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# WHAT FUTURE FOR THE HONG KONG DOLLAR CORPORATE BOND MARKET?

*Tony Latter*

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# What Future for the Hong Kong Dollar Corporate Bond Market?

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## Abstract

There have been persistent calls for development of bond markets in Asia. This study focuses, in particular, on prospects for the corporate bond market in Hong Kong. The distinctive approach has been to elicit the views of the actual or prospective end-users of the market, or those representing their interests, since, without the corporate issuers and the ultimate investors, the market could not be expected to mature further.

The market lacks sufficient mass to generate the liquidity, fine pricing and narrow spreads observable in, say, the US market; but it is in all other respects efficient. There is little evidence of unsatisfied demand to issue or to invest. This reflects the limited population of companies which could, given size, credit standing, costs, etc, realistically aspire to issue; the limited investor appetite for such paper; and the competing attractions of the US dollar market for both sides.

A comparison of the characteristics of bank finance and the bond market suggests that the purported advantages of the latter in providing a 'spare tyre' for times of crisis may be exaggerated. In particular, many of those who have argued, notably since the 1997 Asian financial crisis, for action to develop the corporate bond market, have seemingly failed to appreciate that only a minority of firms can realistically expect to access the market, and that the market itself, especially at sub-investment grade, can, if existing at all, be extremely capricious.

Regardless of how the Hong Kong dollar market fares, Hong Kong institutions should continue to contribute value added to the economy through the arrangement, distribution, etc of bond issues more generally, and should be well placed for involvement in renminbi bond business, once that is permitted to develop further.

[1] This paper was finalised in May.

The views expressed in this paper are those of the author, and do not necessarily reflect those of the Hong Kong Institute for Monetary Research, its Council of Advisors, or the Board of Directors.

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The views of those interlocutors are reflected throughout the paper but, as agreed with them, the paper does not attribute points of view to named individuals or institutions, although on occasions the context may implicitly identify a particular party.

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# 1. Introduction and Background

*Introduction*

The context for this paper traces back to the Asian financial crisis of 1997. A widely held consensus subsequently emerged to the effect that some of the pain of that crisis could have been avoided if businesses had not been so heavily dependent on bank credit, which so suddenly became hard to obtain or renew, and if there had been a better developed bond market through which alternative and less immediately vulnerable debt finance could have been held in place.[2]

This paper re-examines that view, and some of the other issues relating to bond markets which were raised at the time. It investigates, in particular, arguments surrounding the development of the Hong Kong dollar corporate debt market.

*Greenspan*

Most famously, perhaps, Alan Greenspan coined the "spare tyre" analogy – although his reference to capital markets holding up well in the face of the real estate collapse in 1990 bears less of a convincing ring today:

"The existence of multiple avenues of financial intermediation has served the United States well in recent decades … [W]hen American banks seized up in 1990 as a consequence of a collapse in the value of real estate collateral, the capital markets, largely unaffected by the decline in values, were able to substitute for the loss of bank financial intermediation. … This leads one to wonder whether East Asia's recent problems would have been less severe had those economies not relied so heavily on banks as their principal means of financial intermediation. … Before the crisis broke there was little reason to question the three decades of phenomenally solid East Asian economic growth, largely financed through the banking system, so long as rapidly expanding bank credit outpaced lagging losses and hence depressed the ratio of nonperforming loans to total bank assets. The failure to have alternative forms of intermediation was of little consequence so long as the primary means worked. That is, the lack of a spare tire is of no concern if you do not get a flat. East Asia had no spare tires."[3]

*International Monetary Fund*

Greenspan was by no means alone. The IMF had already referred approvingly to:

"efforts of a number of countries to facilitate the development of local capital markets, especially bond markets, to reduce the importance of banks in intermediating capital flows".[4]

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[2] Similar concerns had also been expressed in earlier years. Thus, as recounted by Eichengreen and Luengnaruemitchai (2004), as early as 1995 the World Bank issued studies recommending that Asian countries should accelerate bond market development.

[3] See Greenspan (2000).

[4] See IMF (1999), p27.

But the concern, in the context of the Asian crisis, was not only about dependence on banks but also the unhealthy reliance on foreign currency borrowings, often intermediated through local banks. Thus the IMF referred to:

"the risk that capital inflows become a substitute for the mobilisation and effective intermediation of domestic financial resources".[5]

*Asian Development Bank*

Somewhat later, the challenge to develop bond markets was still nagging the Asian Development Bank:

"… here in Asia, commercial banks have been the predominant providers of credit for all types of borrowing requirements. Generally speaking, there has been an over-reliance on the banking sector for long-term funding. Banks have limited capacity to provide long-term funding as they rely on short-term deposits for their funding source. Alternative lending mechanisms need to be created. Well developed domestic capital markets provide one such mechanism. Such markets can provide long-term financing in local currency more efficiently than relying on banks."[6]

*Association of South East Asian Nations*

The ASEAN+3 forum also took up the cause:

"We agreed to intensify our efforts to develop regional bond markets. This will further strengthen our financial systems by better utilizing the aggregate savings in the region and minimizing the risk of maturity and currency mismatches. Voluntary working groups have been established to further discuss a range of key issues crucial to further development of the domestic and regional bond markets, such as, securitization, credit guarantee, promotion of local currency denominated bonds, credit rating, and foreign exchange transactions and settlement issues."[7]

*Pacific Economic Cooperation Council*

PECC had its say too:

"The 1997-98 financial crisis made clear the potential role of long-term local currency bond markets in avoiding the 'double (maturity and currency) mismatch' problem that greatly contributed to its occurrence, and in diversifying sources of debt financing within the economy."[8]

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[5] See IMF (1998), p7.

[6] See Shin (2003).

[7] See ASEAN (2003).

[8] See PECC (2004).

*Asia-Pacific Economic Cooperation - Securitisation*

Meanwhile APEC finance ministers had launched an initiative on the "Development of securitisation and credit guarantee markets" in the belief that this might hold the key to drawing increasing numbers of private sector borrowers into the market. It was reported that the initiative had been -

"successful in promoting the development of domestic securitisation and credit guarantee markets, especially in the three economies receiving expert advice [China, Mexico, Thailand]. The experts panels have recommended concrete action plans to the national authorities for removing market impediments and considerable progress has been made in the implementation of market reforms. The co-chairs encourage APEC member economies to continue with their efforts and momentum in developing the markets by implementing the action plans and panel experts' recommendations."[9]

The initiative was formally brought to a close in September 2004 after its designated two years. Despite the optimistic tone, there have been few signs of securitisation or credit guarantees taking much hold in the countries concerned.

Indeed, the 2007 subprime crisis in the United States sparked a period of intense risk aversion among global investors to so-called structured issues. Around the world the market became extremely cautious, with pricing affected accordingly; in some cases the market seized up completely. Although there have been some tentative signs of recovery, the crisis has exposed various problems in the securitisation market, such as the temptation towards adverse selection in the packaging process and the progressive diminution or opacity of risk information as the loans are passed further from the originator.

Even so, there are still hopes for progress with the initiative, particularly for the credit guarantee aspect in some countries, notably China, in order to assist lesser names to access the bond markets.

*Bank for International Settlements*

Throughout the decade the international central banking community has sustained an interest in the topic. In the immediate aftermath of the Asian crisis, the BIS noted:

"The consequences of banking sector fragility for enterprise funding have been amplified by high corporate dependence on bank credit in Asia and the frequent lack of deep and well-developed money and capital markets".[10]

Almost a decade later, in 2007, a report by a BIS committee revisited those issues – implicitly acknowledging, however, that not much progress had yet been achieved.[11]

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9 See APEC (2004).

