



HONG KONG MONETARY AUTHORITY

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

7 February 2022

[Translation]



HONG KONG MONETARY AUTHORITY

- The Hong Kong Monetary Authority (HKMA)'s main functions are:
 - To maintain currency stability within the framework of the Linked Exchange Rate System
 - To promote the stability and integrity of the financial system, including the banking system
 - To help maintain Hong Kong's status as an international financial centre, including the maintenance and development of Hong Kong's financial infrastructure
 - To manage the Exchange Fund

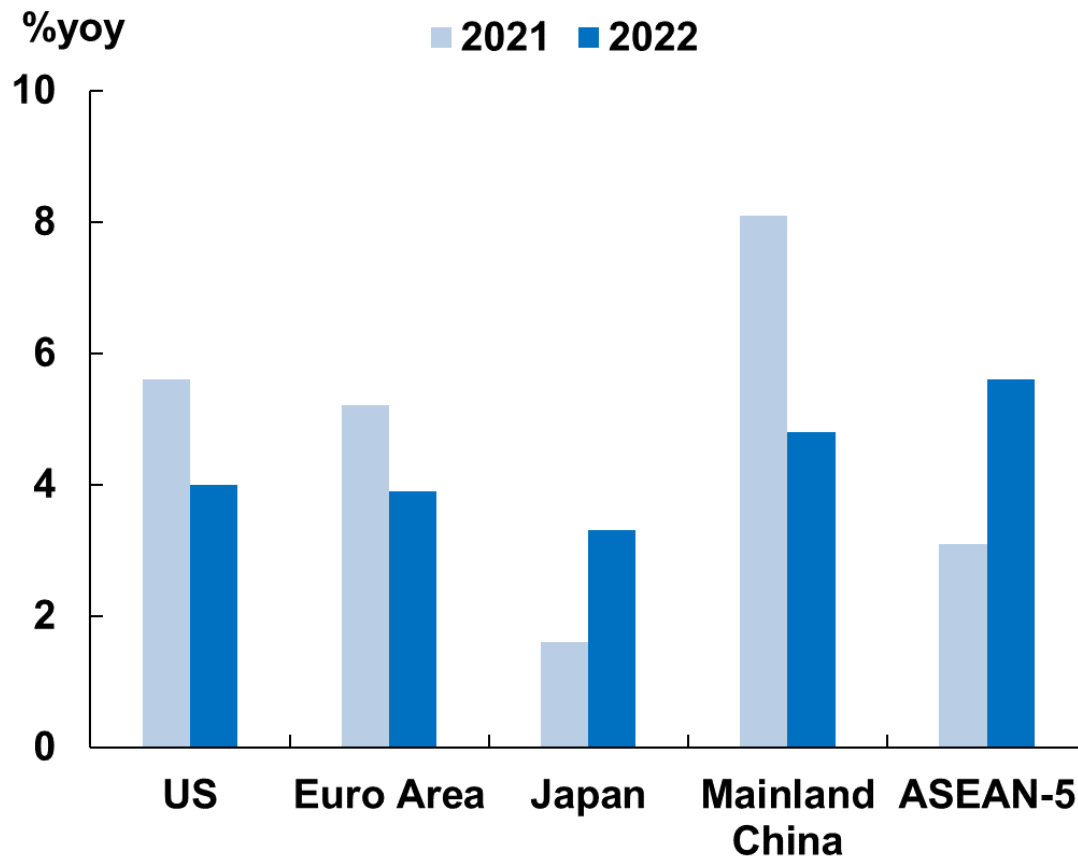


- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Development of Financial Market
4. Financial Infrastructure
5. Investment Performance of the Exchange Fund
6. Hong Kong Mortgage Corporation



GLOBAL RECOVERY TO CONTINUE THIS YEAR

IMF's GDP growth projections

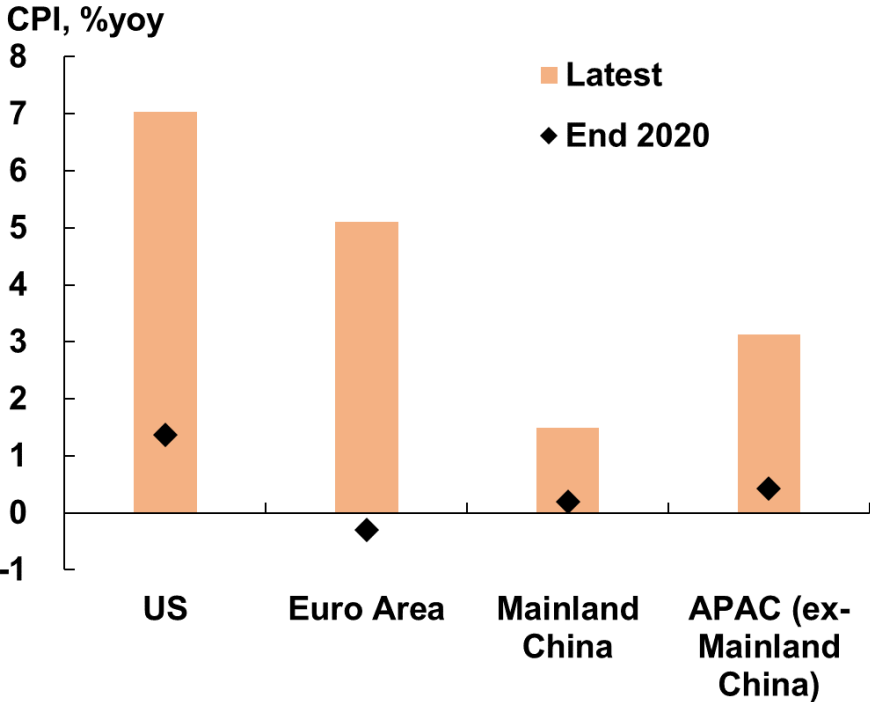


Source: International Monetary Fund



US FED IS EXPECTED TO BEGIN RATE HIKES SOON

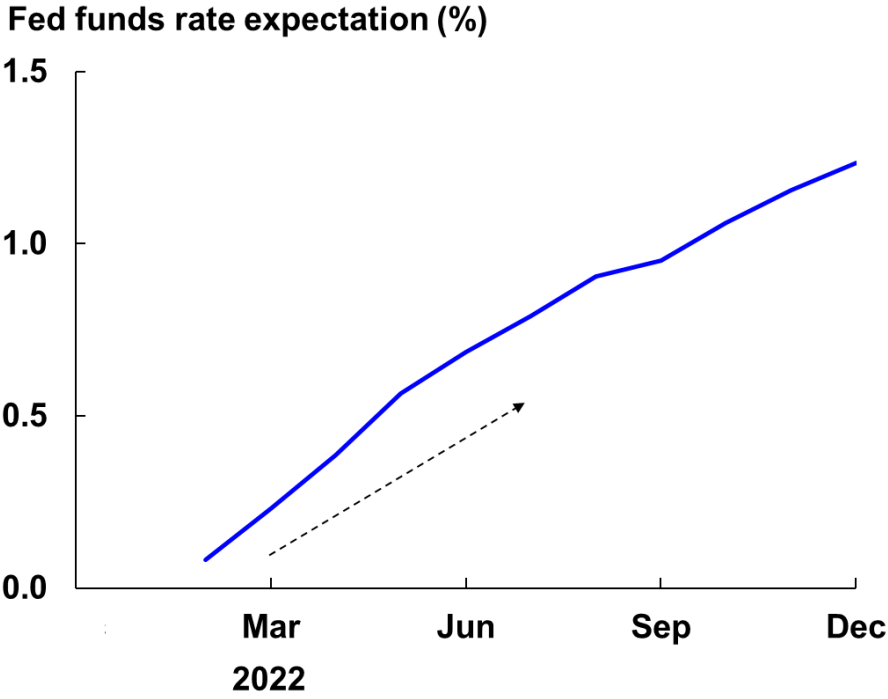
More pronounced inflationary pressures in the US



Note: Data as of January 2022 for Euro Area and end-2021 for the rest. Data for the Asia Pacific (APAC) region (excluding Mainland China) are taken as the simple average of: Australia, Hong Kong, Indonesia, Japan, New Zealand, Malaysia, the Philippines, Singapore, South Korea and Thailand.

