



HONG KONG MONETARY AUTHORITY

Briefing to the Legislative Council Panel on Financial Affairs

5 February 2018

[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



2017 IN REVIEW

Real economy

- Synchronised pick-up of growth momentum across major economies

Asset markets

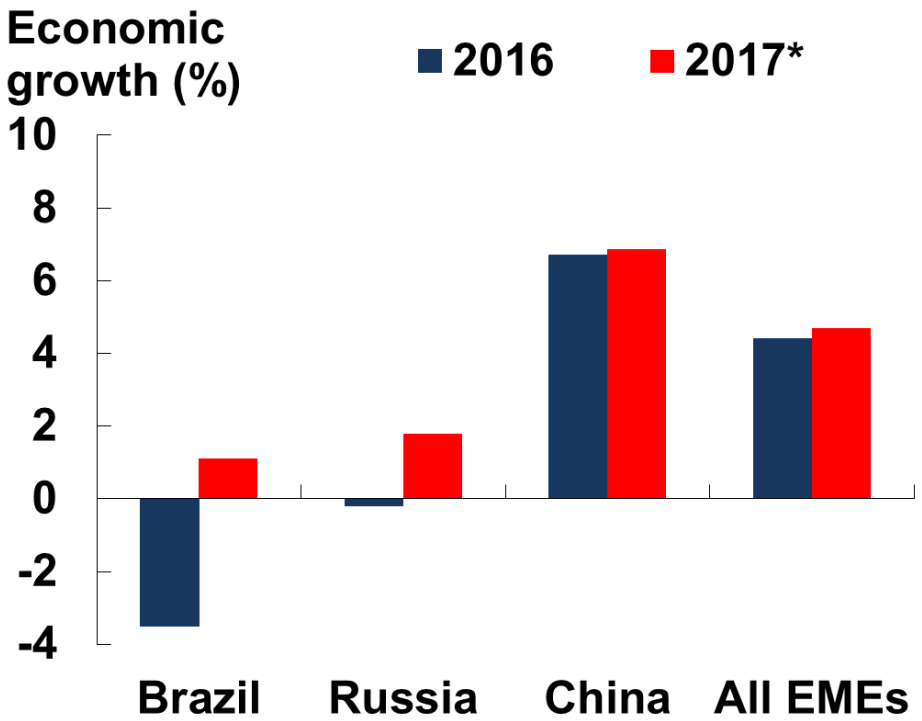
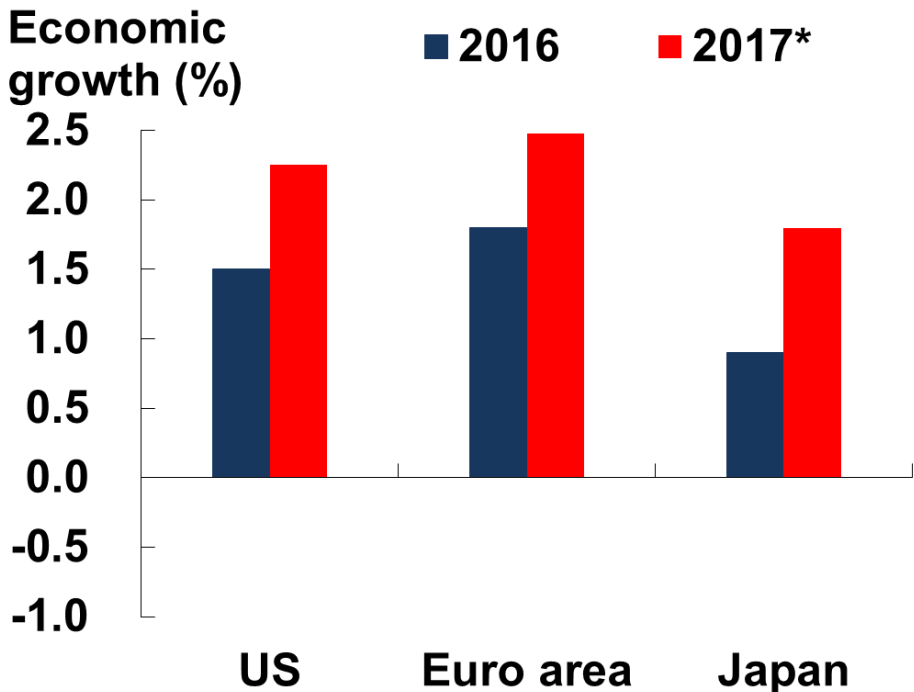
- Stellar performance, with equity markets reaching historical highs

Foreign exchange market

- Notwithstanding three rate hikes and the commencement of balance sheet normalisation by the US Federal Reserve, the US dollar weakened rather than strengthened



