

Hong Kong, China

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) has been rising since end-March, particularly at the longer-end (**Figure 1**). Between end-March and end-May, yields rose 4 basis points (bps) or less for tenors of 2-years or less, while yields rose 13 bps–31 bps for longer-dated tenors. The rise in yields was prompted by statements from United States (US) Federal Reserve (Fed) Chairman Ben Bernanke in May that the pace of Fed bond purchases could be tapered later in 2013 and halted in 2014 should economic data support such action.

Between end-May and end-July, yields rose between 3 bps and 15 bps on tenors of 3-years or less, and between 41 bps and 84 bps on longer-dated tenors. The larger increase in yields at the longer-end of the curve caused the 2- versus 10-year spread to rise to 196 bps at end-July from 120 bps at end-May.

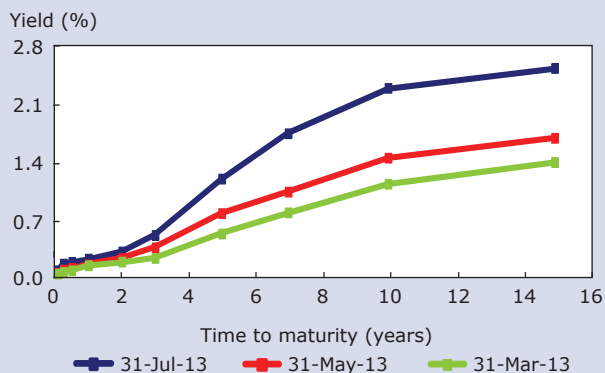
The rise in Hong Kong, China's bond yields tracks closely with yield changes in the US Treasuries market as Hong Kong, China does not have an independent monetary policy and pegs its dollar to the US dollar.

The rise in yields also reflects improvements in Hong Kong, China's economy as well as rising inflation. Hong Kong, China's economic growth rose in 2Q13, to 3.3% year-on-year (y-o-y) from 2.9% in 1Q13. Growth was supported mostly by domestic demand, with private consumption adding 2.9 percentage points to GDP growth. In June, retail sales rose 14.7% y-o-y in June from 12.9% in May.

The government now expects GDP growth for 2013 to be between 2.5%–3.5% compared with its original forecast of 1.5%–3.5%.

Inflation has also risen in Hong Kong, China mostly due to the feed-through effects of higher housing

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



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

rents in 2012. Consumer price inflation rose to 6.9% y-o-y in July from 4.1% in June. Inflation in May was at 3.9%. The government expects further upside risks to inflation from the feed-through effects of housing rents but noted moderating influences on inflation in the latter half of 2013, such as lower import prices and a slower pace of increases in housing rents in certain areas.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 10.7% y-o-y to HKD1.5 trillion (US\$192 billion) at end-June (**Table 1**). On a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding rose 4.4% in 2Q13.

Total LCY government bonds outstanding rose 15.7% y-o-y and 7.0% q-o-q as of end-June. Government bonds include Exchange Fund Bills (EFBs), Exchange Fund Notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR Bonds).

The amount of LCY government bonds outstanding at end-June reached HKD834 billion. Most of the growth in government bonds in 2Q13 could be attributed to growth in EFBs, which expanded

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	HKD	US\$	HKD	US\$	HKD	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,345	173	1,426	184	1,488	192	1.1	3.8	4.4	10.7
Government	720	93	779	100	834	107	2.1	5.3	7.0	15.7
Exchange Fund Bills	587	76	640	82	682	88	0.1	0.4	6.5	16.0
Exchange Fund Notes	69	9	69	9	68	9	(0.4)	(0.9)	(0.4)	(0.9)
HKSAR Bonds	64	8	71	9	84	11	29.3	113.3	18.4	30.5
Corporate	624	80	646	83	655	84	(0.1)	1.5	1.3	4.9

() = negative, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, 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 an LCY base and do not include currency effects.

Sources: Hong Kong Monetary Authority and Bloomberg LP.

16.0% y-o-y to HKD682 billion from HKD587 billion at end-June 2012. On the other hand, the stock of EFNs declined slightly by 0.9% y-o-y to HKD68 billion. HKSAR bonds grew rapidly in 2Q13, rising 30.5% y-o-y, although the absolute amount of HKSAR bonds remains much lower than EFBs.

Under the Institutional Bond Issuance Programme, HKD3 billion of 3-year HKSAR bonds were issued in May and HKD2 billion of 5-year HKSAR bonds were issued in July. Under the Retail Bond Issuance Programme, HKD10 billion of 3-year HKSAR bonds were issued. A total of HKD15 billion worth of HKSAR bonds were issued in 2Q13.

Turnover volumes for EFBs and EFNs declined significantly in 2012 and 2013 compared with 2011 levels. The turnover volumes in 1H12 and 1H13 were equivalent to only 3% and 2%, respectively, of the turnover volume in the first half of 2011. The drop in trading volumes was due to a December 2011 change in the criteria for market makers, which previously included trading volume, as the Hong Kong Monetary Authority (HKMA) had become concerned with "round-tripping" trades used to artificially increase trading volume.

