



HONG KONG MONETARY AUTHORITY

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

5 May 2014



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

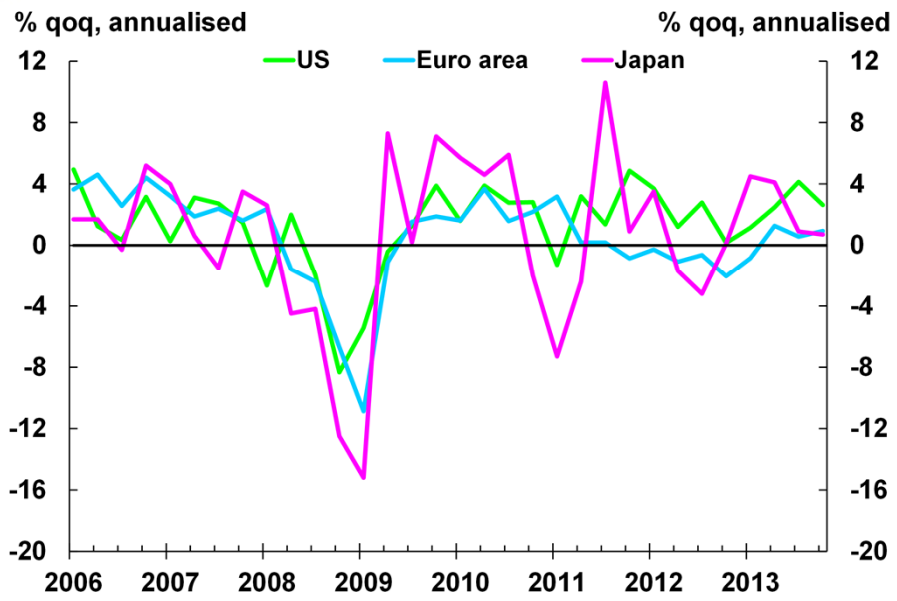
(% year-on-year)

	2013 Estimates	2014 Forecasts	2015 Forecasts
US	1.9	2.7	3.0
Euro area	-0.4	1.2	1.5
Japan	1.5	1.3	1.3
Asia (ex-Japan)	6.1	6.0	6.1
Mainland China	7.7	7.3	7.2
Hong Kong	2.9	3.4	3.5

Sources: April Consensus Forecasts and Official Statistics



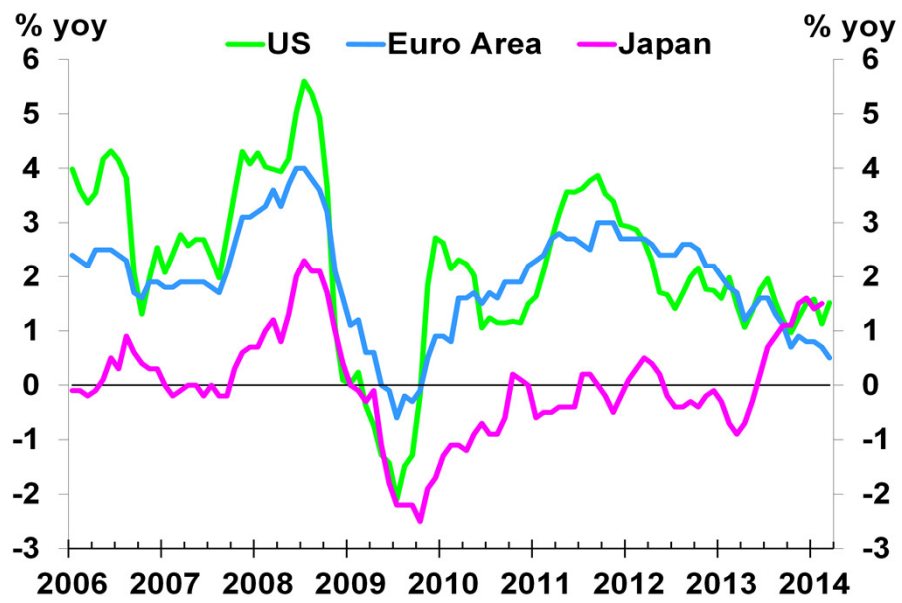
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



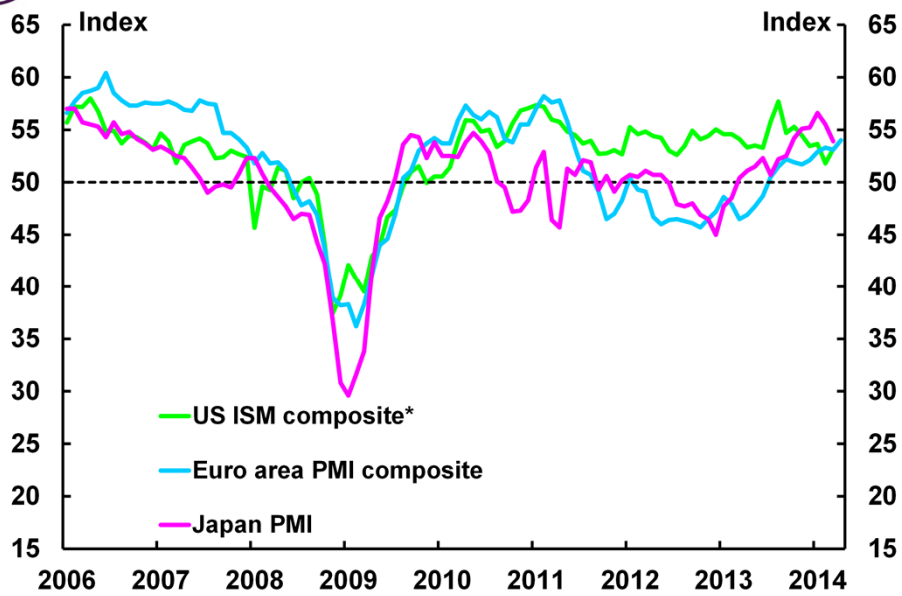
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

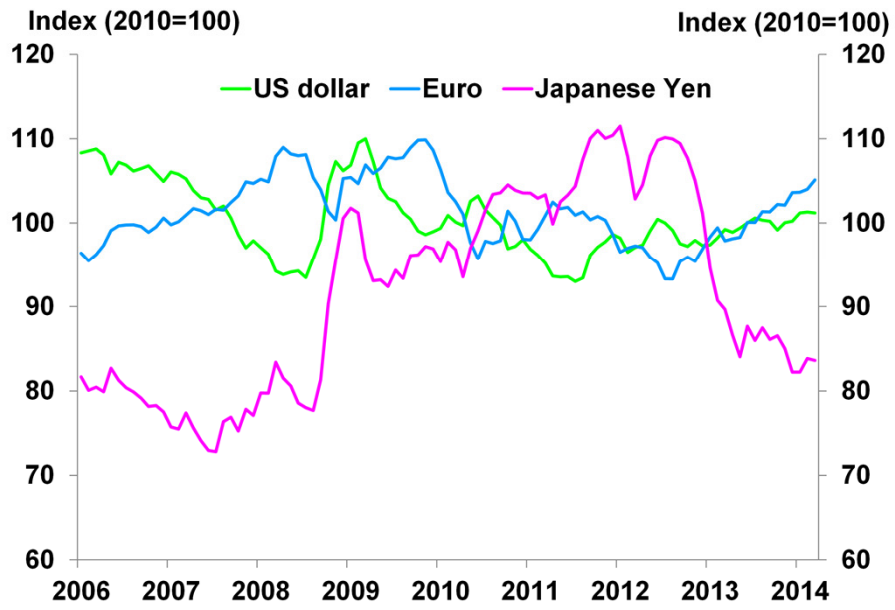


*Weighted average of the ISM manufacturing and non-manufacturing indices

Source: Bloomberg



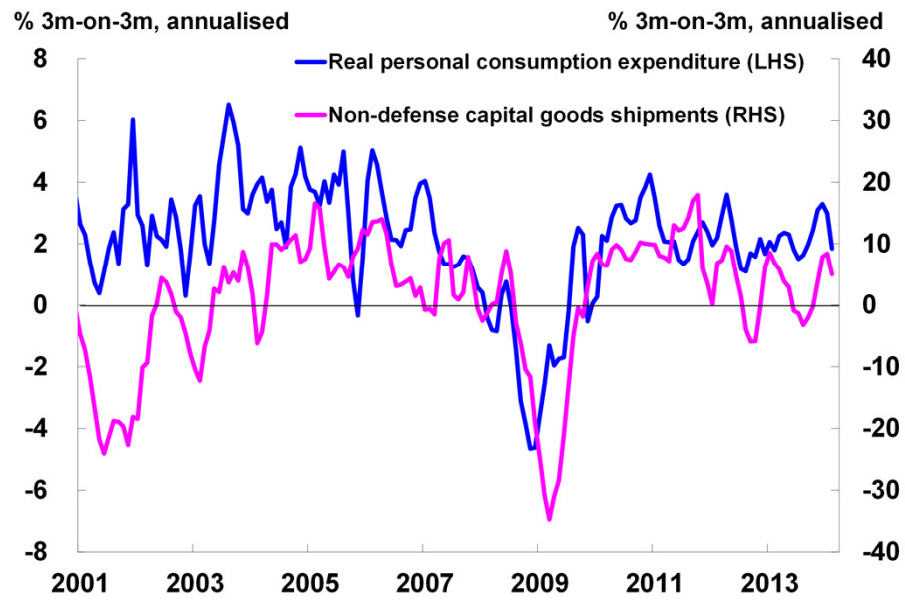
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



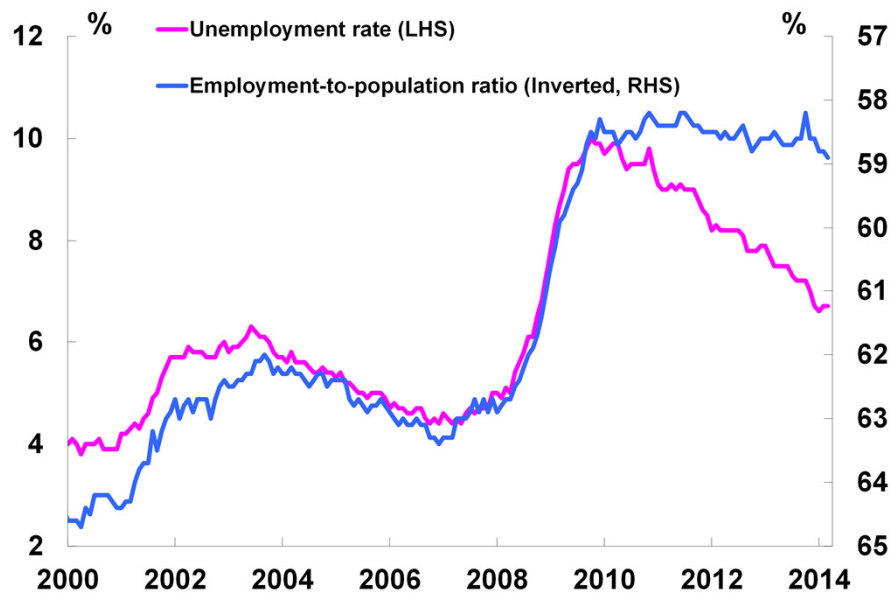
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



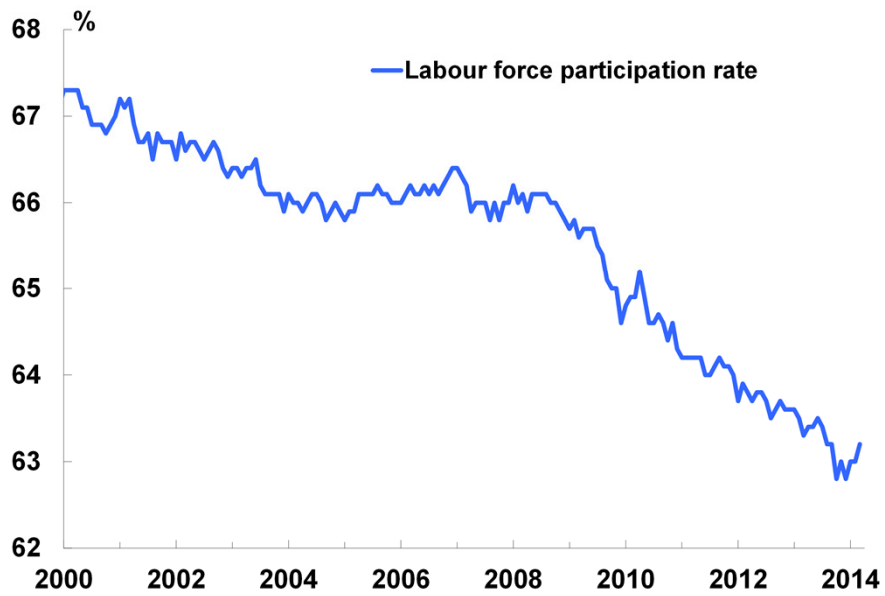
US: LABOUR MARKET SITUATION



Source: CEIC



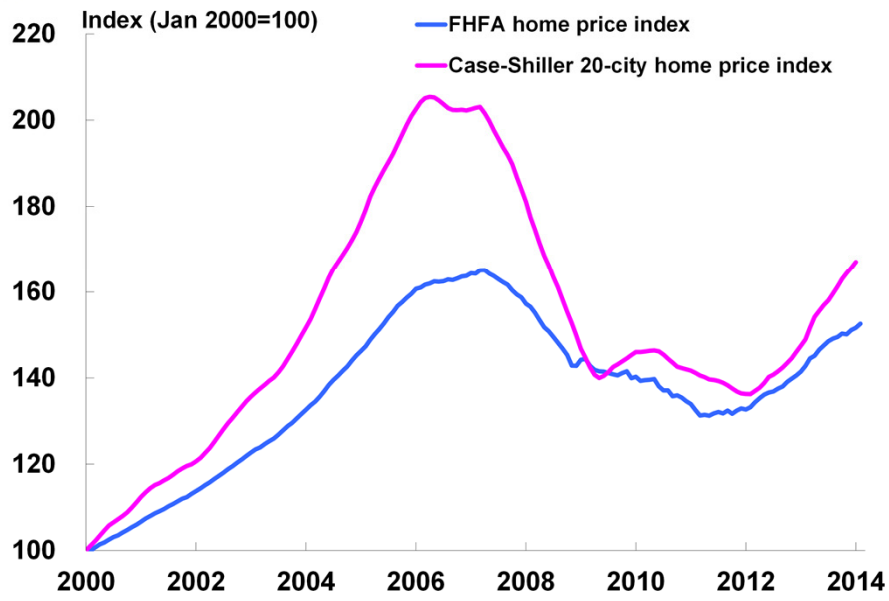
US: LABOUR FORCE PARTICIPATION



Source: CEIC



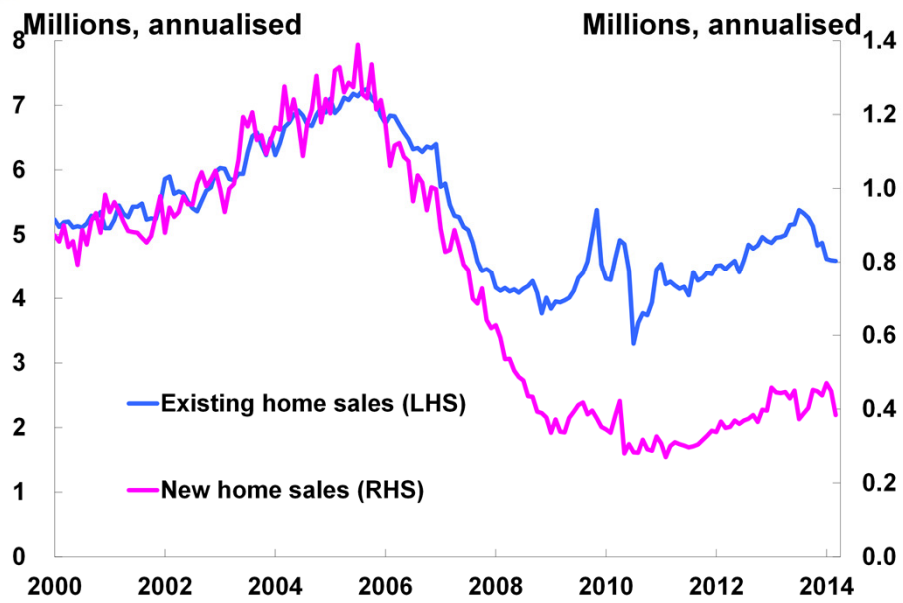
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