10 See Bank for International Settlements (1998), p46.

11 See Bank for International Settlements (2007).

*Academics*

In addition to official bodies, academics have tended to agree on the importance of bond market development. According to a leading American professor:

"This episode of financial turmoil … created an awareness of the need for better diversified debt markets and specifically for bond markets to supplement the availability of bank finance."[12]

Plenty of analysis of the issues has also been carried out in research circles in Asia.[13]

*Hong Kong*

Specifically in respect of Hong Kong, there has been broad support, too, over these years for the idea of developing bond markets further:

Thus, from the financial secretary:

"The failure to establish a strong and robust Asian bond market is among the reasons that led to the recent financial turmoil."[14]

From the head of the Monetary Authority:

"A further long-term solution lies in the development of stable and transparent debt markets in the region. The excessive reliance in Asia on short-term financing from overseas lenders through weakly regulated banking systems, and all the turbulence that this has entailed, is a reflection of the lack of deep and diversified debt markets in the region."[15]

And again from the Monetary Authority:

"There is clear consensus that a key priority for the region is to develop deeper, longer-maturity, more stable and more transparent debt markets in Asia to recycle the large amount of Asian domestic savings…"[16]

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[12] See Eichengreen (2006).

[13] See, for example, Lejot et al (2003), Schmidt (2004), Eichengreen et al (2004b), and Arner et al (2006).

[14] See Tsang (1998); he was financial secretary at the time.

[15] See Yam (1999).

[16] See HKMA (1999).

And, most recently, from the deputy chief executive of the HKMA :

"A key priority is to bridge the credit gap between issuers and investors. Asian investors' preference for high-quality bonds at AA or above, … but few … issuers in the region have such ratings. … This calls for creative thinking and further capacity building in terms of credit enhancement arrangements, structuring solutions and credit-rating capacity."[17]

However, it is notable that, while these four quotations have an Asian dimension, there is no explicit acknowledgement that Hong Kong itself deserves particular attention. Indeed, Hong Kong weathered the 1997 Asian crisis and its own turmoil the following year without a banking crisis and without the business sector facing meltdown. Many of the worries which were relevant in Thailand and elsewhere, such as dependence on short-term foreign currency inflows, or governments exerting undue influence on bank lending decisions, have in no way applied to Hong Kong.

Over the past couple of years the Monetary Authority has carried out a review of debt market development. Phase 1, which was completed in October 2006, led to various adjustments to the Exchange Fund issuance programme and procedures, and to the market-making regime. It also saw the end of a moratorium on multinational institutions issuing paper of less than three-year term. The Phase 2 report, which has been considering a range of other issues, is, at the time of writing, being considered by the government.[18] Nothing in either phase appears likely to impinge very closely on the issues addressed in this paper.

## 2. Current Situation and Issues Arising

*The Agenda*

There are many well rehearsed arguments in support of developing local debt markets. These include: to fund government; to provide instruments that are convenient vehicles for official monetary operations and which assist financial institutions in managing their liquidity; to enable corporate borrowers to spread their debts across a wider range of maturities and investors, and to reduce dependence on bank credits; to increase choice in the risk-reward spectrum for investors and investing institutions; and, in certain instances, to reduce or avoid dependency on mismatched foreign currency borrowing.

The desire to develop the markets has produced, over the decade, a long agenda for discussion, some of which has been translated into action. It has included such issues as regulation, market infrastructure, taxation, the significance of government issuance, the desirability of increasing corporate issuance, attracting funds to stay in the Asian region, currency denomination and foreign exchange risk, the pros and cons of offshore issuance, short versus long-term, fixed versus floating, benchmarks and pricing, market depth, secondary market liquidity, securitisation and credit enhancement, and so on.

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[17] See Pang (2007).

[18] See HKMA (2007) and (2008).

*State of Development*

Official commentators have sought to draw comfort from some apparently positive responses of the region's markets to their exhortations. Thus, in 2004 the BIS noted that "Local currency bond markets have experienced rapid growth since the Asian crisis".[19] However, in respect of corporate issuance, they had to admit that the market was still mainly the preserve of highly rated issuers only – in many cases quasi-government bodies – and that secondary markets remained inactive.[20]

The fact remains that, in emerging markets generally, domestic bond issuance has tended to continue to be dominated by governments and other public sector entities. According to the Committee on the Global Financial System,[21] public sector debt securities (including those issued by the central bank) accounted for three quarters of domestic securities outstanding in emerging markets in 2005, well above the average figure in industrial countries. Within that figure, central bank issuance in particular was high, partly reflecting the sterilisation of large accumulations of foreign exchange reserves in some countries. Corporate debt, however, accounted for only 10%.

All in all, debt markets may not have progressed to the extent that officials and other backers may have been hoping for.

*ABF 1 and 2*

A prominent official gesture in the Asian region towards developing the bond market has been the launch of the two Asian Bond Funds on the initiative of the EMEAP Group (Executives Meeting of East Asia and Pacific Central Banks). In essence, the Funds offer pooled investments in the region's sovereign and quasi-sovereign debt instruments, with ABF1 exclusively in US dollar denominated paper and confined to central bank investors, and ABF2 in local currencies and open to all investors.

The objective of the ABF exercise was to spread the bond market habit and to catalyse improvements in market infrastructure and associated legal and taxation frameworks in countries where these were perceived to act as a brake on market development.

In the case of Hong Kong, where such matters had already been addressed and largely resolved, there has not been any clear additionality from the ABF initiative. In the context of the corporate bond market, with which the present study is mainly concerned, the initiative is of no direct relevance.

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[19] See Jiang and McCauley (2004).

[20] See Gyntelberg, Ma and Remolona (2004).

[21] See BIS (2007).

Indeed, it is not clear how relevant the ABF initiative is to developing markets elsewhere either. The funds hold only high-grade paper, for which there may anyway be no shortage of investor demand, and the buy-and-hold strategy of central banks, which are seen as the main investors (exclusively so in the case of ABF1), will not spur market liquidity.[22] Perhaps the main benefit has been the improvements to market infrastructure that the associated peer group scrutiny has prompted in some centres.

*This Study*

In Hong Kong there is a well developed market in Exchange Fund bills and notes, and the bond market has had no difficulty in satisfying other government borrowing needs when they have arisen. Banks use the debt market efficiently as an extension of the interbank market, and a number of overseas banks have been particularly attracted to it in recent years by the scope to obtain cheaper funding, when swapped into their home currencies, than would be available to them at home.

At the same time however, non-bank corporate issuance remains modest and is confined to a few major companies in the property, utility and transportation sectors, some of which fall into the quasi-government category. Should that be a matter for concern? The corporate bond market may be seen by some as a box which needs to be ticked in assessing whether Hong Kong is a mature financial centre. However, the business community and the investing community may be quite content with things as they are. If that is the case, and given Hong Kong's sound banking system, on which most businesses seem content to depend to meet their borrowing needs, there might be no obvious cause for concern.

A key question, therefore, is whether the needs of businesses and investors are indeed being satisfied, or whether there may be some form of market failure in the intermediation process that requires remedial attention. It is pertinent that the calls for the bond market to be further developed have come mainly from central bankers and other officials, from those in the financial industry who are involved in the arrangement and promotion of debt issuance, and from academics. Each of these constituencies may have its own vested interest in perpetuating the debate or in developing the business. But seldom does one hear the voice of the actual issuer, or potential issuer, or of the investors who hold or may consider holding such paper in their portfolios.

The views of these two constituencies are plainly of great importance, since they represent the ultimate supply of and demand for corporate paper.

This paper will examine available statistics and review progress on various of the issues which were highlighted in the aftermath of the Asian crisis. Principally, however, the paper is focused on ascertaining and analysing the views of those ultimate market participants regarding the development of the corporate bond market in Hong Kong. As such it is necessarily an exercise that is based much on anecdote, rather than a quantitatively empirical approach. What is special to this study, however, is the attempt to bring together into one place a large body of qualitative and judgemental evidence, particularly from what one may term the end-users of the market.

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[22] These points were made by Eichengreen (2004a).

The core of the project has been personal exchanges with more than thirty persons, representing borrowers; investors; those in the banking community involved in corporate lending, corporate finance advice, fund management and investment advice; rating agencies and market analysts. Although the ‘vested interests’ referred to earlier have not been ignored, priority has been accorded to the end-users.

