The Hong Kong debt market in 2013

by Monetary Management Department

The international debt market experienced much volatility in 2013. Expectation of tapering of asset purchases in the US in the second quarter led to a sell-off in the fixed income market, which affected primary market issuance activities. In the Hong Kong dollar debt market, while issuances remained active, there was a drop in the total amount of debt issuances by the non-public issuers during the year. Meanwhile, the offshore renminbi bond market continued to grow, with issuance volume again setting a new record. The Hong Kong SAR Government announced that it would implement two liquidity enhancement measures under the Government Bond Programme to further promote the liquidity of bonds in the institutional bond market.

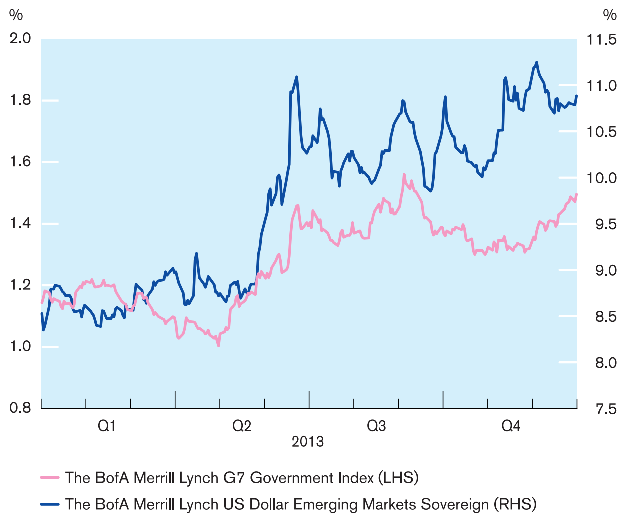
Overview of the international bond market

While global bond yields generally trended downward in the early part of 2013, the market turned more volatile from late May as remarks from the then US Federal Reserve Chairman Ben Bernanke raised concerns that US monetary policy could soon be tightened amid improving economic conditions in the US. Meanwhile, interbank interest rates in Mainland China spiked in June, triggering concerns over tightening liquidity. The international bond market responded with soaring yields in both developed and emerging markets (Chart 1).

The global bond market remained volatile entering the second half, as monetary policies in some of the developed markets were moving in opposite directions. In August, the Bank of England Monetary Policy Committee started to provide explicit forward guidance to enhance the effectiveness of monetary stimulus. Then in November the European Central Bank (ECB) cut the benchmark interest rate to a record low of 0.25% amid an outlook of prolonged

CHART 1

Average borrowing costs in developed and emerging markets



Average yields of the following benchmark indices are used as proxies to the yield levels of the corresponding markets.

Developed markets	The BofA Merrill Lynch G7 Government Index
Emerging markets	The BofA Merrill Lynch US Dollar Emerging Markets Sovereign

Source: Thomson Reuters.

low inflation and broad-based weakness in the economy of the euro area. In the US, the Federal Open Market Committee announced in December that the monthly asset purchases would be reduced by US$10 billion starting from January 2014, signalling a beginning of the end to the series of quantitative easing programmes that started in 2008.

While the tapering of asset purchases by the US Federal Reserve signalled improving economic fundamentals in the US, the continued expansionary stance of other major central banks, notably the ECB, suggests that the path of economic recovery in the developed markets remained challenging. Nevertheless, as economic conditions continued to improve, the flush of liquidity in the global financial markets in the past few years is expected to be reversed, leading to upward pressure on bond yields. The withdrawal of liquidity is expected to have repercussions for not only developed markets, but also emerging markets. Overshadowed by such developments, the outlook for the global debt market in 2014 is expected to remain challenging.

