



HONG KONG MONETARY AUTHORITY

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

6 May 2019

[Translation]

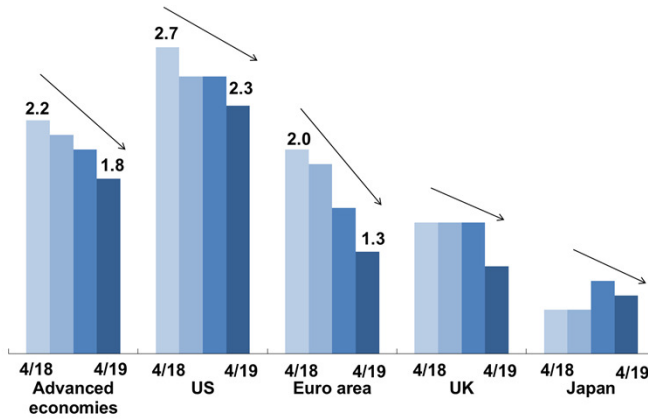


- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



GROWTH OUTLOOK MODERATES

2019 growth forecasts for advanced economies



Note: The four vertical bars (from light blue to navy blue) for each of the five economies shown in the chart represent the 2019 growth forecasts published by the International Monetary Fund in April 2018, October 2018, January 2019 and April 2019 respectively.

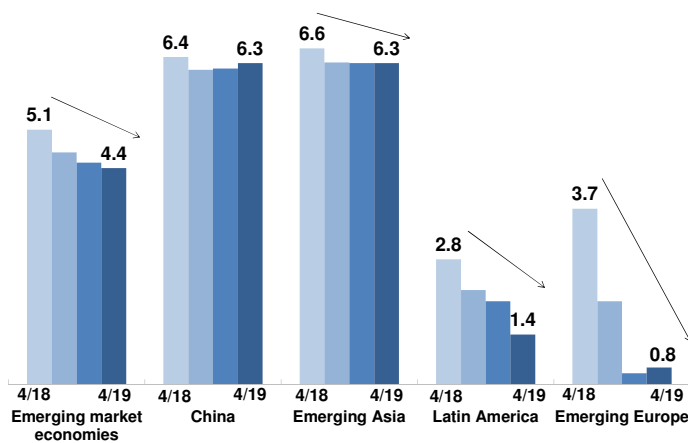
Source: International Monetary Fund (IMF)

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GROWTH OUTLOOK MODERATES

2019 growth forecasts for emerging market economies



Note: The four vertical bars (from light blue to navy blue) for each of the economies shown in the chart represent the 2019 growth forecasts published by the International Monetary Fund in April 2018, October 2018, January 2019 and April 2019 respectively. Emerging Asia includes China.

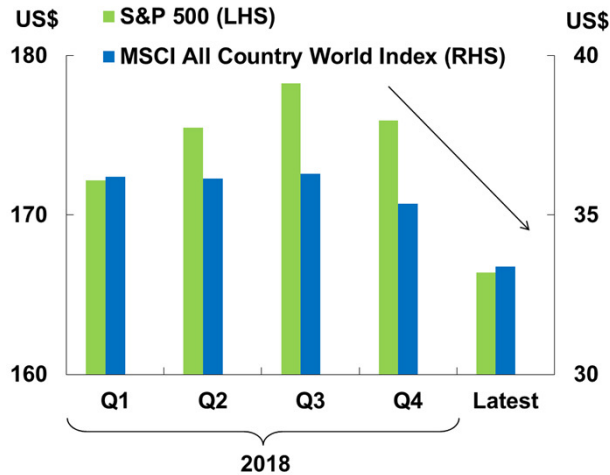
Source: International Monetary Fund (IMF)

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UNCERTAIN OUTLOOK FOR CORPORATE PROFITABILITY

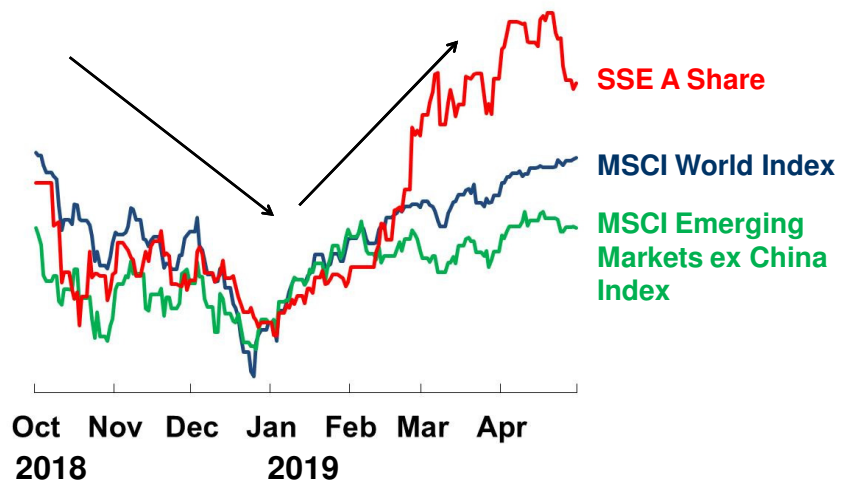
Earnings per share (EPS) forecasts for 2019



