4. Monetary and financial conditions

The Hong Kong dollar continued to trade close to the strong-side Convertibility Undertaking, with the strong-side Convertibility Undertaking triggered intermittently in September and October 2020. The strong demand for the Hong Kong dollar was driven mainly by equity-related demand arising from vibrant initial public offering activities and the southbound Stock Connects. Along with the expansion of the Aggregate Balance to more than HK$450 billion, Hong Kong Interbank Offered Rates softened across the board. While the uncertainties related to the development of the COVID-19 pandemic, pace of economic recovery and lingering China-US tensions may heighten fund-flow volatility, Hong Kong is able to withstand the volatility given its ample foreign reserves and robust banking system.

4.1 Exchange rate and capital flows

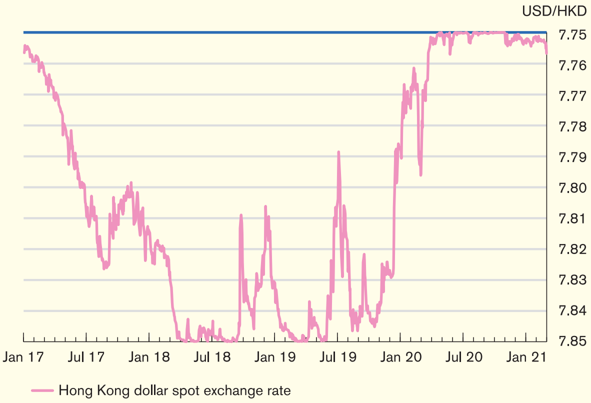
The Hong Kong dollar traded close to the strong-side Convertibility Undertaking (CU), driven mainly by equity-related demand arising from vibrant initial public offering (IPO) activities and the southbound Stock Connects (Chart 4.1). Despite some repatriation of monies raised from the IPO subscriptions, the Hong Kong dollar remained trading in a narrow range of 7.7505 to 7.7544 in November and December 2020, underpinned by improved sentiment in the local stock market and anticipated funding needs towards the year-end. With equity fund-raising activities staying strong in the first two months of 2021 (Chart 4.2), the exchange rate closed at 7.7568 on 26 February 2021. Overall, the Hong Kong dollar continued to trade in a smooth and orderly manner.

During the review period, there were strong inflows to the Hong Kong dollar, as shown by the repeated triggering of the strong-side CU and the increase in the Aggregate Balance (AB). The strong-side CU was triggered 47 times in September and October 2020. In accordance with the design of the Linked Exchange Rate System (LERS), the HKMA sold Hong Kong dollars totalling HK$263.3 billion, leading to an increase of the AB from HK$193.1 billion at the end of August to HK$457.5 billion at the end of February (Chart 4.3). For 2020 as a whole, the strong-side CU was triggered 85 times, resulting in accumulated inflows of HK$383.5 billion.

From a cross-border perspective, there was no sign of significant outflows from the Hong Kong banking system as total deposits increased[28]. Meanwhile, the latest Balance of Payment statistics indicated that non-residents' direct investment inflows into Hong Kong continued in the fourth quarter of 2020, and did not show any abnormal flow pattern.

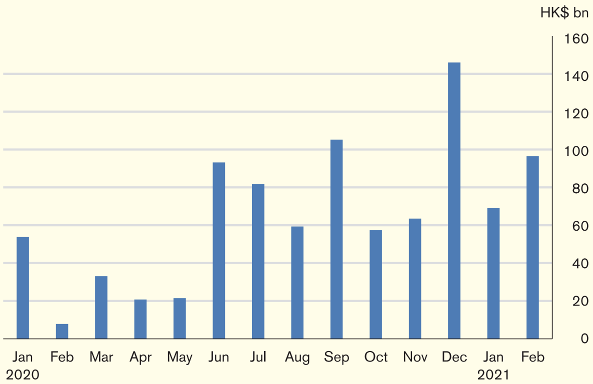
[28] For a detailed analysis of Hong Kong's deposit growth, see section 4.2.

Chart 4.1
Hong Kong dollar exchange rate



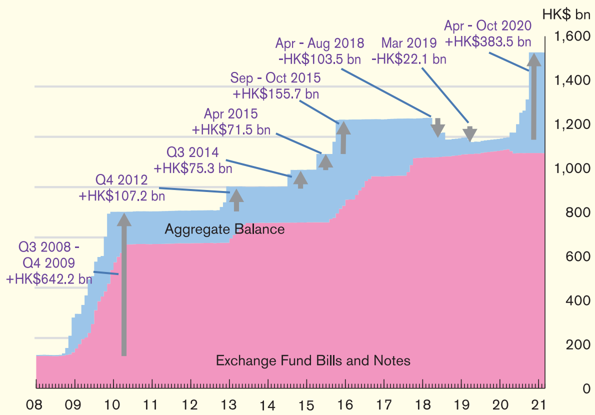
Source: HKMA.

Chart 4.2
Equity funds raised in Hong Kong Stock Exchange (HKEX)



Source: HKEX.

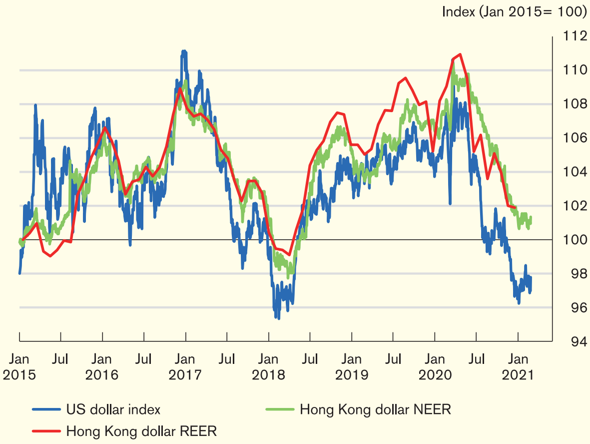
Chart 4.3
Aggregate Balance and Exchange Fund Bills and Notes (EFBNs)



Source: HKMA.

Broadly in line with the weakening of the US dollar against major currencies, the Hong Kong dollar nominal effective exchange rate index (NEER) declined during the review period (Chart 4.4). The Hong Kong dollar real effective exchange rate index (REER) generally tracked the movement of the NEER, as the small inflation differential between Hong Kong and its trading partners had only a limited impact on the REER.

Chart 4.4
NEER and REER



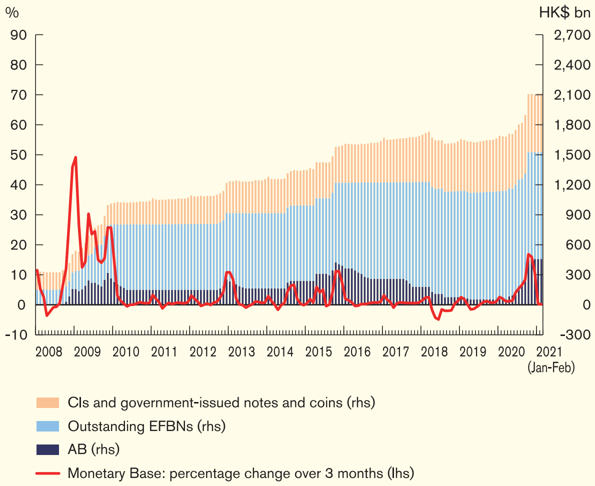
Note: The REER is seasonally adjusted and available only on a monthly basis.
Sources: CEIC, C&SD and HKMA staff estimates.

Looking ahead, the uncertainties related to the development of the pandemic, pace of economic recovery and lingering China-US tensions may heighten fund-flow volatility. As an international financial centre which embraces a wide range of capital-raising activities such as IPOs, Hong Kong sees enormous amounts of funds flowing into and out of the city. On the one hand, these fund-raising activities may attract international investors to allocate funds to Hong Kong. On the other hand, the funds raised by the listed companies may be transferred out of Hong Kong for business needs afterwards. Given its ample foreign reserves and robust banking system, Hong Kong is able to withstand fund-flow volatility without compromising its financial stability.

