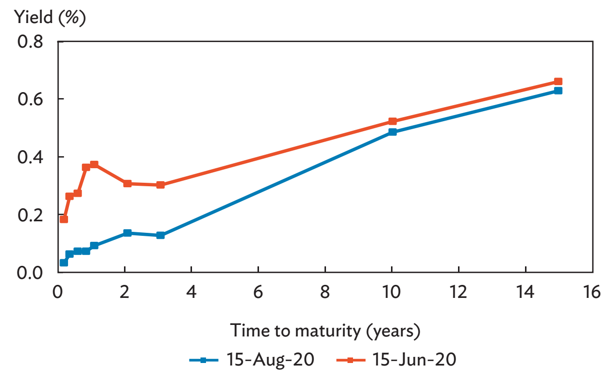
Hong Kong, China

Yield Movements

Between 15 June and 15 August, local currency (LCY) bond market yields in Hong Kong, China fell across all tenors, shifting the yield curve downward (**Figure 1**). The downward shift was more evident at the shorter-end of the curve, as tenors with maturities of 1 year or less shed an average of 22 basis points (bps). Bond yields for maturities of 2 years or more fell an average of 10 bps, with the 15-year yield showing the smallest dip at 3 bps. During the review period, the spread between 2-year and 10-year bond yields widened from 22 bps to 35 bps.

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



Source: Based on data from Bloomberg LP.

Hong Kong, China's government bond yields tracked United States (US) Treasury yields during the review period. US Treasury yields fell an average of 4 bps from 15 June to 15 August: yields for maturities of 1 year or below fell an average of 6 bps, while those for maturities of 2 years and longer dropped an average of 4 bps. The fall in US Treasury yields was partly driven by weakened investor sentiment regarding the US economy amid the coronavirus disease (COVID-19) pandemic, the slow progress of the latest fiscal relief package in the US Congress, and uncertainties over the upcoming election. Moreover, the Federal Reserve continued its bond-buying policy to keep rates low.

Demand for the Hong Kong dollar surged during the review period, fueled by carry trade and equity-related activities. The heightened demand for the Hong Kong dollar pushed the strong-side of its trading band against the US dollar in July, prompting the Hong Kong Monetary Authority (HKMA) to spend a total of HKD23.2 billion to maintain the Hong Kong dollar's peg to the US dollar. The HKMA's interventions brought the aggregate balance—an indicator of liquidity in the financial system—from HKD122.1 billion (USD15.8 billion) to HKD187.7 billion (USD24.2 billion) during the review period.

Declining yields also reflected the continuing contraction in Hong Kong, China's economy. Based on advanced estimates, Hong Kong, China's gross domestic product plunged 9.0% year-on-year (y-o-y) in the second quarter (Q2) of 2020 following a 9.1% y-o-y drop in the first quarter (Q1). The economy has been in a technical recession since the third quarter of 2019. Depressed domestic and external demand continued to batter the economy. Private consumption slid further, dropping 14.5% y-o-y in Q2 2020 after a 10.6% y-o-y decrease in the previous quarter. Exports of goods dropped 2.1% y-o-y, while exports of services plummeted 46.6% y-o-y in Q2 2020. Gross fixed capital formation dropped 20.6% y-o-y in Q2 2020 following a 15.8% y-o-y decline in the previous quarter. Due to increased spending on fiscal stimulus to combat the effects of COVID-19 on the economy, government consumption rose 9.6% y-o-y in Q2 2020 after rising 8.8% y-o-y in the prior quarter.

Heightened downside risks—brought about by the combined effects of political unrest, COVID-19, and worsening trade and political tensions between the People's Republic of China and the US—was exacerbated by the new security law that came into effect in Q2 2020. Uncertainties remain as to how the new security law will affect Hong Kong, China's financial system in the long run.

Hong Kong, China posted deflation of 2.3% y-o-y in July, the largest negative reading since November 2003. July's deflation, which reversed the 0.7% y-o-y uptick in June, stemmed mainly from the government's public housing rental payments. Netting out the effects of government one-off relief measures, consumer price inflation in July rose 0.2% y-o-y, which was down from 1.2% y-o-y in June. On a seasonally adjusted month-on-month basis, the average monthly inflation from May to July was –0.1%.

Size and Composition

Hong Kong, China's LCY bond outstanding reached HKD2,267.6 billion at the end of June, up from HKD2,255.5 at the end of March (**Table 1**). The 0.5% quarter-on-quarter (q-o-q) growth in Q2 2020 reversed the 0.5% q-o-q decline in Q1 2020. The q-o-q growth was primarily driven by a 2.3% q-o-q rise in the corporate bond segment as the government bond segment contracted 1.1% q-o-q in Q2 2020, the same rate of decline in Q1 2020. On a y-o-y basis, aggregate bonds outstanding dropped 0.8% in Q2 2020, reversing the tepid 0.3% growth in the prior quarter. Government bonds accounted for a 51.0% share of total LCY bonds outstanding at the end of June.