2017 IN REVIEW: GROWTH IN ADVANCED AND EMERGING MARKET ECONOMIES PICKED UP IN TANDEM

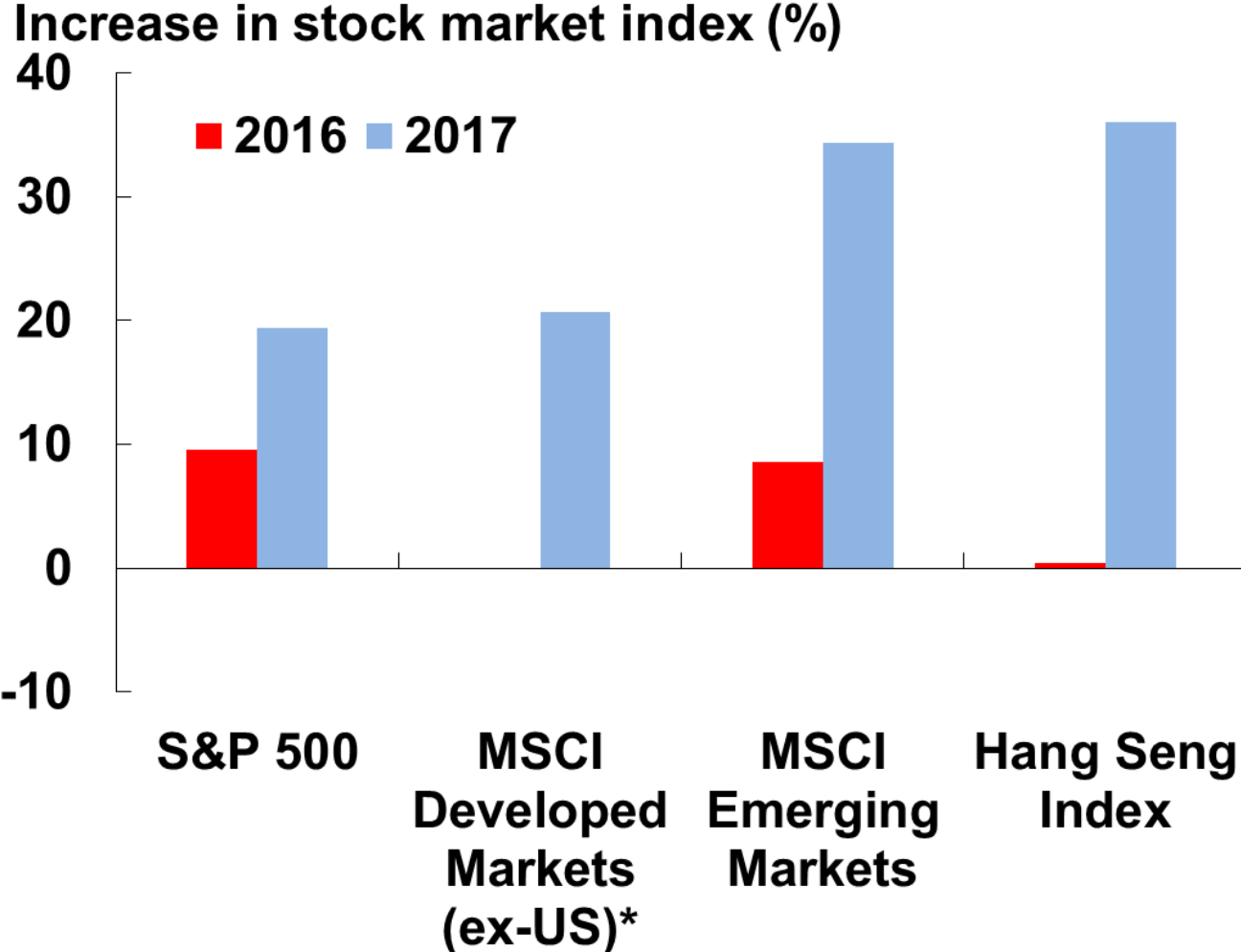


* 2017 growth rates for the US, euro area and China are actual figures; the rest are IMF estimates.

Sources: CEIC and International Monetary Fund



2017 IN REVIEW: BUOYANT ASSET MARKETS

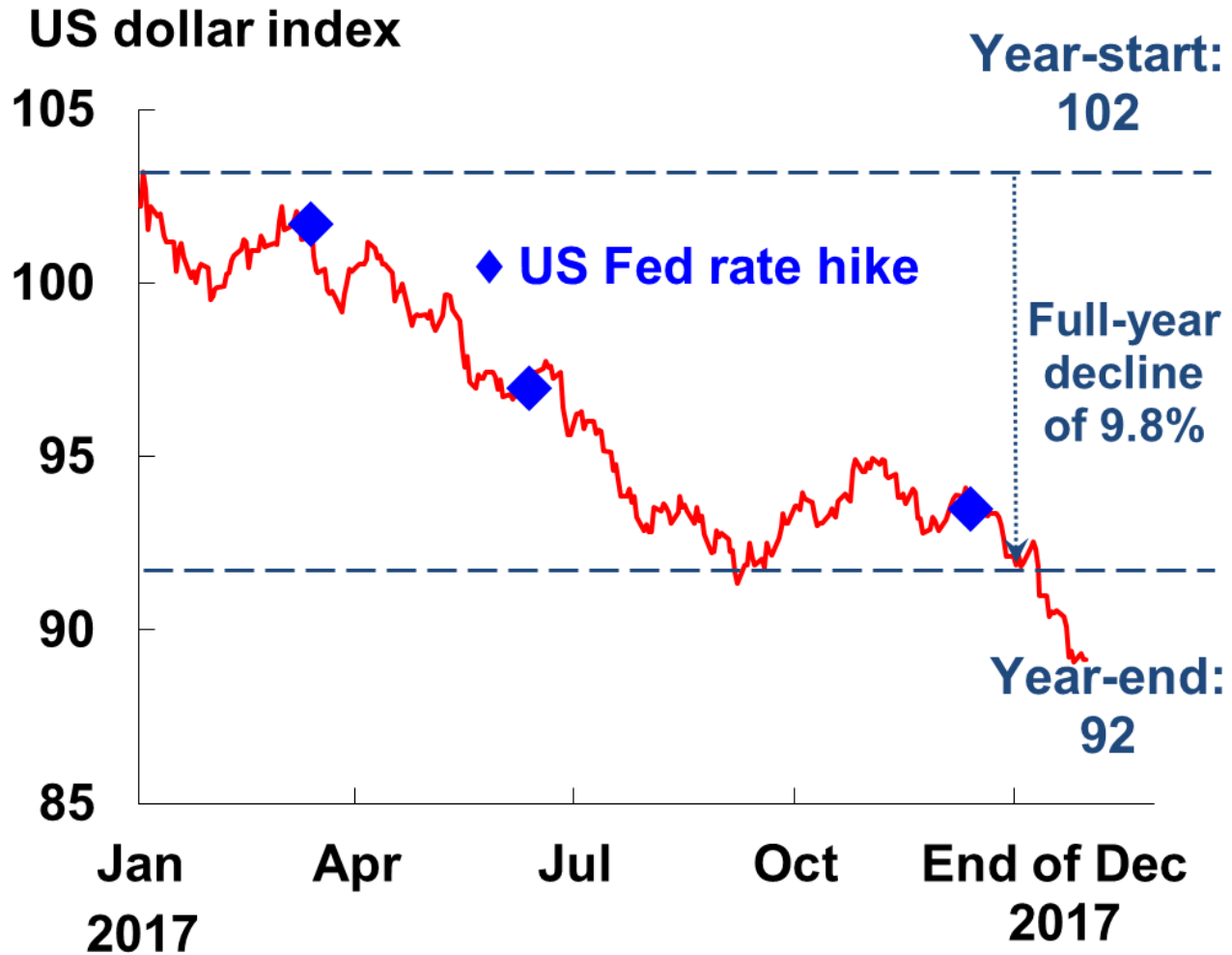


* Refers to MSCI World (ex-US) index.

