



HONG KONG MONETARY AUTHORITY

Briefing to the Legislative Council Panel on Financial Affairs

6 February 2017

[Translation]



- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



MAJOR RISKS TO GLOBAL ECONOMIC AND FINANCIAL STABILITY

- Policy uncertainties of the new US administration
- Capital outflow pressures facing emerging markets
- Financial risks in Mainland China
- Political and economic situations in Europe



POLICY UNCERTAINTIES OF THE NEW US ADMINISTRATION

- Trade protectionist and expansionary fiscal policies to be implemented
- Short-term impact:
 - Market reaction
 - ❖ US equity rallied
 - ❖ Treasury yields rose
 - ❖ US dollar strengthened
 - Stimulate US economic growth
 - Boost US inflation



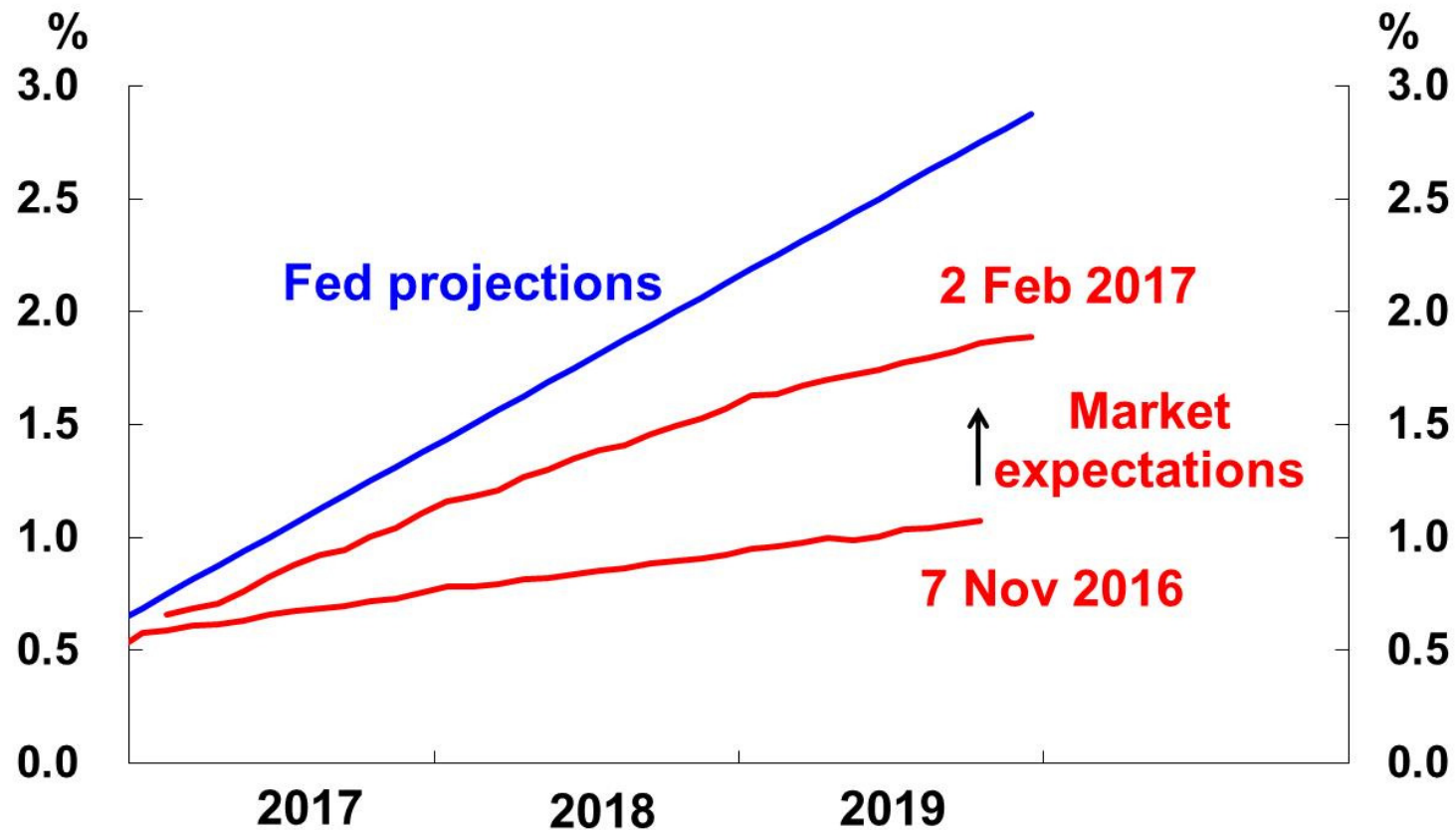
POLICY UNCERTAINTIES OF THE NEW US ADMINISTRATION

- Medium-term impact:
 - Trade protectionist policies may result in a “lose-lose” situation
 - ❖ Free trade is impeded, resulting in lower trade volume
 - ❖ Decrease in global supply chain efficiency raises production costs and pushes up inflation
 - US fiscal deficit may worsen, leading to higher government debt and interest rates