It is accepted that this approach may be criticised as lacking verifiable evidence, especially since the interlocutors, whilst willing to be identified as having participated, preferred, on balance, not to have their individual views attributed. Readers must trust the author to have properly represented those views. A draft of the paper was sent to all those involved and the final version takes account of any resulting feedback.

## 3. Facts and Figures

*Extent of the Market*

The Hong Kong debt market is dominated by issues by the government (almost entirely through Exchange Fund bills and notes) and by banks, especially banks overseas.[23] Given that Exchange Fund paper is overwhelmingly held by banks for liquidity purposes, the market as a whole has been described as “essentially a bank-finance market”.[24] (See Table 1)

In the regional context, in terms of total local currency issues relative to GDP, Hong Kong ranks lowly, mainly because of its limited quantity of government issuance, as illustrated in Figure 1.

As regards the corporate bond market, Figure 1 indicates how Malaysia and Korea are the most significant in the region relative to GDP. Table 2 gives the rankings for corporate issuance in absolute terms. Again, Hong Kong ranks well down the list, even within the region.

The Hong Kong total amounts to 0.15% of the global total for domestic corporate bonds. By way of comparison, Hong Kong’s share in global gross domestic product in 2007 is estimated at 0.39%.

Looking back over the past ten years, it is notable how overseas borrowers (mostly banks) have emerged from a virtually negligible position to become the dominant group in the Hong Kong market. There have been occasional issues by overseas non-bank corporates, but not in a sustained manner.[25] Meanwhile local banks have fallen back. Local non-bank corporates have increased their presence, but still remain relatively insignificant. (See Table 3)

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[23] Unless otherwise stated or implied by the context, “debt market” in this study means the broadest context - ie including bills and certificates of deposits. “Bonds” typically means instruments issued with an original maturity of at least one year, and excludes bills and CDs.

[24] Schmidt (2004), p262.

[25] For example, Schmidt (2004), p283, reports issuance during 2002 by Boeing Capital Corp, Deutsche Bahn, Scottish and Newcastle, Walt Disney Corp, and McDonald’s Corp.

*Mandatory Provident Funds*

When mandatory provident funds were launched in Hong Kong in December 2000, there was some expectation that they might generate a significant increase in investor demand for bonds. However, as Table 4 shows, scheme members have opted mainly for the mixed asset funds, which are only 30% invested in bonds, or for the entirely equity funds.

As a result, only 20% of overall MPF money is invested in debt securities. Moreover, MPFA statistics show that only one half of that is in Hong Kong dollar securities. A common explanation for the preference for US dollar paper is that it offers greater choice and is more liquid, although it is not clear why liquidity should be especially important for MPFs, given the likely high degree of predictability of the future encashment schedule.

Overall, therefore, MPFs hold about HK$27bn in HK dollar debt paper. That is only some 3.5% of the outstanding stock.

*Gearing*

Turning to the indebtedness of the corporate sector, Hong Kong has the lowest gearing in the region according to Figure 2.

Figure 2 is, however, an imperfect measure of the corporate gearing of local businesses because the denominator includes the market capitalisation of overseas companies quoted on local stock exchanges – which for Hong Kong, with the large number of mainland companies listed on its exchange, is quite significant. Figure 2 may therefore be as much indicative of the equity culture among investors as it is of the gearing of businesses.

A similar qualification applies to the data in Table 5. In comparison with industrial countries, it highlights Hong Kong's equity culture. It also shows how, within overall debt, Hong Kong exhibits greater use of bank credit relative to debt finance.

*Secondary Market*

Figure 3 provides an indicator of secondary market activity in the bond market.

Plainly, secondary market turnover in corporate paper is relatively modest almost everywhere. In the case of Hong Kong, supporting evidence can be gleaned from the statistics produced by the Central Moneymarkets Unit, where secondary trading in debt, other than that of the Exchange Fund, typically averages no more than 20 deals each day;[26] and most of those are likely to be in bank rather than non-bank corporate paper.

[26] However, excluding Exchange Fund paper, only some 35% of all HK$ debt issues are lodged with CMU; the rest are presumed to be mainly with Euroclear or Clearstream, which offer a broader range of services than the CMU.

*Securitisation; Listing; Role of Banks*

Despite past official advocacy of the merits of securitisation, the practice has not been embraced much in Hong Kong. Indeed, only official bodies – the Mortgage Corporation and the government's toll revenue securitisation vehicle, Hong Kong Link – have exploited the mechanism.

And few debt securities other than government issuance (Hong Kong Link and Exchange Fund notes) are listed on the Hong Kong Stock Exchange. Trading in those that are listed is virtually non-existent: in the whole of 2007 the only deals recorded for debt listings were in those government issues, and totalled a meagre HK$8mn.

Aside from the Exchange Fund, the Hong Kong debt market is dominated by banks – both local ones and, more significantly, overseas banks, particularly from Australia, Europe and Korea. Those banks exploit arbitrage and swap opportunities to obtain funding more cheaply than available in their domestic money markets. Bank issuance is typically of terms up to three years, and much of it in the form of certificates of deposit. For example, Hong Kong banking statistics show that at end-2007 authorised institutions had HK$122.1bn of CDs outstanding and only HK$16.7bn of other debt instruments. Non-bank corporates issue debt to raise longer-term finance, typically for five years or longer.

## 4. Views of Market Users

*Issuers, Potential Issuers, and Those Promoting Issuance*

The Hong Kong market has limited depth. A top corporate name can raise up to HK$1,000mn – but more typically, in practice, closer to half that – and could probably repeat at approximately annual frequency. The tenor could be up to ten years. Even so, it can take some time for the arranger to place the issue or sell it down. Arrangers trawl for investor interest, or respond to enquiries, but, even outside periods of macro-turbulence as during the past year, there is not always a continuous market at a realistic price. Thus, whereas a syndicated bank credit can be put together in a matter of days, or even just hours, a bond issue will take much longer. However, the ready availability of substitutes, such as bank credit or US dollar debt, means that there is seldom any pain for a corporate if the HK dollar bond market is unable to deliver. In this sense, there is no great clamour for any sort of positive action to develop it into a more attractive market.

By contrast, the same leading company would be able to negotiate a syndicated bank credit in Hong Kong for over HK$10,000 mn, possibly for a term of up to seven years. Or it could go to the US dollar debt market (for example with a private placement under the section 144A regime) for US$300-500mn – some three or four times as much as could so readily be raised in the HK dollar bond market. The US dollars can readily be swapped into HK dollars; despite the swap costs and the associated counterparty risk, that can still prove to be a cost-effective route on account of the depth of the US market. And the tenor available in the US market can be at least as long if not longer than in the Hong Kong market; there are examples of notes up to 12 years from Hong Kong companies.

BIS figures confirm the relative attraction of international issuance relative to the domestic market for Hong Kong corporates. As at September 2007, their outstanding issuance on international markets stood at the equivalent of US$16.2billion, as against US$9.2million equivalent on the domestic Hong Kong market.

Cost-wise, bank credit generally works out as significantly cheaper than bond finance for comparable tenors. This is not only because of a competitive interest margin, but also savings on other costs. The fees involved in setting up a MTN programme, for example, could typically amount to HK$2-3mn, plus further amounts for annual updates. More management time is also required, more formal internal approvals (eg at board level) may have to be sought, and a credit rating may need to be obtained and maintained.

There would be three principal reasons for opting to issue debt securities.

- One would be if, contrary to what was said above, a bond issue proved a cheaper source – for example, for floating rate finance after an interest rate swap.

- The second would be to secure longer-term funding than would be possible from the banks directly. But banks may be able to offer terms certainly for five and in some cases up to seven years. There are not many corporates in Hong Kong who have a natural need to take on debt for longer than that. The life cycle of a property development, for instance, is generally around five years. It is perhaps only major infrastructural projects which have a longer horizon.