Source: CEIC

Market expects the US Fed to begin rate hikes soon



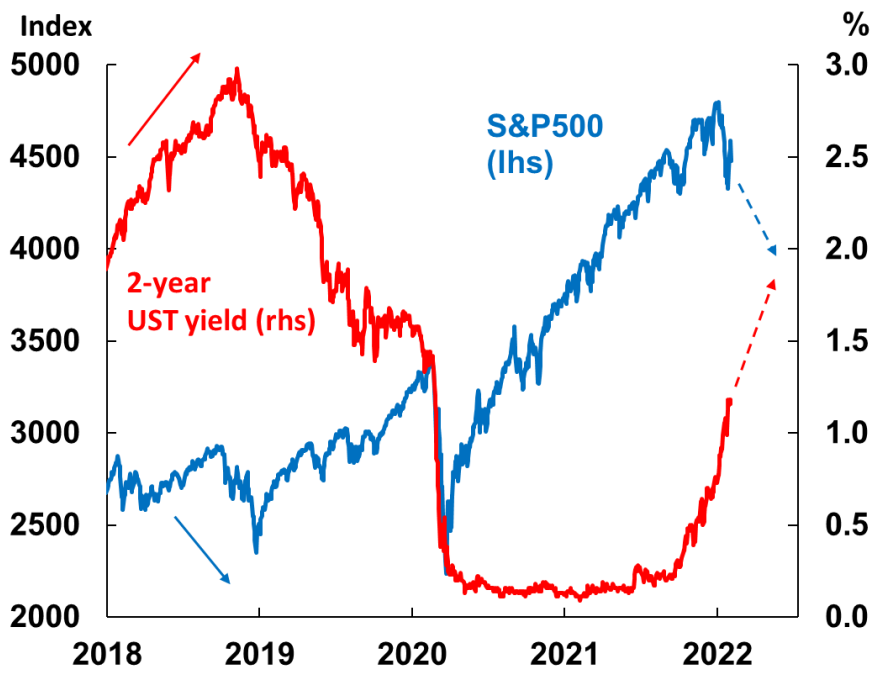
Note: Market expectations as of 3 February 2022.

Source: Datastream



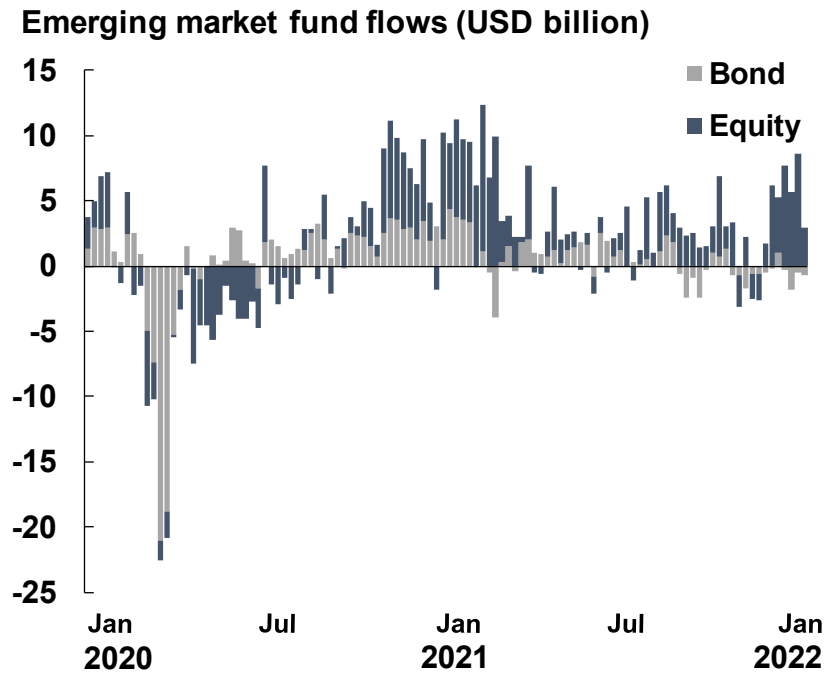
GLOBAL FINANCIAL CONDITIONS WILL TIGHTEN...

Rising interest rate may trigger financial market volatility



Source: St. Louis Fed

Possible outflows from emerging market economies



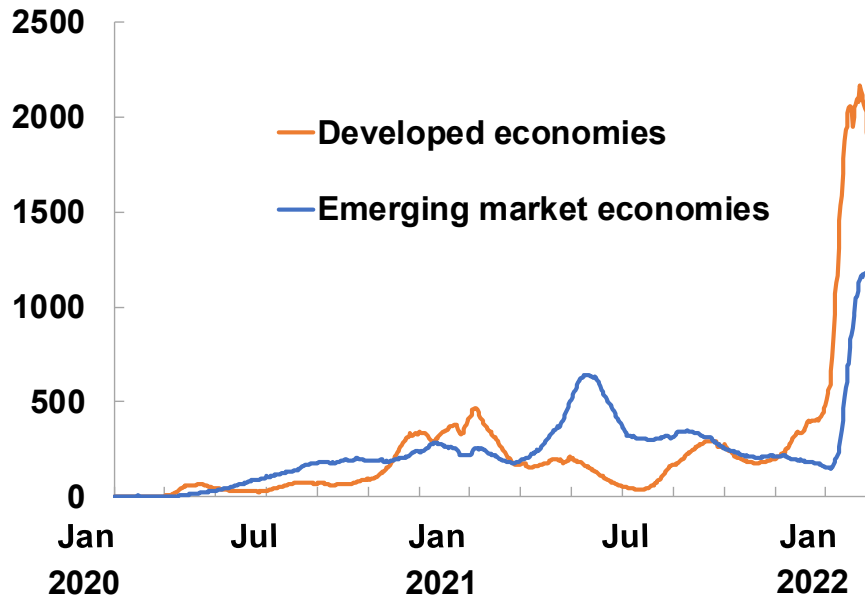
Source: EPFR



...ADDING PRESSURE ON THE GLOBAL ECONOMY, ESPECIALLY EMEs, AS PANDEMIC CONTINUES

Global pandemic continues as mutant viruses spread

No. of new infection cases recorded daily ('000 cases, 7-day moving average)



Note: Developed economies include 35 economies while emerging market economies include 85 economies, such as Mainland China, Russia, India and Brazil.

Source: Our World in Data

Slow vaccination progress in some emerging market economies (EMEs)

Vaccination rate (per 100 persons)	
Mainland China	87.7
Brazil	79.9
India	67.9
Indonesia	66.8
Russia	52.6
The Philippines	50.5
South Africa	32.7

