FEATURE ARTICLE

The Hong Kong debt market in 2012

by Monetary Management Department

While the global debt market remained volatile in the first half of 2012, market sentiment picked up in the second half following further rounds of monetary accommodations from the major central banks. Conditions in the Hong Kong dollar debt market continued to improve. A record volume of Hong Kong dollar debt paper was issued by non-government issuers during the year. Better progress was also made in implementing the Government Bond Programme, including a retail bond offering that set records in the retail bond market in Hong Kong.

Overview of the global market

International bond markets were overshadowed by events in Europe in 2012. The European sovereign debt crisis remained unresolved, despite initial signs of improved market conditions at the beginning of 2012 following the announcement of longer-term refinancing operations by the European Central Bank (ECB) in late 2011. Market conditions started to deteriorate in the second quarter due to various incidents that spurred renewed concerns over the future of the euro. For instance, the market saw higher risks of Greece exiting the euro area when no political party was able to form a government after the parliamentary election held in May. Further signs of financial deterioration in the Spanish banking sector and regional governments also intensified speculation that a full-fledged bailout would be necessary for the country. Borrowing costs in the euro area, especially the debt-laden sovereigns, were again on the rise in the second quarter (Table 1). Against this backdrop ECB President Mario Draghi in July reiterated his determination to rescue the currency, saying the ECB would "do whatever it takes to preserve the euro".

In September the ECB announced it would consider purchasing, without any pre-defined limits, euro area sovereign bonds in the secondary market through Outright Monetary Transactions. Subsequent to these announcements, the market saw lower risk of an imminent break-up of the euro area. Investor confidence was boosted, and the borrowing cost of the debt-laden euro area sovereigns fell to a more sustainable level (Chart 1).

TABLE 1

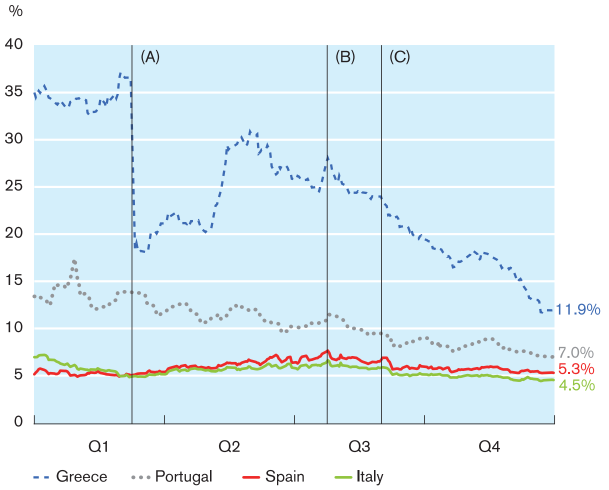
Average borrowing cost of selected euro area sovereigns in the 10-year segment

	Greece	Italy	Portugal	Spain
April	21.29%	5.52%	11.87%	5.83%
May	26.68%	5.66%	11.62%	6.15%
June	28.00%	5.92%	10.67%	6.63%
July	25.91%	6.04%	10.63%	6.86%
August	24.40%	5.85%	9.88%	6.63%
September	20.81%	5.16%	8.61%	5.92%

Source: Bloomberg.

CHART 1

Yields of 10-year government bonds of selected euro area sovereigns in 2012



(A) **12 March:** Greece announced that it had completed a landmark exchange with private investors, and would erase over €94 billion in near and mid-term debt in return for longer-term maturities.

(B) **26 July:** ECB President Mario Draghi said that the ECB would do "whatever it takes to preserve the euro".

(C) **6 September:** The ECB announced that it would conduct Outright Monetary Transactions in the secondary sovereign bond market to provide an effective backstop.

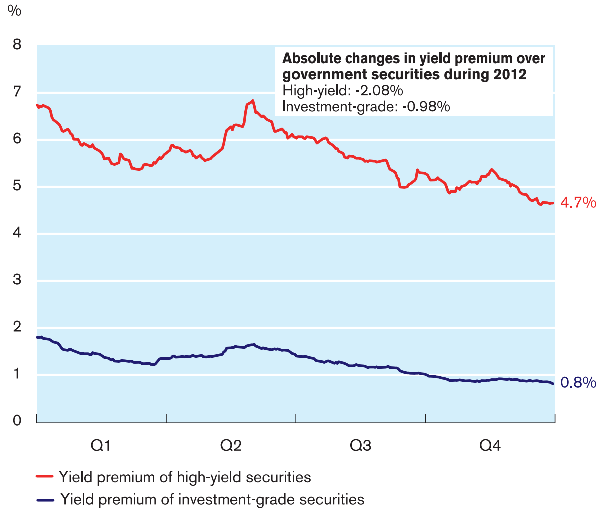
Source: Bloomberg.

