

HONG KONG DOLLAR DEBT MARKET DEVELOPMENTS IN 1999

New issues of Hong Kong dollar debt securities in 1999 declined. The Exchange Fund and multilateral development banks decreased their issuance of debt securities, but this was partly compensated by higher debt issuance by local authorised institutions and corporations, and by overseas borrowers. New corporate debt issuance surged, reflecting strong demand for high-quality corporate paper.

The level of outstanding Hong Kong dollar debt continued to grow in 1999, but at a moderate pace. The increase in outstanding debt was in sharp contrast to the decline in bank lending, reflecting some apparent substitution of corporate debt securities for bank loans.

Hong Kong corporations have made more use of international markets than of domestic market to raise funds. The amount of outstanding international bonds of Hong Kong corporations was much larger than the amount of outstanding debt in the domestic market.

Market Overview

In 1999, new Hong Kong dollar debt issuance, including rollovers of existing debt, amounted to an estimated HK\$397 billion, representing a decline of HK\$16 billion or 4% from HK\$413 billion in 1998. Although local authorised institutions (AIs), overseas borrowers excluding multilateral development banks (MDBs)¹, local corporations, and statutory bodies were more active in issuing debt during the year (their issuance increased by HK\$67 billion compared with 1998), the increases were offset by reduced issuance by the Exchange Fund and MDBs, totalling HK\$83 billion. The differences in new debt issuance were largely due to the difference in rollover of existing debt. The activities of the

