

## Hong Kong, China

### Yield Movements

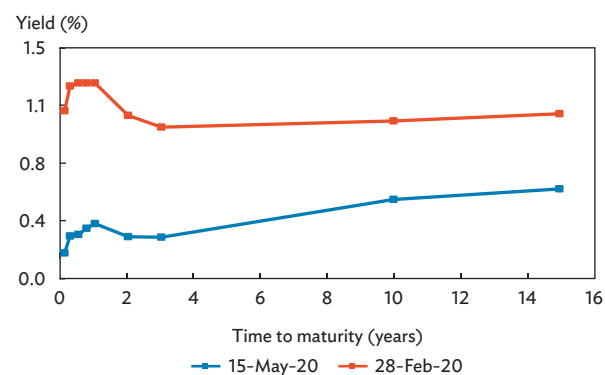
Between 28 February and 15 May, local currency (LCY) government bond yields in Hong Kong, China fell across all tenors, shifting the yield curve downward (**Figure 1**). The drop was more pronounced at the shorter-end of the curve as tenors with maturities of 1 year or below shed an average of 94 basis points (bps). For longer-dated bonds with maturities of 10 years or more, yields fell an average of 50 bps. The 15-year tenor posted the smallest drop at 49 bps.

Hong Kong, China's yield curve was inverted at the beginning of the review period with the spread between the 2-year and 10-year yields at -4 bps. The yield curve had normalized by the end of the review period, with the spread between 2-year and 10-year bonds back in positive territory at 24 bps.

Hong Kong, China's government bond yields tracked United States (US) Treasury yields during the review period. The US yield curve shifted downward, with yields of tenors with maturities of 1 year or below falling an average of 110 bps, and tenors with maturities of 10 years or longer dropping 43 bps on average. The decline in US yields stemmed from a sharp interest rate drop as the Federal Reserve cut the federal funds rate twice in March in response to the coronavirus disease (COVID-19) pandemic. The two rate cuts—a 50-bps cut on 3 March and a 100-bps cut on 15 March—lowered the federal funds target to a range of between 0.0% and 0.25%. To further mitigate risks and address volatility in financial markets, the Federal Reserve also expanded its repo operations and resumed purchasing Treasury and mortgage-backed securities.

To maintain the Hong Kong dollar's peg to the US dollar, the Hong Kong Monetary Authority (HKMA) lowered its base rate by 50 bps to 1.50% on 4 March. In response to the subsequent 100-bps cut by the US Federal Reserve, the HKMA again lowered the base rate to 0.86% on 16 March based on a pre-set formula.<sup>16</sup> Demand for the Hong Kong dollar surged in April, fueled by carry trade activities brought about by the gap between the

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



Source: Based on data from Bloomberg LP.

Hong Kong Interbank Offered Rates (HIBORs) over US interest rates, which combined with seasonal and equity-related demand as high-profile initial public offerings resumed in Hong Kong, China's stock market.

The heightened demand for the Hong Kong dollar pushed the strong-side of its trading band against the US dollar, prompting the HKMA to spend a total of HKD20.7 billion to rein in the local currency in April. A series of HKMA interventions brought the aggregate balance—an indicator of liquidity in the financial system—to HKD84.7 billion, up 55.7% year-to-date by the end of April. To inject further liquidity into the market, the HKMA also reduced its issuance of Exchange Fund Bills (EFBs) by HKD20.0 billion between April and May. By 15 May, the aggregate balance reached HKD94.7 billion, up 74.1% since the start of the year. Consequently, domestic interest rates dropped, with the overnight HIBOR at 0.07% and the 1-month HIBOR at 0.64%.

Falling yields also reflected the contraction of Hong Kong, China's economy. The economic recession deepened in Q1 2020 as the onset of COVID-19 disrupted the economy already battered by the combined impacts of trade tensions between the US and the People's Republic of China (PRC), as well as prolonged political unrest. Gross domestic product (GDP) dropped sharply by 8.9%

<sup>13</sup> The base rate is set at either 50 bps above the lower end of the prevailing target range of the US federal funds rate or the average 5-day moving average of the overnight and 1-month Hong Kong Interbank Offered Rates (HIBORs), whichever is higher. As of 15 March, the 5-day moving average of the overnight and 1-month HIBORs was 0.86%.

year-on-year (y-o-y) in the first quarter (Q1) of 2020, following a 3.0% y-o-y decline in the fourth quarter (Q4) of 2019.

