Hong Kong, China

Yield Movements

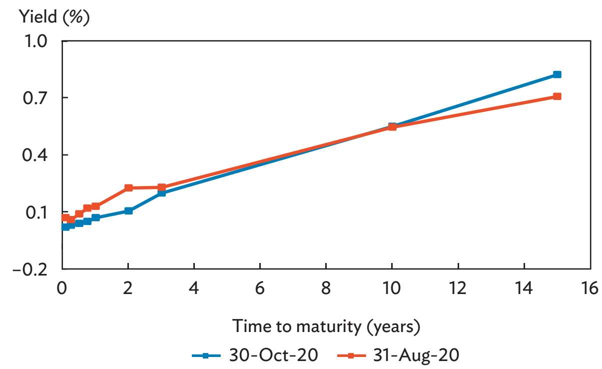
Movements in Hong Kong, China's local currency (LCY) bond market yields were mixed between 31 August and 30 October (**Figure 1**). Yields fell at the shorter-end of the yield curve as bonds with maturities of 3 years or less shed an average of 6 basis points (bps). The 2-year tenor showed the largest drop at 12 bps. Yields rose at the longer-end of the curve, with the yield for the 10-year tenor inching up 1 bp, while the 15-year tenor gained 12 bps. The spread between the 2-year and 10-year tenors widened from 32 bps to 45 bps during the review period.

Heightened uncertainty, brought about by the lingering impact of the coronavirus disease (COVID-19) and exacerbated by political risks, led to the drop in yields at the shorter-end of the curve. The rise in yields at the longer-end of the curve reflected concerns about the debt burden implied by the rising cost of the government's relief efforts to boost the economy.

Declining yields also reflected the lingering weakness in Hong Kong, China's economy. Hong Kong, China's gross domestic product fell 3.5% year-on-year (y-o-y) in the third quarter (Q3) of 2020, a narrower decline than the 9.0% y-o-y contraction in the second quarter (Q2). The improvement stemmed mainly from increased exports, particularly to the People's Republic of China (PRC). Merchandise exports rose 3.9% y-o-y in Q3 2020, rebounding from the 2.2% y-o-y decline in the prior quarter. Although the economy is showing initial signs of improvement amid the PRC's recovery and the local containment of COVID-19, economic performance is still below its level prior to the recession. Unemployment reached a 16-year high of 6.4% in Q3 2020.

Demand for the Hong Kong dollar, fueled by high profile initial public offerings, continued to surge during the review period. High demand continued to push the Hong Kong dollar to the strong-side of its trading band against the US dollar, prompting repeated interventions from the Hong Kong Monetary Authority (HKMA). The HKMA's actions brought the aggregate balance—an indicator of liquidity in the financial system—from HKD193.1 billion (USD24.9 billion) to a record high of HKD457.5 billion (USD59.0 billion) during the review period.

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 consumer prices fell amid a deflationary stretch in Q3 2020. Consumer prices declined 2.2% y-o-y in September, following a 0.4% y-o-y dip in August and a 2.3% y-o-y contraction in July. The government's relief measures, which include waivers of public housing rents and weak demand due to the economic recession, drove deflationary pressures.

Uncertainty over the prolonged global pandemic, frictions between the PRC and the United States, and political risks continued to affect Hong Kong, China's economy and bond market.

Size and Composition

Hong Kong, China's LCY bonds outstanding amounted to HKD2,287.0 (USD295.1 billion) at the end of September, up from HKD2,267.6 billion at the end of June (**Table 1**). The LCY bond market's quarter-on-quarter (q-o-q) growth rose to 0.9% q-o-q in Q3 2020 from 0.5% q-o-q in Q2 2020, driven by a rebound in the government bond segment. On an annual basis, aggregate bonds outstanding increased 1.0% y-o-y in Q3 2020, reversing the 0.8% y-o-y contraction in the previous quarter. The share of government bonds to total LCY bonds outstanding slipped to 50.6% in Q3 2020 from 51.0% in Q2 2020.