Hong Kong Debt Market Review

Reduced Hong Kong dollar debt issuances by the private sector

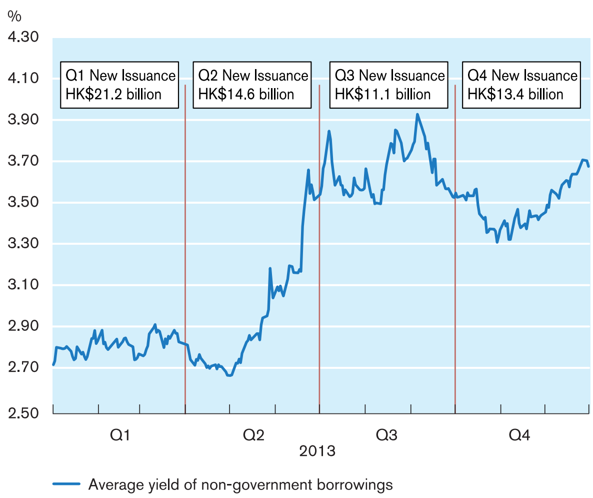
Tracking the global debt market, funding conditions in the Hong Kong dollar debt market were volatile in 2013. Against this backdrop, Hong Kong dollar debt issuances by the non-public issuers fell 20% from a year earlier to HK$203 billion (see Appendix).

The drop in issuance activities was particularly prevalent among bank issuers, i.e. the Authorized Institutions (AIs). The amount of debt securities issued by AIs dropped nearly 25% in 2013. It is noted that the increasing yield may pose difficulty for AIs raising debt securities within their target funding level.

Issuances of Hong Kong dollar debt securities by the non-AI private sector issuers also fell in 2013. In particular, issuance activities dropped significantly in the second and third quarters due to increased yield volatility and recovered only slightly in the fourth quarter (Chart 2). Meanwhile, pricing in the loan market vis-à-vis bond financing reportedly turned more attractive. For instance, pricing for blue-chip financing was reported to drop from around 158 basis points all-in for a three-year loan in early 2013 to around 135 basis points all-in for a five-year loan by end 2013, while yields of Hong Kong dollar bonds rose by nearly a whole percentage point during the year. Against this backdrop, some private sector issuers reportedly switched from the debt market to the loan market to tap cheaper funding.

CHART 2

Average borrowing costs and new issuance size of non-government issuers in Hong Kong dollar bond market



Note: Average yield of the non-government sub-index of the HSBC Hong Kong Dollar Bond Index is used as a proxy to the average borrowing costs of non-government issuers in the Hong Kong dollar market.

Sources: HKMA (New Issuance from non-AI private sector issuers) & Bloomberg (HSBC Hong Kong Dollar Bond Index).

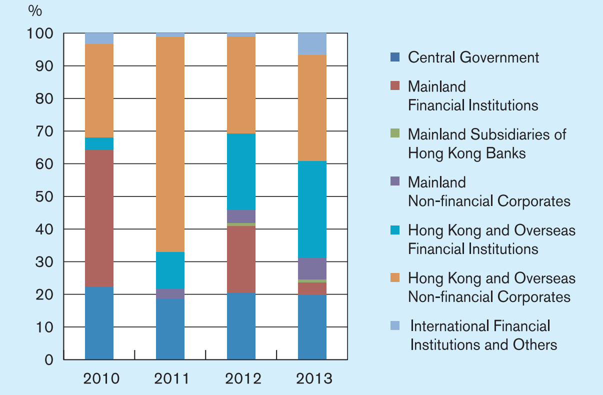
Further development in dim sum bond market

While debt issuance activities were subdued in the Hong Kong dollar segment, issuances in the offshore renminbi (RMB) market reached a record high of RMB116.6 billion in 2013. The types of instruments issued continued to diversify. While issuances had been dominated by fixed-rate issuances in the past, three floating-rate papers were issued in 2013 (Table 1). In particular, it is worth noting that L-Bank, a German issuer, issued the world's first RMB-denominated bond that is linked to the CNH Hong Kong Interbank Offered Rate in November.

