



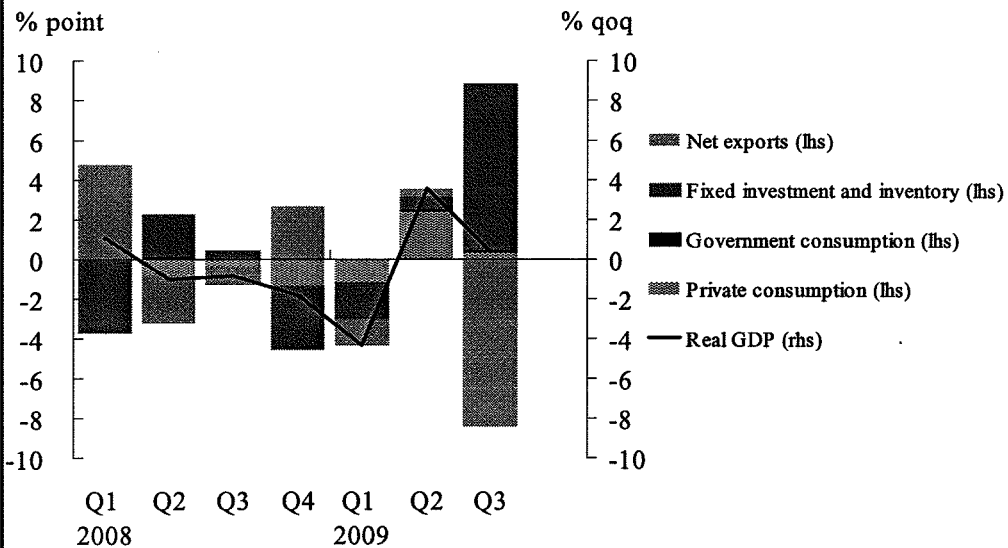
HONG KONG MONETARY AUTHORITY

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

1 February 2010

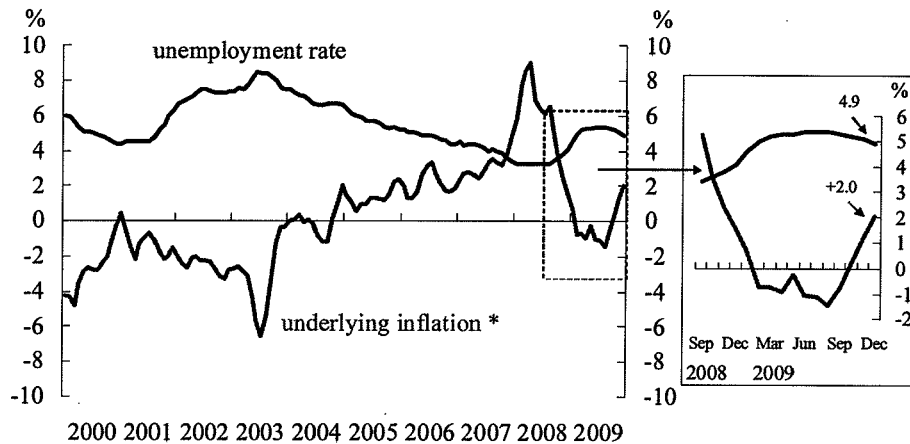


RECOVERY OF THE HONG KONG ECONOMY





UNEMPLOYMENT AND INFLATION



* 3-month-on-3-month annualized change in CCPI

3



ECONOMIC OUTLOOK AND RISKS

- **Market consensus is positive about 2010 economic outlook**
- **But risks remain:**
 - The strength and sustainability of recovery in advanced economies
 - Soundness of global financial institutions and financial market stability
 - Timing of exit strategies
 - Pressure of international capital flows on asset markets

4



RISK (1): UNDERLYING STRENGTH OF THE RECOVERY IN ADVANCED ECONOMIES

	GDP (%)			
	2007	2008	2009e	2010f
Advanced economies	2.7	0.5	-3.2	2.1
Of which: US	2.1	0.4	-2.5	2.7
Euro area	2.7	0.6	-3.9	1.0
Japan	2.3	-1.2	-5.3	1.7
UK	2.6	0.5	-4.8	1.3