MARKETS EXPECT A FASTER PACE OF US RATE HIKES

Expectations of future Federal funds rate



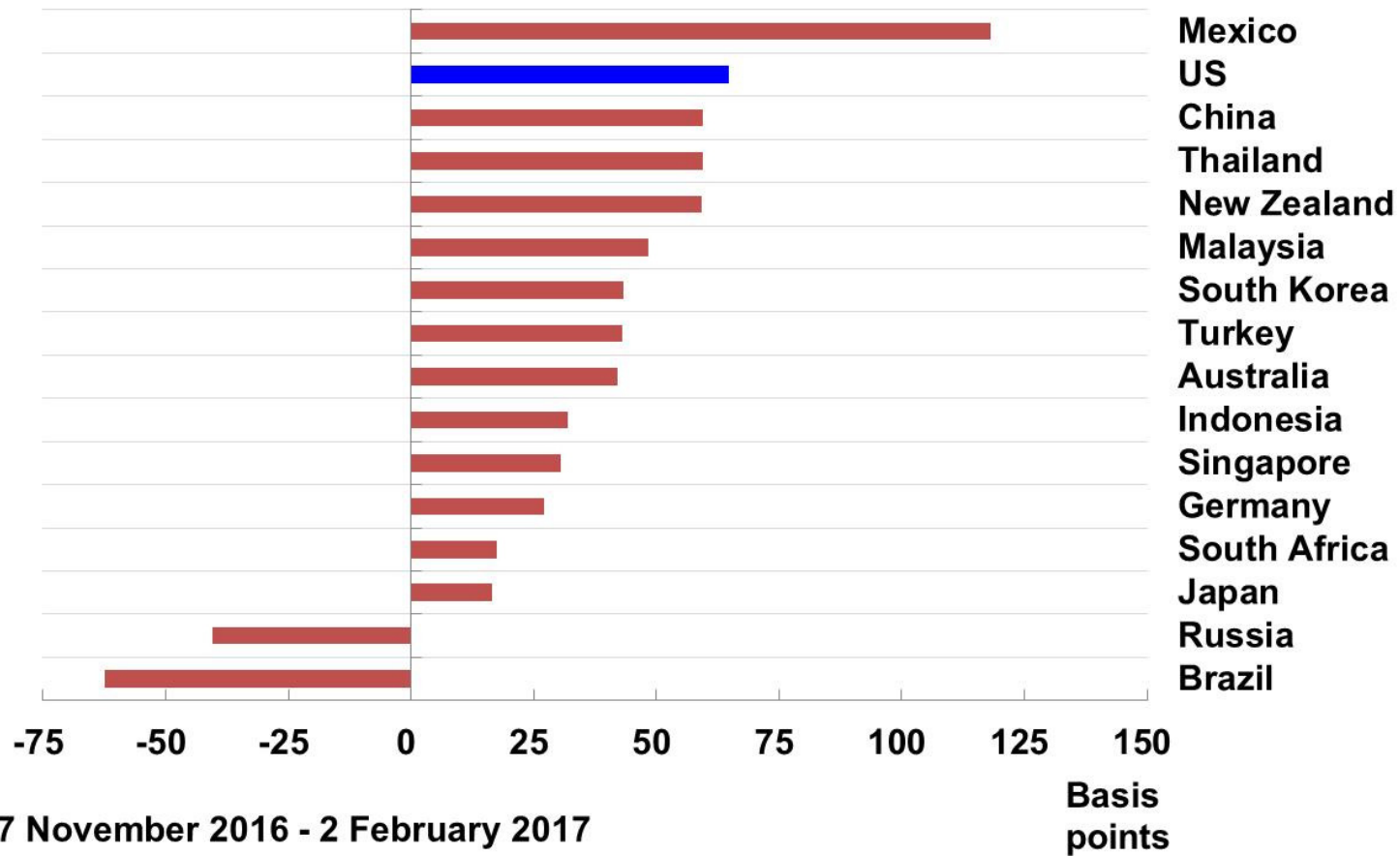
Note: Fed projections refer to the median projections among FOMC members published in December 2016 while market expectations are implied by the Fed funds futures.

Sources: Datastream and US Federal Reserve.



GLOBAL BOND YIELDS ROSE AMID HIGHER US TREASURY YIELDS

Change in 10-year sovereign bond yields since US presidential election



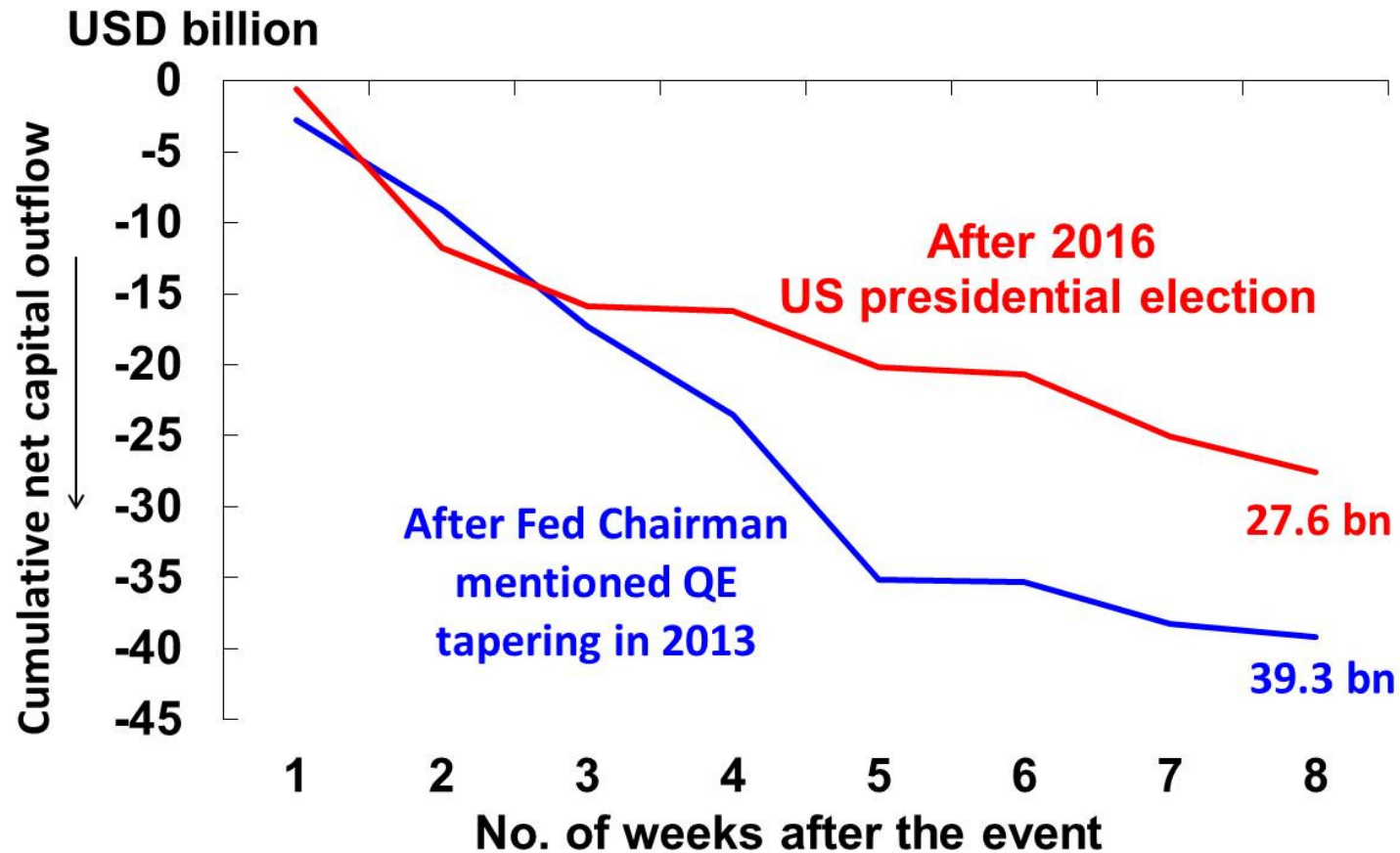
Note: Up to 26 January 2017 for Mainland China.

