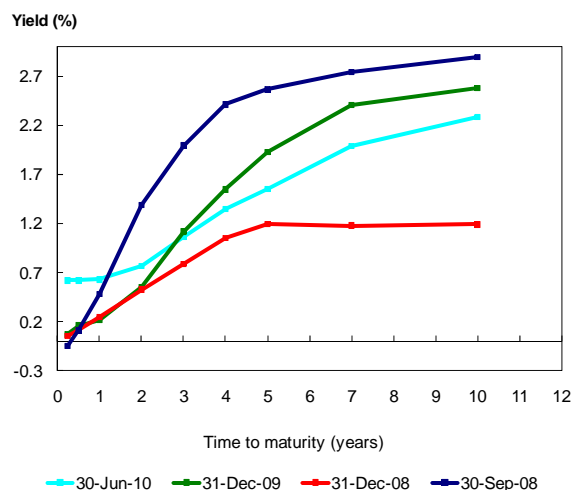


Hong Kong, China— Update

Yield Movements

Yields on Hong Kong, China's Exchange Fund Bills and Notes (EFBN) rose at the short end of the curve through the 2-year tenor between end-December 2009 and end-June. The yield curve also flattened modestly for maturities between 3 and 7 years, while steepening slightly for maturities beyond 7 years **(Figure 1)**. Yields fell the most for the 7-year maturity, shedding 41.9 basis points. The yield spread between 2-year and 10-year maturities narrowed to 152.1 basis points at end-June from 202.8 basis points at end-December 2009.

Figure 1: Hong Kong, China's EFBN Yield Curve



EFBN=Exchange Fund Bills and Notes.
Source: Bloomberg, LP.

The Hong Kong Monetary Authority (HKMA) has kept its base rate steady at a record-low level of 0.5% since December 2008. Consumer price inflation in Hong Kong, China stood at 2.5% year-on-year (y-o-y) in May, compared with 2.4% y-o-y in April, due mainly to increases in the prices of food, utilities, and miscellaneous goods and services. According to the Census and Statistics Department, May's inflation level

remained moderate as the Hong Kong dollar strengthened against the US dollar, and global food and fuel prices subsided.

Hong Kong, China's gross domestic product (GDP) grew 8.2% y-o-y in 1Q10, following revised growth of 2.5% in 4Q09. The first quarter GDP growth was brought about by a 6.5% increase in private consumption, compared with 4.8% in the previous quarter, as well as double-digit growth in gross domestic capital formation and total exports. Merchandise exports rebounded with a 21.6% y-o-y surge in 1Q10 after posting 5 successive quarters of negative export growth.

Size and Composition

As of end-March, the amount of Hong Kong, China's local currency (LCY) bonds outstanding rose 53.3% y-o-y and 7.8% quarter-on-quarter (q-o-q) **(Table 1)**. The total volume of Hong Kong, China's LCY bonds outstanding stood at HKD1.2 trillion (USD155 billion) at the end of 1Q10.

In 1Q10, the total amount of government bonds outstanding—comprising exchange fund bills (EFBs), exchange fund notes (EFNs), and Hong Kong Special Administrative Region (HKSAR) bonds—increased by a significant 185.1% to HKD624 billion (USD80 billion). The stock of EFBs soared 259.2% to HKD542 billion (USD70 billion). EFBs constitute the biggest share of Hong Kong, China's government bonds. On the other hand, the stock of EFNs remained flat at HKD70 billion (USD8.9 billion).

Meanwhile, the stock of HKSAR bonds reached HKD12 billion (USD1.5 billion) in 1Q10. In January, HKD2.5 billion of 10-year government bonds were sold under the Institutional Bond Issuance Programme. The bonds were well-received by institutional investors, with tenders reaching HKD11.8 billion, and carried an annualized yield of 3.12%. Another HKD3.5 billion was raised from a 2-year issue of government bonds in March.

Table 1: Size and Composition of Local Currency Bond Market in Hong Kong, China

	Amount (billion)								Growth Rate (%)						
	Dec-09		Jan-10		Feb-10		Mar-10		Dec-09		Jan-10	Feb-10	Mar-10		
	HKD	USD	HKD	USD	HKD	USD	HKD	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	1,117	144	1,155	149	1,181	152	1,204	155	55.8	12.5	3.4	2.3	53.3	7.8	1.9
Government	540	70	577	74	602	78	624	80	242.2	30.6	7.0	4.4	185.1	15.7	3.6
Exchange Fund Bills	464	60	499	64	525	68	542	70	411.7	35.2	7.5	5.0	259.2	16.8	3.4
Exchange Fund Notes	70	9	70	9	70	9	70	9	4.2	0.1	0.0	0.0	3.2	0.6	0.6
HKSAR Bonds	6	0.7	8	1.0	8	1	12	1	—	—	45.5	0.0	—	109.1	43.8
Corporate	577	74	578	74	579	75	580	75	3.3	(0.4)	0.2	0.2	2.4	0.5	0.2

— = not applicable, HKSAR = Hong Kong Special Administrative Region, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY—USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The amount of corporate bonds outstanding for January and February were estimated based on the compounded monthly growth rate between December 2009 and March 2010.

Source: Hong Kong Monetary Authority and Bloomberg LP.

