



HONG KONG MONETARY AUTHORITY

• CB(1)159/12-13(01)

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

19 November 2012



DISCUSSION TOPICS

Updates on

- Financial and Economic Environment
- Currency Stability
- Banking Stability
- Financial Infrastructure
- Hong Kong as an International Financial Centre
- Investment Environment and Performance of The Exchange Fund
- Hong Kong Mortgage Corporation



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

(% year-on-year)

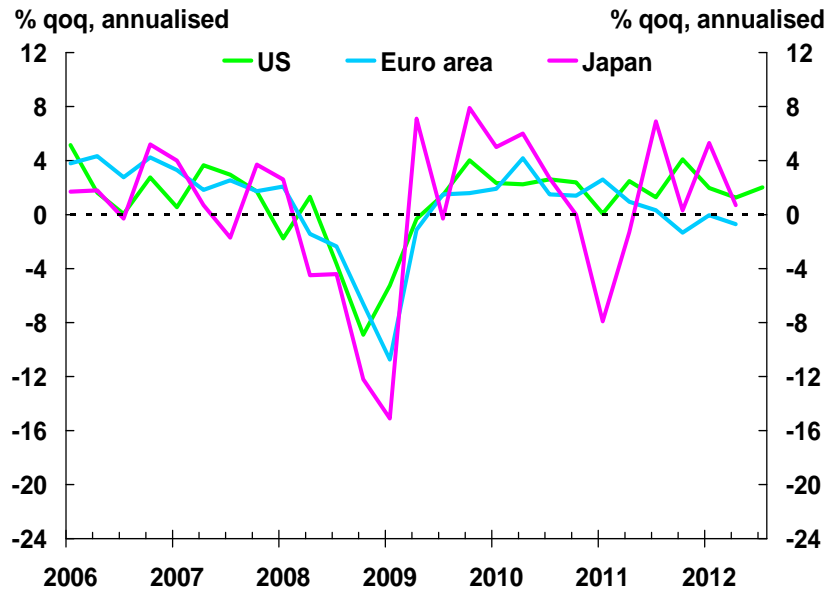
Real GDP Growth

	2011	2012 Forecasts			2013 Forecasts
		Mar 2012 FAP briefing	May 2012 FAP briefing	Nov 2012 FAP briefing	
US	1.8	2.2	2.3	2.1	2.0
Euro area	1.4	-0.3	-0.4	-0.5	0.2
Japan	-0.8	1.8	2.0	2.3	1.3
Asia (ex-Japan)	7.2	6.7	6.7	6.1	6.6
Mainland China	9.3	8.4	8.4	7.7	8.1
Hong Kong	4.9	3.0	3.0	1.6	3.6

Source: Consensus Forecasts



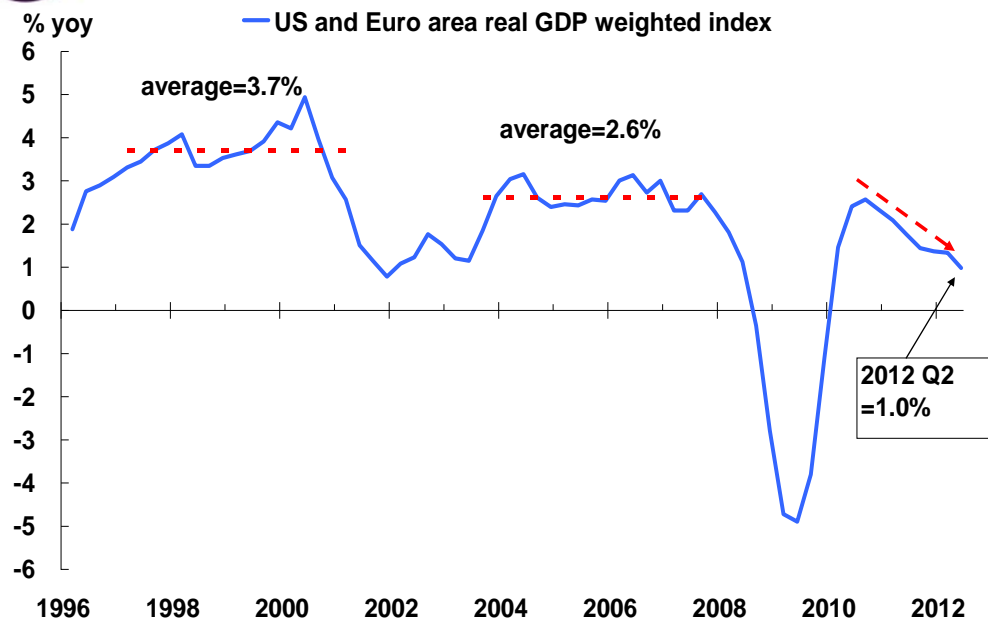
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



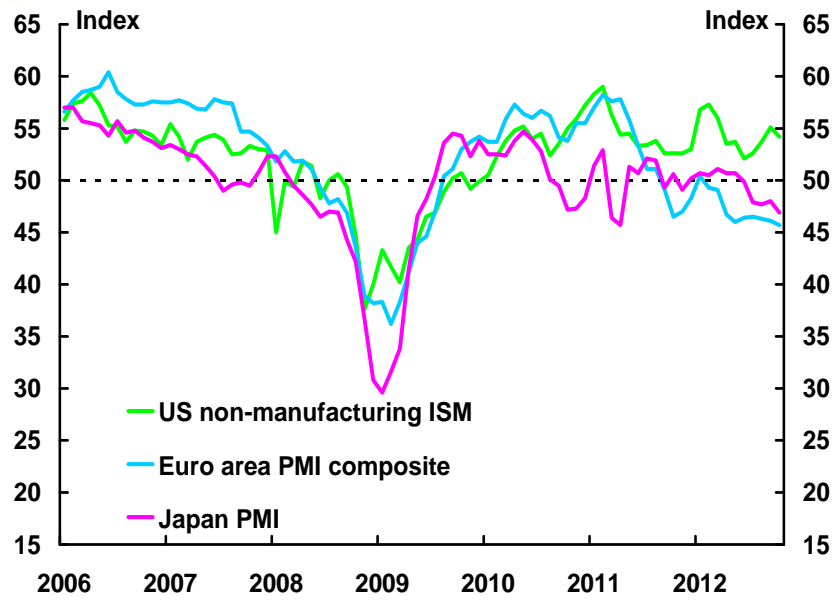
US AND EURO AREA REAL GDP GROWTH



Sources: CEIC and HKMA staff calculations



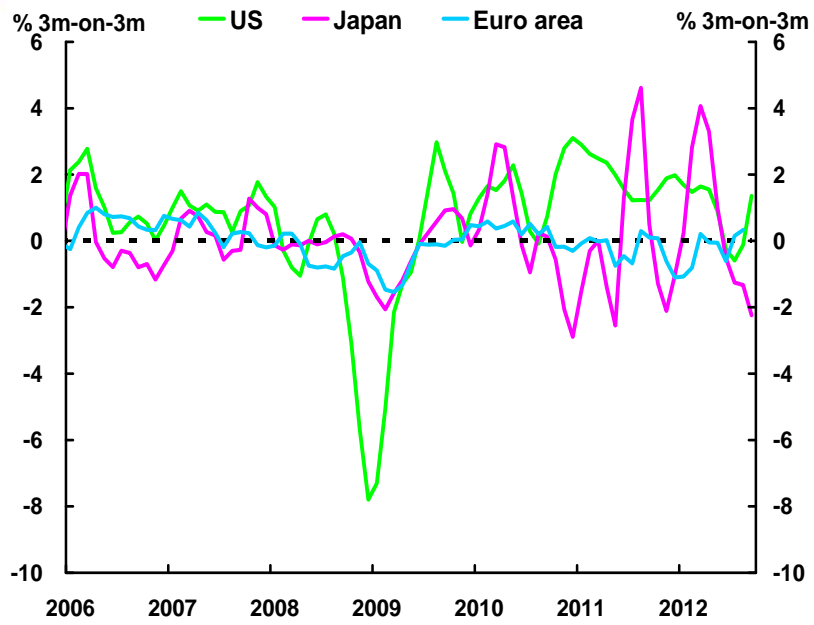
PURCHASING MANAGERS' INDEX IN MAJOR COUNTRIES



Source: Bloomberg



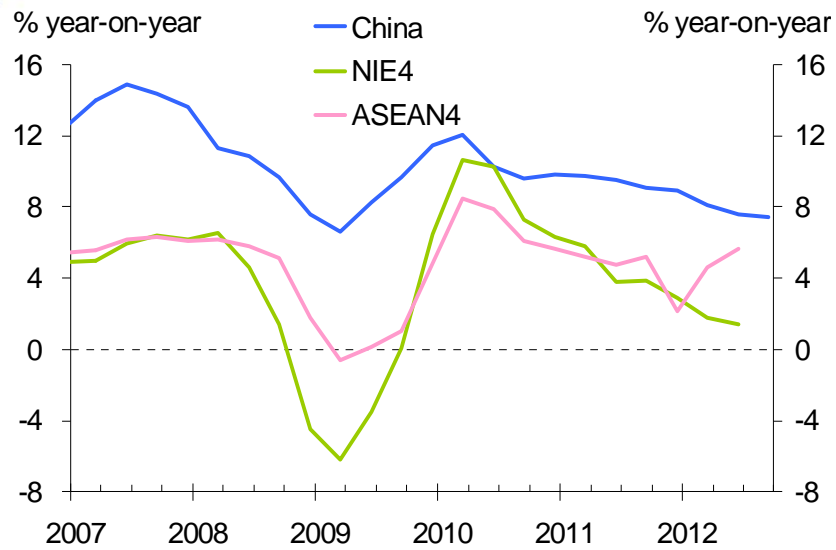
RETAIL SALES IN MAJOR COUNTRIES



Source: CEIC



ASIA: REAL GDP GROWTH



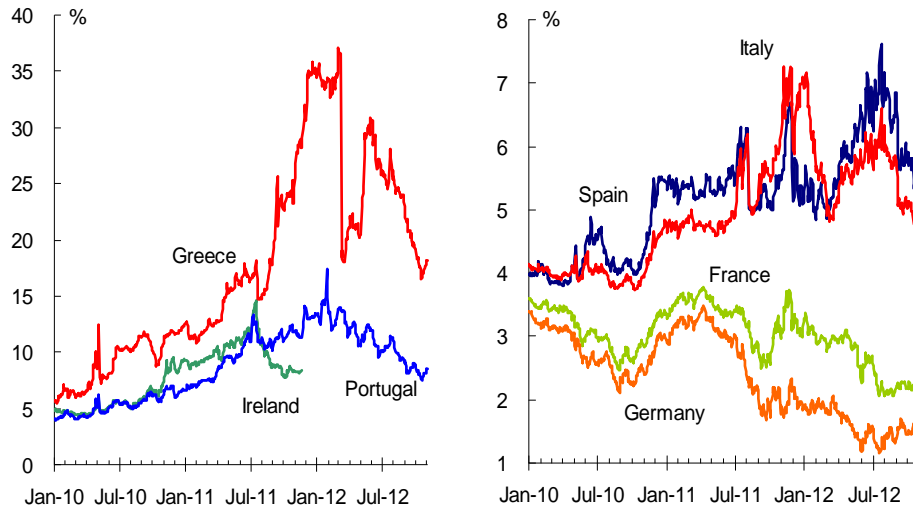
Note: NIE4 includes Hong Kong, Singapore, South Korea and Taiwan; ASEAN4 includes Indonesia, Malaysia, the Philippines and Thailand

Sources: CEIC, IMF and HKMA staff estimates



EUROPE: SOVEREIGN BOND YIELDS

10-year sovereign bond yield

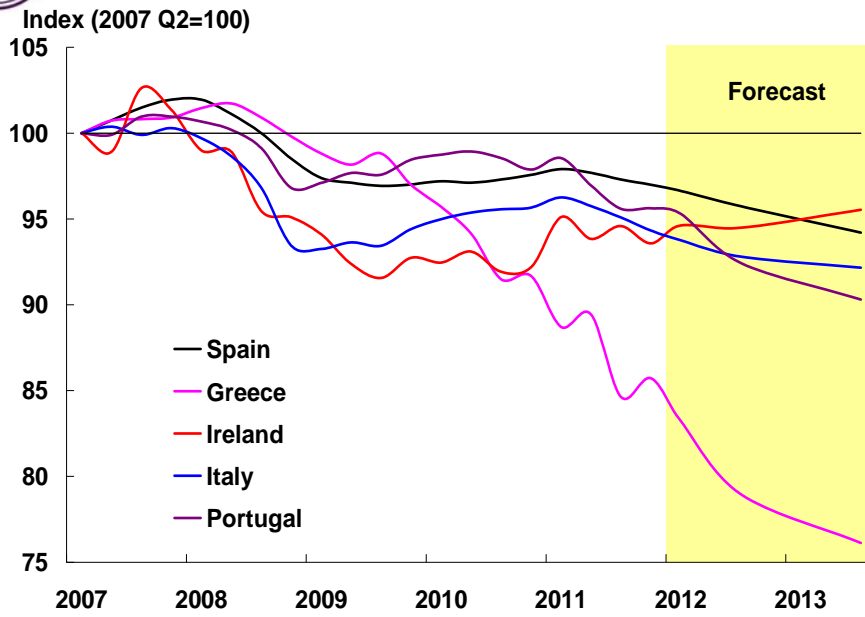


Sources: Bloomberg and Ecwin

Note: Ecwin has stopped publishing Ireland's 10-year bond yield since 22 Nov, 2011