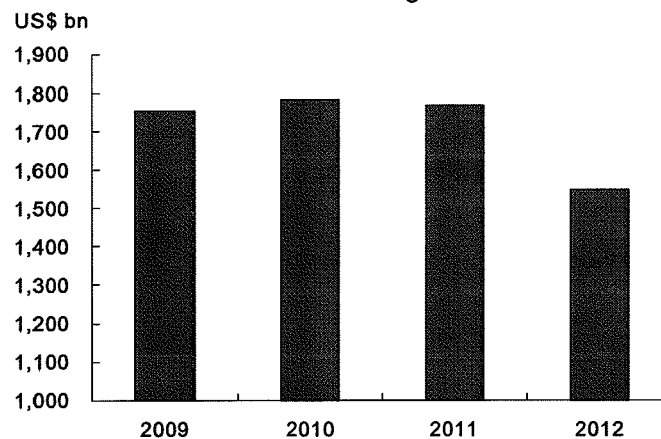
Source: IMF World Economic Outlook, January 2010

5



RISK (2): SOUNDNESS OF GLOBAL FINANCIAL INSTITUTIONS AND MARKETS

Bank debt maturing in 2009-2012*



These numbers refer to the amount of Moody's-rated bank debt maturing in the respective years. Actual total numbers could be considerably higher.

Source: Moody's

6



RISK (3): TIMING OF EXIT STRATEGY

Quantitative Easing: Major Central Banks' Balance Sheets

	Before QE ¹	Latest ²	Growth (%)
US Fed (USD billion)	909	2,237	1,328 (146)
Bank of England (GBP billion)	93	238	145 (155)
European Central Bank (EUR billion)	1,449	1,905	456 (32)

1. End-August 2008

2. US Fed and the BoE: end-2009; ECB: early January 2010.

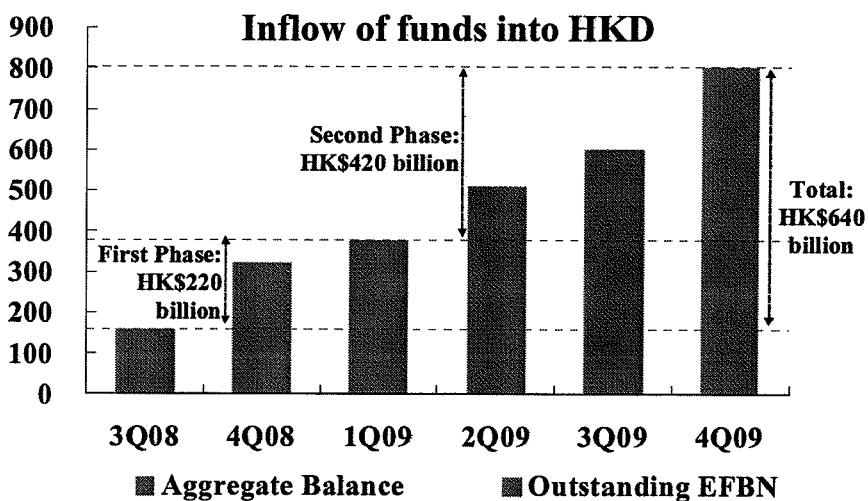
Sources: Websites of various central banks, CEIC

