



HONG KONG MONETARY AUTHORITY

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

5 May 2003



DISCUSSION TOPICS

- **HKMA Annual Report 2002**
- **Update on key responsibilities of HKMA**

2

- Copies of the HKMA Annual Report 2002 were sent to Members on 29 April. Throughout the year 2002, Members were kept up to date on how the HKMA discharged its responsibilities through frequent briefings offered to the Panel. It is useful, however, to recap on developments in key areas in 2002, and our efforts to enhance the HKMA's transparency and accountability to the community. This will be followed in the presentation by a latest update on the work of the HKMA, taking account of the very unusual circumstances that Hong Kong now faces.



HKMA ANNUAL REPORT 2002 HIGHLIGHTS ON KEY RESPONSIBILITIES (1)

- **Monetary stability**
 - **exchange and money markets largely stable, notwithstanding heightened domestic and international risks**
- **Banking stability**
 - **responded to risks of rising personal bankruptcies and residential mortgages in negative equity**
 - **reached agreement on credit data sharing**
 - **relaxed market entry criteria for banks**
 - **finalised detailed features of deposit protection scheme**

3

Monetary stability

- Against the background of domestic economic difficulties and considerable volatility in world markets, the HKMA managed to maintain a high degree of exchange rate stability throughout 2002. This was despite heightened concerns about the budget deficit, which have raised doubt in the long term sustainability of the fixed exchange rate, as seen in the volatility of the forward exchange rate.

Banking stability

- Further progress was made during 2002 towards reducing barriers to competition with the relaxation of market entry criteria, the last of the **market liberalisation** measures in the HKMA's banking sector reform programme begun in 1999. Work proceeded on two schemes aimed at complementing market liberalisation with measures to enhance the **safety and soundness** of the banking system. The structure and design of a deposit protection scheme was finalised, and draft legislation prepared for planned introduction into the Legislative Council in 2003. Consensus was reached with the industry on the framework for a commercial credit reference agency scheme. During 2002 the HKMA worked closely with industry associations and the Privacy Commissioner with the aim of contributing to a fairer and healthier credit environment by allowing the sharing of positive consumer credit data.



HKMA ANNUAL REPORT 2002 HIGHLIGHTS ON KEY RESPONSIBILITIES (2)

- **Market infrastructure**
 - continued efforts on RTGS for foreign currencies
 - international linkages of market infrastructure
 - completed review of banknote design
 - issued new HKSARG \$10 note
- **International finance**
 - active participation in international forums
 - Financial Sector Assessment Programme
 - leading role in regional bond market development initiatives

4

Market infrastructure

- Hong Kong's financial infrastructure continued to operate with a fault-free track record in 2002. The US dollar clearing system saw a steady increase in turnover. Plans were finalised for Hong Kong's euro clearing system. Work also continued on developing the HKMA's Central Moneymarkets Unit (CMU) into a comprehensive securities clearing and settlement platform to serve both Hong Kong and the region: this was carried out through expanding external linkages and adding new features, such as the US Treasuries settlement capability introduced in December 2002.
- Responding to suggestions from the public, the HKSAR Government issued a new \$10 dollar note in the summer of 2002. Planning for a new generation of banknotes, developed by the note-issuing banks and the HKMA, was completed in the year.

International finance

- The HKMA played an active role in international and regional forums and in promoting initiatives that are conducive to financial stability: a number of these forums were hosted by the HKMA in 2002. The HKMA coordinated Hong Kong's participation in the Financial Sector Assessment Programme, a joint IMF / World Bank initiative designed to promote financial stability. During the year a working group chaired by the HKMA under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) formulated proposals for an Asian Bond Fund. Together with its counterparts from Korea and Thailand, the HKMA also co-chaired an APEC initiative on the development of the securitisation and credit guarantee markets.



HKMA ANNUAL REPORT 2002 HIGHLIGHTS ON KEY RESPONSIBILITIES (3)

- **Exchange Fund**
 - **achieved investment return of HK\$47 billion or 5.1%, 120 basis points above the benchmark return**
 - **EFIL completed disposal of Hong Kong equities purchased in August 1998 without disruption to the market**

5

Exchange Fund

- The Exchange Fund had a very satisfactory year in 2002. The investment income of the Fund for the year was HK\$47 billion, representing an investment return of 5.1%. This was 120 basis points higher than the return on the benchmark set for the Fund by the Exchange Fund Advisory Committee and favourable in comparison with similar funds in the market.
- In December 2002 Exchange Fund Investment Ltd completed its programme for disposing of the greater part of the Hong Kong equities purchased by the Exchange Fund in August 1998 during the Asian financial crisis, at a cost of just over HK\$118 billion. The programme raised more than HK\$165 billion for the Exchange Fund. The remainder of the portfolio, valued at HK\$50.9 billion at the end of 2002, has been retained as a long-term investment.



HKMA ANNUAL REPORT 2002 OTHER HIGHLIGHTS

- **New chapter 'About the HKMA'**
- **The HKMA in the Community**
 - **dialogue with legislators**
 - **media relations**
 - **publications**
 - **the HKMA online**
 - **public education programme**
 - **public enquiry services**

6

- In line with its ongoing policy on transparency, a new chapter 'About the HKMA' has been added to the 2002 Annual Report to help set out the HKMA's mandates, the relationship with the HKSAR Government, the accountability and transparency arrangements, and the role of various committees.
- The HKMA's policy of transparency and accessibility is carried out through a variety of channels: extensive contacts with the mass media, regular and special publications, a large and comprehensive bilingual website, an education programme for students, frequent meetings with legislators, a public enquiry service, and public access to the HKMA's library. During the year, a number of these services were improved to keep pace with changing demands and developments.