4.2 Monetary environment and interest rates

During the second half of 2020 and in recent months, Hong Kong's monetary environment stayed accommodative amid continuous inflows into the Hong Kong dollar. The Hong Kong dollar Monetary Base expanded by 20.8% during the eight-month period since the end of June 2020 (Chart 4.5). Analysed by its components, the increase in the Monetary Base during this period was led by the rise in the AB as the strong-side CU was repeatedly triggered. On the other hand, other components, including Certificates of Indebtedness (CIs), government-issued notes and coins, and outstanding EFBNs remained relatively stable.

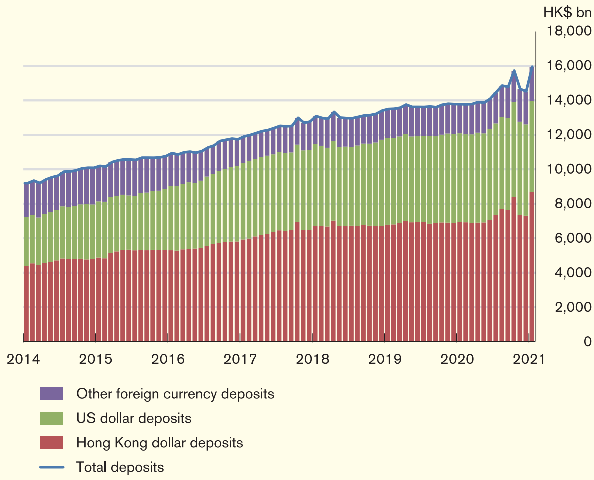
Chart 4.5
Monetary Base components



Source: HKMA.

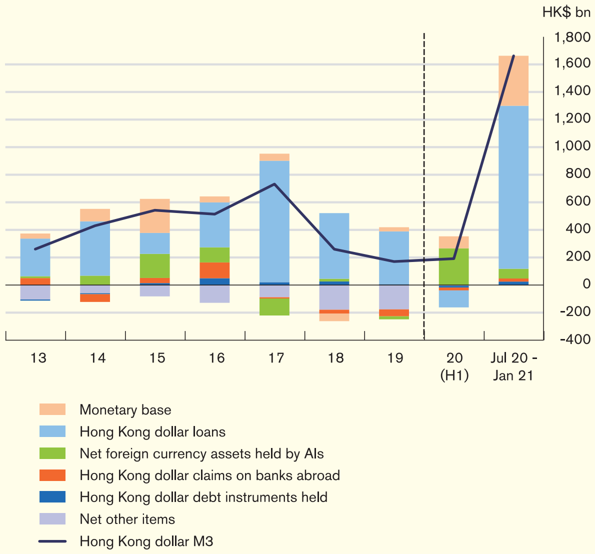
During the review period, the Hong Kong dollar broad money (HK$M3) and its Hong Kong dollar deposit component picked up noticeably between July and October 2020 as well as in January 2021 (Chart 4.6), as large-scale IPO activities brought an increase in Hong Kong dollar deposits through deposit creation from IPO loans. As the IPO activities ended and customers repaid IPO loans, Hong Kong dollar deposits and broad money eased back to normal levels in late 2020. Moving into January 2021, HK$M3 picked up significantly again with sizeable IPO activities straddling the end of January. Overall, HK$M3 rose by 21.7% in the seven-month period since the end of June; it increased by a moderate 9.1% if the effect of IPOs straddling the end of January was excluded. According to an analysis of asset-side counterparts, the growth of HK$M3, excluding IPO loans, was mainly led by the rise in the Monetary Base as a result of the triggering of the strong-side CU (Chart 4.7). As a major component of HK$M3, Hong Kong dollar deposits picked up by 22.9% during the same period, or grew moderately by 9.1% if the effect of IPOs straddling the end of January was excluded. Although Hong Kong dollar time deposits registered a fall due to low deposit rates, such a drop was more than offset by rapid increases in demand and savings deposits underpinned partly by investment demand.

Chart 4.6
Deposits with AIs by currency



Source: HKMA.

Chart 4.7
Changes in HK$M3 and asset-side counterparts

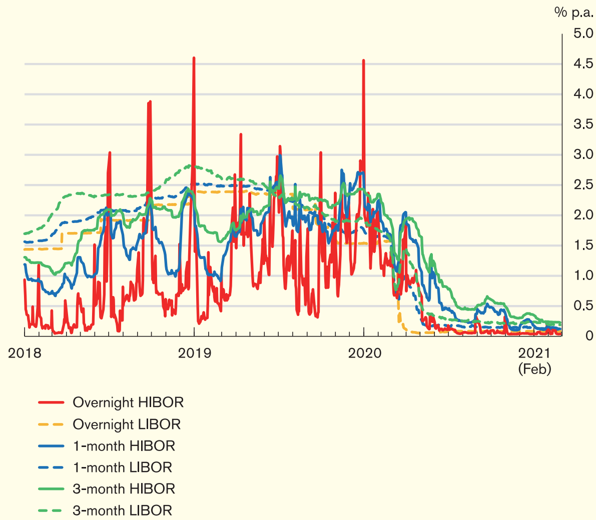


Note: The HK$M3 in the monetary survey has been adjusted to include foreign currency swap deposits.
Source: HKMA staff estimates.

Overall foreign currency deposits picked up steadily by 3.6% in the seven-month period since the end of June. While US dollar deposits recorded a slight decline of 0.3%, partly reflecting a weak US dollar, other foreign currency deposits picked up strongly by 15.5% during the same period, mainly reflecting the expansion of renminbi deposits. As a whole, owing to short-term fluctuations of Hong Kong dollar deposits stemming from IPOs, total deposits with AIs picked up strongly by 13.2% during the review period (Chart 4.6). Excluding IPOs straddling the end of January, total deposits increased moderately by 6.4%. It should be noted that monthly monetary statistics are subject to volatility due to a wide range of transient factors, such as seasonal and IPO-related funding demand as well as business and investment-related activities. Caution is required when interpreting the statistics.

Along with the expansion of the AB, Hong Kong Interbank Offered Rates (HIBORs) generally stayed at very low levels during the review period (Chart 4.8). Despite sizeable IPO fund-raising activities during the second half of 2020, HIBORs did not witness large fluctuations, owing to abundant liquidity in the banking system. Overall, Hong Kong's interbank market continued to function normally.

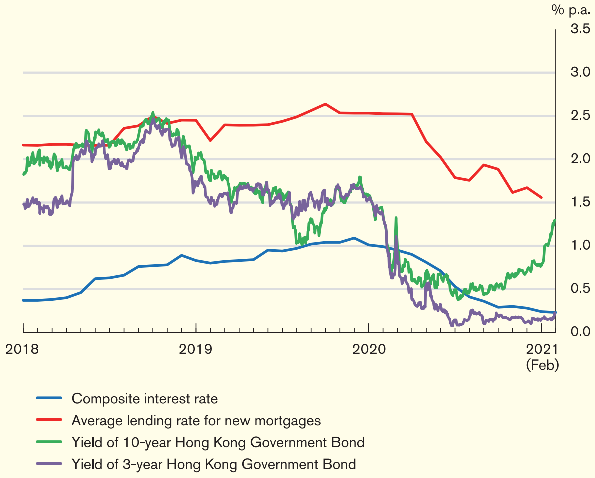
Chart 4.8
Hong Kong dollar and US dollar interbank interest rates



Sources: CEIC and HKMA.

Broadly following the movements of the US dollar yield curve, the Hong Kong dollar yield curve steepened during the review period, with yields for the short tenors edging down and yields for the long tenors moving up (Chart 4.9). Compared with the end of June, the yield of the three-year Hong Kong Government Bond decreased slightly by 4 basis points to 0.23% at the end of February, while the yield of the 10-year Hong Kong Government Bond picked up by 67 basis points to 1.30% during the same period.

Chart 4.9
Yields of Government Bonds, the composite interest rate, and the average lending rate for new mortgages



Sources: HKMA and staff estimates.

