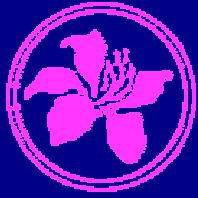


HONG KONG MONETARY AUTHORITY

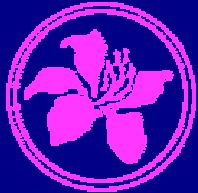
**Briefing to the Legislative Council
Panel on Financial Affairs**

4 February 2002



DISCUSSION TOPICS

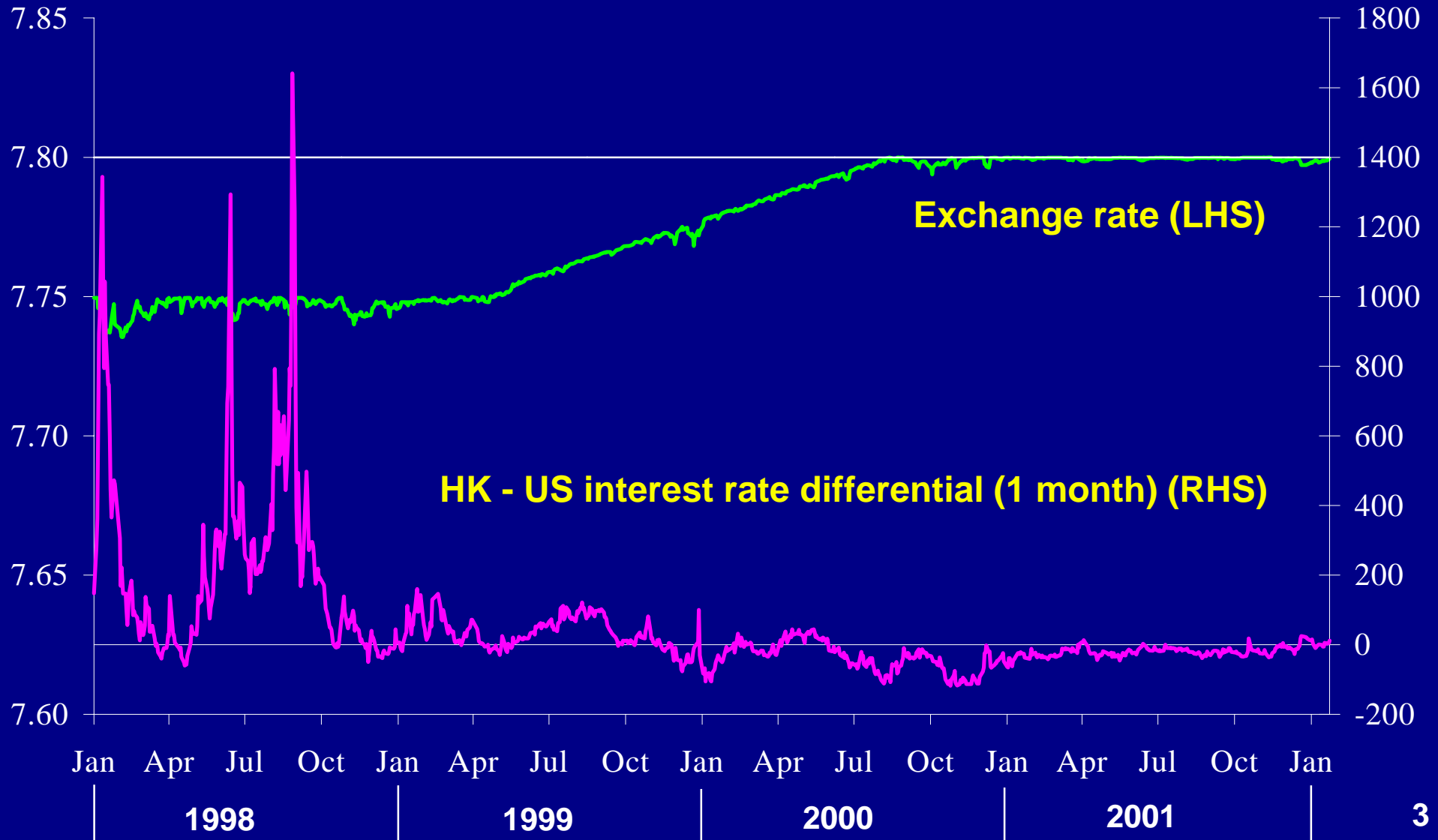
- **Currency**
- **Banking**
- **Financial Infrastructure**
- **Exchange Fund**

