



HONG KONG MONETARY AUTHORITY

**Briefing to the Legislative Council
Panel on Financial Affairs**

19 February 2019



DISCUSSION TOPICS

Updates on

- Financial and Economic Environment
- Currency Stability
- Banking Stability
- Financial Infrastructure
- Hong Kong as an International Financial Centre
- Investment Environment and Performance of the Exchange Fund
- Hong Kong Mortgage Corporation



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

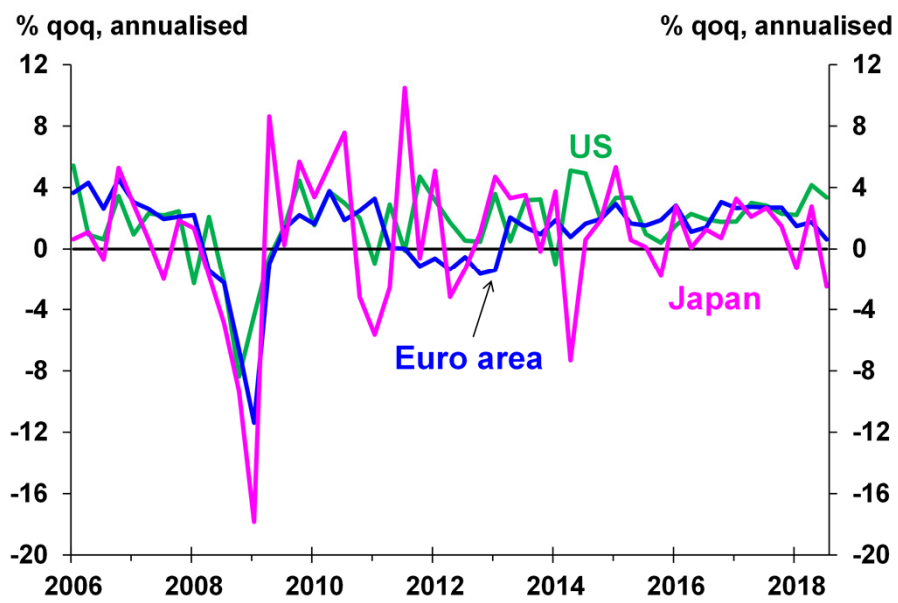
(% year-on-year)

	2017	2018 Forecasts	2019 Forecasts
US	2.2	2.9	2.5
Euro area	2.5	1.9	1.5
Japan	1.9	0.8	1.0
Asia (ex-Japan)	6.0	5.8	5.5
Mainland China	6.9	6.6	6.2
Hong Kong	3.8	3.4	2.4

Sources: January Consensus Forecasts and Official Statistics



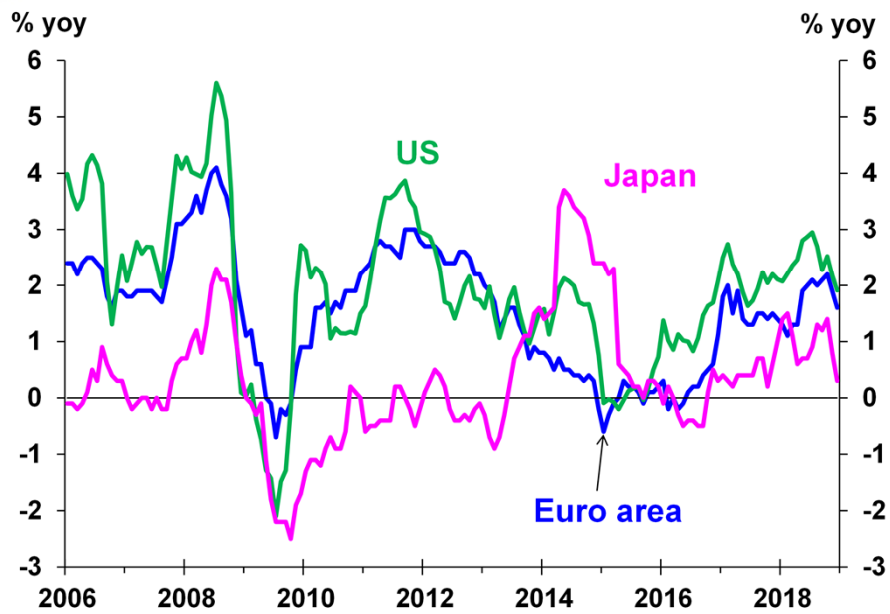
REAL GDP GROWTH IN MAJOR ECONOMIES



Source: CEIC



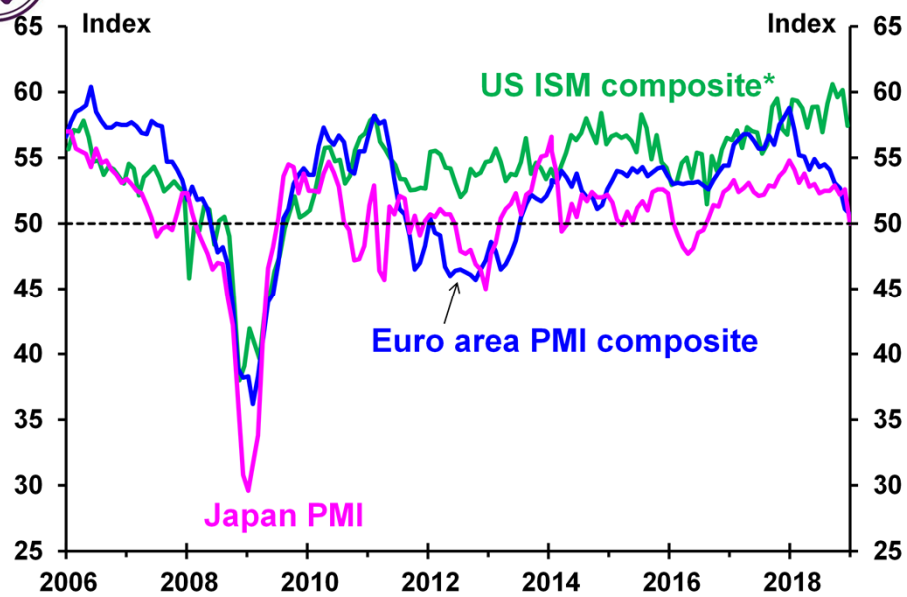
HEADLINE INFLATION IN MAJOR ECONOMIES



Source: CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

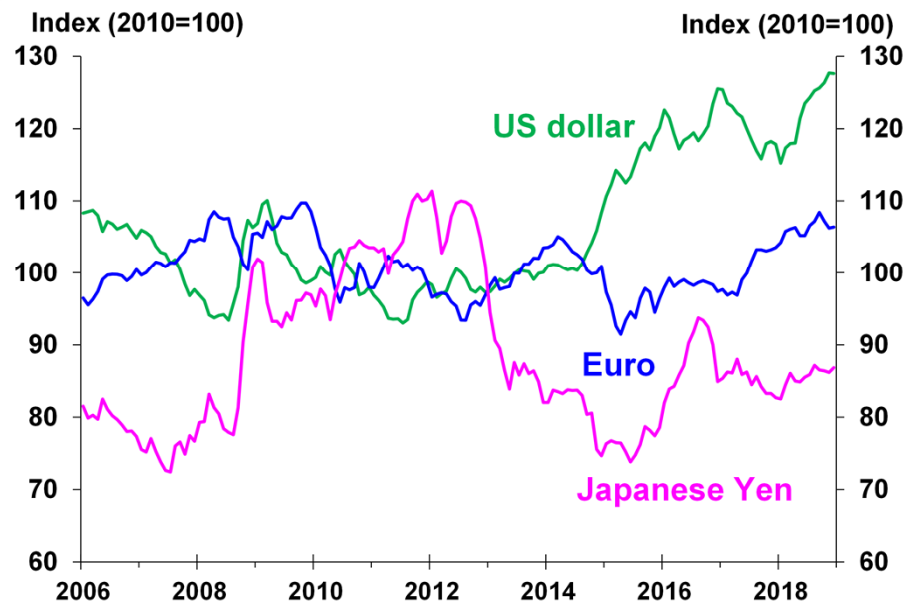


*Weighted average of the ISM manufacturing and non-manufacturing indices

Sources: Bloomberg and CEIC



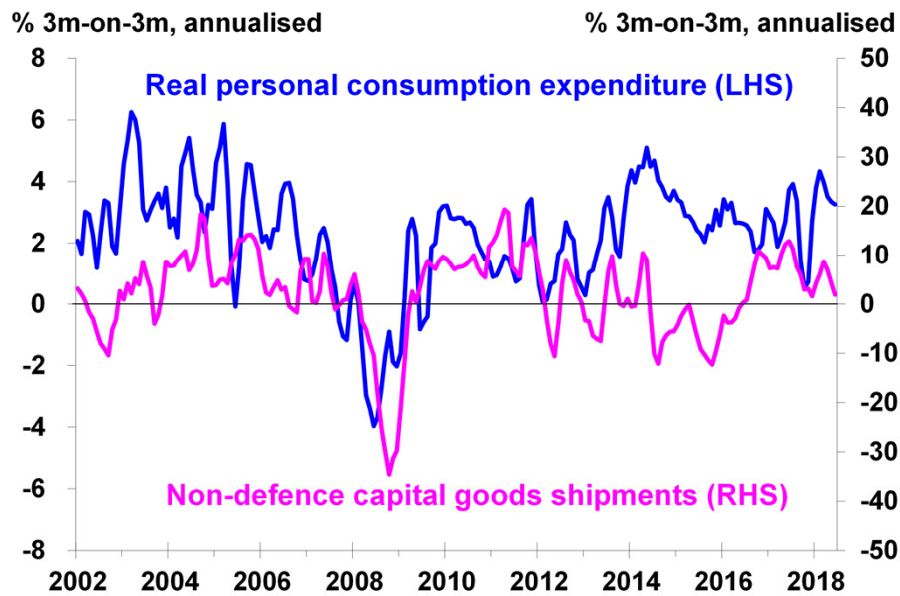
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



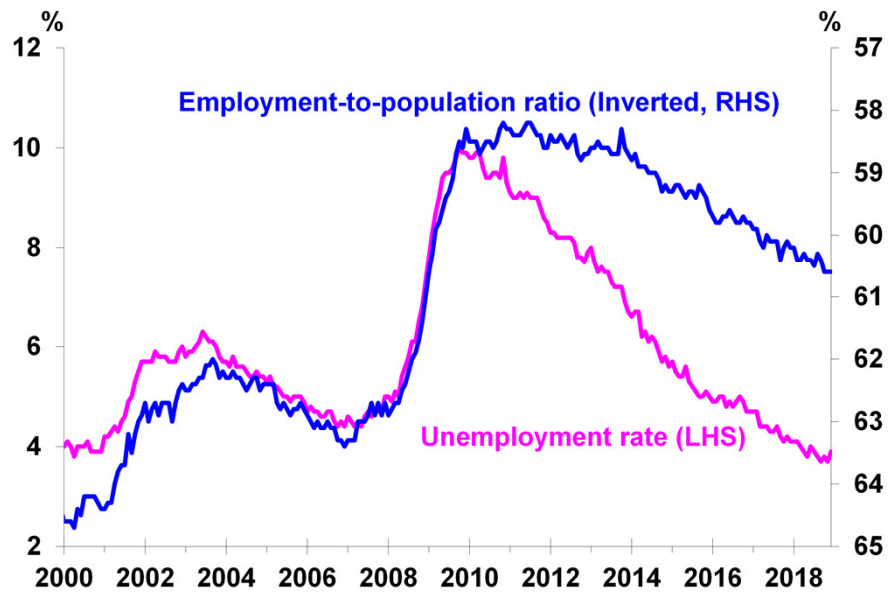
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



