



HONG KONG MONETARY AUTHORITY

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

15 November 2016

[Translation]

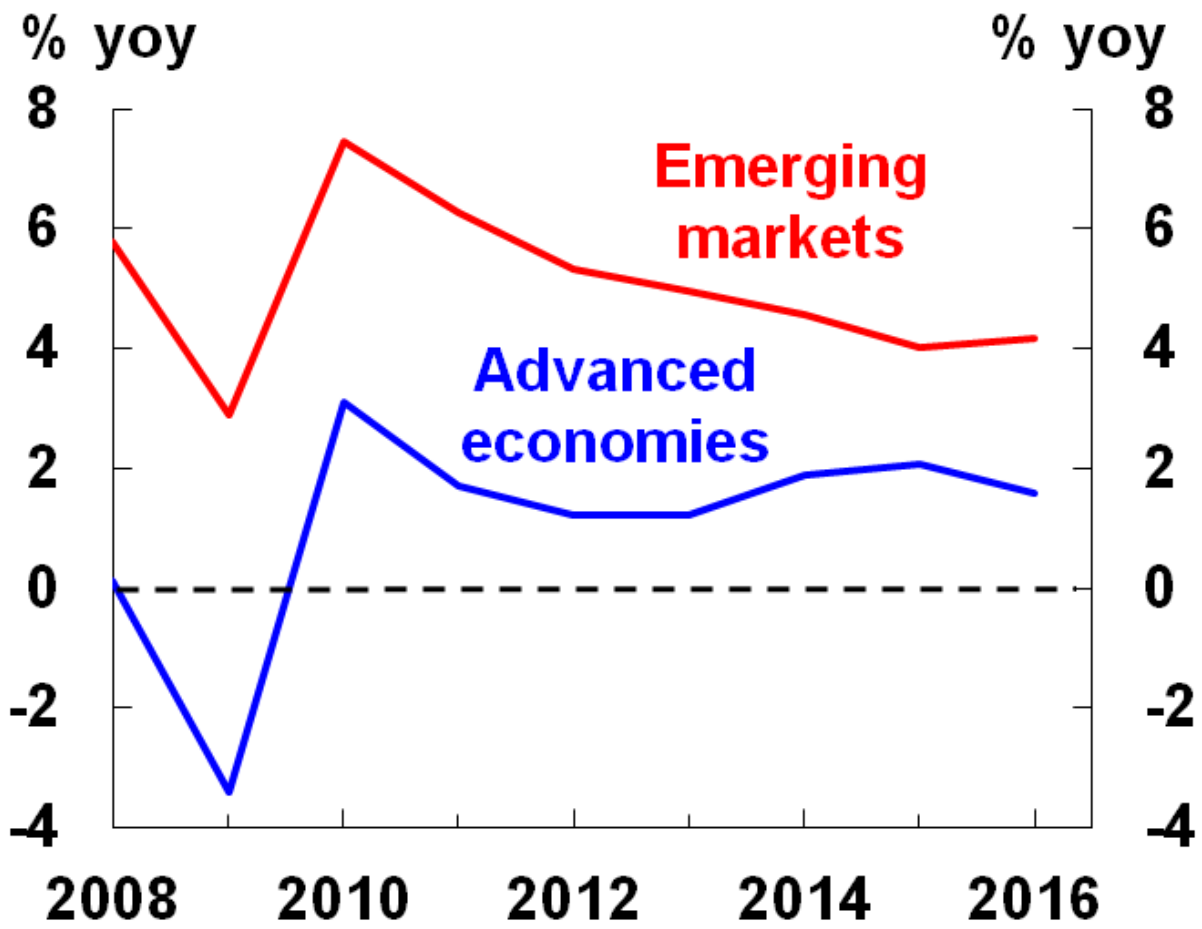


- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



GLOBAL ECONOMIC AND FINANCIAL CONDITIONS: GROWTH HAS MODERATED...

