



HONG KONG MONETARY AUTHORITY

Briefing to the Legislative Council Panel on Financial Affairs

29 May 2017

[Translation]

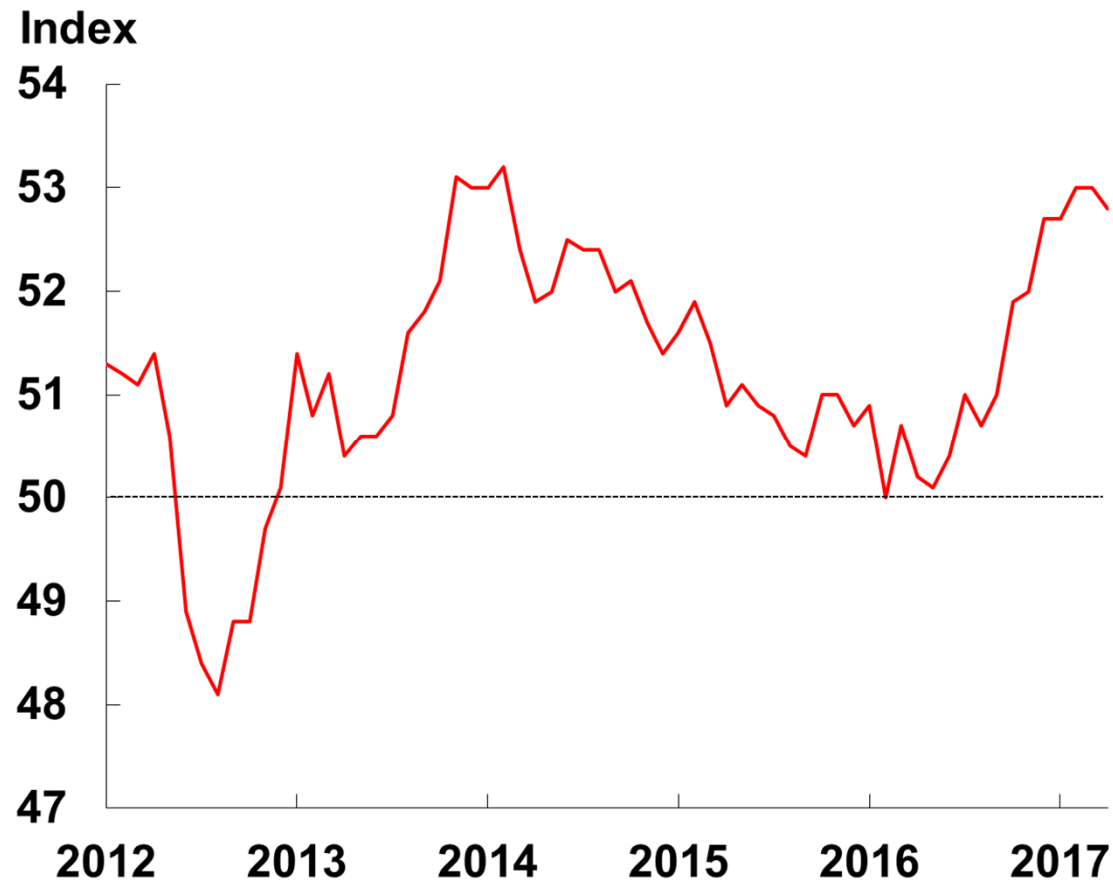


- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund
6. HKMC Life Annuity Scheme



GLOBAL ECONOMIC CONDITIONS HAVE IMPROVED RECENTLY...

Global Manufacturing Purchasing Managers' Index (PMI)



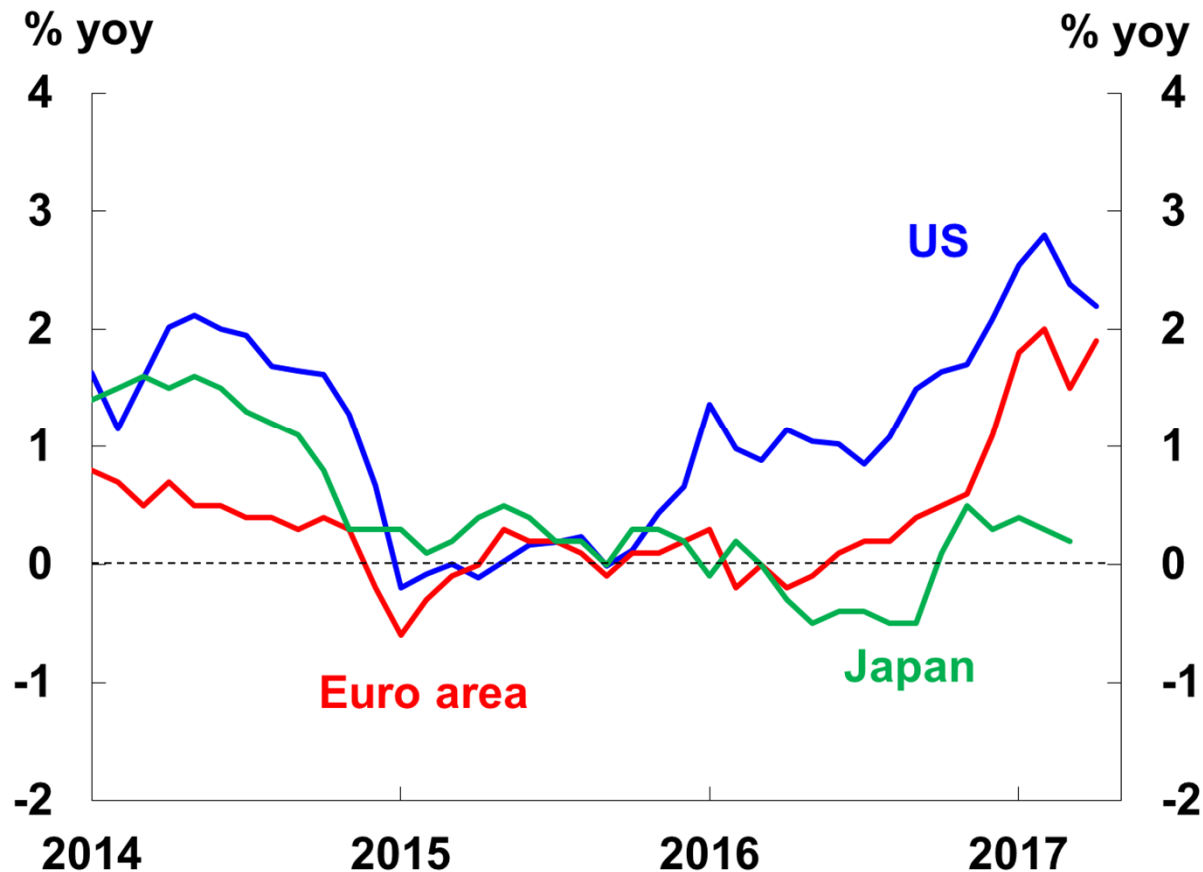
Note: The Global Manufacturing PMI as shown in the chart is produced by JP Morgan and IHS Markit.

Source: Bloomberg.



