立法會

Legislative Council

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Panel on Financial Affairs

Minutes of special meeting
held on Tuesday, 1 March 2011 at 9:00 am
in the Chamber of the Legislative Council Building

Members present	**:**	Hon CHAN Kam-lam, SBS, JP (Chairman) Hon CHAN Kin-por, JP (Deputy Chairman) Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP Dr Hon David LI Kwok-po, GBM, GBS, JP Hon James TO Kun-sun Hon Emily LAU Wai-hing, JP Hon Jeffrey LAM Kin-fung, SBS, JP Hon Andrew LEUNG Kwan-yuen, GBS, JP Hon WONG Ting-kwong, BBS, JP Hon Ronny TONG Ka-wah, SC Hon CHIM Pui-chung Hon KAM Nai-wai, MH Hon Starry LEE Wai-king, JP Dr Hon LAM Tai-fai, BBS, JP Hon Paul CHAN Mo-po, MH, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Members attending	**:**	Prof Hon Patrick LAU Sau-shing, SBS, JP
Members absent	**:**	Hon Albert HO Chun-yan Dr Hon Philip WONG Yu-hong, GBS Hon Abraham SHEK Lai-him, SBS, JP Hon Vincent FANG kang, SBS, JP Hon LEE Wing-tat

Public officers attending	**:**	Agenda Item I Mr Norman CHAN, SBS, JP Chief Executive Hong Kong Monetary Authority Mr Peter PANG, JP Deputy Chief Executive (Development) Hong Kong Monetary Authority Mr Arthur YUEN, JP Deputy Chief Executive (Banking) Hong Kong Monetary Authority Mr Edmond LAU, JP Acting Deputy Chief Executive (Monetary) Hong Kong Monetary Authority
Clerk in attendance	**:**	Ms Anita SIT Chief Council Secretary (1)5
Staff in attendance	**:**	Mr Noel SUNG Senior Council Secretary (1)5 Ms Clara LO Legislative Assistant (1)10

Action

I Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)1410/10-11(01) — Paper provided by the Hong Kong Monetary Authority

Presentation

At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority (CE/HKMA) gave a Powerpoint presentation on global and Hong Kong financial and economic conditions and the work of the Hong Kong Monetary Authority (HKMA).

(*Post-meeting note*: The notes of the Powerpoint presentation were issued to members vide a Lotus Notes e-mail on 11 March 2011.)

Discussion

Inflation

2. Mr Jeffrey LAM said that the inflation figures recently announced by the United States (US) were above market expectation and the interest rates in the US might be raised earlier than expected. He enquired about the possible impact of the latest US economic situation on Hong Kong's inflation situation and property market. Mr Andrew LEUNG shared Mr LAM's concern, and said that the inflation situation in Hong Kong was susceptible to external factors such as the prices of food and raw materials imported from the Mainland and other places. Mr LEUNG enquired about the impact of increases in interest rates in the US on Hong Kong's economy.

3. CE/HKMA responded that the extraordinary low level of interest rates could not be sustained indefinitely. CE/HKMA pointed out that the influx of massive amount of capital into the Asian markets had led to inflationary pressure in Asian economies. Various economies, such as the Mainland, India and Singapore, had adopted different measures to counteract the rising inflationary pressure. Since Hong Kong was an open economy, inflation in Hong Kong would be affected by actions taken by the neighbouring economies. A reverse flow of capital out of Hong Kong was expected if interest rates in the US increased.

4. Mr WONG Ting-kwong enquired about the impact of the quantitative easing policy of the US and European countries, coupled with the appreciation of Renminbi, on the economy and inflation situation of Hong Kong, and on the production costs of Hong Kong manufacturers operating in the Mainland. Mr WONG further enquired whether HKMA would take any measures to counteract the pressure of inflation in Hong Kong.