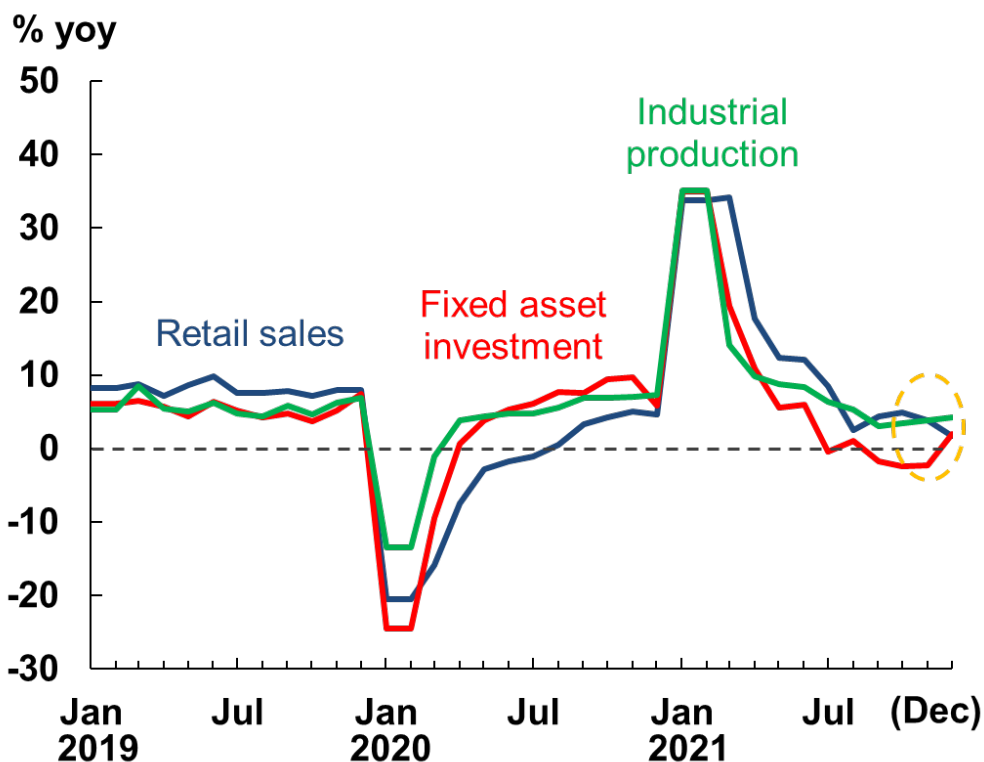
Note: Vaccination rate per 100 persons refers to the proportion of the population who have received at least one dose of vaccine.

Source: Our World in Data



MAINLAND CHINA POLICIES FOCUS ON GROWTH STABILISATION

Economic activities have stabilised somewhat recently



Growth stabilisation as policy focus this year

Policy direction and measures

Fiscal policy

- Accelerate spending and infrastructure investment
- Implement new tax and fee reduction policies

Monetary policy

- Prudent and flexible; keeping liquidity adequate at a reasonable level
- Support small and micro enterprises, technological innovation and green development

Property market

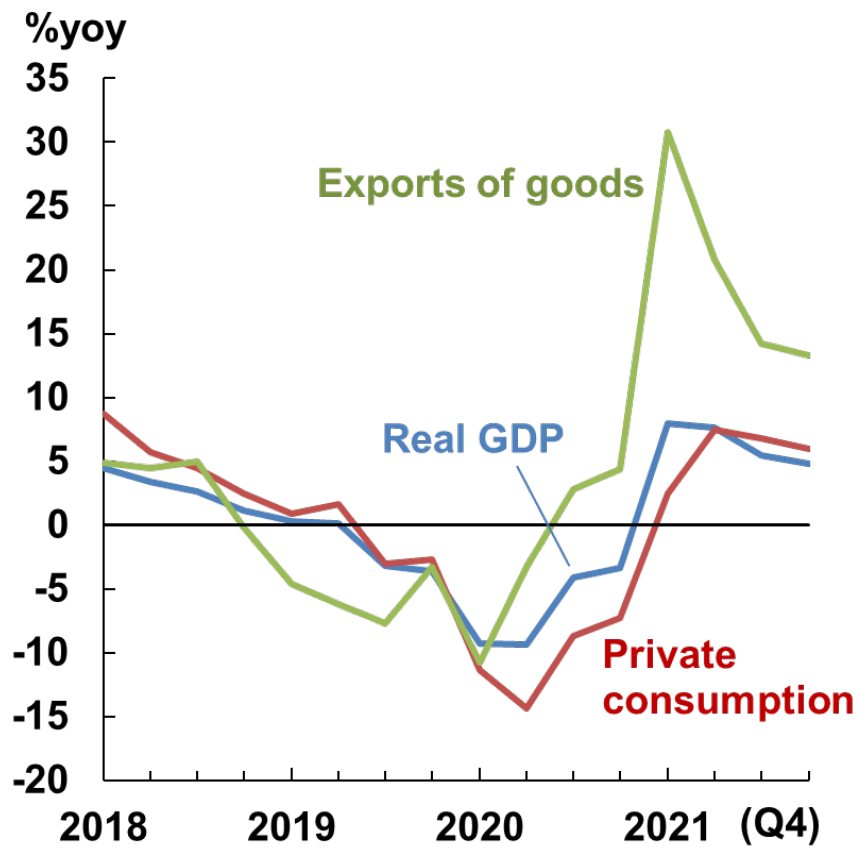
- Houses “are for living in, not for speculation”; to better meet reasonable housing needs
- Promote a virtuous circle in the sector

