



HONG KONG MONETARY AUTHORITY

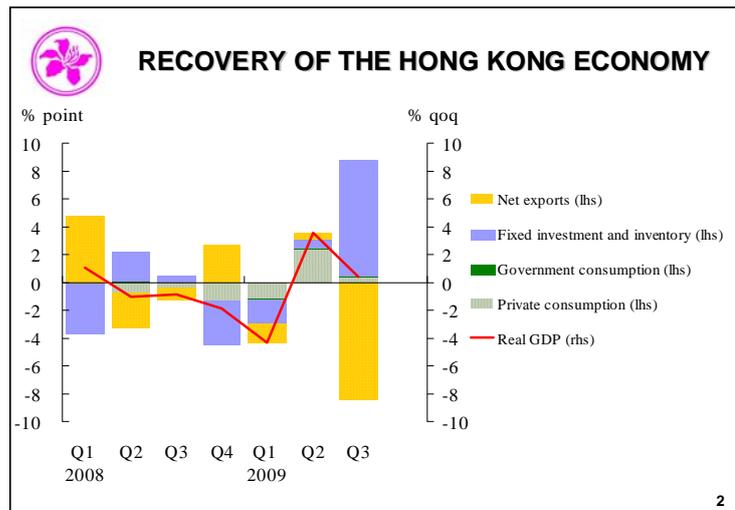
**Briefing to the Legislative Council
Panel on Financial Affairs**

1 February 2010

Recovery of the Hong Kong economy

- In my briefing in November 2009, I pointed out the severe impact the global financial crisis had on Hong Kong's economy. GDP fell for four consecutive quarters by a cumulative 7.8% from the second quarter of 2008 to the first quarter of 2009.

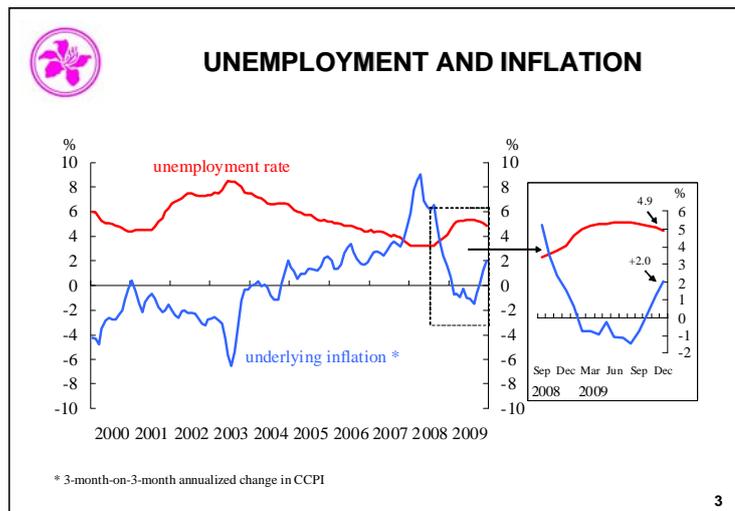
- However, real GDP rebounded strongly by a 3.5% in the second quarter of 2009, reversing the decline in the previous four consecutive quarters. The economy continued to improve in the third quarter of 2009, though at a slower pace of 0.4%.



- Slower growth in the third quarter mainly reflected persistently weak external demand. Overall exports in July declined substantially, resulting in decreases in exports for the third quarter.
- In contrast, domestic demand remained buoyant mainly due to massive inventory restocking spurred by optimism of businesses on retail sales. Imports grew as a result of large-scale inventory restocking. Taking into account the decrease in total exports, net exports declined, offsetting most of the increase in domestic demand and slowing growth in real GDP.
- Real GDP data for the fourth quarter are not yet announced. However, recent economic indicators suggested local economic activity remained strong in the fourth quarter. Total retail sales volume continued to grow in October and November. Growth in total merchandise exports turned positive in volume terms in October, with the momentum continuing in November.

Unemployment and inflation

- The unemployment rate in Hong Kong declined to 4.9% in December 2009 from a three-year high of 5.4% in August.
- Recent job market surveys showed a slight pick-up in hiring sentiment.
- Deflationary pressure gradually receded. The annualised 3-month-on-3-month underlying inflation rate, after staying in negative territory for eight months since February 2009, turned positive in October and continued to rise to 2% in December.



Economic outlook and risks

- Market consensus on the economic outlook for 2010 remained positive. Economic recovery is expected to continue and inflationary pressure may remain moderate. Unemployment will also improve.
- However, the economy is still affected by a number of uncertainties. The most important risks are as follows:

- Strength and sustainability of recovery in advanced economies are questionable
- Global financial institutions and financial market are still fragile
- Difficulty in timing the exit strategies
- Pressure of international capital flows on asset markets.



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

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Risk (1): Underlying strength of the recovery in advanced economies

- This table shows the IMF's projections for GDP growth in major economies in 2010. While these countries will continue to recover, the pace may remain tepid and risks of a downturn still exist.
- While massive fiscal and monetary easing by major countries made the economic pick-up possible, some major economies may lack the strength to continue to grow when the authorities exit from the economic stimulus programmes. The still high level of unemployment rate might also lead to a rise in the long-term unemployment rate and a loss of skilled labour, dampening the prospect for growth. Meanwhile, credit situation is still tight, which is also not conducive to economic recovery.