Source: Bloomberg.



CAPITAL OUTFLOW RISKS FACING EMERGING MARKETS

Cumulative fund outflows from emerging markets



Source: EPFR Global.



MAINLAND CHINA: ECONOMIC AND FINANCIAL ASSESSMENT

- The economy was “advancing steadily” in 2016
- Major tasks in future
 - Strengthen supply-side structural reforms
 - Contain financial risks and keep asset bubbles in check
- Risk factors that are noteworthy
 - Progress of de-capacity and destocking by low efficiency enterprises
 - Effectiveness of deleveraging in Mainland financial markets
 - Capital outflow pressures



DIFFICULT POLITICAL AND ECONOMIC CONDITIONS IN EUROPE

- Europe is clouded by heightened anti-establishment sentiment and a number of uncertainties:
 - The UK to trigger the formal Brexit process by the end of March
 - The Netherlands, France and Germany will hold elections in turn this year
- Many European countries are still plagued by geopolitical and refugee-related issues
- Growth and inflation have improved but unemployment rate remains high and structural reforms are still fraught with challenges



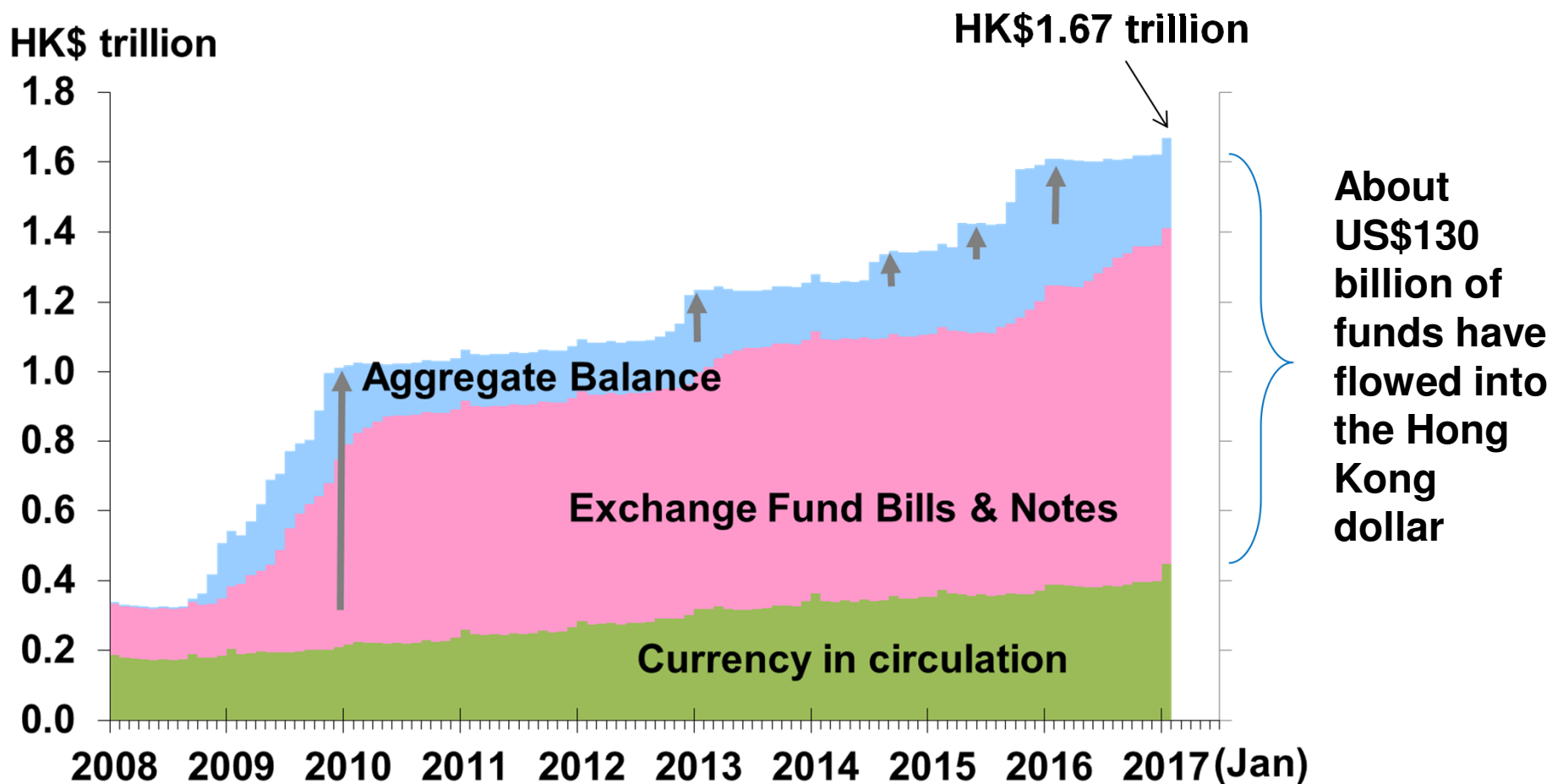
ASSESSMENT OF RISKS TO GLOBAL FINANCIAL STABILITY

