The Hong Kong debt market in 2014

by Monetary Management Department

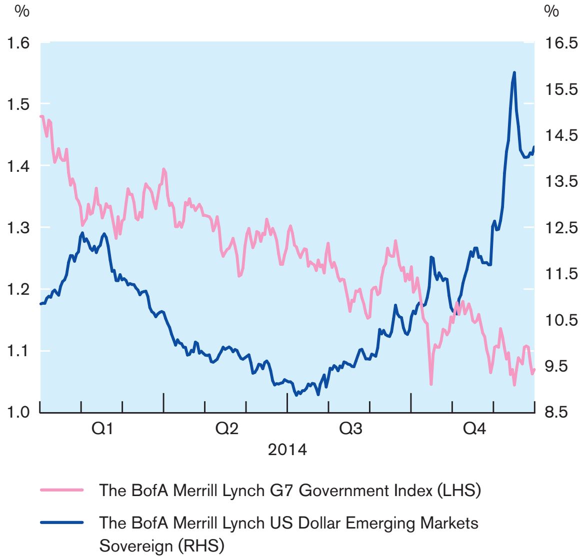
Continuing the previous year's trend, market sentiment in the international debt market remained volatile in 2014. In October the US Federal Reserve announced the end of its asset-purchase programme. However, Europe and Japan rolled out expansionary monetary policies trying to stimulate their own economies. In Hong Kong, the total issuance volume of Hong Kong dollar debt instruments reached a record high. The driving forces came from local corporates and overseas issuers, set off by a slight decline in debt instruments issued by authorized institutions. The Hong Kong SAR Government issued the inaugural sukuk in September and introduced a number of enhancement measures under the Government Bond Programme during the year.

Overview of the international bond market

The Federal Open Market Committee of the US Federal Reserve announced the conclusion of its asset-purchase programme in a statement following its meeting on 28 and 29 October 2014. This signified the end of the US quantitative easing that had lasted for six years. The Committee noted in its statement that "there has been a substantial improvement in the outlook for the labour market" and "sufficient underlying strength in the broader economy to support ongoing progress towards maximum employment in a context of price stability". After the announcement, market expectation of monetary policy normalisation began to heighten, leading to increases in the short-term US treasury yield towards the end of 2014. The expectation also radiated to other parts of the world, causing the borrowing cost in emerging markets to rise during the period.

However, monetary policies in Europe and Japan contrasted sharply with that of the US. The Bank of Japan announced on 31 October 2014 that it would expand its Quantitative and Qualitative Monetary Easing. The bank would accelerate the pace of increase in the monetary base, increase asset purchases and extend the average remaining maturity of Japanese government bond purchases. Similarly, as widely expected, the European Central Bank (ECB) announced on 22 January 2015 expansion of its asset-purchase programme to "address the risks of a too-prolonged period of low inflation". In addition to bonds issued by the private sector, the ECB would also purchase bonds issued by euro area central governments, agencies and European institutions, with a combined monthly asset purchase of up to €60 billion. Overall, global interest rates in developed economies remained low and volatile (Chart 1).

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.

Divergent monetary policies in Europe and the US created a mixed environment for the international bond market. Interest rates in the US were expected to rise despite the abundant liquidity in financial markets. The outlook to a global economic recovery remained fragile, overshadowing the debt market coming into 2015.

