

Hong Kong, China

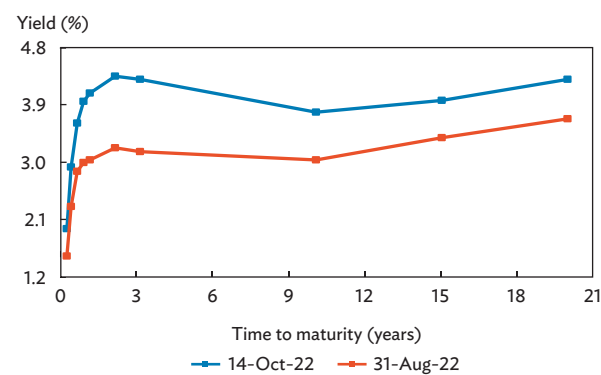
Yield Movements

Between 31 August and 14 October, Hong Kong, China's local currency (LCY) government bond yield curve shifted upward, with yields rising for all tenors (**Figure 1**). Yields rose an average of 80 basis points (bps) across the curve. Bonds with maturities between 1 year and 3 years posted the biggest yield gains, rising 110 bps on average. Yields for bonds with maturities of less than 1 year jumped an average of 69 bps, while yields for bonds with maturities of 10 years or longer rose 65 bps on average. The yield curve remained inverted during the review period. The negative spread between the 10-year and 2-year yields deepened from -19 bps on 31 August to -57 bps on 14 October.

The movements of Hong Kong, China's LCY bond yields during the review period tracked those of United States (US) Treasury yields, owing to the Hong Kong dollar's peg to the US dollar. US Treasury yields jumped an average of 89 bps across all tenors during the review period, with the 2-year Treasury yield posting the highest gain at 100 bps. The US Treasury yield curve remained inverted during the review period, with the negative spread between the 10-year and 2-year yields widening from -30 bps on 31 August to -48 bps on 14 October.

The rise in US Treasury yields was primarily due to the Federal Reserve's continuing aggressive monetary policy tightening to arrest mounting inflation. In its September policy rate meeting, the Federal Reserve increased the target range for its policy rate by 75 bps to a range of 3.00%–3.25%. From March to September, the Federal Reserve had raised its policy rate by a total of 300 bps. To maintain the Hong Kong dollar's peg to the US dollar, the Hong Kong Monetary Authority (HKMA) increased its base rate by 75 bps to 2.75% on 28 July and by another 75 bps to 3.50% on 22 September.¹⁰ The relentless monetary policy tightening by the US and the consequent base rate adjustment by the HKMA continued to create upward pressure on yields at the shorter-end of the government bond yield curves of the US and Hong Kong, China, respectively. Investors

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



Source: Based on data from Bloomberg LP.

priced in the rate hikes as well as expectations that the Federal Reserve would maintain its hawkish monetary policy stance for an extended period.

The inverted yield curve in Hong Kong, China also reflected expectations of a prolonged economic downturn. Hong Kong, China has recorded 3 consecutive quarters of economic contractions in 2022: gross domestic product (GDP) plunged 4.5% year-on-year (y-o-y) in the third quarter (Q3) following contractions of 1.3% year-on-year (y-o-y) in the second quarter (Q2) and 3.9% y-o-y in the first quarter. The GDP decline in Q3 2022 was primarily due to sharp contractions in exports and investment expenditure. Merchandise exports fell 15.6% y-o-y in Q3 2022, following an 8.4% y-o-y drop in Q2 2022 amid weakened global demand and continued cross-border disruptions. Domestic fixed capital formation dropped 14.3% y-o-y in Q3 2022 due to tightened financial conditions brought about by rising interest rates. Hong Kong, China's economy continues to face downside risks from persistent global inflation, continued monetary policy tightening by global central banks, heightened geopolitical tensions, and the uncertain trajectory of the pandemic. In October, the Census and Statistics Department revised downward its full-year 2022 GDP growth forecast to -3.2% from its August projection of -0.5% to 0.5%.

¹⁰ The Hong Kong dollar is pegged to a narrow band of between HKD7.75 and HKD7.85 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.

Hong Kong, China's consumer price inflation remained relatively moderate compared with that of neighboring economies. Inflation jumped to 4.4% y-o-y in September from 1.9% y-o-y in August, mainly due to a low base as a waiver of public housing rentals subdued prices in September 2021. Inflation was relatively low in the prior months at 1.9% y-o-y in July and 1.8% y-o-y in June. In October, the Census and Statistics Department revised its full-year 2022 forecast for headline inflation to 1.9%, down from 2.1% as announced in August.

During the review period, the HKMA intervened multiple times in the currency market to defend the Hong Kong dollar's peg to the US dollar. As a result, the aggregate balance—a measure of liquidity in the local banking system—dropped to HKD106.6 billion on 14 October from HKD125.0 billion on 31 August.

