

## Hong Kong, China

### Yield Movements

Hong Kong, China's local currency (LCY) government bond yield curve shifted downward for all tenors between 1 March and 15 May due to domestic liquidity factors (**Figure 1**). The largest movements were for tenors of 2 years and longer, where yields fell an average of 37 basis points (bps). Yields for tenors of less than 2 years fell an average of 13 bps. As a result of the bigger drop at the long-end of the curve, the 2-year versus 10-year yield spread fell to 76 bps on 15 May from 79 bps on 1 March.

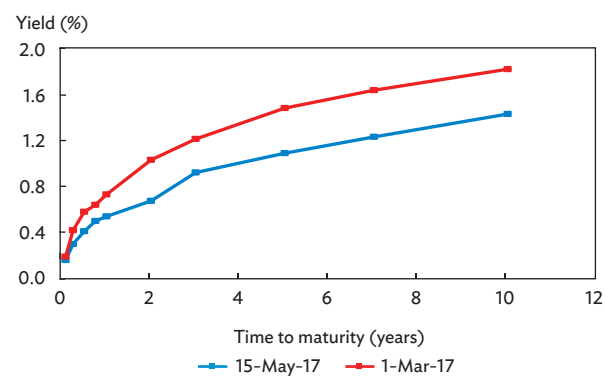
Hong Kong, China's government bond yields closely track United States (US) interest rates, owing to the lack of an independent monetary policy. During the review period, US yields fell for tenors of 3 years and longer by an average of 10 bps. The decline in US yields followed weaker-than-expected US economic data in the first quarter (Q1) of 2017. Real gross domestic product (GDP) growth fell to 1.2% year-on-year (y-o-y) in Q1 2017 from 2.1% y-o-y in the fourth quarter (Q4) of 2016. In contrast, US yields rose at the short-end of the curve following the Federal Reserve's rate hike in March.

In Hong Kong, China, yields also fell for all tenors due to abundant liquidity in Hong Kong, China's financial markets. Since last year, there has been significant demand for HKD-denominated assets, prompting the Hong Kong Monetary Authority to issue additional Exchange Fund Bills (EFBs).

In contrast to the fall in yields, Hong Kong, China's GDP expanded 4.3% y-o-y in Q1 2017 after growing 3.2% y-o-y in Q4 2016. The faster GDP growth rate was due to larger gains in Hong Kong, China's gross domestic capital formation, which expanded 6.4% y-o-y in Q1 2017 versus 5.6% in Q4 2016. There were also gains in consumer spending.

Hong Kong, China experienced an acceleration in inflation, with the rate rising to 2.0% y-o-y in April from 0.5% y-o-y in March. However, the rise was mostly due to a low base effect due to the timing of the Easter holiday and some government subsidies.

**Figure 1: Hong Kong, China's Benchmark Yield Curve—Exchange Fund Bills and Notes**



Source: Based on data from Bloomberg LP.

### Size and Composition

Hong Kong, China's LCY bonds grew 0.4% quarter-on-quarter (q-o-q) and 11.8% y-o-y to stand at HKD1,839 billion at the end of March (**Table 1**). The growth was driven by gains in EFBs and corporate bonds.

Government bonds outstanding rose 0.3% q-o-q and 11.5% y-o-y, mostly due to growth in EFBs, which rose 0.4% q-o-q.

Exchange Fund Notes (EFNs) outstanding continued to decline in Q1 2017 as Hong Kong, China issued only 2-year EFNs, replacing longer tenors with issuances of Hong Kong Special Administrative Region (HKSAR) bonds. EFNs fell 4.6% q-o-q as a result.

HKSAR bonds rose 1.8% q-o-q and 2.6% y-o-y in Q1 2017, though HKSAR bond issuance totaling HKD1.8 billion was down from Q4 2016 levels. Specifically, a 10-year HKD1.2 billion HKSAR bond and a HKD0.6 billion 15-year HKSAR bond were issued under the Institutional Bond Issuance Programme. This compares with a total of HKD6.5 billion worth of HKSAR bonds issued in the previous quarter.

The amount of corporate bonds outstanding rose 0.5% q-o-q and 12.1% y-o-y in Q1 2017. Hong Kong, China's

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2016		Q4 2016		Q1 2017		Q1 2016		Q1 2017	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,646</b>	<b>212</b>	<b>1,831.87</b>	<b>236</b>	<b>1,839</b>	<b>237</b>	<b>1.8</b>	<b>6.5</b>	<b>0.4</b>	<b>11.8</b>
Government	957	123	1,064	137	1,068	137	3.2	11.7	0.3	11.5
Exchange Fund Bills	800	103	915	118	919	118	4.0	16.6	0.4	14.8
Exchange Fund Notes	56	7	48	6	46	6	(3.8)	(15.2)	(4.6)	(18.4)
HKSAR Bonds	101	13	101	13	103	13	1.6	(3.7)	1.8	2.6
Corporate	688	89	767	99	771	99	(0.04)	0.1	0.5	12.1

(-) = negative, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth quarter, USD = United States dollar, 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 an LCY base and do not include currency effects.
4. Data for Q1 2017 are based on *AsianBondsOnline* estimates.