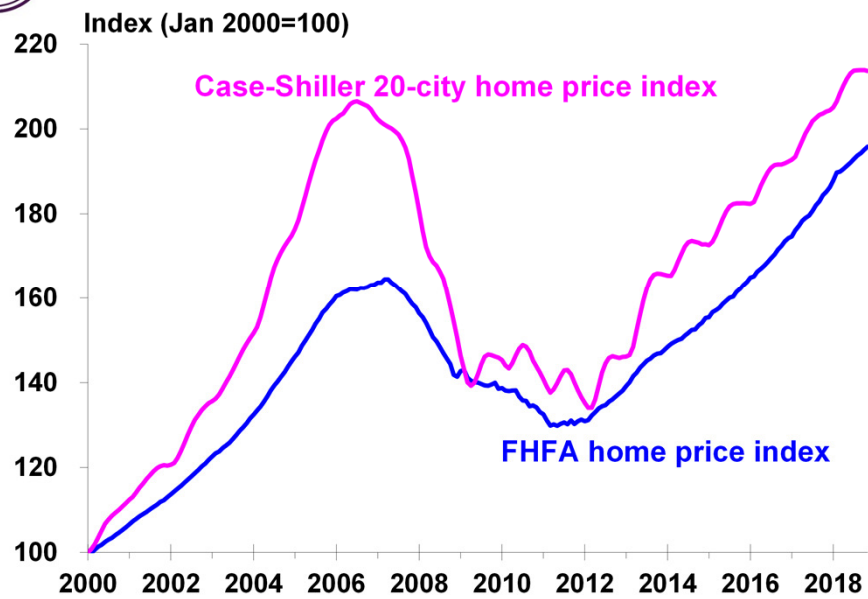
US: LABOUR FORCE PARTICIPATION



Source: CEIC



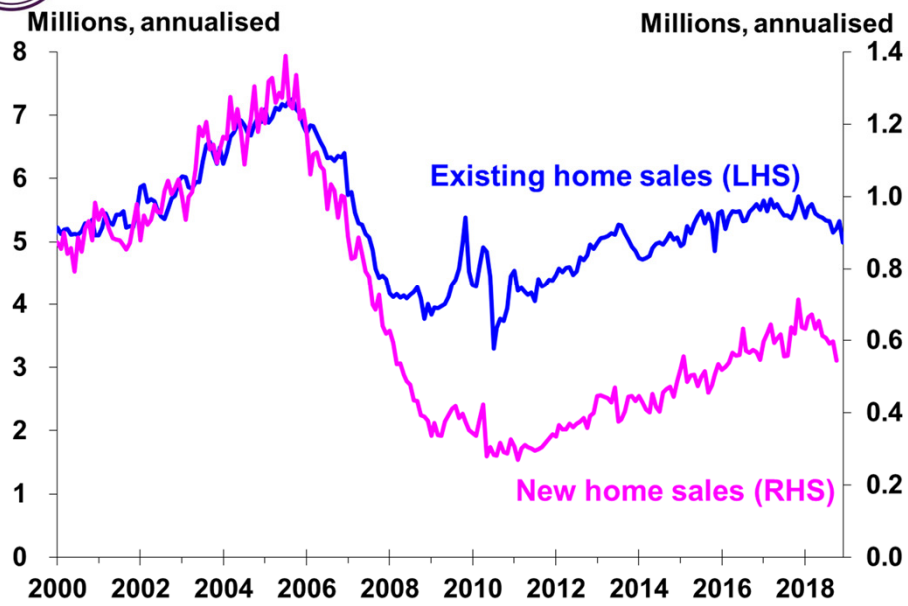
US: HOME PRICES



Sources: CEIC and Datastream



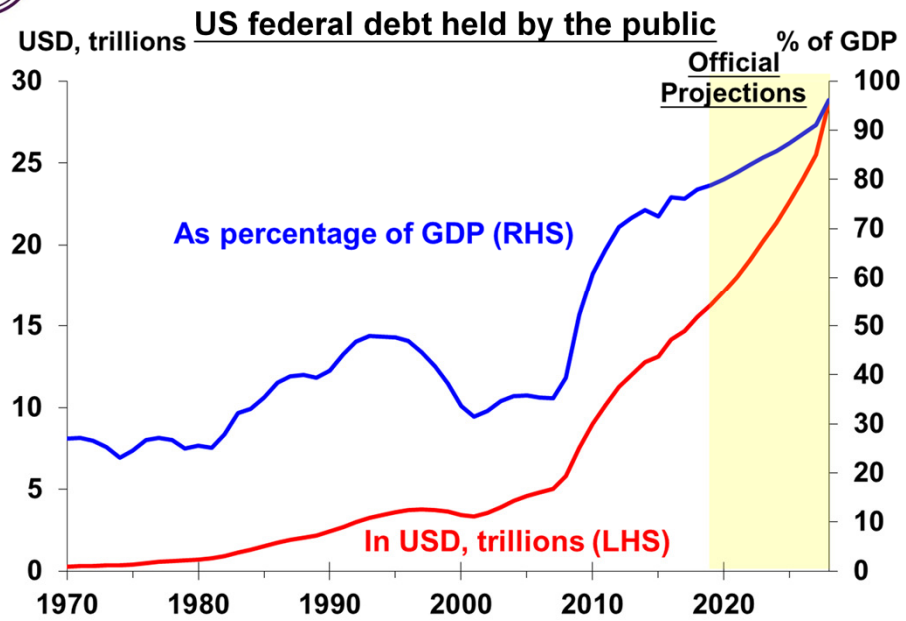
US: HOME SALES



Source: CEIC



US: FEDERAL GOVERNMENT DEBT

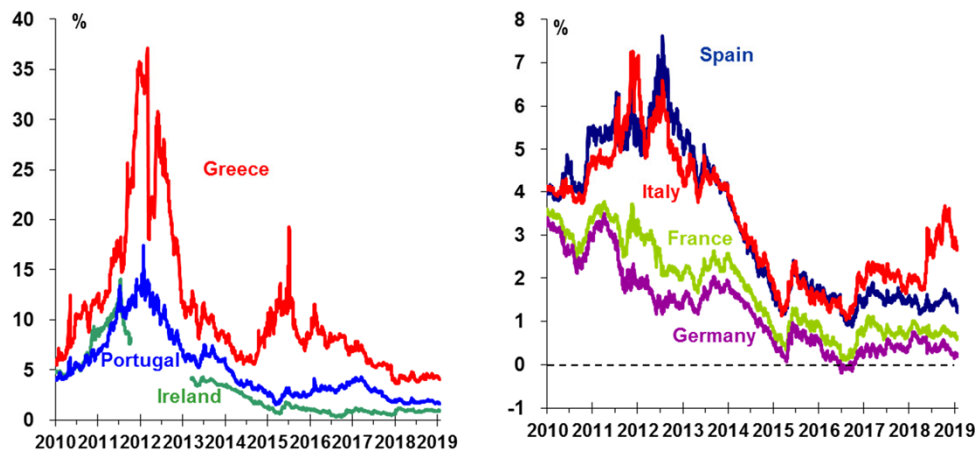


Sources: CEIC and Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

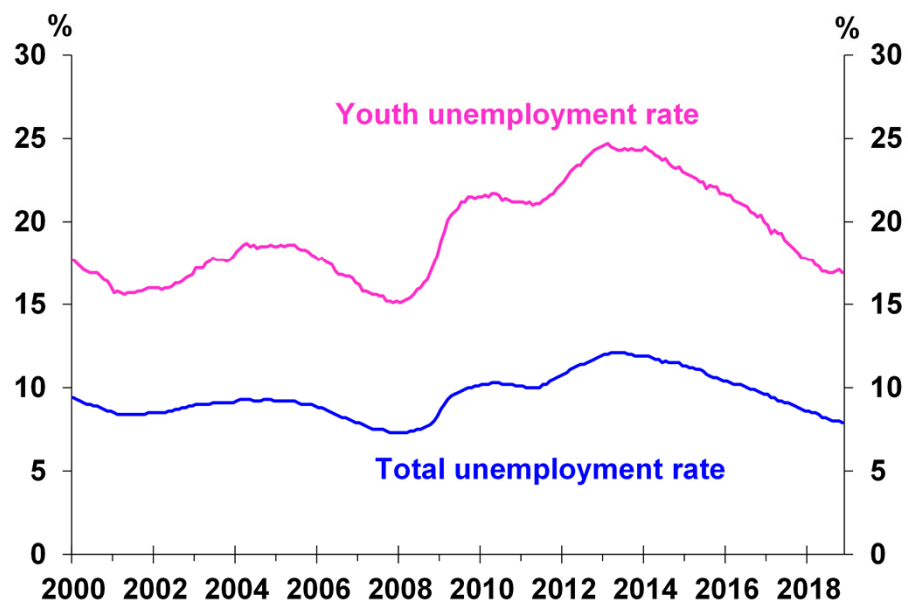
10-year sovereign bond yield



Note: 10-year Irish sovereign bond yield data is not available between 12 Oct 2011 and 14 Mar 2013
Source: Bloomberg



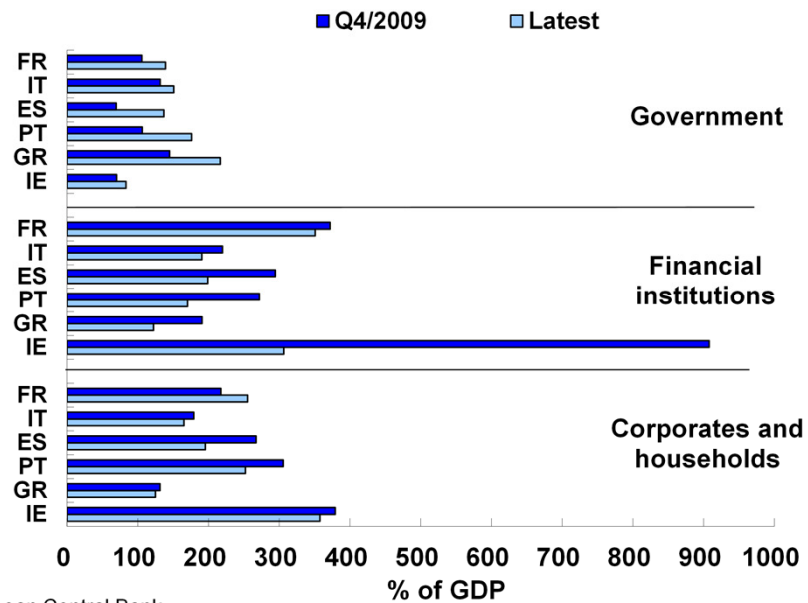
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS



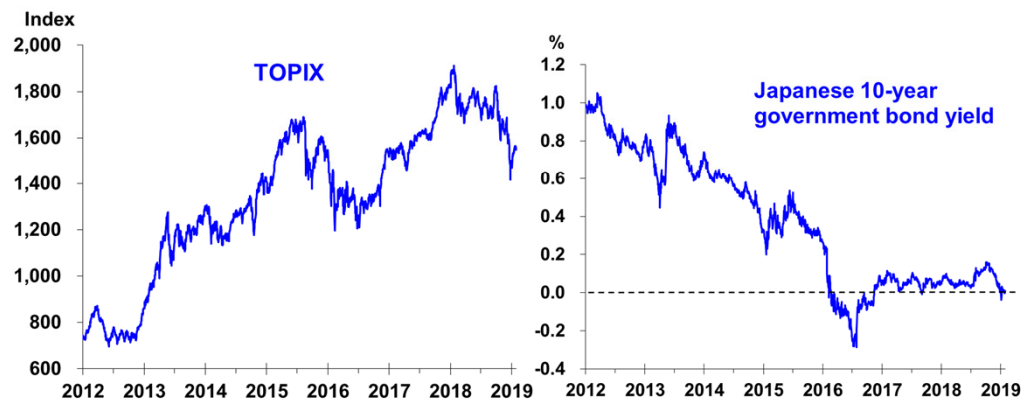
Source: European Central Bank

Note: FR – France, IT – Italy, ES – Spain, PT – Portugal, GR – Greece, IE – Ireland

The latest figures are up to Q3/2018



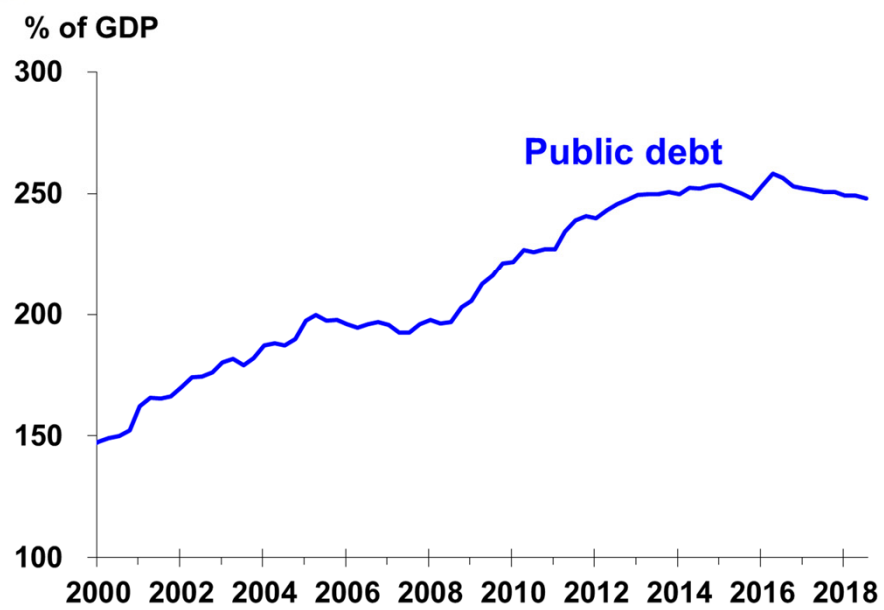
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



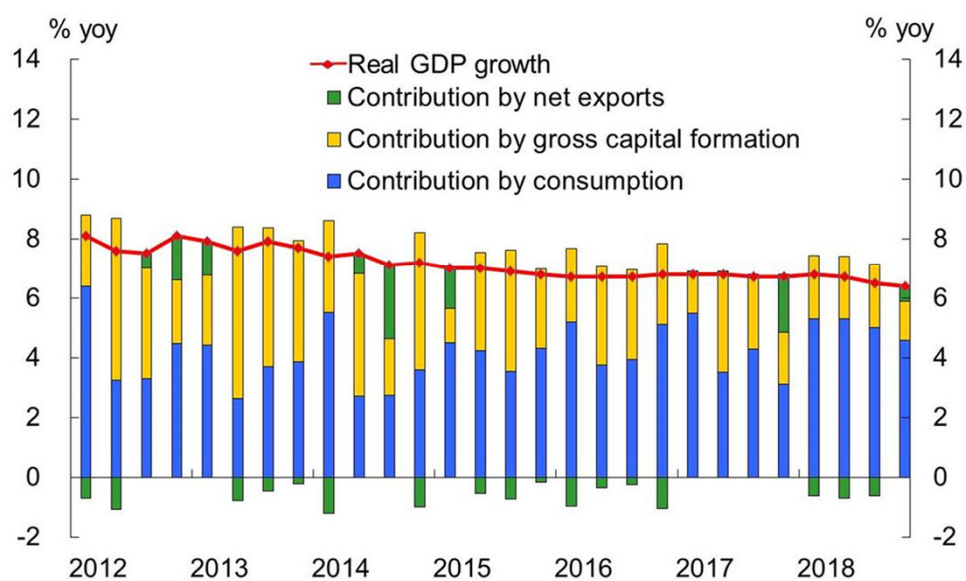
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



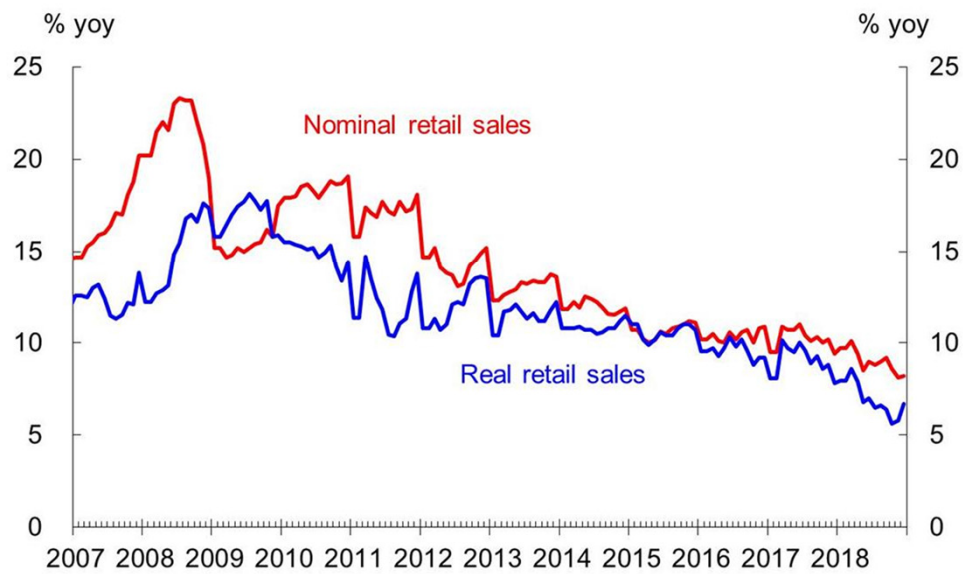
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



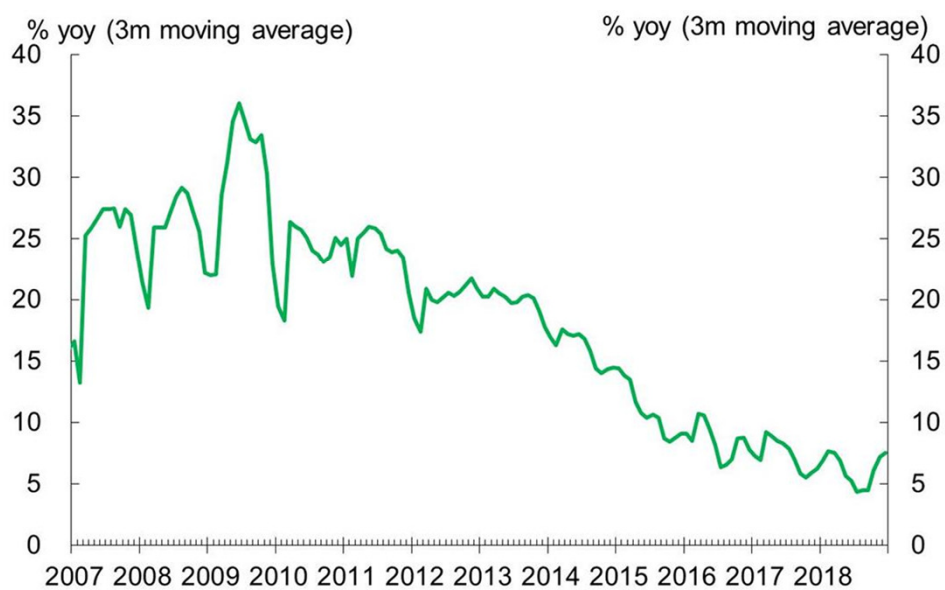
MAINLAND CHINA: RETAIL SALES



Note: January and February figures are the average annual growth rate for the first two months of the year
Sources: WIND and HKMA staff estimates