- The third reason would be to diversify funding sources away from too great a direct dependence on the banks. One or two issuers mentioned their wish to keep a presence in the debt market partly for that reason. But the vast majority of corporates seem content to rely entirely on the banks. For most of them, of course, there is no real choice, since they are either too small for it to be in any way cost-effective for them to launch themselves on the debt market, or they would not command a good enough credit rating (of which more later). It would be fanciful to think that there is a large number of companies waiting in the wings for whom the bond market would be a viable funding route, even if the acknowledged difficulties relating to investor depth and secondary market liquidity were resolved.

There is a view that the absence of a broader bond market results in firms being captive to their bankers and thus paying more (at least at certain times) for their external finance than might otherwise be expected.[27] None of the interviewees for this study gave credence to that view. Anyway, the vast majority of firms could not, because of size or credit standing, realistically contemplate access to the bond market as an alternative to bank finance.

[27] See, for example, Mizen and Yalcin (2005).

*Investors and Potential Investors*

Hong Kong investors may, with some justification, be characterised as having a distinctly polarised attitude – wanting either the relative safety of a bank deposit or bank-issued paper, or the adrenalin of the stock market. This description may fit both individual investors and many institutional funds that are guided by individual preferences (as in the choice of MPF schemes, noted earlier). This may, in turn, help to explain why there does not appear to be much latent demand for corporate debt paper, still less so for anything approximating "junk" (sub-investment grade). The lack of interest in junk may seem paradoxical given the common characterisation of Hong Kong's investing community as risk-seeking, but it simply reflects the fact that those wanting to buy risk will do so in equities. Even during circumstances of low interest rates, such as may have stimulated sub-investment grade issuance in Europe,[28] there was no move in that direction in Hong Kong.

Even so, corporate debt offers some attractions. Longer-term investors such as pension funds should be expected to need some longer-term HK dollar paper. And there is a yield pick-up compared to, say, Exchange Fund paper of comparable term.

But, beyond a certain point, there appears to be no great depth of demand for HK dollar debt. Various explanations are offered:

- There is plenty of bank paper around, which is regarded as safer (but it tends not to be long term).

- Pension funds, insurance companies, mandatory provident funds, etc tend to have strict guidelines as to the quality of paper they can invest in; this may be a reason why lesser names do not contemplate coming to the market, but it would also suggest that there ought to be stronger demand for the top-flight names that enjoy more than satisfactory credit ratings.

- Those institutions are deterred by the illiquidity of the HK dollar market. Even though they might buy with the intention to hold to maturity, they would like sight of a clear exit, should they face a sudden liquidity demand. They therefore turn to the US dollar market. The exchange rate peg has helped to make that attractive at times on an unhedged basis, although most institutions may hedge as a matter of routine once currency exposure exceeds a certain limit. The cost of hedging is balanced by the greater liquidity in the US dollar market.

- Many life assurance companies in Hong Kong have anyway tended to write policies in US dollars, although that situation is said to be changing. The US market offers a far wider range of paper, even if the currency exposure has to be hedged.

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[28] Although the United States is generally regarded as the home of junk bonds, speculative-grade rated companies are estimated to have accounted for about a quarter of rated corporate issuance in Europe in the period 2003-05; see Financial Times (2006).

- More generally, the peg may itself cause the HK market to be sidelined, since it is not seen as offering a currency play; rather, it may be seen by international investors as just a peripheral extension of the US dollar market, and a rather illiquid one at that. This may help explain why the market appears to be largely ignored by international investors.

- The factors causing hesitance among Hong Kong investors towards the HK dollar debt market apply *a fortiori* in the case of potential overseas investors.

## 5. Other Factors Influencing or Relevant to the Market

*Retail Issuance*

Corporates tend to think that retail HK dollar issuance is not worthwhile. The arrangement and distribution costs are high; the investor appetite is mainly for the shorter dates (up to three years), for which period the corporate could readily obtain bank finance – probably at similar or cheaper interest cost, given that retail investors need a sweetener over bank deposit rates. Although retail investors may be prepared to accept a slightly lower return than professionals, the difference is unlikely to be sufficient to compensate for the higher costs. In other words, the corporate will prefer to run an MTN programme in the wholesale market than to bother with the retail angle.

It is not therefore surprising to find that the main HK dollar retail issuance comes from the public sector, notably the Mortgage Corporation, where the continuity of the funding requirement may render a retail programme more viable, and where public policy considerations to promote the market, rather than just the strict costing arithmetic, may play a role in decisions.

It would be wrong to draw direct inferences for the HK dollar retail market from the experience of renminbi retail issues in Hong Kong. The success of those issues, which mainland banking groups have specifically been allowed to launch in Hong Kong, is explicable by the fact that the renminbi exists in a partially controlled environment. RMB bank deposit rates are held down because of the low, controlled rate paid to banks when the funds so collected are placed back in the mainland, whereas the proceeds of the bond issues can be more profitably employed. The margin which can be offered over deposit rates may therefore be considerable – it has reached the order of 2.5%.

*Taxation, Regulation, Infrastructure*

There are few perceived impediments to market development in Hong Kong under these headings.

Existing issuers in the HK dollar bond market have sufficiently high credit ratings to enable their interest payments to qualify for either full (if the issue is for an original maturity of at least seven years) or 50% (if from three to seven years) exemption from profits tax in the hands of investors other than individuals (individuals already pay no tax on interest).[29] The other conditions which the issuer must fulfil to qualify

[29] Inland Revenue Ordinance, sections 12A and 14A.

for the tax concession – a public offering, lodgement with CMU, and minimum denomination of $50,000 – pose no significant obstacles. Existing issuers do not regard the tax question as a problem (even if issuing in the term bracket which only qualifies for 50% relief). The argument that tax would be more of an impediment for issuers who could not achieve the credit-rating threshold is hypothetical, since such companies anyway seem reluctant to access the market (see below).

It is noted that the abolition of inheritance tax in 2006 will have made onshore investment in Hong Kong more attractive for some, but there is no evidence of this having stimulated demand in the bond market.

Market participants do not cite regulatory, bureaucratic or legal procedures as creating undue difficulties. These have been simplified in recent years. Meanwhile the infrastructure for issuing, trading, settlement, custody, etc is highly regarded.

*Credit Ratings*

The minimum ratings required for the profits tax concessions mentioned above are BBB- for the three agencies, Fitch, Standard and Poor's, and Rating and Investment Information; and Baa3 for Moody's.[30] The respective minimum ratings which allow debt securities to be purchased for MPFs are a notch higher at BBB and Baa2.[31]

A corporate would not realistically seek to issue in Hong Kong without obtaining a rating.[32] Most existing bond issuers rate well above those prescribed minima, although there has been a fairly recent instance of a placement of BBB paper. In practice, any prospective new issuer would wish to be assured that it would clear the minimum requirements. Certainly, none would wish to run the risk of being rated B+/B1 or worse, since that would mean that, under the Basel II methodology,[33] banks would have to apply a 150% risk weighting to all exposures to that company. Anyway, as noted earlier, there is no apparent interest among local investors to buy sub-investment grade paper.

*Liquidity and Secondary Market*

As demonstrated by the statistics quoted earlier, there is scarcely any secondary market bond trading in Hong Kong. Market participants say that there is virtually no liquidity at all for paper with more than two or three years to run. Investors adopt a buy-and-hold strategy. Existing investors are presumably reasonably content with this state of affairs. But other potential investors may be put off by it. In fact, a dearth of secondary trading is not uncommon in large segments of the world's leading corporate debt markets. But investors do like the comfort of knowing that they can sell at a reasonable price if they

[30] See HKMA (2006).

[31] MPFA Guidelines III.1, paragraph 10.

[32] One significant corporate has raised funds via private placement in the US market without having a rating.

[33] As set out in Section 61 and Schedule 6 of the Banking (Capital) Rules, LN228 of 2006, Government Gazette 43/2006, Legal Supplement 2.

need to. Moreover, global investors who may in part be motivated by opportunities for asset swapping of credit risk will bypass a market if it is insufficiently illiquid. In these respects the Hong Kong market is somewhat deficient. Although arrangers will generally stand behind an issue and be willing to quote a price, there is usually only one arranger, the market is narrow and the spreads which they quote may therefore be quite wide.

