



**HONG KONG MONETARY AUTHORITY**

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

**1 March 2011**



- 1. International Macro Financial Conditions**
- 2. Assessment of Risk on Hong Kong's Financial Stability**
- 3. Latest Developments of Hong Kong as an International Financial Centre**
- 4. Latest Developments in the Banking Sector**
- 5. Investment Income of the Exchange Fund in 2010**



- 1. International Macro Financial Conditions**
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## GLOBAL ECONOMIC GROWTH FORECASTS

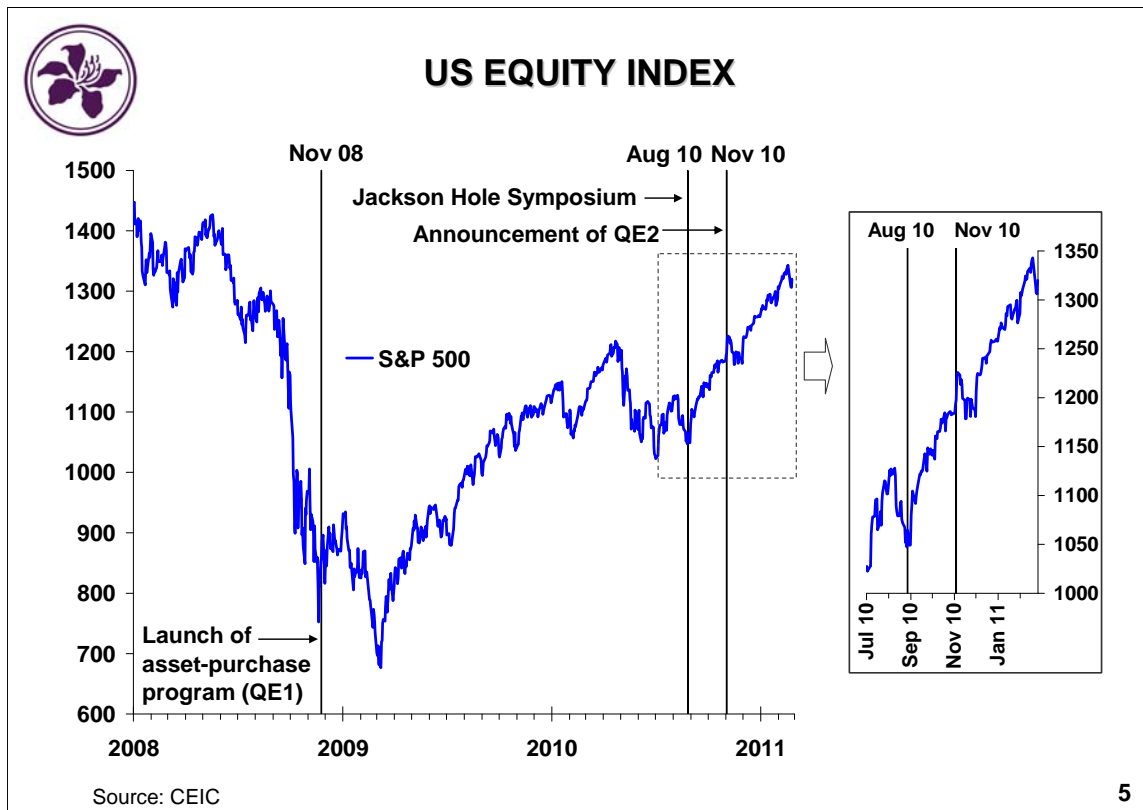
(% year-on-year) Real GDP Growth

	2010	2011 Forecasts		
		May 2010 FAP briefing	Nov 2010 FAP briefing	<b>Feb 2011</b>
<b>US</b>	2.8	3.1	2.4	<b>3.2</b>
<b>Euro area</b>	1.7	1.5	1.4	<b>1.6</b>
<b>Japan</b>	3.9	1.7	1.2	<b>1.5</b>

Source: Consensus Forecasts

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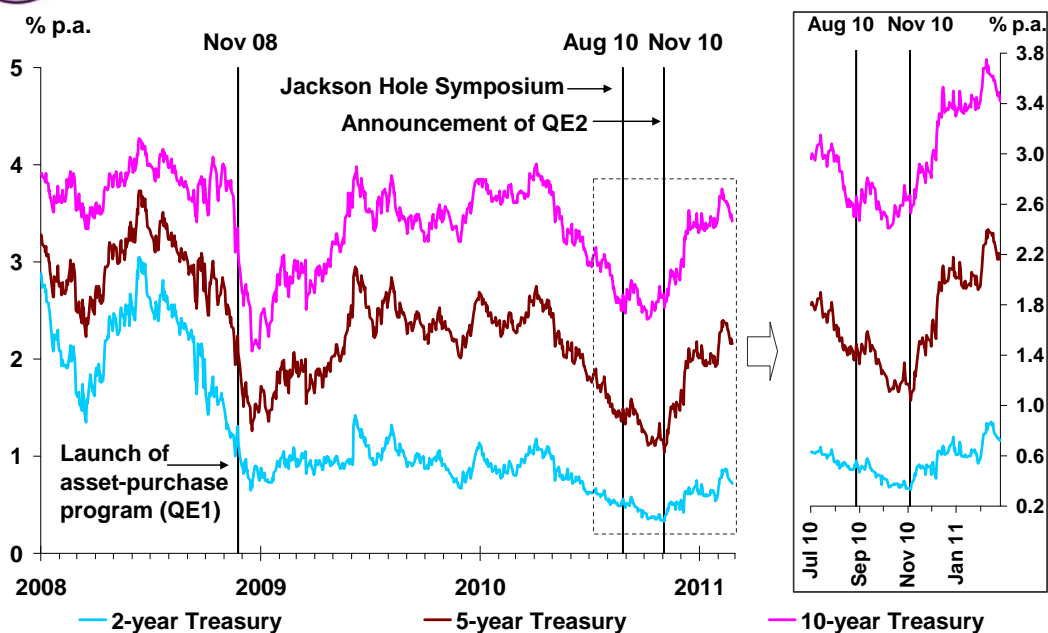
- Since the FA Panel briefing in November 2010, the market has markedly raised its forecast for growth in the US; and has turned more positive on the outlook for the euro area and Japan.
- The upward revision of market forecasts for US growth in 2011 was mainly driven by the better-than-expected private consumption figures and the new fiscal stimulus package which is expected to raise growth rate by about half a percentage point.



- Further monetary easing by the US has led to a sharp rise in equity prices.
- After Chairman Ben Bernanke of the US Federal Reserve signalled in August last year at the Jackson Hole Symposium that a new round of monetary easing would be introduced, the US equity market rebounded sharply. The upward trend has continued since the formal announcement of the second round of quantitative easing (QE2) in November last year.
- Between end-August last year and 25 February 2011, the S&P 500 Index gained about 25%, resulting in an increase of US\$2.4 trillion in market capitalisation (equivalent to 16% of GDP).
- The resulting positive wealth effect probably explains the recent acceleration in household consumption growth.