The contraction in Q1 2020 was the steepest on record for a single quarter and worse than what the economy experienced following the 1997/98 Asian financial crisis. Private consumption dropped 10.1% y-o-y in Q1 2020 due to disruptions in consumer-related activities, while investment expenditure fell 14.3% y-o-y amid sagging investor confidence.

Exports of goods fell 9.9% y-o-y in Q1 2020, weighed down by disruptions to regional supply chains and the sharp drop in global demand as several governments implemented travel bans and social distancing measures to contain the spread of COVID-19. Exports of services plunged 37.8% y-o-y in Q1 2020 as the pandemic halted tourism and hampered cross-border transport and commercial services in February and March.

Consumer price inflation moderated to 1.9% y-o-y in April from 2.3% y-o-y in March as the recession in the domestic economy and the slowdown in global demand eased pressure on prices.

## Size and Composition

Hong Kong, China's LCY bonds outstanding amounted to HKD2,255.4 billion (USD291.0 billion) at the end of March after a 0.5% quarter-on-quarter (q-o-q) contraction in Q1 2020 (Table 1). The drop in LCY bonds

outstanding stemmed from a 1.1% q-o-q contraction in the government bond segment combined with tepid 0.2% q-o-q growth in the corporate bond segment. On a year-on-year basis, growth slowed to 0.3% in Q1 2020 from 1.8% in Q4 2019. Government bonds accounted for a 51.9% share of total LCY bonds outstanding at the end of March.

**Government bonds.** LCY government bonds outstanding stood at HKD1,169.5 billion at the end of March. The stock of government bonds contracted 1.1% q-o-q in Q1 2020, mainly due to the 16.9% q-o-q contraction of Hong Kong Special Administrative Region (HKSAR) bonds. EFBs posted weak 0.4% q-o-q growth, while Exchange Fund Notes (EFNs) posted no growth in Q1 2020. Annual growth of LCY government bonds outstanding decelerated to 0.7% y-o-y in Q1 2020 from 1.2% y-o-y in the previous quarter. Government bond issuance declined 1.8% q-o-q in Q1 2020 as issuance of EFBs, EFNs, and HKSAR bonds contracted during the quarter.

**Exchange Fund Bills.** EFBs outstanding reached HKD1,059.7 at the end of March on growth of 0.4% q-o-q and 2.4% y-o-y. Issuance of EFBs amounted to HKD833.8 billion in Q1 2020, contracting 1.4% q-o-q.

**Exchange Fund Notes.** Since 2015, the HKMA has limited its issuance of EFNs to 2-year tenors. In February, the HKMA issued a 2-year EFN worth HKD1.2 billion. Due to maturities, outstanding EFNs remained steady at HKD26.6 billion in Q1 2020.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2019		Q4 2019		Q1 2020		Q1 2019		Q1 2020	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>2,249</b>	<b>287</b>	<b>2,266</b>	<b>291</b>	<b>2,255</b>	<b>291</b>	<b>1.1</b>	<b>8.5</b>	<b>(0.5)</b>	<b>0.3</b>
Government	1,161	148	1,182	152	1,170	151	(0.6)	1.1	(1.1)	0.7
Exchange Fund Bills	1,035	132	1,055	135	1,060	137	0.5	2.1	0.4	2.4
Exchange Fund Notes	31	4	27	3	27	3	(3.1)	(15.2)	-	(14.7)
HKSAR Bonds	95	12	100	13	83	11	(10.5)	(3.5)	(16.9)	(12.2)
Corporate	1,088	139	1,084	139	1,086	140	3.0	17.8	0.2	(0.2)

( ) = negative, - = not applicable, HKD = Hong Kong dollar, HKSAR = Hong Kong Special Administrative Region, 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 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.

