

Hong Kong, China

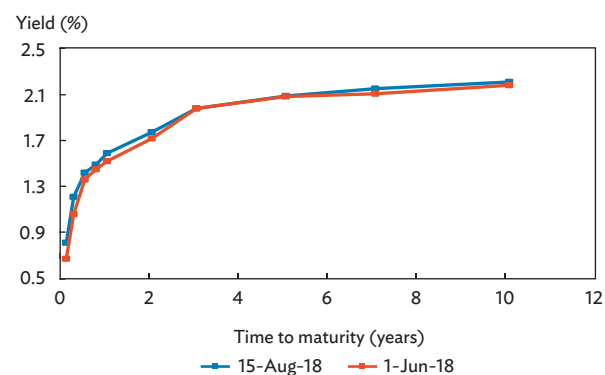
Yield Movements

Hong Kong, China's local currency (LCY) government bond yield curve slightly shifted upward as yields for all tenors, except the 3-year tenor, rose marginally between 1 June and 15 August (**Figure 1**). Yields for shorter-dated bonds (1 year or less) rose an average of 9 basis points (bps) compared with yields for longer-dated bonds (2 years or more), which, excluding the 3-year tenor, rose an average of 3 bps, causing the yield curve to climb steeply at the shorter-end and flatten toward the longer-end. Consequently, the yield spread between the 2-year and 10-year tenors narrowed to 44 bps on 15 August from 46 bps on 1 June.

The movements in Hong Kong, China's bond yields closely track the movements of United States (US) Treasury yields due to the Linked Exchange Rate System under which the Hong Kong dollar is pegged to the US dollar. In June, the Hong Kong Monetary Authority (HKMA) raised its base rate by 25 bps to 2.25% following a 25-bps hike in the target range for the US federal funds rate. In August, the weak-end of the trading band of HKD7.85 against the US dollar was triggered for the third time since April, prompting the HKMA to sell US dollars in exchange for HKD2.2 billion dollars to reduce the Aggregate Balance to HKD107.2 billion. As a result, the Hong Kong Interbank Offered Rate (HIBOR) gradually increased, bringing interbank liquidity down and, in turn, limiting capital outflows.

The rise of the yield curve was accompanied by a slowdown in the local economy. Hong Kong, China's gross domestic product (GDP) in the second quarter (Q2) of 2018 rose 3.5% year-on-year (y-o-y), decelerating from 4.6% y-o-y GDP growth in the first quarter (Q1) of 2018, due to a slowdown in the growth of goods exports and domestic demand. Exports of goods rose 4.6% y-o-y, decelerating from growth of 5.2% y-o-y in Q1 2018, as the impact of the rising trade conflict between the People's Republic of China (PRC) and the US became more pronounced in the export performance of Hong Kong, China in June. Domestic demand rose 6.1% y-o-y, decelerating from 8.8% y-o-y growth in the previous quarter. On a seasonally adjusted quarter-on-quarter (q-o-q) basis, GDP contracted 0.2% in Q2 2018 after an expansion of 2.1% in Q1 2018.

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



Source: Based on data from Bloomberg LP.

Consumer prices rose 2.4% y-o-y in June, up from 2.1% y-o-y in May, due to increases in private housing rentals, prices of saltwater fish, and charges for package tours. The government noted that robust economic conditions, in general, steered prices higher in June. Inflation held steady in July at 2.4% y-o-y.

Size and Composition

Hong Kong, China's LCY bonds outstanding grew in Q2 2018 on both a q-o-q and y-o-y basis to reach HKD1,929 billion (USD246 billion) at the end of June (**Table 1**). Q-o-q growth was 2.1%, reversing the 0.9% q-o-q decline in Q1 2018, driven by growth in both government and corporate bonds. Y-o-y growth was 3.6%, accelerating from the 2.1% y-o-y growth in the previous quarter, solely driven by growth in government bonds. During the review period, the LCY bond market comprised about 60% government bonds and 40% corporate bonds.