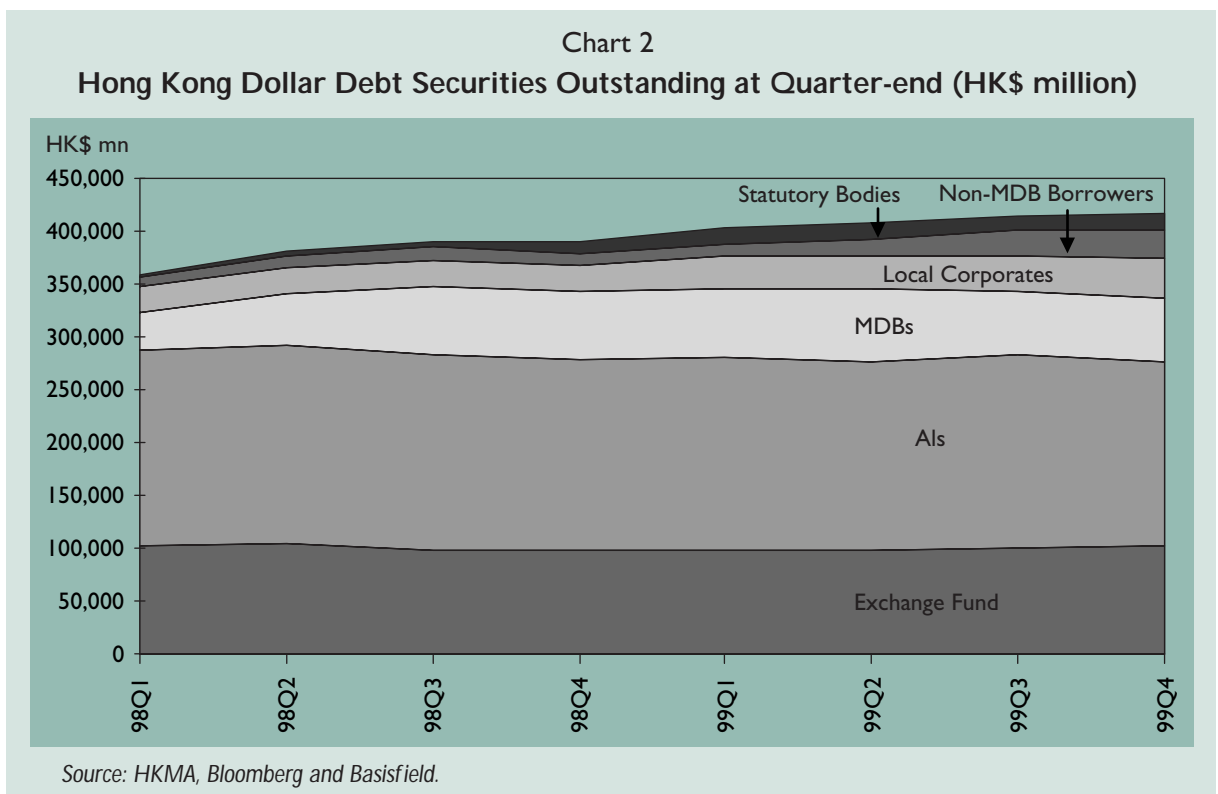
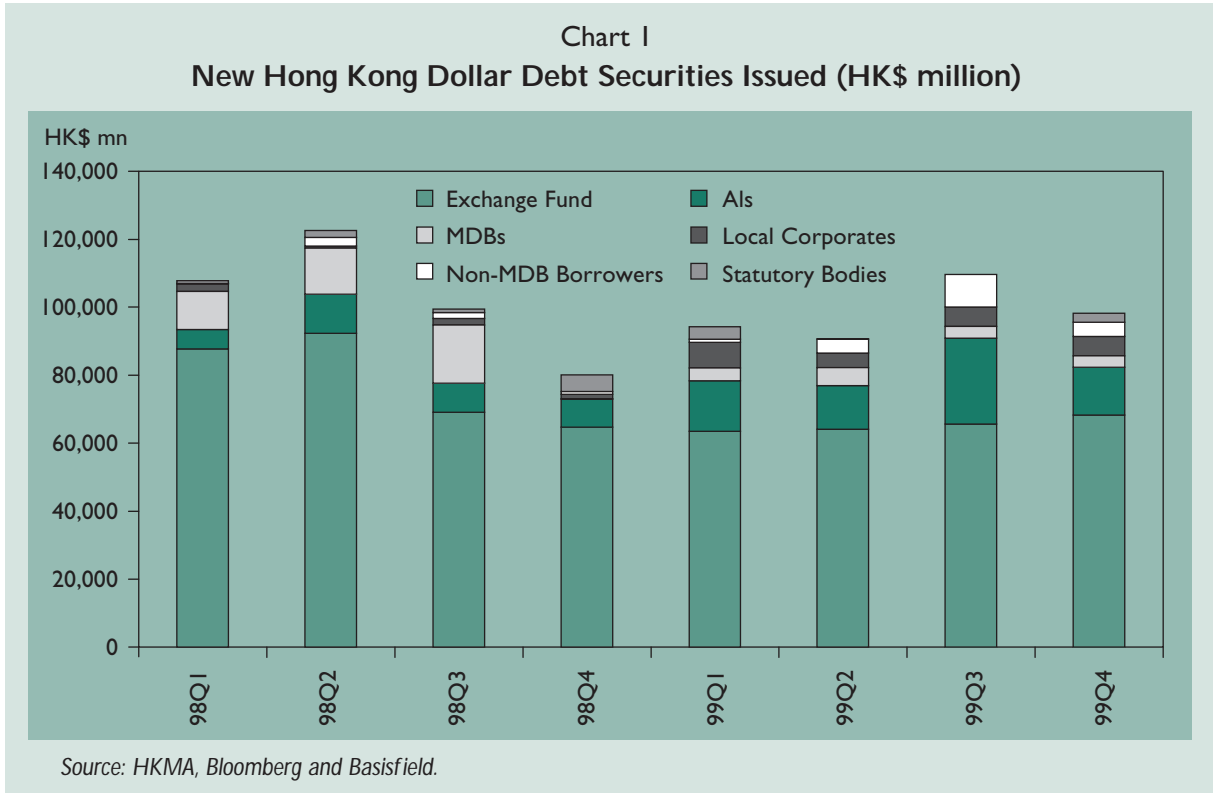
individual issuer groups in 1999 are described in more detail in the sections below.