Global economic growth

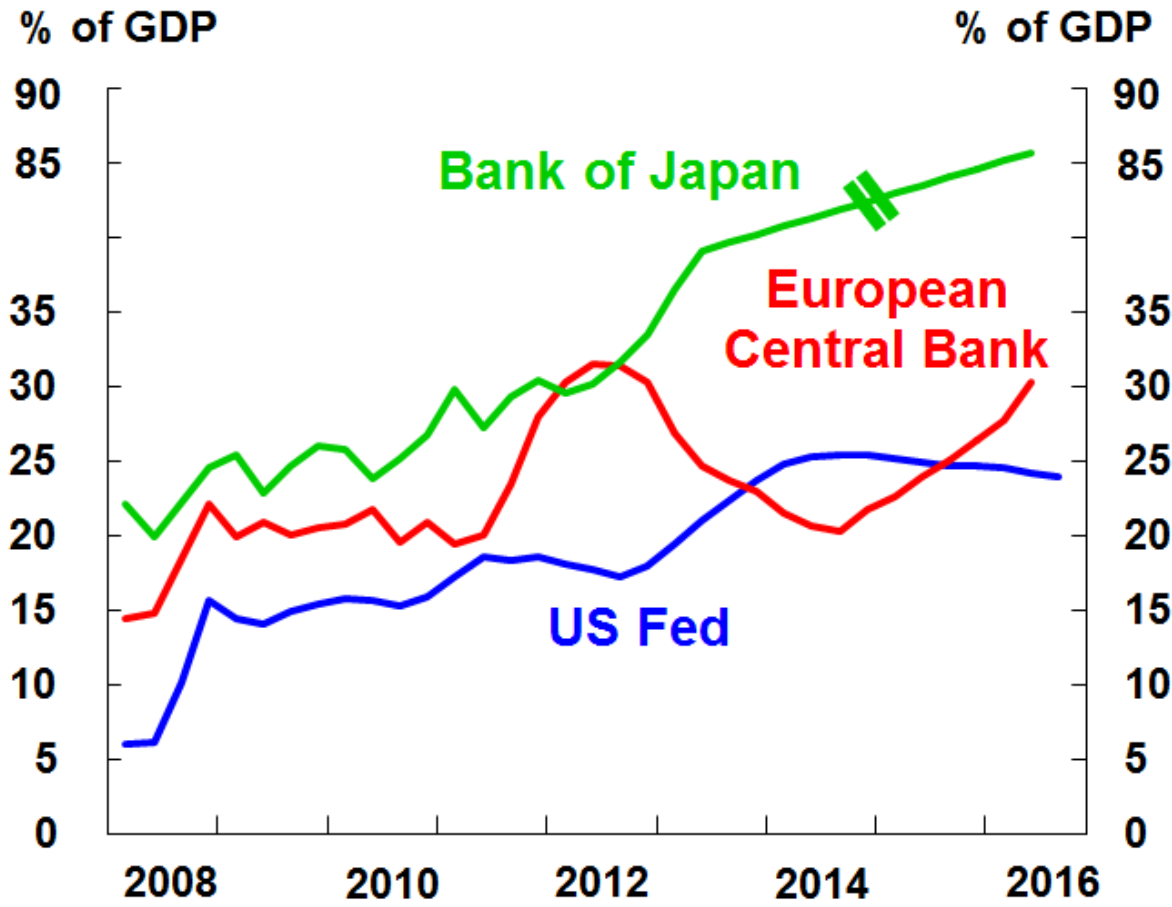


Source: IMF.



...AND MAJOR CENTRAL BANKS HAVE LOOSENED MONETARY POLICIES SIGNIFICANTLY

Balance sheets of major central banks

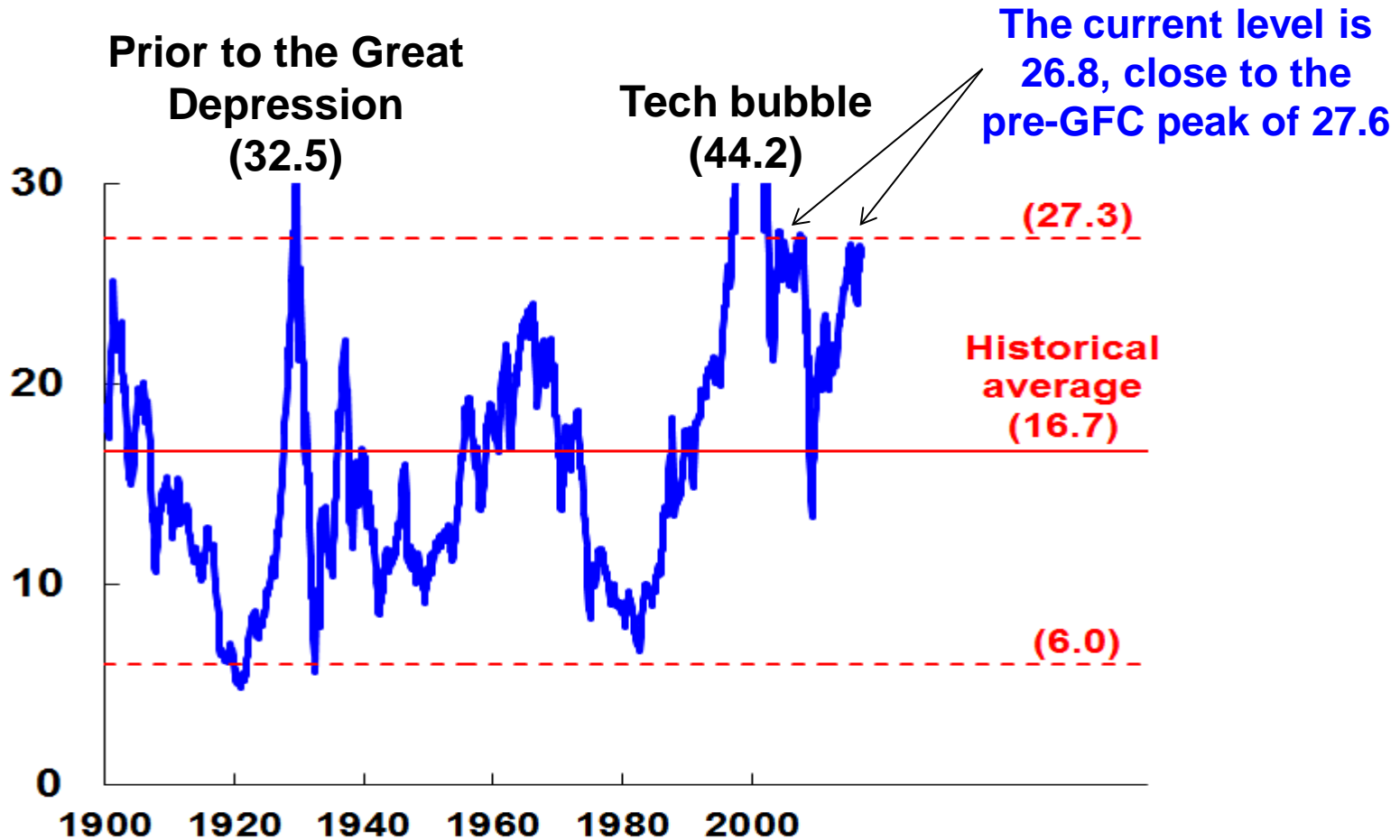


Sources: CEIC and HKMA staff estimates.



PERSISTENTLY LOW INTEREST RATES HAVE LED TO ELEVATED VALUATION OF FINANCIAL ASSETS ...