In theory, a more liquid secondary market, with narrower spreads, would in turn stimulate primary issuance, helping towards finer pricing and a more viable critical market mass. In practice, it is hard to discern how important this might be, given the huge gulf between the Hong Kong market and, say, the US dollar market.

*The "Keep Asian Money in Asia" Argument*

One of the themes to emerge in official circles in the region in the wake of the Asian crisis was that local and regional bond markets needed to be developed so that savings could be recycled within the region, rather than – as the argument ran – disappearing into, say, the US market, whence it could be hard to retrieve them.

It was this line of thinking which, in part, gave rise to the Asian Bond Fund initiative, for example.

Investors will place their money where it can be the most profitably employed, through channels which can route it the most efficiently. Different investors have different perceptions as to where and how their funds can be most advantageously invested, and it is the essence of the arguments about gains from trade and benefits of globalisation that one should permit, and indeed welcome, resulting competitive outcomes – for example, where region A invests in region B, region B in A, and A in C, rather than each in its own. In this light, some of the rhetoric which simply urges that steps should be taken to retain the Asian region's investments within Asia, seems to have been retrograde, to say the least.

The sounder and more laudable part of the underlying thinking behind the ABF initiative was that it would spur improvements to the infrastructure, regulation, legal basis, etc for the markets in the region, so that local centres could, on their own merits, become locations of choice for financial intermediation, regardless of the actual sources and uses of the funds. Such improvements have been progressed with some success.

But if, in spite of all that, investors or borrowers use other centres, then it ill befits places which aspire to be financial centres, and thus vie to win business from around the world, to complain when other centres succeed in the competition to win some of that business.

Possibly the most flawed aspect of the call to keep funds in the region was the belief that funds intermediated within the region would be less prone to interruption in time of crisis. There is no evidence that, unless controls are in place (and this paper is concerned principally with Hong Kong, where there are none), domestic bondholders will be any more loyal to local borrowers than will foreigners. Indeed, *prima facie* they may be even quicker to exit, since they are likely to be more closely attuned to the events which might unsettle confidence.

*The Financial Centre Argument*

An active and mature bond market is one of those attributes which appears to be considered necessary in order to be a serious contender as a regional or international financial centre.

What should be important to Hong Kong, however, is the value added in Hong Kong, rather than the position in ranking lists that reveal only part of the story.

Thus, consider the case of a hypothetical (but not impossible) bond issue for a Hong Kong company, perhaps via a Cayman Islands subsidiary, denominated in US dollars, placed with investors in various jurisdictions, listed on the Luxembourg stock exchange, and lodged with Euroclear in Belgium. None of that will register a positive contribution for Hong Kong in the tables of statistics which are so often employed in assessing financial centre status. But it is quite possible that the largest slice of value added in the intermediation process has accrued in Hong Kong, where the arrangement, documentation, syndication, placing, etc may have been centred.

Market participants are of the opinion that Hong Kong's role in this type of business has been increasing steadily and may continue to do so, to a more substantial extent than the basic Hong Kong bond market statistics may record. (There is, however, a proviso of concern about Singapore offering discreet sweeteners for business to move there).

There is also considerable potential for Hong Kong to exploit its position and expertise further by servicing the renminbi bond market, as and when it is permitted to develop more freely. Indeed, this is what everyone is focused on in the medium-term context. The Hong Kong dollar market might then become little more than a side-show.

*Key Questions*

Whether there is a justification for concern over the relative underdevelopment of the corporate debt market in Hong Kong, or for policy activism to stimulate it, depends on two broad questions:

- Is there a market failure in matching borrowers and lenders?

- Do borrowers fail to take adequate account of the risks to them, and hence for the wider economy, that may arise from relying too much on bank credit?

# 6. Market Failure

*The Issue*

Is there a market failure in the corporate sector of the Hong Kong market? In other words, is there a potentially greater volume of issuance and a greater mass of investor funds that could be successfully intermediated were it not for some or other shortcomings in the workings of the market?

*Government Debt*

Several commentators have focused on the role of government debt as a necessary catalyst for achieving critical mass, and the increased efficiency which that delivers, in the market as a whole. On this view, a deep and efficient government bond market is a prerequisite for the development of the corporate market. The Australian authorities, for example, have been explicit in stating that the bond market is supported very crucially by the government segment, providing depth, benchmarks, a peg for futures contracts, etc.[34]

The Hong Kong government bond market (inclusive of Exchange Fund notes but not bills) is relatively small – 4% of GDP as against 36% for Singapore, 7% Australia, 28% Korea, 29% UK, 24% USA and 62% Japan. Moreover, despite moves in recent years to consolidate issues, the average size of issue in Hong Kong ranks close to the bottom of the international league table, being only 4% of the average in Singapore and less than 1% of that in the UK, USA or Japan.[35] And trading costs, stemming from a typical bid-offer spread of 4-6 basis points, are said to be higher than in the US Treasury market by a factor of around ten. If these shortcomings were resolved – or so it is argued – not only would the market become more liquid, but it might also be possible to develop a meaningful futures market, which would in turn make the debt market as a whole more attractive to potential players.

Those who adhere to that view tend to urge a much stronger government presence in the Hong Kong market, if that market is ever to mature beyond its present state. The first move might, in principle, be to generate much larger benchmark issues. It is argued that the government (eg through the Exchange Fund) should also assume a deliberately proactive role in the secondary market, as trader and market-maker. There is a twofold problem, however, with an approach based on additional issuance. First, it would be contrary to the ground rules espoused for the currency board regime to expand overall Exchange Fund issuance merely for developmental motives. Second, the government itself has no need to raise funds for budgetary purposes.

Although a more active official presence in the secondary market for government paper might enhance the secondary market for corporate paper by raising the general level of liquidity and narrowing spreads, and promoting, in turn, finer primary pricing, such an outcome would by no means be assured; there is

[34] As stated by Battellino and Chambers in BIS (2006).

[35] Figures provided by Fidelity Investments, sourced from Bloomberg.

something of a segmentation between the investor constituencies for the two markets. And in this context it is worth noting an econometric investigation which found that "there is little evidence that the small size of public debt markets is an insurmountable obstacle to corporate bond market development".[36]

The Exchange Fund yield curve already provides a reasonable benchmark for primary issuance in the corporate market, and there is no obvious constraint in the availability of arrangers or in the procedural infrastructure. It is not obvious, therefore, that more energetic official activity would necessarily make it any more attractive for corporates to enter the primary market.

Among corporate issuers and those who advise on issuance, there tends to be a feeling that, regardless of how the official sector is behaving, there is a finite pool of funds looking to invest in HK dollar corporate paper and that there is not much that can be done through official actions to expand that. Existing issuers will tap the market for what it will bear, but, beyond that, they are content to rely on other sources.

*The Search for New Issuers*

What about those who are not current issuers but who might contemplate coming to the market? The truth is that there are few if any which would be likely to go far down that road. Firms do not, in general, have the funding needs to justify an issue of the minimum size which would be economically viable. *A fortiori* they cannot envisage a continuing presence in the market of the sort which could reap economies of scale in issuance and deliver benefits from establishing oneself as a dependable name. Finally, few would be likely to achieve a good enough credit rating to obtain funds at sufficiently attractive rates.

*The Search for New Investors*

The cupboard seems even barer on the investor side. There is no great bond-holding culture in Hong Kong. To the extent that fund managers do require bonds they are happy to take good names in HK dollars, but equally as happy to go to the international markets, with their generally better liquidity, and swap the currencies if needs be. They would probably not be much interested in second-tier names in Hong Kong if those were to come to market; appetites for greater risk are usually satisfied in equities.

*Assessment*

The actual situation may not be so precisely black and white as characterised above. But the general conclusion is that there is not, to any significant extent, a queue of corporates who would love to issue more at prevailing prices if only the investor demand was there; nor a queue of investors hungry for bonds at prevailing prices but thwarted by lack of supply.