Table 2: Top 20 Non-Bank Corporate Issuers

Top 20 Corporate Issuers	Bonds Outstanding (HKD billion)	Bonds Outstanding (USD billion)
The Hong Kong Mortgage Corporate Limited	26.39	3.39
Sun Hung Kai Properties (Capital Market) Ltd.	9.13	1.17
CLP Power Hong Kong Financing Limited	8.52	1.09
Kowloon-Canton Railway Corporation	6.60	0.85
MTR Corporation (C.I.) Ltd.	5.35	0.69
Swire Pacific MTN Financing Limited	4.10	0.53
Hongkong Electric Finance Ltd.	3.50	0.45
Airport Authority Hong Kong	3.10	0.40
Cheung Kong Bond Finance Limited	2.95	0.38
HKCG (Finance) Limited	2.76	0.35
Bauhinia MBS Limited	2.66	0.34
The Link Finance (Cayman) 2009 Limited	2.10	0.27
Urban Renewal Authority	1.50	0.19
Hysan (MTN) Ltd.	1.20	0.15
Wharf Finance (No. 1) Ltd.	1.03	0.13
Wharf Finance Ltd.	1.01	0.13
Cheung Kong Finance (MTN) Ltd.	0.80	0.10
Hong Kong Link 2004 Limited	0.79	0.10
Wharf Finance (BVI)	0.65	0.08
The Hong Kong Land Notes Company Limited	0.20	0.03
Swire Pacific Finance Int'l Limited	0.20	0.03
Total	84.53	10.86

Note: Based on Central Money Markets Unit (CMU) data on tradable and non-bank debt securities issued and outstanding as of 29 June 2010.

Source: Hong Kong Monetary Authority (HKMA).

Hong Kong, China's corporate bonds outstanding grew 2.4% y-o-y and 0.5% q-o-q to HKD580 billion in 1Q10. The top 20 non-bank corporate issuers in Hong Kong, China accounted for about 15% of total corporate bonds outstanding in 1Q10 (**Table 2**). The Hong Kong Mortgage Corporation was Hong Kong, China's top corporate issuer of LCY bonds, with bonds outstanding reaching HKD26.39 billion (USD3.39 billion). It was followed by Sun Hung Kai Properties (Capital Market) Limited at HKD9.13 billion (USD1.17 billion), and CLP Power Hong Kong Financing Limited at HKD8.52 billion (USD1.09 billion).

In 1Q10, corporate bond issuance reached HKD47.41 billion (USD6.11 billion), which was down 9.5% from a year earlier.

Policy, Institutional, and Regulatory Developments

Hong Kong, China and Indonesia Launch a Cross-Border Payment-versus-Payment Link

In February, HKMA and Bank Indonesia (BI) launched a cross-border payment-versus-payment link between Hong Kong, China's US dollar real time gross settlement (RTGS) system and Indonesia's rupiah RTGS system. The link aims to eliminate settlement risk in foreign exchange transactions between the US dollar and Indonesia rupiah. The new link also allows safer and more efficient settlement by eliminating risk arising from the delivery of two currencies in different time zones.

HKMA Issues Circular on Supervisory Principles and Operational Arrangements Regarding Yuan Business in Hong Kong, China

In February, HKMA issued a circular to broaden the type of CNY-denominated transactions permitted in Hong Kong, China. The HKMA circular includes the following supervisory principles and operational arrangements:

(i) Supervisory Principles


- (a) Cross-border flows of yuan funds into and out of the mainland should comply

with the rules and requirements of the People's Republic of China (PRC).

- (b) With regard to yuan funds that have flowed into Hong Kong, China, participating authorized institutions can develop yuan businesses based on the regulatory requirements and market conditions in Hong Kong, China, as long as these businesses do not entail the flow of yuan funds back into the mainland.

(ii) Operational Arrangements

- (a) **Deposit-Taking.** Participating authorized institutions can open yuan deposit accounts for corporate customers to conduct trade settlement transactions in accordance with the standard requirements in Hong Kong, China, including anti-money laundering requirements.
- (b) **Conversion.** Participating authorized institutions should continue to conduct yuan conversions against other currencies in accordance with the existing requirements.
- (c) **Remittance.** Yuan remittances into and out of the mainland must comply with the rules and requirements stipulated by PRC authorities.
- (d) **Lending.** When extending yuan loans or financing corporate customers, participating authorized institutions should observe prudent credit standards and ensure that the associated yuan liquidity risk is managed properly.
- (e) **Yuan Bonds.** The range of eligible issuers, issue arrangements, and target investors are to be determined in accordance with the applicable regulations and market conditions in Hong Kong, China. Participating authorized institutions can also provide their customers with related services such as account opening, bond trading, custodial services, and financing, in accordance with standard banking practices in Hong Kong, China. Bond issuance by mainland entities will continue to be governed by the relevant PRC regulations and requirements.



The bonds to be sold under the program will constitute unsecured liabilities of the government of Hong Kong, China and will not be backed by foreign reserves—in contrast to EFBNs. As the new bonds will not have foreign reserve backing, they are expected to pay a premium over EFBNs.

- (f) **Cheque and Credit Card Services.** Participating authorized institutions can offer these services to corporate customers in accordance with standard banking practices in Hong Kong, China.