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...YET EQUITY MARKETS HAVE REBOUNDED SHARPLY SINCE THE START OF THE YEAR



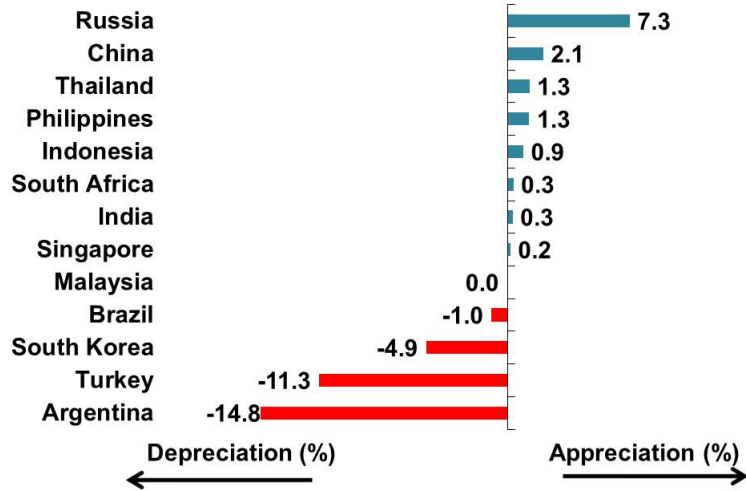
Source: Bloomberg

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THE STRENGTHENING US DOLLAR IS HELD BACK

Changes in exchange rates since the start of the year



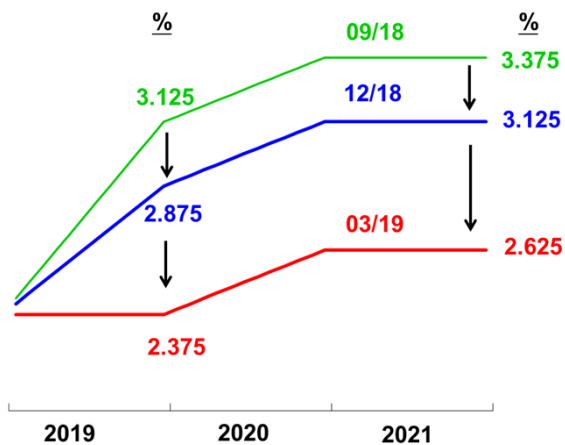
Source: Bloomberg

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THE FED PUTS RATE HIKES ON HOLD

Interest rate projections by the Fed



FOMC statements:

19/12/2018
“... further gradual increases in the target range for the fed funds rate will be consistent with sustained economic expansion and the Fed’s employment and inflation objectives”

30/1/2019#
“... (the Committee) will be patient as it determines future adjustments to the target range for the fed funds rate...”

(#) The same sentence appeared in the March and May 2019 FOMC statements.

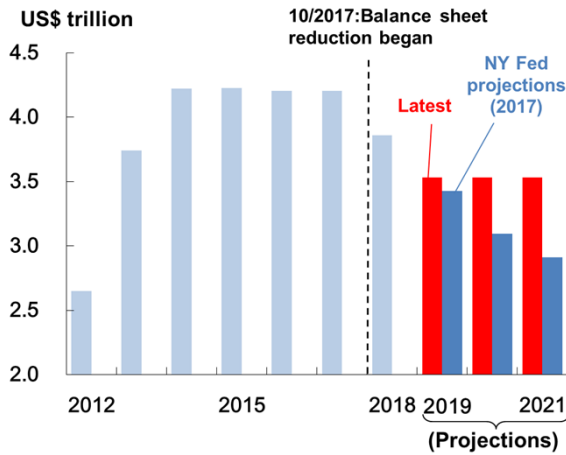
Source: Federal Reserve

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THE FED ALSO CALLS AN END TO BALANCE SHEET REDUCTION

Securities holdings by the Fed



Note: Projections by the New York Fed are its median projections.