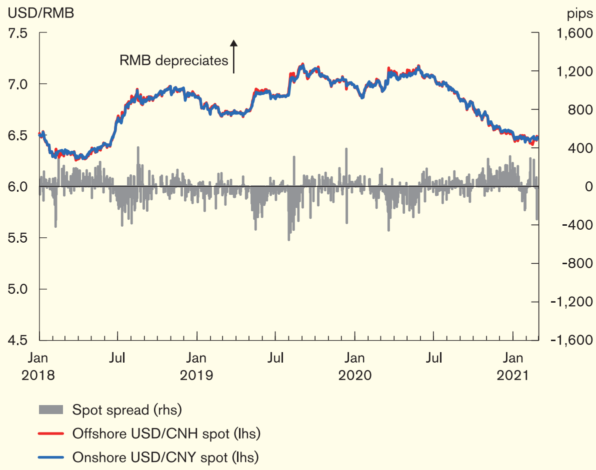
Retail-level Hong Kong dollar interest rates mostly decreased along with the decline in Hong Kong dollar interbank rates. The composite interest rate, which measures the average Hong Kong dollar funding cost of retail banks, dropped further from 0.71% at the end of June to 0.23% at the end of February 2021 (Chart 4.9). As a result of lower funding costs, the average lending rate for new mortgages also declined from 2.02% in June 2020 to 1.56% in January 2021, largely following the movements of the one-month HIBOR. On the other hand, the Best Lending Rates of major retail banks stayed unchanged at between 5.00% and 5.50% during the review period.

Under the LERS, Hong Kong dollar interest rates will be influenced by their US dollar counterparts. As a result, Hong Kong dollar interest rates are likely to continue to stay low given the low-for-long US interest rate environment, with occasional fluctuations stemming from capital market activities and seasonal liquidity demand. In the face of the highly uncertain macro-financial environment, the abundant liquidity in the banking system should provide an adequate buffer for maintaining Hong Kong's monetary and financial stability.

Offshore renminbi banking business

Largely reflecting better economic prospects for Mainland China relative to the rest of the world, as well as a weak US dollar, both the offshore (CNH) and the onshore (CNY) renminbi have appreciated against the US dollar since late May (Chart 4.10). The strengthening of the renminbi was further supported by investment demand following an announcement in late September that Mainland government bonds would be included in FTSE Russell's World Government Bond index. In most of the review period, the CNH traded at a premium over the CNY, with the premium averaging at around 100 pips during the fourth quarter, which remained moderate by historical standards.

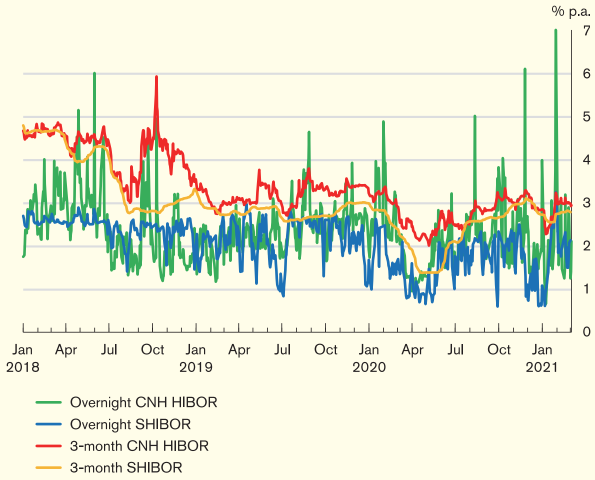
Chart 4.10
CNY and CNH exchange rates



Source: Bloomberg.

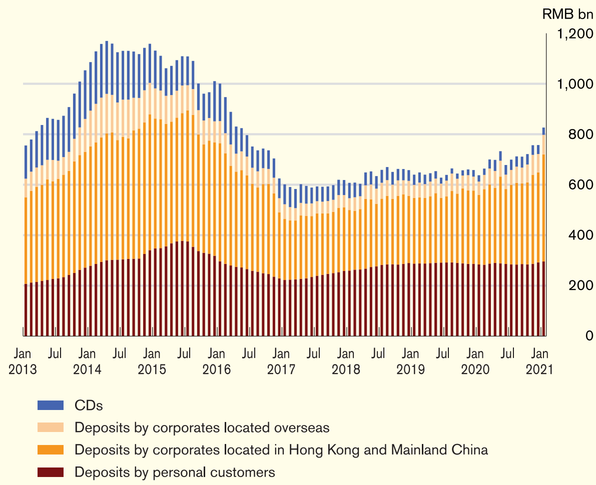
Liquidity conditions in the offshore CNH interbank market continued to be stable during the review period. While the overnight CNH HIBOR witnessed brief fluctuations due to occasional funding needs for northbound remittances and seasonal liquidity demand near the year-end, it mostly traded below 4% (Chart 4.11). Moving along with the onshore counterpart, the three-month CNH HIBOR softened in late December before firming again in late January, driven in part by tight onshore liquidity and seasonal factors.

Chart 4.11
The overnight and the three-month CNH HIBOR fixings



Source: CEIC.

Chart 4.12
Renminbi deposits and CDs in Hong Kong



Source: HKMA.

Hong Kong's CNH liquidity pool continued to grow during the second half of 2020. The pace of increase in renminbi deposits has accelerated since the fourth quarter, in part supported by appreciation of the renminbi and higher interest rates of the renminbi relative to other currencies. Compared with the end of June 2020, the total outstanding amount of renminbi customer deposits and certificates of deposit (CDs) grew faster, by 21.9%, to RMB826.3 billion at the end of January 2021 (Chart 4.12 and Table 4.A). Of the total, renminbi customer deposits expanded by 24.7%, driven mainly by a strong expansion in deposits by corporate customers. On the other hand, outstanding CDs decreased by 25.0% during the same period.

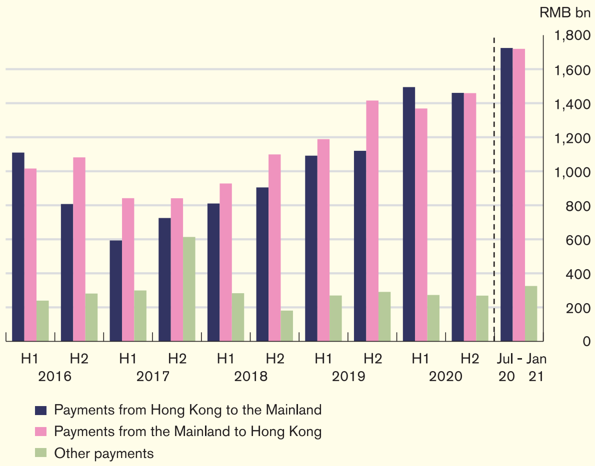
Table 4.A
Offshore renminbi banking statistics

	Dec 2019	Jan 2021
Renminbi deposits & CDs (RMB bn)	658.0	826.3
Of which:		
Renminbi deposits (RMB bn)	632.2	797.7
Share of renminbi deposits in total deposits (%)	5.1	6.0
Renminbi CDs (RMB bn)	25.8	28.6
Renminbi outstanding loans (RMB bn)	153.7	159.2
Number of participating banks in Hong Kong's renminbi clearing platform	204	206
Amount due to overseas banks (RMB bn)	76.3	102.7
Amount due from overseas banks (RMB bn)	95.4	125.6
	2019	2020
Renminbi trade settlement in Hong Kong (RMB bn)	5,376.3	6,324.1
Of which:		
Inward remittances to Hong Kong (RMB bn)	2,604.1	2,827.7
Outward remittances to Mainland China (RMB bn)	2,211.7	2,955.0
Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB bn)	1,133.9	1,191.5

Source: HKMA.

As for other renminbi business, the outstanding amount of renminbi loans decreased by 2.4% to RMB159.2 billion during the seven-month period since the end of June. On the other hand, Hong Kong's renminbi trade settlement continued to pick up strongly. Transactions handled by banks in Hong Kong amounted to RMB3,769.5 billion during the seven-month period between July and January, up by 16.7% compared with the same period last year. Among these transactions, outward remittances to Mainland China picked up more than inward remittances to Hong Kong (Chart 4.13). The deep pool of renminbi liquidity in Hong Kong continued to be adequate to support the large amount of renminbi payments and financial transactions. For 2020 as a whole, average daily turnover of the renminbi Real Time Gross Settlement (RTGS) system stayed high at RMB1,191.5 billion, compared with RMB1,133.9 billion in 2019.

Chart 4.13
Flows of renminbi trade settlement payments



Source: HKMA.