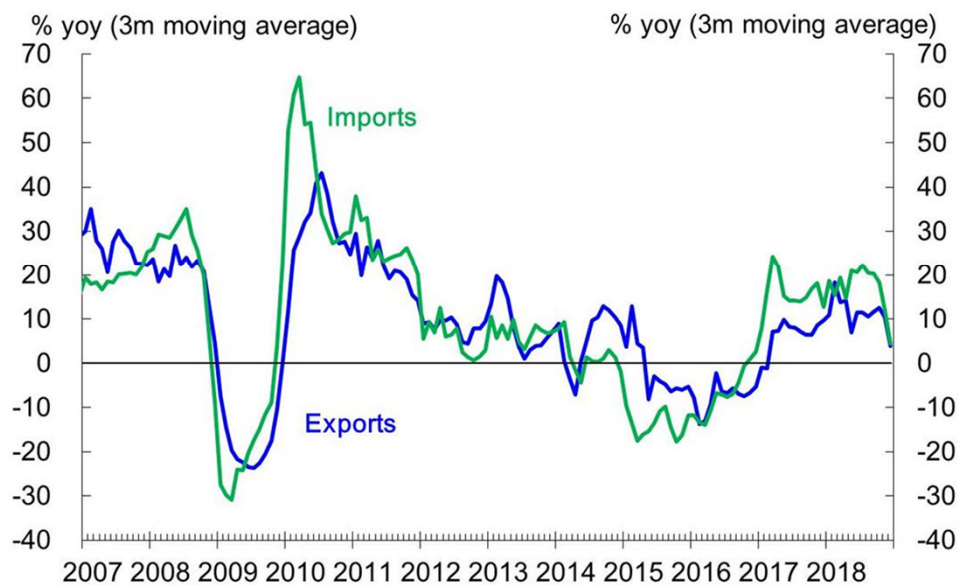
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



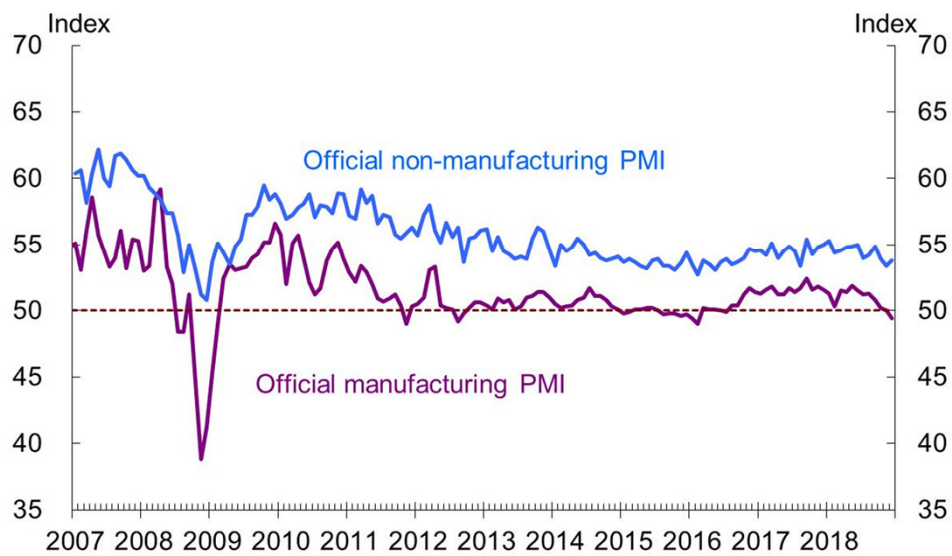
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



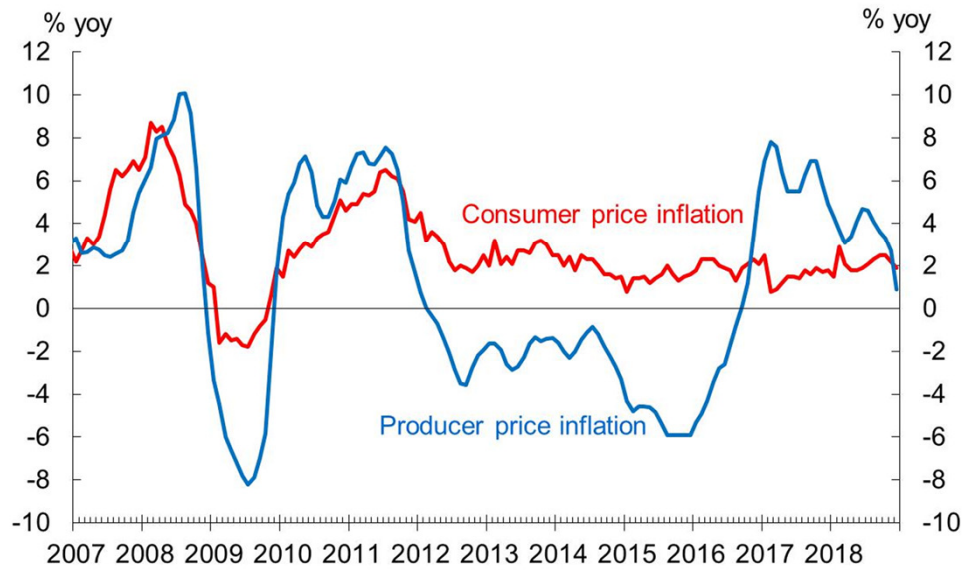
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



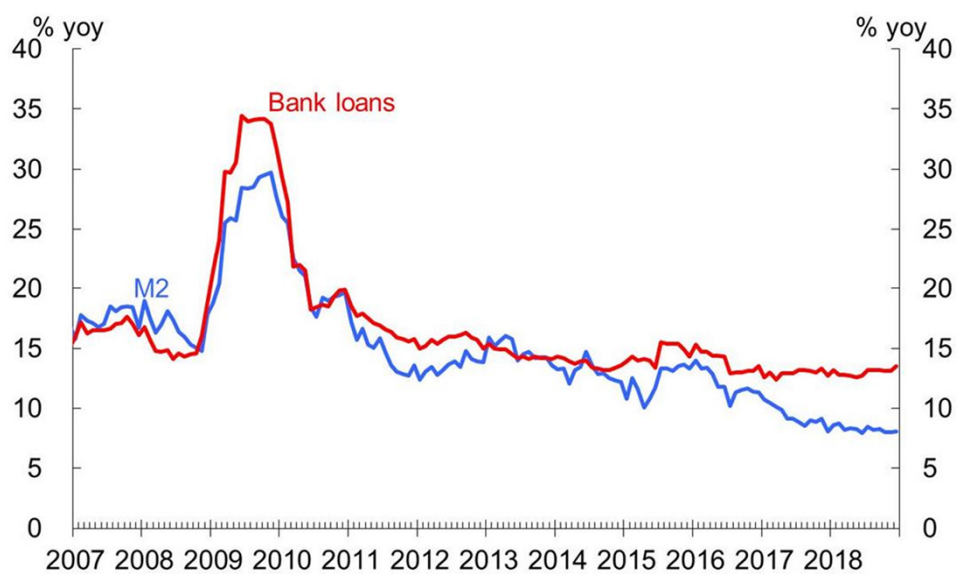
MAINLAND CHINA: INFLATION



Source: CEIC



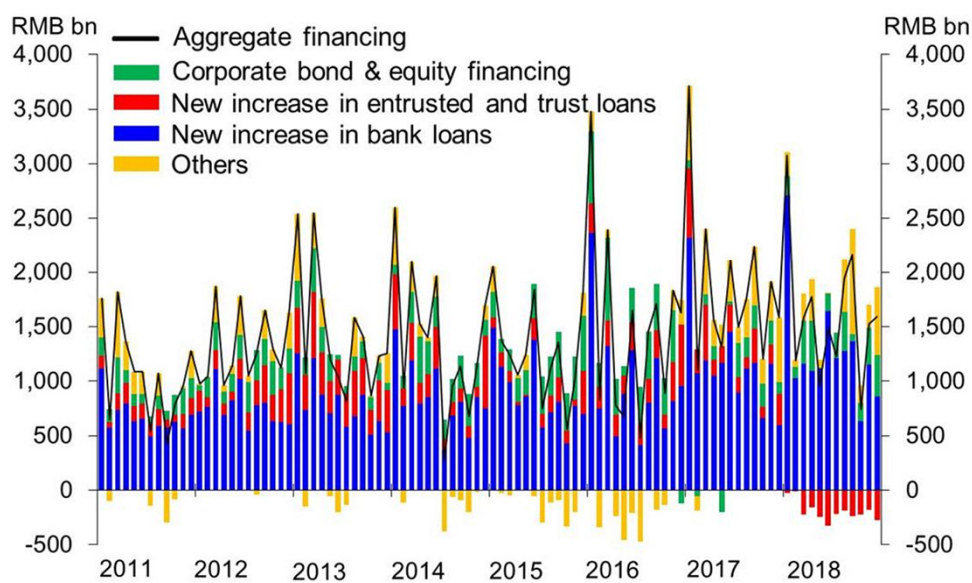
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



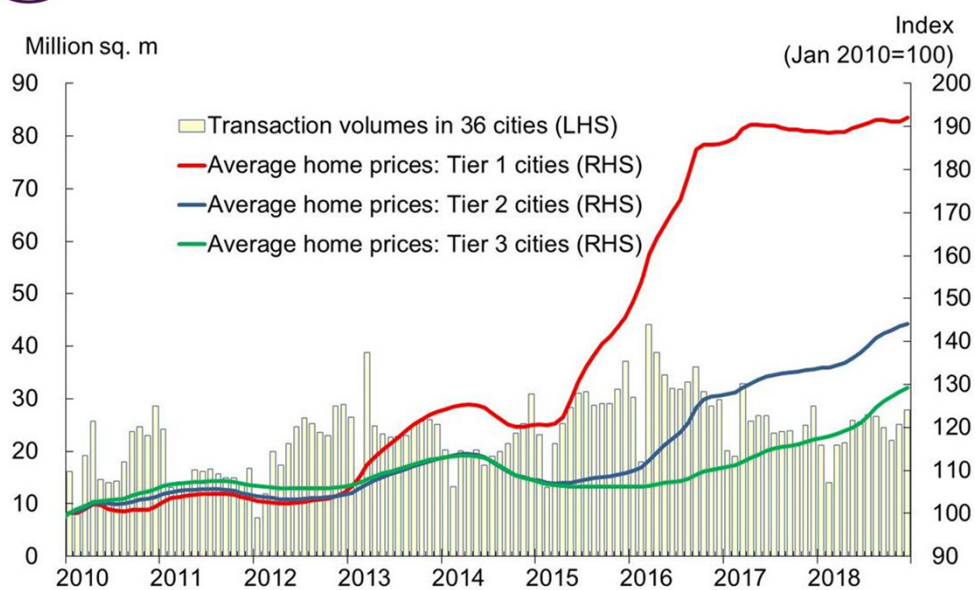
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



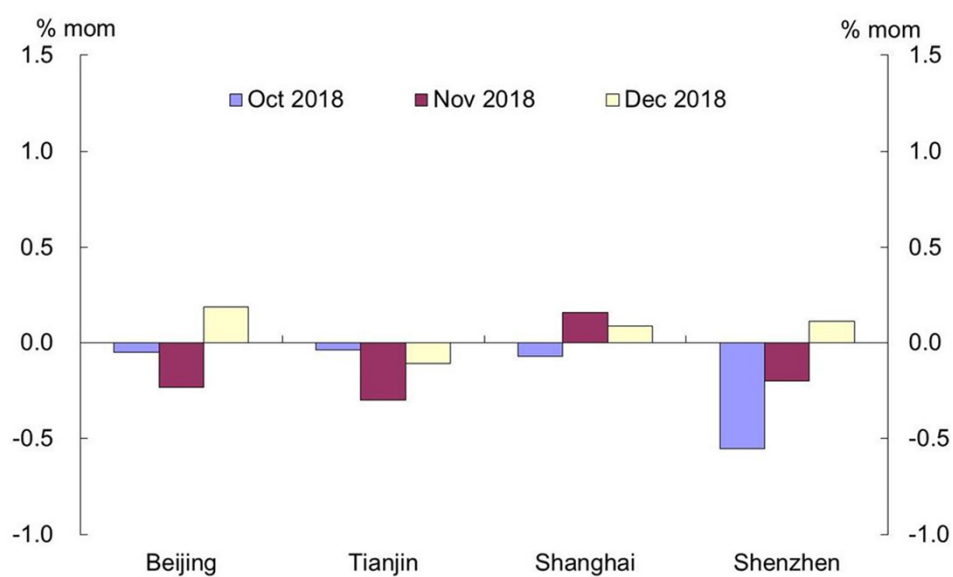
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



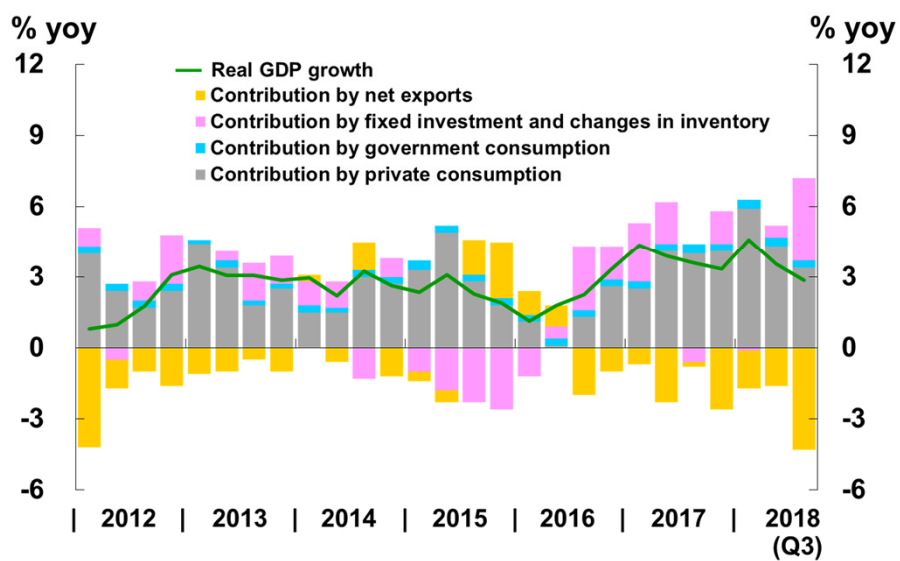
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