- Risks to global financial stability are increasing:
 - US trade, fiscal and monetary policies are more uncertain
 - Near-term risks of capital outflows and asset market corrections in emerging markets have heightened
 - Mainland economy has stabilised but financial risks still need to be handled prudently
 - More uncertain economic and political outlook in Europe



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: MONETARY BASE

Hong Kong dollar Monetary Base has not shrunk

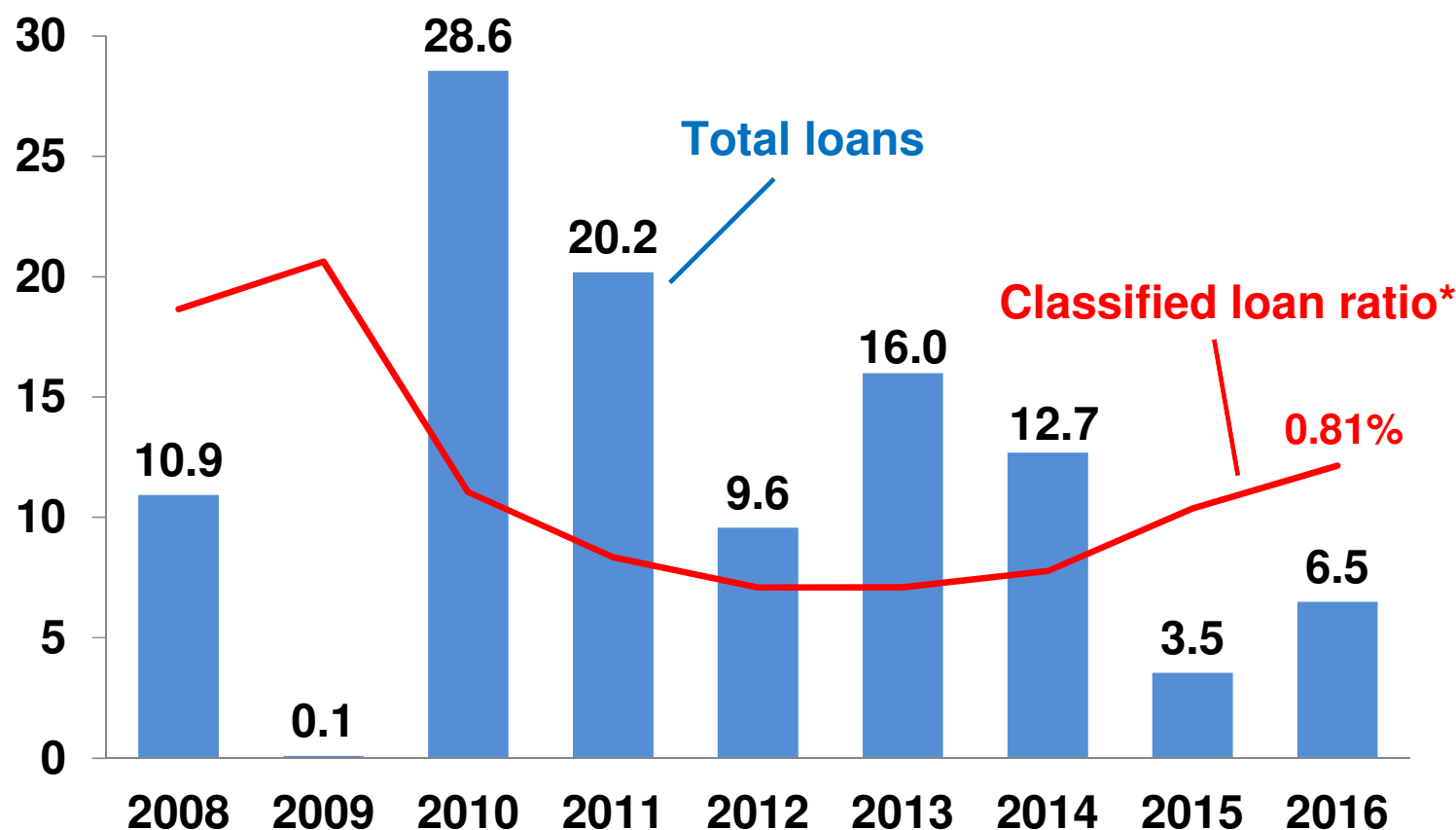




ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: BANK CREDIT

Bank credit grew moderately
with asset quality staying at healthy level

Annualised growth rate of total loans (%)



Note: * The classified loan ratio for 2016 is the figure for Q3.

