

## Hong Kong, China

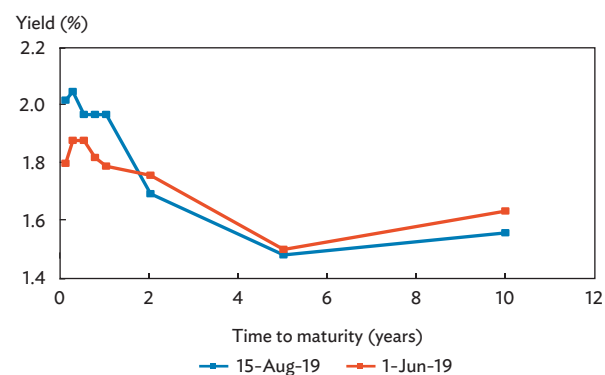
### Yield Movements

The local currency (LCY) government bond yield curve of Hong Kong, China showed unusual movement during the review period. Between 1 June and 15 August, the yield curve rose at the shorter-end but dropped for tenors with maturities of 2 years and longer. The yields of short-dated bonds with maturities below 2 years rose 16 basis points (bps) on average, with the 1-month tenor gaining the most at 22 bps. In contrast, yields fell for bonds with maturities of 2 years and longer. The 2-year tenor shed 6 bps and the 10-year tenor dropped 8 bps (**Figure 1**). The inverted yield curve has been in place since the middle of April, when the 10-year yield fell below the 2-year rate by 2 bps. By the end of the review period, the gap had widened, with the 2-year yield outpacing the 10-year yield by 14 bps.

The yield curve's inversion reflected heightened uncertainties and expectations of an economic slowdown. The political unrest that unfolded during the quarter added to the headwinds brought by the trade dispute between the People's Republic of China and the United States (US). The jump in yields on short-dated bonds reflected tightened liquidity. The Hong Kong Monetary Authority's (HKMA) defense of the currency in the previous quarter reduced the aggregate balance of interbank liquidity to HKD54.3 billion (USD6.9 billion) at the beginning of the review period from HKD76.5 billion (USD9.8 billion) at the beginning of the year. Demand for cash surged during the review period, due to funding needs for companies' mid-year dividend payments and investors' anticipation of high-profile initial public offerings. The uncertainties brought by political protests gave rise to outflow concerns, increasing financial institutions' demand for liquid assets. The dwindling liquidity pushed the Hong Kong Interbank Offered Rate higher, causing bond yields to rise at the shorter-end of the curve.

Falling yields on longer-dated bonds followed a global trend that followed a series of policy rate cuts undertaken by major central banks during the quarter. In August, the HKMA lowered its base rate by 25 bps to 2.50% after the US Federal Reserve cut its key benchmark rate by 25 bps to a range of 2.00%–2.25%.

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



Source: Based on data from Bloomberg LP.

Weakening economic growth also created downward pressure on yields. The gross domestic product (GDP) growth of Hong Kong, China slowed to 0.5% year-on-year (y-o-y) in the second quarter (Q2) of 2019 from 0.6% y-o-y in the previous quarter. On a seasonally adjusted quarter-on-quarter (q-o-q) basis, GDP contracted 0.4% in Q2 2019, reversing the 1.3% q-o-q GDP expansion posted in the previous quarter. Merchandise exports dropped 5.6% y-o-y during the quarter, undermined by softening global economic growth. Gross domestic fixed capital formation contracted 11.6% y-o-y amid weak business sentiment. The government lowered its full-year 2019 growth forecast to a range of between zero and 1.0% from the previous 2.0%–3.0% estimate.

The inflation rate of Hong Kong, China was 3.3% y-o-y in July, the same rate posted in June. On a seasonally adjusted month-on-month basis, the average monthly inflation from May to July stood at 0.3%.

### Size and Composition

The LCY bonds outstanding of Hong Kong, China declined to HKD1,955.5 billion in Q2 2019 from HKD1,959.9 in the previous quarter (**Table 1**). The 0.2% q-o-q drop in Q2 2019 reversed the 0.5% q-o-q growth in Q1 2019, driven largely by a contraction in

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2018		Q1 2019		Q2 2019		Q2 2018		Q2 2019	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,929</b>	<b>246</b>	<b>1,960</b>	<b>250</b>	<b>1,956</b>	<b>250</b>	<b>2.1</b>	<b>3.6</b>	<b>(0.2)</b>	<b>1.4</b>
Government	1,159	148	1,161	148	1,164	149	0.8	7.6	0.2	0.5
Exchange Fund Bills	1,019	130	1,035	132	1,042	133	0.5	10.4	0.6	2.3
Exchange Fund Notes	35	4	31	4	29	4	(4.9)	(18.6)	(5.8)	(16.0)
HKSAR Bonds	105	13	95	12	93	12	6.6	(5.5)	(2.1)	(11.4)
Corporate	771	98	799	102	791	101	3.9	(2.0)	(0.9)	2.7

( ) = negative, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, 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 local currency-USD rates are used.