...DEFLATIONARY RISK HAS ALSO RECEDED

Headline Inflation Rate



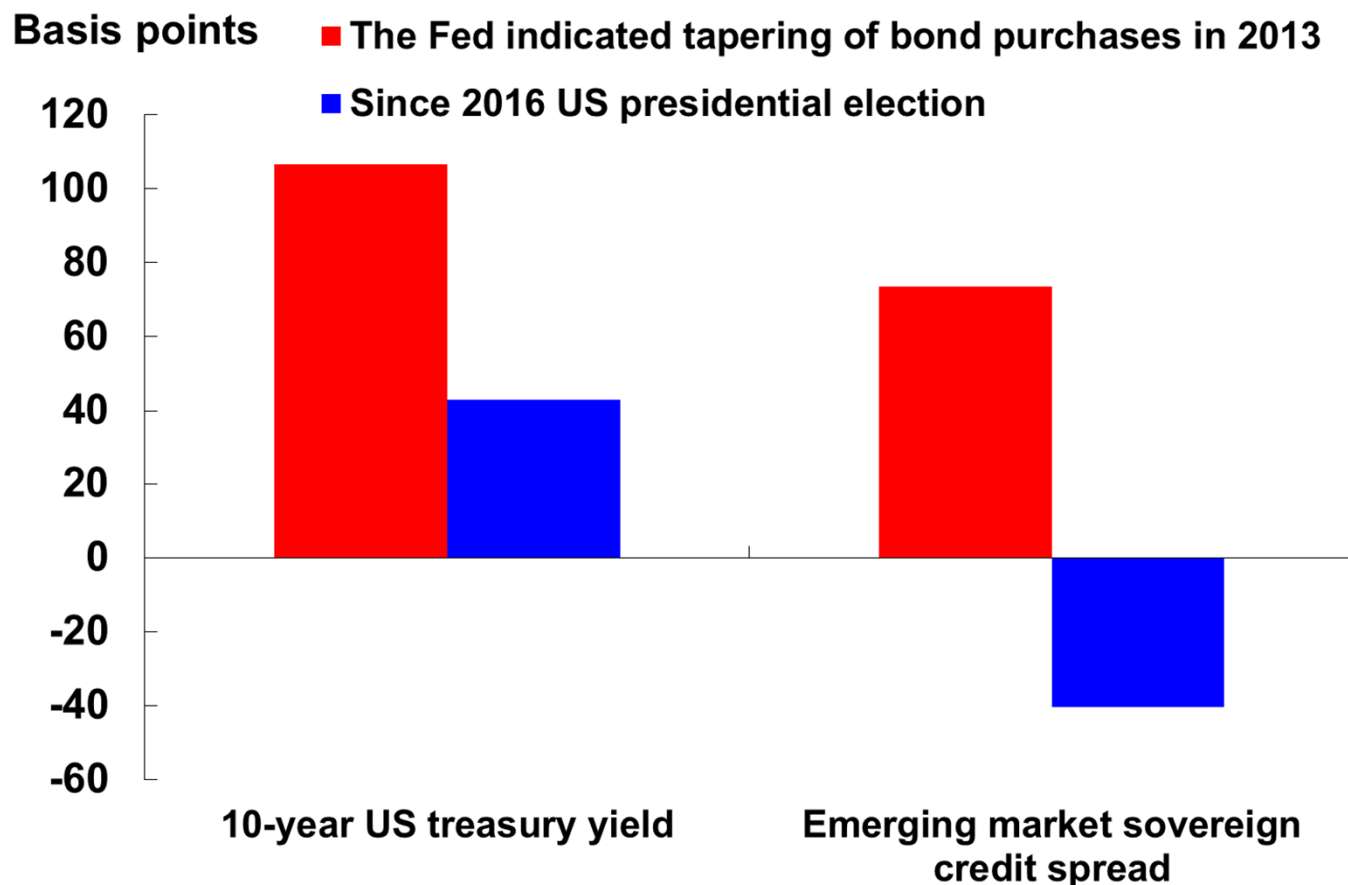
Note: The inflation rate in Japan as shown by the green line has been adjusted for the one-off effect from the 2014 sales tax hike.

Sources: CEIC and Datastream.



SENTIMENT TOWARDS EMERGING MARKETS HAS IMPROVED

Changes in the 10-year US Treasury Yield and Emerging Market Sovereign Credit Spread



Note: Data shown by the red bars are between 21 May 2013 and 5 September 2013 while data shown by the blue bars are between 7 November 2016 and 25 May 2017.

Sources: Bloomberg and JP Morgan.



US: ECONOMIC FUNDAMENTALS REMAIN SOUND...

- US economy has been improving
- Recent business and consumer confidence indicators have surpassed pre-Global Financial Crisis peaks
- Labour market continues to improve, basically in full employment
- Deflationary risk has receded amid stabilised energy and commodity prices
- Fed hiked rate in March, and markets expect two more rate hikes this year



...BUT POLICY UNCERTAINTIES FROM THE NEW ADMINISTRATION CANNOT BE OVERLOOKED

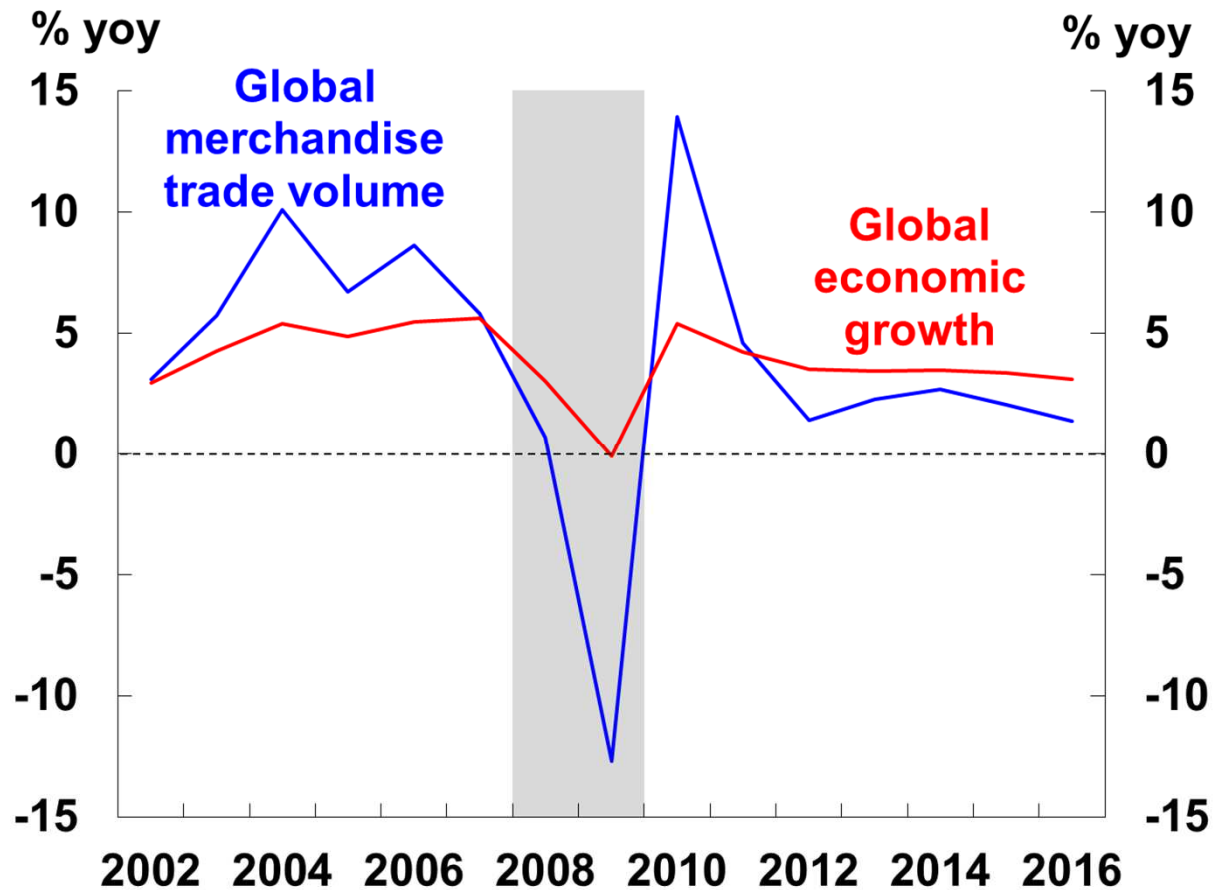
Policy uncertainties from the new US administration has clouded the global economic outlook:

