Yiu-kwan Choi: The debt market of Hong Kong - what can we offer to investors?

Keynote address by Mr Yiu-kwan Choi, Deputy Chief Executive of the Hong Kong Monetary Authority, at the third Annual Asia Pacific Bond Congress, Hong Kong, 13 June 2006.

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Mr. Shale, distinguished guest, ladies and gentlemen,

It gives me great pleasure to speak at this year’s Asia Pacific Bond Congress. On behalf of the Hong Kong Monetary Authority, I would like to extend my warmest welcome to everyone here today, especially those of you who have traveled from afar to visit us. I would like also to thank Euromoney for organizing this excellent event, and for organizing it in Hong Kong for the third time. It is a clear recognition of the important role of Hong Kong - Asia's World City, in the bond markets of the Asia Pacific region.

Like many other financial markets, the bond markets in the Asia Pacific region have recently seen plenty of new developments, challenges as well as opportunities. I am glad to see that the Congress has rightly covered many of these latest issues, and I am sure that for those who were here yesterday would have learnt from my colleague, Ms Julia Leung, about the Hong Kong Monetary Authority’s efforts in enhancing regional cooperation. So today it would probably be useful for me to take a few minutes to share with you on what the HKMA has been doing to develop our bond market, and more importantly, what our market can offer to investors.

Development of the bond market in Hong Kong

Let me give you a quick overview of the current status of the Hong Kong dollar debt market. At the end of 2005, the value of outstanding Hong Kong dollar debt reached $660 billion HK dollars, equivalent to $85 billion US dollars, which is over 30 times the size of the market 14 years ago. The size of the HK dollar debt market relative to GDP also increased significantly to 48% in 2005 from 3% in 1991. In 2005, the gross issuance of Hong Kong dollar debt reached $400 billion HK dollars, or an equivalent of $51 billion US dollars. Everyday, overseas borrowers, financial institutions and corporations participate actively in our market. In Asia, our market has the highest proportion of overseas issues, with the amount outstanding being only second to Japan and Korea.

While we have a very well developed debt market today, one should be aware that there was virtually no debt market in Hong Kong before the 90s. Because of cumulative fiscal surplus, the Hong Kong government had not found it necessary to borrow any money in the market at that time. While this is good from the point of view of fiscal management, it was not conducive to debt market development, in the sense that we did not have a representative yield curve for the Hong Kong dollar.

As we all know, a liquid and deep debt market is an important component of a financial centre. The HKMA therefore decided to develop a local debt market through a two-pronged approach, namely to develop a market of high quality Exchange Fund paper, and to build an efficient financial infrastructure.

A market for exchange fund paper

In order to facilitate the development of a Hong Kong dollar debt market, the HKMA rolled out the Exchange Fund Bills and Notes programme in 1990. This initiative has been very successful in creating a yield curve for Hong Kong dollar. As of today, the yield curve has been extended up to 10 years and serves as a benchmark for debt instruments issued by other entities in the local market.

In order to maintain a liquid market for the Exchange Fund paper, the HKMA has also put in place a market-making system under which market makers are obliged to quote two-way prices. Currently, 26 banks in Hong Kong have been appointed as market makers, and tenders of Exchange Fund Bills and Notes of maturities between 3 months and 10 years are held regularly.

These arrangements have been effective to help promote the liquidity of the Exchange Fund paper and enhance the credibility of the Hong Kong dollar yield curve. Indeed, overseas borrowers have remained the largest issuers in our market, with outstanding debts reaching an equivalent of 32 billion US dollars at the end of 2005, from just 1.3 billion US dollars at the end of 1997.

Financial infrastructure

Let me now move on to another important area of our work: that is the building of an efficient financial infrastructure for the bond market. Our objective is to build a multi-currencies and multi-product payment and settlement platform to make Hong Kong the payment and settlement hub of the region. We believe that a safe and efficient payment and settlement system is crucial to the development of the debt market. Our system will serve not only the local investors but also investors elsewhere in the region to facilitate their fund transfers and delivery versus payments when they buy or sell debt instruments.