Major central banks announced further monetary accommodations during the year aimed at providing further support for a sustainable recovery in the real economy (Table 2). Buoyed by the new flush of liquidity as well as a lacklustre equity market, investors' appetite for fixed income instruments issued by corporate entities increased, resulting in tightening yield premiums for both investment-grade and high-yield securities, compared with their government counterparts (Chart 2).

Despite the monetary measures taken, debt levels in both the banking and public sector in the developed markets remained high. Further deleveraging by banks and austerity measures by the public sector might pose challenges to the recovery of the global economy. The outlook for the global debt market in 2013 remains uncertain.

CHART 2

Yield premium of high-yield or investment-grade securities over government securities in 2012



Average yields of the following benchmark indices are used as proxies to the yield levels of the corresponding asset classes:

Government securities	BofA Merrill Lynch World Sovereign Bond Index
Investment-grade securities	BofA Merrill Lynch Global Large Capital Corporate Bond Index
High-yield securities	BofA Merrill Lynch Global High Yield Constrained Index

Source: Thomson Reuters.

TABLE 2

Summary of key additional monetary accommodations announced by major central banks in 2012

February	The European Central Bank (ECB) announces a second round of longer-term refinancing operations, lending out over €529.5 billion of funds to the European banking system.
	The Bank of England (BoE) announces the expansion of its Asset Purchase Facility (APF) by £50 billion to £325 billion.
	The Bank of Japan (BoJ) announces the expansion of its Asset Purchase Program (APP) by ¥10 trillion to ¥65 trillion.
April	The BoJ announces the expansion of its APP by ¥5 trillion to ¥70 trillion.
July	The BoE announces the expansion of its APF by £50 billion to £375 billion.
September	The US Federal Reserve announces the purchasing of additional agency mortgage-backed securities at a pace of $40 billion per month.
	The ECB announces the conduct of Outright Monetary Transactions to purchase, without any pre-defined limits, euro area sovereign bonds in the secondary market when needed.
	The BoJ announces the expansion of its APP by ¥10 trillion to ¥80 trillion.
October	The BoJ announces the expansion of its APP by ¥11 trillion to ¥91 trillion.
	The BoJ announces the establishment of an unlimited "Stimulating Bank Lending Facility" to provide long-term funds, up to the amount equivalent to the net increase in lending, at a low interest rate to financial institutions.
December	The BoJ announces the expansion of its APP by ¥10 trillion to ¥101 trillion.

Sources: Corresponding central banks.

Hong Kong debt market review

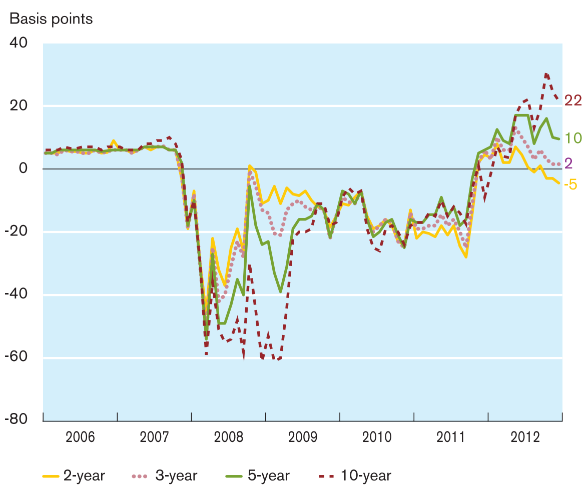
Record volume of Hong Kong dollar debt issuance

Hong Kong dollar debt issuance recorded substantial growth in 2012. Driven by issuances made by authorized institutions (AIs), which were mainly in the form of certificates of deposit, the non-government sector issued a record level of nearly HK$253 billion of Hong Kong dollar debt paper, representing an increase of almost 25% over 2011 (see Appendix).

Meanwhile, debt issuance by overseas issuers increased by HK$4 billion, to more than HK$22 billion, representing a year-on-year growth of nearly 25%. However, it should be noted that issuance volume was still quite low by historical standards. Since the majority of these issuers have little, if any, funding needs in the Hong Kong dollar, their issuance activities tend to be sporadic and opportunistic. They typically come in if they see an affordable funding environment, and will then swap the bond proceeds back into another currency (usually the US dollar) right after the bond issuance. Their decision in issuing in the Hong Kong dollar tends to be affected by both the prevailing Hong Kong dollar interest rate and the cost of swapping between the Hong Kong dollar and the relevant foreign currency during the tenor of the bond, i.e. the all-in funding cost. The USD/HKD basis swap rate is commonly used as a proxy to the all-in funding cost to these issuers. Such swap rates had remained mostly negative since 2008, but turned largely positive in 2012 (Chart 3). Positive basis swap rates suggested a more favourable all-in funding cost environment to overseas issuers, providing a possible explanation for the increase in issuance activities in 2012.

