



Impact of the Resumption of Dollar-denominated Sovereign Bonds Issuance by the Mainland

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Recently, the Mainland's Ministry of Finance issued US\$2 billion in sovereign bonds in Hong Kong, with US\$1 billion each for 5-year and 10-year tenors. The bonds were open for subscription on October 26th. Investors showed strong appetite, with demand for the bonds climbing to 11 times the offering size, amounting to US\$22 billion. The bonds were widely distributed among international investors. About 1/2 of the deal was sold to Asian institutions, 1/3 was allocated to European investors, and some were distributed to US investors.

In fact, the Mainland issued US dollar sovereign bonds for 12 times with totaling US\$ 6.7 billion during 1993 to 2004, and this sale marked the first issuance of dollar-denominated sovereign bonds in 13 years. At present, liquidity remains abundant in global financial markets. The Fed is going to trim its balance sheet in a rather moderate pace, and the ECB will not undertake such kind of operation in the short term, though it will reduce monthly asset purchases from EUR60 billion to EUR30 billion starting January 2018. Facing relatively loose global liquidity, international capital has demand for bonds. The Mainland's sovereign bonds can satisfy investors' needs for high-quality investment products with low risk while offering higher return than United States and Europe.

Considering the reaction of the market, the issuance of the US dollar sovereign bonds has following characteristics.

Firstly, active subscription shows international investors' confidence in The Mainland's sovereign credit and is conducive to RMB internationalization

The smooth promotion of RMB internationalization relies on international investors' confidence in the Mainland's sovereign credit and RMB assets. Earlier this year, two international credit rating agencies, Moody's and the S&P, downgraded the Mainland's sovereign credit rating. The Mainland's Ministry of Finance opined that the result ignored healthy fundamentals and huge development potential of the Mainland's economy because of the limitations and "pro-cyclical" nature in the assessment method of international credit rating agencies. This time, the Mainland didn't seek any rating for the bonds it sold, and investors had to make their own adjustment. During

the process, international investors could strengthen their understanding in the Mainland's economy, which would pave the way for RMB internationalization. Actually, the 10-year bonds were priced to yield 2.687% , 43.7 bps higher than the yield of US Treasury bonds auctioned on August 10th and equivalent to the financing cost of Korea with AA sovereign rating. This reflects that the market has a different judgment on the Mainland's sovereign credit risk from rating agencies and indicates investors' positive views for the Mainland's economic growth and financial stability.

Though the Mainland's economy has slowed down in recent years, its growth pattern is further optimized and the quality has improved significantly thanks to the supply side reform and the upgrading of industrial structure. At present, the Mainland has steered away from investment- and export-led growth to growth based on the combination of domestic consumption, export and investment. In the first three quarters, final consumption expenditure contributed 64.5% to economic growth. In terms of industrial structure, the tertiary sector dominated the Mainland's economic growth, with its contribution surging from 36.2% in 2000 to 59.1% in 2017. Within the tertiary sector, high-tech industries and services industries recorded the most rapid growth. Specifically, in the first three quarters of 2017, annual growth rate of software and information technology industry averaged 23.7%, nearly three times the growth rate of GDP over the same period, and average annual growth rate of leasing and business services was 10.4%, also much higher than GDP growth. These changes indicate that the Mainland possesses enormous potential in the future.

Continuous opening of the Mainland's capital market and the consolidating economic fundamentals have increased foreign institutions' confidence in the Mainland's assets, which lays a solid foundation for RMB internationalization. Latest data shows that foreign institutions increased their holding of RMB bonds for seven consecutive months to a record high of 96.1 billion yuan in September. The proportion of foreign institutions in the Mainland's bond market further rose to 1.62%.