Source: National Bureau of Statistics of China



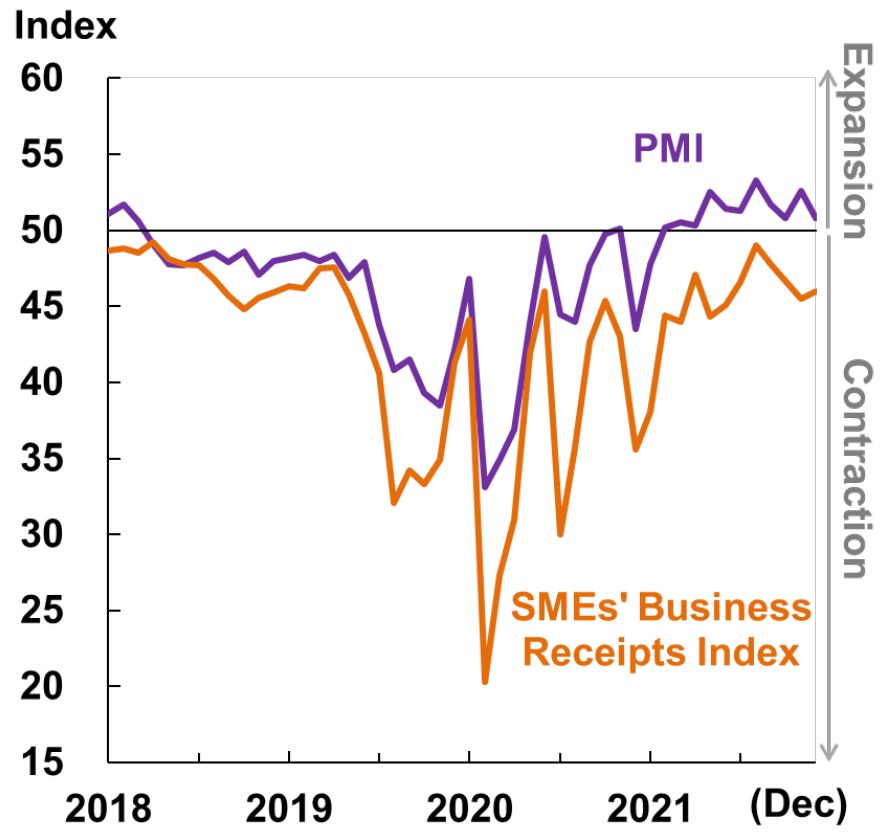
NEW WAVE OF INFECTIONS EXERT PRESSURES ON HONG KONG RECOVERY

Economic activities are expected to slow



Source: C&SD

Business sentiment faces challenges from new wave of infections

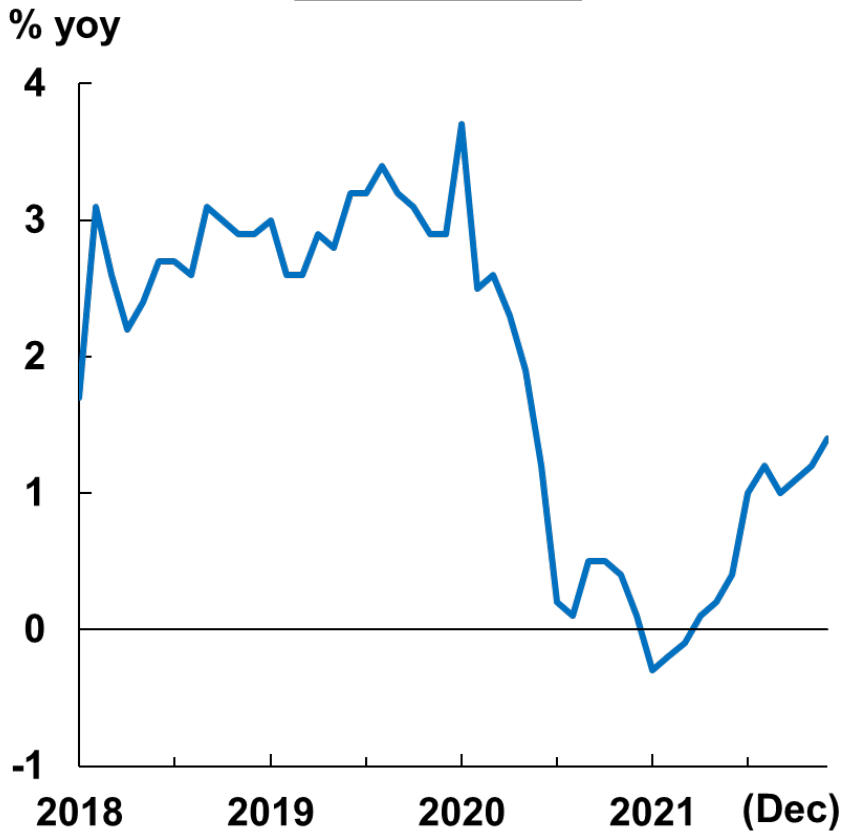


Sources: C&SD and IHS Markit

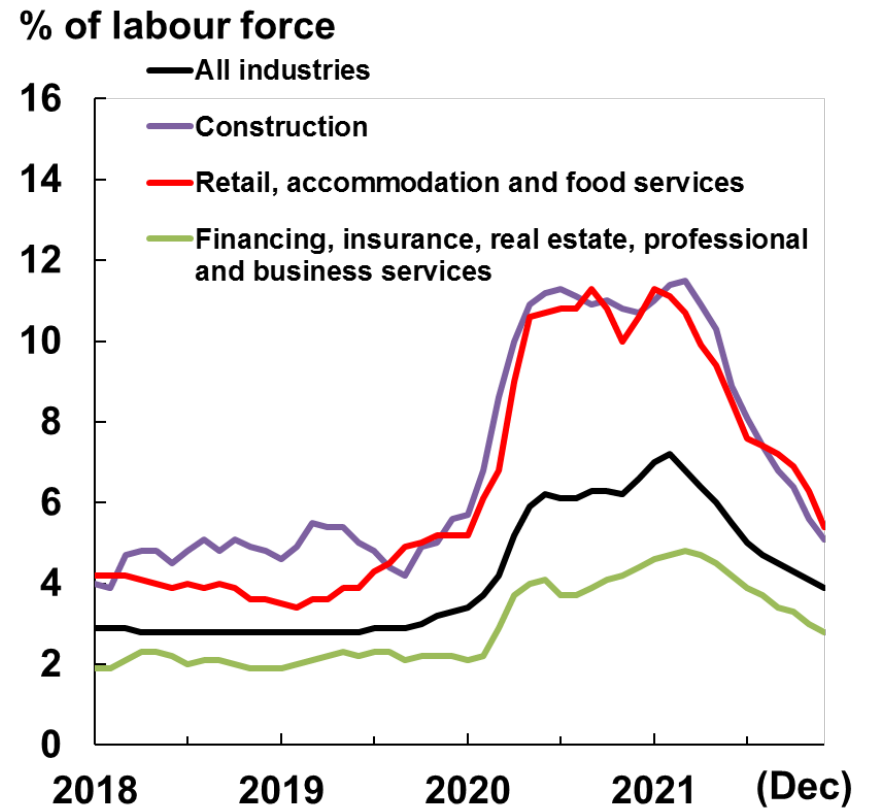


MILD INFLATIONARY PRESSURE WHILE JOB MARKET HAS NOT FULLY RECOVERED

Modest increase in underlying inflation rate

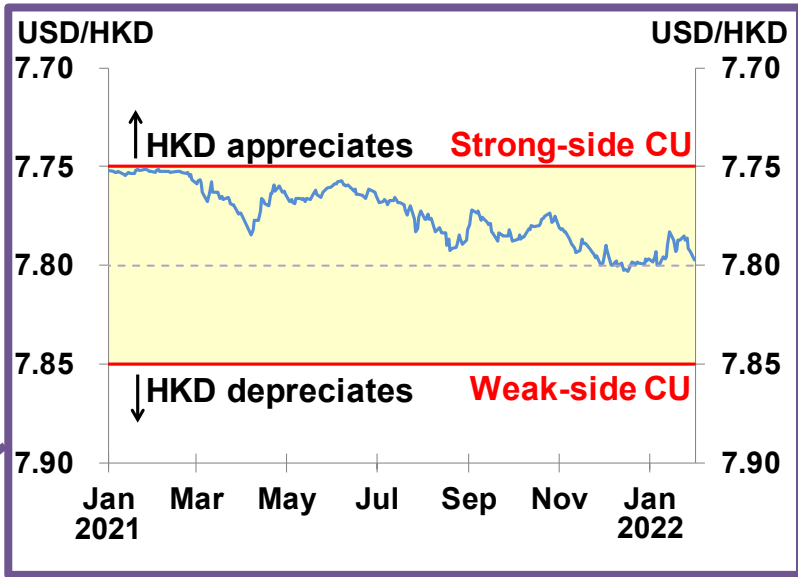
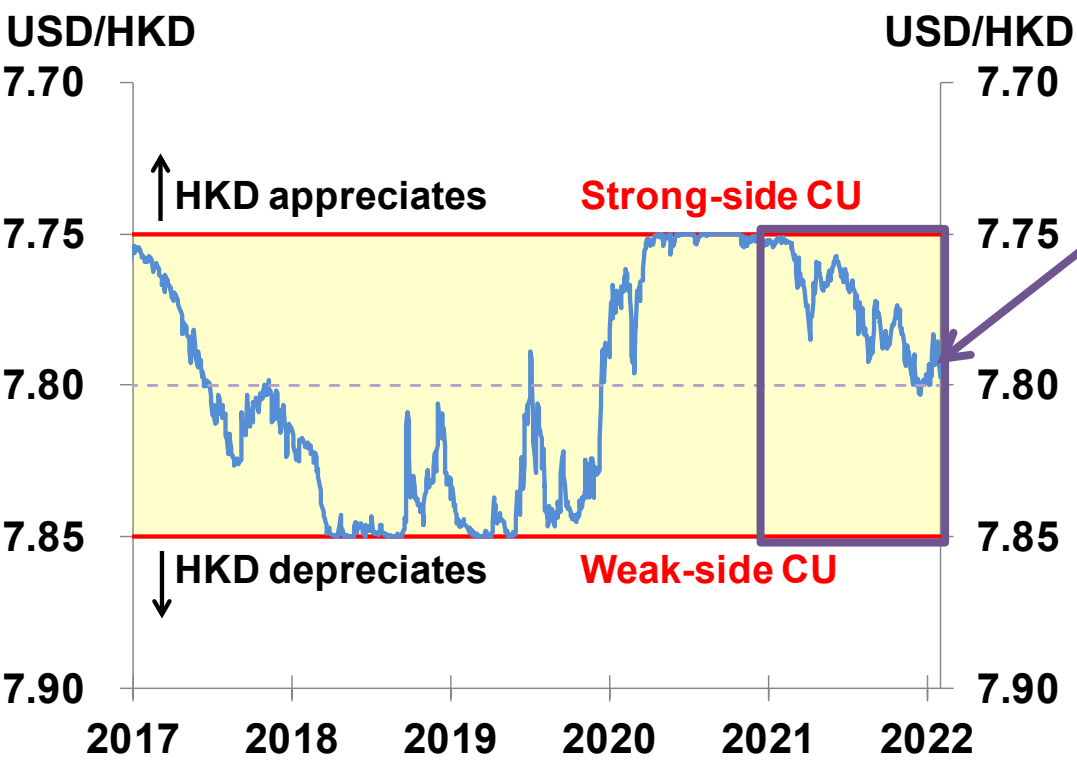