US: HOME SALES

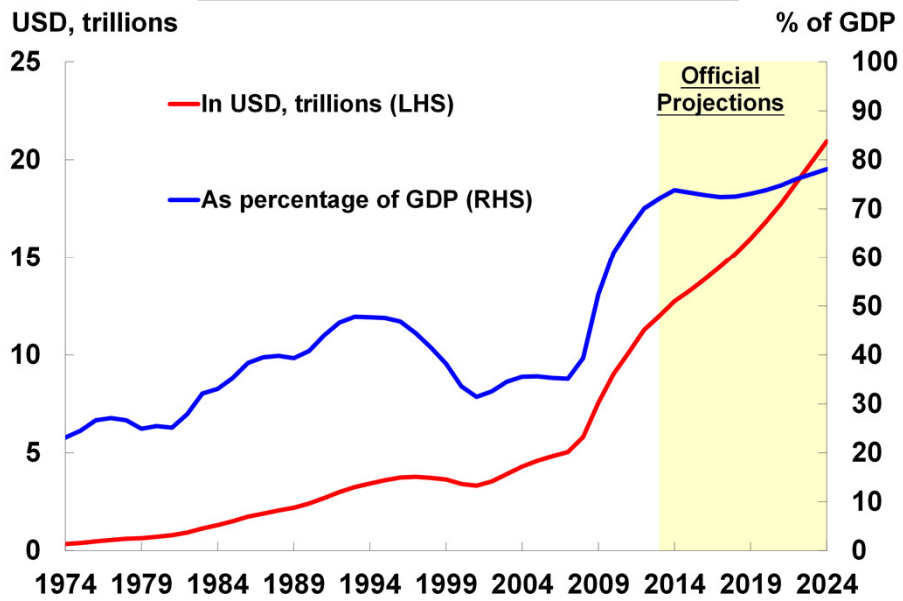


Source: CEIC



US: FEDERAL GOVERNMENT DEBT

US Federal Debt Held by the Public

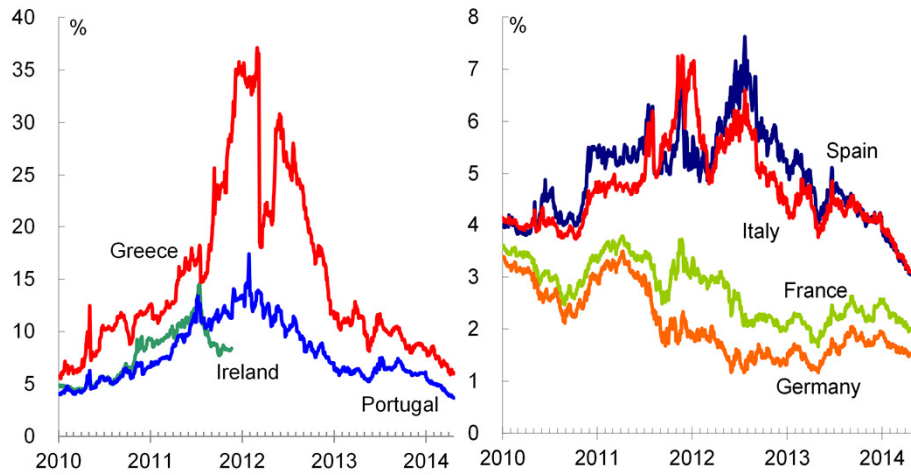


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

10-year sovereign bond yield

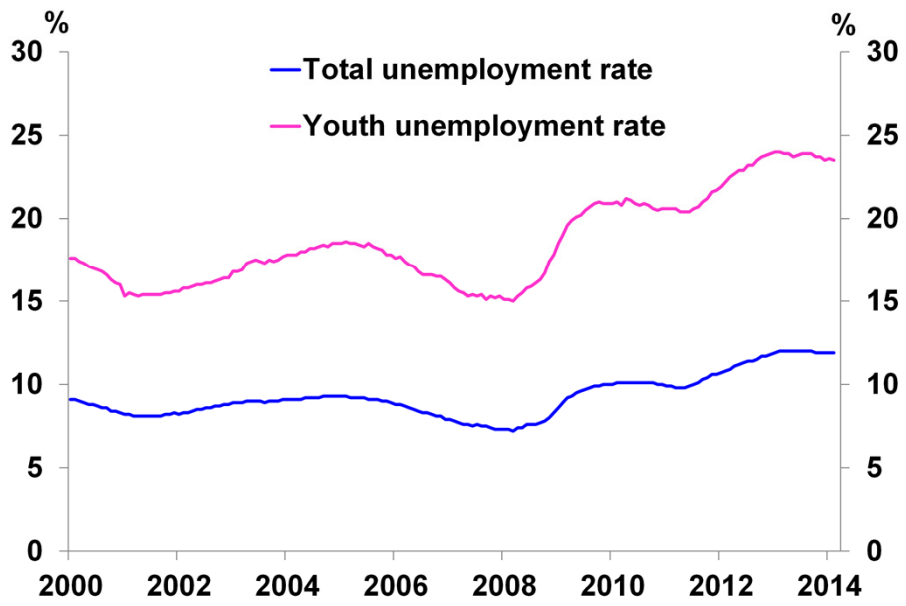


Sources: Bloomberg and EcoWin

Note: EcoWin has stopped publishing Ireland's 10-year bond yield since 22 Nov, 2011



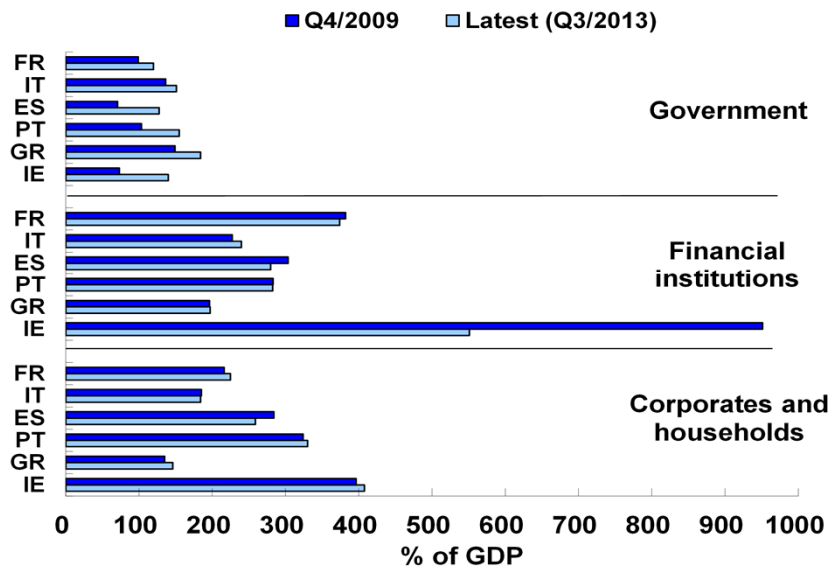
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS IN SELECTED COUNTRIES

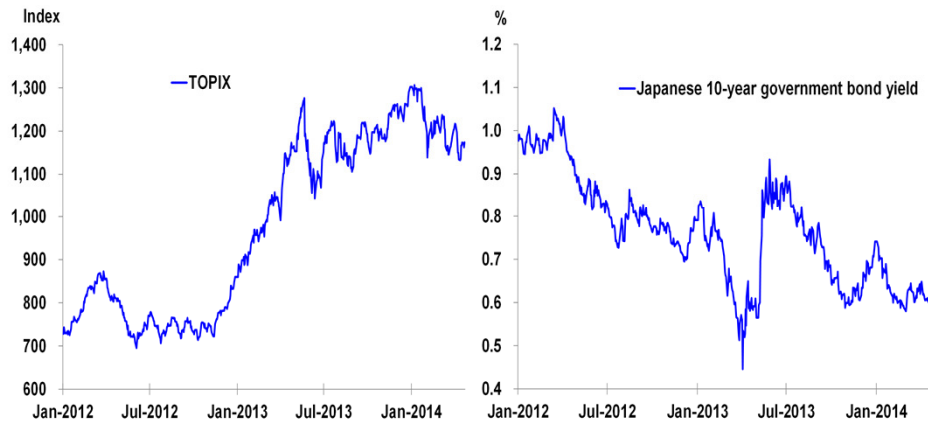


Source: European Central Bank

Note: FR – France, IT – Italy, ES – Spain, PT – Portugal, GR – Greece, IE – Ireland



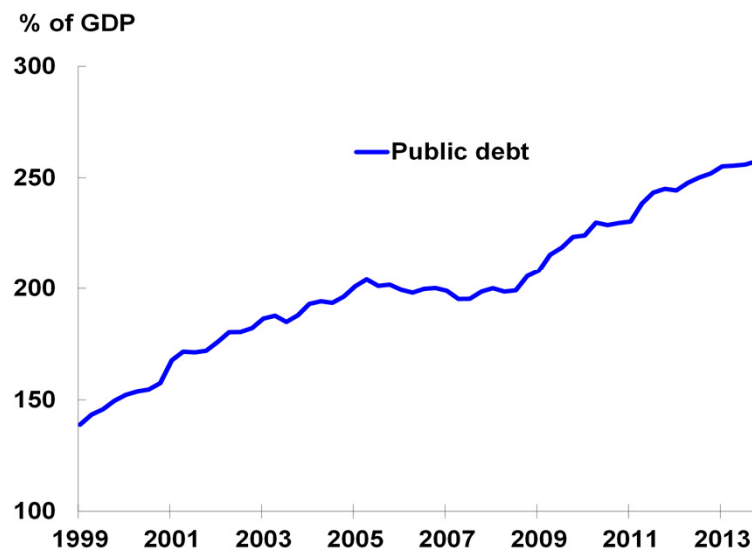
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



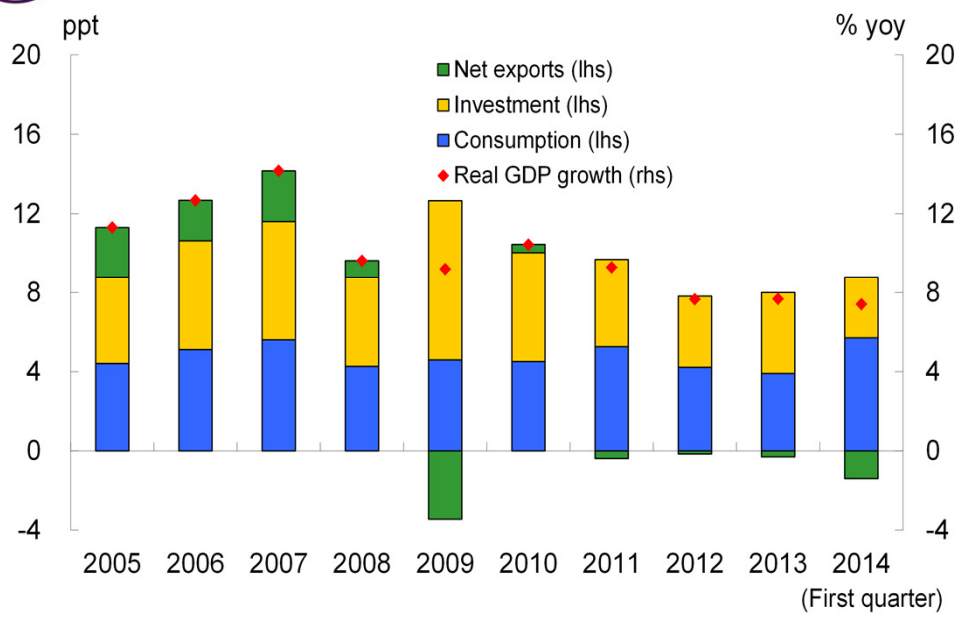
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



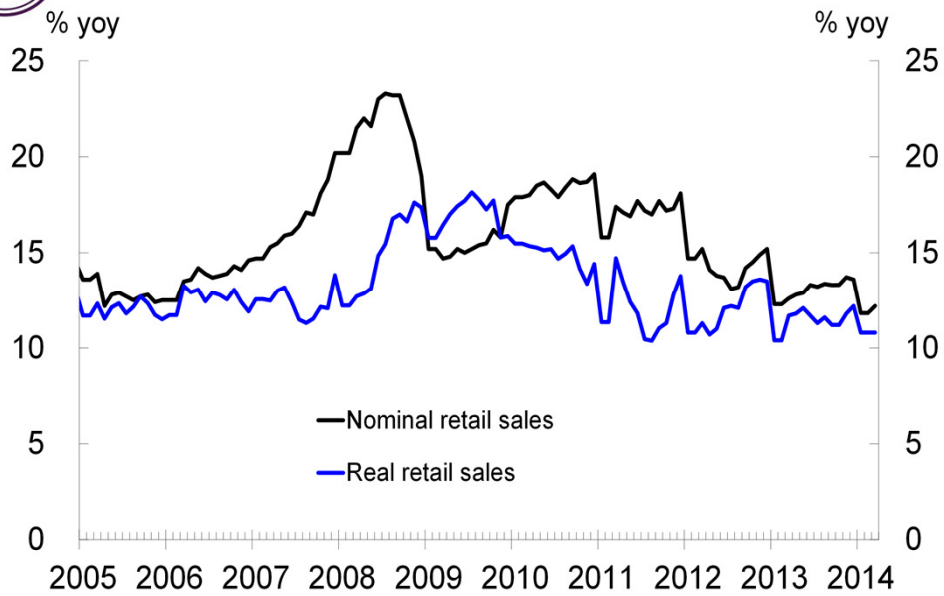
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



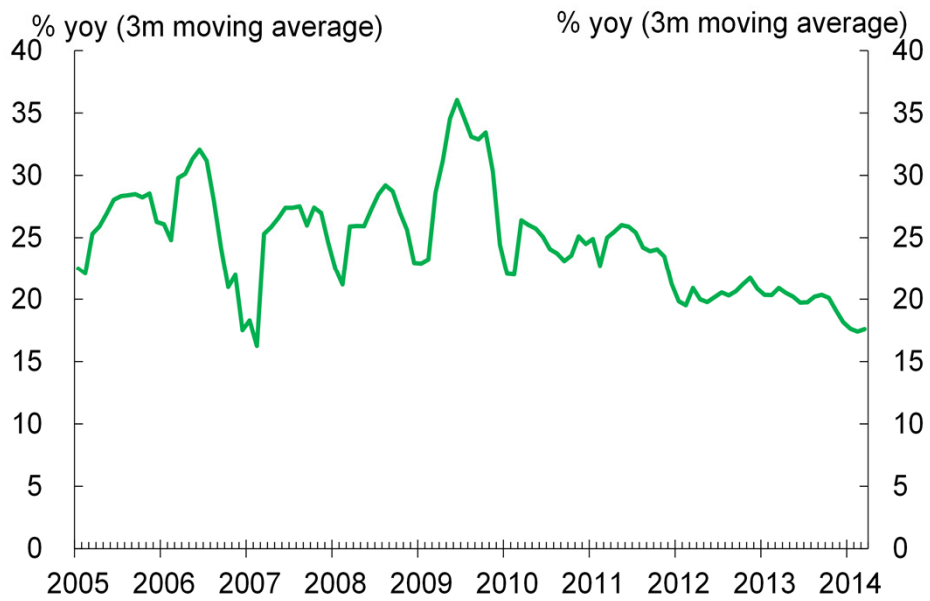
MAINLAND CHINA: RETAIL SALES



* Figures for January and February are the year-on-year growth of the sum of the first two months of the year.
Sources: CEIC, WIND and HKMA staff estimates