The interviewees felt that, after allowing for the relative underdevelopment of the Hong Kong corporate market, pricing was competitive. This serves to lay to rest the allegation, not infrequently voiced in some circles in Hong Kong, that leading banks conspire to suppress the bond market because credit business is more profitable for them. There is a sufficient number of bond arrangers to provide a competitive

[36] See Eichengreen and Luengnaruemitchai (2004).

service. Anyway the premise that credit business is more profitable may be exaggerated, given the competitive nature of that market. Moreover, given that credits may be sold down in similar fashion to bonds, and that banks may hold bonds on their books in similar vein to loans, the distinctions are not so stark as they may appear at first sight.

However, it is inevitable that the prevailing prices, despite being struck in a competitively efficient environment (or at least an environment free of any obvious procedural obstacles), reflect the lack of critical mass in the Hong Kong market. With a deeper market, pricing might be that little bit finer, with a resultant stimulus to volumes. Interviewees were, however, not greatly persuaded that this would, in practice, make much of a difference, given all the other factors characterising the market.

## 7. Corporate Vulnerability

*Over-Reliance on Banks*

The next question is whether corporates, even if content with the structure of their indebtedness, are unwittingly exposing themselves to undue risk because of relatively heavy, and in many cases exclusive, reliance on bank credit. This had been a key point arising from the Asian crisis. The essential questions are: how likely is it that circumstances will arise where a bank wants to claw back funds from its corporate customer, or deny new funds to it; in such circumstances, how easily can the bank do that; and is it realistic then to think that the corporate could have pre-emptively put itself in a less vulnerable position by having established a presence in the bond market?

It is helpful to distinguish between the case where a corporate faces problems because its banker is in trouble, from the case where the corporate itself first runs into difficulties.

*Bank in Trouble*

This instance was much cited in the region following the Asian crisis. But, in contrast to a number of other Asian economies, this risk never crystallised in Hong Kong. Banks remained sound and were not pressurised into terminating facilities because of their own problems, as opposed to problems of their customers.

This issue has come back into focus with the latest global financial crisis. Banks, particularly in the United States and Europe, have been reported as curtailing some of their lending as a result of shrinkage in their capital bases. This has particularly affected small businesses,[37] and personal mortgage borrowers, whose credit standing has taken a battering because of falling real estate prices.

In the context of this paper one must ask whether corporates, if faced with such a tightening of credit, could find comfort in the bond market instead. In most cases the answer is no, simply because the vast majority of affected businesses would never, for reasons of size or standing, be realistic candidates for

[37] For example, tightening of credit availability was cited as a principal factor behind a fourfold increase in British corporate casualties between the first quarter of 2007 and the first quarter of 2008; see Financial Times (2008b).

the bond market. For those that do have a market presence, existing drawings from the markets would of course provide a cushion, but the bond markets are likely to seize up even more quickly than the banks as a source of new finance (see below).

With regard specifically to Hong Kong, it has been spared the full force of the latest global crisis. Although some sort of meltdown in the banking system can never be entirely discounted, it would be hard to persuade any corporates in Hong Kong that they should be thinking about the bond market just in case their bankers get into difficulties. If the problem was confined to a single bank, then the customer would probably be able to find accommodation with another, whilst if the authorities issued too alarmist warnings about a possible system-wide banking crisis, they would risk undermining their own credibility as banking sector supervisor.

*Corporate in Trouble*

Corporates are more likely to worry about the risks which they may face from some deterioration in their own condition, which could be the trigger for financiers to withdraw or curtail facilities to them.

The argument against over-reliance on bank finance has tended to rest to a large extent on the assumption that bank credit is usually for shorter terms than bond finance, and more readily recallable.

The landscape has been changing over the years. Although it is still the case that bank credit is generally of shorter term, facilities of five or even seven years' duration are by no means uncommon nowadays.

Moreover, it has become more difficult to be categorical about the relative continuities of bank credit and bond finance – that is, the likelihood of repayments being demanded, pricing ratcheted up, or facilities to draw new funds being terminated. The arguments put forward in the wake of the Asian crisis tended to characterise banking facilities as being liable to renegotiation, recall or cancellation on demand, and bond finance as being locked in on prevailing terms until maturity. In reality, however, conditions and covenants are in both cases a matter for negotiation when striking a deal. One can only really judge the permanence of any particular line of finance on a case-by-case basis.

What has also been made abundantly clear, both during the Asian crisis and in the immediate past year – is that bond markets can turn against the borrower very abruptly – probably more suddenly than bank finance where relationships count for more. This appears to have been especially true in respect of lower ranked corporates.[38] Yet this is the group which is the main target of the campaign for broader bond market development.

As regards Asian borrowers, even without any serious adverse shift in their circumstances, they reportedly faced adverse shifts in pricing of 100-150 basis points in the bond markets as the sub-prime crisis unfolded – if, indeed, the possibility of raising new funds did not evaporate altogether. The corresponding adverse shift in margins on bank credits was a fraction of that.

[38] For example, in the context of the latest sub-prime induced crisis, the European market was reported in April 2008 and again in May 2008 to have been closed to junk-grade issuers since July 2007, with not a single euro-denominated issue in the intervening period, despite a recent recovery in mainstream issues; see Financial Times (2008a and 2008c).

The credit and debt markets cannot be regarded as discrete systems. They are to a considerable degree mutually dependent, with, in particular, banks holding quantities of debt instruments and extending credit to (or having equity interests in) others that also hold the debt. A disturbance in one market can quickly infect the other.

It seems, therefore, that the main benefit of the bond market is the traditional one, where the corporate needs committed finance for a term which is too long to be negotiated through a bank line. Yet, given the profile of funding requirements for most Hong Kong corporates, the credit market can satisfy most needs. And for those who really need longer-term money, the US dollar bond market provides a ready-made avenue which is in some respects superior to the HK dollar market. The bond market does not serve as an alternative source of new or replacement funding in a time of stress; and, ultimately, the continuity of existing funding, whether from the bond market or the credit market, is only as assured as individual contractual conditions determine.

All in all, there are no very convincing arguments in support of the idea that corporates in Hong Kong are somehow missing a trick or endangering themselves by not paying greater attention to the local debt market. Usage of the bond market by corporates (at least, by those few who could realistically aspire to use it) might soften the initial impact of a major banking crisis, but would not insulate them for long.

## 8. Conclusions

After examining available data on the Hong Kong bond market, this study has concentrated on analysing information and opinions gathered during a series of interviews with interested parties – targeted, in particular, at actual or potential ‘end users’ among both issuers and investors. The aim has been to ascertain how important it may be to develop further the Hong Kong dollar corporate bond market.

At present that market itself is small. There is a limited number of local companies which, given factors such as size and credit standing, can realistically contemplate issuance. Investors have a limited appetite for such paper, given the investment culture in Hong Kong and the ready availability of debt instruments in other markets and currencies. Neither the Hong Kong corporate market nor the Hong Kong currency are especially attractive to international investors. Hong Kong corporates who could borrow in the Hong Kong domestic debt market are likely to have just as good, if not better, opportunities in the international market.

There is no evidence of market failure in the sense of inefficiencies arising from procedural, fiscal or infrastructural obstacles, or anti-competitive behaviour. But the lack of critical mass must be presumed to imply that pricing and spreads are not so fine as they would be in a deeper market.

There is something of a “take it or leave it” attitude. Corporates might issue more in Hong Kong if there was greater depth, but are not overly concerned, since there are ample alternatives. Investors, likewise, might buy a bit more if it was available, but are perfectly content to follow other options.

In the circumstances of Hong Kong, it is difficult to argue that individual corporates should be urged, either for their own good or for the public good, to increase their recourse to the bond market.

Nor does there seem to be much reason for official action in an effort to stimulate the market. Any reduction in hypothetical systemic vulnerability as a result of a more active market is likely to be very marginal.