Sources: Hong Kong Monetary Authority and Bloomberg LP.

top 30 nonbank issuers had outstanding LCY bonds amounting to HKD144.7 billion at the end of March, comprising 18.8% of total corporate bonds outstanding. The top 30 list continued to be dominated by real estate firms and the financing vehicles of corporates (**Table 2**). The Hong Kong Mortgage Corporation remained the top issuer with outstanding bonds of HKD28.0 billion, followed by Sun Hung Kai Properties (Capital Market) with HKD9.1 billion of bonds outstanding and MTR Corporation (C.I.) with HKD8.9 billion. Among the top 30 nonbank issuers at the end of March, six were state-owned companies and eight were Hong Kong Exchange-listed firms.

Among the top five nonbank issuances in Q1 2017, the majority came from real estate-related entities. Comprising the list are Emperor International Holdings, NWD (MTN), MTR Corporation, Hong Kong Mortgage Corporation, and CLP Power Hong Kong Financing (**Table 3**).

## Ratings Update

On 25 May, Moody's Investor Service downgraded Hong Kong, China's credit rating by one notch, the day after downgrading the People's Republic of China's (PRC) debt rating. Hong Kong, China's credit rating is now at Aa2 and reflects the likelihood that Hong Kong, China will be affected by rising debt levels in the PRC given the economic linkages between the two.

## Policy, Institutional, and Regulatory Developments

### The People's Republic of China and Hong Kong, China Launch Bond Market Link

On 17 May, the PRC and Hong Kong, China approved a plan to link the PRC's interbank bond market with Hong Kong, China's bond market. The link will allow Hong Kong, China and foreign investors to invest in the PRC's bond market via Hong Kong, China's financial markets.

Table 2: Top 30 Nonbank Corporate Issuers in Hong Kong, China

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (HKD billion)	LCY Bonds (USD billion)			
1.	The Hong Kong Mortgage Corporation	28.03	3.61	Yes	No	Finance
2.	Sun Hung Kai Properties (Capital Market)	9.13	1.18	No	No	Real Estate
3.	MTR Corporation (C.I.)	8.92	1.15	Yes	Yes	Transportation
4.	Swire Pacific	8.62	1.11	No	Yes	Diversified
5.	CLP Power Hong Kong Financing	7.81	1.00	No	No	Finance
6.	HKCG (Finance)	7.80	1.00	No	No	Finance
7.	The Link Finance (Cayman) 2009	7.79	1.00	No	No	Finance
8.	Hongkong Electric Finance	7.69	0.99	No	No	Finance
9.	NWD (MTN)	7.35	0.95	No	Yes	Finance
10.	Wharf Finance	5.70	0.73	No	No	Finance
11.	Swire Properties MTN Financing	5.20	0.67	No	No	Finance
12.	Vank Real Estate (Hong Kong)	3.65	0.47	No	No	Real Estate
13.	Emperor International Holdings	3.55	0.46	No	Yes	Real Estate
14.	Kowloon-Canton Railway	3.40	0.44	Yes	No	Transportation
15.	Urban Renewal Authority	3.30	0.42	Yes	No	Real Estate
16.	Wheelock Finance	3.10	0.40	No	No	Finance
17.	Cathay Pacific MTN Financing	2.37	0.31	No	Yes	Finance
18.	Leading Affluence	2.30	0.30	No	No	Real Estate
19.	Tencent Holdings	2.20	0.28	No	Yes	Communications
20.	Bohai International Capital	2.00	0.26	No	No	Iron and Steel
21.	China Energy Reserve and Chemicals Group Overseas	2.00	0.26	No	No	Oil
22.	CK Property Finance (MTN)	1.85	0.24	No	No	Finance
23.	Hong Kong Science and Technology Parks	1.71	0.22	Yes	No	Real Estate
24.	Bestgain Real Estate Lyra	1.55	0.20	No	No	Real Estate
25.	Cheung Kong Finance (MTN)	1.50	0.19	No	No	Finance
26.	Airport Authority Hong Kong	1.45	0.19	Yes	No	Transportation
27.	Hysan (MTN)	1.40	0.18	No	Yes	Real Estate
28.	Wharf Finance (No. 1)	1.33	0.17	No	No	Finance
29.	Dragon Drays	1.00	0.13	No	No	Diversified
30.	K. Wah International Financial Services	1.00	0.13	No	Yes	Finance
<b>Total Top 30 Nonbank LCY Corporate Issuers</b>		<b>144.68</b>	<b>18.62</b>			
<b>Total LCY Corporate Bonds</b>		<b>771.46</b>	<b>99.28</b>			
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>18.75%</b>	<b>18.75%</b>			

LCY = local currency.

Notes:

1. Data as of end-March 2017.

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 Local Currency Corporate Bond Issuance in the First Quarter of 2017**

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
NWD (MTN)		
7-year bond	3.50	0.70
12-year bond	4.00	1.15
MTR Corporation		
25-year bond	3.13	0.58
20-year bond	3.00	0.40
Emperor International Holdings		
5-year bond	4.70	0.80
The Hong Kong Mortgage Corporation		
2-year bond	1.48	0.10
2-year bond	1.52	0.10
3-year bond	1.96	0.30
15-year bond	2.65	0.11
CLP Power Hong Kong Financing		
15-year bond	3.16	0.30

HKD = Hong Kong dollar.

Source: Central Moneymarkets Unit, Hong Kong Monetary Authority.