

# The Hong Kong Debt Market in 2017

by the Financial Infrastructure Department

Faster economic growth and subdued inflation globally supported global bond markets in 2017. While the US Federal Reserve raised interest rates three times and began to reduce its balance sheet, the US Treasury yield curve did not rise sharply. In Hong Kong, the total issuance amount of Hong Kong dollar debt instruments increased, mainly attributable to increased issuance of Exchange Fund Bills and Notes. The Government also issued the third sukuk under the Government Bond Programme to support the development of the Islamic bond market.

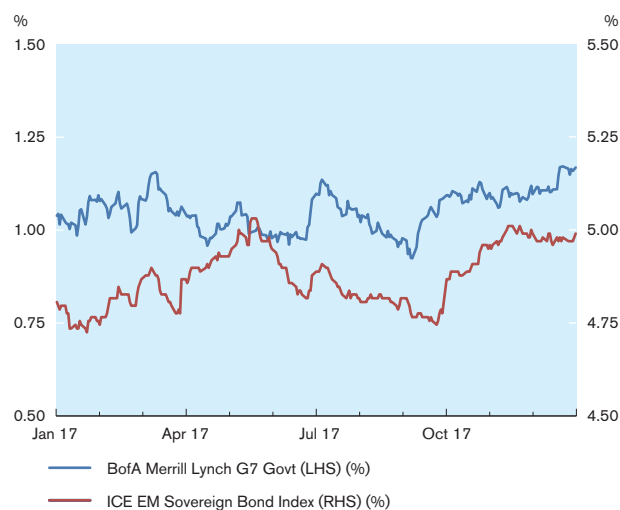
## Overview of global bond markets

The global economy in 2017 saw a rebound with subdued inflation. In developed economies, sovereign bond yields gradually picked up from the third quarter onwards. Sovereign bond yields in emerging markets also increased in tandem with the US Treasury yields after September 2017 (Chart 1).

In the US, the Federal Reserve raised interest rates three times and announced a gradual normalisation of its balance sheet, and the new administration would pursue tax reforms which may widen the fiscal deficit. Short-term US Treasury yields rose while long-term yields remained mostly stable, resulting in a flattening of the yield curve. In Europe, the European Central Bank kept interest rates unchanged during the year, and announced a slowdown in the pace of asset purchases in 2018 amid a pick up in economic growth. Government bond yields of major European economies increased mildly in 2017. In Asia, improved market sentiment and stronger growth momentum boosted yield-searching behaviour, although yields of Asian economies increased in tandem with the US Treasury yields after September 2017.

**CHART 1**

### Average borrowing costs in developed and emerging markets



Notes:

1. Average yields of the BofA Merrill Lynch G7 Government index are used as proxies to the yield levels of developed markets.
2. Average yields of ICE emerging market sovereign bond index are used as proxies to the yield levels of emerging markets.

Sources: Thomson Reuters, Bloomberg and Bank of America Merrill Lynch.

## Hong Kong Debt Market Review

A massive amount of funds have flowed into the Hong Kong dollar since the global financial crisis, keeping domestic interest rates at low levels. The Hong Kong dollar interbank interest rates stayed soft in the first eight months of 2017, before facing more upward pressure towards the end of the year with the one month Hong Kong Interbank Offered Rate (HIBOR) increasing to about 1.2% per annum. The rise was driven mainly by initial public offering-related and year-end funding demand. The Government bond yield curve also shifted upwards in the latter part of 2017.