The amount of LCY corporate bonds outstanding rose to HKD655 billion at end-June, reflecting growth of 4.9% y-o-y and 1.3% q-o-q. The top 24 non-bank corporate issuers in Hong Kong, China accounted for about 16% of total corporate

bonds outstanding in 2Q13 (**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 HKD17.4 billion at end-June. CLP Power Hong Kong Financing Ltd. was the next largest issuer with outstanding bonds of HKD10.9 billion. Sun Hung Kai Properties (Capital Market) Ltd. was the third-largest issuer with outstanding bonds of HKD10 billion.

Financial firms were well represented among the top 24 non-bank corporate issuers in 2Q13, accounting for six of the 24 issuers. Five state-owned companies were included on the list, while 19 were privately owned. Among the companies in Table 2, six are listed on the Hong Kong Exchange. **Table 3** presents some notable issuances from non-bank institutions in 2Q13.

Policy, Institutional, and Regulatory Developments

Taxation on *Sukuk* to be Revised

On 19 June, Hong Kong, China's Inland Revenue Department released the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013. The amendment seeks to promote the development of the *sukuk* (Islamic bond) market in Hong Kong, China by revising the taxation framework for some types of *sukuk*.

Table 2: Top 24 Non-Bank Corporate Issuers in Hong Kong, China

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (HKD billion)	LCY Bonds (US\$ billion)			
1. The Hong Kong Mortgage Corporate	17.38	2.24	Yes	No	Finance
2. CLP Power Hong Kong Financing	10.93	1.41	No	No	Electric
3. Sun Hung Kai Properties (Capital Market)	10.01	1.29	No	No	Real Estate
4. MTR Corporation (C.I.)	6.50	0.84	Yes	Yes	Transportation
5. Wharf Finance	6.18	0.80	No	No	Diversified
6. The Link Finance (Cayman) 2009	5.79	0.75	No	No	Finance
7. HKCG (Finance)	5.60	0.72	No	No	Gas
8. Hongkong Electric Finance	5.51	0.71	No	No	Electric
9. Swire Pacific	4.88	0.63	No	Yes	Diversified
10. Kowloon-Canton Railway	4.80	0.62	Yes	No	Transportation
11. Cheung Kong Bond Finance	4.62	0.60	No	Yes	Finance
12. Urban Renewal Authority	3.90	0.50	Yes	No	Property Development
13. Wheelock Finance	3.74	0.48	No	No	Diversified
14. Yue Xiu Enterprises (Holdings)	3.00	0.39	No	No	Diversified
15. Airport Authority Hong Kong	2.85	0.37	Yes	No	Transportation
16. Hysan (MTN)	2.43	0.31	No	No	Finance
17. Henderson Land MTN	1.83	0.24	No	Yes	Finance
18. Cathay Pacific MTN Financing	1.70	0.22	No	Yes	Airlines
19. Nan Fung Treasury	1.31	0.17	No	No	Real Estate
20. Dragon Drays	1.00	0.13	No	No	Diversified
21. R-Reit International Finance	0.78	0.10	No	No	Real Estate
22. Wing Tai Properties (Finance)	0.58	0.07	No	No	Real Estate
23. HLP Finance	0.56	0.07	No	Yes	Real Estate
24. The Hongkong Land Notes Company	0.20	0.03	No	No	Finance
Total Top 24 Non-Bank LCY Corporate Issuers	106.04	13.67			
Total LCY Corporate Bonds	654.90	84.43			
Top 24 as % of Total LCY Corporate Bonds	16.19%	16.19%			

LCY = local currency.

Notes:

1. Data as of end-June 2013.

2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.

Source: *AsianBondsOnline* calculations based on Hong Kong Monetary Authority data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Hong Kong Mortgage Corporation		
2-year bond	0.46	0.78
3-year bond	0.68	0.78
2-year bond	0.38	0.50
Urban Renewal Authority		
7-year bond	1.64	0.30
10-year bond	2.14	0.30
Sun Hung Kai Properties		
10-year bond	2.95	0.30
Hong Kong Electric Finance		
15-year bond	3.00	0.20

LCY = local currency.

Source: Central Moneymarkets Unit (CMU) HKMA.

RQFII Expanded

On 12 July, the People's Republic of China expanded the Renminbi Qualified Institutional Investor (RQFII) program. The RQFII program had been limited to financial institutions in Hong Kong, China but will now be expanded to include firms in London; Singapore; and Taipei, China.

Revision to the Renminbi Liquidity Facility

On 25 July, HKMA expanded the CNH liquidity facility that provides CNH funds to banks in Hong Kong, China. Previously, banks availing of the facility would receive funds the following day, which had to be repaid after 1 week. With the expansion of the facility, HKMA will provide banks two additional funding options: (i) overnight borrowing with funds available on the same day, and (ii) 1-day borrowing with funds available the following day.