



HONG KONG MONETARY AUTHORITY

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

21 May 2012



DISCUSSION TOPICS

Updates on

- Financial and Economic Environment
- Currency Stability
- Banking Stability
- Financial Infrastructure
- Hong Kong as an International Financial Centre
- Investment Environment and Performance of The Exchange Fund
- Hong Kong Mortgage Corporation



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

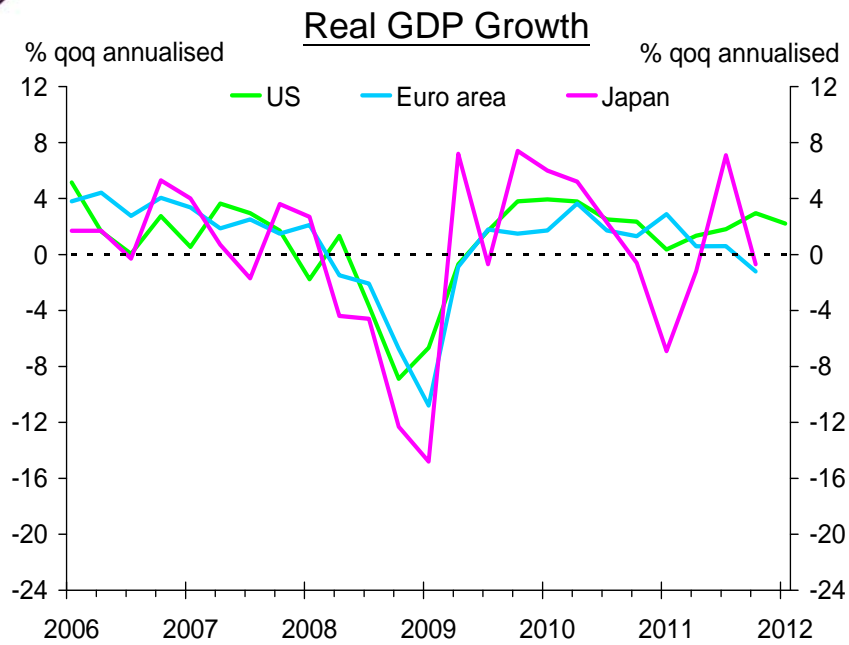
(% year-on-year)

	2011	2012 Forecasts		
		Dec 2011 FAP briefing	Mar 2012 FAP briefing	Apr 2012
US	1.7	2.1	2.2	2.3
Euro area	1.5	0.4	-0.3	-0.4
Japan	-0.7	2.1	1.8	2.0
Asia (ex-Japan)	7.1	6.9	6.7	6.7

Sources: Consensus Forecasts



ECONOMIC SITUATION IN MAJOR COUNTRIES

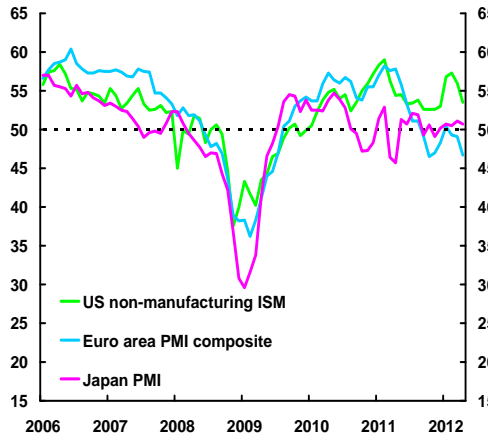


Source: Bloomberg

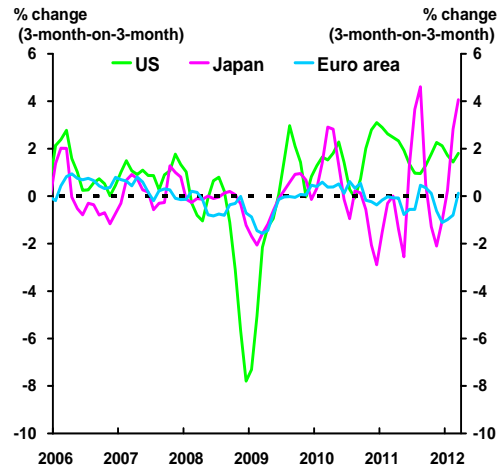


ECONOMIC SITUATION IN MAJOR COUNTRIES

Purchasing Managers' Index



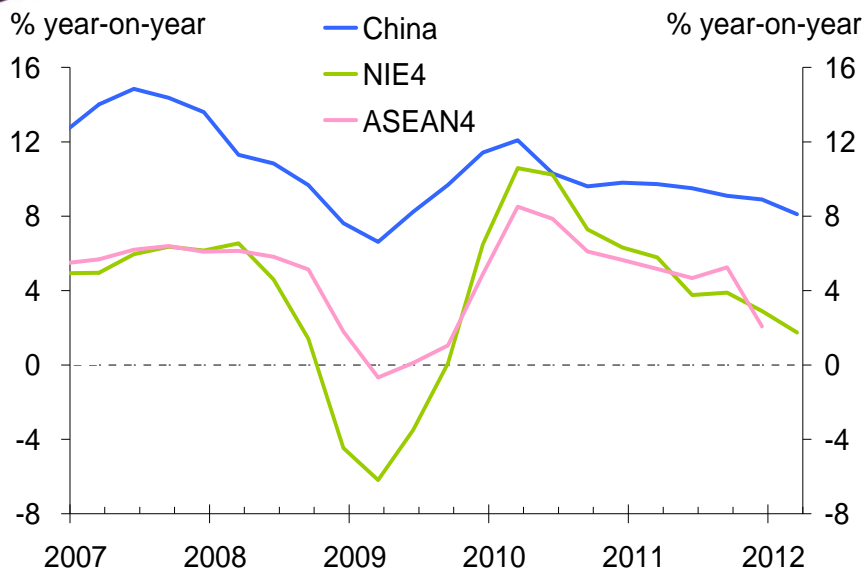
Retail Sales



Sources: Bloomberg and CEIC



ECONOMIC GROWTH IN ASIA



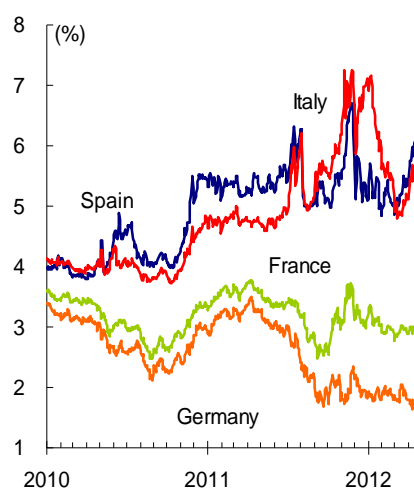
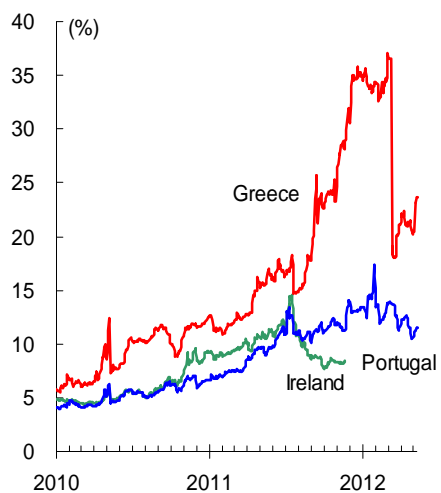
Note: NIE4 includes Hong Kong, Singapore, South Korea and Taiwan; ASEAN4 includes Indonesia, Malaysia, the Philippines and Thailand

Sources: CEIC, IMF and staff estimates



EUROPE: SOVEREIGN DEBT CRISIS

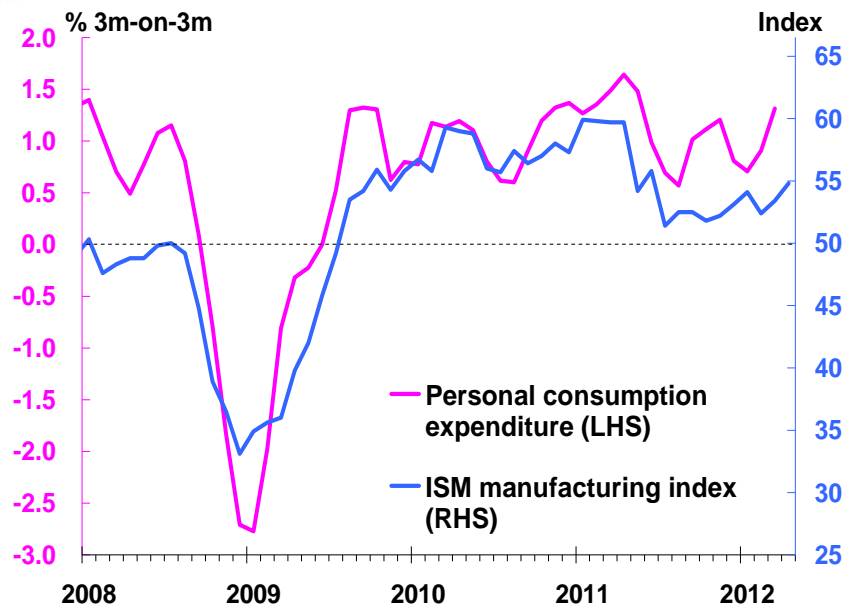
10-year sovereign bond yield



Source: Bloomberg Note: Ecowin has stopped publishing Ireland's 10-year bond yield since 22 Nov, 2011 **8**



US: CONSUMPTION GROWTH & BUSINESS ACTIVITY



Source: CEIC



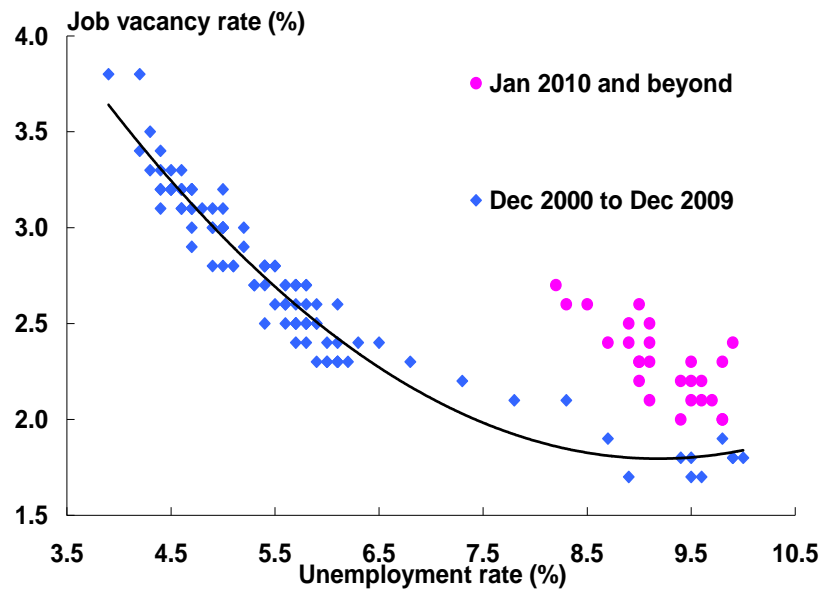
US: WEEKLY INITIAL JOBLESS CLAIMS



Source: CEIC



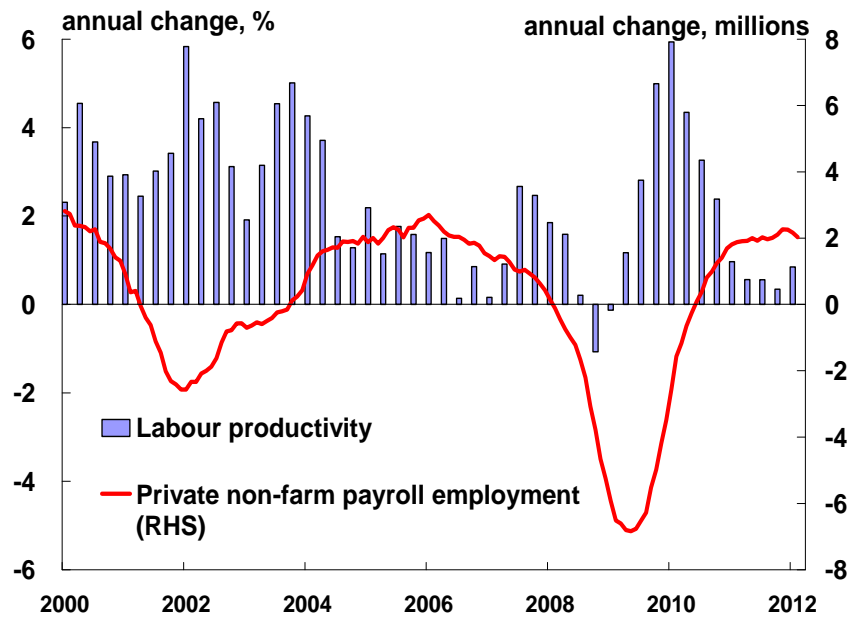
US: STRUCTURAL MISMATCH IN THE LABOUR MARKET