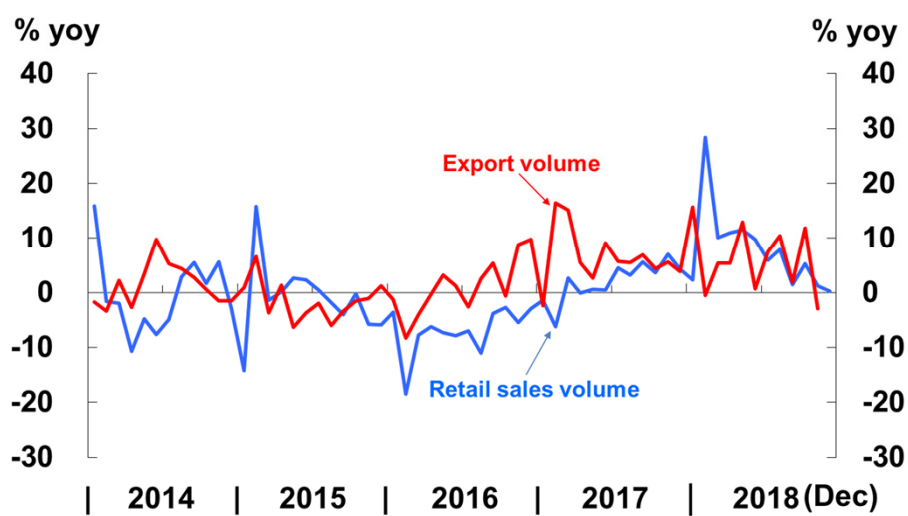
HONG KONG: REAL GDP GROWTH



Source: C&SD



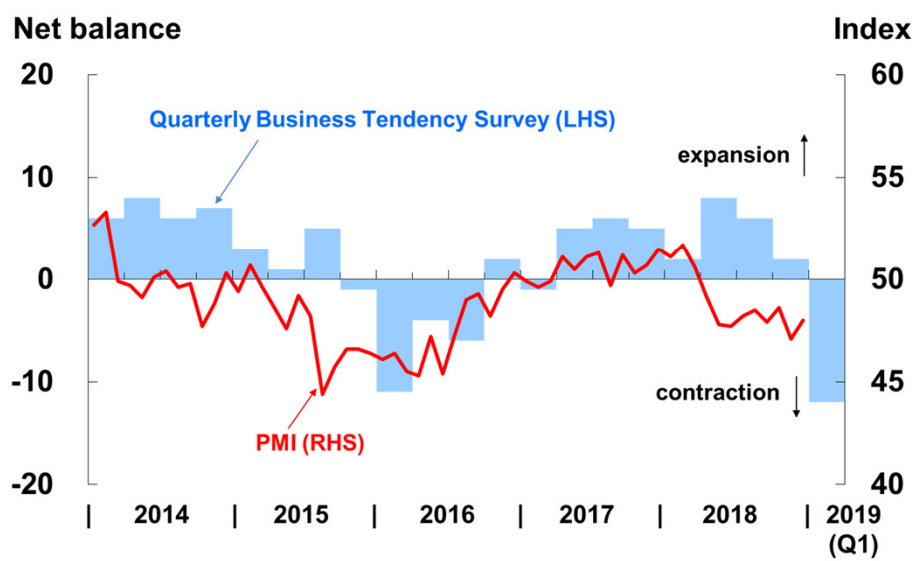
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



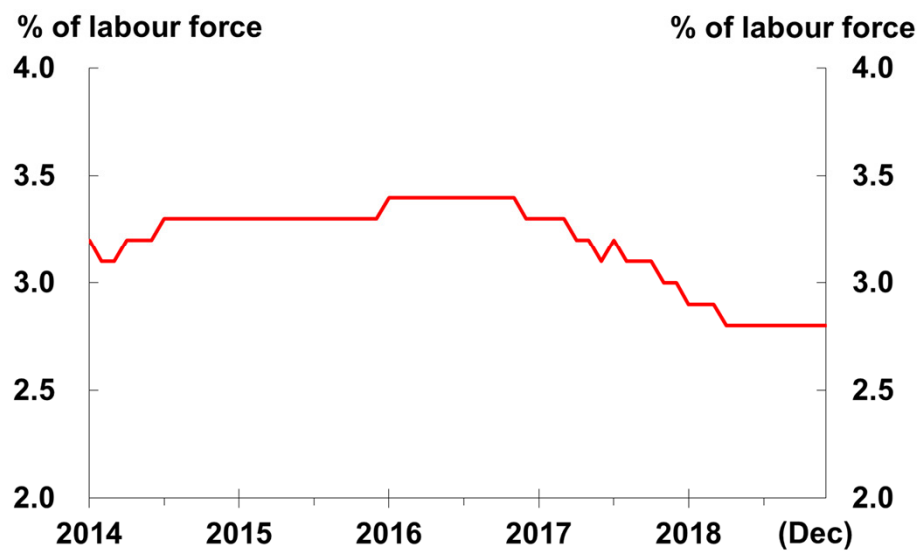
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit



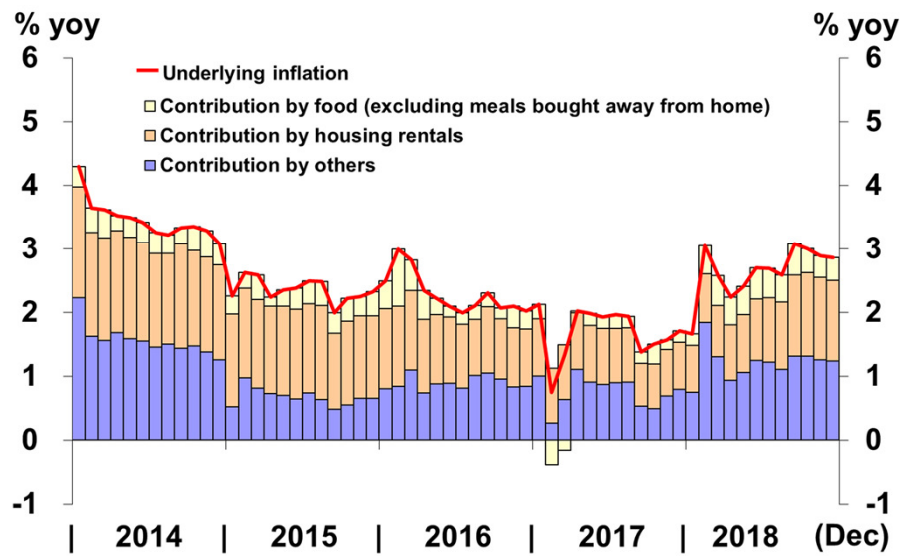
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



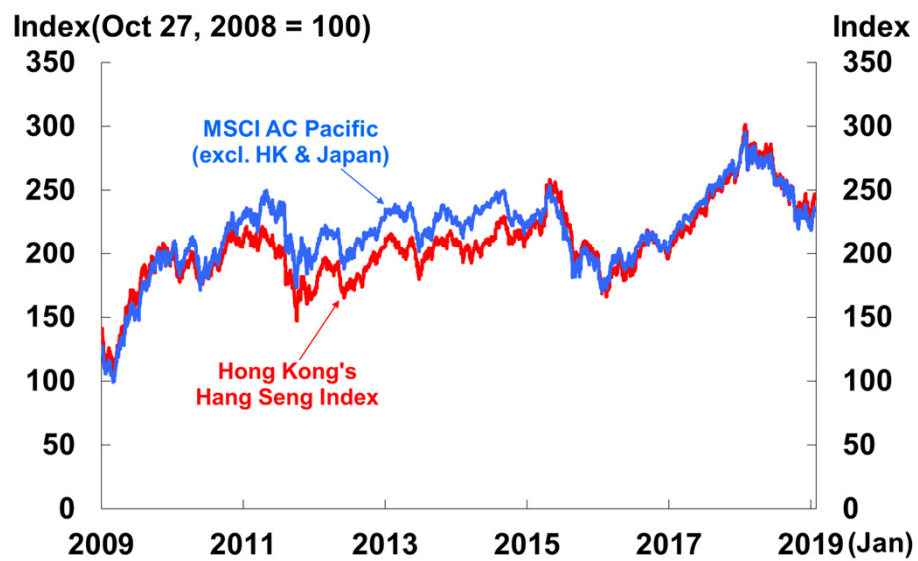
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



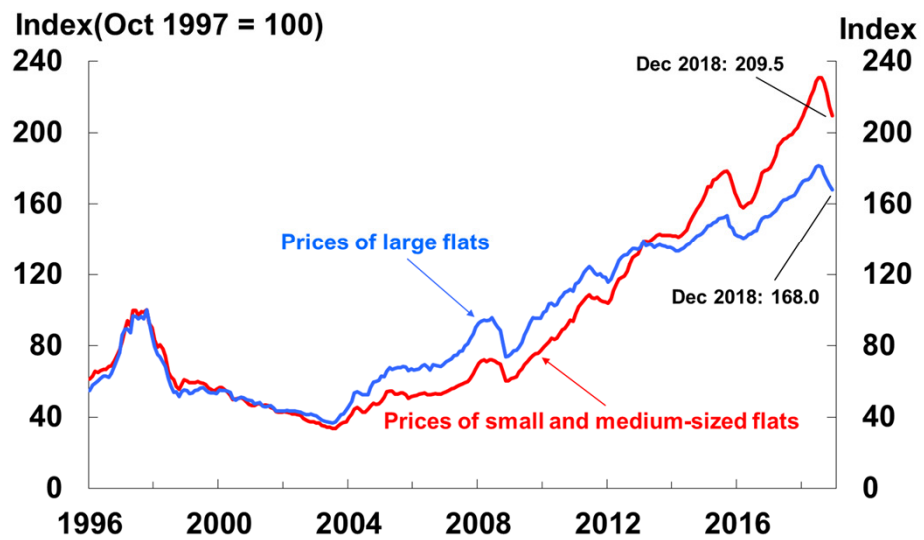
HONG KONG: EQUITY MARKET



Source: Bloomberg



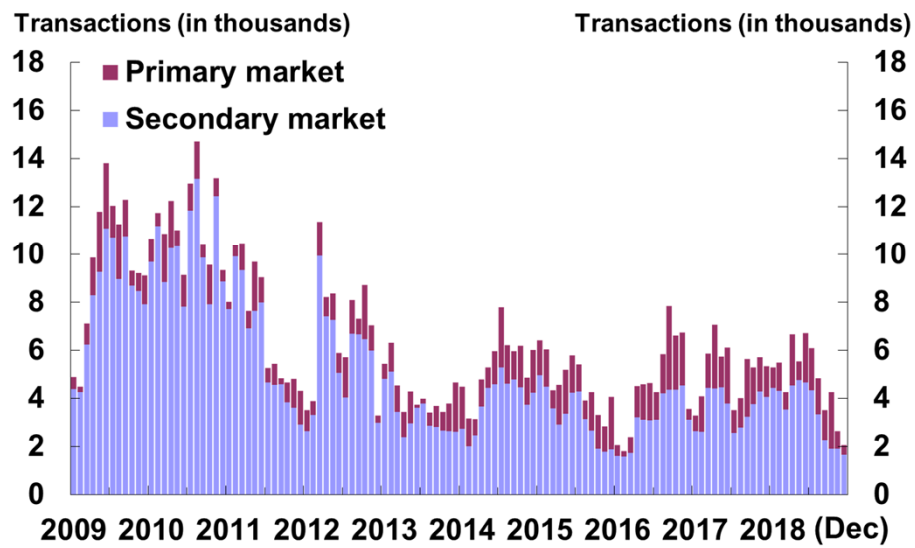
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



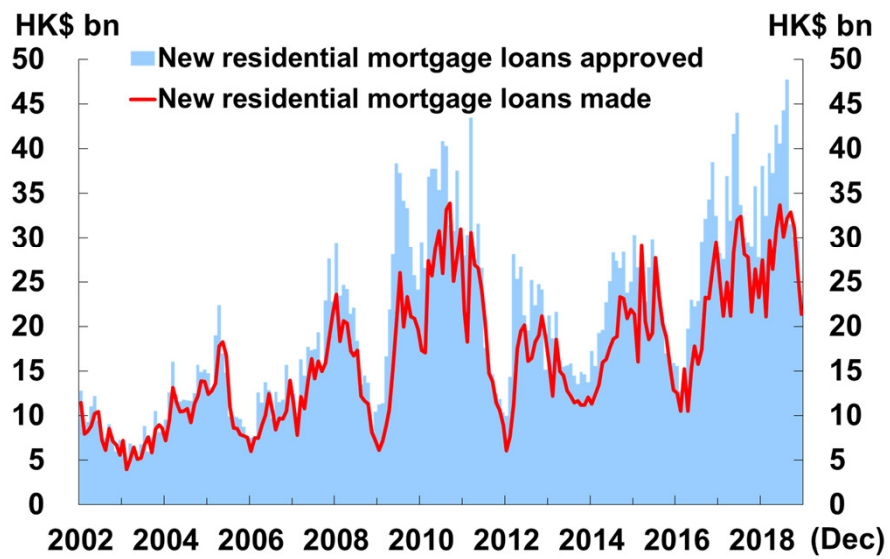
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

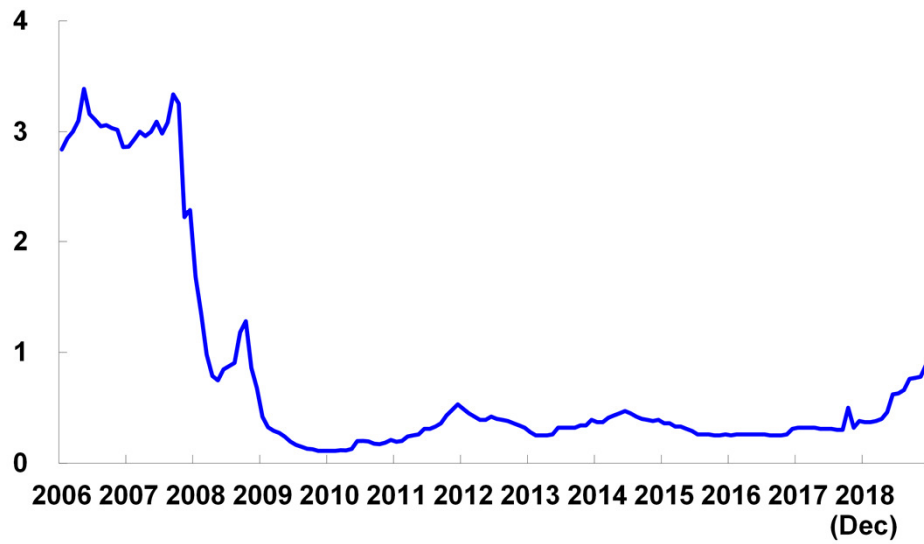


Source: HKMA



HONG KONG: COMPOSITE INTEREST RATE

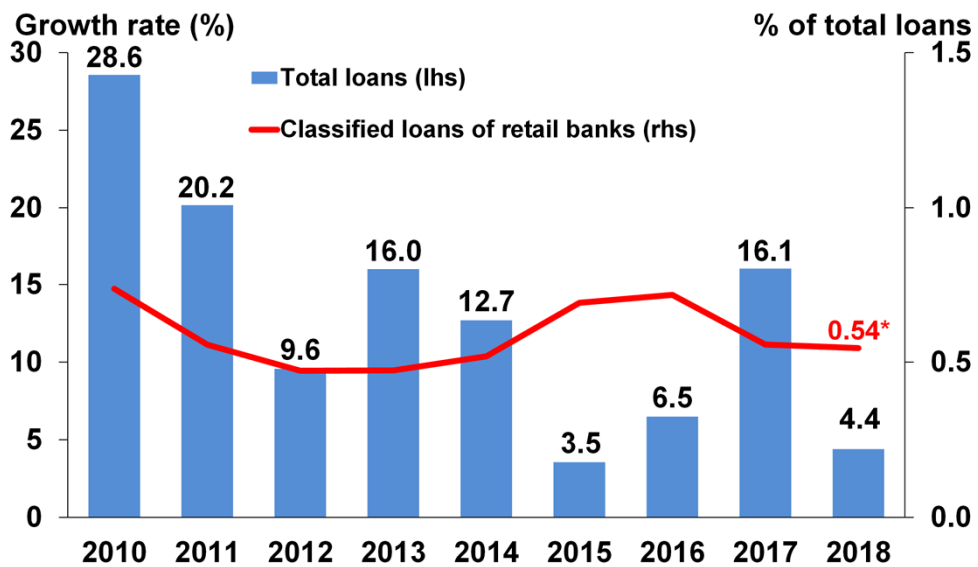
% p.a.