Sources: Fed, New York Fed and HKMA staff estimates

The Fed's comments on balance sheet reduction:

19/12/2018

Powell: "... will continue to use ... (interest) rate ... as the active tool of monetary policy...balance sheet runoff on automatic pilot"

20/3/2019

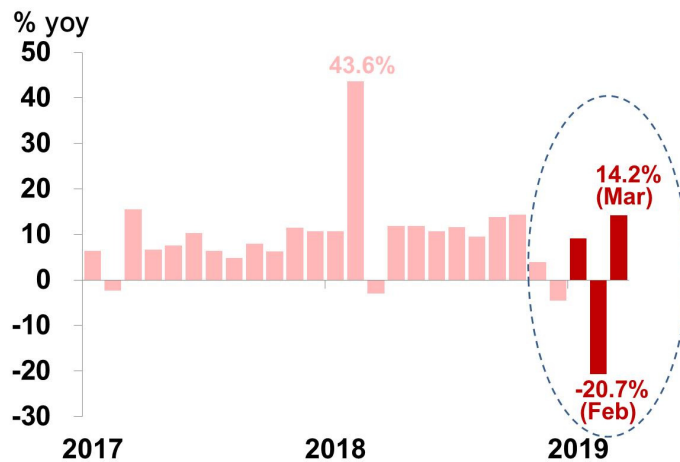
FOMC statement: "...the Committee intends to slow the pace of the decline in reserves over coming quarters ... [and] intends to conclude the reduction of its aggregate securities holdings at the end of September"

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MAINLAND CHINA: IMPACT OF TRADE WAR HAS SURFACED

Mainland China's exports have been volatile in the past few months



Note: Export figures of Mainland China are based on the values of exports in USD.

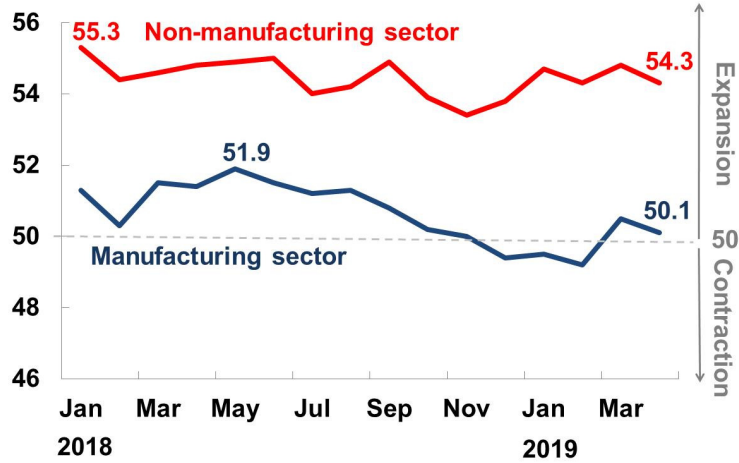
Source: WIND

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MAINLAND CHINA: ECONOMY HAS STABILISED

Mainland's purchasing managers' indexes rebounded recently



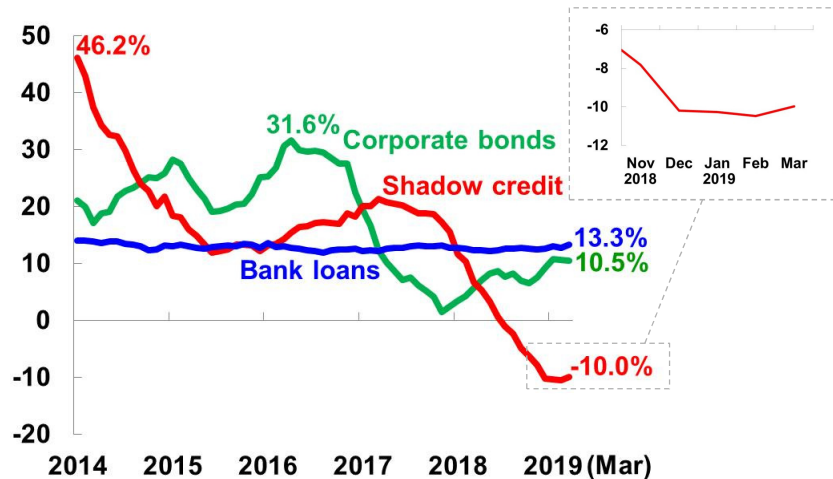
Source: CEIC

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MAINLAND CHINA: ECONOMY HAS STABILISED

Year-on-year growth of aggregate financing (%)



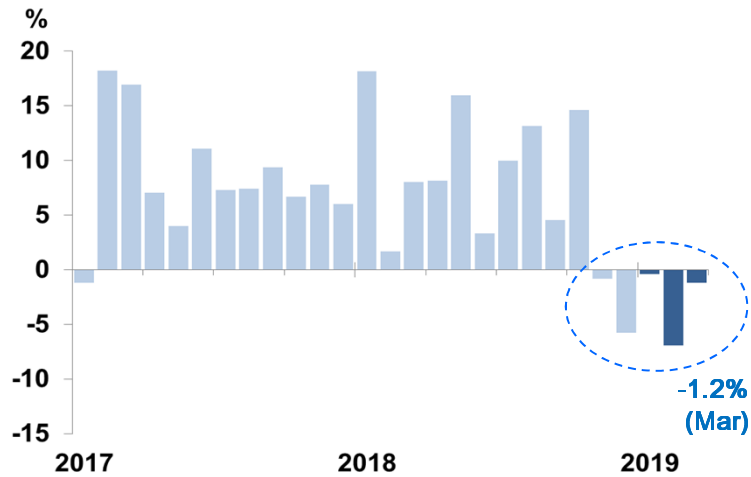
Sources: CEIC, WIND and HKMA staff estimates

