

香港特別行政區政府
財經事務及庫務局
財經事務科
香港添馬添美道二號
政府總部二十四樓



FINANCIAL SERVICES BRANCH
FINANCIAL SERVICES AND
THE TREASURY BUREAU
GOVERNMENT OF THE HONG KONG
SPECIAL ADMINISTRATIVE REGION

24TH FLOOR
CENTRAL GOVERNMENT OFFICES
2 TIM MEI AVENUE
TAMAR
HONG KONG

電話 TEL.: 2810 3075

圖文傳真 FAX.: 2527 0790

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Mr Boris Lam
Legislative Council Complex
1 Legislative Council Road
Central Hong Kong

26 February 2021

Dear Mr Lam,

**Legislative Council Panel on Commerce and Industry
Subcommittee on Issues Relating to the Stimulation of
Hong Kong's Economy**

Follow-up to meeting on 29 January 2021

Thank you for your letter of 2 February 2021 relating follow-up actions raised by the Subcommittee on Issues Relating to the Stimulation of Hong Kong's Economy. Please find the attached response, in consultation with the Hong Kong Monetary Authority, to item (b) in the "List of follow-up actions arising from discussion" in relation to the Exchange Fund.

A handwritten signature in blue ink, appearing to be 'Norris Chan'.

(Norris Chan)

For Secretary for Financial Services and the Treasury

cc. Secretary for Financial Services and the Treasury

(Attn: Ms Rico TAM)

Legislative Council Panel on Commerce and Industry
Subcommittee on Issues Relating to the Stimulation of
Hong Kong's Economy

Follow-up to meeting on 29 January 2021

Item (b) – Exchange Fund

The Exchange Fund's ("EF") primary objective, as laid down in the Exchange Fund Ordinance, is to maintain the stability of the currency of Hong Kong and the stability and integrity of Hong Kong's monetary and financial systems. Underpinned by such purpose, the EF has played a crucial role in helping Hong Kong weather various banking and financial crises in the past few decades. The mechanism under which the accumulated surplus of the Exchange Fund can be used to meet operating and contingency requirements of the Government, as may be considered by the Financial Secretary and authorized by the Chief Executive in Council, are also set out in Section 8 of the EF Ordinance.

2. Due to the unpredictability of the global financial markets, the EF must maintain a considerable scale and high level of liquidity to maintain the market and the public's confidence in the ability of the EF to combat external shocks or speculative attacks, as well as to safeguard the stability of the financial system.

3. The total assets of the EF currently stood at around HK\$4,500 billion. Accumulated surplus only amounted to HK\$850 billion, after taking into account the liabilities of the EF.¹ Reducing the amount of the accumulated surplus substantially will undercut the ability of the EF to perform its main function to defend the financial stability of Hong Kong.

¹ Figures as at the end of December 2020.

4. The size of the accumulated surplus is subject not only to market conditions and investment performance, but also the level of fee payment to placements by the Government, which is based on the average annual rate of return of the EF's Investment Portfolio for the past six years. In any financial year with a negative or insufficient investment income, the EF would need to make use of its accumulated surplus to fulfil its fee payment obligations to the Government, meaning that the accumulated surplus would shrink, such as in the years 2015 and 2018. The decision to alter payment arrangements to the Government should not be taken lightly; instead, such mechanism should be strictly adhered to in order to ensure prudent risk management of EF investments.

5. In considering whether it is necessary to deploy the EF's accumulated surplus to support the economy, the Government should very carefully consider the impact of the use of the EF's surplus on the financial stability of Hong Kong, and the ability to maintain Hong Kong as an international financial centre. This will hinge on a number of factors, including the prevailing macroeconomic conditions, the ability to maintain the stability of the Hong Kong dollar, public confidence in and market perception of the ability of the Government to maintain monetary and financial stability after the deployment of funds, etc. It is not desirable to link this decision to the investment results of the EF, which can vary significantly year to year during turbulent market times like right now.

**Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
February 2021**