Source: Datastream

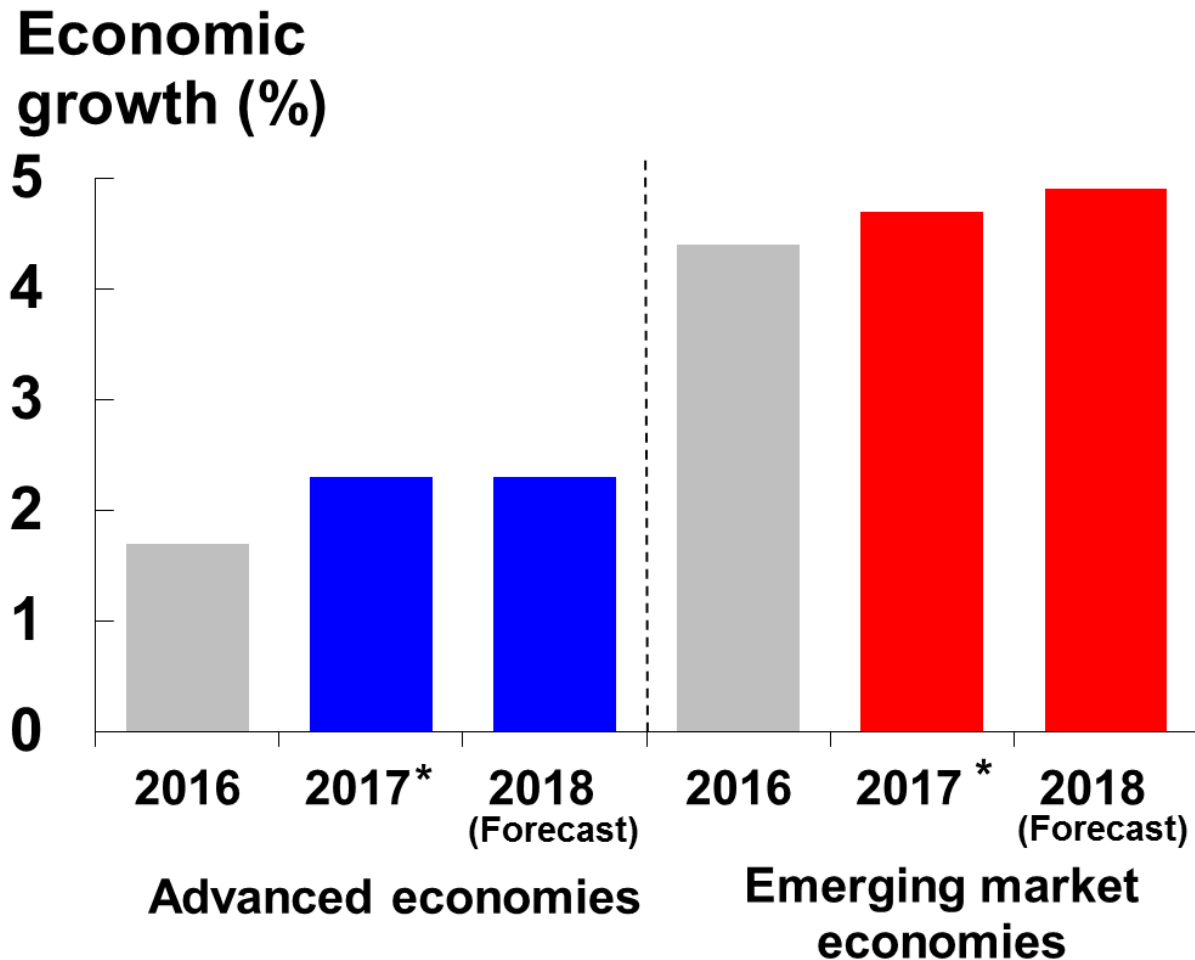


2017 IN REVIEW: WEAKENING OF THE US DOLLAR





OUTLOOK FOR 2018: GROWTH MOMENTUM OF REAL ECONOMY EXPECTED TO SUSTAIN



* 2017 figures are estimates.

Source: International Monetary Fund



BUOYANCY OF ASSET MARKETS IS BASED ON OPTIMISTIC EXPECTATIONS

- Prevailing optimistic market expectations include:
 - Real economy will continue to perform well, driving a sustainable growth in corporate profits
 - Persistently low US inflation coupled with structural changes resulting in lower-than-usual interest rates despite interest rate normalisation by the US Federal Reserve
 - As low rates become the “new normal”, bond market still offers reasonable returns, and hence equity valuations are not excessively high
 - Trade protectionism and geopolitical risks are limited



INTEREST RATE RISKS

- US inflationary pressures may be greater than expected
 - Tightening of US labour market
 - US tax cuts would provide short-term boost to investment and consumption
 - Synchronised global economic growth would drive commodity prices higher
- US tax reforms would lead to a widening of fiscal deficit (by US\$1,500 billion in ten years), which could drive up Treasury yields
- Central banks in the euro area, UK and Japan may tighten their monetary policies
- Repatriation of overseas earnings by US corporates may tighten offshore US dollar liquidity



TRADE PROTECTIONISM AND GEOPOLITICAL RISKS

- US administration's trade policy may affect global trade
 - Having exited the Trans-Pacific Partnership Agreement
 - Mulling over North American Free Trade Agreement renegotiations
 - Introducing import taxes on various goods (e.g. steel from Vietnam, timber and aircraft from Canada, washing machines and solar panels)
 - Limiting mergers and acquisitions of US companies by foreign investors
- Geopolitical tensions may deteriorate
(developments in the Korean Peninsula, political instability in the Middle East, Brexit, acts of terrorism, etc.)