7



RISK (4) : PRESSURES FROM INTERNATIONAL CAPTIAL FLOWS ON ASSET MARKETS

HK\$ billion



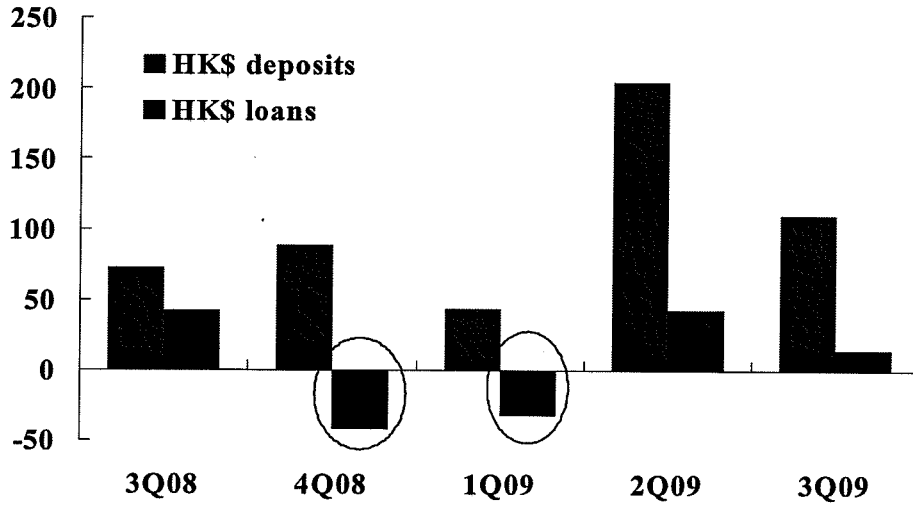
Note: The Outstanding EFBN and the Aggregate Balance are quarter-end figures.

8



CHANGES IN HKD LOANS AND DEPOSITS

HK\$ billion



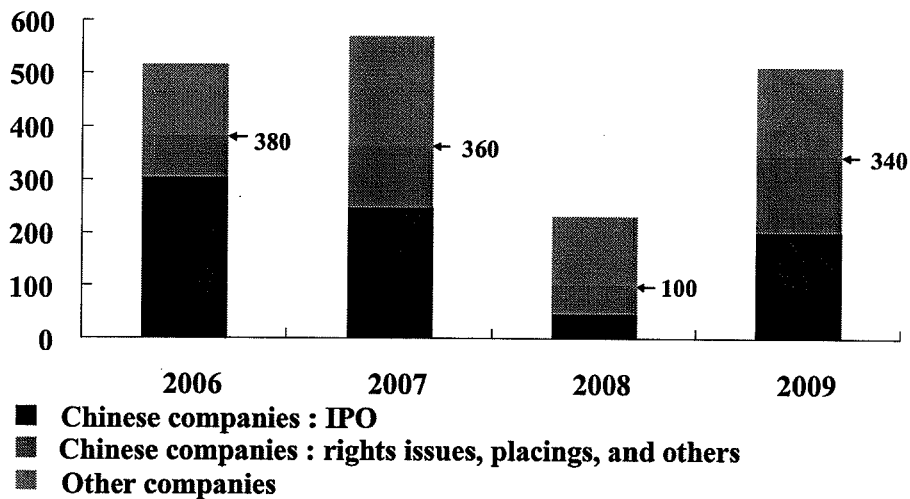
Note: Nominal changes during the quarter.

9



EQUITY FUNDS RAISED IN HONG KONG

HK\$ billion



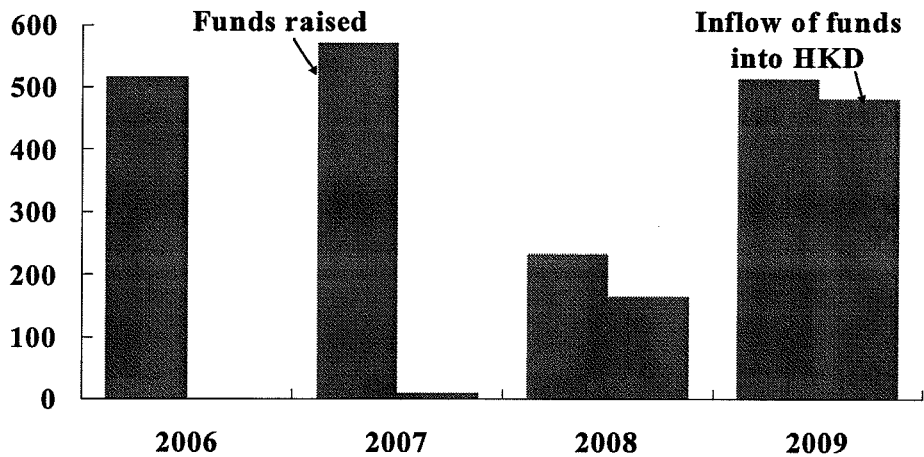
Note: 2008-2009 figures differ from those provided by the HKEx as the activities which did not involve HKD flows have been excluded.