Government bonds. At the end of June, LCY government bonds outstanding amounted to HKD1,156.2 billion, down from HKD1,169.5 billion at the end of March. The stock of government bonds dropped 1.1% q-o-q in Q2 2020 due to the combined reduction in outstanding Exchange Fund Bills (EFBs) and Exchange Fund Notes (EFNs), which outpaced the growth of outstanding Hong Kong Special Administrative Region (HKSAR) bonds. On an annual basis, outstanding LCY government bonds dropped 0.7% y-o-y in Q2 2020, reversing the 0.7% y-o-y growth in Q1 2020. Government bond issuance contracted 0.8% q-o-q in Q2 2020, mainly due to a contraction in EFB issuance, which outpaced the expansion in EFN and HKSAR bond issuance.

Exchange Fund Bills. The outstanding stock of EFBs stood at HKD1,041.9 billion in Q2 2020, down from HKD1,059.7 billion in Q1 2020. The 1.7% q-o-q contraction in Q2 2020 reversed the modest 0.4% q-o-q gain posted in the previous quarter. Issuance of EFBs amounted to HKD821.6 billion in Q2 2020, contracting 1.5% q-o-q.

Exchange Fund Notes. Since 2015, the HKMA has limited its issuance of EFNs to 2-year tenors. In May, the HKMA issued a 2-year EFN worth HKD1.2 billion. Due to maturities, the amount of outstanding EFNs dropped 3.0% q-o-q and 12.2% y-o-y to reach HKD25.8 billion at the end of June.

HKSAR bonds. HKSAR bonds outstanding rose 6.4% q-o-q to reach HKD88.5 billion at the end of Q2 2020. The government issued a 3-year bond worth HKD4.0 billion in April, a 5-year bond worth HKD2.5 billion in May, and a 10-year bond worth HKD1.7 billion in June under the Institutional Bond Issuance Programme.

Corporate bonds. Corporate bonds outstanding reached HKD1,111.3 billion at the end of June. Growth in the corporate bond segment accelerated to 2.3% q-o-q in Q2 2020 from 0.2% q-o-q in Q1 2020. On a y-o-y basis, corporate bonds outstanding declined 0.9% in Q2 2020 following a 0.2% contraction in the previous quarter.

Hong Kong, China's top 30 nonbank issuers had a combined HKD249.9 billion of LCY bonds outstanding at the end of June, accounting for 22.5% of the total corporate bond market (**Table 2**). Government-owned Hong Kong Mortgage Corporation maintained

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2019		Q1 2020		Q2 2020		Q2 2019		Q2 2020	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**2,285**	**293**	**2,255**	**291**	**2,268**	**293**	**1.6**	**5.1**	**0.5**	**(0.8)**
Government	1,164	149	1,170	151	1,156	149	0.2	0.5	(1.1)	(0.7)
Exchange Fund Bills	1,042	133	1,060	137	1,042	134	0.6	2.3	(1.7)	0.003
Exchange Fund Notes	29	4	27	3	26	3	(5.8)	(16.0)	(3.0)	(12.2)
HKSAR Bonds	93	12	83	11	89	11	(2.1)	(11.4)	6.4	(4.5)
Corporate	1,121	144	1,086	140	1,111	143	3.1	10.3	2.3	(0.9)

( ) = negative, – = not applicable, 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.

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	38.7	5.0	Yes	No	Finance
2.	Sun Hung Kai & Co.	18.0	2.3	No	Yes	Finance
3.	The Hong Kong and China Gas Company	15.2	2.0	No	Yes	Utilities
4.	MTR Corporation	13.6	1.8	Yes	Yes	Transportation
5.	Link Holdings	12.9	1.7	No	Yes	Finance
6.	New World Development	12.1	1.6	No	Yes	Diversified
7.	Henderson Land Development	11.6	1.5	No	Yes	Real Estate
8.	Hongkong Land	11.3	1.5	No	No	Real Estate
9.	Swire Pacific	10.3	1.3	No	Yes	Diversified
10.	Hang Lung Properties	8.2	1.1	No	Yes	Real Estate
11.	Hongkong Electric	8.1	1.0	No	No	Utilities
12.	CLP Power Hong Kong Financing	7.7	1.0	No	No	Finance
13.	Swire Properties	7.6	1.0	No	Yes	Diversified
14.	Wharf Real Estate Investment	6.9	0.9	No	Yes	Real Estate
15.	Smart Edge	6.8	0.9	No	No	Finance
16.	Airport Authority Hong Kong	6.6	0.9	Yes	No	Transportation
17.	AIA Group	6.3	0.8	No	Yes	Insurance
18.	Hysan Development Corporation	6.3	0.8	No	Yes	Real Estate
19.	CK Asset Holdings	6.2	0.8	No	Yes	Real Estate
20.	Guotai Junan International Holdings	5.9	0.8	No	Yes	Finance
21.	The Wharf Holdings	5.8	0.7	No	Yes	Finance
22.	Future Days	5.5	0.7	No	No	Transportation
23.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
24.	China Dynamics Holdings	2.4	0.3	No	Yes	Automotive
25.	Champion REIT	2.3	0.3	No	Yes	Real Estate
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	Finance
29.	Cathay Pacific	2.1	0.3	No	Yes	Transportation
30.	IFC Development	2.0	0.3	No	No	Finance
Total Top 30 Nonbank LCY Corporate Issuers		**249.9**	**32.2**			
Total LCY Corporate Bonds		**1,111.3**	**143.4**			
Top 30 as % of Total LCY Corporate Bonds		**22.5%**	**22.5%**			