CHART 3

Key tenors of USD/HKD basis swaps



Source: Bloomberg.

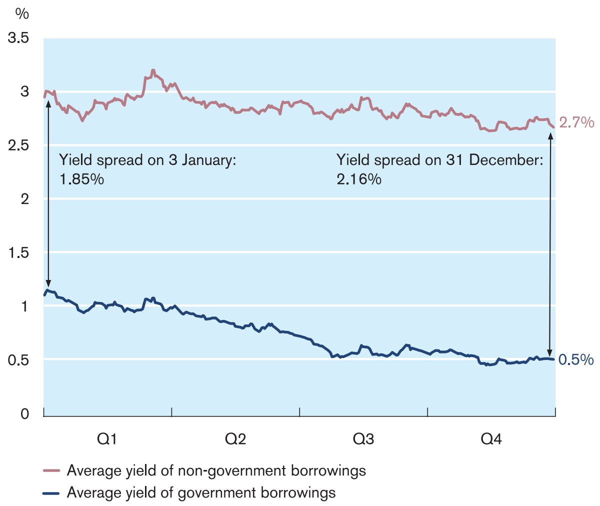
Local corporates increase foreign currency debt issuance

Although debt issuance by AIs and overseas issuers rose in 2012, local corporates issued slightly less Hong Kong dollar debt during the year. Around HK$27 billion of such paper was issued by local corporates, 2% less than in 2011. Nonetheless, it is worth noting that such issuance volume was still the second highest on record.

The slightly lower issuance was probably due to a widening yield premium of non-government borrowings in the Hong Kong dollar market in 2012, the reverse of the situation in the global market (Chart 4). Against this backdrop, some local

CHART 4

Average borrowing costs of government and non-government issuers in the Hong Kong dollar in 2012



Note: Average yields of the government and non-government sub-indices of the HSBC Hong Kong Dollar Bond Index are used as proxies to the average borrowing costs of government and non-government issuers in the Hong Kong dollar market respectively.

Source: Bloomberg.

corporate issuers were reported to have turned more active in issuing foreign currency debt, especially in the US dollar, in an effort to tap the flush of liquidity and tightening yield spreads (Table 3). It is worth noting that the local corporates turned to the foreign currency debt market rather than the loan market to obtain funding. This might be a sign that the debt market had gained ground against the loan market as a viable funding platform for local corporates. It could also be due to higher funding costs faced by individual banks, hence higher borrowing costs for bank loans, deterring corporates from using the bank channel for funding.

Implementation of the Government Bond Programme

Better progress in 2012

Progress was made in developing the public segment of the bond market, mainly through the implementation of the Government Bond Programme (GB Programme). The total amount of Government Bonds (GBs) outstanding under the GB Programme stood at HK$67 billion at the end of 2012, comprising HK$47 billion of institutional GBs and HK$20 billion of retail GBs.

An additional institutional GBs totalling HK$16 billion, with tenors ranging from two to 10 years, were issued in 2012. The bid-to-cover ratios ranged from 2.49 to 3.43, suggesting considerable demand for the bonds. Two of the bonds have also reached a benchmark size of over US$1 billion during the year, which helped attract a wider array of investors to the market (Table 4).

TABLE 4

Institutional Government Bonds outstanding under the Government Bond Programme at the end of 2012

Original maturity	Issue code	Issue size (HK$ billion)
2-year	02GB1303	3.5
	02GB1309	3.5
	02GB1403	3.5
3-year	03GB1505	3.0
5-year	05GB1411	10.0
	05GB1512	8.0
	05GB1612	4.0
10-year	10GB2001	7.5
	10GB2108	4.0
Total		**47.0**

Source: HKMA.

To promote the institutional part of the GB Programme as well as the Hong Kong dollar bond market in general, the Hong Kong Monetary Authority (HKMA) conducted around 20 local and overseas marketing calls during the year. The marketing calls were well received by the market, and provided a positive impact in promoting interest in and appetite for both GBs and Hong Kong dollar bonds. Market information suggests that new foreign investors participated in the Hong Kong dollar bond market subsequent to these marketing calls.