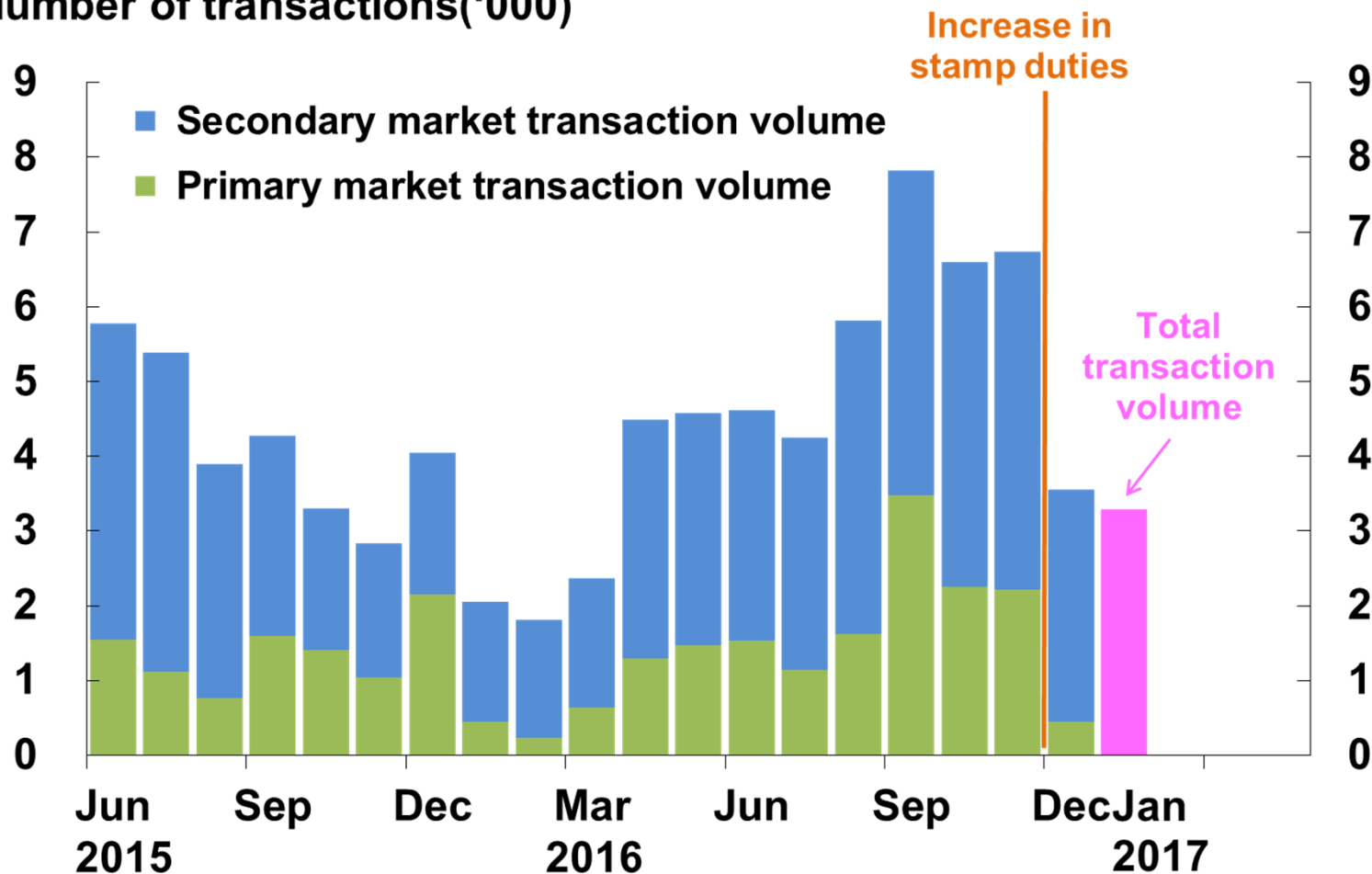
Source: HKMA.



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Transaction volume fell substantially amid the new stamp duty measures

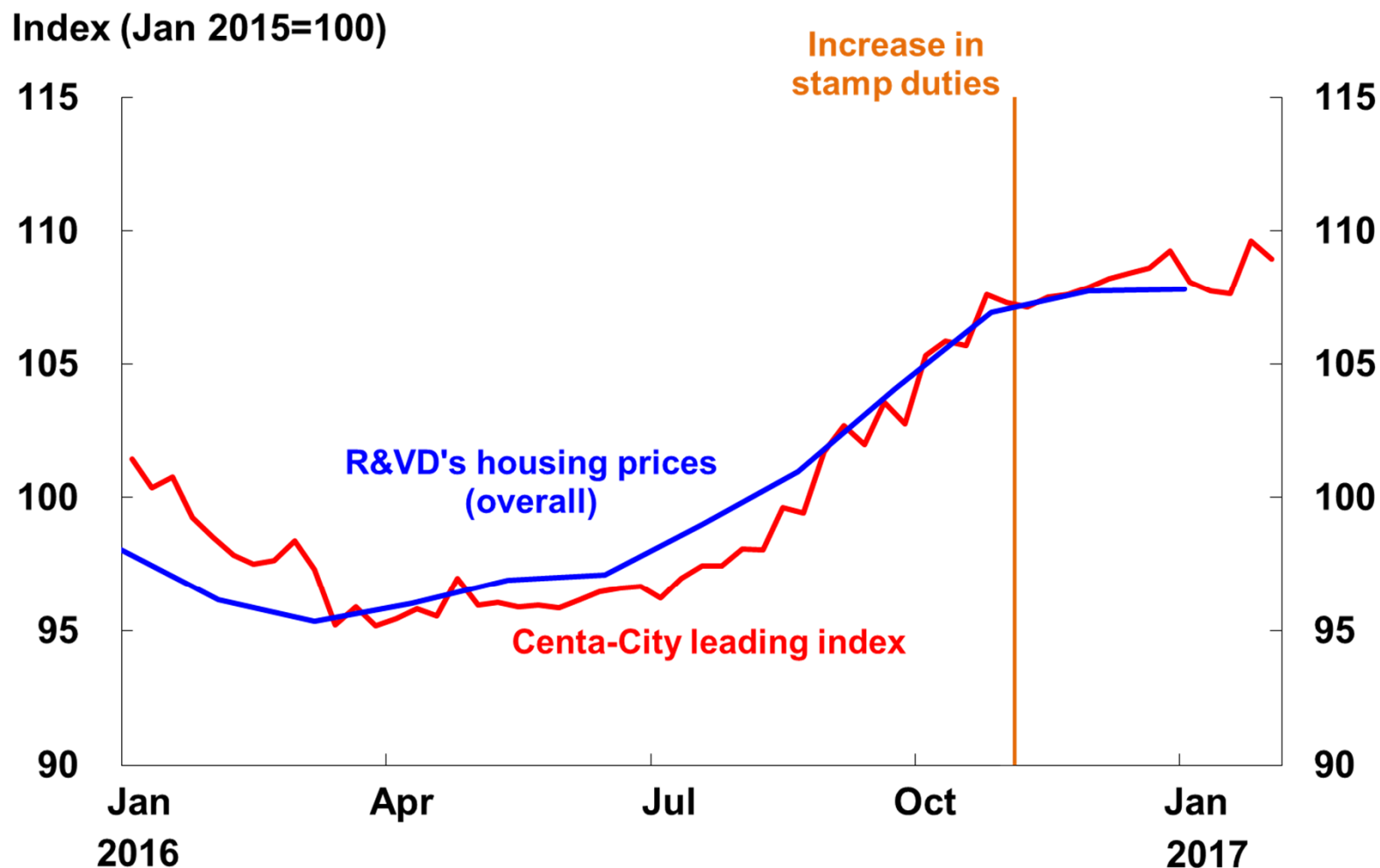
Number of transactions('000)





ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

The trend of housing prices remains to be seen following the new stamp duty measures



Sources: Rating and Valuation Department and Centaline Property Agency Limited.



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: CONCLUSION

- Increasing uncertainties and risks to Hong Kong's macro economic and financial conditions
- Rises in Hong Kong dollar interest rates in tandem with the US interest rate normalisation, as well as the strengthening of the US dollar, will tighten Hong Kong's financial conditions
- The HKMA will closely monitor developments in market conditions and implement appropriate macro prudential measures according to cyclical changes to ensure banking stability
- The public should be prepared for the risks associated with the possible reversal of fund flows and interest rate fluctuations



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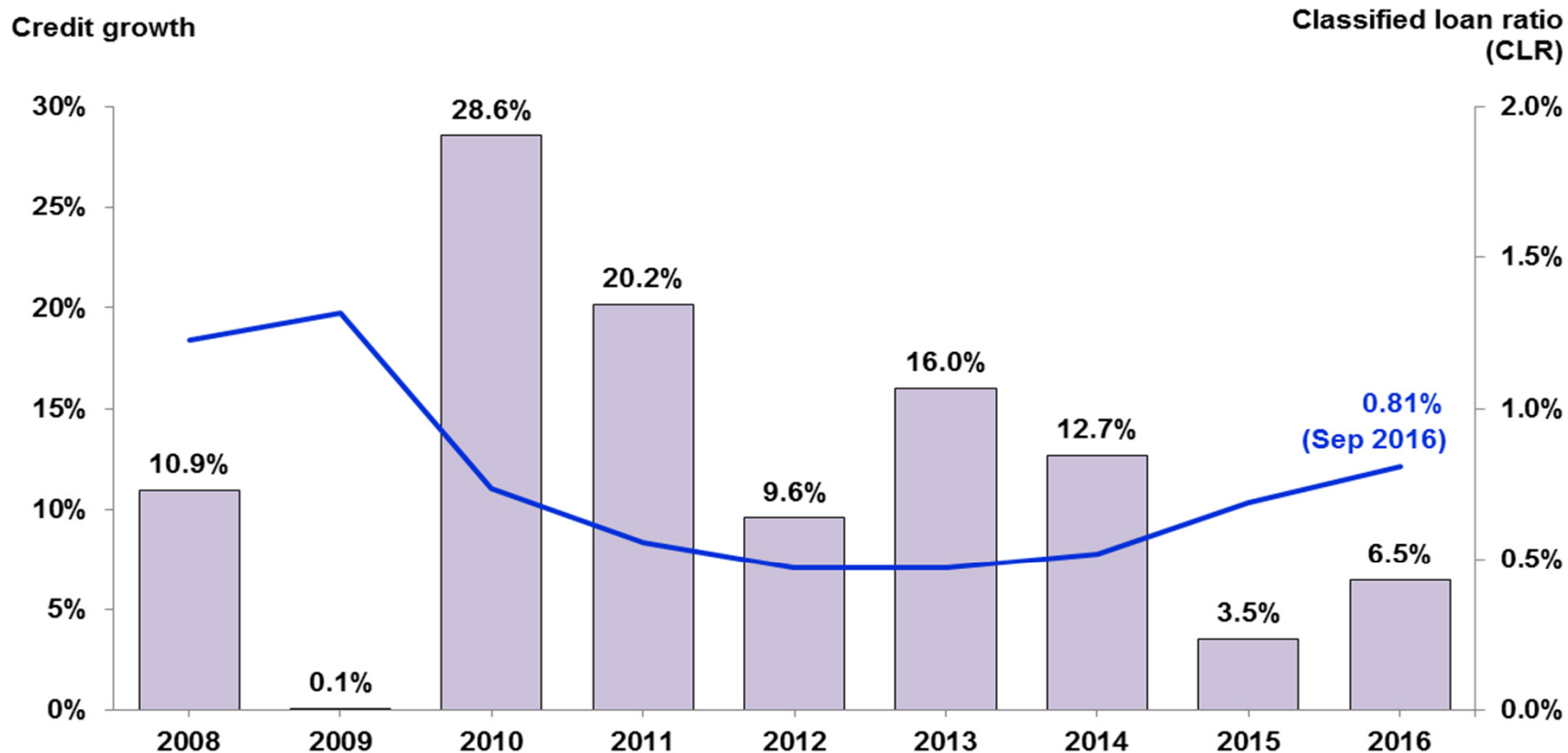
FINANCIAL INCLUSION