EUROPE: REAL GDP IN PERIPHERAL COUNTRIES

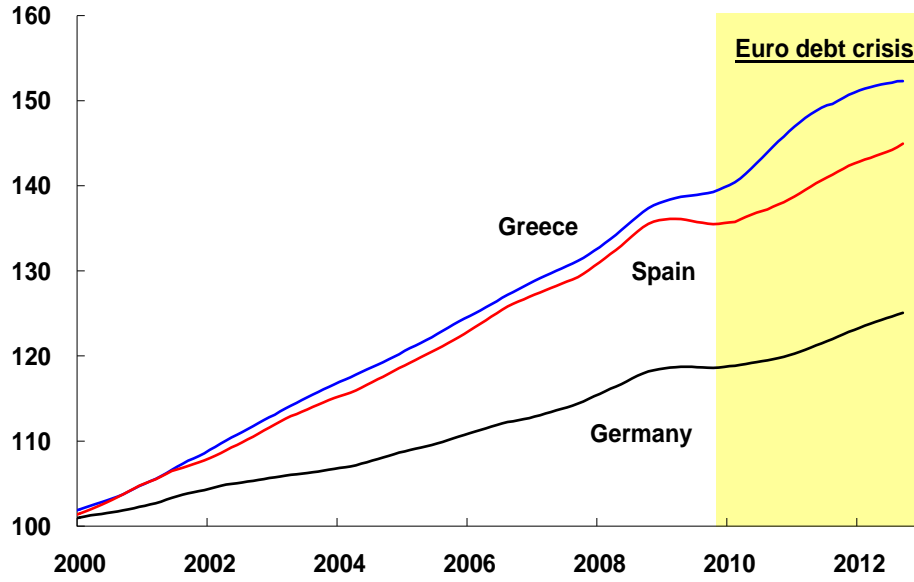


Sources: Data Stream, Consensus Forecasts and HKMA staff calculations



EUROPE: CONSUMER PRICE INDEX

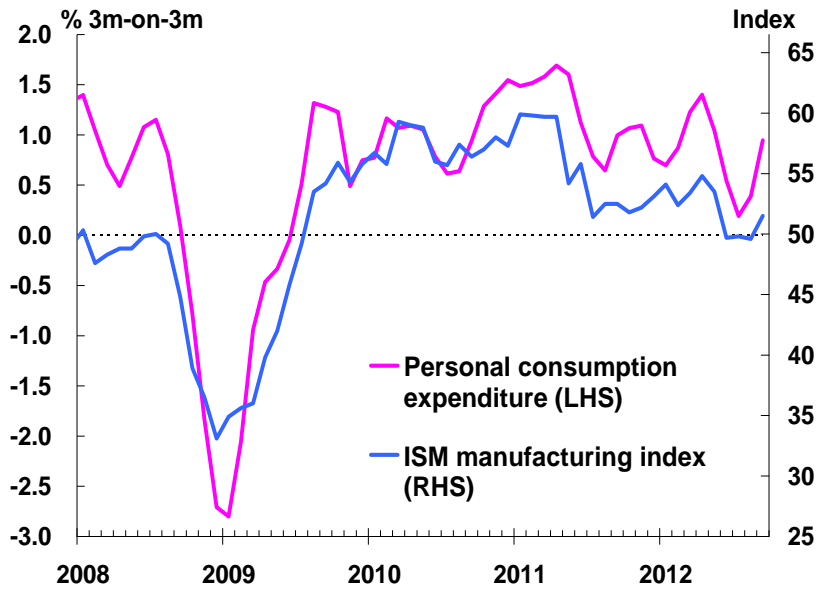
(Index, Jan 1999=100, 12MMVA)



Sources: Data Stream, Consensus Forecasts and HKMA staff calculations



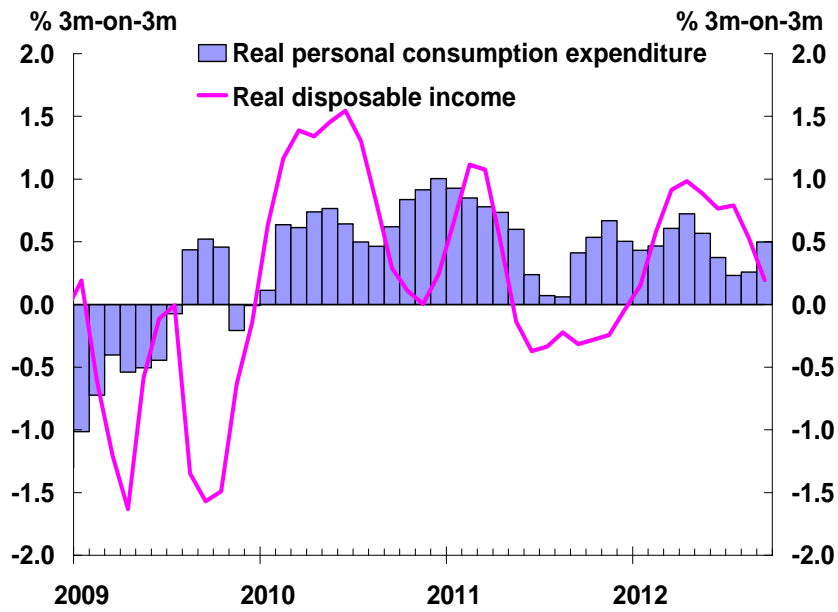
US: CONSUMPTION GROWTH & BUSINESS ACTIVITY



Source: CEIC



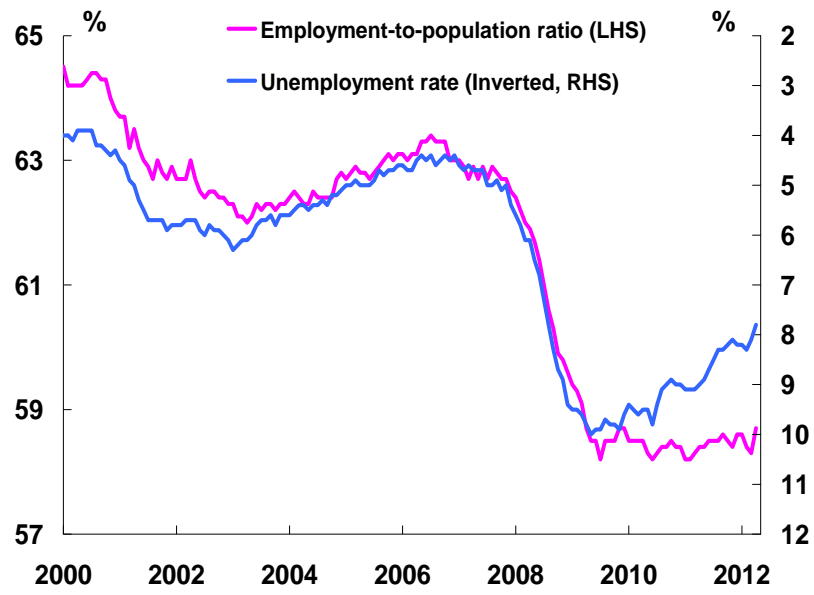
US: CONSUMPTION AND INCOME GROWTH



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



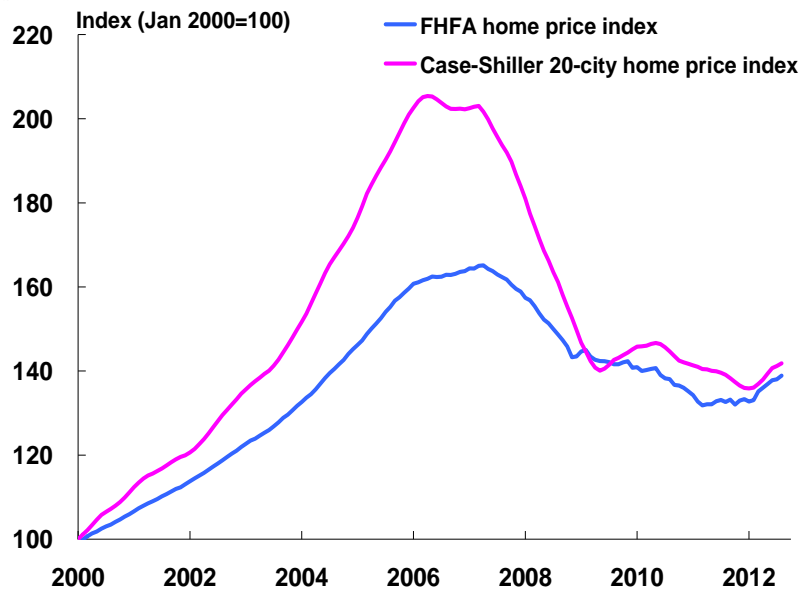
US: LABOUR FORCE PARTICIPATION



Source: CEIC



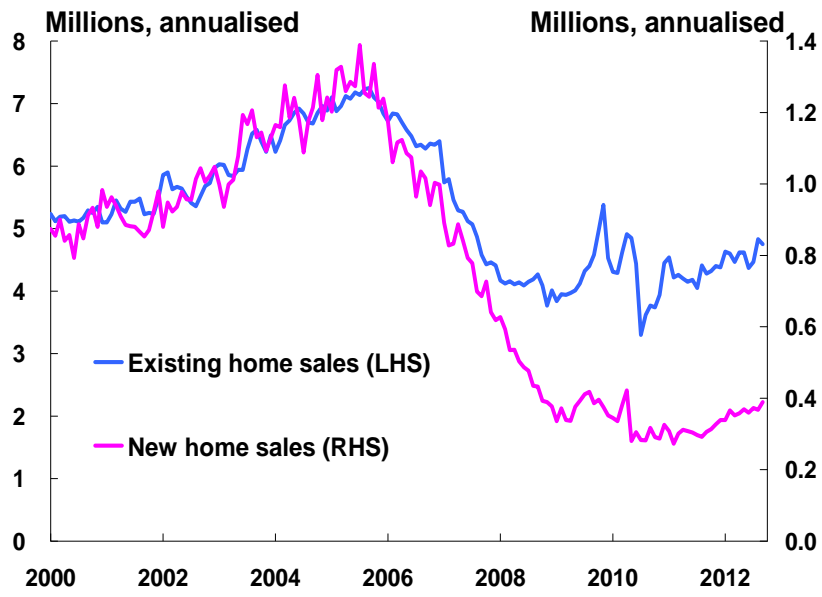
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



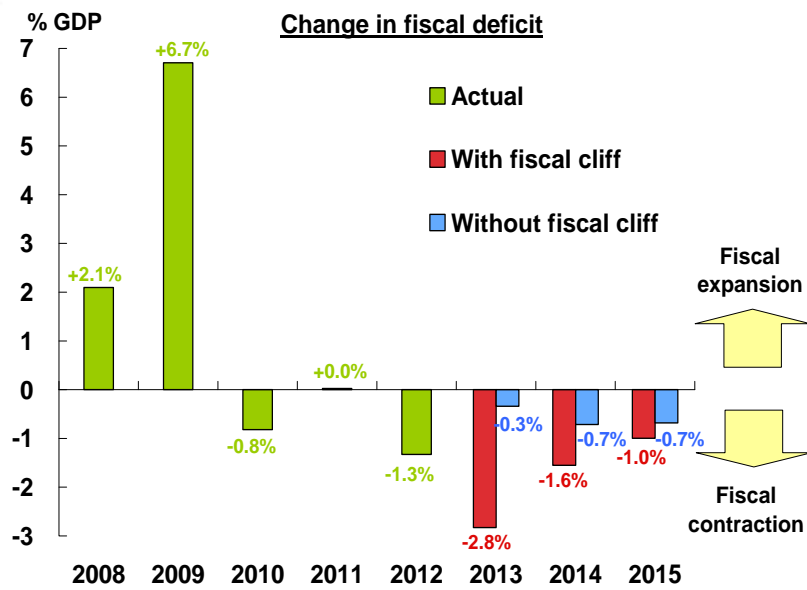
US: HOME SALES



Source: CEIC



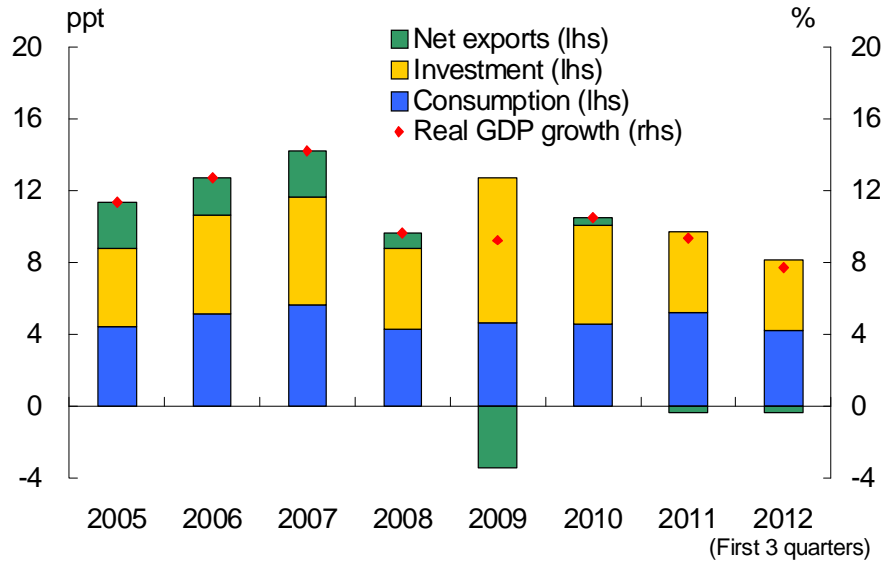
US: FISCAL CONSOLIDATION



Sources: CBO and HKMA staff calculations



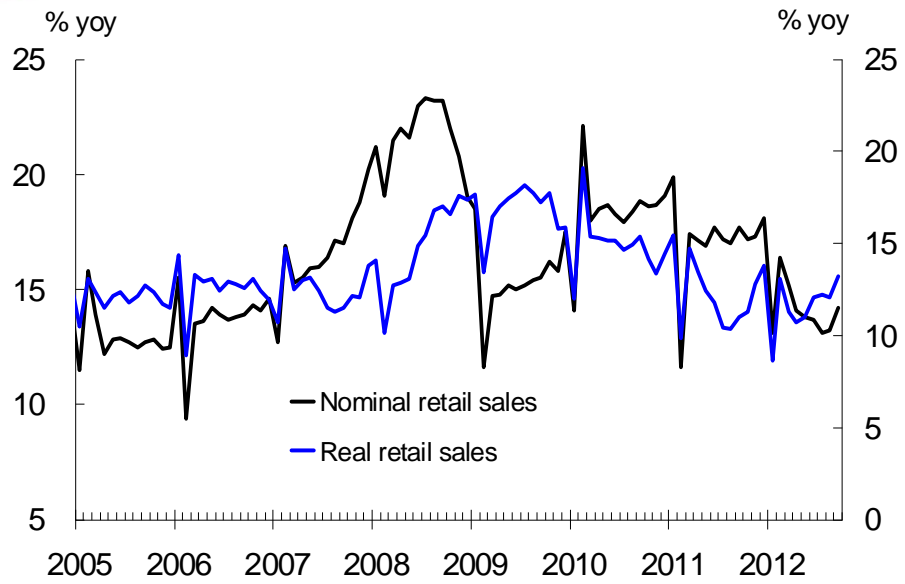
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