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HONG KONG: UNDER THE INFLUENCE OF US-CHINA TRADE TENSIONS

Growth in value of Hong Kong's merchandise exports (% year-on-year)



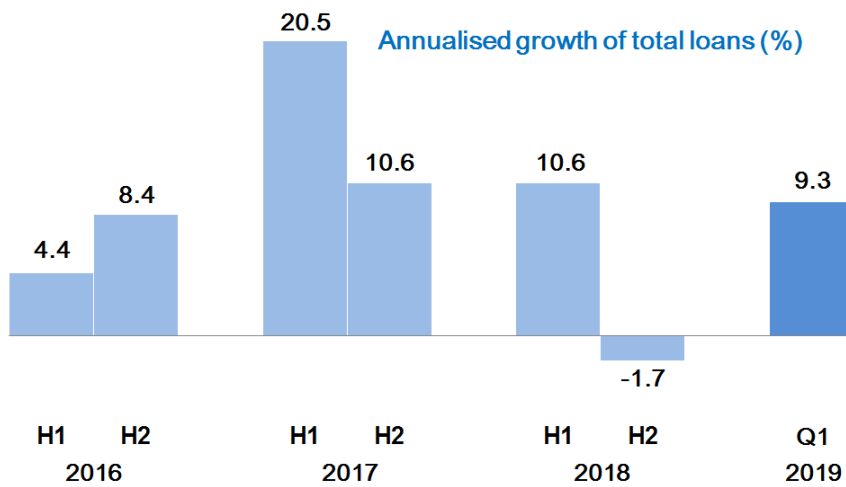
Source: Census and Statistics Department

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HONG KONG: BANK LOANS REBOUNDED

Annualised growth of total loans (%)



Source: HKMA

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GLOBAL ECONOMY: A HOST OF DOWNSIDE RISKS

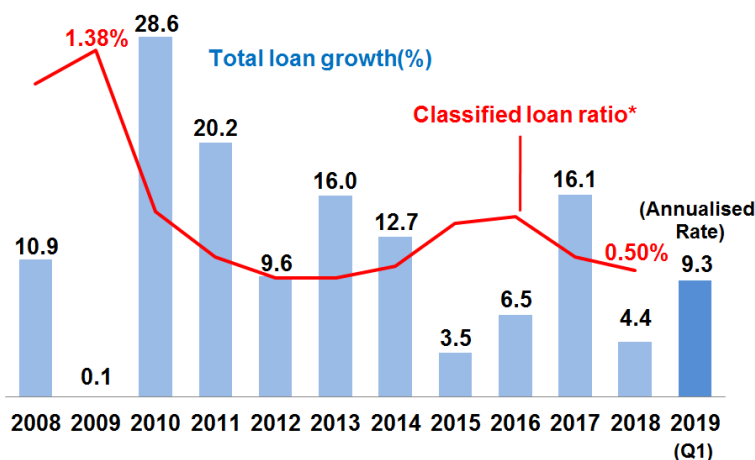
- Slowing global economic growth
- US Fed's pause in rate hikes and move to end balance sheet reduction ease the tightening pressure on global monetary environment
 - Softening US dollar reduces capital outflow pressure faced by emerging markets
 - Support for high valuation in financial markets in the short term
- Potential risks not to be underestimated
 - Despite progress in US-China trade talks, differences abound in technology and other aspects
 - Risks of a hard Brexit remain
 - Talks on North Korea denuclearisation yet to make any progress
 - Increasing geopolitical risks in Venezuela, Ukraine, the Middle East, Libya and other regions