## US LONGER-TERM INTEREST RATES



Source: CEIC

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- Shortly after the Jackson Hole Symposium, medium to longer-term interest rates in the US declined distinctly. In particular, the yield on 5-year Treasuries decreased by about 50 basis points.
- However, yields on US Treasuries increased after the formal announcement of QE2 and rose even faster following the announcement of a new round of fiscal stimulus package by the US Government. This probably reflects that the market has become more optimistic about the economic outlook and expects inflation to rise in the medium to longer term. This, however, may also reflect that the market is increasingly more concerned about the fiscal situation in the US.



## US: NEW FISCAL STIMULUS PACKAGE

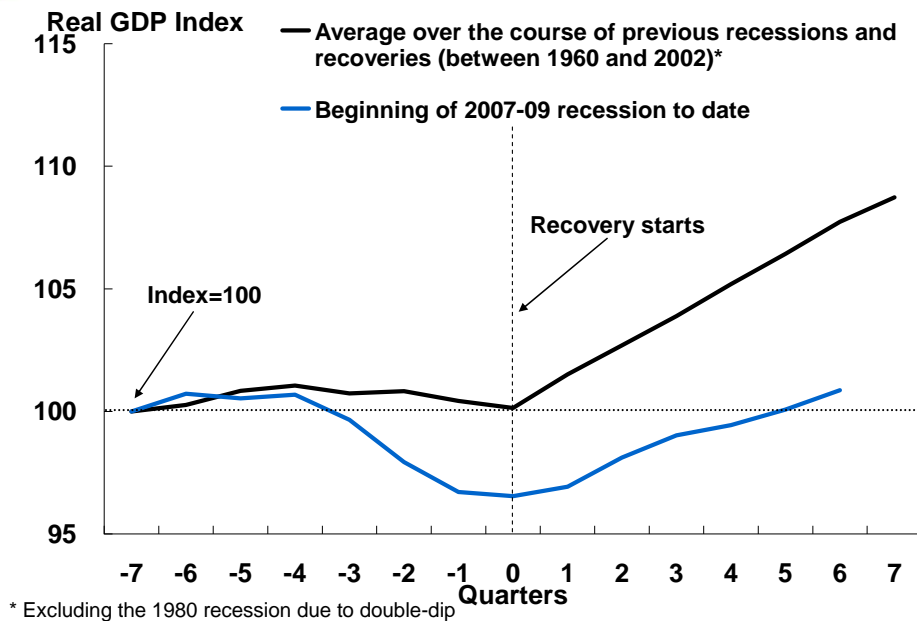
- The new US\$858 billion fiscal stimulus package passed by the Congress in December 2010:
  - Temporary extension of tax relief, including all Bush-era tax cuts (\$668 billion)
  - A 2%, one-year cut in Social Security payroll tax from 6.2% to 4.2% (\$112 billion)
  - Temporary extension of emergency unemployment benefits (\$57 billion)
  - Temporary extension of investment incentives (\$22 billion)

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- Another policy designed to stimulate growth was the introduction of the US\$858 billion (5.9% of GDP) fiscal stimulus package at the end of last year. The package includes temporary extension of many existing tax cuts and an additional 2% reduction in the social security payroll tax.
- Given the new fiscal boost, markets have revised up their US economic growth forecasts for 2011, by about half to one percentage point.



## US: COMPARISON OF CURRENT ECONOMIC RECOVERY WITH PAST CYCLES



Source: CEIC

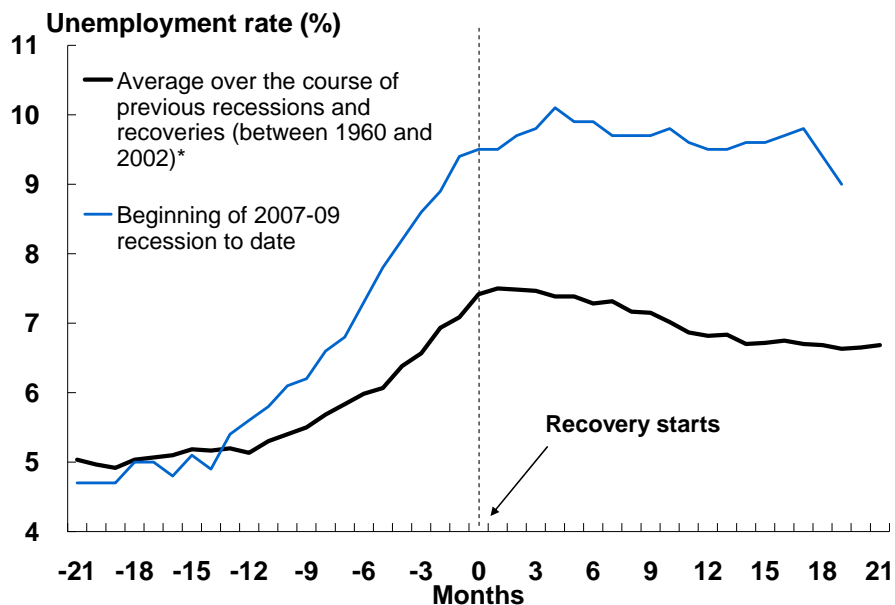
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- Despite the implementation of a series of fiscal stimulus and monetary easing measures during the great recession, the recent economic downturn remains more severe and the ensuing recovery much weaker than those experienced in the past.
- As shown in the chart, the level of real GDP at the start of the recent recession which was approximately seven quarters prior to the start of the current recovery, has been indexed to 100.
- We can see from the chart that the blue line had fallen way below the black line during the period of the great recession, indicating the recent economic downturn was indeed much deeper than those that were previously experienced.
- The pace of the subsequent rebound has also been slower than that of previous recoveries, as indicated by the blue line which has been trending upward at a slower rate than the black line.