Hong Kong is active as a financial centre in the arrangement and distribution of bond issues not only in Hong Kong dollars but also other currencies, notably the US dollar. Although no specific data are available, the value added in the economy by such business is believed to be significant. For the future, Hong Kong should be particularly well placed to win renminbi bond business when that market is freed up. That, at least, is the expectation or hope of all market professionals, and is one reason why there appears to be no great concern about the HK dollar segment not developing more fully.

The clamour, in the wake of the Asian crisis of 1997, for the development of corporate bond markets in the region, was in part an understandable reaction to the banking troubles at the time. But the advocates may not have considered closely enough who, in practical terms, the issuers and investors might be. This paper finds that, at least in the case of Hong Kong, there is no very significant latent natural demand on either side which would spur further growth in the market. And there is no compelling justification for forcing parties artificially in that direction.

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**Table 1. Shares of Outstanding HK Dollar Debt by Type of Issuer**

| Issuers | Percentage of total issuance |
|---|---|
| Exchange Fund | 18 |
| HK government & statutory bodies | 8 |
| HK banks & deposit-taking companies | 18 |
| Overseas issuers# | 48 |
| HK non-bank corporates | 8 |
| | *100* |

Source: HKMA Quarterly Bulletin March 2008

#Predominantly banks; includes small amounts by multilateral development banks.

**Table 2. Corporate Domestic Debt Securities Outstanding, September 2007, US$ bn Equivalent**

| Top five, and selected other western hemisphere | US$bn | Selected Asia-Pacific | US$bn |
|---|---|---|---|
| United States | 2,919 | South Korea | 270 |
| Japan | 703 | China | 86 |
| Spain | 461 | Malaysia | 58 |
| Italy | 344 | Australia | 45 |
| France | 292 | Thailand | 40 |
| | | Hong Kong | 9 |
| Canada | 133 | Singapore | 6 |
| Ireland | 95 | Indonesia | 5 |
| United Kingdom | 24 | | |

Source: BIS Quarterly Review, March 2008

**Table 3. Outstanding HK Dollar Debt by Type of Issuer: Ten-Year Comparison**

| Issuers | end-1997, HK$bn | end-2007, HK$bn |
|---|---|---|
| Exchange Fund | 101.7 | 136.6 |
| Statutory bodies (incl gov't corporations) | 2.3 | 58.5 |
| Government (other than above) | - | 7.7 |
| Multilateral development banks | 26.2 | 13.1 |
| Other overseas borrowers | 10.0 | 350.1 |
| HK banks and deposit-taking companies | 188.4 | 137.4 |
| HK corporates | 26.1 | 60.6 |
| *Total* | *354.7* | *764.2* |

Source: HKMA Monthly Statistical Bulletin (on line)

**Table 4. Mandatory Provident Funds, Net Asset Values of Approved Constituent Funds**

| Type of scheme | Total current value HK$bn, Dec 2007 | *% of total Dec 2007* | % allocation to debt securities within each scheme, Sept 2007 |
|---|---|---|---|
| Capital preservation | 28.3 | *10.7* | 19 |
| Money market | 1.1 | *0.4* | 67 |
| Guarantee | 25.8 | *9.7* | 58 |
| Bonds | 3.1 | *1.1* | 84 |
| Mixed assets | 131.8 | *49.7* | 29 |
| Equities | 74.8 | *28.2* | .. |
| Overall | 265.0 | *100.0* | 20 |

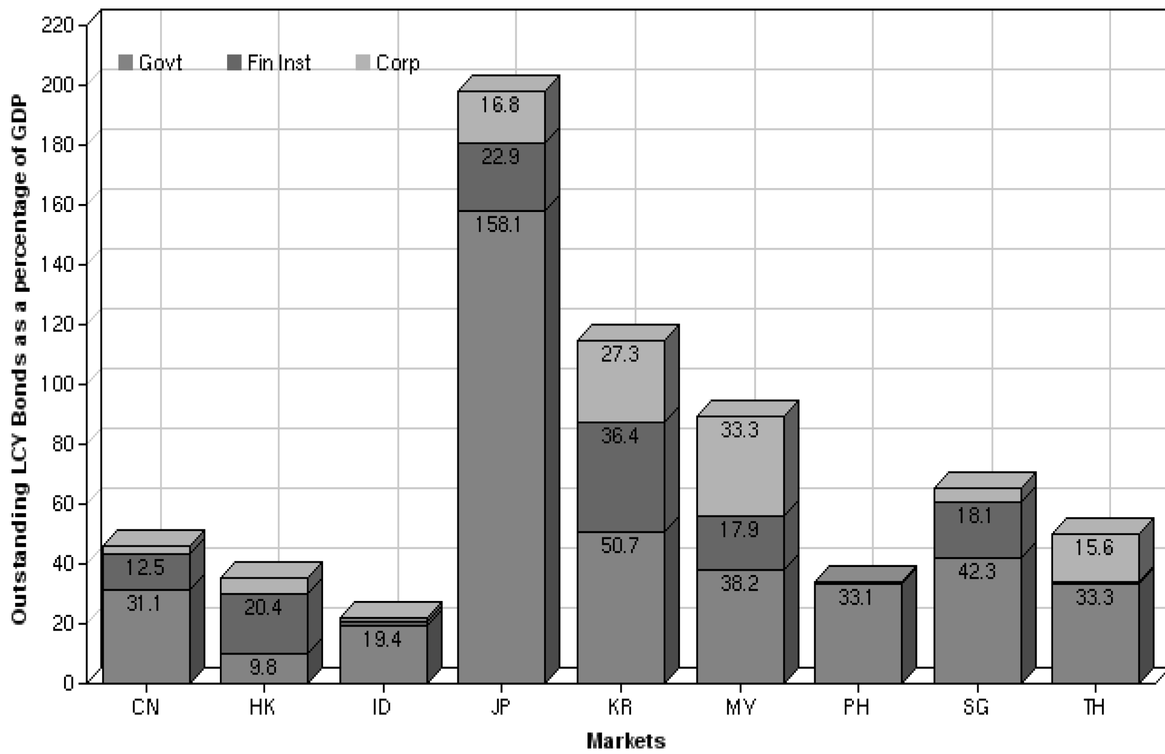
Source: Mandatory Provident Fund Schemes Authority, MPF Schemes Statistical Digest, December 2007.

**Table 5. Financial System Assets as Percentage of GDP**

| Asset class | Hong Kong | Average for selected industrial countries |
|---|---|---|
| Bank claims | 165 | 95 |
| Equity market capitalisation | 593 | 119 |
| Bonds in issue | 56 | 166 |