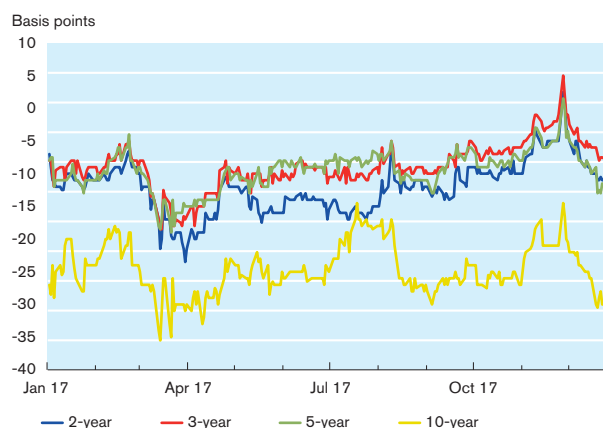
Nonetheless, ample liquidity and subdued inflation supported the demand for bonds. Hong Kong dollar debt issuance increased for the ninth consecutive year to HK\$3.34 trillion, representing an increase of 9.3% over 2016. The increase was largely due to the increased issuance of Exchange Fund Bills and Notes.

### Overseas entities

Debt issuance by overseas entities tends to be opportunistic in nature. Although Hong Kong dollar interest rates, such as HIBOR and Government Bond yields, were lower than their US dollar counterparts, the US dollar/HK dollar basis spreads were in negative territory for most of the year (Chart 2). As such, there was less incentive for overseas issuers to issue Hong Kong dollar bonds. This led to a 18% decline in bond issuance in Hong Kong by overseas issuers (mainly financial institutions, corporates, and multilateral development banks) in 2017 as compared with 2016.

CHART 2

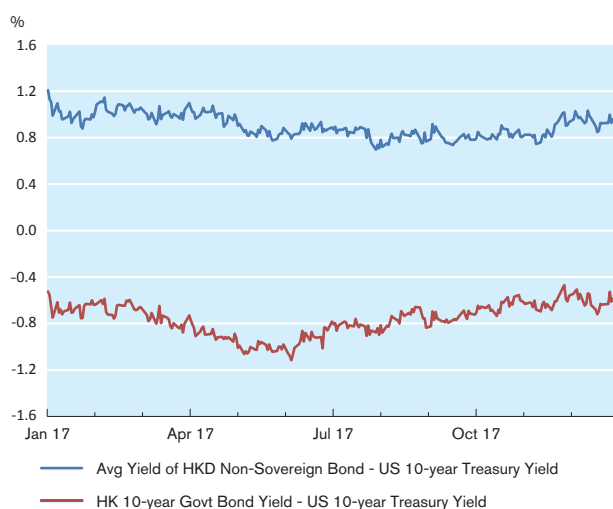
### Key tenors of USD/HKD basis spreads



Source: Bloomberg.

### Local corporates and authorized institutions (AIs)

Strong economic growth supported the demand for corporate bonds. However, from the supply side, local corporates shrank their funding scale in the local debt market with the issuance volume decreasing by 18% from 2016. This suggests that an increase in US Treasury yields has the effect of reducing issuance in corporate bonds in emerging Asia markets. Credit spreads of Hong Kong dollar bonds over US Treasury yields trended downwards in the first half of the year before widening later (Chart 3). Correspondingly, “pre-refinancing” activities were brisk in the first half taking advantage of the low local interest rates, but subsided afterwards. On the other hand, fund-raising activities by AIs increased by 2.5% year-on-year, as AIs tried to secure funding for their regular shorter term funding needs through the issuance of Certificates of Deposit and notes.

**CHART 3****HKD yield spreads with the US 10-year Treasury yield**

Sources: HKMA, Bank of America Merrill Lynch and Bloomberg.

**Downgrade of Hong Kong's credit rating**

In May 2017, Moody's downgraded Hong Kong's credit rating from Aa1 to Aa2. In September, Standard and Poor's also downgraded Hong Kong's credit rating from AAA to AA+. These downgrades were seen to be related to the credit rating of Mainland China, rather than a worsening of Hong Kong's credit fundamentals. Spreads of Hong Kong dollar corporate bonds over US Treasuries did not record a significant increase and the downgrades did not seem to have any material impact on the intention and ability of Hong Kong corporates to issue bonds.