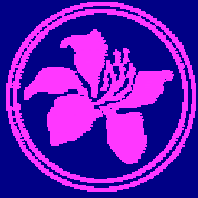


CURRENCY STABILITY - FACTS

HK\$ / US\$

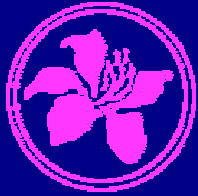
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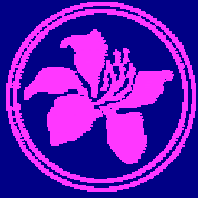
CURRENCY STABILITY - RISKS

- **Yen weakness and implications for regional currencies and RMB exchange rate**
- **Debt crisis in Argentina**
- **Hong Kong markets used as proxy hedge against Asian risks**
- **Public finances in Hong Kong**
- **Support for, and confidence, in the Link**



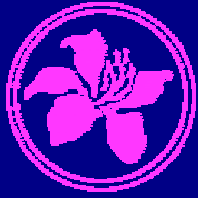
CURRENCY - MARKET EXPECTATIONS





CURRENCY - MARKET EXPECTATIONS

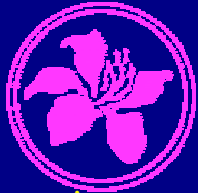




CURRENCY - RISKS OF YEN WEAKNESS

1 Sep 2001=100

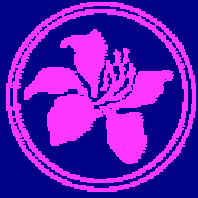




CURRENCY - MARKET EXPECTATIONS ON RMB

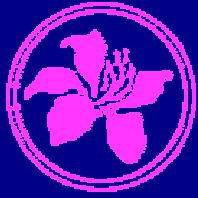


2001



CURRENCY - RISKS OF ARGENTINEAN DEBT CRISIS





BANKING SECTOR PERFORMANCE

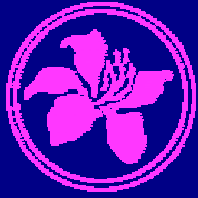
Capital adequacy ratio¹	: 18.30% (Sep 01)	18.00% (Jun 01)
Liquidity ratio²	: 51.38% (Sep 01)	52.47% (Jun 01)
Net interest margin²	: 2.12% (Q3 annualised)	2.17% (Q2 annualised)
Classified loans²	: 6.44% (Sep 01)	6.81% (Jun 01)
Mortgage delinquency ratio³	: 1.22% (Dec 01)	1.28% (Sep 01)
Credit card - charge-off ratio³	: 5.97% (Oct/Nov annualised)	4.75% (Q3 annualised)
Growth of total HK dollar deposits⁴	: 0.10% (Q4)	0.30% (Q3)
Growth of total domestic lending⁴	: -1.30% (Q4)	-1.70% (Q3)

1 *Locally-incorporated AIs*

2 *Locally-incorporated banks*

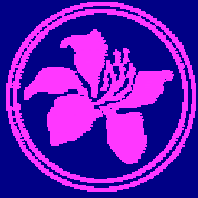
3 *Surveyed AIs (29 for RMLs, 23 for credit cards)*

4 *All AIs*



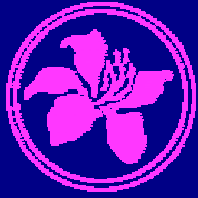
BANKING - EFFICIENCY AND COMPETITION

- **Commercial Credit Reference Agency**
- **Positive consumer credit data**
- **Review of market entry criteria**
- **Banking consumer protection**