TABLE 3

Borrowings by Hong Kong non-bank corporates

	Syndicated loans – Hong Kong dollar and foreign currencies (US$ billion)	Hong Kong dollar debt issuances (US$ billion)	Foreign currency debt issuances (US$ billion)		
				of which	
			Total	in the US dollar	in other foreign currencies
2011	46.4	1.2	15.9	8.8	7.1
2012	43.6	1.2	35.1	28.4	6.7
Change	-6%	0%	+121%	+223%	-6%

Source: Thomson Reuters.

Note: The figures relating to Hong Kong dollar debt issuances may be different from those presented in the Appendix due to different sources and compilation methodologies. No currency breakdown is available for syndicated loan volumes.

The Government successfully issued a second HK$10 billion inflation-linked retail bond (iBond) to Hong Kong residents, which was very well received. The whole offering process was smooth and attracted more than 330,000 valid applications for nearly HK$50 billion of bonds, setting records in the local retail bond market. According to market sources, around 10% of the applicants were said to be first-time investors who had not participated in the bond market before. The issuance added further impetus to enlarging the retail investor base of Hong Kong dollar bonds.

Further measures to develop the local debt market through the Government Bond Programme

To promote the attractiveness of the institutional GBs, the Government will continue to consider appropriate measures to improve the liquidity of individual bonds, as well as conducting more marketing calls and promotions.

The Financial Secretary announced in his 2013-14 Budget Speech that the Government will launch a further iBond issue of up to HK$10 billion to maintain the growth momentum in increasing the investing public's awareness of, and interest in, retail bonds amidst the current low interest rate environment. Similar to the last two issuances, the third iBond will be issued to Hong Kong residents and has a maturity of three years, with interest paid every six months at a rate linked to the inflation rates of the last half-year period. The HKMA is co-ordinating the issuance and aims to complete the issuance as soon as possible.

With a view to enlarging the investor base of both the institutional and retail bond segments, GB Programme will continue to support sustainable development in the local debt market. There have been signs of sustained growth in the demand from investors and financial institutions for high quality public debt paper issued in Asia and other emerging markets, including Hong Kong dollar government debt. Meanwhile, taking into account the planned debt issuances in institutional part and the upcoming iBond, the amount of GBs outstanding under the GB Programme will be approaching the HK$100 billion ceiling approved by the Legislative Council in 2009. To better enable the GB Programme to meet its objective of developing the local debt market, the Financial Secretary proposed in his 2013-14 Budget Speech to double the size of the GB Programme to HK$200 billion from HK$100 billion. The increase will allow more bond issuances to meet the growing demand for such bonds for both regulatory and investment purposes.

Looking ahead

The HKMA will continue to support the Administration's initiatives in increasing the depth and breadth of the local debt market, mainly through continual implementation and refinement of the GB Programme. Relevant measures will be devised and implemented as and where appropriate. The HKMA will also maintain close contact with market participants to strengthen the local debt market as a whole, thereby further enhancing the competitiveness of the Hong Kong dollar debt market as a fund-raising platform and investment venue for both local and overseas market participants.

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 and 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	151,809 (-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%)	94,373	5,470	2,641	51,955	15,724	170,162 (-5.6%)	**389,810 (-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	188,845 (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	202,567 (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%)**

Source: HKMA.

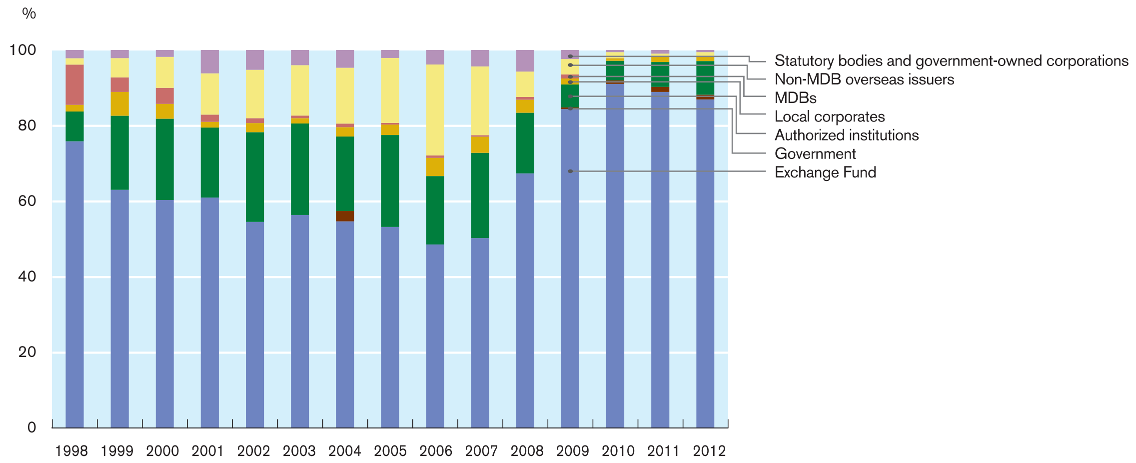
Outstanding size of Hong Kong dollar debt instruments (in HK$ million)