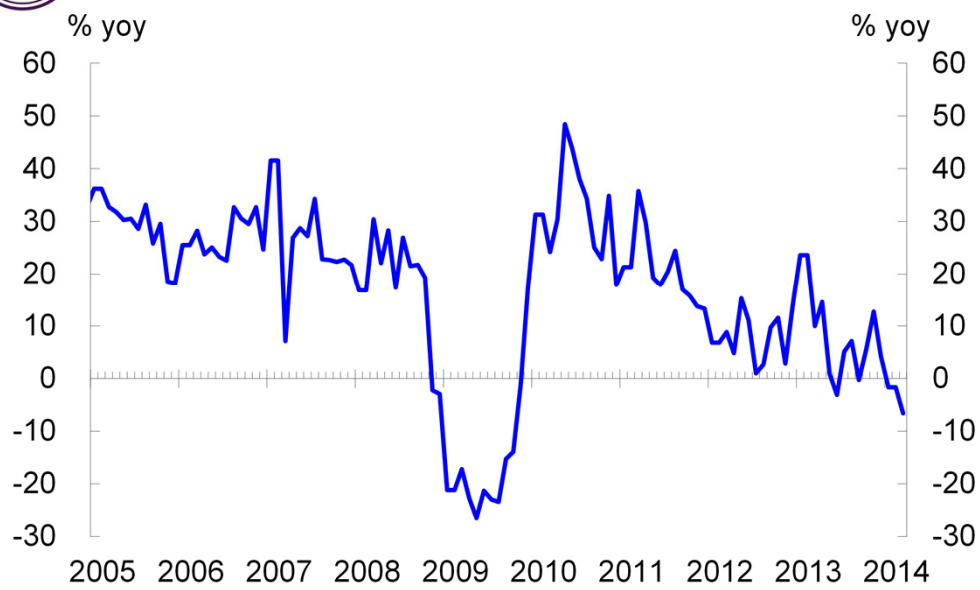
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



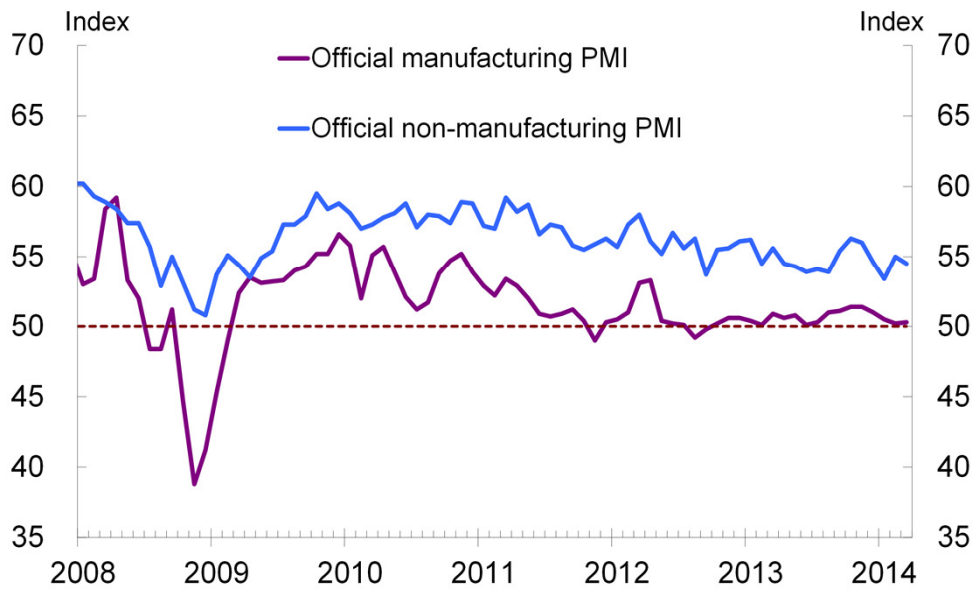
MAINLAND CHINA: EXPORT GROWTH



*Figures for January and February are the year-on-year growth of the sum of the first two months of the year.
Sources: CEIC and HKMA staff estimates



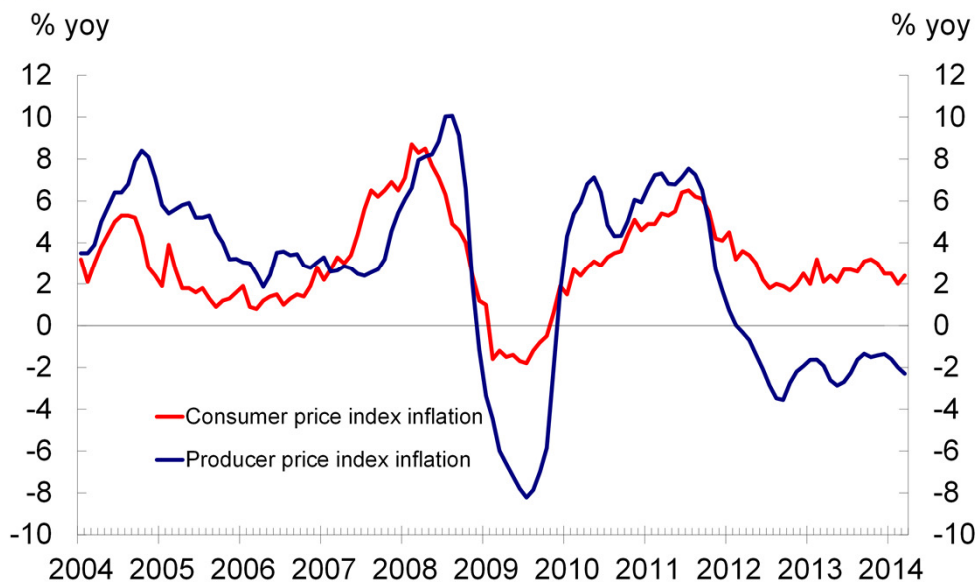
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



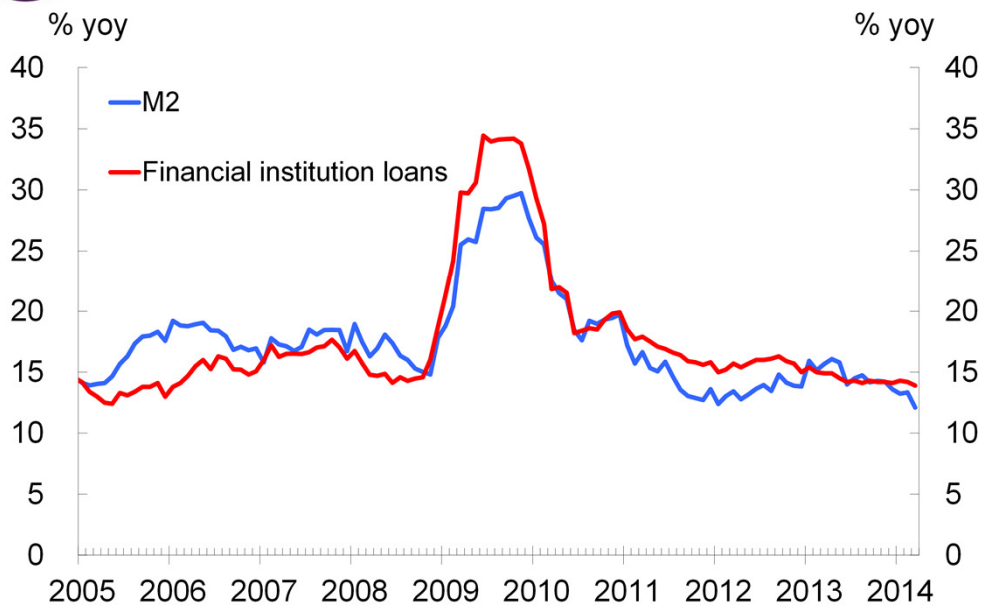
MAINLAND CHINA: INFLATION



Source: CEIC



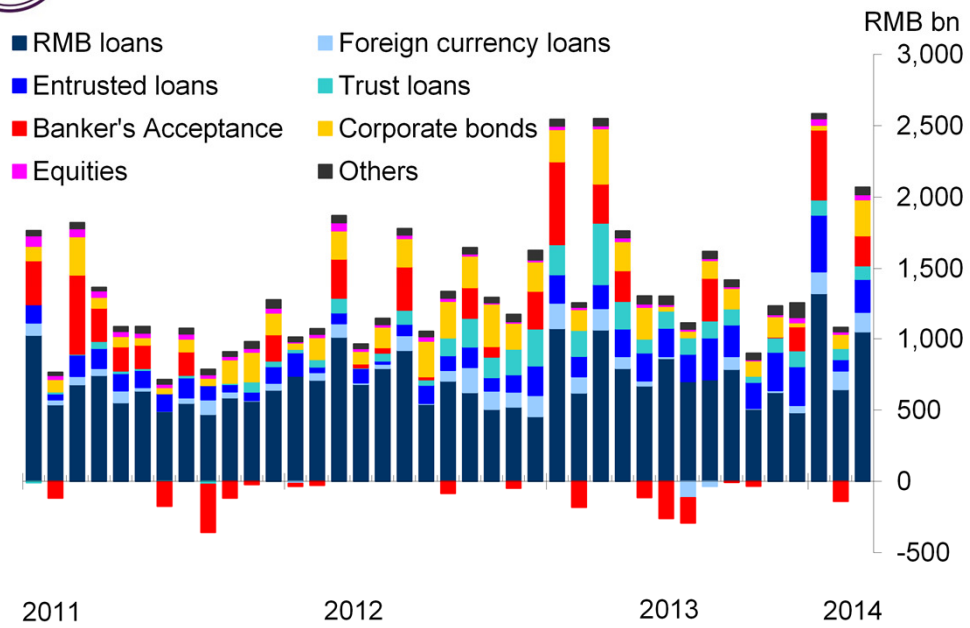
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