**HKSAR bonds.** HKSAR bonds outstanding amounted to HKD83.2 billion at the end of March, down 16.9% q-o-q and 12.2% y-o-y in Q1 2020. The government issued a 10-year HKSAR bond worth HKD1.7 billion in February and a 15-year HKSAR bond worth HKD800.0 million in March under the Institutional Bond Issuance Programme.

**Corporate bonds.** Corporate bonds outstanding reached HKD1.1 billion at the end of March. The corporate bond segment recovered slightly in Q1 2020 with 0.2% q-o-q growth, reversing the 0.9% q-o-q contraction in the previous quarter. On a y-o-y basis, corporate bonds outstanding dropped 0.2% in Q1 2020, reversing the 2.6% gain posted in the previous quarter.

Hong Kong, China's top 30 nonbank issuers had a combined HKD223.8 billion of bonds outstanding at the end of March, accounting for 20.6% of the total corporate bond market (**Table 2**). Government-owned financial firm Hong Kong Mortgage Corporation remained the top issuer with HKD30.0 billion of bonds outstanding at the end of Q1 2020. Sun Hung Kai & Co. maintained its position as second-largest issuer at HKD17.0 billion. The third-largest issuer was MTR corporation, a government-owned transportation company, with HKD13.7 billion. The top 30 issuers were predominantly finance and real estate companies. A majority of the top 30 issuers were listed in the Hong Kong Stock Exchange; only two were government-owned corporations.

Corporate bond issuance reached HKD213.6 billion at the end of March, as issuance growth rebounded to 44.3% q-o-q in Q1 2020 from an 18.9% q-o-q decline in the previous quarter. Among the top nonbank issuers in Q1 2020, government-owned Hong Kong Mortgage Corporation was the largest issuer with an aggregate HKD4.5 billion from 13 issuances, the largest of which was a 2-year bond with a 1.74% coupon worth HKD1.0 billion (**Table 3**). The next top issuers were Wharf Real Estate Investment and Han Lung Properties, each with aggregate issuance worth HKD2.8 billion. Wharf Real Estate Investment issued two 10-year bonds worth HKD800.0 million each, as well as a 7-year bond with a 2.10% coupon worth HKD1.0 billion. Han Lung Properties' issuances included a 5-year bond with a 2.35% coupon worth HKD950.0 million and a 7-year bond with a 3.01% coupon worth HKD700.0 million. There were two issuances of 15-year bonds in Q1 2020, the longest-dated tenor issued during the quarter. Henderson Land Development issued a 15-

year HKD100.0 million bond with a 2.66% coupon, while Hong Kong Land issued a 15-year HKD400.0 million bond with a 2.72% coupon.

## Ratings Update

On 20 April, Fitch Ratings downgraded Hong Kong, China's long-term currency issuer default rating to AA- from AA with a stable outlook, stating that the economy was facing a second major shock from the onset of the COVID-19 pandemic after prolonged political unrest. Fitch Ratings noted that the downgrade reflected Hong Kong, China's increasing integration into the PRC's national governance system and the related rise of economic, financial, and sociopolitical links to the PRC merit a closer alignment of their respective sovereign ratings. The PRC is currently rated one notch below Hong Kong, China at A+. The downgrade puts Hong Kong, China at its lowest rating level since 2007.

## Policy, Institutional, and Regulatory Developments

### Hong Kong Monetary Authority Reduces Countercyclical Capital Buffer to 1.0%

On 16 March, the HKMA reduced its countercyclical buffer to 1.0% from 2.0% amid worsening economic conditions brought about by the COVID-19 outbreak. The move was intended to release additional funds that would allow banks to extend credit to support financing needs in the domestic economy, particularly for sectors and individuals affected by the downturn. The countercyclical buffer is an integral part of the Basel III regulatory capital framework designed to increase the resilience of the banking sector during periods of excess credit growth.

### Hong Kong Monetary Authority Reduces Issuance of Exchange Fund Bills by HKD20.0 billion in April–May

On 9 April, the HKMA announced a reduction in the issuance of EFBs, which was aimed at raising Hong Kong dollar liquidity in the interbank market. The HKMA reduced the issue size of 91-day EFBs by HKD5.0 billion in each of the tenders held on 21 April, 28 April, 5 May, and 12 May. The combined reduction lowered the issuance of EFBs by a total of HKD20.0 billion.