Outstanding Hong Kong dollar debt grew at a moderate pace in 1999, as new bonds issued exceeded bonds maturing in the year. Compared with HK\$390 billion at end-1998, outstanding Hong Kong dollar debt increased by HK\$30 billion or 8%. The increase in outstanding debt was in sharp contrast to the sharp decline in bank lending (outstanding Hong Kong dollar domestic loans extended by all AIs fell by HK\$80 billion or 5% over the year). The debt of non-MDB borrowers, local corporates, statutory bodies, and the Exchange Fund increased by HK\$43 billion, but this was partly offset by decreases of HK\$13 billion in the debt of AIs and MDBs.

¹ MDBs refer to the Asian Development Bank, Council of Europe, European Company for the Financing of Railroad Rolling Stock, European Investment Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, World Bank, International Finance Corporation, African Development Bank and Nordic Investment Bank. Income on debt securities issued by the MDBs is exempt from profits tax. Non-MDB issuers include overseas banks and merchant banks, corporations, and government and state agencies.

Chart 1 shows the amount of new Hong Kong dollar debt issued, and Chart 2 shows the Hong Kong dollar outstanding debt as at quarter-

end, classified by type of issuer. A detailed breakdown is at Annex A.



a. Issues by AIs

In 1999, new debt issued by AIs amounted to HK\$67 billion, more than double the amount in 1998. There was an increase in issuance activity in the third quarter due partly to AIs advancing their debt issuance from the fourth quarter to pre-empt their funding and avoid the Year 2000 period. However, in light of the HK\$73 billion AI debt that matured in 1999, much of the new issuance effectively refunded maturing issues. The decrease in outstanding AI paper was in line with the decrease in outstanding bank loans in the past two years, which reflected cautious lending policies by banks after the Asian financial turmoil. As the loan book was downsized, there was less need to roll over all outstanding paper. As at end-1999, outstanding debt of AIs amounted to HK\$174 billion, down HK\$6 billion or 3% from end-1998.

b. Issues by Local Corporates

New corporate debt issuance in 1999 surged almost threefold to HK\$23 billion from HK\$6 billion in 1998. This increase was due to two reasons. On the supply side, local corporates tapped funds from the debt market, as banks reduced credit lines. On the demand side, ample liquidity in the banking system and Y2K-induced inflows of funds towards the end of the year created strong demand for good quality corporate paper. This drove corporate yields and hence funding costs lower, increasing the attractiveness of issuing bonds. In fact, in 1999, the banking sector's holding of Hong Kong dollar negotiable debt instruments, other than Exchange Fund paper and bank certificates of deposits, increased significantly amid a decline in the sector's Hong Kong dollar loans for local use. This indicates that some substitution of corporate debt securities for bank loans might have taken place.

c. Issues by Non-MDB Overseas Borrowers

In 1999, debt issuance by non-MDB overseas borrowers reached a record HK\$19 billion, up 2.4 times from 1998. The narrowing of HIBOR/LIBOR spreads, coupled with strong demand from banks to park their excess funds in overseas banks with good credit ratings, created favourable conditions for overseas banks to issue bonds in Hong Kong.

As in the case of local AIs, there was an increase in debt issuance by foreign banking institutions in the third quarter, as they attempted to avoid the Year 2000 period. At end-1999, outstanding debt issued by non-MDB overseas borrowers stood at HK\$27 billion, up HK\$15 billion (or 119%) from HK\$12 billion at end-1998.

d. Issues by MDBs

MDBs raised HK\$16 billion in 1999 from the market, down 62% from the HK\$43 billion raised in 1998. MDB debt issuance had increased sharply in the first nine months of 1998 to reach a peak of HK\$17 billion in Q3, but fell significantly thereafter as the MDBs responded to the HKMA's request not to issue Hong Kong dollar debt instruments with a maturity shorter than 3 years. The decrease in MDB debt issuance also reflected weak investor demand for longer-term paper in light of the flat yield curve. At end-1999, outstanding MDB debt amounted to HK\$61 billion, down HK\$7 billion (or 11%) from HK\$68 billion at end-1998. Outstanding MDB debt peaked at HK\$69 billion at end-June 1999.