3. Growth rates are calculated from local currency base and do not include currency effects.

Source: Hong Kong Monetary Authority.

corporate bonds outstanding. Annual growth weakened to 1.4% y-o-y in Q2 2019 from 3.7% y-o-y in Q1 2019 due to slower growth of both government and corporate bonds. The bond market remains dominated by government bonds, which accounted for 59.5% of LCY bonds outstanding in Q2 2019.

**Government bonds.** The outstanding stock of LCY government bonds stood at HKD1,164.1 billion at the end of June, with marginal growth at 0.2% q-o-q and 0.5% y-o-y. The growth was driven by an expansion of Exchange Fund Bills (EFBs), which rose 0.6% q-o-q and 2.3% y-o-y. Both Exchange Fund Notes (EFNs) and Hong Kong Special Administrative Region (HKSAR) Bonds outstanding contracted during the review period. Outstanding EFNs dropped 5.8% q-o-q and 16.0% y-o-y, while HKSAR Bonds outstanding dipped 2.1% q-o-q and 11.4% y-o-y.

Total government issuance amounted to HKD834.7 billion in Q2 2019 on growth of 2.6% q-o-q and 2.8% y-o-y. Issuance of EFBs and EFNs by the HKMA increased 1.9% q-o-q, while issuance of HKSAR Bonds jumped 281.0% as the government re-opened 3-year, 5-year, and 10-year tenors worth a total of HKD8.0 billion during the quarter.

**Exchange Fund Bills.** At the end of June, outstanding EFBs reached HKD1,041.9 billion, driven by strong issuance during the quarter. New issuance edged up to HKD825.5 billion from HKD810.2 billion in the previous quarter. However, due to maturities, the growth of EFBs remained marginal, though slightly higher than in the previous quarter. In q-o-q terms, the growth of EFBs rose

slightly to 0.6% q-o-q in Q2 2019 from 0.5% q-o-q in the previous quarter. Similarly, annual growth improved during the review period, rising to 2.3% y-o-y in Q2 2019 from 2.1% y-o-y in Q1 2019.

**Exchange Fund Notes.** Since 2015, the HKMA has limited the issuance of EFNs to 2-year tenors, issuing on average HKD1.2 billion EFNs per quarter. As a result, outstanding EFNs have declined steadily. Outstanding EFNs stood at HKD29.4 billion at the end of June, down 5.8% q-o-q from HKD31.2 billion at the end of Q1 2019.

**Hong Kong Special Administrative Region Bonds.** HKSAR Bonds outstanding stood at HKD92.7 billion at the end of June, down 2.1% q-o-q and 11.4% y-o-y, following the 10.5% q-o-q and 3.5% y-o-y drop recorded in the previous quarter. In Q2 2019, the government issued a 3-year bond worth HKD4.0 billion, a 5-year bond worth HKD2.5 billion, and a 10-year bond worth HKD1.5 billion under the Institutional Bond Issuance Programme.

**Corporate bonds.** Corporate bonds outstanding reached HKD791.4 billion at the end of June. The 0.9% q-o-q contraction in Q2 2019 reversed the 2.2% q-o-q growth in the previous quarter. Annual growth also slowed to 2.7% y-o-y in Q2 2019 from 7.7% y-o-y in Q1 2019.

The outstanding bonds of the top 31 corporate issuers in Hong Kong, China amounted to HKD217.8 billion in Q2 2019, comprising 27.5% of the total corporate bond market (**Table 2**). Government-owned financial firm Hong Kong Mortgage Corporation remained the top issuer, with outstanding bonds amounting

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	30.7	3.9	Yes	No	Finance
2.	Sun Hung Kai & Co.	16.8	2.2	No	Yes	Finance
3.	MTR Corporation	12.0	1.5	Yes	Yes	Transportation
4.	Link Holdings	11.1	1.4	No	No	Finance
5.	The Hong Kong and China Gas Company	11.1	1.4	No	Yes	Utilities
6.	New World Development	11.0	1.4	No	Yes	Diversified
7.	Hong Kong Land	10.7	1.4	No	No	Real Estate
8.	Haitong International Securities Group	8.6	1.1	No	Yes	Finance
9.	The Wharf (Holdings)	8.6	1.1	No	Yes	Finance
10.	Henderson Land Development	8.3	1.1	No	No	Real Estate
11.	CLP Power Hong Kong Financing	8.3	1.1	No	No	Finance
12.	Swire Pacific	7.9	1.0	No	Yes	Diversified
13.	Smart Edge	6.8	0.9	No	No	Finance
14.	AIA Group	6.3	0.8	No	Yes	Insurance
15.	CK Asset Holdings	6.2	0.8	No	Yes	Real Estate
16.	Swire Properties	5.9	0.8	No	Yes	Real Estate
17.	Hongkong Electric	5.5	0.7	No	No	Utilities
18.	China Merchants Port Holdings	5.5	0.7	No	Yes	Transportation
19.	Hang Lung Properties	4.6	0.6	No	Yes	Real Estate
20.	Hysan Development Company	3.7	0.5	No	Yes	Real Estate
21.	IFC Development Corporation	3.5	0.4	No	No	Finance
22.	Lethai Group	3.0	0.4	No	Yes	Real Estate
23.	Emperor International Holdings	2.9	0.4	No	Yes	Real Estate
24.	Urban Renewal Authority	2.8	0.4	Yes	No	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.	Kowloon-Canton Railway	2.1	0.3	Yes	No	Transportation
30.	CK Hutchison Holdings	2.0	0.3	No	Yes	Diversified
31.	Gluon Xima International	2.0	0.3	No	No	Real Estate
<b>Total Top 31 Nonbank LCY Corporate Issuers</b>		<b>217.8</b>	<b>27.9</b>			
<b>Total LCY Corporate Bonds</b>		<b>791.4</b>	<b>101.3</b>			
<b>Top 31 as % of Total LCY Corporate Bonds</b>		<b>27.5%</b>	<b>27.5%</b>			

