



HONG KONG MONETARY AUTHORITY

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

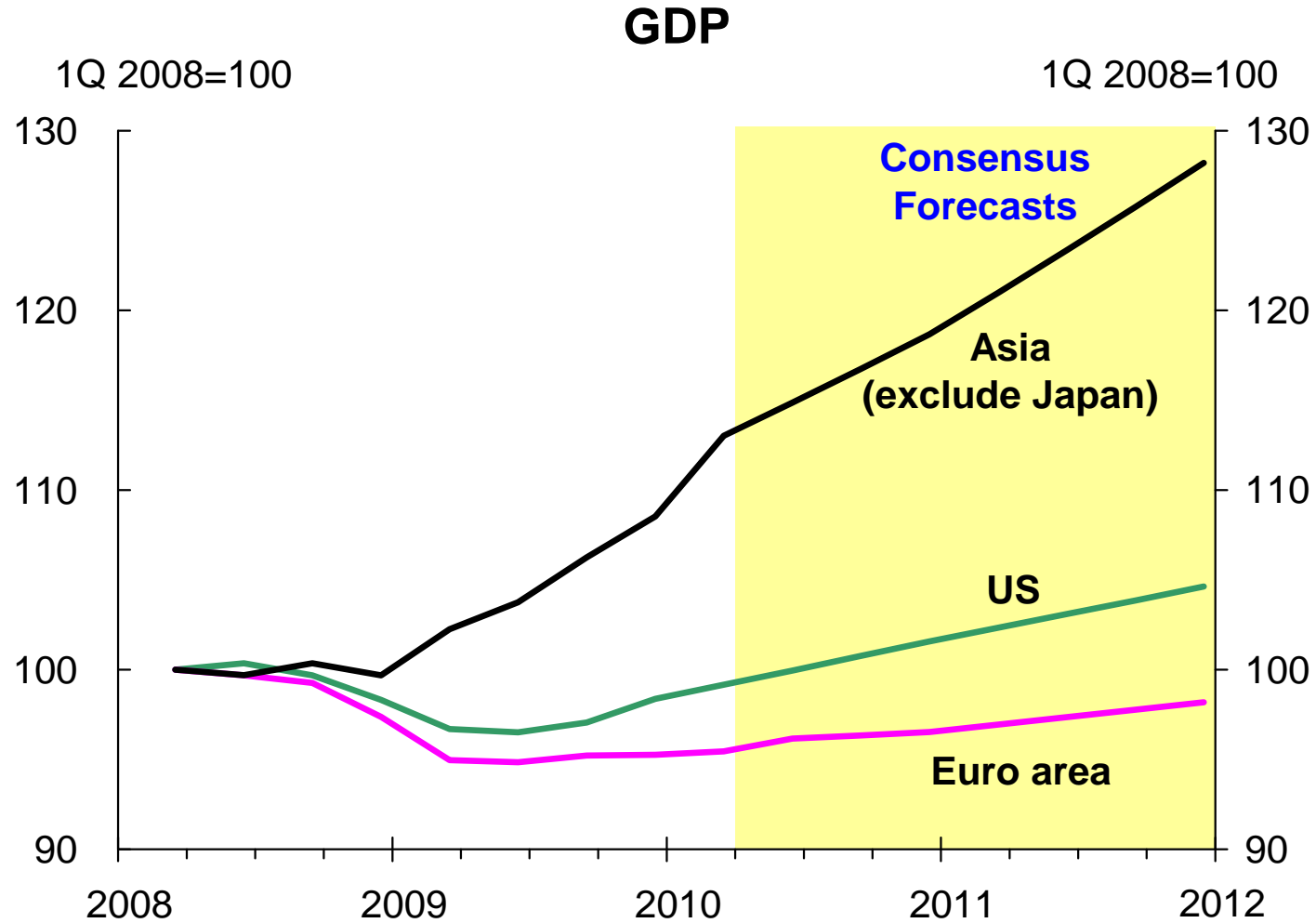
20 May 2010



- 1. Macroeconomy / Monetary conditions**
- 2. Assessment of risk on Hong Kong's financial stability**
- 3. Latest developments in the banking sector**
- 4. Investment income of the Exchange Fund in the first quarter of 2010**



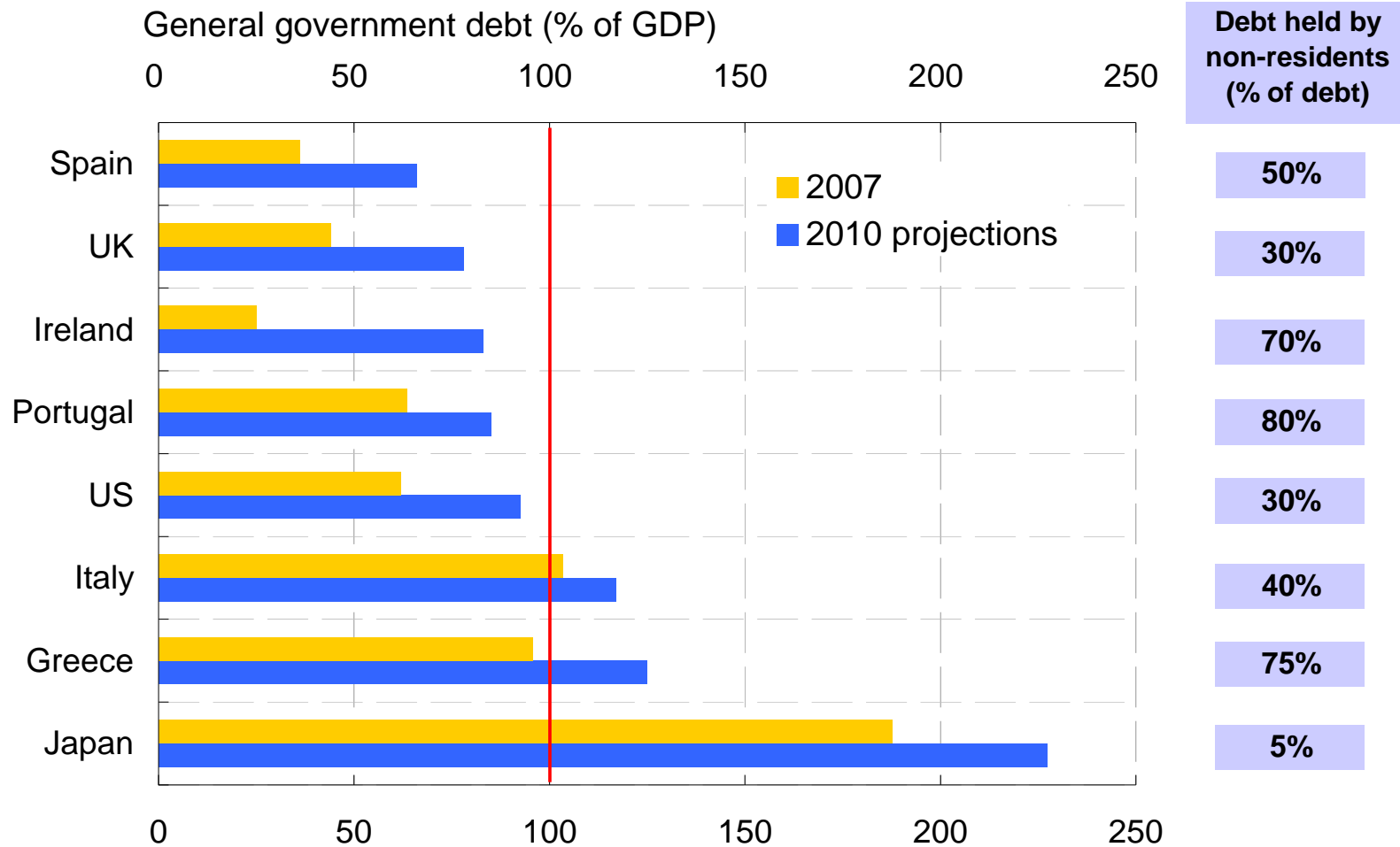
GLOBAL ECONOMIES RECOVERING AT DIFFERENT SPEEDS



Sources: CEIC, Consensus Forecasts (May 2010)



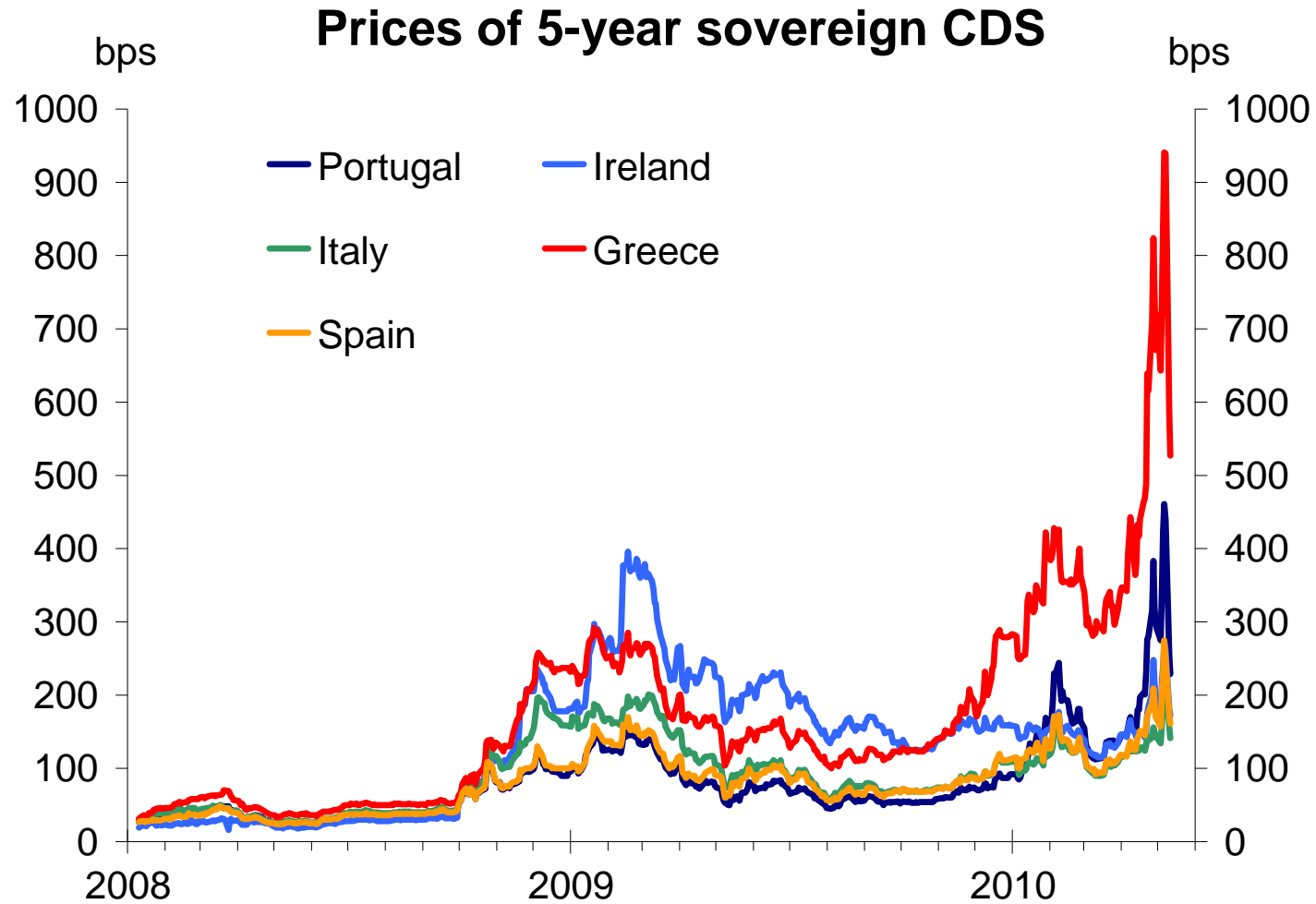
SOVEREIGN DEBT PROBLEMS: GOVERNMENT DEBT IN EUROPE, US AND JAPAN



Sources: IMF World Economic Outlook (April 2010), eurostat · European Commission AMECO database, CEIC, Government data published by the countries, Internet news



