

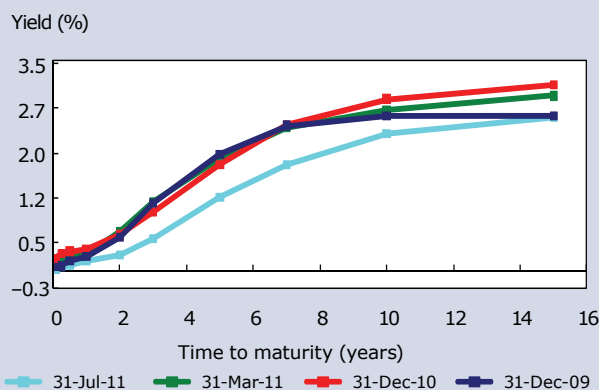
Hong Kong, China—Update

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBN) fell for most maturities between end-December 2010 and end-March, with the exception of the belly of the curve. The 15-year tenor declined the most, falling 19 basis points (bps). Meanwhile, the 3-year tenor rose 17 bps. Between end-March and end-July, the entire yield curve shifted downward (**Figure 1**). Yields declined the most between the 3- and 7-year tenors, falling between 61 bps and 64 bps. In contrast, yields for the 1-year tenor dropped only 12 bps. Meanwhile, the spread between 2- and 10-year maturities fell only slightly to 203 bps, compared with a spread of 204 bps at end-March.

Consumer price inflation in Hong Kong, China accelerated to 5.6% year-on-year (y-o-y) in June, up from 5.2% in May, mainly due to higher food prices and increases in utilities and private housing rental costs. Most of the major components of the composite consumer price index posted y-o-y increases in June, including food (7.2%); electricity, gas, and water (8.2%); housing (6.5%); clothing and footwear (6.7%); miscellaneous goods (4.5%); and miscellaneous services (3.3%).

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



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

Demand has proven resilient, with gross domestic product (GDP) growth accelerating to 7.5% y-o-y in 1Q11 from 6.4% in 4Q10. Growth was driven mainly by the services sector, which expanded 7.1% in 1Q11 from 6.4% in 4Q10. Growth in the construction sector remained particularly robust, expanding 22.2% in 1Q11 from 19.8% in 4Q10. On the other hand, the government is increasingly worried about rising real estate prices, which have been attributed to investments made by residents of the People's Republic of China (PRC). In June, the government enacted a number of measures to slow housing price increases including decreasing maximum loan-to-value ratios.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 5.1% y-o-y to reach HKD1.3 trillion (US\$167.0 billion) at end-June (**Table 1**). However, on a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding grew at a pace of only 0.5%.

Total LCY government bonds outstanding rose 2.6% y-o-y as of end-June, while q-o-q growth was relatively flat in 2Q11 at 0.5%. Government bonds 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 0.6% y-o-y to HKD585 billion as of end-June. On the other hand, the stock of EFNs declined slightly by 0.9% to HKD69.6 billion. HKSAR Bonds outstanding rose 87.5% to reach HKD30.0 billion as of end-June, although they started from a low base of only HKD16.0 billion at end-June 2010.

In March, HKD3.5 billion in 2-year HKSAR Bonds were issued; HKD2.5 billion in 5-year bonds were sold in May.

Table 2: Top 17 Non-Bank Corporate Issuers (as of June 2011)

Top 17 LCY Non-Bank Corporate Bond Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (HKD billion)	LCY Bonds (US\$ billion)				
1. The Hong Kong Mortgage Corporate Ltd.	20.72	2.66	Yes	No	No	Finance
2. Sun Hung Kai Properties (Capital Market) Ltd.	11.80	1.52	No	Yes	No	Finance
3. CLP Power Hong Kong Financing Ltd.	9.90	1.27	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.	4.21	0.54	No	Yes	No	Finance
8. Airport Authority Hong Kong	2.90	0.37	Yes	No	No	Transportation
9. HKCG (Finance) Limited	2.76	0.35	No	Yes	No	Finance
10. The Link Finance (Cayman) 2009 Ltd.	2.68	0.34	No	Yes	No	Finance
11. Cheung Kong Bond Finance Ltd.	2.45	0.31	No	Yes	No	Finance
12. Cheung Kong Finance (MTN) Ltd.	2.45	0.31	No	Yes	No	Finance
13. Wharf Finance Ltd.	2.29	0.29	No	Yes	No	Finance
14. Bauhinia MBS Ltd.	2.21	0.28	Yes	No	No	Finance
15. Hysan (MTN) Ltd.	1.80	0.23	No	Yes	No	Finance
16. Urban Renewal Authority	1.70	0.22	Yes	No	No	Property Development
17. The Hongkong Land Notes Company Ltd.	0.20	0.03	No	Yes	No	Finance
Total Top 17 Non-Bank LCY Corporate Issuers	84.66	10.88				
Total LCY Corporate Bonds	615.31	79.07				
Top 17 as a % of Total LCY Corporate Bonds	13.76%	13.76%				

LCY = local currency.
Source: HKMA Central Moneymarkets Unit (CMU).

Policy, Institutional, and Regulatory Developments

HKMA Launches CNH Fiduciary Account Service for Banks

On 31 March, the Hong Kong Monetary Authority (HKMA) launched the CNH Fiduciary Account Service to provide another investment outlet for banks' CNH deposits as an alternative to the designated clearing bank, Bank of China (BOC). The service will effectively allow banks to invest CNH deposits directly with the People's Bank of China (PBOC) via a custodial arrangement with BOC.

BOC Cuts CNH Deposit Rate

BOC cut its CNH deposit rate to 0.629% from 0.865% on 1 April due to increasing demand for the currency.

SFC to Regulate Credit Rating Agencies

On 28 April, the Securities and Futures Commission (SFC) announced that it would begin requiring credit rating agencies and their analysts to be licensed.

Hong Kong, China Introduces New Property Loan Measures

On 10 June, the Government of the Hong Kong Special Administrative Region of the PRC announced a number of additional measures designed to reign in housing prices. Most of the new measures concern lowering the maximum loan-to-value ratios for residential properties. Additionally, if the borrower is not a resident of Hong Kong, China, the loan-to-value ratio will be lowered by an additional 10%.