

The Hong Kong Debt Market in 2019

by the Financial Infrastructure Department

US-China trade disputes and the global economic slowdown prompted the central banks of both advanced economies and emerging Asian economies to adopt more accommodative monetary policies to guard against downside risks. This sent bond yields down generally, and in some European economies and in Japan, government bond yields had turned negative. Under these circumstances, emerging Asian bonds became more attractive because of relatively higher yields, registering an increase in the issuance amount. In the Hong Kong dollar debt market, the total issuance volume of Hong Kong dollar debt instruments increased, mainly due to the increased issuance of Exchange Fund Bills and Notes.

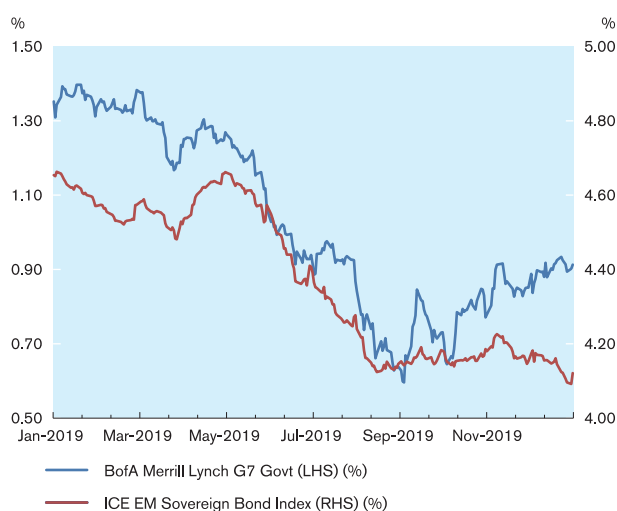
Overview of the international bond market

The global economy softened in 2019, prompting central banks around the world to adopt a more accommodative monetary policy. For example, the US Federal Reserve cut interest rates three times in the second half of 2019 to insure against downside risks, and thereafter kept the policy on hold. US Treasury yields exhibited a downward trend during the year despite a moderate pick up of longer term US Treasuries yields since September 2019, resulting in a steepened yield curve. The European Central Bank delivered various stimulus measures. As a result, government bond yields of some major European Union economies, such as Germany and France, became negative during the year. In Japan, government bond yields also stayed negative in 2019.

The monetary easing in advanced economies contributed to a loosening of financial conditions in emerging Asian markets. Although a number of central banks in the region also cut their policy rates, government bond yields of emerging Asian economies stayed positive, and this, together with expansionary fiscal policies and improved economic and credit fundamentals, created incentives for international investors to search for higher yields and invest in

bonds in the region. An Asian Development Bank's (ADB) survey indicated increased liquidity and trading volumes in most local currency bond markets in 2019¹.

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 BofA Merrill Lynch 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.

¹ Asian Development Bank (2019), *Asia Bond Monitor*, November 2019.

Hong Kong Debt Market Review

Since the global financial crisis, a massive amount of funds has flowed into the Hong Kong dollar. Despite the brief triggering of the Convertibility Undertaking during the early part of 2019, the Aggregate Balance stabilised soon afterwards, and Hong Kong's monetary environment stayed relatively loose during the year. Nonetheless, the Hong Kong dollar short term interest rates (as measured by Hong Kong Interbank Offered Rate (HIBOR) or Exchange Fund Bills and Notes (EFBN) yields) generally increased. The yields of key tenors of Government Bonds decreased initially, but bottomed out in September and started to pick up again since then. The yield curve flattened and, indeed, was inverted during some months of the year. The yield spreads between US Treasuries and Hong Kong Government Bonds narrowed, while the yields of the three-year Hong Kong Government Bonds surpassed their US counterparts, making Hong Kong dollar bonds relatively more attractive.