HKD = Hong Kong dollar, LCY = local currency, USD = United States dollar.

Notes:

1. Data as of 30 June 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.

to HKD30.7 billion. The company with the second-largest amount of outstanding corporate bonds at HKD16.8 billion was Sung Hung Kai & Co., another financial firm. It was followed by MTR Corporation, a government-owned transportation company, with HKD12.0 billion of bonds outstanding. The next two largest issuers, Link Holdings and Hong Kong and China Gas Company, each had HKD11.1 billion of bonds outstanding, followed closely by New World Development with HKD11.0 billion of bonds outstanding. The top 31 issuers in Q2 2019 were mostly finance and real estate companies. Two-thirds were listed on the Hong Kong Stock Exchange and four were government-owned corporations.

Corporate issuance amounted to HKD75.9 billion in Q2 2019, down from HKD108.4 billion in the previous quarter. The top nonbank issuer, Hong Kong Mortgage Corporation, issued a total of HKD7.1 billion bonds from 13 issuances during the quarter, the largest of which was a 2-year bond worth HKD1.0 billion carrying a 1.89% coupon (**Table 3**). Smart Edge, an investment company, was the second-largest issuer during the quarter, with a 2-year bond worth HKD6.8 billion and carrying a 4.33% coupon. Link Holdings, a financial company, was the third-largest issuer during the quarter, with a 5-year bond worth HKD4.0 billion and carrying a 1.6% coupon. Haitong International, another financial firm, issued a total of HKD2.3 billion from four issuances of 1-year bonds carrying coupons ranging from 2.6% to 2.8%. New World Development—a diversified company with real estate, transportation, telecommunication, and other operations— issued a total of HKD1.6 billion from four issuances of 3-year, 10-year, and 15-year bonds with coupons ranging from 3.0% to 15.0%.

## Policy, Institutional, and Regulatory Developments

### Hong Kong Monetary Authority and the Bank of Thailand Collaborate on Financial Innovation

On 12 May, the HKMA and the Bank of Thailand signed a memorandum of understanding to promote collaboration in financial innovation. One potential project highlighted during the signing was a joint research program on central bank digital currency, wherein the two banking authorities may share knowledge and experience from their respective research.

**Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2019**

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Hong Kong Mortgage Corporation		
3-month bills	1.50	0.13
3-month bills	0.00	0.66
3-month bills	1.42	0.47
1-year bond	1.93	0.50
1-year bond	2.06	0.50
1-year bond	1.82	0.55
1-year bond	1.96	0.52
1-year bond	2.00	0.50
1-year bond	1.88	0.90
1.5-year bond	1.76	0.50
2-year bond	1.89	1.00
2-year bond	1.98	0.75
30-year bond	2.98	0.13
Smart Edge		
2-year bond	4.33	6.80
Link Holdings		
5-year bond	1.60	4.00
Haitong International		
1-year bond	2.80	0.60
1-year bond	2.65	0.70
1-year bond	2.75	0.50
1-year bond	2.60	0.53
New World Development		
3-year bond	3.00	0.10
3-year bond	3.00	0.40
10-year bond	10.01	0.45
15-year bond	15.01	0.65

HKD = Hong Kong dollar.  
Source: Bloomberg LP.

### Hong Kong Monetary Authority Keeps Countercyclical Capital Buffer at 2.5%

On 9 July, the HKMA decided to maintain the countercyclical capital buffer (CCyB) at 2.5%. In its press statement, the HKMA noted that the latest data signals a lower CCyB at 1.75% due to the narrowing of the credit-to-GDP gap, which indicated a slowdown in loan growth. However, after considering other factors, including the recovery of residential property prices and banking sector and economy-wide risks, the HKMA decided that holding the CCyB steady at 2.5% was more appropriate to provide an additional buffer should the systemic risks crystallize in the future. The CCyB is an integral part of the Basel III regulatory capital framework designed to increase the resilience of the banking sector in periods of excess credit growth.