## US: COMPARISON OF UNEMPLOYMENT RATES WITH PAST CYCLES

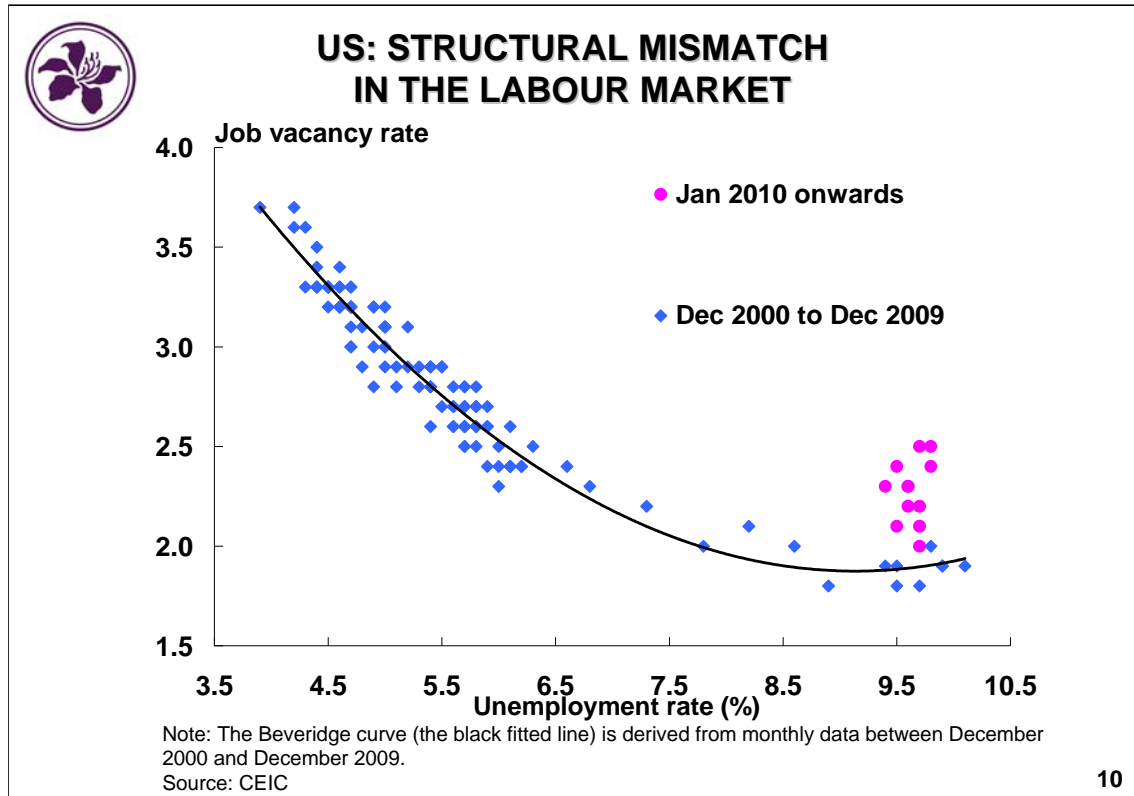


\* Excluding the 1980 recession due to double-dip

Source: CEIC

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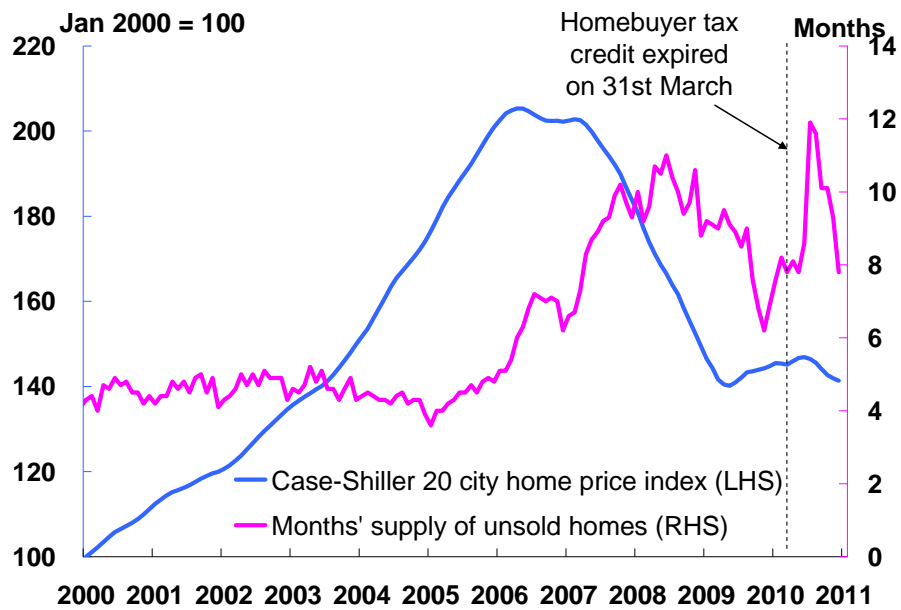
- Unemployment rate had risen to a much higher level during the recent recession and that the subsequent recovery in the labour market has been slower, as compared with those experienced in the past.
- The blue line in the chart represents the unemployment rate over the recent economic downturn and the current recovery; while the black line represents the average unemployment rate over the previous cycles. The chart shows that the unemployment rates at the onset of both the recent and other previous downturns were similar at around 5%. However, the blue line rises to a much higher level than the black line, indicating a much more severe unemployment problem at present.
- The blue line shows that the US unemployment rate has remained at a high level even long after the economic recovery has started; whereas the black line shows that in the past, the unemployment rate had already started to trend down following the start of the recovery. Indeed, the US is currently experiencing a jobless recovery, similar to that experienced in the past two economic recoveries back in 2001 and 1991.



- The US labour market is not only suffering from cyclical problems but also from structural mismatch.
- The Beveridge Curve as shown in the chart plots the relationship between job vacancy rate and the unemployment rate. In theory, we would expect to see lower unemployment rate to correspond with higher job vacancy rate and vice versa. The black line (the Beveridge Curve) is therefore plotted in the chart to reflect this inverse relationship between the two variables.
- The red dots in the chart indicates recent deviations from the Beveridge Curve i.e. a breakdown of the relationship between the unemployment rate and the job vacancy rate as suggested by the Beveridge Curve. This implies that while there exist many job vacancies in the labour market, they are unable to be filled by the unemployed workers.
- The probable reasons are:
  - (1) Sectoral shifts which have caused skill mismatch (mainly in the construction industry); and
  - (2) Problems in the housing market which have reduced geographical mobility of unemployed workers.