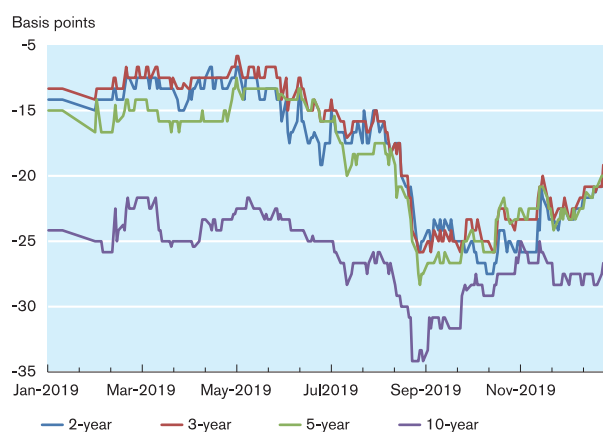
Hong Kong dollar debt issuance in 2019 increased for the eleventh consecutive year to HK\$4.18 trillion, an increase of 2% over 2018. The rise in issuance was largely driven by the increased issuance of EFBNs.

Overseas entities

Overseas entities are cost sensitive and their issuance tends to be opportunistic in nature. Although Hong Kong dollar interest rates, such as HIBORs and Government Bond yields were lower than their US dollar counterparts, the US dollar/Hong Kong dollar basis spreads stayed negative during the year (Chart 2). As a result, the Hong Kong dollar market was less attractive for overseas issuers seeking US dollar funds through the Hong Kong market, compared with tapping the US dollar market directly. A decrease in bond issuance by overseas issuers, including mainly financial institutions and corporates, was observed during the year. Similarly, Multilateral Development Banks, led by the World Bank and the ADB, reduced their issuance in the Hong Kong dollar market, when their bond yields, as AAA-rated institutions, were relatively low and not attractive enough.

CHART 2

Key tenors of USD/HKD basis spreads



Source: Bloomberg.

Local corporates and authorized institutions (AIs)

Local corporates expanded their funding scale in the Hong Kong debt market with the issuance volume up by 14% from 2018. The local corporates remained cash-rich and had access to the international bond market, so they only tapped the Hong Kong dollar market when the cost was low. Re-financing and “pre-refinancing” for general corporate purposes were dominant reasons for bond issuance and some local developers, in particular, may also issue bonds to finance new projects. Funding activities were more active in the first half of the year to take advantage of the low local interest rates and to accommodate the investment patterns of investors. However, as interest rates gradually increased from the end of the third quarter, there were fewer opportunities to obtain cheap funding from the Hong Kong dollar bond market. Intensifying trade tensions and economic slowdown also dampened bond market sentiment. Meanwhile, statutory bodies and government-owned corporations roughly maintained their issuance size in the Hong Kong dollar bond market, whereas AIs' fund-raising activities to support their short term funding needs decreased by 6% year on year.

Other developments

In September 2019, Fitch downgraded Hong Kong's credit rating from AA+ to AA, and Moody's Investors Service changed Hong Kong's credit outlook to "negative" from "stable"². The downgrade was seen as partly prompted by the social incidents which started around the middle of 2019, rather than a worsening of Hong Kong's economic and credit fundamentals. Following the downgrade, the yield spreads of Hong Kong dollar bonds, including Government and corporate bonds, over US Treasuries did not record a significant increase, and the downgrade did not seem to have had any material impact on the bond issuance activities of Hong Kong corporates, partly because the downgrade was more or less expected.

Government Bonds

The HKMA continued to implement the Government Bond Programme to promote the further and sustainable development of the local bond market. At the end of 2019, the total outstanding amount of 13 issues of institutional bonds stood at HK\$91.3 billion. In addition, two Islamic bonds issued under the Government Bond Programme were outstanding, each with an issuance size of US\$1 billion.

During the year, the Government issued the fourth batch of Silver Bond, an inflation-linked bond with a minimum annual interest rate of 3%, targeting Hong Kong residents aged 65 or above. The size of the issuance was HK\$3 billion, with a tenor of three years. The number of valid applications was 56,564, with total subscription over HK\$7.9 billion. The results were very satisfactory against the backdrop of rising bank deposit rates, demonstrating the immense potential of the silver market for the financial sector to tap into. In the 2020-21 Budget, the Government also announced that it would resume the issuance of iBond and continue to issue Silver Bond to promote the development of the retail bond market and the silver market respectively.