BANKING - SAFETY AND SOUNDNESS

- **Deposit Insurance Scheme**
- **Bank consolidation**
- **New Capital Accord**
- **Mortgage loans in negative equity**

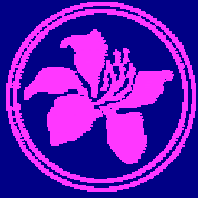


FINANCIAL INFRASTRUCTURE

Objective: reinforce Hong Kong's role as an International Financial Centre

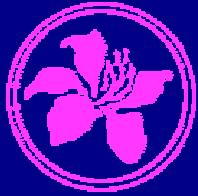
Our competitive advantage: a financial infrastructure in which financial intermediation and other financial transactions can be conducted safely and efficiently

- **Domestic financial activities**
- **International financial activities**
- **Mainland / Hong Kong financial activities**



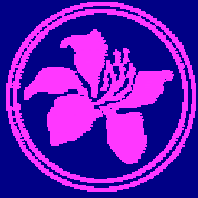
FINANCIAL INFRASTRUCTURE FOR DOMESTIC FINANCIAL ACTIVITIES

- **Debt market development – expansion of market size and promotion of retail investor base**
- **Retail payment systems – self regulatory approach; preparation of industry codes of practices; monitoring e-money development**
- **Integration of payment, clearing and settlement systems for money, debt securities, equities and their derivatives to enhance liquidity and promote real time DvP**



FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

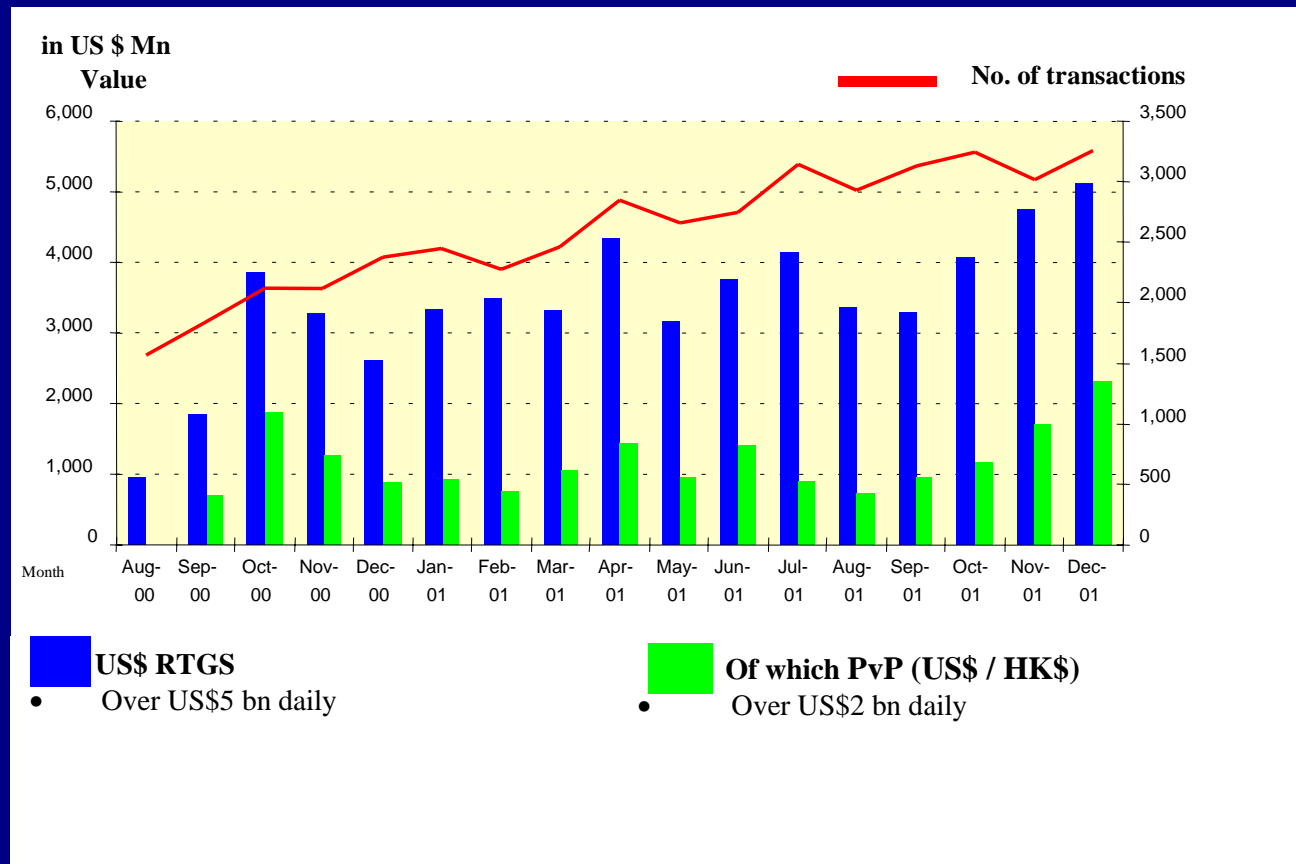
- **Promotion of US dollar RTGS in the region**
- **Proposal to develop a RTGS system for euro and yen**
- **International linkages of payment systems**
- **Promotion of international linkages of debt clearing systems**