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

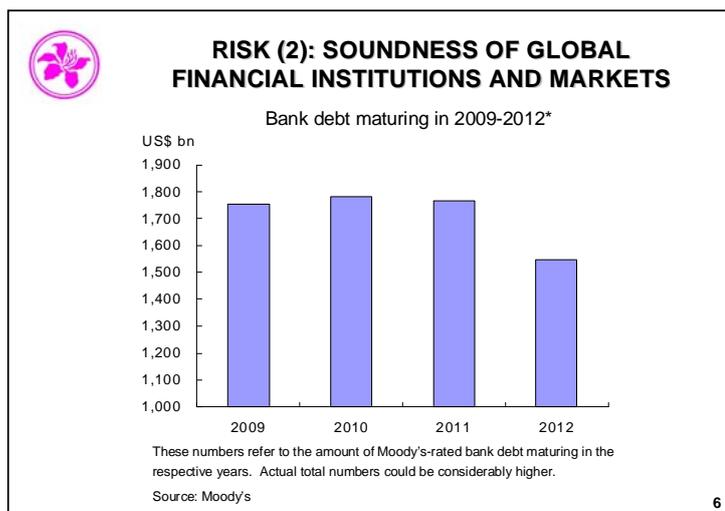
	GDP (%)			
	2007	2008	2009e	2010f
Advanced economies	2.7	0.5	-3.2	2.1
Of which: US	2.1	0.4	-2.5	2.7
Euro area	2.7	0.6	-3.9	1.0
Japan	2.3	-1.2	-5.3	1.7
UK	2.6	0.5	-4.8	1.3

Source: IMF World Economic Outlook, January 2010

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Risk (2): Soundness of global financial institutions and markets

- Financial institutions are generally out of the woods as a result of capital injections and other rescue packages introduced by governments. But some banks might still need to deal with more write offs and possible capital squeeze. While the functioning of some credit markets has gradually returned to normalcy, activities in certain sectors such as securitisation are still a far cry from their pre-crisis levels. This suggests financial intermediation channels have yet to fully open and there is room for improvements in strengthening the financial systems.



- This table shows the funding requirements of banks to meet debt market obligations in the next few years. As average maturity of debt securities issued by banks shortened to 3.2 years in 2009 from 5.8 years in 2006, banks will need to repay more than US\$5 trillion of debts that will be maturing in the three years between 2010 and 2012. The banking sector will continue to face substantial funding pressure, which in turn may affect the cost of funding.

Risk (3): Timing of exit strategy

- The timing of exit strategy is another risk posing great challenges to monetary authorities. This table shows the balance sheets of the major central banks. It can be seen that particularly in the UK and the US, central bank balance sheets have expanded considerably as a result of quantitative easing measures.

	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)

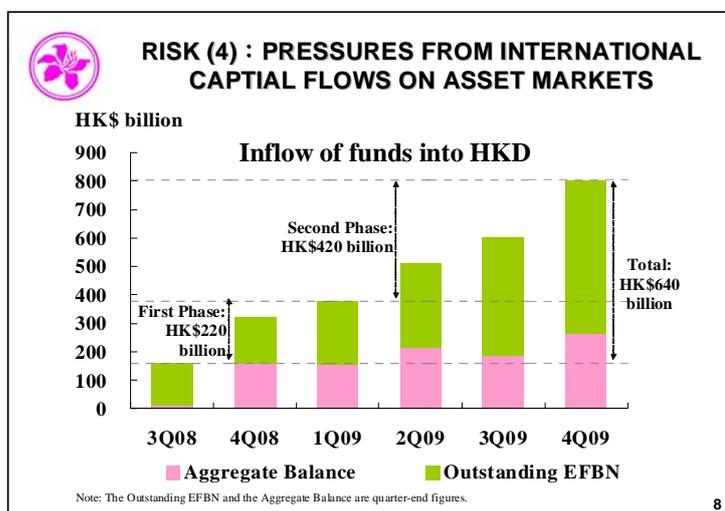
1. End-August 2008 •
2. US Fed and the BoE: end-2009; ECB: early January 2010.
Sources: Websites of various central banks, CEIC

- Timing the exit requires balancing a number of risks. Too early an exit could derail the nascent recovery, risking a relapse into recession; too late an exit might lead to inflation. A late exit by the major economies poses particular challenges for Hong Kong,

since abundant liquidity around the world may lead to capital inflows, sending asset prices further up.