S&P 500 Cyclically Adjusted Price-Earnings Ratio*

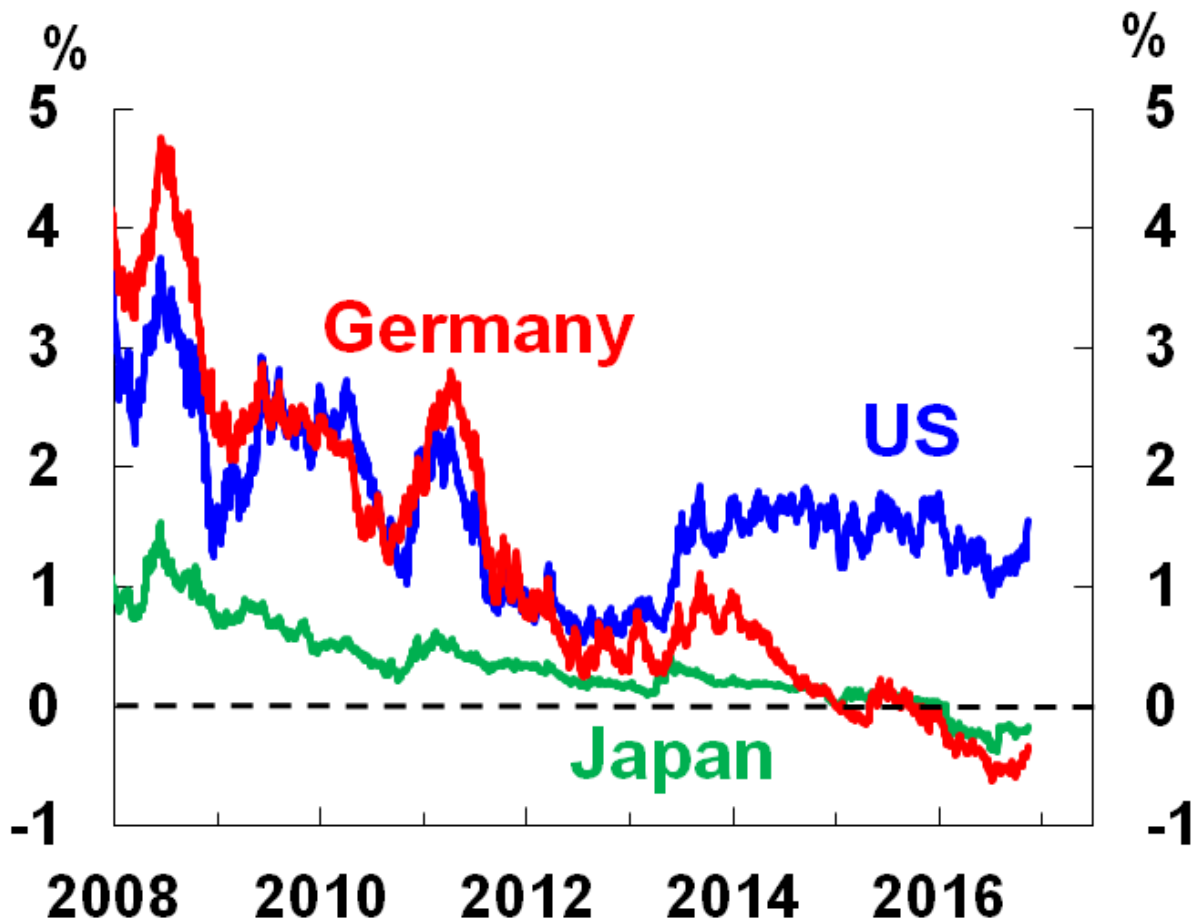


*Defined as share prices divided by 10-year moving average of earnings.
Source: Multpl.com.



...SIGNIFICANT DECLINE IN INCOME FOR SAVERS AND PENSIONERS

5-year sovereign bond yields of the US, Germany and Japan



Source: Bloomberg.



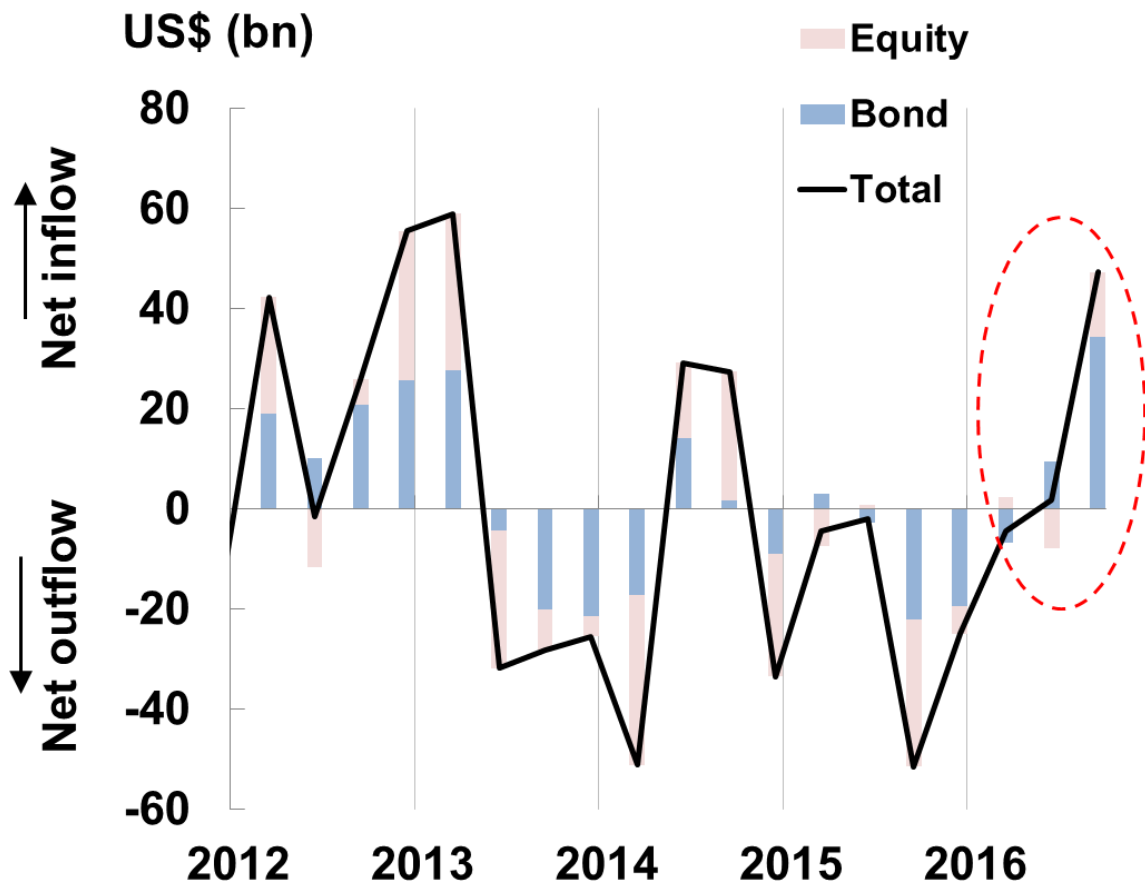
...DIFFICULT BUSINESS CONDITIONS WEIGHING ON PROFITABILITY OF BANKS AND INSURERS

		Banks		Life insurers	
		Pre Global Financial Crisis peak	Latest	Pre Global Financial Crisis peak	Latest
Euro area	P/B ratio	1.9	0.6	2.6	0.7
	ROE (%)	16.8	4.2	19.5	6.2
Japan	P/B ratio	1.9	0.5	5.9	0.7
	ROE (%)	14.0	5.8	10.4	4.8



RENEWED FUND FLOWS TO EMERGING MARKETS IN SEARCH FOR YIELD...