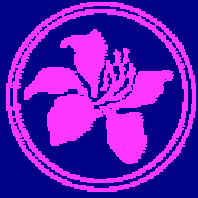


FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

US dollar RTGS turnover (daily average)

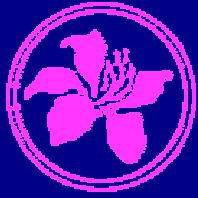
- Rising turnover
- Hong Kong and regional membership
- First ever PvP transaction was done in Hong Kong on 25 September 2000 between HK dollar and US dollar





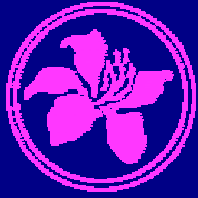
FINANCIAL INFRASTRUCTURE FOR MAINLAND / HONG KONG FINANCIAL ACTIVITIES

- **Warrants special attention because of exchange controls and non-convertible currency in the Mainland, and rapid liberalisation**
- **Objective 1: greater use of Hong Kong for the Mainland's international financial activities**
- **Objective 2: address asymmetric mobility of capital by developing appropriate channels to facilitate cross-border flow of funds**



MAINLAND / HONG KONG FINANCIAL ACTIVITIES – INITIATIVES

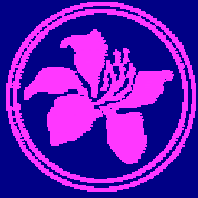
- **Location of international treasury operation of Mainland banks in Hong Kong**
- **Joint cheque clearing between Guangdong and Hong Kong**
- **Linkages in debt clearing systems**
- **Linkages in payment systems**



EXCHANGE FUND PERFORMANCE

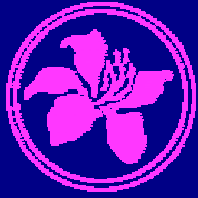
(HK\$ billion)	2001	2000	1999
Gain / (Loss) on HK equities*	(27.1)	(7.3)	96.5
Gain / (Loss) on other equities*	(3.2)	0.5	3.8
Exchange gain / (loss)	(13.1)	(11.2)	(9.9)
Total return from bonds, etc	<u>50.4</u>	<u>63.1</u>	<u>13.4</u>
Investment income	7.0	45.1	103.8