Government bonds. At the end of September, LCY government bonds outstanding reached HKD1,157.6 billion, up slightly from HKD1,156.2 billion at the end of March. Although weak at 0.1% q-o-q, the

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2019		Q2 2020		Q3 2020		Q3 2019		Q3 2020	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**2,264**	**289**	**2,268**	**293**	**2,287**	**295**	**(0.9)**	**4.2**	**0.9**	**1.0**
Government	1,170	149	1,156	149	1,158	149	0.5	1.4	0.1	(1.1)
Exchange Fund Bills	1,048	134	1,042	134	1,042	134	0.6	2.4	0.03	(0.6)
Exchange Fund Notes	28	4	26	3	26	3	(3.4)	(16.5)	0.0	(9.2)
HKSAR Bonds	94	12	89	11	90	12	1.0	(2.9)	1.1	(4.4)
Corporate	1,094	140	1,111	143	1,129	146	(2.4)	7.4	1.6	3.2

( ) = 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.
Source: Hong Kong Monetary Authority.

growth of aggregate government bonds outstanding in Q3 2020 reversed the 1.1% q-o-q contraction in the prior quarter. Strong growth in outstanding Hong Kong Special Administrative Region Bonds was the main driver of the expanding government bonds stock. Outstanding Exchange Fund Bills (EFBs) and Exchange Fund Notes (EFNs) posted positive but weak growth in Q3 2020. On a y-o-y basis, outstanding LCY government bonds continued to contract, dropping 1.1% in Q3 2020 after a 0.7% decline in Q2 2020. All components of LCY government bonds outstanding showed a decline in y-o-y growth in Q3 2020.

Exchange Fund Bills. The outstanding stock of EFBs inched up to HKD1,042.3 billion at the end of September from HKD1,041.9 billion at the end of June. Although weak, the 0.03% q-o-q growth in Q3 2020 reversed the 1.7% q-o-q decline posted in the previous quarter. Issuance of EFBs amounted to HKD903.8 billion in Q3 2020, rising 10.0% q-o-q.

Exchange Fund Notes. Since 2015, the HKMA has limited its issuance of EFNs to 2-year tenors. In August, the HKMA issued a 2-year EFN worth HKD1.2 billion. Due to maturities during the quarter, the amount of outstanding EFNs remained steady in Q3 2020 at HKD25.8 billion. On a y-o-y basis, the outstanding stock of EFNs continued to contract, falling 9.2% in Q3 2020 after a 12.2% decline in the previous quarter.

Hong Kong Special Administrative Region Bonds. HKSAR Bonds outstanding rose 1.1% q-o-q to reach HKD89.5 billion at the end of September. The government issued a 15-year bond worth HKD1.0 billion in September under the Institutional Bond Issuance Programme. On a y-o-y basis, the 4.4% contraction in outstanding HKSAR Bonds in Q3 2020 extended the 4.5% decline posted in the prior quarter.

Corporate bonds. Corporate bonds outstanding expanded 1.6% q-o-q to reach HKD1,129.4 billion at the end of September. On a y-o-y basis, corporate bonds outstanding rose 3.2% in Q3 2020, rebounding from a 0.9% contraction in the previous quarter.

Hong Kong, China's top 30 nonbank issuers had a combined HKD256.0 billion of LCY bonds outstanding at the end of September, accounting for 22.5% of the total corporate bond market (**Table 2**). Hong Kong Mortgage Corporation, Sun Hung Kai & Co., Hong Kong and China Gas Company, MRT, and Link Holdings maintained their positions as the top five issuers with outstanding LCY bonds outstanding of HKD40.7 billion, HKD18.6 billion, HKD16.1 billion, HKD13.0 billion, and HKD12.5 billion, respectively. The top 30 issuers were predominantly finance and real estate companies. Finance companies together accounted for a total of HKD105.5 billion of outstanding corporate bonds, while real estate firms had an aggregate corporate bonds stock of HKD58.0 billion. A majority of the top 30 nonbank issuers were listed on the Hong Kong Stock Exchange; only three were state-owned companies.

Corporate bond issuance totaled HKD215.2 billion at the end September, contracting 8.2% q-o-q amid weak business confidence due to economic and political uncertainties. **Table 3** lists the notable corporate bond issuances in Q3 2020. Among the largest issuances

