

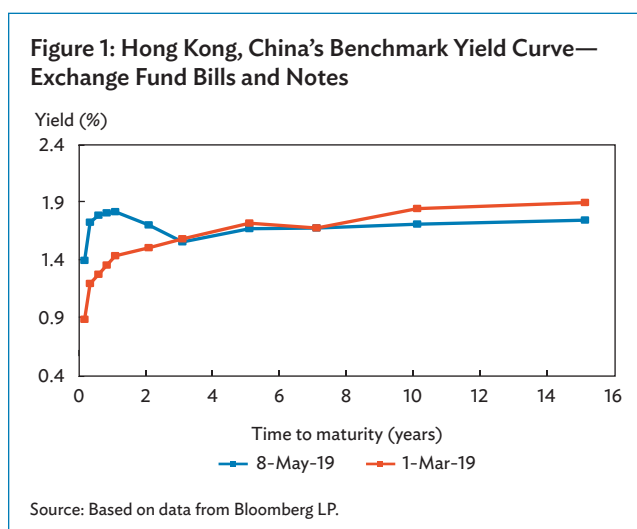
Hong Kong, China

Yield Movements

Hong Kong, China's local currency (LCY) government bond yield curve exhibited mixed movements between 1 March and 8 May (**Figure 1**). For bonds with maturities of 2 years or less, yields rose an average of 43 basis points (bps), with the 2-year tenor posting the smallest gain at 20 bps. For bonds with maturities of 10 years or more, yields fell an average of 14 bps. Yields barely moved between the 3-year and 7-year tenor, falling an average of 4 bps for 3-year and 5-year tenors, and rising less than 1 bp for 7-year bonds. The slight decline in yields for bonds with tenors between 3 years and 7 years drove the yield curve down sharply in the belly, from a steep climb at the short-end until it flattened toward the long-end. The gap between the 2-year and 10-year tenors closed to less than 1 bp.

Despite Hong Kong, China's policy rate being in lockstep with the United States (US) Federal Reserve rate to maintain its currency peg to the US dollar, the market's yield curve has not been moving in sync with the US Treasury yield curve. Weaker demand for loans, caused by a cooling property market and lack of appetite to invest amid trade tensions between the People's Republic of China (PRC) and the US, caused the interbank rate for Hong Kong dollars to rise at a slower pace than the interbank rate for US dollars, leaving banks with excess liquidity and negatively affecting the value of the Hong Kong dollar. To prop up the domestic currency and raise borrowing costs, the Hong Kong Monetary Authority (HKMA) purchased HKD22.1 billion (USD2.8 billion) worth of Hong Kong dollar when it repeatedly fell to the weak-end of its trading band in March. The intervention reduced the aggregate balance to around HKD55 billion, resulting in tighter liquidity in the market. The Hong Kong Interbank Offered Rate rose, easing pressure on the Hong Kong dollar. Yields for shorter-dated bonds also rose, causing the yield curve to steepen at the short-end.

The lackluster yield performance of longer-dated bonds reflected Hong Kong, China's slowing economy. Gross domestic product growth eased to 0.6% year-on-year (y-o-y) in the first quarter (Q1) of 2019 from 1.2% y-o-y in the fourth quarter (Q4) of 2018, weakened by a slowdown in external demand and investment. Merchandise exports



and imports fell 4.1% y-o-y and 4.7% y-o-y, respectively, while gross domestic fixed capital formation saw a decline of 7.1% y-o-y in Q1 2019. Private consumption rose only 0.2% y-o-y during the period.

Inflation in March was 2.1% y-o-y, maintaining its February pace but slowing from the average inflation rate for January–February, which according to the government was due to smaller increases in package tour charges caused by the timing of the Easter holiday, which arrived in April in 2019 versus March in 2018. The Easter holiday subsequently led to April's inflation rate accelerating to 2.9% y-o-y.

Size and Composition

Hong Kong, China's LCY bonds outstanding reached HKD1,960 billion at the end of March, up both on a quarter-on-quarter (q-o-q) and y-o-y basis in Q1 2019 (**Table 1**). Growth moderated to 0.5% q-o-q in Q1 2019 from 1.2% q-o-q in Q4 2018 due to a decline in the government bond segment coupled with marginal growth in the corporate bond segment. Growth climbed to 3.7% y-o-y in Q1 2019 from 2.3% y-o-y in Q4 2018, driven mainly by the corporate bond segment. Despite sluggish issuance in Q1 2019, government bonds continued to comprise the larger share of the bond market, accounting for 59.0% of total LCY bonds outstanding at the end of March.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2018		Q4 2018		Q1 2019		Q1 2018		Q1 2019	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,890	241	1,950	249	1,960	250	(0.9)	2.1	0.5	3.7
Government	1,149	146	1,169	149	1,161	148	(0.4)	7.6	(0.6)	1.1
Exchange Fund Bills	1,014	129	1,031	132	1,035	132	0.3	10.4	0.5	2.1
Exchange Fund Notes	37	5	32	4	31	4	(2.6)	(20.0)	(3.1)	(15.2)
HKSAR Bonds	98	13	106	14	95	12	(6.3)	(4.7)	(10.5)	(3.5)
Corporate	741	94	782	100	799	102	(1.6)	(5.5)	2.2	7.7

() = 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.