Since 2005, the openness of Mainland's bond market has deepened. The Mainland's government allowed international development institutions to issue RMB bonds in Mainland market, allowed QFII (Qualified Foreign Institutional Investors) and RQFII (RMB Qualified Foreign Institutional Investor) to access the China Interbank Bond Market (CIBM), eased its approvals process for foreign fund managers to buy Chinese bonds and expanded the scope of foreign investment institutions in CIBM to commercial banks, insurance companies and other financial institutions. In July 2017, bond connect was launched, providing easy access to the Mainland's bond market for foreign investors. In the 19th National Congress of the Communist Party of China, financial reform and opening up remained one of the main topics. The Mainland's Central bank governor Zhou Xiaochuan commented that the Mainland will further develop in the direction of financial opening, with stock connect, bond connect and financial arrangements related to "One Belt One Road" having expanded

the connectivity between different markets. Zhou Xiaochuan also pointed out that institutional cooperation and financial market access will be further opened.

Some obstacles about derivatives trading tools and market liquidity still exist in the Mainland's bond market, and the Mainland will further improve product variety and market mechanism to deepen its financial opening up.

Secondly, successful issuance of US dollar sovereign bonds serves as a pricing benchmark for Chinese enterprises in their foreign debt financing for “One Belt One Road”

According to “One Belt One Road” strategy, future investment in OBOR countries will account for 70% of the Mainland's total foreign investment, of which investment in infrastructure is the most important. At present, infrastructure construction of many countries along the route lags behind international standards, which restricts their economic growth potential. It is estimated that financing demand for One Belt One Road infrastructure will exceed US\$10 trillion in the next five years. Therefore, the construction of One Belt One Road requires a large amount of capital. However, such demand for huge project financing cannot merely rely on the Mainland's financial resources. Attracting international capital is also key to the success of the strategy.

With Chinese enterprises actively participating in the “One Belt One Road” Initiative, issuance of US dollar bonds in this year have amounted to US\$148.5 billion, 30% higher than the US\$114.2 billion in 2016. Chinese enterprises will likely leverage more on the US Dollar bond market to support their international business for One Belt One Road construction. As demand for external financing gradually climbs, sale of US Dollar sovereign bonds by the government could enrich the treasury yield curve and provide interest rate benchmarks for Chinese enterprises, thus facilitating their overseas financing.

Thirdly, choosing Hong Kong as the venue to issue the bonds indicates the Mainland's solid support for Hong Kong in bolstering its role as an international financial center

With strengthening financial connectivity between the Mainland and Hong Kong, bond issuance by Chinese institutions has surged in recent years, which not only enriches the category of bonds in Hong Kong, but also increases the breadth and depth of Hong Kong's bond market. Data show that bonds issuance by Chinese institutions in Hong Kong (including foreign currency-dominated bonds and RMB-dominated bonds) registered US\$120.2 billion, 1.4 times the amount of US\$ 0.844 billion in 2015. Outstanding amount has increased 134% from US\$ 345.1 billion in 2015 to US\$428.5 billion

at present. Clearly, Hong Kong's status as an international financial center is further consolidated, buoyed by growing financing demand from Chinese institutions.

The Mainland's Ministry of Finance said choosing Hong Kong as the venue to issue the bonds indicates the central government's solid support for Hong Kong in bolstering its role as an international financial center. Actually, The Mainland's Ministry of Finance has issued RMB denominated bonds in Hong Kong since 2009, broadening and deepening Hong Kong's RMB market. Since the first issuance of 6 billion yuan of RMB bonds in Hong Kong, the Mainland's government has issued more than 170 billion yuan worth of RMB bonds of different maturity during the following 9 years, setting up a pricing benchmark for the market. Launch of bond connect in this year also consolidates Hong Kong's role as the gateway for its connectivity with the Mainland's capital market.

Although the changing external environment since 2016 has slowed the development of Hong Kong's RMB capital pool, the Mainland's support for Hong Kong as an international financial center has not weakened. At present, the soft US dollar and low US interest rates provide Chinese institutions with the chance to utilize overseas funds through the resumption of issuance of offshore dollar bonds. With developed financial infrastructure, complete legal supervision system, abundant management experience and professional talents, as well as improved investor structure, Hong Kong has the market base for floating the bonds. So the sale of an appropriate amount of US dollar sovereign bonds in Hong Kong shows the Mainland's support for Hong Kong's as an international financial hub.