Unemployment rate yet to return to pre-pandemic level





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



Year	Trigger of Weak-side CU	Outflows from HKD (HK\$ bn)
2018 Apr - Aug	27 times	103.5
2019 Jan - Mar	8 times	22.1

Year	Trigger of Strong-side CU	Inflows into HKD (HK\$ bn)
2020 Apr	6 times	20.7
2020 Jun - Oct	79 times	362.8



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: BANK DEPOSITS CONTINUE TO GROW

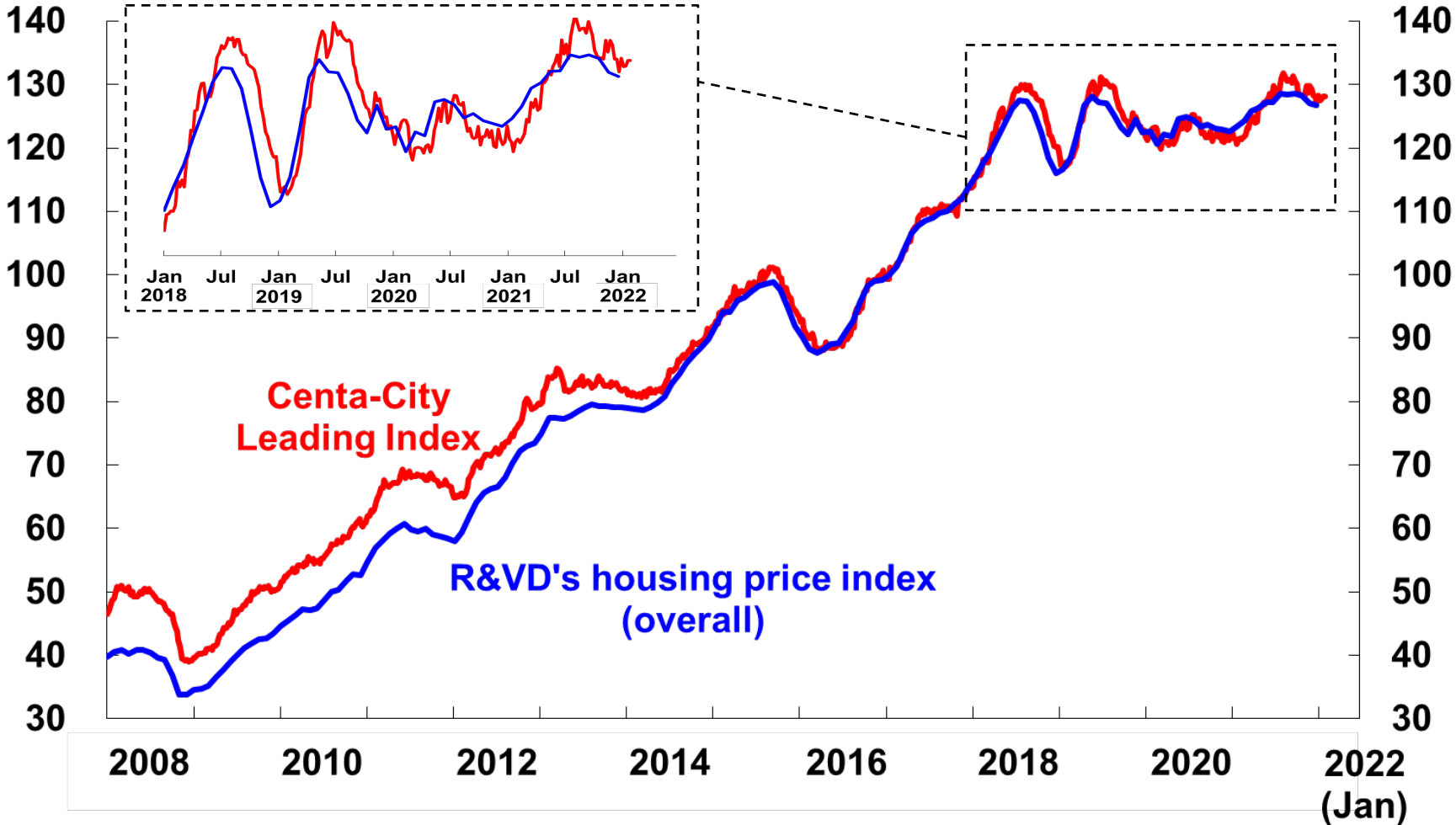
Change during the period (%)

	Total deposits	Hong Kong dollar deposits
First three quarters of 2021	3.4%	2.3%
October	0.2%	0.0%
November	0.6%	-0.1%
December	0.4%	-0.8%
Full year 2021	4.6%	1.4%



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY PRICES HOVER AT HIGH LEVELS

Index
(Jan 2017 = 100)

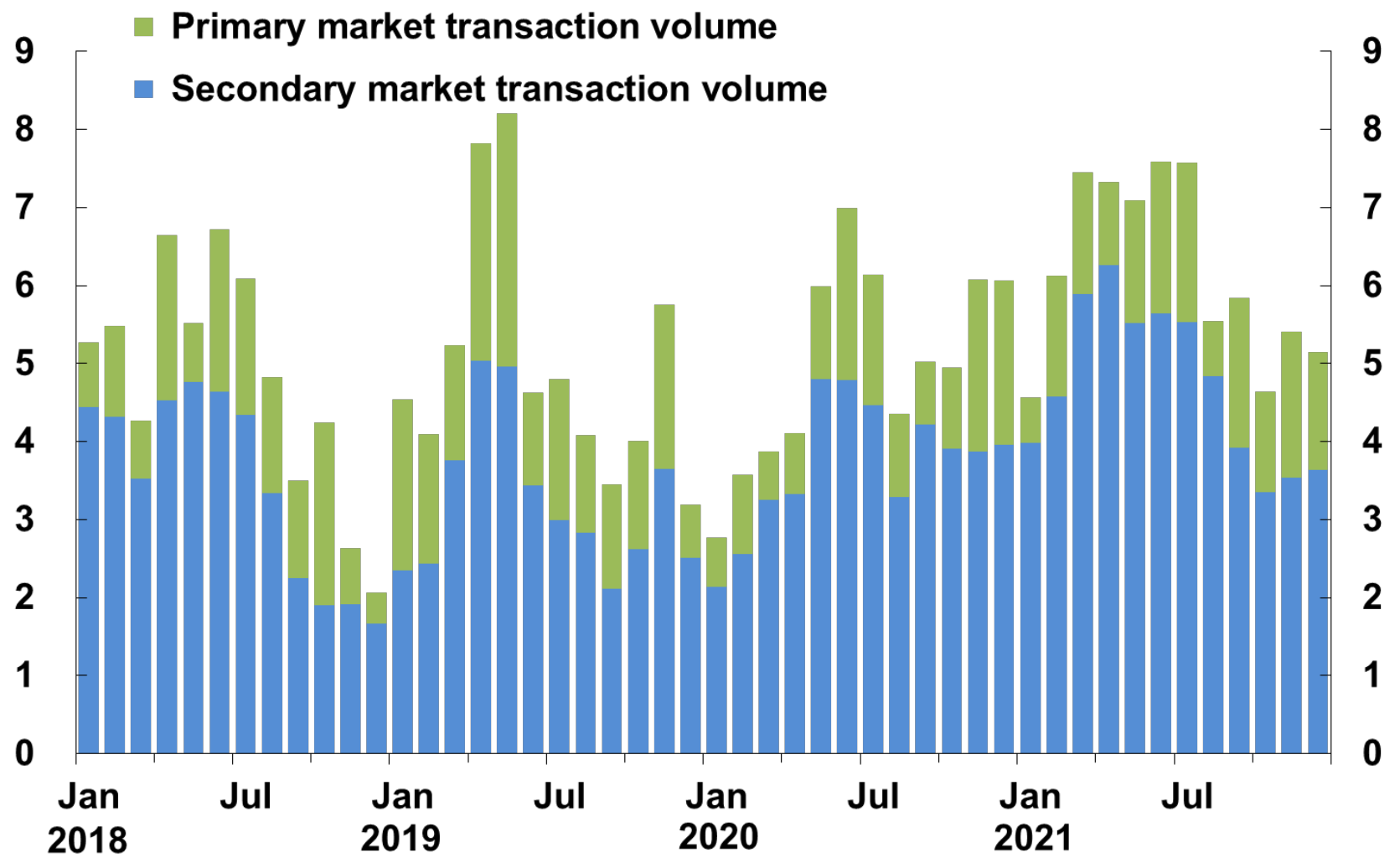


Sources: Rating and Valuation Department and Centaline Property Agency Limited



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

Number of transactions ('000)





