

Hong Kong, China

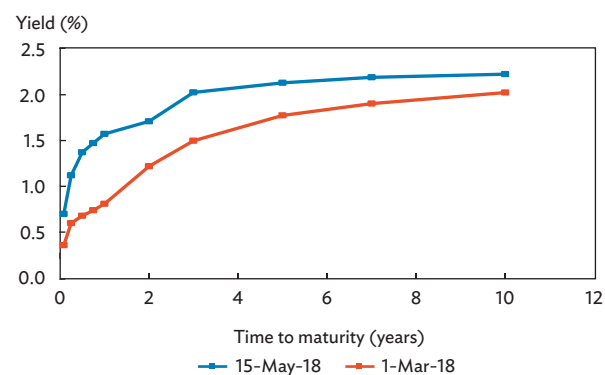
Yield Movements

Hong Kong, China's local currency (LCY) government bond yield curve shifted upward for all tenors between 1 March and 15 May due to tightening domestic liquidity (**Figure 1**). Excluding the 1-month tenor, yields for maturities of 1-year or less rose an average of 68 basis points (bps). Yields with maturities of 2 years or more (excluding the 15-year tenor) rose an average of 37 bps. This resulted in the curve climbing more steeply at the short-end and flattening at the long-end of the curve. Consequently, the yield spread between 2-year and 10-year bonds narrowed to 51 bps during the review period.

Hong Kong, China's government bond yields closely track United States (US) Treasury yields. During the review period, the US yield curve shifted upward, with an average gain of 31 bps for all tenors except 1-month and 30-year tenors, which rose 16 bps and 12 bps, respectively. The benchmark 10-year US Treasury yield rose to a 4-year high, reaching 3.1% on 15 May. The rise in US yields was due to the interest rate increase of 25 bps in March as the US Federal Reserve gradually moves toward normalization and away from an accommodative monetary policy that was implemented to mitigate the effects of the global financial crisis.

In the absence of an independent monetary policy, Hong Kong, China follows the Federal Reserve's monetary policy, with the Hong Kong dollar pegged to the US dollar. Hong Kong, China likewise raised its base rate by 25 bps in March to 2.0% alongside the US interest rate hike. In April, the Hong Kong Monetary Authority (HKMA) started buying Hong Kong dollars when the domestic currency fell to the weak-end of its trading band at HKD7.85 against the US dollar. It initially bought HKD816 million to reduce the aggregate balance of liquidity in the market to HKD179 billion. In a series of interventions that followed, the HKMA has mopped up a total of HKD51.3 billion from the market. The move to buy Hong Kong dollars is intended to further reduce the aggregate balance of liquidity and, in turn, raise local interest rates. Within a week of intervention, interest rates rose to their highest level since 2008.

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



Source: Based on data from Bloomberg LP.

Alongside the rise in yields, Hong Kong, China's gross domestic product expanded 4.7% year-on-year (y-o-y) in the first quarter (Q1) of 2018, up from 3.4% y-o-y growth in the fourth quarter of 2017. It was the fastest pace of growth since the second quarter of 2011, surpassing the high-end of the growth forecast of 4.0% for full-year 2018. The robust growth was driven by gains in exports of goods, which accelerated to 5.2% y-o-y in Q1 2018 from 3.4% y-o-y in the fourth quarter of 2017, and the resilient growth of domestic demand, which expanded 8.6% y-o-y versus 6.3% y-o-y over the same period.

Consumer prices rose 1.9% y-o-y in April, slower than the 2.6% y-o-y inflation rate in March, mainly due to smaller increases in package tour charges since the Easter holiday arrived in the earlier month. The government noted that inflationary pressures remained largely moderate in April. Inflation for the first 4 months of 2018 stood at 2.3% y-o-y.

Size and Composition

Hong Kong, China's LCY bonds outstanding reached HKD1,890 billion at the end of March, down 0.9% quarter-on-quarter (q-o-q), but up 2.1% y-o-y (**Table 1**). The q-o-q decline was due to contractions in both government and corporate bonds. On a y-o-y basis, the contraction in corporate bonds dampened the

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2017		Q4 2017		Q1 2018		Q1 2017		Q1 2018	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,852	238	1,907	244	1,890	241	1.1	12.5	(0.9)	2.1
Government	1,068	137	1,153	148	1,149	146	0.3	11.5	(0.4)	7.6
Exchange Fund Bills	919	118	1,011	129	1,014	129	0.4	14.8	0.3	10.4
Exchange Fund Notes	46	6	38	5	37	5	(4.6)	(18.4)	(2.6)	(20.0)
HKSAR Bonds	103	13	105	13	98	13	1.8	2.6	(6.3)	(4.7)
Corporate	784	101	754	96	741	94	2.2	13.9	(1.6)	(5.5)

() = 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.