## US: HOUSE PRICES AND SUPPLY OF UNSOLD HOMES



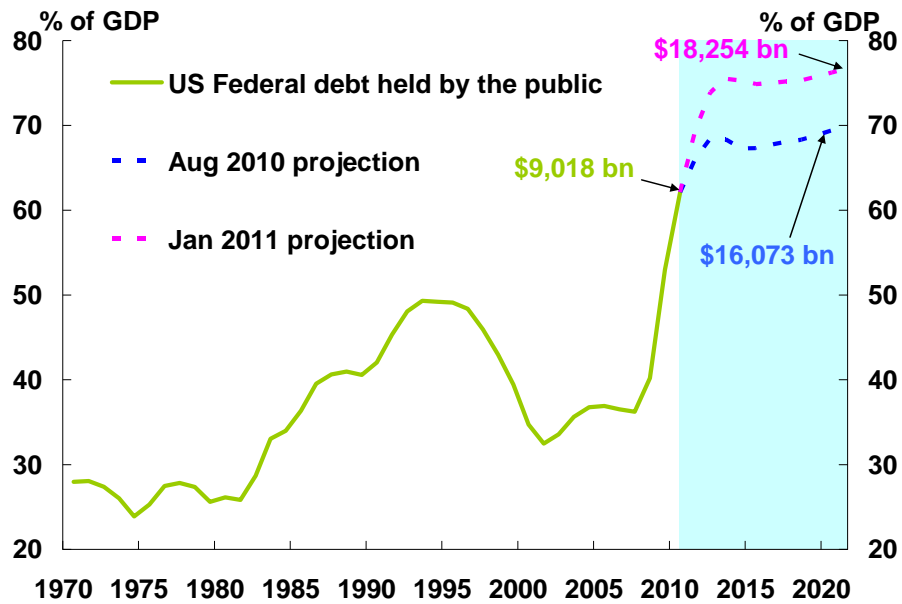
Source: CEIC

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- House prices are facing downward pressure as a result of continuing over-supply and sluggish demand. The Case-Shiller 20 City Home Price Index has been declining for five consecutive months.
- Meanwhile, the home equity ratio has decreased considerably.



## US: FISCAL SITUATION



Source: Congressional Budget Office

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- While the fiscal stimulus package recently approved by the US Congress would provide support to the US economy in the near term, it has also worsened the budget deficit and led to further deterioration in the long-run fiscal position in the US.



## ASSESSMENT OF THE US ECONOMY

- Favourable factors supporting growth in the short term:
  - Fiscal stimulus measures
  - Accommodating monetary conditions
  - Improved corporate earnings
  - Positive wealth effect arising from a buoyant equity market
  
- A number of risks to economic growth in the medium-to-longer term:
  - Increases in long-term interest rates
  - Reduced scope for fiscal policies
  - Household deleveraging yet to be completed
  - Continued weakness in the housing market
    - Negative wealth effect to drag on growth
    - Reduced geographical mobility of unemployed workers



## Assessment of the economies of Europe and Japan

### Europe

- Weak European economies are still troubled by the sovereign debt problem
- Major economies such as Germany and France are expected to see slow but steady growth

### Japan

- High growth rate in 2010 not likely to repeat
- Japan's economy will see slow but steady growth in the short term
- Fiscal problems and an aging population will continue to pose risks to the medium-to-longer term outlook



## ASIAN ECONOMIC GROWTH FORECASTS

(% year-on-year)

### Real GDP Growth

	<b>2010</b>	<b>2011 Forecasts</b>
Hong Kong	6.8	4.8
China	10.3	9.3
Korea	6.1	4.5
Singapore	14.5	5.1
Taiwan	10.5	4.5
Indonesia	6.1	6.2
Thailand	7.8	4.5

Source: CEIC and Consensus Forecasts (Feb 2011)

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- Asian economies recorded strong growth in 2010. Market forecasts indicate that growth of these economies will remain robust in 2011, albeit at a slightly more moderate rate.



## CURRENCY APPRECIATION AND RESERVES ACCUMULATION IN ASIAN ECONOMIES

	Change in foreign reserves in 2010		Currency appreciation against USD in 2010 (%)
	(USD bn)	(%)	
Hong Kong	12.9 <sup>1</sup>	5.0 <sup>1</sup>	-
Mainland China	448.2	18.7	3.4
Indonesia	30.1	45.5	4.6
Korea	21.6	8.0	3.2
Singapore	37.9	20.2	9.3
Taiwan	33.8	9.7	9.7
Thailand	33.7	24.4	11.0

1. The increase in foreign reserves in Hong Kong was partly contributed by the investment income

Source: Bloomberg and CEIC

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- There has been increasing inflows of funds into Asia on the back of its better economic prospects than Europe and the US.
- As a result, Asian economies recorded considerable increases in their foreign reserves last year. Their currencies also faced appreciating pressure.
- Fund inflows to Hong Kong were less than those to other Asian economies. This may in part reflect that funds would not be able to earn high returns through currency appreciation and interest rate arbitrage under the Linked Exchange Rate System in Hong Kong.



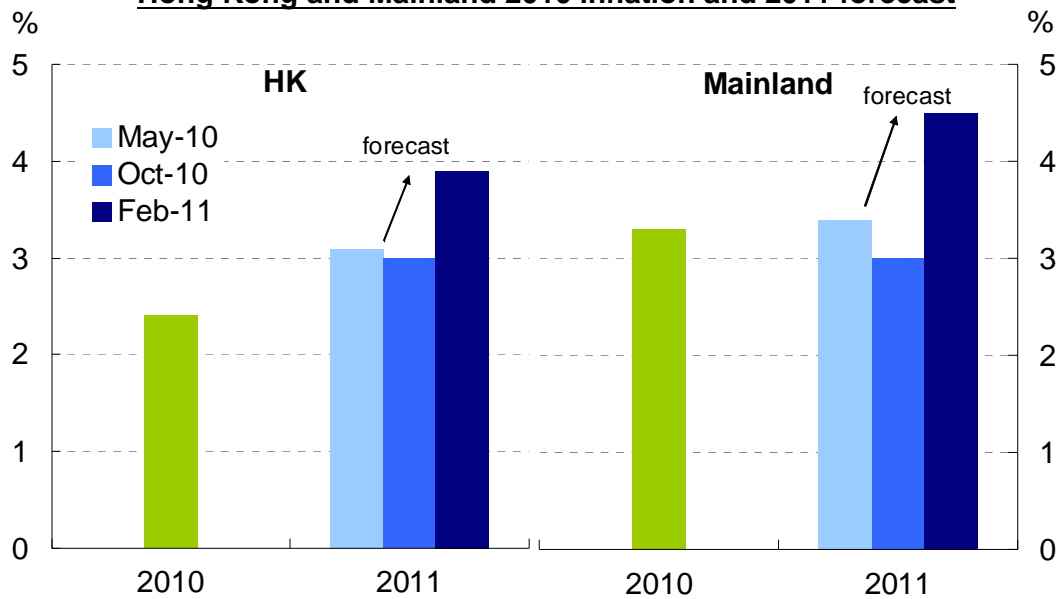


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## ASSESSMENT OF RISK ON HONG KONG'S FINANCIAL STABILITY: INFLATION

### Hong Kong and Mainland 2010 inflation and 2011 forecast



Source : Consensus Forecast (May and Oct 2010 and Feb 2011)