5. In response, CE/HKMA said that 18% of Hong Kong's imported goods came from the Mainland. The prices of goods imported from the Mainland might be affected by demand and supply factors as well as the appreciation of Renminbi. The HKMA estimated that an appreciation in Renminbi by 10% would increase the inflation rate in Hong Kong by no more than one percentage point. As far as Hong Kong manufacturing companies operating in the Mainland were concerned, the production costs had risen substantially in recent years partly due to the significant increase in wages. The arrangement for settling the transactions between Hong Kong manufacturers and Mainland

companies in Renminbi had helped reduce the exchange rate risk facing Hong Kong manufacturers. CE/HKMA pointed out that Hong Kong did not have an autonomous interest rate policy under the Linked Exchange Rate system. The interest rates in Hong Kong were mainly affected by the inflows and outflows of capital and were closely linked to the US interest rates. The banking sector and investors should be mindful about the risk of an asset price bubble due to extraordinarily low interest rates as a result of an abnormal macro economic situation around the world.

6. Ms Starry LEE opined that the impact of inflation expectation would be even greater than that of actual inflation. Ms LEE asked whether HKMA would recommend to the Government a mechanism for monitoring inflation and anticipation of inflation, so that timely measures could be taken to counteract inflation, such as increasing the supply of food to mitigate rising food prices. CE/HKMA responded that inflation expectation and actual inflation were inter-related, and monitoring the inflation expectation was a challenging task mainly because there were many unstable factors affecting the inflation expectation and/or actual inflation, such as increases in oil prices, which would have a significant impact on production costs. CE/HKMA pointed out that the HKMA would focus on analysing the impact of inflation on the stability of the banking and financial systems. Private housing rentals were an important factor affecting inflation. While the measures introduced by the HKMA on the property market primarily focussed on the banks' credit risk management and stability of the banking system, they could also indirectly address the problem of inflation by stabilising the increases in private housing rentals.

7. Mr KAM Nai-wai enquired about the impact on inflation if a tax concession of up to $6,000 was granted to taxpayers in the Budget for 2011-12. CE/HKMA responded that Mr KAM Nai-wai's enquiry would be relayed to the Government Economist.

Fuel price

8. Mr Jeffrey LAM expressed concern that the crises in North Africa might lead to an upsurge in oil prices. He enquired whether HKMA had made any assessment about the impact on Hong Kong of the increase in oil prices resulting from the turbulences in the Middle East and North Africa (MENA) region.

9. CE/HKMA responded that so far the unstable situation in the MENA region did not seem to have a significant impact on oil supply and oil prices. However, any upsurge in oil prices would adversely affect the recovery of

many economies in the world. The incidents in the MENA region would have little impact on banking stability in Hong Kong.

Property market

10. Mr Ronny TONG was concerned that despite the anti-speculation measures introduced by the Government in November 2010, the prices and volume of transactions in the property market in January 2011 had returned to the pre-November level. The effectiveness of the anti-speculation measures was in doubt. Based on the Centa-City Leading Index, property prices had risen by about 7% from August 2010 to January 2011. Mr TONG enquired whether HKMA would take further measures, e.g. by further reducing the loan-to-value ratio for properties, to curb speculative activities in the property market in order to prevent a property market bubble.

11. CE/HKMA responded that the measures introduced by the Government aimed to dampen the cyclical effects of the property market, and such measures would inevitably affect some genuine homebuyers. In order to maintain the stability of the banking system, the HKMA had introduced three rounds of prudential measures since October 2009 on banks' mortgage business, and the loan-to-value ratio for residential properties at or above $12 million had already been reduced to 50%. Where the situation warranted, HKMA would not hesitate to take further steps to maintain the stability of the banking system in Hong Kong.

12. Given that the medium-to-long-term interest rates in the US began to rise, and the general market view that the interest rates in the major financial markets would rise again in early 2012, the Deputy Chairman enquired whether HKMA had conducted any analysis regarding the pace and magnitude of the increase in interest rates, and the impact on the property market.

13. CE/HKMA responded that the financial markets had generally anticipated that the interest rates in the US would rise by 25 basis points in the first quarter of 2012. As regards the pace and magnitude of the interest rate hike, it would take time for the interest rates to increase from nearly zero to a normal level. However, once the interest rates started to rise again, the behaviour of investors might change.