Risk (4): Pressures from International Capital Flows on Assets Markets

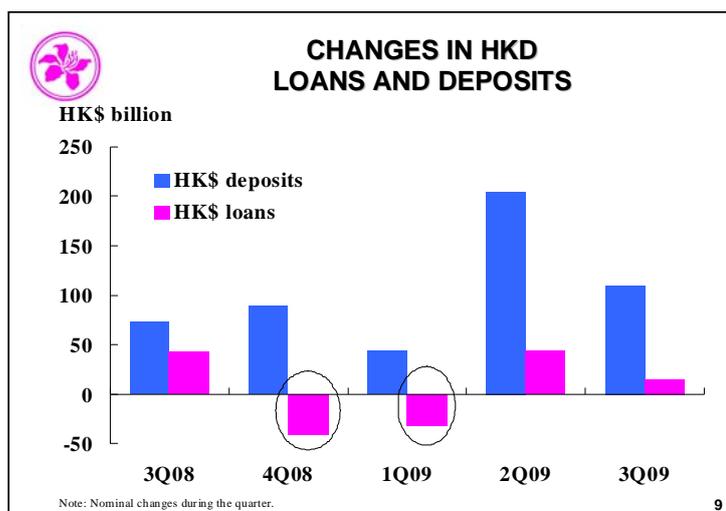
- I mentioned in my last briefing that capital inflows between 1 October 2008 and 13 November 2009 amounted to HK\$567.5 billion. The figure has gone up by HK\$72.5 billion to HK\$640 billion by the end of 2009. Capital inflows refer to the amount of Hong Kong dollars sold by the HKMA in exchange for US dollars in response to market demand. Of the amount of inflows, HK\$386 billion was reflected in the additional issuance of Exchange Fund paper, and the remaining HK\$254 billion in the expansion in the Aggregate Balance.



- Hong Kong does not implement any capital control. It is therefore difficult to collect comprehensive data to determine the nature of these fund flows. Nevertheless, using information from variable sources, we try to analyse the reasons for capital inflows at different stages.
 - Initial stage (from the fourth quarter of 2008 to the first quarter of 2009): total fund inflows amounted to HK\$220 billion, about one third of the total amount of inflows since the outbreak of the global financial crisis.
 - Recent stage (since the second quarter of 2009): total fund inflows amounted to HK\$420 billion.

Changes in Hong Kong dollar loans and deposits

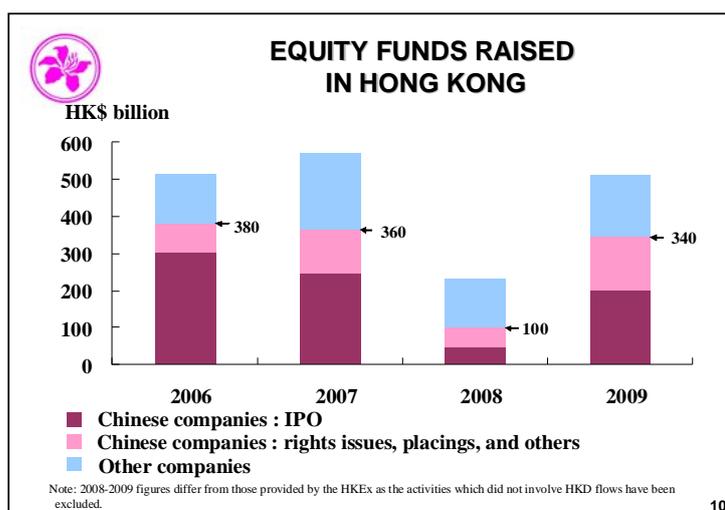
- Soon after the outbreak of the financial tsunami, credit concerns were intensified by the subprime mortgage problems in the US. Investors became more risk averse and financial institutions reduced their leverage and lending.



- Balance-of-payments statistics also indicated that private-sector capital inflows in the fourth quarter of 2008 mainly took the form of reduced overseas deposits held by banks and other private-sector entities (banks: HK\$307.1 billion; others: HK\$84.8 billion). This may partly reflect risk aversion and the repatriation of funds to Hong Kong to meet liquidity needs at a time when credit conditions were tightened. The situation moderated in the first quarter of 2009.
- Hong Kong also came under the pressure of tighten credit, as reflected in the decrease in Hong Kong dollar lending in the fourth quarter of 2008 and the first quarter of 2009.
- Faced with tight credit conditions, local corporations and residents repatriated funds from abroad to meet liquidity needs. Another possible reason was that our robust banking sector and the introduction of the full deposit guarantee attracted safe-haven inflows to Hong Kong.
- As a result Hong Kong dollar loans decreased while Hong Kong dollar deposits increased, partly reflecting funds being moved to Hong Kong.
- Loans resumed small growth in the second quarter. Credit crunch apparently was not the main reason for fund inflows.

Equity funds raised in Hong Kong

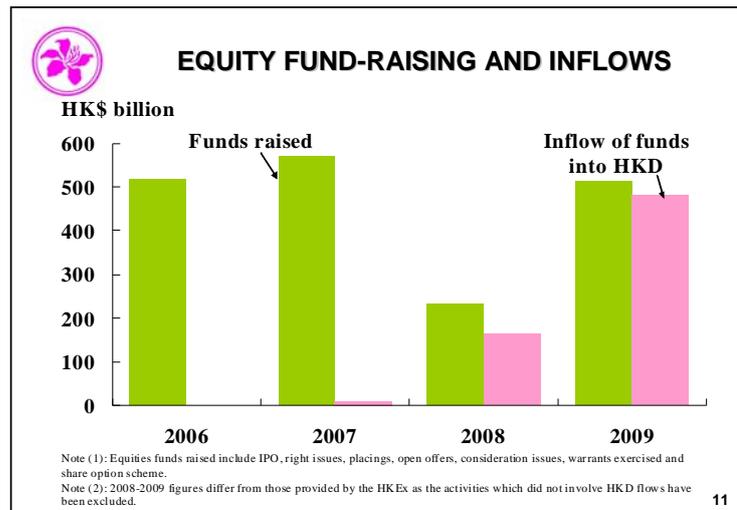
- Entering the second quarter of 2009, global financial markets stabilised and investors became less risk averse. Market liquidity was abundant and interest rates declined to very low levels as a result of continued monetary easing around the world. Prompted by a search for higher returns and optimism about better outlook for Hong Kong and the Mainland, overseas funds continued to flow into the Hong Kong dollar. Equity investments accounted for a substantial portion of the inflows.