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

Asset quality stayed at healthy levels



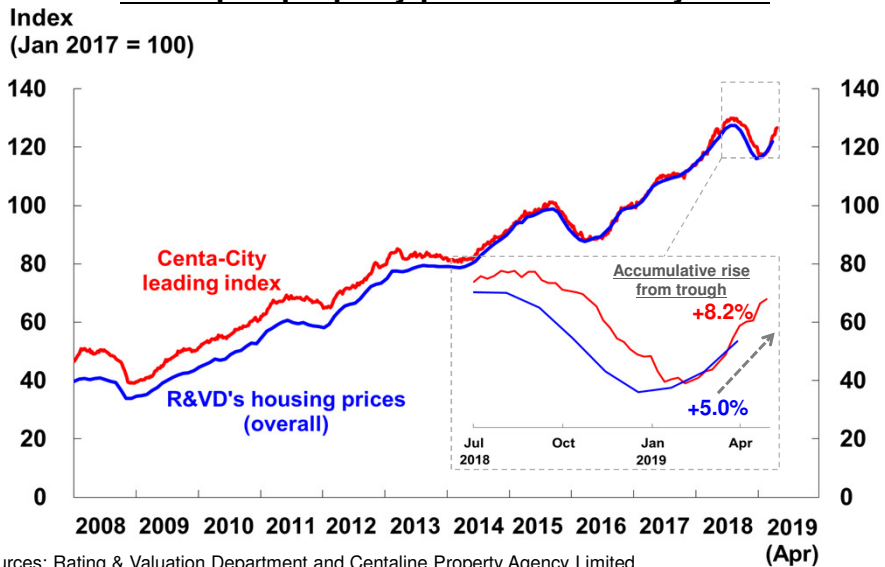
Note: * Classified loan ratio covers only retail banks. Classified loan ratio for 2018 denotes figure for Q4.
Source: HKMA

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

Pick-up in property prices since early 2019

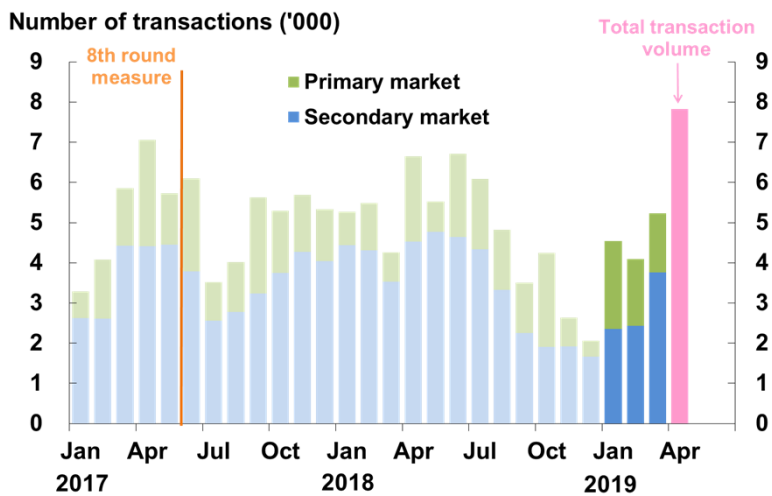


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ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Vibrant trading activity since early 2019



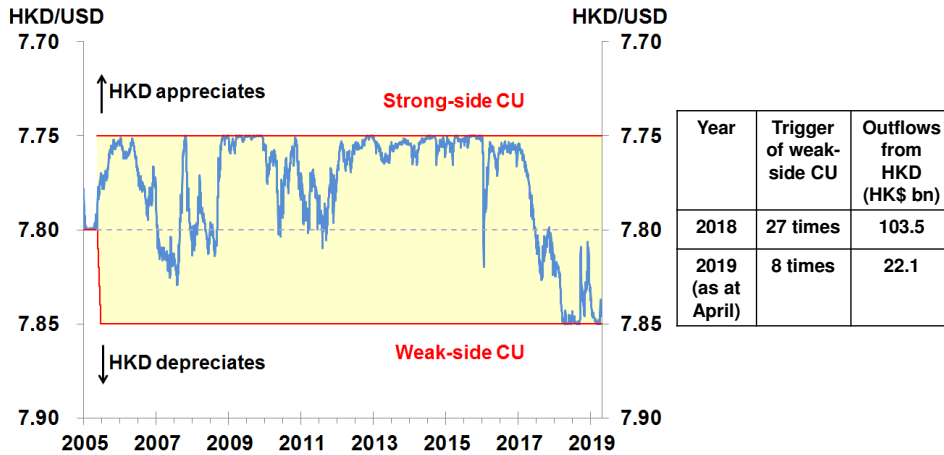
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ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: HKD STABILITY

HKD close to the 7.85

weak-side Convertibility Undertaking recently



Source: HKMA

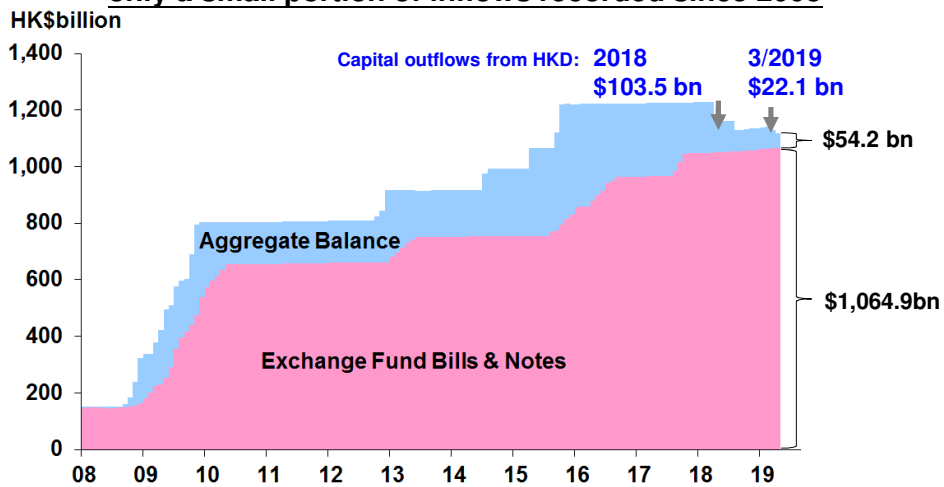
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ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: A ROBUST MONETARY BASE