There were also signs of increasing diversification in the issuer base. In 2013, issuances made by international financial institutions accounted for nearly 7% of the total volume, while those made by Hong Kong and overseas non-financial corporations made up nearly a third (Chart 3). It is worth noting that some of these international financial institutions and corporates do not have funding needs in RMB. Nonetheless, given the deep pool of liquidity in the offshore RMB market in Hong Kong, these issuers took the opportunity to issue in RMB and swap the proceeds into other currencies in order to lock in a lower all-in funding cost.

CHART 3

Dim sum bond issuer distribution



	2010	2011	2012	2013
Central Government	22.3%	18.5%	20.5%	19.8%
Mainland Financial Institutions	41.9%	0.0%	20.5%	3.9%
Mainland Subsidiaries of Hong Kong Banks	0.0%	0.0%	0.9%	0.9%
Mainland Non-financial Corporates	0.0%	3.3%	3.9%	6.9%
Hong Kong and Overseas Financial Institutions	3.9%	11.2%	23.5%	29.4%
Hong Kong and Overseas Non-financial Corporates	28.5%	65.8%	29.7%	32.4%
International Financial Institutions and Others	3.4%	1.1%	1.0%	6.7%

Note: Figures may not add up to totals due to rounding.

Source: Newswire.

TABLE 1

RMB-denominated floating-rate notes issued since 2007

	Issuer	Month issued	Issue size (RMB billion)	Maturity	Reference rate
2007			Nil		
2008			Nil		
2009	HSBC Bank (China)	June	1.0	2-year	3M SHIBOR
	China Development Bank	August	1.0	2-year	3M SHIBOR
2010	China Development Bank	October	2.0	3-year	3M SHIBOR
2011			Nil		
2012			Nil		
2013	HSBC Bank (China)	January	1.0	2-year	3M SHIBOR
	L-Bank	November	0.25	1-year	3M CNH HIBOR
	China Development Bank	November	1.9	2-year	3M CNH HIBOR

Source: Newswire.

Two further developments are noteworthy. First, the Ministry of Finance issued the first 30-year sovereign bond to institutional investors in June, which extended the benchmark yield curve for RMB bonds in Hong Kong further. Secondly, China Development Bank, which is one of the three policy banks of China, established a RMB7 billion yuan Debt Issuance Programme (DIP) in Hong Kong during the year. This is the first offshore RMB DIP set up by Mainland financial institutions. The DIP allows China Development Bank to issue bonds of multiple terms, types and tenors under a single framework. The move suggests that issuers increasingly consider the offshore RMB market as a reliable funding platform.

Implementation of the Government Bond Programme

Increasing Government Bond supply in 2013

The Government continued to implement the Government Bond (GB) Programme in 2013. To provide adequate room for the implementation of the GB Programme, the Financial Secretary announced in the 2013-14 Budget Speech that the size of the GB Programme would be expanded from HK$100 billion to HK$200 billion. The increased programme size took effect in May. At the end of 2013, the total amount of bonds outstanding under the GB Programme amounted to HK$90 billion, comprising HK$60 billion of institutional bonds and HK$30 billion of retail bonds.

Promoting liquidity in the institutional market

A record HK$20 billion worth of institutional bonds, with tenors ranging from two to ten years, were issued during the year and remained well received. In order to minimise market fragmentation, re-opening is used as far as practicable so as to build up a sizable issue size for individual GB. Two institutional bond issues have also reached a size of over US$1 billion. Such a size is considered by the investing community as efficient for trading and investment purposes, which helps promote secondary market liquidity.

To further improve the liquidity of the bonds issued in the institutional market, the Government announced in late 2013 that two liquidity enhancement measures, namely, switch tender and bond swap facility, would be introduced in early 2014.

Switch tender aims to address any lasting supply-demand mismatch by allowing Primary Dealers (PDs) to permanently switch their off-the-run GBs into the same principal amounts of benchmark bonds through competitive tenders. Specifically, the Government may initiate and announce a switch tender to switch a certain amount of an off-the-run bond into an on-the-run bond. This helps increase the supply of bonds in greater demand and reduces the supply of those with less market appeal, thus optimising the structure and enhancing the overall liquidity of the GB Programme.