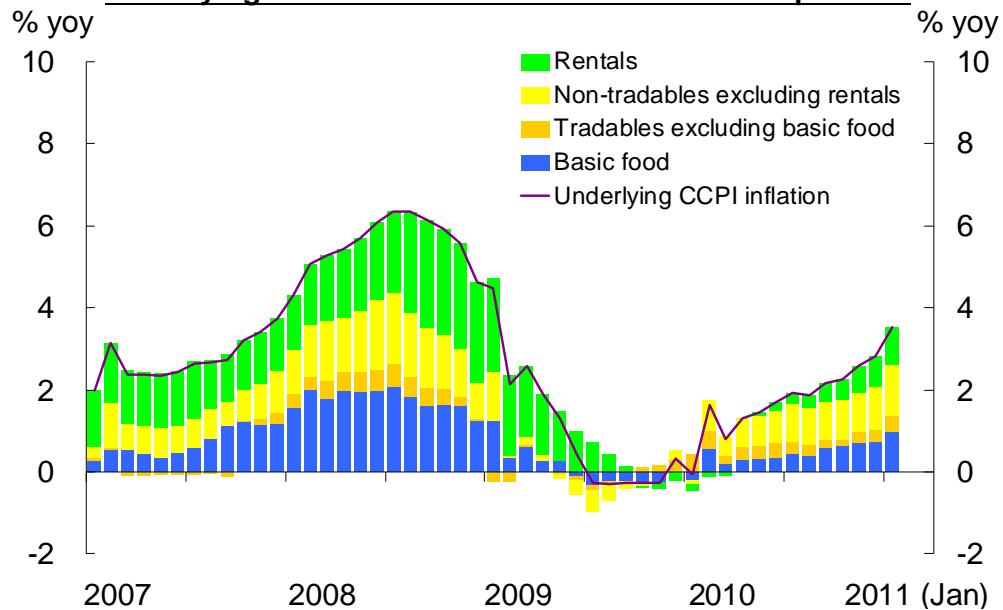
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- We expect inflationary pressures in Hong Kong and Mainland China to increase further in 2011.
  - Compared with the situation at the Panel meetings in May and October last year, the market has adjusted upward its forecast for Hong Kong's inflation in 2011.
  - According to the latest consensus forecast, the inflation rate in Hong Kong would increase from 2.4% in 2010 to 3.9% in 2011. The Government's forecast for inflation rate in 2011 is 4.5%.
  - The inflation rate on the Mainland is expected to increase from 3.3% in 2010 to 4.5% in 2011.



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

### Underlying inflation and contributions of its components



Underlying inflation: Netting out the effects of all Government's one-off relief measures from headline inflation.

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- The pick-up in inflation in recent months was mainly driven by increases in rentals and food prices. Local costs such as public utilities, education and transport services have also continued to rise.



## INFLATIONARY PRESSURES IN ASIAN ECONOMIES

(% year-on-year) Annual inflation rate

	Hong Kong	Mainland China	Indonesia	Korea	Singapore	Taiwan	Thailand
2008	4.3	5.9	9.8	4.7	6.6	3.5	5.5
2009	0.5	-0.7	4.8	2.8	0.6	-0.9	-0.8
2010	2.4	3.3	5.1	2.9	2.8	1.0	3.3
2011 (Forecast)	3.9	4.5	6.8	3.7	3.2	1.9	3.4

Sources: Census and Statistics Department, CEIC and Consensus Forecasts (Feb 2011)

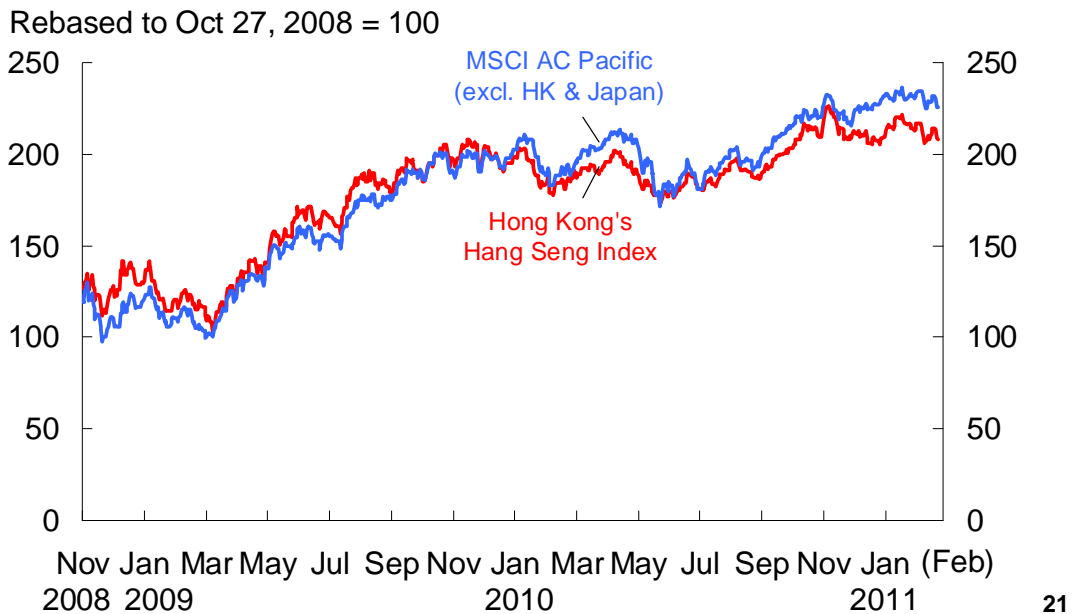
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- Many economies in Asia are facing increasing inflationary pressures as a result of more favourable economic outlook and recent surges in commodity prices.



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

### Hong Kong and Asia Pacific equity market performance



- The Hong Kong equity market under-performed other equity markets, especially those in the Asia-Pacific region.
- The MSCI AC Pacific Index (excluding Hong Kong and Japan) gained 14% in 2010, higher than the 5% increase in the Hang Seng Index. The Hang Seng Index also underperformed the S&P 500 (a 13% gain in 2010) and the FTSE (a 9% gain).



## **PRUDENTIAL MEASURES ON PROPERTY MORTGAGES**

- Introduced more stringent requirements for mortgage lending to strengthen banks' risk management on 19 November 2010
  - LTV ratio reduced to 50% for properties at or above HK\$12 million, and 60% for value at or above HK\$8 million
  - 50% LTV for non-owner-occupied residential properties, properties held by companies, industrial and commercial properties, and mortgages granted on borrowers' net worth
  - Standardised DSR at 50% and stressed DSR at 60%
- The HKMA is conducting thematic on-site examinations on 21 banks starting from early 2011 to monitor compliance