The development of Hong Kong's offshore renminbi business will continue to depend on Mainland's economic prospects, China-US tensions and the development of the COVID-19 pandemic. With efficient financial infrastructure and multiple access channels for cross-border portfolio investment vis-à-vis the Mainland, Hong Kong's offshore renminbi business is expected to benefit from ongoing liberalisation of Mainland's capital account, increasing demand for renminbi assets from international investors, and deepening regional economic and financial cooperation under the Belt and Road and the Guangdong-Hong Kong-Macao Greater Bay Area initiatives.

Asset markets

Hong Kong equity prices rebounded after a sharp correction at the beginning of the review period. The rally was in tandem with the rise in global equity prices and strong buying interest from Mainland investors through southbound trading on the two Stock Connects. Meanwhile, the Hong Kong dollar and offshore renminbi debt markets expanded steadily in the second half of 2020. While the residential property market broadly held up, the non-residential property market remained generally weak amid the lingering pandemic.

4.3 Equity market

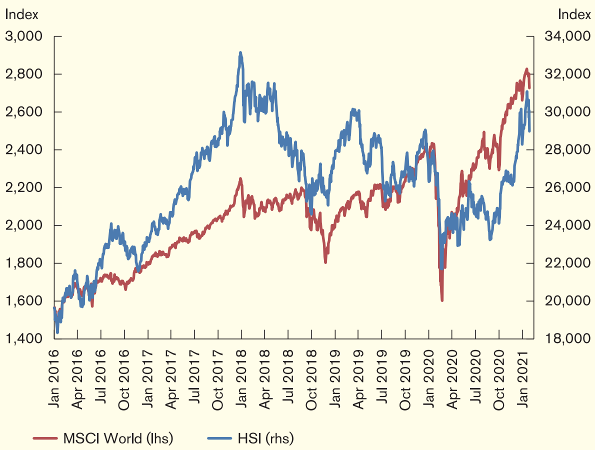
On the back of strong gains in global equity markets and keen southbound buying interest, the Hong Kong equity market rebounded in the review period after a sharp correction in the September of 2020. While renewed waves of COVID-19 infections have stalled recovery in most developed economies with new lockdown measures since the fourth quarter of 2020, global equity markets rose as unprecedented monetary easing measures in major economies continued to lend support to asset markets and, more importantly, investors could be optimistic that the positive vaccine developments might speed up recovery of the global economy. During the review period, global equity markets were also further bolstered by developments that might help reduce key uncertainties hanging over the world. These included progress on additional fiscal stimulus by the US government after the presidential election results were confirmed, and the reaching of a post-Brexit trade agreement between the UK and the European Union before the December deadline.

Stepping into 2021, the Hang Seng Index (HSI) has broadly maintained its upward momentum amid strong buying flows from the southbound Stock Connects despite an executive order from the administration of Donald Trump that banned US investors from owning shares of companies deemed to have ties to Mainland's military, and related announcements by US stock exchanges. Towards the end of the review period, the HSI was under consolidation amid concerns on over-valuation in equities and worries about an earlier-than-expected rate hike in US after rallying to a new high of over 31,000 points in 32 months in mid-February.

Overall, the local market rose by 15.1%, from September 2020 to February 2021, while the MSCI World Index gained by 10.5% in the same period (Chart 4.14). Option-implied volatilities surged at the beginning of the review period, but have since subsided as calm returned to the market. However, the SKEW Index rebounded towards the end of the review period, reflecting that investors were once again concerned about heightened tail risks and were hence willing to pay more for downside protection (Chart 4.15)[29].

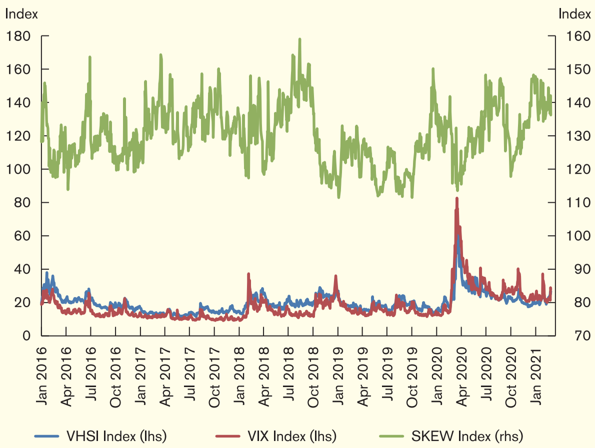
[29] The SKEW Index is calculated by the Chicago Board Options Exchange from the prices of the S&P 500 out-of-the-money options. A SKEW value of 100 means that the probability of outlier negative returns on a 30-day horizon is negligible. As the SKEW rises above 100, the left tail of the S&P500 returns distribution acquires more weight, suggesting that the probability of outlier negative returns has become more significant. For details, see https://www.cboe.com/products/vix-index-volatility/volatility-indicators/skew.

Chart 4.14
Equity prices and the MSCI World Index



Sources: Bloomberg and Reuters.

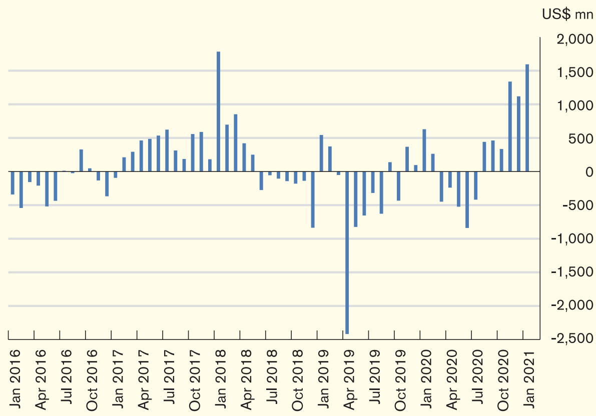
Chart 4.15
Option-implied volatilities of the HSI and S&P500, and the SKEW index



Sources: Bloomberg and Reuters.

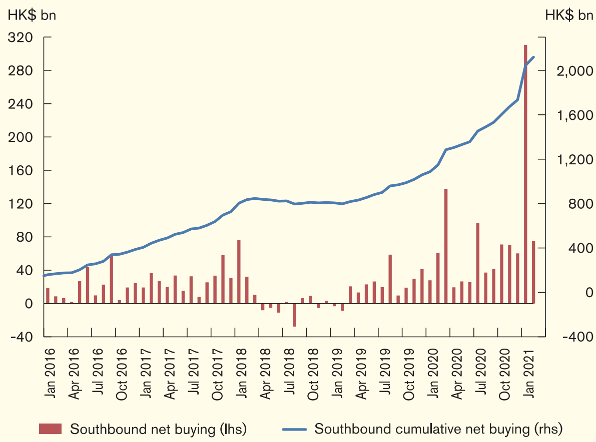
With an improved risk appetite, net inflows to the Hong Kong stock market had been observed since September 2020, totaling US$4,850.1 million from September 2020 to January 2021, the best five-month period in more than two years (Chart 4.16). Net southbound buying through the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connects had been recorded since March 2019. During the review period, the cumulative net buying amount increased by 42.2% to HK$2,119.5 billion and surged to a peak at the end of February, with a record-breaking level of over HK$300 billion of southbound net buying in January 2021. (Chart 4.17).

Chart 4.16
Equity market fund flows into Hong Kong



Source: EPFR Global.

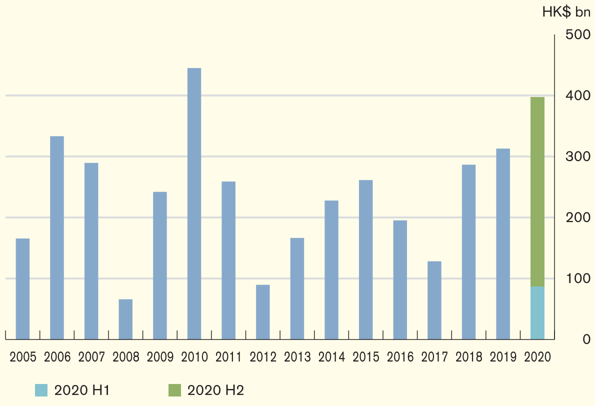
Chart 4.17
Net flows through Stock Connect



Note: Southbound net buying is the sum of such buying on the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect.
Sources: CEIC, HKEX and HKMA staff estimates.