Fund flows into emerging markets

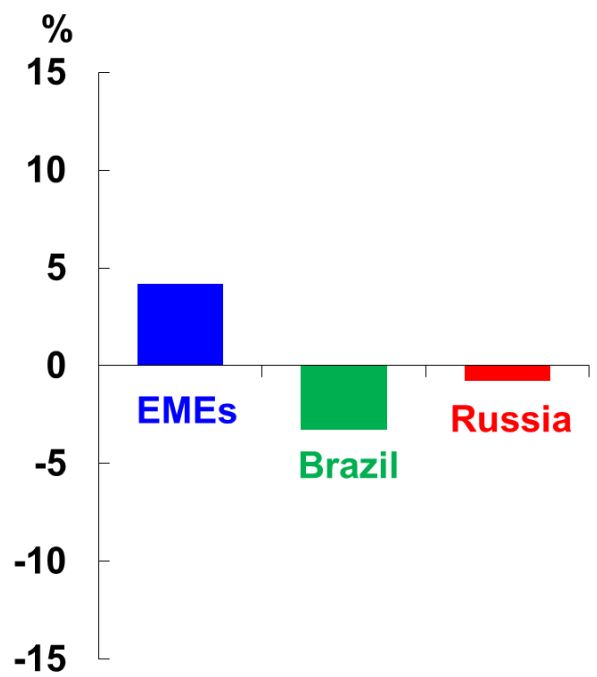


Source: EPFR Global.