HKD = Hong Kong dollar, LCY = local currency, REIT = real estate investment trust, USD = United States dollar.
Notes:
1. Data as of 30 June 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.

its position as the top issuer with bonds outstanding amounting to HKD38.7 billion at the end of June. Sung Hung Kai & Co., a finance firm, also retained its position as the second-largest issuer with bonds outstanding of HKD18.0 billion at the end of Q2 2020. The Hong Kong and China Gas Company became the third-largest issuer in Q2 2020 with an outstanding amount of HKD15.2 billion, overtaking MTR Corporation, which had HKD13.6 billion of outstanding bonds. The top 30 issuers were predominantly finance and real estate companies. A majority of them were listed in the Hong Kong Stock Exchange and only three were state-owned companies.

Corporate bond issuance reached HKD234.5 billion at the end of June. Issuance growth moderated to 9.8% q-o-q in Q2 2020 from 44.3% q-o-q in Q1 2020. Among the largest issuances during the quarter were bonds issued by the Airport Authority Hong Kong, Hong Kong Mortgage Corporation, and Hong Kong and China Gas Company. The Airport Authority Hong Kong, the state-owned operator of Hong Kong International Airport, issued bonds amounting to HKD5.2 billion, including a 5-year bond with a 1.62% coupon worth HKD0.7 billion, a 7-year bond with a 1.95% coupon worth HKD0.80 billion, and a 10-year bond with a 2.30% coupon worth HKD0.9 billion (**Table 3**).

Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2020

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
Airport Authority Hong Kong		
5-year bond	1.62	0.70
7-year bond	1.95	0.80
10-year bond	2.30	0.90
Hong Kong Mortgage Corporation		
1-year bond	0.00	1.00
3-year bond	0.97	1.00
4-year bond	1.31	0.25
The Hong Kong and China Gas Company		
30-year bond	2.57	1.51
30-year bond	2.57	0.41
Hongkong Electric		
15-year bond	2.59	0.56
30-year bond	2.59	1.24
Goutai Junan International Holdings		
1-year bond	2.53	0.83
1-year bond	2.50	0.50
MTR Corporation		
35-year bond	2.55	0.50

HKD = Hong Kong dollar.
Source: Bloomberg LP.

Government-owned Hong Kong Mortgage Corporation's issuances included a zero coupon 1-year bond worth HKD1.0 billion, a 3-year bond with a 0.97% coupon worth HKD1.0 billion, and a 4-year bond with a 1.31% coupon worth HKD0.25 billion.

Goutai Junan International Holdings, a financial firm, issued a total of HKD4.0 billion worth of bonds including a 1-year bond with a 2.53% coupon worth HKD0.8 billion and a 1-year bond with a 2.50% coupon worth HKD0.5 billion.

There were several issuances of long-dated bonds in Q2 2020, including two 30-year bonds issued by the Hong Kong and China Gas Company, which carried coupons of 2.57% each and were worth a total of HKD1.92 billion. Among Hong Kong Electric's issuances during the quarter was a 30-year bond with a 2.59% coupon worth HKD1.24 billion. MTR Corporation issued the longest-dated bond during the quarter: a 35-year bond with a 2.55% coupon worth HKD0.5 billion.

Policy, Institutional, and Regulatory Developments

The People's Bank of China, Hong Kong Monetary Authority, and Monetary Authority of Macao Launch Cross-Boundary Wealth Management Pilot Scheme

On 29 June, the People's Bank of China, the HKMA, and the Monetary Authority of Macao launched a pilot scheme for cross-boundary wealth management in the Greater Bay Area. Wealth Management Connect is an arrangement wherein residents in the Greater Bay Area can undertake cross-boundary investment in wealth management products managed by banks in the Greater Bay Area. The arrangement will be governed by the respective laws and regulations on retail wealth management products applicable in the three areas as well as international standards and practices. Cross-boundary remittances under the scheme will be carried out in renminbi, with currency conversion conducted in the offshore markets. Relevant regulators in the People's Republic of China; Hong Kong, China; and Macau, China will agree on supervisory cooperation to protect investor interests and maintain fair trading.

Hong Kong Monetary Authority Keeps Countercyclical Capital Buffer at 1.0%

On 7 July, the HKMA decided to hold the countercyclical capital buffer (CCyB) at 1.00%. The HKMA noted that the latest data based on Q1 2020 indicators signal a higher CCyB at 2.25%. However, the HKMA gauged that economic recovery will be protracted given the high level of uncertainty. The HKMA decided to hold the CCyB steady at 1.00% and continue monitoring the economic situation. A lower CCyB provides additional funds for banks, allowing them to extend credit to support financing needs in various sectors of the economy. 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.