China's Bond Connect scheme

Why in news?

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China recently opened itself to foreign investors by liberalising rules that regulate participation in its massive bond market.

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Why China made such a move?

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- China's bond market, the third largest, is estimated to be over $9 trillion in value and is expected to double in size over the next five years.
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- Yet foreign investors own less than 2% of the overall bond market.
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- This is due to China's policy of raising significant barriers to the free entry and exit of capital.
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- In this situation, the new 'Bond Connect scheme' will allow large foreign investors to **buy and sell mainland Chinese bonds through offshore accounts** in Hong Kong.
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- Of late, China's central bank has also been tightening monetary policy to squeeze out liquidity, which in turn, led bond yields in China to be higher than in many developed economies.
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How it will help China?

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- The scheme will **boost the borrowing potential** of the Chinese sovereign as well as of corporations.
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- It will improve bond market liquidity by offering access to a wider pool of international capital.
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- The entry of more private capital into the Chinese economy can encourage investments in economic projects.
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- The inflow of foreign capital **will help Beijing control the yuan.**
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- And, after the inclusion of the yuan in the **International Monetary Fund's basket of currencies** in 2016, the present bond reform gives a further boost to the Chinese currency.
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- In the long run, greater participation of foreign investors will increase the usage of the yuan, and thus aid Beijing's efforts to **internationalise the currency.**
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- This in turn will also help **bring more stability to China's financial markets** which is known for its high levels of volatility.
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What is Bond market?

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- The bond market is where **debt securities are issued and traded.**
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- The bond market primarily includes government-issued securities and corporate debt securities, and it facilitates the **transfer of capital from savers to the issuers or organizations** that requires capital.
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- It is composed of the **primary market** (through which debt securities are issued and sold by borrowers to lenders) and the **secondary market** (through which investors buy and sell previously issued debt securities among themselves).
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- Although the stock market often commands more attention, the **bond market is actually many times bigger** and is vital to the ongoing operation of the public and private sectors.
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Source: The Hindu

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