In May 2019, the Government successfully offered its inaugural green bond under the Government Green Bond Programme, with an issuance size of US\$1 billion and a tenor of five years. The landmark transaction set an important new benchmark for potential issuers in Hong Kong and the region. Proceeds raised under the Programme are credited to the Capital Works Reserve Fund to finance or refinance public works projects that provide environmental benefits and support the sustainable development of Hong Kong. In the 2020-21 Budget, the Government announced its plan to issue green bonds totalling HK\$66 billion within the next five years, having regard to the market situation.

Looking ahead

The local bond market may continue to face headwinds in 2020, particularly with the slowdown in the domestic economy caused by the lingering US-China trade tensions and the outbreak of coronavirus. These may dampen corporate investment and hence bond issuance amount, while heightening credit risk. While issuers may be willing to obtain more financing, the actual issuance will depend on whether funding costs are attractive. However, there are positive developments in the retail bond market with several retail bond issuances in the pipeline this year. The HKMA will continue to support the development of the local bond market through the implementation of the Government Bond Programme, Government Green Bond Programme, and various other initiatives.

² Subsequently in January 2020, Moody's downgraded Hong Kong's credit rating, from Aa2 to Aa3.

APPENDIX (see notes)

Table B1: 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	34,359	0	44,502	12,856	9,171	100,888	417,738
1999	261,443	0	261,443 (-17.5%)	82,838	6,744	15,920	39,123	8,931	153,556 (52.2%)	414,999 (-0.7%)
2000	275,036	0	275,036 (5.2%)	97,881	3,900	19,330	51,474	8,325	180,910 (17.8%)	455,946 (9.9%)
2001	237,009	0	237,009 (-13.8%)	74,134	1,000	7,462	45,139	24,075	151,810 (-16.1%)	388,818 (-14.7%)
2002	216,228	0	216,228 (-8.8%)	96,608	6,354	5,200	51,401	20,760	180,323 (18.8%)	396,551 (2.0%)
2003	219,648	0	219,648 (1.6%)	94,479	1,570	2,641	55,750	15,724	170,164 (-5.6%)	389,811 (-1.7%)
2004	205,986	10,250	216,236 (-1.6%)	75,670	6,699	3,530	56,890	17,799	160,588 (-5.6%)	376,824 (-3.3%)
2005	213,761	0	213,761 (-1.1%)	101,039	11,574	1,800	65,263	8,560	188,236 (17.2%)	401,997 (6.7%)
2006	220,415	0	220,415 (3.1%)	83,442	22,624	2,950	107,244	17,419	233,679 (24.1%)	454,094 (13.0%)
2007	223,521	0	223,521 (1.4%)	99,586	18,153	1,700	82,459	19,368	221,266 (-5.3%)	444,787 (-2.0%)
2008	285,875	0	285,875 (27.9%)	67,524	5,966	3,000	37,687	24,308	138,485 (-37.4%)	424,360 (-4.6%)
2009	1,047,728	5,500	1,053,228 (268.4%)	74,836	13,861	13,145	57,152	29,852	188,846 (36.4%)	1,242,073 (192.7%)
2010	1,816,752	18,500	1,835,252 (74.3%)	102,913	15,464	315	30,841	11,187	160,720 (-14.9%)	1,995,972 (60.7%)
2011	1,841,278	27,500	1,868,778 (1.8%)	134,638	22,429	0	25,304	20,195	202,566 (26.0%)	2,071,345 (3.8%)
2012	1,851,575	26,000	1,877,575 (0.5%)	190,833	16,512	790	32,640	12,027	252,802 (24.8%)	2,130,377 (2.8%)
2013	2,123,448	30,000	2,153,448 (14.7%)	143,978	19,638	940	28,105	10,665	203,326 (-19.6%)	2,356,774 (10.6%)
2014	2,177,293	30,800	2,208,093 (2.5%)	124,248	28,871	1337	57,818	9,647	221,921 (9.1%)	2,430,015 (3.1%)
2015	2,242,206	30,400	2,272,606 (2.9%)	136,350	12,481	0	60,564	12,015	221,410 (-0.2%)	2,494,017 (2.6%)
2016	2,689,622	29,400	2,719,022 (19.6%)	180,346	15,431	5529	111,339	20,898	333,543 (50.6%)	3,052,565 (22.4%)
2017	3,000,429	19,600	3,020,029 (11.1%)	185,892	9,316	3,230	95,292	21,542	315,271 (-5.5%)	3,335,300 (9.3%)
2018	3,232,955	19,600	3,252,555	342,541	34,618	9,048	430,313	23,702	840,221	4,092,776
2019	3,393,971	20,400	3,414,371	323,152	39,380	6,295	376,214	24,585	769,625	4,183,996