- Rising threats of trade protectionism
- Tax reforms to attract corporates' repatriation of overseas profits
- Measures to stimulate the economy and employment could increase inflationary pressures



PROTECTIONISM LIKELY WEIGHS ON THE SLOWING GLOBAL TRADE

Global Trade and Economic Growth



Note: Grey area denotes period of economic recession during the Global Financial Crisis.

Sources: CPB Netherlands Bureau for Economic Policy Analysis, US National Bureau of Economic Research and International Monetary Fund.



TAX REFORMS THAT INDUCE CORPORATES' REPATRIATION OF OVERSEAS PROFITS MAY AFFECT GLOBAL CAPITAL FLOWS

	2004 US Homeland Investment Act	Currently
Estimated overseas profits held by US corporates	About US\$ 1.1 trillion	About US\$ 3 trillion
Funds repatriated	About US\$ 360 billion	?

Sources: US Joint Committee on Taxation and HKMA staff estimates.



NEW US ADMINISTRATION'S POLICIES COULD PUSH UP INFLATION AND AFFECT THE PACE OF US INTEREST RATE NORMALISATION

- The new US administration's policies may fuel inflation
 - Trade protectionist policies may push up import prices
 - Fiscal stimulus measures would push up wages amid low unemployment rate
- Fiscal stimulus and tax concession measures would aggravate the fiscal deficit and push up Treasury yields



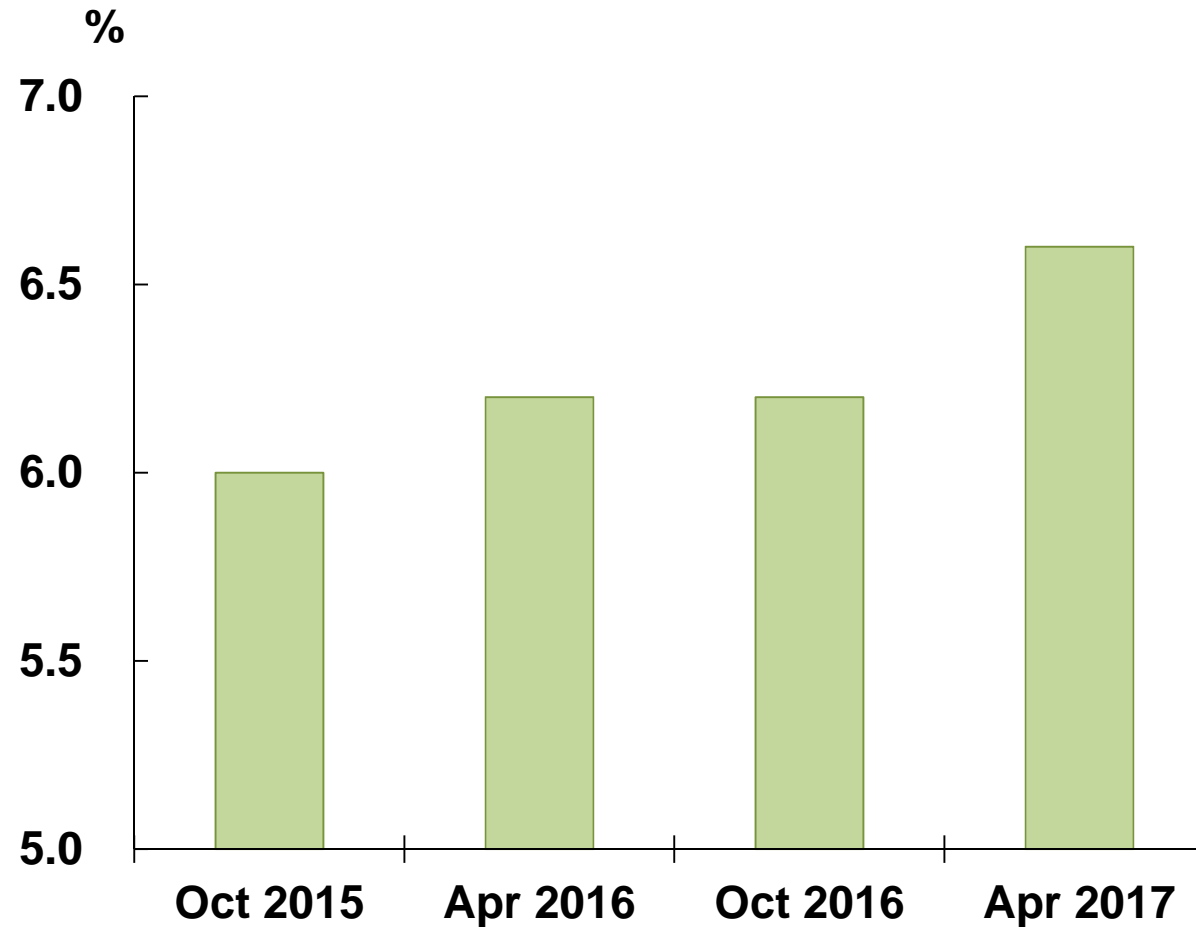
ASSESSMENT OF RISKS TO GLOBAL FINANCIAL STABILITY

- Overall growth outlook in both advanced and emerging market economies have improved
- Yet world trade and global supply chains are faced with policy uncertainties
- The pace of US interest rate normalisation remains uncertain
- European economies are improving but structural reforms remain slow and unemployment rate is still high
- Geopolitical risks have heightened