Note: The Beveridge curve (the black fitted line) is derived from monthly data between December 2000 and December 2009
Source: CEIC



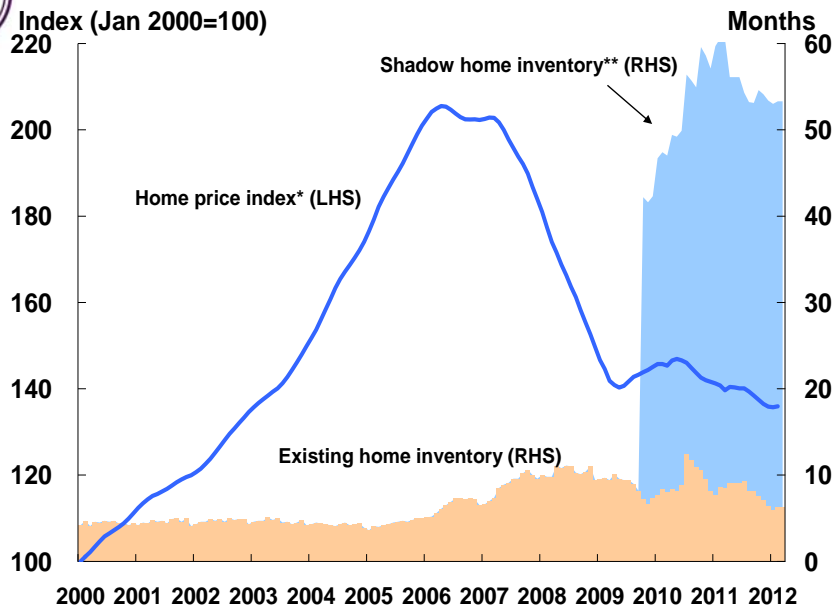
US: LABOUR PRODUCTIVITY AND PRIVATE NON-FARM PAYROLL EMPLOYMENT



Source: CEIC



US : HOUSE PRICES AND HOME INVENTORY



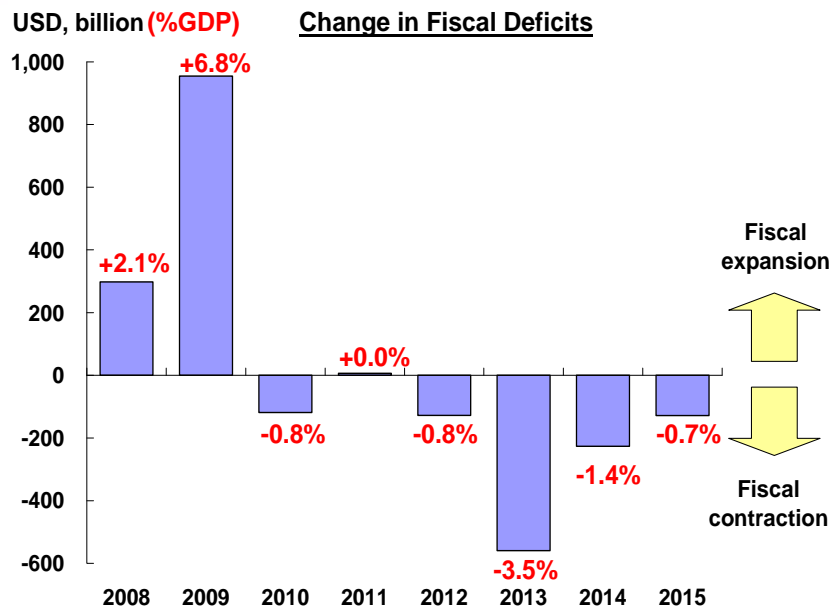
* Case-Shiller 20-city home price index

** Standard and Poor's estimates include the total number of homes with mortgage loans more than 90 days delinquent, currently or recently in foreclosure and those that are real estate owned (REO)

Sources: Standard & Poor's and CEIC



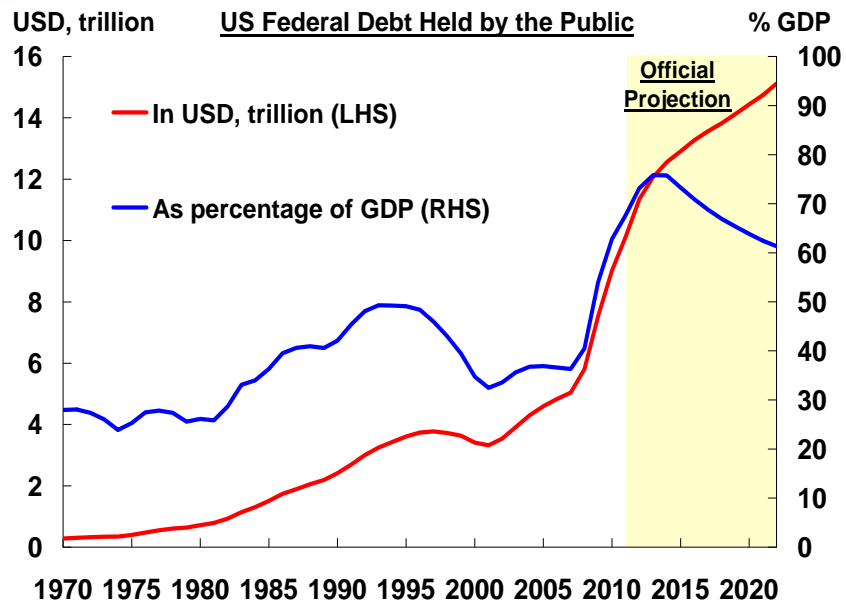
US: FISCAL CONSOLIDATION



Sources: US Congressional Budget Office (CBO) and CEIC



US: FEDERAL GOVERNMENT DEBT



Source: CBO



ECONOMIC ASSESSMENT OF MAINLAND

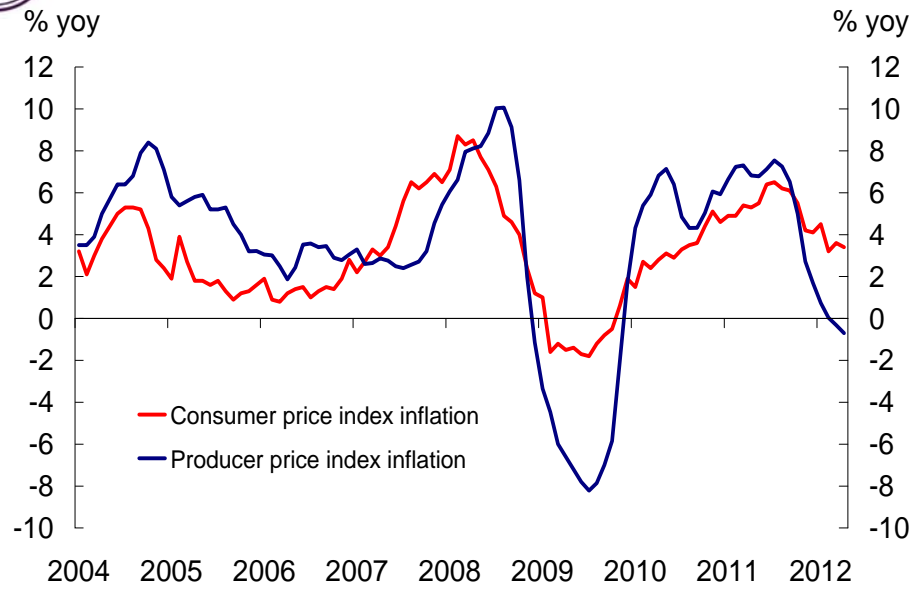
Forecasts of Major Indicators for 2012

	2010	2011	2012 Consensus Forecasts	
			Feb 2012	Apr 2012
Real GDP growth (%)	10.4	9.2	8.4	8.4
CPI inflation (%)	3.3	5.4	3.3	3.3

Sources: CEIC and Consensus Forecasts (February 2012, April 2012)