Government bonds. LCY government bonds outstanding amounted to HKD1,159 billion at the end of June, up 0.8% q-o-q in Q2 2018, reversing the 0.4% q-o-q decline in Q1 2018, and 7.6% y-o-y, maintaining the previous quarter's y-o-y growth rate. Q-o-q growth in government bonds were mostly accounted for by Hong Kong Special Administrative Region (HKSAR) bonds, while y-o-y growth was solely driven by the strong issuance of Exchange Fund Bills (EFBs). The aggregate amount of

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2017		Q1 2018		Q2 2018		Q2 2017		Q2 2018	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,862	239	1,890	241	1,929	246	0.6	6.1	2.1	3.6
Government	1,076	138	1,149	146	1,159	148	0.8	6.3	0.8	7.6
Exchange Fund Bills	923	118	1,014	129	1,019	130	0.4	7.4	0.5	10.4
Exchange Fund Notes	43	6	37	5	35	4	(6.5)	(19.5)	(4.9)	(18.6)
HKSAR Bonds	111	14	98	13	105	13	7.5	10.2	6.6	(5.5)
Corporate	786	101	741	94	771	98	0.2	5.9	3.9	(2.0)

() = negative, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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.

government bonds outstanding at the end of the review period was predominantly composed of EFBs.

Exchange Fund Bills. EFBs outstanding amounted to HKD1,019 billion at the end of June, accounting for about 88% of the aggregate government bond market and growing at a pace of 0.5% q-o-q and 10.4% y-o-y. Issuance of EFBs reached HKD805 billion at the end of June.

Exchange Fund Notes. Exchange Fund Notes outstanding continued to decline in Q2 2018 dropping to HKD35 billion at the end of June, down 4.9% q-o-q and 18.6% y-o-y.

HKSAR bonds. HKSAR bonds outstanding amounted to HKD105 billion at the end of June, up 6.6% q-o-q but down 5.5% y-o-y. In Q2 2018, the government issued two HKSAR bonds, valued at HKD4 billion with a 3-year tenor and the other valued at HKD2.5 billion with a 5-year tenor, under the Institutional Bond Issuance Programme.

Corporate bonds. The amount of corporate bonds outstanding totaled HKD771 billion at the end of June, up 3.9% q-o-q but down 2.0% y-o-y. Hong Kong, China's top 30 nonbank corporate issuers had LCY outstanding bonds amounting to HKD202 billion at the end of June, accounting for 26.3% of the total corporate bonds outstanding (**Table 2**). In the lead was Hong Kong Mortgage Corporation with an outstanding amount of HKD29 billion. Real estate firms dominated the list, comprising more than one-third of the top 30, followed by financing firms. Of the top 30, two-thirds were listed

on the Hong Kong Stock Exchange and four were state-owned corporations.

In Q2 2018, the top five nonbank issuances came from the government, financial firms, and a real estate company. Government-owned Hong Kong Mortgage Corporation remained the top corporate issuer with 13 issuances (**Table 3**). Haitong International Securities, a financing firm, came in second with six issuances, two of which were the largest issuances for the period, amounting to HKD1.5 billion each. LT Commercial Real Estate was third, followed by financing firms AIA Group and Value Success International.

Policy, Institutional, and Regulatory Developments

People's Bank of China Enhances Cross-Border Fund Flow Management

In May, the People's Bank of China announced a series of measures to enhance cross-border fund flow management. These include enhancing the existing policy framework to allow offshore renminbi business-clearing banks and participating banks to tap renminbi liquidity from the onshore market to support offshore renminbi business development, implementing the central bank's bilateral currency swap agreements, adjusting the required reserve ratio of renminbi deposits placed by Hong Kong, China's renminbi business-clearing bank in the settlement account in People's Bank of China's Shenzhen subbranch to 0%, and further enhancing the currency conversion