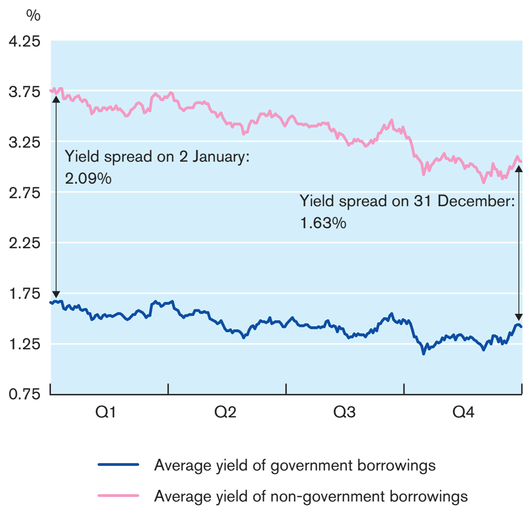
Hong Kong Debt Market Review

Local and overseas corporates

Hong Kong dollar debt issuance in 2014 reached a record high for a sixth consecutive year. It was a testament to the continued growth of Hong Kong dollar debt market, attracting an increasing number of issuers to use this funding channel. For the year, the total issue volume increased 3.1% to reach HK$2.43 trillion.

Growth in issuance was mainly driven by local corporates and overseas issuers. The amount of debt securities issued by local corporates reached a record high of HK$33 billion, 30% more than 2013. Funding costs continued to show a downward trend during the year. The continuing low-interest-rate environment gave the issuers an incentive to lock up the funding cost when favourable market conditions permitted, given a more complicated interest rate outlook in the year ahead. The tightening yield premium of non-government borrowings in the Hong Kong dollar market provided another incentive for corporate borrowings (Chart 2).

CHART 2
Average borrowing costs of government and non-government issuers in the Hong Kong dollar in 2014

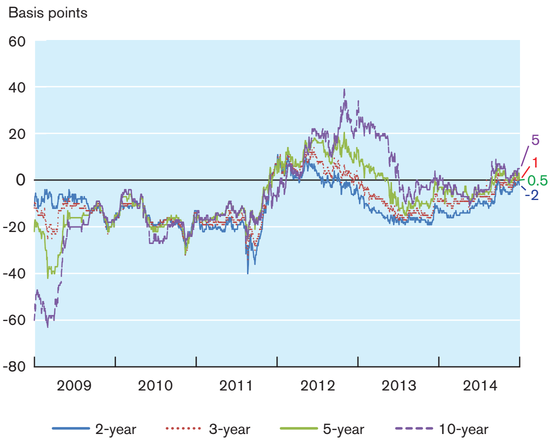


Note: Average yields of the government and non-government sub-indices of the HSBC Hong Kong Dollar Bond Index are used as proxies to the average borrowing costs of government and non-government issuers in the Hong Kong dollar market respectively.

Source: Bloomberg.

The tapping of the Hong Kong dollar market by overseas issuers also registered a considerable increase. Issuance volume in 2014 more than doubled from 2013. Overseas issuers often issue bonds in Hong Kong to expand their investor base and broaden the funding sources. Typically, with less funding need in Hong Kong dollars than local corporates, the overseas corporates tended to be more opportunistic in timing their bond issuance. They issued bonds whenever the swap market conditions were favourable. In 2014, the US dollar/HK dollar basis swap rates were, in general, higher than those of the previous year, leading to more favourable all-in funding costs to overseas issuers (Chart 3).

CHART 3
Key tenors of USD/HKD basis swaps



Source: Bloomberg.

Authorized institutions

In 2014, fund-raising activities by the authorized institutions (AIs) slowed down slightly. The issuance volume declined by 11% from a year earlier to HK$127 billion, despite still being considered high by historical standards.

The reduced issuance volume from AIs might be due to increased funding from their parent banks or holding companies. In light of the phased implementation of Basel III, more AIs issued Basel III-compliance capital instruments in foreign currencies to improve their capital structure. From a capital structure perspective, issuing senior Hong Kong dollar debts was not the AIs' priority, possibly explaining why their funding activities in the Hong Kong dollar bond market dropped in 2014.

Government Bond Programme

Enhancement measures

The HKMA launched the Government Bond (GB) Programme in 2009 to promote further and sustainable development of the local bond market. Twelve issues of institutional bonds totalling HK$66.5 billion and three issues of inflation-linked retail bonds (i.e. the iBond) totalling HK$30 billion were outstanding at the end of 2014.

