

# Hong Kong, China—Update

## Yield Movements

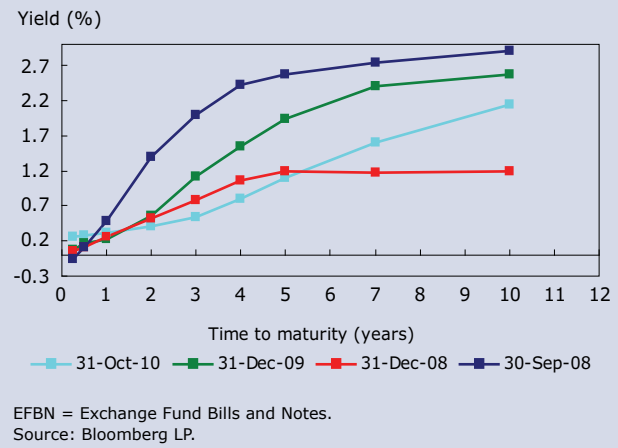
The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBN) between end-December 2009 and end-October 2010 rose 9–18 basis points at the short-end, but tightened by as much as 84 basis points along the rest of the curve (**Figure 1**). The yield on the 2-year tenor fell 15 basis points, while yields on 4-, 5-, and 7- year tenors fell 75, 84, and 81 basis points, respectively. The spread between 2-year and 10-year maturities fell from 203 basis points as of end-December to 174 basis points as of end- October.

The continued tightening along most of the EFBN yield curve reflected the large inflows of foreign capital into Hong Kong, China's financial markets. Also, these inflows into HKD-denominated instruments was paralleled by inflows into the rapidly growing yuan market in Hong Kong, China.

Consumer price inflation in Hong Kong, China eased to 2.6% year-on-year (y-o-y) in September from 3.0% in August. The drop in inflation was due to a lower base effect in August caused by the government's one-off electricity charge subsidy in August 2009. For January through September, consumer price inflation stood at 2.3% y-o-y.

Domestic demand has proven resilient, with retail sales in September rising 17.2% y-o-y—the 13<sup>th</sup> consecutive month that retail sales have expanded. Manufacturing activity in the Special Administrative Region has remained robust, with the HSBC Purchasing Managers' Index (PMI) for October standing at 53.0, compared with 52.8 in September. (A PMI reading above 50 is indicative of an expansion of manufacturing activity.) Hong Kong, China's economy grew 6.8% y-o-y in 3Q10, slightly higher than 6.5% y-o-y growth in 2Q10. Private consumption expenditure expanded 5.7% y-o-y on account of the improving employment situation as well as rising incomes.

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



Merchandise exports remained strong, rising 20.8% y-o-y due to strong domestic demand and further expansion in intra-regional production activity in Asian markets. On a quarter-on-quarter (q-o-q) basis, the economy expanded 0.7%.

## Size and Composition

As of end-September, Hong Kong, China's local currency (LCY) bonds outstanding reached HKD1.25 trillion, representing a y-o-y growth rate of 25.8% (**Table 1**). On a q-o-q basis, LCY bonds outstanding rose 1.3% in 3Q10.

Total government bonds outstanding—comprising exchange fund bills (EFBs), exchange fund notes (EFNs), and Hong Kong Special Administrative Region (HKSAR) bonds—grew 61.2% y-o-y. As was the case in the previous quarter, the growth in total government bonds outstanding was largely attributable to the growth of EFBs, which expanded 69.4% y-o-y. As of end-September, the stock of EFNs remained flat at its June 2010 level of HKD70.0 billion, while HKSAR bonds outstanding rose to HKD19.5 billion, compared with HKD16.0 billion at the end of June. On a

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

	Amount (billion)						Growth Rate (%)													
	Jun-10		Jul-10		Aug-10		Sep-10		Jun-10		Jul-10		Aug-10		Sep-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			
	1,237	159	1,241	160	1,245	160	1,253	161	43.3	2.7	0.3	25.8	1.3	0.6	131.4	6.9	0.0	61.2	0.6	0.6
Government	667	86	668	86	668	86	672	87	131.4	6.9	0.0	61.2	0.6	0.6	164.4	7.1	0.0	69.4	0.1	0.1
Exchange Fund Bills	581	75	581	75	582	75	582	75	2.3	0.1	0.0	0.9	0.0	0.0	—	39.1	0.0	457.1	21.9	21.9
Exchange Fund Notes	70	9	70	9	70	9	70	9	(0.9)	(1.9)	0.7	0.3	2.1	0.7						
HKSAR Bonds	16	2	16	2	16	2	20	3												
Corporate	569	73	573	74	577	74	581	75												

— = 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 July to August were estimated based on the compounded monthly growth rate between June and September
- Source: Hong Kong Monetary Authority and Bloomberg LP.

y-o-y basis, HKSAR bonds expanded 457.1%, owing to the low base of comparison in 2009 when HKSAR bonds outstanding amounted to only HKD3.5 billion.