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	28.51	3.63	Yes	No	Finance
2.	Haitong International Securities Group	13.26	1.69	No	Yes	Finance
3.	Sun Hung Kai & Co.	12.90	1.64	No	Yes	Real Estate
4.	MTR Corporation	12.49	1.59	Yes	Yes	Transportation
5.	The Hong Kong and China Gas Company	11.34	1.44	No	Yes	Utilities
6.	Hong Kong Land	9.69	1.23	No	No	Real Estate
7.	New World Development	9.41	1.20	No	Yes	Diversified
8.	The Wharf (Holdings)	9.07	1.16	No	Yes	Finance
9.	CLP Power Hong Kong Financing	8.81	1.12	No	No	Finance
10.	Swire Pacific	8.57	1.09	No	Yes	Diversified
11.	Link Holdings	7.95	1.01	No	No	Finance
12.	Henderson Land Development	6.63	0.85	No	No	Real Estate
13.	Swire Properties	5.93	0.76	No	Yes	Real Estate
14.	Hongkong Electric	5.84	0.74	No	No	Utilities
15.	China Merchants Port Holdings	5.70	0.73	No	Yes	Transportation
16.	Hang Lung Properties	4.61	0.59	No	Yes	Real Estate
17.	Value Success International	4.25	0.54	No	No	Finance
18.	CK Asset Holdings	4.20	0.53	No	Yes	Real Estate
19.	AlA Group	3.90	0.50	No	Yes	Insurance
20.	IFC Development Corporation	3.50	0.45	No	No	Finance
21.	Kowloon-Canton Railway	3.40	0.43	Yes	No	Transportation
22.	LT Commercial Real Estate	3.02	0.38	No	Yes	Real Estate
23.	Urban Renewal Authority	2.80	0.36	Yes	No	Real Estate
24.	Emperor International Holdings	2.60	0.33	No	Yes	Real Estate
25.	Wharf Real Estate Investment	2.59	0.33	No	Yes	Real Estate
26.	CK Hutchison Holdings	2.50	0.32	No	Yes	Diversified
27.	China Dynamics (Holdings)	2.36	0.30	No	Yes	Diversified
28.	ASM Pacific Technology	2.25	0.29	No	Yes	Technology
29.	The 13 Holdings	2.22	0.28	No	Yes	Industrial
30.	Hysan Development	2.15	0.27	No	Yes	Real Estate
Total Top 30 Nonbank LCY Corporate Issuers		202.42	25.80			
Total LCY Corporate Bonds		770.55	98.20			
Top 30 as % of Total LCY Corporate Bonds		26.27%	26.27%			

LCY = local currency.

Notes:

1. Data as of 30 June 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 Second 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	0.00	0.55	6-month bond	0.00	1.00
3-month bond	1.30	0.62	6-month bond	0.00	1.50
3-month bond	0.00	0.08	1-year bond	2.70	0.45
3-month bond	0.00	0.45	1-year bond	2.00	0.35
1-year bond	1.89	0.43	1-year bond	2.10	0.34
1-year bond	1.84	0.29	1-year bond	0.00	1.50
1-year bond	2.02	0.38	LT Commercial Real Estate		
2-year bond	1.69	1.00	3-year bond	2.00	4.00
2-year bond	1.69	0.30	AIA Group		
2.5-year bond	2.18	0.30	3-year bond	2.76	3.90
3-year bond	2.29	0.30	Value Success International		
3-year bond	2.31	0.35	1-year bond	2.65	1.50
10-year bond	2.69	0.40	1-year bond	2.50	1.20

HKD = Hong Kong dollar.
Source: Bloomberg LP.

mechanism for Shanghai–Hong Kong Stock Connect and Shenzhen–Hong Kong Stock Connect to facilitate overseas investors’ use of renminbi and foreign currencies for investments. The changes were well received by the HKMA, which believes the new measures will ensure smooth offshore market operations and support Hong Kong, China’s development as the global offshore renminbi business hub.

Government Increases Shareholding in HKEx to 6.0%

In June, the government increased its shareholding with the Hong Kong Exchanges and Clearing Limited (HKEx) for the exchange fund account to 6.0%, a modest and limited increase from 5.88% in September 2007. Exchange fund shareholding is the government’s approach to contribute to the development of the HKEx, particularly in strategic partnerships and linkages with other institutions in the region.

HKMA Co-Hosts the 2018 Green and Social Bond Principles Annual General Meeting and Conference

In cooperation with the International Capital Market Association, the HKMA hosted the 2018 Green and Social Bond Principles Annual General Meeting and Conference in Hong Kong, China in June. The flagship event, which was held for the first time in Asia, signified the growing influence of the region in the development of green bonds and sustainable finance, and recognized Hong Kong, China’s status as an international financial center. The conference focused on developing the global green, social, and sustainability bond markets, and on the convergence toward market-based global standards. The 2018 update of the Green Bond Principles, Social Bond Principles, and Sustainability Bond Guidelines, along with publications providing guidance to further strengthen and interconnect the market ecosystem, is expected to be released following the conference.