During the year, the HKMA introduced a number of enhancement measures to the GB Programme. Bond swap facility and switch tender were introduced in the first half of the year to further improve the liquidity of institutional bonds. The bond swap facility addresses temporary supply-demand mismatch by allowing Primary Dealers (PDs) of the GB Programme, at their initiation, to temporarily swap certain amounts of an institutional bond into another based on prevailing market prices for a certain period. The switch tender allows the PDs to permanently switch their off-the-run GBs into the same principal amounts of benchmark bonds through competitive tenders.

The first switch tender was held on 14 May. The HKMA offered HK$0.8 billion 10-year GBs with a remaining maturity of about 8.5 years for tenders, at the same time redeeming early the same nominal amount of another 10-year GB with a remaining maturity of about 5.5 years. The switch tender was warmly received by the market with the bid-to-cover ratio (the ratio of bonds applied for to bonds issued) at 2.83. The HKMA is committed to conducting more switch tenders as appropriate, according to market demand.

The HKMA announced on 8 December 2014 the introduction of two more enhancement measures. Firstly, the tenors of bonds issued under the Exchange Fund Bills and Notes Programme and the GB Programme were streamlined. Starting from 2015, HKMA will only issue new Exchange Fund papers for tenors of two years or below; and new GBs only for three years or above. The amount of GBs to be issued will be suitably increased to meet investors' demand for longer term high-quality Hong Kong dollar bonds. In the long run after the streamlining, a unitary benchmark yield curve representing the credit standing of the Government will be formed, facilitating other issuers to price their Hong Kong dollar issues.

Secondly, the HKMA introduced a discount facility for GBs so as to provide greater flexibility for banks to manage liquidity. The facility provides up to a total of HK$10 billion overnight liquidity against a sale and repurchase of GBs, with terms and conditions similar to those applied to Exchange Fund papers. The HKMA would obtain funding from the market for the facility as necessary to maintain the size of the Aggregate Balance in accordance with the Currency Board principles.

Inaugural sukuk

On 18 September 2014, the Government issued an inaugural sukuk under the GB Programme with an issuance size of US$1 billion and a tenor of 5 years. It marked the world's first US dollar-denominated sukuk originated by an AAA-rated government. The sukuk used an Ijarah structure, underpinned by selected units in two commercial properties in Hong Kong. The sukuk was issued by a special-purpose vehicle established and wholly owned by the HKSAR Government, and was listed in Hong Kong, Malaysia and Dubai. The sukuk attracted orders exceeding US$4.7 billion from global investors. Priced at a spread of 23 basis points over the corresponding yield of US Treasuries, it achieved the tightest spread ever on a benchmark US dollar issuance from an Asian (ex-Japan) government, setting an important new benchmark for Hong Kong and the rest of Asia. Following the legislative changes in July 2013 facilitating sukuk issuance in Hong Kong, this transaction demonstrated to the global investment market the viability of using Hong Kong's platform to issue sukuk.

Retail bonds

The Government issued HK$10 billion iBond in 2014. It was the fourth-consecutive series of iBond since 2011. Over 488,000 valid applications were received, applying for nearly HK$30 billion principal amount of the bonds. According to market sources, around 10% of the successful subscribers were first-time bond investors. The iBond issuances not only provided an additional choice of investment to the public, but also sustained the growth momentum of the local retail bond market through enhancing public awareness of, and interest in, bonds. The subscription result of the iBond issuance broadens the investor base of the local retail bond market, encouraging more issuers to consider tapping the market through retail issuance.

Looking forward

The HKMA will continually communicate with market participants looking for ways to enhance the local fund-raising environment. As an important vehicle to promote development of the Hong Kong dollar debt market, the GB Programme will continue to develop and grow. Particular efforts will be made on facilitating secondary market trading and broadening the investor base. The Government will also actively consider a further sukuk issuance, when market conditions are favourable, in a bid to attract more issuers and investors to the local 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%)**
2014	2,177,293	30,800	2,208,093 (2.5%)	127,130	33,278	1,337	50,529	9,647	221,922 (9.1%)	**2,430,015 (3.1%)**

Source: HKMA.