10



EQUITY FUND-RAISING AND INFLOWS

HK\$ billion



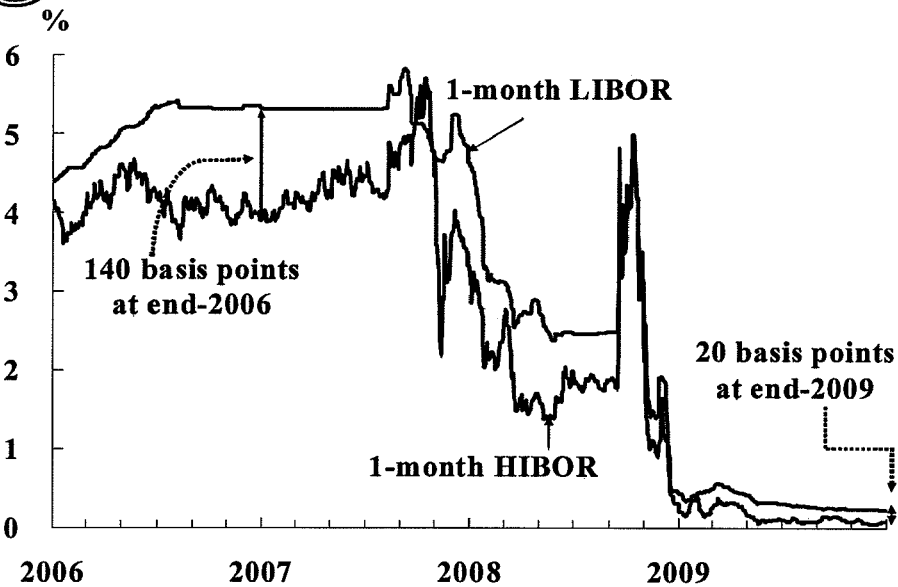
Note (1): Equities funds raised include IPO, right issues, placings, open offers, consideration issues, warrants exercised and share option scheme.

Note (2): 2008-2009 figures differ from those provided by the HKEx as the activities which did not involve HKD flows have been excluded.