Capital outflows accounted for

only a small portion of inflows recorded since 2008



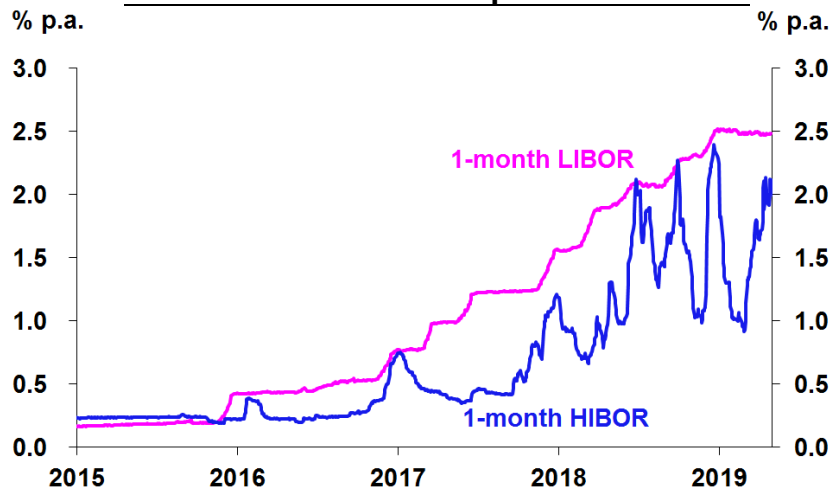
Source: HKMA

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ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: HKD & USD INTEREST RATES

HKD-USD interest rate spreads narrowed



Source: HKMA

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

- Despite a slowing global economic growth, the Fed's pause in rate hikes and move to end balance sheet reduction will help ease downward pressure
- However, potential risks must be heeded as volatilities in financial markets may resume
- While Hong Kong's economy and financial markets will be affected by external factors, our financial system is robust and resilient
- Property market has rebounded after some brief corrections, so there are uncertainties in cyclical changes
- The public should make preparations and manage risks properly to address market volatilities

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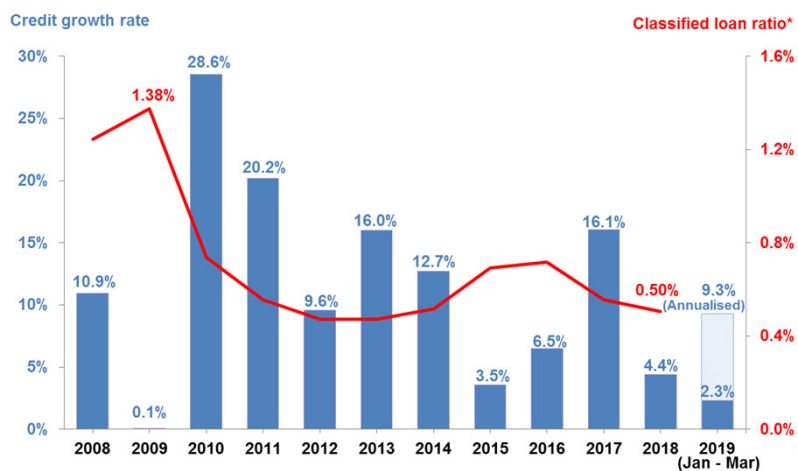
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BANKING SECTOR PERFORMANCE