UPDATE ON KEY RESPONSIBILITIES OF HKMA

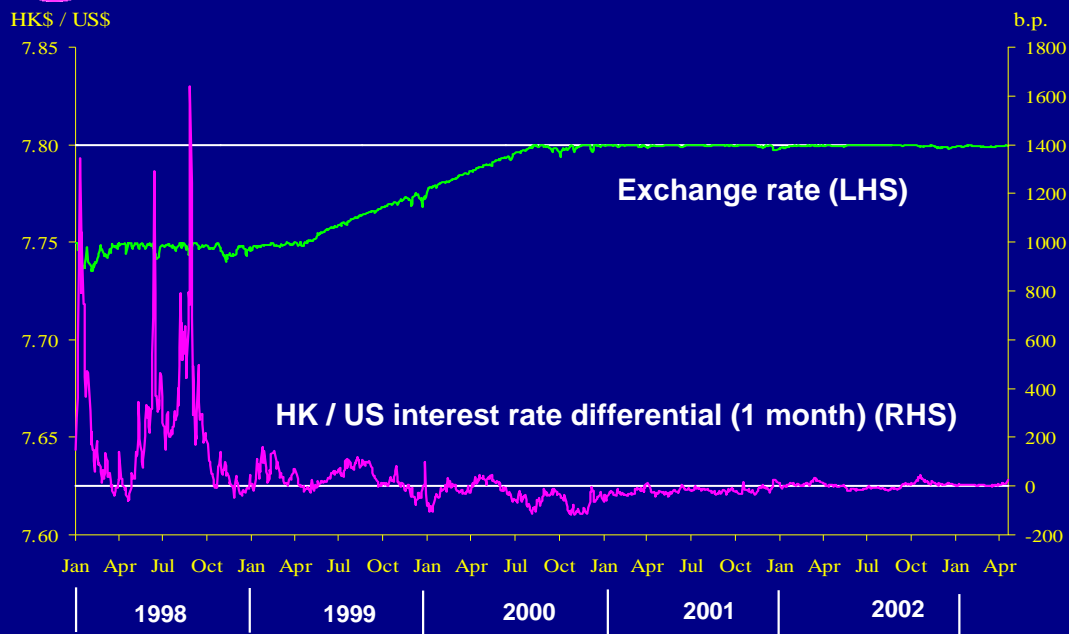
- **Currency**
- **Banking**
- **Financial infrastructure**
- **Exchange Fund**

7

- This part of the presentation covers the four key responsibilities of the HKMA:
 - to maintain currency stability, within the framework of the linked exchange rate system;
 - to promote the safety and stability of the banking system;
 - to enhance the efficiency, integrity and development of the financial infrastructure, particularly payment and settlement arrangements; and
 - to manage the Exchange Fund in a sound and prudent manner.



CURRENCY STABILITY



8

- Although the external environment and the domestic economic situation have deteriorated since the last HKMA presentation to the Panel in February 2003, the HK dollar exchange rate has continued to be stable against the US dollar.
- The differential between HK and US dollar short-term interest rates has stayed close to zero.



CURRENCY - MARKET EXPECTATIONS



9

- The 12-month HK dollar forward points gradually declined after the subsidence of the Asian financial crisis and the introduction of the technical measures to strengthen the Currency Board system in August 1998. They have, on the whole, stayed close to zero since the middle of 2000. Looking more closely at the short-term movements, however, the forward market for the exchange rate exhibited considerable volatility.



CURRENCY - MARKET EXPECTATIONS



- The forward points rose to a high of nearly 300 points recently, largely reflecting market worries about the impact of SARS on the economic outlook and fiscal deficit.



CURRENCY - RISKS & VULNERABILITIES

External

- **War in Iraq and its aftermath**
- **Uncertain global economic outlook**
- **Volatility in exchange rates among G3 currencies**
- **Financial market volatility**

11

- **The end of the Iraq war** has cleared some of the uncertainties which might have held up business investment and consumer spending. The world economy is likely to benefit from a more stable supply of oil. Nevertheless, geopolitical tensions in the Middle East and security concern may continue to linger.
- **Global economic outlook remains uncertain**, in the face of the weaknesses which emerged in many industrial economies even before the war, and the SARS outbreak. In the US, reflecting partly post-bubble adjustment, business investment is sluggish, and the labour market is soft. Further growth in consumer spending may be constrained by the already high debt burden, and the flattening of house prices and mortgage rate which together would limit mortgage refinancing. Growth in Germany and Japan continues to be hampered by structural rigidities. Furthermore, the room for policy stimulus is limited, particularly in Europe where fiscal loosening is restrained by the Growth and Stability Pact and the monetary policy is not particularly accommodative. Although the (non-Japan) Asian region has been growing relatively fast, the SARS outbreak is likely to weaken their near-term prospects.
- **The volatility of G3 currencies** remains a major concern, as the US dollar needs to adjust to correct the large current account deficit (5% of GDP). Any sharp and abrupt adjustment of the US dollar may disrupt financial market stability.
- **Financial market volatility may increase as a result of the above factors.** Global stock prices posted rebounds following the end of the Iraq war. Nevertheless, they are susceptible to any faltered hopes of renewed economic growth.



CURRENCY - RISKS & VULNERABILITIES

Hong Kong specific

- **Severity of SARS attack**
- **Unprecedented adverse economic shock**
- **Further deflationary pressure**
- **Public finance**
- **Balance of payments position**
- **Market sentiment weakening**