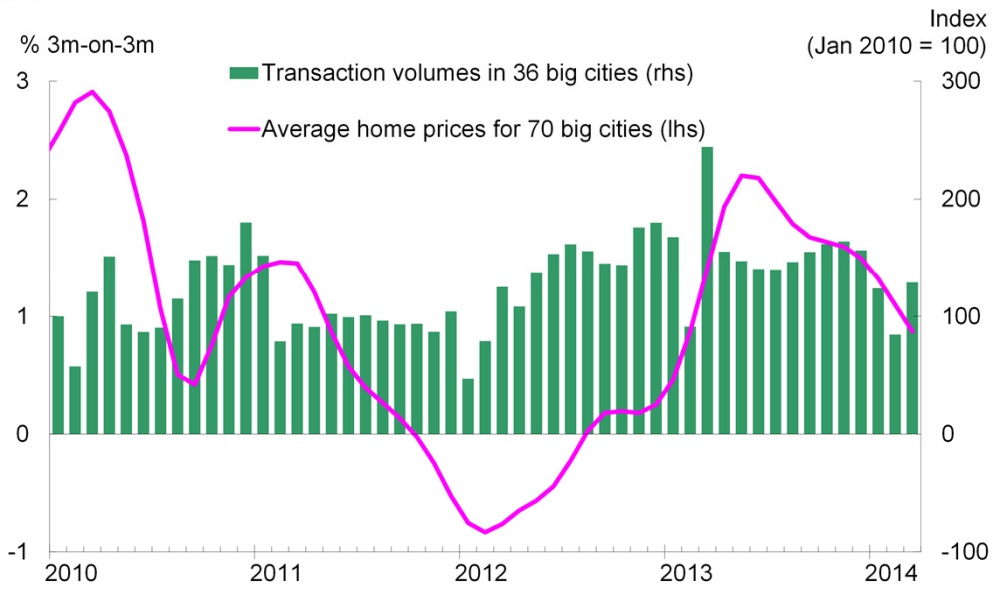
MAINLAND CHINA: TOTAL SOCIAL FINANCING



Source: CEIC



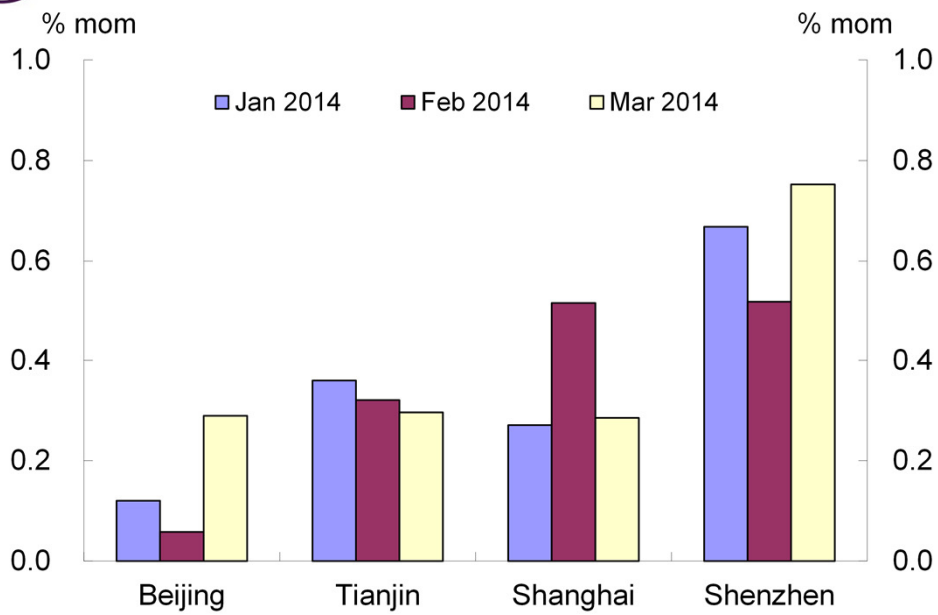
MAINLAND CHINA: PROPERTY TRANSACTION VOLUME AND PRICE CHANGES IN BIG CITIES



Sources: CEIC, WIND and HKMA staff estimates



MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES

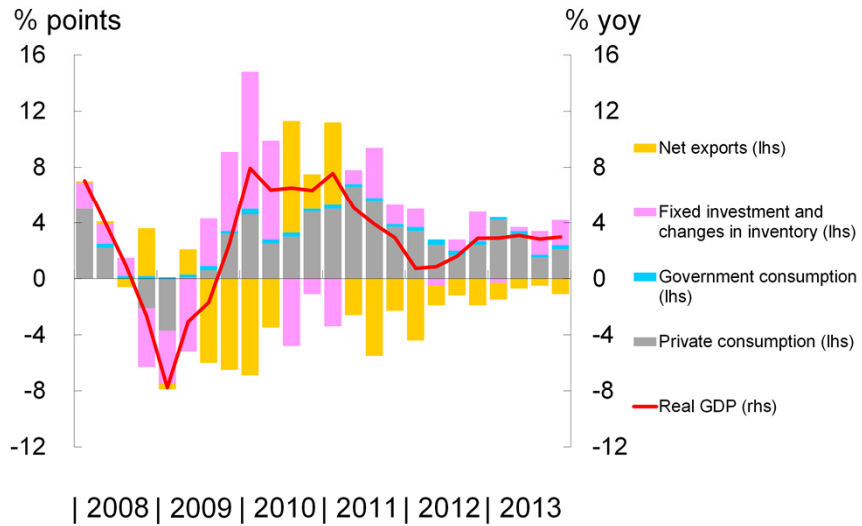


Sources: CEIC, WIND and HKMA staff estimates



HONG KONG: REAL GDP GROWTH

Changes in Real GDP and contributions by major components

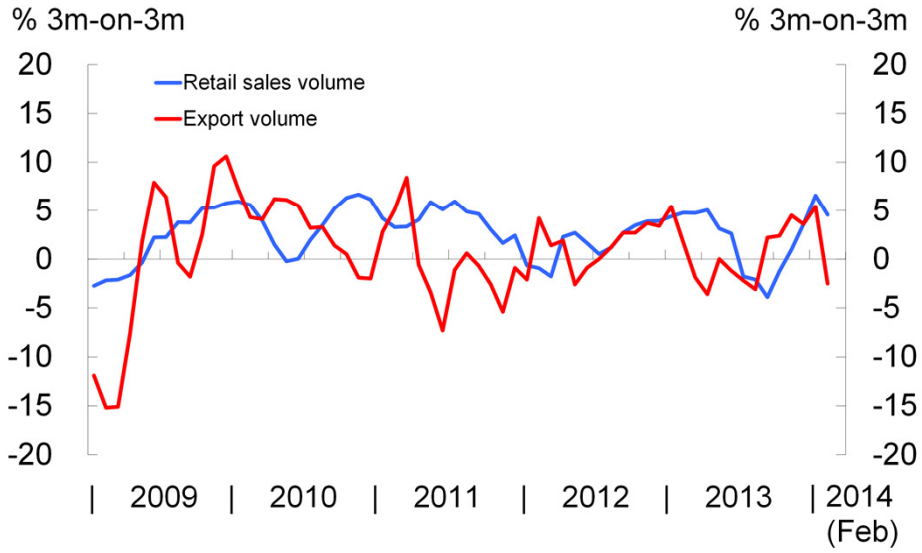


Source: C&SD



HONG KONG: ECONOMIC ACTIVITY

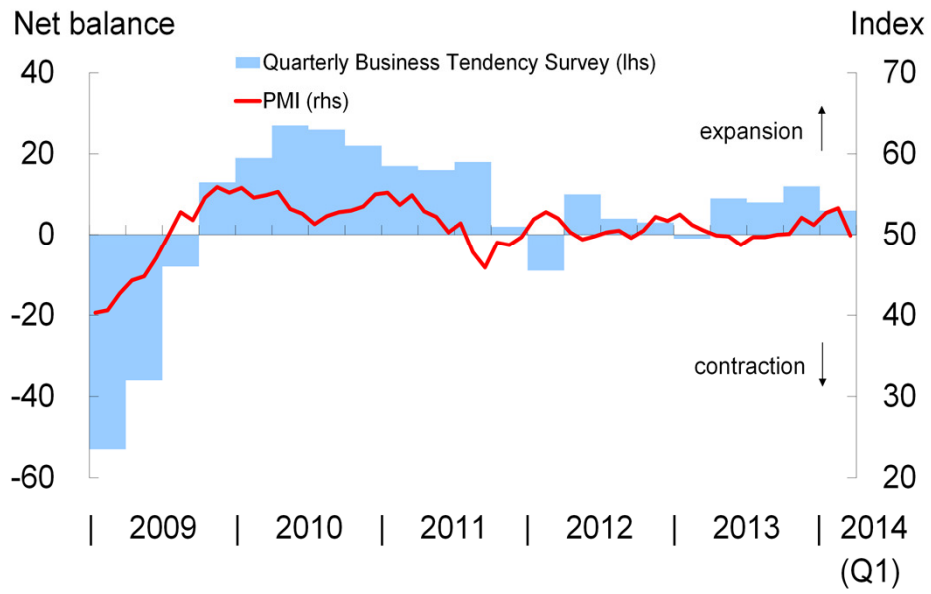
Retail Sales and Exports



Source: C&SD



HONG KONG: BUSINESS OUTLOOK

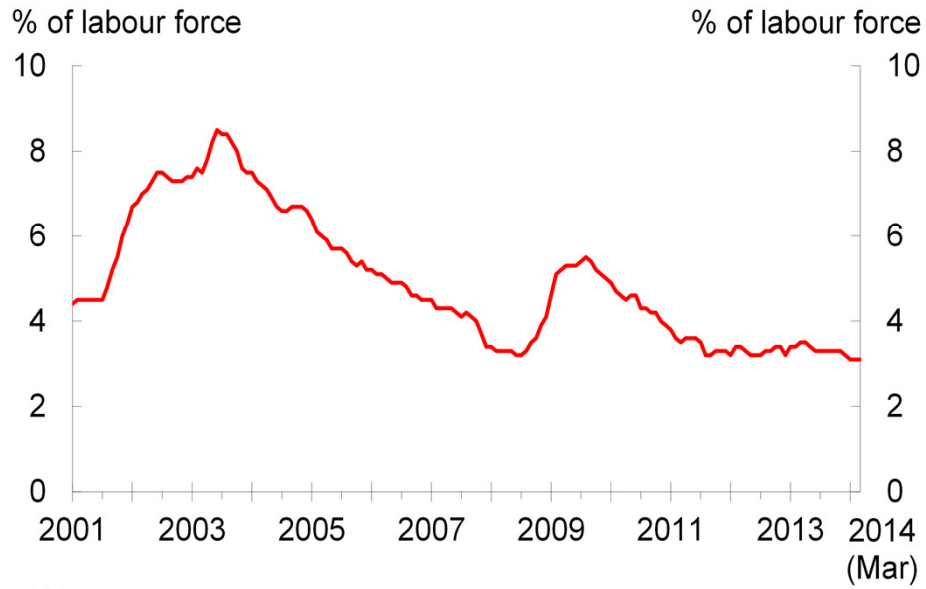


Sources: C&SD and Markit Economics



HONG KONG: LABOUR MARKET

Unemployment rate

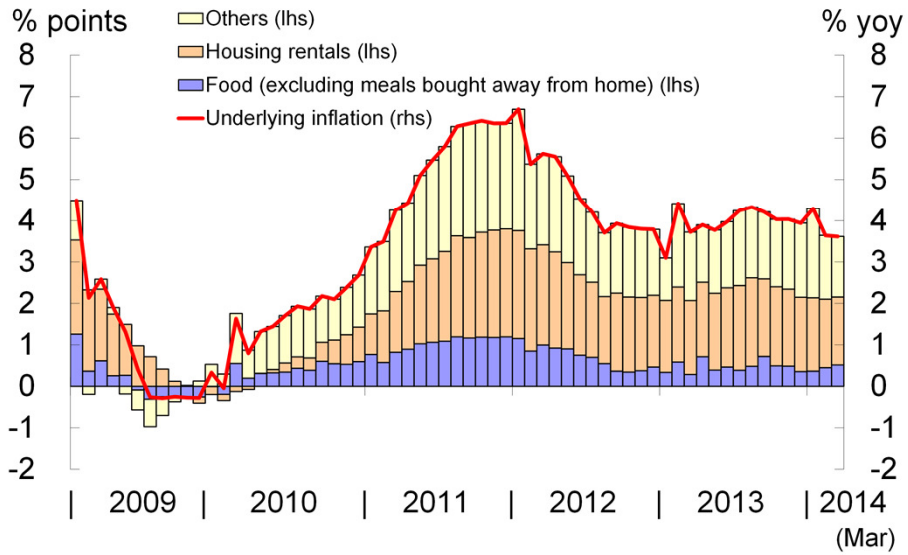


Source: C&SD



HONG KONG: INFLATION

Underlying inflation and contributions of its components

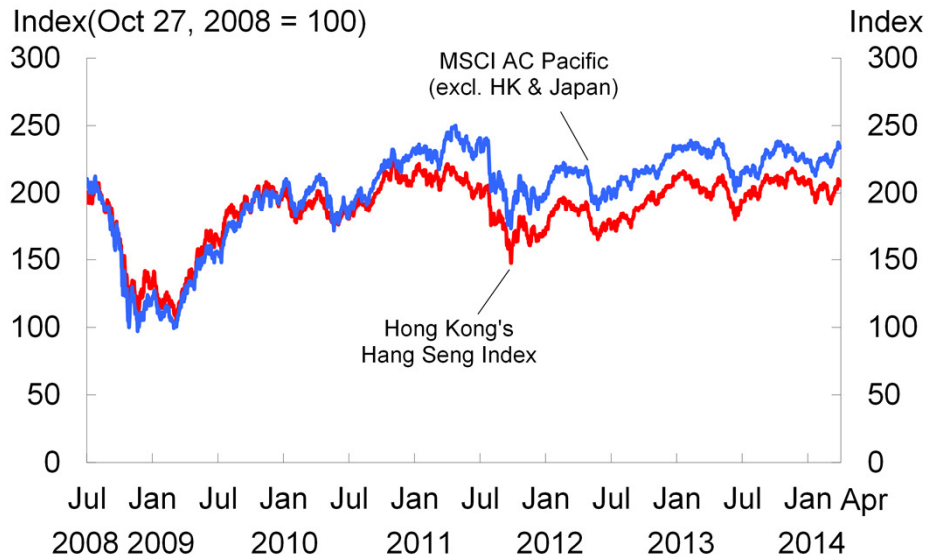


Sources: C&SD and HKMA staff estimates



HONG KONG: EQUITY MARKET

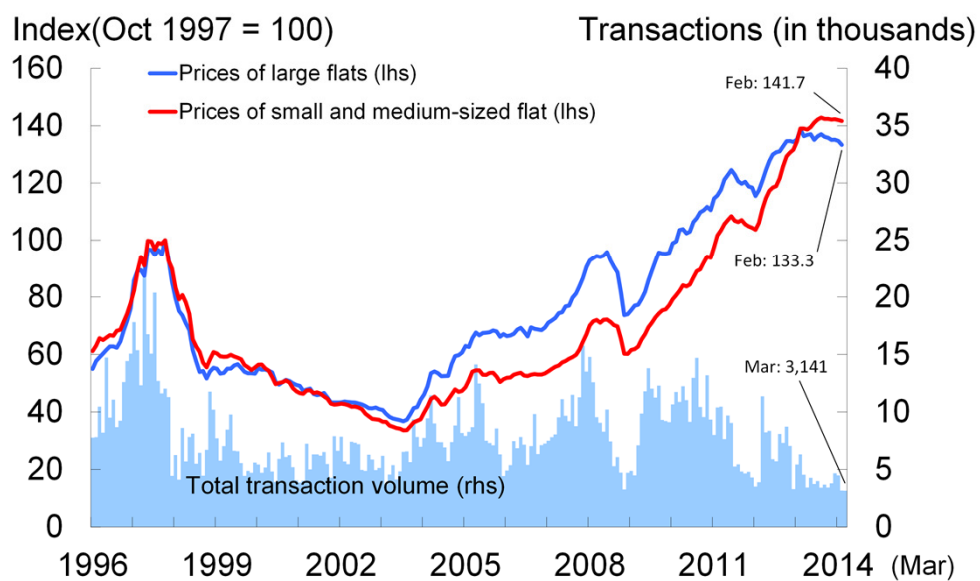
Hong Kong and Asia Pacific equity market performance



Source: Bloomberg



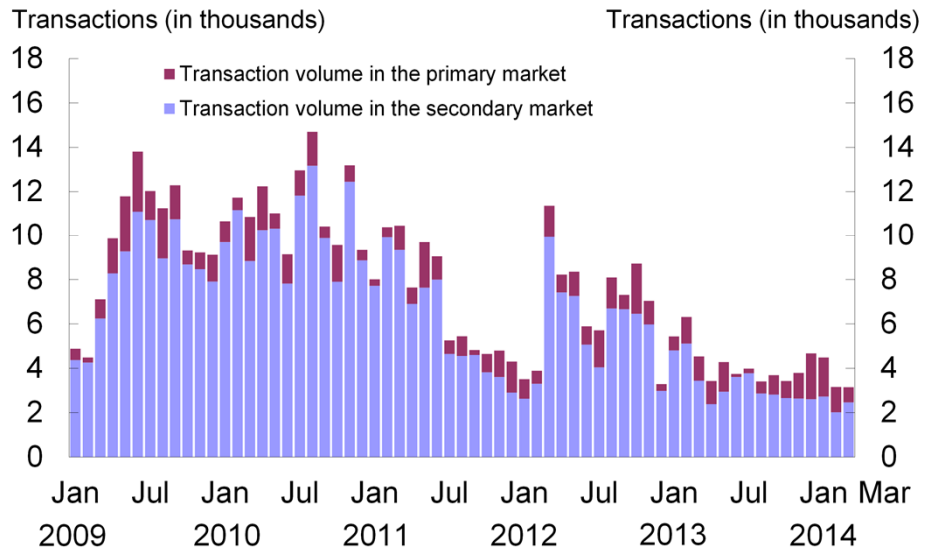
HONG KONG: RESIDENTIAL PROPERTY PRICES AND TRANSACTION VOLUME



Source: Rating and Valuation Department and The Land Registry



HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS

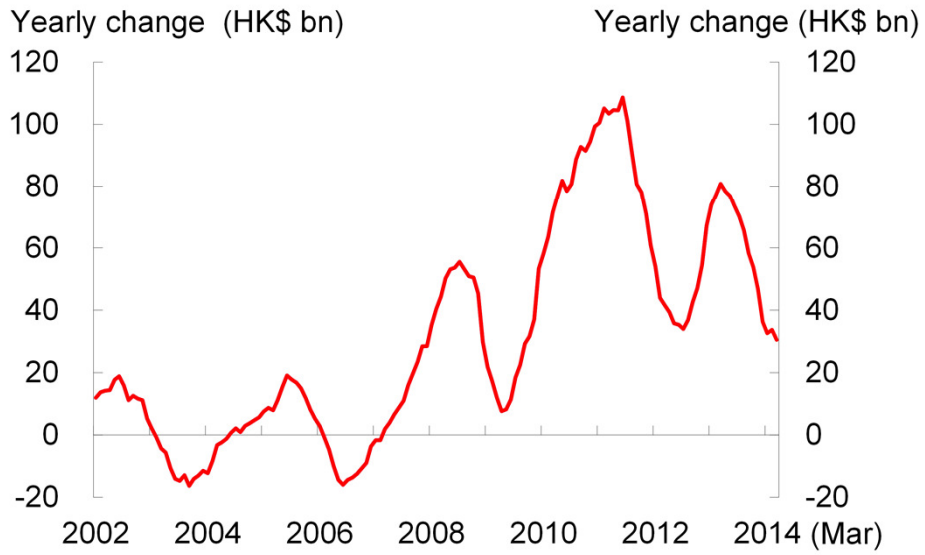


Source: The Land Registry



HONG KONG: OUTSTANDING RESIDENTIAL MORTGAGE LOANS

Changes in outstanding residential mortgage loans

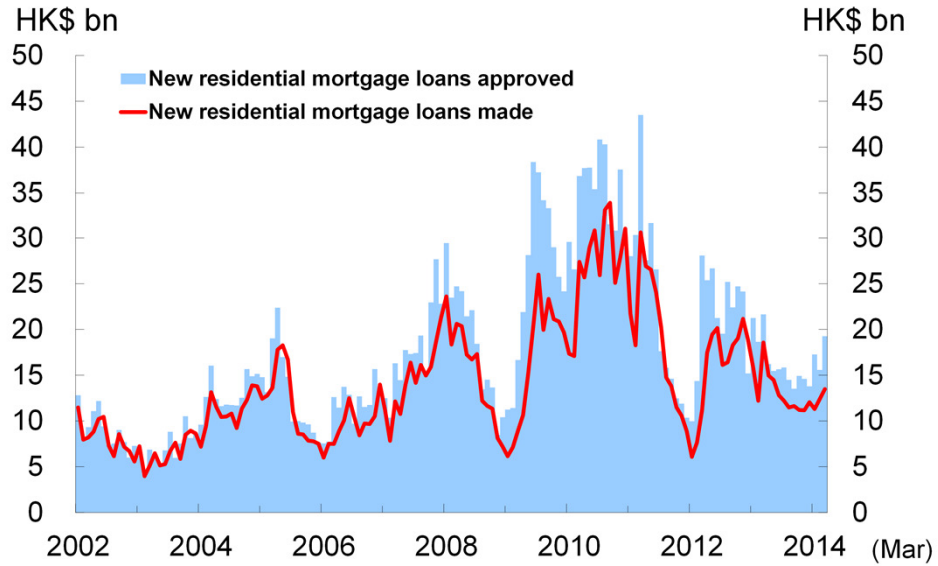


Source: HKMA



HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

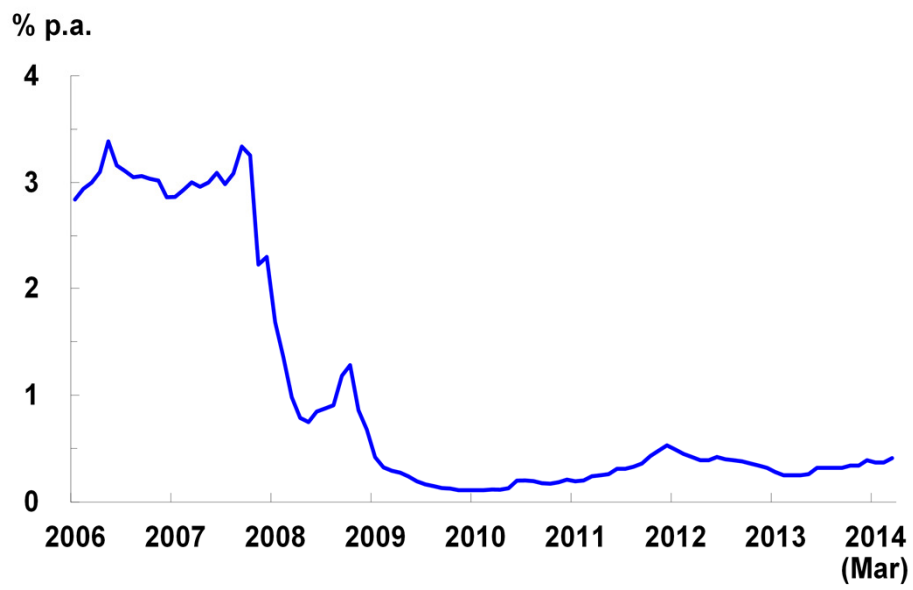
New residential mortgage loans made and approved