- Fund raising activities in the stock market were buoyant in 2009, with more than HK\$500 billion raised through IPOs, rights issues and placements, of which HK\$340 billion (67%) was raised by companies on the Mainland. As far as IPOs are concerned, HK\$200 billion was raised by Mainland companies.
- The HK\$500 billion came from both within and outside Hong Kong. There are no reliable data accurately pointing to their sources. Since a big chunk of the fund-raising activities took place through international placement, usually taking up 70%-80% of an IPO, we therefore believe that large amounts of funds flowed into the Hong Kong dollar from overseas.
- Assuming 70% of the funds were exchanged into Hong Kong dollars, the amount of funds flowing into our currency could be as large as HK\$350 billion.
- The listed companies or the newly-listed ones would determine the use of the proceeds depending on the nature of the companies and their purpose of raising the funds. Most of the fund-raising activities last year involved Mainland companies. Market participants believed that these Mainland companies would repatriate the funds to the Mainland to finance their operations, but it may take time for them to repatriate the funds.
- Our informal enquiry suggests that, at the end of November 2009, about 77% of the funds raised by Mainland companies might still be held as Hong Kong dollar deposits in the Hong Kong or Mainland banking system without being exchanged into other currencies. As mentioned above, Mainland companies raised a total of HK\$340 billion funds from the equity market. So we may deduce that as much as HK\$260 billion of their proceeds might still be held in the Hong Kong dollars. With regard to non-Mainland companies, some of the funds raised might be used to meet local operational needs and therefore not exchanged into other currencies.
- It is estimated that as much as HK\$300 billion might still be held as Hong Kong dollar deposits at the end of 2009. However, this might be a temporary phenomenon. When the funds raised are exchanged into other currencies, the Hong Kong dollars held by these companies would decrease.

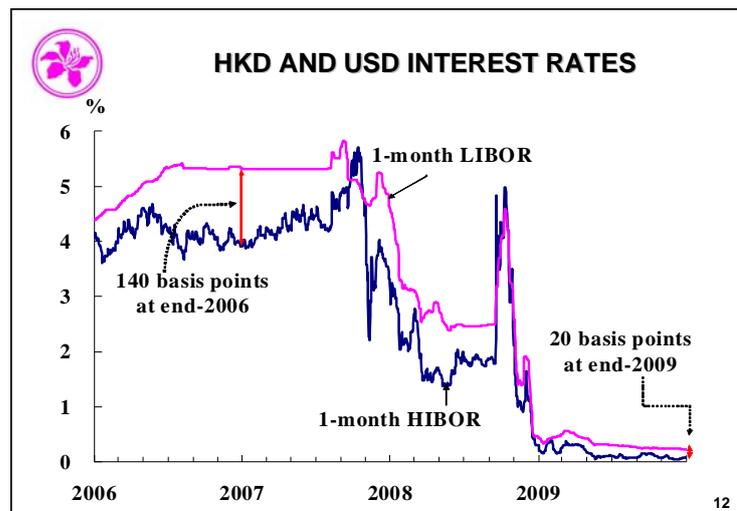
Equity fund-raising and inflows

- In fact, the total amount of funds raised in 2009 was close to the levels of 2006-07 when the stock market was just as active (2006: \$516 billion; 2007: \$571.1 billion). Fund raising activities during 2006-07 also involved huge capital inflows. But why wasn't the Hong Kong dollar exchange rate pushed to the level of the strong-side Convertibility Undertaking rate?



Hong Kong dollar and US dollar interest rates

- Hong Kong dollar-US dollar interest-rate spread was wider in 2006-07 (about 140 basis points at the end of 2006) leading to carry trades that involved selling Hong Kong dollars and buying US dollars. These carry trades offset the upward pressure on the Hong Kong dollar caused by the fund inflows. However, the interest-rate spread has narrowed considerably since the end of 2008 (about 20 basis points at the end of 2009). As a result, carry trades were no longer attractive and could not provide a counteracting force against the pressure of fund inflows into the Hong Kong dollar.