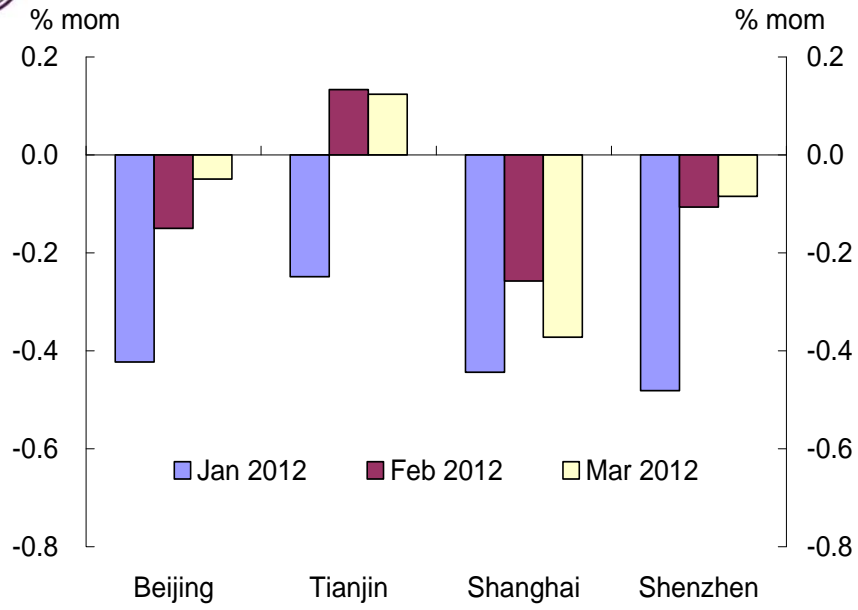
MAINLAND INFLATION RATES



Source: CEIC



HOUSING PRICE CHANGES IN MAINLAND MAJOR CITIES

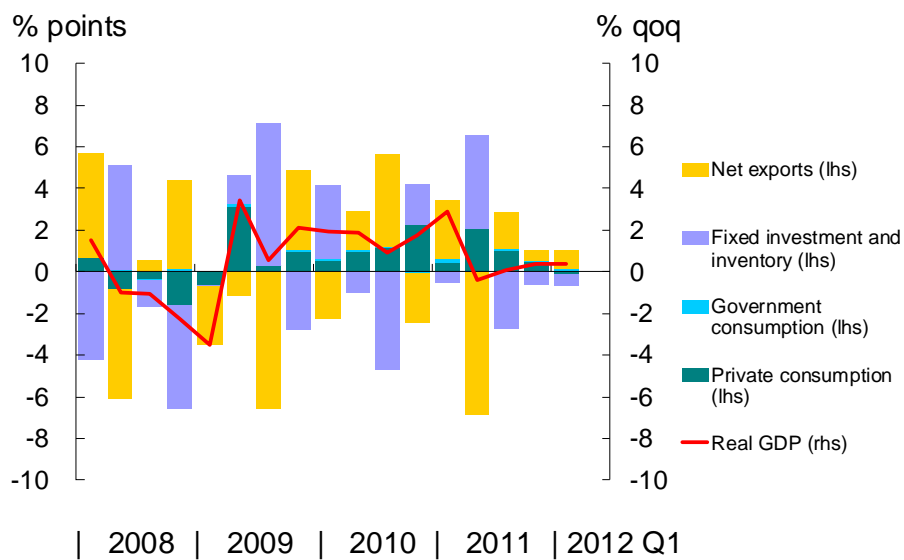


Sources: CEIC, WIND and staff estimates



HONG KONG ECONOMIC SITUATION

Changes in Real GDP and contributions by major components

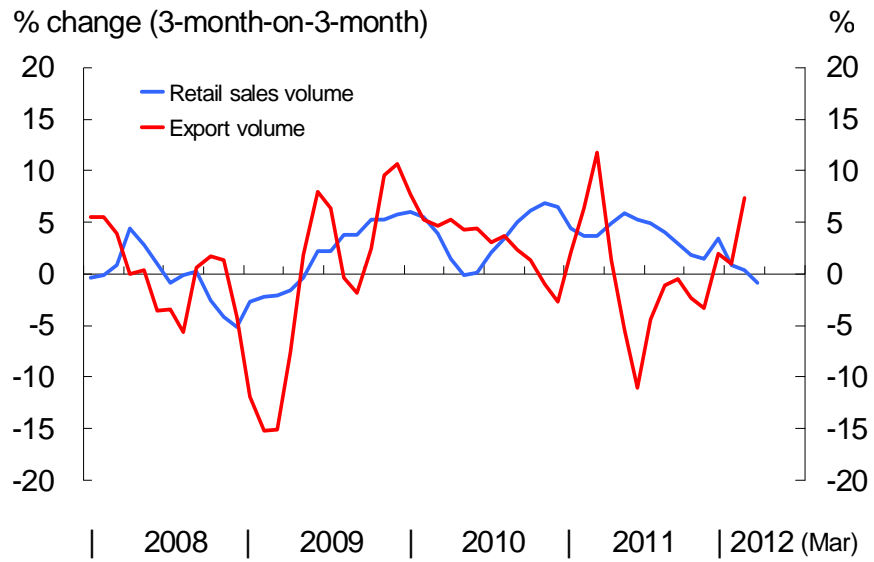


Sources: Census and Statistics Department (C&SD) and staff estimates



HONG KONG ECONOMIC SITUATION

Retail Sales and Exports

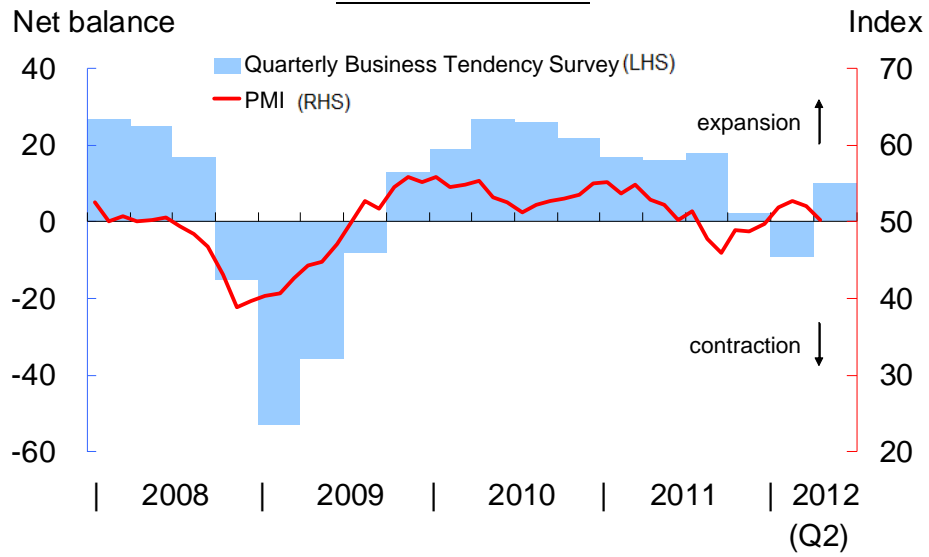


Source: C&SD



HONG KONG ECONOMIC SITUATION

Business Outlook

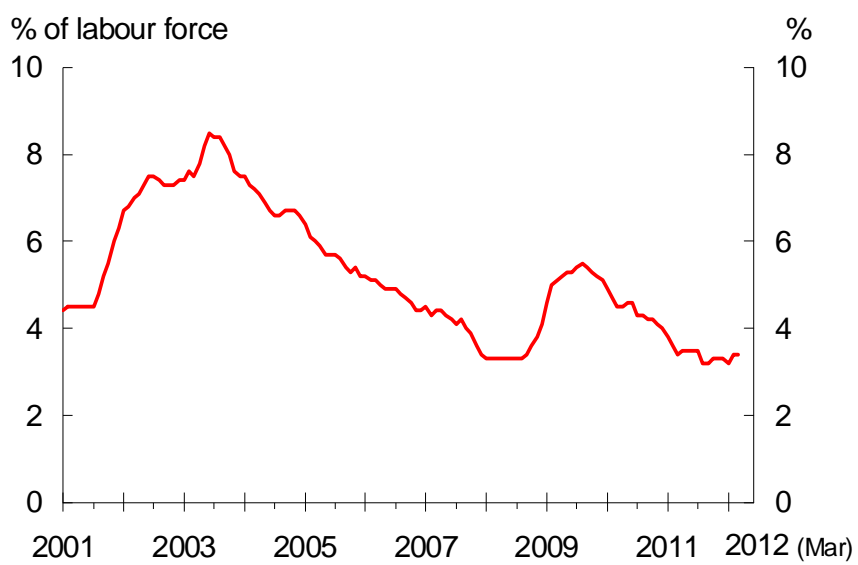


Sources: C&SD and Markit Economics



HONG KONG ECONOMIC SITUATION

Unemployment rate

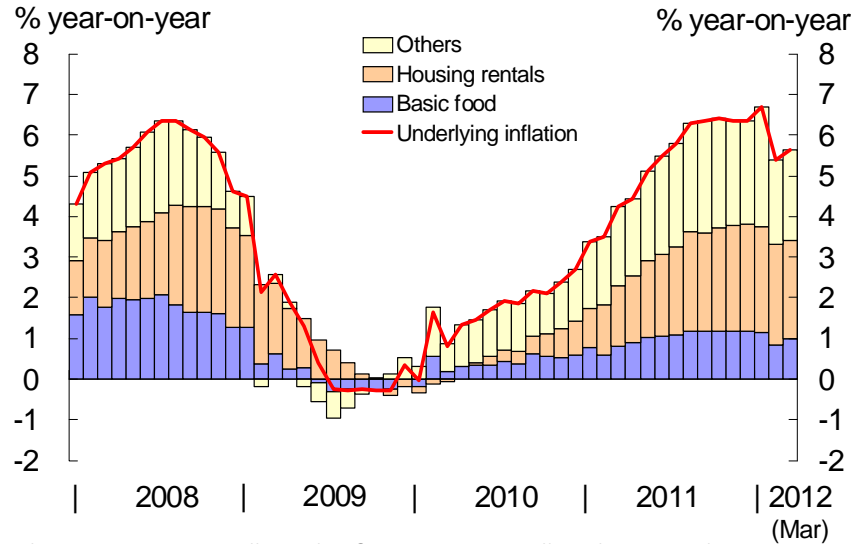


Source: C&SD



HONG KONG ECONOMIC SITUATION

Underlying inflation and contributions of its components



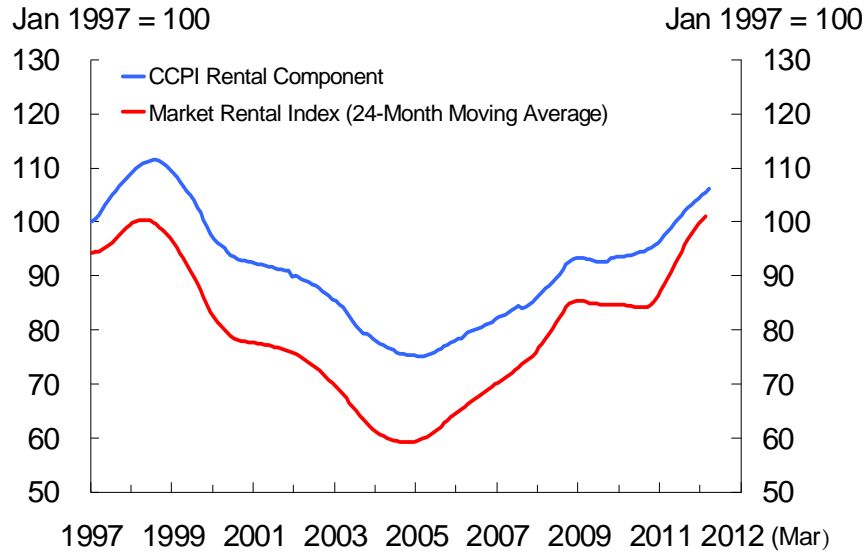
Underlying inflation: Netting out the effects of all Government's one-off relief measures from headline inflation

Sources: C&SD and staff estimates



HONG KONG ECONOMIC SITUATION

CCPI rental component and residential property rental index

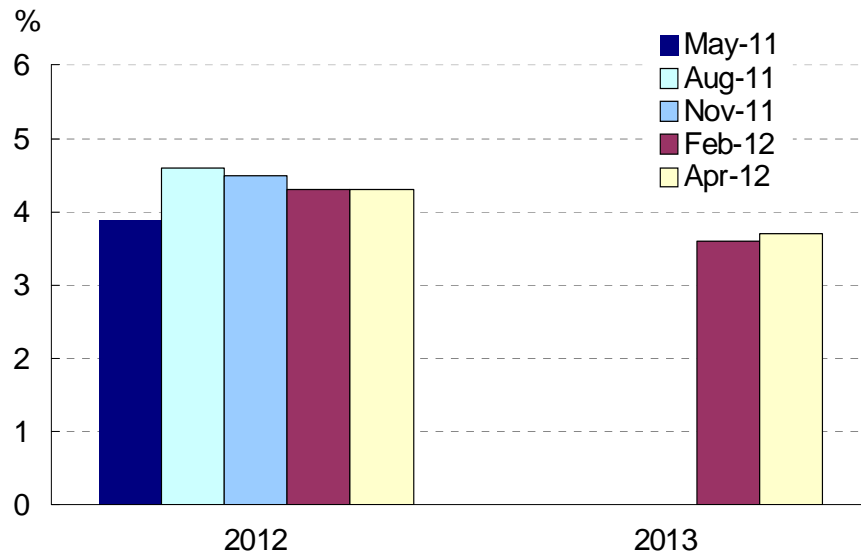


Sources: Rating and Valuation Department (R&VD), C&SD and staff estimates



HONG KONG ECONOMIC SITUATION

2012 and 2013 inflation forecasts

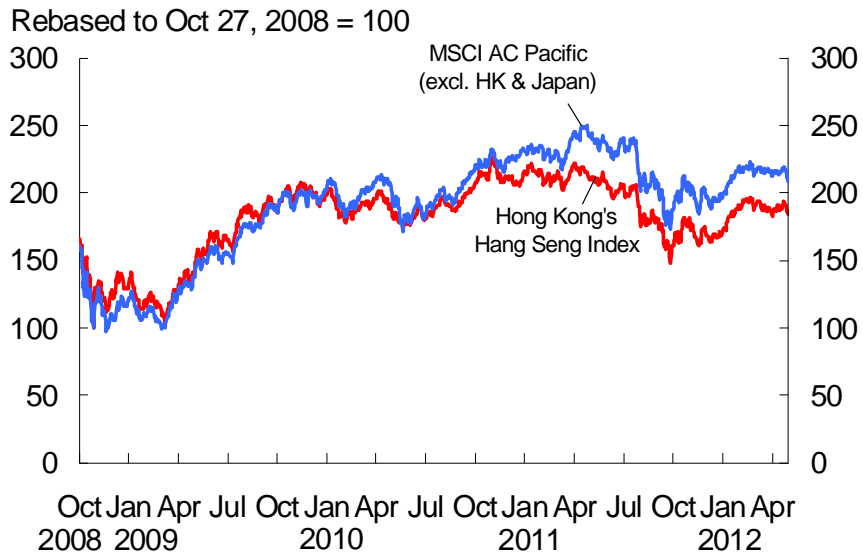


Source: Consensus Forecast (May, Aug, Nov 2011, Feb and Apr 2012)