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

	2010				2011	
	Aug	Sep	Oct	Nov	Dec	Jan
<b>Number of transactions (Land Registry)</b>	14,699	10,424	9,552	13,189	9,328	8,002
<b>Weekly average transactions in 35 popular estates (Midland)</b>	239	156	357	215	187	329
<b>Housing prices (R&amp;VD) (Oct 1997 = 100)</b>	89.6	90.3	92.6	94.4	93.6	/
<b>Housing prices (Centaline) (Oct 1997 = 100)</b>	83.2	84.5	85.5	87.9	88.4	90.1
<b>Number of new mortgage loans approved</b>	17,114	13,893	13,257	16,230	12,879	12,351
<b>Number of new applications for mortgage loans</b>	23,663	17,459	20,363	23,060	14,416	19,474
<b>Number of applications for MIP</b>	3,764	2,127	2,219	2,663	1,909	2,722

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- With the introduction of property market measures by the Government and the HKMA last November, speculative activities cooled down rapidly and the buying sentiment was dampened to a certain extent. But more recently, there are signs that the property market has become active again. The impact of the property market measures can be observed from the following set of data.
- According to the Land Registry, transaction volume contracted markedly after the introduction of the measures, down 29% month on month to 9,328 in December, before dropping further to 8,002 in January this year.
- However, there are signs that property market has become active again. According to provisional records of the Midland Realty, transaction volume of 35 selected popular housing estates rebounded in early January, despite some softening in recent weeks due to the Chinese New Year holiday effect.
- Property prices adjusted downward immediately after the introduction of the measures. According to the Rating and Valuation Department, property prices decreased by 0.9% month on month last December.
- However, the Centa-City Leading Index trended upward more recently, recording a 1.9% month-on-month rise in January.
- Mortgage lending was also affected by the new measures.
- The latest Residential Mortgage Survey indicates that the number of new mortgage loans approved had declined since November, decreasing by 23% month on month in December and by 3.2% in January this year.
- The number of new applications for mortgage loans also decreased by more than 20%, with the LTV ratio declining to 57.8% in January.
- The number of applications for the Mortgage Insurance Programme (MIP) began to decline markedly in mid-November last year, and dropped 28% month on month in December.
- However, since mid-January this year, the number of MIP applications has returned to the level prior to the introduction of the new measures in November last year.



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

- Short-term trading activities have reduced following the announcement of the government measures in mid-November.
- It is expected that buyers in the property market will comprise mainly of owner-occupiers and medium-to-long-term investors. Factors determining future market developments will include homebuyers' affordability, supply of land and housing, mortgage borrowing costs, as well as investors' expectations on future property price trend and all of the above-mentioned factors.
- Higher inflation may strengthen incentives for home-purchase and add upward pressure to property prices.
- On the other hand, the Government is committed to increasing land supply.
- Interest rates may make a turn earlier than expected:
  - The European Central Bank may tighten monetary policy amid rising inflation
  - The medium-to-long-term interest rates in the US have already risen. If the economy continues to recover at the current pace, the Federal Reserve could adjust the current accommodating monetary policy earlier than expected
  - Regulations and monetary tightening on the Mainland will, to a certain extent, affect demand for credit in Hong Kong and interest rates
- The HKMA will continue to closely monitor market developments and introduce further measures to maintain banking stability if necessary.





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## DEVELOPMENT OF OFFSHORE RMB BUSINESS IN HONG KONG

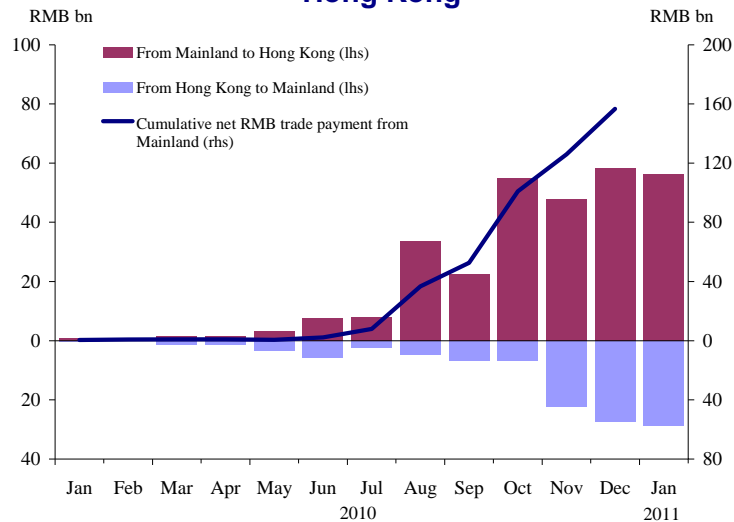
- A year of rapid development

February 2010	HKMA provided elucidation on supervisory principles to streamline operational arrangements of offshore renminbi business in Hong Kong
June 2010	Coverage of renminbi trade settlement pilot scheme expanded
July 2010	Clearing Agreement on Renminbi Business amended, with restrictions on account opening of corporate and interbank fund transfers removed
August 2010	Arrangement allowing Hong Kong banks to invest in the Mainland's interbank bond market launched
November 2010	Renminbi sovereign bonds issued through HKMA's Central Moneymarkets Unit (CMU)
December 2010	Number of Mainland enterprises eligible for settling merchandise exports in renminbi increased significantly
December 2010	Refinement measures regarding Hong Kong's offshore renminbi business introduced
January 2011	Pilot scheme for settlement of Mainland's overseas direct investment in renminbi launched



## RMB TRADE SETTLEMENT ON RAPID GROWTH

### RMB trade settlement conducted through Hong Kong



- After the expansion of RMB trade settlement scheme in June 2010, the amount of RMB trade settlement conducted through HK increased rapidly, from about RMB 4 bn per month in H1, to about RMB 57 bn per month in H2
- In 2010, total RMB trade settlement conducted through HK amounted to RMB 369.2 bn. Most of them were payments from Mainland importers to Hong Kong, with a net payment of RMB 156.7 bn to Hong Kong for trade settlement