MAINLAND CHINA: WITH STABILISING ECONOMY, MARKET TURNS OPTIMISTIC ON GROWTH OUTLOOK

IMF's growth projection for 2017

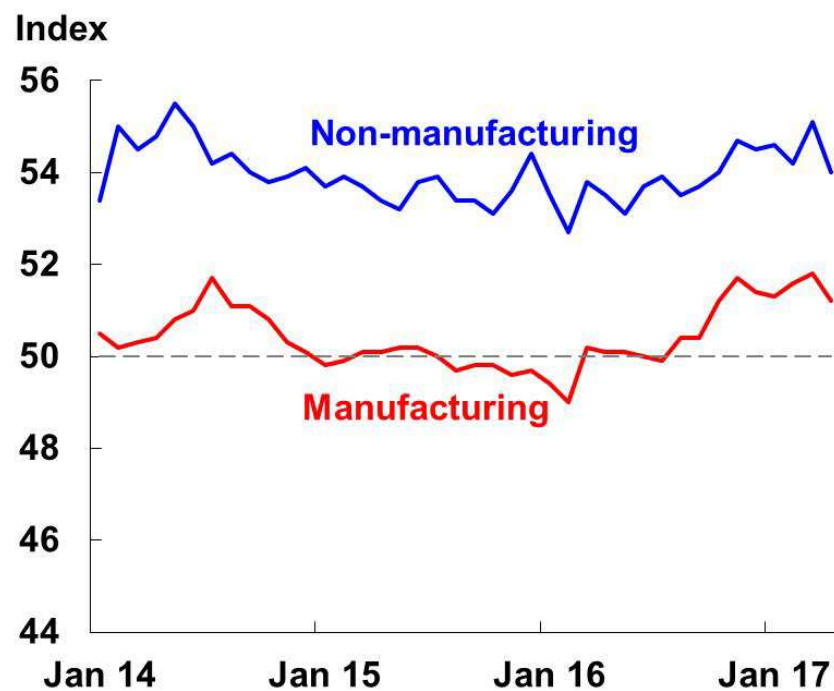


Source: International Monetary Fund.

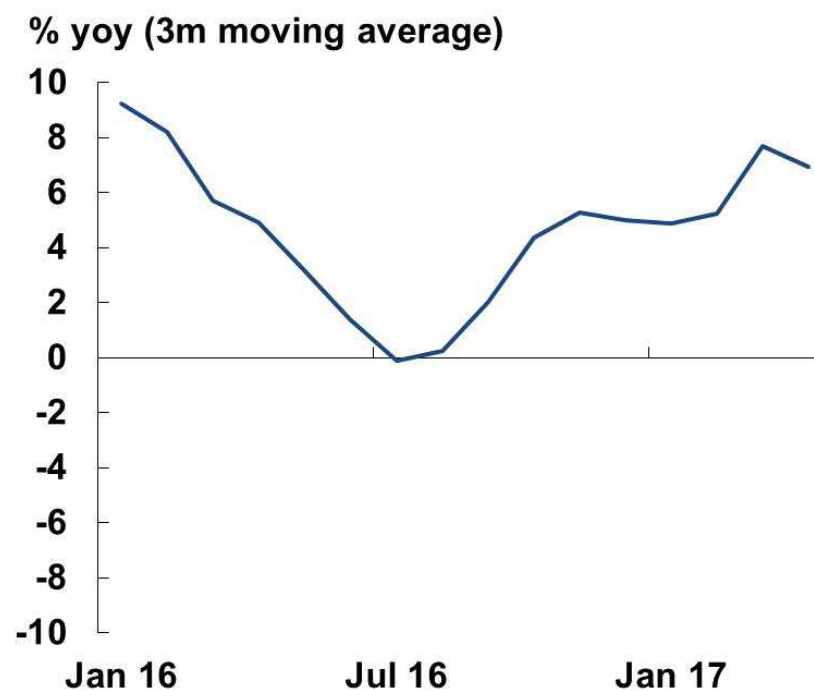


MAINLAND CHINA: INCREASE IN KEY ECONOMIC INDICATORS

Purchasing Managers' Index



Private fixed asset investment

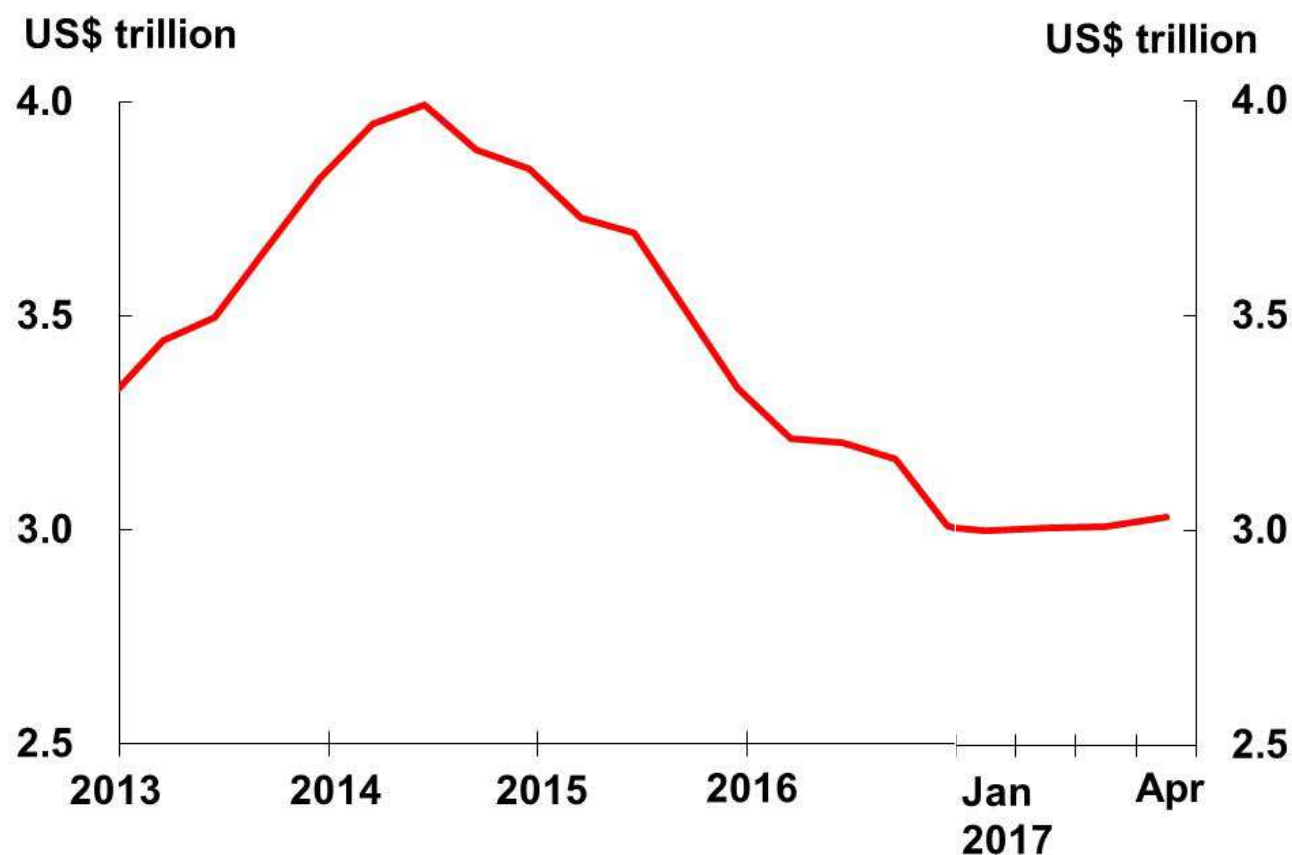


Sources: CEIC and HKMA staff estimates.



