

Hong Kong, China—Update

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) flattened between end-June and end-October. **(Figure 1)**. The yield curve flattened as yields on longer tenors moved downward while yields on the shorter-end were roughly unchanged. Yields for 6- to 12-month maturities were unchanged, while yields for 1-month to 3-year maturities fell by 2 basis points (bps) or more. In contrast, yields fell between 8 bps and 29 bps for the longer-dated tenors. The 10-year tenor fell 29 bps while the 15-year tenor fell 26 bps.

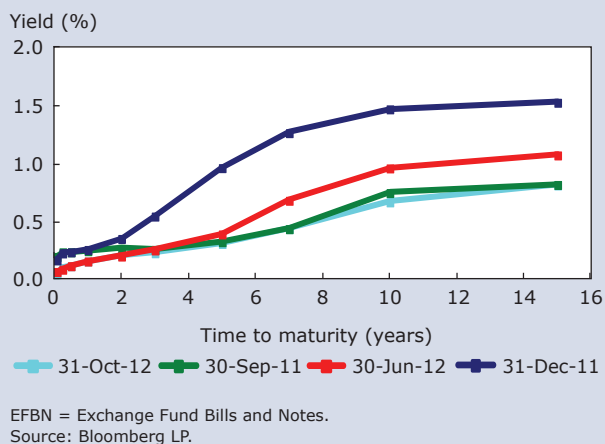
Due to the fall in yields for longer-term tenors, the spread between the 2- and 10-year rates fell to 46 bps at end-October from 76 bps at end-June.

The fall in longer-tenor yields was due to increased demand for high-quality Exchange Fund Bills and Notes due to increased risk aversion on renewed concerns over the global slowdown.

The performance of Hong Kong, China's economy improved in September. Export growth recovered to expand 15.2% year-on-year (y-o-y), from marginal growth of only 0.6% in August, as demand from Asia and the United States (US) improved. However, the government's outlook for 2012 suggests that economic growth remains weak. The annual gross domestic product (GDP) growth rate for 2012 is forecast at 1%–2%.

The government also remains concerned over rising property prices as a driver of inflation, which rebounded to 3.7% y-o-y in August from 1.6% in July, increasing slightly again to 3.8% in September. Inflation is rising mostly due to increases in property prices and other housing-related costs.

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



Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 3.3% y-o-y to HKD1.4 trillion (US\$176 billion) as of end-September **(Table 1)**. On a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding rose 1.3% in 3Q12.

Total LCY government bonds outstanding rose 3.4% y-o-y and 0.1% q-o-q to reach HKD721 billion as of end-September. Government bonds include Exchange Fund Bills (EFBs), Exchange Fund Notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR Bonds).

Most of the growth in government bonds in 3Q12 can be attributed to growth in HKSAR Bonds, which expanded 50.6% y-o-y to HKD64 billion. On the other hand, the stock of EFNs declined slightly by 0.9% y-o-y to HKD69 billion, while EFBs grew only slightly by 0.5% y-o-y to HKD588 billion.

In September, HKD3.5 billion worth of 2-year HKSAR Bonds were issued.

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

	Amount (billion)						Growth Rate (%)									
	Jun-12		Jul-12		Aug-12		Sep-12		Jun-12		Jul-12		Aug-12		Sep-12	
	HKD	US\$	HKD	US\$	HKD	US\$	HKD	US\$	y-o-y	q-o-q	m-o-m	q-o-q	m-o-m	q-o-q	m-o-m	q-o-q
Total	1,347	174	1,353	174	1,358	175	1,364	176	3.7	1.2	0.4	1.2	0.4	0.4	1.3	0.4
Government	720	93	721	93	721	93	721	93	5.3	2.1	0.01	2.1	0.01	0.0	3.4	0.1
Exchange Fund Bills	587	76	588	76	588	76	588	76	0.4	0.1	0.01	0.1	0.01	0.0	0.5	0.1
Exchange Fund Notes	69	9	69	9	69	9	69	9	(0.9)	(0.4)	0.00	(0.4)	0.00	0.0	(0.9)	0.0
HKSAR Bonds	64	8	64	8	64	8	64	8	113.3	29.3	0.00	29.3	0.00	0.0	50.6	0.0
Corporate	627	81	632	82	638	82	643	83	1.9	0.1	0.9	0.1	0.9	3.3	2.6	0.9

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-US\$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.

Source: Hong Kong Monetary Authority and Bloomberg LP.