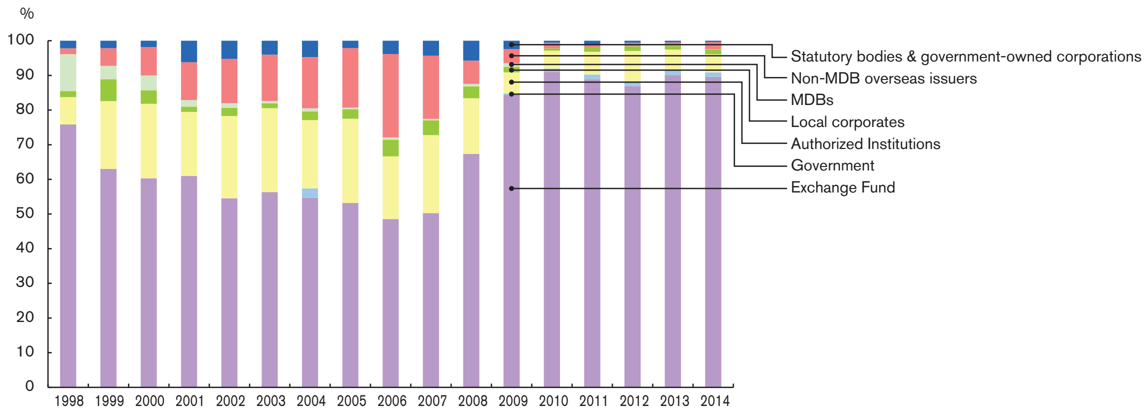
Outstanding size of Hong Kong dollar debt instruments (in HK$ million)

	(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%)	206,471	68,265	14,253	199,943	64,618	553,550 (-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%)**
2014	752,630	98,000	850,630 (0.9%)	232,796	137,624	6,101	141,670	40,990	559,182 (-3.0%)	**1,409,812 (-0.7%)**

Source: HKMA.

CHART B1

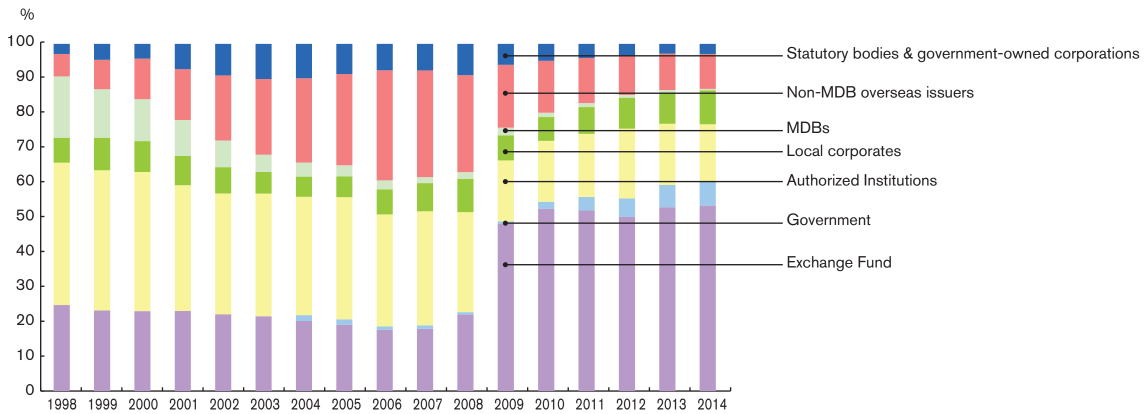
Proportions of Hong Kong dollar debt issuance activities (by type of issuers)



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 between 1998 and 2013 have been revised.
5. Figures may not add up to total because of rounding.