



**HONG KONG MONETARY AUTHORITY**

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

**3 November 2014**



## 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

### Real GDP Growth

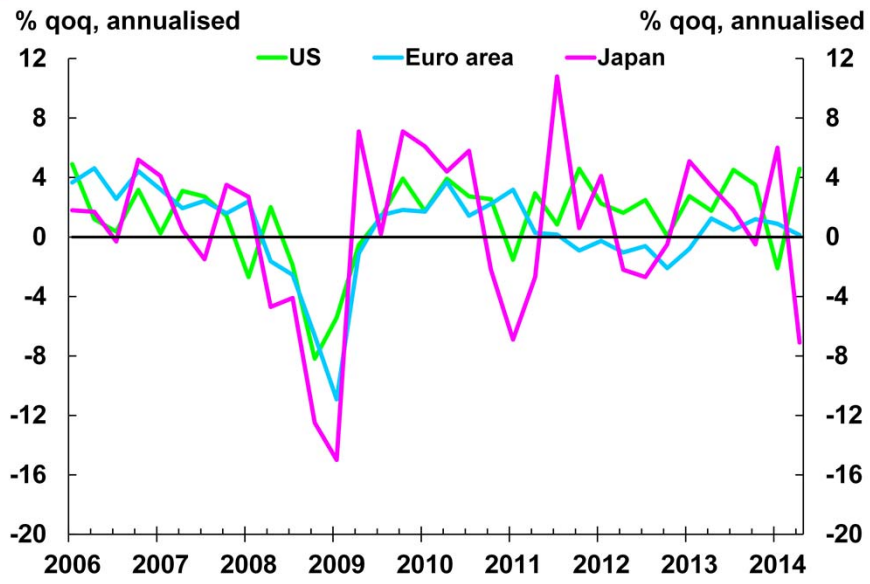
(% year-on-year)

	2013	2014 Forecasts	2015 Forecasts
<b>US</b>	2.2	2.2	3.1
<b>Euro area</b>	-0.4	0.8	1.2
<b>Japan</b>	1.5	1.1	1.2
<b>Asia (ex-Japan)</b>	6.2	6.0	6.1
<b>Mainland China</b>	7.7	7.3	7.1
<b>Hong Kong</b>	2.9	2.3	3.0

Sources: October Consensus Forecasts and Official Statistics



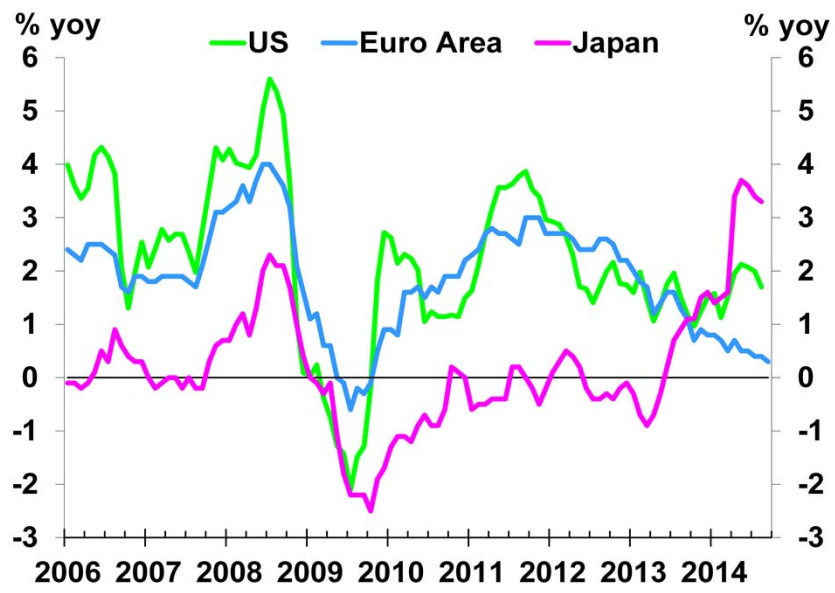
## REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



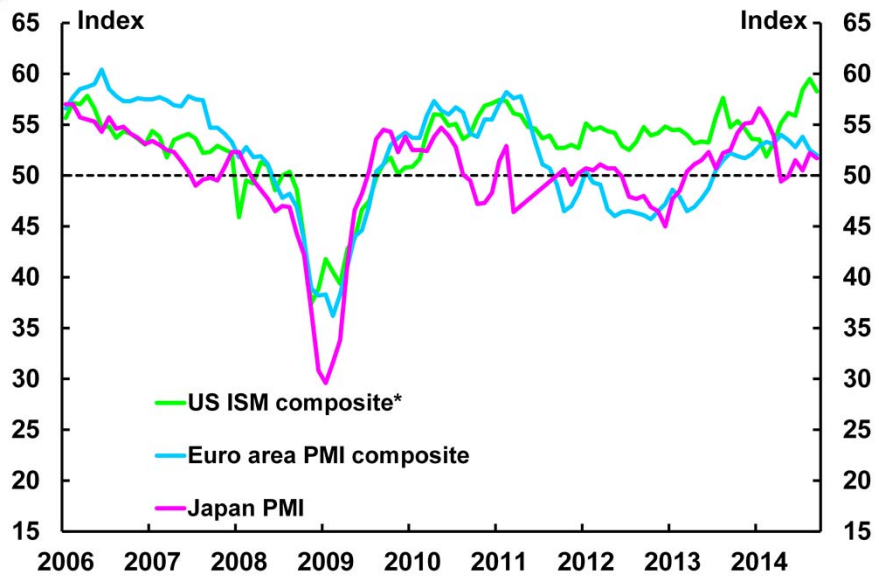
## HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



## PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

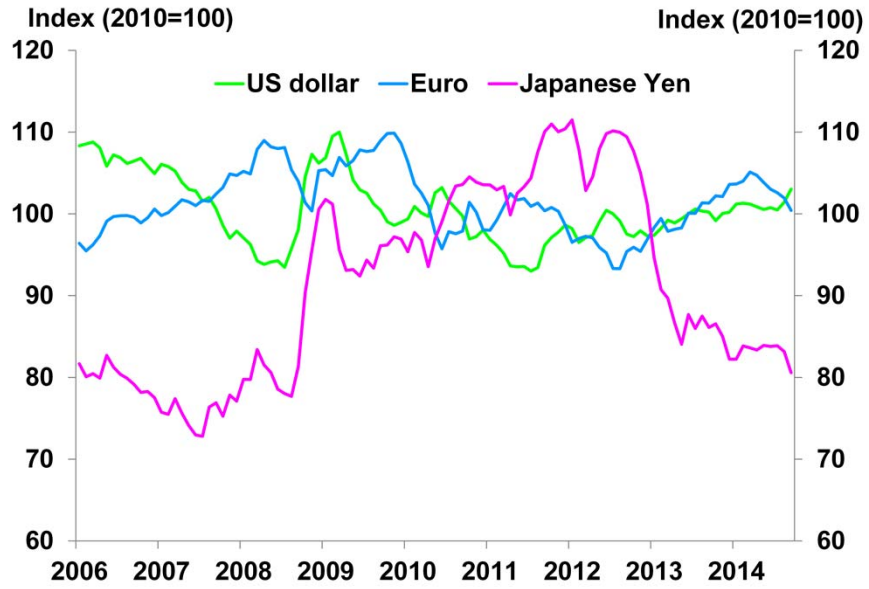


\*Weighted average of the ISM manufacturing and non-manufacturing indices

Source: Bloomberg



## NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES

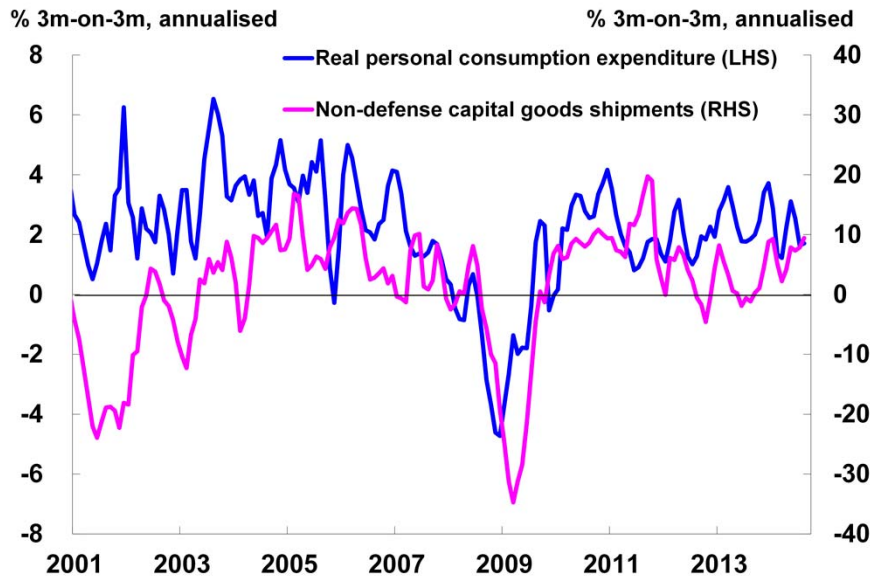


Source: CEIC





## US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



## US: LABOUR MARKET SITUATION



Source: CEIC



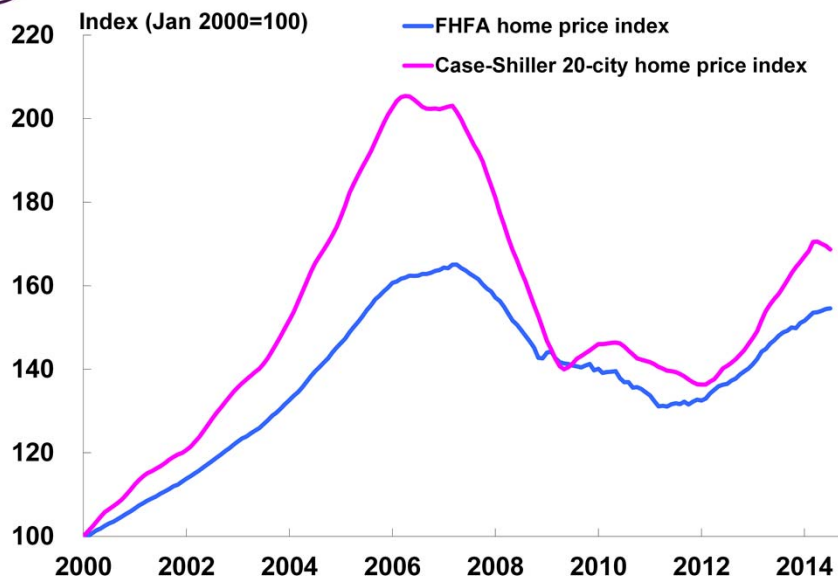
## US: LABOUR FORCE PARTICIPATION



Source: CEIC



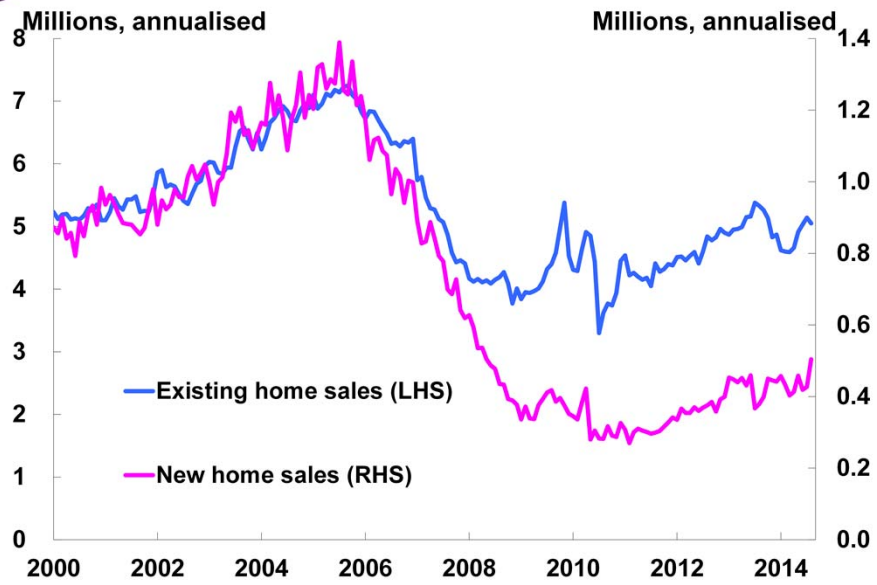
## US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



## US: HOME SALES

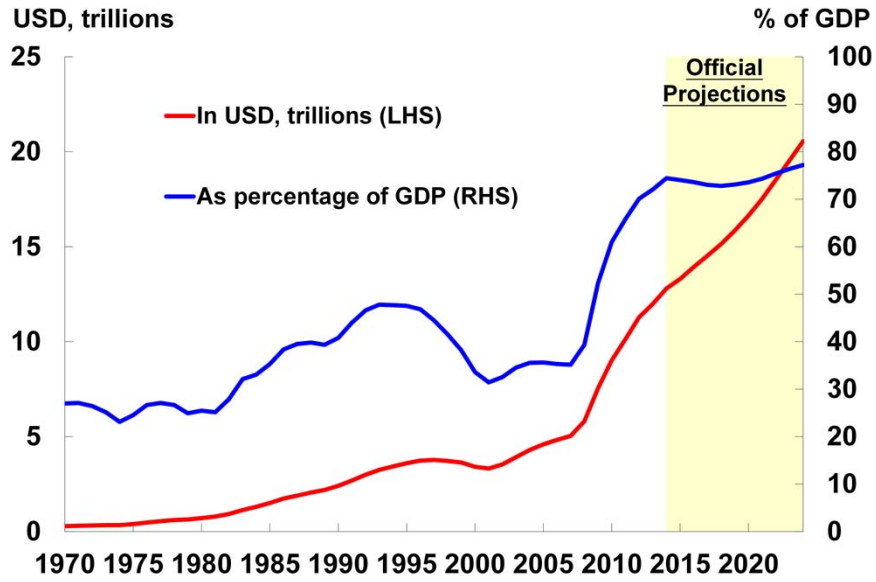


Source: CEIC



# US: FEDERAL GOVERNMENT DEBT

## US federal debt held by the public

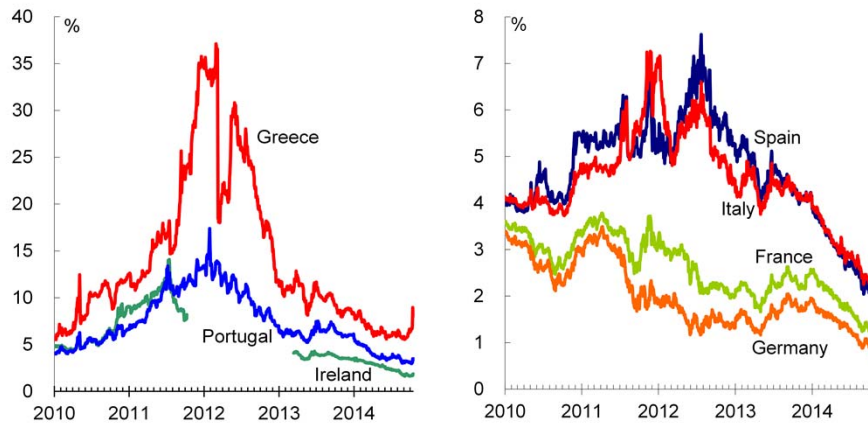


Source: Congressional Budget Office



## EURO AREA: SOVEREIGN BOND YIELDS

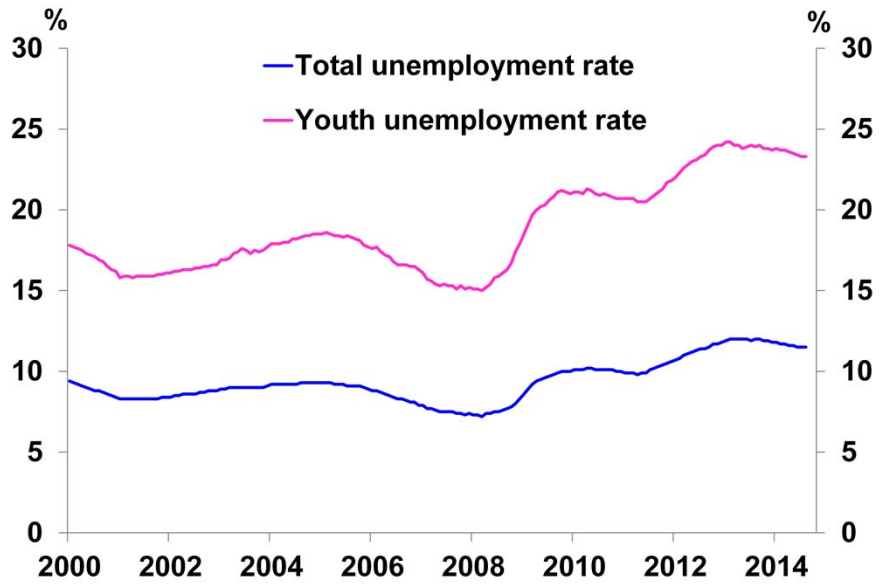
### 10-year sovereign bond yield



Note: 10-year Irish sovereign bond yield data is not available between 12 Oct 2011 and 14 Mar 2013  
Source: Bloomberg