Source: HKMA



HONG KONG: LOAN GROWTH AND ASSET QUALITY

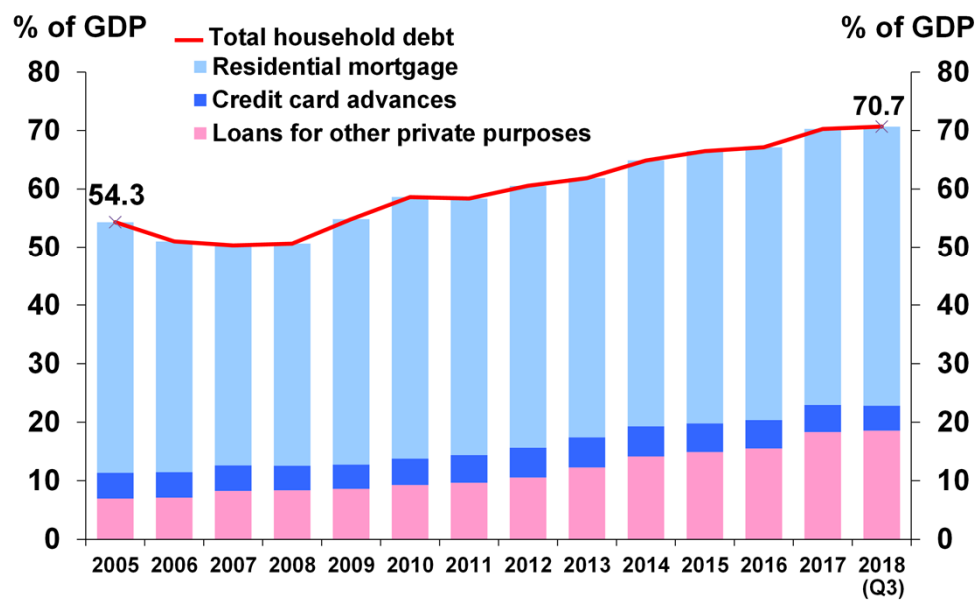


Note: * The figure is for Q3 2018.

Source: HKMA



HONG KONG: HOUSEHOLD DEBT



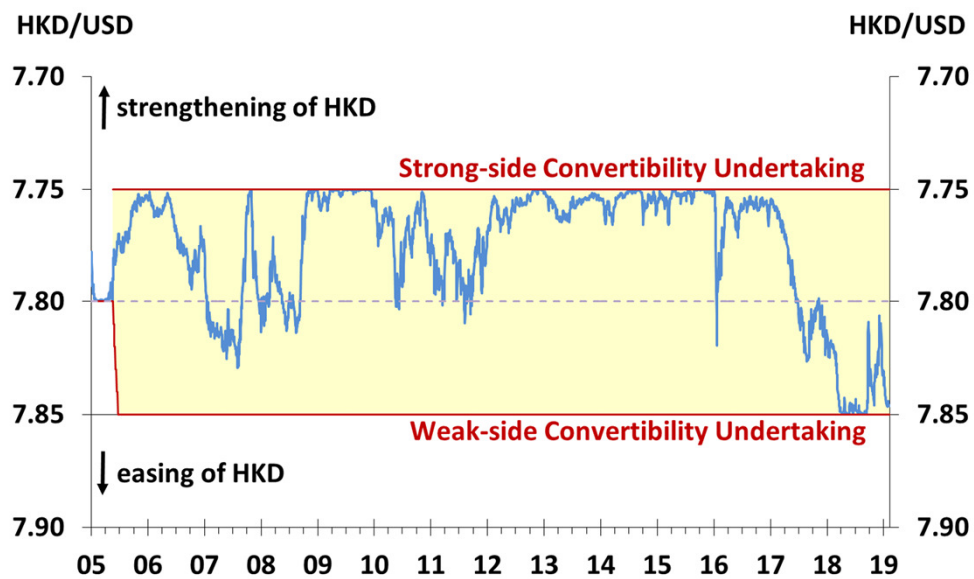
Source: HKMA



CURRENCY STABILITY

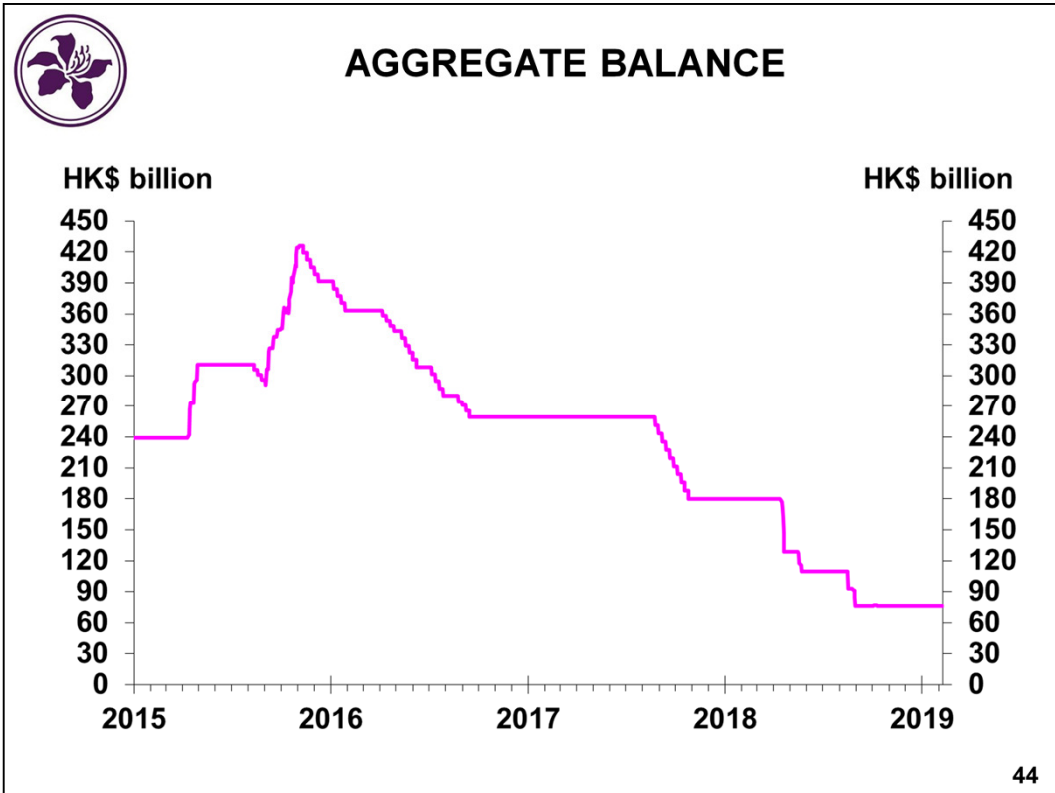


HONG KONG DOLLAR SPOT EXCHANGE RATE



43

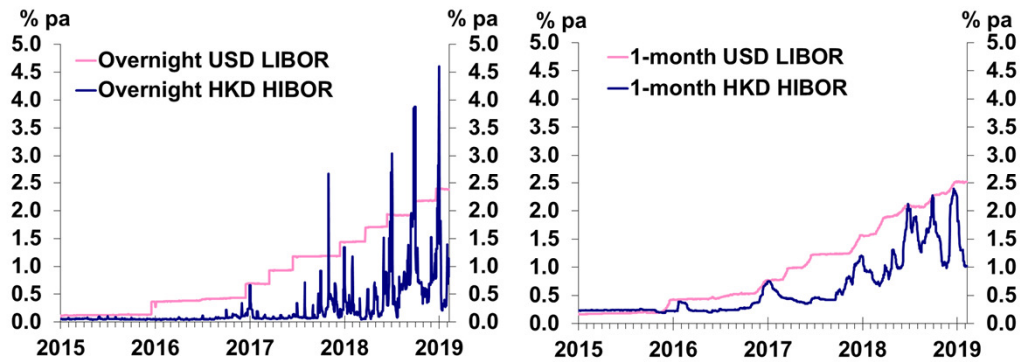
- HKD spot exchange rate hovered within the weak side of the Convertibility Zone (7.80-7.85) since November 2018, with occasional spikes driven by tightness in HKD interbank interest rates.



- The weak-side Convertibility Undertaking has not been triggered since September 2018. The Aggregate Balance steadied at about HK\$76.4 billion.



DOMESTIC INTEREST RATES



- Alongside higher US interest rates, Hong Kong Interbank Offered Rates (HIBORs) broadly picked up. Short-term HIBORs surged briefly in the latter part of December 2018 amid increased funding demand for HKD near year-end.



- The 12-month HKD forward discount largely tracked the movements of interest rate spreads between HKD and USD, easing to around -700 pips in early February.

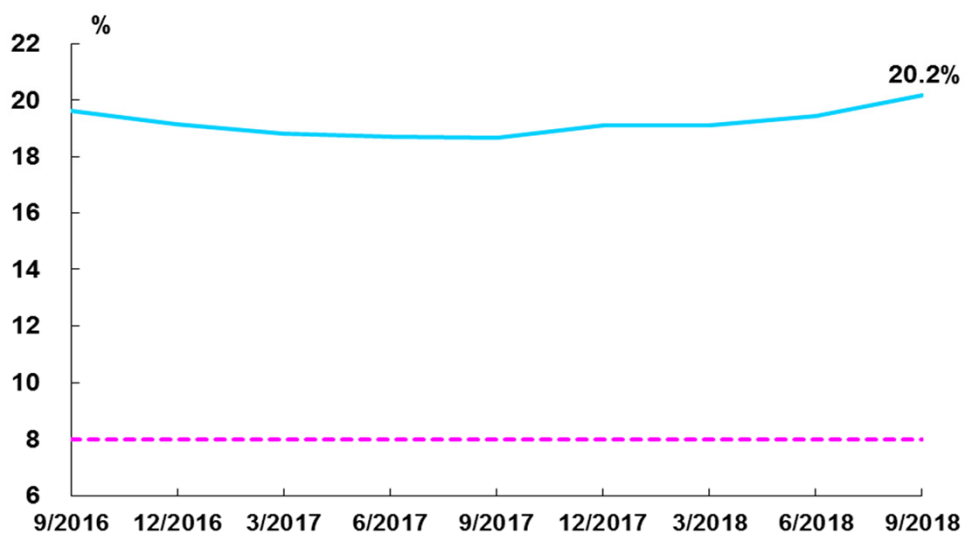


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Capital position of locally incorporated authorized institutions (AIs) continued to be strong



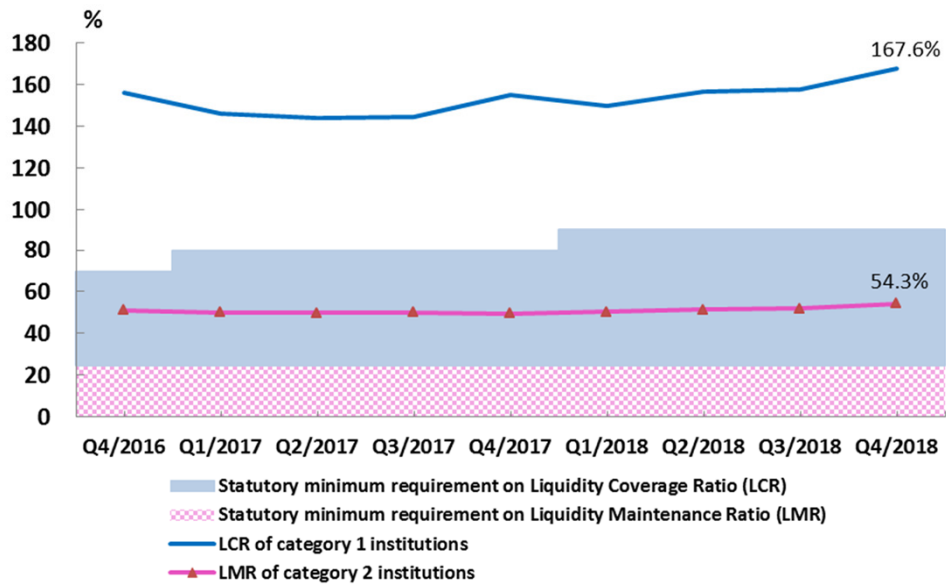
48

- The banking sector remained well capitalised. The consolidated capital adequacy ratio of locally incorporated AIs stood at 20.2% at end-September 2018, well above the international minimum requirement of 8%.



BANKING SECTOR PERFORMANCE

Liquidity position remained sound



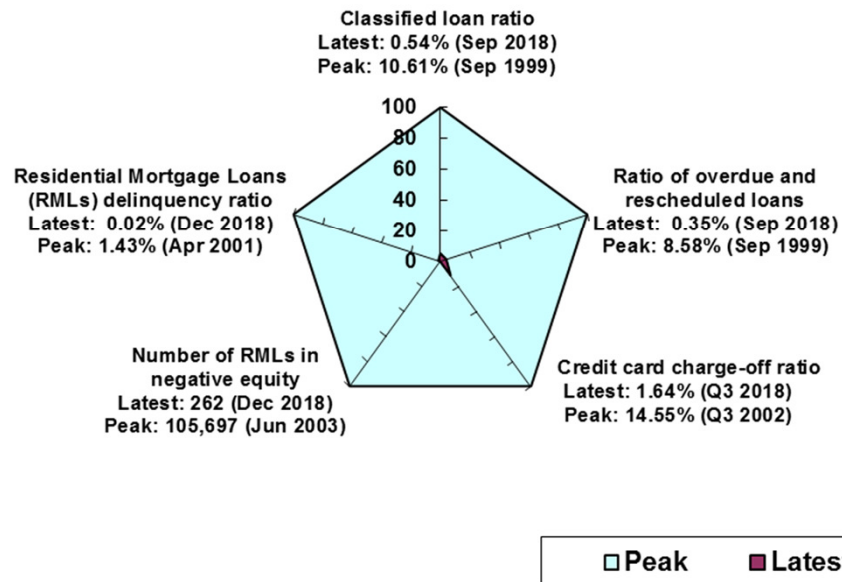
49

- In the fourth quarter of 2018, the quarterly average LCR of category 1 institutions was 167.6%, well above the 90% statutory minimum requirement applicable for 2018. For category 2 institutions, their quarterly average LMR was 54.3%, also well above the 25% statutory minimum requirement.



BANKING SECTOR PERFORMANCE

Asset quality stayed healthy



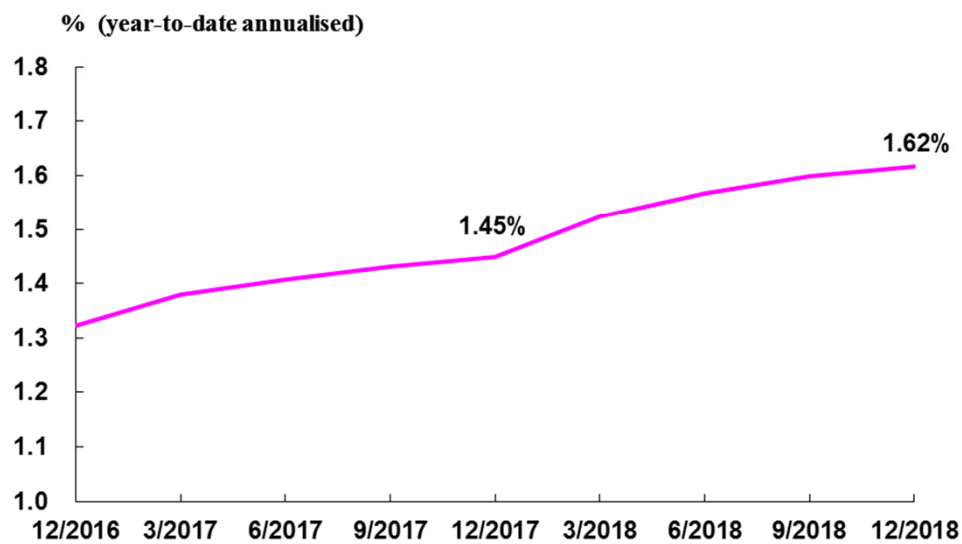
50

- The asset quality of retail banks stayed healthy. Their classified loan ratio increased slightly to 0.54% at end-September 2018 from 0.53% a quarter earlier, remaining well below the long-run historical average of 2.2% since 2000. For the banking sector as a whole, the classified loan ratio edged down to 0.60% from 0.61% during the same period.



