Hong Kong, China

Yield Movements

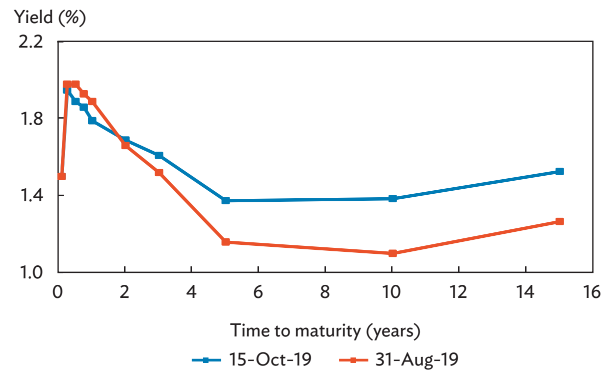
Between 31 August and 15 October, local currency (LCY) government bond yields in Hong Kong, China fell slightly for shorter-dated tenors and jumped for medium- to longer-dated tenors (**Figure 1**). Tenors with maturities of 1 year or below shed an average of 7 basis points (bps), while tenors with maturities of 2 years or longer gained 18 bps on average. Yield movements tracked 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 dropped for maturities below 2 years and rose for Treasuries with longer maturities.

Hong Kong, China's yield curve has been inverted since the second quarter (Q2) of the year, though the negative spread between the 2-year and 10-year yield narrowed during the review period from 56 bps on 31 August to 30 bps on 15 October.

The inverted yield curve reflects expectations of an economic downturn in Hong Kong, China. Months of unrelenting political protests has caused declines in tourism earnings and retail sales, adding pressure to the economy that has already been weakened by the continuing trade dispute between the People's Republic of China and the US. Based on advanced estimates, Hong Kong, China's gross domestic product growth contracted 2.9% year-on-year (y-o-y) in the third quarter (Q3) of 2019. In quarter-on-quarter (q-o-q) seasonally adjusted terms, Hong Kong, China's GDP contracted 3.2% q-o-q in Q3 2019 following a 0.5% q-o-q drop in Q2 2019. The two consecutive quarters of negative growth indicated that the economy has fallen into a technical recession.

The rise in yields for medium- to longer-term bonds also reflected higher borrowing costs as investors factor in risks associated with political uncertainties. In September, Fitch Ratings downgraded Hong Kong, China's issuer default rating one notch from AA+ to AA amid months of social protests that have undermined political stability and the business environment.

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



Source: Based on data from Bloomberg LP.

To match rate adjustments by the US Federal Reserve, the Hong Kong Monetary Authority (HKMA) lowered its policy rate by 25 bps each in August, September, and October. The rate cuts lowered the base rate from 2.75% to 2.00%.

Inflation remained moderate in Q3 2019. The composite consumer price inflation growth rate eased to 3.2% y-o-y in September from 3.5% y-o-y in August.

To boost sluggish economic growth, the government implemented several policies during the review period. In August, the government announced fiscal support measures worth HKD19.1 billion to aid citizens and businesses affected by the economic downturn. In September, the government-owned Hong Kong Mortgage Corporation (HKMC) introduced a relief measure targeted to small and medium-sized enterprises (SMEs) facing cash flow pressure. The relief measure allowed SME borrowers a temporary moratorium on principal payments for up to 12 months.

On 14 October, the HKMA lowered the countercyclical capital buffer (CCyB)—the amount of cash that banks are required to keep as reserves—from 2.5% to 2.0%, releasing capital that had previously built up in the banking sector. The move injected an additional HKD200 billion–HKD300 billion into the economy.

Size and Composition

Hong Kong, China's LCY bonds outstanding dropped slightly to HKD1,954.7 (USD249.4) at the end of Q3 2019 from HKD1,955.5 billion (USD250.4) in Q2 2019 (**Table 1**). The 0.04% q-o-q dip in Q3 2019 was smaller than the 0.2% q-o-q drop in the prior quarter and was largely driven by contractions in Exchange Fund Notes (EFNs) and corporate bonds outstanding. Annual growth rose to 2.1% y-o-y in Q3 2019 from 1.4% y-o-y in Q2 2019 due to stronger growth in both government and corporate bonds. Government bonds, accounted for 59.9% of LCY bonds outstanding at the end of September.

Government bonds. The outstanding stock of LCY government bonds stood at HKD1,170.4 billion at the end of September on growth of 0.5% q-o-q and 1.4% y-o-y. The growth was driven by the expansion of outstanding Exchange Fund Bills (EFBs) and Hong Kong Administrative Special Administrative Region (HKSAR) bonds, which rose 0.6% q-o-q and 1.0% q-o-q, respectively. Outstanding EFNs dropped 3.4% q-o-q during the review period due to maturities.