- The HKMA has been encouraging banks, when developing their business, to take into account the needs of the grassroots for basic banking services
- Apart from physical branches, banks provide basic banking services via other channels
 - Internet banking services (over 10 million personal internet accounts)
 - ATMs (3,305, representing an increase of about 40% from ten years ago)
 - Mobile branches (2)
 - Video teller machines (205)
- The HKMA is discussing with the banking industry about setting up physical branches to enhance services in areas which are underserved by banking networks



CREDIT GROWTH AND ASSET QUALITY

Bank credit grew moderately
with asset quality staying at healthy level



■ Credit growth (LHS)

— CLR of retail banks, covering HK offices, overseas branches and major overseas subsidiaries (RHS)



BASEL STANDARDS IMPLEMENTATION

- Amendment of Banking (Disclosure) Rules: Revised Basel Pillar 3 disclosure
- Amendment of Banking (Liquidity) Rules: Net Stable Funding Ratio
- Amendments of Banking (Capital) Rules:
 - Securitisation framework
 - Leverage ratio
 - Counterparty credit risk exposure
- Amendment of Banking Ordinance: Exposure limits



HONG KONG RESOLUTION REGIME

- Financial Institutions (Resolution) Ordinance:
Protected Arrangements Regulations
- Code of Practice
- Resolution planning



SME FINANCING

- According to information provided by banks, aggregate credit facility limits granted to SMEs in the first three quarters of 2016 increased slightly
- Credit facility limits granted to SMEs in Q3 2016:
 - Number of SMEs with credit facility limits unchanged accounted for 89.8% of total SME customers
 - Number of SMEs with credit facility limits raised accounted for 5.7% of total SME customers
 - Number of SMEs with credit facility limits reduced accounted for 4.4% of total SME customers
- In Q4 2016, the number of applications received under the SME Financing Guarantee Scheme recorded a quarter-on-quarter increase of 14%. There is remaining loan guarantee commitment of around HK\$80 billion under the Scheme, and SMEs are welcome to apply



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REGULATORY REGIME FOR STORED VALUE FACILITIES (SVF)

- A total of 13 SVF licences were granted in August and November 2016
- The SVF licensees are implementing their business plans, gradually introducing new services or enhancing their existing ones to provide the public with more choices
- The HKMA has commenced regular supervision of SVF licensees and stepped up publicity efforts via various channels to alert the public of issues including security and privacy when using SVFs



LATEST FINTECH INITIATIVES

- Implemented the “Cybersecurity Fortification Initiative” for banks in December 2016
- So far, nine cases of pilot trials of new fintech solutions have been conducted by five banks using the Fintech Supervisory Sandbox
- Published first-stage research on distributed ledger technology at end-2016
- Fintech Innovation Hub has commenced operation and more than ten banks and SVF licensees have used the Hub
- Recruitment of interns under the Fintech Career Accelerator Scheme is underway to nurture new fintech talents



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DEVELOPMENT OF OFFSHORE RMB BUSINESS IN HONG KONG

- Global offshore RMB business in general moderated last year, due to factors including financial market volatilities and market expectation on RMB exchange rate
- The CNH market in Hong Kong continues to function orderly. The average daily turnover of the RMB RTGS system stayed at a high level of RMB860 billion last year. According to SWIFT, 70% of the world's RMB payment was handled through Hong Kong in 2016
- In October 2016, HKMA expanded the RMB liquidity facility for the CNH market in Hong Kong and enhanced the transparency of its usage with a view to further strengthening market liquidity
- The launch of Shenzhen-Hong Kong Stock Connect in December last year and the continued progress of RMB internationalisation will provide further impetus to the RMB business in Hong Kong



PROMOTING HONG KONG'S FINANCIAL PLATFORM

Corporate Treasury Centres (CTCs)

- Following the enactment of a new tax regime in June last year, a number of corporations are actively planning to set up or expand their CTC operation in Hong Kong. The HKMA will continue to step up its marketing effort

Infrastructure Financing Centre

- Established in July last year, the Infrastructure Financing Facilitation Office (IFFO) has been organising and participating in a number of seminars and workshops on infrastructure investment and financing
- Over 60 organisations from around the world joined IFFO as partners
- Memorandums of understanding were signed in December last year with China Development Bank and the Export-Import Bank of China respectively to jointly facilitate infrastructure investment and financing activities



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INVESTMENT INCOME

	← 2016 → (unaudited)					2015	2014	2013	2012
(HK\$ billion)	Full year	Q4	Q3	Q2	Q1	Full year	Full year	Full year	Full year
Hong Kong equities*	5.3	(8.0)	16.8	2.7	(6.2)	(5.0)	6.5	10.1	30.7
Other equities	28.3	14.6	18.5	5.1	(9.9)	7.1	33.7	71.8	42.8
Bonds	33.0	(17.7)	6.4	19.3	25.0	15.9	47.3	(19.1)	33.1
Other investments@	10.2	-	4.6	4.3	1.3	11.1	9.9	16.8	6.4
Foreign exchange#	<u>(15.8)</u>	<u>(19.3)</u>	<u>0.8</u>	<u>(12.5)</u>	<u>15.2</u>	<u>(44.9)</u>	<u>(52.7)</u>	<u>1.6</u>	<u>(1.4)</u>
Investment income/(loss)	61.0	(30.4)	47.1	18.9	25.4	(15.8)	44.7	81.2	111.6

* Excluding valuation changes of the Strategic Portfolio

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio (LTGP). (The above figures represent valuation changes up to the end of September 2016. Valuations of these investments from October to December are not yet available.)

