represent the Exchange Rate between SDR and CNY

since it does not own any in the first place. Instead, the IBRD-issued SDR is a price mechanism that represents the amount of claim against the IBRD based on the SDR exchange rate which is in turn determined by the basket of currencies.

What's in for the bondholders?

This initiative by the World Bank aims at supporting the Chinese government's effort to promote the internationalization of RMB. For bondholders, they are able to diversify their investment, effectively lending in RMB but virtually holding a basket of currencies as represented by the SDR. The SDR-denominated bond provides a channel for investors to gain exposure to foreign currencies without the need to exchange for those currencies. This is extremely appealing to Chinese investors given the current capital controls in owning sizable foreign assets. The SDR bond increases Chinese investors' access to foreign currencies in the domestic bond market.

Upcoming Supply

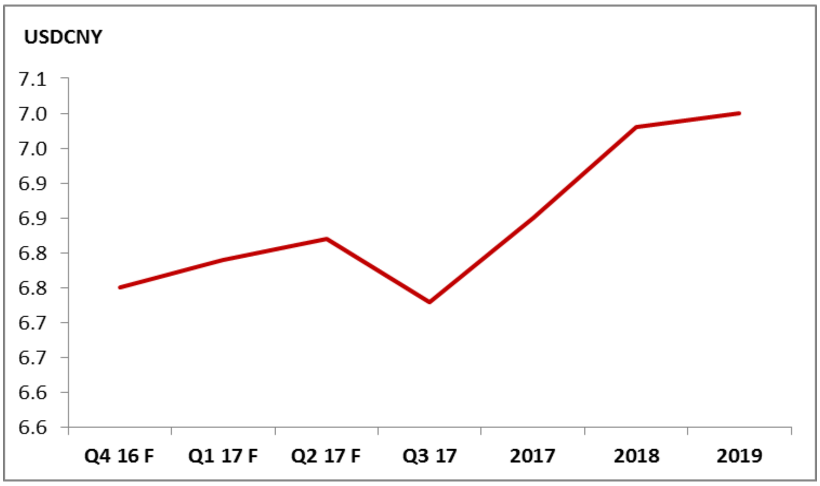
The remaining portion of the SDR-denominated Issuance Program (~SDR1.5bn in size) is expected to be rolled out relatively soon given that the last issue was heavily oversubscribed (2.5x the original amount was subscribed by over 50 domestic and overseas financial institutions). China Development Bank has announced on August that it planned to issue either 6-month or 1-year SDR-denominated bond amounting to 200-500mn SDR units in Shanghai Free Trade Zone. The issuance is expected to be settled fully in RMB corresponding to the issue by the World Bank. Likewise, Industrial & Commercial Bank of China (Asia) Ltd. and Standard Chartered PLC. have expressed their intentions to issue SDR bonds in China's onshore interbank market given the popular demand seen recently.

Future Demand

We expect the demand to remain strong on the upcoming supply. The demand will likely be driven by Chinese domestic investors given that the RMB is expected to depreciate over the next 3 years (Figure 1). Investors would probably seek diversification in their RMB exposure through the purchase of SDR bonds to hedge against RMB downside currency risk, especially given the current capital controls to invest in foreign assets.

In the secondary market space, we did see the SDR500mn 0.49%'19s bond being quoted which could infer that the SDR bond is relatively liquid. Secondary trading would hence be sustainable and therefore be supportive of future SDR bond demand.

Figure 1: USDCNY Forecast



Source: Bloomberg Foreign Exchange Forecast Consensus

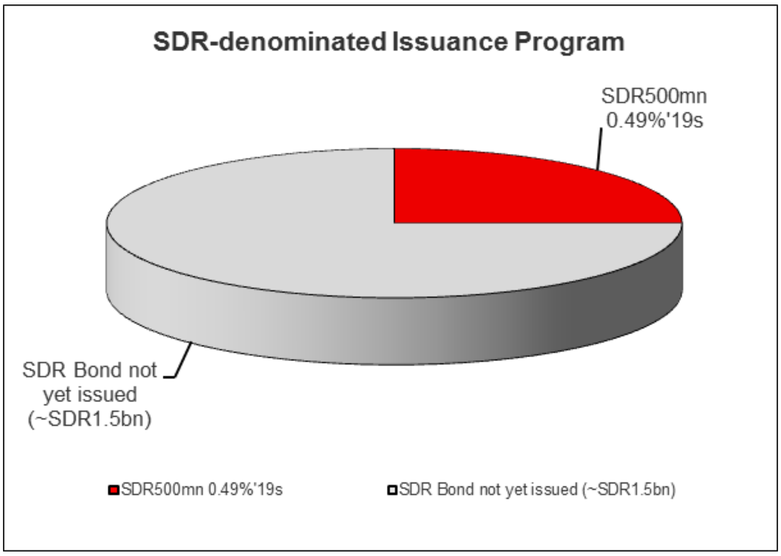
World Bank's Issue at a glance…

Issuer - International Bank for Reconstruction and Development (World Bank)

Issue Approved by →

People's Bank of China (PBoC) for issue in Chinese domestic bond market

As part of



- The World Bank is an international financial institution that comprises of two main institutions
  1) International Bank for Reconstruction and Development (IBRD)
  2) International Development Association
- They are jointly known as the World Bank, sharing the same entity
- Majority of World Bank's funds come from its members (paid-in capital) , and borrowings on capital markets
- Enjoyed low cost of borrowing with credit rating of triple-A since 1959

Issuer rating:	Aaa/AAA
Maturity:	3 years
Offering period:	August 31, 2016 to September 2, 2016
Amount:	500 million SDRs
Settlement date:	September 2, 2016
Coupon:	0.49% per annum
Coupon payment dates:	Paid annually on September 2 of each year, in Chinese Renminbi
Maturity date:	September 2, 2019, payments made in Chinese Renminbi
Issue price:	100%
Issue yield:	0.49%
Settlement, clearing and custodian:	Interbank Market Clearing House Co., Ltd (also known as the "Shanghai Clearing House")
Law:	People's Republic of China law
ISIN:	CND10000BPQ1
Lead bookrunner:	Industrial and Commercial Bank of China, Ltd.
Co-bookrunner:	HSBC Bank (China) Company Limited
Joint lead underwriters:	China Construction Bank Corporation and China Development Bank Corporation

Source: World Bank

The credit research team would like to acknowledge and give due credit to the contribution of Chan Yu Fan.