BANKING SECTOR PERFORMANCE

Net interest margin widened



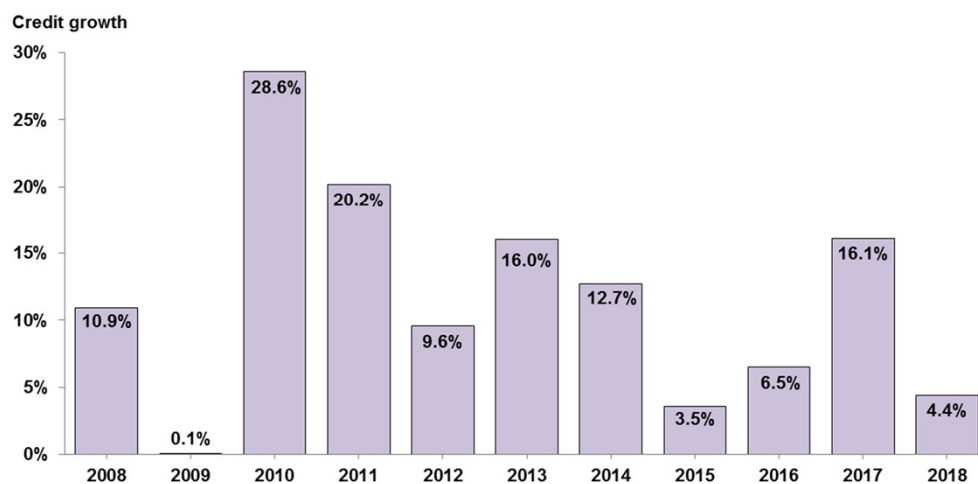
51

- The net interest margin of retail banks' Hong Kong offices widened to 1.62% in 2018 from 1.45% in 2017.



BANKING SECTOR PERFORMANCE

Credit growth moderated



Source: HKMA

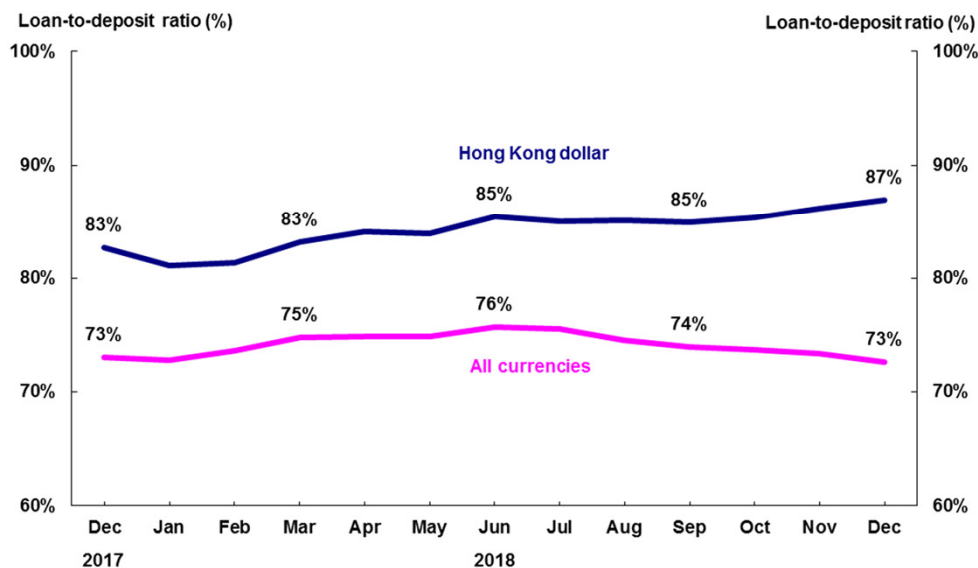
52

- Credit growth moderated to 4.4% in 2018, lower than that of 16.1% in 2017. The slower credit growth was attributable to weaker credit demand against uncertain global economic and trade environment.



BANKING SECTOR PERFORMANCE

Loan-to-deposit ratios were stable



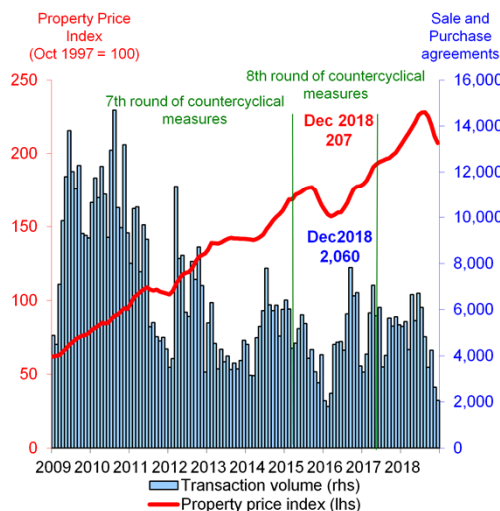
53

- Hong Kong-dollar loan-to-deposit ratio increased slightly to 87% at end-December 2018 from 85% at end-September 2018.
- All currencies loan-to-deposit ratio edged down to 73% from 74% during the same period.



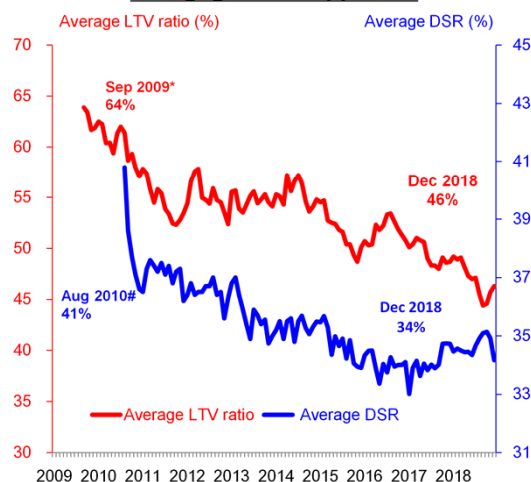
PROPERTY MORTGAGE LOANS

Residential property price index and transaction volume



Sources: R&VD and Land Registry

Average loan-to-value (LTV) ratio and debt servicing ratio (DSR) for new residential mortgage loans approved



* Before the first round of HKMA's countercyclical measures was introduced

When the tighter requirement on debt servicing ratio was introduced by the HKMA

54

Latest statistics on residential mortgage loans (RMLs)

	Monthly average in 2017	Monthly average in 2018	Jul 2018	Aug 2018	Sep 2018	Oct 2018	Nov 2018	Dec 2018
Number of sale and purchase agreements	5,133	4,771	6,091	4,822	3,500	4,243	2,635	2,060
Number of new RML applications	11,947	12,567	14,217	17,963	7,977	10,754	9,431	7,435
Number of new RMLs approved	8,699	9,010	10,716	11,690	7,712	7,417	7,341	5,699

Latest statistics on residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	12/2018	207.3
	Recent peak	7/2018	228.3
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	3/2/2019	170.0
	Recent peak	12/8/2018	188.6
	Peak in 1997	19/10/1997	102.9



INTERNATIONAL STANDARDS IMPLEMENTATION

- Banking (Liquidity) (Amendment) Rules 2019
- Banking (Capital) (Amendment) Rules 2019 / 2020

55

The following legislative proposals are being prepared for the purpose of implementing the Basel regulatory standards:

Liquidity standards

- We plan to introduce a set of Banking (Liquidity) (Amendment) Rules 2019 to accept Basel III-compliant listed equities and triple-B rated debt securities as high quality liquid assets under the “level 2B assets” class for the Liquidity Coverage Ratio. We will also follow the latest Basel guidance to implement a 5% “required stable funding” requirement for derivative liabilities under the Net Stable Funding Ratio. Subject to the progress of legislation, we plan to implement these amendments from 1 October 2019 or 1 January 2020.

Capital standards

- Meanwhile, we are in the process of preparing a set of Banking (Capital) (Amendment) Rules, mainly to incorporate the following three Basel capital standards:
 - banks’ equity investments in funds;
 - the standardised approach for measuring counterparty credit risk of derivative contracts; and
 - banks’ exposures to central counterparties (in centrally-cleared transactions), replacing the interim capital standard that has been implemented in Hong Kong since 2013.
- The amendment rules are currently targeted to be submitted to the Legislative Council (LegCo) either towards the end of 2019 or sometime within the first half of 2020, in order for the standards to take effect in Hong Kong within 2020. (Note: These standards were originally scheduled to be effective on 1 January 2017 according to the Basel timeline. Local implementation has been deferred to track more closely the implementation schedules in other major jurisdictions.)



RESOLUTION REGIME

- The rules on loss-absorbing capacity requirements (LAC Rules) for authorized institutions (AIs) came into operation in December 2018. The Inland Revenue (Amendment) (No. 6) Bill 2018 has resumed second reading on 30 January 2019
- The HKMA expects to finalise Financial Institutions (Resolution) Ordinance (FIRO) code of practice chapter in the first quarter of 2019
- Continue to operationalise the FIRO by progressing other secondary legislation

56

- Following the completion of LegCo negative vetting procedure, the LAC Rules came into operation on 14 December 2018.
- To clarify the uncertainties of tax treatment of LAC instruments arising from their loss-absorbing characteristics, the Inland Revenue (Amendment) (No.6) Bill 2018 proposes amendments to afford debt-like profits tax treatment for the instruments, and exempt transfers of the instruments from stamp duty.
- Consultation on the draft of FIRO code of practice chapter providing further guidance on the LAC Rules was closed on 3 December 2018. The HKMA expects to finalise the chapter in the first quarter of 2019.
- On other subsidiary legislation to be made to operationalise FIRO, the HKMA plans to consult on policy proposals for imposing contractual requirements on AIs under sections 92 of FIRO regarding stays on early termination rights of financial contract around the first quarter of 2019.



FINANCIAL INCLUSION

Banking services delivery channels

- More physical branches for underserved areas
- Exploring further expansion of cash withdrawal service by the elderly without the need to make purchase

Bank account opening and maintenance

- Mystery shopping programme and thematic reviews
- Exploring the use of new technology to enhance efficiency of customer due diligence process
- On-going communication with the banking industry, business community and relevant stakeholders

57

- With the encouragement of the HKMA, the Hong Kong Association of Banks (HKAB) introduced in 2018 a scheme for the elderly to withdraw cash at convenience stores and post offices without the need to make purchases. The scheme covers over 330 convenience stores and seven post offices to enhance the elderly's access to cash withdrawal service across Hong Kong. The HKMA will continue to work with the banking industry to explore further expansion of the service.
- On bank account opening, the service provider engaged by the HKMA has completed the on-site fieldwork at retail banks. The HKMA is now analysing the review results.
- The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018 became effective last year, allowing greater flexibility for banks to remotely process account opening and update customers' information. The HKMA has been maintaining close dialogues with banks and fintech companies on their initiatives through the Fintech Supervisory Sandbox and Chatroom. Meanwhile, we are working with HKAB to explore how technology, including a know-your-customer utility, can potentially be used to enhance efficiency to customer due diligence processes and customer experience.
- The HKMA continued to work closely with and engage the banking industry and the business community on issues concerning opening and maintenance of bank accounts. We will, having regard to the feedback collected, explore with the banks any further improvement measures.



BANKING CONSUMER PROTECTION

- Announced supervisory measures for bank culture in December 2018
- Worked closely with Hong Kong Association of Banks (HKAB) in developing a set of standardised procedures for the industry to handle cases of mis-transfer of funds erroneously made by customers
- Working closely with HKAB to follow up with TransUnion (TU) in respect of suspected security loopholes in its online consumer credit report service

58

- **Supervision for Bank Culture:** Following the consultation with the banking industry associations, and drawing upon experience from overseas practices, we have announced supervisory measures for bank culture in December 2018 (covering self-assessment, focus reviews and culture dialogues) with a view to gauging the progress of bank culture reform in Hong Kong and providing further guidance where necessary.
- **Mis-transfer of Funds Made by Customers:** Regarding the situation where bank customers erroneously transfer funds to wrong recipients and request assistance from their banks to recover the mis-transferred funds, the HKMA requested the banking industry to look into the matter and seek to further enhance banks' existing process. The HKAB, in consultation with the HKMA, has worked out a set of standardised procedures to provide greater clarity and further enhancement to banks' existing processes. The HKMA has also issued a circular in January 2019 to remind banks to have a proper process for ensuring that the aforementioned procedures are duly adopted and enforced. The procedures will be effective from 25 March 2019.
- **TU incident:** TU is conducting a full investigation and working on enhancing its security controls, while its online credit report services were suspended. The HKMA will continue to work closely with HKAB in following up with TU. The HKMA will also make reference to the results of the investigation being conducted by the Office of the Privacy Commissioner for Personal Data, and work with the banking industry to review the contractual arrangement between the industry and credit reference agency, with a view to strengthening the current arrangement.



BANKING INVESTOR PROTECTION (cont'd)

- Provided guidance to the banking industry, including:
 - offline distribution and advisory activities for structured investment products not regulated by Securities and Futures Ordinance (SFO)
 - enhanced investor protection measures on sale and distribution of debt instruments with loss-absorption features and related products
 - prevention and management of misconduct risks in selling of investment funds
- Consulted the banking industry on streamlining investor protection measures
- Working with Insurance Authority to implement the new statutory regime for regulating insurance intermediaries

59

- The HKMA provided guidance to the banking industry on:
 - offline distribution and advisory activities for structured investment products not regulated by SFO on 30 October 2018. This guidance aligns the regulatory requirements for both online and offline sales. In particular, the same additional investor protection measures would be applied to the offline sale of complex products;
 - enhanced investor protection measures governing the sale and distribution of debt instruments with loss-absorption features and related products on 30 October 2018;
 - how to take into account a customer's investment horizon in suitability assessment on 18 October 2018; and
 - prevention and management of misconduct risks in selling of investment funds on 21 December 2018.
- The HKMA has conducted a holistic review of the investor protection measures for selling investment products, insurance products and Mandatory Provident Fund products, including physical segregation, audio-recording of sale process and assessment of vulnerable customers. The HKMA has consulted the banking industry on the proposed streamlined arrangement and will continue to work closely with the industry on the details of the arrangement to enhance customer experience while protecting investors.
- The HKMA also instituted a mystery shopping programme in 2018 to test check authorized institutions' (AIs) selling practices in respect of investment and insurance products.
- The HKMA continued to work with the Insurance Authority to prepare for the implementation of the statutory regime under the new Insurance Ordinance for regulating insurance intermediaries, including a collaboration framework for inspection and investigation of insurance intermediary activities of AIs, and formulation of rules and regulatory requirements for the new regime.



ENHANCED COMPETENCY FRAMEWORK (ECF) FOR BANKING PRACTITIONERS

- Finalising the industry consultation of the ECF module on credit risk management
- To develop the ECF module on risk management and compliance, and explore other potential areas of talent development for the industry

60

- With the support from the banking industry and relevant professional bodies, the formal industry consultation of the ECF on credit risk management was launched in October 2018. The HKMA is finalising the industry consultation. Depending on the feedback received, this ECF module is expected to be launched in the first quarter of 2019.
- The HKMA will continue to collaborate with the relevant parties to develop the ECF on risk management and compliance and explore other potential areas of talent development for meeting the evolving needs of the banking industry.



CONSUMER EDUCATION PROGRAMME

- Rolled out an educational campaign to promote proper handling of personal credit products
- Arranged seasonal promotion to advocate smart use of credit cards and issues to note when using personal loans to pay tax



61

- The HKMA rolled out a new educational campaign via a feature story series broadcast in a popular TV infotainment programme, and promotion of online video, comics and infographics on multiple platforms, to promote appropriate attitude and highlight the implications of improper use of personal credit products.
- Seasonal promotion was also arranged to advocate smart use of credit cards during festive seasons and remind the public of the issues to note when using personal loans to pay tax.