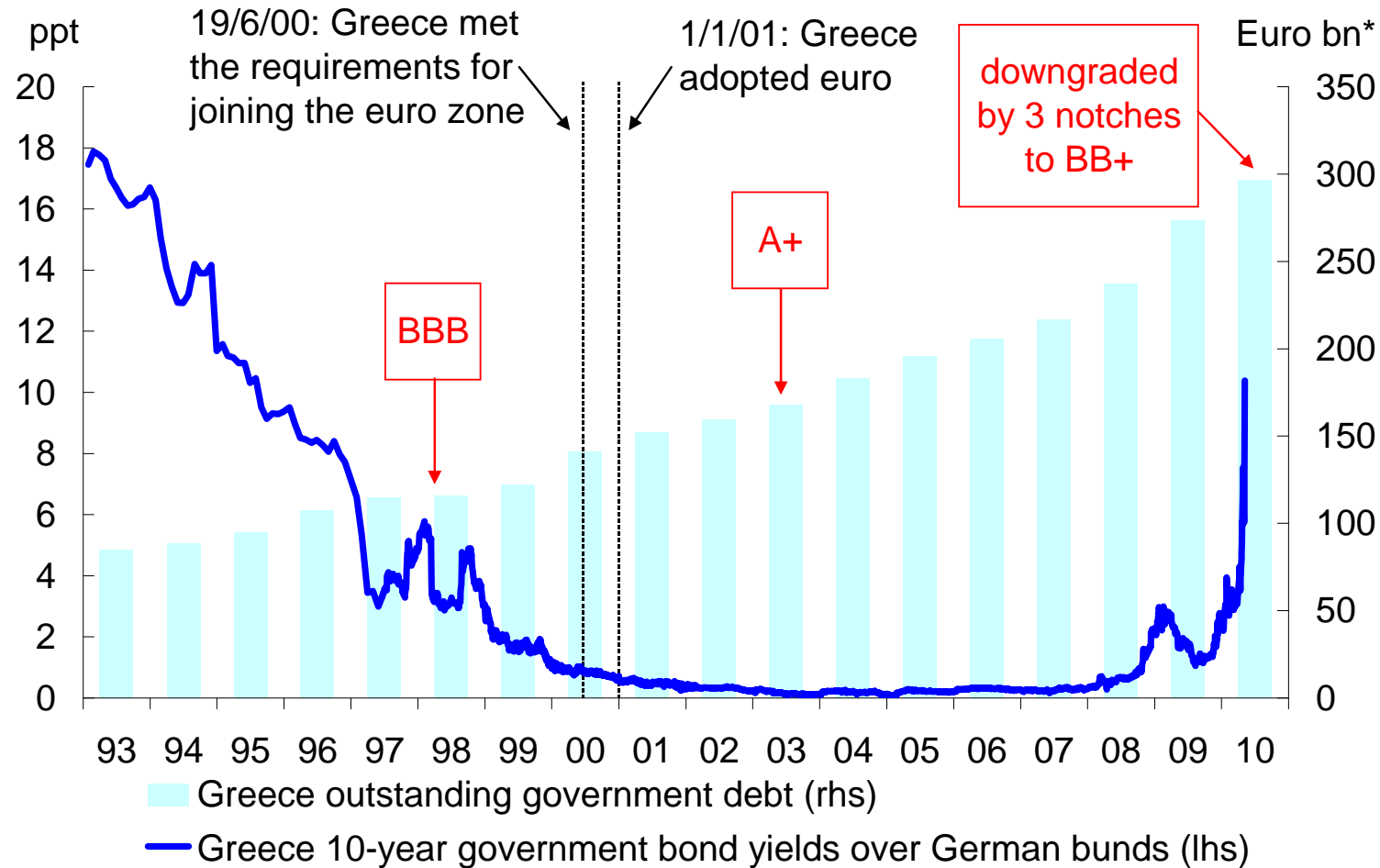
EUROPEAN SOVEREIGN DEBT PROBLEMS: CDS SPREADS



Source: Bloomberg



SOVEREIGN DEBT PROBLEMS: GREEK GOVERNMENT BOND YIELD AND GOVERNMENT DEBT



Standard & Poor's credit ratings

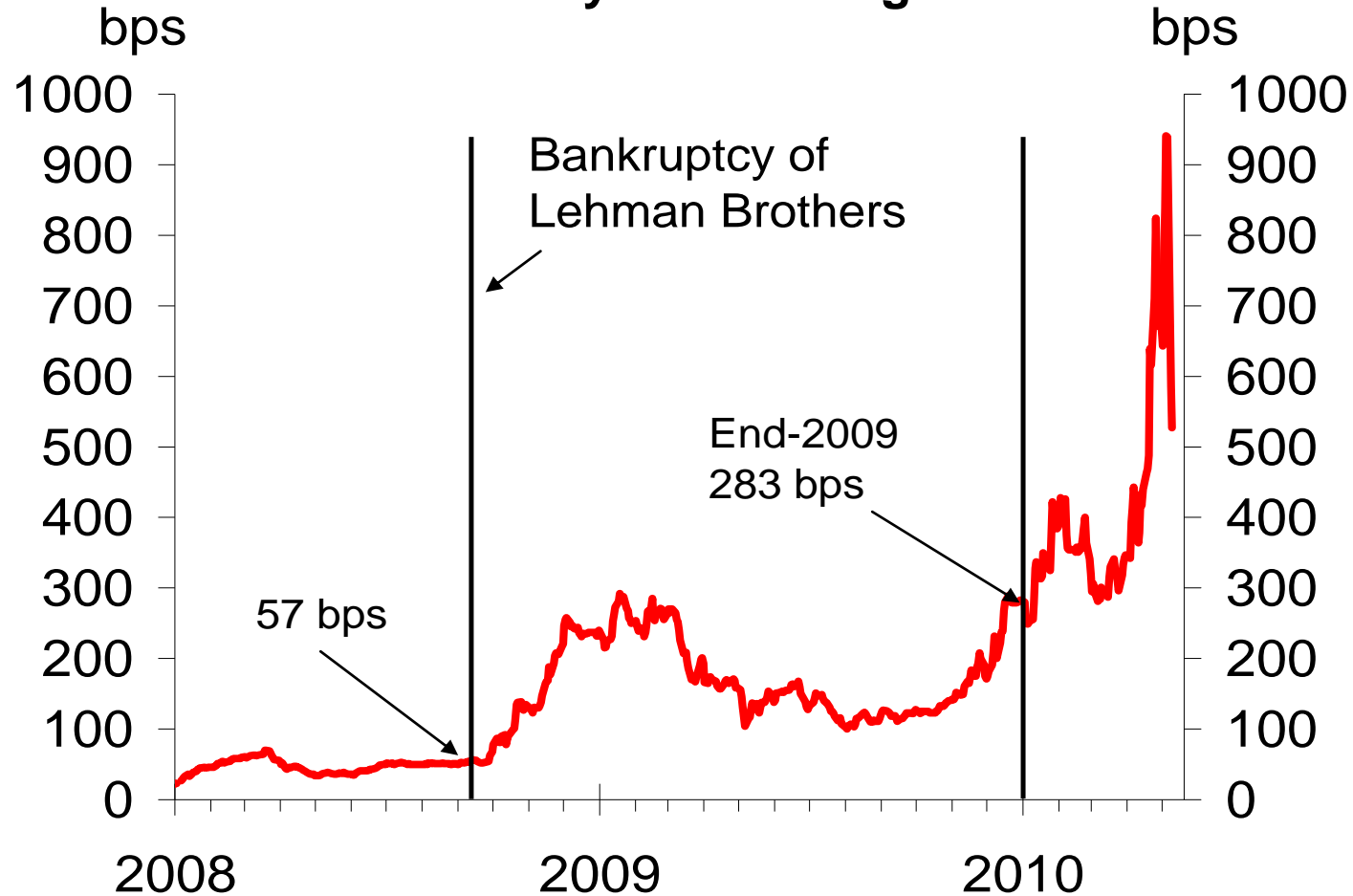
* ECU before 1999

Sources: EcoWin, European Commission AMECO database, and Reuters



SOVEREIGN DEBT PROBLEMS: CDS SPREAD OF GREECE

Prices of 5-year sovereign CDS



Source: Bloomberg

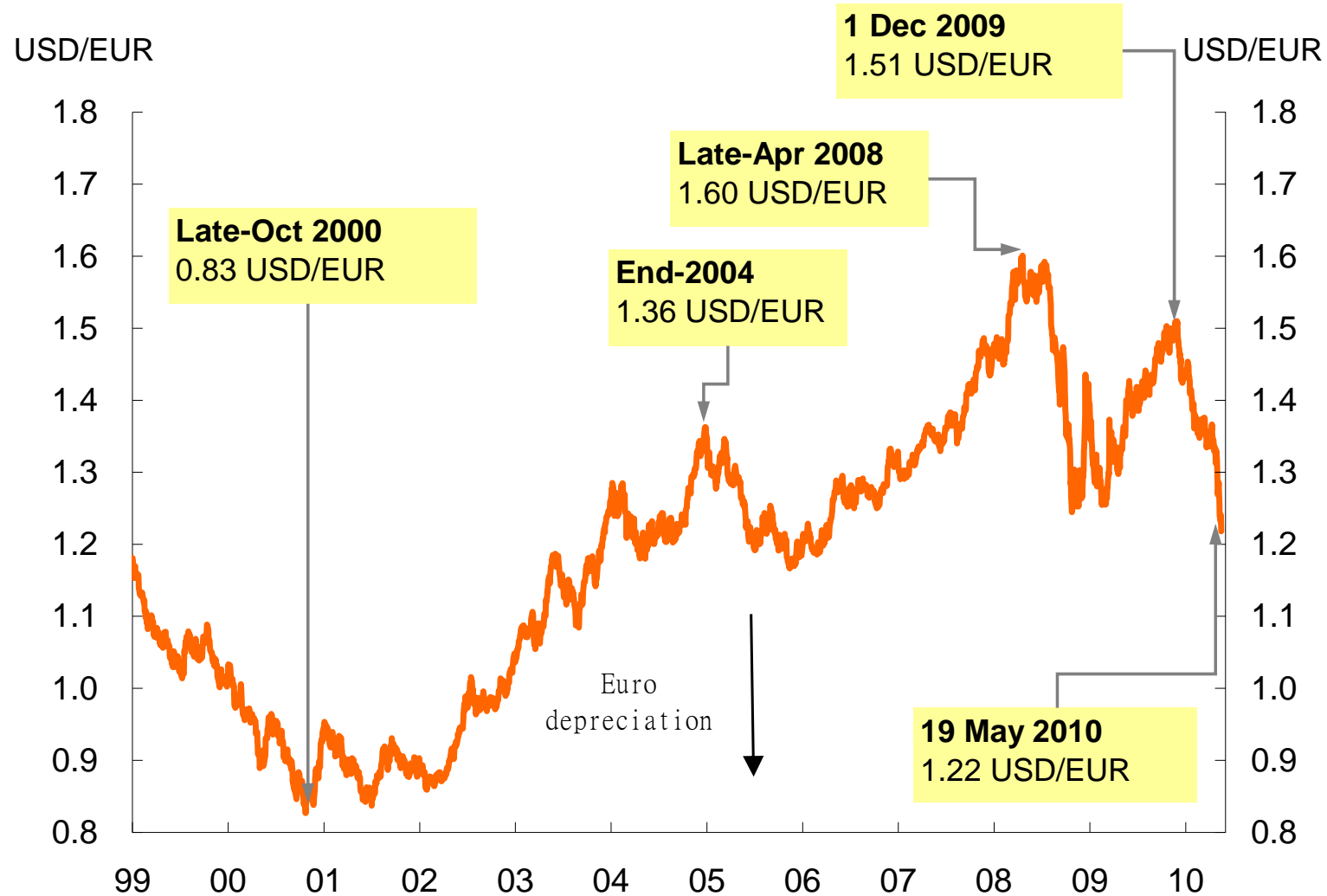


EU/IMF MEASURES TO AVERT A SOVEREIGN DEBT CRISIS IN EUROPE

- Loans and guarantees up to €750 billion are provided to the EU members by the EU and the IMF (earlier EU and IMF has agreed to provide Greece with a financing package of €110 billion)
- European Central Bank to buy government and private bonds in the secondary market and provide up to 6-month liquidity to the European banking sector
- Re-open the US dollar liquidity swap facilities between the Federal Reserve and other major central banks
- Other heavily indebted countries have also announced measures to reduce fiscal deficits and government debts