## EURO AREA: UNEMPLOYMENT RATE

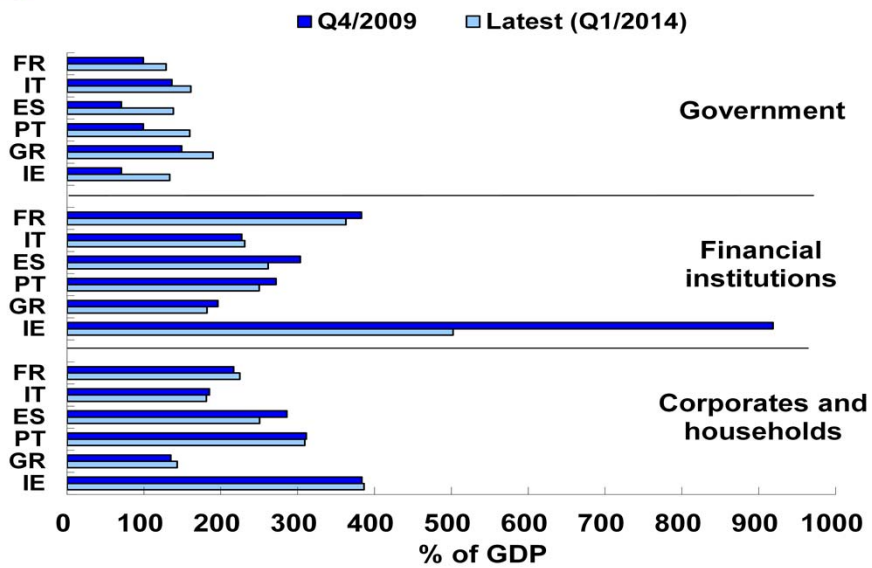


Source: Bloomberg





## EURO AREA: OVERALL INDEBTEDNESS

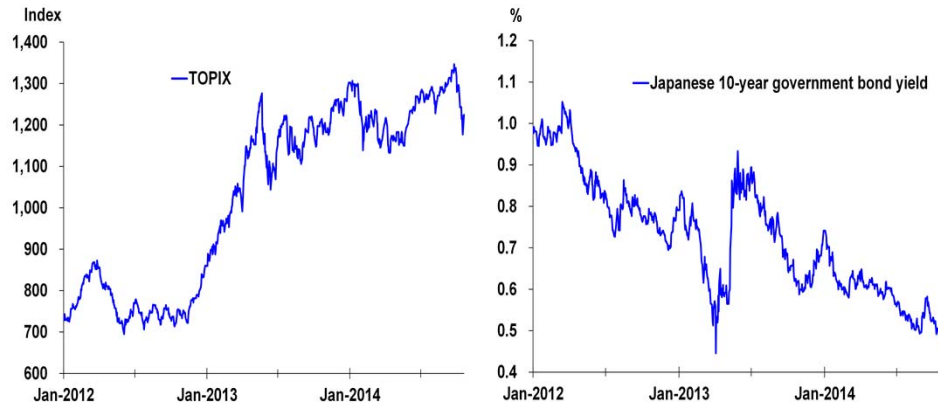


Source: European Central Bank

Note: FR – France, IT – Italy, ES – Spain, PT – Portugal, GR – Greece, IE – Ireland



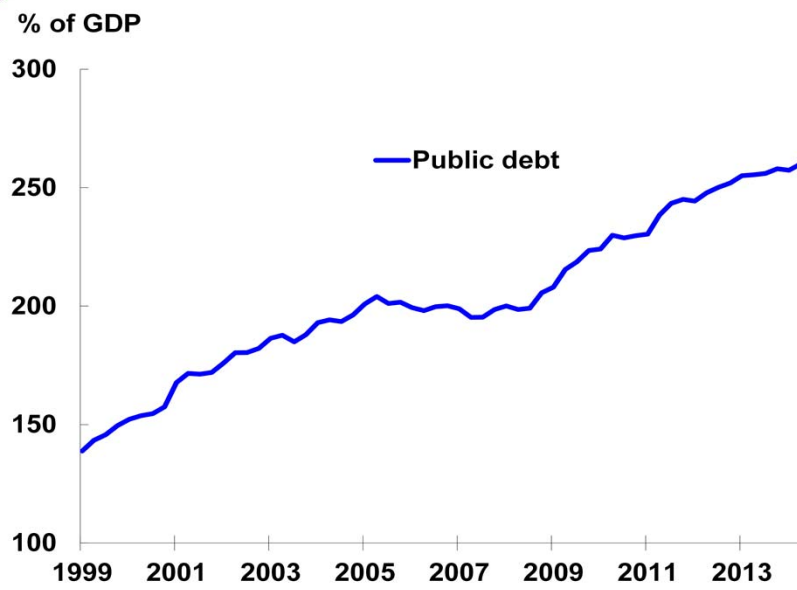
## JAPAN: FINANCIAL MARKETS



Source: Bloomberg



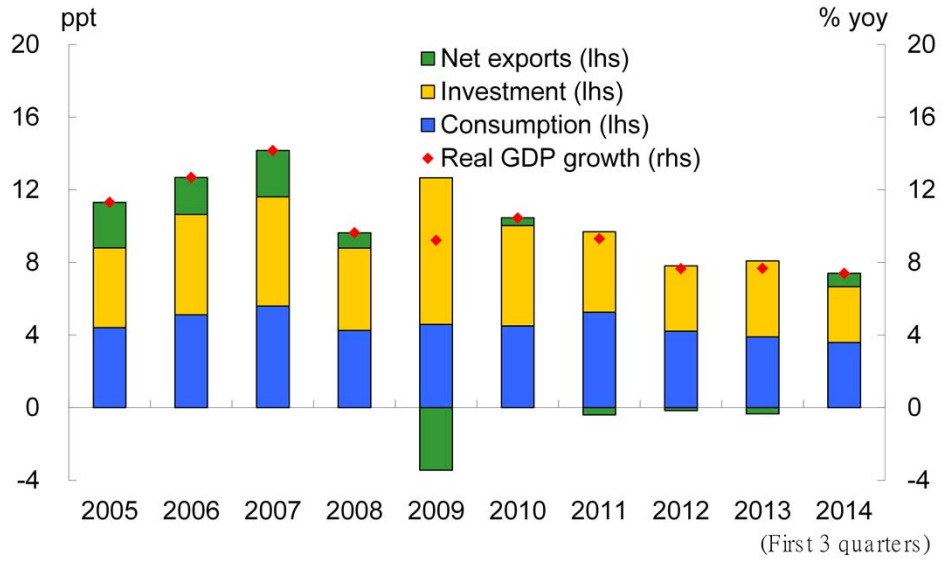
## JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



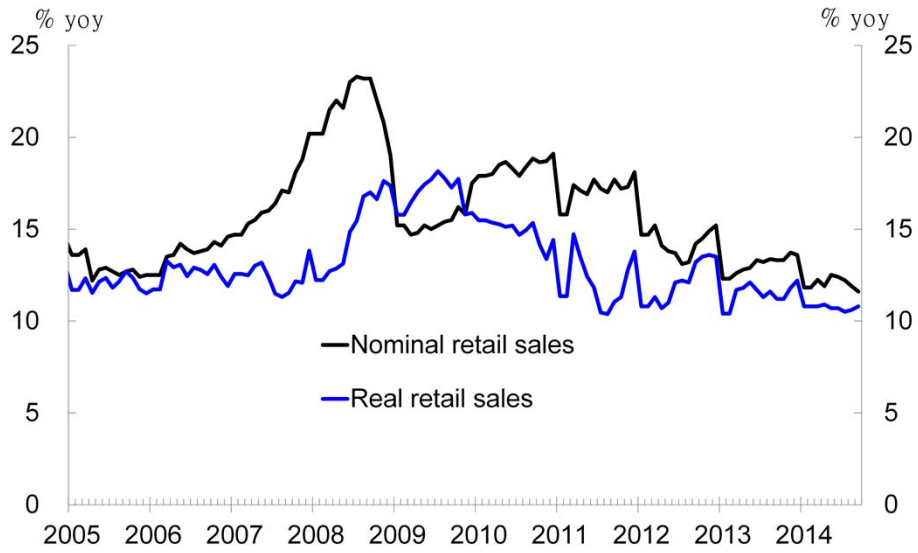
## MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



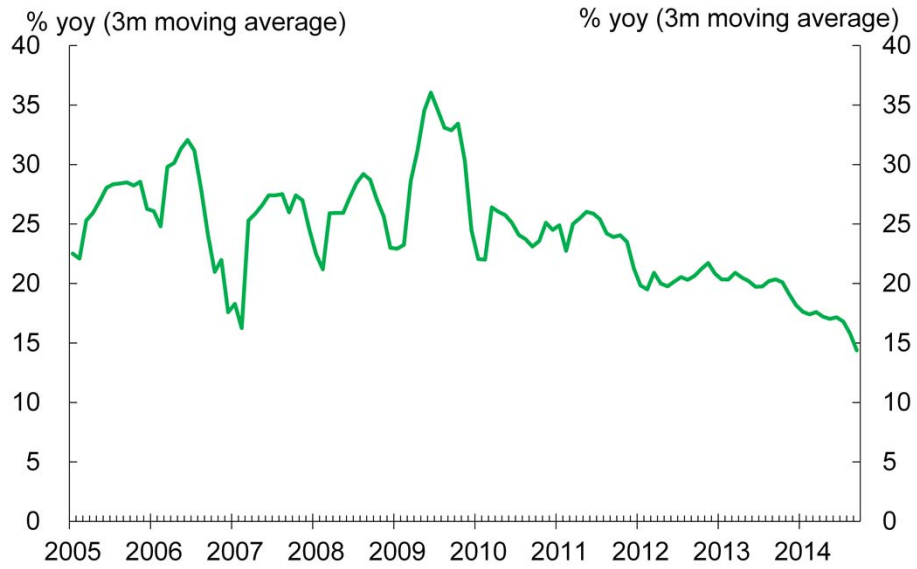
## MAINLAND CHINA: RETAIL SALES



\* Figures for January and February are the year-on-year growth of the sum of the first two months of the year.  
Sources: CEIC, WIND and HKMA staff estimates



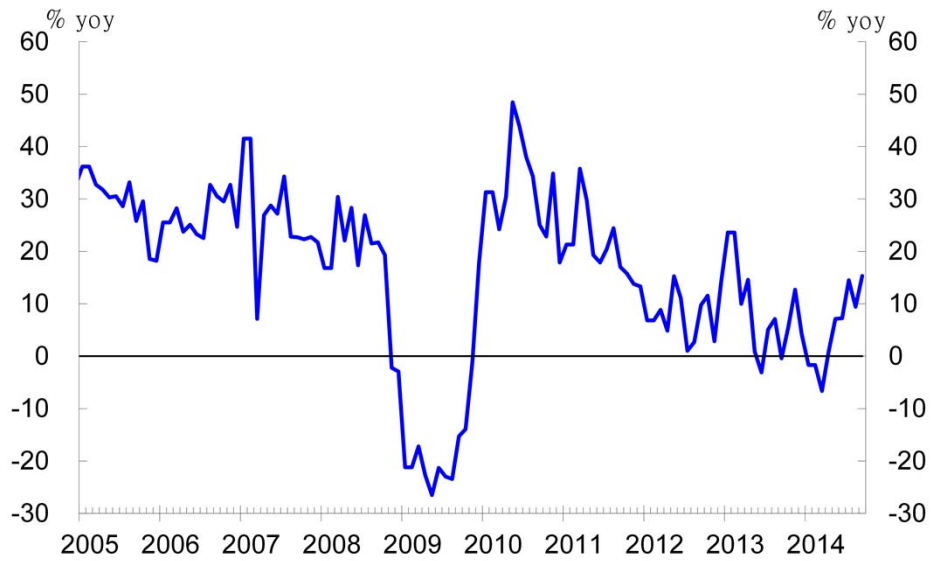
## MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



## MAINLAND CHINA: EXPORT GROWTH

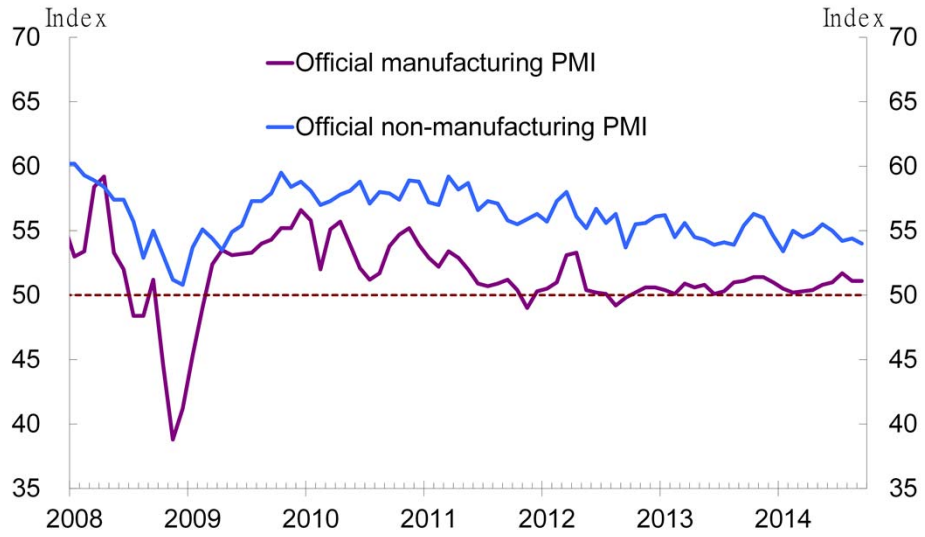


\*Figures for January and February are the year-on-year growth of the sum of the first two months of the year.