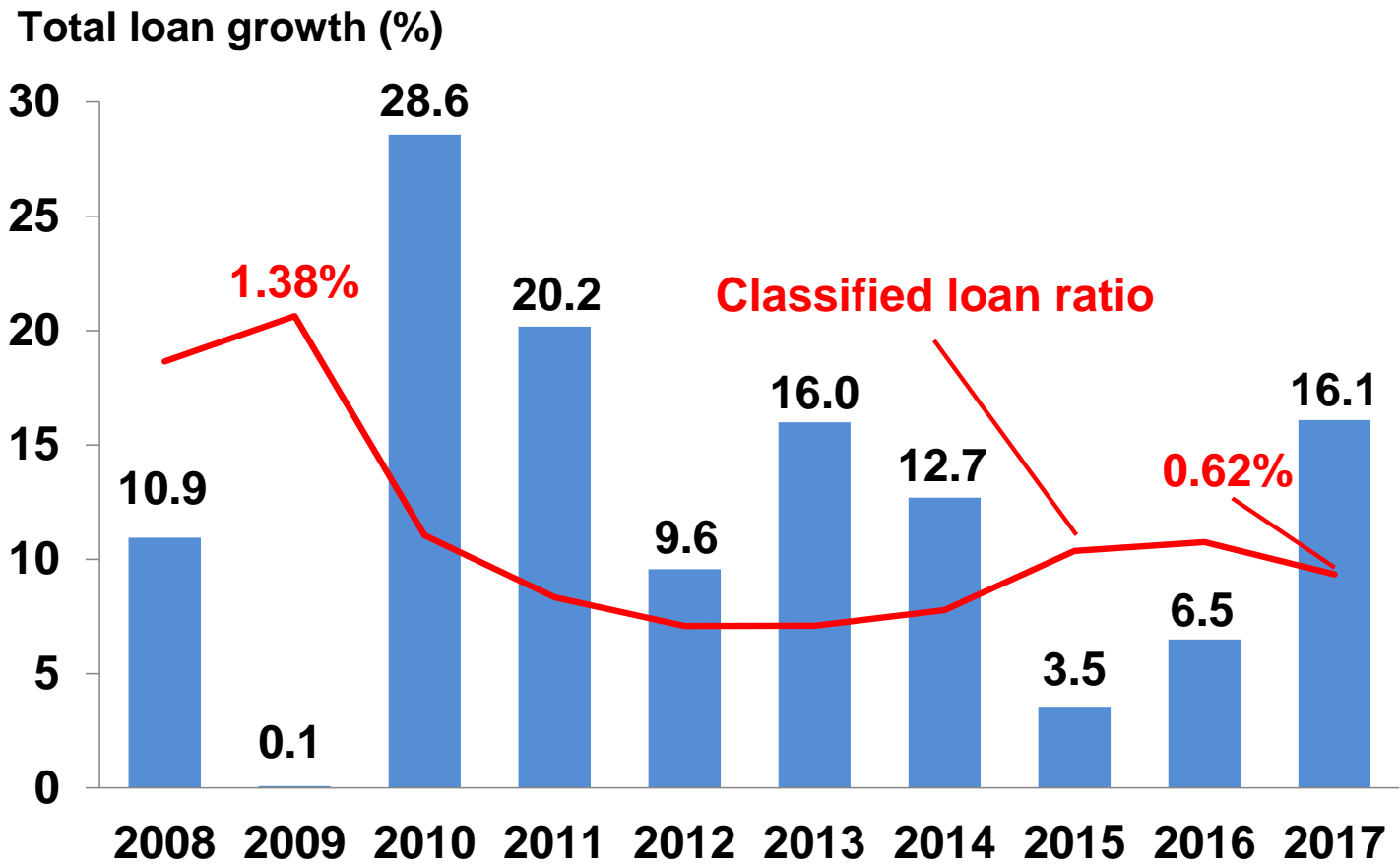
MAINLAND CHINA: PRIORITY OF ECONOMIC DEVELOPMENT

- Shift of focus from increasing speed of growth to quality economic development
 - Continuing effort in structural reform (deepening state-owned enterprise reforms and encouraging technological innovation)
 - Preventing and addressing environmental pollution
 - Promoting sustainable and inclusive economic development
- Strengthening effort in curbing systemic risk in financial sector
 - Guarding against the risk of overheating in the property market and abiding by the principle that “houses are for people to live in, not for speculation”
 - Continuing its efforts in deleveraging
 - Guiding the financial services sector in serving the needs of real economy