Sources: Hong Kong Monetary Authority.

expansion in government bonds. At the end of March, government bonds accounted for 61.0% of total LCY bonds outstanding.

Government bonds. LCY government bonds outstanding amounted to HKD1,149 billion at the end of March, down 0.4% q-o-q, but up 7.6% y-o-y. The q-o-q slowdown was driven by decreases in Hong Kong Special Administrative Region (HKSAR) bonds and Exchange Fund Notes (EFNs). The expansion was driven by Exchange Fund Bills (EFBs), which rose 0.3% q-o-q and 10.4% y-o-y to reach HKD1,104 billion at the end of March.

The amount of EFNs outstanding continued to decline in Q1 2018, down 2.6% q-o-q and 20.0% y-o-y, falling to HKD37 billion at the end of March due to a lack of issuance since EFNs became limited to a maturity of 2 years.

HKSAR bonds fell 6.3% q-o-q and 4.7% y-o-y in Q1 2018, totaling HKD98 billion at the end of March as total issuance in Q1 2018 reached HKD1.8 billion. In Q1 2018, the government issued two HKSAR bonds, one valued at HKD600 million with a 15-year tenor and the other valued at HKD1.2 billion with a 10-year tenor, under the Institutional Bond Issuance Programme.

Corporate bonds. The amount of LCY corporate bonds outstanding totaled HKD741 billion at the end of March, down 1.6% q-o-q and 5.5% y-o-y in Q1 2018. Hong Kong, China's top 30 nonbank corporate issuers had LCY outstanding bonds amounting to HKD186 billion at the

end of March, accounting for 25.1% of total corporate bonds outstanding (**Table 2**). Real estate firms continued to dominate the corporate market, comprising one-third of the top 30. The Hong Kong Mortgage Corporation remained the top issuer with outstanding bonds of HKD31.7 billion at the end of March, followed by Sun Hung Kai Properties with HKD12.4 billion and MTR Corporation with HKD11.5 billion. Among the top 30, 4 were state-owned banks and 21 were listed on the Hong Kong Stock Exchange.

Among the top five nonbank corporate issuers in Q1 2018, the Hong Kong Mortgage Corporation still took the lead with 14 issuances, the largest of which was a HKD1.9 billion bond (**Table 3**). Haitong International Securities, a financing firm, was second. It was followed by two special purpose vehicles, Henderson Land Development and Wharf Real Estate Investment Company, and Huajin Holdings, an investment holdings firm.

Policy, Institutional, and Regulatory Developments

HKMA Announces Details of the Pilot Bond Grant Scheme

On 10 May, the HKMA issued a circular on the eligibility criteria for the 3-year Pilot Bond Grant Scheme (PBGS), which seeks to attract local, People's Republic of China-based, and overseas enterprises to issue bonds in Hong Kong, China. The PBGS is set to be launched upon the completion of the legislative process for the 2018/19

Table 2: Top 30 Nonbank Corporate Issuers of Local Currency Corporate Bonds 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	31.66	4.03	Yes	No	Finance
2.	Sun Hung Kai Properties (Capital Market)	12.40	1.58	No	Yes	Real Estate
3.	MTR Corporation	11.50	1.46	Yes	Yes	Transportation
4.	The Hong Kong and China Gas Company	11.04	1.41	No	Yes	Utilities
5.	New World Development	9.41	1.20	No	Yes	Diversified
6.	Swire Pacific	8.67	1.10	No	Yes	Diversified
7.	Hong Kong Land	8.59	1.09	No	No	Real Estate
8.	Link Holdings	8.53	1.09	No	No	Finance
9.	CLP Power Hong Kong Financing	7.81	0.99	No	No	Finance
10.	The Wharf (Holdings)	7.62	0.97	No	Yes	Finance
11.	Haitong International Securities Group	7.12	0.91	No	Yes	Finance
12.	Swire Properties	5.93	0.76	No	Yes	Real Estate
13.	Hongkong Electric	5.84	0.74	No	No	Utilities
14.	China Merchants Port Holdings	5.70	0.73	No	Yes	Transportation
15.	Hang Lung Properties	4.61	0.59	No	Yes	Real Estate
16.	CK Asset Holdings	4.20	0.53	No	Yes	Real Estate
17.	Henderson Land Development	4.15	0.53	No	No	Real Estate
18.	Kowloon-Canton Railway	3.40	0.43	Yes	No	Transportation
19.	FDG Electric Vehicles	2.89	0.37	No	Yes	Energy
20.	Urban Renewal Authority	2.80	0.36	Yes	No	Real Estate
21.	Emperor International Holdings	2.60	0.33	No	Yes	Real Estate
22.	CK Hutchison Holdings	2.50	0.32	No	Yes	Diversified
23.	China Dynamics (Holdings)	2.36	0.30	No	Yes	Diversified
24.	Hysan Development Company	2.30	0.29	No	Yes	Real Estate
25.	ASM Pacific Technology	2.25	0.29	No	Yes	Technology
26.	The 13 Holdings	2.22	0.28	No	Yes	Industrial
27.	Green Leader Holdings Group	2.18	0.28	No	Yes	Diversified
28.	Gluon Xima International	2.00	0.25	No	No	Real Estate
29.	China Agri-Products Exchange	1.99	0.25	No	Yes	Consumer, non-cyclical
30.	Cathay Pacific Airways	1.98	0.25	No	Yes	Transportation
Total Top 30 Nonbank LCY Corporate Issuers		186.21	23.72			
Total LCY Corporate Bonds		741.28	94.45			
Top 30 as % of Total LCY Corporate Bonds		25.1%	25.1%			