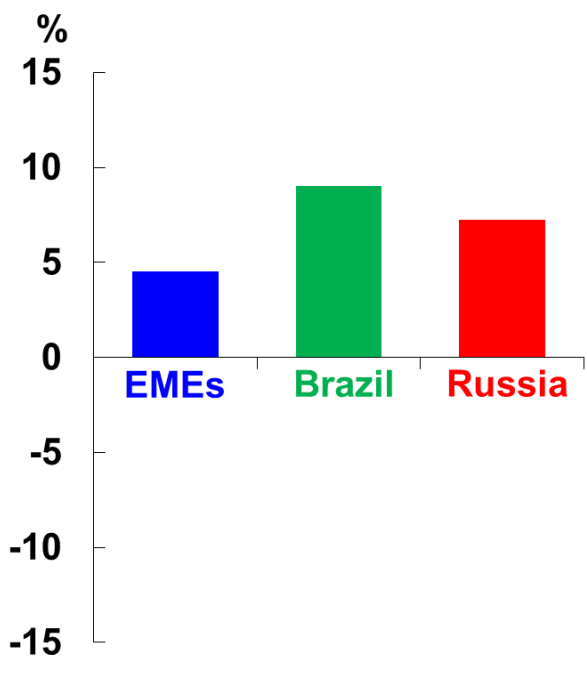


...YET SOME EMERGING MARKETS ARE STILL FACING DIFFICULT ECONOMIC CONDITIONS

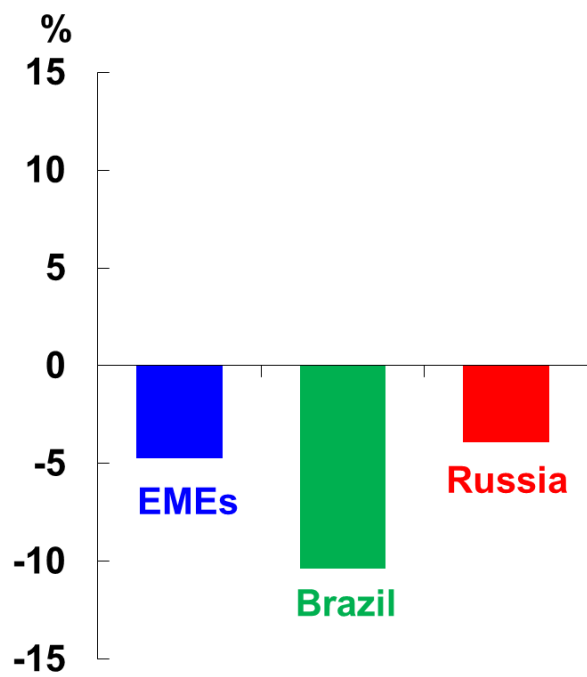
Real GDP growth



Inflation



Fiscal balance

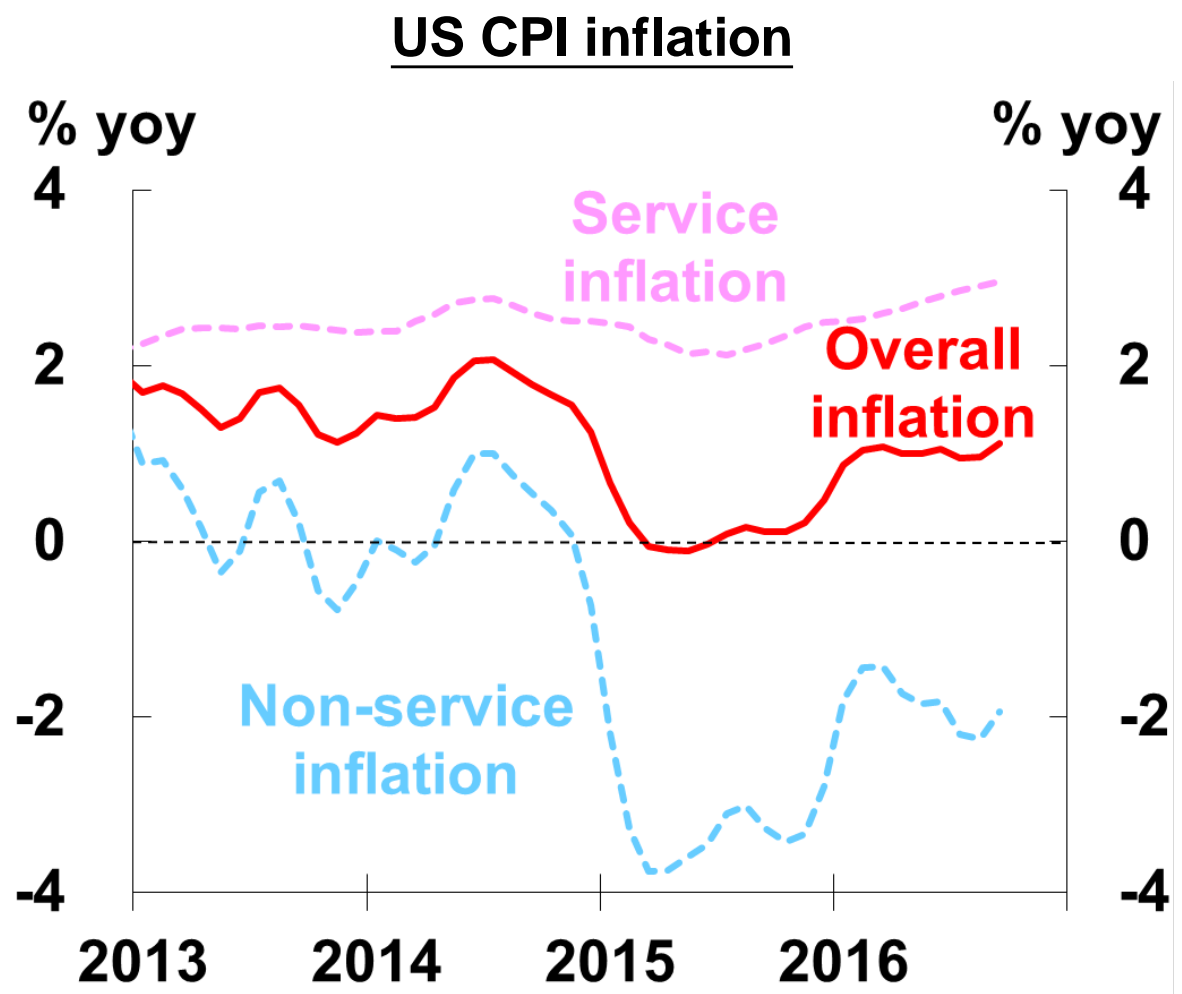


Data shown are 2016 estimates.

Source: IMF World Economic Outlook, October 2016.



US INFLATION HAS BEEN PICKING UP

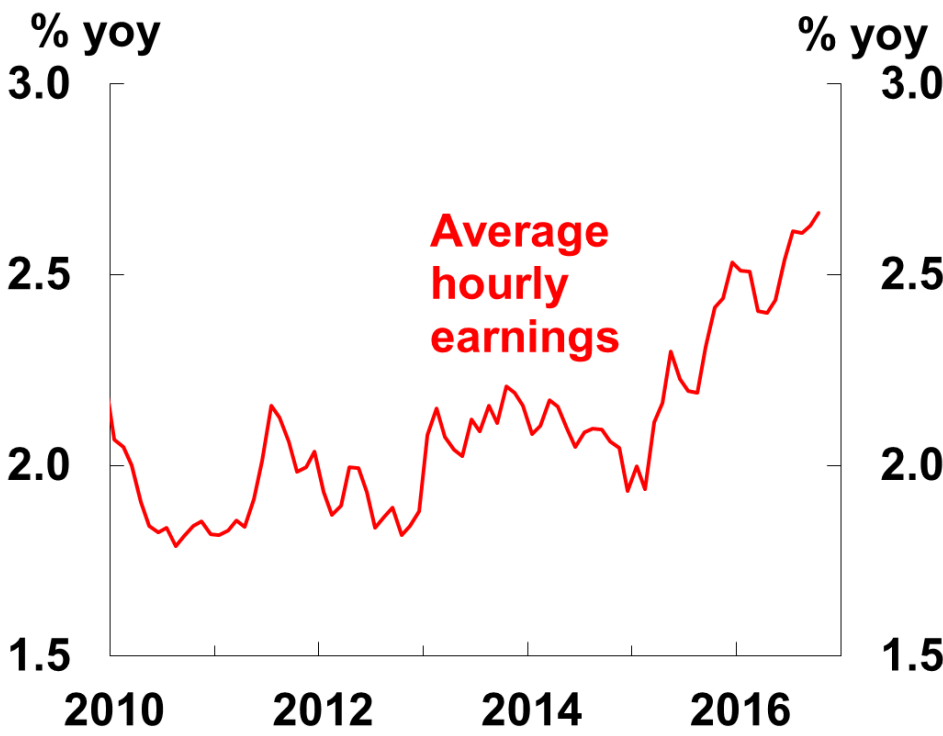


Note: Data shown are 3-month moving averages. Non-service inflation includes food, energy and goods.
Source: CEIC.