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	40.7	5.2	Yes	No	Finance
2.	Sun Hung Kai & Co.	18.6	2.4	No	Yes	Finance
3.	The Hong Kong and China Gas Company	16.1	2.1	No	Yes	Utilities
4.	MTR	13.0	1.7	Yes	Yes	Transportation
5.	Link Holdings	12.5	1.6	No	Yes	Finance
6.	Hongkong Land	12.5	1.6	No	No	Real Estate
7.	New World Development	12.1	1.6	No	Yes	Diversified
8.	Henderson Land Development	12.0	1.6	No	Yes	Real Estate
9.	Swire Pacific	10.3	1.3	No	Yes	Diversified
10.	Hang Lung Properties	9.4	1.2	No	Yes	Real Estate
11.	Hongkong Electric	8.5	1.1	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.	Guotai Junan International Holdings	7.3	0.9	No	Yes	Finance
15.	Wharf Real Estate Investment	6.9	0.9	No	Yes	Real Estate
16.	Smart Edge	6.8	0.9	No	No	Finance
17.	Airport Authority Hong Kong	6.6	0.9	Yes	No	Transportation
18.	AIA Group	6.3	0.8	No	Yes	Insurance
19.	CK Asset Holdings	6.2	0.8	No	Yes	Real Estate
20.	Hysan Development	5.7	0.7	No	Yes	Real Estate
21.	The Wharf Holdings	5.5	0.7	No	Yes	Finance
22.	Future Days	5.0	0.6	No	No	Transportation
23.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
24.	Cathay Pacific	2.5	0.3	No	Yes	Transportation
25.	China Dynamics Holdings	2.4	0.3	No	Yes	Automotive
26.	Champion REIT	2.3	0.3	No	Yes	Real Estate
27.	South Shore Holdings	2.2	0.3	No	Yes	Industrial
28.	Emperor Capital Group	2.2	0.3	No	Yes	Finance
29.	Emperor International Holdings	2.2	0.3	No	Yes	Finance
30.	IFC Development	2.0	0.3	No	No	Finance
Total Top 30 Nonbank LCY Corporate Issuers		**256.0**	**33.0**			
Total LCY Corporate Bonds		**1,129.4**	**145.7**			
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 September 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 Issuances in the Third Quarter of 2020

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
Hong Kong Mortgage Corporation		
1.5-year bond	0.74	0.50
2-year bond	0.76	0.10
3-year bond	0.93	0.50
5-year bond	0.90	0.17
Guotai Junan International Holdings		
1-year bond	0.00	0.60
1-year bond	2.00	0.38
1-year bond	1.80	0.28
Hongkong Land		
15-year bond	2.65	0.80
15-year bond	2.90	0.40
Hang Lung Properties		
5-year bond	2.35	0.50
5-year bond	2.25	0.42
5-year bond	2.25	0.24
The Hong Kong and China Gas Company		
10-year bond	1.98	0.70
10-year bond	1.98	0.22

HKD = Hong Kong dollar.
Source: Bloomberg LP.

during the quarter were bonds issued by Hong Kong Mortgage Corporation, Guotai Junan International Holdings, Hongkong Land, Hang Lung Properties, and Hong Kong and China Gas Company.

Government-owned Hong Kong Mortgage Corporation issued a total of HKD10.3 billion of bonds in Q3 2020, including a 1.5-year bond with a 0.74% coupon worth HKD0.5 billion, a 2-year bond with a 0.76% coupon worth HKD0.1 billion, a 3-year bond with a 0.93% coupon worth HKD0.5 billion, and a 5-year bond with a 0.90% coupon worth HKD0.2 billion.

Goutai Junan International Holdings, a financial firm, issued a total of HKD2.2 billion, including a zero coupon 1-year bond worth HKD0.6 billion, a 1-year bond with a 2.0% coupon worth HKD0.4 billion, and a 1-year bond with a 1.8% coupon worth HKD0.3 billion.

Hongkong Land issued two 15-year bonds with 2.65% and 2.90% coupons and worth a total of HKD1.20 billion. Hang Lung Properties issued three 5-year bonds worth a total of HKD1.16 billion with coupons ranging from 2.25% to 2.35%. The Hong Kong and China Gas Company raised HKD0.92 billion from two issuances of 10-year bonds, both with a 1.98% coupon.

Policy, Institutional, and Regulatory Developments

Hong Kong Monetary Authority Holds Countercyclical Capital Buffer at 1.0%

On 12 October, the HKMA announced that the countercyclical capital buffer (CCyB) would remain unchanged at 1.0%. The HKMA noted that the latest data based on Q2 2020 indicators signaled the need for a higher CCyB of 2.5%. However, the HKMA deemed that considering the high level of uncertainty facing the economy, holding the CCyB steady at 1.0% was more appropriate. A lower CCyB releases additional liquidity into the banking system by raising banks' lending capacity to support 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.