LCY = local currency.

Notes:

1. Data as of 31 March 2018.

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

Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 3: Notable Local Currency Corporate Bond Issuance in the First Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
The Hong Kong Mortgage Corporation			Haitong International Securities		
3-month bond	0.78	0.54	1-year bond	0.00	1.30
3-month bond	0.78	0.42	1-year bond	2.51	0.78
3-month bond	0.00	0.28	1-year bond	2.80	0.54
3-month bond	0.00	0.23	1-year bond	2.37	0.28
3-month bond	0.00	0.12	1-year bond	2.65	0.20
1-year bond	1.60	1.00	Henderson Land Development		
1-year bond	1.38	0.78	7-year bond	3.09	0.48
2-year bond	1.74	1.00	10-year bond	3.58	0.30
2-year bond	1.83	0.17	10-year bond	3.63	0.29
3-year bond	1.26	1.90	10-year bond	3.43	0.25
3-year bond	1.79	1.00	12-year bond	3.62	0.20
3-year bond	2.05	0.54	Wharf Real Estate Investment Company		
4-year bond	2.29	0.10	7-year bond	2.95	0.50
7-year bond	2.59	0.30	7-year bond	2.95	0.50
			10-year bond	3.07	0.50
			10-year bond	3.10	0.50
			Huajun Holdings		
			4-year bond	10.22	0.22

HKD = Hong Kong dollar.
Source: Bloomberg LP.

budget. Key eligibility criteria of the PBGS include the following:

- (i) Eligible issuers are first-time issuers who have not issued bonds in Hong Kong, China in the 5-year period between 10 May 2013 and 9 May 2018, both days inclusive.
- (ii) To be eligible, the bond must be issued in Hong Kong, China and have an issuance size of at least HKD1.5 billion (or the equivalent in foreign currency); it should be lodged with and cleared by the Central Moneymarkets Units or listed on the Hong Kong Stock Exchange, and should be issued to at least 10 persons (or fewer than 10 persons if none of them are an associate of the issuer).
- (iii) The grant amount for each bond issue is equivalent to half of the eligible issuance expenses with a limit of HKD2.5 million if the bond, its issuer, or guarantors have received a credit rating from a rating agency recognized by the HKMA; or HKD1.25 million if none of the bond, its issuer, or guarantors have a credit rating. Each issuer can apply for a grant for two bond issuances at most.

HKMA Supports Enhancements to the QDI Scheme

In a press release in May, the HKMA announced that it is working with the Government of the Special Administrative Region of Hong Kong, China on enhancements to the Qualifying Debt Instrument (QDI) Scheme. The enhancements include expanding the 100% profits tax exemption coverage from debt instruments with an original maturity of at least 7 years to instruments of any duration; and to allow debt instruments listed on the Hong Kong Stock Exchange to become eligible as a QDI in addition to those lodged and cleared by the Central Moneymarkets Unit.

HKMA Pursuing a Green Bond Initiative

In the same press release, the HKMA also announced that it has appointed an advisor to study relevant issues and report its findings on green finance in Hong Kong, China and the government's first green bond issuance. The HKMA declared that it stands ready to assist the government by selecting arrangers to issue the inaugural green bond.