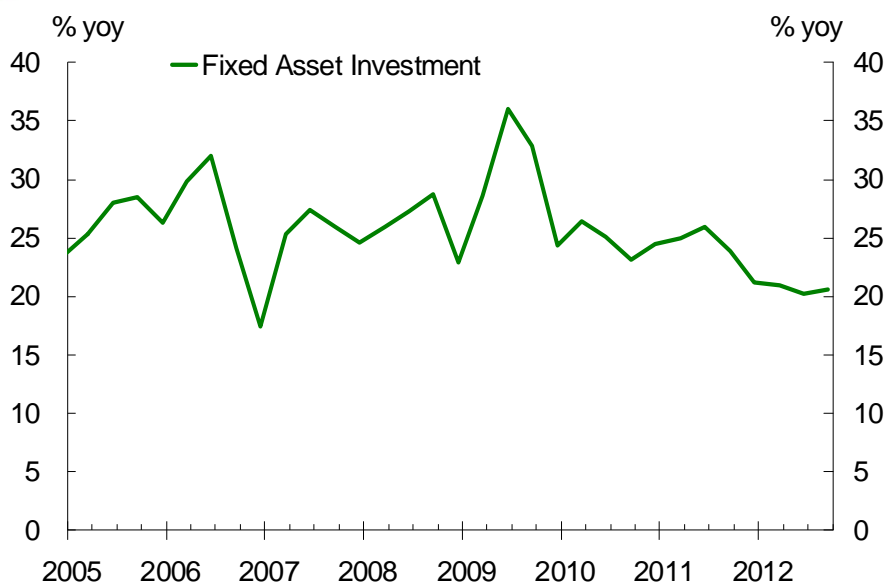
MAINLAND CHINA: RETAIL SALES



Sources: CEIC, WIND and HKMA staff estimates



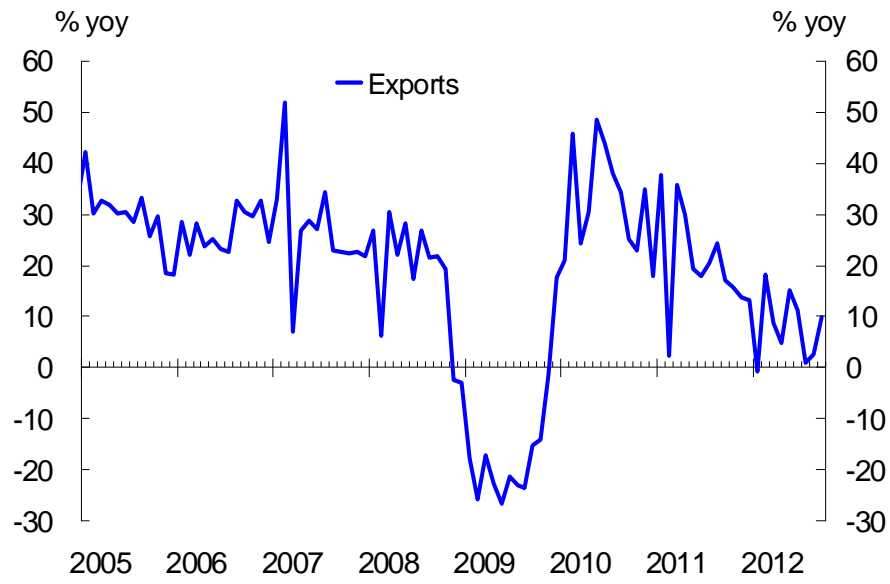
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



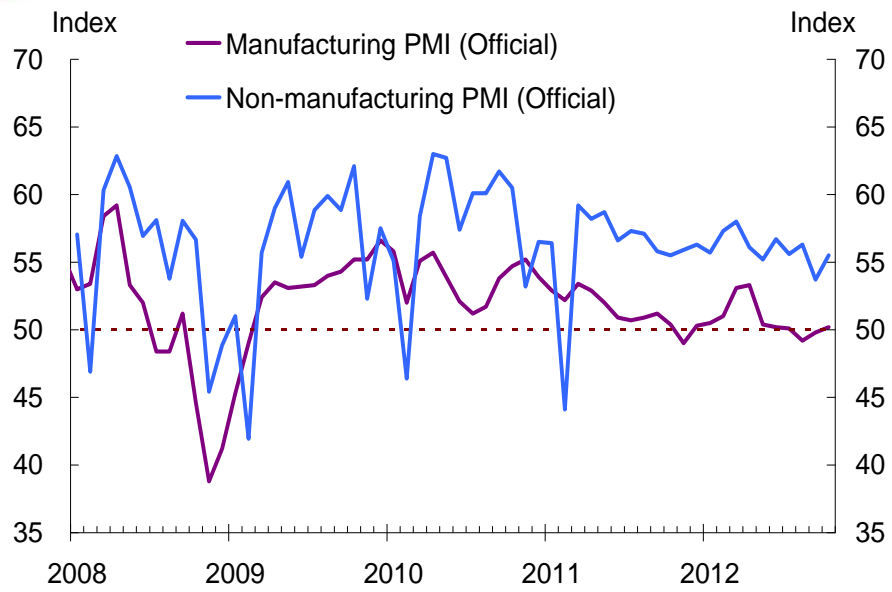
MAINLAND CHINA: EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



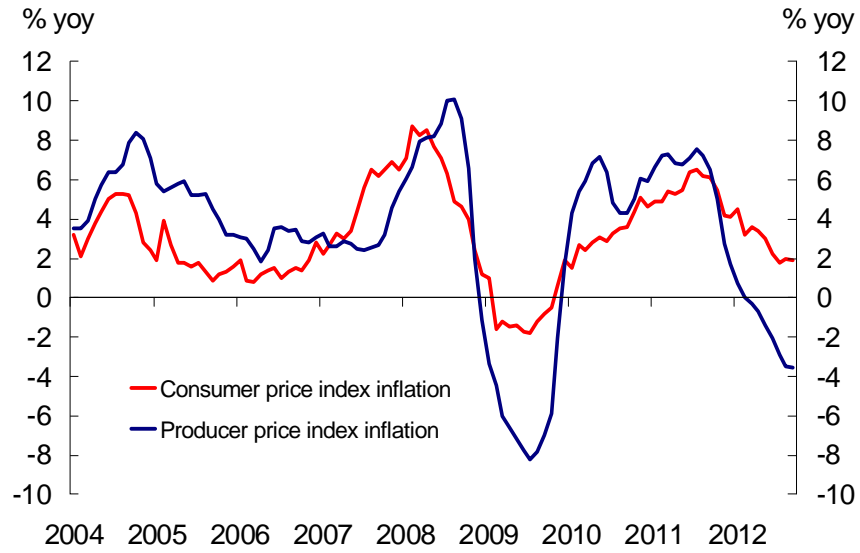
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