Sources: CEIC and HKMA staff estimates



## MAINLAND CHINA: PURCHASING MANAGERS' INDEX

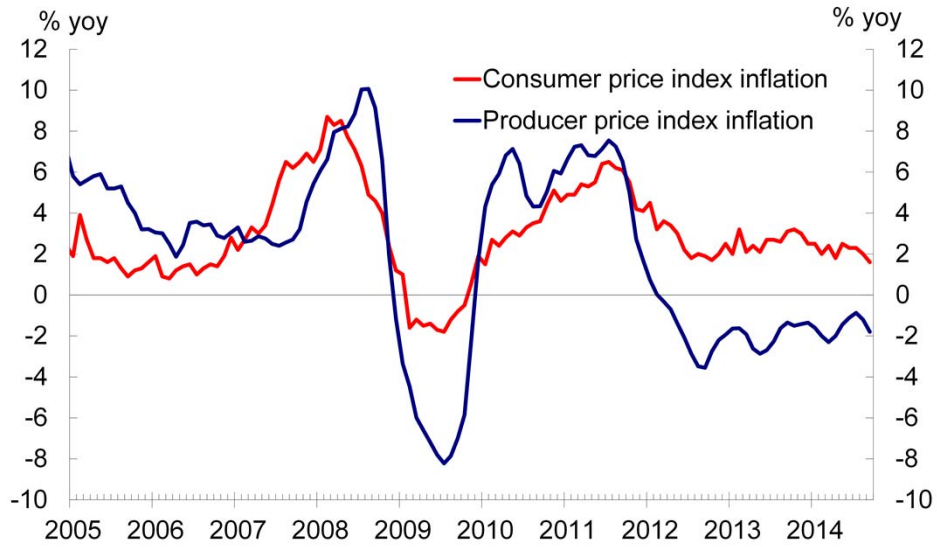


Source: CEIC





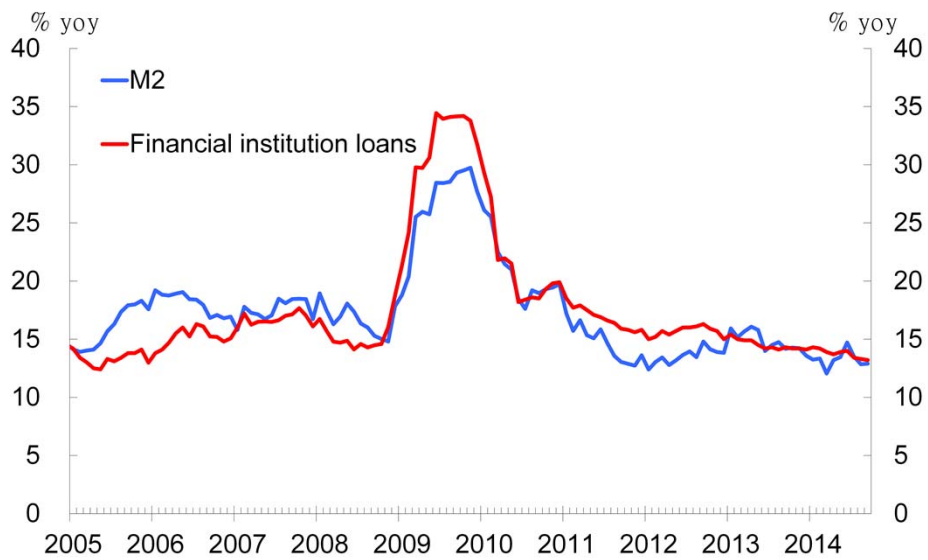
## MAINLAND CHINA: INFLATION



Source: CEIC



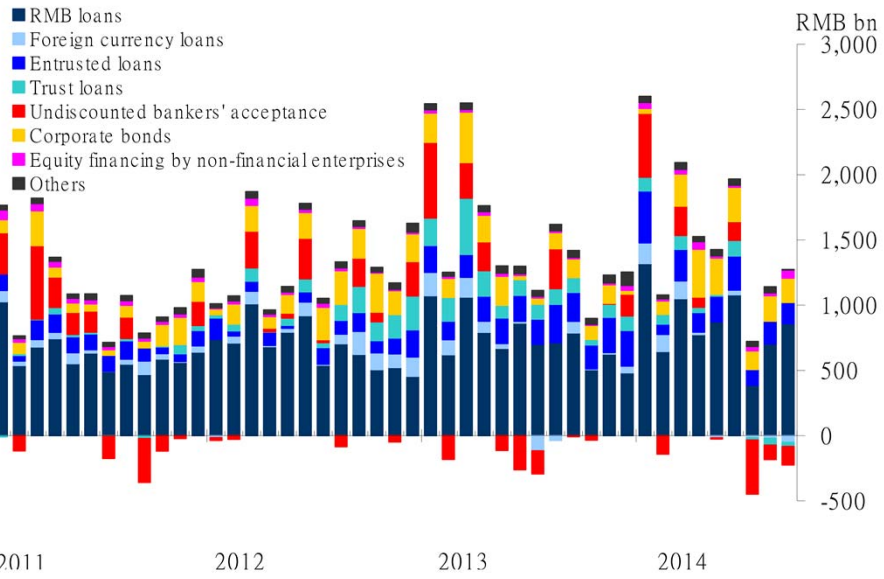
## MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



