

Debt Instruments - Bonds

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Recent HK government's HK\$ 20 billion bond issue stimulates the bond market in HK. The issue was a success reflected by the strong demand from both institutional and retail investors. 2-year bond yields 2.176% and 4-year bond yields 3.511%. These HK government bonds will become the benchmark indicator for other issuers to follow.

Bonds issue is one of the direct financing debt instruments to raise funds directly from investors. Public (government or government-linked agencies) or private (private companies) entities are keen to issue bonds. Bond price/yields depends on the credit of the issuer, market condition and supply. In general, all-in cost for bond issuer could be lowered because of direct financing. Banks usually charge a margin spread above their funding cost.

Bond rating

International rating agencies such as Moody's and S & P's give ratings (rankings) on individual issuers' ability to service their bond repayments.

Credit ratings are usually divided into nine ranks, namely: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C. Each rank is subdivided into three classes by 1, 2 and 3. Aaa is the highest ranking.

Country rating/sovereign ceiling

Government or government wholly-owned agencies are usually ranked as the top rank according to their country ratings or sovereign ceilings. Some countries may have different ratings on foreign and domestic currency bonds because of the different risks of servicing foreign currency debts.

Countries with both domestic and foreign currency long term bonds rated Aaa include: Ireland, USA, UAE, Australia, Austria, Holland, Canada, Singapore, Swiss, Sweden, Spain, Denmark, Germany, New Zealand, Finland, France, etc.

There are some Aaa issuers which investors regard as super-Aaa. They are World Bank, Asian Development Bank etc. because of their super-national nature.

Usually an issuer cannot get a rating higher than its own country's rating. Hong Kong SAR is one of the special cases. Hong Kong SAR foreign currency bonds (A1) rank higher than PRC's (A2). Hong Kong has a well-developed legal and monetary infrastructure, transparent and sound foreign exchange system. Most important is that Hong Kong government and public bodies have little foreign currency debts.

Hong Kong government has a Aa3 rating on domestic currency bonds by Moody's.

Not every bond is rated by rating agencies. When the issue size is big and the issuer wants to have an independent rating for market promotion, issuer will appoint rating agencies for a rating of their bonds. Some smaller-sized issues and privately-placed bonds would not need to be rated.

There are many types of bonds including foreign currency denominated bonds, structured bonds, convertible bonds, etc. Issuers may consult their financial advisors to tailor make a bond issue according to their funding requirements.

Next issue we will continue to brief on various debt instruments and different types of bonds.