We have therefore been working actively on linkages between the Central Moneymarkets Unit (the CMU), which is our key custodian system for debt instruments in Hong Kong, and other custodian systems in the region and international custodian systems such as the Euroclear and Clearstream. These linkages have been instrumental in fostering cross-border bond trading and investment.

With the seamless interfaces between the CMU and the Real Time Gross Settlement (RTGS) systems in Hong Kong for the Hong Kong dollar, US dollar and Euro, all transactions in debt instruments denominated in any of these three currencies and under the custodianship of the CMU can be settled in Hong Kong on a DvP basis in an efficient way.

The recent IPO of the Bank of China Limited is probably a good example to demonstrate the efficiency and robustness of our HKD RTGS system: being a settlement system which typically handles an average turnover of $400 to $500 billion Hong Kong dollars a day, it saw a record high turnover of $1.23 trillion on 1 June when the Bank of China was listed on that day. Notwithstanding such huge amount of settlement, the inter-bank payments were processed smoothly on that day.

To further develop Hong Kong into a payment and settlement hub for the region, we will continue to explore opportunities for linking our RTGS systems and the CMU with similar systems in the region. For example, the HKMA has been working with Bank Negara Malaysia for the establishment of a link between the Ringgit RTGS system and the US dollar RTGS system in Hong Kong. This is aimed at reducing the settlement risk of Ringgit/US dollar foreign exchange transactions through PvP settlement in the Asian time zone. The link is expected to go live by the end of 2006. We are exploring similar linkages with other Asian central banks.

Bond Price Bulletin

One of the factors affecting secondary market activities in the bond market is the lack of information on bond prices. To help overcome this problem, the HKMA launched the Bond Price Bulletin at the beginning of 2006. The bulletin provides investors with convenient on-line access to information on bond products and bond prices provided by eight major banks in Hong Kong. Indicative bid/offer prices of over 200 bonds of different currencies issued by both public and private sector entities are provided by the eight contributing banks.

Outlook

Let me now turn to talk about the outlook of our debt market.

Notwithstanding the achievements we have made so far in developing our debt market, we fully appreciate that there is nothing to be complacent and there are still many challenges facing us. The HKMA has therefore embarked on a review of our debt market development with a view to identifying measures which can be adopted to help market development.

On the demand side, everybody knows that the Mainland of China is enjoying a rapid economic growth and business opportunities are mushrooming. The recent announcement by the Mainland authorities of measures to liberalise portfolio investment outflows has marked the emergence of such kind of opportunity for Hong Kong. Under these new rules, each Chinese citizen is allowed, among other things, to invest in fixed income securities overseas within certain limits. We expect that this will help boost the demand for fixed income securities although we do not know exactly how much such investment outflows will be approved by the Mainland authorities in the initial years.

Given our experience and achievements in financial services and the fact that we are the only international financial centre of China, I am sure that Hong Kong is well positioned to grasp the opportunity.

Apart from the initiatives and developments I just mentioned, I believe that it would be useful to highlight a few fundamental factors which make Hong Kong an ideal place for the bond market. The first is our free capital mobility. The absence of capital controls means that there are no restrictions on foreign enterprises using our capital markets to raise funds. Foreign investors can also freely invest in our markets and easily remit the proceeds back home. Secondly, our well-developed financial markets, including derivative markets, would allow issuers and investors to manage any interest rate risk or exchange rate risk effectively. Thirdly, Hong Kong has a critical mass of financial institutions which stand ready to support issuers to tap the capital markets. Hong Kong is also an asset management centre thus providing a large investor base for debt instruments. Last but not least, the absence of capital gains tax and interest withholding tax would also favour bond market development. Our exceptional geographical, cultural and language advantages also make Hong Kong an ideal place to link up the Mainland of China with the rest of world.

On our part, the HKMA will continue to play a leading role in enhancing the development of the debt market in Hong Kong, by removing market frictions and unnecessary restrictions, and by keeping up with the best practices adopted in other well-developed markets.

Lastly, I would like to thank Euromoney again for inviting me to speak. I look forward to the continued cooperation with our partners on the healthy development of the bond market in this region. Thank you.