HONG KONG'S FINANCIAL SECTOR REMAINS ROBUST

- The spread of mutant viruses has triggered renewed lockdowns in some economies, bringing uncertainties to the global economic recovery outlook
- Geopolitical risks (e.g. Ukraine) may bring shocks to global financial and energy markets
- US Fed rate hikes may trigger a reversal in fund flows, causing notable fluctuation in emerging markets and high-valuation asset markets
- While US Fed rate hikes are expected to be transmitted to HKD interest rates under the Linked Exchange Rate System, adjustment paces of local rates are unlikely to be too quick given the substantial HKD monetary base
- Hong Kong's banking sector has abundant liquidity and can cope with reversals in fund flows
- The HKMA will continue to closely monitor the market situation and safeguard monetary and financial stability in accordance with the Linked Exchange Rate System

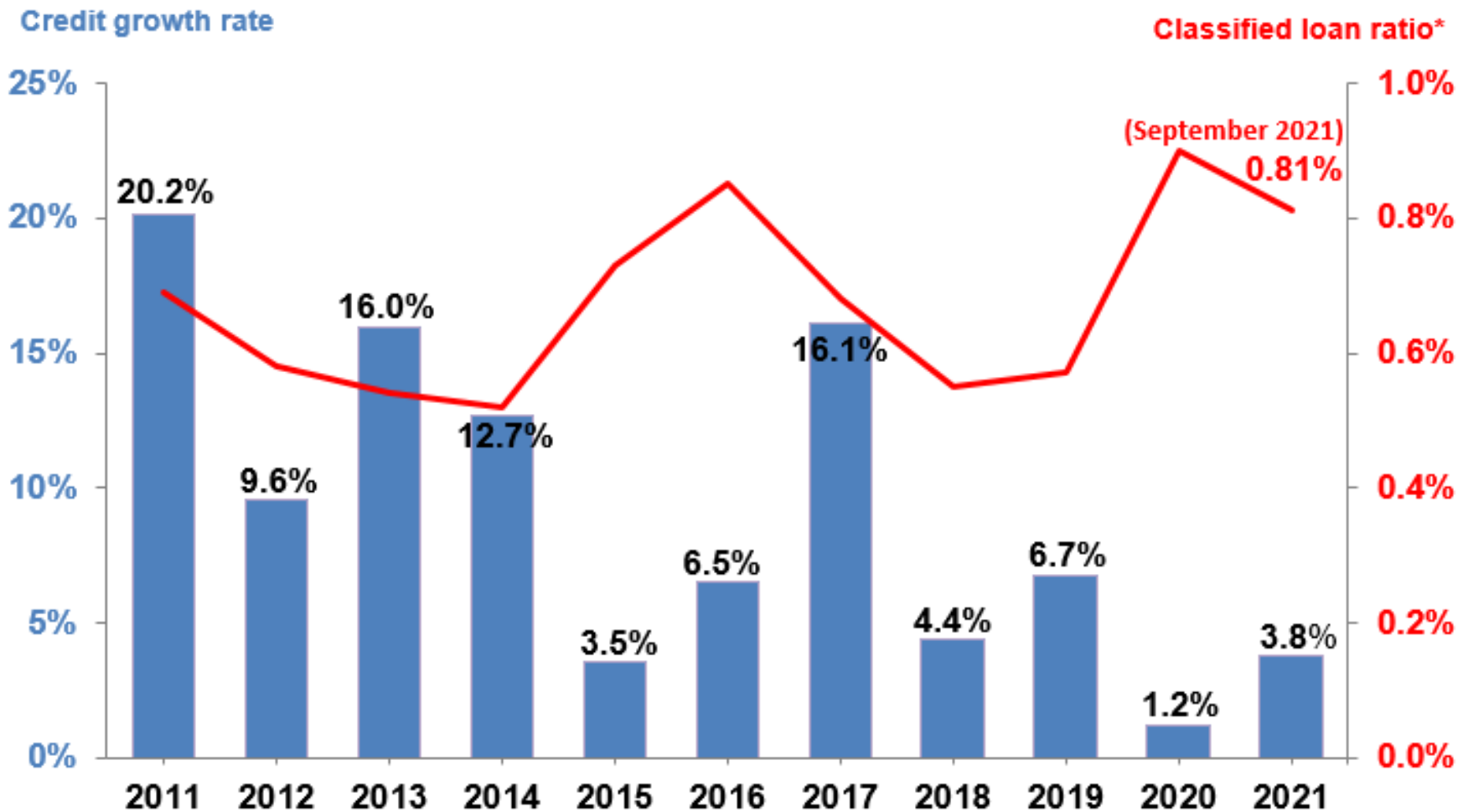


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BANKING SECTOR PERFORMANCE

Credit grew at a moderate pace,
while asset quality remains healthy



Notes: * Classified loan ratio of all authorized institutions

Source: HKMA



FIGHTING THE VIRUS AND SUPPORTING THE ECONOMY

- Aggregate number of cases involving credit relief (up to December 2021):
 - Corporate customers: 83,000 cases (HK\$920 billion)
 - Individual customers: 52,000 cases (HK\$53 billion)
- The take-up rate of the “Pre-approved Principal Payment Holiday Scheme” (Scheme) is 3%, as compared to 16% when the Scheme was first launched
- The Scheme has been in place for almost two years and is set to expire at the end of April. The HKMA and the Banking Sector SME Lending Coordination Mechanism are considering ways to strike a balance between banks’ need for prudent risk management and supporting corporates that are still hard-pressed by the pandemic



INTERNATIONAL STANDARDS IMPLEMENTATION

Basel revised capital treatment on banks' equity investments in funds

- Q1 2022: Amendments to Banking (Capital) Rules

Basel III final reforms

- Q1 2023: Amendments to Banking (Capital) Rules and Banking (Disclosure) Rules

Consequential and other technical updates

- Q1 2023: Amendments to Banking (Exposure Limits) Rules



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STRONG GROWTH IN OFFSHORE RMB BUSINESS

- Hong Kong - the largest global offshore RMB business hub:
 - Over 70% of world's RMB payments settled through Hong Kong
 - HK offshore RMB bond market grew significantly in terms of quantity and diversity (First Mainland municipal government offshore RMB bond was issued in Hong Kong by the Shenzhen government in October 2021)
- In 2021, offshore RMB business in Hong Kong registered solid growth

(RMB bn)	2021	2020	Growth
RMB deposits (incl. outstanding Certificates of Deposit)	944.7	757.2	25%
Offshore RMB bond issuance (Total amount during the year)	109.6	58.6	87%
Outstanding RMB loans	163.6	152.1	8%
RMB Real Time Gross Settlement (RTGS) Turnover (daily average)	1,522.6	1,191.5	28%



MUTUAL MARKET CONNECT SCHEMES

- **Stock Connect** trading activities continued to register strong growth:

Stock Connect Average Daily Turnover	2021	2020	YoY growth
Shanghai-HK (Northbound) (RMB bn)	55.2	39.1	+41%
Shenzhen-HK (Northbound) (RMB bn)	65.0	52.2	+24%
Shanghai-HK (Southbound) (HKD bn)	20.1	13.1	+53%
Shenzhen-HK (Southbound) (HKD bn)	21.6	11.3	+91%