11



HKD AND USD INTEREST RATES



140 basis points at end-2006

20 basis points at end-2009

12



PRESSURES FROM INTERNATIONAL CAPITAL FLOWS ON ASSET MARKETS

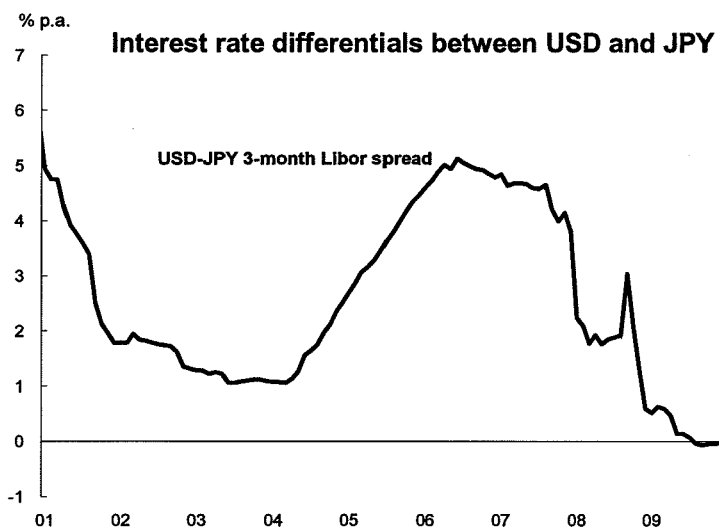
Risk Assessment for Hong Kong

- A large part of the inflows into the Hong Kong dollar in 2009 was equity-related
- Funds raised by Mainland corporations amounted to \$340 billion, a majority of which has not yet been exchanged into other currencies
- These Mainland corporations are expected to gradually exchange the funds into other currencies
- But the pressure from capital inflows might persist if equity fund-raising remains active and US interest rates remain low
- Alert to risks:
 - Formation of asset-price bubble
 - Reversal of capital flows / interest rates turning upwards

13



INTERNATIONAL CAPITAL FLOWS: USD CARRY TRADES (1)



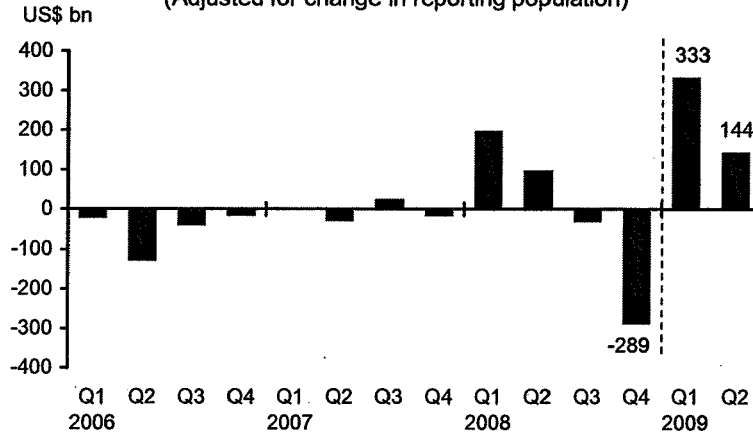
Source: Bloomberg

14



INTERNATIONAL CAPITAL FLOWS: USD CARRY TRADES (2)

Change in net external claims of banks in the US
(Adjusted for change in reporting population)



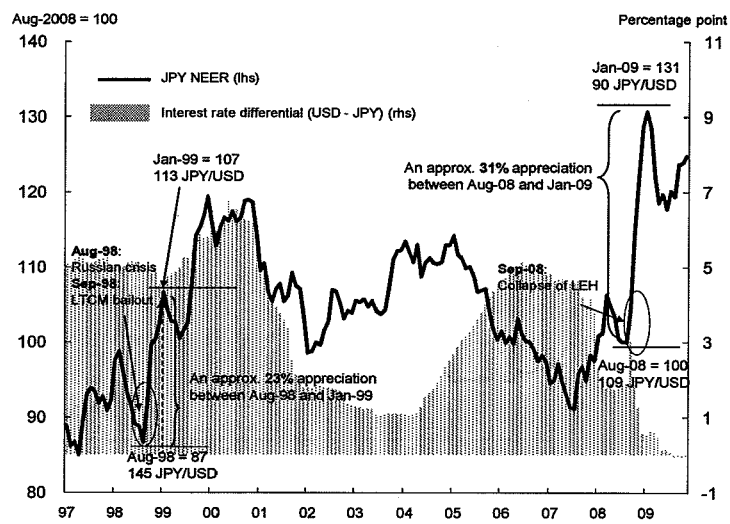
Note: Reporting population has increased to include former investment banks since Dec 2008.