The bond swap facility aims to address temporary supply-demand mismatch by allowing PDs to temporarily swap certain amount of an institutional bond into another institutional bond based on prevailing market prices for a certain period. The bond swap facility enables a PD to quickly obtain from HKMA a particular bond for sale to a requesting institutional investor, and then return that bond when the PD acquires it from the market later. In other words, it will allow PDs to run two-way trading positions along the yield curve more efficiently, as they can quote an executable offer price on virtually all of the outstanding issues by obtaining specific GBs through the facility when necessary. The bond swap facility was launched in mid-February 2014 and has already been used by the PDs.

Promoting the investor base of the local retail bond market

The third issue of inflation-linked retail bonds, i.e. the iBonds, was issued as announced in the 2013-14 Budget Speech. Over 520,000 valid applications for nearly HK$40 billion in principal amount of the bond were received. The number of valid applications set another record in the local retail bond market. It is worth noting that around 13% of those who subscribed for the third iBond were reported to be first-time investors. We believe that iBond issuances have further enhanced the investing public's awareness of and interest in bonds, through participating in the subscription and trading process, and hence promoting the development of a retail bond market in Hong Kong.

Looking forward

As part of its ongoing efforts to improve the competitiveness of Hong Kong's financial markets, the HKMA will continue to support the development of the Hong Kong debt market. Continued efforts will be made to promote interest in the Hong Kong dollar debt market, mainly through implementation of the GB Programme. The HKMA will also work closely with other market participants to promote the depth and breadth of the Hong Kong debt market.

APPENDIX (see notes)

Issuances 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%)**

Source: HKMA.

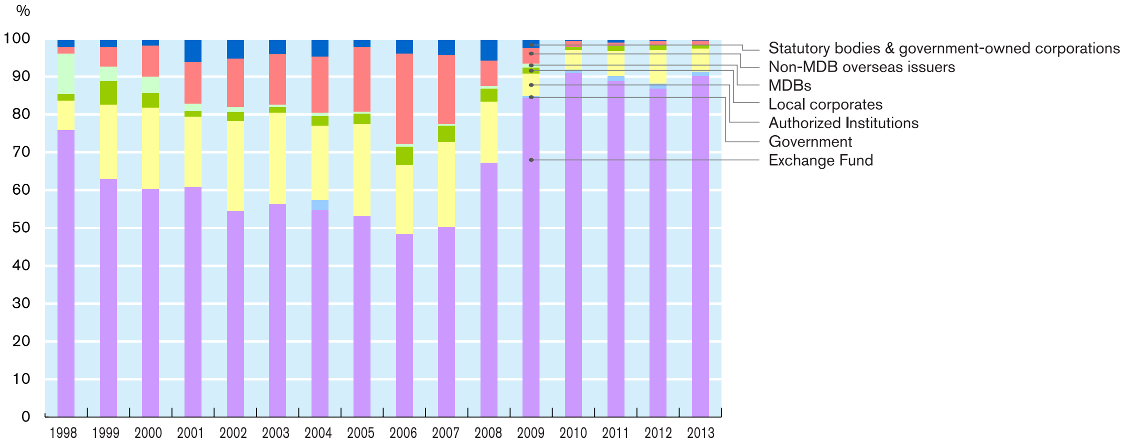
Outstanding size of Hong Kong dollar debt instruments (in HK$ million)