Size and Composition

Hong Kong, China's LCY bond market reached a size of HKD2,748.2 billion (USD350.1 billion) at the end of September after rising 4.9% quarter-on-quarter (q-o-q) and 13.2% y-o-y in Q3 2022 (Table 1). Growth accelerated from 2.9% q-o-q and 7.9% y-o-y in Q2 2022 primarily due to faster expansions in both the government and corporate bond segments. Growth in government bonds outstanding more than doubled to 3.7% q-o-q in Q3 2022 from 1.5% q-o-q in the previous quarter. Meanwhile, the stock of outstanding corporate bonds rose 6.2% q-o-q in Q3 2022, up from 4.4% q-o-q in the previous quarter. Government bonds comprised 52.1% of Hong Kong, China's LCY bond market, while

corporate bonds represented the remaining 47.9% at the end of September.

Government bonds. Outstanding LCY government bonds amounted to HKD1,432.8 billion at the end of September. Quarterly growth in outstanding government bonds was driven by robust growth in Hong Kong Special Administrative Region (HKSAR) bonds and Exchange Fund Bills (EFBs). Exchange Fund Notes (EFNs) continued to contract. On an annual basis, LCY government bonds outstanding rose 14.4% y-o-y in Q3 2022, up from 13.6% y-o-y growth in the prior quarter. At the end of September, LCY government bonds outstanding comprised 82.0% EFBs, 1.5% EFNs, and 16.5% HKSAR bonds.

Total issuance of new government bonds reached HKD1,001.4 billion in Q3 2022 after expanding 3.5% q-o-q and 14.6% y-o-y. Growth was supported by robust issuance of HKSAR bonds and EFBs, which rose 71.9% q-o-q and 1.5% q-o-q, respectively, during the review period.

Exchange Fund Bills. The stock of outstanding EFBs reached HKD1,174.3 billion at the end of September on growth of 0.6% q-o-q and 10.3% y-o-y. New EFBs issued in Q3 2022 totaled HKD961.2 billion. EFB issuance growth picked up, rising to 1.5% q-o-q in Q3 2022 from 1.1% q-o-q in the preceding quarter.

Exchange Fund Notes. Outstanding EFNs totaled HKD22.0 billion at the end of September, down from HKD22.6 billion at the end of June. The HKMA

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2021		Q2 2022		Q3 2022		Q3 2021		Q3 2022	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,429	312	2,619	334	2,748	350	0.1	6.1	4.9	13.2
Government	1,252	161	1,381	176	1,433	183	3.0	8.2	3.7	14.4
Exchange Fund Bills	1,064	137	1,168	149	1,174	150	1.9	2.1	0.6	10.3
Exchange Fund Notes	24	3	23	3	22	3	0.0	(6.2)	(2.7)	(9.1)
HKSAR Bonds	164	21	191	24	236	30	11.1	82.8	24.0	44.5
Corporate	1,176	151	1,238	158	1,315	168	(2.9)	4.1	6.2	11.8

() = 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. 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.

issued HKD1.2 billion of 2-year EFNs in August with a record-high coupon of 2.84%.

HKSAR bonds. The outstanding stock of HKSAR bonds reached HKD236.5 billion at the end of September after expanding 24.0% q-o-q. HKSAR bond issuance totaled HKD49.0 billion in Q3 2022. Issuances under the Institutional Bond Programme included HKD1.5 billion of 10-year HKSAR bonds issued in July, HKD1.5 billion of 1-year floating rate notes indexed to the Hong Kong Overnight Index Average issued in August, and HKD1.0 billion of 15-year bonds issued in September. In September, the government issued HKD45.0 billion of 3-year Silver Bonds under its Retail Bond Issuance Programme. Due to strong demand, the issuance amount of the Silver Bonds, which are intended for senior citizens, was higher than the target issuance of HKD35.0 billion.

Corporate bonds. Hong Kong, China's LCY corporate bond market reached a size of HKD1,315.4 billion at the end of September. Growth accelerated to 6.2% q-o-q in Q3 2022 from 4.4% q-o-q in the previous quarter.

The outstanding LCY bonds of the top 30 nonbank issuers in Hong Kong, China totaled HKD311.2 billion at the end of September, representing 23.7% of the total LCY corporate bond market (**Table 2**). Hong Kong Mortgage Corporation remained the largest issuer, with an outstanding debt stock of HKD86.5 billion at the end of September. Sun Hung Kai & Co. and the Hong Kong and China Gas Company were the next largest issuers with outstanding debt stocks of HKD20.5 billion and HKD18.6 billion, respectively. Firms in the finance, real estate, and transportation sectors dominated the top 30 nonbank issuers list. Only four of the top 30 nonbank issuers were state-owned firms, while the majority were listed on the Hong Kong Stock Exchange.

Corporate bond issuance in Q3 2022 amounted to HKD241.6 billion. Issuance contracted 3.3% q-o-q in Q3 2022 amid rising borrowing costs and heightened uncertainties. Continued monetary policy tightening by the US Federal Reserve and the consequent base rate adjustments by the HKMA raised borrowing costs. Meanwhile, the extended economic downturn soured investor confidence, resulting in less corporate borrowing during the quarter.