This is primarily the effect of translating non-US dollar foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging



INVESTMENT DIVERSIFICATION

As of end-2016 (unaudited)

Asset Classes	Market Value HK\$ billion	Annualised IRR (Since inception from 2009 till 2016)
Private Equity	112.0	10.9%
Real Estate	62.9	
Total	174.9	

Note: Outstanding investment commitments at the end of 2016 amounted to HK\$133.8 billion



INCOME AND EXPENDITURE

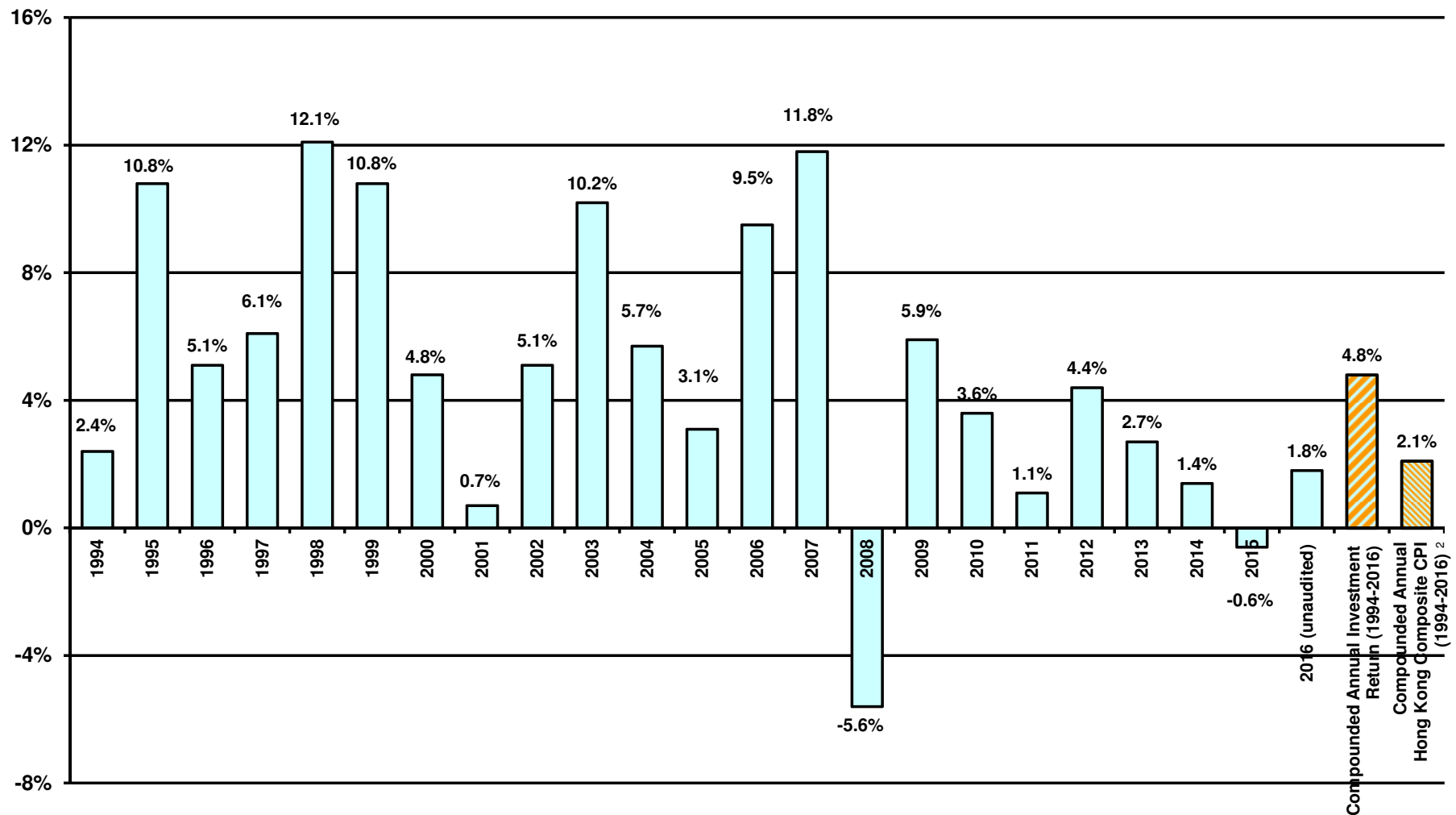
(HK\$ billion)	← 2016 →					2015
	Full year	Q4	Q3	Q2	Q1	Full year
	(unaudited)					
Investment income/(loss)	61.0	(30.4)	47.1	18.9	25.4	(15.8)
Other income	0.2	0.1	0.0	0.1	0.0	0.2
Interest and other expenses	<u>(6.4)</u>	<u>(1.9)</u>	<u>(1.6)</u>	<u>(1.7)</u>	<u>(1.2)</u>	<u>(4.8)</u>
Net income/(loss)	54.8	(32.2)	45.5	17.3	24.2	(20.4)
Fee payable to Fiscal Reserves*#	(23.0)	(5.8)	(5.5)	(5.7)	(6.0)	(46.7)
Fee payable to HKSAR government funds and statutory bodies*	(9.6)	(2.5)	(2.4)	(2.4)	(2.3)	(14.7)

* The rate of fee payment is 3.3% for 2016 and 5.5% for 2015

This does not include the 2016 fee payment to the Future Fund because such amount will only be calculated when the figures on the LTGP annual performance for 2016 are available



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2016) ¹



¹ Investment return calculation excludes the holdings in the Strategic Portfolio

² Composite CPI is calculated based on the 2014/2015-based series