**Other developments**

The HKMA and the People's Bank of China jointly launched the Bond Connect in July 2017, with Northbound Trading coming into operation in the first phase, enabling overseas institutional investors to invest in the interbank bond market in Mainland China, through the cross-border financial infrastructure linkages between the HKMA Central Moneymarkets Unit and other financial infrastructure institutions of Mainland China and Hong Kong. The Bond Connect provides an additional and more convenient channel for overseas investors to access

the Mainland bond markets, using common practices in international financial markets. Operation of the Northbound Trading has been smooth, with over 240 investors participating and daily turnover averaging RMB2 billion up to the end of 2017.

The Ministry of Finance has issued renminbi sovereign bonds in Hong Kong every year since 2009. In October 2017, it issued its first US dollar sovereign bonds in Hong Kong, with a total issuance amount of US\$2 billion (US\$1 billion in 5-year tenor and the remaining US\$1 billion in 10-year tenor).

**Government Bond (GB) Programme**

The HKMA continued to implement the GB Programme to promote the further and sustainable development of the local bond market. At the end of 2017, there were a total of 13 issues of institutional bonds outstanding with total amount reaching HK\$78.9 billion.

**Retail bonds**

During the year, the Government issued the second batch of Silver Bond. Silver Bond is an inflation-linked bond with a minimum annual interest rate of 2% and targets Hong Kong residents aged 65 or above. The size of the 2017 issuance was HK\$3 billion, with a tenor of three years. The number of valid applications was 44,842, with total subscription amounting to nearly HK\$4.2 billion. The success demonstrated the immense potential of the silver market for the financial sector to tap into.

On the other hand, the issuance of iBond was suspended by the Government in 2017, owing to the subdued inflation and rising interest rates which diminished the bond's attractiveness. The iBond was launched in 2011 amid the persistently low interest rate environment and high inflation rate, and aimed to provide Hong Kong residents with an investment product to help cope with inflation. A total of six iBonds were issued in the past. At the end of 2017, two issues of iBond and two issues of Silver Bond, totalling HK\$25.9 billion, were outstanding.

## *Islamic bonds*

In February 2017, the Government successfully offered its third US dollar denominated sukuk with an issuance size of US\$1 billion and a tenor of 10 years (subsequent to two sukuk issuances in 2014 and 2015 respectively). This was a landmark transaction as Hong Kong was the first AAA-government to launch a sukuk with a 10-year tenor. This latest sukuk has extended the yield curve, setting an important new benchmark for potential issuers in Hong Kong and globally. Despite the uncertain global environment and the longer tenor, the sukuk still saw strong demand, attracting orders of US\$1.7 billion. The 10-year tenor had also attracted new investors which had not participated in the previous two sukuk issuances. At the end of 2017, three US dollar sukuk issues, each with an issuance size of US\$1 billion, were outstanding.

## **Looking ahead**

Given the normalisation of monetary policies by major central banks, the costs of debt financing could increase and this may have a bearing on Hong Kong's debt market in 2018. Nonetheless, there are favourable developments which may provide support to the local debt market. For instance, the admission of Hong Kong as a member of the Asian Infrastructure Investment Bank in 2017 may bring new infrastructure financing opportunities. In addition, as announced in the 2017 Policy Address, the Government plans to issue green bonds to encourage investors to finance their green projects through Hong Kong's capital markets. The HKMA will also continue to support the development of the Hong Kong dollar debt market through the implementation of the GB Programme, and continue to enhance the Bond Connect Northbound Trading operations and explore potential areas of further development of the Bond Connect.