e. Issues by Statutory Bodies

Statutory bodies raised HK\$10 billion from the market in 1999, up 25% from HK\$8 billion raised in 1998. The Hong Kong Mortgage Corporation (HKMC) was particularly active. It issued debt of HK\$7.9 billion in 1999, including HK\$6.3 billion in notes and bills under its Note and Debt Issuing Programme, and HK\$1.6 billion in mortgage-back securities (MBSs) with maturities ranging from 5 to 30 years. At end-1999, outstanding statutory body paper amounted to HK\$21 billion, almost double the amount at end-1998.

f. Exchange Fund Paper

Including rollovers, issuance of Exchange Fund paper in 1999 amounted to HK\$261 billion, down HK\$56 billion or 17% from HK\$317 billion in 1998. Any addition to the stock of Exchange Fund paper was curtailed, following the introduction of the seven technical measures in September 1998 to strengthen the currency board system. One of the measures is that the HKMA will issue new

Exchange Fund paper only when there is an inflow of funds enabling the additional paper to be fully backed by foreign reserves. In fact, the only net source of addition to the stock in 1999 arose, beginning in April 1999, from the issuance of 91-day Exchange Fund Bills to absorb interest payments on outstanding paper. Among the issues of Exchange Fund Notes during the year, there were two series of 10-year Notes to replace 28-day Exchange Fund Bills. Overall, the outstanding Exchange Fund paper registered a slight increase of 5% over 1998 (from HK\$97 billion to HK\$102 billion).

Hong Kong Dollar Fixed-Rate Market

In 1999, new issues of fixed-rate bonds were 13% less than in 1998 (Annex B). Their share in new Hong Kong dollar debt issuance fell substantially to 87% from 95% in 1998, due to the sharp increase in new floating-rate issues. Als replaced MDBs as the biggest supplier of new fixed-rate debt (other than the Exchange Fund) in 1999. Local corporates and non-MDB borrowers were also active in issuing fixed-rate bonds. In contrast, the Exchange Fund and statutory bodies issued less paper in the year. At end-1999, outstanding fixed-rate debt amounted to HK\$271 billion, up HK\$41 billion (or 18%) from end-1998.

The average remaining maturity of outstanding debt decreased in 1999 (Table 1), being dragged down by the particularly short tenors of Exchange Fund and Als' issues. Also, over 70% of the new AI issues had a maturity of one year or less. The

new MDB debt all had an original maturity of three years. On the other hand, the tenor of new issuance by non-MDB borrowers and local corporations generally increased.

Hong Kong Dollar Floating-Rate Market

Floating-rate issuance surged by 1.8 times in 1999 from 1998 (Annex C). This was mainly due to the sharp increase in AI issuance, which rose by 1.2 times, from HK\$16 billion to HK\$36 billion. Issuance by non-MDB overseas borrowers also surged to HK\$8 billion from an insignificant level in 1998. New issues by local corporates also increased strongly, by HK\$4 billion or 3.4 times. There was a sudden increase in floating-rate debt issuance by the MDBs in Q1 1999 (the amount issued doubled the amount issued in 1998). However, issuance activity halted after the HKMA clarified that issuing floating-rate notes was not in line with the request for MDBs to issue instruments with a tenor of 3 years or more. The MBSs launched by the HKMC in Q4 were the only floating-rate issues launched by the statutory bodies in 1999. Chart 3 shows the issuance of new fixed- and floating-rate debt in 1999.