Source: Hong Kong Monetary Authority.

Government bonds. LCY government bonds outstanding amounted to HKD1,161 billion at the end of March. Contractions in both Exchange Fund Notes (EFNs) and Hong Kong Special Administrative Region (HKSAR) bonds outstanding in Q1 2019 caused the government bond market's growth to ease to 0.6% q-o-q from 1.2% q-o-q in the previous quarter and to grow at a slightly slower pace of 1.1% y-o-y versus 1.3% y-o-y in Q4 2018.

Exchange Fund Bills. Exchange Fund Bills outstanding amounted to HKD1,035 billion at the end of March, growing on both a q-o-q and y-o-y basis as issuance remained strong in the face of maturing bills, totaling HKD810 billion during the review period. However, due to maturities, the growth of Exchange Fund Bills was marginal in Q1 2019 at 0.5% q-o-q and 2.1% y-o-y.

Exchange Fund Notes. EFN outstanding continued their downward trend that has been in place since the HKMA started limiting the issuance of EFNs to 2-year tenors in 2015, falling 3.1% q-o-q and 15.2% y-o-y to HKD31 billion at the end of March. In February, the HKMA issued a 2-year EFN worth HKD1.2 billion.

HKSAR bonds. HKSAR bonds outstanding amounted to HKD95 billion at the end of March, down 10.5% q-o-q and 3.5% y-o-y, reversing growth of 9.8% q-o-q and 1.0% y-o-y in Q4 2018. In Q1 2019, the government issued a 10-year bond worth HKD1.5 billion and a 15-year bond worth HKD600 million under the Institutional Bond Issuance Programme.

Corporate bonds. Corporate bonds outstanding amounted to HKD799 billion at the end of March, growing 2.2% q-o-q after expanding 2.7% q-o-q in Q4 2018 and accelerating to 7.7% y-o-y growth from 3.7% y-o-y in Q4 2018. Hong Kong, China's top 30 nonbank corporate issuers together accounted for outstanding bonds of HKD212 billion, or 26.6% of total corporate bond market (**Table 2**). Government-owned financial firm Hong Kong Mortgage Corporation, the top issuer in Hong Kong, China, had outstanding bonds of HKD32.4 billion. It was followed by another financial firm, Sun Hung Kai & Co., with outstanding bonds of HKD16.9 billion, and MTR Corporation, a government-owned transport company, with outstanding bonds of HKD12.2 billion. The top 30 issuers were predominantly real estate companies and financing firms. Of the top 30 list, two-thirds are listed on the Hong Kong Stock Exchange and four are government-owned corporations.

Corporate issuances reached HKD108 billion in Q1 2019, or double the amount in Q4 2018. Among the top nonbank issuers in Q1 2019, government-owned Hong Kong Mortgage Corporation was the largest with aggregate issuance of HKD9.8 billion from 24 issuances, the largest of which was a zero-coupon, 5-year bond worth HKD1.0 billion. The next top issuer was Sun Hung Kai & Co. with aggregate issuance of HKD2.6 billion from five issuances. AIA Group, an insurance company, was the third-largest issuer and had the two single-largest bonds in Q1 2019. One was a 3.5-year bond worth HKD1.3 billion and carrying a 4.12% coupon, and the other was a 10-year bond worth HKD1.1 billion and carrying a 3.68% coupon.