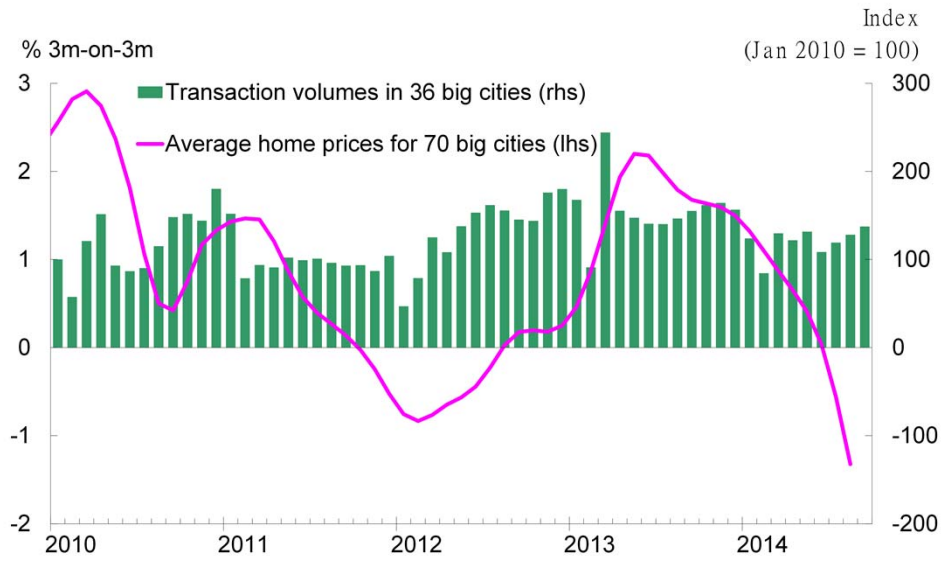
## MAINLAND CHINA: AGGREGATE FINANCING TO THE REAL ECONOMY



Source: CEIC



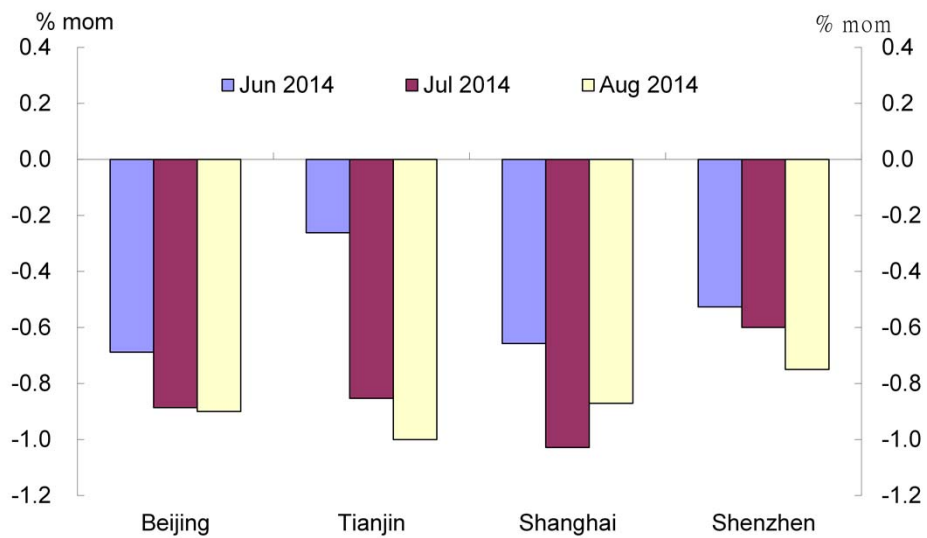
## MAINLAND CHINA: PROPERTY TRANSACTION VOLUME AND PRICE CHANGES IN BIG CITIES



Sources: CEIC, WIND and HKMA staff estimates



## MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES

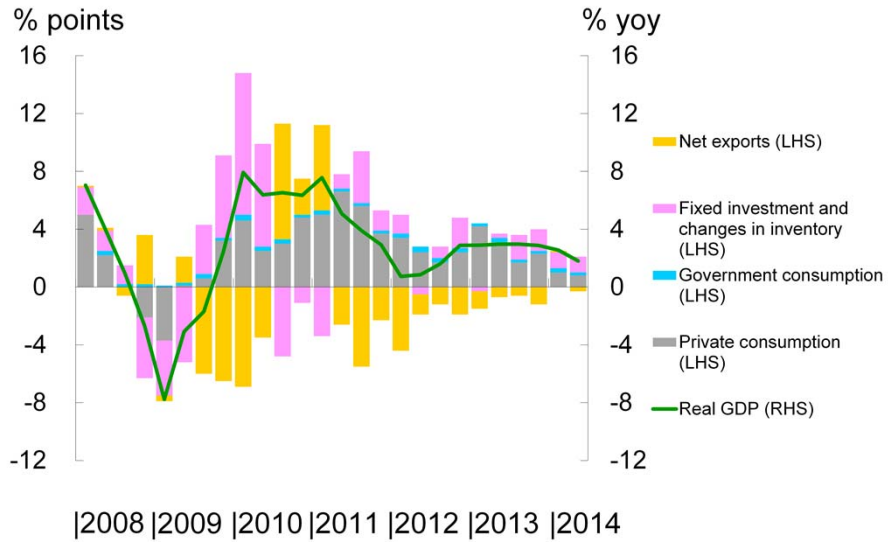


Sources: CEIC, WIND and HKMA staff estimates



## HONG KONG: REAL GDP GROWTH

### Changes in Real GDP and contributions by major components

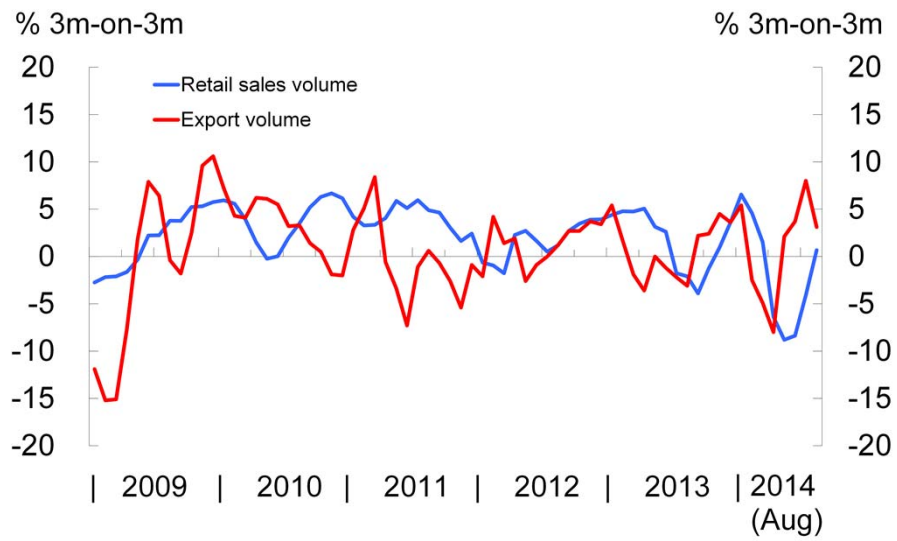


Source: C&SD



# HONG KONG: ECONOMIC ACTIVITY

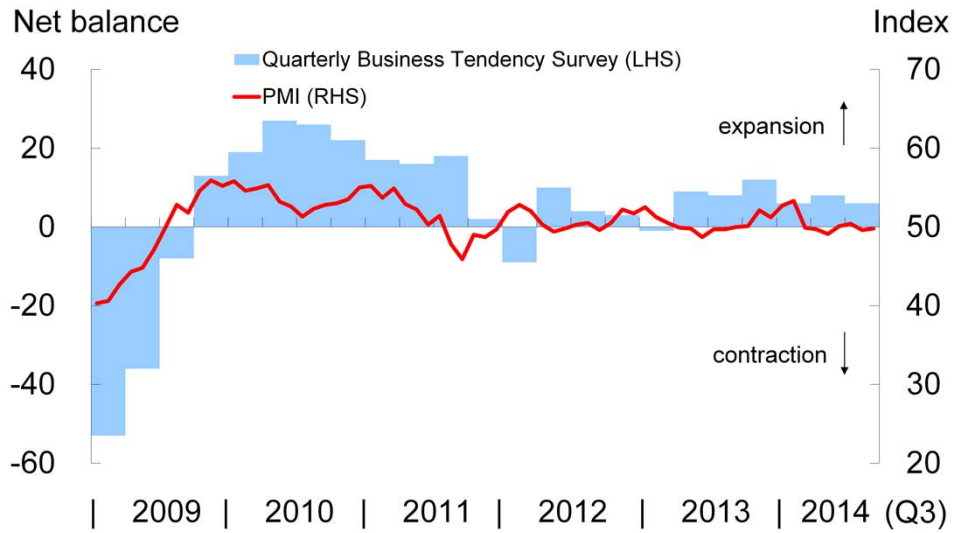
## Retail Sales and Exports



Source: C&SD



## HONG KONG: BUSINESS OUTLOOK



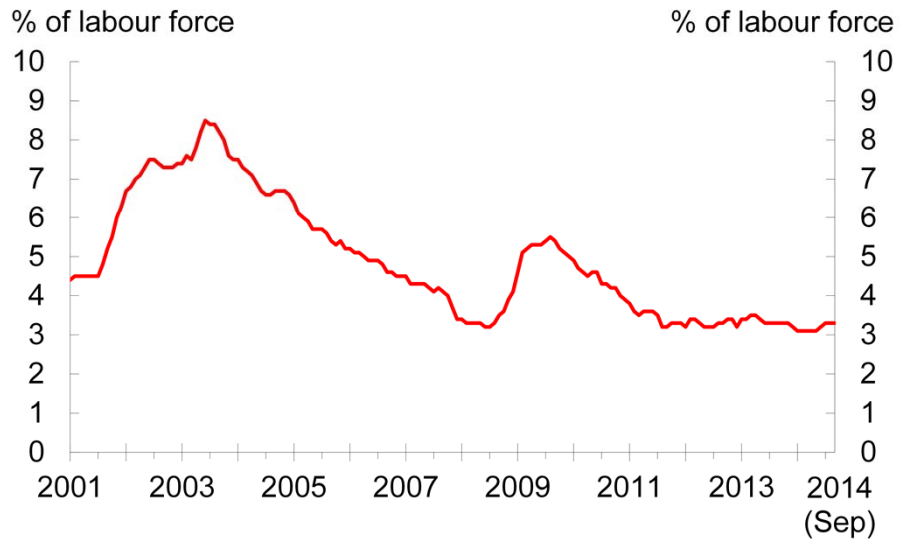
Sources: C&SD and Markit Economics





## HONG KONG: LABOUR MARKET

### Unemployment rate

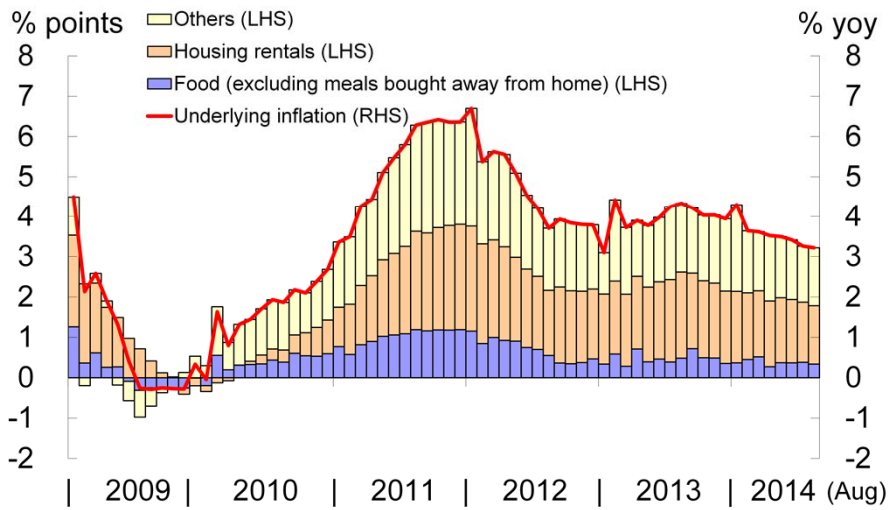


Source: C&SD



# HONG KONG: INFLATION

## Underlying inflation and contributions of its components

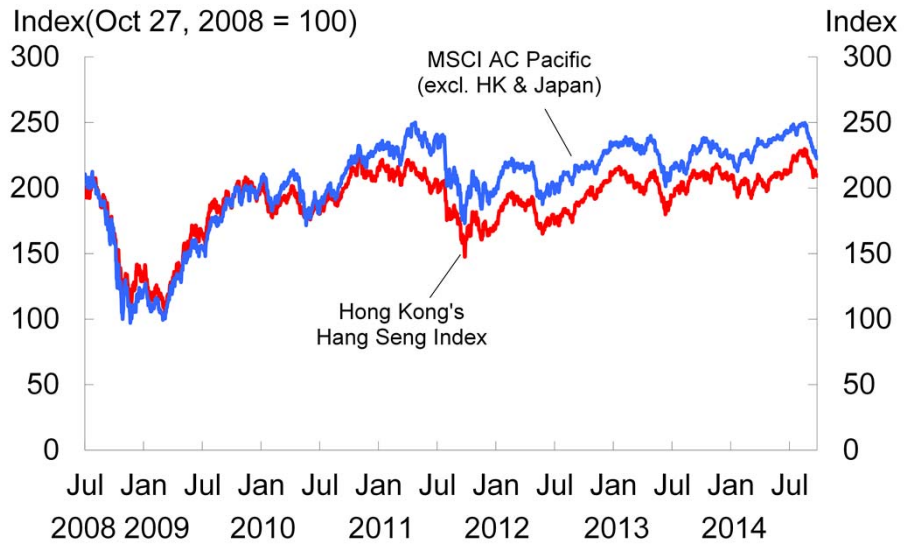


Sources: C&SD and HKMA staff estimates



## HONG KONG: EQUITY MARKET

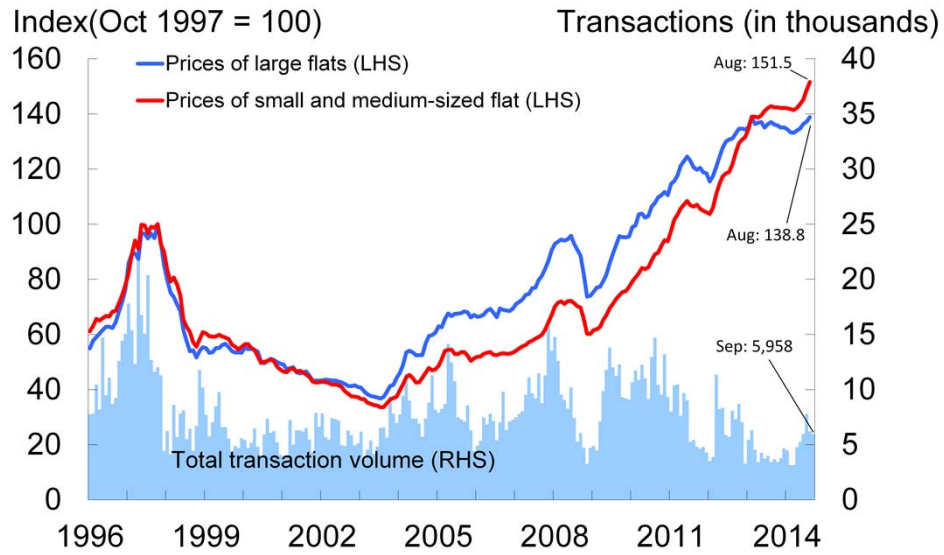
### Hong Kong and Asia Pacific equity market performance



Source: Bloomberg



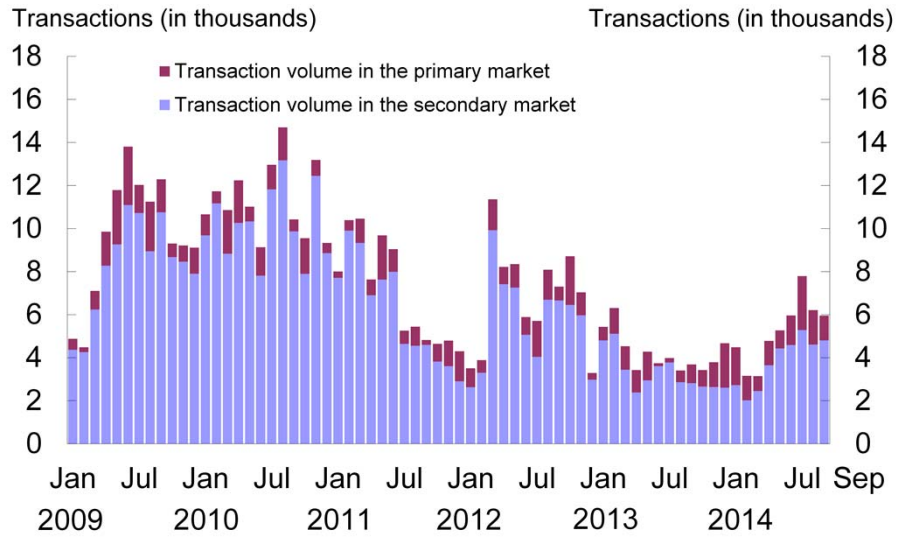
## HONG KONG: RESIDENTIAL PROPERTY PRICES AND TRANSACTION VOLUME



Source: Rating and Valuation Department and The Land Registry



## HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS

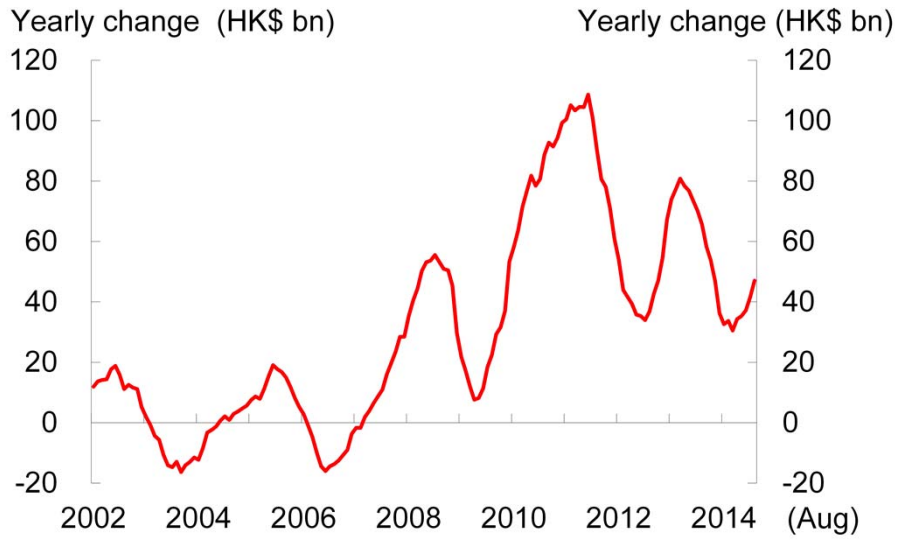


Source: The Land Registry



## HONG KONG: OUTSTANDING RESIDENTIAL MORTGAGE LOANS

### Changes in outstanding residential mortgage loans

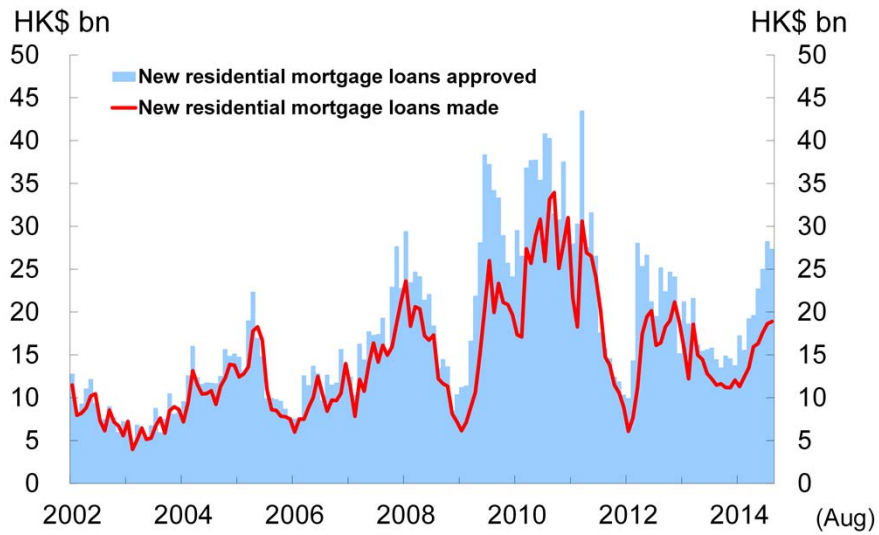


Source: HKMA



## HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

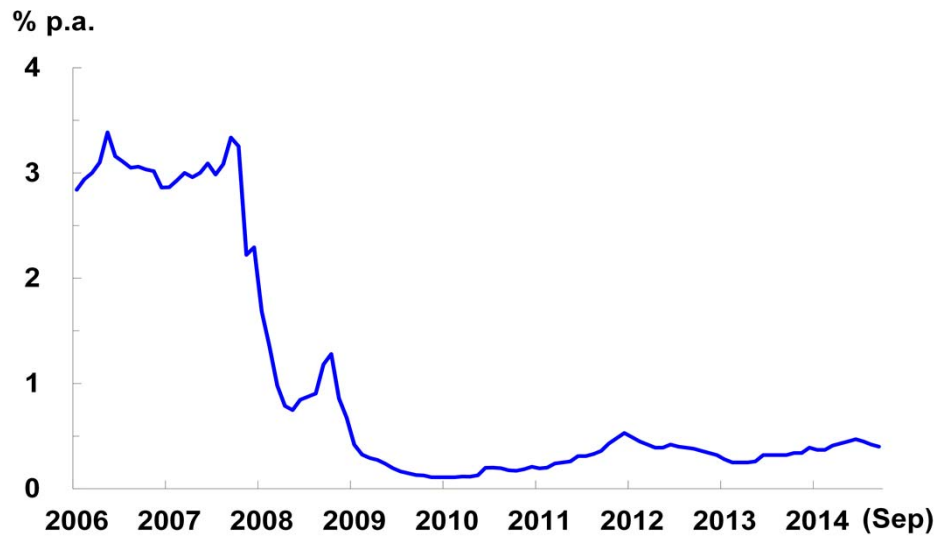
### New residential mortgage loans made and approved