MAINLAND CHINA: CAPITAL OUTFLOW PRESSURES EASED

Foreign reserves

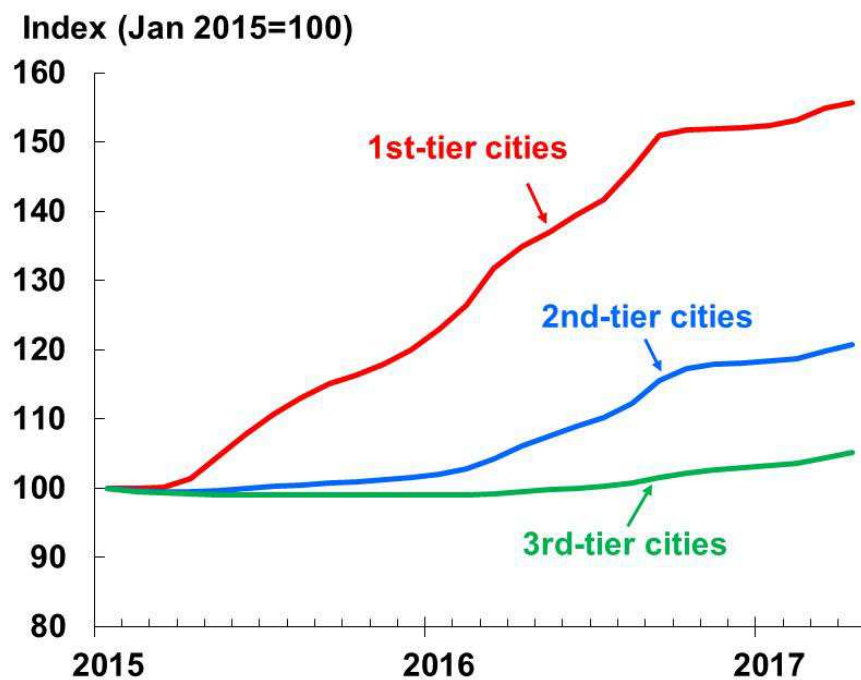


Source: CEIC.

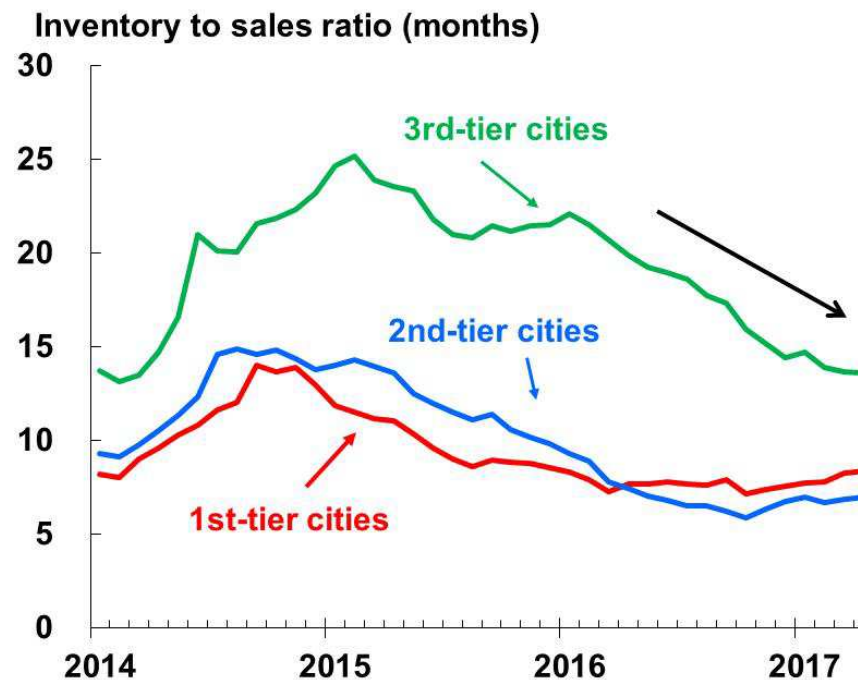


MAINLAND CHINA: PROPERTY MARKET RISKS STILL WARRANT ATTENTION

Residential property prices



Housing inventory to sales ratios

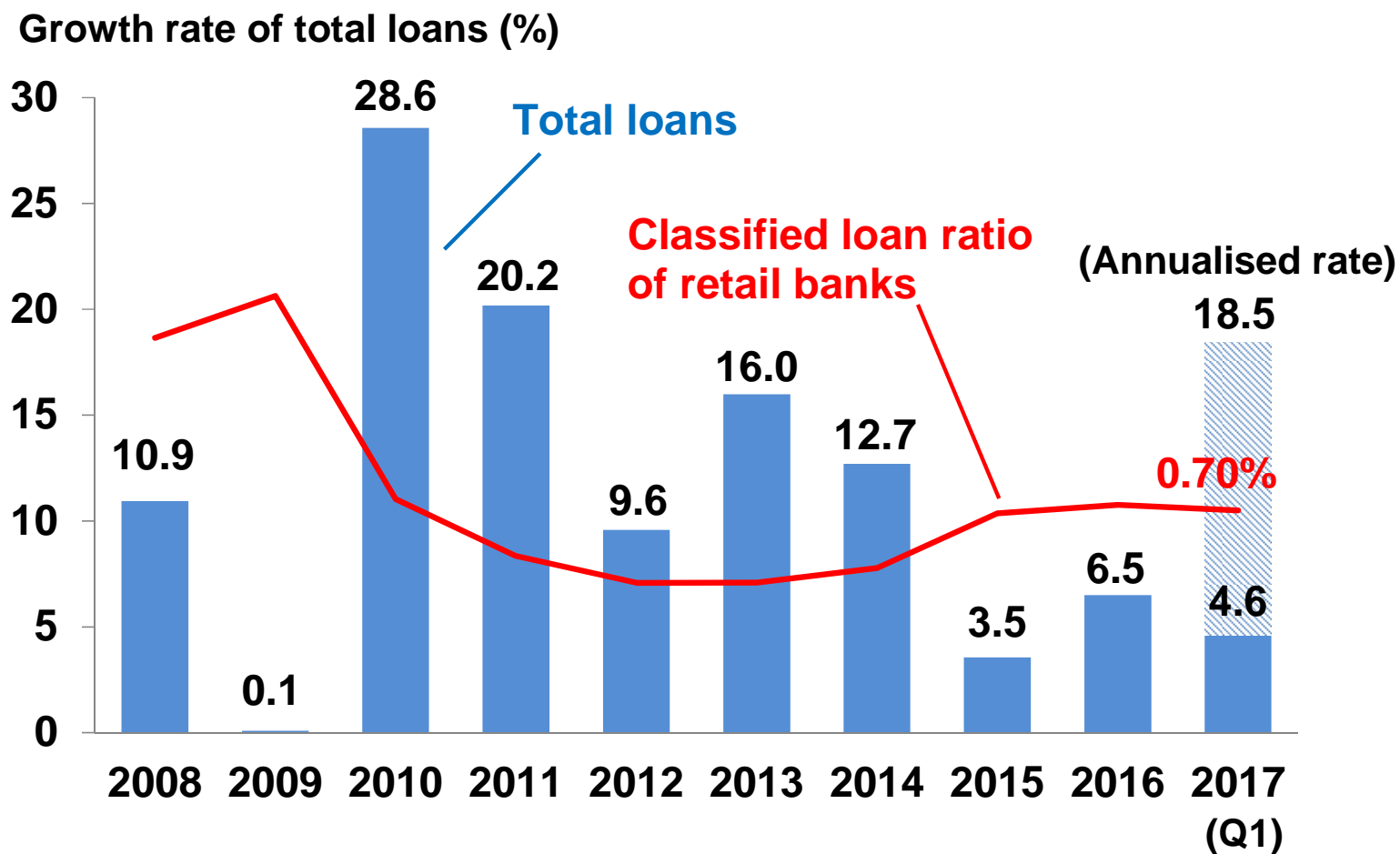


Sources: CEIC and HKMA staff estimates.