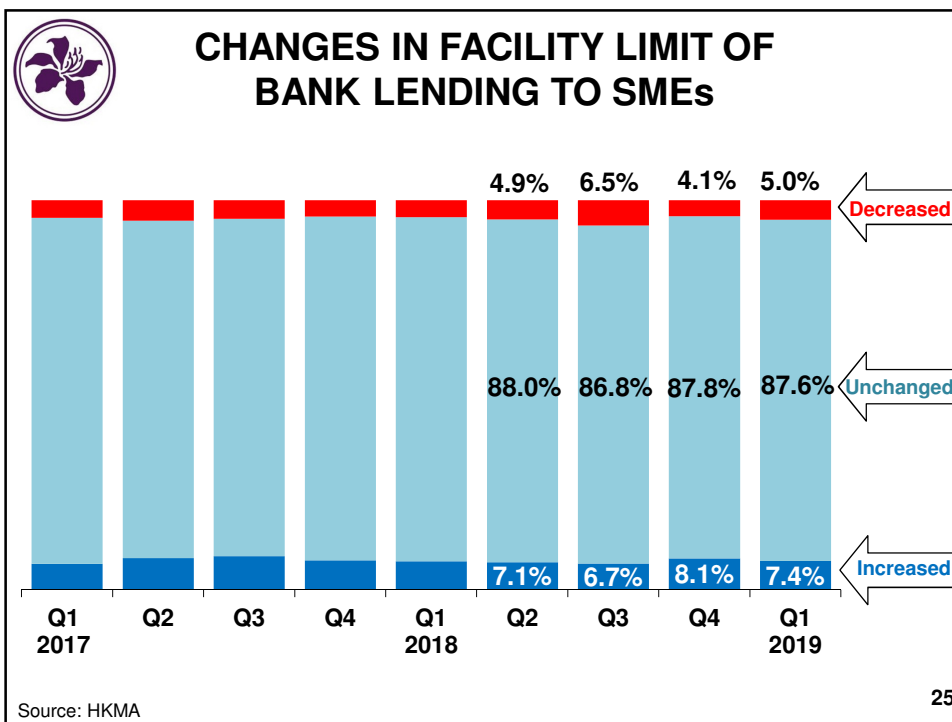
Total loans grew at a moderate pace,
with asset quality staying at a healthy level



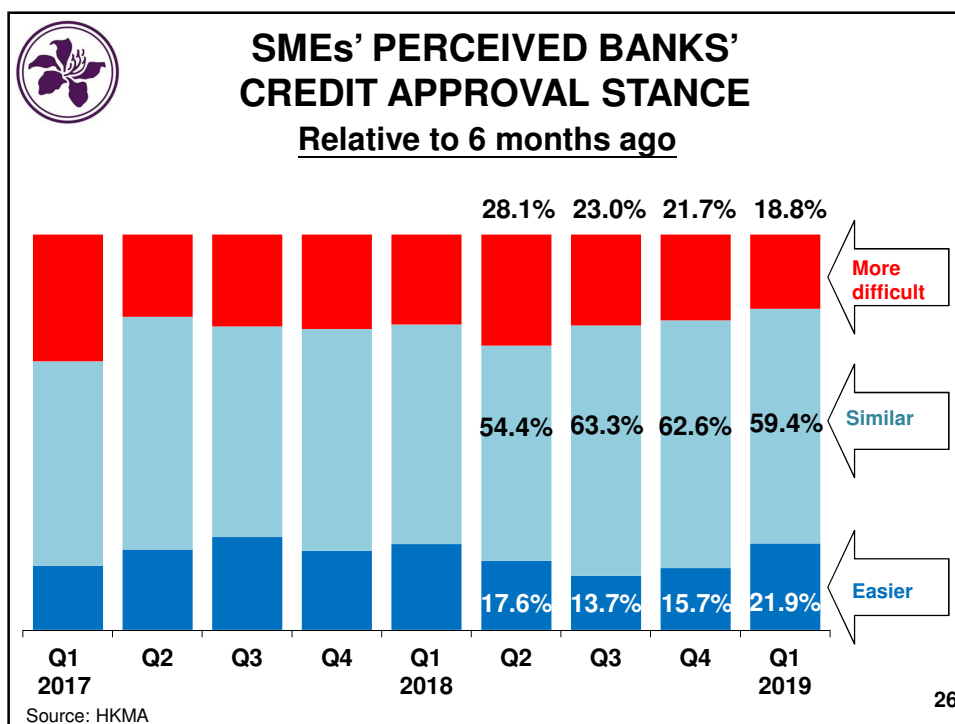
Note: * Classified loan ratio of retail banks

Source: HKMA

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LEGISLATIVE WORK

International Standards

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

Resolution Regime

- The Inland Revenue (Amendment) Ordinance 2019 commenced operation on 15 February 2019
- The finalised Financial Institutions (Resolution) Ordinance (FIRO) code of practice chapter in relation to the rules on loss-absorbing capacity requirements was published on 20 March 2019
- Continue to operationalise the FIRO by progressing other secondary legislation

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VIRTUAL BANKING

- The HKMA announced the granting of four virtual banking licences, and is making good progress in the processing of the remaining applications which have been shortlisted for detailed due diligence
- The virtual banks expected that services can be launched within six to nine months after the granting of licence. They are now actively conducting the preparatory work for the commencement of business

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FASTER PAYMENT SYSTEM (FPS)

- FPS adoption continued to grow. As of 30 April 2019:
 - Registrations: 2.7 million
 - Transaction value: HK\$272 billion
 - Transaction number: 14 million
 - Average daily transaction value: HK\$1.3 billion
 - Average daily transaction number: 63,000

