

Hong Kong, China

Yield Movements

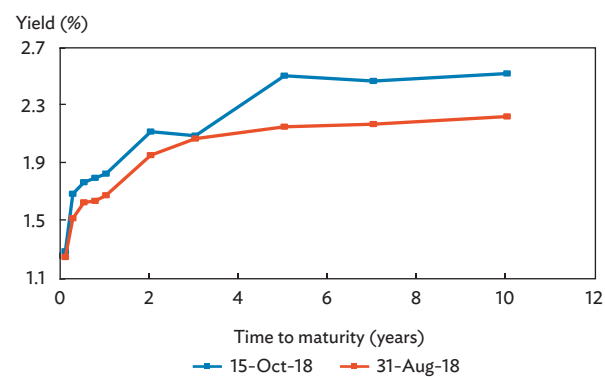
Between 31 August and 15 October, Hong Kong, China's local currency (LCY) government bond yield curve shifted upward as yields rose for all tenors (**Figure 1**). Excluding the 1-month tenor, yields for shorter-dated bonds (2 years or less) rose an average of 16 basis points (bps). Excluding the 3-year tenor, yields for longer-dated bonds (5 years or more) rose an average of 33 bps. The marginal increase of 2 bps in yields for 3-year bonds led the yield curve to gradually rise at the shorter-end, take a dip near the belly (3-year), and climb steeply toward the longer-end. With longer-dated bonds rising faster than shorter-dated bonds, the yield spread between the 2-year and 10-year tenors widened to 40 bps on 15 October from 27 bps on 31 August. The movements in Hong Kong, China's bond yields closely track the movements of United States (US) Treasury yields as the Hong Kong dollar is pegged to the US dollar. During the review period, US yields rose for all tenors, rendering the US Treasury yield curve to, likewise, shift upward.

In September, the Hong Kong Monetary Authority (HKMA) raised its base rate by 25 bps to 2.50% following a 25-bps hike in the target range for the US federal funds rate.

In contrast to the rise of the yield curve, Hong Kong, China's gross domestic product growth moderated in the second quarter (Q2) of 2018 to 3.5% year-on-year (y-o-y) from 4.6% y-o-y in the previous quarter due to a slowdown in goods exports and domestic demand. On a seasonally adjusted quarter-on-quarter (q-o-q) basis, gross domestic product contracted 0.2% in Q2 2018 after an expansion of 2.1% in the first quarter. In September, the growth of exports of goods decelerated to 4.5% y-o-y from 13.1% y-o-y in August as the impacts of the trade conflict between the People's Republic of China (PRC) and the US became more apparent.

Inflation in September rose to 2.7% y-o-y from 2.3% y-o-y in August. The upward adjustment in public housing rentals mainly contributed to the faster rise in inflation during the month. On a seasonally adjusted month-on-month basis, however, the average inflation rate from July to September held steady at 0.2%.

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 bond market continued to expand through the third quarter (Q3) of 2018 to reach a size of HKD1,955 billion (USD250 billion) at the end of September (**Table 1**). Growth moderated to 1.4% q-o-q from 2.1% q-o-q in Q2 2018. Growth was driven by the rise in stock of corporate bonds. Year-on-year (y-o-y) growth was 3.6%, maintaining the previous quarter's y-o-y growth and driven by expansion in both the government and corporate bond segments. At the end of September, the LCY bond market comprised 59% government bonds and 41% corporate bonds.

Government bonds. LCY government bonds outstanding amounted to HKD1,154 billion at the end of September, down 0.4% q-o-q, but up 3.4% y-o-y. Contractions in Hong Kong Special Administrative Region (HKSAR) bonds and Exchange Fund Notes (EFNs) led to the q-o-q decline, but the strong issuance of Exchange Fund Bills (EFBs) kept y-o-y growth afloat. The aggregate amount of government bonds outstanding at the end of the review period predominantly comprised EFBs.

Exchange Fund Bills. EFBs outstanding amounted to HKD1,024 billion at the end of September, accounting for 89% of the aggregate government bond market. Q-o-q growth was 0.5%, the same as the previous quarter's growth rate, while annual growth decelerated to 5.2% from

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,887	242	1,929	246	1,955	250	1.3	3.0	1.4	3.6
Government	1,116	143	1,159	148	1,154	147	3.7	4.6	(0.4)	3.4
Exchange Fund Bills	974	125	1,019	130	1,024	131	5.5	6.9	0.5	5.2
Exchange Fund Notes	41	5	35	4	34	4	(5.1)	(20.3)	(2.9)	(16.7)
HKSAR Bonds	101	13	105	13	96	12	(8.5)	(3.8)	(7.9)	(4.9)
Corporate	771	99	771	98	801	102	(2.0)	0.9	3.9	3.9

() = negative, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third 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. Corporate bonds for Q3 2018 are based on *AsianBondsOnline* estimates.

