

Hong Kong, China

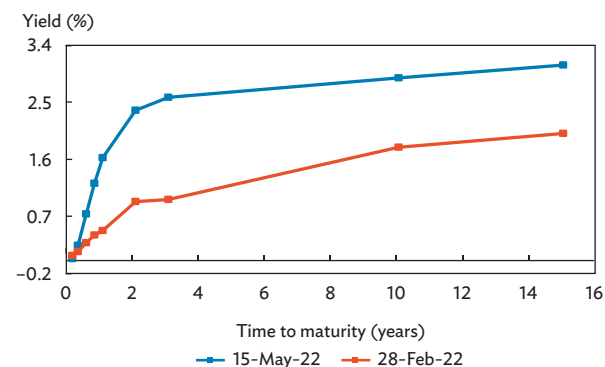
Yield Movements

Between 28 February and 15 May, the local currency (LCY) government bond yield curve in Hong Kong, China shifted upward, with yields rising for all tenors except the 1-month tenor, which fell 5 basis points (bps) (**Figure 1**). On average, yields gained 96 bps across the curve. Yields for bonds with maturities of 1 year or less climbed an average of 63 bps, while yields for bonds with maturities longer than 1 year jumped 130 bps on average. The 3-year tenor showed the largest yield gain, jumping 160 bps. The 2-year yield soared 143 bps, while the 10-year jumped 109 bps. The spread between the 2-year and 10-year bond yields narrowed to 51 bps on 15 May from 85 bps on 28 February.

The rise in yields of Hong Kong, China's LCY bonds broadly tracked the jump in United States (US) Treasury yields during the review period as the Hong Kong dollar is pegged to the US dollar. US Treasury yields rose for all tenors, surging an average of 95 bps. The rise in US Treasury yields was largely driven by elevated inflation and the ensuing aggressive monetary policy tightening of the US Federal Reserve. Pandemic-driven supply chain disruptions, exacerbated by supply shocks caused by the Russian invasion of Ukraine as well as heightened domestic demand, triggered soaring prices. Consumer price inflation in the US climbed to 8.6% year-on-year (y-o-y) in May from 8.3% y-o-y in April. The US Federal Reserve adjusted upward the target for its policy rate by 25 bps to a range of 0.25%–0.50% in its 14–15 March meeting, and by an additional 50 bps to a range of 0.75%–1.00% in its 4–5 May meeting.

To maintain the Hong Kong dollar's peg to the US dollar, the Hong Kong Monetary Authority (HKMA) raised its base rate by 25 bps to 0.75% on 17 March and by another 50 bps to 1.25% on 5 May.¹² Despite the rise in the base rate, excess liquidity in the local banking system kept the Hong Kong Interbank Offered Rate low. The gap between US interest rates and the Hong Kong Interbank Offered Rate encouraged carry trades, pushing the Hong Kong dollar to the weak-side of its trading band against the US dollar in May. On 13 May, the HKMA

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



Source: Based on data from Bloomberg LP.

purchased HKD1.6 billion (USD202.0 million) to maintain the local currency's peg to the US dollar. The HKMA's intervention lowered the aggregate balance—an indicator of liquidity in the financial system—to HKD336.0 billion on 13 May from HKD377.5 billion at the beginning of the year.

Hong Kong, China's gross domestic product (GDP) contracted by 4.0% year-on-year (y-o-y) in the first quarter (Q1) of 2022, reversing the growth posted in the preceding 4 quarters. Merchandise exports fell 4.5% y-o-y as global demand declined and pandemic-induced, cross-border transportation bottlenecks curtailed the movement of goods. Private consumption contracted 5.5% y-o-y as restrictions imposed to curb a severe fifth wave of coronavirus disease (COVID-19) infections constrained economic activities. Investment expenditure fell 8.4% y-o-y as heightened local and global uncertainties worsened business sentiment. In May, the government revised its GDP growth forecast for full-year 2022 downward to 1.0%–2.0% from a forecast of 2.0%–3.5% previously announced in February.

Consumer price inflation in Hong Kong, China remained relatively mild compared to that of other economies in emerging East Asia. In May, consumer price inflation eased to 1.2% y-o-y from 1.3% y-o-y in April and 1.7% y-o-y in March. The underlying inflation, which

¹² The Hong Kong dollar is pegged to a narrow band of between 7.75 and 7.85 versus the US dollar. The base rate is set at either 50 bps above the lower end of the prevailing target range of the US Federal Reserve rate or the average of the 5-day moving averages of the overnight and 1-month Hong Kong Interbank Offered Rate, whichever is higher.

nets out the effects of the government's relief measures, inched up to 1.7% y-o-y in May from 1.6% y-o-y in April. While external price pressures are expected to persist, the government projects that domestic cost pressures will remain moderate. Government forecasts for full-year 2022 headline and underlying inflation are 2.1% and 2.0%, respectively.