MOVEMENTS OF THE EURO EXCHANGE RATE

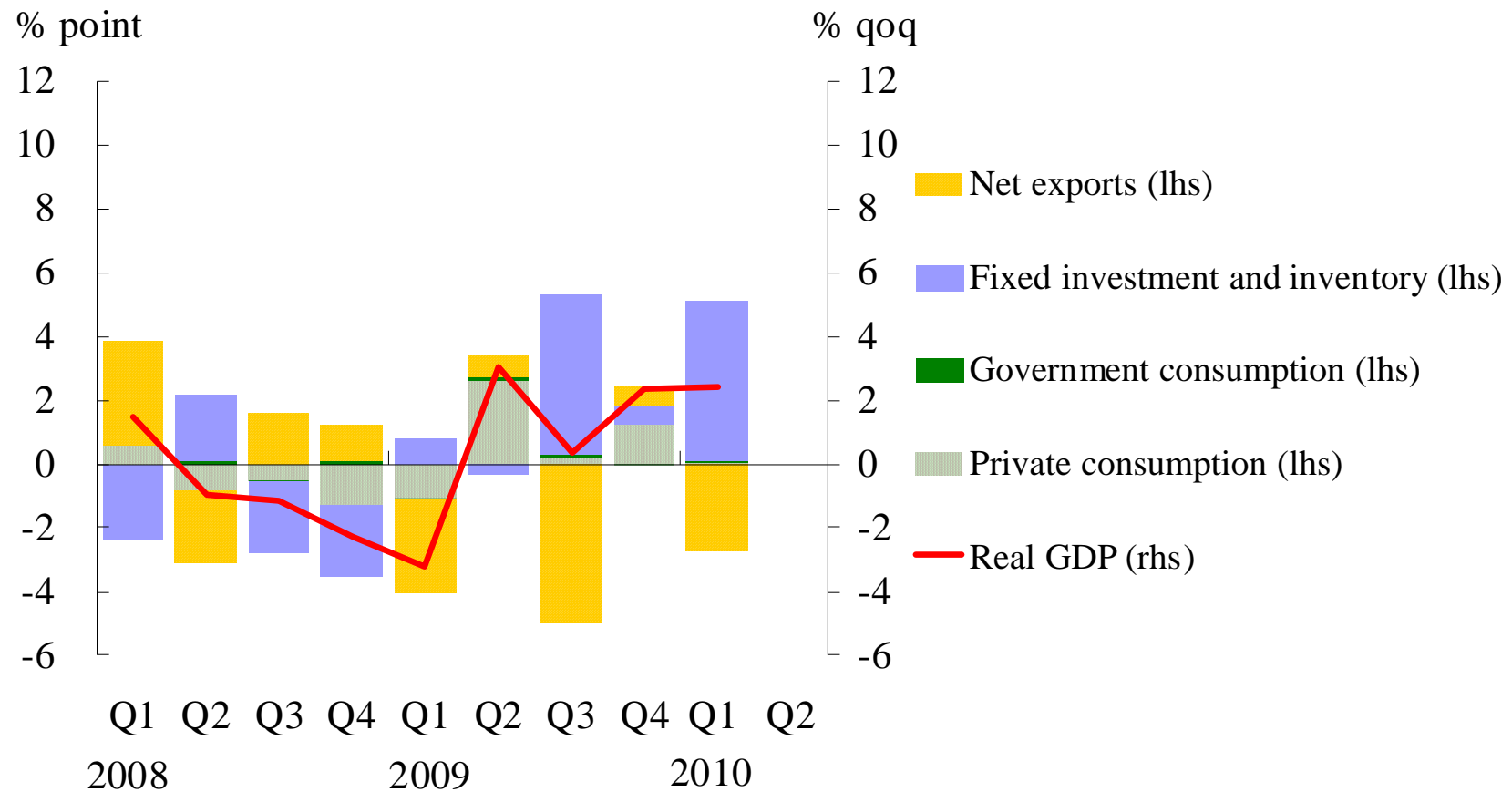


Sources: Bloomberg and CEIC



HONG KONG ECONOMIC SITUATION: REAL GDP GROWTH

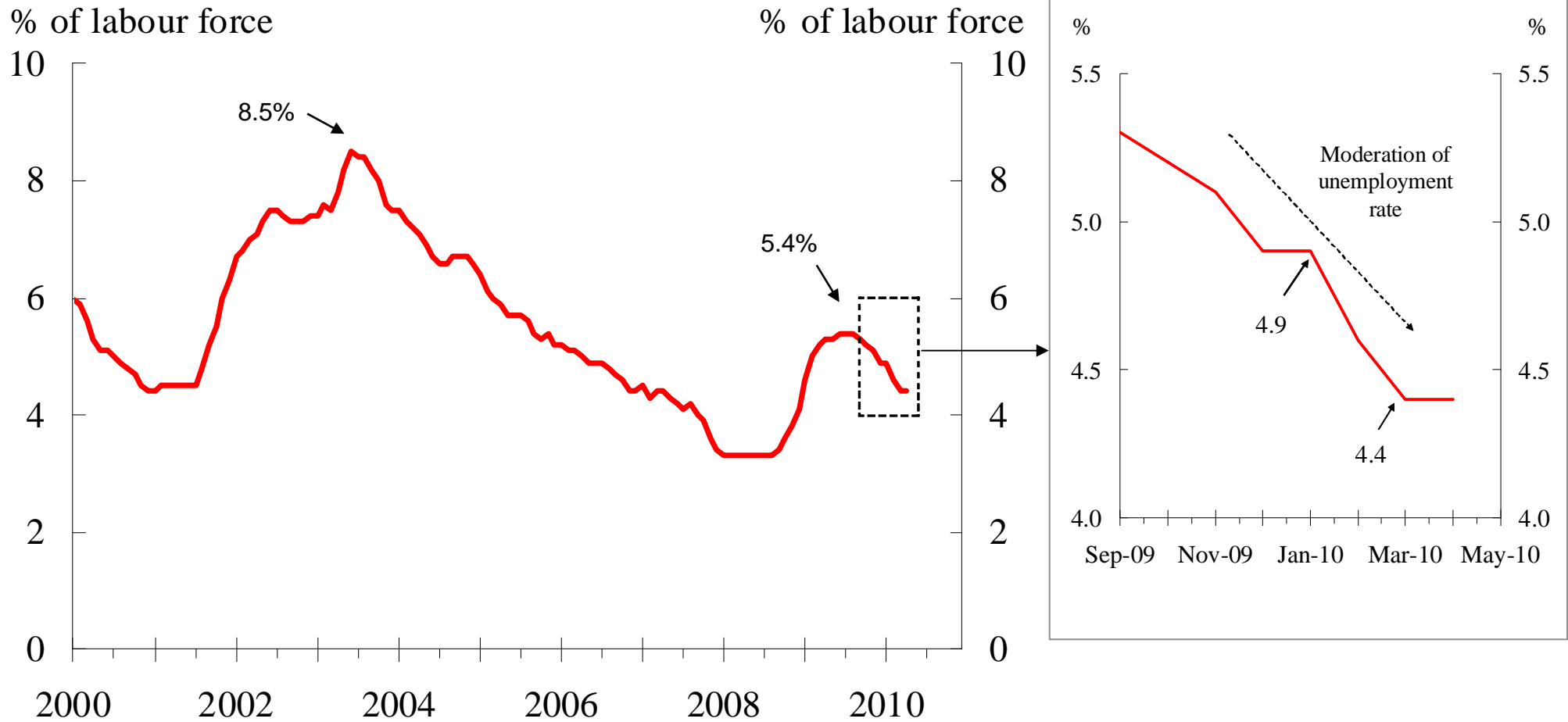
Change in Real GDP





HONG KONG ECONOMIC SITUATION: LABOUR MARKET

Unemployment Rate



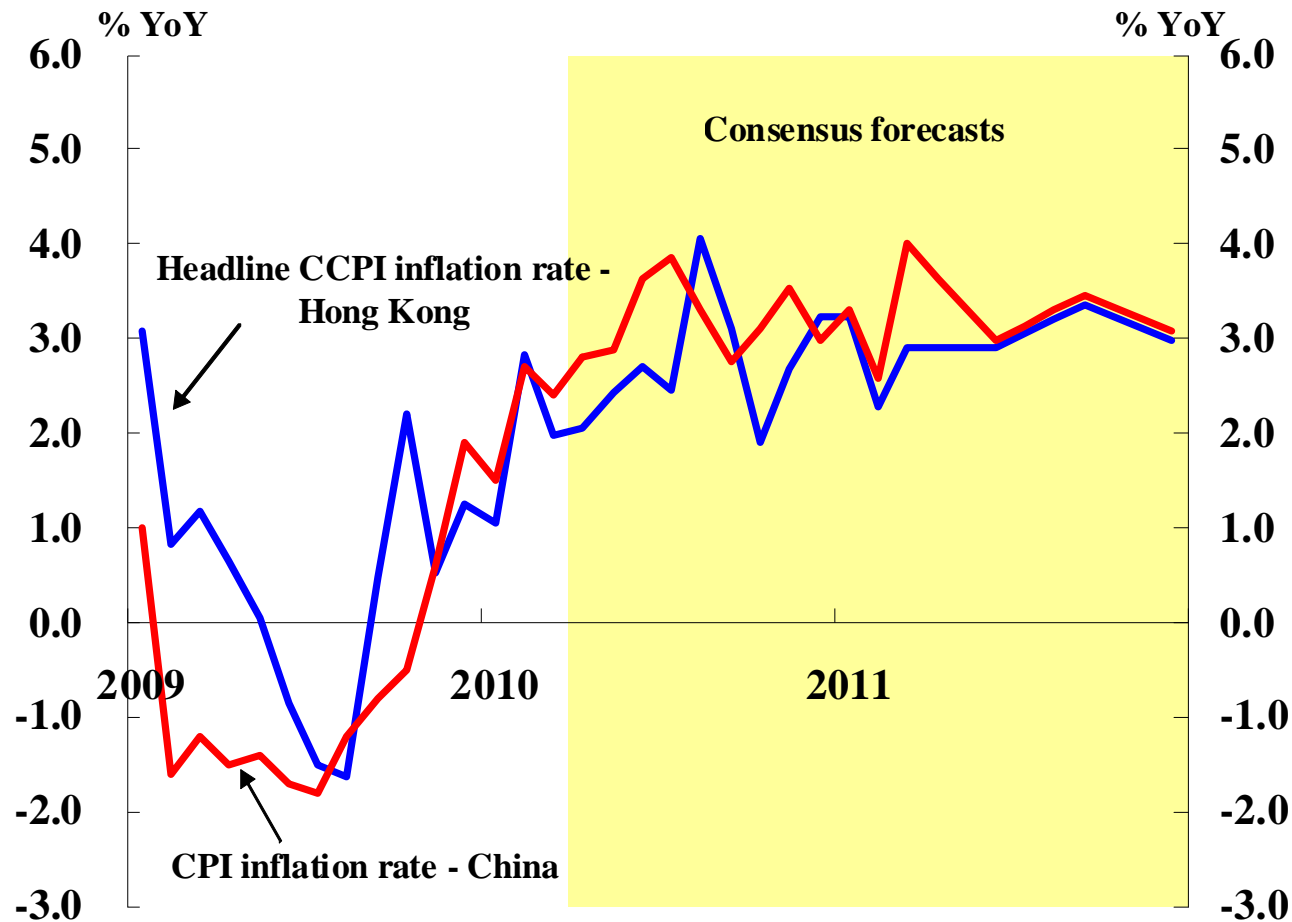


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ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: INFLATION

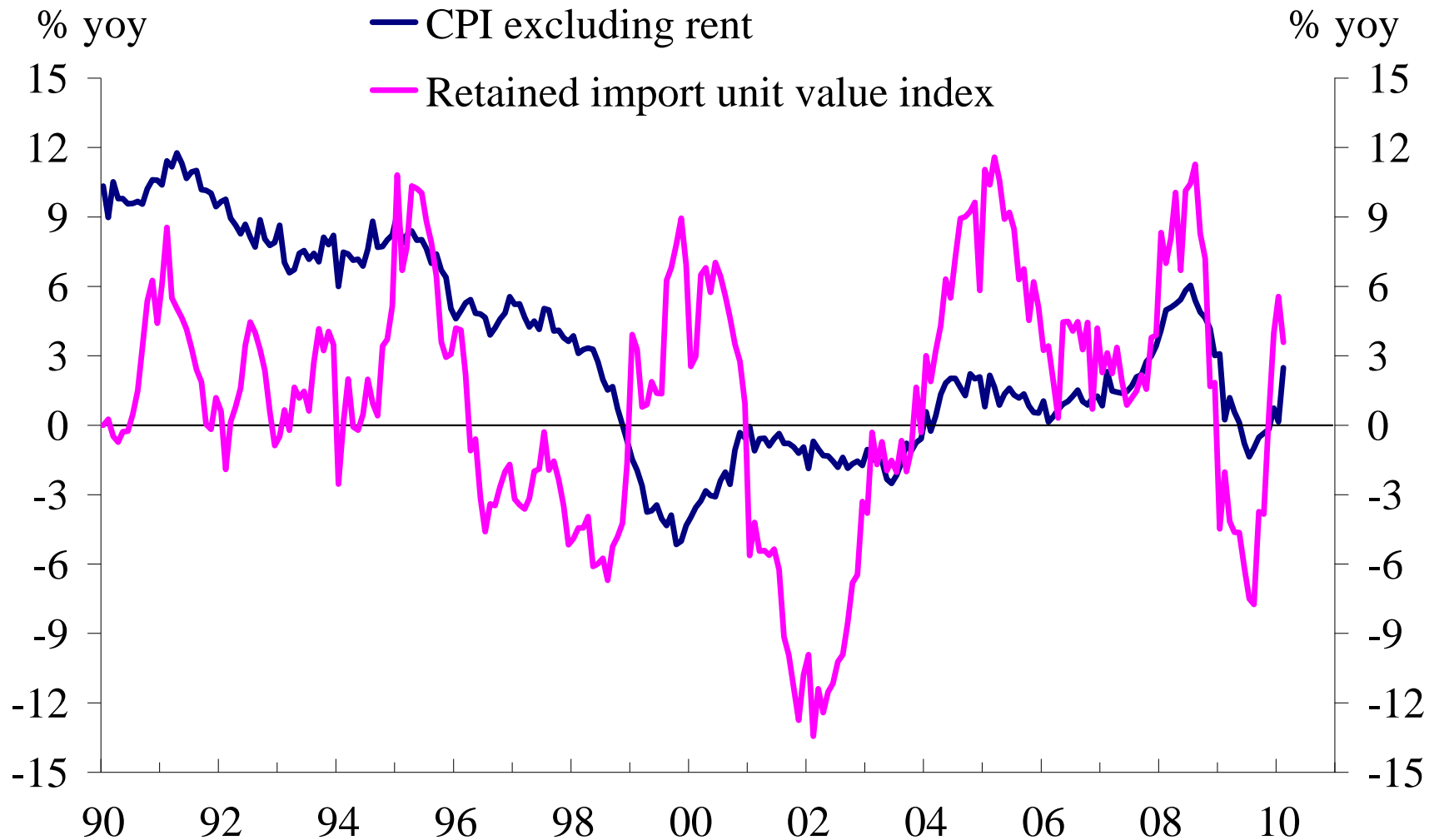
Inflation Trend of Mainland and Hong Kong





ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: INFLATION

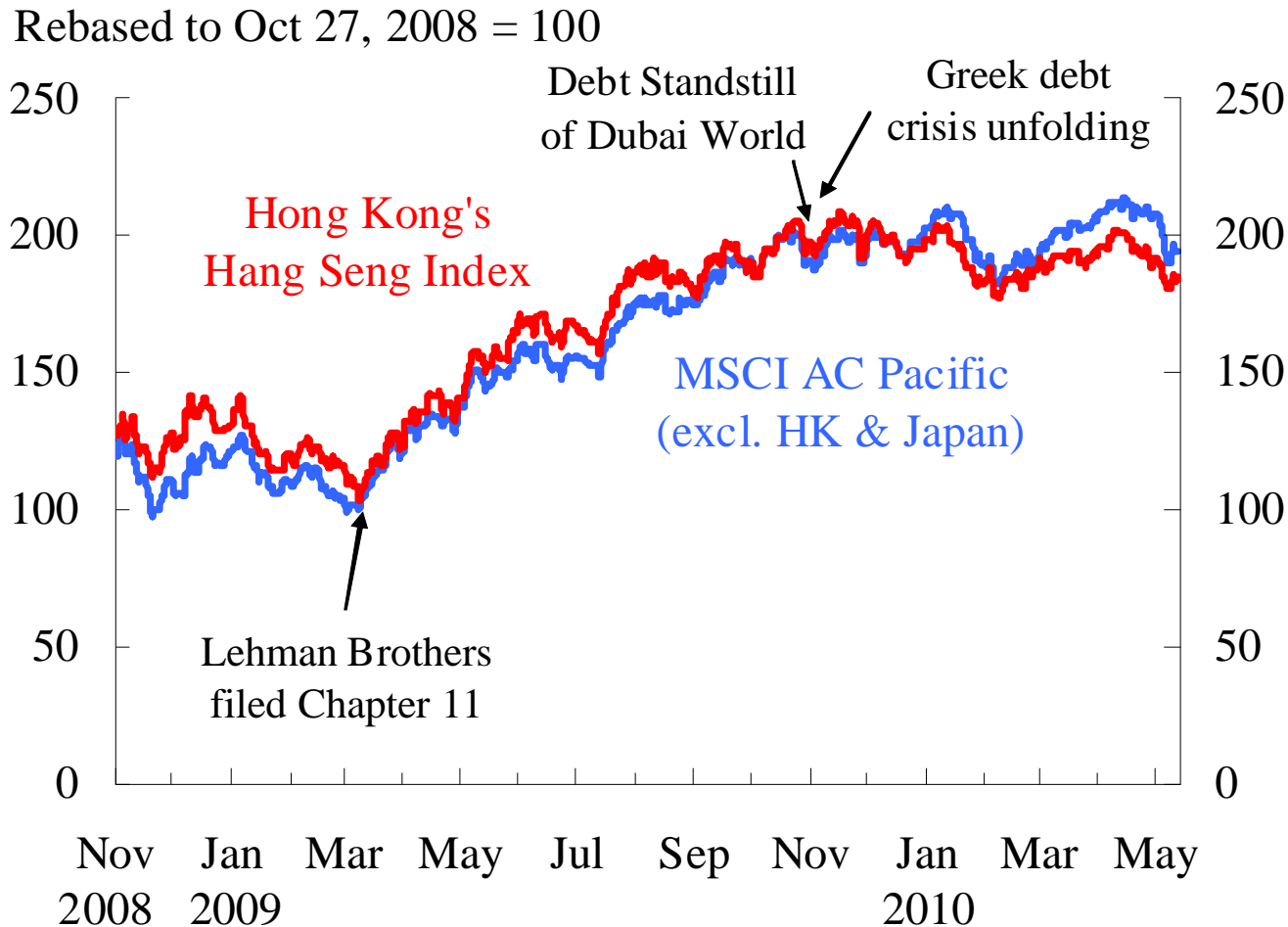
Retained import prices and consumer prices





ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: EQUITY MARKET

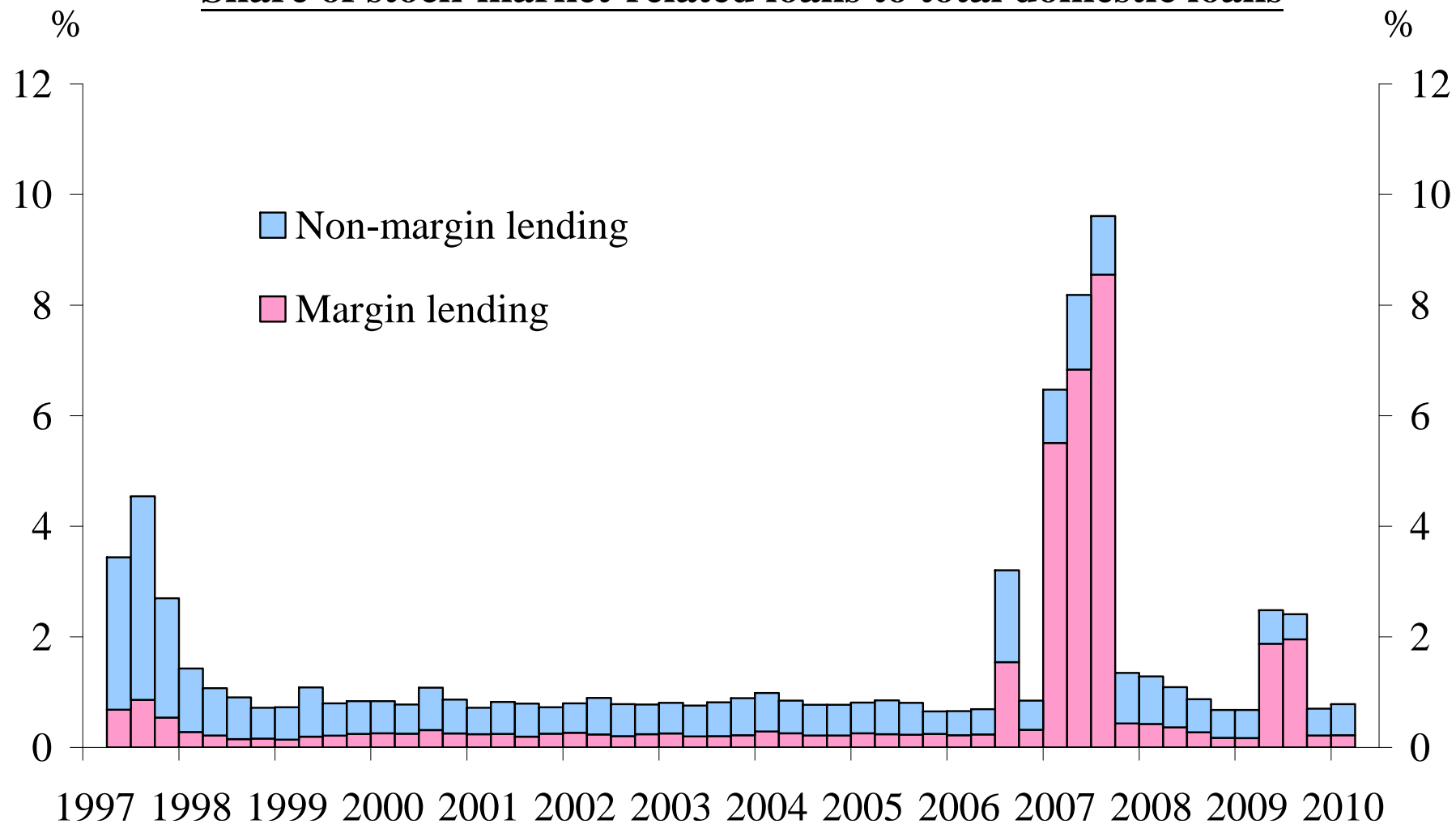
Hong Kong and Asia Pacific equity market performance





ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: EQUITY MARKET

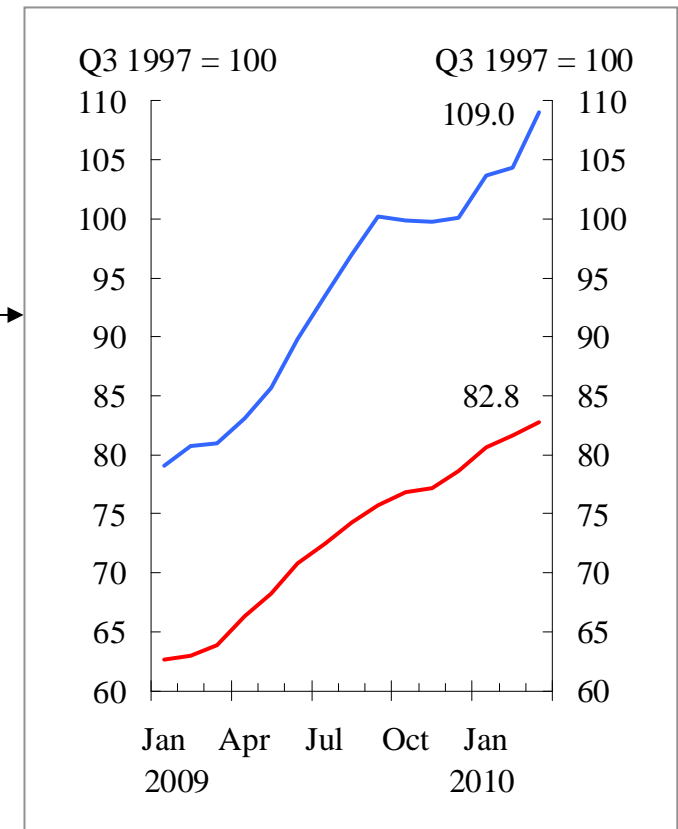
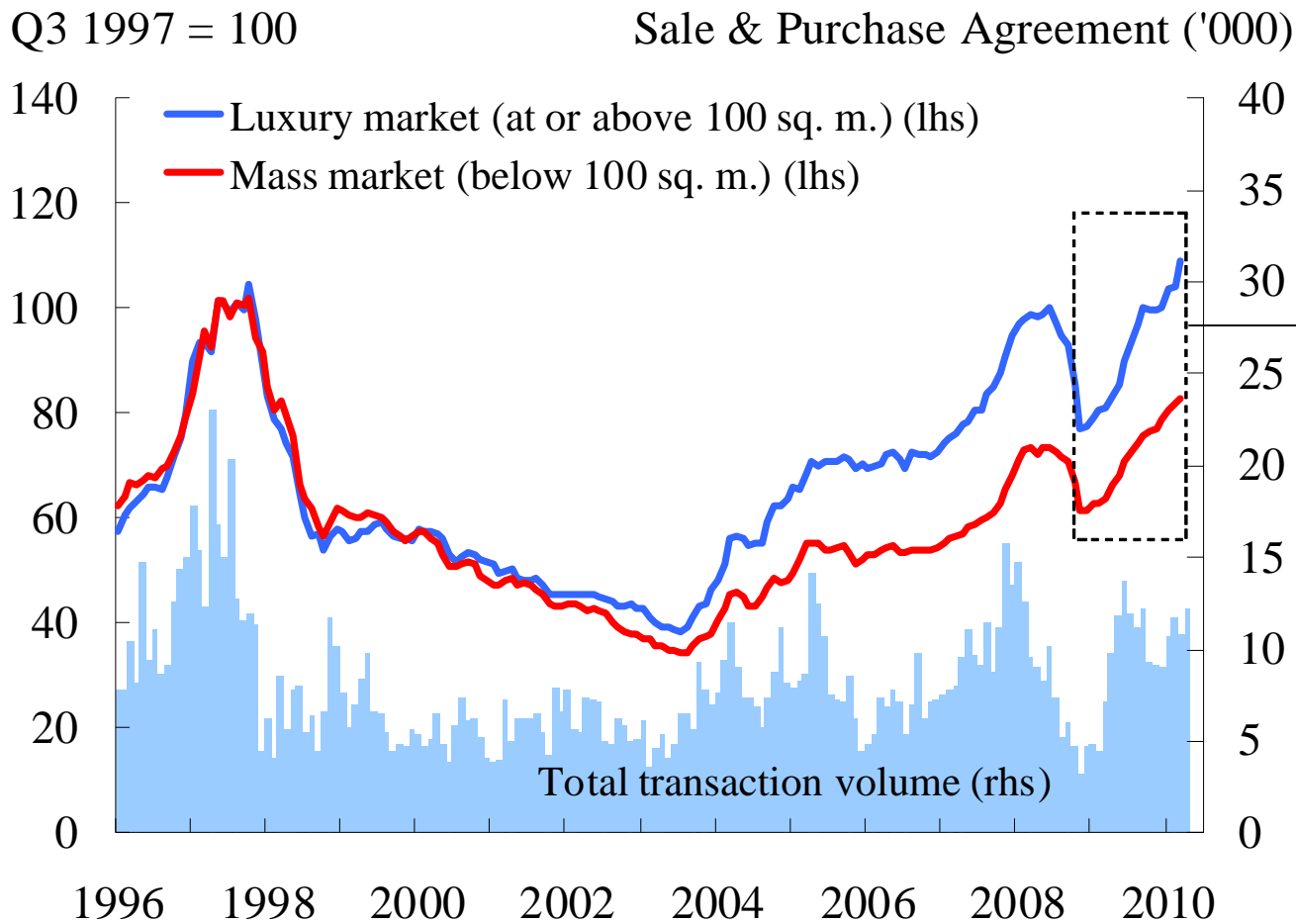
Share of stock-market-related loans to total domestic loans





ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Residential property prices and transaction volume

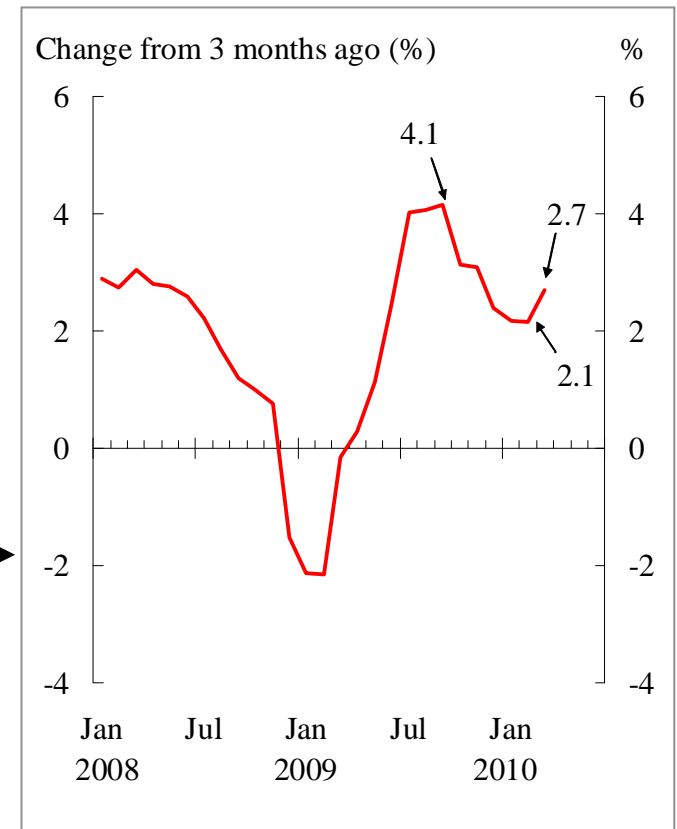
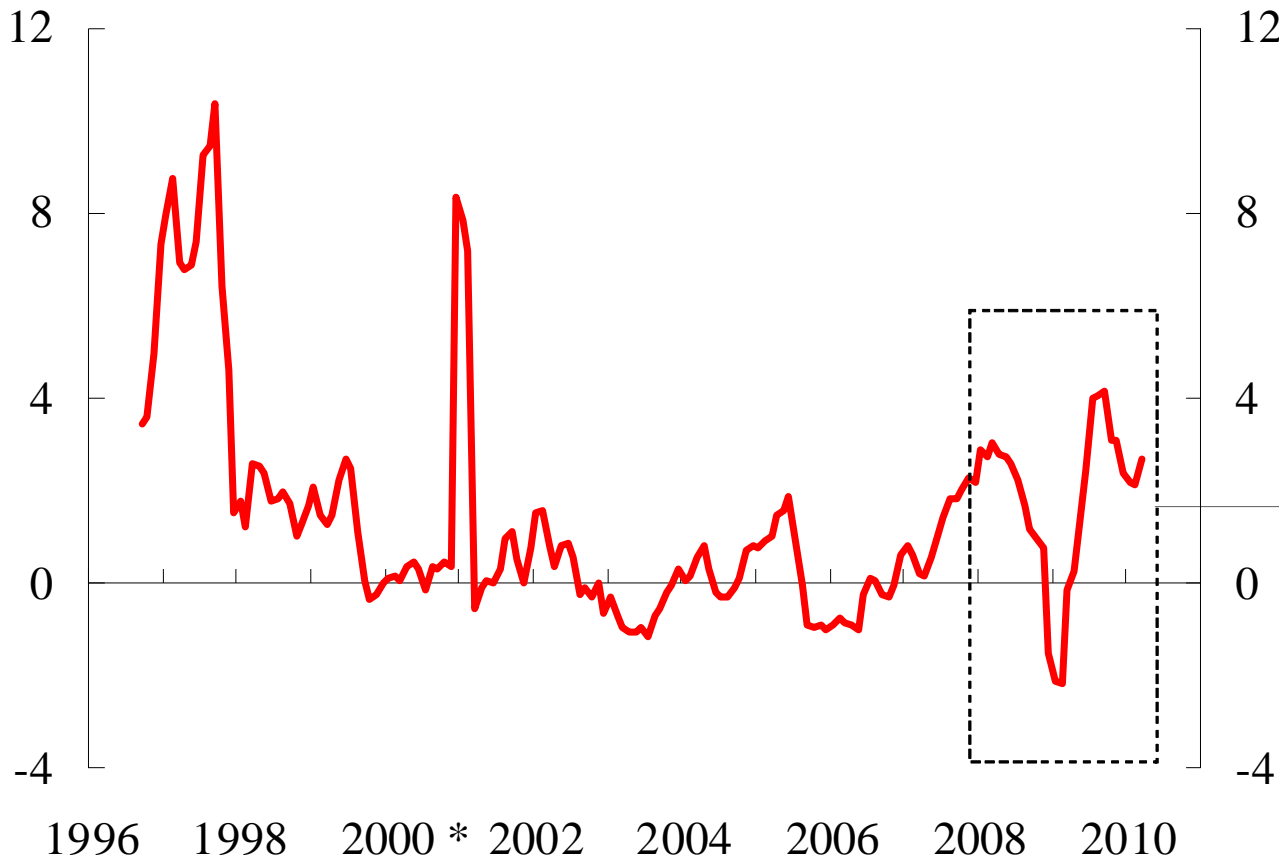




ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Outstanding mortgage loans

Change from 3 months ago (%)

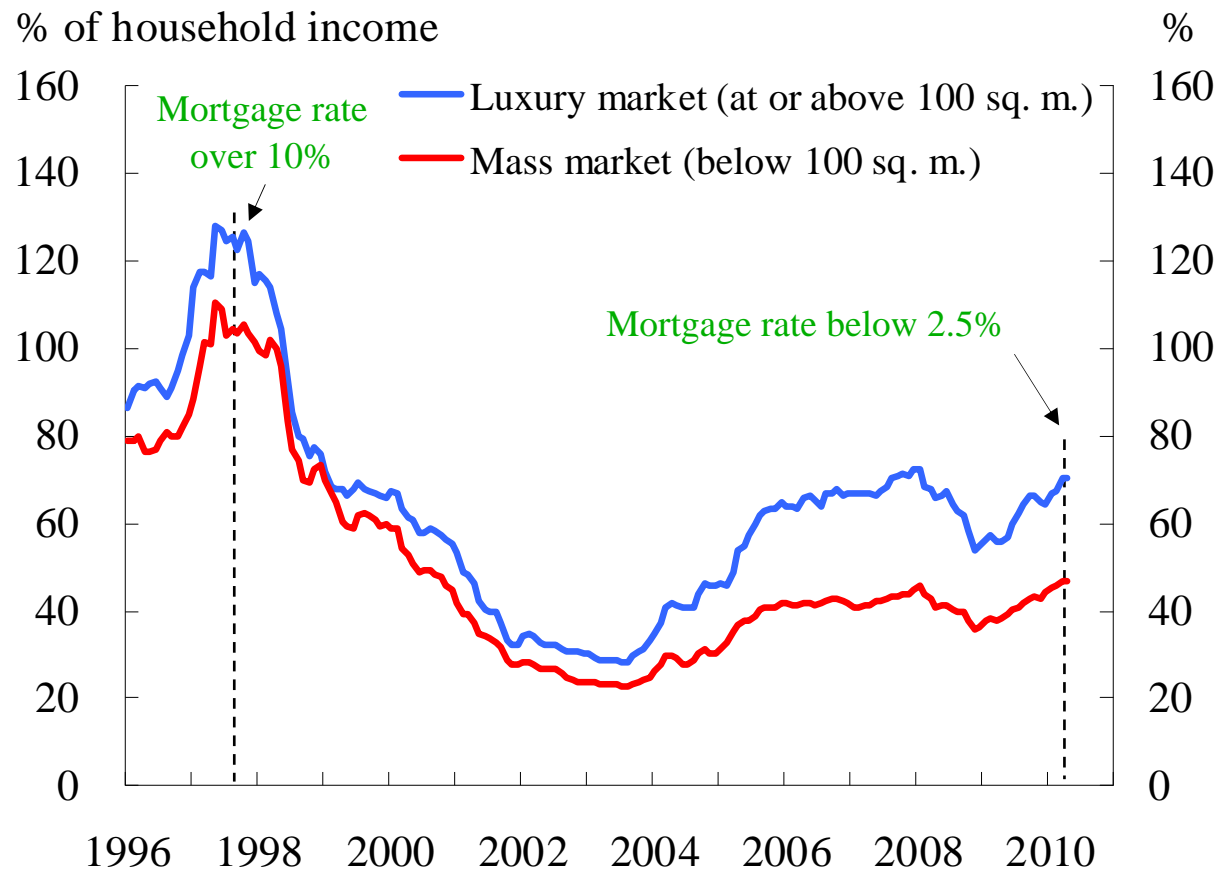


* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions.



ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Mortgage repayment-to-income ratio

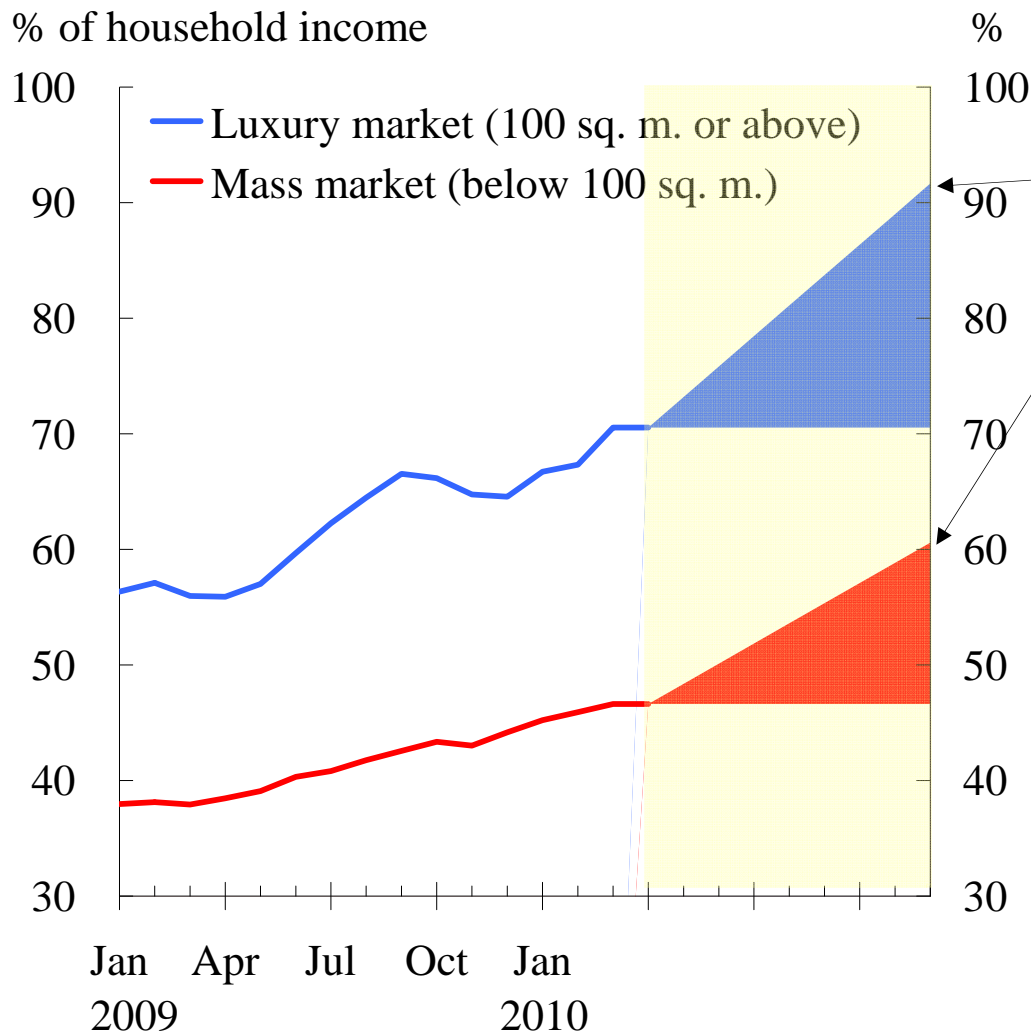


Note: For the luxury market, the ratio is calculated based on the 95th percentile income of households residing in private housing. For the mass market, it is based on the median income of households residing in private housing.



ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Impact of mortgage rate increase on mortgage repayment-to-income ratio

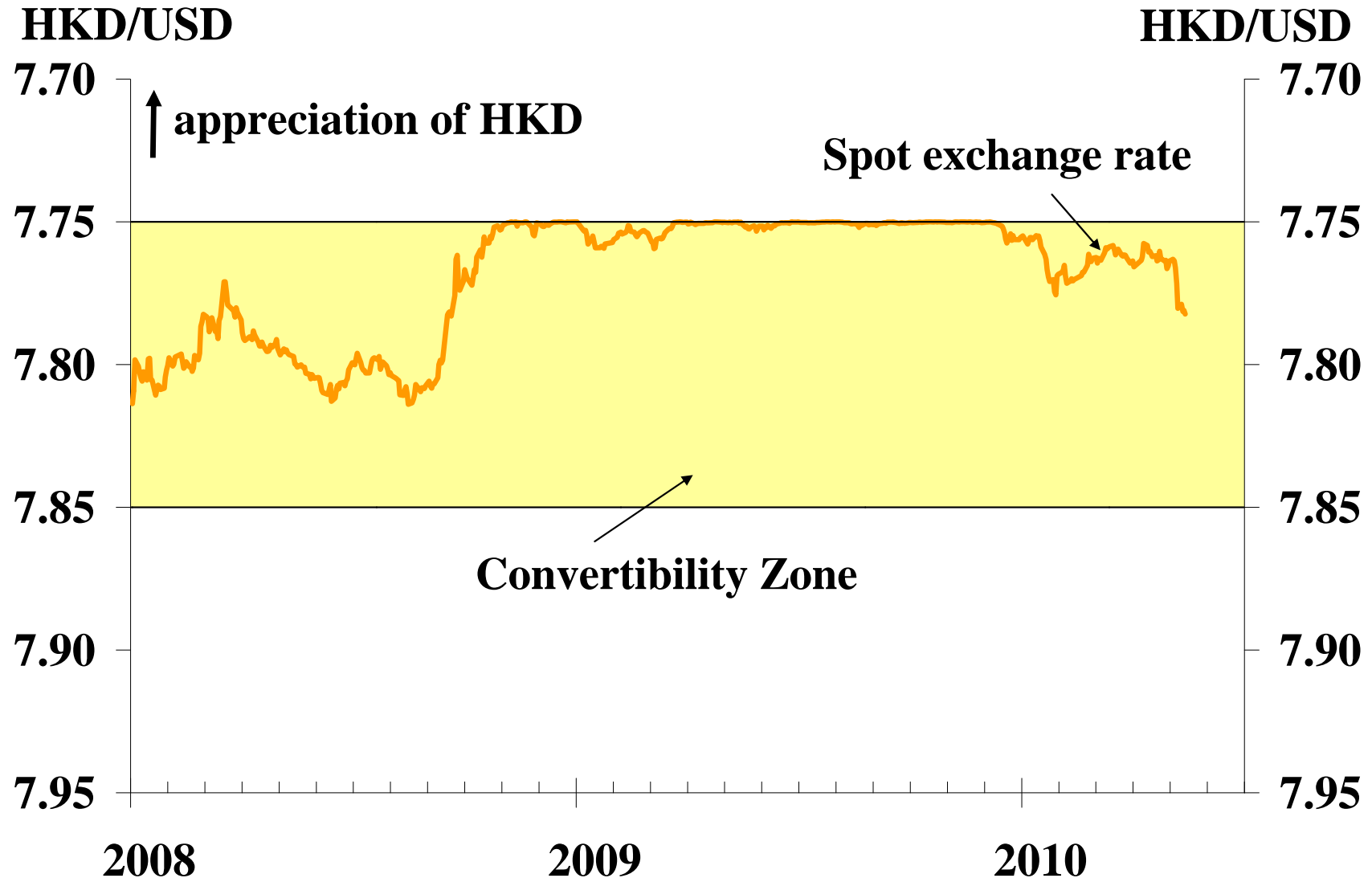


If mortgage interest rate rises by 300 bps,

- Repayment amount will rise by about 30%, assuming no change in repayment period



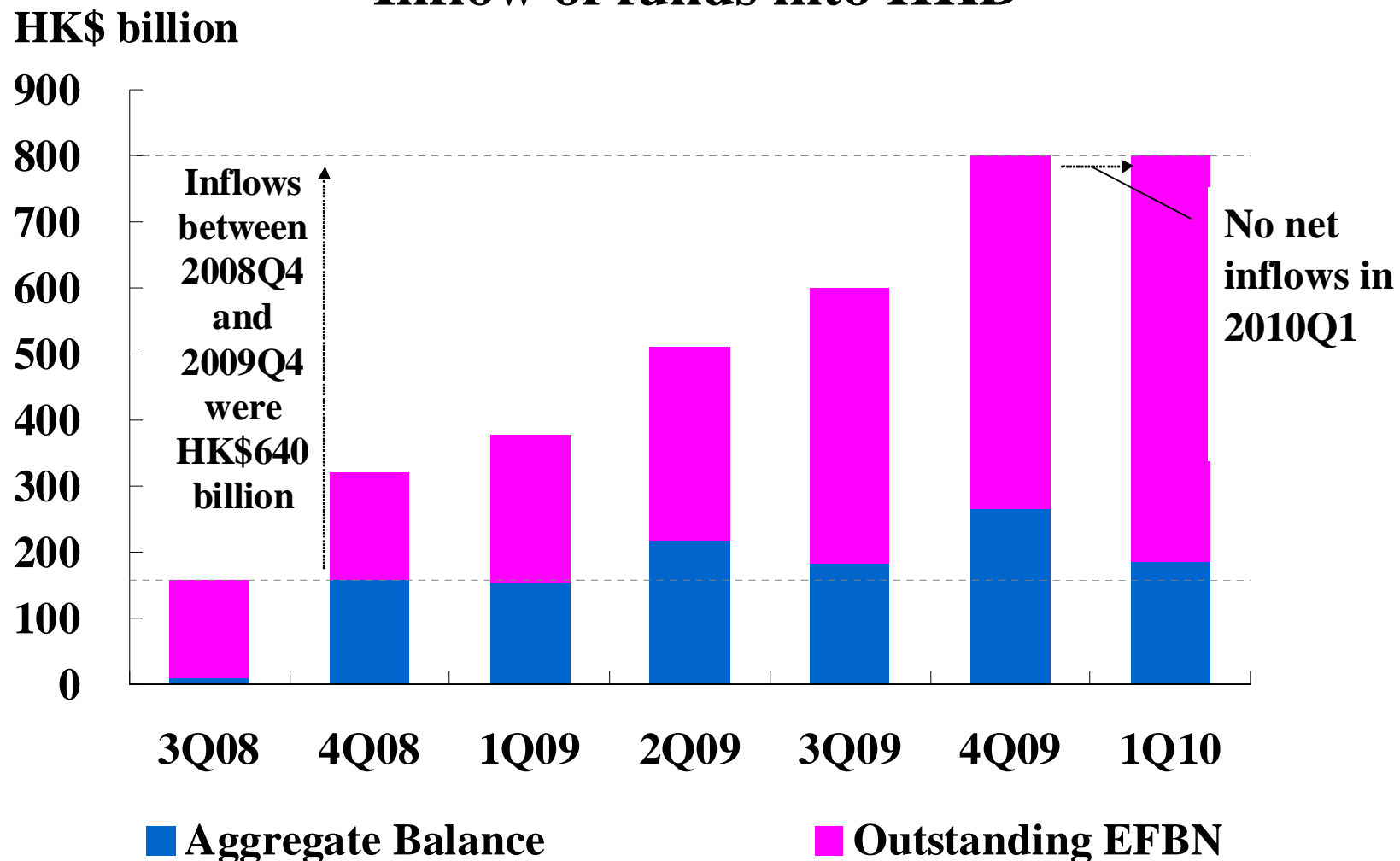
ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: CAPITAL FLOWS





ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: CAPITAL FLOWS

Inflow of funds into HKD

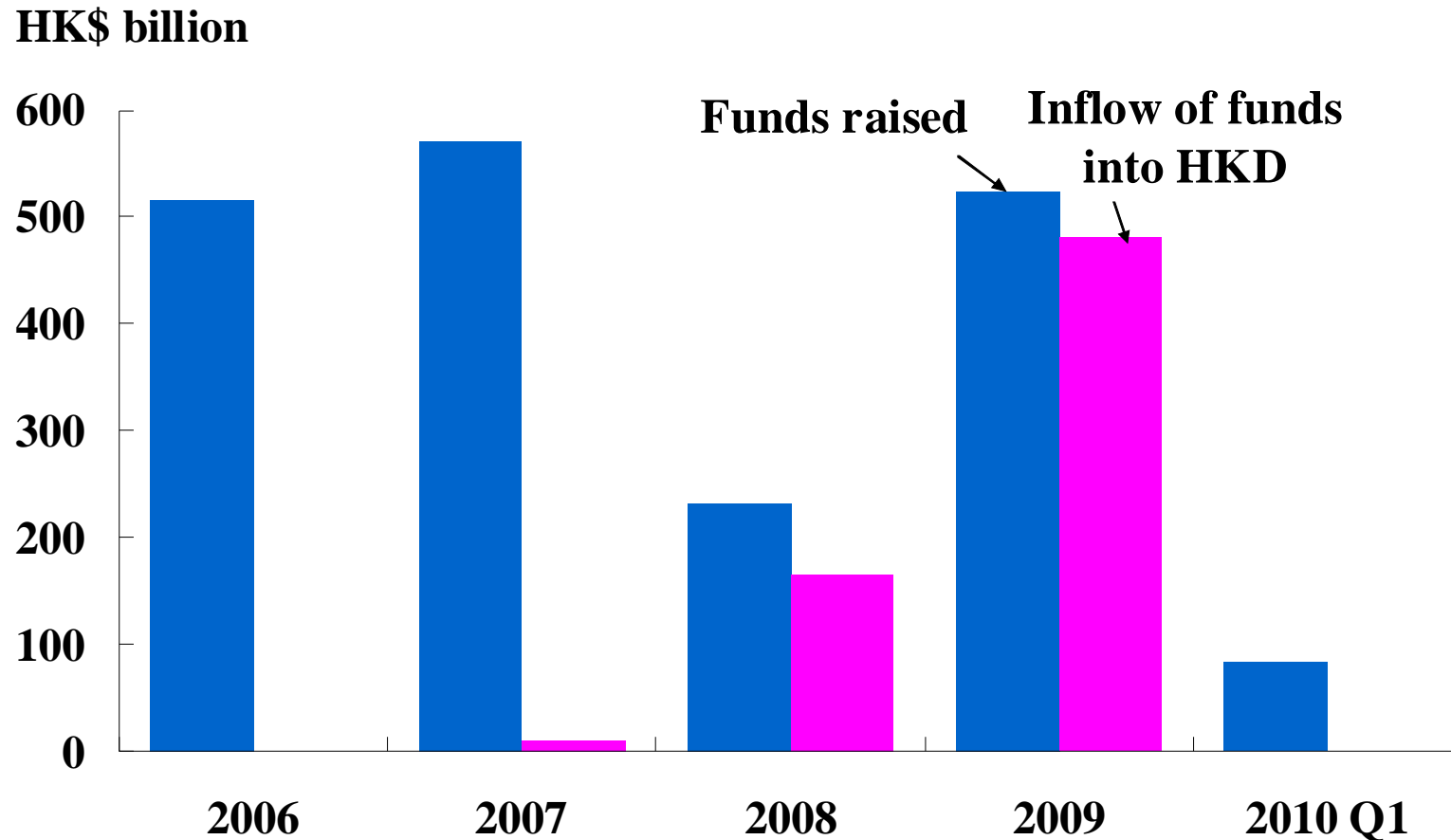


Note: The Outstanding EFBN and the Aggregate Balance are quarter-end figures.



ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: CAPITAL FLOWS

Equity fund-raising activities and inflows



Note (1): Equities funds raised include IPO, right issues, placings, open offers, consideration issues, warrants exercised and share option scheme.

Note (2): 2008-2009 figures differ from those provided by the HKEx as the activities which did not involve HKD flows have been excluded.



CONCLUSION (1)

- The low-interest-rate environment and monetary easing in the US and the euro area will persist for some time.
- Funds that flowed into the Hong Kong dollar during late-2008 and 2009 have not left Hong Kong. More funds might flow into the Hong Kong dollar if fund-raising activities in the equity market become more active again in the second half of the year.
- Given the exceptionally low interest rate, abundant liquidity and positive economic conditions, the risk of an asset bubble (especially in the property market) forming in Hong Kong has not lessened.



CONCLUSION (2)

- The HKMA has taken supervisory measures requiring banks to manage their credit risk properly. The loan-to-value ratio for residential mortgages on properties valued at \$20 million or more has been lowered to 60% (At the same time, the Government has taken steps to reduce the risk of a bubble forming in the property market through managing the supply of land and introducing other measures).
- Home-buyers should be alert to the risk of over-stretching themselves in applying for mortgages. Otherwise, they might face difficulties in repaying the loans when interest rates rise to a normal level.
- Investors should exercise caution as external factors affecting capital flows and interest rate movements in Hong Kong are clouded with uncertainties.

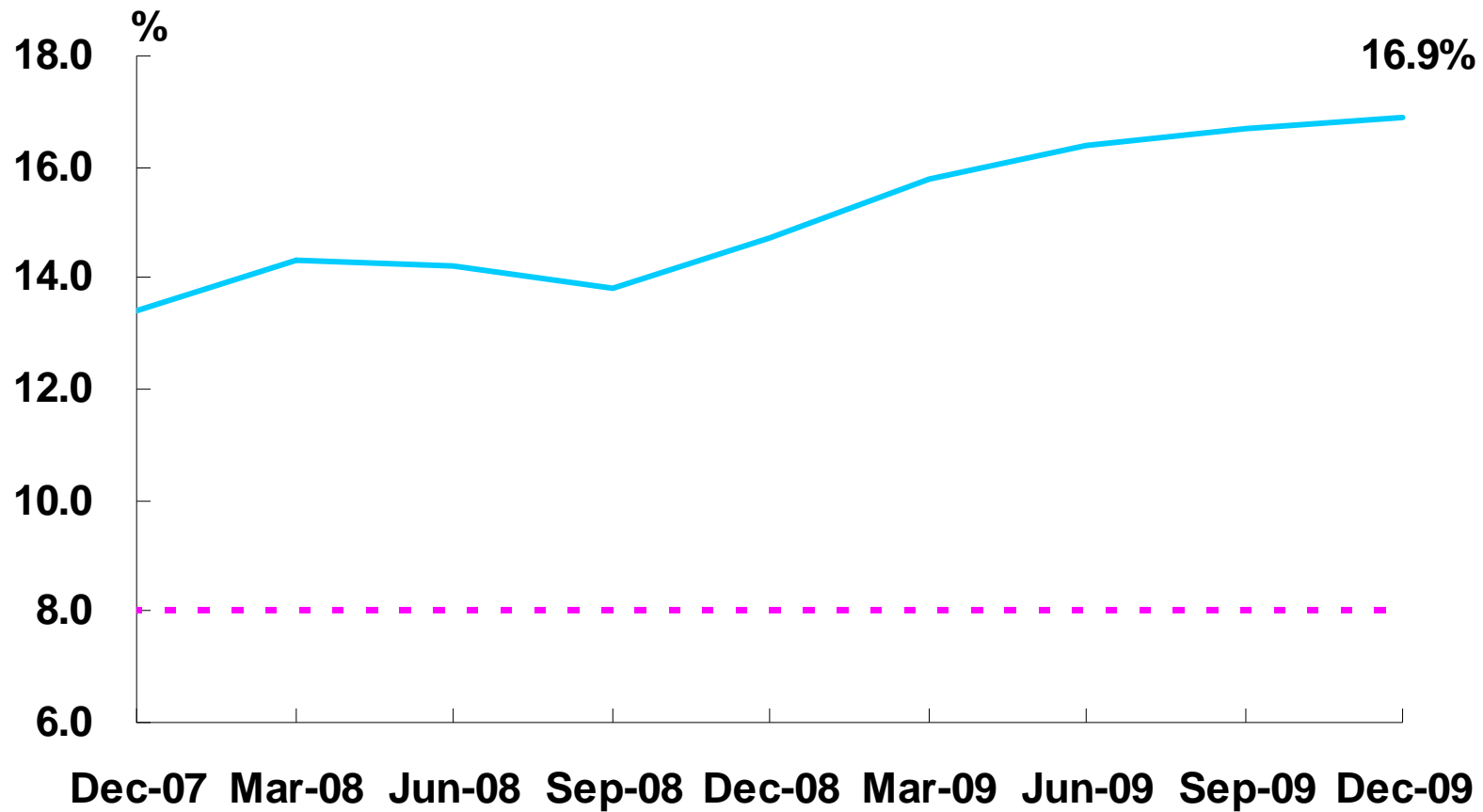


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BANKING SECTOR PERFORMANCE

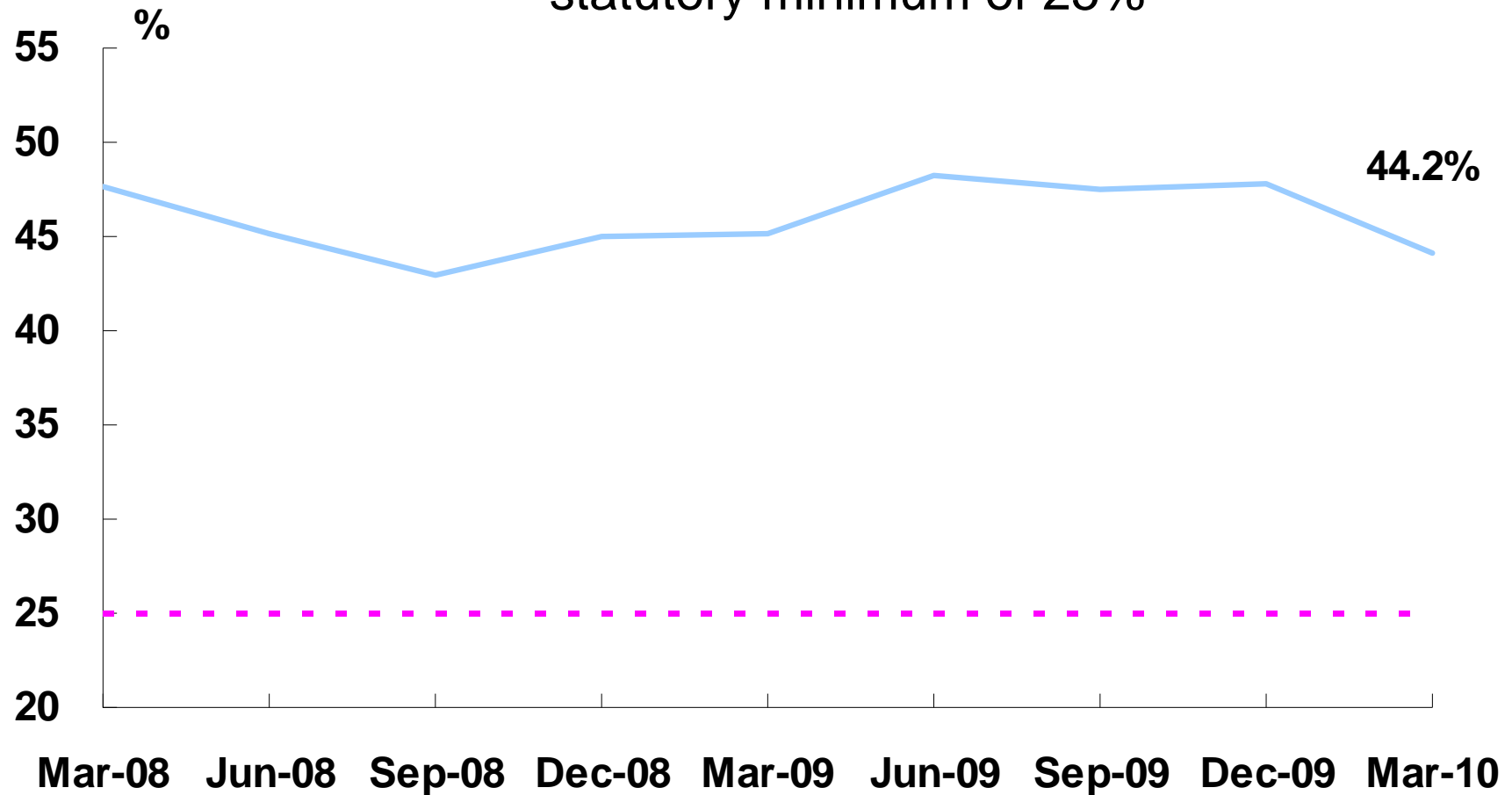
Locally incorporated AIs continued to be well capitalised





BANKING SECTOR PERFORMANCE

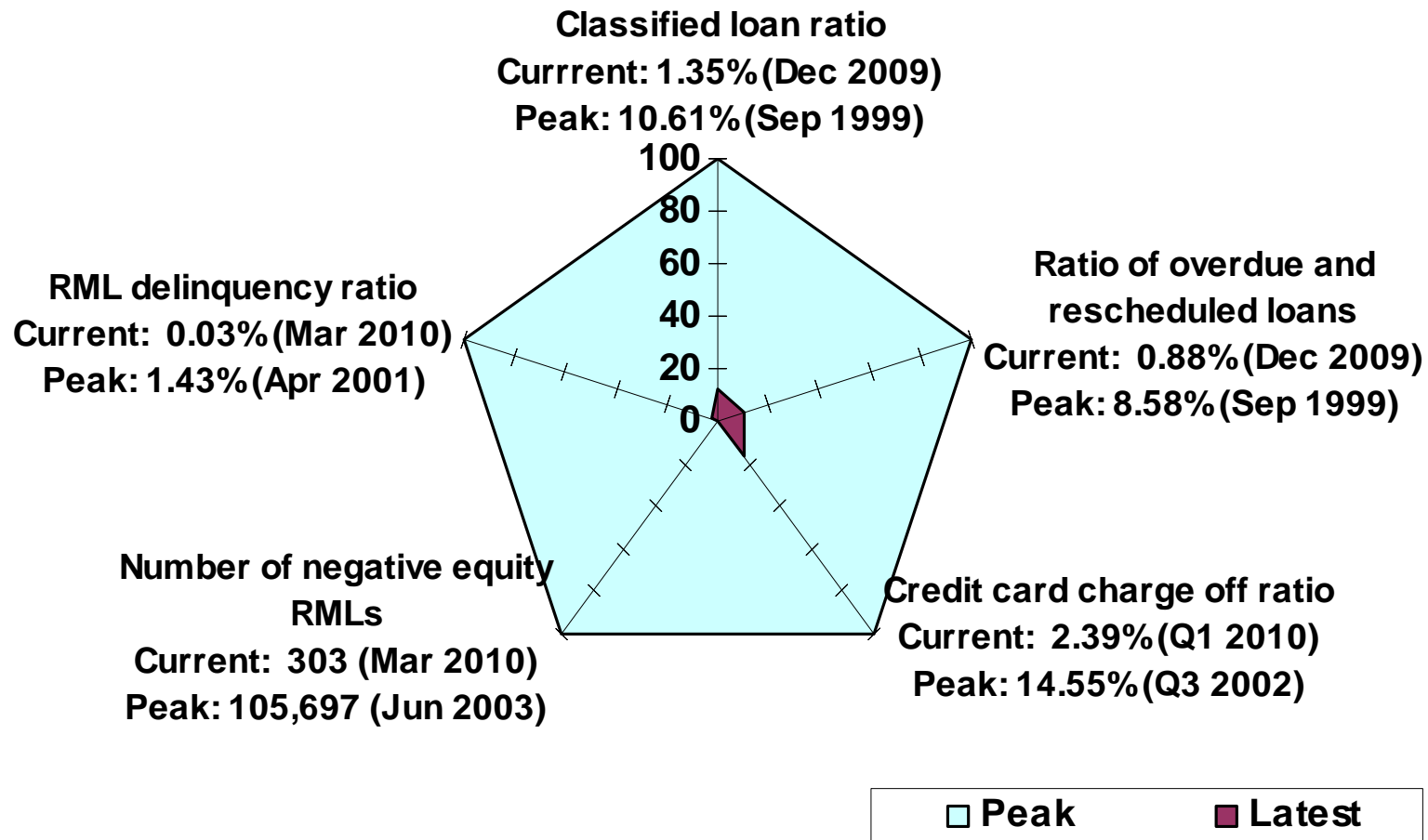
Liquidity ratio of retail banks remained well above statutory minimum of 25%