In the primary market, IPOs in Hong Kong registered sustained growth in 2020 in terms of the funds raised. There were 154 IPOs, raising a total of HK$397.5 billion (Chart 4.18), an increase of 27.05% from 2019. In 2020, the HKEX ranked second among the world's IPO markets, attributable partly to more Mainland firms having sought secondary listings in Hong Kong. In the past year, eight US-listed Mainland companies completed their secondary listings in Hong Kong, raising a total of HK$127.9 billion.

Chart 4.18
The IPO market in Hong Kong



Source: HKEX.

Looking ahead, the outlook for the local equity market will remain clouded by uncertainties over the development and impact of the pandemic. In particular, global economic growth and market sentiment will hinge on the pace and efficacy of vaccine rollouts. Furthermore, market sentiment may be dampened by uncertainties surrounding the China-US relationship, which could have a significant impact on the Hong Kong stock market. As such, the local equity market would remain susceptible to volatility in the external environment.

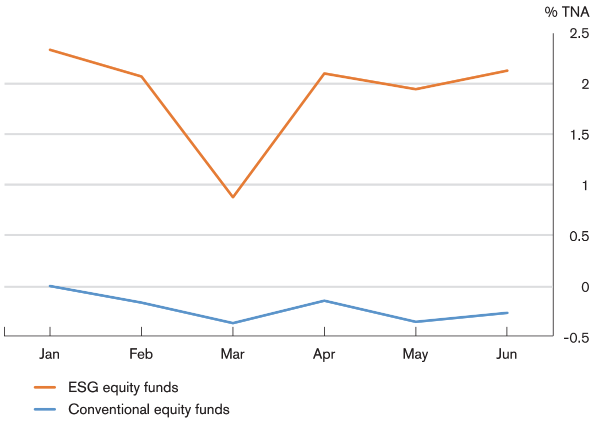
Latest developments in the stock market also suggest that environmental, social and governance (ESG) factors have played an increasingly important role in determining stock valuations. Indeed, ESG equity funds were found to be relatively resilient to market turbulence during the pandemic, suggesting that ESG factors significantly differentiated between the stock valuation of firms. Box 3 studies the effect of ESG disclosures on stock valuations using a sample of ESG reports issued by Hong Kong-listed firms. Our findings suggest that firms' exposure to ESG risks is one important source of uncertainty in their stock valuations, and such uncertainty can be reduced effectively by their ESG disclosures.

Box 3
Effects of ESG disclosures on stock valuations

Introduction[30]

ESG investing refers to the consideration of non-financial factors related to ESG issues, alongside financial factors, in the investment decision-making process. ESG equity funds are found to be relatively resilient to market turbulence during the COVID-19 pandemic (Chart B3.1), suggesting that ESG factors significantly differentiated between the stock valuations of firms. Relatedly, inadequate disclosures about ESG-related risks would limit investors' ability to assess these risks properly. This could become a source of financial stability risks, as stock markets could be vulnerable to abrupt price corrections to ESG risks systemically.

Chart B3.1
Inflows into ESG equity funds during the first half of 2020



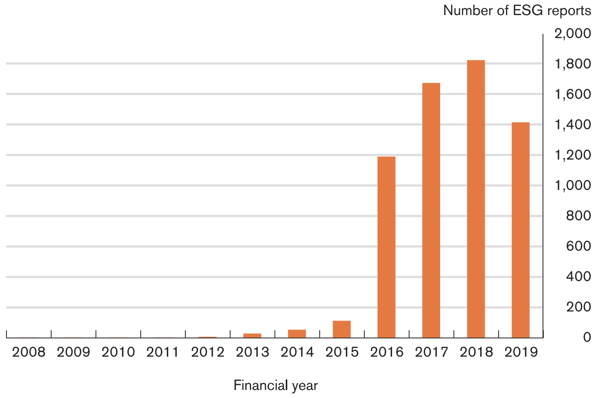
Note: Conventional and ESG equity funds are based on classification by source.
Source: EPFR.

This Box focuses on firms listed on the HKEX and examines whether the ESG disclosures of firms affect the informational efficiency and volatility of their stock prices. In theory, more transparent disclosures on ESG matters could reduce information asymmetry between listed firms and investors, and promote price discovery in the market. ESG disclosures may also reduce the volatility of stock prices by, arguably, lowering uncertainty arising from the exposure of firms to ESG risks.

Data and methodology

We source the firms' ESG disclosures from their annual ESG reports. Since 2016, when the "comply or explain" requirement on ESG disclosure came into force, the number of ESG reports issued has increased tenfold and stayed above that level (Chart B3.2)[31].

Chart B3.2
Number of ESG reports issued by Hong Kong-listed firms



Note: The figure for the 2019 financial year covers only reports issued on or before 29 May 2020.
Source: HKMA staff calculations based on ESG reports collected from the "HKEXnews" website.

[30] Wu (2020), "What can we learn from analysing listed firms' ESG reports? – observations from Hong Kong based on textual analysis," *HKMA Research Memorandum*, 05/2020.

[31] "Comply or explain" requirement means listed firms need to report on the "comply or explain" provisions in the ESG reporting guide. If the listed firm does not report on one or more of these provisions, it must provide reasons in its ESG report. These provisions have been upgraded to mandatory reporting for financial years commencing on or after July 2020.

As the information in the ESG reports is mainly textual and unstructured, we use computer-based textual analysis to convert the information into several attributes to facilitate a better comparison of ESG disclosures (Table B3.A)[32].

Table B3.A
Attributes derived from textual analysis

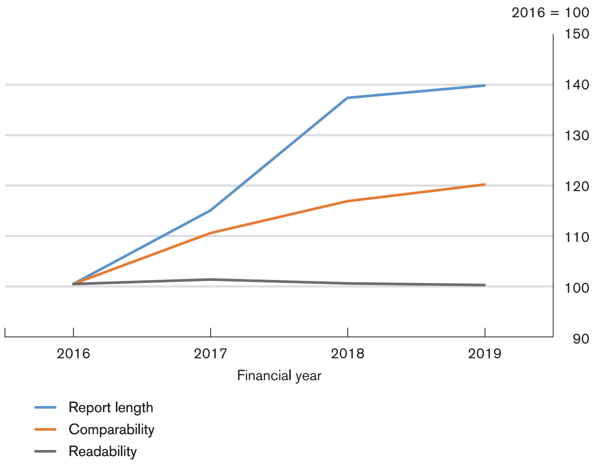
Attributes	Description / Definition
Report length	Measures the amount of information based on the number of words in the ESG report
Readability	Measured by the average length of a sentence and complexity of words
Comparability	Measured by the similarity of words used in the ESG reports across different firms
Topic identification	Identifies topics by different combinations of keywords that are commonly discussed among ESG reports
Forward-looking content	A sentence is classified as forward-looking if it contains forward-looking words (e.g. will, future)

Taking these attributes as independent variables, we estimate two panel data regression models to estimate their relationships with the bid-ask spread of stock prices (a measure of informational efficiency) and the standard deviation of daily stock returns (a measure of stock price volatility) respectively[33]. The regression sample consists of 1,571 listed firms covering the period from the 2016 to 2019 financial years[34].

Empirical findings

The textual analysis highlights four observations. First, the length of ESG disclosure reports has generally increased since 2016. Firms in sectors more exposed to environmental issues, such as utilities and energy, tend to disclose more information. Second, the comparability of ESG reports among firms has increased over time, while little improvement is seen in the reports' readability (Chart B3.3). Third, regarding the content of reports, environmental issues (e.g. greenhouse gas, energy consumption and hazardous waste) have received increasing attention, while social (e.g. employee safety and social responsibility) and governance-related (e.g. law and regulation, and corporate governance) disclosures continue to dominate the discussions. Finally, forward-looking information accounted for an important part of the firms' ESG disclosures, providing important information on the long-term ESG risks of listed firms.

Chart B3.3
Trends in the selected attributes of ESG reports



Notes:
(1) The figures refer to the median value of the selected attributes, covering ESG reports issued in each financial year.
(2) All attributes are normalised based on the 2016 financial year having a value of 100.

[32] Unstructured information refers to information that either does not have a pre-defined data model or is not organised in a pre-defined manner. Some techniques are required to convert it into structured data for analysis and interpretation.

[33] Variables such as firms' size, leverage ratio, stock price, return on assets, previous return and market volatility are included in the panel regression models to control for factors that could affect the bid-ask spread of stock prices or standard deviation of stock returns.