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

Hong Kong and Asia Pacific equity market performance

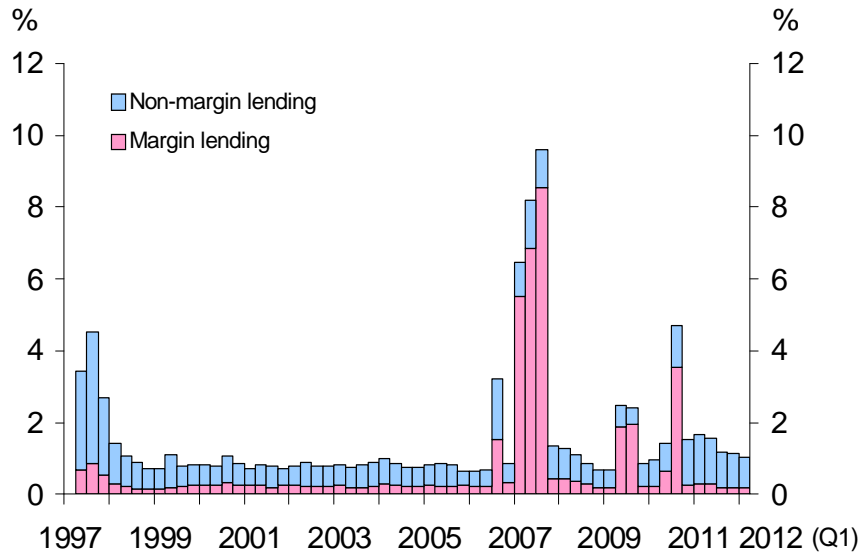


Source: Bloomberg



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

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

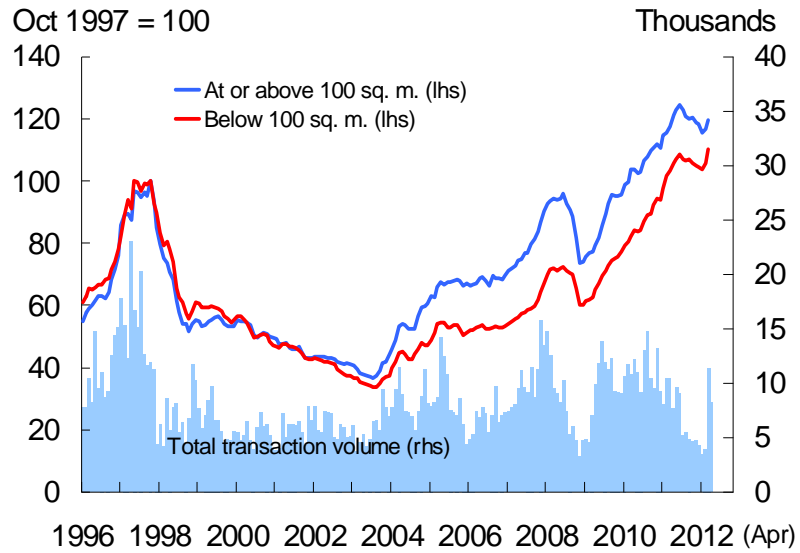


Source: HKMA



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

Residential property prices and transaction volume

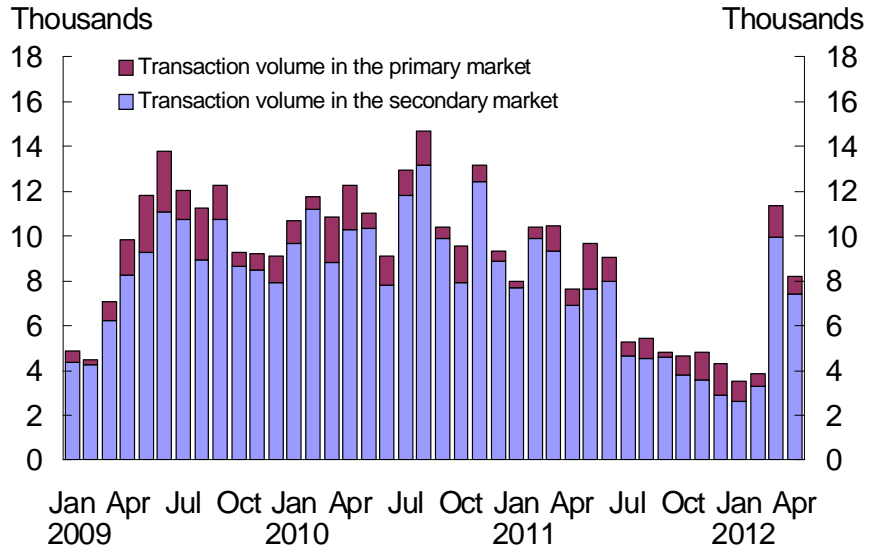


Source: R&VD



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

Transaction volumes in residential property market

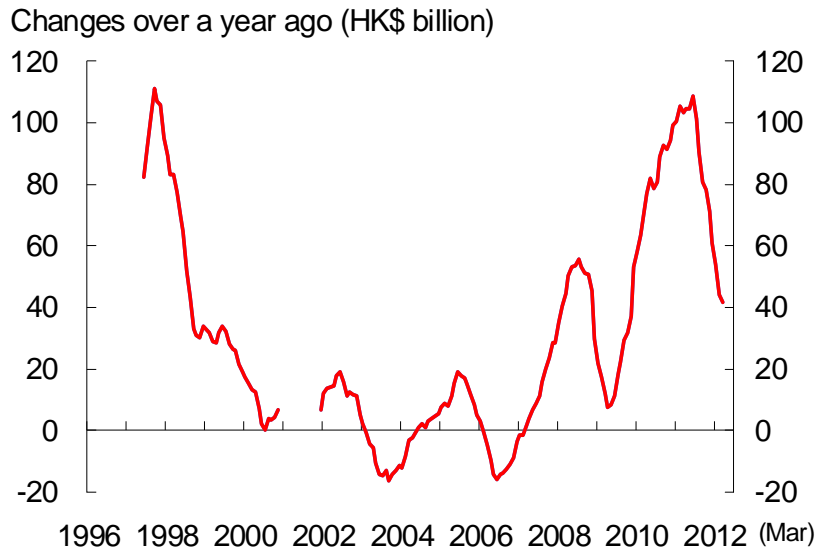


Source: Land Registry



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

Changes in outstanding mortgage loans

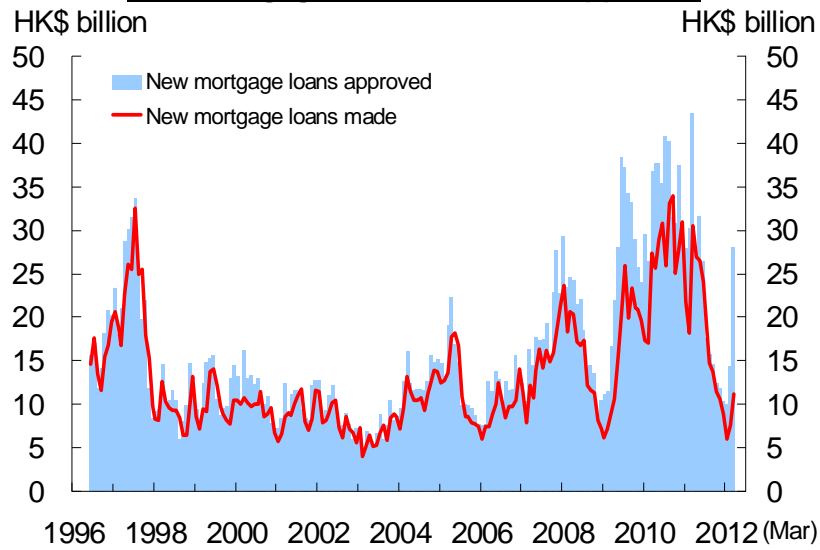


* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



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

New mortgage loans made and approved



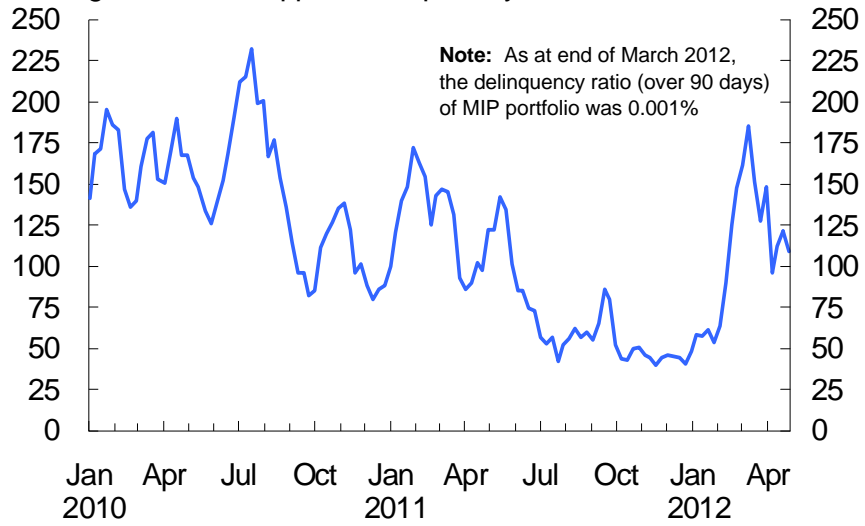
* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



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

MIP loan applications

Average number of applications per day



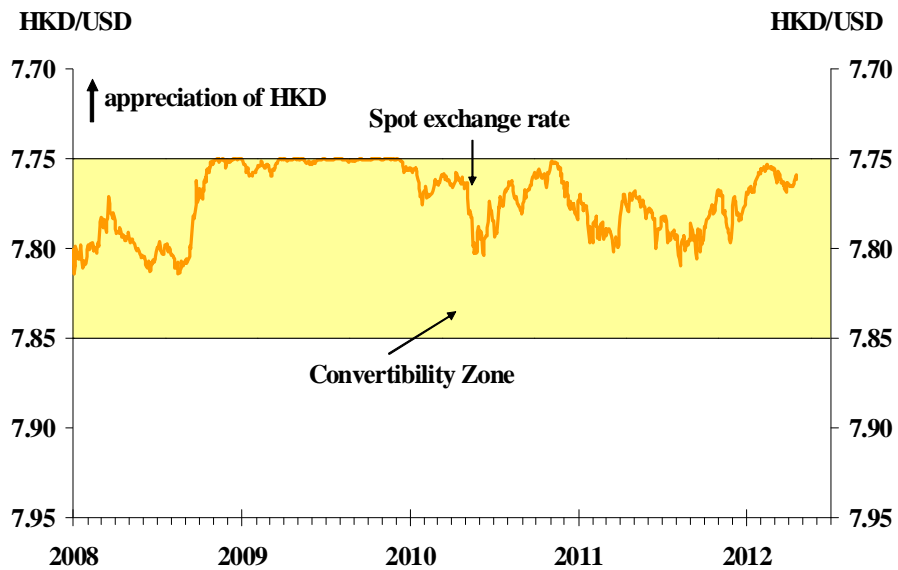
Source: Hong Kong Mortgage Corporation



CURRENCY STABILITY



HONG KONG DOLLAR SPOT EXCHANGE RATE

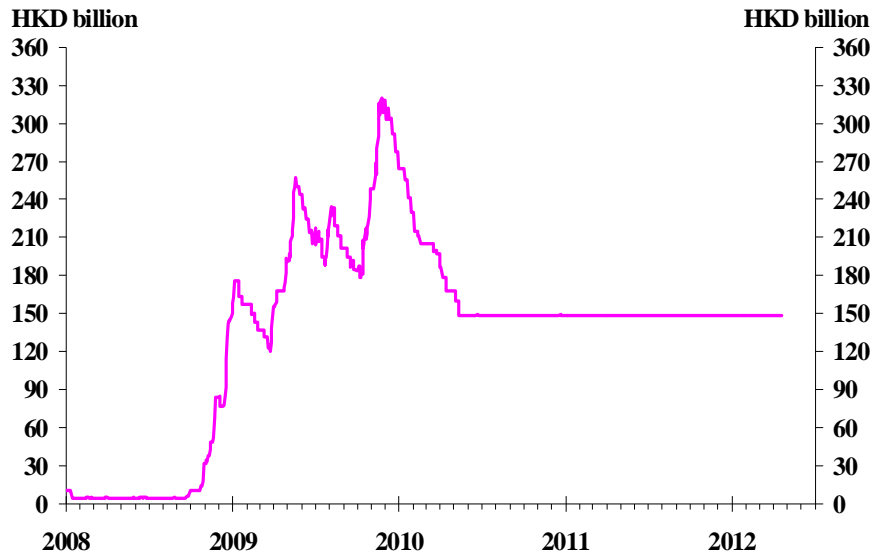


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- In March and early April, the Hong Kong dollar spot exchange rate retreated from its February high-level, alongside decline in stock market on lingering concerns about global economic growth. Since mid-April, the spot exchange rate has strengthened again on news of widening CNY trading band.