* including dividends

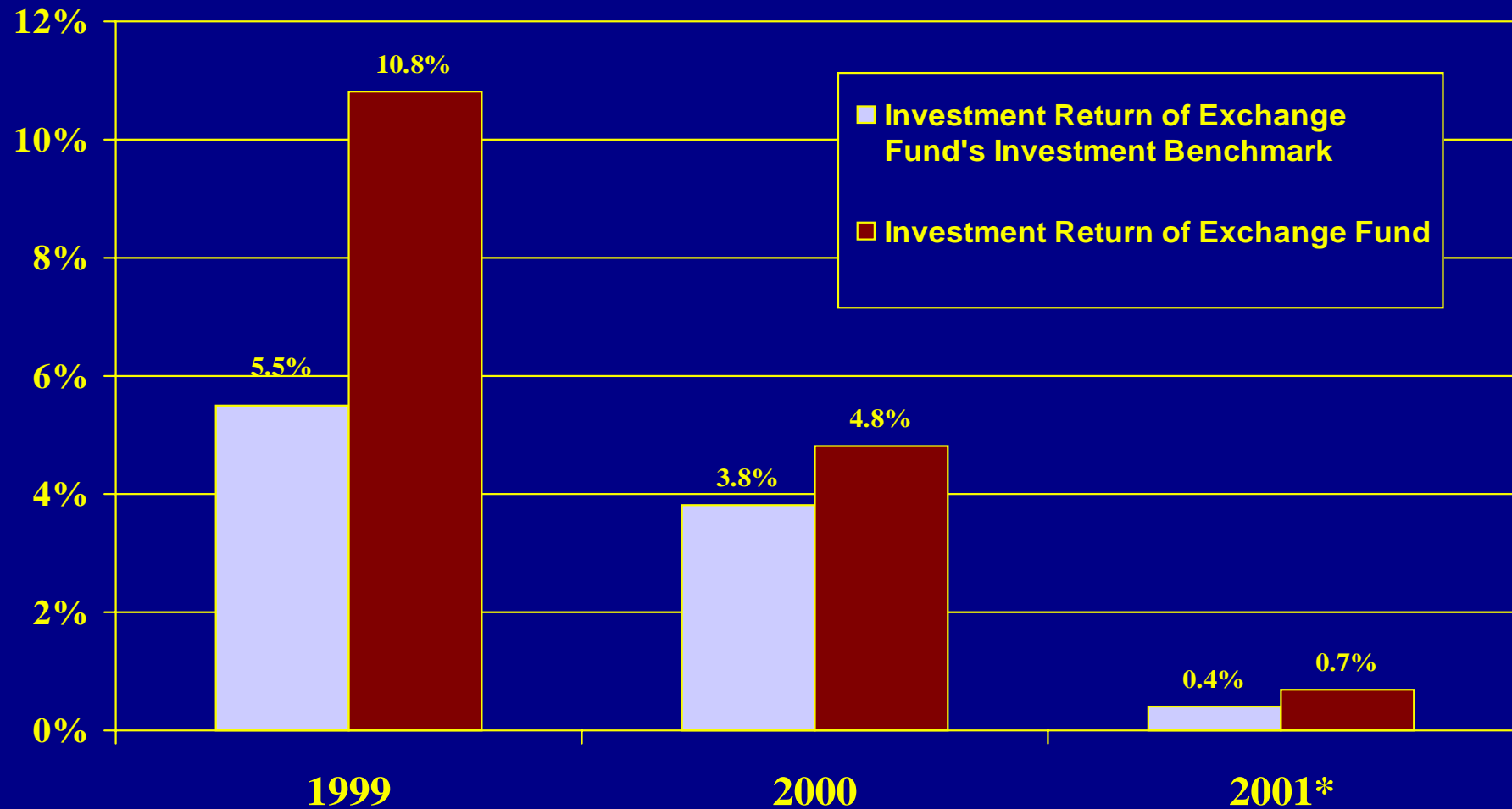


EXCHANGE FUND INVESTMENT BENCHMARK

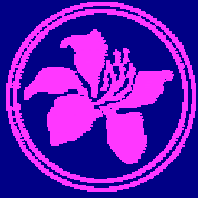
Bonds	80%
Equities	20% (Hong Kong : 5%)
Currencies	80% US dollar bloc
	15% European bloc
	5% Yen