Source: HKMA



## HONG KONG: COMPOSITE INTEREST RATE

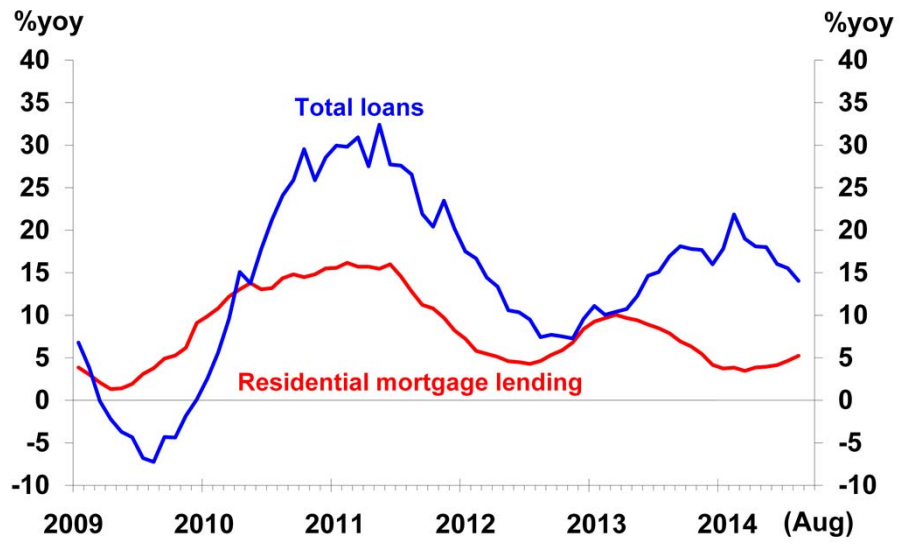


Source: HKMA





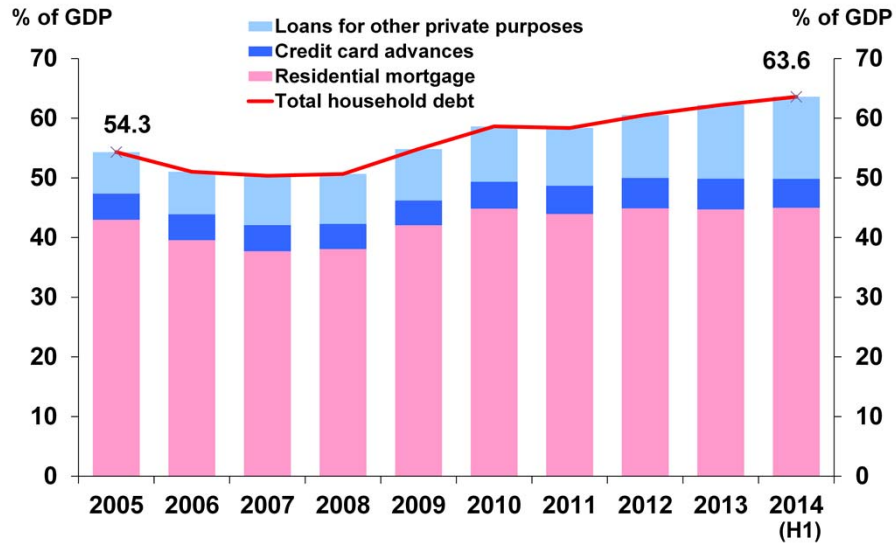
# HONG KONG: LOAN GROWTH



Source: HKMA



## HONG KONG: HOUSEHOLD DEBT



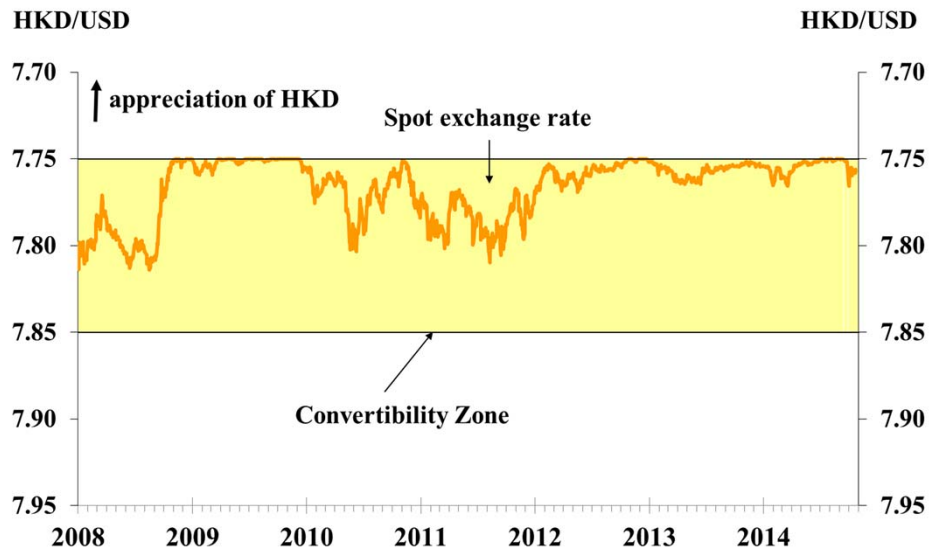
Sources: C&SD and HKMA staff estimates



# CURRENCY STABILITY



## HONG KONG DOLLAR SPOT EXCHANGE RATE

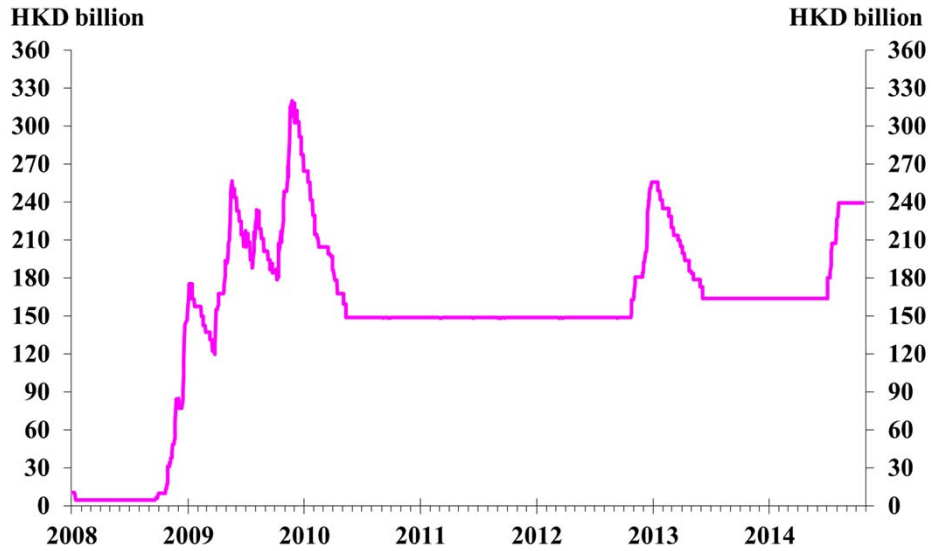


44

- The spot rate of Hong Kong dollar against United States dollar strengthened to 7.75 in July and August 2014, resulting in repeated triggering of the strong-side Convertibility Undertaking. Demand for the Hong Kong dollar increased, partly due to commercial activities, including merger and acquisition activities and dividend distributions, and partly due to the relatively buoyant stock market.
- Hong Kong dollar softened briefly towards the end of September / early October.



## AGGREGATE BALANCE

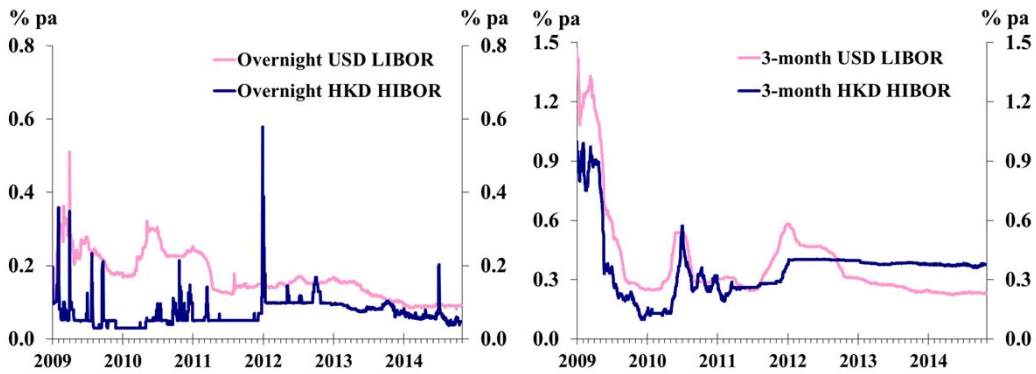


45

- The strong-side Convertibility Undertaking was triggered multiple times in July and early August 2014. In response to banks' demand, the HKMA bought a total of US\$9.72 billion between 1 July and 5 August. As a result, the Aggregate Balance rose from HK\$164 billion at the end of June to around HK\$240 billion at the end of August 2014.



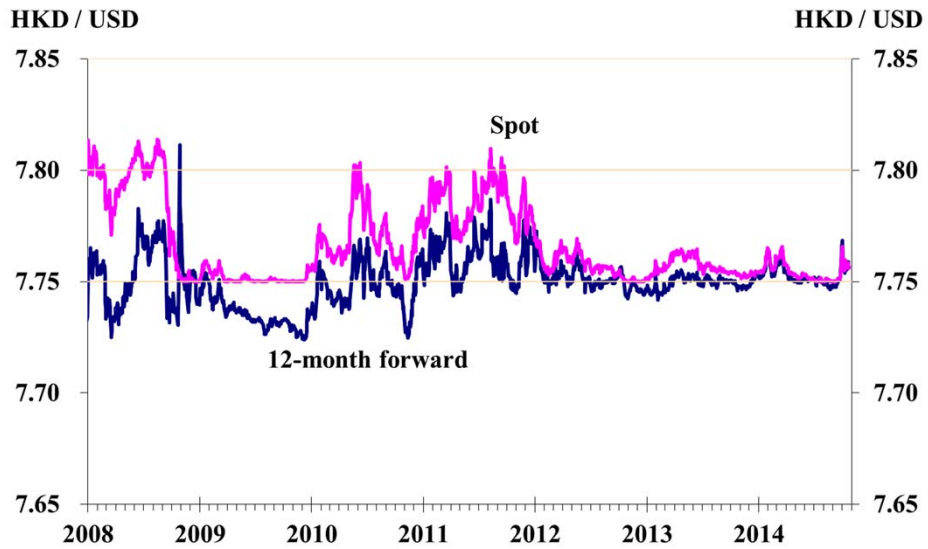
## DOMESTIC INTEREST RATES



- Overnight Hong Kong dollar HIBOR surged to as high as 0.20% on 2 July 2014 due to increased demand for Hong Kong dollar. Nonetheless, following an increase in Aggregate Balance, the interest rates retraced afterwards.



## HONG KONG DOLLAR FORWARD EXCHANGE RATE



47

- Hong Kong dollar forward exchange rate tracked closely the movements in the Hong Kong dollar spot rate over the last few months.



## **COIN COLLECTION MOBILE KIOSKS PILOT SCHEME**

- As a 2-year pilot scheme started in October 2014, two Coin Carts will serve all districts on a rotating basis. They will provide services at locations that are convenient to the public without obstructing the traffic. The service schedule is on HKMA website
- Users may choose to receive banknotes in exchange for coins, or add value to Octopus cards; they can also donate to the Community Chest
- Each Coin Cart has two high-speed coin authentication machines, an elevating platform for wheelchair users, and staff providing assistance throughout the coin-exchange service



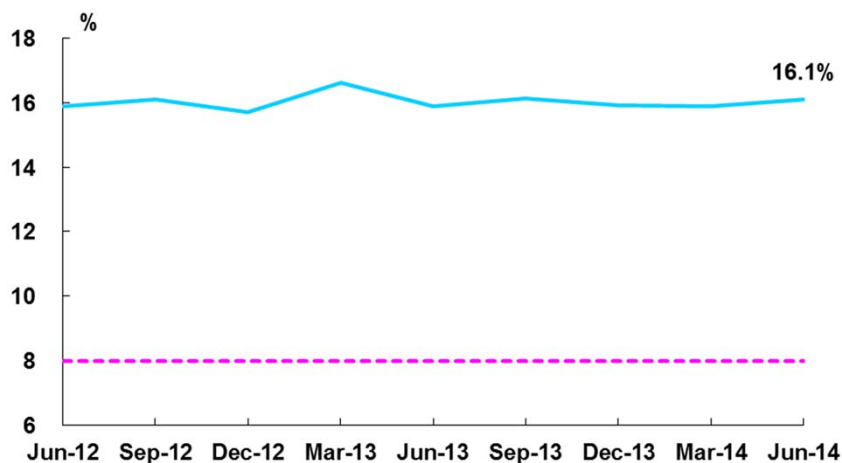


# **BANKING STABILITY**



## BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



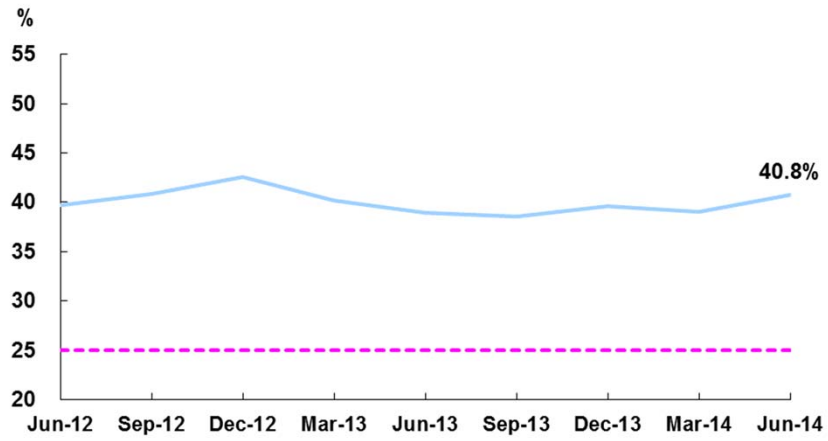
50

- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs increased to 16.1% at end-June 2014 from 15.9% at end-March 2014 due to a faster increase in the capital base (+4.1%) than the increase in risk-weighted amount (+3.2%). The consolidated CAR remained well above the international standard of 8%.



## BANKING SECTOR PERFORMANCE

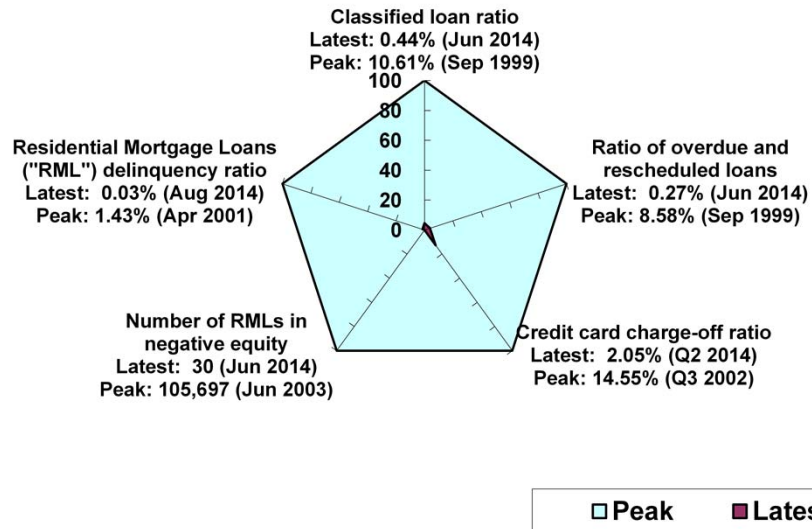
Quarterly average liquidity ratio of retail banks remained well above statutory minimum of 25%





## BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards

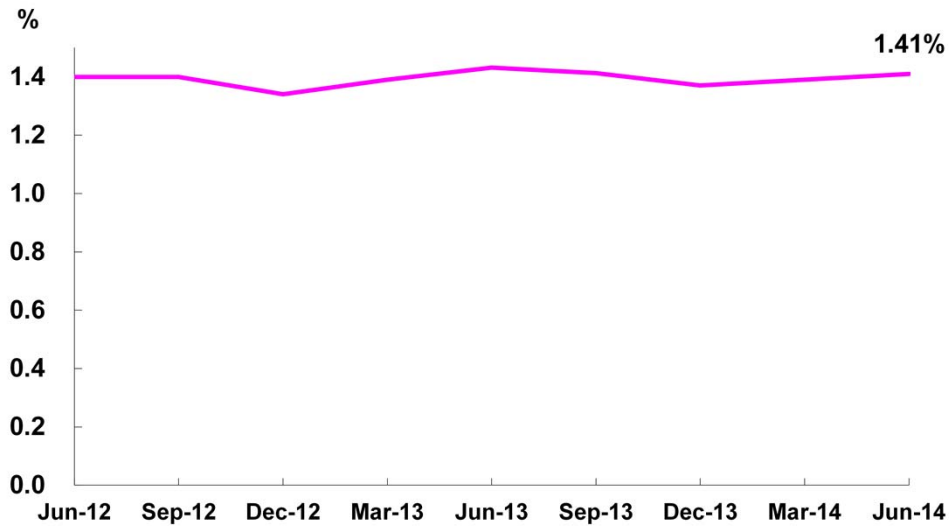


- The HKMA will continue to monitor closely the asset quality of retail banks' loan portfolios.