AGGREGATE BALANCE

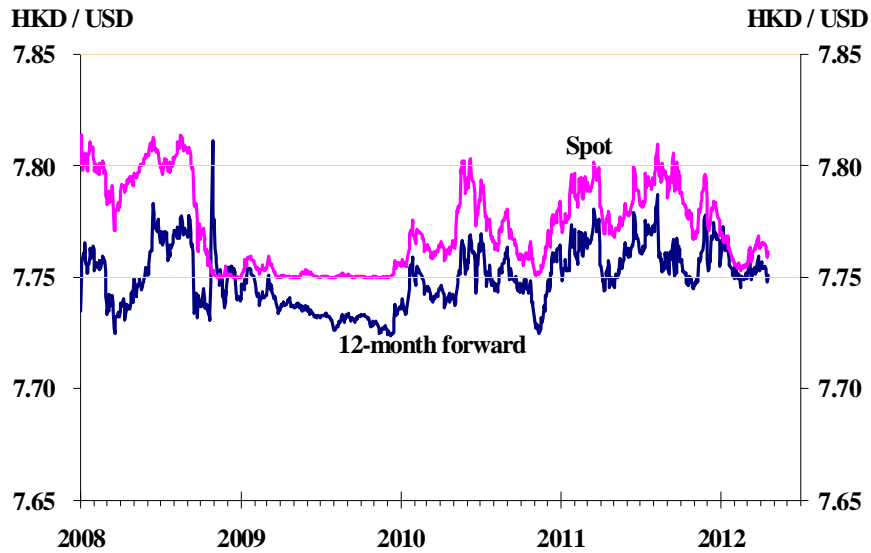


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- Liquidity remained abundant in the interbank market. The Aggregate Balance has stayed steady at around HK\$150 billion since mid-May 2010.



HONG KONG DOLLAR FORWARD EXCHANGE RATE

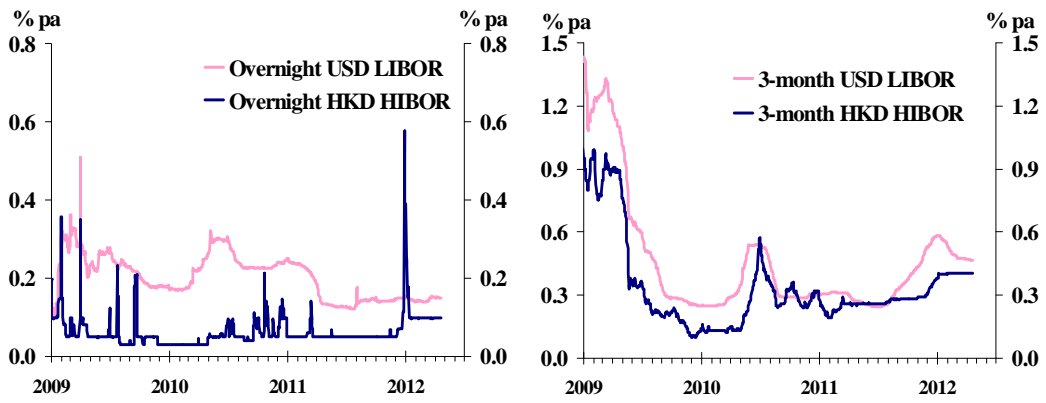


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- The Hong Kong dollar forwards eased modestly, leading to some widening of forward discounts over the past two months.



DOMESTIC INTEREST RATES



- Short-term Hong Kong dollar interest rates have remained stable and stayed below their US dollar counterparts.

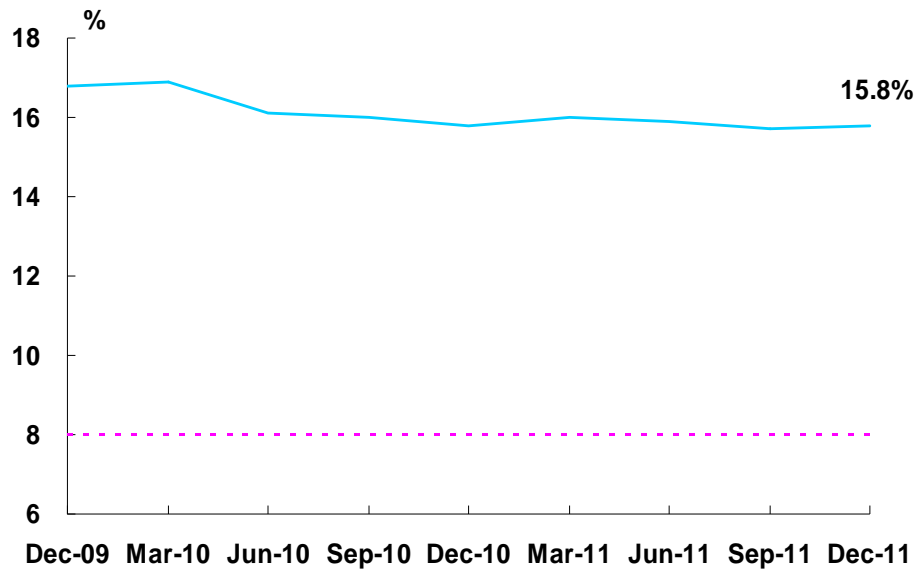


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



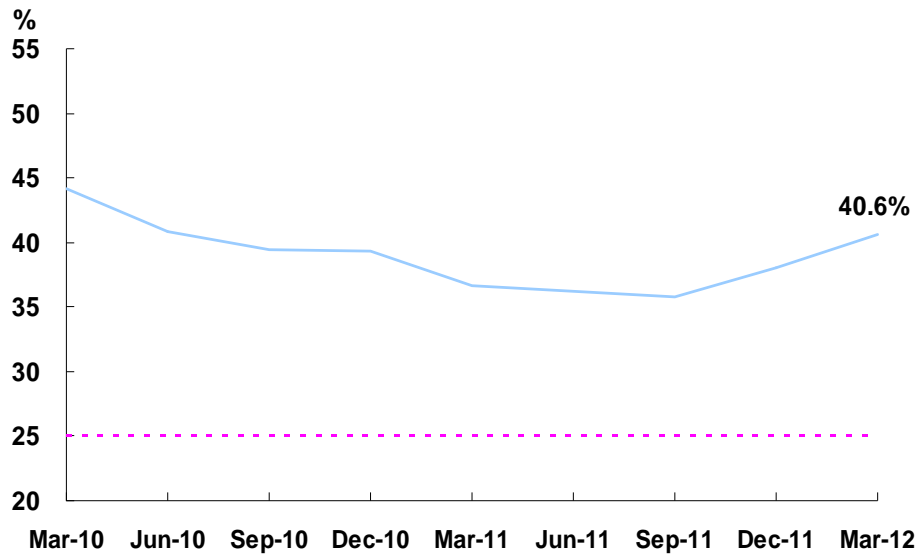
41

- The consolidated capital adequacy ratio of locally incorporated AIs was 15.8% at the end of December 2011, compared with 15.7% at the end of September 2011. The ratio remained well above the international standard of 8%.



BANKING SECTOR PERFORMANCE

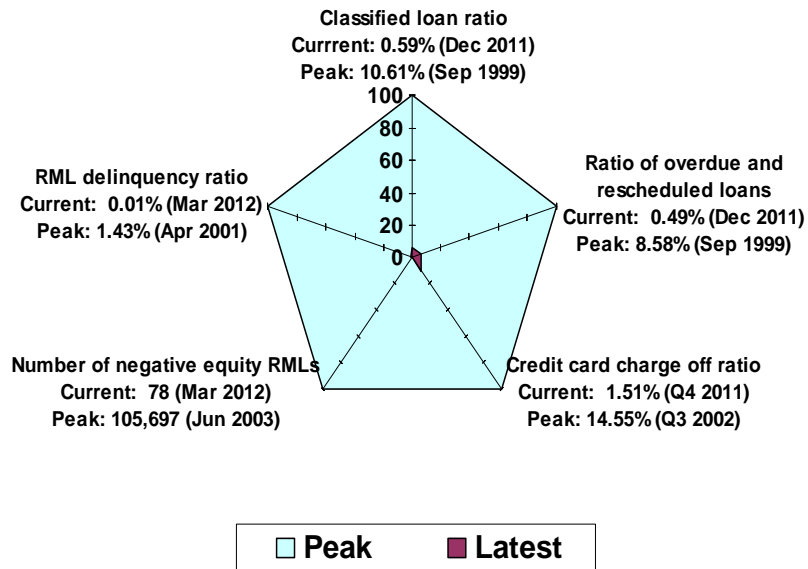
Liquidity ratio of retail banks remained well above statutory minimum of 25%





BANKING SECTOR PERFORMANCE

Asset quality indicators remained good compared with historical standards

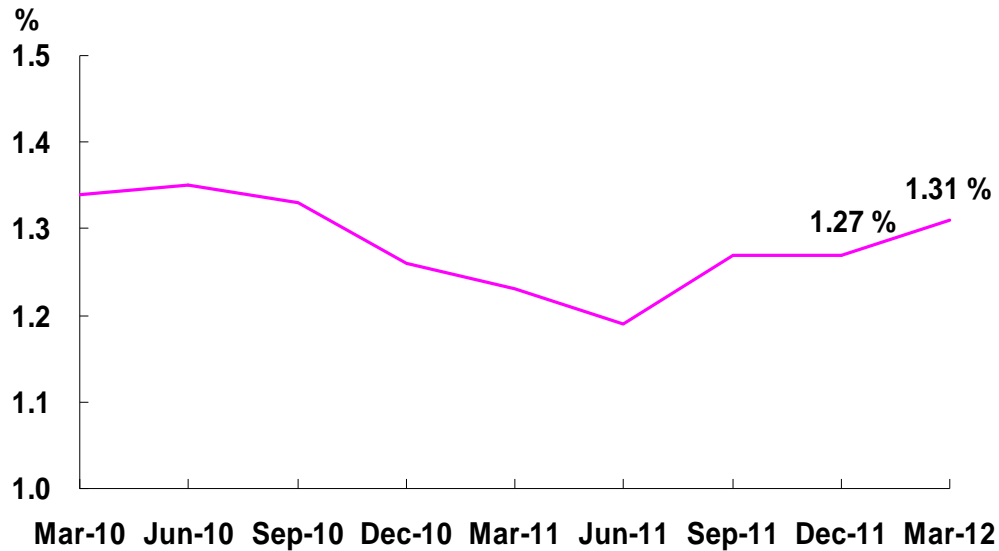


- The HKMA continues to monitor closely the asset quality of retail banks' loan portfolios.



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks

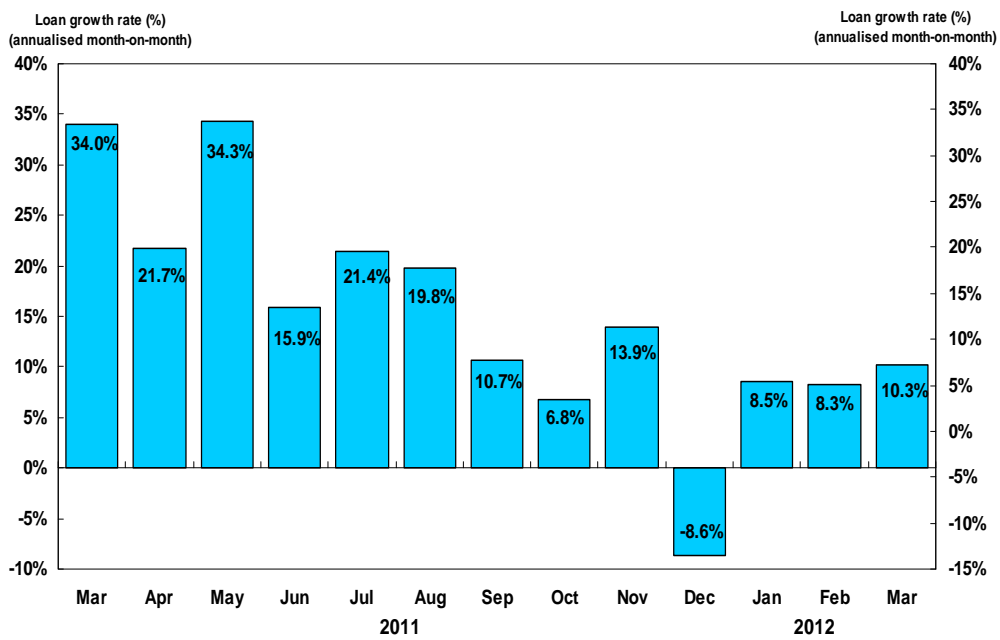


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- The quarterly annualised net interest margin of retail banks increased to 1.31% in Q1 2012.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in Q1 2012 increased by 8.6% compared with the same period last year. Benign increases in net interest income (+14%) contributed to the profit growth.