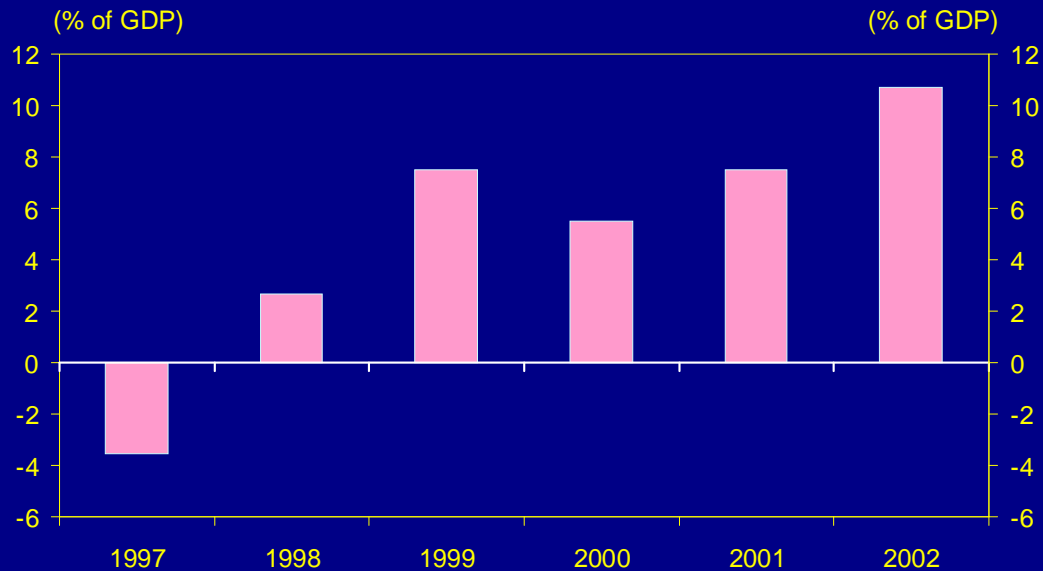
12

- **The SARS outbreak has hit Hong Kong severely**, at a time when the Hong Kong economy was beginning to show signs of recovery.
- **The domestic economic activity is being adversely affected**, directly through local consumption, tourism, and travel-related business, and indirectly through asset prices, employment, and disruptions of normal business activity. There may be additional impact from the slower growth of the region, particularly the Mainland, since SARS has meant a de facto embargo (hopefully short-term) on the international mobility of people.
- The economy is likely to experience **further deflationary pressure** alongside the weakening of economic growth.
- **Pressures on public finance are likely to rise** in the face of lower economic growth and increased spending to tackle the epidemic.
- **The balance of payments position needs close monitoring**, as capital flows are susceptible to domestic economic and financial developments.
- **Market sentiment has continued to weaken**, as investors are concerned about the impact of the SARS shock on the economy and fiscal finance. This is reflected in the recent rise in the risk premium on the HK dollar.



BALANCE OF PAYMENTS

Current Account Balance



13

- The statistics indicate continued improvement in the current account surplus over the past few years to a high level of 11% of GDP in 2002. The strong current account surplus reflected in part an improvement in competitiveness owing to the depreciation of the real effective exchange rate, and in part weak domestic demand and declining property prices, which led to increased household saving. The surge in inbound tourism, partly associated with the relaxation of travel controls over Mainland residents, also contributed significantly to the current account surplus.



BALANCE OF PAYMENTS

	2001		2002			
	Q3	Q4	Q1	Q2	Q3	Q4
	(In percent of GDP)					
Current account balance	10.2	11.7	10.2	6.3	12.3	13.8
Of which:						
Goods	-3.5	-1.5	-4.1	-5.3	-1.7	-1.7
Services	10.2	12.1	10.6	12.1	12.7	15.8
Of which:						
<i>Travel, inbound</i>	4.5	5.3	5.2	6.5	5.5	7.2
Factor income	4.6	2.2	4.9	0.7	2.5	0.7
Capital and financial non-reserve assets	-19.0	-9.9	-14.2	-10.9	-19.8	-20.5
Of which:						
Direct investment	2.3	-1.8	-3.4	4.9	-10.0	-1.0
Portfolio investment	-25.3	-28.0	2.3	-38.2	-25.3	-29.1
Reserve assets*	8.1	2.4	-1.3	1.0	2.4	3.5

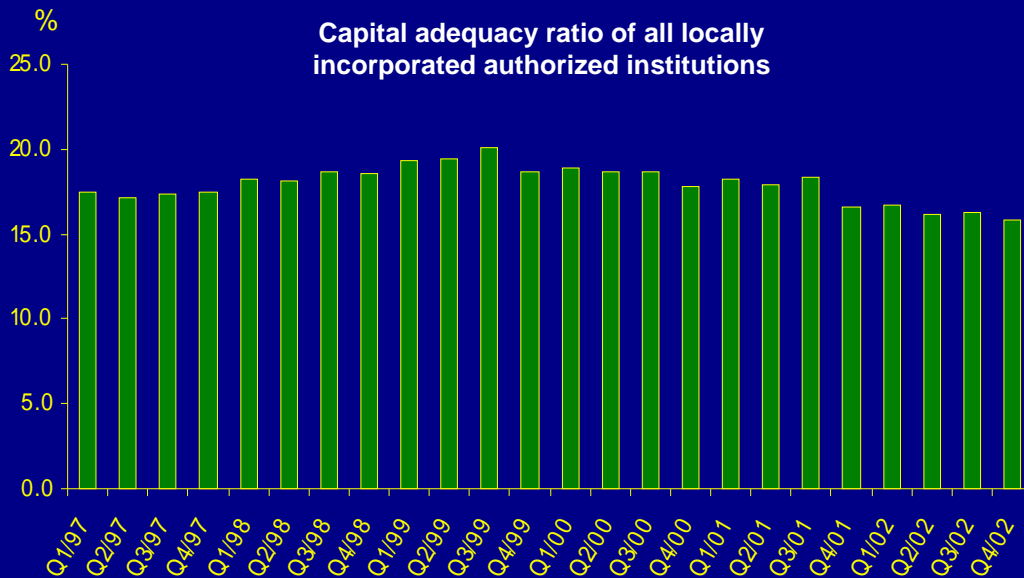
* A negative value represents an increase in reserve assets.

14

- It is difficult to distinguish whether the net outflow in the capital and financial account was an endogenous response to the surplus in the current account, or an exogenous one. Nevertheless, economic analysis (see RM 05/2003) suggests some autonomous net portfolio and foreign direct investment outflows, which was financed in part by the current account surplus. However, this autonomous net outflow was in line with economic fundamentals, reflecting in particular a portfolio re-balancing to seek higher rates of return on foreign assets. Thus, the statistics have not shown any significant evidence of a capital flight triggered by reduced confidence. But the situation has to be closely monitored because the current account surplus will shrink as a result of the adverse economic consequences of SARS.