	(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)
1998	97,450	0	97,450	161,110	28,286	69,402	25,529	11,366	295,693	**393,143**
1999	101,874	0	101,874 (4.5%)	177,437	41,219	61,287	37,259	20,117	337,319 (14.1%)	**439,192 (11.7%)**
2000	108,602	0	108,602 (6.6%)	189,137	41,970	57,062	55,103	20,047	363,319 (7.7%)	**471,921 (7.5%)**
2001	113,750	0	113,750 (4.7%)	178,788	41,703	51,104	72,351	35,873	379,819 (4.5%)	**493,568 (4.6%)**
2002	117,476	0	117,476 (3.3%)	184,736	40,245	40,834	99,514	48,212	413,541 (8.9%)	**531,018 (7.6%)**
2003	120,152	0	120,152 (2.3%)	196,972	34,519	27,855	121,486	56,441	437,273 (5.7%)	**557,426 (5.0%)**
2004	122,579	10,250	132,829 (10.6%)	207,214	35,338	24,735	147,579	60,186	475,052 (8.6%)	**607,880 (9.1%)**
2005	126,709	10,250	136,959 (3.1%)	233,442	39,624	21,535	174,247	57,712	526,560 (10.8%)	**663,520 (9.2%)**
2006	131,788	7,700	139,488 (1.8%)	241,030	53,864	19,555	237,308	56,876	608,633 (15.6%)	**748,121 (12.8%)**
2007	136,646	7,700	144,346 (3.5%)	250,941	62,044	13,155	234,482	58,476	619,098 (1.7%)	**763,443 (2.0%)**
2008	157,653	5,000	162,653 (12.7%)	206,470	68,265	14,253	199,943	64,618	553,549 (-10.6%)	**716,202 (-6.2%)**
2009	534,062	7,000	541,062 (232.6%)	194,590	79,962	24,348	200,686	66,643	566,229 (2.3%)	**1,107,291 (54.6%)**
2010	653,138	25,500	678,638 (25.4%)	218,866	85,575	15,513	186,166	60,592	566,712 (0.1%)	**1,245,350 (12.5%)**
2011	655,413	49,500	704,913 (3.9%)	228,943	97,284	14,731	163,724	51,034	555,716 (-1.9%)	**1,260,629 (1.2%)**
2012	657,384	68,500	725,884 (3.0%)	263,418	116,188	10,271	147,669	45,159	582,705 (4.9%)	**1,308,590 (3.8%)**
2013	751,151	91,500	842,651 (16.1%)	250,104	127,937	10,214	148,698	39,816	576,769 (-1.0%)	**1,419,420 (8.5%)**

Source: HKMA.

CHART B1

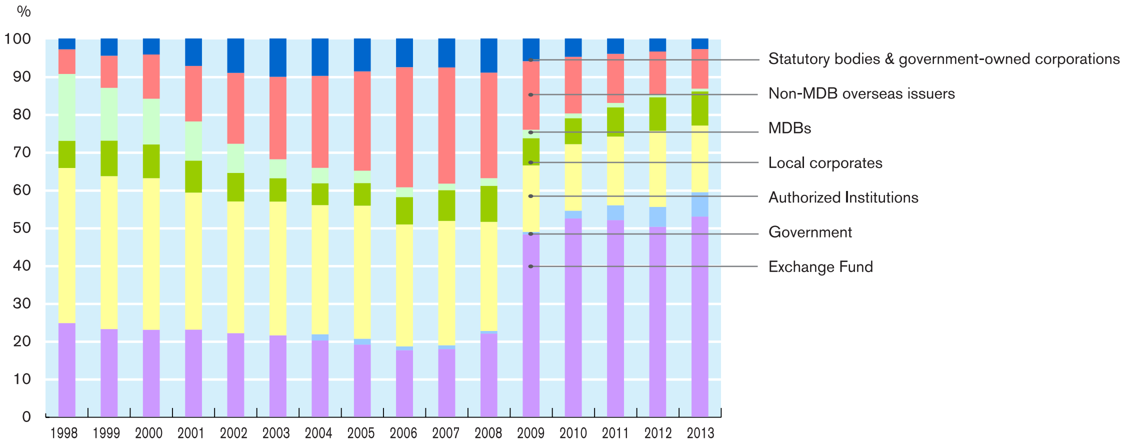
Proportions of Hong Kong dollar debt issuance activities (by type of issuers)



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 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, and Hong Kong Housing Society. 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 between 1998 and 2012 have been revised.
5. Figures may not add up to total because of rounding.