- **Northbound Trading under Bond Connect** continued to see active trading. Average daily turnover amounted to RMB25.8 billion in 2021, up 34% compared to 2020
- **Southbound Trading under Bond Connect** launched in September 2021, facilitating the two-way opening up of the Mainland bond market and growth of the Hong Kong bond market in the long run. Smooth operations since launch and well received by market
- **Cross-boundary Wealth Management Connect** launched in October 2021. As at end-January 2022, 24 Hong Kong banks are eligible to commence services with their Mainland partner banks, laying a solid foundation for steady development of the scheme



DEVELOPING HONG KONG'S FINANCIAL PLATFORM – GREEN FINANCE

- The Green and Sustainable Finance Cross-Agency Steering Group co-chaired by the HKMA and the SFC announced in December 2021 the progress made and the way forward, with focus on talent development and data-related work of the Centre for Green and Sustainable Finance, taxonomies, climate-related disclosures and sustainability reporting as well as carbon market opportunities
- The HKMA assisted the Government in successfully issuing close to US\$4 billion equivalent institutional green bonds in November 2021, covering US dollar, euro and renminbi tranches in multiple tenors and is actively working on the inaugural retail green bond issuance
- The HKMA is assisting the Government in administering the Green and Sustainable Finance Grant Scheme, which was launched in May 2021 to attract more green and sustainable financing activities to Hong Kong by covering part of the expenses on bond issuances and external review services. The scheme has been well received by the market. As at end-January 2022, over 50 applications across various kinds of green and sustainable debt instruments have been approved



CRYPTO-ASSETS AND STABLECOINS

- On 12 January, the HKMA issued a discussion paper on crypto-assets and stablecoins
- The paper sets out the HKMA's thinking on the regulation of payment-related stablecoins and invites views from the industry and public
- The policy objectives are to safeguard Hong Kong's monetary and financial stability while supporting financial innovation, with a view to complying with the relevant international regulatory recommendations



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FINANCIAL INFRASTRUCTURE : OVERVIEW

Payment systems

- Four Real Time Gross Settlement (RTGS) Systems for HKD, RMB, USD and Euro:
 - Average daily turnover in 2021 reaching HK\$940 billion, RMB1,523 billion, US\$50 billion and €0.5 billion respectively
- Faster Payment System:
 - 9.62 million registrations at end-2021; the average daily volume of Hong Kong dollar transactions in 2021 rose by 90% from 2020 to 670,000

Central Moneymarkets Unit (CMU)

- Providing settlement and custodian service for debt securities
 - HK\$2,211 billion equivalent outstanding debt securities lodged with CMU at end-2021
- Supporting Bond Connect
 - 3,233 institutional investors at end-2021; RMB26 billion average daily turnover in 2021 for Northbound Trading

Hong Kong Trade Repository: maintains an electronic database of over-the-counter derivative transactions

- 3,251,179 outstanding transactions at end-2021

New fintech initiatives

- E.g. Commercial Data Interchange, Multiple Central Bank Digital Currency (CBDC) Bridge (mBridge) project



LATEST FINTECH INITIATIVES

- Guangdong-Hong Kong-Macao Greater Bay Area (GBA) Fintech Innovation Supervisory “Network Link-up”
- Considerable progress made on initiatives under the “Fintech 2025” Strategy:
 - Retail Central Bank Digital Currency (CBDC): released a technical whitepaper on e-HKD
 - Wholesale CBDC: identified 15 potential use cases, with priority to pilot the international trade settlement use case in 2022
 - Announced the pilot launch of the Commercial Data Interchange
 - Launched Fintech Supervisory Sandbox 3.0
- Co-organised with InvestHK “Hong Kong FinTech Week 2021”, attracting over 20,000 attendees and more than 4 million online views from 87 economies



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THE EXCHANGE FUND

Statutory Purposes*

- The primary purpose of the Exchange Fund is to **affect the exchange value of the currency of Hong Kong**
- Having regard to the primary purpose, may also be used to **maintain the stability and integrity of the monetary and financial systems of Hong Kong** with a view to **maintaining Hong Kong as an international financial centre**

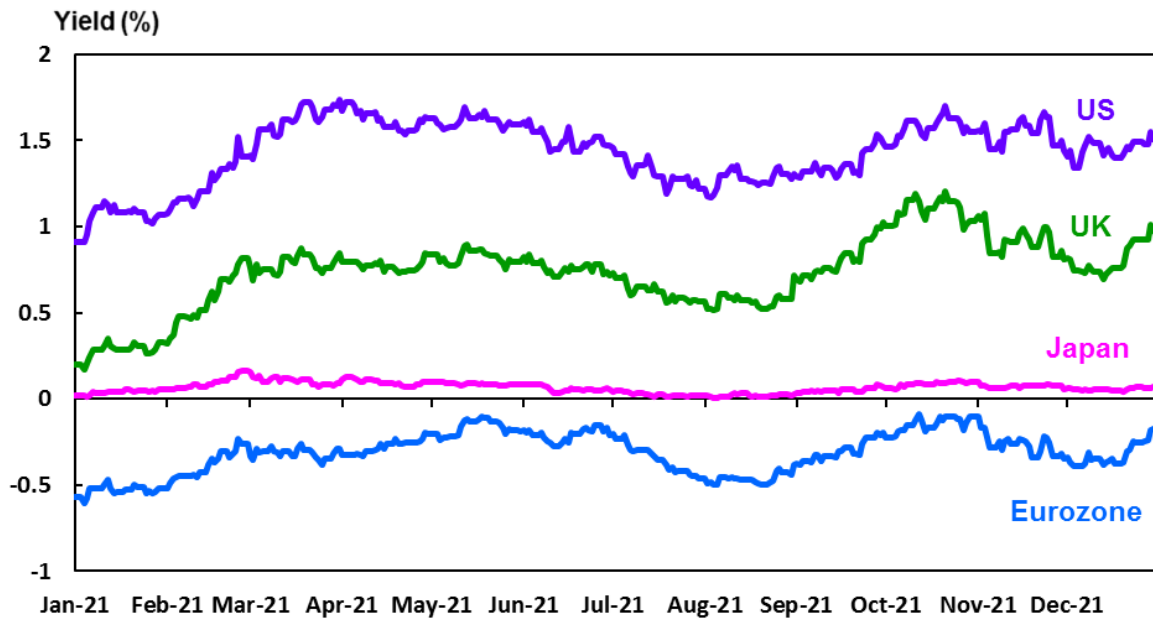
Investment Objectives

- (1) to preserve capital
- (2) to ensure that the entire Monetary Base at all times will be fully backed by highly liquid US dollar denominated assets
- (3) to ensure sufficient liquidity for the purpose of maintaining monetary and financial stability
- (4) subject to (1) – (3), to achieve an investment return that will preserve the long-term purchasing power of the Fund

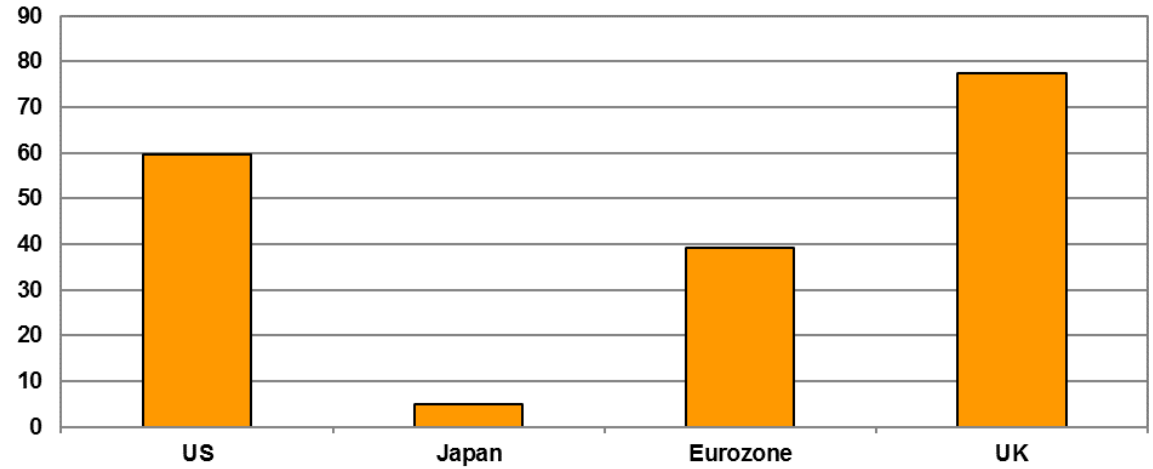
* In accordance with the provisions of The Exchange Fund Ordinance (Cap. 66) (s.3(1)) and (s.3(1A))