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

Credit growth picked up while asset quality stayed at a healthy level

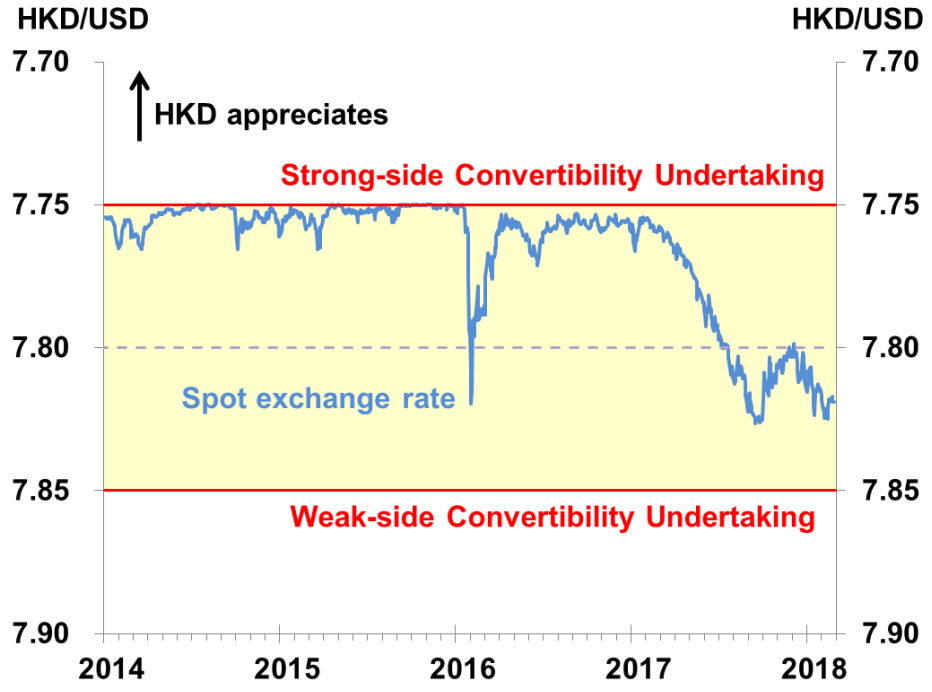
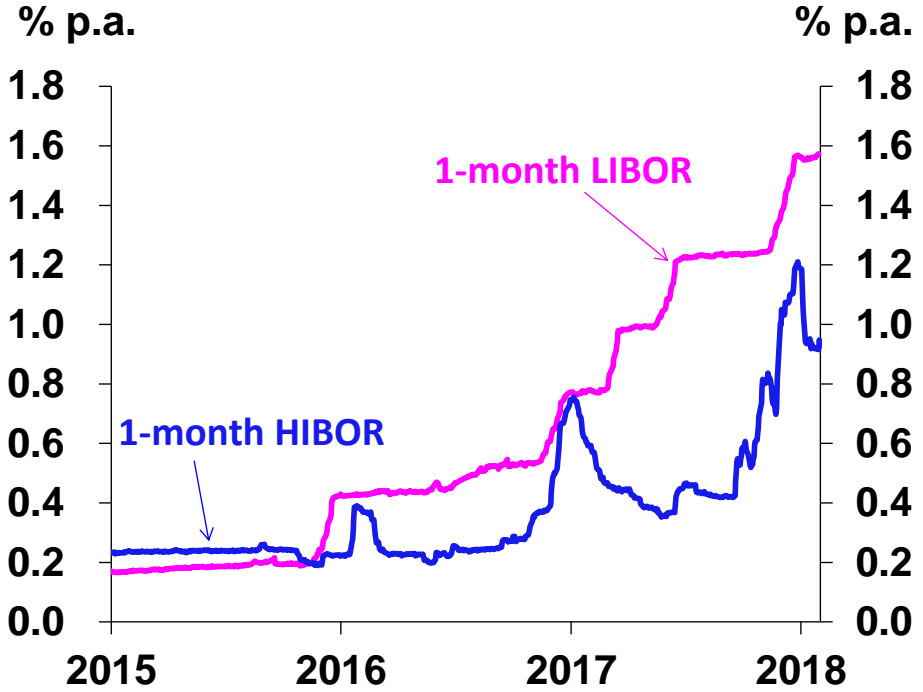


Note: Classified loan ratio covers retail banks only.



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

HIBORS went up and HKD weakened

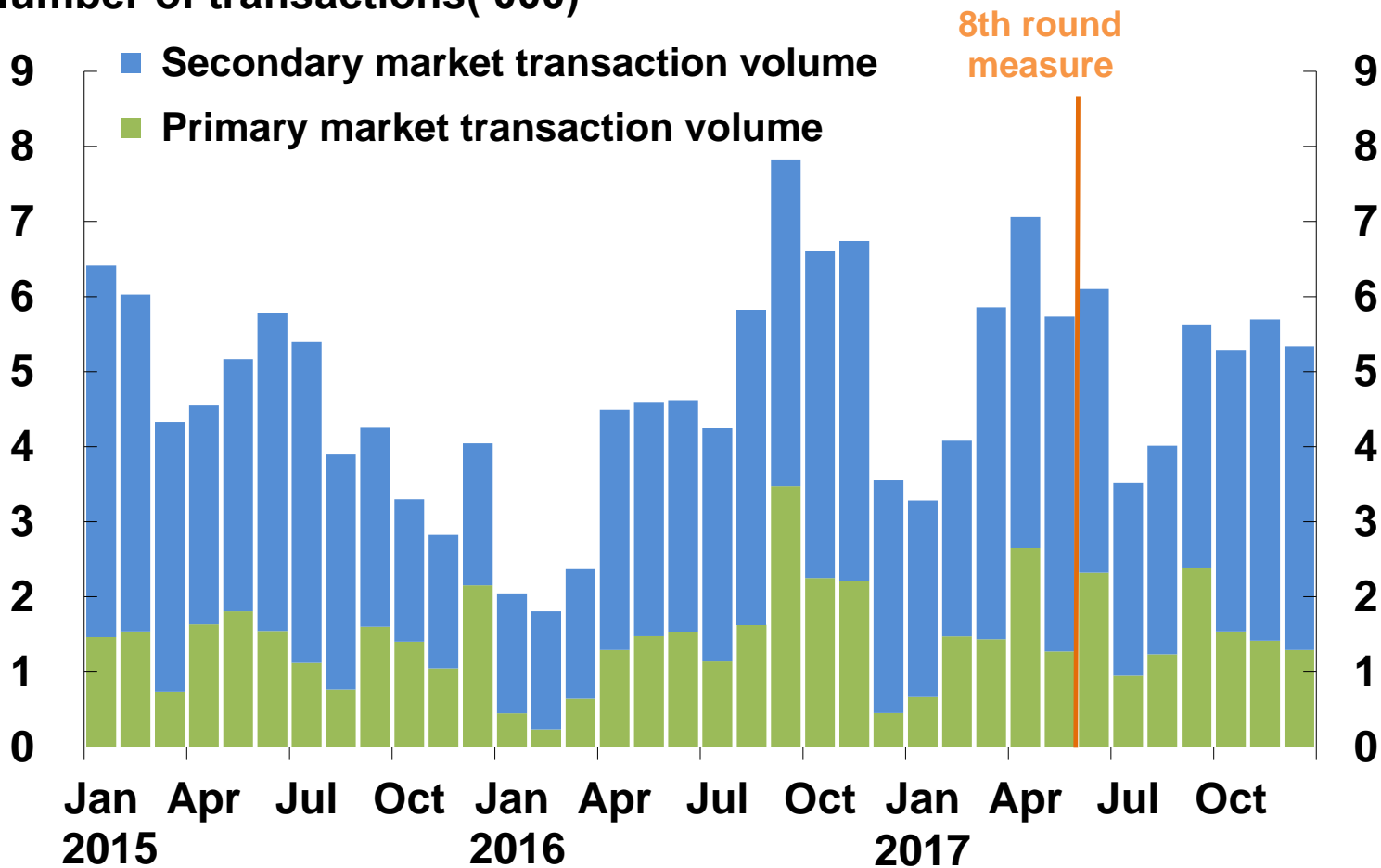




ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Transaction volume picked up