With the promotion of "One Belt One Road" strategy, Hong Kong will continue to serve as the gateway for overseas capital, providing professional service including risk assessment, project financing and financial management for One Belt One Road construction. At present, Hong Kong has increased its support for One Belt One Road. For example, Hong Kong Monetary Authority (HKMA) has established the Infrastructure Financing Facilitation Office (IFFO) to facilitate infrastructure investment and their financing for One Belt One Road. In the future, Hong Kong is likely to become the financing center for "One Belt One Road" initiative, supporting related construction through funds from international loans, equity and bonds issuance. Selecting Hong Kong to float the bonds highlights that the Mainland's continuous support Hong Kong to play its unique advantage and to be the super connector for "One Belt One Road". Hong Kong should also seize the opportunity to deepen its financial cooperation with the Mainland and thus play a greater role in the Mainland's New Era.

主要經濟指標 (Key Economic Indicators)

	2015	2016	2016/Q1	2017/Q2
一. 本地生產總值 GDP				
總量 (億元) GDP(\$100 Million)	22,464	23,586	6,285	6,270
升幅 (%) Change(%)	2.4	1.9	4.3	3.8
二. 對外貿易 External Trade			2017/9	2017/1-9
外貿總值 (億元) Total trade(\$100 Million)				
港產品出口 Domestic exports	469	429	39	322
轉口 Re-exports	35,584	35,454	3,548	27,815
總出口 Total exports	36,053	35,882	3,587	28,138
進口 Total imports	40,464	40,084	4,034	31,517
貿易差額 Trade balance	-4,411	-4,201	-447	-3,380
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	-15.2	-8.5	6.5	1.4
轉口 Re-exports	-1.6	-0.4	9.4	8.6
總出口 Total exports	-1.8	-0.5	9.4	8.5
進口 Imports	-4.1	-0.9	9.7	8.8
三. 消費物價 Consumer Price			2017/9	2017/1-9
綜合消費物價升幅 (%) Change in Composite CPI(%)	3.0	2.4	1.4	1.4
四. 樓宇買賣 Sale & Purchase of Building Units			2017/10	2017/1-10
合約宗數 (宗) No. of agreements	76,159	73,004	7,063	69,056
年升幅 (%) Change(%)	-6.5	-4.1	-17.5	20.3
五. 勞動就業 Employment			2017/6-2017/8	2017/7-2017/9
失業人數 (萬人) Unemployed(ten thousands)	12.9	13.3	13	12.8
失業率 (%) Unemployment rate(%)	3.3	3.4	3.1	3.1
就業不足率 (%) Underemployment rate(%)	1.4	1.4	1.1	1.1
六. 零售市場 Retail Market			2017/8	2017/1-8
零售額升幅 (%) Change in value of total sales(%)	-3.7	-8.1	2.7	0.3
零售量升幅 (%) Change in volume of total sales(%)	-0.3	-7.1	3.2	0.3
七. 訪港遊客 Visitors			2017/9	2017/1-9
總人數 (萬人次) arrivals (ten thousands)	5,931	5,665	463.5	4263.5
年升幅 (%) Change(%)	-2.5	-4.5	4.8	2.2
八. 金融市場 Financial Market			2017/8	2017/9
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	775.1	775.6	782.6	781
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	15.4	12.3	8.5	7.1
M2	5.5	7.7	10.8	8.8
M3	5.5	7.7	10.8	8.9
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	6.7	9.1	9.9	7.5
港元存款 In HK\$	10.7	9.4	13.3	13.2
外幣存款 In foreign currency	3.1	8.8	6.5	2.0
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	3.5	6.5	15.7	15.7
當地放款 use in HK	3.5	7.4	15.2	15.1
海外放款 use outside HK	3.6	4.5	17.2	16.9
貿易有關放款 Trade financing	-16.3	0.2	4.7	8.5
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	21,914	22,000	27,970	27,554