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STORED VALUE FACILITIES (SVFs)

- SVF usage continued to grow in Q4 2018:
 - Accounts in use: 56.1 million (+20.1% year-on-year (yoy))
 - Average daily transaction number: 17.8 million (+9.7% yoy)
 - Average daily transaction value: HK\$523 million (+24.4% yoy)
- SVF licensees continue to extend their business reach, e.g. cross-border remittance and retail payments, public transport and small merchants
- SVF Security 2.0
 - Enhancements in SVF account structure and account opening
 - Completed industry consultation and finalising way forward

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LATEST FINTECH INITIATIVES

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

- Over 300 registrations from third-party service providers were recorded to access banks' Phase I Open APIs
- Phase II implementation underway

Global Financial Innovation Network (GFIN)

- The HKMA is a founding member of GFIN, which was launched in January 2019
- Processing applications for cross-border testing of fintech products

Fintech Career Accelerator Scheme 2.0

- 175 gap year placement positions to be offered by 18 banks and three stored value facility operators

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INTEREST RATE BENCHMARKS

- Continue to work with the Treasury Markets Association (TMA) on development of an alternative reference rate for HIBOR. TMA has proposed Hong Kong Dollar Overnight Index Average (HONIA) as the alternative rate, and is conducting a consultation with the industry on some technical refinements to HONIA
- TMA will also engage the industry on promoting the use of HONIA in their day-to-day transactions
- Continue to closely monitor benchmark reforms in other major jurisdictions, in particular possible discontinuation of LIBOR after end-2021. The HKMA issued a letter to banks in March reminding them to start early assessment of risks and implications on their operation arising from the reforms, and develop plans to ensure a smooth transition

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RMB BUSINESS / GREATER BAY AREA

- Bond Connect is operating smoothly, with over 840 investors having registered. Daily turnover reached RMB5.7 billion in the first four months of this year, as RMB bonds are included into a major international index by phases
- RMB deposit pool remained stable at around RMB650 billion in the first quarter of 2019. Daily average turnover of RMB RTGS system reached a high level of about RMB1,100 billion
- The Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area was promulgated in February. Financial facilitation measures under the Bay Area have been rolled out, including use of Hong Kong e-wallets for cross-border payments and pilot scheme to open Mainland bank accounts under streamlined process. The HKMA will continue to work with Mainland authorities to study other financial facilitation measures

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PROMOTING GREEN FINANCE

- Co-organised with Climate Bond Initiative (CBI) the launch of Hong Kong Green Bond Market Briefing Report in February 2019
 - This is the first time that the CBI publishes a report on Hong Kong green bond market and the report shows that Hong Kong market has been growing robustly. In 2018, green bonds arranged and issued in Hong Kong totalled US\$11 billion, more than three times the amount in 2017
- Taking forward the preparatory work for implementation of the Government Green Bond Programme
- Planning more measures to further promote Hong Kong's green finance platform
 - To organise the Green Finance Forum on 7 May
 - To co-organise the Sixth Climate Business Forum with International Finance Corporation in Hong Kong in early 2020

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INVESTMENT INCOME

| | 2019 | 2018 | 2017 |
|----------------------------|--------------|---------------|--------------|
| | (unaudited) | | |
| (HK\$ billion) | Q1 | Full Year | Full Year |
| Bonds | 36.7 | 57.4 | 34.4 |
| Hong Kong equities* | 20.8 | (20.7) | 58.3 |
| Other equities | 49.9 | (38.7) | 80.4 |
| Foreign exchange# | 13.5 | (9.0) | 53.5 |
| Other investments@ | - | 21.9 | 37.4 |
| Investment income | 120.9 | 10.9 | 264.0 |

* 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. Valuations of these investments for the first quarter of 2019 are not yet available.

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INCOME AND EXPENDITURE

| | 2019 | 2018 | 2017 |
|---|--------------|---------------|--------------|
| | (unaudited) | | |
| (HK\$ billion) | Q1 | Full Year | Full Year |
| Investment income | 120.9 | 10.9 | 264.0 |
| Other income | - | 0.2 | 0.2 |
| Interest and other expenses | <u>(5.3)</u> | <u>(17.9)</u> | <u>(9.9)</u> |
| Net income/(loss) | 115.6 | (6.8) | 254.3 |
| Fee payment to Fiscal Reserves*# | (7.7) | (60.2) | (46.2) |
| Fee payment to HKSAR government funds and statutory bodies* | (2.2) | (13.8) | (8.6) |

* The rate of fee payment is 2.9% for 2019, 4.6% for 2018 and 2.8% for 2017.

This does not include the 2019 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2019 is available.

(The composite rate was 6.1% for 2018 and 9.6% for 2017. Fee payable to the Future Fund was HK\$16.4 billion for 2018 and HK\$22.7 billion for 2017.)