BANKING SECTOR PERFORMANCE



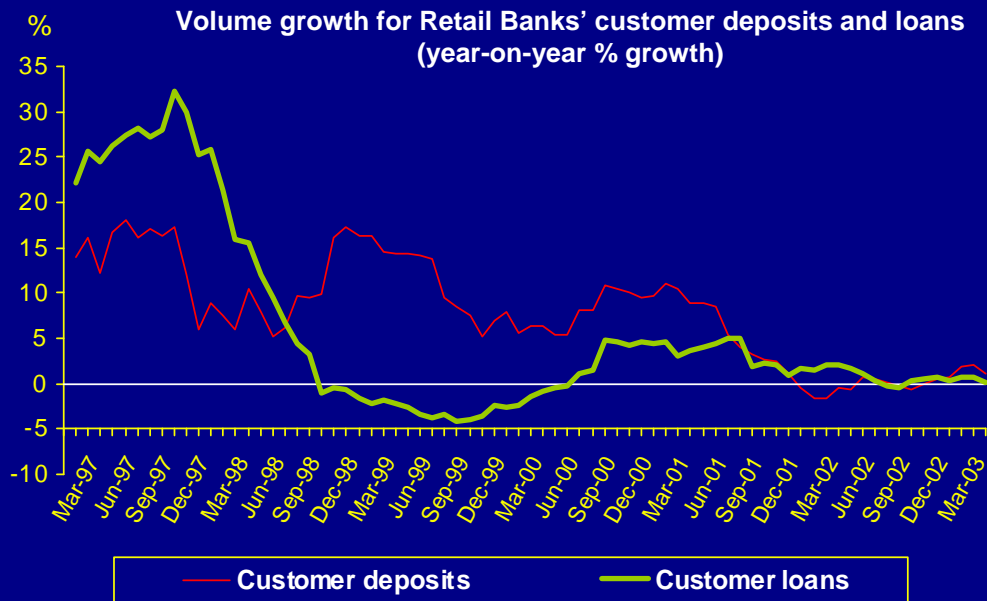
Note: There is a break in series at end-December 2001 owing to a change in the reporting population.

15

- The capital adequacy ratio of all locally incorporated authorized institutions was 15.8% at the end of 2002, well above the minimum international standard of 8%.
- It is likely that the operating environment of banks will be affected by the outbreak of SARS given its impact on the overall economy. However, the impact will depend on how long the crisis lasts. The balance sheets of the banks are strong and are capable of withstanding stressful conditions.



BANKING SECTOR PERFORMANCE

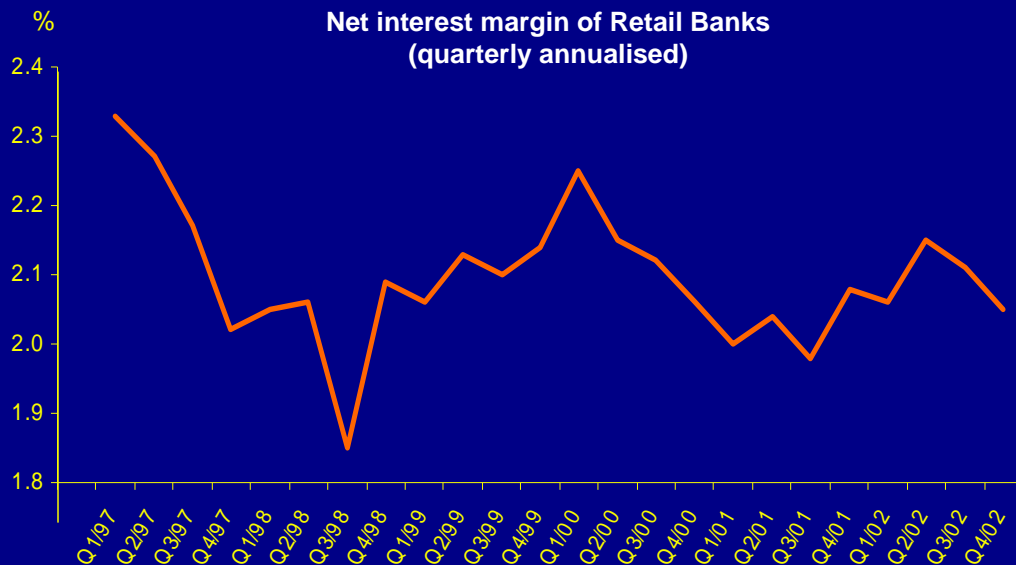


16

- Retail banks' customer deposits grew by 1.1% year-on-year at end-March 2003. This rise came largely from a continued increase in demand and savings deposits, while time deposits contracted further due to the historically low interest rate environment.
- Growth of retail banks' total loans remained virtually flat in Q1 2003. Preliminary figures show that residential mortgage loans (excluding loans under Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme) declined by 0.8% in first quarter of 2003 after rising 2.2% in 2002. This is mainly attributable to the weak appetite for property in the light of the decline in property prices.
- The HK dollar loan-to-deposit ratio edged up to 79.6% at end-March 2003 from 78.6% at end-December 2002.
- The share of HK dollar to total deposits of retail banks was virtually unchanged at 61% at end-March 2003, compared with end-December 2002. The ratio was 62.2% a year ago.