Source: BIS locational banking statistics

15



INTERNATIONAL CAPITAL FLOWS: IMPACT OF UNWINDING OF JPY CARRY TRADES ON JPY EXCHANGE RATE



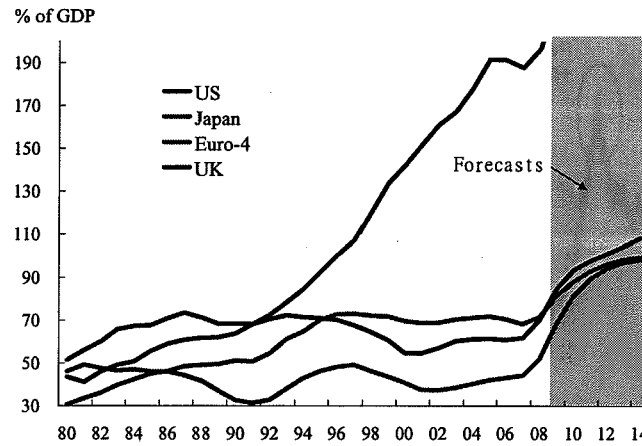
Source: CEIC

16



WILL HIGHER GOVERNMENT DEBT LEAD TO A WEAKENING OF CURRENCIES?

General Government Debt: US, euro area, Japan, and the UK



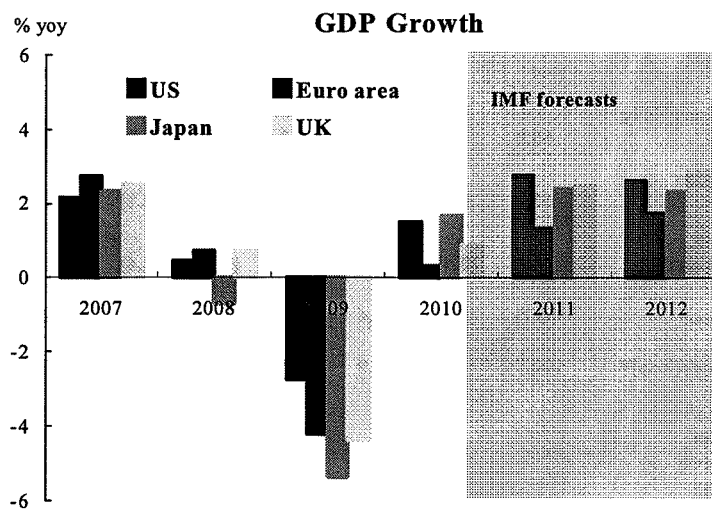
Note: Euro-4 refers to Germany, France, Italy, and Spain. All debt figures are retrieved from the IMF except those of Spain.