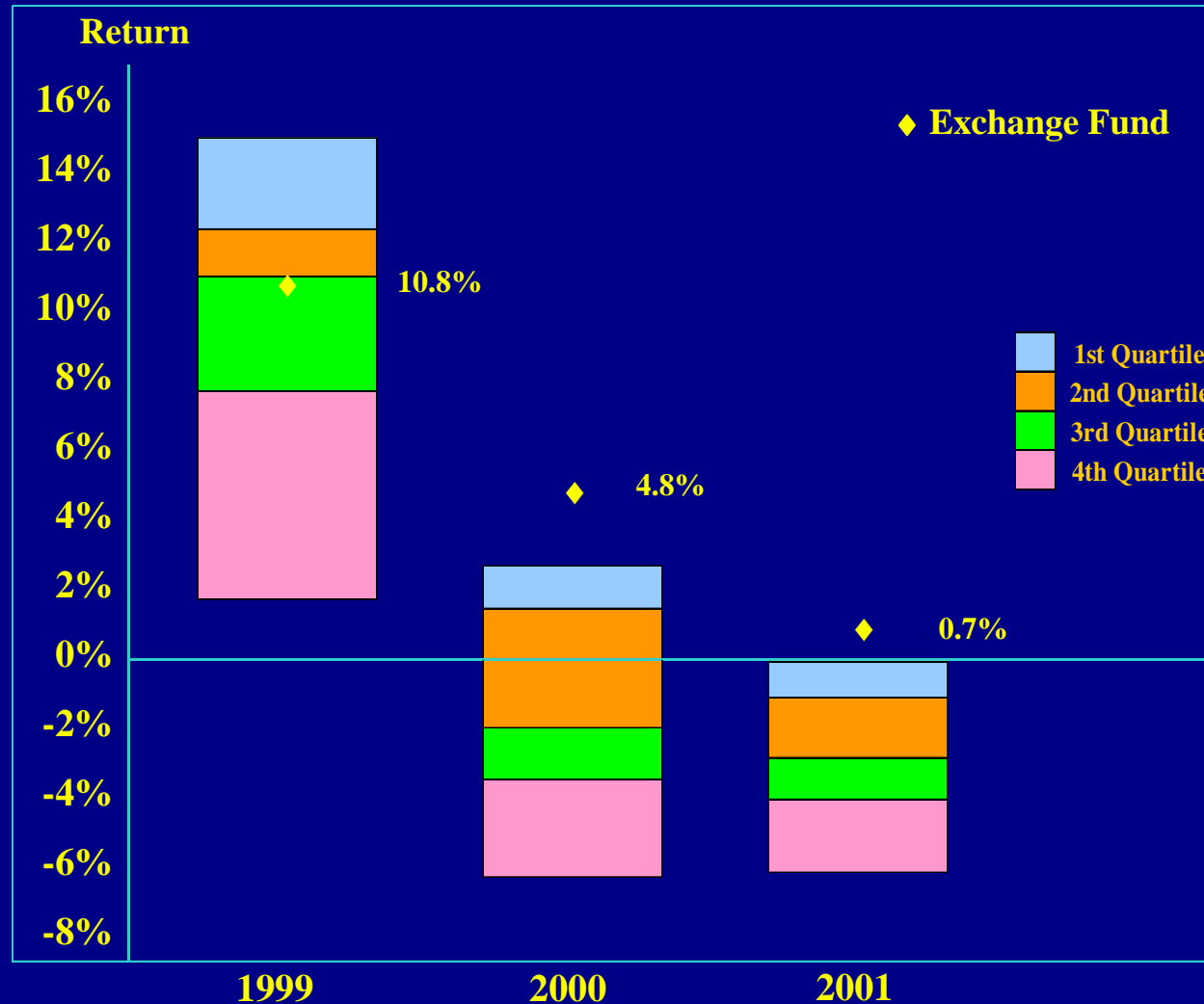
EXCHANGE FUND PERFORMANCE AGAINST BENCHMARK