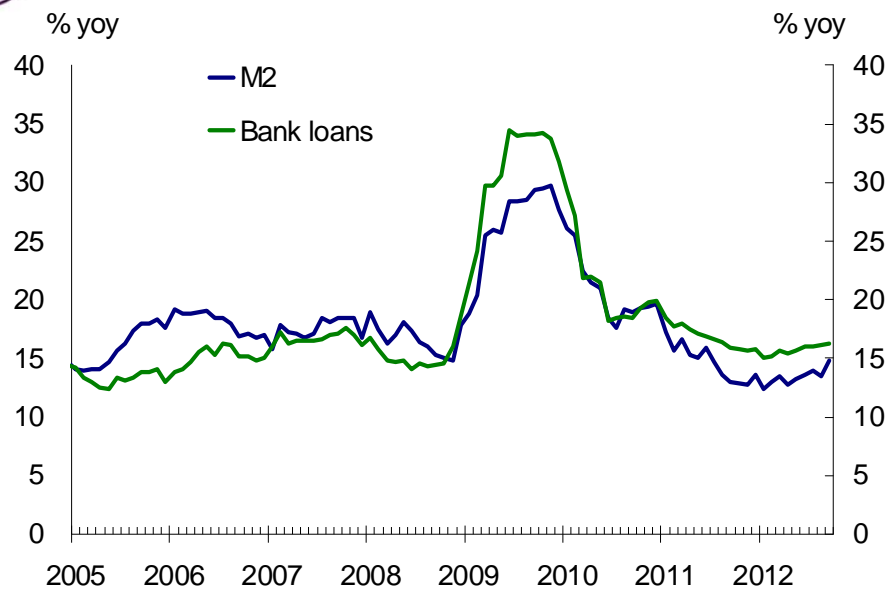
MAINLAND CHINA: INFLATION



Source: CEIC



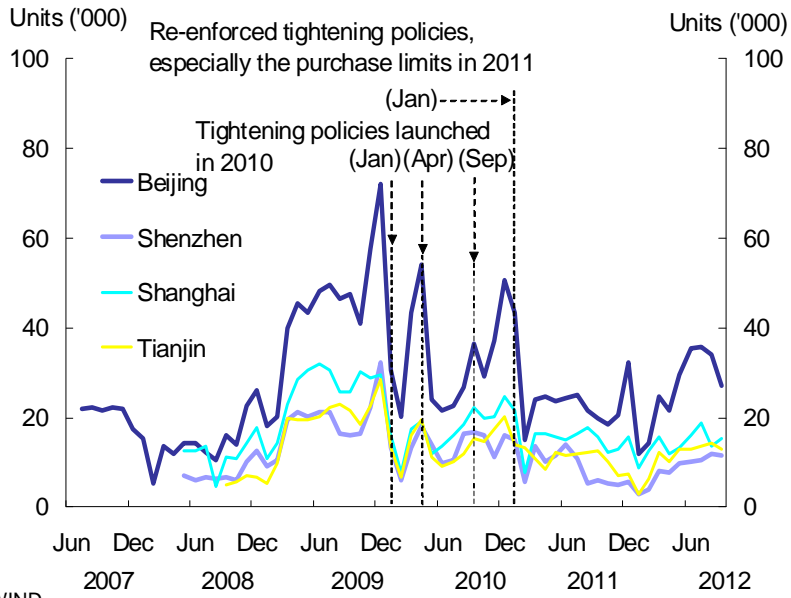
MAINLAND CHINA: MONEY AND LOAN GROWTH



Sources: CEIC and HKMA staff estimates



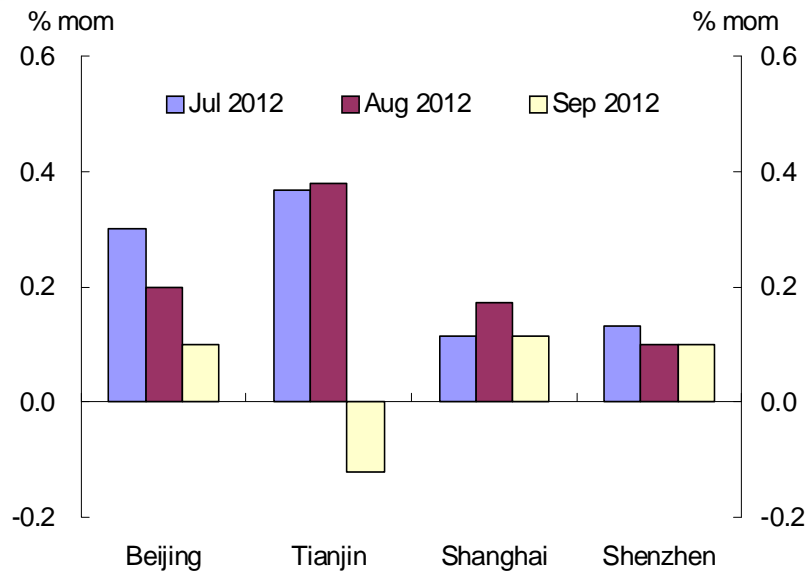
MAINLAND CHINA: PROPERTY TRANSACTION VOLUME IN MAJOR CITIES



Source: WIND



MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES

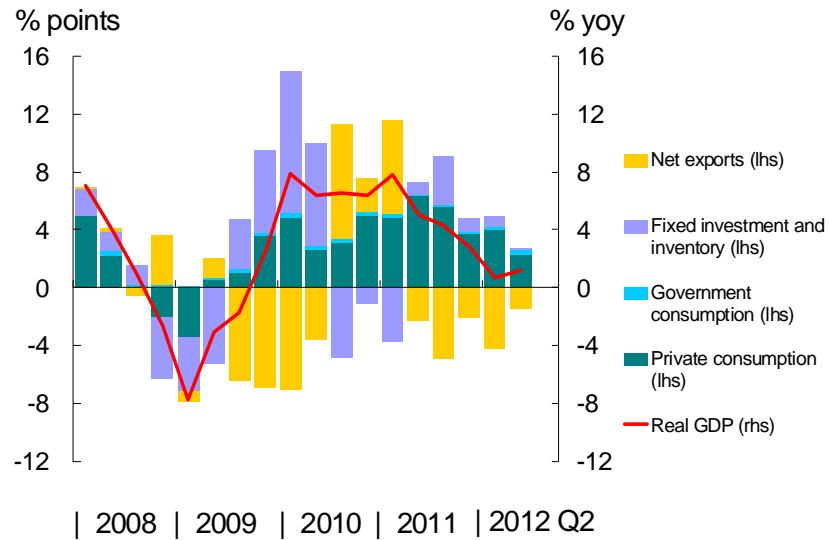


Sources: CEIC, WIND and HKMA staff estimates



HONG KONG: REAL GDP GROWTH

Changes in Real GDP and contributions by major components

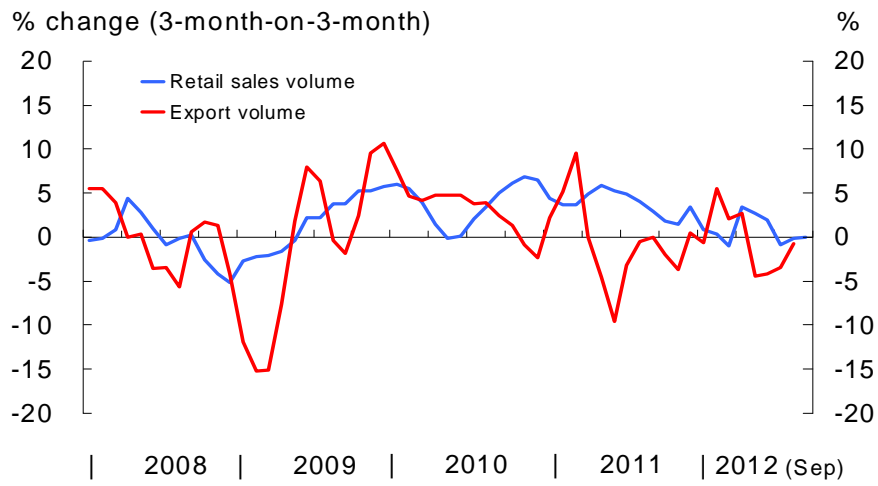


Sources: C&SD and HKMA staff estimates



HONG KONG: ECONOMIC ACTIVITY

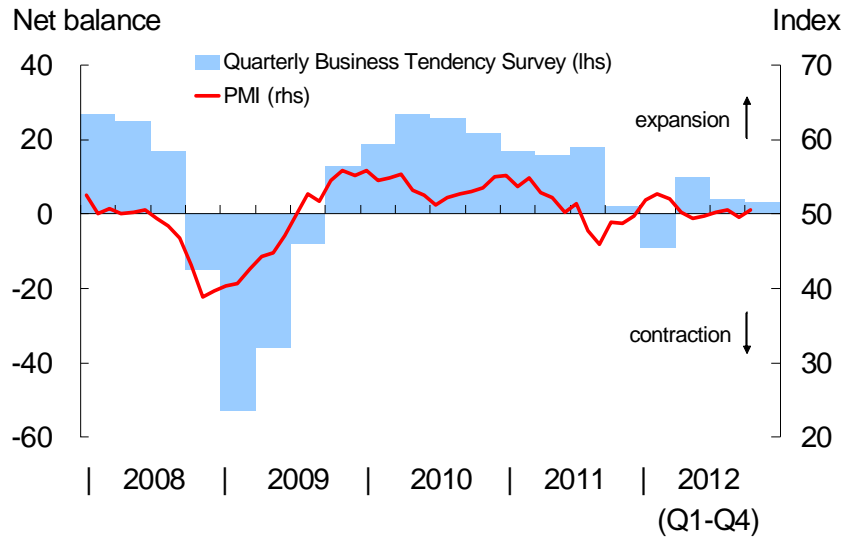
Retail Sales and Exports



Source: C&SD



HONG KONG: BUSINESS OUTLOOK

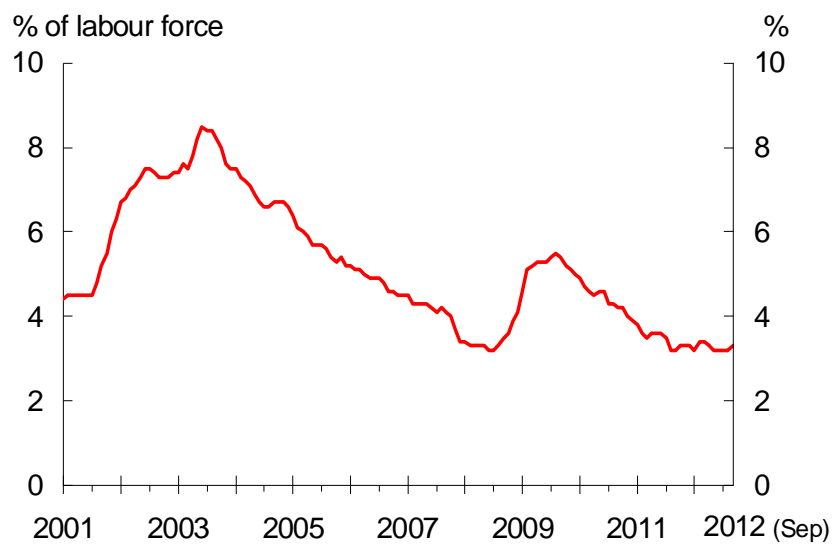


Sources: C&SD and Markit Economics



HONG KONG: LABOUR MARKET

Unemployment rate

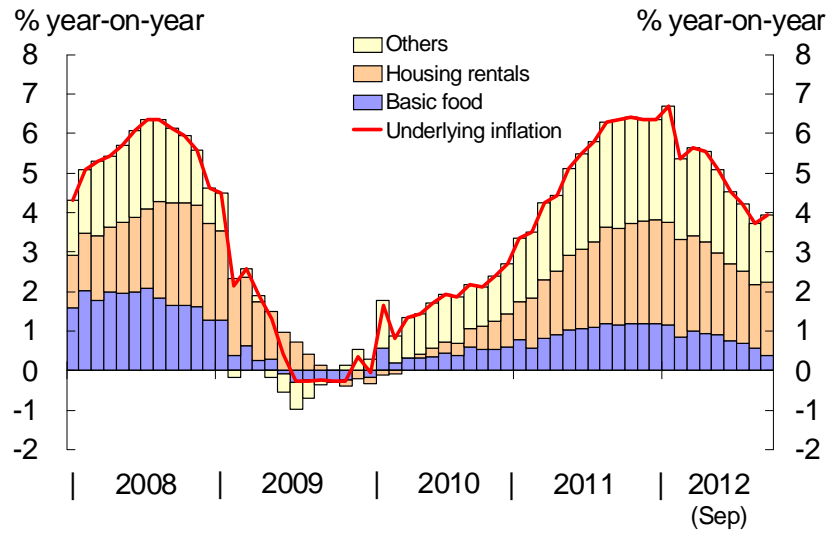


Source: C&SD



HONG KONG: INFLATION

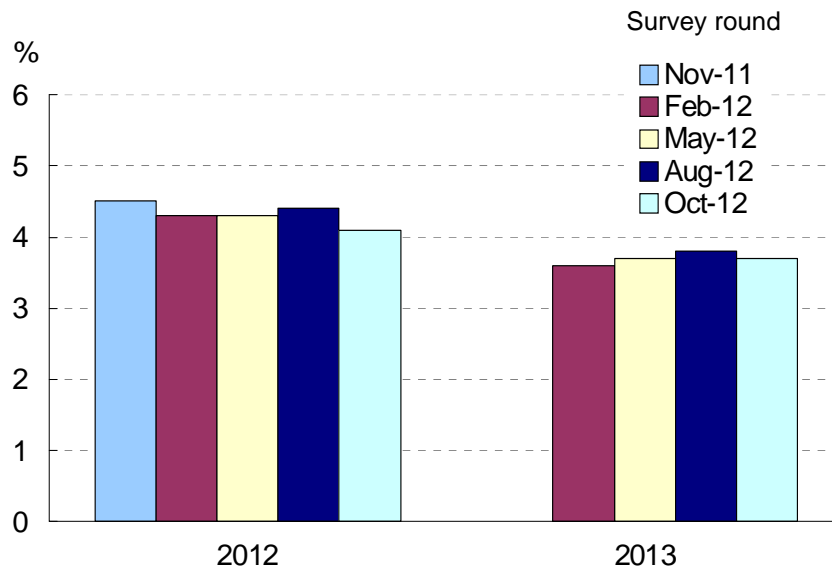
Underlying inflation and contributions of its components



Underlying inflation: Netting out the effects of all Government's one-off relief measures from headline inflation
Sources: C&SD and HKMA staff estimates



HONG KONG: INFLATION FORECASTS

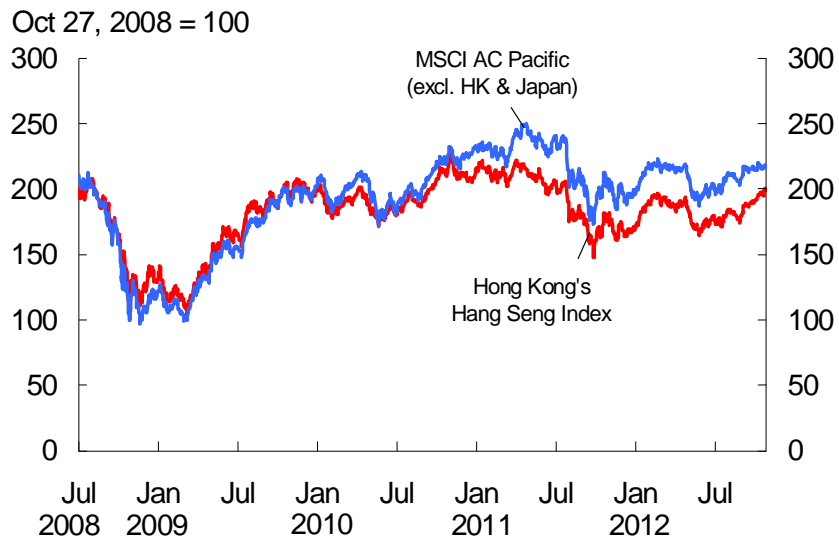


Source: Consensus Forecasts (Nov 2011, Feb, May, Aug and Oct 2012)



HONG KONG: EQUITY MARKET

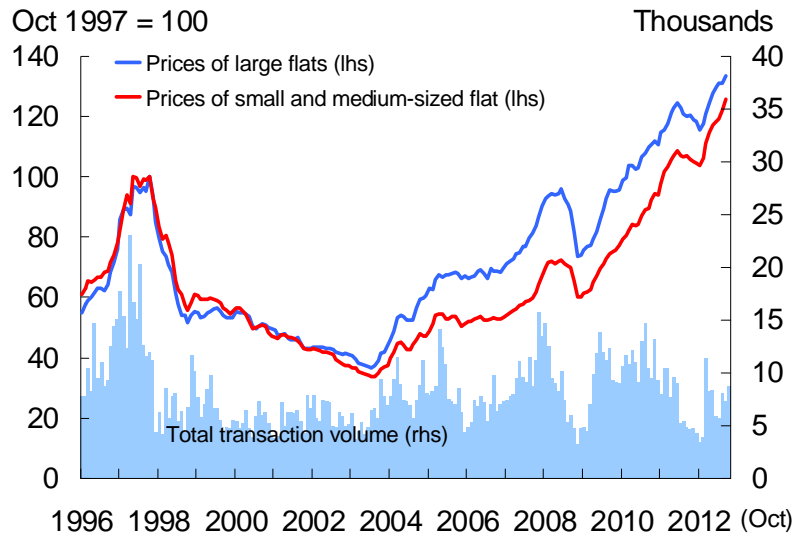
Hong Kong and Asia Pacific equity market performance