## BANKING SECTOR PERFORMANCE

Net interest margin of retail banks remained stable



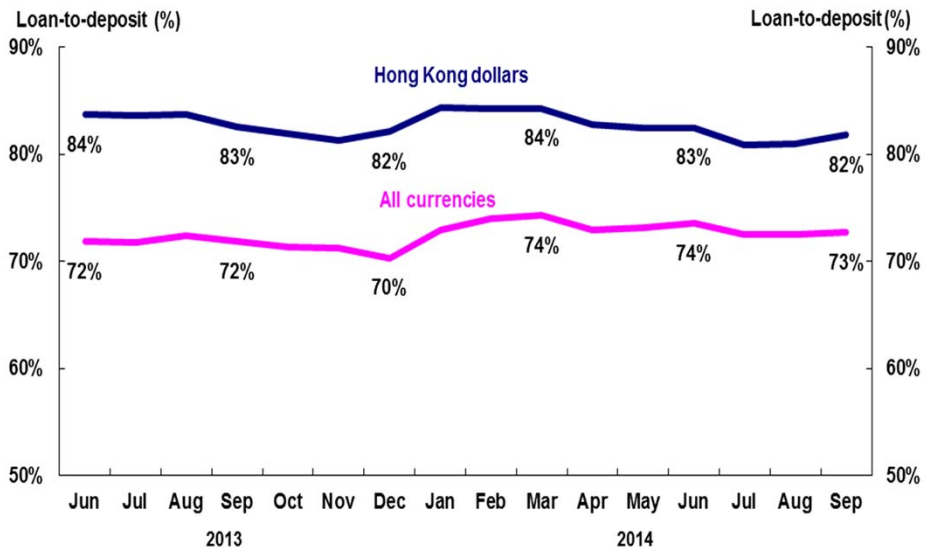
53

- The quarterly annualised net interest margin (NIM) of retail banks' Hong Kong offices widened to 1.41% in Q2 2014 from 1.39% in Q1 2014.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in first half of 2014 slightly increased by 1.1% as compared with the same period last year. This was due to the fact that much of the growth in net interest income was offset by an increase in operating expenses coupled with a decline in non-interest income during the period.



## CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong slightly decreased



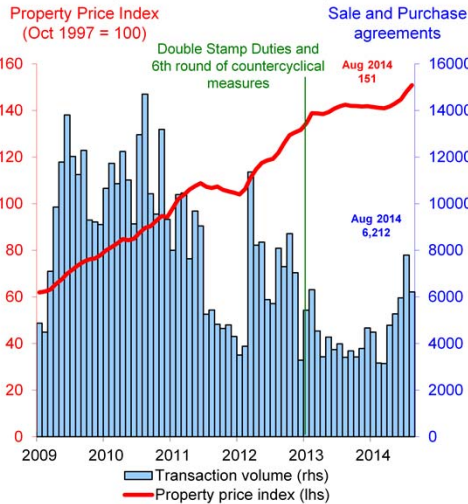
54

- The Hong Kong dollar loan-to-deposit ratio slightly declined to 82% at end-September 2014 from 83% at end-June 2014. The decline was due to a faster growth pace of Hong Kong dollar deposits (+1.5%) than that of Hong Kong dollar loans (+0.7%).
- The all currencies loan-to-deposit ratio also slightly declined to 73% at end-September 2014 from 74% at end-June 2014. The decrease was due to the faster increase in total deposits (+3.2%) than the increase in total loans (+1.9%)
- The HKMA will continue to monitor movement of the loan-to-deposit ratio.

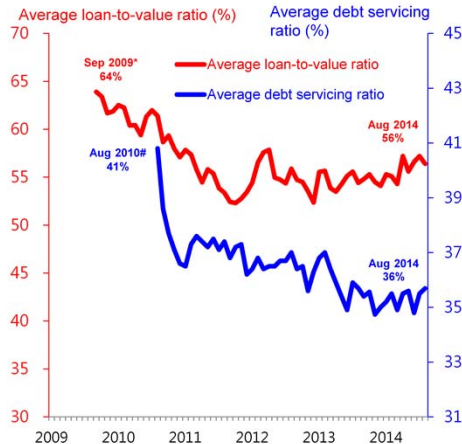


## RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

**Residential property price index and transaction volume**



**Average loan-to-value ratio and debt servicing ratio for new residential mortgage loans approved**



### Latest statistics for residential mortgage loans ("RMLs")

	Monthly average in 2012	Monthly average in 2013	Apr 2014	May 2014	Jun 2014	July 2014	Aug 2014
Number of sale and purchase agreements	6,778	4,223	4,781	5,270	5,960	7,792	6,212
Number of new RML applications	11,634	8,694	9,156	11,175	11,442	12,728	11,719
Number of new RMLs approved	8,210	5,952	6,326	7,444	7,990	8,995	8,680

### Latest statistics for residential property prices

Property price index		Period	Property price index
Rating & Valuation Department (10/1997=100)	Latest position	08/2014	150.8
	Recent Peak	08/2014	150.8
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	28/9/2014	128.1
	Recent Peak	28/9/2014	128.1
	Peak in 1997	19/10/1997	102.9

The HKMA will continue to closely monitor the property and mortgage lending markets. The HKMA will continue to tighten the countercyclical measures if the upward cycle of the property market persists and loosen the measures introduced earlier as appropriate if the downward cycle of the property market is confirmed.



## BASEL III IMPLEMENTATION PROGRESS

### Submitted to LegCo

- Banking (Amendment) Ordinance 2012 (Commencement) Notice 2014
- Banking (Capital) (Amendment) Rules 2014
- Banking (Liquidity) Rules

### Consultations

- Disclosure requirements associated with 2<sup>nd</sup> phase
- Supervisory guidelines re “Countercyclical Capital Buffer” and “Systemically Important Banks”

56

### Legislation

- 3 pieces of subsidiary legislation for 2<sup>nd</sup> phase of Basel III implementation submitted to LegCo on 29 Oct for negative vetting:
  - **Banking (Amendment) Ordinance (BAO) Commencement Notice** – to commence operation of liquidity-related provisions in the BAO 2012 which were not covered in the previous Commencement Notice enacted in 2012 for the 1<sup>st</sup> phase of Basel III implementation
  - **Banking (Capital) (Amendment) Rules (BCAR)** and **Banking (Liquidity) Rules (BLR)** – to respectively implement capital buffers and Liquidity Coverage Ratio (LCR) pertaining to 2<sup>nd</sup> phase of Basel III implementation. Both sets of rules have taken account of comments received from statutory consultation, which were mostly to seek clarifications on specific areas at a technical level.

### Consultations

- To consult the industry on draft Banking (Disclosure) (Amendment) Rules and proposed disclosure requirements associated with LCR, capital buffers and Leverage Ratio, with a view to developing a set of amendments to the Banking (Disclosure) Rules for submission to LegCo within 2014.
- Draft Supervisory Policy Manual (SPM) module on Countercyclical Capital Buffer (CCyB) under Basel III (explaining the MA’s approach towards implementing it) issued for industry consultation on 14 August. Industry comments received being addressed.
- Draft SPM module on SIBs issued for consultation on 8 October.





## **CROSS-SECTOR RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG**

- Legislative reform to meet international standards: Financial Stability Board (FSB)'s "Key Attributes of Effective Resolution Regimes"
- Fill gaps in HK regulators' existing toolkits to support resolution of failing financial institutions
- First three-month public consultation closed in April 2014
- Second consultation exercise expected to be launched in late 2014 with a view to introducing a Bill into LegCo by Q4 2015

57

- As highlighted to the FAP at its meetings in February and May 2014, as part of policy measures designed to reduce the risks posed by systemically important financial institutions (SIFIs), the FSB set new standards for resolution (in its "Key Attributes of Effective Resolution Regimes for Financial Institutions") in late 2011;
- The Hong Kong authorities (in self-assessments) and the FSB (in a peer review) identified a series of gaps in the existing toolkits available to the regulators when compared with these new standards. Legislative reform is necessary to fill these gaps and provide for an effective resolution regime such that in the event that any SIFI were to reach a point of non-viability in the future, the authorities in Hong Kong will be in a position to deal with it effectively in a manner that protects both financial stability and public funds;
- The FSTB, together with HKMA, Securities and Futures Commission and the Office of the Commissioner of Insurance, issued a first-stage three-month public consultation paper setting out the authorities' initial thinking and proposals in January 2014. A total of 33 submissions were received from a wide range of stakeholders;
- Following proactive engagement with stakeholders during the consultation period, the FSTB and the regulators have carefully reviewed respondents' submissions to the first-stage consultation while developing further proposals through a cross-authority working group. A second public consultation exercise providing more details on the proposals and tackling some of the more complex issues is expected to take place in late 2014 with a view to introducing a Bill into LegCo in Q4 2015.



## INVESTOR AND CONSUMER PROTECTION

- Under the Enhanced Competency Framework for private wealth management practitioners, the relevant training programmes commenced in late October
- Issued circular in July to share with AIs certain issues and good practices in relation to sale of investment products identified in supervisory process
- Continue to participate in the work of the Organisation for Economic Co-operation and Development Task Force on Financial Consumer Protection in developing effective approaches to support the implementation of the G20 High-Level Principles on Financial Consumer Protection
- Launched a series of consumer education videos since mid-September. Organised an exhibition to promote the videos, and broadcasted "smart tips" on radio and print media to promote smart and responsible use of banking services

58

- An enhanced competency framework (ECF) specifically established for private wealth management (PWM) practitioners in Hong Kong was launched in June this year to encourage PWM practitioners to enhance on an on-going basis their professional competence, ethics and compliance. The ECF is part of the HKMA's initiative to work with the industry to enhance the competence of bank staff. This will help build Hong Kong's brand as a premier international financial centre. The HKMA will explore similar efforts in other areas of banking operations (e.g. compliance and risk management) in future.
- In July, HKMA issued a circular to banks to share certain issues and good practices in relation to the sale of investment products identified during our supervisory process and to reiterate the applicable regulatory requirements as well as the HKMA's expected standards. The circular covered different aspects of issues and practices, e.g. product due diligence, staff training, customer risk profiling and suitability assessment.
- The HKMA is a member of the Task Force on Financial Consumer Protection of the Organisation for Economic Co-operation and Development (OECD) (the Task Force) and has been participating actively in the development of the G20 High-level Principles on Financial Consumer Protection. The Task Force's summary report on effective approaches to support the implementation of the three priority principles (namely, "Disclosure and Transparency", "Responsible Business Conduct of Financial Services Providers and Authorised Agents" and "Complaints Handling and Redress") was endorsed in the G20 Summit held in September 2013. The summary report on effective approaches for the remaining seven principles will be submitted to the G20 Summit for endorsement in November 2014. The HKMA is studying the feasibility of implementing the effective approaches in Hong Kong.
- The HKMA has launched four consumer education videos on public transport, Internet, smartphone apps since mid-September. The HKMA will continue to promote smart tips on the use of credit cards and self-banking services (e.g. ATMs, internet banking and mobile banking) through broadcasting audio clips on radio and smartphone apps, organising roving exhibitions and seminars, publishing featured articles on printed media and distributing information leaflets.



## VIDEO SERIES ON CONSUMER EDUCATION



59

- The videos are available on the HKMA website (<http://www.hkma.gov.hk>) and the newly launched “HKMA Smart Tips Channel” on YouTube (<http://www.youtube.com/user/HKMASmartTips>).



## ENHANCEMENTS TO DEPOSIT PROTECTION SCHEME

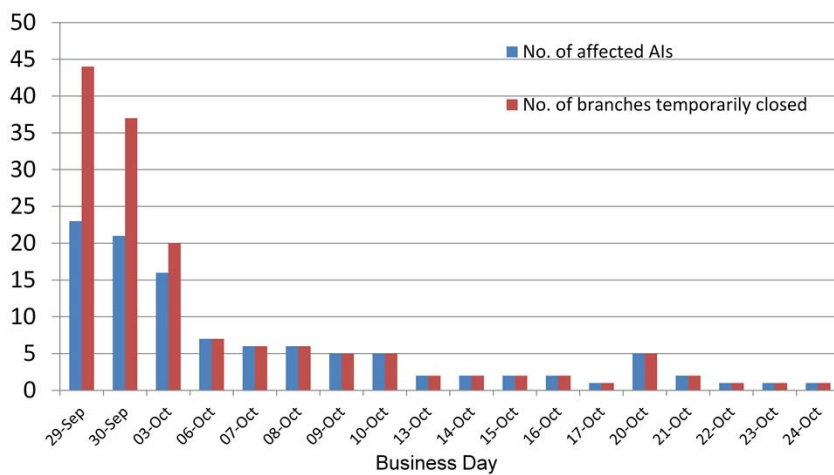
- 3-month public consultation launched in September 2014
- Aim: swifter payouts, change to gross payout basis
- Benefit to:
  - Depositors - Faster access to compensation
  - Banks - Simpler systems
  - Deposit Protection Scheme
    - More effective financial safety net
    - In line with peers

60

- The FSTB and the HKMA jointly launched a three-month public consultation on the proposed enhancements to the Deposit Protection Scheme (DPS) on 12 September 2014. The key proposal is to adopt gross basis for deposit compensation calculation so as to achieve a faster payout in case there is a bank failure.
- Under the proposed gross payout approach, set-off between the protected deposits held by a depositor against his liability owed to the failed bank will be dis-applied up to the DPS protection limit (i.e. HK\$500,000 at present) for determining the amount of compensation payment.
- For reference: other enhancement proposals include: (1) providing more certainty for determining the “Quantification Date” for more expeditious calculation of accrued interest and conversion of foreign currencies deposits into Hong Kong dollars in a payout and (2) enabling the use of electronic communication channels in addition to paper communication for notifying depositors about details of payout
- Upon implementation of gross payout and other related enhancements, it is expected that:
  - Depositors will have quicker access to their deposit compensation payments when the DPS is triggered (receiving full compensation within 1 week under most circumstances as compared to a timeframe of 2 weeks for interim payments and 6 weeks for final payments under the current netting approach)
  - Banks can simplify the depositors’ data maintenance requirements in preparing for payout readiness
  - A more effective DPS can reinforce depositors’ confidence and thus contributing to general financial stability
  - The proposed enhancements are similar to reforms recently adopted by other overseas deposit insurers (e.g. the UK, the Netherlands, Singapore and Australia) and address the recommendation of the IMF to consider changing the present rule on netting in compensation determination to achieve swifter payouts.



