

Press release

LCQ3: Issuance of government bonds

Wednesday, May 8, 2013

Following is a question by the Hon James Tien and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (May 8):

Question:

The Government launched the Government Bond Programme (Bond Programme) in 2009 and issued two rounds of inflation-linked retail bonds (iBond) under the Bond Programme, with a view to promoting the development of the retail bond market in Hong Kong and providing an investment alternative to Hong Kong residents in the high inflation environment. The Government is at present preparing to re-issue iBond of up to HK\$10 billion. In this connection, will the Government inform this Council:

- (a) of the respective amounts of retail and institutional bonds issued in the past four years and their ratios in the issued amounts of the Bond Programme, as well as the respective numbers of investors successfully subscribing for the bonds;
- (b) whether it has conducted an analysis of the background of the investors who subscribed for the aforesaid bonds; if it has, of the details; if not, the reasons for that; whether it has put in place policies to broaden the base of investors in bond subscription;
- (c) of the measures in place to increase the liquidity of government bonds in the secondary market;
- (d) whether it has planned to issue Renminbi-denominated bonds or bonds denominated in other foreign currencies; if it has, of the details and the timetable; if not, the reasons for that;
- (e) given that the sums received from issuance of bonds by the Government must be credited to the Bond Fund, and that the Bond Fund is placed with the Exchange Fund for investment purposes, of the respective annual returns, rates of return and administrative fees of these investments in the past three years, and the total amount of interests paid by the Government in respect of the various types of government bonds; and

(f) whether the authorities have assessed if the Bond Programme has affected the quantities of bonds issued by private institutions, and if it has achieved its objectives of assisting to promote the development of the retail bond market in Hong Kong and providing an investment alternative to Hong Kong residents; if they have, of the assessment results; if not, the reasons for that?

Reply:

President,

(a) and (b) The Government Bond Programme (GBP) consists of an institutional part and a retail part. The amounts of institutional and retail bonds issued in the past four years and their ratios in the issued amounts under the GBP were set out in Table 1 of Annex.

Institutional bonds are tendered by auction in which 11 Primary Dealers (PDs) participate, and distributed to other institutional investors through these PDs.

As institutional Government Bonds (GBs) can be traded in the secondary market and held by institutional investors through accounts on a nominee basis, we do not have information of the exact numbers and background of these investors. This notwithstanding, according to the understanding of the Hong Kong Monetary Authority (HKMA) from the PDs, the distribution of investors of institutional GBs at tenders is broadly set out in Table 2 of Annex.

As for the retail part, the Government has issued two series of iBonds, each in a size of HK\$10 billion, through public subscription by Hong Kong residents in their personal capacity. The numbers of Hong Kong residents successfully subscribing for iBonds were set out in Table 3 of Annex.

Following the expansion of the issuance size of GBs, we expect the liquidity of GBs to increase gradually. This will help broaden the investors' base. We will continue to engage market players to explore measures to increase the liquidity of GBs and to broaden the investors' base.

(c) In order to increase the liquidity of institutional GBs in secondary market, our usual practice is to enlarge the size of individual issuances as far as practicable. This helps reduce the number of tranches of outstanding bonds and minimise market fragmentation,

thus facilitating trading by market participants. In addition, the Government will re-open bonds issued, as this arrangement is considered by the investing community effective to satisfy various investment and secondary market trading purposes. The Government will continue to study experiences of other markets and explore implementation of various measures to further improve the liquidity of GBs.

For retail bonds, the two series of iBonds have been listed on the Stock Exchange of Hong Kong (SEHK). Investors can trade iBonds on SEHK through securities brokers (i.e. the "Exchange" market). In addition, HKMA has appointed 18 placing banks as market makers in the two iBond issuances. These market makers will quote a bid price to their customers upon request (i.e. the "over-the-counter" (OTC) market). Having an "Exchange" market and an "OTC" market can satisfy the needs of different investors and promote the liquidity of iBonds.

(d) The overriding objective of the GBP is to promote the further development of the local bond market. Principally, we issue Hong Kong dollar bonds under the GBP at present, in order to broaden the scale of the Hong Kong dollar bond market first. In addition, the Government will continue to closely monitor the developments of the financial markets, and to maintain dialogues with market players. Subject to market conditions and changes to market demand, the Government will consider, based on the overriding objective of promoting the further development of the local bond market, issuing bonds denominated in other currencies as appropriate, taking into account relevant factors (including interest rates and the potential impact on other prospective non-local currency bond issuers in Hong Kong), as well as the sustainability of the Bond Fund.

(e) The Bond Fund is placed with the Exchange Fund for investment and attracts investment income on the basis of the "fixed rate" sharing arrangement applicable to fiscal reserves. The "fixed rates" applied to the Bond Fund in each year since the establishment of the GBP were set out in Table 4 of Annex.

According to the accounts of Bond Fund audited by the Audit Commission, the investment income, interest payment and other expenditures of the Bond Fund in the last three financial years were set out in Table 5 of Annex.

(f) Since the establishment of the GBP, more private sector entities have conducted Hong Kong dollar bond issuances in tandem. Between 2008 (i.e. before implementation of the GBP) and 2012, issuances made by the non-public segment increased from around HK\$138 billion to almost HK\$243 billion, representing an

annual growth of approximately 12.8%. This was conducive to enhancing the effectiveness of the local bond market as a financial intermediation channel to complement the banking sector and equity market. Moreover, we believe that the two issuances of iBonds have been successful in developing the local retail bond market. About 10-15% of investors who have subscribed for iBonds in the two issuances were first-time investors, as they specifically opened an investment account for the subscription. We believe that iBond issuances have further enhanced the investing public's awareness of and interest in bonds, through participating in the subscription and trading process, hence promoting the development of a retail bond market in Hong Kong.

Ends