The amount of LCY corporate bonds outstanding rose slightly to HKD643 billion at end-September, reflecting growth of 3.3% y-o-y and 2.6% q-o-q. The top 28 non-bank corporate issuers in Hong Kong, China accounted for almost 17% of total corporate bonds outstanding as of end-September (**Table 2**). Hong Kong, China's top corporate issuer of LCY bonds remained the state-owned Hong Kong Mortgage Corporation (HKMC) with outstanding bonds valued at HKD17.7 billion. CLP Power Hong Kong Financing Ltd. was the next largest issuer at HKD11.3 billion. Sun Hung Kai Properties (Capital Market) Ltd. was the third largest issuer with outstanding bonds of HKD10.9 billion.

Financial firms dominated the list of the top 25 non-bank corporate issuers at end-September, accounting for nine out of the 28 issuers. Six state-owned companies were included on the list, while 18 were privately owned. Among the companies in Table 2, eight were listed on the Hong Kong Exchange.

Policy, Institutional, and Regulatory Developments

HKMA Implements Prudential Loan Property Measures

On 14 September, the Hong Kong Monetary Authority (HKMA) released new regulations regarding property lending in order to limit property price risks. For borrowers with multiple properties under mortgage, the loan-to-value ratios and debt servicing ratios were adjusted. Also, the maximum mortgage loan tenor was reduced to 30 years.

HKMA to Implement First Phase of Basel III

On 19 October, HKMA announced that the first phase of its implementation of Basel III requirements would take effect on 1 January 2013. The first phase consists mostly of changes to the capital adequacy ratio, splitting it into three distinct ratios: (i) common equity Tier 1 capital ratio, (ii) Tier 1 capital ratio, and (iii) total capital ratio.

Table 2: Top 28 Non-Bank Corporate Issuers in Hong Kong, China (as of end-September 2012)

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.	17.70	2.28	Yes	No	No	Finance
2. CLP Power Hong Kong Financing Ltd.	11.33	1.46	No	Yes	No	Electric
3. Sun Hung Kai Properties (Capital Market) Ltd.	10.86	1.40	No	Yes	No	Real Estate
4. Kowloon-Canton Railway Corporation	6.30	0.81	Yes	No	No	Transportation
5. MTR Corporation (C.I.) Ltd.	6.20	0.80	Yes	No	Yes	Transportation
6. HKCG (Finance) Limited	5.60	0.72	No	Yes	No	Gas
7. The Link Finance (Cayman) 2009 Ltd.	5.29	0.68	No	Yes	No	Finance
8. Swire Pacific MTN Financing Ltd.	4.98	0.64	No	No	Yes	Diversified
9. Hongkong Electric Finance Ltd.	4.81	0.62	No	Yes	No	Electric
10. Wheelock Finance Ltd.	3.75	0.48	No	Yes	No	Diversified
11. Cheung Kong Bond Finance Ltd.	3.45	0.44	No	Yes	Yes	Finance
12. Airport Authority Hong Kong	2.85	0.37	Yes	No	No	Transportation
13. Wharf Finance Ltd.	2.50	0.32	No	Yes	No	Diversified
14. Urban Renewal Authority	2.50	0.32	Yes	No	No	Property Development
15. Hysan (MTN) Ltd.	2.43	0.31	No	Yes	No	Finance
16. Cheung Kong Finance (MTN) Ltd.	2.21	0.28	No	Yes	No	Finance
17. Yue Xiu Enterprises (Holdings) Ltd.	2.00	0.26	No	Yes	No	Diversified
18. Henderson Land MTN Ltd.	1.83	0.24	No	Yes	Yes	Finance
19. Cathay Pacific MTN Financing Ltd.	1.18	0.15	No	No	Yes	Airlines
20. Wharf Finance (No.1) Ltd.	1.14	0.15	No	Yes	No	Diversified
21. Dragon Drays Ltd.	1.00	0.13	No	Yes	No	Diversified
22. Swire Properties MTN Financing Ltd.	0.80	0.10	No	No	Yes	Diversified
23. Nan Fung Treasury Ltd.	0.80	0.10	No	Yes	No	Real Estate
24. Wharf Finance (BVI) Ltd.	0.45	0.06	No	Yes	No	Diversified
25. HLP Finance Ltd.	0.41	0.05	No	No	Yes	Real Estate
26. Bauhinia MBS Ltd.	0.26	0.03	Yes	No	No	Finance
27. Cheung Kong Infrastructure Finance (BVI) Ltd.	0.26	0.03	No	Yes	Yes	Finance
28. The Hongkong Land Notes Company Ltd.	0.20	0.03	No	Yes	No	Finance
Total Top 28 Non-Bank LCY Corporate Issuers	103.09	13.29				
Total LCY Corporate Bonds	643.21	82.95				
Top 28 as % of Total LCY Corporate Bonds	16.0%	16.0%				

LCY = local currency.

Note: Based on Central Money Markets Unit data on tradeable non-bank debt securities issued and outstanding as of 2 July 2012.

Source: Hong Kong Monetary Authority.