Table 2: Top 31 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	32.4	4.1	Yes	No	Finance
2.	Sun Hung Kai	16.9	2.2	No	Yes	Finance
3.	MTR Corporation	12.2	1.6	Yes	Yes	Transportation
4.	Hong Kong Land	11.8	1.5	No	No	Real Estate
5.	The Hong Kong and China Gas Company	11.6	1.5	No	Yes	Utilities
6.	New World Development	9.4	1.2	No	Yes	Diversified
7.	Haitong International Securities Group	9.0	1.2	No	Yes	Finance
8.	CLP Power Hong Kong Financing	8.8	1.1	No	No	Finance
9.	The Wharf (Holdings)	8.6	1.1	No	Yes	Finance
10.	Henderson Land Development	7.7	1.0	No	No	Real Estate
11.	Swire Pacific	7.6	1.0	No	Yes	Diversified
12.	Link Holdings	7.4	0.9	No	No	Finance
13.	AIA Group	6.3	0.8	No	Yes	Insurance
14.	CK Asset Holdings	6.2	0.8	No	Yes	Real Estate
15.	Swire Properties	5.9	0.8	No	Yes	Real Estate
16.	Hongkong Electric	5.8	0.7	No	No	Utilities
17.	China Merchants Port Holdings	5.7	0.7	No	Yes	Transportation
18.	Hang Lung Properties	4.6	0.6	No	Yes	Real Estate
19.	IFC Development Corporation	3.5	0.4	No	No	Finance
20.	Kowloon-Canton Railway	3.4	0.4	Yes	No	Transportation
21.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
22.	Hysan Development Company	3.0	0.4	No	Yes	Real Estate
23.	Urban Renewal Authority	2.8	0.4	Yes	No	Real Estate
24.	Emperor International Holdings	2.6	0.3	No	Yes	Real Estate
25.	Wharf Real Estate Investment	2.6	0.3	No	Yes	Real Estate
26.	Champion REIT	2.5	0.3	No	Yes	Real Estate
27.	China Dynamics (Holdings)	2.4	0.3	No	Yes	Diversified
28.	The 13 Holdings	2.2	0.3	No	Yes	Industrial
29.	CK Hutchison Holdings	2.0	0.3	No	Yes	Diversified
30.	Gluon Xima International	2.0	0.3	No	No	Real Estate
31.	China Agri-Products Exchange	2.0	0.3	No	Yes	Consumer, non-cyclical
Total Top 30 Nonbank LCY Corporate Issuers		212.1	27.0			
Total LCY Corporate Bonds		798.7	101.7			
Top 30 as % of Total LCY Corporate Bonds		26.6%	26.6%			

LCY = local currency.

Notes:

1. Data as of 31 March 2019.

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 2019

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Hong Kong Mortgage Corporation		
3-month bond	0.00	0.66
5-year bond	0.00	1.00
30-year bond	3.15	0.58
Sun Hung Kai & Co.		
7-year bond	3.12	0.62
10-year bond	3.21	1.00
AIA Group		
3.5-year bond	2.95	1.30
12-year bond	3.68	1.10
Hong Kong Land		
15-year bond	3.67	0.60

HKD = Hong Kong dollar.
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

HKMA Maintains Countercyclical Capital Buffer at 2.5%

In April, the HKMA maintained its countercyclical capital buffer (CcyB) at 2.5%. The decision to keep the CcyB at its current rate was based on the significantly high level of credit to gross domestic product gap of 12%, despite the indicative buffer guide signaling a lower CCyB of 0.75%. This resulted from a recent narrowing of the property price-to-rental gap to slightly below 3% from more than 10% in the previous quarter. The CCyB, as an integral part of the Basel III regulatory capital framework, was designed to increase the resilience of the banking sector in periods of excess credit growth allowing the latter to act as a “shock absorber” in times of stress.

HKMA Launches Key Sustainable Banking and Green Finance Measures

In May, the HKMA launched three sets of measures to support and promote Hong Kong, China’s green finance development at the HKMA Green Finance Forum. These measures include (i) green and sustainable banking, (ii) responsible investment, and (iii) a Centre for Green Finance. Green and sustainable banking involves

developing a common framework to assess the “greenness baseline” of banks, engaging relevant stakeholders in consultations, and monitoring and evaluating banks’ progress in meeting targets. Responsible investment implies that the HKMA will adopt a principle to give priority to green and environmental investments and social and governance investments for which long-term returns are comparable to other investments on a risk-adjusted basis. The HKMA already supports responsible investment, including investing in the Managed Co-Lending Portfolio Programme of the International Finance Corporation, with a substantial part of this initiative targeting sustainable investments across emerging markets. The third measure involves the establishment of the Centre for Green Finance under the HKMA Infrastructure Financing Facilitation Office to serve as a platform for technical support and experience sharing for the green development of Hong Kong, China’s banking and finance industry.

Hong Kong, China Joins Green Bond Pledge

In May, Hong Kong, China became the first Asian signatory to the Green Bond Pledge, a pledge that calls on signatories to support long-term infrastructure and capital projects that address environmental impact and climate risk, and issue green bonds to finance a low-carbon transition. In line with the objectives of the pledge, the government stated that its Climate Action Plan 2030+ is targeted to reduce Hong Kong, China’s carbon intensity by 65%–70% below its 2005 level by 2030. This bond program encourages issuers to arrange financing for their green projects through capital markets in Hong Kong, China. Signing the pledge is among several ongoing efforts of the government to turn Hong Kong, China into a regional hub for green finance. The Green Bond Pledge is a joint initiative developed by international climate finance and sustainability groups including the Climate Bonds Initiative, Mission2020, Ceres, Cassa De Possiti e Prestiti, Citizens’ Climate Lobby, California Governor’s Office, California Treasurer’s Office, Global Optimism, Natural Resources Defense Council, and The Climate Group. It was launched by former United Nations climate chief Christiana Figueres at the Climate Bonds Annual Conference in March 2018.