Size and Composition

Hong Kong, China's LCY bond market reached a size of HKD2,546.2 billion (USD325.1 billion) at the end of March (**Table 1**). Overall growth dropped to 0.8% quarter-on-quarter (q-o-q) in Q1 2022 from 4.0% q-o-q in the fourth quarter (Q4) of 2021 due primarily to a contraction in the corporate bond segment. On a y-o-y basis, Hong Kong, China's LCY bond market expanded 4.1% in Q1 2022, down from 5.0% in Q4 2021. Government bonds comprised 53.4% of Hong Kong, China's LCY bond market at the end of March, up from 52.2% at the end of December.

Government bonds. Outstanding LCY government bonds amounted to HKD1,360.6 billion at the end of March on growth of 3.3% q-o-q and 14.6% y-o-y. The q-o-q growth in Q1 2021 was driven by increases in the outstanding stock of Exchange Fund Bills (EFBs) and Hong Kong Special Administrative Region (HKSAR) bonds. The stock of Exchange Fund Notes (EFNs) was steady between Q4 2021 and Q1 2022.

Issuance of new government bonds totaled HKD941.2 billion in Q1 2022 on growth of 2.5% q-o-q and 15.1% y-o-y. Issuance growth was primarily driven by increased issuance of EFBs, which the HKMA implemented from September 2021 to February 2022.

Exchange Fund Bills. EFBs outstanding reached HKD1,165.8 billion at the end of March on growth of 3.6% q-o-q and 11.7% y-o-y. EFBs comprised 85.7% of total LCY government bonds at the end of March. Issuance of EFBs totaled HKD936.7 billion in Q1 2022. Issuance growth eased to 3.0% q-o-q in Q1 2022 from 6.9% q-o-q in the previous quarter. To absorb excess liquidity in the financial system, the HKMA increased its issuance of 91-day EFBs by HKD5.0 billion in each of the regular tenders from September 2021 to February 2022. EFB issuance reverted to its previous level in March, hence the impact on issuance was greater in Q4 2021 than in Q1 2022.

Exchange Fund Notes. Outstanding EFNs totaled HKD23.4 billion at the end of March. Issuance of EFNs has been limited to 2-year tenors since 2015. In February, the HKMA issued HKD1.2 billion of 2-year EFNs. Due to maturities, the stock of outstanding EFNs remained the same between the end of December and the end of March. On a y-o-y basis, outstanding EFNs contracted 6.4% in Q1 2021, the same rate of decline recorded in the previous quarter. EFNs accounted for 1.7% of total LCY government bonds at the end of March.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2021		Q4 2021		Q1 2022		Q1 2021		Q1 2022	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,446	315	2,525	324	2,546	325	1.7	8.4	0.8	4.1
Government	1,187	153	1,317	169	1,361	174	0.2	1.5	3.3	14.6
Exchange Fund Bills	1,043	134	1,125	144	1,166	149	0.02	(1.5)	3.6	11.7
Exchange Fund Notes	25	3	23	3	23	3	-	(6.0)	-	(6.4)
HKSAR Bonds	119	15	168	22	171	22	2.3	43.2	1.9	43.8
Corporate	1,258	162	1,208	155	1,186	151	3.1	15.9	(1.9)	(5.8)

() = negative, 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. Bloomberg LP end-of-period local currency-USD rates are used.
2. 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 HKD171.4 billion at the end of March on growth of 1.9% q-o-q and 43.8% y-o-y. HKSAR bond issuance totaled HKD3.3 billion in Q1 2022. In January, the government issued HKD1.5 billion of 10-year government bonds through a reopening of an existing 15-year bond. In February, the HKMA issued HKD1.0 billion of 1-year floating-rate notes indexed to the Hong Kong Dollar Overnight Index Average. In March, the government issued HKD0.8 billion of 15-year bonds. HKSAR bonds comprised 12.6% of total LCY government bonds at the end of March.

Corporate bonds. Hong Kong, China's LCY corporate bond market reached a size of HKD1,185.6 billion at the end of March. The LCY corporate bond market contracted 1.9% q-o-q in Q1 2022, reversing the 2.7% q-o-q growth recorded in the previous quarter. The decline in the LCY corporate bond stock in Q1 2022 was primarily due to a relatively high volume of maturities, which outpaced the growth in issuance.

LCY bonds outstanding of the top 30 nonbank issuers in Hong Kong, China totaled HKD314.8 billion at the end of Q1 2022, accounting for 26.6% of the total corporate bond market (**Table 2**). Hong Kong Mortgage Corporation, Sun Hung Kai & Co., Hong Kong and China Gas Company, New World Development, and Hang Lung Properties were the top five nonbank issuers with outstanding bonds at the end of March of HKD80.7 billion, HKD20.6 billion, HKD17.8 billion, HKD15.8 billion, and HKD13.6 billion, respectively. The top 30 issuers were primarily finance and real estate firms. At the end of Q1 2022, finance firms collectively held a total of HKD144.5 billion of outstanding corporate bonds, comprising 12.2% of the LCY corporate bond market. Real estate companies had a total of HKD64.1 billion of outstanding corporate debt at the end of March, comprising 5.4% of the LCY corporate bond market.

Corporate debt issuance totaled HKD216.1 billion in Q1 2022 on an expansion of 5.5% q-o-q as corporates took advantage of relatively low interest rates to finance funding needs in anticipation of rising borrowing costs in the future as global central banks raise policy rates to temper inflation.