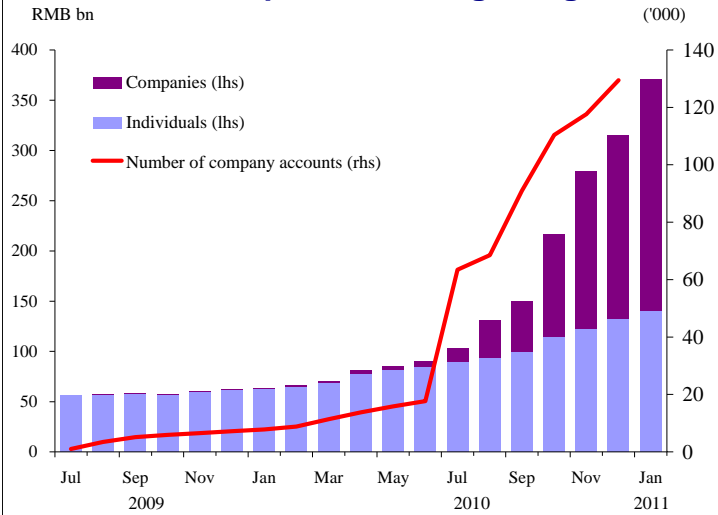
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- In 2010, total RMB trade settlement conducted through HK amounted to RMB 369.2 bn. Most of them were payments from Mainland to Hong Kong: payments from Hong Kong to Mainland amounted to RMB 82.9 bn, while payments from Mainland to Hong Kong amounted to RMB 239.6 bn; and with a net payment of RMB 156.7 bn to Hong Kong for trade settlement.
- These RMB funds remain in Hong Kong and constitute a main source of supply in the local RMB market. Of the RMB 82.9 bn paid from Hong Kong to Mainland enterprises, only about RMB 10 bn was obtained by conversion in Shanghai's foreign exchange market through the Clearing Bank. Given the abundant supply of RMB funds in the local market, even when the arrangement for conducting RMB conversions in Shanghai was suspended in Oct 2010, RMB business in Hong Kong has progressed well and not been much affected. This shows that the offshore pool of RMB funds in Hong Kong is serving the function of supplying RMB funds to meet the demand from local enterprises, such that there is no need to rely heavily on the onshore conversion window in Shanghai for trade settlement. In other words, the conversion window in Shanghai serves a supplementary rather than the main source of RMB funds for trade settlement purpose.
- Against this background, the HKMA introduced in Dec 2010 the following refinement measures:
  - Clarification on the arrangement for the conversion of RMB for trade settlement purpose conducted by participating banks through the Clearing Bank in the China Foreign Exchange Trading System in Shanghai. It is estimated that the demand for RMB conversion in Shanghai would be within RMB 4 bn in Q1 2011
  - RMB 20 billion provided by the HKMA, through its currency swap arrangement with the PBoC, as a standing arrangement to maintain a stable supply of RMB for cross-border trade settlement
  - Given that the convertibility of RMB is restricted at present, participating AIs are required to limit their RMB net open positions (whether net long or net short) to 10% of their RMB assets or liabilities
- The refinement measures have become effective in Jan 2011. HKMA is having close communications with the banking industry on the implementation arrangements.
- In January 2011, total RMB trade settlement conducted through HK amounted to RMB 108.0 bn. Most of them were payments from Mainland to Hong Kong: payments from Hong Kong to Mainland amounted to RMB 28.6 bn, while payments from Mainland to Hong Kong amounted to RMB 56.1 bn; and with a net payment of RMB 27.5 bn to Hong Kong for trade settlement.



## INCREASING RMB DEPOSIT BASE IN HONG KONG

### RMB deposits in Hong Kong

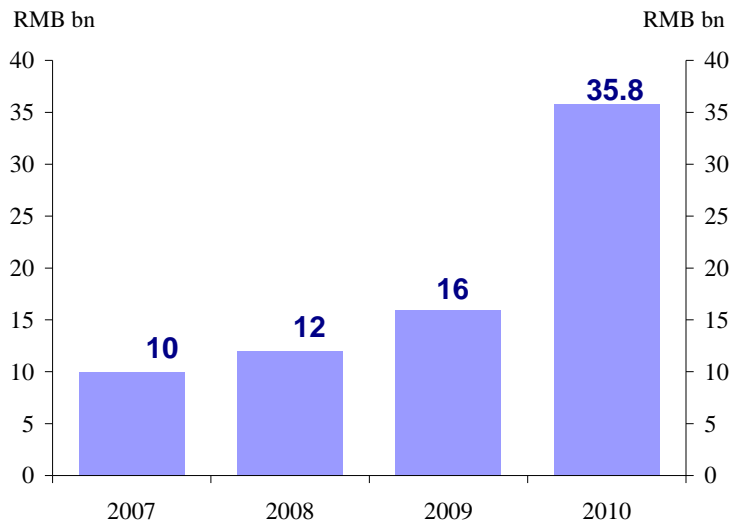


- RMB deposits increased by four times to RMB 314.9 bn at end-Dec; and further increased to RMB 370.6 bn at end-Jan 2011
- Mainly attributed to an increase in RMB receipts by corporate customers through trade settlement transactions
- At end-Jan, RMB deposits by corporate customers amounted to RMB 230.3 bn, accounting for 62% (2009: 1%) of total RMB deposits
- The number of corporate accounts also increased to nearly 130,000 (2009: 7,200)



## FURTHER DEVELOPMENT OF RMB BOND MARKET

### RMB bond issuance in Hong Kong



- **Expansion of issuers in 2010:** from Mainland financial institutions to HK corporations, multinationals and international financial institutions
- **Tenors:** from 2 or 3 years to 10 years (e.g. bonds issued by the Ministry of Finance of China and the Asian Development Bank)



## **RMB BUSINESS IN HONG KONG – FURTHER DEVELOPMENT**

- Actively promote the use of Hong Kong's RMB platform for settlement of the Mainland's overseas direct investment (ODI) and foreign direct investment (FDI) into the Mainland in RMB
- Facilitate the development of various RMB financial products in Hong Kong
- Enhance the circulation of RMB funds and interaction between the offshore and onshore markets
- Capitalise the "first mover" advantage by actively promoting the development of Hong Kong as the offshore RMB centre



## **ADVANCEMENT OF HONG KONG'S SOVEREIGN CREDIT RATINGS**

- Attained upgrades in Hong Kong's sovereign credit ratings by all three major international credit rating agencies:
  - Moody's upgraded Hong Kong's ratings to Aa1, only one notch below the highest rating category, and assigned a "Positive" outlook to Hong Kong's ratings (Nov 2010)
  - Fitch upgraded Hong Kong's ratings to AA+, only one notch below the highest rating category (Nov 2010)
  - S&P upgraded Hong Kong's ratings to triple-A, the highest rating category (Dec 2010)
- Hong Kong was the only economy around the world being upgraded to AAA in 2010



## REFORMING OTC DERIVATIVES MARKET

- The Financial Stability Board (FSB) has recently approved a report containing recommendations to promote consistent implementation of the G20's commitments concerning –
  - Increasing the proportion of the market that is standardised
  - Moving standardised OTC derivatives to exchanges or electronic trading platforms
  - Moving to central clearing of standardised OTC derivatives by end 2012
  - Ensuring that OTC derivatives transactions are reported to trade repositories by end 2012
- As a member of the FSB and to fulfil the role of an international financial centre, we have the responsibility to comply with international standards
- Under the current regulatory framework, the HKMA, the SFC and the Government will work together in building the regulatory regime for OTC derivatives market and consult the market on the detailed regulatory requirements by Q3 2011





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## SUPERVISION ON CREDIT GROWTH

- 29% growth in loans in 2010, with substantial growth in:
  - property related lending (+19%)
  - trade finance (+57%)
  - wholesale and retail sector (+53%)
  