[34] The number of firms in the regression analysis is smaller than the number of firms issuing ESG reports (Chart B3.2) as certain firm-year observations with outlier values or incomplete data are removed from the regression analysis.

We further examine how the key attributes of ESG disclosure will affect the bid-ask spread of stock prices and standard deviation of stock returns. Empirical findings suggest that firms can benefit from ESG disclosure, because it improves informational efficiency and reduces the uncertainty of stock valuation. Specifically, estimation results of the panel data regressions show that firms with more ESG disclosures and more forward-looking information are associated with a smaller bid-ask spread of stock prices (i.e. better informational efficiency, as shown in the middle column of Table B3.B). In addition, firms that disclosed more environment-related and forward-looking information are associated with a smaller standard deviation of stock returns (i.e. lower volatility, as shown in the right-hand column of Table B3.B).

Table B3.B
Estimated relationship between ESG disclosures and stock valuations

Attributes of ESG reports	Better informational efficiency	Lower volatility
Longer report	**	
More readable		*
More comparable		
Environmentally oriented		**
More forward-looking content	***	*

Notes:
(1) A blank entry denotes the estimated relationship is not statistically significant at the 10% level.
(2) ***, ** and * denote the estimated relationship being statistically significant at the 1%, 5% and 10% levels respectively.
(3) An ESG report is characterised as environmentally oriented if it is dominated by an environment-related topic.

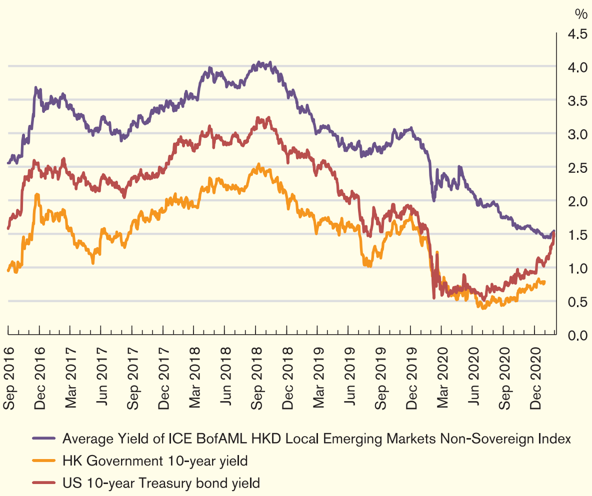
Conclusion

Our findings show that the exposure of firms to ESG risks is one important source of uncertainty in their stock valuations, and such uncertainty can be reduced effectively by ESG disclosures. The fact that firms can benefit from being more transparent in ESG issues will provide a strong support to stock market regulators in their ongoing efforts to improve listed firms' ESG disclosures.

4.4 Debt market

The Hong Kong dollar debt market continued to expand in the second half of 2020 on the back of steady growth in issuances. The yield of Hong Kong dollar 10-year sovereign bond, while still hovering around its historically low level, rebounded a bit in tandem with an increase in US Treasury yield during the review period amid concerns over rising inflationary pressure with better growth outturns and the prospect of higher government borrowing to support additional fiscal stimulus in the US. Meanwhile, the yield of Hong Kong dollar non-sovereign bonds continued to decrease (Chart 4.19).

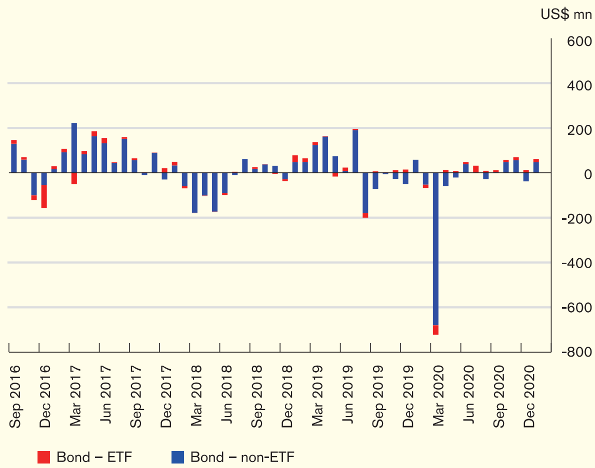
Chart 4.19
Hong Kong dollar sovereign and non-sovereign bond yields and US ten-year Treasury yield



Sources: ICE Data Indices and HKMA.

Net bond fund flows to Hong Kong returned after a sharp net outflow of US$742.5 million in the first half of 2020. Confidence was gradually restored by unprecedented support from central banks and government stimulus measures globally. The uptick in confidence, together with improved liquidity conditions, contributed to a net bond fund inflow to Hong Kong of US$101 million in the fourth quarter of 2020. Since September 2020, non-exchange traded fund (non-ETF) bond funds, which have garnered inflows, were the main contributor, accounting for 66.0% of the total net inflows of bond funds between September 2020 and January 2021. (Chart 4.20).

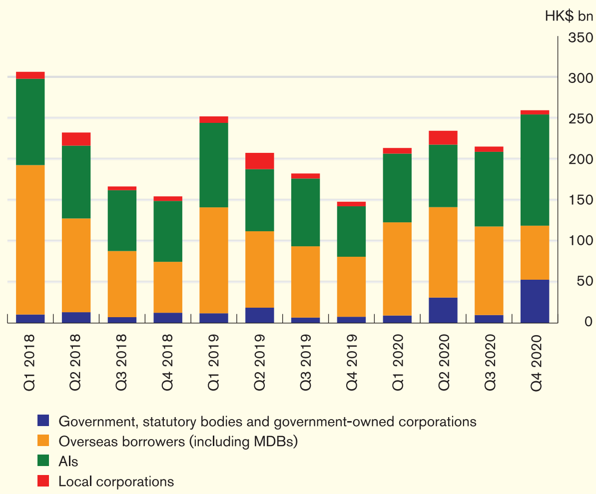
Chart 4.20
ETF and non-ETF bond fund flows into Hong Kong



Source: EPFR Global.

The total issuance of Hong Kong dollar debt in the second half of 2020 increased by 9.8% year-on-year to HK$2,209.6 billion. The increase was driven by a more than threefold increase in non-EFBN issuances by the government sector and a 57.1% increase in issuances by authorized institutions (Chart 4.21), and a 3.2% increase in the issuance of EFBNs.

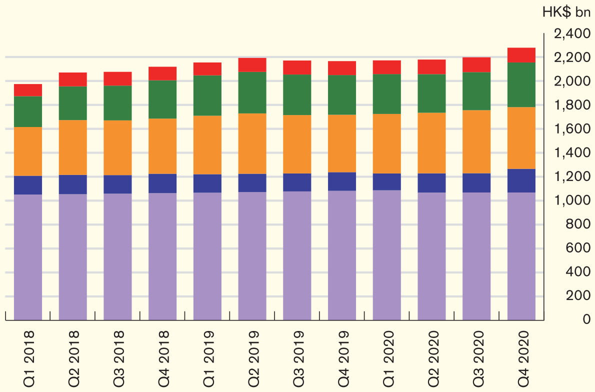
Chart 4.21
New issuance of non-EFBNs Hong Kong dollar debt



Source: HKMA.

As a result, the outstanding amount of Hong Kong dollar debt expanded by 5.2% year-on-year to HK$2,278 billion at the end of December 2020 (Chart 4.22). The amount was equivalent to 28.7% of HK$M3, and to 23.8% of the Hong Kong dollar-denominated assets of the banking sector. Within the total, the government sector saw non-EFBN debt outstanding rising by 26.9% from a low base a year ago to HK$198 billion, while outstanding EFBNs declined marginally by 1.3% year-on-year to HK$1,068 billion.