Table 3 shows notable issuers in Q1 2022. AIA Group, an insurance company, had the single-largest issuance of HKD6.5 billion for a 2-year bond. State-owned Hong Kong Mortgage Corporation remained the largest issuer after raising HKD15.3 billion from 39 issuances, including a 1-year bond worth HKD1.0 billion and a 5-year bond worth HKD0.5 billion. Haitong International issued a 92-day bond worth HKD0.9 billion and a 364-day bond worth 1.0 billion during the review period. Guotai Junan International raised a total of HKD1.9 billion from three issuances of short-term bonds. The longest tenor issued in Q1 2022 was Swire Pacific's 10-year bond worth HKD0.5 billion.

Ratings Update

On 7 April, Fitch Ratings affirmed Hong Kong, China's long-term foreign currency issuer default rating at AA- with a stable outlook. The rating affirmation was based on Hong Kong, China's large fiscal reserve, robust external finances, and high per capita income. Fitch Ratings forecast Hong Kong, China's GDP growth to ease to 1.0% in 2022 from 6.4% in 2021 due to the impacts of the latest wave of COVID-19 as well as potential spillovers of a slowdown in growth in the People's Republic of China. The rating agency also affirmed Hong Kong, China's long-term local currency issuer default rating at AA- with a stable outlook.

Policy, Institutional, and Regulatory Developments

Hong Kong Monetary Authority Maintains Countercyclical Capital Buffer Ratio at 1.0%

On 5 May, the HKMA held the countercyclical capital buffer ratio (CCyB) steady at 1.0%. The HKMA noted that the latest economic data as of Q4 2021 signaled a CCyB of 1.0%. Furthermore, economic activities slowed in Q1 2022 and uncertainties regarding global and domestic conditions heightened. Thus, the HKMA decided to keep the CCyB unchanged at 1.0% and will continue to closely monitor developments. The CCyB is an integral part of the Basel III regulatory capital framework intended to improve the resilience of the banking sector.

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	80.7	10.3	Yes	No	Finance
2. Sun Hung Kai & Co.	20.6	2.6	No	Yes	Finance
3. The Hong Kong and China Gas Company	17.8	2.3	No	Yes	Utilities
4. New World Development	15.8	2.0	No	Yes	Diversified
5. Hang Lung Properties	13.6	1.7	No	Yes	Real Estate
6. Link Holdings	13.1	1.7	No	Yes	Finance
7. Henderson Land Development	12.9	1.6	No	Yes	Real Estate
8. MTR	12.0	1.5	Yes	Yes	Transportation
9. Hongkong Land	12.0	1.5	No	No	Real Estate
10. CK Asset Holdings	10.0	1.3	No	Yes	Real Estate
11. Swire Pacific	9.7	1.2	No	Yes	Diversified
12. The Wharf Holdings	9.7	1.2	No	Yes	Finance
13. Cathay Pacific	9.0	1.1	No	Yes	Transportation
14. Airport Authority	8.9	1.1	Yes	No	Transportation
15. AIA Group	8.9	1.1	No	Yes	Insurance
16. Hongkong Electric	8.5	1.1	No	No	Utilities
17. CLP Power Hong Kong Financing	7.4	0.9	No	No	Finance
18. Swire Properties	7.3	0.9	No	Yes	Diversified
19. Hysan Development Corporation	5.9	0.8	No	Yes	Real Estate
20. Guotai Junan International Holdings	5.8	0.7	No	Yes	Finance
21. Future Days	3.7	0.5	No	No	Transportation
22. Wheelock and Company	3.3	0.4	No	Yes	Real Estate
23. Lerthai Group	3.0	0.4	No	Yes	Real Estate
24. Haitong International	3.0	0.4	No	Yes	Finance
25. Farsail Goldman International	2.4	0.3	No	No	Finance
26. Ev Dynamics Holdings	2.4	0.3	No	Yes	Diversified
27. South Shore Holdings	2.2	0.3	No	Yes	Industrial
28. IFC Development	2.0	0.3	No	No	Finance
29. Nan Fung	1.8	0.2	No	No	Real Estate
30. Champion REIT	1.7	0.2	No	Yes	Real Estate
Total Top 30 Nonbank LCY Corporate Issuers	314.8	40.2			
Total LCY Corporate Bonds	1,185.6	151.4			
Top 30 as % of Total LCY Corporate Bonds	26.6%	26.6%			

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

Notes:

1. Data as of 31 March 2022.

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 First Quarter of 2022

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
AIA Group		
2-year bond	2.25	6,500
Hong Kong Mortgage Corporation		
1-year bond	0.61	1,000
2-year bond	1.43	1,000
3-year bond	1.66	450
5-year bond	1.90	500
Haitong International		
92-day bond	0.75	900
364-day bond	1.00	1,025
Guotai Junan International ^a		
181-day bond	0.80	1,200
181-day bond	0.83	460
182-day bond	0.00	240
Swire Pacific		
10-year bond	2.83	500

HKD = Hong Kong dollar.

^a Multiple issuance of the same tenor indicates issuance on different dates.

Source: Bloomberg LP.