14. Mr KAM Nai-wai opined that the anti-speculation measures so far taken by the Government to tackle the risk of a property market bubble were inadequate because the housing prices, the number of property transactions and new mortgage loans had risen to the pre-November 2010 level. Mr KAM

enquired whether HKMA would take further measures to maintain banking stability.

15. CE/HKMA responded that HKMA had introduced measures to maintain banking stability, such as reducing the maximum loan-to-value ratios for properties of different values, lowering the debt-servicing-ratios of mortgage loan applicants, and requiring the banks to conduct stress tests on the borrowers. CE/HKMA added that apart from reinforcing the existing measures, HKMA might introduce other measures as and when necessary.

Exchange Fund

16. Ir Dr Raymond HO enquired whether HKMA would consider increasing the investment of the Exchange Fund in Renminbi bonds. Ir Dr HO and Mr KAM Nai-wai also enquired about the payment to the fiscal reserves from the Exchange Fund in 2011.

17. CE/HKMA responded that a significant portion of the Exchange Fund was invested in bonds, and HKMA would take a proactive approach in making investments in Reminbi assets. The Mainland authorities had given approval for the Exchange Fund to invest in the Mainland's interbank bond market for up to RMB15 billion. CE/HKMA remarked that the fee payable to the fiscal reserves was calculated based on the average annual rate of return of the Investment Portfolio of the Exchange Fund over the past six years. The rate for payment to the fiscal reserves in 2010 was 6%.

18. Mr Ronny TONG expressed concern that the investments of the Exchange Fund recorded a loss of $12.1 billion in the second quarter of 2010. Mr TONG enquired about the reasons for the loss.

19. CE/HKMA responded that when the European sovereign debt crisis broke out in the second quarter of 2010, share prices in the global stock markets dropped, leading to losses in the Exchange Fund's holding of foreign equities. At the same time, the US dollar had become a safe haven for investors in the foreign exchange markets, resulting in depreciation in other currencies against the US dollar and causing an exchange loss in the Exchange Fund.

20. Mrs Regina IP expressed concern that the investment return of the Exchange Fund had continued to decline over the years, from an average of 5.9% since 1994, to 4.9% in the past five years, and to 3.6% in 2010. She opined that discounting inflation, the actual investment return was only slightly higher than 1%. Mrs IP pointed out that based on a report of the Asian Wall Street Journal in September 2010, the Government of Singapore Investment

Corporation (GIC) had accomplished an annual investment return of 7.1%. Mrs IP opined that HKMA had a responsibility to enhance the investment return of the Exchange Fund, taking into consideration that the Government would issue iBonds and was prepared to pay an interest for iBond holders higher than the inflation rate. Mrs IP enquired whether consideration would be given to linking the salaries of HKMA senior management with the investment return of the Exchange Fund. Mrs IP further enquired whether the Government would consider using part of the Exchange Fund, say 10%, to set up a separate investment fund in order to improve the investment return. Mr James TO shared Mrs IP's view that a separate investment fund should be established.

21. CE/HKMA responded that the return of any investment was subject to changes in the investment environment. Different rates of return were achieved by different funds with different investment objectives at different times. Some sovereign funds suffered from heavy losses during 2008 and 2009. CE/HKMA pointed out that even though some university endowment funds in the US might appear to have achieved a high investment return, they were susceptible to heavy losses during a financial crisis. The primary purpose of the Exchange Fund was to maintain the stability of the exchange value of the Hong Kong currency. The GIC did not serve the same purpose as the Exchange Fund, and the GIC could make investments in high-risk / high-return financial products. Given the specific statutory objectives of the Exchange Fund, its investments should concentrate on financial products with a high level of liquidity, such as quality US Treasury securities of relatively short maturity. A direct comparison between the investment return of the Exchange Fund and other trust funds would not be appropriate. CE/HKMA remarked that Mrs IP and Mr TO's suggestion of setting up a separate investment fund would be relayed to the Financial Secretary for consideration.