International Fund Raising Activities of Local Corporations

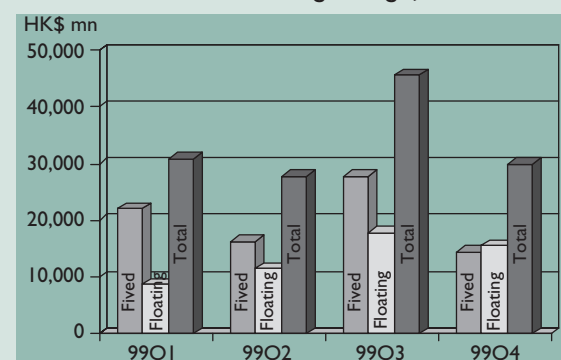
According to Bank for International Settlements (BIS) and HKMA statistics, Hong Kong corporations were most active, among the Hong Kong issuer groups, in issuing foreign currency debt

Table 1 : Average Maturity of Outstanding Debt at Quarter-Ends (Years)

Issure	Average Maturity				
	98Q4	99Q1	99Q2	99Q3	99Q4
Exchange Fund	1.4	1.3	1.3	1.3	1.2
Statutory Bodies	2.6	2.8	2.5	2.3	1.7
MDBs	1.9	1.8	1.7	2.0	1.8
Non-MDB					
Borrowers	2.1	1.9	1.8	1.8	1.6
Als	2.8	2.5	2.4	2.3	2.2
Local Corporates	1.9	2.3	2.3	2.3	2.2
All Issuers	1.9	1.8	1.8	1.8	1.7

Source: HKMA, Bloomberg and Basisfield

Chart 3
New Fixed-Rate and Floating-Rate Debt Issued in Hong Kong (HK\$ million)



Source: HKMA, Bloomberg and Basisfield.

in international markets (Table 2). At end-September 1999, outstanding international bonds of Hong Kong corporations (excluding financial institutions), denominated in Hong Kong dollar and foreign currencies, amounted to around US\$17 billion², much larger than the outstanding debt of around US\$5 billion in the domestic market. It thus appears that local corporations have made more use of international markets than domestic market to raise funds.

Table 2 : Outstanding Debt Securities at End-September 1999 (US\$ billion)

	International	Domestic
Public Sector	1.7	14.4
Banking Sector	1.6	24.6
Corporate Sector	17.0	5.3
All Hong Kong Issuers	20.3	44.3

Source: BIS and HKMA database.

Local corporations have been very active in issuing debt in the US Yankee market, which is more attractive than the other international markets. The minimum credit rating requirement on debt issuance is less stringent and access to US dollar investors is wider. Also, as the market is deeper and more liquid, the Hong Kong corporations can raise larger amounts of funds at longer maturities in one go. For example, on 1 August 1997, Hutchison Whampoa issued at the same time four international bonds with maturities ranging from 10 to 40 years, raising US\$2 billion (equivalent to HK\$15.5 billion). It would be difficult for a fund-raising exercise of this size and tenor to be launched in the domestic market. The US dollar proceeds can be easily swapped into Hong Kong dollars at low cost, given the stable Hong Kong dollar exchange rate and the depth of the swap market.

Despite strong corporate debt issuance outside Hong Kong, funds raised by Hong Kong corporations from international debt markets are

small relative to international claims of BIS reporting foreign banks on the Hong Kong corporate sector.³ At end-September 1999, outstanding international debt of Hong Kong corporations represented about 29% of total international claims on the non-bank private sector. This suggests that bank finance has remained a major source of funding for local corporations, despite an increase in the amount of funds raised from international bond markets in recent years. For Hong Kong as a whole, funds raised from international debt markets were also small relative to total international claims of BIS reporting banks on the territory. At end-September 1999, outstanding international debt of Hong Kong represented only 17% of total international claims of BIS reporting banks on Hong Kong. By tenor, around 70% of the international claims had maturities of one year or less, reflecting the short-term nature of these funds.

Over the past two years, total claims of BIS reporting banks on Hong Kong fell significantly, reflecting Hong Kong's reduced dependence on such capital inflows. Claims at end-June 1999 were 43% lower than the US\$212 billion at end-1997 (Table 3). After the Asian financial crisis broke out, foreign banks became more cautious towards lending to the region, including Hong Kong. Japanese banks are the major fund suppliers. Claims of Japanese banks on Hong Kong represented about one-third of the total claims.

