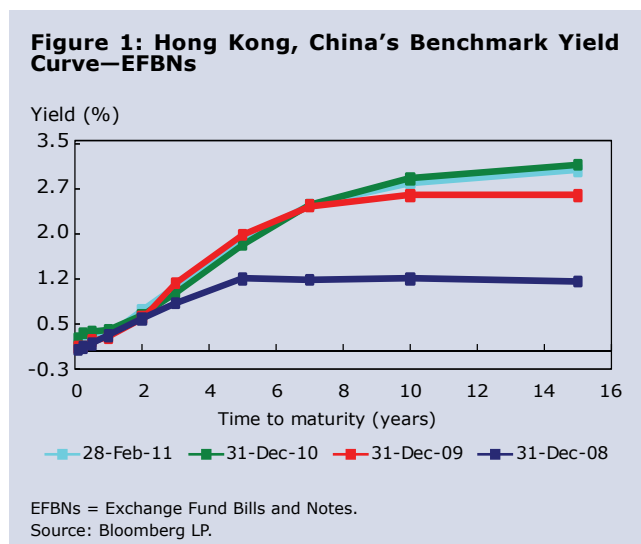


Hong Kong, China—Update

Yield Movements

The yield curve for Hong Kong, China's exchange fund bills and notes (EFBNs) rose for most maturities in 2010, but tightened by 15–17 basis points for the 3-, 4-, and 5-year maturities. However, by end-February 2011, yields at the short-end and long-end of the curve had tightened 7–10 basis points, while yields rose in the belly of the curve (**Figure 1**). The yield on the 4-year tenor increased the most, rising 12 basis points. The spread between 2-year and 10-year maturities narrowed to 212 basis points, compared with a spread of 227 points at end-December 2010.

Consumer price inflation in Hong Kong, China accelerated to 3.6% year-on-year (y-o-y) in January, up from 3.1% in December. The higher inflation level was mainly due to higher food prices and increases in private housing rentals. Most of the major components of the composite consumer price index posted y-o-y increases in January, including food (8.2%); electricity, gas, and water (7.0%); clothing and footwear (5.0%); miscellaneous goods (3.6%); and miscellaneous services (2.7%). For 2011, the government expects inflation to continue to rise to 4.5%.



Domestic demand has proven resilient, with retail sales in December climbing 18.5% y-o-y, leading to a sixteenth consecutive month of positive growth. Also, manufacturing activity remains robust, with the HSBC Purchasing Managers' Index (PMI) for January rising to 55.2, the highest level in 9 months. (A PMI reading above 50 is indicative of an expansion of manufacturing activity.)

Hong Kong, China's gross domestic product (GDP) grew 6.2% y-o-y in 4Q10, slightly lower than the 6.7% growth realized in 3Q10. Private consumption expanded 7.1% y-o-y, an improvement over 4.9% growth in 3Q10. Merchandise export growth moderated to 8.4% y-o-y in 4Q10 after rising 20.8% in 3Q10. On a quarter-on-quarter (q-o-q) basis, the economy expanded 1.5%. For 2010 as a whole, the economy registered GDP growth of 6.8%, a turnaround from a contraction of 2.7% in 2009. The government expects GDP to grow 4.0%–5.0% in 2011.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market climbed 14.0% y-o-y to HKD1.3 trillion (USD163.7 billion) at end-December (**Table 1**). On a q-o-q basis, LCY bonds outstanding grew at a pace of only 1.6% in 4Q10.

Total government bonds outstanding rose 25.5% y-o-y as of end-December, while q-o-q growth was relatively flat in 4Q10. Government bonds outstanding in Hong Kong, China include exchange fund bills (EFBs), exchange fund notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR bonds).