Pressure from international capital flows on asset markets

- A large part of the inflows into the Hong Kong dollar since Q2 2009 was equity-related, of which \$340 billion was raised by Mainland corporations. Since these Mainland corporations do not need Hong Kong dollars for their operations, the funds they raised will eventually be exchanged into other currencies. But this process takes time. According to our understanding, up to November 2009, a majority of these funds has not been exchanged into foreign currencies.
- However, while the funds will gradually be exchanged into other currencies, the transactions only represent a change of hands in the market. The Hong Kong dollar funds will still remain in Hong Kong's banking system.
- Looking ahead in 2010, the pressure of capital inflows might persist if the equity market continues to be buoyant, equity fund-raising remains active and US interest rates remain low.
- Asset-price bubble remains a major risk under the current accommodative monetary environment. There are signs indicating that expectations of consumer price inflation and asset price inflation are on the rise. Abundant liquidity provides banks with an incentive to lend more. Investors may also be tempted to borrow more given the persistently low interest rates. These factors further fuel the local asset markets.
- On the contrary, if capital flows reverse resulting in strong outflows from the Hong Kong dollar, asset prices might fall and interest rates will go up according to the Currency Board system. These might have an impact on the financial markets and investors. The public should therefore be alert to these risks.



PRESSURES FROM INTERNATIONAL CAPITAL FLOWS ON ASSET MARKETS

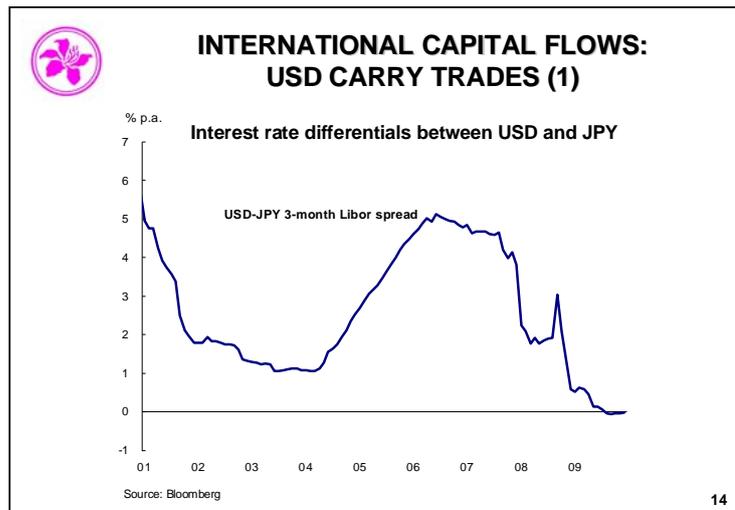
Risk Assessment for Hong Kong

- 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

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International capital flows: US-dollar carry trades (1)

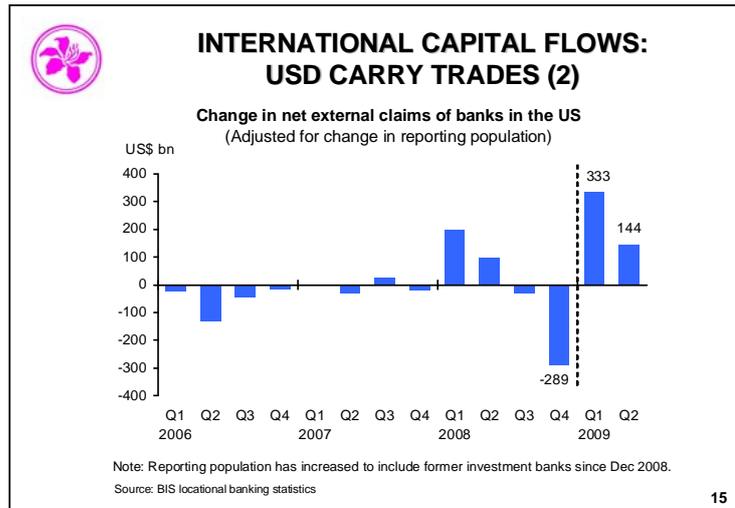
- Risks of international capital flows are associated with movements of US-dollar interest rates.
- The US Federal Reserve began lowering US-dollar interest rates in September 2007, reaching nearly zero since December 2008. Coupled with a series of quantitative easing measures, the US dollar has become the currency with the lowest interest rates.



- If US-dollar interest rates move up, the interest-rate spreads between the US dollar and other major currencies will change.
- As shown in the chart, the interest-rate differential between the US dollar and Japanese yen has narrowed since the collapse of Lehman Brothers in September 2008, with US-dollar interest rates lower than their Japanese counterparts in August 2009.
- Meanwhile, the global financial market began to stabilise since March last year. As investors' aversion to risk lessened, the role of the US dollar as a safe-haven currency also diminished, leading to the depreciation of the US dollar.
- With low interest rates and a weak exchange rate, US dollar-funded carry trades have become active recently.
- Carry trades refer to the borrowing of a currency with low interest rates and investing the funds into other assets of higher returns, such as currencies, equities and other asset markets to profit from the interest-rate spreads and capital appreciation.

International capital flows: US-dollar carry trades (2)

- In fact, while the accommodative monetary policy in the US failed to reverse the tight credit conditions in the nation, it has led to outflow of funds that fuel credit expansion overseas.



