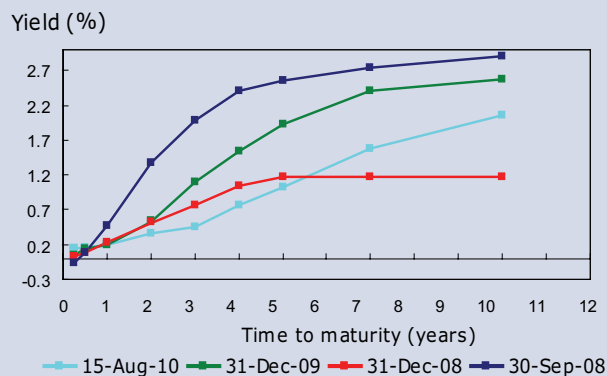


Hong Kong, China—Update

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBN) shifted downward between end-December 2009 and mid-August 2010 for maturities of 1-year through 10-years (**Figure 1**). On the other hand, yields at the short-end of the curve rose slightly by 1–8 basis points. Yields fell the most for the 5-year tenor, shedding 89 basis points. The yield spread between 2-year and 10-year maturities narrowed to 170 basis points in mid-August from 203 basis points at end-December.

Figure 1: Hong Kong, China's Benchmark Yield Curve—EFBNs



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 eased to 1.3% year-on-year (y-o-y) in July from 2.8% in June. The slowdown in the inflation rate was largely due to the government's decision to make rental payments for 2 months on behalf of all public housing tenants. All components of the consumer price index recorded y-o-y increases in July, except for housing and durable goods. In the first 7 months of the year, consumer price inflation reached 2.1% y-o-y.

Hong Kong, China recorded gross domestic product (GDP) growth of 6.5% y-o-y in 2Q10, following revised growth of 8.0% in 1Q10. Domestic demand remained resilient as private consumption increased by 4.6% y-o-y in 2Q10 on account of the improving economic situation and rising incomes. Also, investment spending surged 15.2% y-o-y from 8.2% in 1Q10. Merchandise exports remained strong, expanding by 20.1% y-o-y in 2Q10, boosted by growth in many Asian markets and further recovery in import demand.

Size and Composition

At the end of June, Hong Kong, China's local currency (LCY) bonds outstanding reached HKD1.2 trillion (USD159 billion) for y-o-y growth of 43.3% (**Table 1**). On a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding grew by 2.7% in 2Q10.

Total government bonds outstanding—comprising exchange fund bills (EFB), exchange fund notes (EFN), and Hong Kong Special Administrative Region (HKSAR) bonds—grew by a notable 131.4% to HKD667 billion (USD86 billion) in 2Q10. The growth in government bonds is largely attributed to the 164.4% y-o-y increase in EFBs to HKD581 billion (USD75 billion). EFBs account for 87% of Hong Kong, China's government bonds. On the other hand, the stock of EFNs only grew by 2.3% y-o-y to HKD70 billion (USD9 billion) in 2Q10.

Meanwhile, the stock of HKSAR bonds rose to HKD16 billion (USD2 billion) at the end of June. In May, HKD3 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 HKD8 billion, and carried an annualized yield of 2.955%. This was followed by another HKD1.5 billion issue of 5-year government bonds in June. The bonds were oversubscribed with demand reaching HKD4.8 billion. The 5-year bonds carried an annualized yield of 1.658%.

Table 1: Size and Composition of the LCY Bond Market in Hong Kong, China

	Amount (billion)						Growth Rate (%)										
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10		May-10		Jun-10		
	HKD	USD	HKD	USD	HKD	USD	HKD	USD	Y-o-y	q-o-q	m-o-m	Y-o-y	q-o-q	m-o-m	Y-o-y	q-o-q	m-o-m
Total	1,204	155	1,220	157	1,238	159	1,237	159	53.3	8.4	1.3	43.3	2.7	1.5	43.3	2.7	(0.1)
Government	624	80	643	83	665	85	667	86	185.1	16.8	3.1	131.4	6.9	3.4	131.4	6.9	0.3
Exchange Fund Bills	542	70	561	72	581	75	581	75	259.2	16.8	3.5	164.4	7.1	3.5	164.4	7.1	0.0
Exchange Fund Notes	70	9	70	9	70	9	70	9	3.2	0.6	0.0	2.3	0.1	(0.9)	2.3	0.1	1.0
HKSAR Bonds	12	1.5	12	1.5	15	2	16	2	—	—	0.0	—	39.1	26.1	—	39.1	10.3
Corporate	580	75	577	74	573	74	569	73	2.4	0.5	(0.6)	(0.9)	(1.9)	(0.6)	(0.9)	(1.9)	(0.6)

— = not applicable, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, 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 April and May were estimated based on the compounded monthly growth rate between March and June.

Source: Hong Kong Monetary Authority and Bloomberg LP.

Corporate bonds outstanding in Hong Kong, China in 2Q10 fell by 0.9% y-o-y and 1.9% q-o-q to HKD569 billion (USD73 billion). The top 20 non-bank corporate issuers in Hong Kong, China accounted for almost 15% of total corporate bonds outstanding in 2Q10 (**Table 2**). The Hong Kong Mortgage Corporation was Hong Kong, China's top corporate issuer of LCY bonds with bonds outstanding reaching HKD26.4 billion at the end of June, followed by Sun Hung Kai Properties (Capital Market) Limited with bonds outstanding of HKD9.1 billion, and CLP Power Hong Kong Financing Limited with HKD8.5 billion.

At the end of June, corporate bond issuance had declined 34.0% y-o-y to reach HKD38.2 billion (USD4.9 billion).

Table 2: Top 20 Non-Bank Corporate Issuers, June 2010

Top 20 Non-Bank Corporate Issuers	Outstanding Amount	
	LCY Bonds (HKD billion)	LCY Bonds (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

LCY = local currency.

Note:

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

Source: Hong Kong Monetary Authority.

Policy, Institutional, and Regulatory Developments

HKMA and PBOC Signs Supplementary Memorandum of Cooperation on Yuan Transactions

On 19 July, the HKMA and People’s Bank of China (PBOC) signed a supplementary memorandum of cooperation regarding the expansion of the existing yuan trade settlement scheme. The HKMA and PBOC have agreed to strengthen cooperation and further promote Hong Kong, China’s status as a yuan market platform in an effort to develop more CNY-denominated business outside of the PRC.

Also, the PBOC and Bank of China (Hong Kong) signed a revised settlement agreement on yuan clearing. According to the HKMA, following the revision of the settlement agreement, there will no longer be restrictions on banks in Hong Kong, China on establishing yuan accounts for and providing related services to financial institutions. In addition, individuals and corporations will be able to conduct yuan payments and transfers through banks. As a result, many types of CNY-denominated financial intermediation are expected to be introduced in Hong Kong, China.