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

Strong total loan growth in Q1; asset quality remains healthy



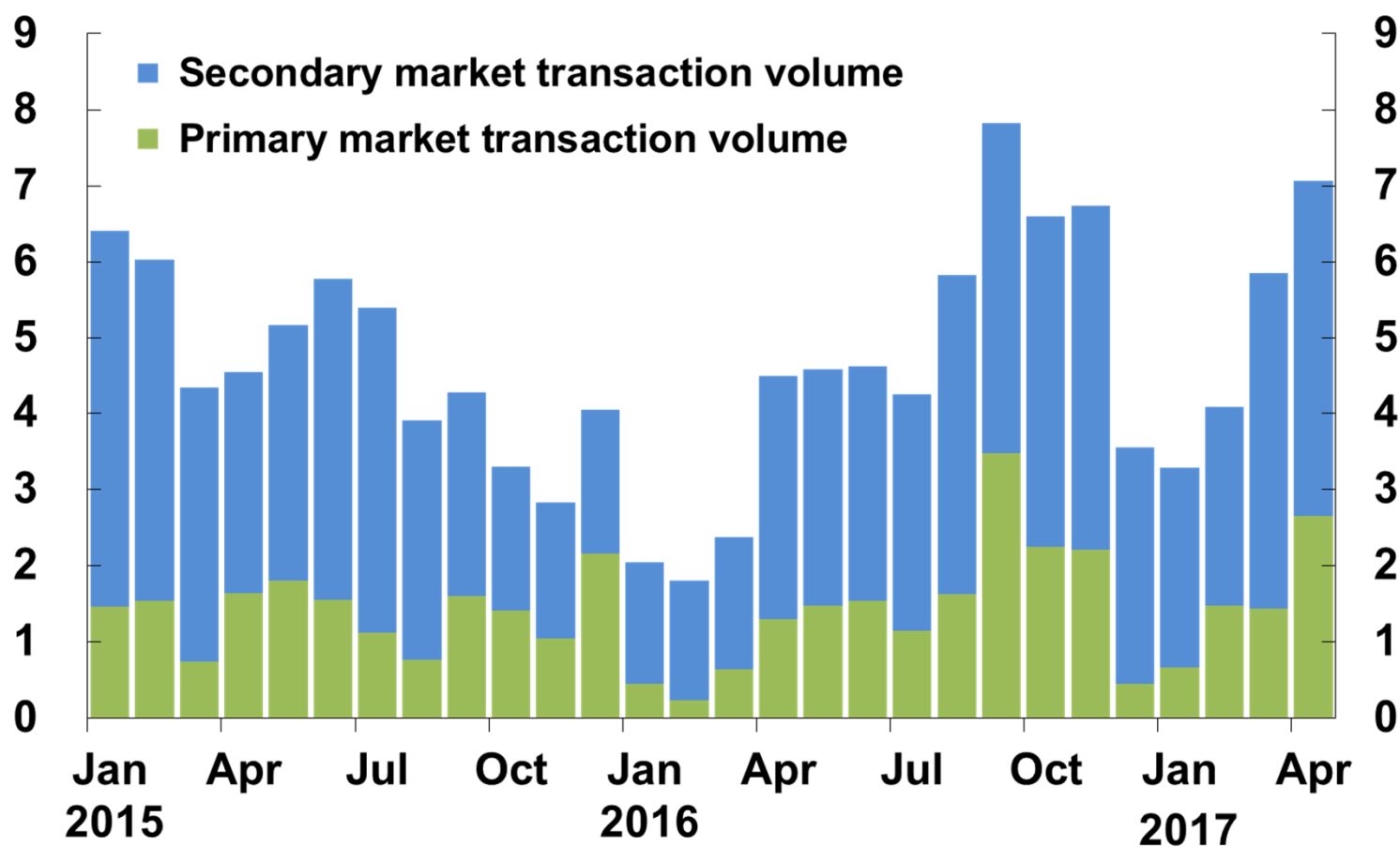
Source: HKMA.



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

Property transaction volume picks up again

Number of transactions('000)

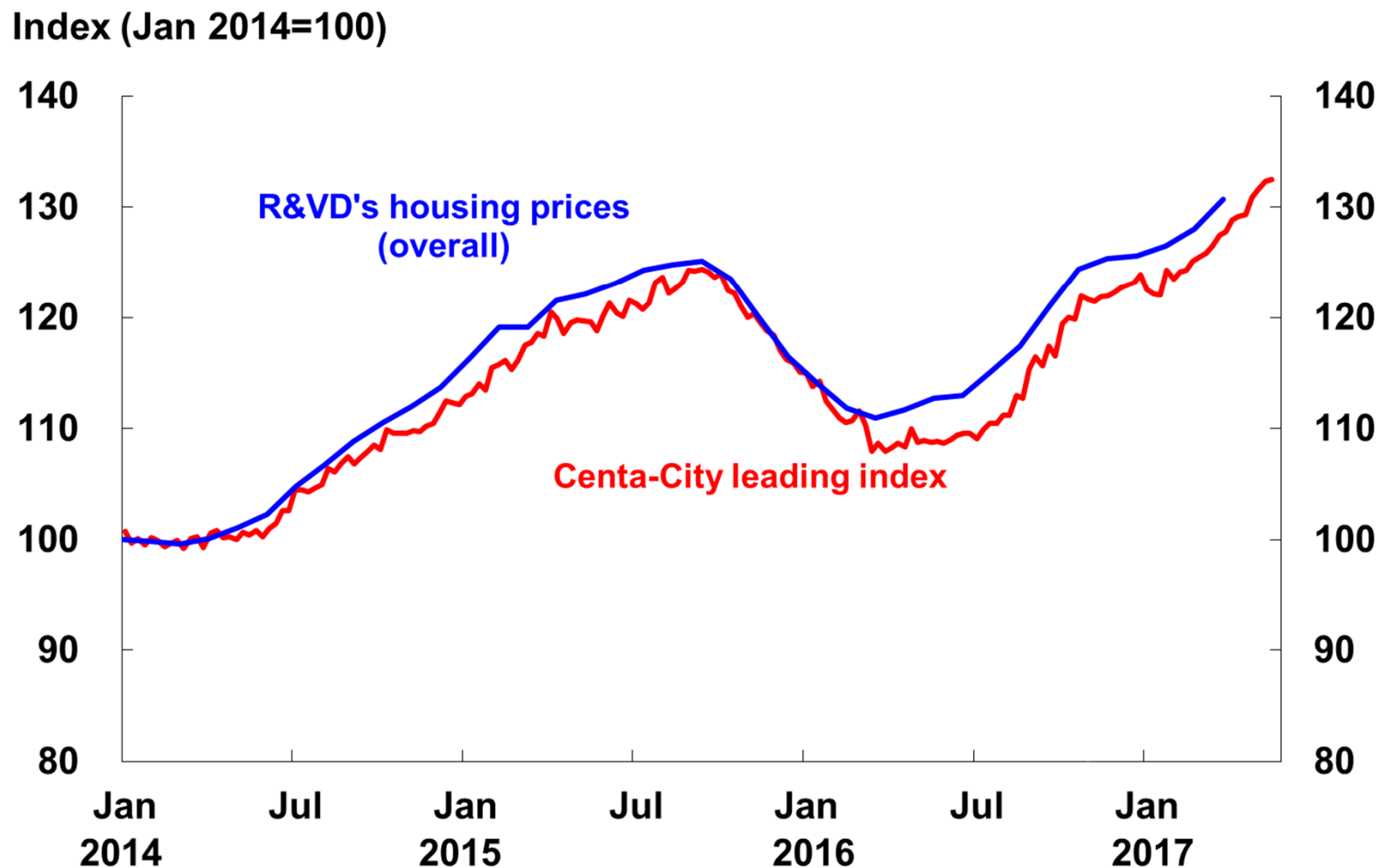


Source: Land Registry.