BANKING SECTOR PERFORMANCE

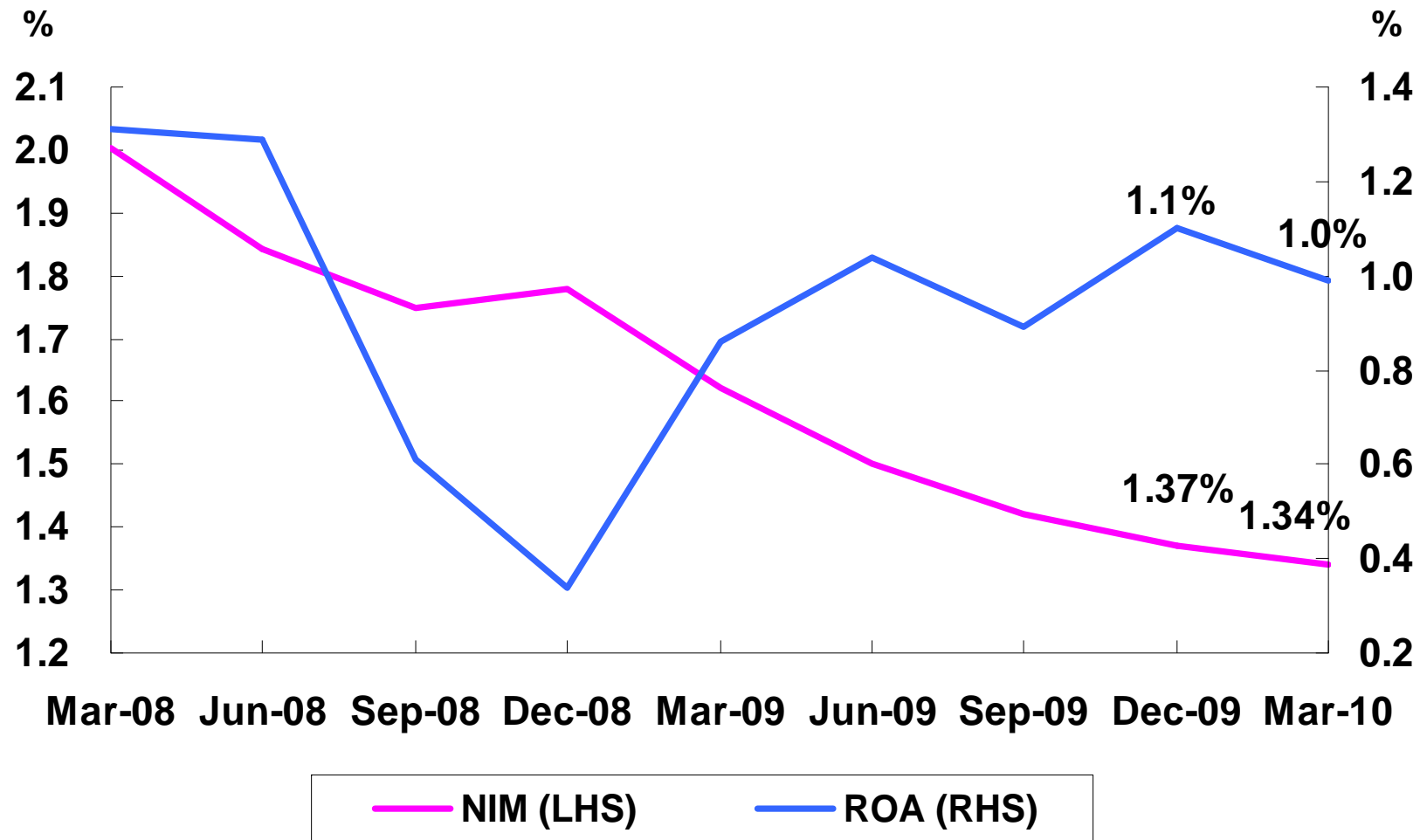
Asset quality indicators remained at comfortable levels compared with historical standards





BANKING SECTOR PERFORMANCE

Net interest margin and return on assets of retail banks





SUPERVISORY POLICY INITIATIVES

- Regulatory Capital Framework:
 - Basel Committee reform proposals
 - Amendment of Banking (Capital) Rules
- Liquidity regime:
 - Implementation of revised standards
- Supervisory guidance:
 - Guideline on remuneration issued in Mar 2010
 - Consultation on guidance on fair valuation practices for financial instruments



DEPOSIT PROTECTION

- The amendment bill for enhancing the Deposit Protection Scheme (DPS) was introduced into LegCo in April
- The enhanced DPS (including the new protection limit of \$500,000) expected to be effective immediately after the expiry of the full deposit guarantee
- The HKMA participated in a tripartite working group with the central banks of Malaysia and Singapore to implement a concerted exit strategy for full deposit guarantee by the end of this year by all three jurisdictions as scheduled



INVESTOR PROTECTION

- Mystery shopping programme to be implemented in the second half of 2010
- Assisting the Government on establishing the Investor Education Council and Financial Dispute Resolution Centre
- Working with SFC on implementation of proposed new measures to enhance investor protection, such as:
 - investor characterisation process
 - pre-sale disclosure of commissions and other commercial interests
- Introducing the Pre-Investment Cooling-Off Period



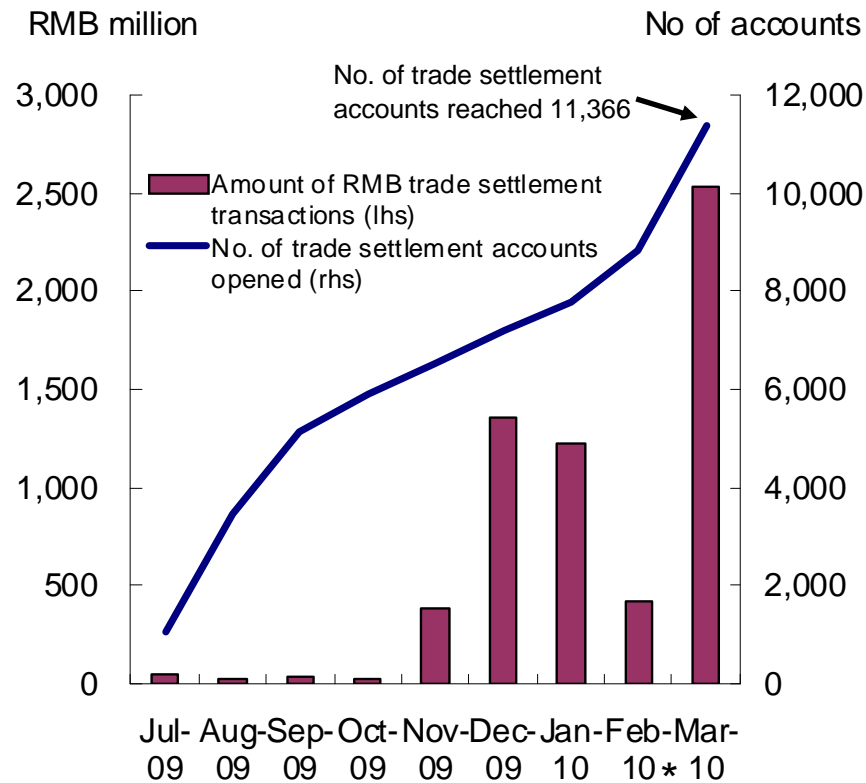
RENMINBI BUSINESS IN HONG KONG (1)

- On 11 February, HKMA issued an elucidation of the supervisory principles and operational arrangements regarding RMB business in Hong Kong to simplify the operational procedures and increase the flexibility in developing diversified RMB-denominated financial products in Hong Kong:
 - Mainland authorities and banks are responsible for verifying whether transactions undertaken by the Mainland counterparts are in compliance with the relevant rules and requirements in the Mainland, while Participating AIs in Hong Kong will process the RMB transactions in accordance with the usual banking practices in Hong Kong
 - With regard to the RMB funds that have flowed into Hong Kong, Participating AIs can develop RMB businesses based on the regulatory requirements and market conditions in Hong Kong

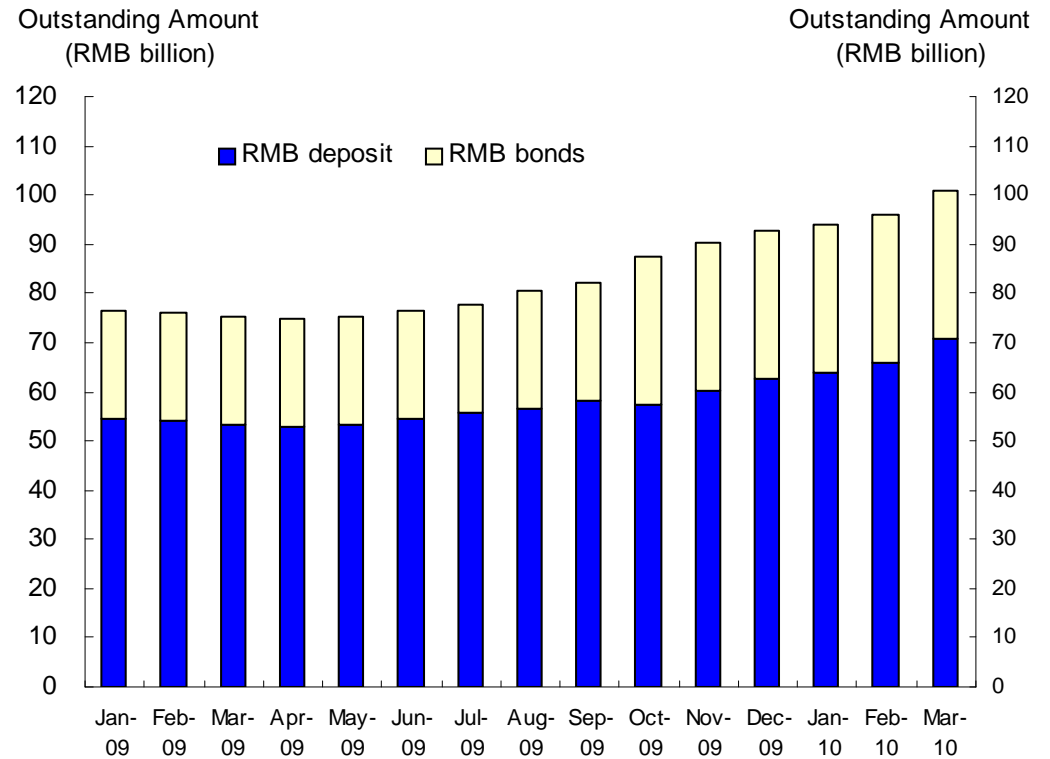


RENMINBI BUSINESS IN HONG KONG (2)

RMB trade settlement gained momentum in March 2010



RMB deposits and bonds issuance in Hong Kong increasing steadily



* The Chinese New Year fell in February in 2010, so there were fewer working days than usual in that month.



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INVESTMENT INCOME

	2010	2009	2008	2007
(HK\$ billion)	Q1 *	Full Year	Full Year	Full Year
Gain/(Loss) on Hong Kong equities ^{^@}	(3.1)	48.9	(77.9)	55.8
Gain/(Loss) on other equities [^]	11.2	48.8	(73.1)	6.7
Exchange gain/(loss)	(8.7)	9.8	(12.4)	18.7
Return from bonds [#]	<u>11.4</u>	<u>(0.6)</u>	<u>88.4</u>	<u>61.0</u>
Investment income/(loss) [@]	10.8	106.9	(75.0)	142.2

* Unaudited figures

[^] Including dividends

[#] Including interest

[@] Excluding valuation changes in Strategic Portfolio



CHANGES IN INVESTMENT INCOME, PAYMENT TO FISCAL RESERVES AND ACCUMULATED SURPLUS

(HK\$ billion)	2010		2009			
	Q1*	Full year	Q4	Q3	Q2	Q1
Investment income/(loss)	10.8	106.9	10.0	71.9	58.5	(33.5)
Other income	0.0	0.2	0.0	0.0	0.2	0.0
Interest and other expenses	<u>(0.9)</u>	<u>(3.8)</u>	<u>(1.0)</u>	<u>(0.9)</u>	<u>(1.2)</u>	<u>(0.7)</u>
Net investment income/(loss)	9.9	103.3	9.0	71.0	57.5	(34.2)
Payment to Fiscal Reserves #	(8.5)	(33.5)	(7.9)	(8.0)	(8.5)	(9.1)
Payment to HKSAR government funds and statutory bodies #	<u>(0.8)</u>	<u>(1.2)</u>	<u>(0.6)</u>	<u>(0.3)</u>	<u>(0.3)</u>	0.0
Valuation change of Strategic Portfolio^	<u>(0.6)</u>	<u>4.4</u>	<u>0.0</u>	<u>1.3</u>	<u>3.2</u>	<u>(0.1)</u>
Increase/(Decrease) in EF Accumulated Surplus	0.0	73.0	0.5	64.0	51.9	(43.4)

* Unaudited figures

The fixed rate of fee payment is 6.3% for 2010 and 6.8% for 2009

^ Including dividends