BANKING SECTOR PERFORMANCE

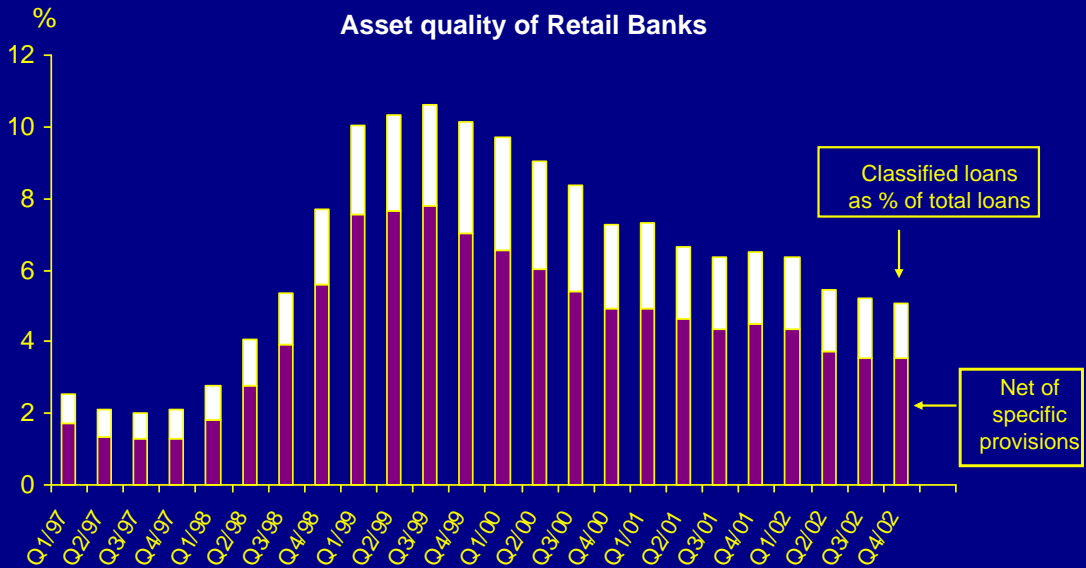


17

- Retail banks' annualised net interest margin increased to 2.09% in 2002 from 2.03% in 2001. The increase was helped by the widening of deposit margins, interest derived from treasury business and higher-yielding securities, against a decline in average interest bearing assets. Other operating income declined, attributable largely to losses in investments held for trading arising from unrealised mark-to-market losses. Non-interest income continued to account for about 30% of retail banks' total income.



BANKING SECTOR PERFORMANCE

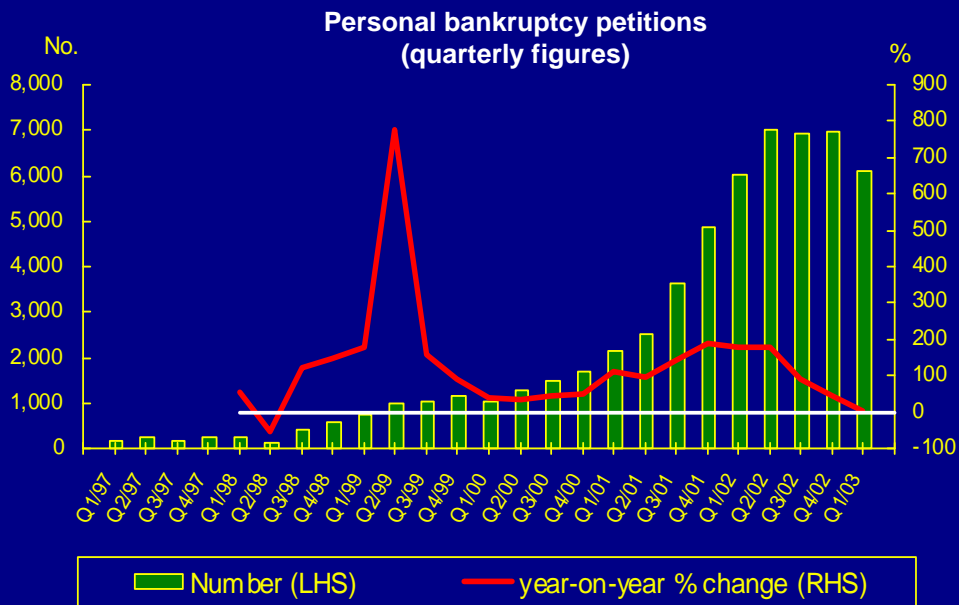


18

- Asset quality improved further in the fourth quarter of 2002, with the ratio of classified loans (net) decreasing to 3.5% of total loans. Reduced debt servicing burden in a low interest rate environment and increased write-offs were the main driving forces behind the improvement in the ratios.
- The HKMA has been closely monitoring the impact of recent developments on banks' asset quality. It is, however, premature to give a detailed assessment of the impact.



BANKING SECTOR PERFORMANCE

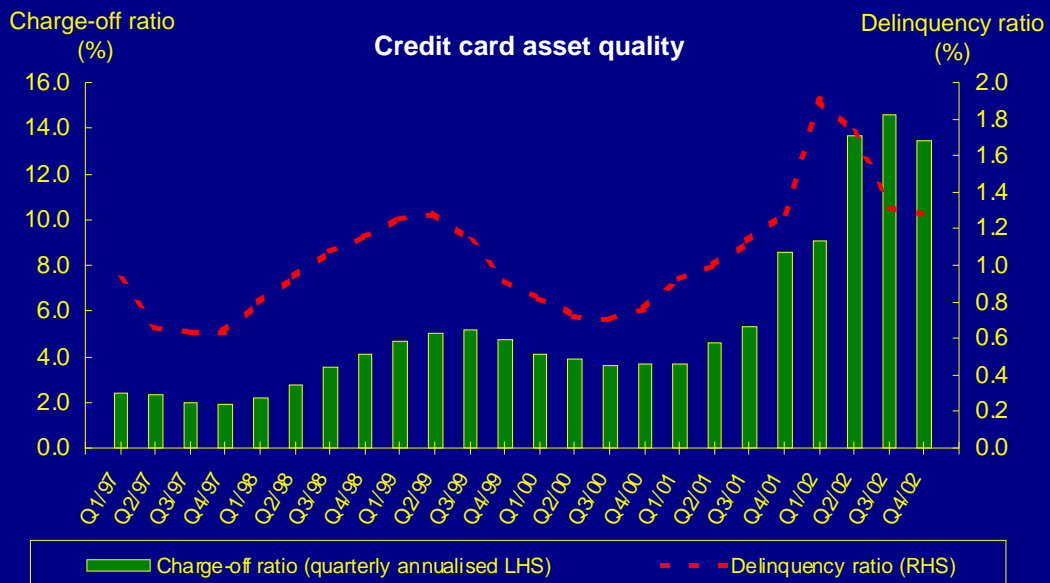


19

- The number of bankruptcy petitions presented was 6,119 in the first quarter of 2003, down from 6,973 in the fourth quarter of 2002. As unemployment may increase under the influence of SARS, the stabilisation seen in the last few quarters may not be sustainable.