Source: HKMA



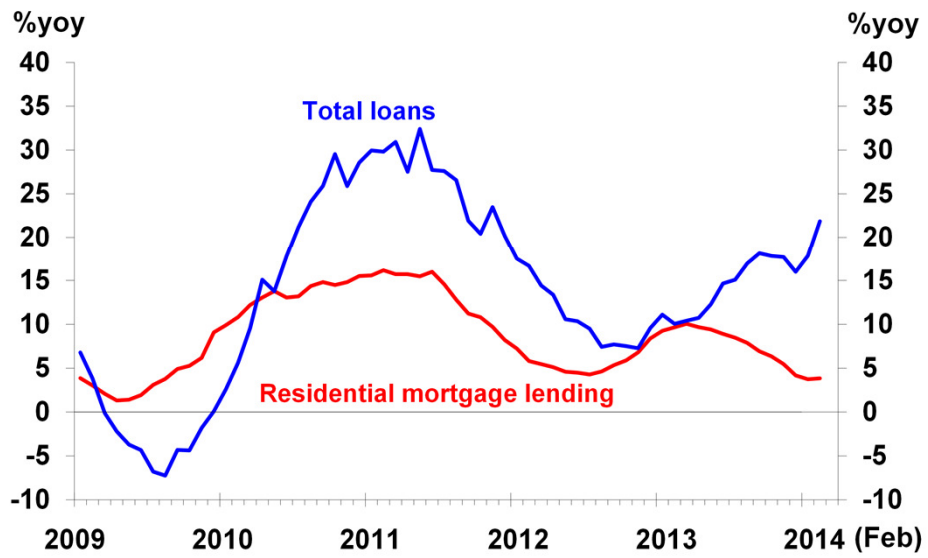
HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA



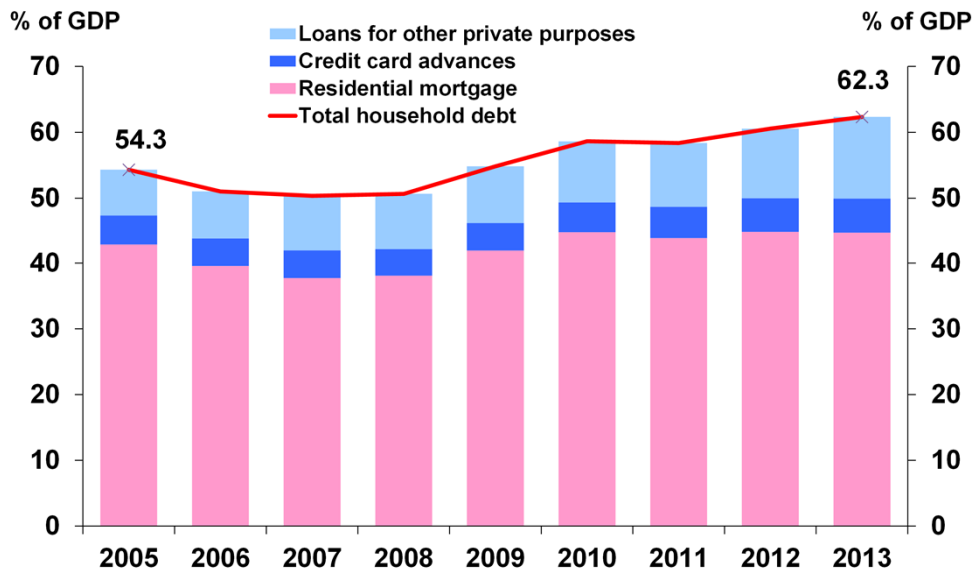
HONG KONG: LOAN GROWTH



Source: HKMA



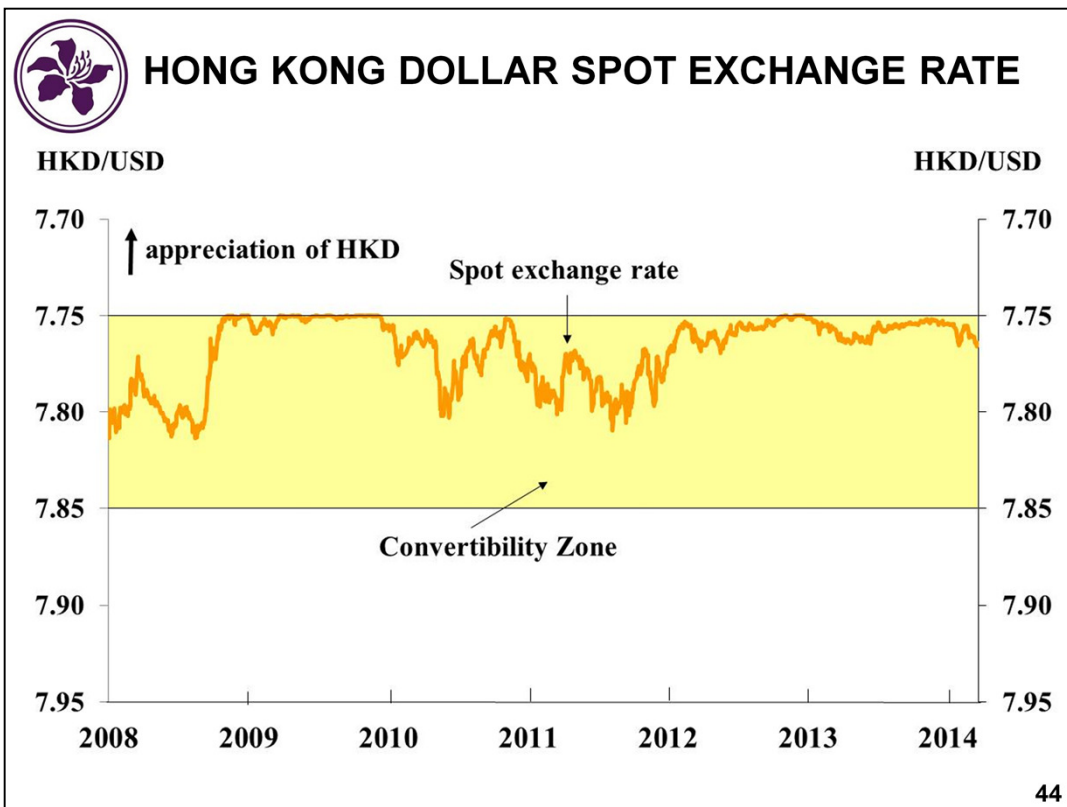
HONG KONG: HOUSEHOLD DEBT



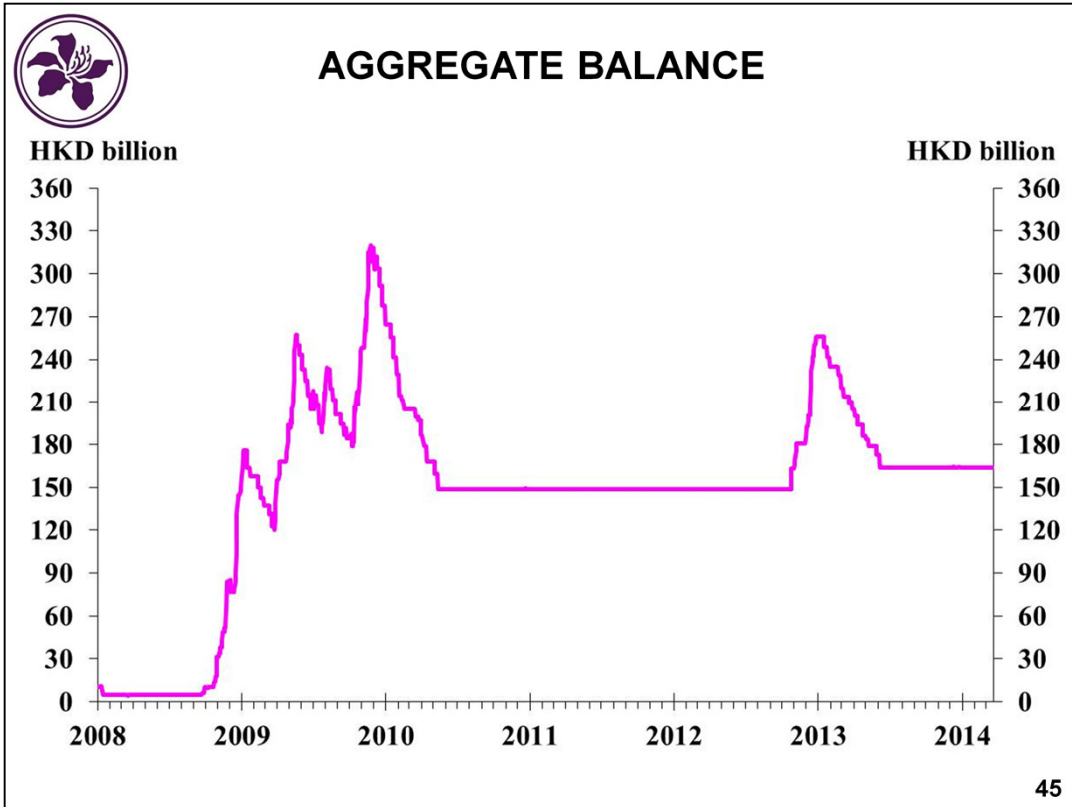
Sources: C&SD and HKMA staff estimates



CURRENCY STABILITY



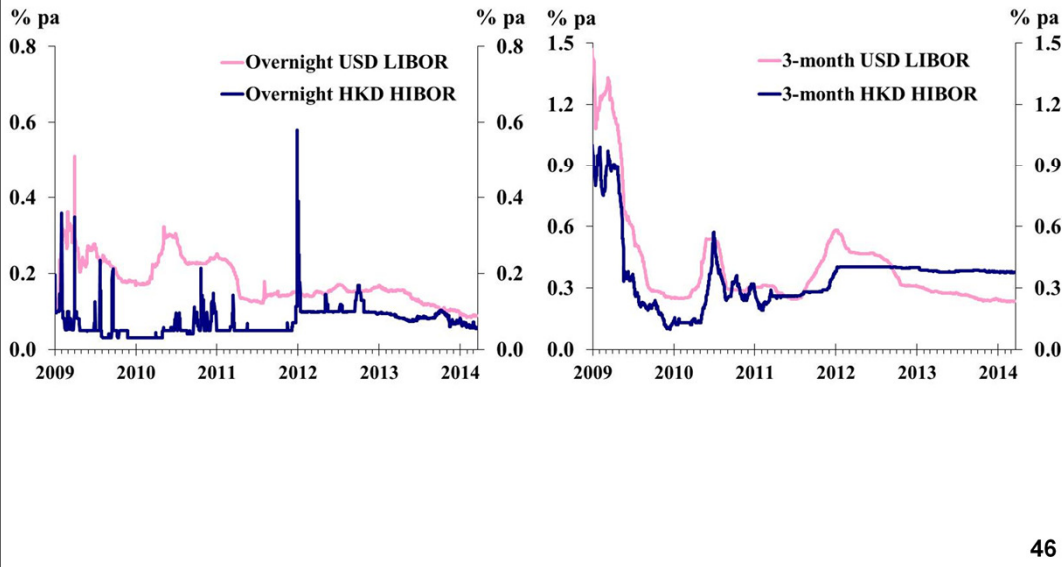
- Since February 2014, the HKD has been broadly stable against the USD at around 7.76, despite the weakening in RMB exchange rate and risk aversion due to rising geopolitical risks.
- There has been no triggering of the strong-side Convertibility Undertaking since 2013.



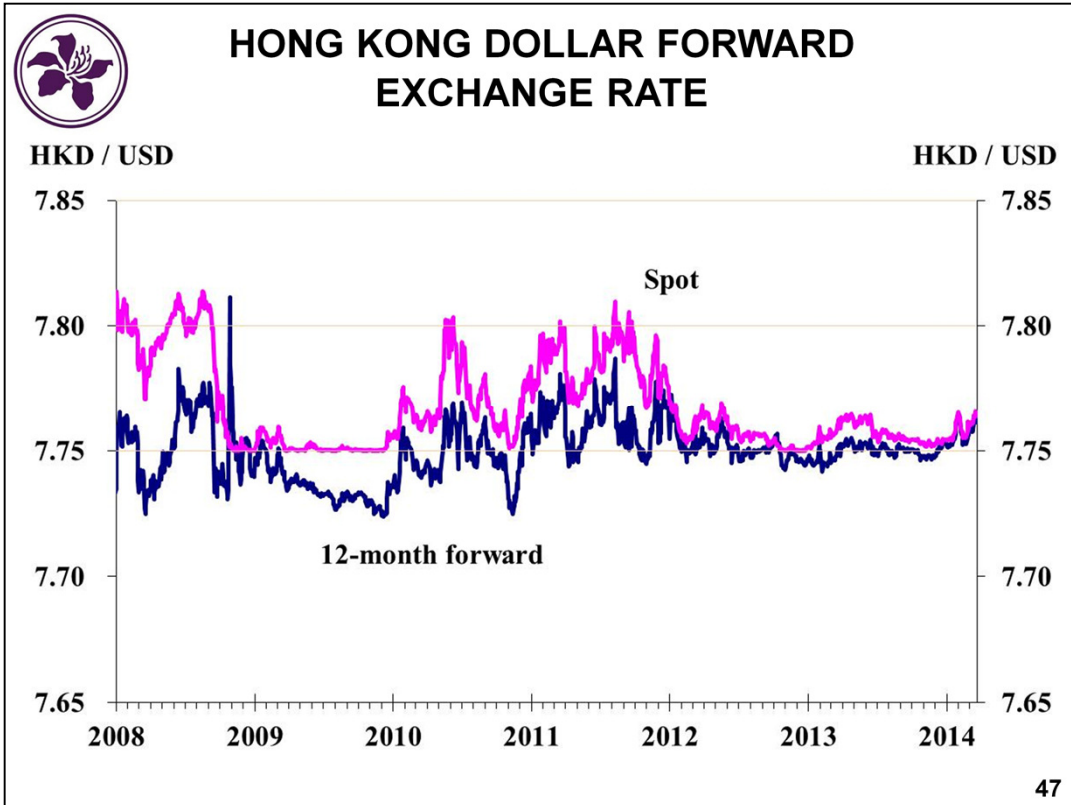
- The Aggregate Balance has remained steady at around HK\$160 billion since June 2013.



DOMESTIC INTEREST RATES



- Short-term Hong Kong dollar interbank interest rates remained steady.



- 12-month HKD forward exchange rate was broadly steady.



COIN COLLECTION MOBILE KIOSKS PILOT SCHEME

- Launch date : Mid-September 2014
- As a 2-year pilot scheme, two mobile kiosks will serve all districts on a rotation basis. They will provide services at locations that are convenient to the public without blocking the traffic. The HKMA will announce service schedule on its website
- Users may choose to receive banknotes in exchange for coins, or add value to Octopus cards
- Each mobile kiosk has two high-speed coin authentication machines, an elevating platform for wheelchair users, and a team of staff providing assistance throughout the coin-exchange service

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- The HKMA launches the Coin Collection Programme to enable the public to exchange spare coins free of charge. In addition to going to the banks, members of public may exchange their coins for banknotes or Octopus value at the mobile kiosks. The Government's plan of collection of coins for re-circulation is environmentally friendly and can save minting costs.
- The mobile kiosks are equipped with coin authentication machines that can process coins of different denominations and give value to the total sum.
- Target launch date is around mid-September 2014, alteration and design of the mobile kiosks are in progress. The HKMA will publish in advance the service schedule covering all 18 districts.

