

Hong Kong Bond Market Challenges and Opportunities

This chapter discusses some of the real and perceived challenges facing the Hong Kong bond market and its participants, and also describes the possible mitigating factors or market developments that could address these challenges in an appropriate manner.

A. Challenges in the Hong Kong Bond Market

1. Issuance of Renminbi Bonds by Companies in the People's Republic of China

In its *Half-Yearly Monetary and Financial Stability Report, March 2016*, the HKMA commented that regulatory changes in the PRC might make it easier for PRC-based companies to tap the onshore bond market instead of continuing to issue offshore renminbi bonds in the Hong Kong bond market. The HKMA is, hence, expecting the issuance volume of renminbi bonds by PRC-based companies to possibly remain subdued for the near future.

As reported by the HKMA, after a period of rapid growth, the offshore renminbi debt market in Hong Kong, China is showing signs of moderation. In 2015, offshore renminbi debt issuance amounted to RMB350.6 billion, down 19.3% from the previous year, marking the first annual decline since 2007.⁸⁸

2. Competition for Offshore Renminbi Issuances

According to market feedback and media reports, the increasing competition among established and emerging renminbi offshore centers may lead to a reduction in the issuance of offshore renminbi debt securities in the Hong Kong bond market. In recent years, Singapore, Luxembourg, and (most recently) London have seen an increase in offshore renminbi bond and note issuance activities that have found strong investor interest in their markets and time zones. The concern of Hong Kong bond market participants is that this may affect the issuance volume and liquidity of the offshore renminbi bond market in Hong Kong, China.

At the same time, the International Monetary Fund's decision to include renminbi in its Special Drawing Rights basket may boost demand for renminbi-denominated assets in the long-run across all markets in general and in Hong Kong, China in particular as the most established of these markets.

⁸⁸ Selected statements adopted from Hong Kong Monetary Authority. 2016. *Half-Yearly Monetary and Financial Stability Report March 2016*. http://www.hkma.gov.hk/media/eng/publication-and-research/quarterly-bulletin/qb201603/E_Half-yearly_201603.pdf

3. Limited Size of Repo Market

The relatively small size of the repo market in Hong Kong, China is partly due to the established practice of banks funding in the unsecured interbank and foreign exchange swap markets rather than repo. Since the global financial crisis, there are signs that banks are less willing to engage in unsecured lending. However, given the abundant liquidity in the local banking sector at present, the need for funding activities is rather limited, suggesting that banks may not have strong motivation to increase their use of repo.

Notwithstanding the above, the HKMA is aware that recent developments in international financial regulations may result in a reallocation of assets for use as collateral. An efficient repo market would be conducive to such reallocations. To support the further development of the repo market in Hong Kong, China, the HKMA will continue to refine and provide the necessary financial infrastructure to facilitate the conduct of repo both locally as well as on a cross-border basis. The HKMA will also closely monitor the developments in international financial regulations and their implications for the development of the repo market in Hong Kong, China.⁸⁹

B. Opportunities in the Hong Kong Bond Market

1. General Regulatory Environment

Since the global financial crisis, regulators around the world have been strengthening laws and regulations across many areas of the capital and financial markets. Of particular interest have been banking regulations and the focus on risk-weighted capital. The outcome for the financial markets include a limitation of what banks can or are willing to lend, to whom, and under what circumstances. A number of these regulatory initiatives may, in consequence, lead to a rebalancing of funding options for the corporate sector from bank loans to the capital markets.

While not unique to Hong Kong, China, this development might just positively influence the interest of potential domestic issuers to consider raising funds via bond, note, or *sukuk* issuance, and to diversify their debt portfolio. Such increased interest, coupled with a broader and deeper investor base (see below), might also have a beneficial impact on funding costs.

3. Association of Southeast Asian Nations Plus Three Multi-Currency Bond Issuance Framework

The implementation of AMBIF is expected to benefit not only AMBIF issuances, but the Hong Kong bond market at large (see also Chapter X). ABMI and policy bodies and regulatory authorities in Hong Kong, China focus on a suitable balance between bank loan and capital market funding opportunities for corporates. AMBIF has been created to provide an additional bond, note, or *sukuk* issuance avenue for these corporates. AMBIF in Hong Kong, China focuses on the issuance of bonds and notes in the form of private placements to Institutional Investors, which is further supported by the Professional Bonds profile listing option on SEHK (please also refer to Chapter III.I).

At the same time, the Hong Kong bond market generates strong interest from potential AMBIF bond or note issuers who may already have substantial commercial operations

⁸⁹ Statements contained in Executives Meeting of East Asia–Pacific Central Banks. 2014. *EMEAP Repo Markets: State of Play—A Report by the EMEAP Working Group on Financial Markets*. http://www.emeap.org/emeapdb/upload%5CWGMeeting%5CEMEAP_Working_Group_on_FinancialMarkets_-_Report_on_EMEAP_Repo_Markets_...pdf

in the region and would like to issue bonds and notes and use local currency proceeds in these markets in order to, for example, eliminate foreign exchange risk or more effectively manage their debt portfolio. The value proposition for Hong Kong, China is the significant presence of professional investors, and the role of a listing hub. AMBIF is likely to attract the attention of these investors in local currency bonds and notes.