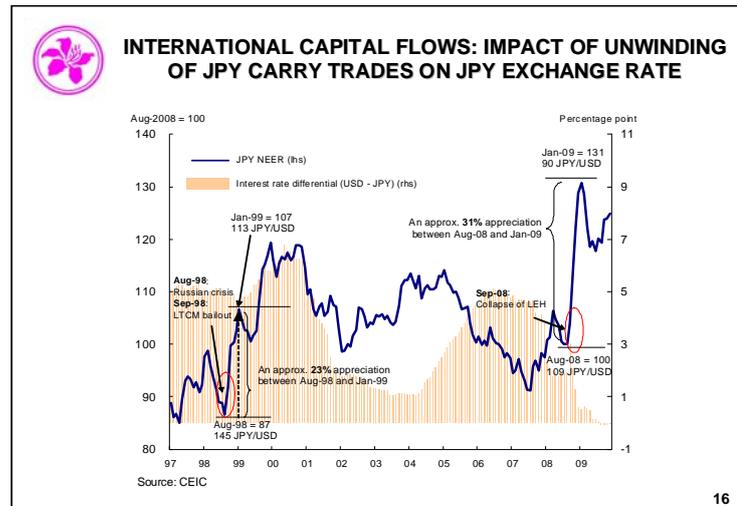
- Statistics of the Bank for International Settlements indicates that the US banking sector has experienced a big reversal. After recording net cross-border inflows of

US\$321 billion in the second half of 2008, the banking sector registered net outflows of US\$477 billion in the first half of 2009. We believe these outflows from the US are one of the factors contributing to the surge in asset prices in Asia.

- As mentioned in my last briefing in November, an increase in the US interest rates or strengthening of the US dollar may lead to a reversal of the capital flows; and US dollar-funded carry trades will exacerbate the impact of a reversal in the flows of funds on the financial market, making it more volatile.
- When US-dollar interest rates rise or the US dollar strengthens, investors will no longer use the US dollar to fund their carry trades. When they unwind these US dollar-funded carry trades and take a long position in the US dollar, the US dollar might appreciate considerably, resulting in funds flowing out of the Hong Kong dollar.

International capital flows: Impact of unwinding of Japanese-yen carry trades on the Japanese-yen exchange rate

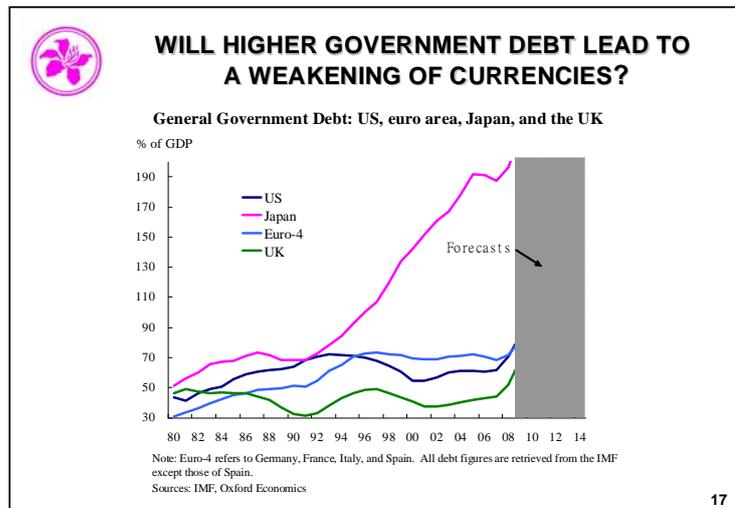
- The previous trend in the Japanese yen may explain the impact of a sudden and large-scale unwinding of carry trades on exchange rates.
- Because Japanese-yen interest rates stayed at a low level for a prolonged period, the yen became the most popular currency for funding carry trades prior to the outbreak of the financial crisis in 2008. After the collapse of Lehman Brothers in September 2008, investors' risk aversion heightened substantially and they scrambled to reduce their holdings of high-risk assets. International investors doing carry trades are no exception. They unwound their Japanese-yen carry trades and took a long position in the Japanese yen, leading to a sharp appreciation of the yen. The nominal effective exchange rate (NEER) of the Japanese yen increased by 31% in the five months since August 2008.



- A similar episode with the Japanese-yen exchange rate increasing sharply also occurred in the 1990s during the LTCM crisis. The NEER of the Japanese yen also rose rapidly by more than 20% in several months. The market consensus at that time was that the surge in the Japanese-yen exchange rate was mainly caused by the unwinding of Japanese-yen carry trades and the taking of long positions in the yen by investors.
- Similarly, substantial unwinding of US dollar-funded carry trades might also lead to sharp appreciation of the US dollar, resulting in funds flowing out of the Hong Kong dollar. Although there are no substantive evidences in the market showing large amounts of carry trades, the exchange-rate movements described above reflect the potential impact of carry trades on the foreign-exchange markets.
- The popularity of using US dollars to fund carry trades reflects investors' expectation that the US dollar will continue to be weak and the interest rates will remain low. But as I said in my briefing in November, the weakness of the US dollar should not be taken for granted.

Will more government debts necessarily lead to weakening of its currency?