Table 3 shows notable nonbank corporate bond issuances in Q3 2022. Hong Kong Mortgage Corporation was the largest issuer with a total of HKD10.6 billion from 27 issuances of bonds with maturities ranging from 91 days to 3 years. The state-owned Airport Authority was the second-largest issuer in Q3 2022, with four issuances totaling HKD1.8 billion. The next largest issuers during the quarter were the Hong Kong and China Gas Company and MTR, which raised a total of HKD1.5 billion and HKD1.3 billion, respectively. The longest tenor issued in Q3 2022 was a 10-year bond with a 4.10% coupon issued by the Hong Kong and China Gas Company.

Policy, Institutional, and Regulatory Developments

Hong Kong Monetary Authority Announces Tentative Issuance for Hong Kong Special Administrative Region Government Bonds

On 30 September, the HKMA announced the tentative issuance schedule for HKSAR bonds under the Institutional Bond Issuance Programme for the period between October 2022 and March 2023. The issuance schedule included planned issuances of bonds with tenors ranging from 1 year to 20 years. Of note are two planned switch tenders. The first such switch tender will involve the issuance of a 3-year HKSAR bond in exchange for the early redemption of a 15-year HKSAR bond with an original maturity of March 2032. The other switch tender will involve the issuance of a 3-year bond in exchange for the early redemption of a 15-year bond with an original maturity of March 2036. Switch tender operations are intended to promote liquidity in the bond market by allowing market participants to switch bonds with different maturities through a competitive tender.

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	86.5	11.0	Yes	No	Finance
2.	Sun Hung Kai & Co.	20.5	2.6	No	Yes	Finance
3.	The Hong Kong and China Gas Company	18.6	2.4	No	Yes	Utilities
4.	New World Development	15.3	1.9	No	Yes	Diversified
5.	Airport Authority	15.2	1.9	Yes	No	Transportation
6.	Henderson Land Development	14.7	1.9	No	Yes	Real Estate
7.	Hang Lung Properties	12.7	1.6	No	Yes	Real Estate
8.	Hongkong Land	12.0	1.5	No	No	Real Estate
9.	Wharf Real Estate Investment Company	11.2	1.4	No	Yes	Finance
10.	MTR	10.7	1.4	Yes	Yes	Transportation
11.	Link Holdings	9.3	1.2	No	Yes	Finance
12.	Cathay Pacific	8.9	1.1	No	Yes	Transportation
13.	Swire Pacific	8.7	1.1	No	Yes	Diversified
14.	CK Asset Holdings	8.5	1.1	No	Yes	Real Estate
15.	Hongkong Electric	8.5	1.1	No	No	Utilities
16.	AIA Group	7.6	1.0	No	Yes	Insurance
17.	Swire Properties	7.3	0.9	No	Yes	Diversified
18.	CLP Power Hong Kong Financing	6.6	0.8	No	No	Finance
19.	Hysan Development Corporation	5.9	0.8	No	Yes	Real Estate
20.	Lerthai Group	3.0	0.4	No	Yes	Real Estate
21.	Haitong International	2.8	0.4	No	Yes	Finance
22.	Wheelock and Company	2.8	0.4	No	Yes	Real Estate
23.	Ev Dynamics Holdings	2.4	0.3	No	Yes	Diversified
24.	South Shore Holdings	2.2	0.3	No	Yes	Industrial
25.	Future Days	2.2	0.3	No	No	Transportation
26.	IFC Development	2.0	0.3	No	No	Finance
27.	Champion REIT	1.7	0.2	No	Yes	Real Estate
28.	Asia Standard Hotel Group	1.2	0.2	No	Yes	Finance
29.	Yuexiu REIT	1.1	0.1	No	Yes	Real Estate
30.	Urban Renewal Authority	1.1	0.1	Yes	No	Industrial Services
Total Top 30 Nonbank LCY Corporate Issuers		311.2	39.6			
Total LCY Corporate Bonds		1,315.4	167.6			
Top 30 as % of Total LCY Corporate Bonds		23.7%	23.7%			

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

Notes:

1. Data as of 30 September 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 Third Quarter of 2022

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)	Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD million)
Hong Kong Mortgage Corporation ^a			MTR ^a		
91-day bond	0.00	1,000	2-year bond	4.20	300
91-day bond	0.00	1,000	2-year bond	3.25	500
1-year bond	3.40	900	3-year bond	3.11	250
2-year bond	3.00	804	3-year bond	3.05	251
3-year bond	3.09	300	Henderson Land ^a		
Airport Authority ^a			2-year bond	4.10	150
5-year bond	3.20	335	2-year bond	3.70	500
5-year bond	3.20	365	Wharf Real Estate Investment Company		
5-year bond	3.20	574	3-year bond	4.00	300
5-year bond	3.30	575	Cathay Pacific		
The Hong Kong and China Gas Company ^a			2-year bond	5.00	200
2-year bond	3.81	400			
3-year bond	3.76	380			
3-year bond	3.83	400			
10-year bond	4.10	350			

HKD = Hong Kong dollar.

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

Source: Bloomberg LP.