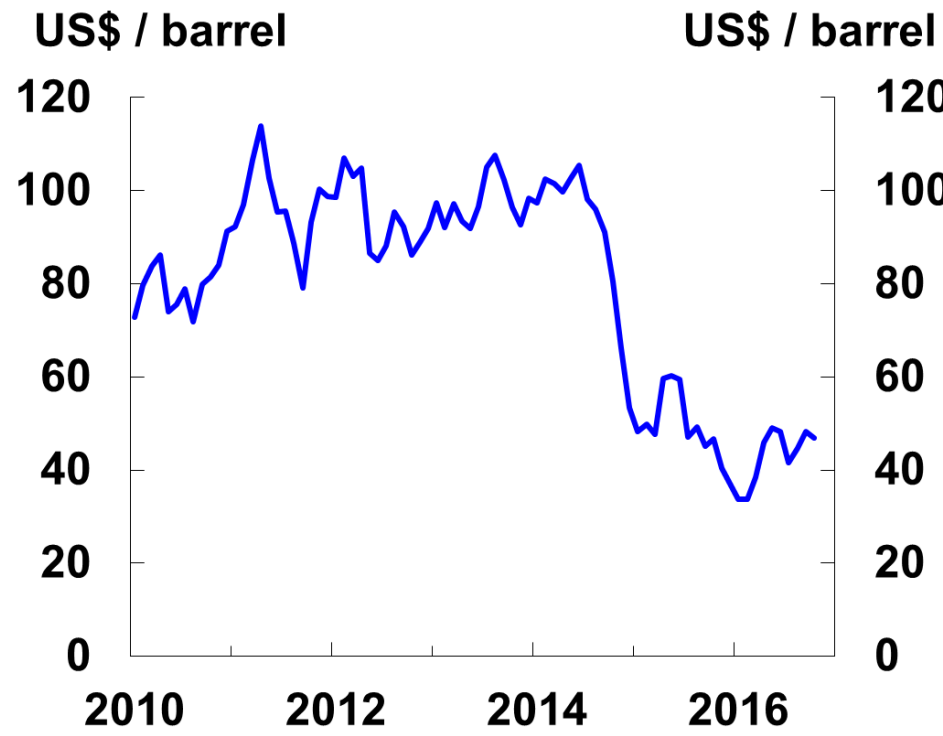


US: RISING WAGES AND STABILISING COMMODITY PRICES WOULD ADD TO INFLATIONARY PRESSURE

Wage growth



Crude oil price



Note: Data shown are 3-month moving averages.

Source: CEIC.

Source: Datastream.



MAINLAND CHINA: REFORM CONTINUES AMID STABLE ECONOMIC GROWTH

- Mainland economy has gradually stabilised and capital outflow pressure has also diminished
- Market concerns about a hard-landing have abated
- Relatively fast corporate debt growth and renewed signs of heating up of the property market are areas of concern
 - Mainland authorities have gradually closed down state-owned enterprises in overcapacity sector to address the corporate debt problem
 - New measures have also been introduced to address the risk of overheating in the property market



GLOBAL ECONOMIC AND FINANCIAL IMPACTS OF THE US ELECTION OUTCOME

- There will be policy changes under the new administration but the specific details remain uncertain
- Election pledges by the President-elect:
 - Anti-free trade and increasing tariffs
 - Significant tax cuts and increases in infrastructure spending
 - Relaxation of financial regulations
- If implemented, such policies may have significant impacts on US trade, economic development, inflation outlook, financial market development and fiscal burden