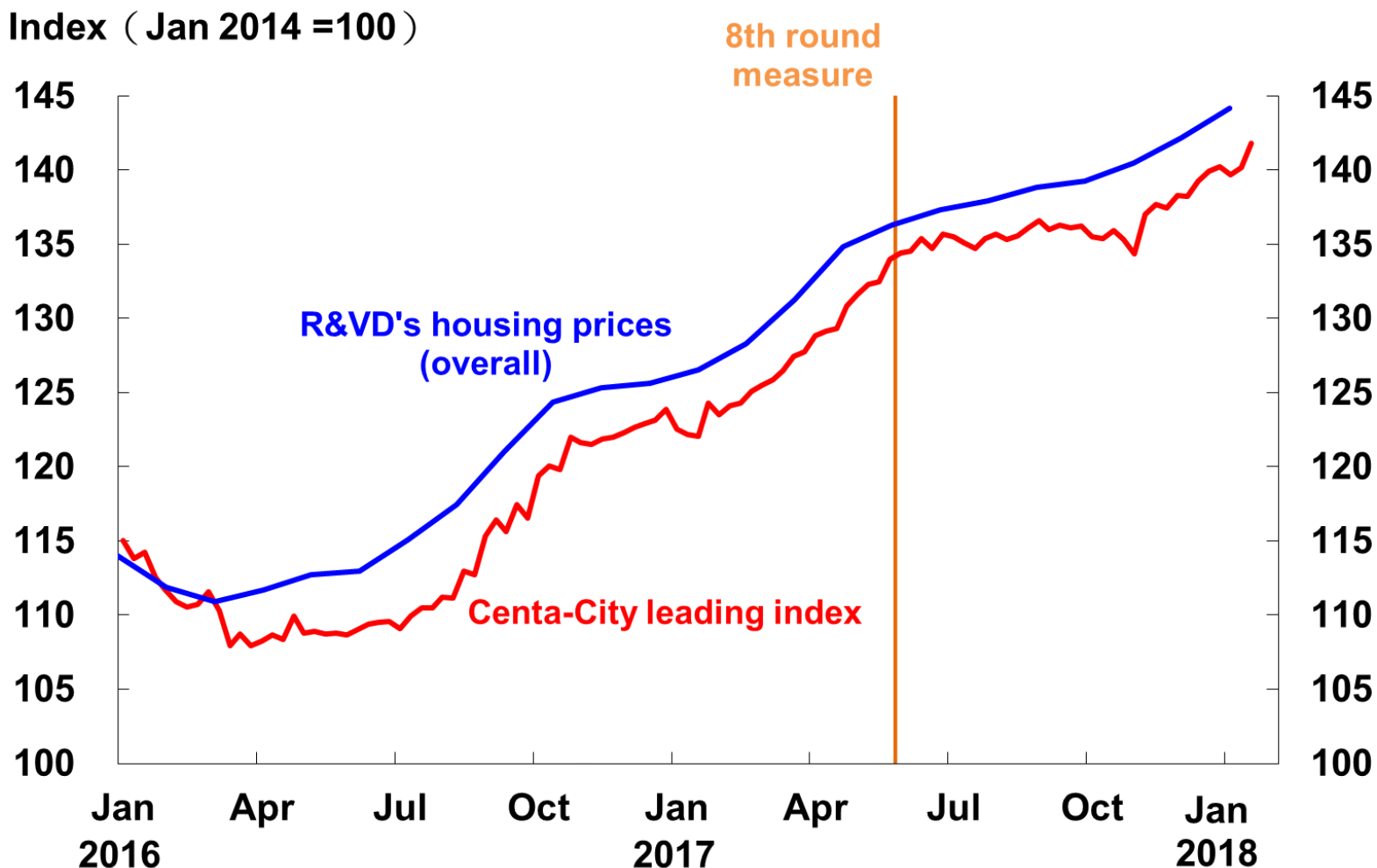
Number of transactions('000)





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

Property prices continued to go up





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

- The global economy continued to improve and asset markets were buoyant in 2017. Hong Kong property market also saw an increase in both prices and transaction volume
- However, high valuations in asset markets have been based on optimistic expectations of persistently low interest rates and limited risks from trade protectionism and geopolitical tensions
- Should the actual outcomes do not tally with the above optimistic expectations, significant corrections could take place
- Despite the prevailing positive sentiments, the HKMA reminds the public to avoid excessive leverage and manage risks prudently