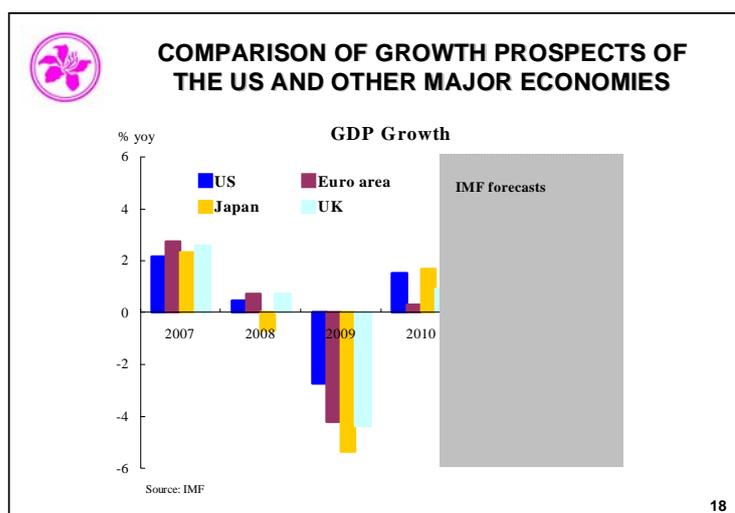
- Why is it that so many investors expect the US dollar to remain weak? I will briefly analyse the major factors contributing to the weakening of the US dollar and explain why the dollar may not necessarily remain weak despite these factors.
- One factor is the market expectation of an increase in US government debt.



- But let's not forget that exchange rates are relative.
- With the introduction of fiscal stimulus packages to support the economy and large-scale bailout plans to save the banks and financial systems, the debt situations of many governments have worsened. The current and expected situation of the US government is no worse than that of other countries, particularly Japan.
- The IMF expects that general government debt in the US would be 108% of its GDP in 2014, which is much lower than Japan's current level of around 200%, and comparable to the level of Euro-4 (99%) and the UK (98%).

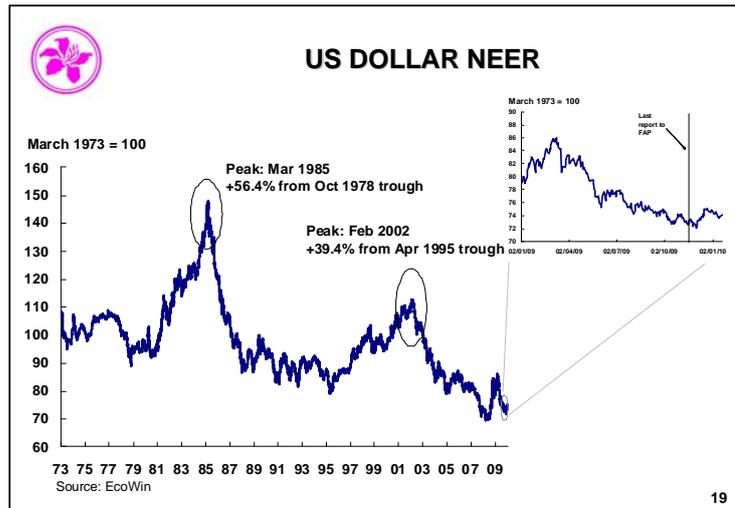
Comparison of outlook for the US and other major economies

- Investors' bearish sentiment towards the outlook for the US economy is another reason for the continued weakening of the US dollar.
- However, as shown by the chart, the outlook for the US economy is no worse than that for other major economies because the effects of this global financial crisis are widespread and many major economies will need time to recover.



US-dollar Nominal Effective Exchange Rate

- Investors should not take a one-sided bet against the US dollar, since the movements of the exchange rate can be very volatile in the short run.
- The US-dollar exchange rate has gone through many ups and downs since my last briefing. The chart shows that the US-dollar exchange rate rebounded slightly recently. It shows that exchange rates are affected by many factors and can go either way; and market expectation of its movements may also change easily.



- When US-dollar interest rates rise or if the market expects the US dollar to strengthen, US dollar-funded carry trades will be unwound. May I alert the public again to the risk of a reversal in capital flows, which could lead to volatilities in Hong Kong dollar interest rates and have a large impact on the economy and asset prices.

Investment income

- Most of the asset classes of the Exchange Fund recorded investment gains for 2009. Investment income of the Exchange Fund for the year (excluding valuation changes in the Strategic Portfolio) amounted to HK\$106.7 billion.
- Gains on equities made the largest contribution to investment income. As investors became more optimistic about the outlook for the economic recovery and invested more aggressively, major equity markets rebounded strongly since March.
- Exchange gains were mainly resulted from the weakening of the US dollar against other major foreign currencies since April.
- Bond yields, especially long-term yields, rose in the first half of 2009 amid market concern about inflation and substantial increases in the supply of US government bonds. But the negative impact of the increases in interest rates on bond prices was largely offset by the Exchange Fund's interest income from bonds for 2009.
- The HKMA will continue to be vigilant in the uncertain investment environment and manage the Exchange Fund prudently under the guidance of the Exchange Fund Advisory Committee and its Investment Sub-Committee

(HK\$ billion)	Full year *	2009				2008	2007	2006
		Q4	Q3	Q2	Q1	Full year	Full year	Full year
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

Investment income, payment to the fiscal reserves and changes in the Accumulated Surplus

- The fixed rate for calculating the payment to the Treasury for 2009 is 6.8%. Based on this fixed rate, the Exchange Fund paid HK\$33.5 billion to the Fiscal Reserves for 2009.
- Taking into account other incomes and expenses and valuation gains in the Strategic Portfolio, the Accumulated Surplus increased by HK\$72.8 billion in 2009.