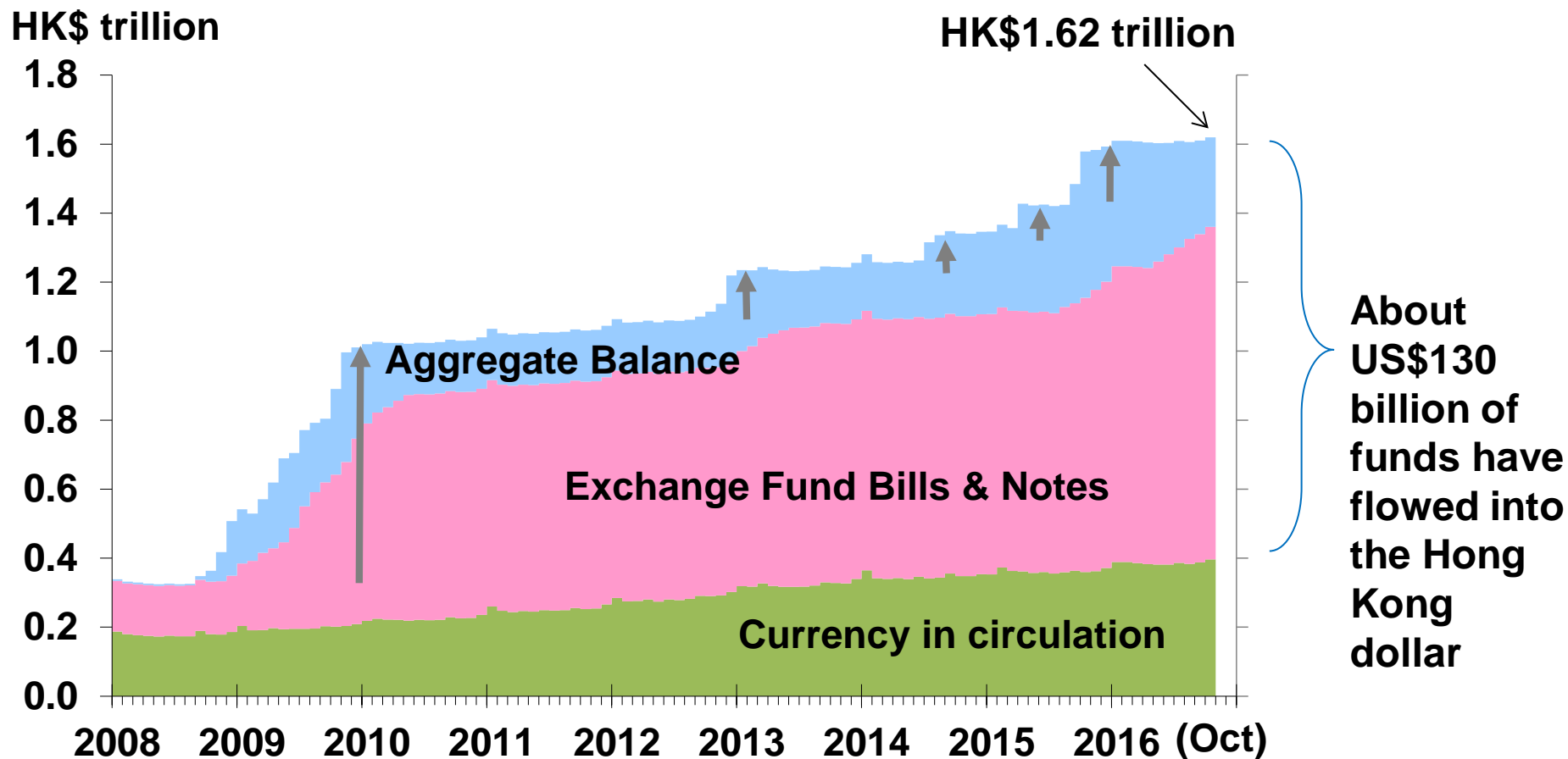
ASSESSMENT OF RISKS TO GLOBAL FINANCIAL STABILITY

- Ultra-low interest rates and quantitative easing policies
 - Their effectiveness in stimulating the economy is questionable
 - Have caused distortions and imbalances in the financial markets
 - Have led to financial vulnerabilities
- US inflation is rising but the pace of interest rate normalisation remains uncertain, while the US election outcome will bring more uncertainties
- Risk of hard landing in Mainland China has subsided but concerns over corporate debts and property market conditions remain



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: MONETARY BASE

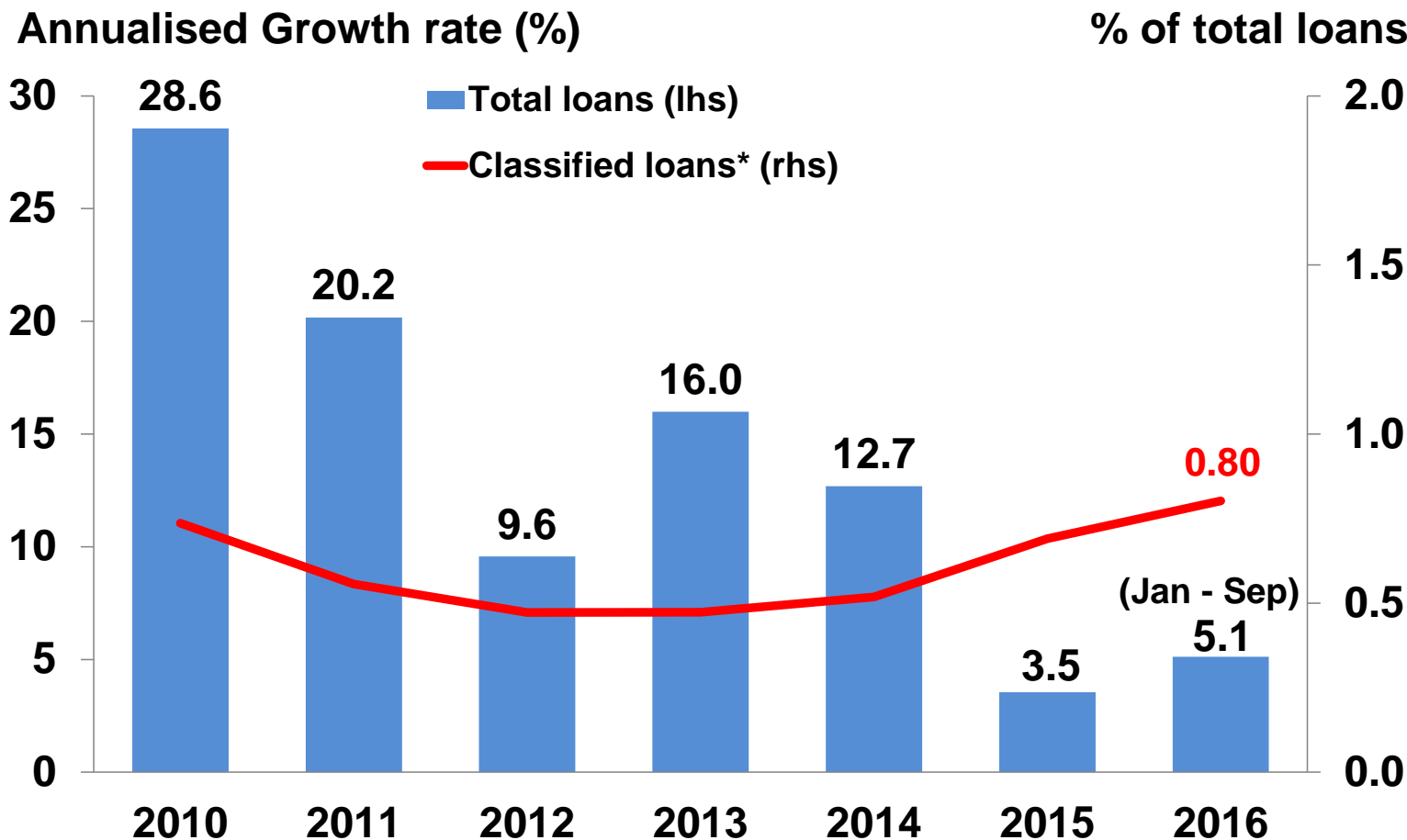
Ample HKD liquidity





ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: LOAN GROWTH AND ASSET QUALITY