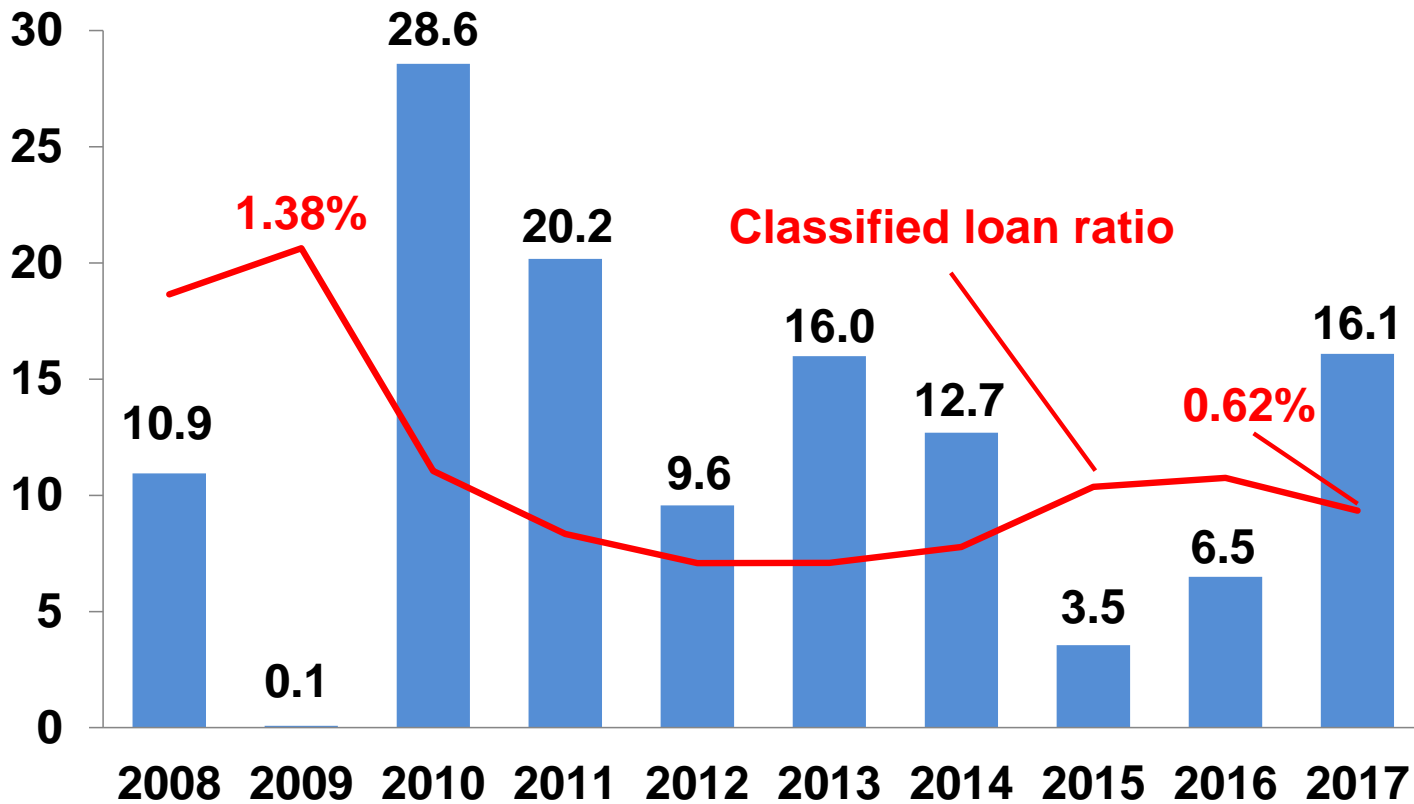
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BANKING SECTOR PERFORMANCE

Credit growth picked up while
asset quality stayed at a healthy level

Total loan growth (%)



Note: Classified loan ratio covers retail banks only.



LEGISLATIVE PROPOSALS (1)

- Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017
 - Fine-tune some customer due diligence requirements for financial institutions in the light of technological development
- Developing subsidiary legislation under Financial Institutions (Resolution) Ordinance (FIRO) as well as other relevant legislation to implement resolution regime
 - Loss-absorbing capacity (LAC) rules for authorized institutions under the FIRO, and related Inland Revenue Ordinance amendment bill to clarify tax treatment of LAC instruments. Public consultation was launched in January 2018



LEGISLATIVE PROPOSALS (2)

- Banking (Amendment) Bill 2017
 - Large exposures rules
- Banking (Disclosure) (Amendment) Rules 2018
- Banking (Capital) (Amendment) Rules 2018
- Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018



SMART BANKING

- Fintech Supervisory Sandbox 2.0
- Introduction of Virtual Banking
- Banking Made Easy



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FASTER PAYMENT SYSTEM (FPS)

FPS will be launched in September 2018

- Full connectivity among banks and Stored Value Facilities operators
- Payment and settlement on a real-time basis
- 24x7 operation
- Multi-currency: covering Hong Kong dollar and renminbi
- Support mobile phone numbers and email addresses for receiving payments
- Covering both individuals and corporations
- A single common QR code standard to be implemented for different payment schemes



LATEST FINTECH INITIATIVES (1)

Open Application Programming Interface

- Consulting the industry on the framework

Launch of Fintech Career Accelerator Scheme 2.0

- Entrepreneurship summer boot camp
- Shenzhen summer internship programme
- Gap year full-time placement programme
- Full-time graduate programme



LATEST FINTECH INITIATIVES (2)

Further strengthening cross-border cooperation

- Co-organising a fintech award with Shenzhen
- Developing a Global Trade Connectivity Network with Singapore to facilitate exchange of trade finance information between the two places



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OFFSHORE RENMINBI (RMB) BUSINESS

- Bond Connect is operating smoothly. Over 240 investors have joined Bond Connect, with an average daily turnover of RMB2-3 billion. The HKMA will continue to promote Bond Connect to overseas investors and enhance operational arrangements
- RMB deposit pool contracted in the first half of 2017 but rebounded about 5% in the second half to RMB618.4 billion. Turnover recorded by RMB Real Time Gross Settlement system stayed at a high level, averaging RMB900 billion per day
- The HKMA is expanding global network for RMB business cooperation, including the signing of a Memorandum of Understanding with Switzerland in January on multifaceted financial cooperation. The Hong Kong-London Financial Services Forum was convened in December 2017 to deepen cooperation on infrastructure financing and investment, as well as fintech
- The HKMA is working with Mainland authorities and financial industry to explore suitable financial and banking related measures to support Guangdong-Hong Kong-Macao Bay Area development



DEVELOPING HONG KONG'S FINANCIAL PLATFORM

Corporate Treasury Centres (CTCs)

- Actively engaging multinational and Mainland enterprises to promote Hong Kong as a preferred regional destination for CTCs

Developing an Onshore Platform for Private Equity (PE) Funds

- Financial Services and the Treasury Bureau has set up a taskforce to review the legal framework and associated tax treatment of Hong Kong's onshore PE fund platform

Promoting Green Finance

- The HKMA will host a major international conference on green bond in June to promote Hong Kong's international profile on green finance

Infrastructure Investments and Financing

- Leveraging on the network of the Infrastructure Financing Facilitation Office platform, the China Development Bank issued its first Belt and Road bond in Hong Kong in December 2017



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INVESTMENT INCOME

←—————2017—————→ 2016 2015 2014 2013

(unaudited)

(HK\$ billion)	Full year	2H	1H	Full year	Full year	Full year	Full year
Hong Kong equities*	58.3	30.5	27.8	5.3	(5.0)	6.5	10.1
Other equities	80.2	40.1	40.1	28.6	7.1	33.7	71.8
Bonds	34.3	17.8	16.5	33.1	15.9	47.3	(19.1)
Foreign exchange#	53.5	19.2	34.3	(15.8)	(44.9)	(52.7)	1.6
Other investments@	<u>25.7</u>	<u>8.2</u>	<u>17.5</u>	<u>16.9</u>	<u>11.1</u>	<u>9.9</u>	<u>16.8</u>
Investment income/(loss)	252.0	115.8	136.2	68.1	(15.8)	44.7	81.2

* Excluding valuation changes of the Strategic Portfolio

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

@ 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 2017. Valuations of these investments from October to December are not yet available.)