Total government issuance amounted to HKD838.5 billion in Q3 2019 on growth of 1.0% q-o-q and 2.9% y-o-y. Issuance of EFBs and EFNs by the HKMA increased 1.0% q-o-q, while issuance of HKSAR bonds dropped 52.5% q-o-q from a high base in the previous quarter.

Exchange Fund Bills. In Q3 2019, outstanding EFBs rose 0.6% q-o-q to reach HKD1,048.4 billion at the end of September, driven by strong issuance. New issuance edged up to HKD833.5 billion from HKD825.5 billion in the previous quarter. Due to maturities, the growth was slower than the 1.9% rise in outstanding EFBs recorded in the previous quarter.

Exchange Fund Notes. Since January 2015, the HKMA has streamlined issuance of EFNs and HKSAR bonds to avoid overlaps in longer tenors and to establish a single benchmark yield curve. EFN issuance has been limited to the 2-year tenor at an average of HKD1.2 billion EFNs per quarter. As a result, outstanding EFNs declined steadily. Outstanding EFNs stood at HKD28.4 billion at the end of September, down 3.4% q-o-q from HKD29.4 billion at the end of Q2 2019.

Hong Kong Special Administrative Region Bonds. HKSAR bonds outstanding stood at HKD93.7 billion at the end of September, up 1.0% q-o-q from HKD92.7 billion in the previous quarter. In Q3 2019, the government issued a total of HKD3.8 billion of HKSAR bonds. HKD3.0 billion comprised Silver Bonds, an investment instrument intended for senior citizens, while HKD0.8 billion came from the issuance of 15-year HKSAR bonds.

Corporate bonds. Corporate bonds outstanding reached HKD784.3 billion at the end of September. The 0.9% q-o-q contraction in Q3 2019 reversed the 1.2% q-o-q growth in the previous quarter.

The outstanding bonds of the top 30 nonbank corporate issuers in Hong Kong, China amounted to HKD217.6 billion in Q3 2019, comprising 27.7% of the total corporate bond market (**Table 2**). Government-owned financial firm HKMC remained the top issuer,

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2018		Q2 2019		Q3 2019		Q3 2018		Q3 2019	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,915**	**245**	**1,956**	**250**	**1,955**	**249**	**(0.7)**	**1.5**	**(0.04)**	**2.1**
Government	1,154	147	1,164	149	1,170	149	(0.4)	3.4	0.5	1.4
Exchange Fund Bills	1,024	131	1,042	133	1,048	134	0.5	5.2	0.6	2.4
Exchange Fund Notes	34	4	29	4	28	4	(2.9)	(16.7)	(3.4)	(16.5)
HKSAR Bonds	96	12	93	12	94	12	(7.9)	(4.9)	1.0	(2.9)
Corporate	761	97	791	101	784	100	(1.2)	(1.2)	(0.9)	3.1

( ) = negative, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, 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 local currency–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. Q3 data for corporate bonds outstanding are based on *AsianBondsOnline* estimates.

Source: Hong Kong Monetary Authority.

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	29.8	3.8	Yes	No	Finance
2.	Sun Hung Kai & Co., Limited	16.7	2.1	No	Yes	Finance
3.	Link Holdings	12.5	1.6	No	No	Finance
4.	MTR Corporation	12.4	1.6	Yes	Yes	Transportation
5.	New World Development	12.1	1.5	No	Yes	Diversified
6.	Hong Kong Land	11.6	1.5	No	No	Real Estate
7.	The Hong Kong and China Gas Company	11.1	1.4	No	Yes	Utilities
8.	Swire Pacific	9.4	1.2	No	Yes	Diversified
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	7.7	1.0	No	No	Finance
12.	Haitong International Securities Group	7.0	0.9	No	Yes	Finance
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	5.6	0.7	No	Yes	Diversified
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	4.4	0.6	No	Yes	Real Estate
21.	IFC Development Corporation	3.5	0.4	No	No	Finance
22.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
23.	Emperor International Holdings	2.9	0.4	No	Yes	Real Estate
24.	Wharf Real Estate Investment	2.6	0.3	No	Yes	Real Estate
25.	Champion REIT	2.5	0.3	No	Yes	Real Estate
26.	China Dynamics Holdings	2.4	0.3	No	Yes	Automotive
27.	Urban Renewal Authority	2.3	0.3	Yes	No	Real Estate
28.	South Shore 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
Total Top 30 Nonbank LCY Corporate Issuers		**217.6**	**27.8**			
Total LCY Corporate Bonds		**784.3**	**100.0**			
Top 31 as % of Total LCY Corporate Bonds		**27.7%**	**27.7%**			

HKD = Hong Kong dollar, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of 30 September 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.

with outstanding bonds amounting to HKD29.8 billion. The top 30 issuers in Q3 2019 were mostly finance and real estate companies. A distant second was Sun Hung Kai & Co., with outstanding bonds of HKD16.7 billion. Link Holdings, MTR Corporation, New World Development, and Hong Kong Land were the next four largest issuers, with outstanding bonds exceeding HKD10.0 billion each. Of the top 30, two-thirds are listed on the Hong Kong Stock Exchange and three are government-owned corporations.