Corporate bonds outstanding in Hong Kong, China in 3Q10 rose 0.3% y-o-y to HKD581.0 billion, while on a q-o-q basis, the outstanding amount of corporate bonds rose 2.1%. The top 20 non-bank corporate issuers in Hong Kong, China accounted for about 15% of total corporate bonds outstanding in 3Q10 (**Table 2**). The Hong Kong Mortgage Corporation (HKMC) remained Hong Kong, China's largest single corporate issuer of local currency bonds with HKD27.6 billion of bonds outstanding as of end-September.

**Table 2: Top 20 Non-Bank Corporate Issuers**

Top 20 Non-Bank Corporate Issuers	Outstanding Amount	
	LCY Bonds (HKD billion)	LCY Bonds (USD billion)
The Hong Kong Mortgage Corporate Ltd	27.63	3.56
Sun Hung Kai Properties (Capital Market) Ltd	9.39	1.21
CLP Power Hong Kong Financing Ltd	8.78	1.13
Kowloon-Canton Railway Corp	6.60	0.85
MTR Corporation (C.I.) Ltd	5.20	0.67
Swire Pacific MTN Financing Ltd	4.10	0.53
Hongkong Electric Finance Ltd	3.80	0.49
Cheung Kong Bond Finance Ltd	2.95	0.38
Airport Authority Hong Kong	2.90	0.37
HKCG (Finance) Ltd	2.76	0.36
Bauhinia MBS Ltd	2.73	0.35
The Link Finance (Cayman) 2009 Ltd	2.23	0.29
Hysan (MTN) Ltd	1.77	0.23
Urban Renewal Authority	1.50	0.19
Wharf Finance (No. 1) Ltd	1.07	0.14
Wharf Finance Ltd	1.03	0.13
Cheung Kong Finance (MTN) Ltd	1.00	0.13
Hong Kong Link 2004 Ltd	0.80	0.10
Wharf Finance (BVI)	0.48	0.06
Swire Pacific Finance Int'l Ltd	0.20	0.03
<b>Total</b>	<b>86.92</b>	<b>11.20</b>

LCY = local currency.

Note: Based on Central Money Markets Unit (CMU) data on tradable non-bank debt securities issued and still outstanding as of 19 October 2010.

Source: Hong Kong Monetary Authority.

## Rating Changes

In November, Moody's Investors Service upgraded Hong Kong, China's government bond rating to Aa1 from Aa2 (**Table 3**). Moody's also raised Hong Kong, China's foreign currency bank deposit ceiling to Aa1 and the foreign currency bond ceiling to Aaa. Moody's assigned a positive outlook to the ratings. Moody's cited the following factors as contributing to Hong Kong, China's rating upgrade: (i) prospects for continued and improving government financial strength; (ii) lessening vulnerability to external shocks; (iii) favorable prospects for the economic performance of the People's Republic of China in the coming years, which will provide support to economic growth and financial developments in Hong Kong, China.

**Table 3: Selected Sovereign Ratings and Outlook for Hong Kong, China**

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Aa1	AA+	AA
Outlook	positive	stable	stable

FCY = foreign currency, LT = long term.  
Source: Ratings agencies.

## Policy, Institutional, and Regulatory Developments

### ADB Raises CNY1.2 Billion in First Supranational Issue in Hong Kong, China

In October, the Asian Development Bank (ADB) raised CNY1.2 billion of 10-year bonds in Hong Kong, China. The bonds were sold at par and with a coupon rate of 2.85%. The offering was the first issued in Hong Kong, China by a highly-rated supranational. The bonds are expected to provide a benchmark for longer-term debt since most yuan bonds sold in Hong Kong, China have tenors of 5 years or less. Proceeds from the issuance will be used to finance ADB projects in the People's Republic of China.