	(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 and 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	337,318 (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	379,818 (4.5%)	**493,568 (4.6%)**
2002	117,476	0	117,476 (3.3%)	184,736	40,245	40,834	99,514	48,212	413,542 (8.9%)	**531,018 (7.6%)**
2003	120,152	0	120,152 (2.3%)	196,971	34,519	27,855	121,486	56,441	437,273 (5.7%)	**557,425 (5.0%)**
2004	122,579	10,250	132,829 (10.6%)	207,237	35,338	24,735	147,579	60,186	475,075 (8.6%)	**607,904 (9.1%)**
2005	126,709	10,250	136,959 (3.1%)	233,650	39,624	21,535	174,247	57,712	526,769 (10.9%)	**663,728 (9.2%)**
2006	131,788	7,700	139,488 (1.8%)	241,050	53,864	19,555	237,308	56,876	608,653 (15.5%)	**748,141 (12.7%)**
2007	136,646	7,700	144,346 (3.5%)	251,717	62,044	13,155	234,482	58,476	619,874 (1.8%)	**764,220 (2.1%)**
2008	157,653	5,000	162,653 (12.7%)	206,877	68,265	14,253	199,943	64,618	553,955 (-10.6%)	**716,608 (-6.2%)**
2009	534,062	7,000	541,062 (232.6%)	195,345	79,962	24,348	200,686	66,643	566,985 (2.4%)	**1,108,047 (54.6%)**
2010	653,138	25,500	678,638 (25.4%)	219,170	85,575	15,513	186,166	60,592	567,016 (0.0%)	**1,245,654 (12.4%)**
2011	655,413	49,500	704,913 (3.9%)	229,243	97,284	14,731	163,724	51,034	556,016 (-1.9%)	**1,260,929 (1.2%)**
2012	657,384	68,500	725,884 (3.0%)	263,618	116,188	10,271	147,669	45,159	582,906 (4.8%)	**1,308,790 (3.8%)**

Source: HKMA.

CHART B1

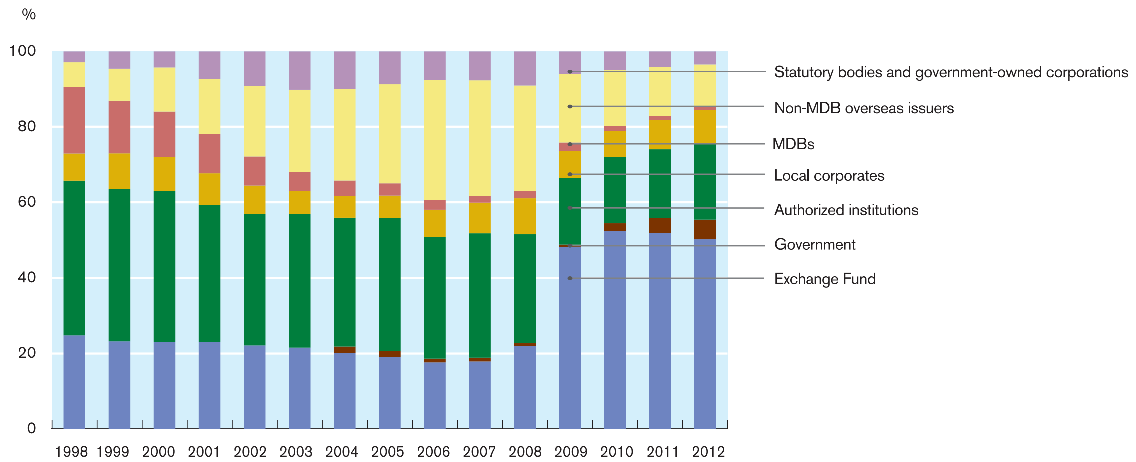
Proportions of Hong Kong dollar debt issuance activities (by type of issuers)



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, and the Nordic Investment Bank. 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 Housing Authority, Hong Kong Link 2004 Limited, Kowloon-Canton Railway Corporation and MTR Corporation Limited. 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 2011 have been revised.
5. Figures may not add up to total because of rounding.