* Preliminary, unaudited figures for 2001

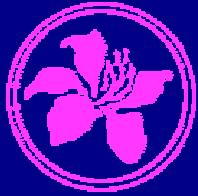


INVESTMENT PERFORMANCE OF EXCHANGE FUND AND COMPARABLE BALANCED FUNDS

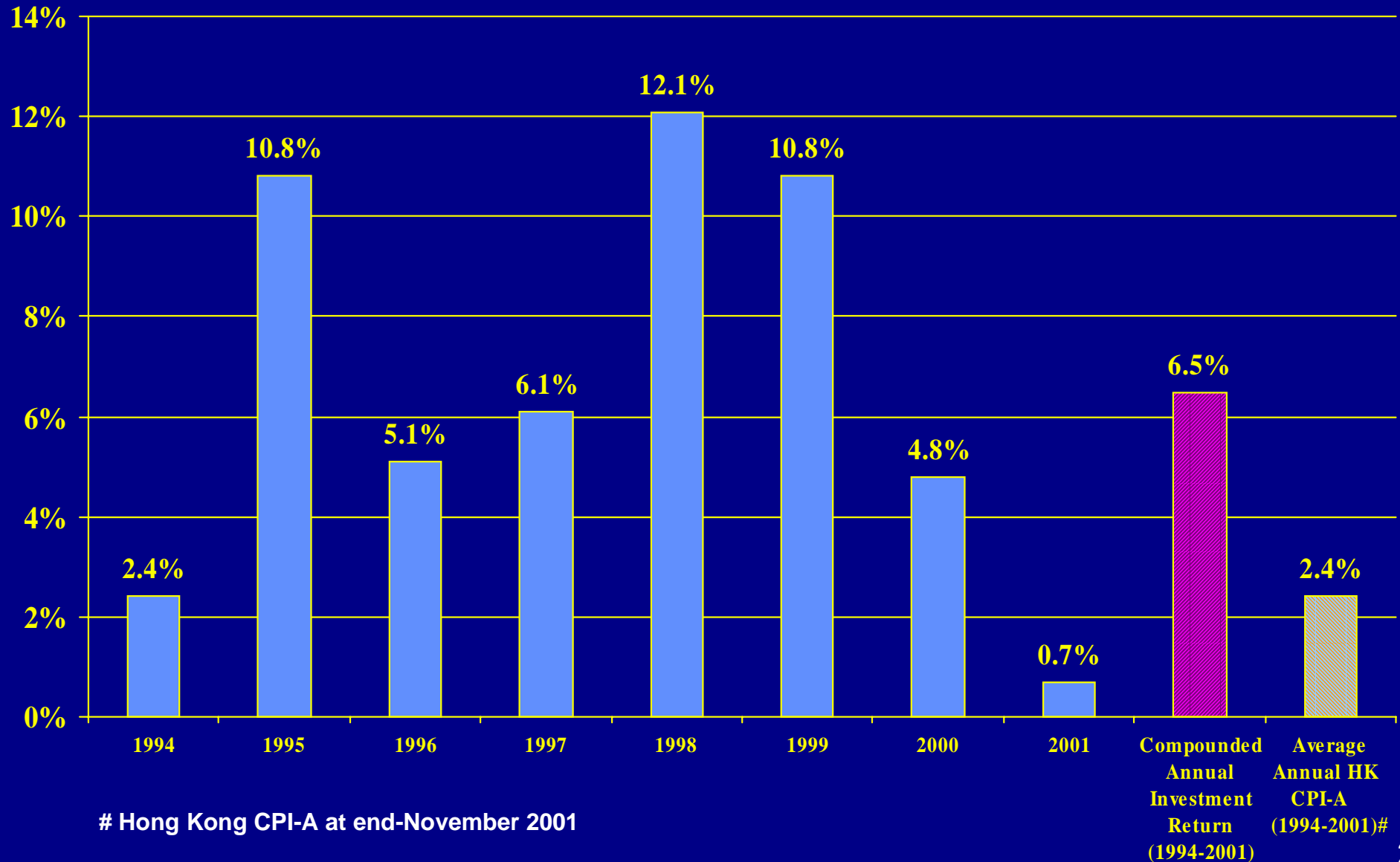


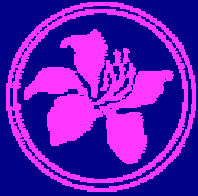
Balanced Funds with 20% - 30% Equity Component