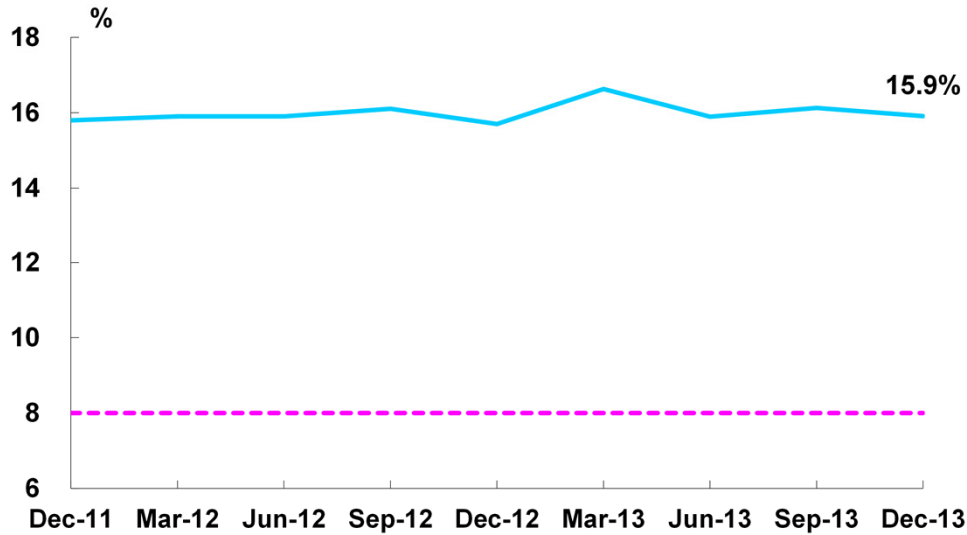


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



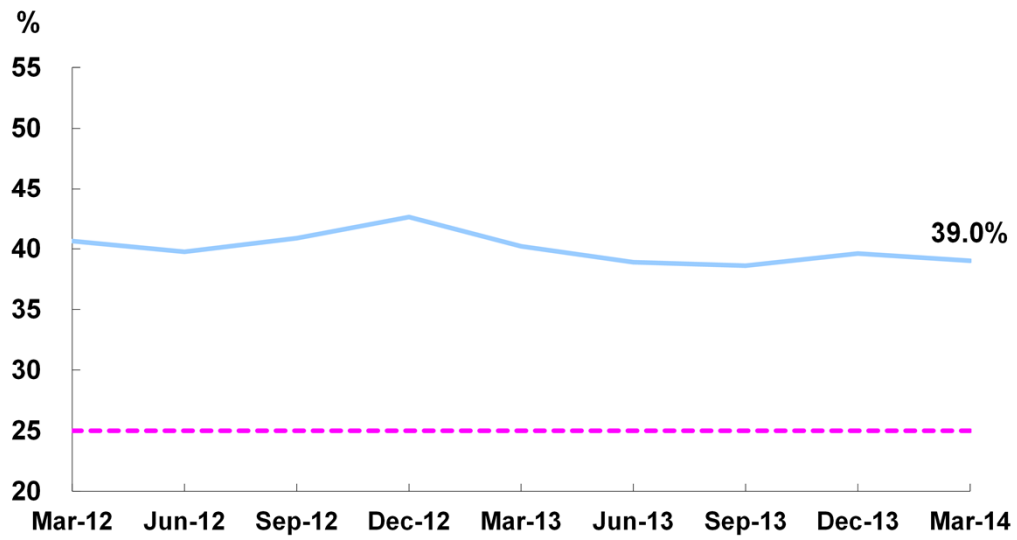
50

- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs slightly reduced to 15.9% at end-December 2013 from 16.1% at end-September 2013 due to a faster increase in risk-weighted amount (+4.0%) than the increase in the capital base (+2.6%). The consolidated CAR remained well above the international standard of 8%.



BANKING SECTOR PERFORMANCE

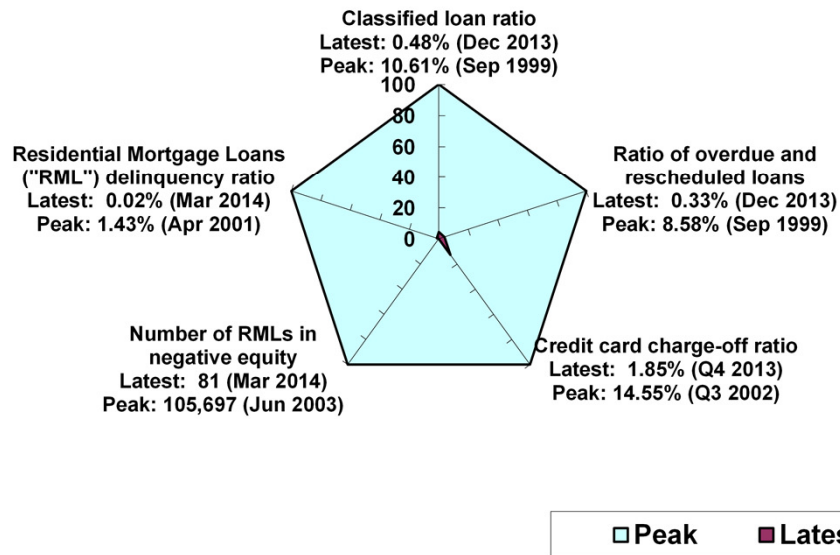
Quarterly average liquidity ratio of retail banks remained well above statutory minimum of 25%





BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards

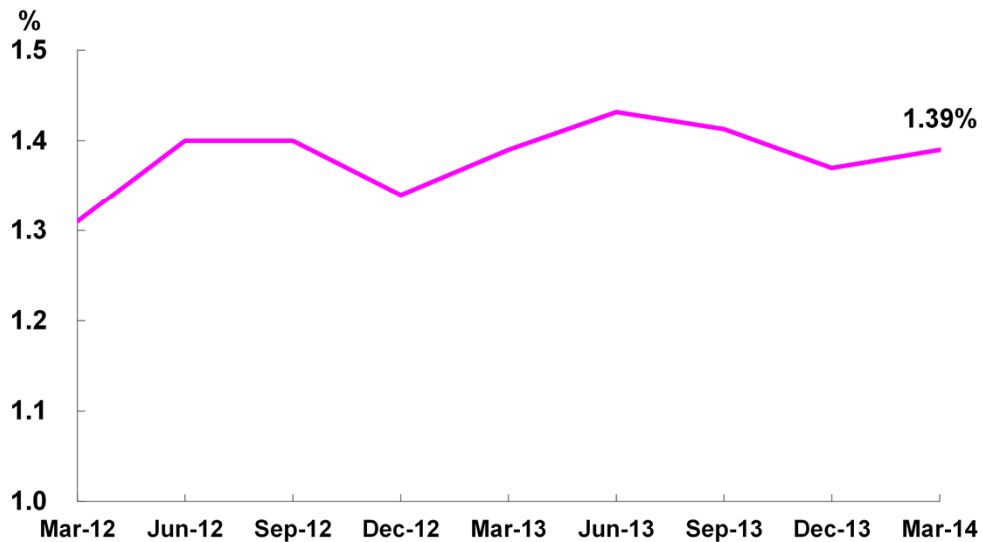


- The HKMA will continue to monitor closely the asset quality of retail banks' loan portfolios.



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks



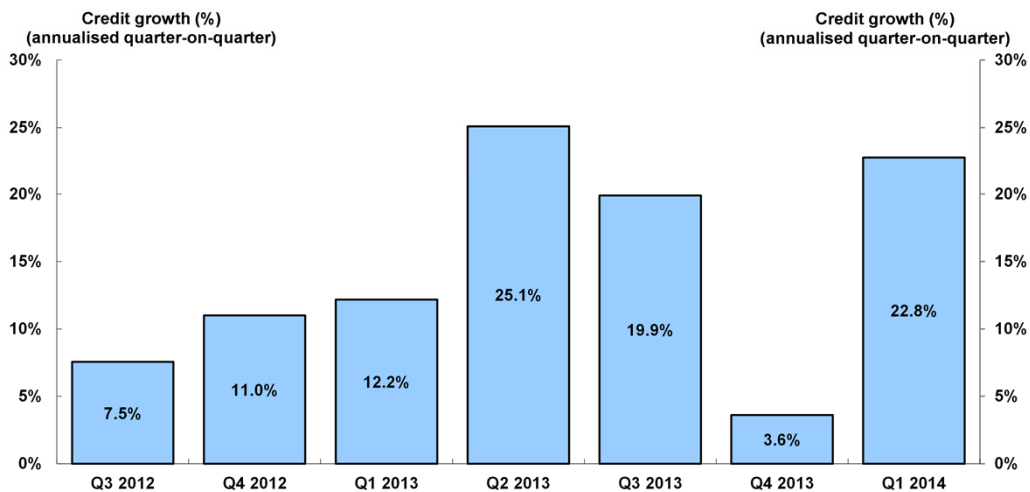
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- The quarter-on-quarter annualised net interest margin (NIM) of retail banks' Hong Kong offices edged up to 1.39% in Q1/2014 from 1.37% in Q4/2013.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in Q1/2014 increased by 10.7% compared with the same period last year. Moderate increases in net interest income (+16%) contributed to the profit growth.



CREDIT GROWTH

Credit growth rebounded in the first quarter of 2014



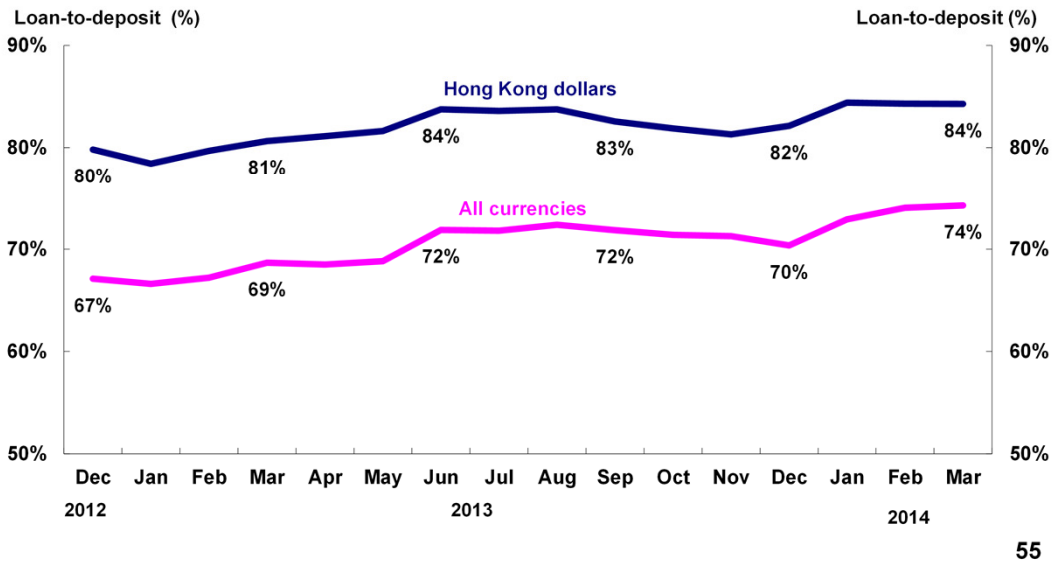
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- After a slow down of credit growth in the fourth quarter of 2013, the rate of growth rebounded into 22.8% in an annualised term in the first quarter of 2014.
- In light of the accelerated credit growth in early 2014, the HKMA will review the Stable Funding Requirement earlier, using the end-March 2014 position instead of original plan to review based on end-June 2014 position.
- The HKMA will continue to monitor credit growth of the banking sector.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong increased

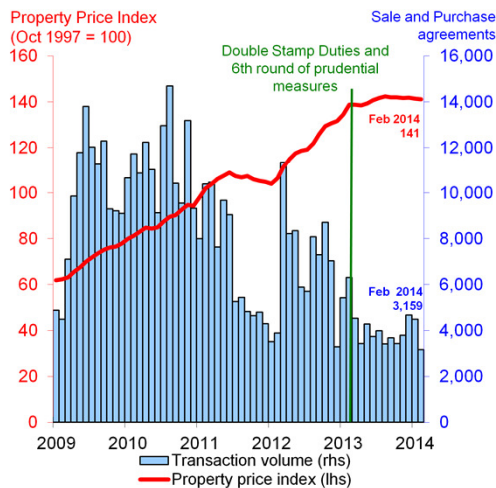


- Owing to a faster increase in Hong Kong dollar loans (+3.9%) than the increase in Hong Kong dollar deposits (+1.2%), Hong Kong dollar loan-to-deposit ratio increased to 84% at end-March 2014 from 82% at end-December 2013.
- The HKMA will continue to monitor movement of the loan-to-deposit ratio.



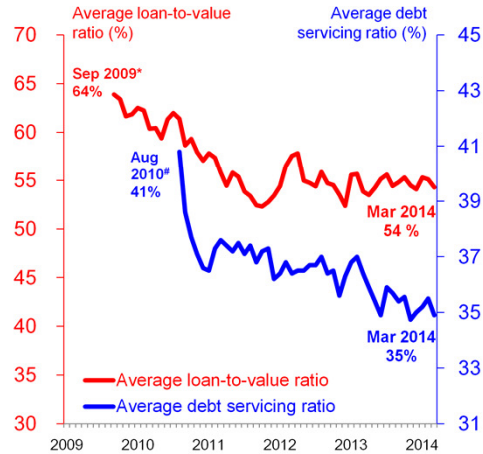
RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

Residential property price index and transaction volume



Sources: R&VD and Land Registry

Average loan-to-value ratio and debt servicing ratio for new residential mortgage loans approved



* Before the first round of HKMA's prudential measures was introduced

When the tighter requirement on debt servicing ratio was introduced

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Latest statistics for residential mortgage loans ("RMLs")

	Monthly average in 2012	Monthly average in 2013	Dec 2013	Jan 2014	Feb 2014	Mar 2014
Number of sale and purchase agreements	6,778	4,223	4,667	4,488	3,159	3,141
Number of new RML applications	11,634	8,694	7,594	8,927	7,198	9,416
Number of new RMLs approved	8,210	5,952	4,862	5,799	5,103	6,249

Latest statistics for residential property prices

Property price index		Period	Property price index
R&VD (10/1997=100)	Latest position	02/2014	141.2
	Recent Peak	8/2013	142.5
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	13/4/2014	119.0
	Recent Peak	8/9/2013	121.9
	Peak in 1997	19/10/1997	102.9

The HKMA will continue to closely monitor mortgage market developments and introduce appropriate measures as and when necessary to safeguard banking stability.



BASEL III IMPLEMENTATION PROGRESS

Legislative changes in Q4

- Banking (Capital) (Amendment) Rules 2014
- Banking (Disclosure) (Amendment) Rules 2014
- Banking (Liquidity) Rules

Consultations

- Countercyclical capital buffer
- Higher loss absorbency for systemically important banks

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Legislative changes in Q4

- Quick recap – Next phase of Basel III standards will cover:
 - Capital - the two capital buffers (“capital conservation buffer” and “countercyclical capital buffer”) and, in the case of banks identified as “systemically important”, a higher loss absorbency requirement;
 - Liquidity – the liquidity coverage ratio (and for Hong Kong, together with some modifications to the existing liquidity ratio); and
 - Disclosure – disclosures associated with the said capital and liquidity standards as well as those in relation to the leverage ratio.
- According to the Basel implementation timeline, legislation for these standards should be in place by 1 January 2015. We are currently working in conjunction with the FSTB and the DoJ in preparing the implementing rules, which will take the form of:
 - in the case of capital and disclosure standards, amendments to existing Banking (Capital) Rules and Banking (Disclosure) Rules; and
 - in the case of liquidity standards, a new set of Banking (Liquidity) Rules.

Consultations

- Meanwhile, consultations are in progress regarding certain operational aspects of the capital standards:
 - Countercyclical capital buffer – the HKMA is finalising its proposals on the technical mechanics for operating the buffer in view of comments received from the industry during consultation; and
 - Higher loss absorbency (HLA) – the HKMA has recently put out for consultation its policy proposals for a framework to identify systemically important banks in Hong Kong and assess the required level of HLA to be applied to them. The consultation is scheduled to close on 26 May.