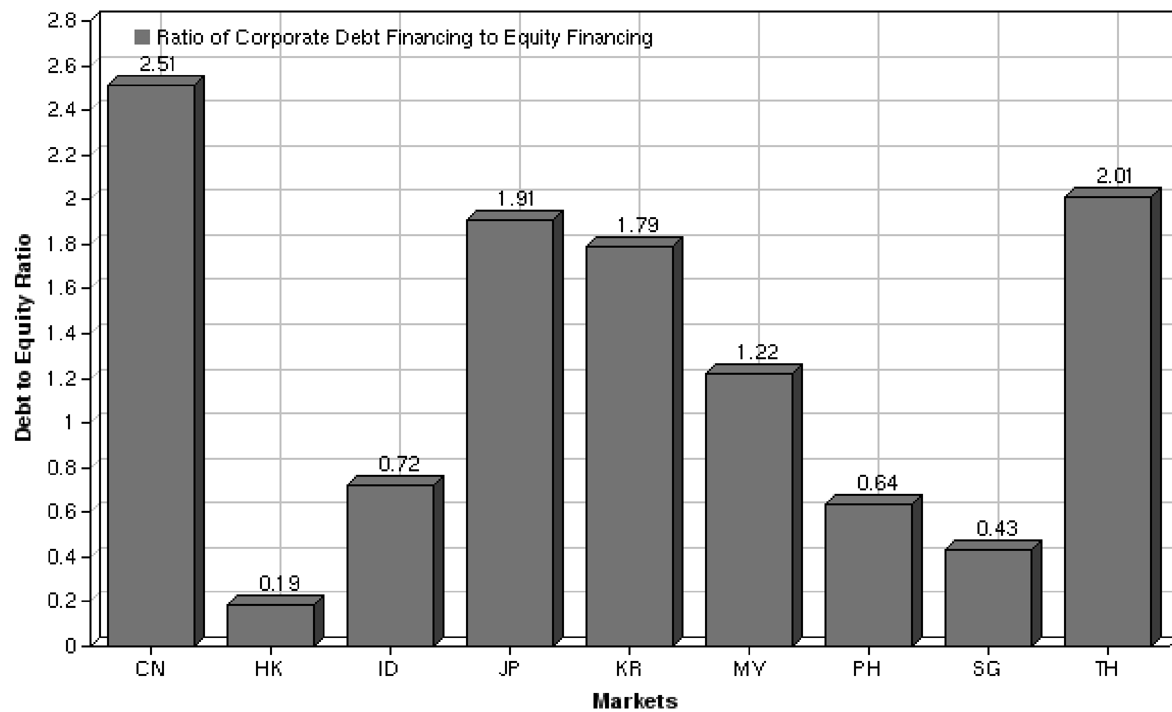
Source: CGFS/BIS, annex table 1 in CGFS paper 28, June 2007; aggregate data for all bonds, all bank landing, etc. Industrial countries comprise Australia, Belgium, Canada, Germany, Spain, the United Kingdom and the United States.

**Figure 1. Relative Sizes of Total Local Currency Bond Markets, with Breakdown Between Government, Financial Institution and Other Corporate Issuers**



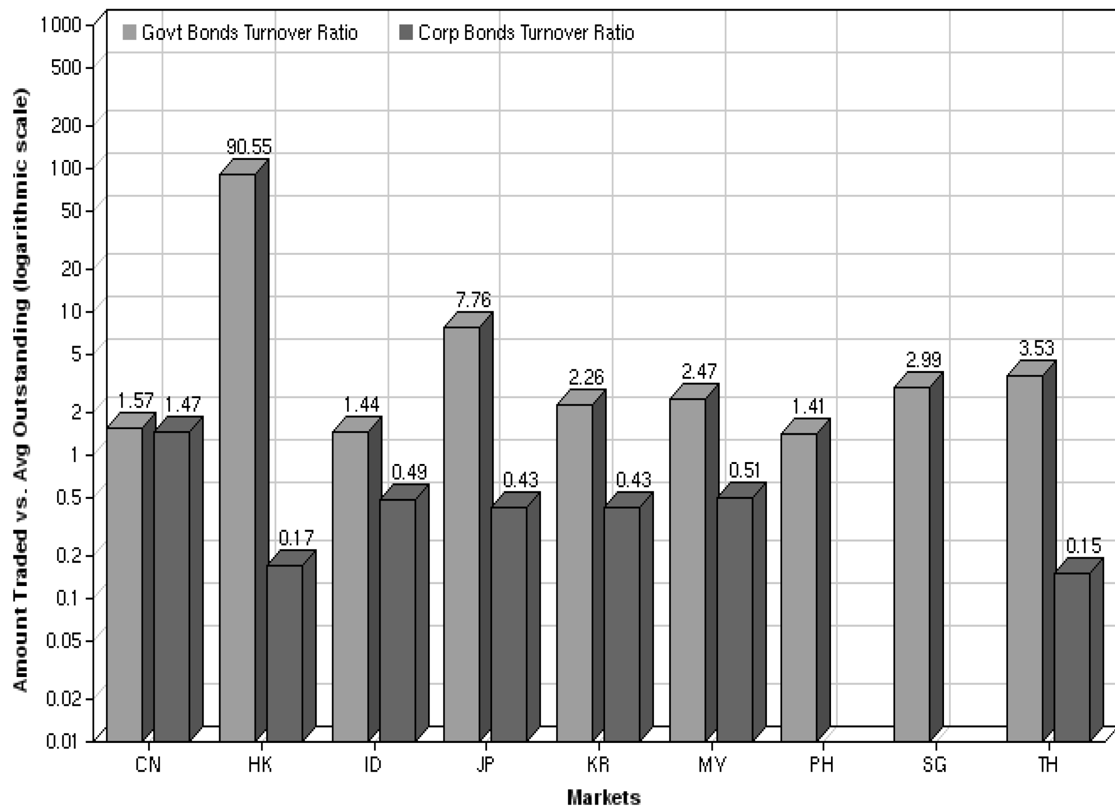

Note: Chart reproduced with permission of Asiabondsonline.adb.org. ©Asian Development Bank. Figures are for June 2007.

**Figure 2. Corporate Gearing**




Note: Chart reproduced with permission of Asiabondsonline.adb.org ©Asian Development Bank. The chart refers to March 2007, and shows the ratio of total local currency corporate debt outstanding plus domestic credit supplied by the banking sector, to capitalisation of the local stock market. Corporate, in this presentation, includes banks.

**Figure 3. Bond Market Turnover, Government and Corporate**




Note: Chart reproduced with permission of Asiabondsonline.adb.org. ©Asian Development Bank. Figures for 2007. Value of bonds traded as a proportion of outstanding stock. Corporate, in this presentation, includes banks. Note logarithmic scale.

# Appendix

Persons who were interviewed or provided written submissions

Bank of China (Hong Kong)

Cecil Wong Sze Chai *Head of Corporate Finance*

Lawrence Law Hong Ping *General Manager, Head of Personal Banking*

Phebe Chan Pui Sze *Head of Funds and Structured Products*

Wendy Zhang Xiao Wei *Manager, Corporate Finance*

Citigroup

Joe Lo *Director and Senior Economist, Asia Pacific*

Kathy H M Cheung *Country Corporate Affairs Director*

Janis You *Vice-president, Corporate Affairs*

Terence Chia *Vice-president, Debt Capital Market, Hong Kong*

Hongkong and Shanghai Banking Corporation Ltd

Helen P K Wong *Managing Director, Corporate Banking*

Au King-lun *Director & Head of Institutional Business, Asia Pacific*

Cartinal Pun *Head of Investor Sales, Hong Kong*

Elaine Y L Chan *Head of HK Dollar Bond Trading*

Gina Tang *Head of Debt Capital Markets, Hong Kong*

Standard Chartered Bank

Beverly Kwok *Head, Debt Capital Markets, Hong Kong*

Frances Cheung *Fixed Income Strategist, Global Research*

Cheung Kong Holdings Ltd

Edmond Ip *Deputy Managing Director*

CLP Holdings

Francis Ho *Group Treasurer*

Henderson Land Development Co Ltd

Alexander Au *Executive Director and Chief Financial Officer*

MTR Corporation

Jeff W Kwan *Treasurer*

Jimmy C C Lau *General Manager, Financial Control and Treasury*

Swire Pacific

Martin Cubbon *Group Financial Director*

Fidelity Investments Management (Hong Kong ) Ltd
Rick Patel *Portfolio Manager, Fixed Income*
Bryan Collins *Trader, Fixed Income*

State Street Global Advisers
Ng Kheng-Siang *Head of Asian Fixed Income*

Standard & Poor's
Ryan Tsang *Senior Director, Greater China*
John Bailey *Managing Director, Hong Kong*

Bank for International Settlements
Robert McCauley *Chief Representative, Asia and Pacific*

Hong Kong Monetary Authority
Peter Pang *Deputy Chief Executive*
Julia Leung *Executive Director*
Kitty Lai *Head*, *Monetary Operations*
Alfred Wong *Senior Manager, Market Research*

Hong Kong Mortgage Corporation
James Lau *Chief Executive*
Raymond Liu *Senior Vice-President, Finance*

University of Hong Kong
Douglas Arner *Director, Asian Institute of International Financial Law*
Paul Lejot *Visiting Fellow, Asian Institute of International Financial Law*