The growth in total government bonds outstanding was largely attributed to the growth of EFBs, which expanded 25.6% in 2010. On the other hand, the stock of EFNs remained flat at HKD69.9 billion (USD9.0 billion). HKSAR bonds outstanding rose 336.4% in 2010 to reach HKD24.0 billion (USD3.1 billion), having come from a low base of

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

	Amount (billion)						Growth Rate (%)									
	Sep-10		Oct-10		Nov-10		Dec-10		Sep-10		Oct-10		Nov-10		Dec-10	
	HKD	USD	HKD	USD	HKD	USD	HKD	USD	y-o-y	q-o-q	m-o-m	USD	HKD	y-o-y	q-o-q	m-o-m
Total	1,253	161	1,260	163	1,265	163	1,273	164	25.8	1.3	0.6	164	164	14.0	1.6	0.6
Government	672	87	674	87	674	87	677	87	61.2	0.6	0.3	87	87	25.5	0.8	0.5
Exchange Fund Bills	582	75	582	75	583	75	583	75	69.4	0.1	0.03	75	75	25.6	0.2	0.1
Exchange Fund Notes	70	9	70	9	70	9	70	9	0.9	0.0	0.0	9	9	0.3	(0.4)	0.4
HKSAR Bonds	20	2.5	22	3	22	3	24	3	457.1	21.9	10.3	3	3	336.4	23.1	11.6
Corporate	581	75	586	76	591	76	596	77	0.3	2.1	0.8	77	77	3.2	2.5	0.8

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 October and November were estimated based on the compounded monthly growth rate between September and December.
- Source: Hong Kong Monetary Authority and Bloomberg LP.

only HKD6.0 billion (USD0.7 billion) at the end of 2009.

In October, HKD2.0 billion in 10-year Special Administrative Region (SAR) government bonds were issued under the Institutional Bond Issuance Programme. An additional HKD2.5 billion in 5-year bonds were sold in December. Both of these bond issues were well received by institutional investors, with tenders reaching HKD6.3 billion and HKD6.2 billion, respectively.

Corporate bonds outstanding reached HKD595.7 billion (USD76.6 billion) at end-2010 for growth of 3.2% y-o-y and 2.5% q-o-q. The top 18 non-bank corporate issuers in Hong Kong, China accounted for about 15% of total corporate bonds outstanding as of end-December (**Table 2**). Hong Kong, China's top corporate issuer of LCY bonds was state-owned Hong Kong Mortgage Corporation (HKMC), with bonds valued at HKD24.3 billion (USD3.1 billion). Sun Hung Kai Properties (Capital Market) Ltd. was in the second spot with outstanding bonds of HKD9.9 billion (USD1.3 billion), while CLP Power Hong Kong Financing Ltd. was in the third spot with HKD9.3 billion (USD1.2 billion).

Finance-related firms dominated the list of the top 18 non-bank corporate issuers, accounting for over 70% of the list. Seven state-owned companies were included in the list, while 11 were privately owned. Among the companies in Table 2, only one company is listed on the Hong Kong Exchanges and Clearing Limited.

Offshore Renminbi Bond Market

The offshore renminbi bond market in Hong Kong, China has grown dramatically since its inception in 2009. By 23 February, cumulative renminbi bond issuance had reached CNY82 billion. Low borrowing costs and the renminbi's expected appreciation against the United States (US) dollar have attracted both lenders and investors. Outstanding renminbi deposits in Hong Kong, China reached CNY314 billion at the end of 2010, a dramatic increase from only CNY895 million at the end of 2004, the year in which renminbi deposits