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

Property prices continue to rise

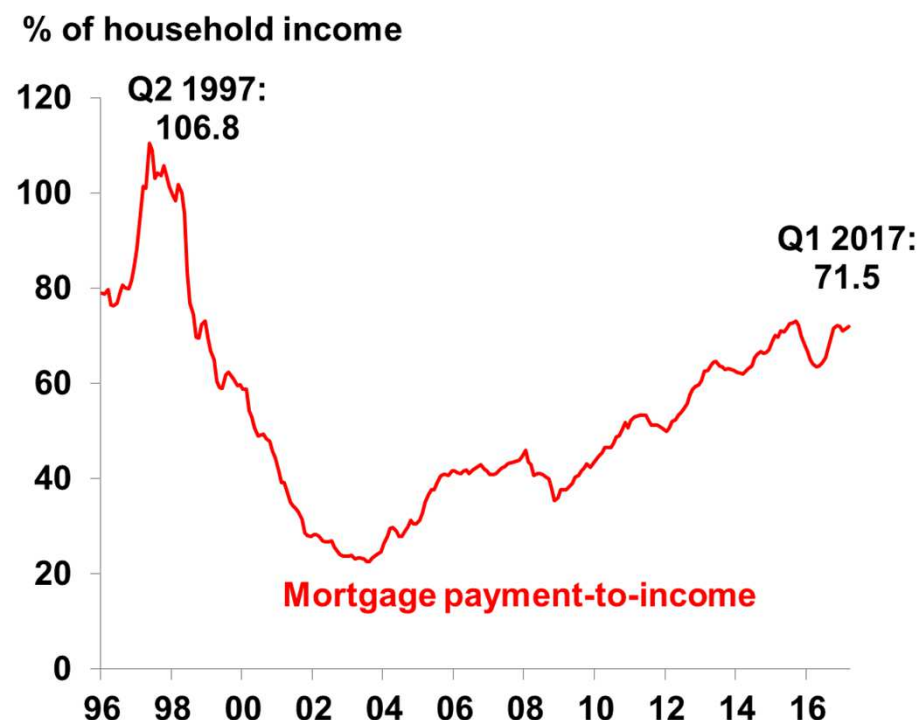


Sources: Rating and Valuation Department and Centaline Property Agency Limited.



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

Housing affordability deteriorates further



Sources: Rating and Valuation Department, Census and Statistics Department and HKMA.



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

- Introduced measures on 12 May to strengthen the risk management of banks for lending to property developers:
 - Tightening the caps on ratios for construction financing
 - Requiring banks to set aside an adequate amount of capital with reference to the level of mortgage exposures of property developers
- Introduced the 8th round of counter-cyclical macroprudential measures on 19 May to strengthen banks' risk management for mortgage business:
 - Raising the risk-weight floor for new residential mortgage loans granted by banks using Internal Ratings-Based Approach from 15% to 25%
 - For borrowers with one or more pre-existing mortgages: lowering the applicable loan-to-value ratio cap by 10 percentage points
 - For borrowers with income mainly derived from outside Hong Kong: lowering the applicable debt servicing ratio limit by 10 percentage points



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

- Global economic conditions have improved but uncertainties still abound
- Under the Linked Exchange Rate System, US interest rate normalisation will cause a gradual rise in local interest rates
- Continued increase in property prices further impairs housing affordability, heightening the risk of overheating in the property market and leading to greater repercussions when the cycle turns
- The HKMA has taken further measures to strengthen the resilience of the banking system to shocks
- The public should be prepared and manage the risk properly

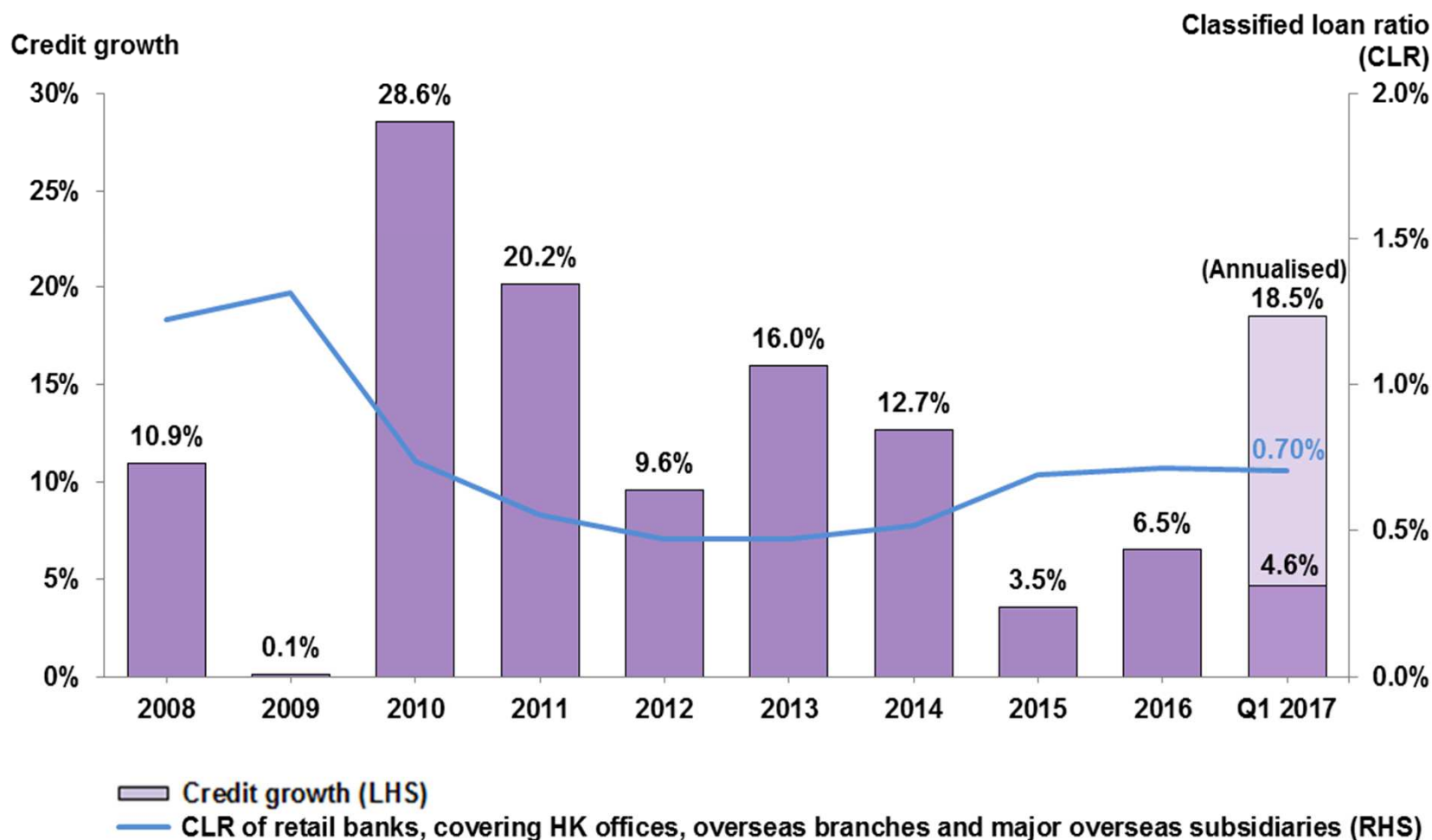


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CREDIT GROWTH AND ASSET QUALITY