## APPENDIX (see notes)

## Issuance of Hong Kong dollar debt instruments (in HK\$ million)

	(A) Exchange Fund	(B) Government	(A) + (B) Public Segment (year-on- year rate of change)	(C) Authorized Institutions	(D) Local corporates	(E) MDBs	(F) Non-MDB overseas issuers	(G) Statutory bodies & government- owned corporations	(C) to (G) Non-public Segment (year-on- year rate of change)	Total (year-on- year rate of change)
1998	316,850	0	316,850	32,889	7,320	44,502	7,006	9,171	100,888	417,738
1999	261,443	0	261,443 (-17.5%)	81,280	26,228	15,920	21,197	8,931	153,556 (52.2%)	414,999 (-0.7%)
2000	275,036	0	275,036 (5.2%)	97,949	17,902	19,330	37,404	8,325	180,910 (17.8%)	455,946 (9.9%)
2001	237,009	0	237,009 (-13.8%)	72,001	5,808	7,462	42,464	24,075	151,810 (-16.1%)	388,818 (-14.7%)
2002	216,228	0	216,228 (-8.8%)	94,133	9,484	5,200	50,746	20,760	180,323 (18.8%)	396,551 (2.0%)
2003	219,648	0	219,648 (1.6%)	94,374	5,470	2,641	51,955	15,724	170,164 (-5.6%)	389,811 (-1.7%)
2004	205,986	10,250	216,236 (-1.6%)	74,289	9,321	3,530	55,649	17,799	160,588 (-5.6%)	376,824 (-3.3%)
2005	213,761	0	213,761 (-1.1%)	97,795	11,067	1,800	69,014	8,560	188,236 (17.2%)	401,997 (6.7%)
2006	220,415	0	220,415 (3.1%)	82,242	21,771	2,950	109,297	17,419	233,679 (24.1%)	454,094 (13.0%)
2007	223,521	0	223,521 (1.4%)	100,143	19,078	1,700	80,977	19,368	221,266 (-5.3%)	444,787 (-2.0%)
2008	285,875	0	285,875 (27.9%)	68,029	14,592	3,000	28,556	24,308	138,485 (-37.4%)	424,360 (-4.6%)
2009	1,047,728	5,500	1,053,228 (268.4%)	75,566	19,539	13,145	50,744	29,852	188,846 (36.4%)	1,242,073 (192.7%)
2010	1,816,752	18,500	1,835,252 (74.3%)	103,413	13,583	315	32,222	11,187	160,720 (-14.9%)	1,995,972 (60.7%)
2011	1,841,278	27,500	1,868,778 (1.8%)	136,310	28,282	0	17,779	20,195	202,566 (26.0%)	2,071,345 (3.8%)
2012	1,851,575	26,000	1,877,575 (0.5%)	190,078	27,688	790	22,219	12,027	252,802 (24.8%)	2,130,377 (2.8%)
2013	2,123,448	30,000	2,153,448 (14.7%)	143,027	25,573	940	23,121	10,665	203,326 (-19.6%)	2,356,774 (10.6%)
2014	2,177,293	30,800	2,208,093 (2.5%)	127,130	33,278	1,337	50,529	9,647	221,921 (9.1%)	2,430,015 (3.1%)
2015	2,242,206	30,400	2,272,606 (2.9%)	136,350	14,186	0	58,859	12,015	221,410 (-0.2%)	2,494,017 (2.6%)
2016	2,689,622	29,400	2,719,022 (19.6%)	181,244	25,157	5,529	100,715	20,898	333,543 (50.6%)	3,052,565 (22.4%)
2017	3,000,429	19,600	3,020,029 (11.1%)	185,772	20,728	3,230	84,000	21,541	315,271 (-5.5%)	3,335,300 (9.3%)

Source: HKMA.

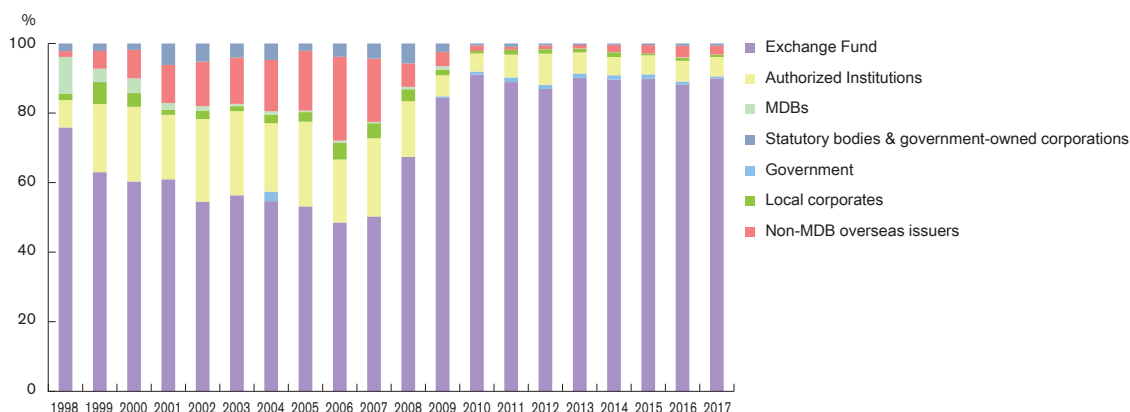
## Outstanding size of Hong Kong dollar debt instruments (in HK\$ million)