Sources: Hong Kong Monetary Authority.

10.4% in Q2 2018. With more bills maturing, despite the strong level of issuance during the period, issuance of EFBs reached HKD810 billion at the end of September. The HKMA has been strongly issuing EFBs to replace maturing EFNs in order to maintain the overall size of Exchange Fund papers since issuance of EFNs became limited to the 2-year tenor.

Exchange Fund Notes. EFNs outstanding continued to decline in Q3 2018, dropping to HKD34 billion at the end of September, down 2.9% q-o-q and 16.7% y-o-y. Issuance of EFNs has been limited to the 2-year tenor since January 2015 in order to minimize overlap in longer tenors of HKSAR bonds, leading to fewer issuances of notes. Only one EFN valued at HKD1.2 billion was issued between July and September.

HKSAR bonds. HKSAR bonds outstanding amounted to HKD96 billion at the end of September, down 7.9% q-o-q, reversing the 6.6% q-o-q growth in Q2 2018, and down 4.9% y-o-y after falling 5.5% y-o-y in Q2 2018. In Q3 2018, two HKSAR bonds were issued under the Institutional Bond Issuance Programme, one valued at HKD1.2 billion with a 10-year tenor and the other valued at HKD600 million with a 15-year tenor.

Corporate bonds. Corporate bonds outstanding amounted to HKD801 billion at the end of September,

up 3.9% on both a q-o-q and y-o-y basis. Hong Kong, China's top 30 nonbank corporate issuers had LCY outstanding bonds amounting to HKD205 billion at the end of September, accounting for 25.9% of the total corporate bond market (**Table 2**). Financial firms took the top three spots. Government-owned Hong Kong Mortgage Corporation, the top issuer since the start of the year, had outstanding bonds of HKD31 billion. A distant second was Sun Hung Kai & Co. with an outstanding amount of HKD14 billion, followed by Haitong International Securities Group with an outstanding amount of HKD12 billion. The top 30 list was dominated by firms coming from real estate and finance industries. Of the top 30, two-thirds are listed on the Hong Kong Stock Exchange and four are state-owned corporations.

In Q3 2018, notable nonbank issuances came from a state-owned entity, a real estate company, and financial firms. Hong Kong Mortgage Corporation remained the top issuer with an aggregate issuance amount of HKD5 billion, but the largest issuance was a 10-year bond worth HKD2 billion from real estate company CK Asset Holdings through CK Property Finance MTN (**Table 3**). Financing firms Sun Hung Kai & Co. and Haitong International Securities Group were the other two top issuers with aggregate issuance amounts of HKD1.9 billion and HKD1.4 billion, respectively.