DEPOSIT PROTECTION SCHEME (DPS)

- Implemented the new payout system in January 2019 to streamline the payout operation
- Announced the results of the “HongKongers’ Sense of Security on Savings” survey to promote the DPS as “Guardian of Deposits”
- Executed a social media engagement campaign and participated in Hong Kong Brands and Products Expo to build resonance on the importance of saving and DPS protection



62

- The payout system modernisation project of the Hong Kong Deposit Protection Board (the Board) has been completed. The new system, which streamlines the operational workflow and enhances the overall system efficiency and resilience, went live in January 2019.
- The Board conducted a “Hongkongers’ Sense of Security on Savings” survey to understand Hong Kong people’s saving practices, followed by a media briefing to announce the survey results to promote the value of the DPS as “Guardian of Deposits”.
- The Board executed an engagement campaign on social media featuring well-known artistes participating in a money-saving competition to build resonance with the public on the importance of saving and DPS protection. In addition, the Board participated in Hong Kong Brands and Products Expo to enhance the public’s understanding of DPS key features via educational game and distribution of publicity materials.



ACADEMY OF FINANCE (AoF)

- The HKMA continues to work on the establishment of the AoF by mid-2019 in consultation with the Preparatory Committee



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Financial infrastructure remains safe and efficient
- Operation of Bond Connect has been smooth; actively promote Bond Connect to overseas investors
- Further refine the over-the-counter derivatives trade repository (TR) according to the relevant local and international standards

65

Bond Connect

- Since the launch of Bond Connect on 3 July 2017, related settlement operations performed by the Central Moneymarkets Unit has been smooth. With the Delivery-versus-Payment (DvP) settlement fully implemented in August 2018, the HKMA has been maintaining close communication with the People's Bank of China and relevant Mainland institutions to explore enhancements to trading arrangements.
- The HKMA has participated in roadshows in major financial centres in Asia, Europe and North America to actively promote Bond Connect to overseas investors.

Over-the-counter derivatives trade repository

- Since the reporting function of the TR was launched in July 2013, reporting by banks to the TR has been smooth.



FASTER PAYMENT SYSTEM (FPS)

- FPS has been widely used by the public since its launch in September 2018. As of end-2018:
 - Registrations: Over 2 million
 - Transaction value: HK\$104 billion
 - Transaction number: 4.8 million
 - Average daily transaction value: HK\$1.1 billion
 - Average daily transaction number: 50,000
 - Average amount per transaction: HK\$22,000

66

- Starting from 17 September 2018, the public can make use of the internet banking or mobile app of participating banks and stored value facilities (SVFs) to register their mobile phone number or email address with the FPS as an account proxy for receiving funds. From 30 September 2018, the public can make transfers or receive funds using the FPS.
- Currently, a total of 21 banks (including most retail banks) and 10 SVFs in Hong Kong have participated in the system to provide FPS services for their customers.
- FPS has received a total of over 2 million registrations, including 1,422,000 in mobile numbers, 327,000 in email addresses, and 284,000 in FPS ID as of 31 December 2018. FPS ID is a unique random number generated by FPS to be associated with the account of a customer of a FPS participant for receiving payments.
- FPS has processed over 4.8 million transactions with transaction amount totalling over HK\$104 billion and RMB2.75 billion as of 31 December 2018.
- The development of the FPS in HK, in terms of registration number and transaction value, is comparable to other jurisdictions in the region.



LATEST FINTECH INITIATIVES

Open Application Programming Interface (Open API) for the banking industry

- Over 500 Open APIs launched by banks since Phase I of Open API implemented in January 2019

Distributed Ledger Technology (DLT)-based trade finance platform, eTradeConnect

- Proof-of-Concept on connecting with a platform in Europe underway

Enhanced cross-border collaboration

- 18 jurisdictions attended Hong Kong Fintech Roundtable hosted by HKMA in January 2019
- HKMA-hosted panels at Fintech Week attracted over 4,000 participants

67

Open Application Programming Interface

- By end-January 2019, the deadline for Phase I Open API (product and service information), 20 retail banks launched Open APIs, covering information of deposits, loans, insurance, investments, and other banking products and services.
- Banks are working to open up more functionalities in subsequent phases.

DLT-based trade finance platform - eTradeConnect

- eTradeConnect was developed by a consortium of 12 banks in Hong Kong.
- In October 2018, a Memorandum of Understanding was signed between the operators of eTradeConnect and a European trade finance platform to conduct a Proof-of-Concept on connecting the two platforms.
- The HKMA will continue to facilitate the development of eTradeConnect and its connection with other regions.

Enhanced cross-border fintech collaboration

Fintech Roundtable

- Took place on 9 January 2019; Attended by about 45 senior representatives from 18 jurisdictions, including Japan, Singapore, Switzerland, the UK, and the US.

Hong Kong Fintech Week 2018

- Held from 29 October to 2 November 2018; The HKMA organised and led six of the panel discussions, attracting more than 4,000 participants.



STORED VALUE FACILITIES (SVFs) AND RETAIL PAYMENT SYSTEMS (RPSs)

- Usage continued to grow in Q3 2018:
 - Accounts in use: 54.1 million (+20.6% year-on-year)
 - Average daily transaction number: 16.5 million (+6.9% year-on-year)
 - Average daily transaction value: HK\$490 million (+29.7% year-on-year)
 - Average value per transaction: HK\$29 (+21.3% year-on-year)
- SVF licensees continue to extend their business reach to different sectors, e.g. cross-border remittance, public transportation and small merchants
- e-Wallets are gradually resuming bank direct debit authorisation service
- Continue to oversee six designated RPSs



REGULATORY DEVELOPMENT OF THE OVER-THE-COUNTER (OTC) DERIVATIVES MARKET

- Continued to develop specific regulatory requirements covering different aspects
- Following public consultation, the subsidiary legislation to expand the mandatory clearing obligation was tabled before LegCo in December 2018 for operation in March 2019
- As of end-2018, the Hong Kong Trade Repository logged 2.52 million total outstanding OTC derivatives trades which covered five asset classes under mandatory reporting requirements, i.e. foreign exchange, interest rate, equity, credit and commodity derivatives

69

Further enhancement to the OTC Derivatives Regulatory Regime

- Following the enactment of the Securities and Futures (Amendment) Ordinance 2014, which provides for the regulatory regime for the OTC derivatives market, we continue to develop specific regulatory requirements covering different aspects.
- A joint consultation conclusion paper with Securities and Futures Commission, summarising the new requirements on the use of Legal Entity Identifier for reporting obligations, an expanded clearing obligation and the trading determination process, was published in June 2018. The subsidiary legislation for expanding mandatory clearing obligation was tabled before LegCo for negative vetting in December 2018 and is expected to take effect from 1 March 2019.



INTEREST RATE BENCHMARKS

- Participating in the Financial Stability Board (FSB) Official Sector Steering Group (OSSG) with regard to the reform of interest rate benchmarks
- Enhancing the administration of interest rate benchmarks in Hong Kong (HKD HIBOR and CNH HIBOR) through the Treasury Markets Association (TMA)
- Closely monitoring the development of other major currencies' interest rate benchmarks (e.g. LIBOR), and work with the industry in preparation for changes in the future

70

- The FSB OSSG was formed to coordinate work to reform interest rate benchmarks after a number of manipulation cases were discovered in 2014. As an FSB member, the HKMA participates in the OSSG. Moreover, through TMA, the HKMA enhances Hong Kong Interbank Offered Rate (HIBOR) administration to ensure that local interest rate benchmarks are in line with international standards.
- LIBOR is the most important interest rate benchmark in the global financial system, as it covers major currencies such as USD and GBP. Currently, the UK Financial Conduct Authority (FCA) is using its legal power to compel banks to contribute to the determination of LIBOR but it has made it clear that it will stop doing so after the end of 2021.
- In September 2018, the UK FCA and Prudential Regulatory Authority sent a joint letter to the CEOs of banks, reminding their senior management and boards of directors to pay attention to the risks associated with the possible discontinuation of LIBOR after 2021. The US Federal Reserve and Bank of England have already launched alternative reference rates for their currencies. The FCA indicates that it will continue to work with the banks to sustain LIBOR until the end of 2021, and it cautions that financial institutions must get prepared for the transition from LIBOR to the alternative reference rates.
- As an international financial centre, Hong Kong has a lot of local financial transactions referencing LIBOR. As such, the HKMA is closely monitoring international developments related to LIBOR reform. Recently, a working group has been established under TMA to raise market awareness of the LIBOR discontinuation and work with the local financial industry to get ready for the transition.

- While there is no plan to discontinue HIBOR, the HKMA, as a FSB member, has an obligation to put in place an alternative reference rate as a contingent fall-back. TMA members discussed the issue and proposed adopting HKD Overnight Index Average (HONIA) as the alternative reference rate. Unlike HIBOR, HONIA is an overnight interbank interest rate based on actual transaction data. It is very similar to the alternative reference rates for USD and GBP. TMA will conduct a consultation in the first quarter of 2019.



CURRENCY

- 2018 New Series Banknotes — the three note-issuing banks' new \$1000 and \$500 notes are already in circulation, and the remaining three denominations will enter circulation by phases between mid-2019 and 2020
- Two “Coin Carts” will continue to collect coins from members of the public in 18 districts

GOVERNMENT BOND PROGRAMME

- To issue the fourth batch of Silver Bond targeting Hong Kong residents aged 65 or above in 2019

71

2018 New Series Banknotes

The new \$100 notes are expected to be issued this year, and the \$20 and \$50 notes before 2020 Chinese New Year.

Coin Collection Programme

- Two Coin Carts collect coins from members of the public in 18 districts on a rotational basis.
- 528,000 people were served and 436 million coins with a total face value of HK\$608 million were collected in the past four years.

Government Bond Programme

Institutional part – outstanding as at end-2018:

- Twelve Government bonds totalling HK\$87.1 billion
- Three Islamic bonds totalling US\$3 billion

Retail part:

- One iBond and three Silver Bonds totalling HK\$18.8 billion were outstanding as at end-2018.
- The third batch of Silver Bond was issued in December 2018. The issuance size was HK\$3 billion and interest rate is linked to inflation, subject to a minimum of 3%. A total of 45,488 valid applications were received (average allotment 6.6 lots), with an oversubscription of 1.1 times.

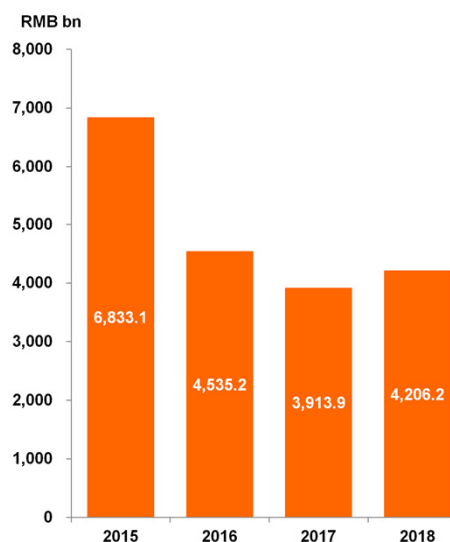


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

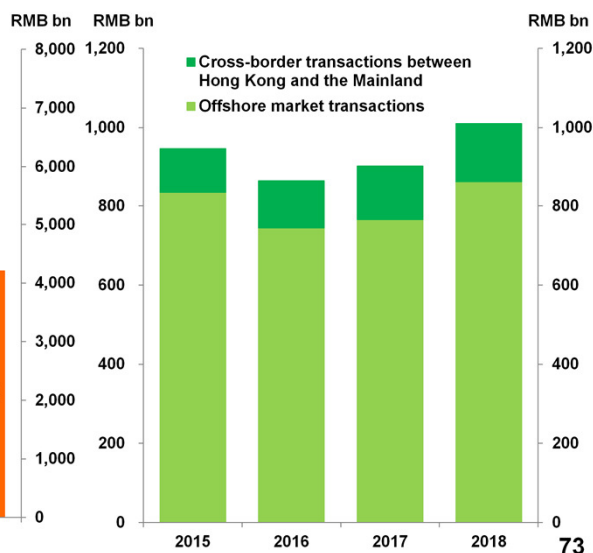


RMB TRADE SETTLEMENT AND PAYMENT

**RMB trade settlement
handled by banks in Hong Kong**



**Average daily turnover of Hong Kong
RMB RTGS System**

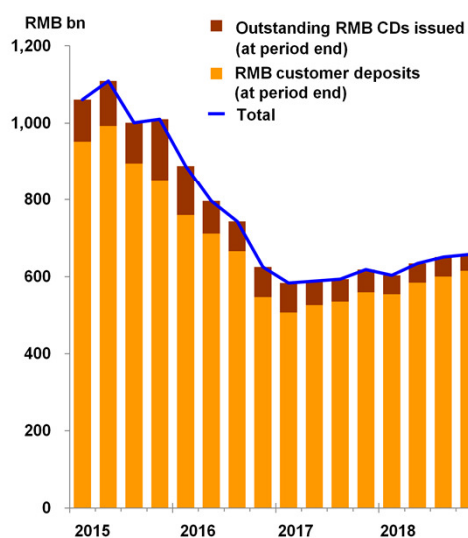


- In 2018, RMB trade settlement handled by banks in Hong Kong totalled RMB4,206.2 billion.
- In 2018, the average daily turnover of Hong Kong RMB Real Time Gross Settlement (RTGS) system stood at RMB1,010 billion.

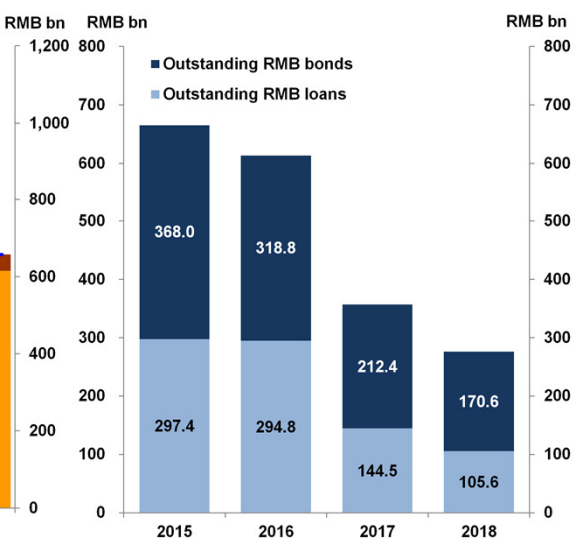


RMB LIQUIDITY POOL AND FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



74

- At end-2018, RMB customer deposits and outstanding RMB CDs amounted to RMB615.0 billion and RMB42.7 billion respectively, totalling RMB657.7 billion.
- At end-2018, outstanding RMB loans amounted to RMB105.6 billion. Outstanding dim sum bonds amounted to RMB170.6 billion. The dim sum bond issuance totalled RMB41.9 billion for the year of 2018.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	2018	2017	2016	2015
1 No. of participating banks of Hong Kong's RMB clearing platform	200	203	210	217
Of which:				
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	173	178	184	192
2 Amount due to overseas banks (RMB billion)	80.4	95.4	69.0	105.7
3 Amount due from overseas banks (RMB billion)	132.8	131.3	91.6	132.1

75

- The HKMA maintained and deepened ongoing collaborative dialogues with other offshore RMB centres, including Australia, the UK, France and Switzerland, and continued our marketing efforts through participation in industry events to promote Hong Kong's RMB business platform and our unique role as a springboard between Mainland China and the rest of the world.
- The HKMA hosted a panel session on "China Growth Story: What's Next and Where the Opportunities are" in November 2018 in Tokyo as part of the "Think Global, Think Hong Kong" event to promote Hong Kong's status as the key gateway to China opportunities.
- The HKMA hosted a financial seminar with Paris EUROPLACE in January 2019 to discuss the latest developments in the financial sector and explored financial collaboration opportunities, including China opportunities, fintech and green finance.