Source: Bloomberg



HONG KONG: RESIDENTIAL PROPERTY PRICES AND TRANSACTION VOLUME

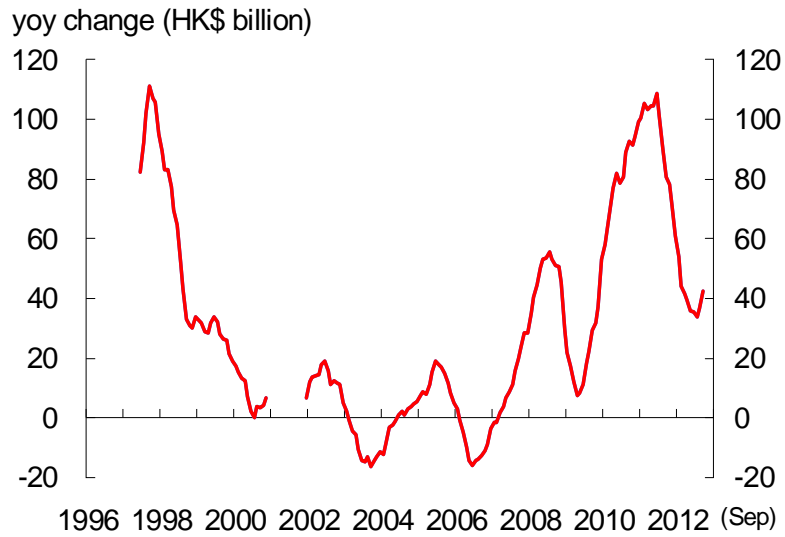


Source: Rating and Valuation Department



HONG KONG: OUTSTANDING MORTGAGE LOANS

Changes in outstanding mortgage loans

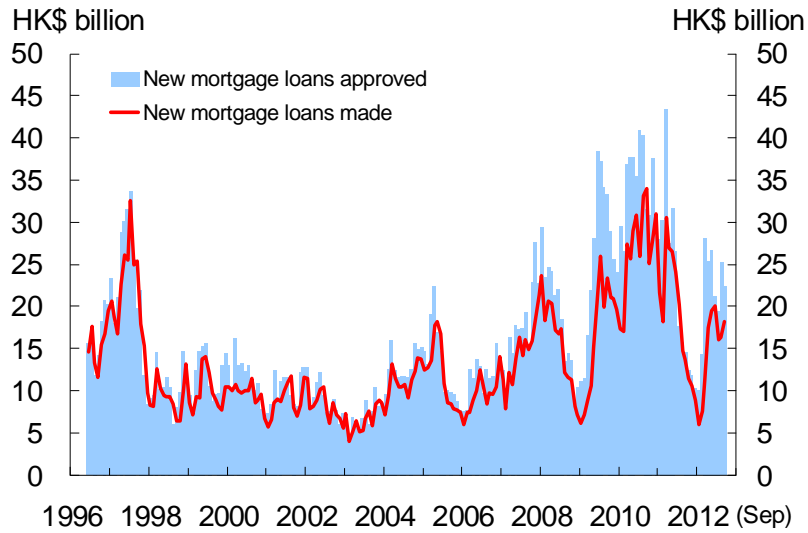


* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



HONG KONG: NEW MORTGAGE LOANS

New mortgage loans made and approved



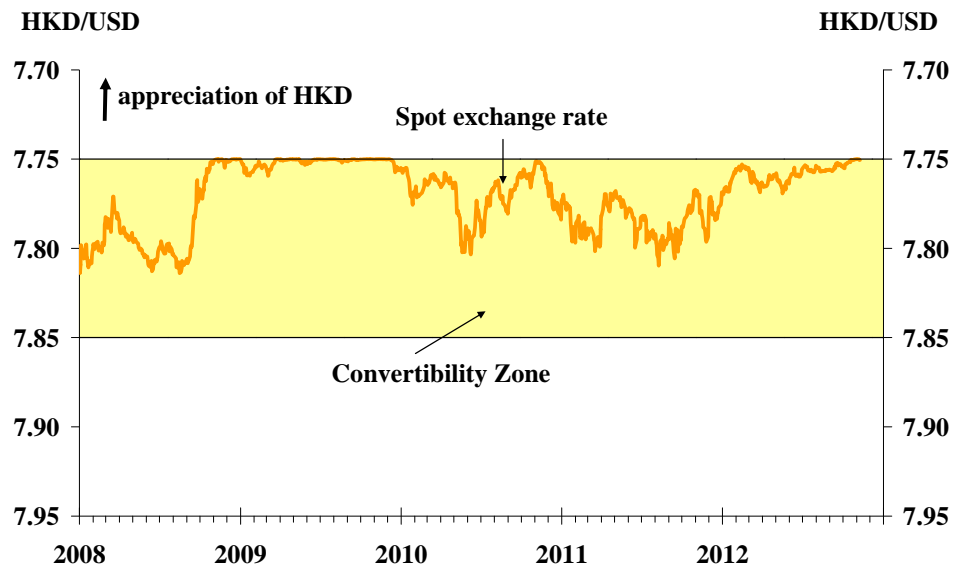
* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



CURRENCY STABILITY

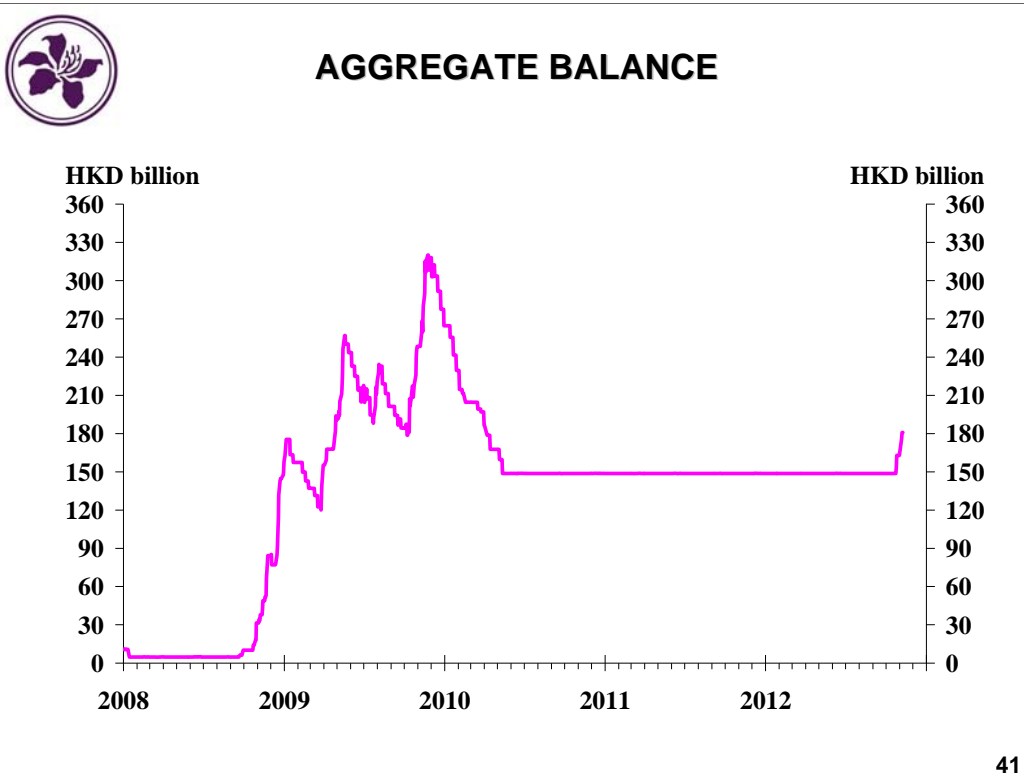


HONG KONG DOLLAR SPOT EXCHANGE RATE



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- The Hong Kong dollar spot exchange rate has traded with a firm bias since June, alongside higher regional currencies and equities, as risk appetite improved on a less strained European market, the launch of QE3 by the US Fed, and signs of a bottoming out of Mainland China's economic growth.
- It strengthened to 7.75 a number of times since late October, triggering the strong-side Convertibility Undertaking and prompting the HKMA to purchase US dollars for HK dollars to maintain exchange rate stability. The last time the Strong-side CU was triggered was in December 2009.



- Liquidity remained abundant in the interbank market.
- With the triggerings of the strong-side CU since late October, the HKMA injected a total of HK\$32.2 billion into the banking system. The Aggregate Balance, having been steady for about 2.5 years, rose to HK\$180.9 billion on November 6.

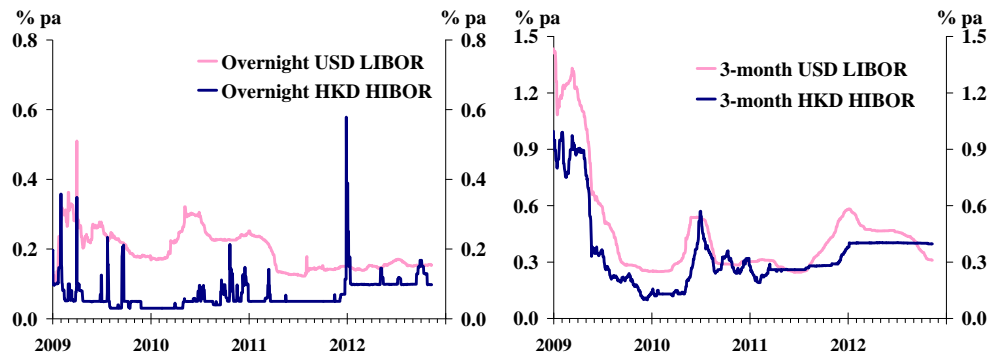


CAPITAL INFLOWS AND ASSOCIATE RISKS

- Under the currency board system, the HKMA undertakes to purchase USD and sell HKD at 7.75. So, when the strong-side Convertibility Undertaking is triggered, the HKMA will passively purchase USD and sell HKD. There is no limit on the size of such operations
- The latest net inflows were likely driven by an improvement in market sentiment in light of better-than-expected economic readings of Mainland China and the launch of QE3 by the US Fed
- It is difficult to predict the future direction of fund flows. Any sudden shift in market sentiment amid lingering uncertainties on the eurozone sovereign debt problem and US fiscal cliff may trigger a reversal of fund flows, leading to greater volatility in the exchange rate and interest rates
- Public should be aware of such risks and avoid over-sketching themselves financially



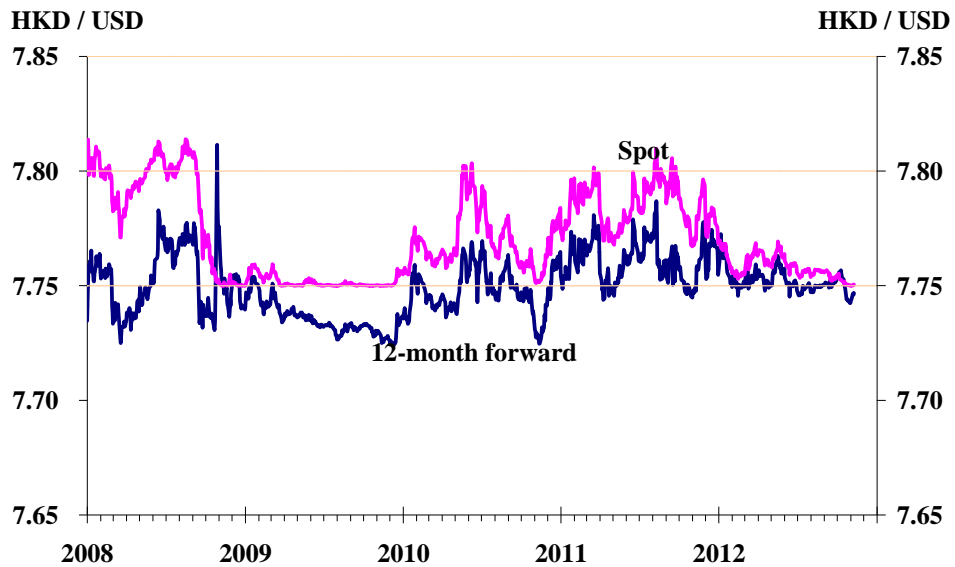
DOMESTIC INTEREST RATES



- Short-term Hong Kong dollar interest rates have remained largely stable while US dollar interest rates have declined. The spread between 3-month HIBOR and LIBOR has turned into positive territory since mid-September.



HONG KONG DOLLAR FORWARD EXCHANGE RATE



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- In line with the narrowing of interest rates between Hong Kong dollar and US dollar, the 12-month Hong Kong dollar forward discounts nearly dissipated.

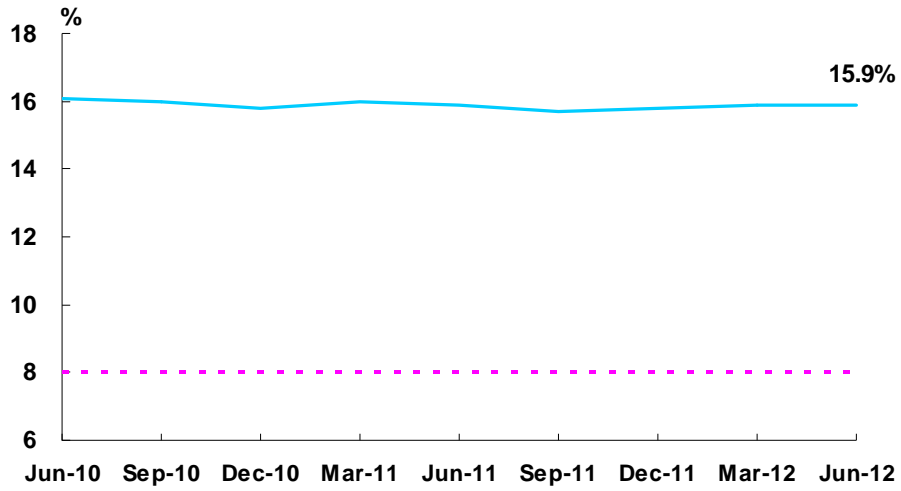


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



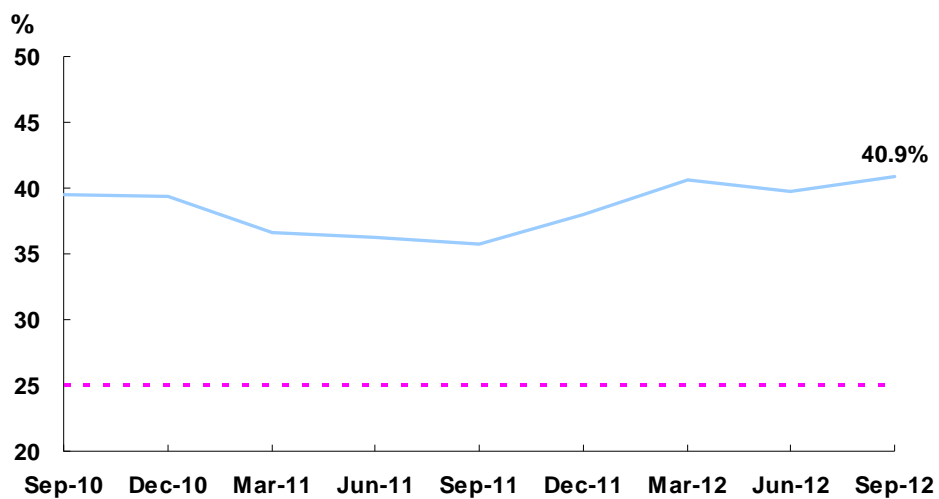
46

- The consolidated capital adequacy ratio of locally incorporated AIs remained unchanged at 15.9% at end-June 2012, and was well above the international standard of 8%.