22. Mr Paul CHAN requested that HKMA should provide information on the amounts of investment in different categories of investment products and the respective investment returns, and the benchmark for assessing the level of returns. Mr CHAN enquired whether HKMA had earmarked a portion of the Exchange Fund for investment in products with higher yields despite the higher risk involved.

23. CE/HKMA responded that the investment strategy of the Exchange Fund was mapped out based on the objectives of maintaining the stability of Hong Kong's currency and financial market set out in the Exchange Fund Ordinance (Cap. 66), and the monitoring mechanism on the investment strategy had been operating for a long time and proved to be effective. CE/HKMA pointed out that since the amounts of investment of the Exchange Fund in different investment products were sensitive market information, it was not

suitable for HKMA to disclose details of its holdings. CE/HKMA added that a small portion of the Exchange Fund had been invested in alternative investments that had low correlations with conventional asset classes, with a view to meeting the medium and long term investment goals of the Exchange Fund.

iBonds

24. Mr Andrew LEUNG enquired about the details of the issuance of iBonds announced in the 2011-12 Budget.

25. CE/HKMA responded that the HKMA was responsible for assisting the Government in implementing the programme to issue iBonds. The HKMA believed that inflation–linked bonds would be well received by the public, as their coupon rates would be higher than that of ordinary fixed-rate bonds, such as the 3-year Exchange Fund Notes. The details of the iBond scheme were still being worked out and would be announced after a concrete programme had been drawn up.

Supervision on credit growth in banks

26. Noting that bank loans grew by 29% in 2010, Ir Dr Raymond HO enquired about the measures taken by HKMA to assess banks' credit underwriting standards. The Deputy Chief Executive (Banking), HKMA (DCE(B)/HKMA) responded that the credit growth rate in 2010 had been the highest for the past 10 years, and HKMA had stepped up on-site examination of banks to ensure that the banks had not compromised their credit underwriting standards. The measures taken by the HKMA included the checking of credit assessments performed by front-line staff in processing loan applications and ascertaining whether the loans had been used according to the declared purposes. The banks would also be requested to review and, where necessary, increase their regulatory reserve as a countercyclical measure to provide themselves with a buffer for the potential increases in the credit costs in future.

Lehman Brothers Minibonds Incident

27. Mr Ronny TONG pointed out that the Lehman Brothers Minibonds Incident had yet to be settled as many investors still requested that the regulators should investigate into the complaints against financial institutions in mis-selling structured products, and there were outstanding prosecution cases in court relating to the Incident. Mr TONG enquired whether the HKMA would continue to pursue the complaint cases relating to the Incident.

28. DCE(B)/HKMA responded that the HKMA would continue to make weekly public announcements on the updated position of the complaints relating to the Lehman Brothers Minibonds Incident. HKMA had completed the investigation into the great majority of the complaint cases by March 2010, and proceeded to pursue disciplinary actions in the substantiated cases. The parties involved would be given time to respond to HKMA's proposed disciplinary actions according to the established rules and statutory procedures. Announcement of the outcome of the investigations would only be made when all the necessary procedures were completed.

29. Mr James TO said that HKMA and the Securities and Futures Commission (SFC) had indicated, during the announcement of the settlement arrangements agreed among SFC, HKMA and the 16 Distributing Banks in July 2009, that they would not pursue the investigation of the relevant cases if the settlement arrangements were accepted by the investors concerned. He enquired whether HKMA and SFC would proactively provide information to the Commercial Crime Bureau of the Police for investigation of the complaints relating to the Lehman Brothers Minibonds Incident if there was evidence to show that there was systemic misconduct involved in the cases and/or criminal offences had been committed.

30. DCE(B)/HKMA responded that if there was any suspected criminal offence involved in the sale of Lehman Brothers Minibonds and related structured products, the case would be referred to the Police for investigation notwithstanding settlement agreements reached between the banks and the investors. Since many investors in the Lehman Brothers Minibonds Incident had reached settlement agreements with the banks before investigation of the relevant cases had been completed, the regulators would not be in a position to conclude whether those cases involved misconduct that warranted disciplinary actions. Nevertheless, the HKMA would continue to liaise with and provide support to the Police regarding investigation of criminal cases relating to the Lehman Brothers Minibonds Incident.