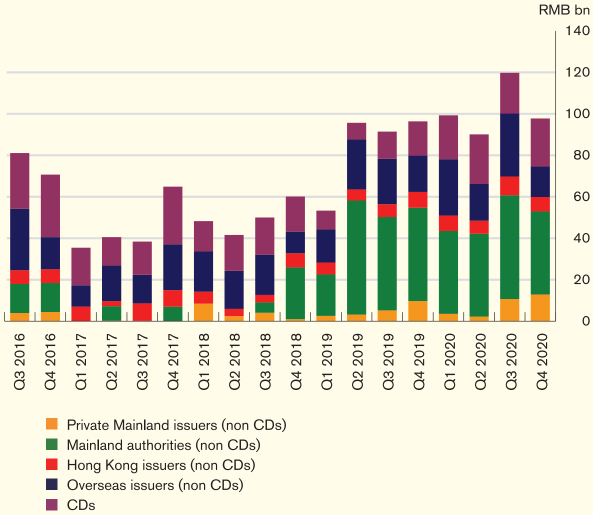
Chart 4.22
Outstanding Hong Kong dollar debt by issuer



Source: HKMA.

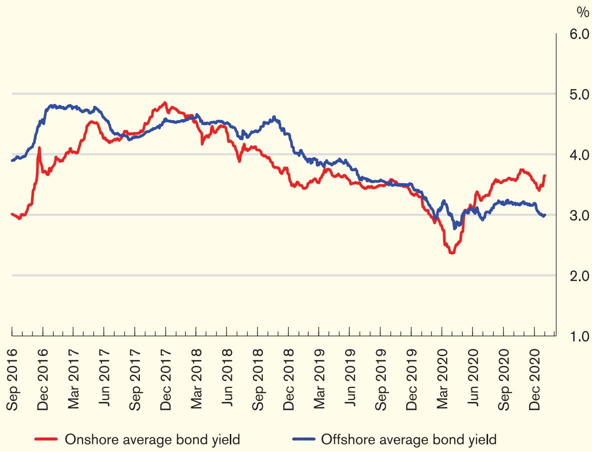
The offshore renminbi debt market in Hong Kong continued to grow steadily in the second half of 2020. As sentiment in the offshore renminbi (CNH) debt market improved, total new issuance increased by 14.9% in the second half of 2020 from the first half to RMB217.6 billion. This increase was driven mainly by a greater than threefold increase in issuances by private Mainland issuers. In addition, debt issued by Mainland authorities and Hong Kong issuers increased by 12.5% and 17.6%, respectively (Chart 4.23). Onshore bond yields started to pick up last April, while offshore bond yields remained at low levels partly due to strong buying interest from international investors. As a result, the yield difference widened in the second half of 2020 (Chart 4.24).

Chart 4.23
New issuance of offshore renminbi debt in Hong Kong by issuer



Sources: Newswires and HKMA staff estimates.

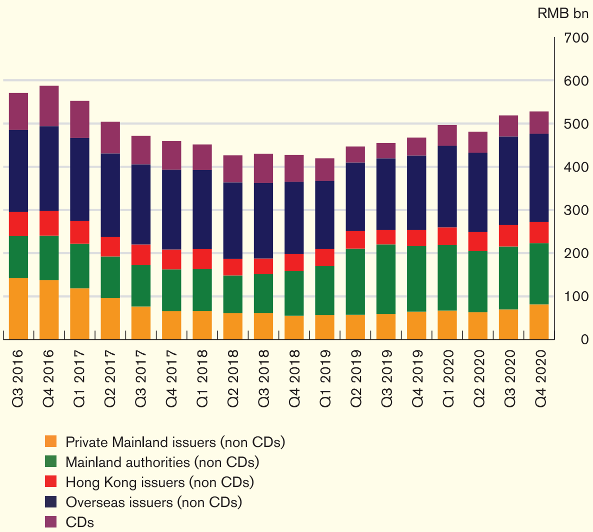
Chart 4.24
Average yields of onshore vs. offshore renminbi bond indices



Sources: Bloomberg, Hang Seng Indexes Company Ltd, and China Central Depository & Clearing Co., Ltd.

Due to the rapid growth in new issuance, the total outstanding amount of CNH debt securities recorded a 12.9% year-on-year increase to RMB528.0 billion at the end of December 2020 (Chart 4.25).

Chart 4.25
Outstanding amount of CNH debt in Hong Kong



Sources: Newswires and HKMA staff estimates.

Near-term prospects for the Hong Kong dollar and CNH debt markets remain uncertain. In particular, for CNH debt, the prospects of a weaker US dollar against the renminbi, combined with the "lower-for-longer" interest rate environment, are likely to attract more foreign investors to markets that can offer them relatively high yields and potentially also foreign exchange gains. That said, uncertainties in the pace of global economic recovery, in terms of the development of the pandemic and lingering concerns of continued US policy restrictions by the new administration on investment in some Chinese entities, are likely to weigh on market sentiment.

In the latest Budget unveiled in February 2021, the Government announced its plans to enhance the efficiency and capacity of the Central Moneymarkets Unit (CMU) to cope with the developments of Bond Connect and retail bond market. In the medium term, local debt market development is set to be boosted by a number of policy initiatives in the Government Bond Programme, particularly on green finance[35].

On 27 January 2021, the Government announced the successful offering of US$2.5 billion of green bonds under the Government Green Bond Programme. Green finance is expected to be an important driver in local bond market development as the market is strategically positioned to attract issuances of green bonds denominated in multiple currencies, capitalising on Hong Kong's strengths as an international financial centre while boosting Hong Kong's profile as a financing platform for green projects on the Mainland and overseas[36].

4.5 Property markets

Residential property market

The residential property market broadly held up, despite new waves of local COVID-19 infections. Transaction activities were restrained in the third quarter of 2020 amid the third wave of local infections, but picked up in the last quarter of 2020 as many new development projects were launched after the third wave receded (Chart 4.26). For 2020 as a whole, the housing transaction was about 60,000 units, similar to 2019. Following some stabilisation of the fourth wave of local infections in early 2021, housing transactions picked up in February after a temporary dip in January.

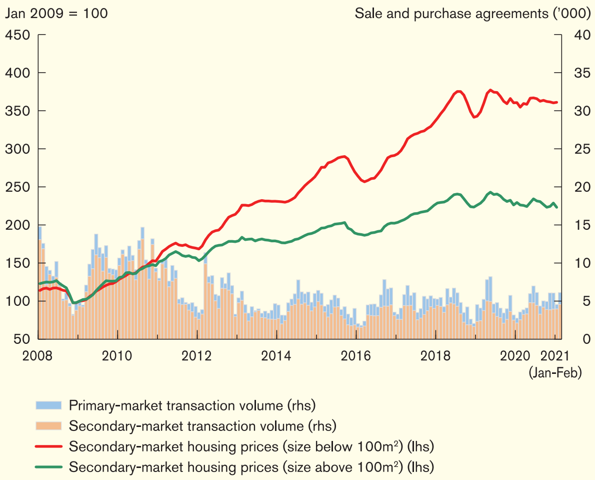
Secondary-market housing prices have consolidated slightly since mid-2020. In particular, large flats (with a saleable area of at least 100m^2) saw relatively larger consolidation than small and medium-sized flats (with a saleable area of less than 100m^2) (Chart 4.26). Overall, housing prices declined mildly by 1.9% in the second half of 2020[37]. In early 2021, the Centa-City Leading Index remained roughly stable in February compared with end-2020.

[35] The Government launched HK$15 billion of inflation-linked retail bonds and the fifth batch of the Silver Bond, also totalling HK$15 billion, in October and November of 2020 respectively.

[36] According to Dealogic, green bonds listed in Hong Kong totalled US$22.9 billion at the end of December 2020, mostly denominated in other currencies, such as the US dollar (81.1%), the euro (13.1%) and the renminbi (3.3%). Only 2.5% were denominated in the Hong Kong dollar.

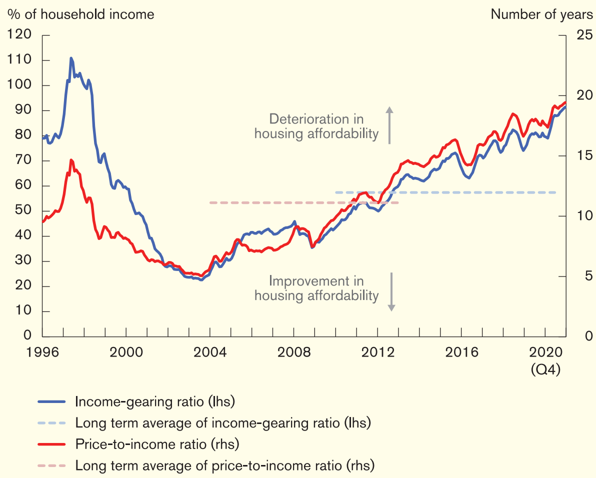
[37] Official housing prices recorded a slight increase of 0.1% for the whole year, the smallest annual rise since 2008.