CREDIT GROWTH



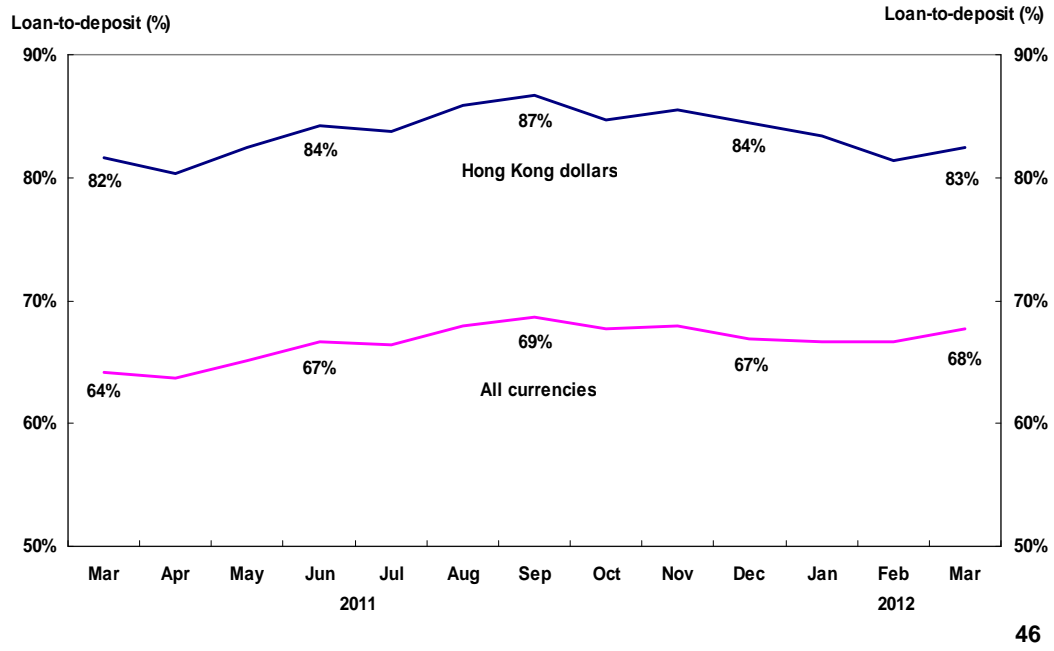
45

- Loan growth has slowed down since H2 2011.
- In Q1 2012, credit growth remained at a moderate level at an annualised rate of 9.1%.



CREDIT GROWTH

Change in loan-to-deposit ratio of banks in Hong Kong

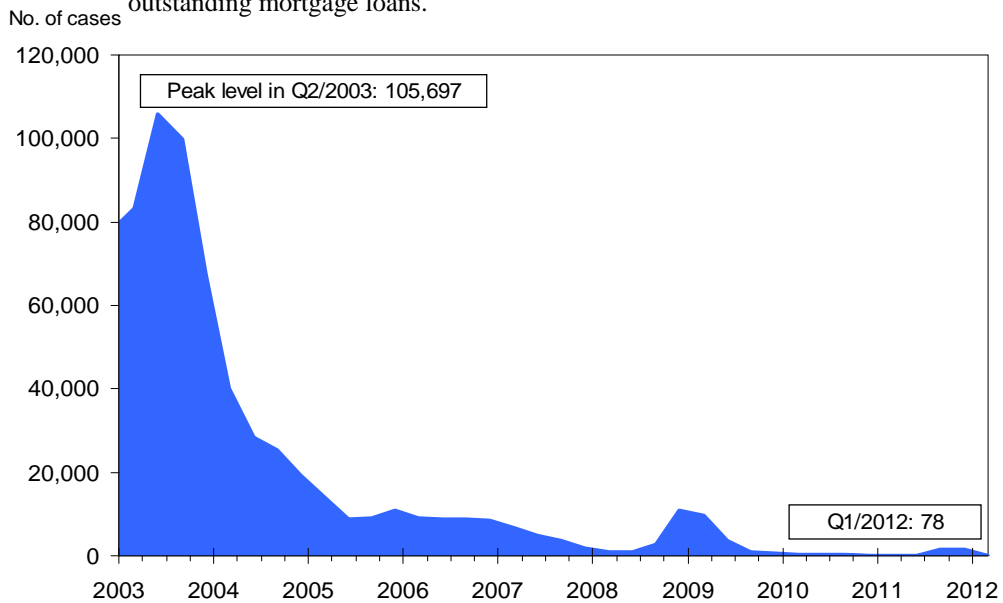


- Hong Kong dollar loan-to-deposit ratio decreased to 83% at end-March 2012 from 84% at end-December 2011. The HKMA will continue to monitor the movement of the loan-to-deposit ratio.



RESIDENTIAL MORTGAGE LOANS (“RMLs”) IN NEGATIVE EQUITY

The number of RMLs in negative equity accounted for a very small portion of total outstanding mortgage loans.



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Statistics on RMLs in negative equity

	6/2003	3/2011	6/2011	9/2011	12/2011	3/2012
Total outstanding number of RMLs in negative equity	105,697 (22%)	59 (0.01%)	48 (0.01%)	1,653 (0.3%)	1,465 (0.3%)	78 (0.02%)
Total outstanding value of RMLs in negative equity (HK\$Mn)	164,577 (31%)	72 (0.01%)	58 (0.01%)	4,148 (0.5%)	3,647 (0.5%)	236 (0.03%)
Value of unsecured portion (HK\$Mn)	35,316 (6.75%)	22 *	18 *	165 (0.02%)	122 (0.02%)	4 *
Proportion of RMLs in negative equity with delinquencies of more than three months	2.3%	0%	0%	0%	0%	0%

() as percentage of total outstanding RMLs

* Less than 0.01% as percentage of total outstanding RMLs



INVESTOR AND CONSUMER PROTECTION

- Exploring ways to promote the private banking industry whilst maintaining an appropriate degree of investor protection
- Working closely with relevant regulators in preparation for the statutory regime for the regulation of MPF intermediaries
- Providing assistance to enable the establishment of Investor Education Centre and Financial Dispute Resolution Centre

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- To accord with the Government's policy initiative in enhancing Hong Kong's position as a major asset management centre in Asia, the HKMA has been working with the private banking industry to explore possible ways to promote the industry whilst maintaining an appropriate degree of protection to customers.
- The HKMA has been working closely with the Financial Services and the Treasury Bureau (FSTB), the Mandatory Provident Fund Schemes Authority (MPFA) and other frontline regulators on the preparatory work in relation to the implementation of the statutory regime for the regulation of MPF intermediaries, e.g. formulation of the new Guidelines on Conduct Requirements.
- The Financial Dispute Resolution Centre Limited (FDRC) was incorporated on 18 November 2011 and is expected to come into operation by mid 2012. The HKMA is closely working with FSTB and Securities and Futures Commission (SFC) in finalising the Terms of Reference for FDRC and on other operational details in preparation for the operation of FDRC.



DEPOSIT PROTECTION

- The design of the DPS will be reviewed against the Core Principles for Effective Deposit Insurance Systems this year, taking into account the results of the Financial Stability Board peer review of deposit insurance systems
- Selected banks have been requested to submit an audit report to certify the correctness of their calculation of amount of relevant deposits for the purpose of contribution assessment by end-April 2012
- Review of the self assessment reports on compliance by banks with the Representation Rules was completed. Results were satisfactory in general
- Planning to conduct another series of publicity campaigns to maintain public awareness of the DPS at a high level



BASEL III IMPLEMENTATION PROGRESS

- Consultation on first phase of policy proposals completed. Industry comments being considered
- Other tasks in 2012:
 - Consultation on second phase of policy proposals (including details of disclosure requirements and liquidity standards)
 - Statutory consultation on the draft rules before tabling at LegCo

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Consultation on first phase of policy proposals

- Issued in January 2012 for industry consultation, covering proposals in relation to
 - the revised definition of capital (including the constituent elements of the capital base and the required regulatory deductions that must be made in the calculation);
 - the strengthened counterparty credit risk requirements (including the capital treatment of banks' exposures to central counterparties);
 - the integration of Pillar 2 requirements into the Basel III framework; and
 - certain aspects of the Basel III liquidity standards (including scope of application and relationship with the existing liquidity ratio in the Banking Ordinance).
- The consultation closed on 20 March. The HKMA has recently issued its response to the industry's comments.

Other tasks in the coming year

- A second round of consultation papers are expected to be issued in May. These will cover the disclosure requirements relating to the capital base and further details on the liquidity standards (such as the criteria for determining which AIs will be subject to the Basel III liquidity standards, the treatment of intragroup transactions under the new standards, and the enhanced framework for the existing 25% minimum liquidity ratio).
- The consultation results will form the basis for amending the Banking (Capital) Rules and the Banking (Disclosure) Rules for the first phase of implementation of the Basel III capital standards in Hong Kong (i.e. those that go into effect from 1 January 2013). The HKMA intends to issue the text of the draft rules for statutory consultation in Q3 prior to submitting the rules to LegCo in Q4.



FINANCIAL INFRASTRUCTURE



REFORMING OTC DERIVATIVES MARKET

G20 Commitments

- All standardised OTC derivative contracts should be traded on exchanges/electronic trading platforms and cleared through central counterparties
- OTC derivative contracts should be reported to trade repositories

Implementation

- **Regulation:**
 - Aim to introduce the Securities and Futures (Amendment) Bill into the Legislative Council in Q4 2012 to implement the clearing and reporting requirements. The target is to implement the new regulations in mid-2013
- **Central Counterparty:**
 - HKEx is building a local central counterparty for OTC derivatives, which is expected to commence operation by end 2012
- **Trade Repository:**
 - HKMA is expanding the functions of the Central Moneymarkets Unit to develop a local trade repository, which is expected to commence operation in Q2 2013

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- HKMA and SFC conducted a public consultation on the proposed regulatory regime for the OTC derivatives market in October 2011. The target is to publish the consultation conclusions in Q2 2012 to respond to the comments received from the consultation.
- The detailed requirements of the new regulatory regime will be set out in the subsidiary legislation in the form of rules. HKMA and SFC aim to conduct a public consultation on the draft subsidiary legislation in Q4 2012.
- The local trade repository will be ready to provide the necessary matching service to facilitate clearing by the local central counterparty by end 2012 and ready to receive information from users upon satisfactory testing of the system in Q2 2013.



GOVERNMENT BOND PROGRAMME

Institutional Bond Issuance Programme:

- Nine issues totalling HK\$39.5 billion outstanding as at end April
- Tenors from 2 years up to 10 years have been offered in order to build a benchmark yield curve
- The tenders attracted a diverse group of end-investors, such as investment funds, insurance companies and pension funds

Retail Bond Issuance Programme:

- HK\$10 billion of inflation-linked bond (iBond) was issued in July 2011
- Further issuance of iBond was announced by the Financial Secretary in his Budget Speech
- Up to HK\$10 billion will be offered to HK residents
- Preparatory work is in progress and the issuance is expected to complete within the second quarter

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- The primary objective of the GBP is to promote the further and sustainable development of Hong Kong's bond market through systematic issuance of government bonds. It can also help promote financial stability by making our debt market an effective channel of financial intermediation, complementing the banking and equity markets.
- The GBP is a long-term programme comprising an Institutional Bond Issuance Programme and a Retail Bond Issuance Programme.
- By enlarging the investor base over time, the GBP is expected to improve liquidity and attract more issuers to raise funds via the bond market. This will help increase the breadth and depth of our bond market, thereby consolidating our role as an international financial centre.
- The objective of the Retail Programme is to enhance the interest and awareness of local individual investors in bond investments. The Financial Secretary announced a second inflation-linked bond (the "iBond") issuance to further promote the sustainable development of retail bond market in his 2012-13 Budget Speech.
- The HKMA is tasked to co-ordinate the issuance, and is working closely with the external service providers, such as the co-arrangers (Bank of China (Hong Kong) Limited and The Hongkong and Shanghai Banking Corporation Limited) to complete the issuance within the second quarter. Offering details will be announced in due course.



PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector to explore ways to strengthen the competitiveness of Hong Kong's asset management industry and reinforce Hong Kong's position as a leading asset management centre
- Stepping up marketing efforts to proactively reach out to overseas and Mainland asset managers and investors to promote Hong Kong's financial platform. Promotional campaigns so far covered New York, London, Switzerland and Luxembourg
- Building on the feedback from our regular dialogues with industry players, we continue to improve our platform and keep pace with the latest developments in the asset management industry

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- With the promising growth prospects of the Asian region, there has been increasing interest for overseas asset managers to expand into Asia. To capitalise on this trend and attract more asset managers into Hong Kong, the HKMA is working in conjunction with other Government agencies and market players to promote Hong Kong's asset management business, thereby reinforcing Hong Kong's role as a premier international financial centre.
- To this end, the HKMA is taking part in a joint Government campaign, along with the Financial Services and the Treasury Bureau and the Securities and Futures Commission, in holding a series of promotional roadshows in leading global financial centres. Since November 2010, the campaign has visited London, New York, Switzerland and Luxembourg, during which the HKMA also took the opportunities to meet with key asset managers based in their financial centres to promote the financial platform in Hong Kong and listen to their business plans in Asia and their views on potential hurdles for their operations in Hong Kong.



DEVELOPMENT OF ISLAMIC FINANCE

- Support the Government in drawing up a legislative proposal to amend Hong Kong's tax laws to level the playing field between Islamic and conventional bonds
- Two-month consultation on legislative proposal launched by the Government at the end of March
- Purpose of consultation is to gauge market views on the proposed legislative amendments, ensuring that they are practicable and able to meet the latest market development needs



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Continue to enhance financial infrastructure, especially for supporting the continual growth of RMB business in Hong Kong
 - the operating hours of the RMB RTGS system in Hong Kong will be extended from the current 10 hours to 15 hours, from 8:30 to 23:30 (Hong Kong time), starting from 25 June 2012
 - cross-border joint direct debit transfers service between Hong Kong and Guangdong Province through HKD and RMB China UnionPay debit cards issued in Hong Kong and directly debiting RMB accounts in Hong Kong will be launched on 3 July 2012
- Developing a trade repository for over-the-counter derivatives trades to enhance market surveillance and transparency, and bring Hong Kong in line with international standards

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Operation of financial infrastructure

- The HKD, USD, EUR and RMB Real Time Gross Settlement (RTGS) systems and the Central Moneymarkets Unit (CMU) have been operating smoothly.

Financial infrastructure to support RMB business

- To better serve financial institutions in different regions for offshore RMB business through the Hong Kong infrastructure and enhance the competitiveness of the RMB clearing platform in Hong Kong, the daily operating hours of the RMB RTGS system will be extended from the current 10 hours to 15 hours starting from 25 June 2012. The project has been progressing on schedule. Upon launch, the extended operating window will be able to cover both the Asian and European business hours and early US business hours.
- The cross-border joint direct debit transfers service is modelled on the existing service between Hong Kong and Shenzhen through the use of HKD and RMB China UnionPay (CUP) debit cards issued in Hong Kong and directly debiting RMB accounts in Hong Kong. This service, scheduled for launch on 3 July 2012, will provide Hong Kong residents with a more convenient payment channel for making regular and recurring cross-border small-value payments to merchants in Guangdong Province, such as payments of property management fee and utilities bills.

Trade Repository

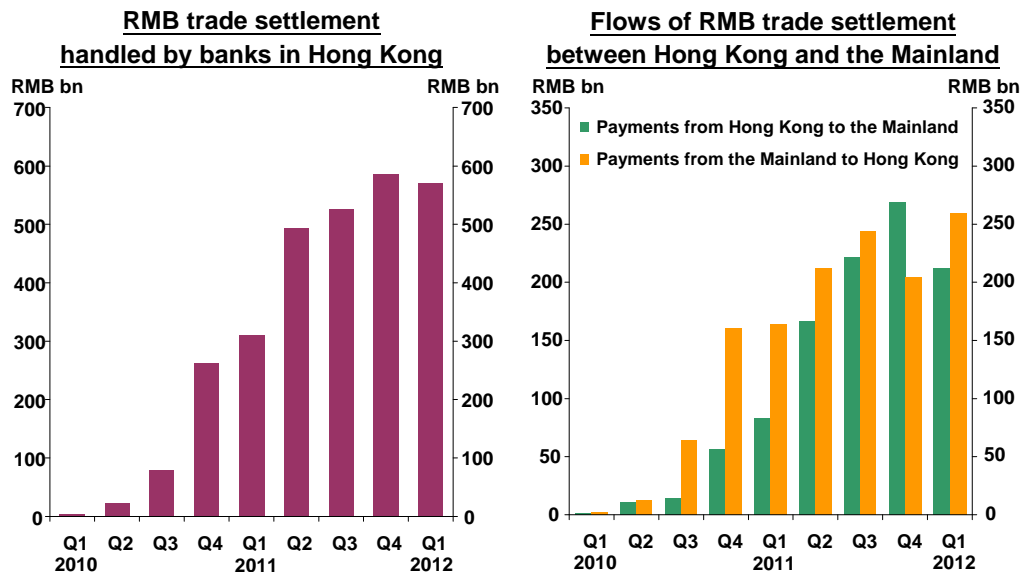
- The system development work for the trade repository has been progressing as scheduled. The system will be launched shortly before the relevant legislation takes effect.



HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE



Steady growth in RMB trade settlement handled by Hong Kong banks



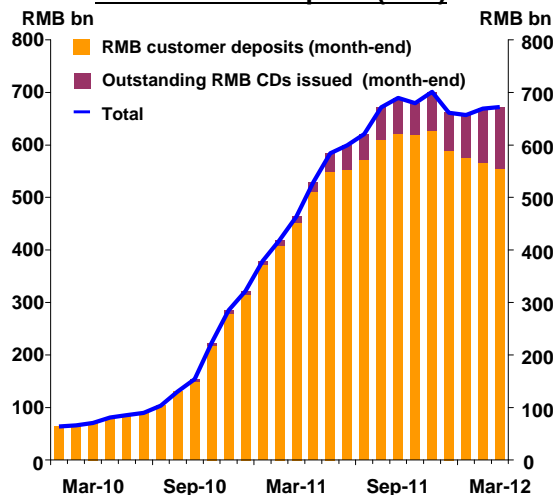
58

- Hong Kong's offshore RMB business continued to grow steadily in the first quarter of 2012.
- In Q1 2012, Mainland's RMB trade settlement amounted to RMB 580.4 billion yuan. During the same period, RMB trade settlement handled by banks in Hong Kong amounted to RMB 571.2 billion yuan. In addition, there were two-way flows of RMB trade settlement activities. The ratio of payments from Hong Kong to the Mainland vs those from the Mainland to Hong Kong was 1:1.2 in Q1 2012.



Vibrant RMB financing activities

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities

RMB dim-sum bond market

	Jan - Apr 2012	Jan - Apr 2011
Amount of issuance (RMB billion)	36.7	19.0
No. of issuers	30	23

RMB bank lending

	End-Mar 2012	End 2011
Outstanding RMB loans (RMB billion)	42.0	30.8

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- Banks have been increasingly issuing certificates of deposit (CDs) as a means to tap RMB liquidity. The decrease in RMB customer deposits of RMB 34.2 billion yuan in Q1 2012 was more than offset by the RMB 45.1 billion yuan increase in the outstanding amount of CDs issued by banks. At end-March, the outstanding amount of RMB customer deposits and CDs issued amounted to RMB 554.3 billion yuan and RMB 118.1 billion yuan respectively, totalling RMB 672.4 billion yuan at end-March, up from RMB 661.6 billion yuan at end-2011.
- RMB financing activities in Hong Kong continued to be vibrant. In the first four months of 2012, RMB bond issuance in Hong Kong amounted to some RMB 37 billion yuan, almost doubling the issuance size in the same period last year. Meanwhile, the range of issuers continued to diversify. In particular, there was the first RMB bond by an issuer from the Middle East in March 2012.
- RMB lending business by banks in Hong Kong continued to grow, with the outstanding amount of RMB loans increasing to RMB 42 billion yuan at end-March 2012, from some RMB 30 billion yuan at end-2011.



Further development of Hong Kong's role as global hub for offshore RMB business

	<u>Q1 2012</u>	<u>2011</u>	<u>Growth</u>
1 No. of participating banks of Hong Kong's RMB clearing platform	194	187	+4%
Of which:	170	165	+3%
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks			
2 No. of RMB correspondent accounts set up by overseas banks at Hong Kong banks	1,104	968	+14%
3 Amount due to overseas banks (RMB billion at period-end)	128.5	116.4	+10%
4 Amount due from overseas banks (RMB billion at period-end)	146.1	121.7	+20%

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- In order to better serve financial institutions and corporates from different parts of the world, the operating hours of the RMB Real Time Gross Settlement system in Hong Kong will be extended to 11:30 pm by the end of June. This will give financial institutions in London and other financial centres in the European time zone an extended window to settle offshore RMB payments through Hong Kong.



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Chiang Mai Initiative Multilateralisation (CMIM)

- ASEAN+3 Finance Ministers and Central Bank Governors agreed on 3 May 2012 to enhance the CMIM including an increase of its total size from US\$120 billion to US\$240 billion
- Hong Kong's commitment will increase from US\$4.2 billion to US\$8.4 billion, and the amount that Hong Kong is eligible to borrow will increase from US\$2.1 billion to US\$6.3 billion accordingly

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- On 3 May, the ASEAN+3 Finance Ministers and Central Bank Governors agreed to strengthen the crisis resolution mechanism and introduce a crisis prevention function for CMIM. Specifically, the total size of CMIM will be increased from US\$120 billion to US\$240 billion along with a number of operational enhancements. Amidst the current immense uncertainties in the global financial system, the relevant enhancements of the CMIM arrangement are timely and necessary.
- It is crucial that Hong Kong, as a leading International Financial Centre, is part of this process, thereby contributing to and benefiting from the enhanced CMIM, in promoting financial stability in Asia.



