Motion on
"Impact of the United States' ending the quantitative easing measures"
at the Legislative Council meeting on 10 July 2013

Progress Report

Purpose

At the Legislative Council meeting on 10 July 2013, the motion on "Impact of the United States' ending the quantitative easing measures" moved by Hon Andrew LEUNG, as amended by Hon Christopher CHEUNG and Ir Dr Hon LO Wai-kwok, was passed. The full text of the motion is at **Annex**. This paper briefs Members on the latest developments.

Latest financial and economic situation

2. Although following its meeting on 18 September, the United States ("US") Federal Reserve ("Fed") announced that it would keep its benchmark interest rate and the scale of its quantitative easing ("QE") measures unchanged, the expectation of eventual changes in US' monetary policy will continue to affect the global financial market and economy as well as cause a shift in capital flows amongst different markets and asset classes. In Asia, a tapering in the US' QE measures may lead to repatriation of funds from Asia back to the US, thus affecting the regional economic outlook. In addition, the shrinkage of liquidity may weigh on investor risk appetite and therefore reduce demand for assets which are of relatively higher-risk, such as equities. During May-August 2013, the stock market in Thailand slid 19%, making it the worst performer in the region. The Indian and Indonesian stock markets also dropped 7.7% and 16.7% respectively. In addition, a number of currencies in emerging markets recorded notable declines, with the Indian Rupee and Indonesian Rupiah dropping 18.5% and 13.3% during May-August to a record low and a 4-year low respectively. For Hong Kong, although the Hang Seng Index has recovered from its nine-month low of around 19,800 in late June 2013, investor sentiment may continue to be affected by worries about the withdrawal of stimulus measures in the US, interest rate movements and global economic outlook.

3. Meanwhile, the Hong Kong Dollar exchange rates and interbank rates remain steady. Hong Kong's currency board system is able to cope

with capital outflows. The sizable increase in foreign reserves arising from capital inflows since 2008 (US$100 billion) would act as a buffer against capital outflows in the future. In addition, under the currency board system, the automatic interest rate adjustment mechanism triggered by capital outflows would help maintain exchange rate stability.

4. The Hong Kong Monetary Authority ("HKMA") is also monitoring the loan growth and liquidity of the banking sector. Total loan growth of the local banking sector was 1.4% in July, easing from 3.3% recorded in June. The local retail banks' liquidity positions remained at a comfortable level, with the quarterly average liquidity ratio standing at 40.2% in Q1 2013, well above the 25% minimum requirement. Notwithstanding this, HKMA has reminded banks to take appropriate precautionary steps to ensure sufficient liquidity for maintaining stable business operations under different market stress scenarios. The Government together with our financial regulators will continue to closely monitor the impact of US monetary policy on the Hong Kong financial markets, and will act swiftly as and when necessary to ensure the proper functioning of our markets.

5. As regards the general economy, even though the recent data on the advanced economies have been more positive, with the US growing moderately and the Eurozone showing signs of emerging from recession, uncertainties in the external environment abound. Most notably, uncertainties stemming from the future direction of US monetary policy, which had already induced bouts of financial markets gyrations, would increase the risks of capital flows reversal to Asian and emerging economies. Partisan debates over the national debt ceiling in the US may re-surface later this year. Growth in the Eurozone may still be constrained by its deeply-rooted structural problems, and the heightened geopolitical tensions in the Middle East could also be a source of concern. As such, Hong Kong's trade performance is likely to see some fluctuations in the period ahead. Nonetheless, the relatively fast growing Mainland economy as well as Hong Kong's resilient domestic demand should continue to render support to our overall economic performance.

6. In light of the persistently weak export markets and a challenging external economic environment, the Government has launched and enhanced various measures to assist Small- and Medium-sized Enterprises ("SMEs") in obtaining loans and exploring export markets. On financing, with the continuous support of the $100 billion total loan guarantee commitment provided by the Government, the

Hong Kong Mortgage Corporation Limited has extended the application period for the special concessionary measures under the SME Financing Guarantee Scheme for one year to end of February 2014. As at the end of July 2013, over 7 200 applications have been approved, involving a total loan guarantee amount of about $24.9 billion. More than 5 000 enterprises employing over 130 000 people have benefitted. To help more Hong Kong enterprises develop domestic sales in the Mainland, the Hong Kong Trade Development Council will set up more Design Galleries in the Mainland. In particular, the Design Gallery shop located in Qingdao has just opened in August 2013.

7. The Supplement X to the Mainland and Hong Kong Closer Economic Partnership Arrangement, which was signed on 29 August 2013, will enable Hong Kong services industries to develop the Mainland market and is conducive to the continued economic cooperation and development of the two places. In the area of financial services, for example, qualified Hong Kong-funded financial institutions are allowed to set up full-licensed joint venture securities companies in designated areas and provinces, and the shareholding percentage of Hong Kong securities and fund management companies in the joint venture set up in the Mainland is further increased to over 50%. These measures will further expand the scope of business of Hong Kong securities and futures industry in the Mainland.