(HK\$ billion)	Full year (unaudited)	2009				2008
		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	(3.8)	(1.0)	(0.9)	(1.2)	(0.7)	(6.5)
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 [^]	4.3	(0.1)	1.3	3.2	(0.1)	(8.9)
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

Banking supervision and deposit protection

- The HKMA is implementing a number of measures put forward by the Basel Committee, including:

- working towards issuing the finalised version of the “Guideline on A Sound Remuneration System” in the first quarter of 2010 following the completion of a consultation.



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**

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- reviewing the consultation paper on the enhancement of global capital and liquidity standards and assessing the impact of the proposals on Hong Kong’s banking system.
- formulating proposals to enhance the liquidity regulatory framework, taking into account requirements set out in the Principles for Sound Liquidity Risk Management and Supervision and local circumstances.
- revising the supervisory guideline on “Use of Fair Value Option for Financial Instruments” to help banks adopting more prudent and robust valuation methods and control practices in their holdings of financial instruments.
- **Banking (Capital) Rules:** The Basel Committee enhanced the Basel II framework in July last year to raise the capital requirements on trading book and securitisation activities. The HKMA has consulted the industry on the proposals of implementing these enhancements and introduced a number of other refinements to the capital framework taking into account the experience gained from implementing the capital rules. Preparation for legislative amendments is underway.

- The Deposit Protection Board has reviewed the Deposit Protection Scheme and consulted the public on the results of the review; and finalised the proposals of revising the Scheme. It aims to submit legislative proposals to LegCo in Q2 2010 to raise the coverage to HK\$500,000 and introduce other changes, and complete the legislative process as soon as possible so as to effect the enhancements before the full deposit guarantee expires at the end of 2010.
- The Board is preparing for the implementation of the enhancements, including organising briefings for banks and public education and promotion activities.
- Discussions among the HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore under the tripartite working group on co-ordinating the exit from full deposit guarantees in the respective jurisdictions are underway.

Lehman-related issues

Investigation progress:

- The Lehman Brothers Minibond Repurchase Scheme enables a vast majority of minibond customers to recover at least 60% or 70% of the principal. Around 25,000 investors are eligible for the Scheme. At the end of 2009, more than 24,400 eligible customers (about 98%) have accepted the repurchase offers.



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**

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- In mid-January 2010, around 13,000 Lehman Brothers minibond complaints have been resolved under the Repurchase Scheme and around 600 Lehman Brothers-related complaints resolved through the banks' enhanced complaint handling procedures. Together with around 1,000 Lehman Brothers-related complaints that are under the disciplinary process and around 2,700 Lehman Brothers-related complaints being closed because of insufficient prima facie evidence or disciplinary grounds, around 80% of all Lehman Brothers-related complaints have been handled or resolved. The HKMA aims to substantially complete the investigation of the remaining cases by the end of March 2010.

Investor protection:

- In response to the SFC's consultation on its proposals to enhance protection for the investing public, the Hong Kong Association of Banks supported the SFC's overall objective of further enhancing investor protection, but indicated that a balance should be reached in protecting the investors and the need to maintain an efficient distribution system for investment products. The HKMA is reviewing the banking industry's comments.
- An independent consultant jointly commissioned by the HKMA and the SFC completed its report on the implementation of the mystery shopping programme in December 2009. The programme will be implemented this year.
- The HKMA is assisting the Government in preparing for the launch of consultations on proposals to enhance investor education and establish a financial dispute resolution system.

Renminbi business in Hong Kong

- Renminbi trade settlement business on a steady rise:
 - The number of authorized institutions engaging in renminbi trade settlement business increased to 52 in the fourth quarter of 2009 from 32 in the previous quarter.
 - The number of overseas banks that have signed the clearing agreement with the Hong Kong Clearing Bank increased from two in the third quarter of 2009 to 15 at the end of the year. These banks can use Hong Kong's clearing platform to process trade settlements in renminbi.
 - The amount of renminbi trade settlement increased in November and December 2009 following the publication of the Mainland pilot enterprise list and the requirements on export tax rebate in August.
 - Preliminary statistics indicated that the volume of renminbi trade settlement in November and December 2009 reached RMB 378 million and RMB 1.36 billion respectively, much higher than the cumulative amount of RMB 115 million in the first four months of the scheme.
- The HKMA has been actively promoting the further development of renminbi business in Hong Kong. After my briefing to LegCo in November last year, I led an HKAB delegation to visit Shanghai and Beijing at the end of the month. We discussed a number of issues with Mainland officials and departments, including the development of renminbi business in Hong Kong. The HKMA and the PBoC are analysing some of the ideas put forward during these discussions.
- In December 2009, the Chief Executive of the HKSAR relayed a message from Premier Wen Jia-bao about the various areas in which the Mainland would support the development of renminbi business in Hong Kong. The HKMA will follow up with the Mainland authorities.



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

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