	(A) Exchange Fund	(B) Government	(A) + (B) Public Segment (year-on- year rate of change)	(C) Authorized Institutions	(D) Local corporates	(E) MDBs	(F) Non-MDB overseas issuers	(G) Statutory bodies & government- owned corporations	(C) to (G) Non-public Segment (year-on- year rate of change)	Total (year-on- year rate of change)
<b>1998</b>	97,450	0	97,450	161,110	28,286	69,402	25,529	11,366	295,693	<b>393,143</b>
<b>1999</b>	101,874	0	101,874 (4.5%)	177,437	41,219	61,287	37,259	20,117	337,319 (14.1%)	<b>439,192 (11.7%)</b>
<b>2000</b>	108,602	0	108,602 (6.6%)	189,137	41,970	57,062	55,103	20,047	363,319 (7.7%)	<b>471,921 (7.5%)</b>
<b>2001</b>	113,750	0	113,750 (4.7%)	178,788	41,703	51,104	72,351	35,873	379,819 (4.5%)	<b>493,568 (4.6%)</b>
<b>2002</b>	117,476	0	117,476 (3.3%)	184,736	40,245	40,834	99,514	48,212	413,541 (8.9%)	<b>531,018 (7.6%)</b>
<b>2003</b>	120,152	0	120,152 (2.3%)	196,972	34,519	27,855	121,486	56,441	437,273 (5.7%)	<b>557,426 (5.0%)</b>
<b>2004</b>	122,579	10,250	132,829 (10.6%)	207,214	35,338	24,735	147,579	60,186	475,052 (8.6%)	<b>607,880 (9.1%)</b>
<b>2005</b>	126,709	10,250	136,959 (3.1%)	233,442	39,624	21,535	174,247	57,712	526,560 (10.8%)	<b>663,520 (9.2%)</b>
<b>2006</b>	131,788	7,700	139,488 (1.8%)	241,030	53,864	19,555	237,308	56,876	608,633 (15.6%)	<b>748,121 (12.8%)</b>
<b>2007</b>	136,646	7,700	144,346 (3.5%)	250,941	62,044	13,155	234,482	58,476	619,098 (1.7%)	<b>763,443 (2.0%)</b>
<b>2008</b>	157,653	5,000	162,653 (12.7%)	206,471	68,265	14,253	199,943	64,618	553,550 (-10.6%)	<b>716,202 (-6.2%)</b>
<b>2009</b>	534,062	7,000	541,062 (232.6%)	194,590	79,962	24,348	200,686	66,643	566,229 (2.3%)	<b>1,107,291 (54.6%)</b>
<b>2010</b>	653,138	25,500	678,638 (25.4%)	218,866	85,575	15,513	186,166	60,592	566,712 (0.1%)	<b>1,245,350 (12.5%)</b>
<b>2011</b>	655,413	49,500	704,913 (3.9%)	228,943	97,284	14,731	163,724	51,034	555,716 (-1.9%)	<b>1,260,629 (1.2%)</b>
<b>2012</b>	657,384	68,500	725,884 (3.0%)	263,418	116,188	10,271	147,669	45,159	582,705 (4.9%)	<b>1,308,590 (3.8%)</b>
<b>2013</b>	751,151	91,500	842,651 (16.1%)	250,104	127,937	10,214	148,698	39,816	576,769 (-1.0%)	<b>1,419,420 (8.5%)</b>
<b>2014</b>	752,630	98,000	850,630 (0.9%)	232,796	137,624	6,101	141,670	40,990	559,181 (-3.0%)	<b>1,409,812 (-0.7%)</b>
<b>2015</b>	828,421	100,400	928,821 (9.2%)	239,958	141,659	5,301	157,948	43,351	588,216 (5.2%)	<b>1,517,037 (7.6%)</b>
<b>2016</b>	963,098	102,800	1,065,898 (14.8%)	273,146	153,414	10,550	177,558	50,010	664,678 (13.0%)	<b>1,730,576 (14.1%)</b>
<b>2017</b>	1,048,479	106,400	1,154,879 (8.3%)	242,649	160,639	9,854	180,500	53,647	647,289 (-2.6%)	<b>1,802,168 (4.1%)</b>