8. On infrastructure spending, we obtained funding approval of $90.9 billion in the 2012-13 legislative session from the Finance Committee for upgrading 39 projects to Category A. With many of the major infrastructure projects entering their construction peak, we expect that the annual capital works expenditure will increase from $62.4 billion in 2012-13 to exceed $70 billion in the coming few years. The Government will continue to invest in infrastructure to foster economic development and bring improvements to the quality of life of our people.

Local property market

9. The residential property market has been quiet in the past few months after the announcement of the latest demand-side management measures by the Government in late February and also the US Fed's indication of its intention to reduce asset purchase later this year.

10. The Government has been mindful of property market risks. While raising flat supply through increasing land supply is the Government's top policy priority in ensuring a healthy and stable

development of the property market, we have introduced several rounds of demand-side management measures to address the irrational exuberant property market amid the extremely low interest rates and abundant liquidity, with a view to helping the community to avoid greater pain should there be any adjustment caused by a change in interest rates or other external factors. Given the Government's sustained efforts, the total flat supply in the coming few years rose to 70 000 units as estimated at end June, the highest since September 2007. At the same time, it is also our policy to accord priority to address the home ownership needs of Hong Kong permanent residents in midst of the tight supply situation. HKMA is also concerned about the risks of excessive credit growth and property price bubble amid continued low interest rates and abundant interbank liquidity. To safeguard the stability of the banking system, HKMA has introduced six rounds of counter-cyclical prudential measures to strengthen banks' mortgage underwriting standards. These measures help strengthen the resilience of the banking system to possible correction in property prices.

11. The demand-side management measures have yielded results which meet the policy objectives. Both speculative activities and purchases of residential properties by non-local individuals and non-local companies have diminished since the respective introduction of the Special Stamp Duty in November 2010 and the Buyer's Stamp Duty in October 2012. The property market has cooled off since the introduction of the Doubled Stamp Duty in February 2013. Overall flat prices increased by 0.4% per month on average during March to July 2013, a notable deceleration from the monthly average increase of 2.7% in the first two months of 2013. The above shows that the relevant demand-side management measures have been effective in addressing the irrational property market exuberance, and changed the irrational expectation that property prices could only go up.

12. While the Government is determined to adopt the supply-led strategy as the basis to address the housing situation at source, the Government considers that the demand-side management measures are essential to ensure the healthy and stable development of the property market and the overall macroeconomic and financial stability of Hong Kong under the current exceptional circumstances. The Government will continue to closely collaborate with the Legislative Council and look forward to the enactment of the relevant bill in a timely manner. Under the expectations on US Fed's tapering of asset purchase, international capital flows, and the market, may continue to show fluctuations in the periods ahead, with ramifications on asset prices including flat prices in

Hong Kong. We will monitor the property market closely and make appropriate adjustments to the measures in a timely manner as and when necessary upon careful assessment by making reference to a basket of indicators, including property prices, housing affordability of the general public, volume of property transactions, demand-supply balance for residential properties, mortgage loan growth, etc.

Conclusion

13. As a small, open economy and a major international financial centre, the economic cycle in Hong Kong is closely linked with the global economic and financial conditions. Hence, the Government has been closely monitoring the external economic and monetary background and their implications on the development of the Hong Kong economy. We will act swiftly as and when necessary to ensure the proper functioning of our financial markets and stability in our economy.

Financial Services and the Treasury Bureau
26 September 2013

<u>Annex</u>

Motion on
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Moved by Hon Andrew LEUNG
at the Council meeting of 10 July 2013

<u>Motion as amended by Hon Christopher CHEUNG and Ir Dr Hon LO Wai-kwok</u>

That, following the announcement by Bernanke, Chairman of the Federal Reserve Board of the United States, that the quantitative easing measures will be ended gradually, which has immediately triggered a wave of global financial fluctuations, this Council urges the HKSAR Government to closely keep in view the impacts of the incident on the global economic and financial environment, ensure the stability and robustness of Hong Kong's financial system, maintain sustainable economic growth, and when necessary, introduce appropriate measures, including considering the revocation of 'the two harsh measures' in a timely manner, i.e. the Buyer's Stamp Duty and the Special Stamp Duty which are targeted at the property market, to prevent the recurrence of negative equity, and assist members of the public and small and medium enterprises in facing a new market order; this Council also urges the Government to take precautions by fully evaluating the impacts of a market reversal, once occurred, on Hong Kong's overall economy and labour market, and push forward infrastructure projects in a timely manner.