Table B2: 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	175,286	10,283	69,402	29,356	11,366	295,693	393,143
1999	101,874	0	101,874 (4.5%)	186,036	15,477	61,287	54,402	20,117	337,319 (14.1%)	439,192 (11.7%)
2000	108,602	0	108,602 (6.6%)	192,990	13,027	57,062	80,193	20,047	363,319 (7.7%)	471,921 (7.5%)
2001	113,750	0	113,750 (4.7%)	182,682	11,402	51,104	98,758	35,873	379,819 (4.5%)	493,568 (4.6%)
2002	117,476	0	117,476 (3.3%)	190,520	16,156	40,834	117,819	48,212	413,541 (8.9%)	531,018 (7.6%)
2003	120,152	0	120,152 (2.3%)	199,295	13,905	27,855	139,777	56,441	437,273 (5.7%)	557,426 (5.0%)
2004	122,579	10,250	132,829 (10.6%)	209,401	18,914	24,735	161,816	60,186	475,052 (8.6%)	607,880 (9.1%)
2005	126,709	10,250	136,959 (3.1%)	237,942	28,723	21,535	180,648	57,712	526,560 (10.8%)	663,520 (9.2%)
2006	131,788	7,700	139,488 (1.8%)	246,890	47,734	19,555	237,578	56,876	608,633 (15.6%)	748,121 (12.8%)
2007	136,646	7,700	144,346 (3.5%)	255,491	57,632	13,155	234,344	58,476	619,098 (1.7%)	763,443 (2.0%)
2008	157,653	5,000	162,653 (12.7%)	209,089	57,973	14,253	207,616	64,618	553,550 (-10.6%)	716,202 (-6.2%)
2009	534,062	7,000	541,062 (232.6%)	195,915	62,547	24,348	216,777	66,643	566,229 (2.3%)	1,107,291 (54.6%)
2010	653,138	25,500	678,638 (25.4%)	218,641	65,445	15,513	206,521	60,592	566,712 (0.1%)	1,245,350 (12.5%)
2011	655,413	49,500	704,913 (3.9%)	229,416	66,211	14,731	194,323	51,034	555,716 (-1.9%)	1,260,629 (1.2%)
2012	657,384	68,500	725,884 (3.0%)	264,696	76,486	10,271	186,094	45,159	582,705 (4.9%)	1,308,590 (3.8%)
2013	751,151	91,500	842,651 (16.1%)	252,053	88,896	10,214	185,790	39,816	576,769 (-1.0%)	1,419,420 (8.5%)
2014	752,630	98,000	850,630 (0.9%)	233,444	96,486	6,101	182,161	40,990	559,181 (-3.0%)	1,409,812 (-0.7%)
2015	828,421	100,400	928,821 (9.2%)	239,870	95,581	5,301	204,114	43,351	588,216 (5.2%)	1,517,037 (7.6%)
2016	963,098	102,791	1,065,889 (14.8%)	271,352	99,424	10,550	233,342	50,010	664,677 (9.6%)	1,730,566 (14.1%)
2017	1,048,479	106,320	1,154,799 (8.3%)	241,071	99,020	9,854	243,697	53,647	647,290 (-2.6%)	1,802,089 (4.1%)
2018	1,062,715	107,368	1,170,083	319,663	113,856	17,917	442,763	54,787	948,986	2,119,069
2019	1,082,063	100,135	1,182,198	331,269	116,806	21,222	458,466	55,904	983,666	2,165,864