- The HKMA
  - has gathered information about the reasons for the credit growth
  - will ensure the banks will not lower loan approval requirements
  - is conducting on-site examinations to assess banks' credit underwriting standards



## SHARING OF MORTGAGE DATA FOR CREDIT ASSESSMENT

- The financial services industry, represented by the Consumer Credit Forum, proposes the sharing of positive mortgage data for credit assessment
- The HKMA fully supports the proposal
- The Office of the Privacy Commissioner for Personal Data (“PCO”) published a consultation paper on the sharing of mortgage data for credit assessment on 5 January (Consultation period finished on 8 February)
- The public focus is more on whether
  - non-residential mortgage data should be shared
  - banks should be allowed to have access to the shared mortgage data when processing applications for non-mortgage lending (e.g. credit cards or personal loans)
  - Pre-existing mortgage data should be shared
- The HKMA will work closely with the PCO and the banking sector in taking this proposal forward

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- The HKMA welcomes the PCO’s public consultation on positive mortgage data sharing. The HKMA fully supports the proposal as it would further strengthen credit risk management of lenders and is conducive to the overall stability of the banking system in Hong Kong, which is crucial to the interest of depositors as well as the financial stability and economic development of Hong Kong as a whole.
- The HKMA is aware of the issues that have attracted the interest of the public. The scope of the proposed sharing of data should cover non-residential properties and the pre-existing mortgage data in order to fill the gap and fulfill the objective of the proposal, that is, to strengthen credit risk management of the lending institutions (which in turn encourages responsible lending and borrowing activities and reduce the risk of over-borrowing). In addition, if banks are not allowed to have access to “mortgage count” in processing non-mortgage borrowing applications, they will not be able to assess the borrower’s overall repayment ability (including mortgage, credit card payments and non-collateralised loans). We therefore consider that it would be not appropriate if the banks are not allowed to have access to “mortgage count.”



## INVESTOR / CONSUMER PROTECTION

### Investor protection

- Fieldwork of mystery shopper exercise completed in 2010
- The HKMA issued circular in December 2010 reminding AIs to adopt a cautious approach when selling accumulators
- The HKMA has been providing assistance to the Financial Services and the Treasury Bureau on the establishment of Investor Education Council and Financial Dispute Resolution Centre

### Consumer protection

- Credit card reform measures



## DEPOSIT PROTECTION

- Full deposit guarantee expired at the end of 2010
- The protection limit of the Deposit Protection Scheme (DPS) increased to \$500,000 with effect from 1 January 2011
- Improved representation requirements on protection status of deposits have also taken effect
- Large-scale multi-media publicity activities are continuing to increase public awareness of the expiry of the full deposit guarantee and the increased deposit protection provided by the enhanced DPS



## IMPLEMENTATION OF BASEL III

- Final text of Basel III – reforms to strengthen banks' capital adequacy and liquidity – published in December 2010:
  - Tightening the definition of regulatory capital and increasing the minimum requirements of common equity and tier-1 capital
  - Establishing conservation / countercyclical capital buffers
  - Supplementing the capital adequacy ratio with a non-risk based leverage ratio
  - Introducing a new liquidity coverage ratio and a net stable funding ratio
- HKMA plans to phase-in the new requirements from 1 January 2013 in line with Basel Committee timetable
- Legislative process will begin soon

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- The new requirements will be phased in over a period of 6 years from 1 January 2013 to 1 January 2019. The Basel Committee adopted this transitional period so as to allow banks ample time to move to the new standards while still supporting a sound economic recovery. The HKMA's current intention is to follow the Basel Committee's transitional arrangement for the various parts of the Basel III package, to maintain a level playing field internationally.
- Implementation of the Basel III standards in Hong Kong will entail amendment of the Banking Ordinance, the Banking (Capital) Rules and the Banking (Disclosure) Rules. The HKMA will be consulting the banking industry in due course on its implementation proposals and working to transcribe the Basel III standards into the necessary legislation, rules and guidance in preparation for 2013.



1. International Macro Financial Conditions
2. Assessment of Risk on Hong Kong's Financial Stability
3. Latest Developments of Hong Kong as an International Financial Centre
4. Latest Developments in the Banking Sector
5. **Investment Income of the Exchange Fund in 2010**



## INVESTMENT INCOME

(HK\$ billion)	2010					2009	2008	2007	2006
	Full year *	Q4	Q3	Q2	Q1	Full year	Full year	Full year	Full year
Bonds#	42.1	(18.6)	19.9	29.4	11.4	(0.6)	88.4	61.0	31.9
Hong Kong equities^@	11.6	4.3	15.0	(4.6)	(3.1)	48.9	(77.9)	55.8	35.9
Foreign equities^	27.0	19.1	18.1	(21.4)	11.2	48.8	(73.1)	6.7	18.7
Foreign exchange	(3.1)	0.5	20.7	(15.6)	(8.7)	9.8	(12.4)	18.7	17.3
Other investments&	1.4	0.2	0.8	0.1	0.3	0.8	-	-	-
Investment income/(loss)^@&	79.0	5.5	74.5	(12.1)	11.1	107.7	(75.0)	142.2	103.8

\* Unaudited figures

# Including interest

^ Including dividends

@ Excluding valuation changes in Strategic Portfolio (HK\$2.6 billion)

& Including valuation changes of investment held by EF's investment holding subsidiaries





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

(HK\$ billion)	2010					2009
	Full year (unaudited)	Q4	Q3	Q2	Q1	Full year
Investment income/(loss)	79.0	5.5	74.5	(12.1)	11.1	107.7
<b>Other income</b>	<b>0.2</b>	-	<b>0.1</b>	<b>0.1</b>	-	<b>0.2</b>
<b>Interest and other expenses</b>	<b>(4.8)</b>	<b>(1.2)</b>	<b>(1.2)</b>	<b>(1.5)</b>	<b>(0.9)</b>	<b>(3.8)</b>
<b>Net investment income/(loss)</b>	<b>74.4</b>	<b>4.3</b>	<b>73.4</b>	<b>(13.5)</b>	<b>10.2</b>	<b>104.1</b>
Payment to Fiscal Reserves #	(33.8)	(8.6)	(8.3)	(8.4)	(8.5)	(33.5)
<b>Payment to HKSAR government funds and statutory bodies #</b>	<b>(3.9)</b>	<b>(1.1)</b>	<b>(1.1)</b>	<b>(0.9)</b>	<b>(0.8)</b>	<b>(1.2)</b>
<b>Valuation change of Strategic Portfolio less investment held by EF's investment holding subsidiaries^</b>	<b>1.2</b>	<b>1.3</b>	<b>1.2</b>	<b>(0.4)</b>	<b>(0.9)</b>	<b>3.6</b>
Increase/(Decrease) in EF Accumulated Surplus	37.9	(4.1)	65.2	(23.2)	-	73.0

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

^ Including dividends