Chart 4.26
Residential property prices and transaction volume



Sources: R&VD and Land Registry.

Chart 4.27
Indicators of housing affordability



Sources: R&VD, C&SD and HKMA staff estimates.

Housing affordability became more stretched, mainly due to a fall in household income. The housing price-to-income ratio climbed to 19.3 in the fourth quarter of 2020, compared with the historical peak of 14.6 in 1997. While the average interest rate for new mortgages went down during 2020, repayment ability deteriorated along with falling household incomes. Meanwhile, the income-gearing ratio reached a high of 90.7%, well above the long-term average (Chart 4.27)[38]. Although housing prices edged down only slightly and rentals flattened in the second half of 2020, the buy-rent gap stayed elevated[39]. In tandem, residential rental yields remained low at 2.0–2.4% in January 2021.

While the pandemic and the prolonged economic fallout continued to pose downside risks to the housing market, macroprudential measures implemented by the HKMA since 2009 have strengthened banks' resilience to property market shocks. The debt-servicing ratio for new mortgages stayed low at around 37% in the seven months to January 2021. The average LTV ratio for new mortgages was 58% in January 2021, below the prevailing ratio of 64% before the measures were first introduced.

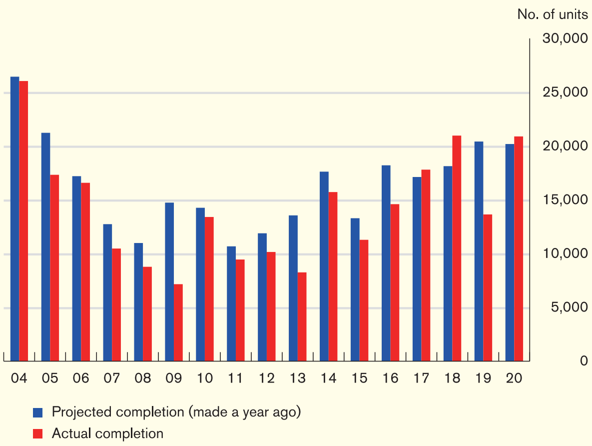
The residential property market outlook is subject to a number of uncertainties and risks as discussed in previous chapters. On the one hand, the high unemployment rate and the fall in household income will weigh on housing demand. On the other hand, the prolonged ultra-low interest rates are expected to provide support for asset prices. Over the longer term, the outlook for the housing market will depend on the supply-demand gap. Actual completions reached 20,900 units in 2020, the second highest in the recent decade (Chart 4.28), and the Government projects that private housing supply will remain high in the upcoming years[40].

[38] The price-to-income ratio measures the average price of a typical $50m^2$ flat relative to the median income of households living in private housing. Alternately, the income-gearing ratio compares mortgage payment for a typical $50m^2$ flat (under a 20-year mortgage scheme with a 70% loan-to-value ratio (LTV ratio)) to the median income of households living in private housing. The income-gearing ratio is not the same as a borrower's actual debt-servicing ratio, which is subject to a maximum cap under HKMA prudential measures.

[39] The buy-rent gap estimates the cost of owner-occupied housing (under a 20-year mortgage scheme with a 70% LTV ratio) relative to rentals.

[40] For example, gross completions are projected at around 19,100 units per year in 2021 and 2022, compared with the annual average of 14,300 units in the past 10 years (2011–2020).

Chart 4.28
Projected and actual private flat completion



Sources: Transport and Housing Bureau and R&VD.

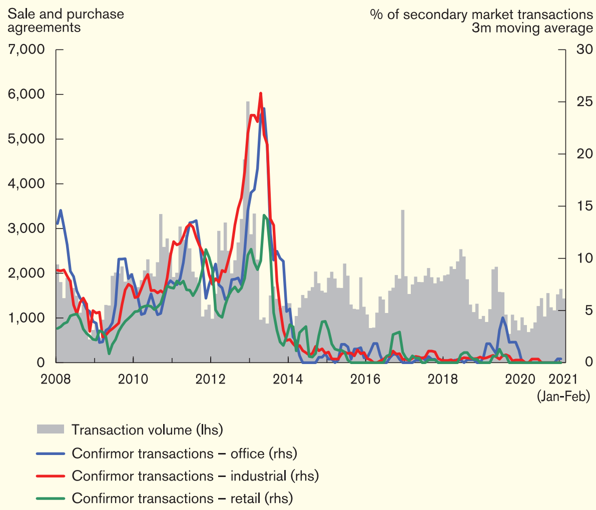
Non-residential property market

The non-residential property market remained generally weak. Overall transactions reached a record low of 13,442 units for the whole of 2020, although activity picked up in late 2020 (Chart 4.29). Speculative activities stayed muted, as indicated by confirmor transactions. Restrained by the challenging economic environment, prices of non-residential properties remained soft during the second half of 2020 (Chart 4.30). Similarly, the leasing market for commercial properties continued to be sluggish, with rentals of office space recording enlarged declines (Chart 4.31). Rental yields across segments stayed low at 2.6–3.1% in January 2021.

The non-residential property market may continue to face headwinds in the near term, as economic activities will take time to recover even with the new vaccines. In particular, the prices and rentals of office space and retail premises may remain under pressure given higher vacancies. Over the longer term, some post-pandemic behavioural changes may have long-lasting effects on the commercial property market. For example, the rise of remote working could reduce demand for office space in the future.

In view of slackening market demand over the past two years, the Government considered it appropriate to abolish the Doubled Ad Valorem Stamp Duty (DSD) for non-residential property as a demand management measure, effective on 26 November 2020[41]. The abolition of DSD could facilitate the selling of non-residential property by companies that are encountering financial difficulties or liquidity needs due to the economic downturn. Earlier in August 2020, the HKMA adjusted countercyclical macroprudential measures on non-residential property, raising the applicable LTV ratio caps for mortgage loans on non-residential property by 10 percentage points. The HKMA will continue to monitor developments closely and introduce appropriate measures in response to changes in the property market cycle to safeguard banking stability.

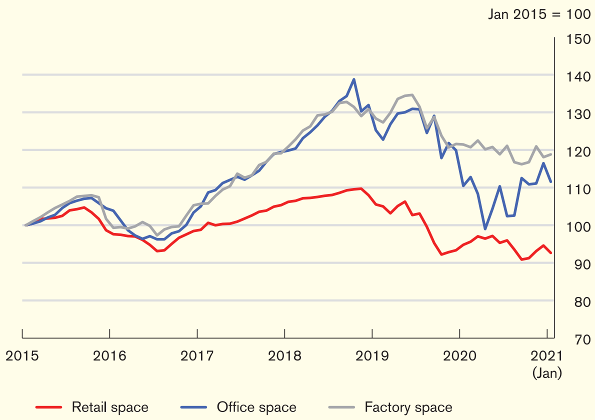
Chart 4.29
Transactions in non-residential properties



Sources: Land Registry and Centaline Property Agency Limited.

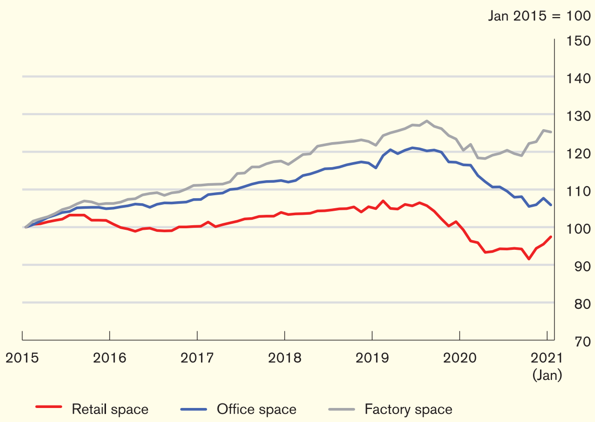
[41] The DSD was introduced in February 2013 to curb speculation and maintain property market stability against the backdrop of an overheating property market with active transaction activities and soaring prices.

Chart 4.30
Non-residential property price indices



Source: R&VD.

Chart 4.31
Non-residential property rental indices



Source: R&VD.