MAJOR DEVELOPED MARKETS 10-YEAR GOVERNMENT BOND YIELDS TRENDED UPWARDS BUT REMAINED AT LOW LEVELS



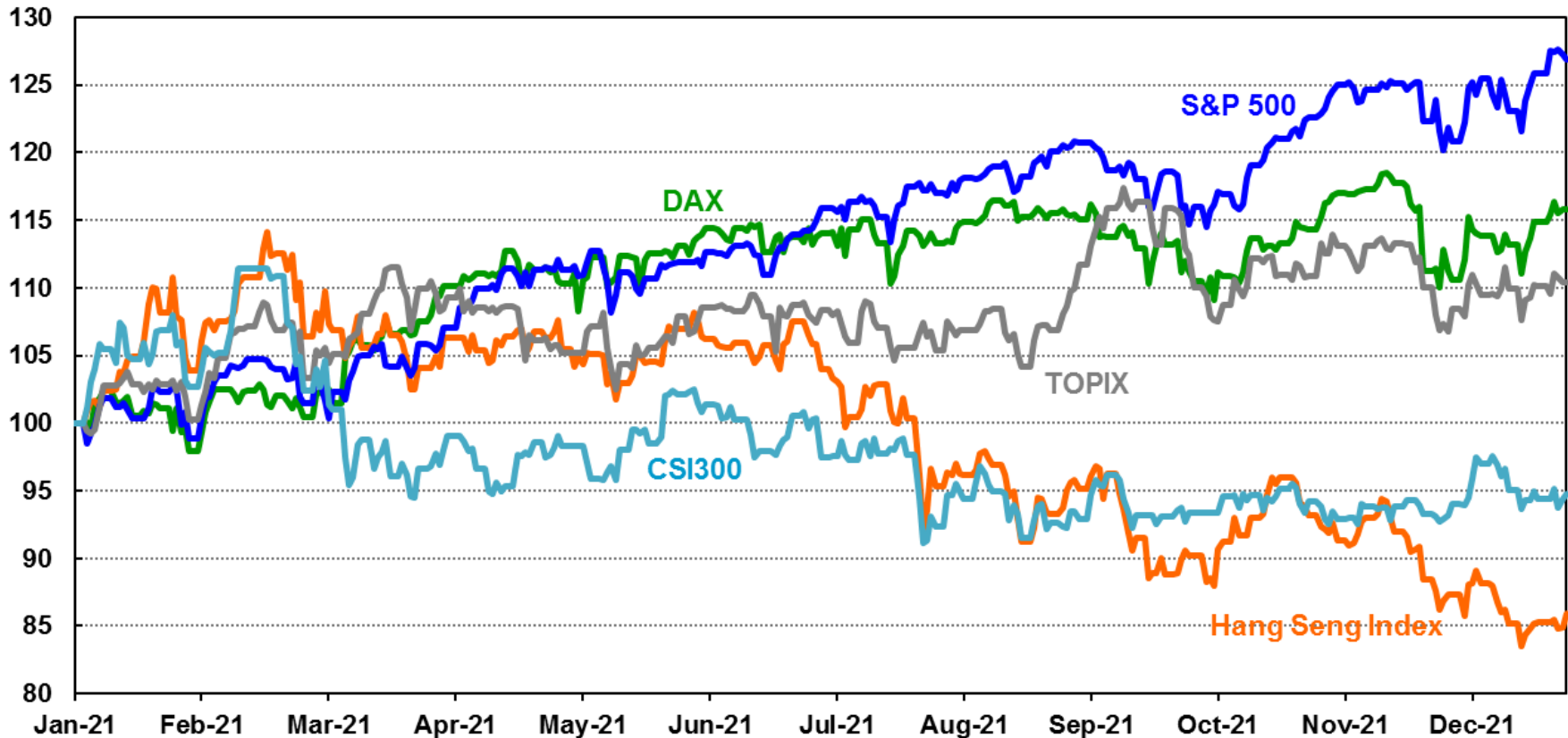
2021 Q1 - Q4 bond yield change (bps)





MAJOR EQUITY MARKETS ROSE SHARPLY WHILE HK AND MAINLAND MARKETS DIPPED

Normalised Index Level (2020 year-end = 100)





INVESTMENT INCOME

	← 2021 → (unaudited)			2020	2019
(HK\$ billion)	Full year	2H	1H	Full year	Full year
Bonds	12.4	11.1	1.3	92.7	114.5
Hong Kong equities*	(21.0)	(33.5)	12.5	4.0	22.1
Other equities	68.4	22.0	46.4	69.9	100.7
Foreign exchange[#]	16.8	14.0	2.8	9.6	(13.0)
Other investments[@]	93.9	17.2	76.7	59.6	37.9
Investment income	170.5	30.8	139.7	235.8	262.2

* 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. This figure represents valuation changes up to the end of September 2021.

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



INCOME AND EXPENDITURE

(HK\$ billion)	← 2021 →			2020	2019
	(unaudited)				
	Full year	2H	1H	Full year	Full year
Investment income	170.5	30.8	139.7	235.8	262.2
Other income	0.2	0.1	0.1	0.2	0.2
Interest and other expenses	<u>(6.1)</u>	<u>(2.8)</u>	<u>(3.3)</u>	<u>(14.6)</u>	<u>(24.8)</u>
Net income	164.6	28.1	136.5	221.4	237.6
Fee payment to Fiscal Reserves*#	(34.4)	(16.4)	(18.0)	(69.8)	(53.8)
Fee payment to HKSAR government funds and statutory bodies*	(16.8)	(8.9)	(7.9)	(11.5)	(9.0)

* The rate of fee payment is 4.7% for 2021, 3.7% for 2020 and 2.9% for 2019.

This does not include the 2021 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2021 is available.

(The composite rate was 12.3% for 2020 and 8.7% for 2019. Fee payable to the Future Fund was HK\$37.2 billion for 2020 and HK\$24.4 billion for 2019.)



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2021)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 2021. The audited full year return will be disclosed in the annual report of 2021 to be released later this year.

³ Composite CPI is calculated based on the 2019/2020-based series.



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MORTGAGE INSURANCE PROGRAMME (MIP)

- In 2021, around 58,800 applications have been approved, of which over 45,700 are under the new coverage after the MIP revisions in October 2019. Over 90% of approved applications are from the first-time homebuyers. In 2022, as of 15 January, around 1,600 applications have been approved, of which around 1,200 applications are under the new coverage after the MIP revisions
- Principal moratorium or extension of repayment schedules is available to borrowers to help reduce their repayment burden



SME FINANCING GUARANTEE SCHEME (SFGS)

- Special 100% Loan Guarantee:
 - As of 15 January 2022, over 47,400 applications were approved, amounting to about HK\$82.7 billion. Around 31,400 applications have chosen the principal moratorium option
- 80% and 90% Guarantee Products:
 - As of 15 January 2022, over 27,000 applications were approved, amounting to about HK\$103.7 billion. Around 1,900 applications have chosen the principal moratorium option
- The application period for the SFGS products and principal moratorium has been extended to end-June 2022



100% PERSONAL LOAN GUARANTEE SCHEME

- As of 15 January 2022, around 36,100 applications were approved, amounting to about HK\$2.5 billion. Average loan size was about HK\$69,400
- The application period has been extended to end-April 2022