BANKING SECTOR PERFORMANCE

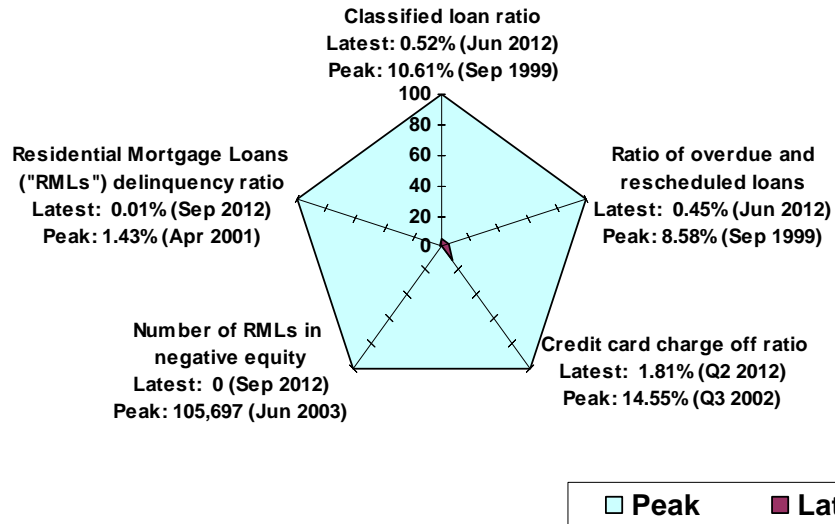
Liquidity ratio of retail banks remained well above statutory minimum of 25%





BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards

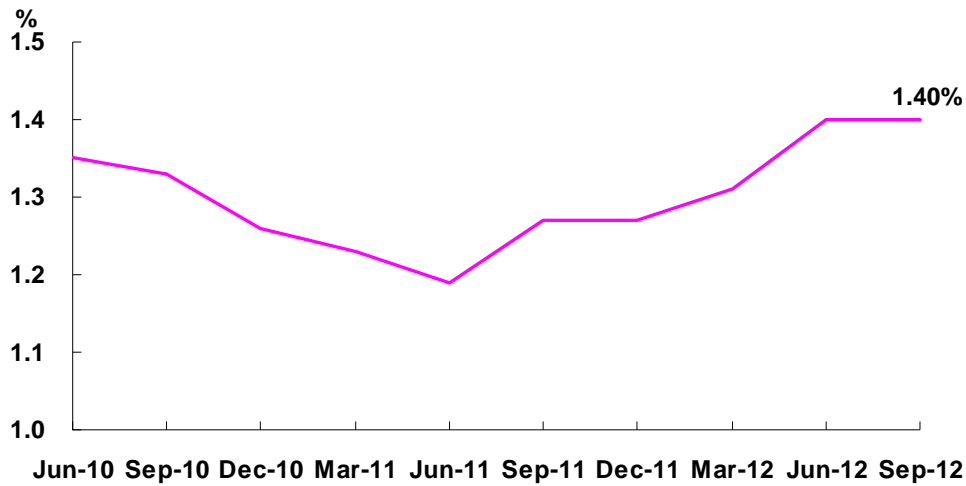


- The HKMA will continue to monitor closely the asset quality of retail banks' loan portfolios.



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks remained stable



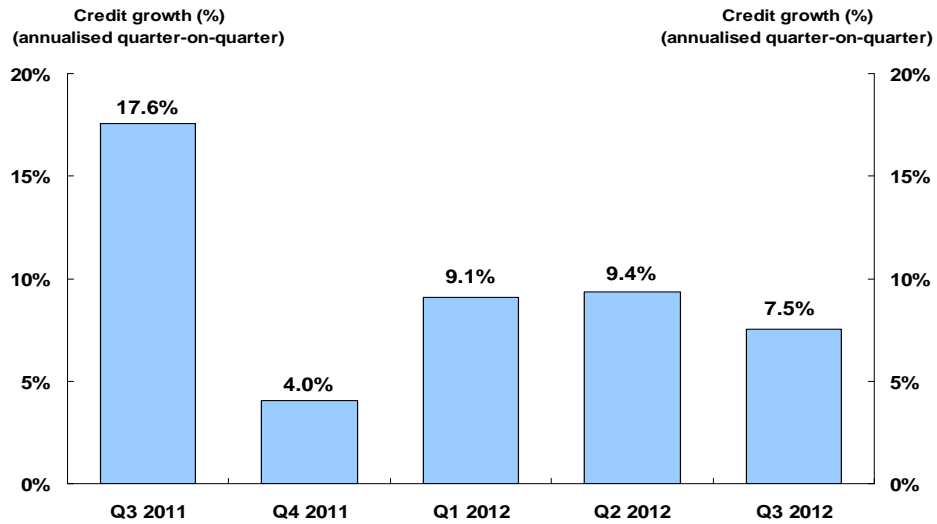
49

- The quarterly annualised net interest margin of retail banks increased to 1.40% in Q2/2012 and remained stable in Q3/2012.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in Q1/2012 - Q3/2012 increased by 13.9% compared with the same period last year. Benign increases in net interest income (+16%) contributed to most of the profit growth.



CREDIT GROWTH

Credit growth remained at a moderate level in the first three quarters of 2012



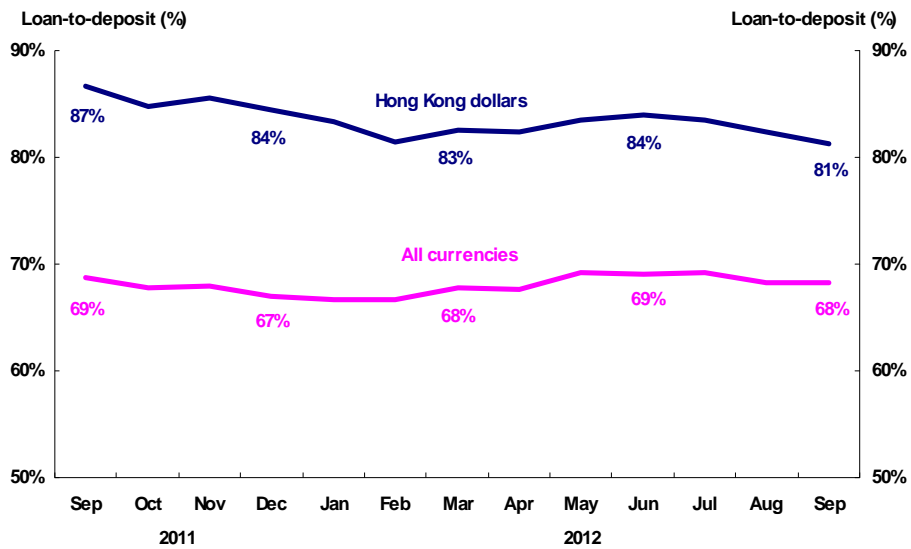
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- In the first three-quarters of 2012, credit growth was at an annualised rate of 8.8%. It is much slower than the 20.2% growth recorded in 2011.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong have improved in recent months



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- Hong Kong dollar loan-to-deposit ratio decreased to 81% at end-September 2012 from 84% at end-June 2012.
- The HKMA will continue to monitor the movement of the loan-to-deposit ratio.



RISK MANAGEMENT IN PROPERTY MORTGAGE LENDING

- With the introduction of the third round of quantitative easing by the US Federal Reserve, more capital could flow into emerging markets
- Risk of property price bubble in Hong Kong increases
- The HKMA introduced on 14 September 2012 the fifth round of countercyclical macroprudential measures. These include:
 - tightening the maximum loan-to-value ratio and debt servicing ratio for mortgage loan applicants with multiple properties under mortgage
 - limiting the maximum loan tenor for all new property mortgages to 30 years

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- Based on the experience in Hong Kong, borrowers with multiple mortgages have higher level of indebtedness and leverage, and have higher chance of default than those with only one property under mortgage during property market and economic downturns.
- Prolonged loan tenor not only will increase credit risk of banks, but will also weaken the ability of borrowers to withstand interest rate risk.

	Sep 2009 (i.e. before the 1 st round of macroprudential countercyclical measures was introduced)	Sep 2012
Average tenor of new mortgage loans	22 years	25.4 years

- New measures applicable to applicants with one or more properties under mortgage

Debt servicing ratio (DSR) based lending

Maximum DSR : lowered to 40% from 50%

Maximum stressed DSR : lowered to 50% from 60%

Exemption arrangement : An applicant with just one property with outstanding mortgage loans and the new mortgage loan is for:

- (i) self-occupied purpose;
- (ii) replacement of an existing property; or
- (iii) cash-out refinancing secured by the existing mortgaged property

Net worth based lending

Maximum LTV ratio : lowered to 30% from 40%

Borrowers whose principal income is derived from outside HK

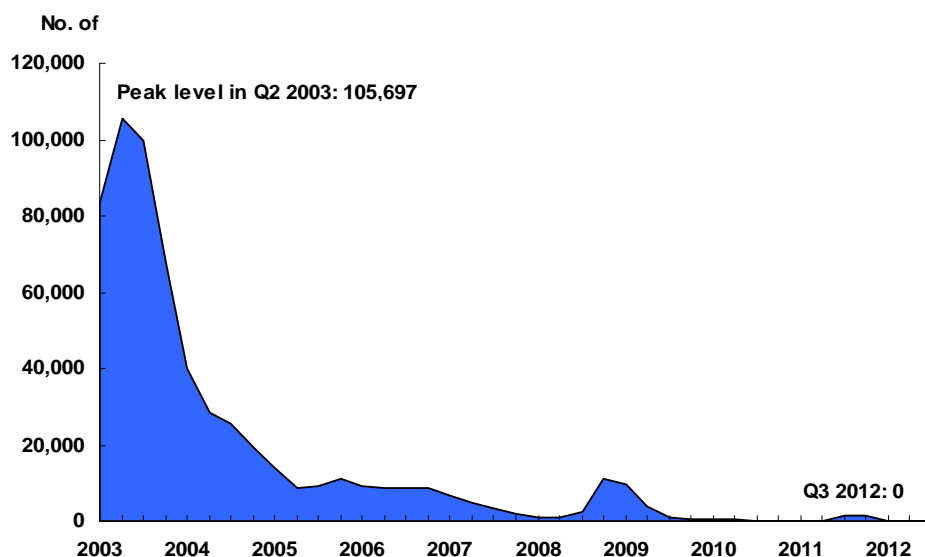
Maximum LTV ratio : 20 percentage points below the applicable LTV ratio

- The HKMA will continue to monitor closely the market developments and introduce appropriate measures in response to changes in the property market cycle to safeguard banking stability.



RESIDENTIAL MORTGAGE LOANS (“RMLs”) IN NEGATIVE EQUITY

Banks did not report any RMLs in negative equity in Q3/2012



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Statistics on RMLs in negative equity

	6/2003	9/2011	12/2011	3/2012	6/2012	9/2012
Total outstanding number of RMLs in negative equity	105,697 (22%)	1,653 (0.3%)	1,465 (0.3%)	78 (0.02%)	5 *	0
Total outstanding value of RMLs in negative equity (HK\$Mn)	164,577 (31%)	4,148 (0.5%)	3,647 (0.5%)	236 (0.03%)	16 *	0
Value of unsecured portion (HK\$Mn)	35,828 (6.75%)	165 (0.02%)	122 (0.02%)	4 *	0.3 *	0
Proportion of RMLs in negative equity with delinquencies of more than three months	2.3%	0%	0%	0%	0%	0%

() as percentage of total outstanding RMLs

* Less than 0.01% as percentage of total outstanding RMLs



INVESTOR AND CONSUMER PROTECTION

- Developing an enhanced competency framework for the private wealth management practitioners
- Working closely with relevant regulators on implementation of the statutory regime for the regulation of MPF intermediaries
- Providing assistance to enable the smooth operation of Financial Dispute Resolution Centre and the establishment of Investor Education Centre

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- With a view to raising the competency and ethical standards of industry practitioners and to developing and maintaining a pool of professional talents for the private wealth management (PWM) industry in Hong Kong, the HKMA and the Securities and Futures Commission (SFC) are working with the industry and professional bodies to develop an enhanced competency framework covering the requisite level of competency and on-going professional development of PWM practitioners.
- The statutory regime for MPF intermediaries and the Employee Choice Arrangement have both come into effect on 1 November 2012. The HKMA cooperates with the Mandatory Provident Fund Schemes Authority and the other financial regulators on implementation matters. The HKMA issued a circular on 18 September 2012 reminding authorized institutions to comply with the applicable regulatory requirements.
- The Financial Dispute Resolution Centre Limited (FDRC) commenced operation on 19 June 2012.
- The HKMA has been working closely with the SFC on setting up the Investor Education Centre (IEC). A board of directors, including representatives from the HKMA among other financial regulators, the financial sector and the Education Bureau, will be set up to decide the scope and strategy of the work of the IEC. The IEC is expected to start operation in Q4 2012.



DEPOSIT PROTECTION

- Undertaking a self-assessment of the Deposit Protection Scheme (DPS) against the Core Principles for Effective Deposit Insurance Systems to evaluate the standard of compliance with the Core Principles and identify areas that may require further enhancements to improve the effectiveness of the DPS
- A publicity campaign launched in August 2012 was well received by the public
- A full-scope rehearsal conducted in mid-September 2012 to test the capability of the Hong Kong Deposit Protection Board and payout agents. Result was satisfactory



Basel III Implementation Progress

First phase of implementation:

- Capital standards
 - Rules tabled at LegCo for negative vetting
 - Consultation conducted on revisions to the Pillar 2 “Supervisory Review Process”
- Disclosure standards
 - Industry consultation on draft rules

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First phase of implementation

- **Pillar 1** - Rules implementing the first phase of the Basel III capital standards were tabled at LegCo on 24 October for negative vetting. Subject to completing negative vetting, the rules will take effect from 1 Jan 2013 in line with the Basel Committee’s timetable.
- **Pillar 2** – The banking industry were consulted in October on a revised module within the HKMA’s Supervisory Policy Manual dealing with the “Supervisory Review Process”, which sets out the manner in which Pillar 2 capital requirements should be determined and operate under Basel III.
- **Pillar 3** – The industry is being consulted on the proposed Rules for implementing new disclosure standards reflecting the changes to the Capital Rules. These should take effect at the end of June 2013 under the Basel timeline.