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.	Hong Kong Mortgage Corporation	31.30	4.00	Yes	No	Finance
2.	Sun Hung Kai & Co.	13.75	1.76	No	Yes	Finance
3.	Haitong International Securities Group	12.39	1.58	No	Yes	Finance
4.	MTR Corporation	12.24	1.56	Yes	Yes	Transportation
5.	The Hong Kong and China Gas Company	11.61	1.48	No	Yes	Utilities
6.	The Wharf (Holdings)	9.90	1.26	No	Yes	Finance
7.	Hong Kong Land	9.69	1.24	No	No	Real Estate
8.	New World Development	9.41	1.20	No	Yes	Diversified
9.	CLP Power Hong Kong Financing	8.81	1.12	No	No	Finance
10.	Swire Pacific	7.94	1.01	No	Yes	Diversified
11.	Link Holdings	7.44	0.95	No	No	Finance
12.	Henderson Land Development	7.23	0.92	No	No	Real Estate
13.	CK Asset Holdings	6.20	0.79	No	Yes	Real Estate
14.	Swire Properties	5.93	0.76	No	Yes	Real Estate
15.	Hongkong Electric	5.84	0.75	No	No	Utilities
16.	China Merchants Port Holdings	5.70	0.73	No	Yes	Transportation
17.	Hang Lung Properties	4.61	0.59	No	Yes	Real Estate
18.	AIA Group	3.90	0.50	No	Yes	Insurance
19.	IFC Development Corporation	3.50	0.45	No	No	Finance
20.	Kowloon-Canton Railway	3.40	0.43	Yes	No	Transportation
21.	LT Commercial Real Estate	3.02	0.39	No	Yes	Real Estate
22.	Urban Renewal Authority	2.80	0.36	Yes	No	Real Estate
23.	Emperor International Holdings	2.60	0.33	No	Yes	Real Estate
24.	Wharf Real Estate Investment	2.59	0.33	No	Yes	Real Estate
25.	Champion REIT	2.54	0.32	No	Yes	Real Estate
26.	China Dynamics (Holdings)	2.36	0.30	No	Yes	Diversified
27.	ASM Pacific Technology	2.25	0.29	No	Yes	Technology
28.	The 13 Holdings	2.22	0.28	No	Yes	Industrial
29.	Hysan Development Company	2.15	0.27	No	Yes	Real Estate
30.	CK Hutchison Holdings	2.00	0.26	No	Yes	Diversified
30.	Gluon Xima International	2.00	0.26	No	No	Real Estate
Total Top 30 Nonbank LCY Corporate Issuers		207.30	26.48			
Total LCY Corporate Bonds		800.98	102.32			
Top 30 as % of Total LCY Corporate Bonds		25.9%	25.9%			

LCY = local currency.

Notes:

1. Data as of 30 September 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 Third Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Hong Kong Mortgage Corporation		
3-month bond	0.00	0.93
3-month bond	0.00	0.75
3-month bond	1.50	0.62
3-month bond	1.69	0.48
3-month bond	1.54	0.45
3-month bond	1.49	0.39
3-month bond	0.00	0.35
3-month bond	0.00	0.35
5-month bond	1.80	0.20
3-month bond	0.00	0.20
3-month bond	1.70	0.20
3-month bond	0.00	0.20
3-month bond	1.61	0.13
3-year bond	2.63	0.07
1-year bond	2.05	0.06
CK Asset Holdings		
10-year bond	3.57	2.00
Sun Hung Kai & Co.		
10-year bond	3.51	0.35
10-year bond	3.55	0.33
10-year bond	3.55	0.30
10-year bond	3.55	0.30
5-year bond	3.35	0.30
5-year bond	3.25	0.30
Haitong International Securities Group		
1-year bond	3.00	0.80
1-year bond	3.16	0.23
1-year bond	3.39	0.21
1-year bond	3.00	0.20

HKD = Hong Kong dollar.
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

Delivery-versus-Payment Settlement Fully Implemented in Bond Connect

In August, delivery-versus-payment settlement was fully implemented under the Bond Connect program. This mechanism allows for the payment and delivery of securities in real time, reduces settlement risks,

and facilitates settlement efficiency, providing more convenience to international investors through Bond Connect.

HKMA Includes CNY-Denominated Bills in List of Eligible Collateral for Renminbi Liquidity Facility

In September, the HKMA expanded the list of eligible collateral for the Renminbi Liquidity Facility to include CNY-denominated bills issued in Hong Kong, China by the People's Bank of China. In a memorandum signed by the two government bodies, tendering and issuance of People's Bank of China bills will be done through the HKMA Central Moneymarkets Unit's bond tendering platform.

Launch of the Hong Kong Green Finance Association

In September, the Hong Kong Green Finance Association was officially launched at the Green Finance Forum held at the Hong Kong Stock Exchange. The association aims to provide greater access and opportunities for Hong Kong, China's financial institutions to participate in green financing transactions locally, in the PRC, and in markets included in the Belt and Road Initiative. It seeks to position Hong Kong, China as a leading international green finance hub in line with the global trend of implementing the United Nations' Sustainable Development Goals and the Paris Agreement.

The PRC Issues Renminbi Sovereign Bonds through HKMA

In October, the Ministry of Finance of the PRC issued two renminbi sovereign bonds through the HKMA's Central Moneymarkets Unit; this follows the issuance of two renminbi sovereign bonds in July. The first additional bond worth CNY3.0 billion and with a coupon rate of 3.65% will be consolidated with a CNY3.0 billion bond issued on 9 July and due in 2020. The second additional bond worth CNY1.5 billion and with a coupon rate of 3.8% will be consolidated with a CNY1.7 billion bond issued on 9 July and due in 2030.