PROMOTING GREEN FINANCE

- In the first three quarters in 2018, at least 28 green bonds were issued in Hong Kong, with an aggregate size of over US\$8 billion. Issuers included multilateral development banks, and corporates and financial institutions from Hong Kong, the Mainland and overseas.
- The HKMA has been promoting green finance in Hong Kong, including:
 - Taking forward the preparatory work related to the inaugural green bond offering under the Government Green Bond Programme
 - Co-organised with the Research Bureau of the People's Bank of China and the Hong Kong Green Finance Association a study tour on issuing green bond in Hong Kong for potential Mainland issuers on 13-15 January 2019



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

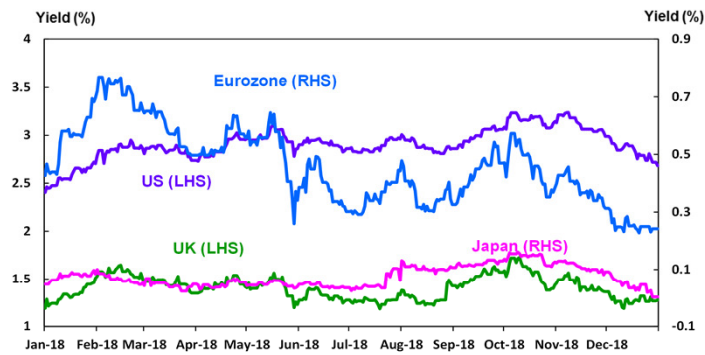


INVESTMENT ENVIRONMENT IN 2018

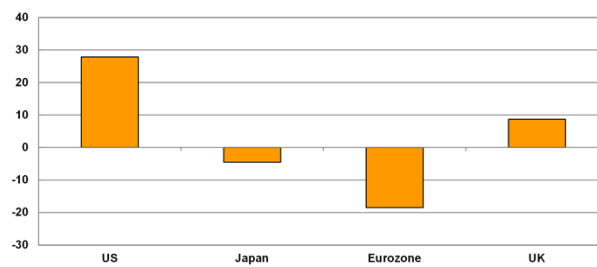
- **Interest rates:** 10-year US Treasury yield rose to a 7-year high of 3.2% in November before softening to 2.7% at year-end on haven demand
- **Equity markets:** Emerging markets and Hong Kong equity indices fell in the year amid intensifying China-US trade conflict. US equities performed relatively well in the first three quarters of the year given the US tax reform proposals and solid corporate earnings. That said, US equities corrected substantially in the fourth quarter amid market worries on US rate hike and China-US trade conflict. This wave of correction spread globally, with major equity indices worldwide recording double-digit losses in the fourth quarter
- **Exchange rates:** US dollar strengthened in tandem with US rate hikes in the year. Major currencies such as the euro and renminbi fell by around 5% against the US dollar. Some emerging market currencies suffered a further blow given domestic political and economic upheavals, with the Argentine peso and Turkish lira depreciating by around 50% and 30% respectively against the US dollar



CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN 2018



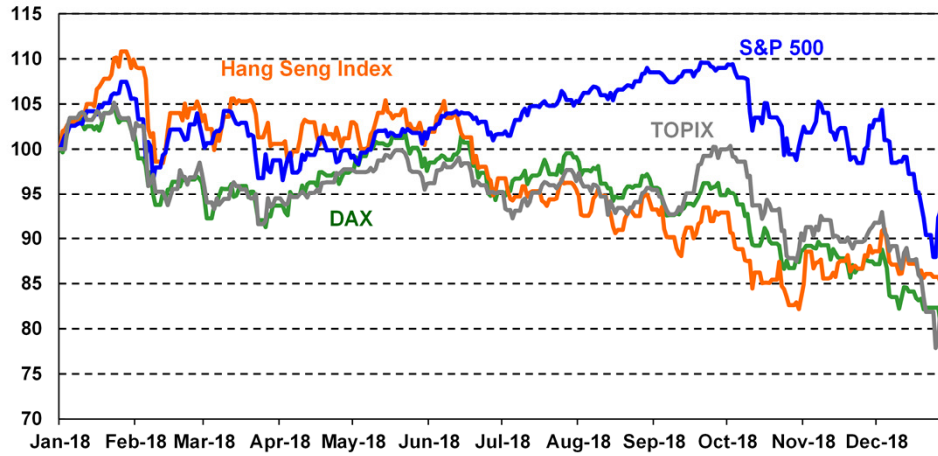
2018 Q1 to Q4 bond yield change (bps)





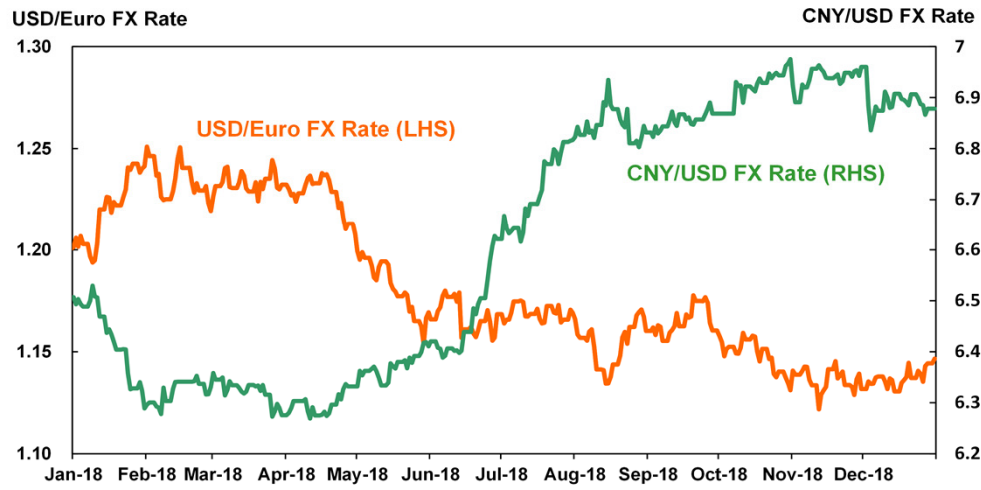
EQUITY MARKETS IN 2018

Normalised Index Level (2017 year-end = 100)





CURRENCY MARKETS IN 2018





INVESTMENT INCOME

	← 2018 → I			2017	2016
	(unaudited)				
(HK\$ billion)	Full year	2H	1H	Full year	Full year
Bonds	57.4	37.9	19.5	34.4	33.1
Hong Kong equities*	(20.7)	(17.3)	(3.4)	58.3	5.3
Other equities	(38.3)	(35.6)	(2.7)	80.4	28.6
Foreign exchange[#]	(9.0)	(14.0)	5.0	53.5	(15.8)
Other investments[@]	<u>24.5</u>	<u>7.9</u>	<u>16.6</u>	<u>37.4</u>	<u>16.9</u>
Investment income/(loss)	13.9	(21.1)	35.0	264.0	68.1

* 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. This figure represents valuation changes up to the end of September 2018. Valuations of these investments from October to December are not yet available.



INCOME AND EXPENDITURE

	I ← 2018 → I (unaudited)			2017	2016
(HK\$ billion)	Full year	2H	1H	Full year	Full year
Investment income/(loss)	13.9	(21.1)	35.0	264.0	68.1
Other income	0.2	0.1	0.1	0.2	0.2
Interest and other expenses	<u>(18.1)</u>	<u>(10.8)</u>	<u>(7.3)</u>	<u>(9.9)</u>	<u>(6.4)</u>
Net (loss)/income	(4.0)	(31.8)	27.8	254.3	61.9
Fee payment to Fiscal Reserves**	(43.8)	(21.6)	(22.2)	(46.2)	(33.1)
Fee payment to HKSAR government funds and statutory bodies*	(13.8)	(6.9)	(6.9)	(8.6)	(9.6)

* The rate of fee payment is 4.6% for 2018, 2.8% for 2017 and 3.3% for 2016.

This does not include the 2018 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2018 is available.

(The composite rate was 9.6% for 2017 and 4.5% for 2016. Fee payable to the Future Fund was HK\$22.7 billion for 2017 and HK\$10.1 billion for 2016).



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Dec 2018	At 31 Dec 2017	Change
ASSETS	(unaudited)		
Deposits	326.0	346.9	(20.9)
Debt securities	2,826.2	2,761.6	64.6
Hong Kong equities*	175.5	204.2	(28.7)
Other equities	456.9	507.5	(50.6)
Other assets#	<u>274.8</u>	<u>195.1</u>	<u>79.7</u>
Total assets	<u>4,059.4</u>	<u>4,015.3</u>	<u>44.1</u>
LIABILITIES AND EQUITY			
Certificates of Indebtedness	485.7	456.7	29.0
Government-issued currency notes & coins in circulation	12.6	12.2	0.4
Balance of the banking system	78.6	179.8	(101.2)
Exchange Fund Bills and Notes issued	1,129.6	1,045.8	83.8
Placements by banks and other financial institutions	56.3	59.4	(3.1)
Placements by Fiscal Reserves®	1,173.5	1,073.8	99.7
Placements by HKSAR government funds and statutory bodies	320.6	305.1	15.5
Placements by subsidiaries	7.7	-	7.7
Other liabilities	<u>194.8</u>	<u>169.4</u>	<u>25.4</u>
Total liabilities	<u>3,459.4</u>	<u>3,302.2</u>	<u>157.2</u>
Accumulated Surplus	599.4	713.1	(113.7)
Revaluation reserve	<u>0.6</u>	<u>-</u>	<u>0.6</u>
Total equity	<u>600.0</u>	<u>713.1</u>	<u>(113.1)</u>
Total liabilities and equity	<u>4,059.4</u>	<u>4,015.3</u>	<u>44.1</u>

* Including shares of the Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio.

Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$162.4 billion at 31 Dec 2018 (HK\$135.2 billion at 31 Dec 2017).

® Including placements by the Future Fund of HK\$224.5 billion.



HISTORICAL INVESTMENT INCOME

(HK\$ billion)

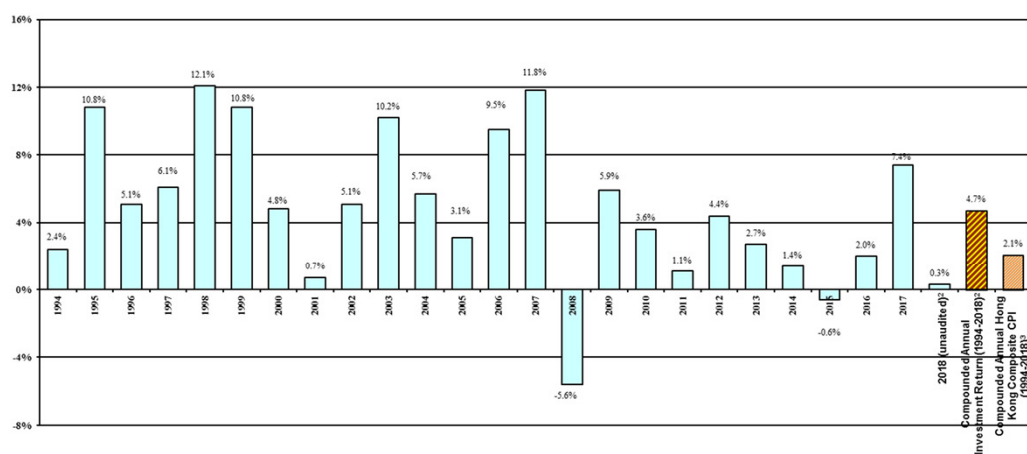
Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009*#	107.7	10.6	71.9	58.7	(33.5)
2010*#	79.4	5.9	74.5	(12.1)	11.1
2011*#	27.1	22.1	(41.4)	21.6	24.8
2012*#	111.6	30.3	42.4	(5.6)	44.5
2013*#	81.2	30.7	54.7	(23.3)	19.1
2014*#	44.7	6.1	(17.8)	43.3	13.1
2015*#	(15.8)	21.0	(63.8)	18.7	8.3
2016*#	68.1	(23.3)	47.1	18.9	25.4
2017*#	264.0	66.0	61.8	71.3	64.9
2018* (unaudited)	13.9	(30.6)	9.5	0.0	35.0

* Excluding valuation changes of the Strategic Portfolio

Including valuation changes of private equity and real estate investments held under the LTGP



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2018)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 2018. The audited full year return will be disclosed in the annual report of 2018 to be released later this year.

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



INVESTMENT DIVERSIFICATION

- Began to invest in alternative assets in 2009 under the Long-Term Growth Portfolio (LTGP). The progress of the LTGP in 2018 has been good. Positions at the end of September 2018 and performance since inception are as follows:

As of end-September 2018 (unaudited)

Asset Classes	Market Value HK\$ billion	Annualised IRR (Since inception from 2009 till end-Sep 2018)
Private Equity	190.9	} 13.8%
Real Estate	87.4	
Total	278.3	

Note: Outstanding investment commitments at the end of 2018 amounted to HK\$200.0 billion



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since its launch in March 1999, the MIP has helped over 141,600 families attain home ownership
- In 2018, the total number of loans drawdown and aggregate loan amount under the MIP were 8,355 cases and HK\$32.5 billion respectively, at a level similar to that in 2017
- About 88% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME

- As at end-December 2018, 3,105 applications had been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$15,300
 - Payment terms: 10-year (25.5%), 15-year (15.6%), 20-year (12.5%), life (46.4%)
 - Average property value: HK\$5.3 million
 - Average property age: 30 years

90

- Note: Figures in percentage for individual items may not add up to 100% due to rounding.



SME FINANCING GUARANTEE SCHEME (SFGS)

- In accordance with the Government's policy objectives to assist SMEs, application period for 80% loan guarantee product was extended to 30 June 2019
- Additional enhancement measures were launched in November 2018: (1) reducing existing annual guarantee fee rates by 50%; (2) increasing maximum facility amount from \$12 million to \$15 million; and (3) lengthening maximum facility guarantee period from 5 years to 7 years
- As at end-December 2018, 14,558 applications had been approved, involving a total loan amount of around HK\$58.5 billion. Key data of the approved applications are as follows:

Average guarantee period	4.6 years	Enterprises with less than 50 employees	91%
Average loan size	HK\$4.02 million	Benefitted enterprises and the related no. of employees	8,355 enterprises and 215,517 employees
Average loan interest rate and average guarantee fee rate	4.91% p.a. 0.50% p.a.		

91

- Industry types of approved applications for 80% loan guarantee product:

Manufacturing sector **21.2%**

- Textiles and clothing 3.9%
- Electronics 2.0%
- Plastics 1.7%
- Printing and publishing 1.5%

Non-manufacturing sector **78.8%**

- Trading 45.5%
- Wholesale and retail 9.6%
- Engineering 3.4%
- Construction 3.3%



LIFE ANNUITY SCHEME

- HKMC Annuity Limited introduced three enhancement measures to the HKMC Annuity Plan and a year-round continuous sales model on 12 December 2018
- The three enhancement measures include 100% lump-sum death benefit protection, special withdrawal for medical and dental expenses, and relaxation of maximum premium amount per person from HK\$1 million to HK\$2 million
- The enhancements introduced offer a greater protection and flexibility to the customers, thereby enabling them to apply for the Plan with a greater sense of security
- Adoption of the year-round continuous sales model with no subscription period restriction enables customers to experience a more convenient and efficient application process and have a clearer understanding of product features