Table 2: Top 18 Non-Bank Issuers of LCY Corporate Bonds in Hong Kong China (as of 31 December 2010)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Sector
	LCY Bonds (HKD billion)	LCY Bonds (USD billion)				
1. The Hong Kong Mortgage Corporate Ltd.	24.31	3.13	Yes	No	No	Finance
2. Sun Hung Kai Properties (Capital Market) Ltd.	9.89	1.27	No	Yes	No	Finance
3. CLP Power Hong Kong Financing Ltd.	9.28	1.19	No	Yes	No	Finance
4. Kowloon-Canton Railway Corporation	6.60	0.85	Yes	No	No	Transportation
5. MTR Corporation (C.I.) Ltd.	5.20	0.67	Yes	No	Yes	Transportation
6. Swire Pacific MTN Financing Ltd.	4.80	0.62	No	Yes	No	Finance
7. Hongkong Electric Finance Ltd.	3.80	0.49	No	Yes	No	Finance
8. Cheung Kong Bond Finance Ltd.	2.95	0.38	No	Yes	No	Finance
9. Airport Authority Hong Kong	2.90	0.37	Yes	No	No	Transportation
10. HKCG (Finance) Ltd.	2.76	0.36	No	Yes	No	Finance
11. Wharf Finance Ltd.	2.29	0.30	No	Yes	No	Finance
12. Bauhinia MBS Ltd.	2.21	0.28	Yes	No	No	Finance
13. The Link Finance (Cayman) 2009 Ltd.	2.10	0.27	No	Yes	No	Finance
14. Hysan (MTN) Ltd.	1.80	0.23	No	Yes	No	Finance
15. Urban Renewal Authority	1.50	0.19	Yes	No	No	Property Development
16. Cheung Kong Finance (MTN) Ltd.	0.80	0.10	No	Yes	No	Finance
17. Hong Kong Link 2004 Ltd.	0.79	0.10	Yes	No	No	Infrastructure
18. The Hongkong Land Notes Company Ltd.	0.20	0.03	No	Yes	No	Finance
Total Top 18 Non-Bank Corporate Issuers	84.18	10.83				

LCY = local currency.

Note:

Based on Central Money Markets Unit (CMU) data on tradeable non-bank debt securities issued and still outstanding as of 21 January 2011.

Source: Hong Kong Monetary Authority.

were first offered. Issuers in the renminbi bond market have included high-grade issuers such as the government of the People's Republic of China (PRC) and lower-rated institutions such as Galaxy Entertainment.

Rating Changes

On 10 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 (FCY) bank deposit ceiling to Aa1 and the FCY 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 ratings upgrade: (i) prospects for continued and improving government financial strength; (ii) lessening vulnerability to external shocks; and (iii) favorable prospects for the PRC's economic performance in the coming years, which will provide support to economic growth and financial development in Hong Kong, China.

On 25 November, Fitch Ratings raised Hong Kong, China's FCY long-term debt to AA+ from AA. The outlook on the ratings was stable. Fitch cited Hong Kong, China's strong economic growth and the government's prudent fiscal management as the reason for the upgrade.

On 16 December, Standard & Poor's (S&P) upgraded Hong Kong, China's long-term FCY and LCY ratings to AAA from AA+. The outlook on the ratings was stable. S&P attributed the upgrade to Hong Kong, China's large net external creditor position, the government's accumulated fiscal reserves, and above-average growth potential.

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

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

FCY = foreign currency, LT = long term.

Source: Ratings agencies.

Policy, Institutional, and Regulatory Developments

Hong Kong, China Introduces Property Measures

On 19 November, the government of the Hong Kong Special Administrative Region of the People's Republic of China announced a number of measures designed to rein in housing prices, including additional stamp duties on property held for less than 6 months and higher down payments on some types of properties.

In addition to these measures, on 23 February the government announced that it would increase the available land supply for private and public housing development.

HSBC and Bank of China Offer Renminbi Cashier Checks

On 14 February, as part of the continued development of the offshore renminbi market, HSBC and Bank of China announced that they have begun issuing CNY-denominated cashier's checks on behalf of clients. HSBC's first renminbi cashier check was issued on behalf of tea seller Hung Fook Toong. Meanwhile, Bank of China is also offering renminbi cashier checks through its branches.

Bank of China Offers Renminbi Repos

On 20 February, Bank of China announced that it would begin offering renminbi repurchase and lending facilities in Hong Kong, China. According to the bank, the launch of these facilities will spur the development of new CNY-denominated products and facilitate renminbi settlements.