Sources: IMF, Oxford Economics

17



COMPARISON OF GROWTH PROSPECTS OF THE US AND OTHER MAJOR ECONOMIES

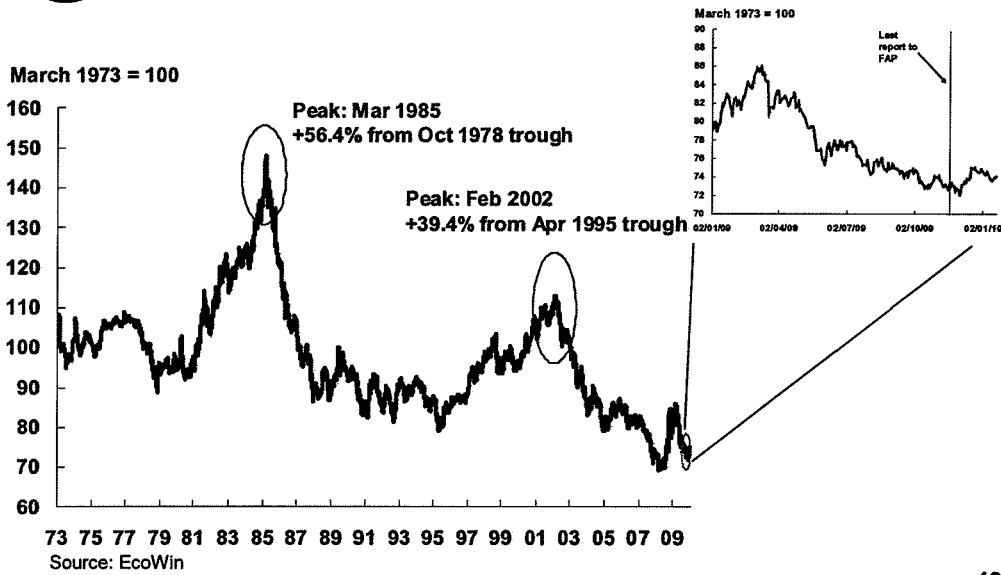


Source: IMF

18



US DOLLAR NEER



19



INVESTMENT INCOME

(HK\$ billion)	Full year *	2009				2008 Full year	2007 Full year	2006 Full year
		Q4	Q3	Q2	Q1			
Gain/(Loss) on Hong Kong equities [^] @	48.9	6.9	15.9	30.3	(4.2)	(77.9)	55.8	35.9
Gain/(Loss) on other equities [^]	48.7	10.0	27.4	27.3	(16.0)	(73.1)	6.7	18.7
Exchange gain/(loss)	9.8	(3.4)	11.2	11.7	(9.7)	(12.4)	18.7	17.3
Return from bonds [#]	(0.7)	(3.7)	17.4	(10.8)	(3.6)	88.4	61.0	31.9
Investment income/(loss) [@]	106.7	9.8	71.9	58.5	(33.5)	(75.0)	142.2	103.8

* Unaudited figures

[^] Including dividends

[#] Including interest

[@] Excluding valuation changes in Strategic Portfolio

20



CHANGES IN INVESTMENT INCOME, PAYMENT TO FISCAL RESERVES AND ACCUMULATED SURPLUS

(HK\$ billion)	2009					2008
	Full year (unaudited)	Q4	Q3	Q2	Q1	Full year
Investment income/(loss)	106.7	9.8	71.9	58.5	(33.5)	(75.0)
Other income	0.3	0.1	0.0	0.2	0.0	0.3
Interest and other expenses	<u>(3.8)</u>	<u>(1.0)</u>	<u>(0.9)</u>	<u>(1.2)</u>	<u>(0.7)</u>	<u>(6.5)</u>
Net investment income/(loss)	103.2	8.9	71.0	57.5	(34.2)	(81.2)
Payment to Fiscal Reserves #	(33.5)	(7.9)	(8.0)	(8.5)	(9.1)	(46.4)
Payment to HKSAR government funds and statutory bodies #	(1.2)	(0.6)	(0.3)	(0.3)	0.0	0.0
Valuation change of Strategic Portfolio [^]	<u>4.3</u>	<u>(0.1)</u>	<u>1.3</u>	<u>3.2</u>	<u>(0.1)</u>	<u>(8.9)</u>
Increase/(Decrease) in EF Accumulated Surplus	72.8	0.3	64.0	51.9	(43.4)	(136.5)

The fixed rate of fee payment is 6.8% for 2009 and 9.4% for 2008.

[^] Including dividends

21



BANKING SUPERVISION AND DEPOSIT PROTECTION

- **Basel Committee Proposals:**
 - Guideline on A Sound Remuneration System
 - Global capital and liquidity standards
 - Principles for Sound Liquidity Risk Management and Supervision
 - Use of Fair Value Option for Financial Instruments
 - Amendments to Banking (Capital) Rules
- **Review of and amendment to the Deposit Protection Scheme**
- **Multi-lateral coordination of the exit from full deposit guarantees**

22



LEHMAN-RELATED ISSUES

Investigation progress:

- Around 80% of Lehman-related complaints had been handled or resolved by mid-January 2010
- The HKMA aims to substantially complete the investigation of all outstanding complaints by the end of March 2010

Investor protection:

- Continue to work with SFC and Government to implement measures to enhance investor protection

23



RENMINBI BUSINESS IN HONG KONG

- Renminbi trade-settlement business on the rise, with the number of participating banks and the amount settled through the arrangement increasing considerably
- Led an HKAB delegation to visit Shanghai and Beijing at the end of November for extensive discussions on a number of issues including development of renminbi business in Hong Kong
- Development of Hong Kong's renminbi business continues:
 - Promote trade settlement in renminbi
 - Develop more financial products denominated in renminbi
 - Increase the amount and types of issuers of renminbi bonds

24