## TEMPORARY CLOSURE OF BANK BRANCHES DUE TO THE "OCCUPY CENTRAL" MOVEMENT



No material disruptions to the overall operation of the banking sector have been caused so far.



# **FINANCIAL INFRASTRUCTURE**



## REGULATORY DEVELOPMENT OF THE OTC DERIVATIVES MARKET

- The Securities and Futures (Amendment) Bill 2013 was passed by the LegCo in Q1 2014. Detailed rules are now under preparation for implementing the regulatory regime for the over-the-counter (OTC) derivatives market in Hong Kong
- Public consultation on the first set of draft rules, which focused on the mandatory reporting and related record keeping obligations, was conducted in Q3 2014
- The HKMA and SFC are revising the draft rules taking into account responses received. The target is to introduce the proposed rules into LegCo in early 2015.

63

- As an interim measure before the new legislation comes into effect, the HKMA has mandated the reporting of specified OTC derivative transactions between licensed banks to the trade repository set up by the HKMA with effect from 5 August 2013.
- The regulatory regime for the OTC derivatives market in Hong Kong is expected to take effect around Q1 2015, with the mandatory reporting and related record keeping obligations taking effect first.



## GOVERNMENT BOND PROGRAMME

### **Institutional Bond Issuance Programme:**

- 12 issues totalling HK\$73.5 billion were outstanding as at end October
- A yield curve from two years to ten years is established to form the basis for other issuers to price their issues

### **Liquidity enhancement measures for institutional bonds:**

- The HKMA has implemented two measures, namely, bond swap facility and switch tender, to promote the liquidity of the institutional bond market

### **Retail Bond Issuance Programme:**

- The HKMA issued the fourth iBond in August. Total subscription amount was \$28.8 billion, 1.9 times issue amount
- Three series of iBonds totalling HK\$30 billion were outstanding as at end October





## PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector 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 promote Hong Kong's financial platform to overseas and Mainland asset owners and asset managers
- Building on the feedback from our regular dialogues with industry players, we will continue to improve our platform and keep up with the latest developments in the asset management industry

65

- Over the past few years, our outreach team held over 830 meetings with over 480 financial institutions to showcase the unique competitive advantages of Hong Kong as a financial centre.
- Our outreach campaign has had very encouraging results, with some notable asset owners and asset managers choosing to set up their Asia headquarters in Hong Kong. Being an asset owner ourselves, the HKMA has a unique advantage in relating to other asset owners on their criteria in choosing an overseas investment hub.
- On platform building, the HKMA conducts reviews of legal, regulatory, tax and other issues to inform policy formulation concerning the development of Hong Kong's asset management industry. The HKMA also provides necessary support to the Financial Services and the Treasury Bureau and other agencies in taking forward new initiatives announced by the Financial Secretary, such as the proposed extension of profits tax exemption to offshore private equity funds, the proposed exemption of stamp duty for the transfer of all exchange traded funds shares or units, and the review of the Inland Revenue Ordinance in respect of the taxation regime of corporate treasury activities. On the latter, the HKMA has joined the Government Task Force to explore room for optimisation under the Inland Revenue Ordinance so as to create a conducive tax environment for genuine corporate treasury centre activities with a view to enhancing Hong Kong's competitiveness as a regional corporate treasury centre.



## CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The combined fund management business in Hong Kong hit a record high of US\$ 2.1 trillion at the end of 2013, a 27% increase over 2012
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- Over 60 of the 100 largest global money managers have offices in Hong Kong
- In terms of private banking, 20 private banks have opened for business in Hong Kong since 2009, bringing the total to 46 banks offering private wealth management services in Hong Kong today (as of Oct 2014)

66

- According to the Securities and Futures Commission (SFC)'s survey, 72% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2013, attesting to the fact that Hong Kong is a preferred location for asset management business in the region.
- The number of licensed corporations for asset management has increased from 680 in 2008 to 967 in March 2014.
- Over 60 of the 100 largest global money managers have offices in Hong Kong (ranked by assets under management as of end 2013), and about 60 of them are licensed by the SFC.
- Achieved leading positions as an asset management centre in the region. Hong Kong is a leading hub for:
  1. Hong Kong is the second largest private equity hub in Asia with over 370 private equity firms as of end 2013.
  2. Over 60% of Qualified Foreign Institutional Investor managers, over 70% Qualified Domestic Institutional Investor managers and over 90% of Renminbi Qualified Foreign Institutional Investor managers have a presence in Hong Kong as of September 2014.
  3. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increasing from 538 in 2010 to 676 at end September 2012.



## DEVELOPMENT OF ISLAMIC FINANCE

- Successfully completed the inaugural offering of Government sukuk under the Government Bond Programme, marking the world's first United States dollar-denominated sukuk originated by an AAA-rated government
- The Government sukuk, with an issuance size of US\$1 billion and a tenor of 5 years, was priced at 2.005% (23 basis points over 5-year US Treasuries), representing the tightest spread ever achieved on a benchmark United States dollar issuance from an Asian (ex-Japan) government
- The sukuk saw strong demand from global investors, attracting orders exceeding US\$4.7 billion. The paper was finally allocated to over 120 global institutional investors
- Will continue to maintain close dialogue with market players. Hopefully, the sukuk issuance will encourage more issuers and investors to participate in our market



## FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- A new linkage between Hong Kong's United States dollar Real Time Gross Settlement (RTGS) system and Thailand's Thai Baht (THB) RTGS system, BAHTNET, was established as planned on 28 July 2014. The linkage facilitates cross-border payment-versus-payment settlement of USD/THB foreign exchange transactions and helps eliminate the relevant settlement risk
- Reporting to the over-the-counter (OTC) derivatives trade repository (TR) of the HKMA has been smooth. The TR will be further developed to meet local reporting requirements and international standards

68

### **Operation of financial infrastructure**

- The Hong Kong Dollar, United States dollar, Euro and RMB Real Time Gross Settlement (RTGS) systems, the Central Moneymarkets Unit (CMU) and the Trade Repository (TR) for over-the-counter (OTC) derivatives have been operating smoothly.

### **USD-THB payment-vs- payment link**

- Under close cooperation of the HKMA and Bank of Thailand, linkage between Hong Kong's United States dollar RTGS system and Thailand's Thai Baht RTGS system, BAHTNET, was established as planned on 28 July 2014. The new linkage facilitates cross-border payment-versus-payment settlement of USD/THB foreign exchange transactions. The operation has been smooth so far.

### **OTC derivatives Trade Repository**

- Since the reporting function of the TR was launched in July 2013, reporting (by banks) to the TR has been smooth.
- A new phase of the TR system was launched by end-September 2014, mainly for expanding product scope to cover the remaining commonly traded interest rate and foreign exchange derivative products in the local market, and adding equity derivative products.
- Preparations are being made to support the targetted commencement in 2015 of the mandatory reporting under the new OTC derivatives market regulatory regime.



## LEGISLATIVE FRAMEWORK FOR STORED VALUE FACILITIES AND RETAIL PAYMENT SYSTEMS

- Preparation of the draft Clearing and Settlement Systems (Amendment) Bill to put in place a legal framework for regulating stored-value facilities (SVF) and retail payment systems (RPS) in Hong Kong is in final stage
- The new regulatory framework seeks to ensure adequate protection of users' float maintained with SVF issuers and the security and soundness of the operations of SVF and RPS in Hong Kong
- The draft Bill includes provisions to:
  - (i) introduce a licensing regime for SVF and a designation regime for RPS
  - (ii) introduce relevant supervisory powers and enforcement powers of the MA
  - (iii) introduce offences and sanctions with references from other legislations
  - (iv) introduce an enhanced appeal mechanisms; and
  - (v) repeal the stored value card regime under the existing Banking Ordinance
- The FSTB and HKMA have previously consulted the public including industry players and bodies on the key policy proposals in the Bill
- Consultation conclusion will be jointly issued by FSTB and MA in October 2014. The Bill is scheduled for introduction into LegCo in February 2015

69

### Legislative framework for stored value facilities and retail payment systems

- Drafting of the Clearing and Settlement Systems (Amendment) Bill to amend the Clearing and Settlement Systems Ordinance (CSSO) is in final stage.
- The purpose of the Bill is to put in place a legal framework for implementing regulations on stored value facilities (SVF) and retail payment systems (RPS) in Hong Kong in order to ensure adequate protection of users' float maintained by the issuers of SVF and the security and soundness of innovative retail payment products and systems.
- The draft Bill includes provisions to:
  - implement a licensing regime for SVF covering both device-based and non-device based SVF with a series of licensing criteria including physical presence in Hong Kong; principal business has to be SVF issuing; financial strength; float safeguarding and management; fitness and propriety of ownership and management; anti-money laundering and counter terrorist financing requirements; security and soundness of system and business scheme, etc.;
  - implement a designation regime for RPS under which RPS that are important to the public and financial stability of Hong Kong will be so designated by the HKMA and subject to the HKMA's regulation;
  - empower the HKMA to exercise necessary supervisory functions on SVF and designated RPS including powers to conduct on-site and off-site supervision; gather information; make regulations; issue guidelines; impose operating rules; and give directions, etc.;
  - empower the HKMA to exercise necessary enforcement actions on SVF and RPS including the conduct of investigation;
  - with reference to other legislation including the Banking Ordinance, Securities and Futures Ordinance and the Anti-Money Laundering and Counter Terrorists Financing (Financial Institutions) Ordinance, introduce relevant offenses and sanctions for contravention of the CSSO including minor sanctions such as caution, warning and reprimand; and
  - enhancement to the existing appeal mechanism under the CSSO to enable persons aggrieved by a reviewable decision of the HKMA made under the CSSO to refer to the decision to an Appeal Tribunal for review
- The HKMA and FSTB jointly conducted a 3-month public consultation on the proposed regulation between 22 May 2013 and 22 Aug 2013. Comments received indicated that there were general supportive to the regulatory proposals. Where appropriate, we have incorporated these comments in the draft Bill.
- A consultation conclusion will be issued to the public in October 2014. The Bill is scheduled for introduction into the LegCo in February 2015.

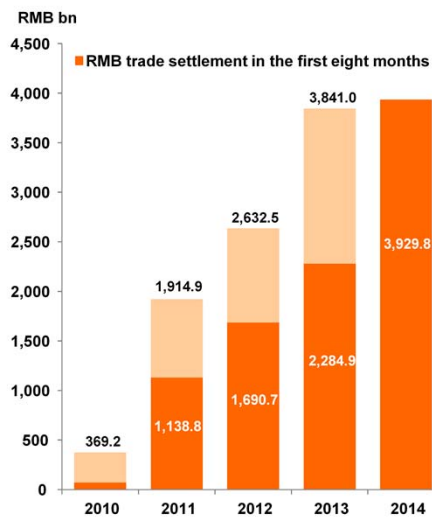


# **HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE**

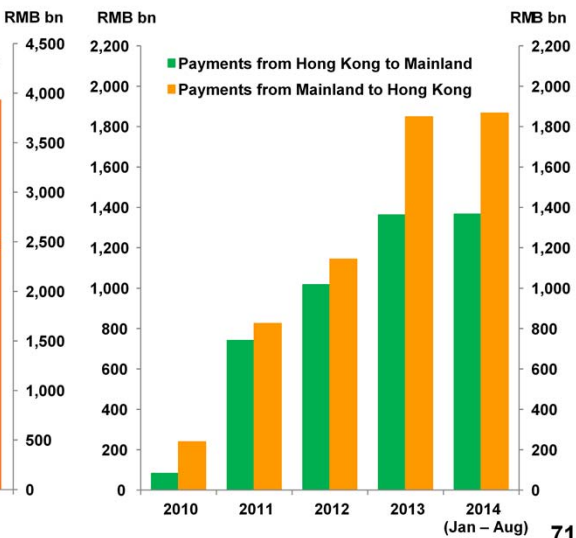


## FURTHER EXPANSION IN RMB TRADE SETTLEMENT

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



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

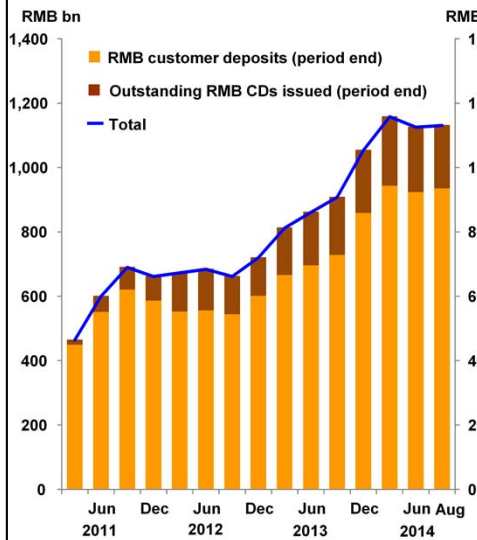


- In the first eight months of 2014, RMB trade settlement handled by banks in Hong Kong amounted to RMB3.9298 trillion, up 72% compared with the same period in 2013, and exceeding the annual total of 2013. The ratio of payments to and from the Mainland was 1:1.4.

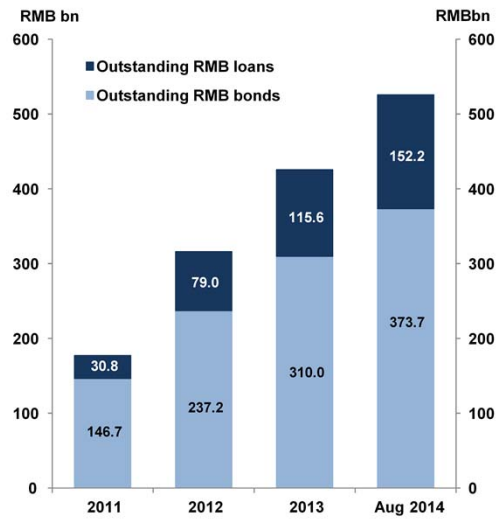


## VIBRANT RMB FINANCING ACTIVITIES

**RMB customer deposits and certificates of deposit (CDs)**



**RMB financing activities**



72

- At end August 2014, RMB customer deposits and outstanding RMB certificates of deposit amounted to RMB936.8 billion and RMB193.5 billion respectively, totaling RMB1.1303 trillion, a 7% growth from RMB1.0530 trillion at the end of 2013.
- The RMB dim sum bond market was active in the first three quarters of 2014, with issuance totalling RMB163.6 billion, 40% more than the total amount of RMB116.6 billion in 2013. Issuers include corporates and financial institutions from the Mainland and overseas markets. Outstanding dim sum bonds amounted to some RMB374.0 billion at end September 2014, up about 20% from end 2013.
- RMB bank lending continued to grow, with outstanding amount of RMB loans increasing to RMB152.2 billion at end August 2014, a growth of 32% from the end of 2013.