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	30.0	3.9	Yes	No	Finance
2.	Sun Hung Kai & Co.	17.0	2.2	No	Yes	Finance
3.	MTR Corporation	13.7	1.8	Yes	Yes	Transportation
4.	The Hong Kong and China Gas Company	13.3	1.7	No	Yes	Utilities
5.	Link Holdings	11.9	1.5	No	No	Finance
6.	New World Development	11.8	1.5	No	Yes	Diversified
7.	Hong Kong Land	10.9	1.4	No	No	Real Estate
8.	Henderson Land Development	10.9	1.4	No	No	Real Estate
9.	Swire Pacific	10.0	1.3	No	Yes	Diversified
10.	CLP Power Hong Kong Financing	7.7	1.0	No	No	Finance
11.	Hang Lung Properties	7.1	0.9	No	Yes	Real Estate
12.	Smart Edge	6.8	0.9	No	No	Finance
13.	The Wharf (Holdings)	6.7	0.9	No	Yes	Finance
14.	Hongkong Electric	6.3	0.8	No	No	Utilities
15.	AIA Group	6.3	0.8	No	Yes	Insurance
16.	CK Asset Holdings	6.2	0.8	No	Yes	Real Estate
17.	Wharf Real Estate Investment	5.9	0.8	No	Yes	Real Estate
18.	Hysan Development Company	5.9	0.8	No	Yes	Real Estate
19.	Swire Properties	5.6	0.7	No	Yes	Diversified
20.	Future Days	5.5	0.7	No	No	Transportation
21.	Guotai Junan Holdings	3.1	0.4	No	Yes	Finance
22.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
23.	Haitong International Securities Group	2.7	0.3	No	Yes	Finance
24.	Champion REIT	2.5	0.3	No	Yes	Real Estate
25.	China Dynamics Holdings	2.4	0.3	No	Yes	Automotive
26.	South Shore Holdings	2.2	0.3	No	Yes	Industrial
27.	Emperor Capital Group	2.2	0.3	No	Yes	Finance
28.	Emperor International Holdings	2.2	0.3	No	Yes	Real Estate
29.	Cathay Pacific Airways	2.1	0.3	No	Yes	Transportation
30.	Nan Fung Treasury	1.8	0.2	No	No	Finance
<b>Total Top 30 Nonbank LCY Corporate Issuers</b>		<b>223.8</b>	<b>28.9</b>			
<b>Total LCY Corporate Bonds</b>		<b>1,085.9</b>	<b>140.1</b>			
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>20.6%</b>	<b>20.6%</b>			

HKD = Hong Kong dollar, LCY = local currency, REIT = real estate investment trust, USD = United States dollar.

Notes:

1. Data as of 31 March 2020.

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 2020**

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
Wharf Real Estate Investment		
7-year bond	2.10	1.00
10-year bond	2.69	0.80
10-year bond	2.80	0.80
Hong Kong Mortgage Corporation		
1-year bond	1.90	0.50
2-year bond	1.74	1.00
4-year bond	1.19	0.25
Hang Lung Properties		
5-year bond	2.35	0.95
7-year bond	3.01	0.70
Hong Kong Land		
15-year bond	2.72	0.40
Henderson Land Development		
15-year bond	2.66	0.10

HKD = Hong Kong dollar.  
Source: Bloomberg LP.

## Hong Kong Monetary Authority Introduces a Temporary US Dollar Liquidity Facility

On 22 April, the HKMA announced the introduction of a temporary US dollar liquidity facility that will provide US dollar liquidity assistance to licensed banks through competitive tenders of 7-day repurchase transactions. Starting 6 May, the HKMA began conducting a tender once per week. Eligible banks can submit a bid of at least USD100.0 million or multiples thereof. The HKMA intends to maintain the facility, which currently has USD10.0 billion of available funds, until 30 September. It will also consider market conditions and revise arrangements as necessary.