31. With reference to the Lehman Brothers Minibonds Incident, Mr Ronny TONG enquired about the number of cases where disciplinary actions against the banks were being considered. Mr TONG remarked that HKMA should also disclose whether any prosecution action under section 107 of the Securities and Futures Ordinance (Cap. 571) (SFO) would be taken, and if not, the reasons for not taking such prosecution actions. Mr TONG said that some complainants had complained that HKMA and SFC even refused to accept their complaints.

32. DCE(B)/HKMA responded that the HKMA would continue its practice of issuing a press release every week on its official website about the status of

the complaint cases relating to the Lehman Brothers Minibonds Incident, which included the number of cases involving possible disciplinary actions. DCE(B)/HKMA pointed out that the Police was responsible for the investigation and prosecution of cases under section 107 of SFO, and the HKMA would refer such cases to the Police for action as appropriate. CE/HKMA supplemented that HKMA would not refuse to accept complaints filed by complainants, although not every case would be investigated into unless there was prima facie evidence of breaches of the legislation or regulations.

Linked Exchange Rate system

33. Noting that the speed of appreciation of Renminbi in 2010 was much slower than that of other Asian currencies, the Deputy Chairman enquired whether the appreciation of Renminbi would accelerate in 2011. In view of the rapid increase in the amount of Renminbi deposits in Hong Kong, the Deputy Chairman enquired whether consideration would be given to pegging the Hong Kong dollar with Renminbi when the total amount of Renminbi deposits had reached a substantial level.

34. CE/HKMA responded that he expected that the currency market would continue to be volatile in 2011. Coupled with the influx of capital into the Asian markets, volatile exchange rates would add pressure on inflation. CE/HKMA added that one of the reasons for the increase in Renminbi deposits in Hong Kong might be the transfer of foreign currencies deposits into Renminbi deposits. With the development of off-shore Renminbi settlement business in Hong Kong, more overseas enterprises would use the Renminbi settlement service and therefore increase their Renminbi deposits in Hong Kong. CE/HKMA remarked that the conditions for making any change to the Linked Exchange Rate system did not exist.

Labour market

35. With reference to slide No. 10 of the Powerpoint presentation regarding structural mismatch in the US labour market, the Deputy Chairman requested HKMA to provide information, similar to the chart in slide No. 10, on an analysis of the labour mismatch situation in Hong Kong and on any mismatch in the fields of work.

36. CE/HKMA undertook to provide the information requested by the Deputy Chairman.

(*Post-meeting note*: The relevant information provided by HKMA was issued to Members vide LC Paper No. CB(1)1698/10-11 dated 24 March 2011.)

Contents of future briefings

37. The Chairman said that HKMA had provided comprehensive information on global and local financial and economic situations in this and past briefings for the Panel. He suggested that in HKMA's future briefings, CE/HKMA might consider including information on the latest regulatory reforms/measures for the financial sectors as discussed in international forums, including but not limited to those forums attended by representatives of the HKMA. He further suggested that given the close economic relations between Hong Kong and the Mainland, CE/HKMA might also consider including more information on the economic and financial market developments in the Mainland which was relevant to Hong Kong, e.g. the arrangements for trade settlement in Renminbi.

38. CE/HKMA responded that the HKMA remained vigilant in the assessment of the risks affecting Hong Kong's financial stability, having regard to the prevalent international macro financial conditions. Given that the flow of capital and movement of interest rates in Hong Kong were to a large extent affected by the US market, he had devoted a substantial portion of his briefings to the analysis of the US economic situation. CE/HKMA said that he would include more information on the economic and financial market developments in the Mainland affecting Hong Kong and issues of public concern discussed in international financial forums in future briefings.

II Any other business

39. There being no other business, the meeting ended at 10:54 am.

Council Business Division 1
Legislative Council Secretariat
27 May 2011