Note to the tables:

The debt securities statistics from 2018 are reclassified in accordance with the latest international statistical standards set out in the Handbook of Securities Statistics published by the Bank for International Settlements, the International Monetary Fund and the European Central Bank. Hence, they may not be comparable with those for the previous years.

CHART B1

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

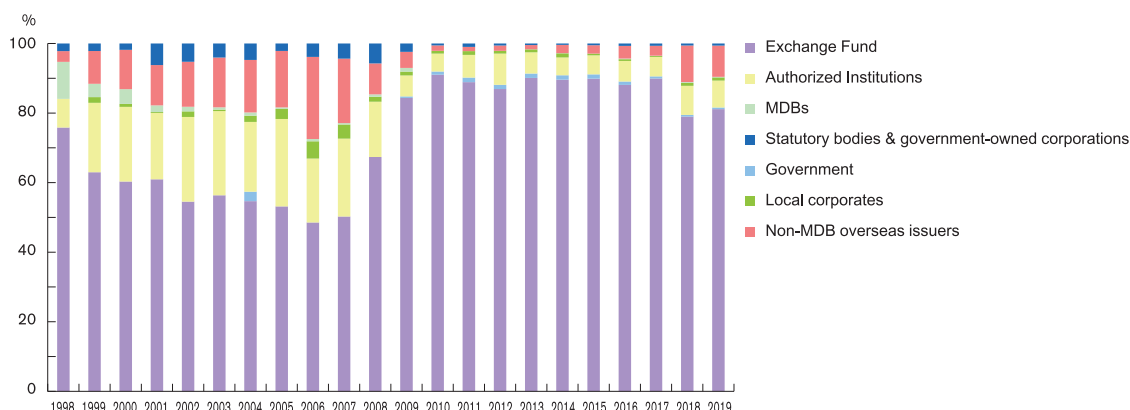
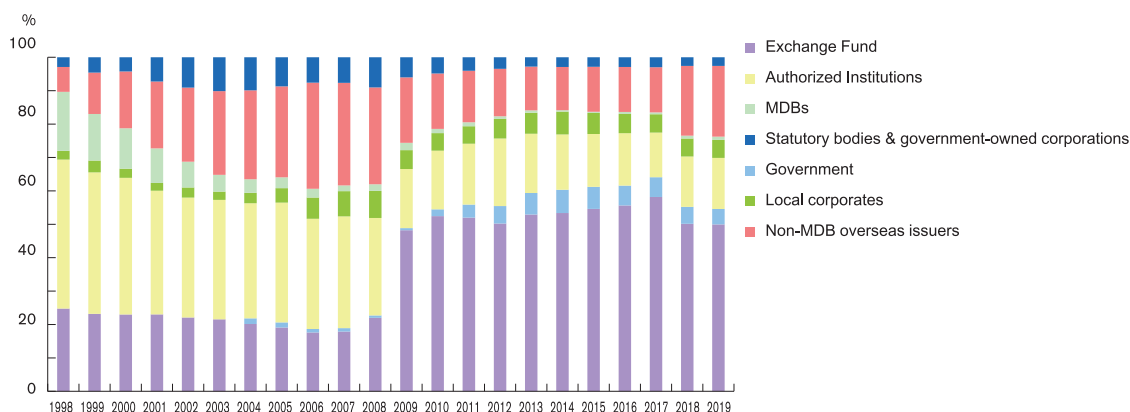


CHART B2

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



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.
5. The debt securities statistics from 2018 are reclassified in accordance with the latest international statistical standards set out in the Handbook of Securities Statistics published by the Bank for International Settlements, the International Monetary Fund and the European Central Bank. Hence, they may not be comparable with those for the previous years.