BANKING SECTOR PERFORMANCE



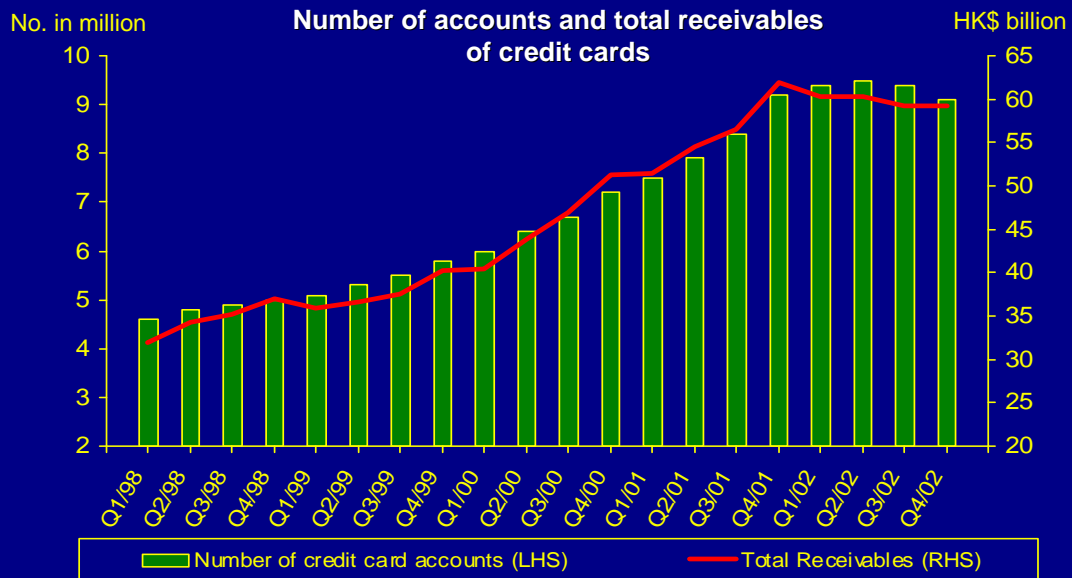
Note: There is a break in series at Q4 2001 owing to an increase in the number of surveyed institutions.

20

- The quality of the credit card portfolio remained weak, although there were some signs that the situation was stabilising in the fourth quarter. The amount charged off in the fourth quarter was HK\$2.24 billion or 3.78% of average receivables during the quarter. The delinquency ratio decreased further to 1.28% at the end of 2002 as a result of charge-offs made.
- The stabilising situation appeared to have continued in early 2003 on the back of a number of factors: fewer bankruptcy petitions, more card restructuring which has taken some pressure off these ratios.



BANKING SECTOR PERFORMANCE



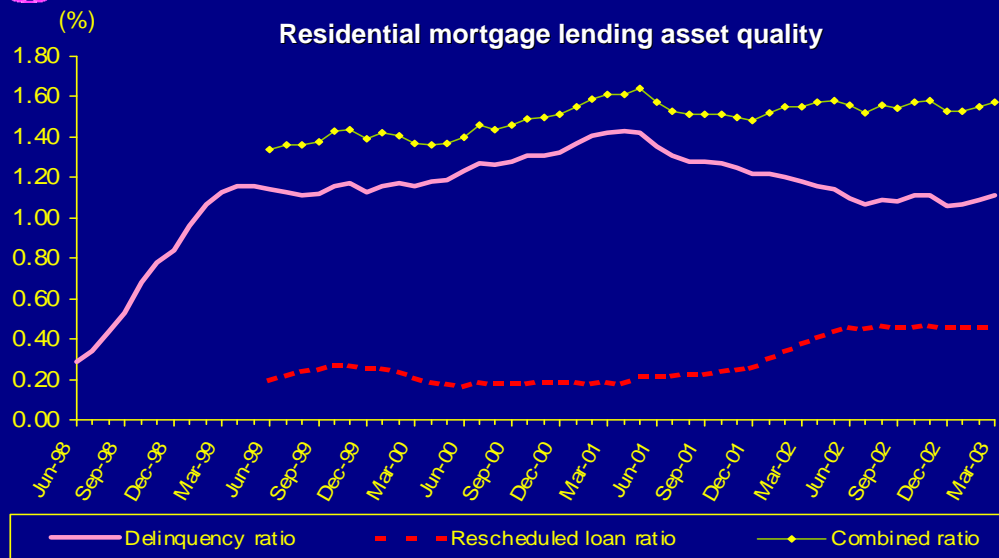
Note: There is a break in series at Q4 2001 owing to an increase in the number of surveyed institutions.

21

- Total receivables rose marginally by 0.1% in the fourth quarter of 2002 after falling for three straight quarters. The total number of credit card accounts however continued to fall, by 3.0%, owing to a combination of factors including the effects of charge-offs, tightening of credit card issuance and lending policies, and termination of dormant accounts.
- Based on available figures the number of card accounts continued to decline in early 2003, in part due to the transfer of restructured card receivables out of the card portfolio by some authorized institutions and in part due to write-offs.



BANKING SECTOR PERFORMANCE



Note: There is a break in series at December 2000 owing to an increase in the number of surveyed institutions.

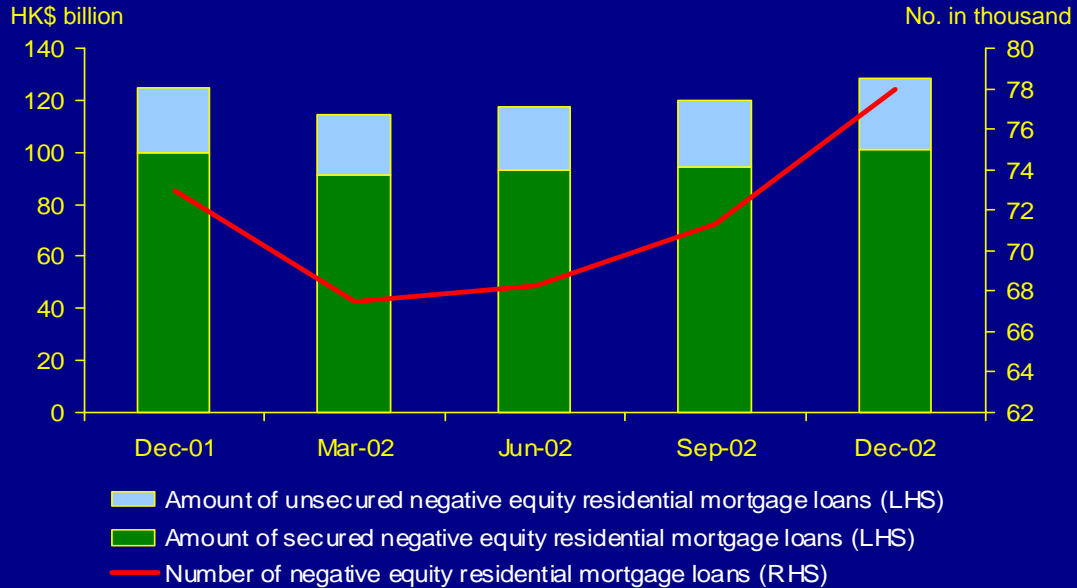
22

- The quality of the residential mortgage loan portfolio continued to hold up well with the delinquency ratio for the overall mortgage portfolio standing at 1.11% at end-Mar and the rescheduled mortgage loan ratio at 0.46%.