Table 3 : International Claims on Hong Kong by Country (US\$ billion)

	End of Period			
	Dec-97	Jun-98	Dec-98	Jun-99
Japan	76.3	54.6	38.7	38.1
UK	34.2	32.8	28.1	26.0
Germany	28.0	24.1	22.4	16.0
France	15.6	12.6	9.7	9.2
USA	8.8	6.1	4.7	5.9
Others	48.9	39.7	27.8	25.8
Total	211.8	169.9	131.4	121.0

Source: "BIS Quarterly Review", March, June, August and November 1999, and February 2000: Table 9B.

² "BIS Quarterly Review", November 1999: Table 12D.

³ International claims refer to consolidated claims in all currencies and local claims in non-local currencies of BIS reporting banks.

Japanese banks have reduced by half their exposures to Hong Kong between end-1997 and mid-1999, from US\$76 billion to US\$38 billion. Hong Kong has suffered a disproportionate share of global credit tightening from Japanese banks. The remarkable fall in Japanese banks' loans reflects largely the contraction in offshore lending, in particular Euroyen Impact Loans.⁴ These loans were repatriated back to Japan due to the need of Japanese banks to meet capital adequacy ratios; the valuation effect of a weaker yen; and interest rate deregulation in Japan, which has reduced the advantage of booking Euroyen loans overseas.

Conclusion

The Hong Kong dollar debt market continued to grow in 1999. The main contribution to growth was from the private sector, especially local corporations and the non-MDB overseas borrowers. This contrasts sharply with the growth pattern observed in preceding years when the public sector issuers, in particular, the Exchange Fund, and the MDBs dominated new debt issuance. Although the share of local corporate debt in the local debt market is still small relative to the Exchange Fund and the AIs, it is encouraging to see local corporations making more use of the debt market to raise funds instead of relying solely on bank borrowing for funding. Recently, there has been a series of longer-term bond issues, led by the MDBs. This should help to develop the longer-term market, which remains relatively undeveloped in Hong Kong. 🌐

- Prepared by the Market Research Division

4 Euroyen Impact Loans are loans made to customers in Japan by domestic branches of Japanese banks but booked in their overseas offices. Prior to their retreat from global markets, over 80% of loans extended by Japanese banks in Hong Kong were offshore loans, of which more than 90% were the Euroyen loans.

**New Hong Kong Dollar Debt Securities Issued
(HK\$ million)**

	Exchange Fund	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	87,750	500	11,205	105	5,654	2,350	107,564
Q2	95,250	2,000	14,635	2,505	10,554	630	125,574
Q3	69,100	1,000	17,097	2,120	8,262	1,850	99,429
Q4	64,750	4,791	100	825	8,213	1,350	80,029
1998	316,850	8,291	43,037	5,555	32,683	6,180	412,596
99Q1	63,450	3,650	3,700	902	14,970	7,564	94,236
Q2	64,106	100	5,320	3,998	12,806	4,280	90,610
Q3	65,613	0	3,550	9,618	25,196	5,673	109,650
Q4	68,274	6,636	3,300	4,233	14,116	5,711	102,270
1999	261,443	10,386	15,870	18,751	67,088	23,228	396,766
Increase/ Decrease Over '98	(55,407)	2,095	(27,167)	13,196	34,405	17,048	(15,830)

**Hong Kong Dollar Debt Securities Outstanding at Quarter-Ends
(HK\$ million)**

	Exchange Fund	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	103,450	2,795	36,805	9,133	184,532	22,908	359,623
Q2	105,250	4,695	50,840	11,274	185,503	22,908	380,470
Q3	97,450	5,695	67,937	13,174	183,504	23,058	390,818
Q4	97,450	10,486	67,737	12,449	179,455	22,533	390,110
99Q1	97,450	14,036	66,687	13,046	182,990	28,247	402,456
Q2	98,806	14,056	68,907	15,983	177,705	31,627	407,084
Q3	100,363	14,056	60,137	23,196	182,046	34,450	414,248
Q4	101,874	20,692	60,537	27,209	173,556	36,461	420,329
Increase/ Decrease Over '98	4,424	10,206	(7,200)	14,760	(5,899)	13,928	30,219

Source: HKMA, Bloomberg and Basisfield.