INTERNATIONAL STANDARDS TO DEAL WITH “TOO-BIG-TO-FAIL” FINANCIAL INSTITUTIONS

- Legislative reform to meet international standards: Financial Stability Board (FSB)’s “Key Attributes of Effective Resolution Regimes”
- Fill gaps in HK regulators’ existing toolkits to support resolution of failing financial institutions
- Three-month public consultation closed on 6 April 2014; 33 submissions received
- Proactive stakeholder engagement during consultation period
- Second consultation exercise later in 2014, with a view to implementation by FSB’s end-2015 deadline

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- As highlighted to the FAP in February 2014, as part of policy measures designed to reduce the risks posed by systemically important financial institutions (SIFIs), the FSB set new standards for resolution (in its “Key Attributes of Effective Resolution Regimes for Financial Institutions”) in late 2011.
- The Hong Kong authorities (in self-assessments) and the FSB (in a peer review) identified a series of gaps in the existing toolkits available to the regulators when compared with these new standards. Legislative reform is necessary to fill these gaps and provide for an effective resolution regime such that in the event that any SIFI were to reach a point of non-viability in the future, the authorities in Hong Kong will be in a position to deal with it effectively in a manner that protects both financial stability and public funds.
- FSTB, together with HKMA, SFC and the OCI, issued a first-stage public consultation paper setting out the authorities’ initial thinking and proposals in early January. The three-month consultation, which ended on 6 April 2014, resulted in the receipt of 33 submissions from a wide range of stakeholders which are being carefully reviewed.
- The Government and financial regulators have proactively engaged with stakeholders during the consultation period. The HKMA, SFC and OCI have met with stakeholders from the sectors under their respective purviews while the FSTB led a number of sessions with some LegCo FAP members and certain professional associations to discuss the proposals in more detail.
- To meet the FSB’s end-2015 deadline for implementation of the Key Attributes by all member jurisdictions, and to ensure that Hong Kong does not fall behind other key financial centres, it is proposed that a second public consultation exercise addressing the more complex aspects of the proposals take place later in 2014, with a view to introducing a Bill into the LegCo by early-2015.



INVESTOR AND CONSUMER PROTECTION

- Will launch the enhanced competency framework for private wealth management practitioners shortly
- Continued to participate in the work of the Organisation for Economic Co-operation and Development Task Force on Financial Consumer Protection in developing effective approaches to support the implementation of the G20 High-Level Principles on Financial Consumer Protection
- Promulgated generic examples to assist AIs' implementation of the Treat Customers Fairly principles
- Further progress made on consumer education including an exhibition for public and "smart tips" on radio and print media to promote smart and responsible use of banking services

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- With the advice and assistance of the HKMA, the private wealth management (PWM) industry will launch shortly an enhanced competency framework shortly, establishing the enhanced level of competence and ongoing professional development of PWM practitioners. It is expected that practitioners can start to enrol in July for relevant training programmes and examinations commencing in the second half of this year.
- The HKMA is a member of the Task Force on Financial Consumer Protection of the Organisation for Economic Co-operation and Development (OECD) (the Task Force) and has been participating actively in the development of the G20 High-level Principles on Financial Consumer Protection. Following the publication of the Principles in October 2011, the Task Force has been developing effective approaches to support the implementation of the Principles. The Task Force's summary report on effective approaches to support the implementation of the three priority principles (namely, "Disclosure and Transparency", "Responsible Business Conduct of Financial Services Providers and Authorised Agents" and "Complaints Handling and Redress") was endorsed in the G20 Summit held in September 2013. The Task Force is now developing the effective approaches to support the implementation of the remaining 7 principles. The HKMA will continue to contribute to the work of the Task Force.
- The Treat Customers Fairly Charter (the Charter) was launched on 28 October 2013. The HKMA has consulted the industry associations and issued a circular to all AIs on 28 March 2014 providing them with some generic examples of measures to support implementation of the Charter principles. The examples are designed to enhance AIs' understanding of the spirit of each principle and illustrate how the principles may be implemented. They do not represent the only ways to implement the principles and are far from exhaustive. AIs are encouraged to consider these examples and come up with specific measures appropriate to their businesses to implement the principles. We believe that implementation of these measures will assist AIs in developing a customer centric culture which will ensure customers are treated fairly and their interests are taken into account in everyday business decisions at all levels in the AIs. The HKMA will monitor how the industry adopts specific measures to implement the Charter principles.
- The HKMA continues to promote smart tips on the use of credit cards and self-banking services (e.g. ATMs, internet banking and mobile banking) through broadcasting audio clips on radio stations and smartphone apps, organising roving exhibitions and seminars, arranging print publicity, and distributing information leaflets.



DEPOSIT PROTECTION

- Self assessment reports and on-site examination findings on compliance with the Representation Rules: results were satisfactory
- Implemented the revised Information System Guideline
- Requested selected banks to submit an audit report to certify the correctness of their calculation of amount of relevant deposits for the purpose of contribution assessment

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- The self-assessment review for 2013-14 of member banks' compliance with the DPS Representation Rules was completed. From April 2013 to March 2014, the HKMA has completed 12 on-site examinations for monitoring member banks' compliance with the Representation Rules in greater detail. The results reveal that the overall compliance level is satisfactory in general.
- Member banks are implementing the new requirements of the amended Information System Guideline to improve the availability and quality of the information to be provided for making deposit compensation payments upon a bank failure. Their level of compliance will be monitored by a bi-monthly survey and compliance reviews under an enhanced compliance review program.
- The amount of contribution payable by member banks is calculated on the basis of the amount of relevant deposits reported in the returns of relevant deposits and the supervisory ratings assigned by the Monetary Authority to each member bank. Collection of 2014 contribution of HK\$388 million for all member banks has been completed. To ensure that the amount of relevant deposits reported in the returns are accurate, 35 member banks have been selected and required to conduct an audit review by the end of April 2014.



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:**
 - The Securities and Futures (Amendment) Bill 2013 was passed by the Legislative Council in March 2014. Detailed rules are now under preparation for consultation in Q2 2014
 - Interim Reporting Requirements :
 - As an interim measure before the new legislation comes into effect, the HKMA has mandated the reporting of specified OTC derivative transactions between licensed banks to the trade repository developed by the HKMA with effect from 5 August 2013
- **Central Counterparty:**
 - HKEx has developed a local central counterparty for OTC derivatives, which commenced operation in Q4 2013
- **Trade Repository:**
 - The HKMA launched the trade repository (TR) for OTC derivatives in December 2012

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- The detailed requirements of the new regulatory regime will be set out in the subsidiary legislation in the form of rules. The HKMA and SFC target to conduct the public consultation on the draft subsidiary legislation in phases, and the first round of public consultation on the draft subsidiary legislation is planned for Q2 2014.



GOVERNMENT BOND PROGRAMME

Institutional Bond Issuance Programme:

- 10 issues totalling HK\$64 billion were outstanding as at end March
- A yield curve from two years to ten years is established to form the basis for other issuers to price their issues

Liquidity enhancement measures for institutional bonds:

- The HKMA implemented two measures, namely, bond swap facility and switch tender, to promote the liquidity of the institutional bond market

Retail Bond Issuance Programme:

- Three iBonds totalling HK\$30 billion were outstanding as at end March
- The HKMA is co-ordinating the issuance of the fourth iBond

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- The primary objective of the Government Bond Programme (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 equity markets and the banking sector.
- The GBP is a long-term programme comprising an Institutional Bond Issuance Programme and a Retail Bond Issuance Programme. As at end March 2014, the total outstanding issuance amount was HK\$94 billion, including 10 issues of institutional bonds totalling HK\$64 billion and three issues of retail bonds (i.e. the iBonds) totalling HK\$30 billion.
- The bond swap facility allows Primary Dealers (PDs) to temporarily swap their institutional bond holdings with the Government. The facility was launched on 17 February 2014 and has been used by the PDs on a need basis. As regards switch tender, it allows PDs to permanently switch from a pre-announced off-the-run bond into a pre-announced benchmark bond. The first switch tender will be held in mid-May, where up to \$800 million of the existing 10-year benchmark bond will be on offer. Other details of the tender, such as the off-the-run bond to be early redeemed, will be determined and announced closer to the time.
- The Financial Secretary announced in the 2014-15 Budget that up to HK\$10 billion of a fourth iBond would be issued to Hong Kong residents. The HKMA is co-ordinating the issuance. 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 promote Hong Kong's financial platform to overseas and Mainland asset owners and asset managers
- 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.
- Over the past two and a half years our outreach team held over 730 meetings with 440 financial institutions to showcase the unique competitive advantages of Hong Kong as a financial centre.
- Our outreach campaign has had very encouraging results, with some notable asset owners and asset managers choosing to set up their Asia headquarters in Hong Kong. Being an asset owner ourselves, the HKMA has a unique advantage in relating to other asset owners' criteria in choosing an overseas investment hub.
- On platform building, HKMA conducts reviews of legal, regulatory, tax and other issues to inform policy formulation concerning the development of Hong Kong's asset management industry. HKMA also provides necessary support to the Financial Services and the Treasury Bureau and other agencies in taking forward new initiatives announced by the Financial Secretary, such as the proposed extension of profits tax exemption to offshore private equity funds and the review of the Inland Revenue Ordinance in respect of the taxation of corporate treasury activities. On the latter, HKMA has joined the Government Task Force to explore room for optimisation under the Inland Revenue Ordinance so as to create a conducive tax environment for genuine corporate treasury centre activities with a view to enhancing Hong Kong's competitiveness as a regional corporate treasury centre.



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The combined fund management business in Hong Kong hit a record high of US\$ 1.6 trillion at the end of 2012, a 39% increase over 2011
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- 66 of the 100 largest global money managers have offices in Hong Kong at the end of 2012
- In terms of private banking, 16 private banks have opened for business since 2009, bringing the total to 46 banks offering private wealth management services in Hong Kong today

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- According to the SFC survey, 65% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2012, attesting to the fact that Hong Kong is still a preferred location for asset management business in the region.
- The number of licensed corporations for asset management has increased from 680 in 2008 to 950 in December 2013.
- 66 of the 100 largest global money managers have offices in Hong Kong in 2012, and 57 of them are licensed by the SFC.
- Achieved leadership positions as an asset management centre in the region. Hong Kong is a leading hub for:
 1. Hong Kong is the second largest private equity hub in Asia with over 370 private equity firms as of end 2013.
 2. 62% of Qualified Foreign Institutional Investor and 74% Qualified Domestic Institutional Investor managers and 98% of Renminbi Qualified Foreign Institutional Investor managers have a presence in Hong Kong as of end February 2014.
 3. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increasing from 538 in 2010 to 676 as of 30 September 2012.



DEVELOPMENT OF ISLAMIC FINANCE

- Provided support to the Government in completing the legislative exercise to amend the Loans Ordinance to provide a legal basis for issuance of Islamic bonds (sukuk) under the Government Bond Programme in an effort to promote the development of sukuk market in Hong Kong
- Working closely with the Government in formulating a detailed plan for the inaugural issuance of Government sukuk under the Government Bond Programme
- Organised an Islamic finance conference on 14 April 2014 in Hong Kong in collaboration with Bank Negara Malaysia to promote market awareness and understanding on sukuk as a viable fund-raising and investment instrument

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- The Loans (Amendment) Bill 2014 was passed by LegCo on 26 March 2014.



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Reporting to the over-the-counter (OTC) derivatives trade repository (TR) of the HKMA has been smooth. The TR will be further developed to meet local reporting requirements and international standards

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Operation of financial infrastructure

- The HKD, USD, EUR and RMB Real Time Gross Settlement (RTGS) systems, the Central Moneymarkets Unit (CMU) and the Trade Repository (TR) for over-the-counter (OTC) derivatives have been operating smoothly.

OTC derivatives Trade Repository

- Since the reporting function of the TR was launched in July 2013, reporting (by banks) to the TR has been smooth.
- The next phase of the TR system is targeted for launch in September 2014, mainly for expanding product scope to cover the remaining commonly traded interest rate and foreign exchange derivative products in the local market, and adding equity derivative products.
- Preparations are being made to support the commencement of mandatory reporting under the new OTC derivatives market regulatory regime, expectedly in the fourth quarter of 2014.



RETAIL PAYMENT INITIATIVES

Electronic Bill Presentment and Payment (EBPP) service

- After the launch of EBPP on 11 December 2013, 18 banks have rolled out the EBPP service and other banks will join it gradually
- Major Government departments such as the Water Supplies Department and Rating and Valuation Department target to join the EBPP service by the end of this year

NFC mobile payment service

- The HKMA worked closely with a task force under Hong Kong Association of Banks (HKAB) on a set of common standards and guidelines which were issued by HKAB on 25 November 2013 for banks to follow

Legislative framework for stored value facilities and retail payment systems

- Policy adjustments for incorporation in the draft Bill is being considered, taking into account comments received from the public consultation where appropriate
- Preparatory work for the drafting of the Bill is at an advanced stage. Targeting to introduce to LegCo in the 2014-2015 Legislative Year

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Electronic Bill Presentment and Payment (EBPP) service

- The EBPP is a consolidated platform for the straight-through processing of electronic bill ('e-bill') presentments and payments. Users only need to go to one place – their internet banking accounts – to receive, view, manage and schedule payments for various e-bills issued by merchants. Through this multi-currency platform, e-payments can be made in Hong Kong dollar, renminbi and US dollar.
- 23 banks which cover 99% of internet banking accounts have agreed to take part in the EBPP service, with 18 of them ready to start the service immediately.
- Merchants and service providers from different sectors will join the service in stages once they have finalised the service arrangements and made the required internal system changes.

NFC mobile payment service

- The standards and guidelines cover three aspects, including interoperability requirements between devices and systems, operation guidelines of NFC mobile payment services, and security requirements.
- The HKMA supports a market-driven approach for shared infrastructure development as it suits the Hong Kong market.
- 5 banks, 1 stored value card operator and 4 mobile operators have cooperated to launch or announced to launch different types of NFC mobile payment services. We anticipate that more banks will launch the service.

Legislative framework for stored value facilities and retail payment systems

- The proposed legislation seeks to empower the HKMA to exercise supervisory and enforcement functions on stored value facilities (SVF) and oversight function on designated retail payment systems (RPS), with a view to ensuring adequate consumer protection, safety and soundness of such facilities and systems in Hong Kong.
- Following the formal industry consultation with over 30 industry participants in end-January 2013, the HKMA and FSTB jointly conducted a 3-month public consultation on the proposed regulation between 22 May 2013 and 22 Aug 2013. Feedbacks received indicated general support to the regulatory proposals.
- We are analysing the comments and considering appropriate policy adjustments, if necessary, taking into account the comments received. Preparatory work for the drafting of the Bill is at an advance stage. We aim to introduce the Bill to LegCo in the 2014-2015 Legislative Year.