Source: HKMA.

CHART B1

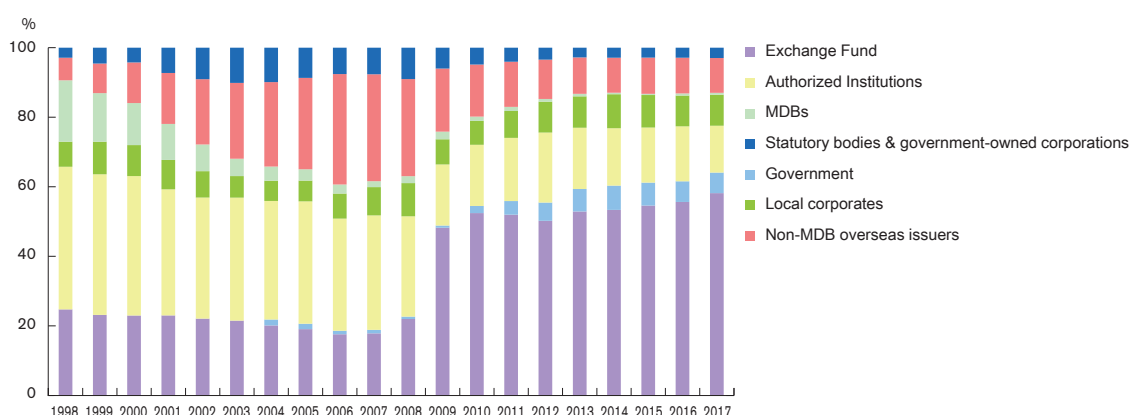
Proportions of Hong Kong dollar debt issuance activities (by type of issuers)



Source: HKMA.

CHART B2

Proportions of outstanding Hong Kong dollar debt instruments (by type of issuers)



Source: HKMA.

Notes:

1. Authorized institutions include licensed banks, restricted licence banks and deposit-taking companies.
2. Multilateral development banks (MDBs) refer to the Asian Development Bank, the Council of Europe Development Bank (formerly known as the Council of Europe Social Development Fund), the European Company for the Financing of Railroad Rolling Stock, the European Investment Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Finance Corporation, the African Development Bank, the Nordic Investment Bank, and the CAF - Development Bank of Latin America. Income earned on Hong Kong dollar debt securities issued by the MDBs is exempt from profits tax.
3. Statutory bodies and government-owned corporations include Bauhinia Mortgage-backed Securities Limited, The Hong Kong Mortgage Corporation, Airport Authority Hong Kong, Hong Kong Link 2004 Limited, Kowloon-Canton Railway Corporation, MTR Corporation Limited, Hong Kong Interbank Clearing Limited, Urban Renewal Authority, Hong Kong Housing Society, and the Hong Kong Science and Technology Parks Corporation. It should be noted that while the issuers are public bodies in the legal sense, they are typically considered as non-public issuers by the market. Hence, they are categorised under the "non-public" segment in the tables above.
4. Figures may not add up to total because of rounding.