INVESTMENT DIVERSIFICATION

As of end-September 2017 (unaudited)

Asset Classes	Market Value HK\$ billion	Annualised Internal Rate of Return (since inception from 2009 till September 2017)
Private Equity	141.1	13.5%
Real Estate	73.4	
Total	214.5	

Note: Outstanding investment commitments at the end of 2017 amounted to HK\$162.7 billion



INCOME AND EXPENDITURE

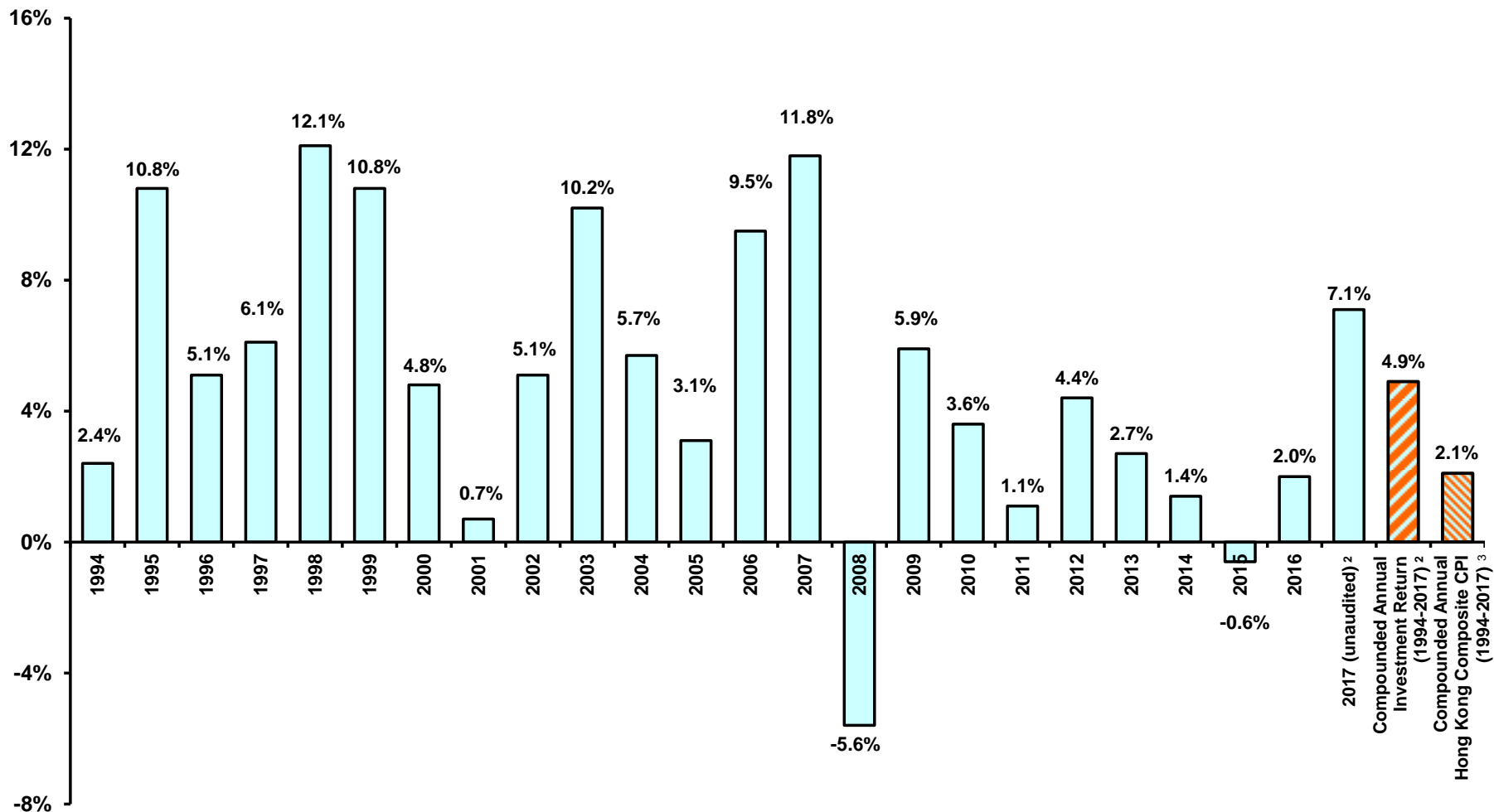
(HK\$ billion)	← 2017 →			2016
	Full year	2H	1H	Full year
	(unaudited)			
Investment income	252.0	115.8	136.2	68.1
Other income	0.2	0.1	0.1	0.2
Interest and other expenses	<u>(9.8)</u>	<u>(4.8)</u>	<u>(5.0)</u>	<u>(6.4)</u>
Net income	242.4	111.1	131.3	61.9
Fee payment to Fiscal Reserves*#	(23.5)	(12.1)	(11.4)	(33.1)
Fee payment to HKSAR government funds and statutory bodies*	(8.6)	(4.3)	(4.3)	(9.6)

* The rate of fee payment is 2.8% for 2017 and 3.3% for 2016.

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



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2017)¹



¹ Investment return calculation excludes the holdings in the Strategic Portfolio.

² The return includes the performance of LTGP up to the end of September 2017. The audited full year return will be disclosed in the annual report of 2017 to be released later this year.

³ Composite CPI is calculated based on the 2014/2015-based series.