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Group of Twenty (G20)

- The HKMA attended the G20 Finance Ministers and Central Bank Governors' Meeting as part of the China delegation on 19-20 April in Washington D.C. The discussion focused on latest developments of the global economy, augmentation of IMF resources, and financial regulatory reforms

Financial Stability Board (FSB)

- The HKMA continues to participate actively in FSB meetings and activities. Key areas of work include extending the framework for systemically important financial institutions to domestic systemically important banks, OTC derivatives market reform, strengthening regulation of shadow banking system, and reviewing the FSB governance structure. The next FSB Plenary meeting will be held in Hong Kong on 29-30 May

Executives' Meeting of East Asia and Pacific Central Banks (EMEAP)

- The HKMA conducts analyses to assess risks and vulnerabilities in the region and policy implications, in particular those associated with the European debt crisis, slowdown in regional growth and rising oil prices. The analyses will form the basis for discussion at the EMEAP Monetary and Financial Stability Committee Meeting to be held on 28 May

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- The HKMA attended the G20 Finance Ministers and Central Bank Governors' Meeting as part of the China delegation on 19-20 April in Washington D.C. Key issues discussed include: (i) the global economy; (ii) augmentation of IMF resources; and (iii) financial regulation. To increase the resources available for crisis prevention and resolution, the IMF is able to secure over US\$430 bn new resources from a number of members. This is in addition to the quota increase under the 2010 IMF Governance and Quota Reform.
- The HKMA continued to participate actively in FSB meetings and activities. At the Plenary conference call in March, members reviewed the progress of financial regulatory reforms. Key areas of work include extending the SIFI framework to domestic systemically important banks, implementing OTC derivatives market reforms and strengthening of regulation and oversight of the shadow banking system. The HKMA has been participating actively in relevant international discussions to ensure that our views are heard. Tasked by G20, the FSB is considering options to strengthen its organisation structure and capacity to meet its expanded mandate. The next FSB Plenary meeting will be held in Hong Kong on 29-30 May 2012.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND



INVESTMENT ENVIRONMENT IN Q1 2012

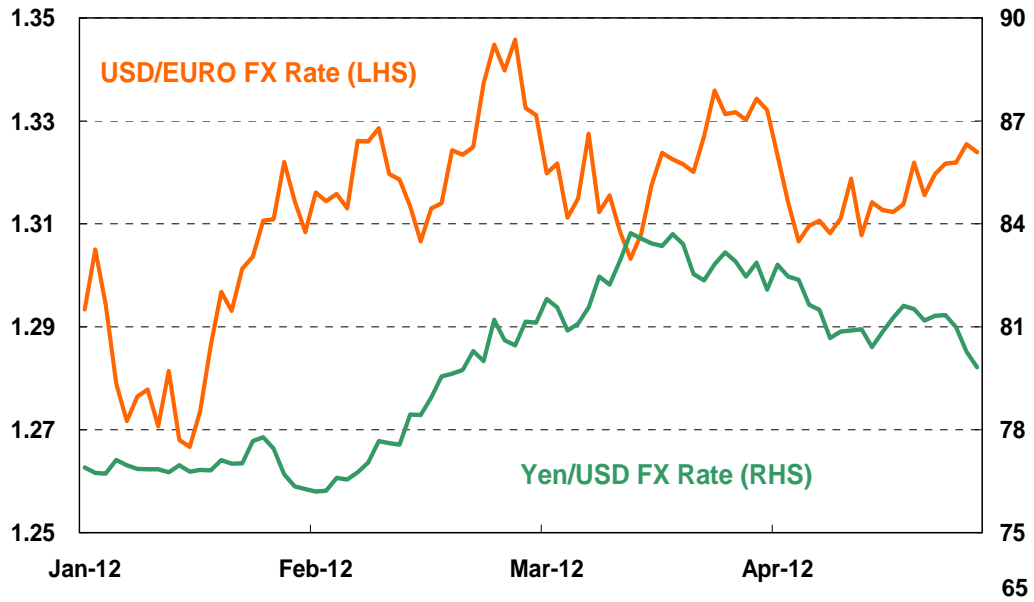
- **Exchange rates:** The Euro rebounded against the dollar as concerns about euro zone debt crisis eased upon the implementation of the Greek debt restructuring programme and liquidity injections by the ECB with 3-year loans to support European banks. The Yen weakened on further quantitative easing by the Bank of Japan
- **Equity markets:** Major stock markets in developed economies extended gains in Q1. Perceived risk of the eurozone debt crisis declined as the lending capacity of the EU/IMF was expanded. Better-than-expected earnings, improved investors' risk appetite and expectation of further easing by major central banks supported global equities
- **Interest rates:** Less demand of safe haven flows on positive developments in Europe and signs of improvements in the US economy pushed US Treasury yields higher in March
- Recent election results of France and Greece might bring renewed uncertainties to the investment environment



CURRENCY MARKETS

USD/Euro FX Rate

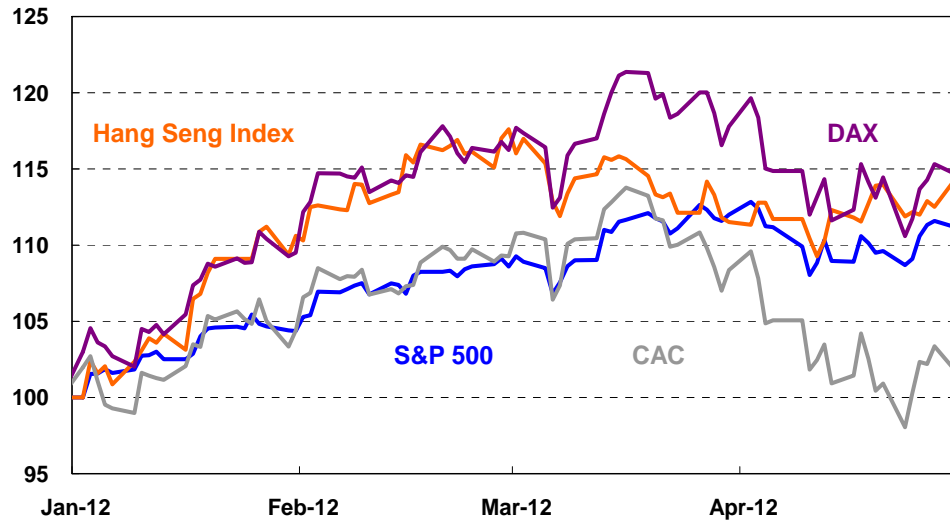
Yen/USD FX Rate





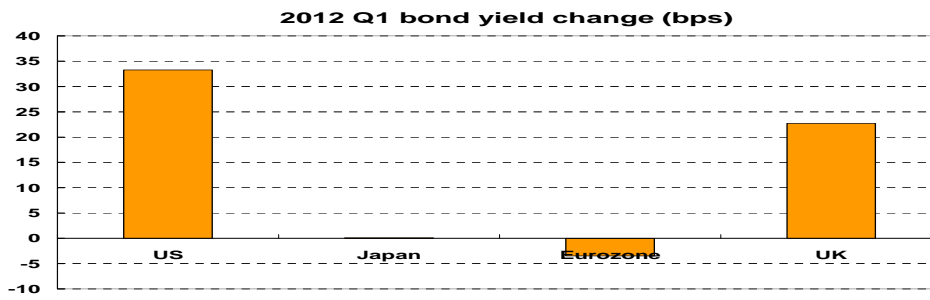
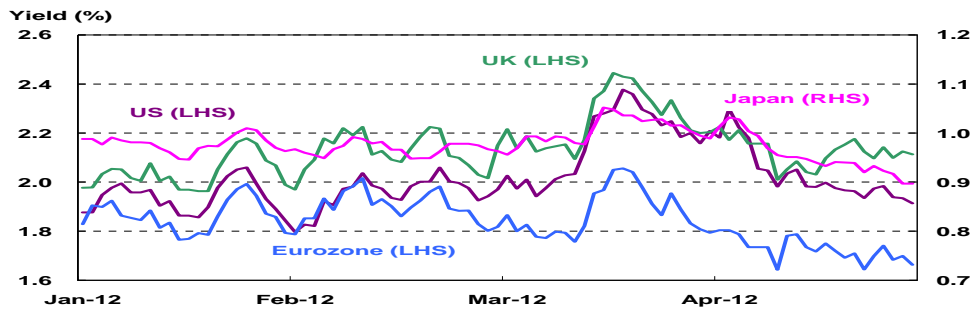
EQUITY MARKETS

Normalized Index Level (2011 year-end = 100)





CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS





INVESTMENT INCOME

	2012	2011	2010	2009
(HK\$ billion)	Q1*	Full Year	Full Year	Full Year
Bonds#		71.9	42.1	(0.6)
Hong Kong equities^@		(24.2)	11.6	48.9
Other equities^		(12.2)	27.1	48.8
Foreign exchange		(9.1)	(3.1)	9.8
Other investments&		<u>0.7</u>	<u>1.7</u>	<u>0.8</u>
Investment income@&		27.1	79.4	107.7

* Unaudited figures

^ Including dividends

Including interest

@ Excluding valuation changes in Strategic Portfolio

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



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

(HK\$ billion)	2012 ←		2011 →			
	Q1*	Full year	Q4	Q3	Q2	Q1
Investment income/(loss)		27.1	22.1	(41.4)	21.6	24.8
Other income		0.2	-	0.1	0.1	-
Interest and other expenses		<u>(4.7)</u>	<u>(0.9)</u>	<u>(1.0)</u>	<u>(1.6)</u>	<u>(1.2)</u>
Net investment income/(loss)		22.6	21.2	(42.3)	20.1	23.6
Payment to Fiscal Reserves#		(37.0)	(9.5)	(9.2)	(9.1)	(9.2)
Payment to HKSAR government funds and statutory bodies#		(5.6)	(1.7)	(1.5)	(1.3)	(1.1)
Valuation change of Strategic Portfolio less valuation change of investment held by EF's investment holding subsidiaries^		<u>(3.6)</u>	<u>(0.1)</u>	<u>(1.7)</u>	<u>(0.5)</u>	<u>(1.3)</u>
Increase/(Decrease) in EF Accumulated Surplus		(23.6)	9.9	(54.7)	9.2	12.0

* Unaudited figures

The fixed rate of fee payment is 5.6% for 2012 and 6.0% for 2011

^ Including dividends



HISTORICAL INVESTMENT INCOME

(HK\$ billion)

Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009*&	107.7	10.6	71.9	58.7	(33.5)
2010*&	79.4	5.9	74.5	(12.1)	11.1
2011*&	27.1	22.1	(41.4)	21.6	24.8
2012*&#	N/A	N/A	N/A	N/A	

* Excluding valuation changes in the Strategic Portfolio

Unaudited figures

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

N/A: Not Applicable



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Mar 2012*	At 31 Dec 2011	At 31 Dec 2010
ASSETS			
Deposits		221.7	198.4
Debt securities		1,844.4	1,706.7
Hong Kong equities		120.6	152.6
Other equities		238.2	245.3
Other assets#		<u>63.1</u>	<u>42.0</u>
Total assets		<u>2,488.0</u>	<u>2,345.0</u>
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness		258.7	225.9
Government-issued currency notes & coins in circulation		9.9	8.9
Balance of the banking system		148.7	148.7
Exchange Fund Bills and Notes		655.8	654.2
Placements by banks and other financial institutions		24.5	23.2
Placements by Fiscal Reserves		663.5	592.3
Placements by HKSAR government funds and statutory bodies		126.2	76.8
Other liabilities		<u>32.8</u>	<u>23.5</u>
Total liabilities		1,920.1	1,753.5
Accumulated Surplus		<u>567.9</u>	<u>591.5</u>
Total liabilities and fund equity		<u>2,488.0</u>	<u>2,345.0</u>

* Unaudited figures

Including investment in EF's investment holding subsidiaries amounted to HK\$31.1 billion at 31 Dec 2011



HONG KONG MORTGAGE CORPORATION



Reverse Mortgage Programme

- Good response since the launch on 11 July 2011
- By 10 May 2012, 228 applications approved with total property value at HK\$839 million
 - Average age of borrowers: 71 years old
 - Payment terms: 10-year (35%), 15-year (20%), 20-year (12%), life (33%)
 - Average property value: HK\$3.7 million
 - Average monthly payout: HK\$13,500
 - Average property age: 31 years
- To review in Q3/2012 after one year's operation



SME Financing Guarantee Scheme (“SFSGS”)

- Since the launch on 1 January 2011, as at 10 May 2012:
 - 265 applications approved (*Note*)
 - total loan amount about HK\$913 million
 - average loan interest rate is 5.3% p.a.
 - average guarantee fee is 1.6% p.a.

- In response to a request from the Government, the HKMC launches in May 2012 a special product under the SFSGS to assist SMEs in obtaining bank financing under challenging market conditions:
 - the new product provides 80% loan guarantee
 - guarantee fee is substantially reduced – only about 30% of the guarantee fee payable for 70% guarantee protection
 - application period is open for nine months
 - total loan commitment for the 80% product is HK\$100 billion
 - the Government bears all losses and claims arising from the new product while the HKMC provides the operating platform

Note : Excluding applications already expired or withdrawn



Microfinance Pilot Scheme

- A three-year microfinance pilot scheme with a tentative aggregate loan amount of HK\$100 million to be launched in mid-2012
- Three types of loans – business start-up, self-employment and self-enhancement (with loan ceilings at HK\$300,000, HK\$200,000 and HK\$100,000 respectively)
- Several banks will join the scheme, with many opting for 50/50 share of funding alongside the HKMC
- Several voluntary agencies will also join to provide the supporting network in training and mentorship