New Hong Kong Dollar Fixed-Rate Debt Securities Issued
(HK\$ million)

	Exchange Fund	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	87,750	500	11,205	105	4,674	1,350	105,584
Q2	95,250	2,000	14,635	2,505	6,289	630	121,309
Q3	69,100	1,000	15,997	2,120	2,007	1,550	91,774
Q4	64,750	4,791	0	670	3,693	1,350	75,254
1998	316,850	8,291	41,837	5,400	16,663	4,880	393,921
99Q1	63,450	3,650	1,300	420	10,150	6,515	85,485
Q2	64,106	100	5,320	1,258	4,026	4,280	79,090
Q3	65,613	0	3,550	7,231	12,036	3,450	91,880
Q4	68,274	5,000	3,300	1,833	5,144	3,253	86,804
1999	261,443	8,750	13,470	10,742	31,356	17,498	343,259
Increase/ Decrease Over '98	(55,407)	459	(28,367)	5,342	14,693	12,618	(50,662)

Hong Kong Dollar Fixed-Rate Debt Securities Outstanding at Quarter-Ends
(HK\$ million)

	Exchange Fund	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	103,450	2,795	34,805	6,013	42,099	4,230	193,392
Q2	105,250	4,695	48,840	8,154	46,851	4,230	218,020
Q3	97,450	5,695	64,837	10,054	46,437	4,130	228,603
Q4	97,450	10,486	64,537	10,674	43,427	4,005	230,579
99Q1	97,450	14,036	61,087	10,789	50,966	9,170	243,498
Q2	98,806	14,056	63,307	10,986	51,906	12,550	251,611
Q3	100,363	14,056	54,637	15,862	59,725	14,450	259,093
Q4	101,874	19,056	57,137	17,475	59,518	16,303	271,363
Increase/ Decrease Over '98	4,424	8,570	(7,400)	6,801	16,091	12,298	40,784

Source: HKMA, Bloomberg and Basisfield.

**New Hong Kong Dollar Floating-Rate Debt Securities Issued
(HK\$ million)**

	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	0	0	0	980	1,000	1,980
Q2	0	0	0	4,265	0	4,265
Q3	0	1,100	0	6,255	300	7,655
Q4	0	100	155	4,520	0	4,775
1998	0	1,200	155	16,020	1,300	18,675
99Q1	0	2,400	482	4,820	1,049	8,751
Q2	0	0	2,740	8,780	0	11,520
Q3	0	0	2,387	13,160	2,223	17,770
Q4	1,636	0	2,400	8,972	2,458	15,466
1999	1,636	2,400	8,009	35,732	5,730	53,507
Increase/ Decrease Over '98	1,636	1,200	7,854	19,712	4,430	34,832

**Hong Kong Dollar Floating-Rate Debt Securities Outstanding at Quarter-Ends
(HK\$ million)**

	Statutory Bodies	MDBs	Non-MDB Borrowers	Als	Local Corporates	Total
98Q1	0	2,000	3,120	142,433	18,678	166,231
Q2	0	2,000	3,120	138,652	18,678	162,450
Q3	0	3,100	3,120	137,067	18,928	162,215
Q4	0	3,200	1,775	136,028	18,528	159,531
99Q1	0	5,600	2,257	132,024	19,077	158,958
Q2	0	5,600	4,997	125,799	19,077	155,473
Q3	0	5,500	7,334	122,321	20,000	155,155
Q4	1,636	3,400	9,734	114,038	20,158	148,966
Increase/ Decrease Over '98	1,636	200	7,959	(21,990)	1,630	(10,565)

Source: HKMA, Bloomberg and Basisfield.