## CONTINUED STRENGTHENING OF HONG KONG'S RMB BUSINESS LINKS WITH OTHER PARTS OF THE WORLD

	Aug 2014	2013	2012	2011
1 No. of participating banks of Hong Kong's RMB clearing platform	223	216	204	187
Of which:	197	191	181	165
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks				
2 Amount due to overseas banks (RMB billion)	150.6	166.0	99.1	116.4
3 Amount due from overseas banks (RMB billion)	217.9	164.5	117.1	121.7
4 Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB billion)	648.7	395.4	213.7	121.4

73

- Hong Kong's RMB business links with other parts of the world continue to grow. Collaboration on RMB business between Hong Kong and other markets has also been further broadened. The first Hong Kong-Thailand RMB Business Forum, facilitated by the HKMA and the Bank of Thailand, was held on 13-14 October. The HKMA also organised a seminar on RMB business as part of the Hong Kong Trade Development Council's "Think Asia, Think Hong Kong" campaign in Paris on 28 October.
- The HKMA will continue its RMB business promotion efforts, including supporting private sector dialogues between Hong Kong and other places such as London and Malaysia.



## **MEASURES TO ENHANCE OFFSHORE RMB LIQUIDITY**

### **Intraday CNH liquidity**

- To enhance the provision of intraday CNH liquidity in offshore market, in anticipation of a rise in demand for RMB upon the launch of Shanghai-Hong Kong Stock Connect
- A maximum of RMB 10 billion will be offered in a single day via repos (in addition to the intraday liquidity provided by the Clearing Bank)

### **Primary Liquidity Providers (PLPs)**

- Banks designated as PLPs would
  - expand their market-making activities in CNH instruments
  - make use of their Hong Kong platforms in promoting global offshore RMB business
- Each PLP is provided with a dedicated repo line



## INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

### **Financial Stability Board (FSB)**

- HKMA attended the FSB Plenary Meeting on 17-18 September 2014. Members discussed vulnerabilities affecting the global financial system and progress in various areas of financial regulatory reform, including tackling the “too-big-to-fail” problem, OTC derivatives market, foreign exchange benchmark, shadow banking activities and accounting standards.

### **Committee on the Global Financial System (CGFS) and FSB Standing Committee on Assessment of Vulnerabilities (SCAV)**

- The HKMA co-chaired a workshop jointly organized by CGFS and FSB SCAV on 20 June 2014 in Hong Kong. The workshop discussed current risks affecting corporate balance sheets in emerging markets, and identified relevant data gaps and provided recommendations on how to address such gaps. Representatives from 28 central banks, finance ministries and international financial institutions, as well as some private sector firms, participated in the workshop.

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

- The HKMA attended the EMEAP Governors' Meeting held on 25 July 2014. Governors reviewed recent economic and financial developments in the Asia-Pacific region and their policy implications, and discussed the regional impact of global financial regulatory reforms.



# **INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND**

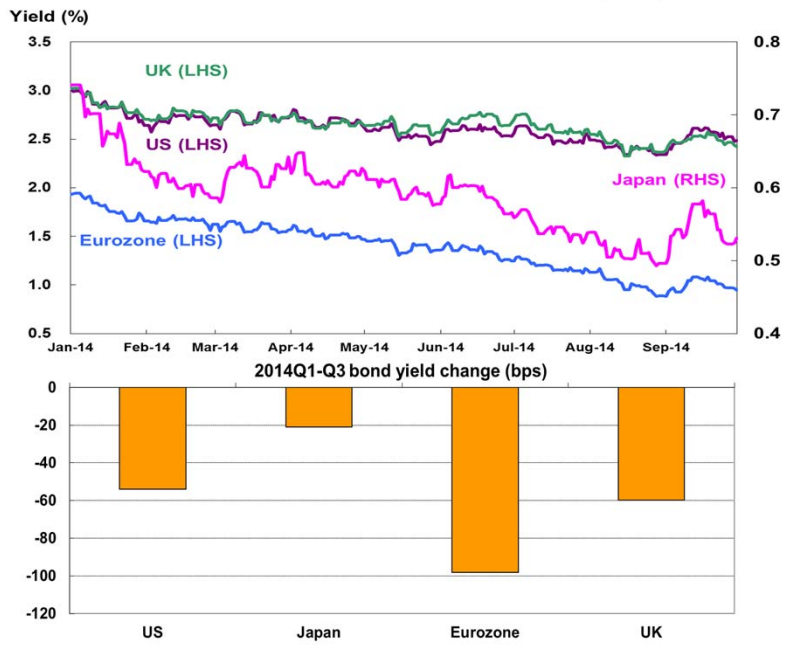


## INVESTMENT ENVIRONMENT IN Q1-Q3 2014

- **Interest rates:** European government bond yields eased on the back of weak economic momentum and lingering disinflationary pressure in Europe, as well as the European Central Bank (ECB)'s aggressive easing. Other major government bond yields fell in tandem
- **Equity markets:** Major stock markets corrected downward in Q3 and finished at similar levels seen at the beginning of the year. S&P500 outperformed other major markets, supported by the improving economic fundamentals in the US
- **Exchange rates:** The Euro weakened against the US dollar in Q3, as a result of the loss in economic momentum in Europe and the ECB's monetary policy accommodation. The Yen also weakened against the dollar in Q3 following the sluggish economic recovery in Japan after the sales tax hike in April



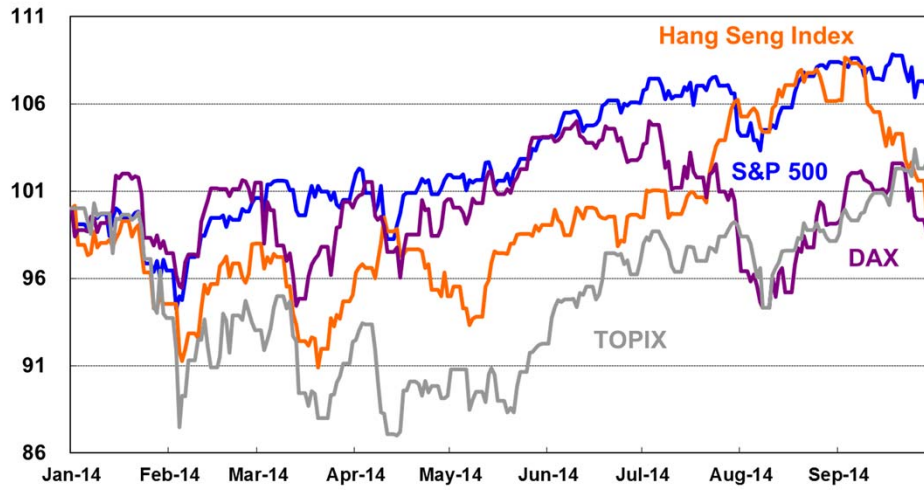
## CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1-Q3 2014





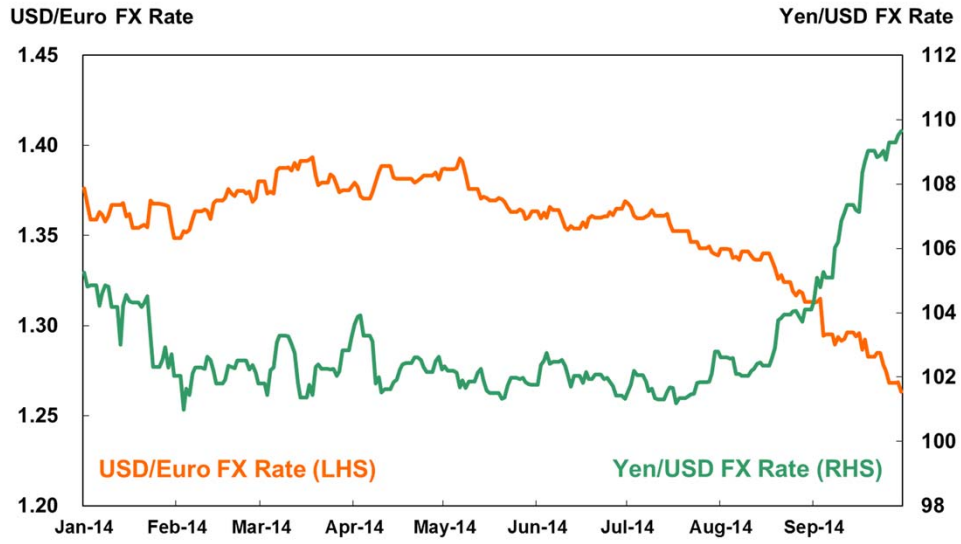
## EQUITY MARKETS IN Q1-Q3 2014

Normalized Index Level (2013 year-end = 100)





## CURRENCY MARKETS IN Q1-Q3 2014







## INVESTMENT INCOME

← 2014 → 2013 2012 2011

(HK\$ billion)	Jan - Sep*	Q3*	Full Year	Full Year	Full Year
<b>Hong Kong equities<sup>@</sup></b>			<b>10.1</b>	<b>30.7</b>	<b>(24.2)</b>
<b>Other equities</b>			<b>71.8</b>	<b>42.8</b>	<b>(12.2)</b>
<b>Bonds</b>			<b>(19.1)</b>	<b>33.1</b>	<b>71.9</b>
<b>Other investments<sup>&amp;</sup></b>			<b>16.8</b>	<b>6.4</b>	<b>0.7</b>
<b>Foreign exchange</b>			<u><b>1.6</b></u>	<u><b>(1.4)</b></u>	<u><b>(9.1)</b></u>
<b>Investment income/(loss)</b>			<b>81.2</b>	<b>111.6</b>	<b>27.1</b>

\* Unaudited figures

<sup>@</sup> Excluding valuation change of the Strategic Portfolio

<sup>&</sup> Including valuation changes of private equity and real estate investments held by Exchange Fund's investment holding subsidiaries

(The above figures represent valuation changes up to the end of June 2014. Valuations of these investments from July to September are not yet available.)



## INCOME AND EXPENDITURE

(HK\$ billion)	← 2014 →				2013
	Jan – Sep*	Q3*	Q2*	Q1*	Full year
<b>Investment income/(loss)</b>		<b>43.3</b>	<b>13.1</b>	<b>81.2</b>	
Other income		0.1	0.0	0.2	
Interest and other expenses		<u>(1.7)</u>	<u>(1.1)</u>	<u>(4.9)</u>	
Net income/(loss)		41.7	12.0	76.5	
<b>Payment to Fiscal Reserves#</b>		<b>(6.8)</b>	<b>(7.1)</b>	<b>(36.8)</b>	
Payment to HKSAR government funds and statutory bodies#		(2.2)	(1.9)	(9.3)	

\* Unaudited figures

# The fixed rate of fee payment is 3.6% for 2014 and 5.0% for 2013.



## 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*&	111.6	30.3	42.4	(5.6)	44.5
2013*&	81.2	30.7	54.7	(23.3)	19.1
2014* <sup>&amp;#</sup>	N/A	N/A		43.3	13.1

\* Excluding valuation change of the Strategic Portfolio

& Including valuation changes of investments held by investment holding subsidiaries

# Unaudited figures

N/A Not Applicable



## EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 30 Sep 2014	At 31 Dec 2013	At 31 Dec 2012
<b>ASSETS</b>			
Deposits		292.8	188.3
Debt securities		2,080.0	2,048.5
Hong Kong equities*		152.9	148.0
Other equities		370.6	283.3
Other assets #		<u>136.5</u>	<u>113.0</u>
<b>Total assets</b>		<b><u>3,032.8</u></b>	<b><u>2,781.1</u></b>
		=====	=====
<b>LIABILITIES AND FUND EQUITY</b>			
Certificates of Indebtedness		327.4	289.8
Government-issued currency notes & coins in circulation		10.6	9.9
Balance of the banking system		164.1	255.9
Exchange Fund Bills and Notes issued		782.6	688.5
Placements by banks and other financial institutions		50.7	0.0
Placements by Fiscal Reserves		773.9	717.5
Placements by HKSAR government funds and statutory bodies		214.9	167.9
Other liabilities		<u>71.1</u>	<u>27.7</u>
<b>Total liabilities</b>		<b><u>2,395.3</u></b>	<b><u>2,157.2</u></b>
Accumulated Surplus		<u>637.5</u>	<u>623.9</u>
<b>Total liabilities and fund equity</b>		<b><u>3,032.8</u></b>	<b><u>2,781.1</u></b>
		=====	=====

\* Hong Kong equities include shares of the Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio.

# Including investment injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$81.9 billion at 30 Sep 2014 (HK\$66.4 billion at 31 Dec 2013 and HK\$53.6 billion at 31 Dec 2012)



# **HONG KONG MORTGAGE CORPORATION**



## **MORTGAGE INSURANCE PROGRAMME (MIP)**

- Since the launch in March 1999, the MIP has helped over 111,000 families to attain home ownership
- In the first 9 months of 2014, the total drawdown amount under the MIP was HK\$11.7 billion and the average loan size was HK\$3.2 million
- About 90% of drawn down loans were for secondary market properties



## REVERSE MORTGAGE PROGRAMME

- By end-Sep 2014, 680 applications have been received:
  - Average age of borrowers: 69 years old
  - Average monthly payout: HK\$14,200
  - Payment terms: 10-year (32%), 15-year (17%), 20-year (14%), life (37%)
  - Average property value: HK\$4.7 million
  - Average property age: 30 years

87

- The HKMC has implemented revision in relation to the refinancing of reverse mortgage loan under the Reverse Mortgage Programme with effect from 1 May 2014.



## SME FINANCING GUARANTEE SCHEME (SFGS)

- In view of the uncertain external economic environment, the Financial Secretary announced in the 2014-15 Budget Speech to further extend the application period for the 80% guarantee product for one year until the end of Feb 2015.
- In September 2014, rolled out a series of refinements to further streamlining the operation of the Scheme and meeting the increasing demand for refinancing of facilities upon the expiry of the 5-year guarantee period of the Government's Special Loan Guarantee Scheme in 2014 and 2015.
- The 80% loan guarantee product has been well received by the market. As at end of September 2014, 9,380 applications were approved, involving a total loan amount of HK\$38.8 billion. Key data of the approved applications are as follows:

Average guarantee period	4.8 years	Average loan size	HK\$4.14 million
Proportion of application from Manufacturing and Non-manufacturing industries	25% and 75% (in terms of applications approved )	Average loan interest rate and average guarantee fee rate	4.82% p.a. 0.54% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	6,174 enterprises and 159,000 employees

88

- Industry types of approved applications for 80% loan guarantee products:

Manufacturing sector – **25.4%**

- Textiles and clothing 5.2%
- Electronics 2.3%
- Plastics 2.0%
- Printing and publishing 1.8%

Non-manufacturing sector – **74.6%**

- Trading 45.9%
- Wholesales and retail 8.4%
- Engineering 2.6%
- Construction 2.6%





## MICROFINANCE SCHEME

- Launched in June 2012 for a trial period of 3 years with a tentative maximum aggregate loan amount of HK\$100 million
- As at end of September 2014, the Scheme received 280 formal loan applications. Out of the vetted applications, 138 have been approved with the total loan amount of HK\$35.52 million. The approval rate is around 52%
- For the approved applications, the average loan size was about HK\$260,000 and the average loan tenor was 4.5 years

89

- Industry types for the approved start-up loans and self-employment loans:
  - Servicing 47 cases (35%)
  - Retailing 58 cases (43%)
  - Wholesales 16 cases (12%)
  - Manufacturing 7 cases (5%)
  - IT related 7 cases (5%)
  - Others 1 case (1%)

\* Component percentages in the table above may not add up to 100% due to rounding.