Other tasks

- The banking reporting returns are currently being updated to reflect the changes made to the Capital Rules.
- The HKMA will continue to engage with the industry in the ongoing implementation process for other areas of Basel III such as the liquidity standards, leverage ratio and capital buffers.



FINANCIAL INFRASTRUCTURE



REFORMING OTC DERIVATIVES MARKET

G20 Commitments

- All standardised OTC derivative contracts should be traded on exchanges/electronic trading platforms and cleared through central counterparties
- OTC derivative contracts should be reported to trade repositories

Implementation

• Regulation:

- Aim to introduce the Securities and Futures (Amendment) Bill into the Legislative Council in early 2013 to implement the clearing and reporting requirements. The target is to implement the new regulations around Q3 2013

• Central Counterparty:

- HKEx is building a local central counterparty for OTC derivatives, which is expected to commence operation in early 2013

• Trade Repository:

- The HKMA is expanding the functions of the Central Moneymarkets Unit to develop a local trade repository, which is expected to launch in 2013 to support mandatory reporting when implemented

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- Following the public consultation on the proposed regulatory regime for the OTC derivatives market in October 2011, the HKMA and SFC published the consultation conclusions to respond to the comments received from the consultation and issued a supplemental consultation paper on the proposed scope of new/expanded regulated activities and the oversight of systemically important players in July 2012. The supplemental consultation was closed on 31 August 2012. The HKMA and SFC are studying the feedbacks received from the supplemental consultation.
- The detailed requirements of the new regulatory regime will be set out in the subsidiary legislation in the form of rules. The HKMA and SFC aim to conduct a public consultation on the draft subsidiary legislation in early 2013.
- The local trade repository will be launched in two stages – the first in Q1 2013 to support any local central counterparty that may be established by then, and then in Q3 2013 to support mandatory reporting when implemented.



GOVERNMENT BOND PROGRAMME

Institutional Bond Issuance Programme:

- Nine issues totalling HK\$44 billion outstanding as at end October
- Tenors from 2 years up to 10 years have been offered in order to build a benchmark yield curve
- The tenders attracted a diverse group of end-investors, such as investment funds, insurance companies and pension funds

Retail Bond Issuance Programme:

- The second batch of HK\$10 billion inflation-linked bond (iBond) was successfully issued in June
- Over 330,000 valid applications were received, applying for around HK\$50 billion principal amount of bonds
- Both the total number of applications and the total application amount have achieved new records in the local retail bond market

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- The primary objective of the GBP is to promote the further and sustainable development of Hong Kong's bond market through systematic issuance of government bonds. It can also help promote financial stability by making our debt market an effective channel of financial intermediation, complementing the equity markets, and the banking sector.
- The GBP is a long-term programme comprising an Institutional Bond Issuance Programme and a Retail Bond Issuance Programme.
- By enlarging the investor base over time, the GBP is expected to improve liquidity and attract more issuers to raise funds via the bond market. This will help increase the breadth and depth of our bond market, thereby consolidating our role as an international financial centre.
- The objective of the Retail Programme is to enhance the interest and awareness of local individual investors in bond investments.
- The Financial Secretary announced a second inflation-linked bond (the "iBond") issuance to further promote the sustainable development of retail bond market in his 2012-13 Budget Speech. The issuance was completed in June 2012. A total of 332,467 valid applications were received for a total of HK\$49,836,180,000 in principal amount of bonds, setting new records in the local retail bond market. The second iBond issuance has further enhanced the investing public's awareness of and interest in bonds and hence promoted the development of a retail bond market in Hong Kong.



PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector to explore ways to strengthen the competitiveness of Hong Kong's asset management industry and reinforce Hong Kong's position as a leading asset management centre
- Stepping up marketing efforts to proactively reach out to overseas and Mainland asset managers and investors to promote Hong Kong's financial platform. Promotional campaigns so far covered major cities in the US, Canada, Europe, Middle East, Southeast Asia and Mainland China
- Building on the feedback from our regular dialogues with industry players, we continue to improve our platform and keep pace with the latest developments in the asset management industry

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- With the promising growth prospects of the Asian region, there has been increasing interest for overseas asset managers to expand into Asia. To capitalise on this trend and attract more asset managers into Hong Kong, the HKMA is working in conjunction with other Government agencies and market players to promote Hong Kong's asset management business, thereby reinforcing Hong Kong's role as a premier international financial centre.
- To this end, the HKMA is taking part in a joint Government campaign, along with the Financial Services and the Treasury Bureau and the Securities and Futures Commission, in holding a series of promotional roadshows in leading global financial centres. Since November 2010, the campaign has visited London, New York, Zurich, Geneva, Lugano and Luxembourg, during which the HKMA also took the opportunities to meet with key asset managers based in their financial centres to promote the financial platform in Hong Kong and listen to their business plans in Asia and their views on potential hurdles for their operations in Hong Kong.
- At the same time, the HKMA has also been reaching out to the market players in major cities in the US, Canada, Europe, Middle East, Southeast Asia and Mainland China to explain the opportunities and advantages presented by Hong Kong as an asset management centre and to highlight Hong Kong's latest positive developments to overseas business decision makers.



DEVELOPMENT OF ISLAMIC FINANCE

- Supporting the Government in drawing up legislative proposals to amend Hong Kong's tax laws to provide a comparable tax regime for Islamic bonds vis-à-vis conventional bonds, including
 - Considering the feedback received during the two-month market consultation on the legislative proposals ended on 28 May 2012
 - Assisting in preparation of the consultation conclusions which were issued on 29 October 2012

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- During the consultation period, a total of 15 submissions were received from a diverse group of stakeholders. A large majority of respondents welcomed the legislative objectives and proposals outlined in the consultation paper.



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Continue to enhance financial infrastructure, especially for supporting the continual growth of RMB business in Hong Kong
 - the operating hours of the RMB RTGS system in Hong Kong were extended from 10 hours to 15 hours, from 8:30 to 23:30 (Hong Kong time), starting from 25 June 2012
 - cross-border joint direct debit transfers service between Hong Kong and Guangdong Province through HKD and RMB China UnionPay debit cards issued in Hong Kong and directly debiting RMB accounts in Hong Kong was launched smoothly on 3 July 2012
- Developing a trade repository for over-the-counter derivatives trades to enhance market surveillance and transparency, and bring Hong Kong in line with international standards

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Operation of financial infrastructure

- The HKD, USD, EUR and RMB Real Time Gross Settlement (RTGS) systems and the Central Moneymarkets Unit (CMU) have been operating smoothly.

Financial infrastructure to support RMB business

- To better serve financial institutions in different regions for offshore RMB business through the Hong Kong infrastructure and enhance the competitiveness of the RMB clearing platform in Hong Kong, the daily operating hours of the RMB RTGS system were extended from 10 hours to 15 hours starting from 25 June 2012. The extended operating window covers both the Asian and European business hours, and early US business hours.
- The cross-border joint direct debit transfers service between Hong Kong and Guangdong is modelled on a similar service between Hong Kong and Shenzhen. It provides Hong Kong residents with a more convenient payment channel for making regular and recurring cross-border small-value payments to merchants in Guangdong Province, such as payment of property management fee and utilities bills.

Trade Repository

- The system development work for the trade repository (TR) has been progressing as scheduled. The system will be launched by the end of this year to support central clearing of OTC derivatives transactions. The reporting service of the TR will be launched shortly before the relevant legislation takes effect.



RETAIL PAYMENT INITIATIVES

- Press conference held on 4 September 2012 to announce the HKMA's strategic plan for developing retail payment infrastructure in Hong Kong
- Progress made so far:
 - **Electronic bill presentment and payment (e-bill) system:**
 - About 20 banks committed to participate in the proposed platform
 - system to be launched in the second half of 2013
 - **e-cheque:**
 - soft consultation underway and to be completed by the end of 2012
 - tentative launch date near the end of 2014
 - **Near Field Communication (NFC) mobile payment:**
 - consultancy firm appointed to conduct a study and advise on the strategy to facilitate NFC mobile payment development in Hong Kong
 - consultancy report expected to be issued in the first quarter of 2013

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Retail Payment Initiatives

- A press conference was held on 4 September 2012 to announce the HKMA's three-pronged strategy of enhancing the retail payment infrastructure and instruments in Hong Kong. The strategy include: (i) moving from paper-based and semi-electronic payment instruments to a fully electronic platform; (ii) exploring the possibility of developing a common interface for Near Field Communication (NFC) mobile payment; and (iii) enhancing the legislative framework to cover innovative payment instruments.

e-bill system

- The e-bill system aims to enhance the public's experience by providing a centralised platform for them to view, manage and pay regular and non-regular bills. Two industry briefing sessions were held on 30 and 31 August. As of now, about 20 banks have committed to participate in the proposed platform. The e-bill system is scheduled for launch in the second half of 2013.

e-cheque

- The HKMA is conducting a study on e-cheque which will provide an additional innovative, safe and efficient payment channel for the public to make payment. e-cheque will be issued, delivered and presented through electronic means, thus saving the need for physical delivery and presentment. Soft consultation with the banking industry continues to gauge their views on the operating model, and will be completed within 2012. System development is expected to commence in early 2013 with the tentative launch date in 2014.

NFC mobile payment

- The HKMA has appointed a consultancy firm to conduct a feasibility study and advise the strategy and approach of establishing an interoperable NFC mobile payment infrastructure in Hong Kong. Indeed, Hong Kong is in the initial stage of NFC mobile payment development and a few NFC mobile payment services will be rolled out in the next few months. It is timely for us to conduct the study in response to the market needs for interoperability and portability. Stakeholder interviews are under way and the study will be completed in the first quarter of 2013.

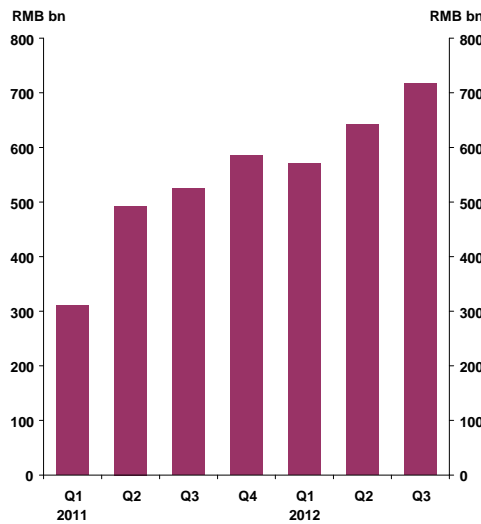


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

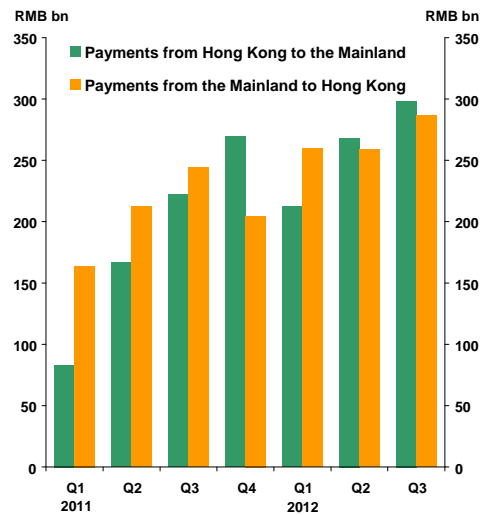


Further expansion of RMB trade settlement

**RMB trade settlement
handled by banks in Hong Kong**



**Flows of RMB trade settlement
between Hong Kong and the Mainland**



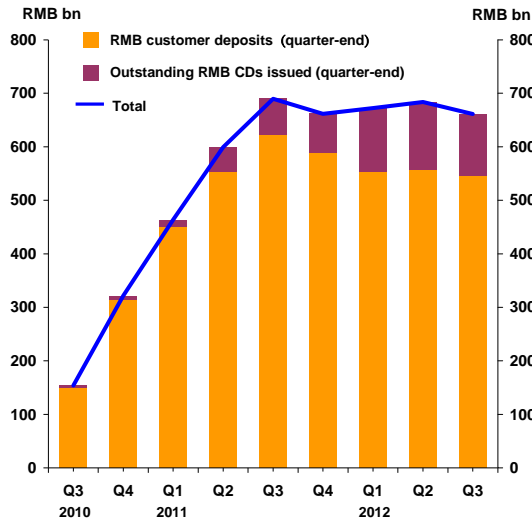
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- Hong Kong's offshore RMB business continued to grow steadily in the first three quarters of 2012.
- In the first nine months of 2012, RMB trade settlement handled by banks in Hong Kong amounted to RMB 1,930 billion yuan, already exceeding the annual total of 2011, while the payment flows to and from the Mainland are balanced.



Steady development of RMB financing activities

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities

RMB dim-sum bond market

	Jan - Sep 2012	Jan - Sep 2011
Amount of issuance (RMB billion)	93.8	85.8
No. of issuers	59	65

RMB bank lending

	End-Sep 2012	End 2011
Outstanding RMB loans (RMB billion)	67.9	30.8

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- At end-September, the outstanding amount of RMB customer deposits and CDs issued amounted to RMB 545.7 billion yuan and RMB 115.4 billion yuan respectively, totalling RMB 661.1 billion yuan.
- Banks have been offering RMB services to personal customers who are non-Hong Kong residents since August. At end-September, over 12,000 RMB accounts were opened by non-resident personal customers, with deposits amounting to over RMB 800 million yuan.
- Alongside with the steady development of RMB bank lending and the dim-sum bond market, the range of RMB investment products has been expanding. A-share exchange traded funds, RMB currency futures and RMB shares are now available in the Hong Kong offshore RMB market.