Corporate issuance amounted to HKD53.1 billion in Q3 2019, down from HKD75.9 billion in the previous quarter. The top nonbank issuer, HKMC, issued a total of HKD2.2 billion bonds from eight issuances during the quarter, including a 30-year bond carrying a 2.65% coupon (**Table 3**). The single-largest issuance was a 7-year bond carrying a 2.50% coupon from Link Holdings. Swire Pacific, Hysan Development Company, and Sun Hung Kai & Co. were the next largest issuers with aggregate issuance amounts of HKD1.1 billion, HKD0.7 billion, and HKD0.4 billion, respectively.

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

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
Hong Kong Mortgage Corporation		
3-month bond	0.00	660.00
3-month bond	1.92	380.00
3-month bond	0.00	370.00
3-month bond	1.99	50.00
1-year bond	2.09	55.00
1-year bond	2.04	85.50
10-year bond	1.57	375.00
30-year bond	2.65	200.00
Link Holdings		
5-year bond	2.28	716.00
7-year bond	2.50	1,000.00
Swire Pacific		
10-year bond	2.95	331.00
10-year bond	2.83	350.00
10-year bond	2.50	400.00
Hysan Development Company		
12-year bond	2.90	400.00
15-year bond	2.81	250.00
Sun Hung Kai & Co., Limited		
10-year bond	2.75	442.00

HKD = Hong Kong dollar.
Source: Bloomberg LP.

Ratings Update

Fitch Downgrades Hong Kong, China's Credit Rating amid Political Unrest

On 5 September, global credit rating agency Fitch Ratings Inc. (Fitch) downgraded Hong Kong, China's issuer default rating after months of antigovernment political protests. Hong Kong, China's long-term LCY issuer default rating was downgraded one notch to AA from AA+ and given a negative outlook. According to Fitch, the persistent political unrest undermined "international perceptions of the quality and effectiveness of [Hong Kong, China's] governance system and rule of law, and have called into question the stability and dynamism of its business environment." The last time Fitch downgraded Hong Kong, China's rating was before the return of the former British colony to the People's Republic of China. The negative outlook reflected Fitch's view that a degree of social discontent is likely to persist, possibly sparking renewed eruptions of political unrest.

Policy, Institutional, and Regulatory Developments

Government Unveils HKD19.1 Billion Economic Support Package

On 15 August, the Government of the Hong Kong Special Administrative Region of the People's Republic of China unveiled fiscal support measures worth HKD19.1 billion to provide support to citizens and businesses affected by the economic downturn. The measures for citizens include extra payments to social security recipients, subsidies for students from the primary and secondary levels, 1 month of free rent for low-income tenants of government housing, and a one-off electricity subsidy worth HKD2,000. The support for businesses includes waivers for 27 groups of fees and charges for the retail, catering, and tourism sectors; a reduction of rent for short-term tenancies of government lands; a new loan guarantee for small businesses; and retraining for workers.

HKMC Introduces Relief Measures for Small and Medium-Sized Enterprises

On 4 September, HKMC Insurance Limited, a subsidiary of HKMC, unveiled a new relief measure—the 80% Guarantee Product of the SME Financing Guarantee Scheme—to assist SMEs facing cash flow pressures. Under the relief measure, SME borrowers may apply to their lenders to temporarily pay only the interest on their loans, deferring repayment of the principal for a maximum of 12 months. The relief measure was designed to help SMEs facing cash flow pressures due to the heightened uncertainties affecting the domestic economy.

HKMA Cuts Countercyclical Capital Buffer by 50 bps to 2.0%

On 14 October, the HKMA lowered the CCyB from 2.5% to 2.0%, the first reduction since 2015. The move was intended to allow banks to release an additional HKD200 billion–HKD300 billion of bank credit. In its press statement, the HKMA stressed that economic conditions in Hong Kong, China have deteriorated since June and the freeing of funds will allow banks to provide support to the economy and help counter the economic downturn. 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.