BANKING SECTOR PERFORMANCE

Residential mortgage lending in negative equity



23

- The number and amount of mortgage loans in negative equity is a potential threat to banking stability. The unsecured portion of these loans is estimated at HK\$28 billion, or 5.1% of the total mortgage lending of the banking sector at end-December 2002. This provides an indication of the risk exposure of the banking sector. The delinquency ratio of negative equity mortgage loans is still not unduly high, at 2.62% at end-December 2002.
- The HKMA is collating the end-March 2003 figures. In the light of recent developments, it would not be surprising to see further increases in both the number of negative equity loans and the delinquency ratio of such loans.



PROGRESS OF PRIORITIES

- **Close monitoring of banks' financial position and performance**
- **Consumer credit data sharing**
 - **revisions to Code of Practice on Consumer Credit to take effect later this year**
 - **to consult industry on guidelines to achieve comprehensive participation by banks and to safeguard customer data privacy**

24

Monitoring of banks' financial position and performance

- In the light of the economic and financial environment, and recent developments, the HKMA will continue to closely monitor banks' financial position and performance, taking account in particular of the impact of SARS. Stress tests will be conducted to detect any early warning signs, such as those arising from a sharp rise in bad debt provisions, further decline in property prices and adverse interest rate changes.

Consumer credit data sharing

- The Code of Practice on Consumer Credit Data will take effect later this year. Following consultation with the industry, the HKMA will issue an industry guideline to require authorized institutions that engage in consumer lending to participate in the sharing of positive consumer data and to have in place adequate controls to safeguard customer data privacy.



PROGRESS OF PRIORITIES

- **Commercial credit reference agency**
 - **sourcing service provider, and designing a programme to explain the scheme to SMEs**
- **Deposit protection scheme**
 - **bill introduced into Legislative Council on 30 April 2003**
- **Implementation of new regime for securities business**
- **Further enhancement of the supervisory framework**

25

Commercial credit reference agency

- The working party formed by industry associations, and with participation from the HKMA, has reached consensus on a number of important issues, including the scope of data sharing, and the definition of SMEs. It is now working on the selection of a vendor and a programme to explain the scheme to SMEs.

Deposit protection scheme

- The Deposit Protection Scheme Bill will be introduced into the Legislative Council on 30 April, following approval by the Chief Executive in Council. If the Bill is enacted by the end of 2003, the aim is to establish Deposit Protection Board in the first half of 2004 for the scheme to be in operation in 2005.

New securities regime

- The HKMA is cooperating actively with the SFC in implementing the new Securities and Futures Ordinance as it applies to authorized institutions.

Enhancement of the supervisory framework

- The HKMA is further developing its prudential policies in such areas as capital adequacy (the new Capital Accord), liquidity and foreign exchange risk.



FINANCIAL INFRASTRUCTURE FOR DOMESTIC FINANCIAL ACTIVITIES

- **Promotion of retail bond market**
 - retail bonds issued by Hong Kong Mortgage Corporation
 - programme to facilitate retail investors' participation in Exchange Fund Notes
- **Upgrade of financial infrastructure**
 - cheque imaging and truncation project on schedule for implementation in June 2003
 - to study the feasibility of moving the existing RTGS/CMU system onto SWIFT platform

26

Promotion of retail bond market

- Bonds issued by the Hong Kong Mortgage Corporation have provided the general public with an additional and relatively safe investment choice. Since October 2001 the HKMC has raised HK\$6.1 billion through four issues of retail bonds to investors.
- The HKMA will also put more focus on the development of the retail bond market by utilising the Exchange Fund Bills and Notes (EFBN) programme, improving the distribution channel, raising retail investors' awareness about EFN and facilitating retail investors to participate in EFN tender through non-competitive bids.

Upgrade of financial infrastructure

- With a view to fostering system inter-operability, the HKMA, in conjunction with the Hong Kong Association of Banks, will study the feasibility of a wider application of the SWIFT platform in Hong Kong's clearing and settlement systems.
- Following an amendment to the Bills of Exchange Ordinance, the new Cheque Imaging and Truncation System will commence operation in June 2003 on schedule. By transforming the current clearing process driven by physical exchange of cheques, this new image-based cheque clearing method will streamline the operation and enhance the efficiency of cheque clearing in Hong Kong.



FINANCIAL INFRASTRUCTURE FOR DOMESTIC FINANCIAL ACTIVITIES

- **Inclusion of Hong Kong dollar in global payment system (CLS system)**
 - **Clearing and Settlement Systems Bill in progress**
- **Retail payment**
 - **first batch of new generation of banknotes to be available later this year**

27

Inclusion of HK dollar in global payment system

- The HKMA is working with the Financial Services and the Treasury Bureau on a Clearing and Settlement System Bill to cater for, among other things, the HK dollar's participation in the Continuous Linked Settlement system. The Bill is expected to be introduced into the Legislative Council in the current session. A briefing by my HKMA colleagues on this Bill will be done later this morning.

Retail payment

- A new generation of banknotes, which makes use of the latest technology to help combat counterfeiting, is currently at the printing stage. The notes are scheduled for issue in stages beginning in late 2003.



FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

- **Development of foreign currency payment systems**
 - US dollar and euro RTGS payment systems
- **Payment system linkages with cities on the Mainland**
 - cheque clearing between Hong Kong and Guangdong
 - Hong Kong dollar RTGS access for banks on Mainland
- **Hong Kong as a regional settlement hub**
 - links from CMU to Euroclear and Clearstream
 - CMU clearing of US treasuries
 - link from CMU to the Mainland's Government Securities Book-Entry System

28

Development of foreign currency payment systems

- The new Euro Clearing System commenced operation on 28 April. The system was commissioned by the HKMA in July 2002, with a commercial bank appointed as the Settlement Institution. The new service will allow financial institutions in Hong Kong and in the region to settle euro transactions real-time in the Asian time zone.

Payment system linkages with cities in the Mainland

- The joint HK dollar cheque clearing services between Hong Kong and Guangdong and the HK dollar RTGS link between Hong Kong and Shenzhen help to facilitate payment flows between Hong Kong and the Mainland. In March 2003, the monthly turnover of these services amounted to HK\$2,703 million.

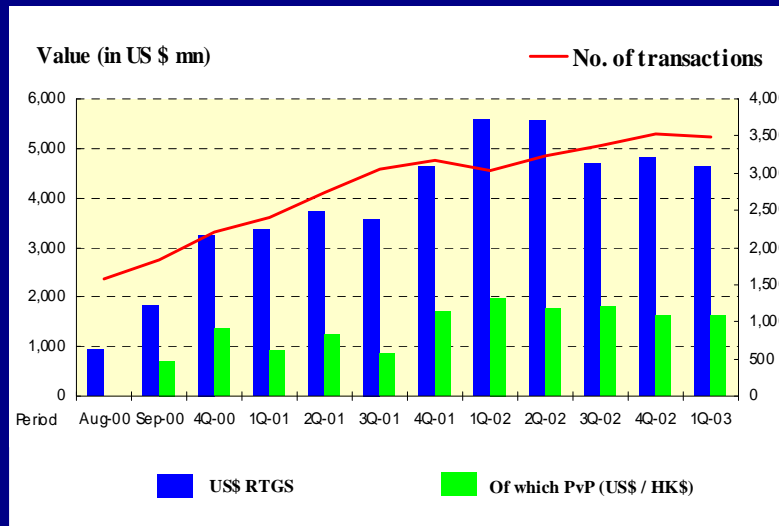
Hong Kong as a regional settlement hub

- The HKMA has been establishing links with several important global debt securities clearing systems, such as Euroclear and Clearstream. Members of these systems can hold and settle debt securities lodged with the CMU. The HKMA has also introduced a new clearing, settlement and custodian service for US Treasuries in December last year. The current value of debt securities held in the CMU through these international and other regional linkages amount to around HK\$25 billion (including both outbound and inbound).
- Another link to be developed in 2003 is that between the Mainland's Government Securities Book-entry System and the CMU. This is a facility to enable authorized financial institutions in the Mainland to clear, settle and hold CMU eligible securities.



FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

US dollar RTGS turnover (daily average)



29

- In the first quarter of 2003, the US dollar RTGS clearing system handled on average 3,500 RTGS transactions daily with a total value of over US\$4.6 billion. During the period, about 1,500 US dollar cheques of a total value of US\$47 million were being cleared daily.



FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

- **APEC Initiative on Development of Securitisation and Credit Guarantee Markets**
 - Hong Kong, Korea and Thailand are co-chairing the Initiative
 - China, Thailand, Philippines and Mexico to receive expert advice on bond market reform programmes
- **Asian Bond Fund**
 - EMEAP Working Group on Financial Markets, which the HKMA chairs, has been spearheading the development
 - detailed design of the Fund being developed

30

- The HKMA is continuing the work with regional economies to implement the APEC Initiative on Development of Securitisation and Credit Guarantee Markets and the Asian Bond Fund. On the former, visiting panels have been or are being formed for those economies which have indicated interest to receive expert advice. On the Asian Bond Fund, the EMEAP group has been working on the technical design and structure of the Asian Bond Fund, which is for investment initially in US dollar-denominated Asian bonds.



EXCHANGE FUND PERFORMANCE

(HK\$ billion)	2002	2001	2000
Gain / (Loss) on HK equities*	(11.8)	(27.1)	(7.3)
Gain / (Loss) on other equities*	(22.7)	(3.3)	0.5
Exchange gain / (loss)	27.2	(13.0)	(11.2)
Total return from bonds, etc	<u>54.3</u>	<u>50.8</u>	<u>63.1</u>
Investment income	47.0	7.4	45.1

* including dividends

Audited figures

31

- The Exchange Fund recorded an investment income of HK\$47 billion in 2002. The main components of this income were:
 - income and valuation gains of HK\$54.3 billion from bonds and other investments
 - a valuation loss of HK\$11.8 billion on the Hong Kong equities portfolio (net of dividends)
 - a valuation loss of HK\$22.7 billion on other equities (net of dividends)
 - an exchange valuation gain of HK\$27.2 billion, mainly as a result of the appreciation of the euro against the US dollar.



EXCHANGE FUND CHANGE IN ACCUMULATED SURPLUS

(HK\$ billion)	2003	← →		2002		
	Q1	Full year*	Q1	Q2	Q3	Q4
Investment income/(loss)	6.7	47.0	(3.7)	26.5	(2.1)	26.3
Other income	0.0	0.2	0.0	0.1	0.0	0.1
Interest and expenses	<u>(1.4)</u>	<u>(7.0)</u>	<u>(1.6)</u>	<u>(1.7)</u>	<u>(1.7)</u>	<u>(2.0)</u>
Net investment income/(loss)	5.3	40.2	(5.3)	24.9	(3.8)	24.4
Treasury's share	<u>(2.1)</u>	<u>(15.6)</u>	<u>1.6</u>	<u>(9.7)</u>	<u>0.8</u>	<u>(8.3)</u>
Increase/(Decrease) in EF accumulated surplus	3.2	24.6	(3.7)	15.2	(3.0)	16.1

* Audited figures

32

- For 2002 as a whole, the fiscal reserves' share of the net investment income amounted to HK\$15.6 billion. The balance of HK\$24.6 billion has been added to the Exchange Fund's accumulated surplus for 2002.



HONG KONG MONETARY AUTHORITY

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

5 May 2003

33