Credit growth accelerated with asset quality staying at healthy level





IMPLEMENTATION OF INTERNATIONAL STANDARDS

- Amendment of Banking (Capital) Rules to implement:
 - Revised securitisation framework
 - Basel III leverage ratio
 - Capital treatment of expected loss provisioning
- Amendment of Banking (Liquidity) Rules to implement Basel III Net Stable Funding Ratio
- Amendment of Banking Ordinance to implement Basel Committee's new large exposure framework and Financial Stability Board's standards relating to recovery planning



HONG KONG RESOLUTION REGIME

- Protected arrangements regulation: tabled before the Legislative Council on 17 May
- Publication of relevant policy papers: institutional arrangements for the discharge of statutory functions, core information requirements for resolution planning
- Loss-absorbing capacity requirements: consultation expected by year end



FINANCIAL INCLUSION

Bank Branch Network

- Implementing the plan for setting up more physical branches
- Working with the banking industry to further enhance barrier-free banking services

Difficulties in Opening Bank Account

- Feedback from Chambers of Commerce shows improvement in customer experience
- Set up dedicated team and dedicated HKMA webpage to provide assistance to applicants for bank accounts



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LATEST FINTECH DEVELOPMENTS

Research on Central Bank Digital Currency

- In collaboration with 3 note-issuing banks, Hong Kong Interbank Clearing Limited and R3 consortium, first stage of the research is expected to be completed in the fourth quarter

Distributed Ledger Technology

- Second-stage research is in progress. Results are expected to be published by the end of the year

Fintech Supervisory Sandbox (FSS)

- 6 banks have used FSS for 15 pilot trials, 9 of which have been completed. Results are encouraging

Haccelerator

- Launched the platform in March 2017 and 2 banks will use it for fintech competitions in May

Fintech Career Accelerator Scheme

- Interviews completed by end of April with more than 400 applicants. Offers are being made to successful students



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BOND CONNECT

- The HKMA and the People's Bank of China announced Bond Connect on 16 May to provide a more convenient cross-border platform that facilitates trading of Mainland bonds by overseas institutional investors
- Bond Connect comprises two components:
 - Settlement : conducted through the accounts opened by the HKMA's Central Moneymarkets Unit (CMU) at the relevant Mainland institutions to provide greater convenience to overseas investors and generate greater demand for Hong Kong's related financial services
 - Trading : enhances trading efficiency by providing a new platform that supports direct trading between overseas investors and Mainland dealers
- Technical preparatory work is underway with a view to rolling out as soon as possible



OFFSHORE RMB BUSINESS AND INFRASTRUCTURE INVESTMENTS AND FINANCING

Offshore RMB business

- CNH market in Hong Kong continues to function orderly and RMB liquidity pool shows further signs of stabilisation. The average daily turnover of the RMB RTGS system stayed at high levels of about RMB900 billion in the first quarter of 2017
- The Central Government's continued commitment to RMB internationalisation and capital account liberalisation will inject impetus to the development of RMB business in Hong Kong

Infrastructure investments and financing

- The Infrastructure Financing Facilitation Office organised the Debt Financing and Investors' Roundtables this March in which a Reference Term Sheet was developed to narrow the gap in expectations between investors and project operators
- Chief Executive of HKMA took part in the Belt and Road Forum for International Cooperation held in Beijing on 14 May to promote the strength of Hong Kong as an investment and financing hub for the Belt and Road Initiative



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INVESTMENT INCOME

	2017		2016	2015
	(unaudited)			
(HK\$ billion)	Q1	Full Year	Full Year	Full Year
Hong Kong equities*	14.3	5.3	(5.0)	
Other equities	24.5	28.6	7.1	
Bonds	6.4	33.1	15.9	
Other investments@	-	16.9	11.1	
Foreign exchange#	<u>11.9</u>	<u>(15.8)</u>	<u>(44.9)</u>	
Investment income/(loss)	57.1	68.1	(15.8)	

* 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 valuation figures for the first quarter of 2017 are not yet available

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



INCOME AND EXPENDITURE

	2017 (unaudited)	2016	2015
(HK\$ billion)	Q1	Full Year	Full Year
Investment income/(loss)	57.1	68.1	(15.8)
Other income	0.0	0.2	0.2
Interest and other expenses	<u>(2.2)</u>	<u>(6.4)</u>	<u>(4.8)</u>
Net income/(loss)	54.9	61.9	(20.4)
Fee payable to Fiscal Reserves ^{*#}	(5.6)	(33.1)	(46.7)
Fee payable to HKSAR government funds and statutory bodies [*]	(2.1)	(9.6)	(14.7)

* The rate of fee payment is 2.8% for 2017, 3.3% for 2016 and 5.5% for 2015

This does not include the 2017 fee payment to the Future Fund because such amount will only be calculated when the composite rate for 2017 is available (For 2016, the composite rate is 4.5% and fee payable to the Future Fund was HK\$10.1 billion).



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HKMC LIFE ANNUITY SCHEME

- The HKMC's Board approved in principle in April to introduce the Life Annuity Scheme
- The Life Annuity Scheme aims at providing an additional financial planning option to the elderly citizens. The design of the Scheme is based on three important principles:
 1. Simple and easy to understand and attractive to the annuitants
 2. Relevant risks can be prudently managed by the insurer
 3. Conform with commercial principles and financially viable and sustainable



TENTATIVE KEY DESIGN FEATURES OF LIFE ANNUITY SCHEME*

- The Scheme will provide immediate, lifetime guaranteed fixed monthly payouts to annuitants aged 65 or above
- The cap and floor of the premium amount are tentatively set at \$1 million and \$50,000 respectively
- Based on the tentative estimate of the highest internal rate of return of 4%, the expected monthly payout for a male annuitant at the entry age of 65 and for \$1 million premium would be about \$5,800
- Each annuitant is guaranteed to receive instalments of monthly annuity payment of total amount equal to 105% of the premium paid, and early surrender is allowed
- The amount offered for subscription will be subject to a quota, tentatively up to \$10 billion for the first batch, with actual amount subject to market conditions and prudent risk management considerations

* subject to validation by independent consultant and approval by insurance industry regulatory authority



PREPARATORY WORK OF LIFE ANNUITY SCHEME

- Preparatory work is in progress, including:
 - validating the details of the Scheme by an independent consultant
 - seeking authorisation by the insurance industry regulatory authority
 - developing concrete proposals on arrangements for premium investment management and capital requirements for the HKMA's consideration and approval
- Strive to launch the Scheme by mid-2018