Source: Watson Wyatt and Standard & Poor's



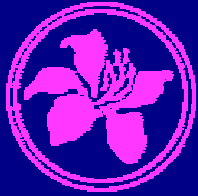
EXCHANGE FUND HISTORICAL RETURN





EXCHANGE FUND ABRIDGED BALANCE SHEET

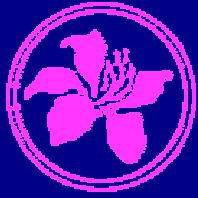
(HK\$ billion)	2001	2000	Change
ASSETS			
Deposits	98.6	73.1	25.5
Debt securities	733.3	729.8	3.5
Hong Kong equities	85.9	152.9	(67.0)
Other equities	35.3	40.6	(5.3)
Other assets	<u>27.5</u>	<u>27.0</u>	<u>0.5</u>
Total assets	980.6	1,023.4	(42.8)
LIABILITIES AND ACCUMULATED SURPLUS			
Certificates of Indebtedness	107.5	99.2	8.3
Coins in circulation	5.7	5.9	(0.2)
Balance of banking system	0.7	0.7	-
Exchange Fund Bills and Notes	118.2	109.3	8.9
Placements by other HKSAR government funds	380.6	417.2	(36.6)
Other liabilities	<u>65.2</u>	<u>84.0</u>	<u>(18.8)</u>
Total liabilities	677.9	716.3	(38.4)
Accumulated surplus	<u>302.7</u>	<u>307.1</u>	<u>(4.4)</u>
Total liabilities and accumulated surplus	980.6	1,023.4	(42.8)



EXCHANGE FUND CHANGE IN ACCUMULATED SURPLUS

(HK\$ billion)	← 2001 →					2000
	Full year	Q1	Q2	Q3	Q4	Full year
Investment income/(loss)	7.0	(14.6)	(2.0)	10.4	13.2	45.1
Other income	0.2	0.1	0.0	0.1	0.0	0.2
Interest and expenses	<u>(9.9)</u>	<u>(2.8)</u>	<u>(2.8)</u>	<u>(2.3)</u>	<u>(2.0)</u>	<u>(11.0)</u>
Net investment income/(loss)	(2.7)	(17.3)	(4.8)	8.2	11.2	34.3
Treasury's share	<u>(1.7)</u>	<u>6.1</u>	<u>1.0*</u>	<u>(4.0)*</u>	<u>(4.8)*</u>	<u>(18.1)</u>
Increase/(Decrease) in EF accumulated surplus	(4.4)	(11.2)	(3.8)	4.2	6.4	16.2

* Treasury's share in the first three quarters of financial year 2001-02 : HK\$7.8 billion.

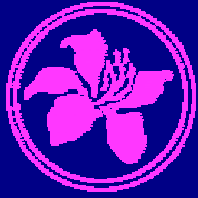


EXCHANGE FUND HONG KONG EQUITY PORTFOLIO

(HK\$ billion)

Investment in August 1998		118.1
Income from Disposal and Dividends (end-Dec 2001)		139.9
Size of remaining portfolio (end-Dec 2001)		85.9
Disposal	36.9	
Long Term Investment*	<u>49.0</u>	

* Including Hong Kong equities transferred from the Land Fund in 1998 (valued at HK\$9 billion in 1998).



HONG KONG MONETARY AUTHORITY

**Briefing to the Legislative Council
Panel on Financial Affairs**

4 February 2002