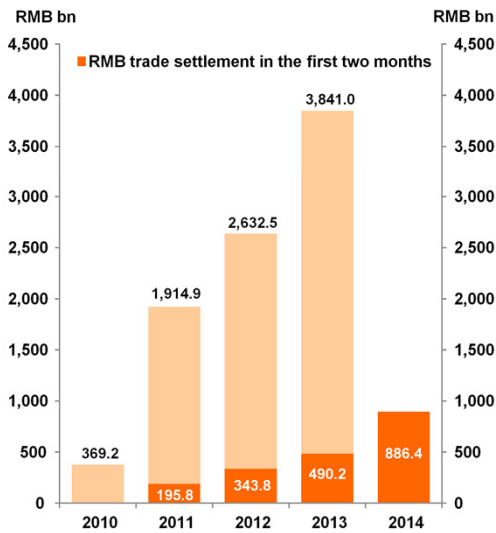


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

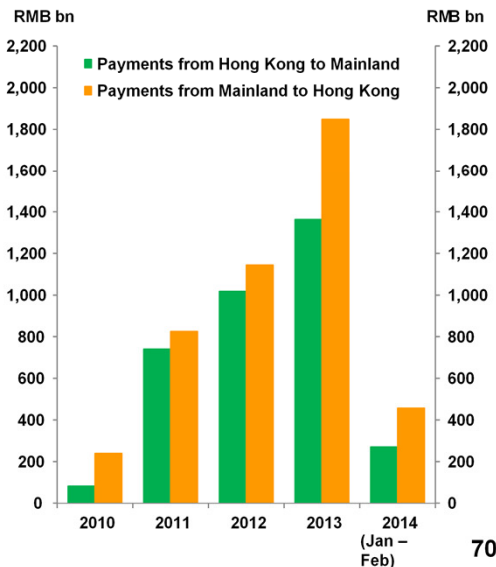


CONTINUED EXPANSION IN RMB TRADE SETTLEMENT

RMB trade settlement handled by banks in Hong Kong



Flows of RMB trade settlement between Hong Kong and the Mainland

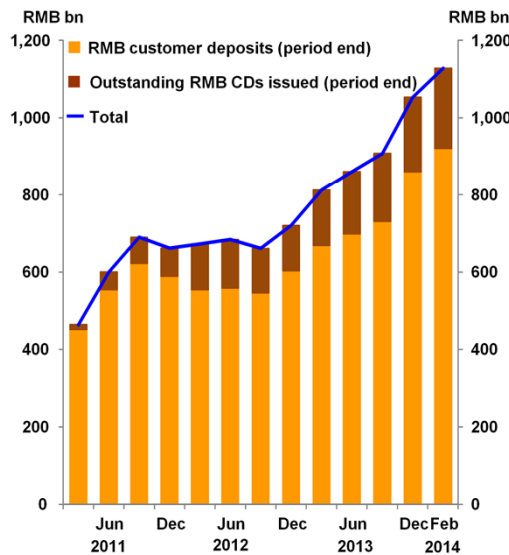


- In the first two months of 2014, RMB trade settlement handled by banks in Hong Kong amounted to RMB886.4 billion, an 81% growth compared with the same period in 2013. The ratio of payments to and from the Mainland was 1:1.7.

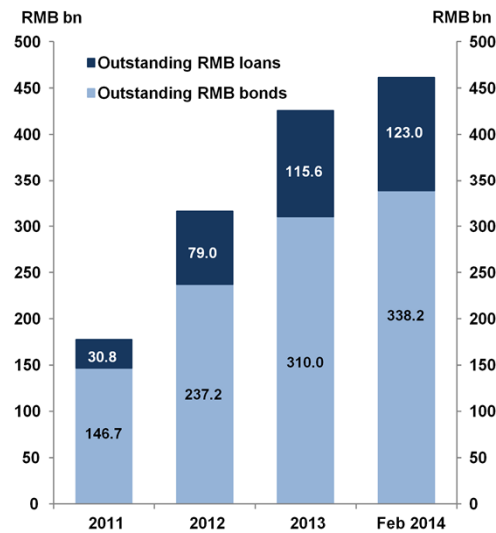


VIBRANT RMB FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end February 2014, RMB customer deposits and outstanding RMB certificates of deposit amounted to RMB920.3 billion and RMB207.7 billion respectively, totaling RMB1,128.1 billion, a 7% growth from RMB1,053.0 billion at the end of 2013.
- Meanwhile, over 107,000 accounts were opened by non-resident personal customers, with deposits exceeding RMB22 billion.
- The RMB dim sum bond market was active in the first quarter of 2014. Issuance in the quarter totalled RMB58.6 billion, more than twice the amount in the first quarter of 2013. Issuers include corporates and financial institutions from all over the world. Outstanding dim sum bonds amounted to some RMB350.0 billion at end March 2014, up 13% from end 2013.
- RMB bank lending grew steadily, with outstanding amount of RMB loans increasing to RMB123.0 billion at end February 2014, a growth of 6% from the end of 2013.



FURTHER STRENGTHENING OF HONG KONG'S RMB BUSINESS LINKS WITH OTHER PARTS OF THE WORLD

	Feb 2014	2013	2012	2011
1 No. of participating banks of Hong Kong's RMB clearing platform	219	216	204	187
Of which:	193	191	181	165
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks				
2 Amount due to overseas banks (RMB billion)	189.0	166.0	99.1	116.4
3 Amount due from overseas banks (RMB billion)	201.5	164.5	117.1	121.7
4 Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB billion)	724.0	395.4	213.7	121.4



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Financial Stability Board (FSB)

- HKMA attended the FSB Plenary Meeting on 31 March 2014. Members discussed vulnerabilities affecting the global financial system and progress in various financial regulatory reform areas, including ending the “too-big-to-fail” problem, OTC derivatives market reforms, and strengthening oversight and regulation of shadow banking activities.

Regional Co-operation

- HKMA continued to participate actively in meetings of regional forums including EMEAP (Executives’ Meeting of East Asia-Pacific Central Banks) and ASEAN+3 to review recent economic and financial developments in the region and to exchange views on issues of common interest.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

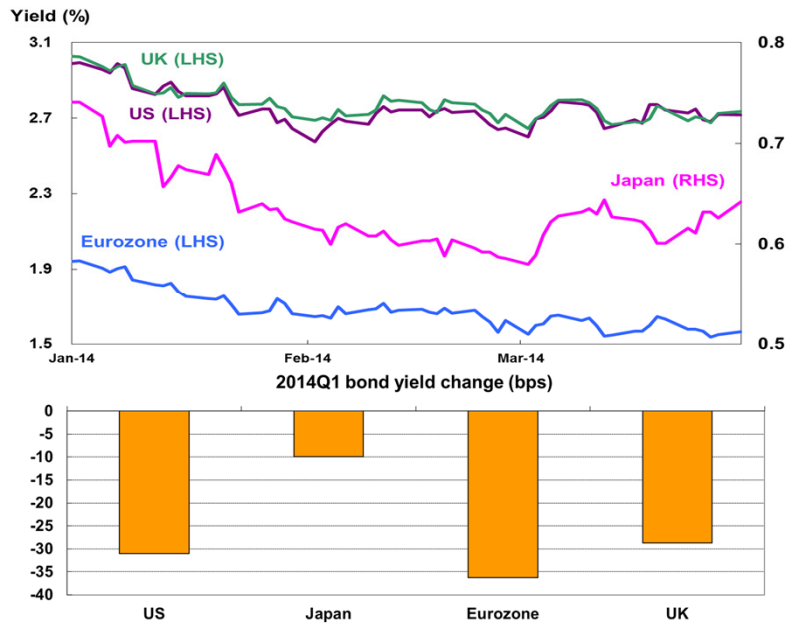


INVESTMENT ENVIRONMENT IN Q1 2014

- **Interest rates:** US Treasury yields moved lower on disappointing US economic data. European government bond yields fell in tandem, while JGB yields remained sluggish
- **Equity markets:** Major stock markets corrected downwards early in the year following stellar gains in the past two years, before recovering to similar levels seen at the beginning of the year. Japan and Hong Kong equity markets, however, lost 7.6% and 5.0% respectively
- **Exchange rates:** The foreign exchange market was in the doldrums. No major trend was observed, while the Euro and the Yen stayed range-bound against the dollar



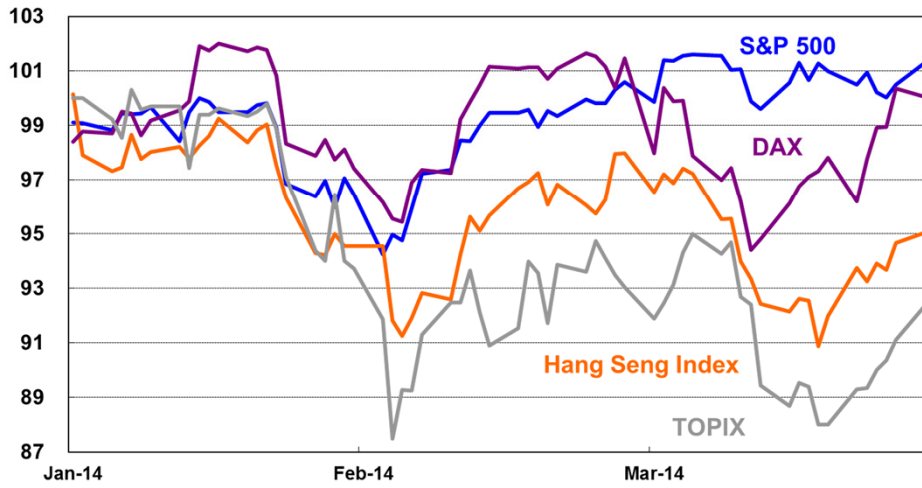
CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1 2014





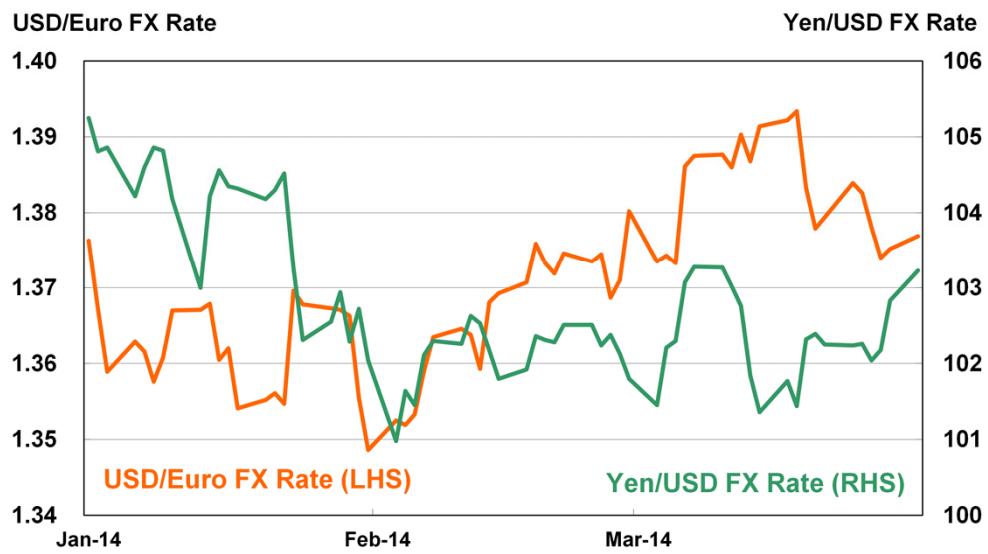
EQUITY MARKETS IN Q1 2014

Normalised Index Level (2013 year-end = 100)





CURRENCY MARKETS IN Q1 2014





INVESTMENT INCOME

	2014	2013	2012	2011
(HK\$ billion)	Q1*	Full Year	Full Year	Full Year
Hong Kong equities [@]	(6.8)	10.1	30.7	(24.2)
Other equities	3.6	71.8	42.8	(12.2)
Bonds	13.2	(19.1)	33.1	71.9
Other investments ^{&}	-	16.8	6.4	0.7
Foreign exchange	<u>1.1</u>	<u>1.6</u>	<u>(1.4)</u>	<u>(9.1)</u>
Investment income ^{@&}	11.1	81.2	111.6	27.1

* Unaudited figures

[@] Excluding valuation changes in Strategic Portfolio

[&] Including valuation changes of private equity and real estate investments held by Exchange Fund's investment holding subsidiaries

(The first quarter valuation change is not available pending the receipt of valuation reports of some investments)



INCOME AND EXPENDITURE

	2014	2013				
(HK\$ billion)	Q1*	Full year	Q4	Q3	Q2	Q1
Investment income/(loss)	11.1	81.2	30.7	54.7	(23.3)	19.1
Other income	-	0.2	-	0.1	0.1	-
Interest and other expenses	<u>(1.1)</u>	<u>(4.9)</u>	<u>(1.2)</u>	<u>(1.3)</u>	<u>(1.5)</u>	<u>(0.9)</u>
Net income/(loss)	10.0	76.5	29.5	53.5	(24.7)	18.2
Payment to Fiscal Reserves#	(7.1)	(36.8)	(9.0)	(9.0)	(9.5)	(9.3)
Payment to HKSAR government funds and statutory bodies#	(1.9)	(9.3)	(2.6)	(2.5)	(2.1)	(2.1)

* Unaudited figures

The fixed rate of fee payment is 3.6% for 2014 and 5.0% for 2013



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* ^{&}	111.6	30.3	42.4	(5.6)	44.5
2013* ^{&}	81.2	30.7	54.7	(23.3)	19.1
2014* ^{&#}	N/A	N/A	N/A	N/A	11.1

* Excluding valuation changes in the Strategic Portfolio

[&] Including valuation changes of investments held by investment holding subsidiaries

[#] Unaudited figures

N/A: Not Applicable



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Mar 2014 (Unaudited)	At 31 Dec 2013	At 31 Dec 2012
ASSETS			
Deposits	273.3	292.8	188.3
Debt securities	2,103.8	2,080.0	2,048.5
Hong Kong equities	144.4	152.9	148.0
Other equities	381.8	370.6	283.3
Other assets #	<u>100.9</u>	<u>136.5</u>	<u>113.0</u>
Total assets	<u>3,004.2</u>	<u>3,032.8</u>	<u>2,781.1</u>
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	326.8	327.4	289.8
Government-issued currency notes & coins in circulation	10.9	10.6	9.9
Balance of the banking system	163.9	164.1	255.9
Exchange Fund Bills and Notes issued	750.0	782.6	688.5
Placements by banks and other financial institutions	50.6	50.7	0.0
Placements by Fiscal Reserves	767.0	773.9	717.5
Placements by HKSAR government funds and statutory bodies	236.1	214.9	167.9
Other liabilities	<u>61.2</u>	<u>71.1</u>	<u>27.7</u>
Total liabilities	2,366.5	2,395.3	2,157.2
Accumulated Surplus	<u>637.7</u>	<u>637.5</u>	<u>623.9</u>
Total liabilities and fund equity	<u>3,004.2</u>	<u>3,032.8</u>	<u>2,781.1</u>

Including investment injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$71.3 billion at 31 Mar 2014 (HK\$66.4 billion at 31 Dec 2013)



HONG KONG MORTGAGE CORPORATION



REVERSE MORTGAGE PROGRAMME

- By end-Mar 2014, 589 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$14,200
 - Payment terms: 10-year (33%), 15-year (17%), 20-year (13%), life (37%)
 - Average property value: HK\$4.6 million
 - Average property age: 30 years

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- The HKMC has accepted the use of Enduring Power Attorney and Part II Order under the Reverse Mortgage Programme since 22 November 2013.



SME FINANCING GUARANTEE SCHEME (SFGS)

- In view of the challenging external economic environment, the Financial Secretary announced in the 2014-15 Budget Speech to further extend the application period for the 80% guarantee products for another one year to end of February 2015.
- The 80% loan guarantee product has been well received by the market. As at end-Mar 2014:
 - 8,531 applications were approved, involving total loan amount of HK\$35.8 billion
 - General characteristics of the approved applications are as follows:

Average guarantee period	4.78 years	Average loan size	HK\$4.20 million
Manufacturing and Non-manufacturing industries	26% and 74% (in terms of applications approved)	Average loan interest rate and average guarantee fee rate	4.78% p.a. 0.54% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related employees	5,757 enterprises and 150,599 employees

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- Industry types of approved applications for 80% loan guarantee products:

Manufacturing sector –

- Textiles and clothing 5.5%
- Electronics 2.5%
- Plastics 2.0%
- Printing and publishing 1.9%

Non-manufacturing sector –

- Trading 45.3%
- Wholesales and retail 8.4%
- Construction 2.6%
- Engineering 2.5%



MICROFINANCE SCHEME

- Launched in June 2012 for a trial period of 3 years with a tentative aggregate loan amount of HK\$100 million
- As at end-Mar 2014, the Scheme received 238 formal loan applications. Out of the vetted applications, 121 have been approved with the total loan amount of HK\$31.6 million. The approval rate is around 56 %
- For the approved applications, the average loan size was about HK\$260,000 and the average loan tenor was 4.5 years

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- Industry type for the approved cases
 - Servicing 50 cases (41%)
 - Retailing 44 cases (36%)
 - Wholesales 15 cases (13%)
 - Manufacturing 6 cases (5%)
 - IT related 5 cases (4%)
 - Others 1 case (1%)
- * Component percentages in the table above may not add up to 100% due to rounding.