Entrenching role of Hong Kong as global hub for RMB settlement and correspondent banking

	<u>Sep 2012</u>	<u>2011</u>	<u>Change</u>
1 No. of participating banks of Hong Kong's RMB clearing platform	199	187	+6%
Of which:	176	165	+7%
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks			
2 No. of RMB correspondent accounts set up by overseas banks at Hong Kong banks	1,315	968	+36%
3 Amount due to overseas banks (RMB billion at period-end)	94.2	116.4	-19%
4 Amount due from overseas banks (RMB billion at period-end)	113.3	121.7	-7%



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Financial Stability Board (FSB)

- HKMA attended the FSB Plenary Meeting held on 10-11 October. The meeting reviewed the key risks pertinent to global financial stability and the progress of regulatory reforms. Key areas of work include, among others, finalising the enhanced prudential framework for domestic systemically important banks, implementing over-the-counter derivatives market reforms, strengthening regulation of the shadow banking system and reviewing the FSB governance structure

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

- HKMA has taken up the chairmanship of the EMEAP Monetary and Financial Stability Committee (MFSC) for a two-year term starting in July 2012. The MFSC is the main EMEAP platform for reviewing economic and financial developments in the Asia-Pacific region, identifying areas of vulnerability and recommending broad policy options in the areas of regional macro-monitoring and crisis management. The next MFSC meeting will be held on 16 November



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

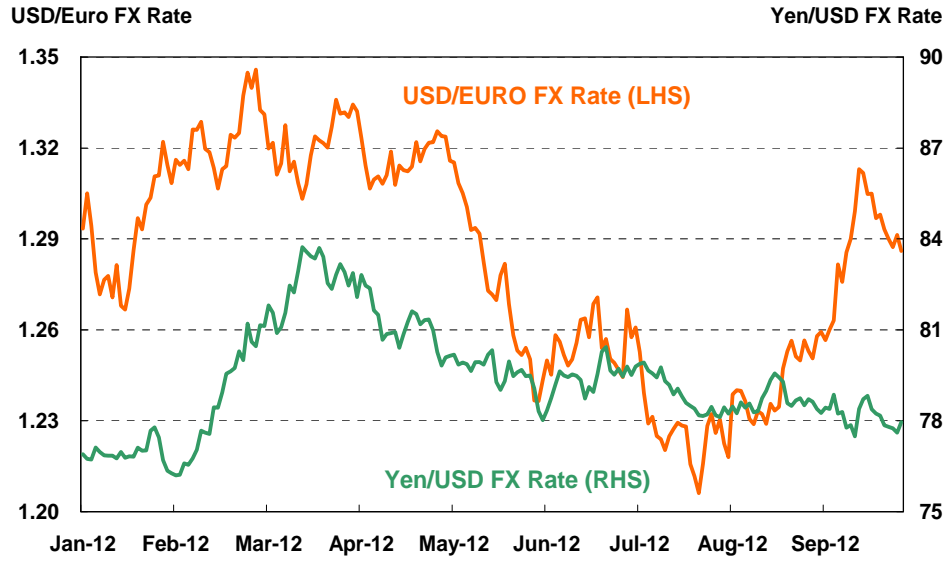


INVESTMENT ENVIRONMENT IN Q1 - Q3 2012

- **Exchange rates:** The Euro weakened in Q2 as market sentiment deteriorated over the developments in the European peripheral countries, but subsequently rose as the European Central Bank's plan to purchase sovereign bonds allayed investors' concerns. The yen weakened against the dollar slightly over the period
- **Equity markets:** Amid heightened concerns about economic environment in Euro-zone, major equity markets in developed economies suffered a correction in Q2 that erased most of the gains recorded in Q1, but rallied in Q3 (except Japan) on investor optimism that more accommodative monetary policies of the major central banks would be forthcoming
- **Interest rates:** Extension of low rate guidance by the Fed supported US Treasuries and pushed the yields lower in the first three quarters. Other major government bond yields moved largely in tandem with the Treasury yields



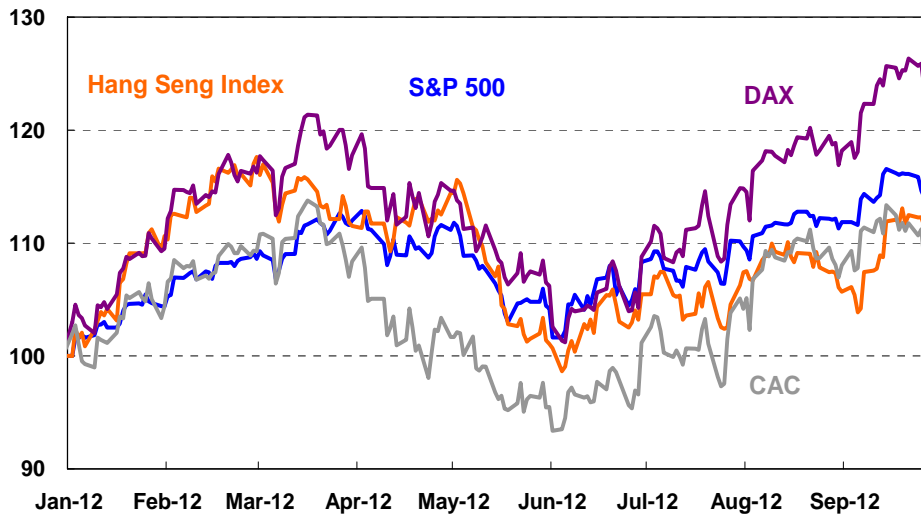
CURRENCY MARKETS





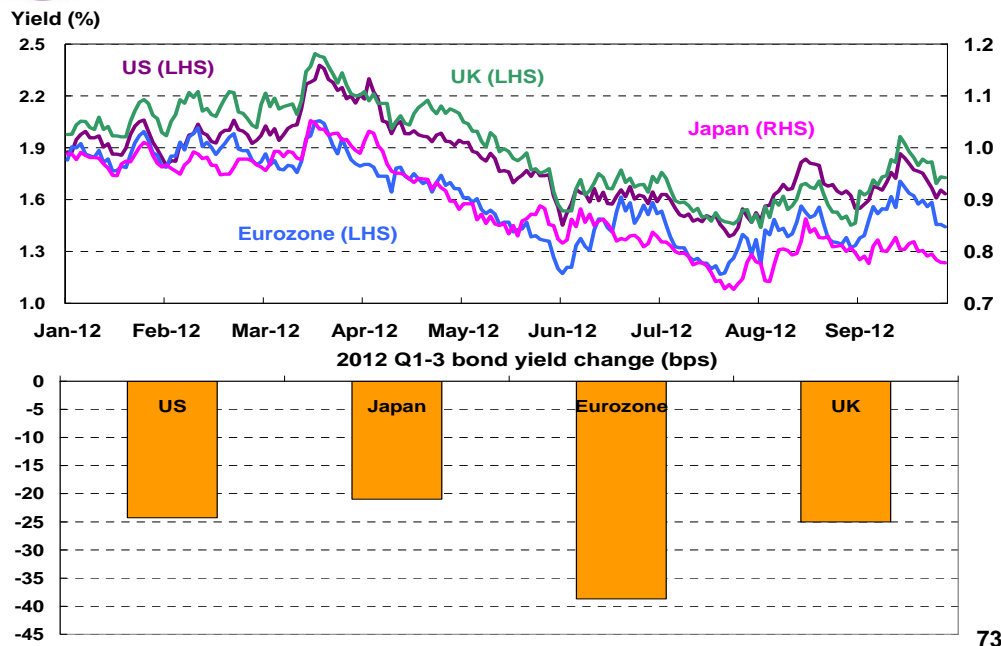
EQUITY MARKETS

Normalized Index Level (2011 year-end = 100)





CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS





INVESTMENT INCOME

← 2012 → 2011 2010 2009

(HK\$ billion)	Jan - Sep*	Q3	Full Year	Full Year	Full Year
Bonds#			71.9	42.1	(0.6)
Hong Kong equities^@			(24.2)	11.6	48.9
Other equities^			(12.2)	27.1	48.8
Foreign exchange			(9.1)	(3.1)	9.8
Other investments&			<u>0.7</u>	<u>1.7</u>	<u>0.8</u>
Investment income@&			27.1	79.4	107.7

* Unaudited figures

^ Including dividends

Including interest

@ Excluding valuation changes in Strategic Portfolio

& Including valuation changes of investment held by EF's investment holding subsidiaries



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

(HK\$ billion)	2012			2011	
	Jan – Sep*	Q3	Q2	Q1 Full year	
Investment income/(loss)			(5.6)	44.5	27.1
Other income			0.1	-	0.2
Interest and other expenses			<u>(1.4)</u>	<u>(0.9)</u>	<u>(4.7)</u>
Net investment income/(loss)			(6.9)	43.6	22.6
Payment to Fiscal Reserves#			(9.6)	(9.7)	(37.0)
Payment to HKSAR government funds and statutory bodies#			(1.9)	(1.8)	(5.6)
Valuation change of Strategic Portfolio less valuation change of investment held by EF's investment holding subsidiaries^			<u>(1.7)</u>	<u>(1.1)</u>	<u>(3.6)</u>
Increase/(Decrease) in EF Accumulated Surplus			(20.1)	31.0	(23.6)

* Unaudited figures

The fixed rate of fee payment is 5.6% for 2012 and 6.0% for 2011

^ Including dividends



HISTORICAL INVESTMENT INCOME

(HK\$ billion)

Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009* ^{&}	107.7	10.6	71.9	58.7	(33.5)
2010* ^{&}	79.4	5.9	74.5	(12.1)	11.1
2011* ^{&}	27.1	22.1	(41.4)	21.6	24.8
2012* ^{&} [#]	N/A	N/A		(5.6)	44.5

* Excluding valuation changes in the Strategic Portfolio

Unaudited figures

[&] Including valuation changes of investment held by EF's investment holding subsidiaries

N/A: Not Applicable



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 30 Sep 2012*	At 31 Dec 2011	At 31 Dec 2010
ASSETS			
Deposits		221.7	198.4
Debt securities		1,844.4	1,706.7
Hong Kong equities		120.6	152.6
Other equities		238.2	245.3
Other assets#		<u>63.1</u>	<u>42.0</u>
Total assets		2,488.0	2,345.0
		=====	=====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness		258.7	225.9
Government-issued currency notes & coins in circulation		9.9	8.9
Balance of the banking system		148.7	148.7
Exchange Fund Bills and Notes		655.8	654.2
Placements by banks and other financial institutions		24.5	23.2
Placements by Fiscal Reserves		663.5	592.3
Placements by HKSAR government funds and statutory bodies		126.2	76.8
Other liabilities		<u>32.8</u>	<u>23.5</u>
Total liabilities		1,920.1	1,753.5
Accumulated Surplus		<u>567.9</u>	<u>591.5</u>
Total liabilities and fund equity		2,488.0	2,345.0
		=====	=====

* Unaudited figures

Including investment in EF's investment holding subsidiaries amounted to HK\$31.1 billion at 31 Dec 2011 and HK\$14.7 billion at 31 Dec 2010



HONG KONG MORTGAGE CORPORATION



Reverse Mortgage Programme

- By end-Oct 2012, 284 applications have been approved:
 - Average age of borrowers: 71 years old
 - Average monthly payout: HK\$13,300
 - Payment terms: 10-year (34%), 15-year (20%), 20-year (12%), life (34%)
 - Average property value: HK\$3.7 million
 - Average property age: 30 years
- To launch 3 enhancements in November 2012
 - lowering the minimum age of borrowers from 60 to 55
 - increasing the maximum specified property value for payout calculation from HK\$8 million to HK\$15 million
 - increasing the maximum lump-sum payout amount



SME Financing Guarantee Scheme (“SFGS”)

- In response to the request from the Government, the HKMC launched in May 2012 an 80% loan guarantee product under the SFGS until end February 2013 to assist SMEs in obtaining bank financing amid challenging economic conditions
- The new product was well received by the market, as at 19 October 2012:
 - 3,924 applications approved
 - total loan amount about HK\$18 billion
 - average loan interest rate and guarantee fee rate are 4.6% p.a. and 0.5% p.a. respectively
- Over 2,800 SMEs involving 82,000 employees have benefitted under the Scheme



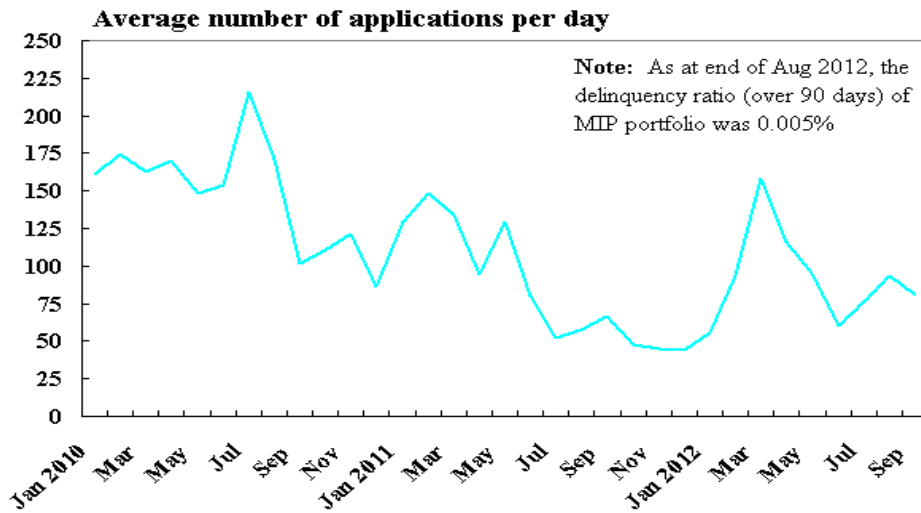
Microfinance Scheme

- Launched in June 2012 to operate over a pilot period of three years with a tentative aggregate loan amount of HK\$100 million
- 6 banks and 5 non-governmental organisations have joined the Microfinance Scheme
- As at end-Oct 2012, the HKMC has received over 1,500 hotline enquiries, 56 formal loan applications, out of which 25 cases have been approved with loans totaling HK\$6.5 million. 16 cases are pending vetting panel interview



Assessment of Risk on Hong Kong's Financial Stability: Property Market

MIP loan applications



Source: Hong Kong Mortgage Corporation