Bank credit grew moderately; signs of deterioration in asset quality



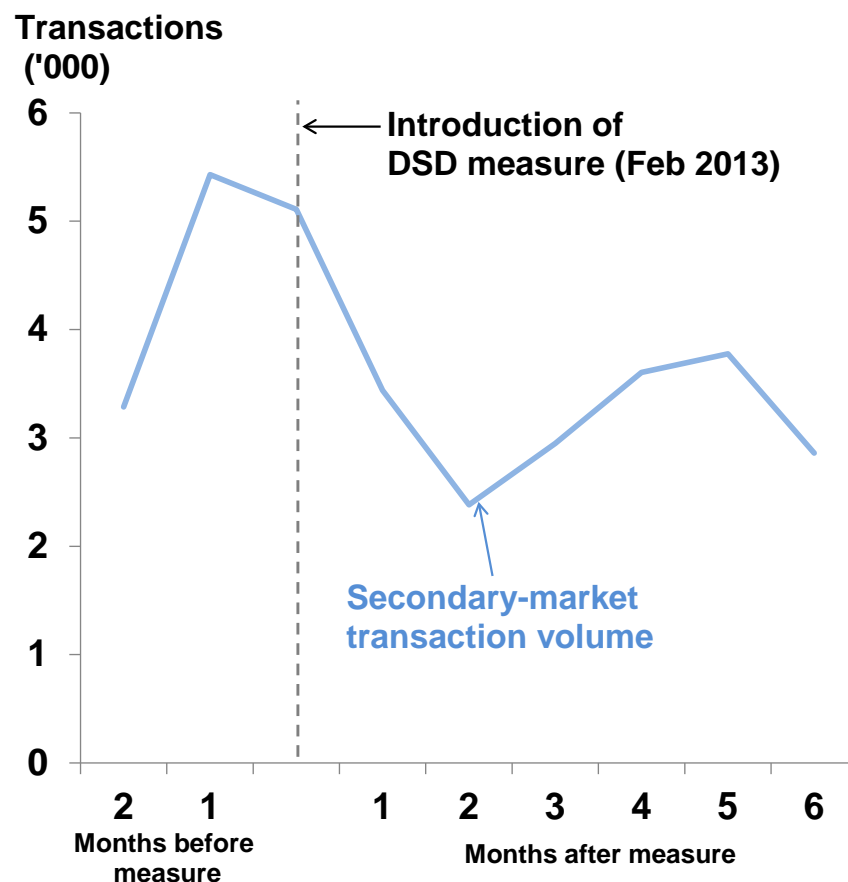
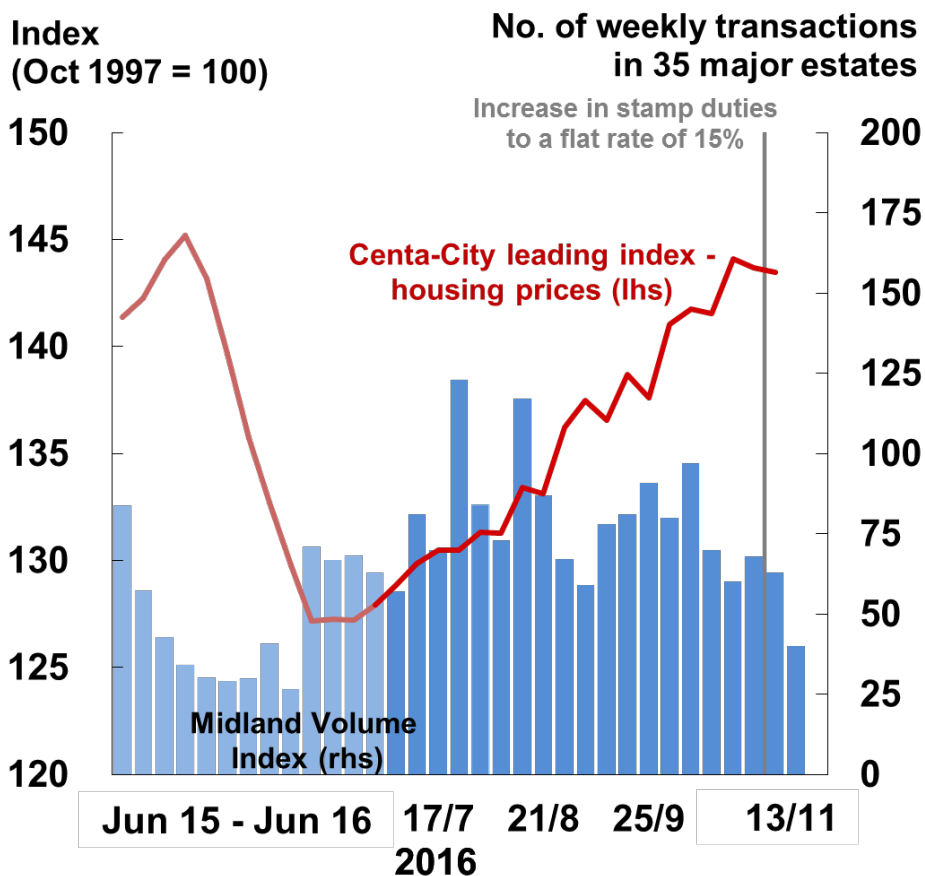
Note: * The classified loan ratio for 2016 is the figure for Q2.

Source: HKMA.



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Amid renewed buoyancy in the property market, the Government introduced a new stamp duty measure



Sources: Midland Realty and Centaline Property Agency Limited.

Source: Land Registry.



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: CONCLUSION

- The uncertain pace of US interest rate normalisation will directly affect Hong Kong's interest rate outlook
- The Hong Kong property market picked up again after consolidating for about six months since September last year; the Government announced a new stamp duty measure on 4 November
- The impact of the new measure on the property market remains to be seen
- The HKMA will continue to monitor developments in the property market closely and, having regard to the evolving cycle of the property market, introduce appropriate measures to maintain banking stability
- The public should manage risks prudently so as to address shocks arising from the reversal of fund flows and interest rate fluctuations



1. Assessment of Risk to Hong Kong's Financial Stability
- 2. Banking Supervision**
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



BASEL STANDARDS IMPLEMENTATION

- Amendment of Banking (Disclosure) Rules (BDR) to implement revised Basel Pillar 3 disclosure package
- Amendment of Banking (Capital) Rules (BCR) to introduce revised Basel capital treatment for counterparty credit risk exposures and equity investment in funds
- Amendment of Banking Ordinance primarily to update requirements on exposure limits



HONG KONG RESOLUTION REGIME

Current status:

- Financial Institutions (Resolution) Ordinance (FIRO) enacted by LegCo in June 2016 (but not yet in force)

Next steps:

- Bring FIRO into operation and develop subsidiary legislation (e.g. protected arrangements)
- Conduct resolution planning for authorized institutions (domestic and cross-border)
- Contribute to the development of internationally harmonised resolution regimes (e.g. participate in Financial Stability Board's policy formulation and share knowledge with supervisory authorities in Asia-Pacific)



BANKING SERVICES DELIVERY CHANNELS (1)

- Number of branches and ATMs of retail banks in Hong Kong:

	2005	2015
Number of branches	1,122	1,174
Number of ATMs	2,361	3,249

- Financial transactions are mostly conducted through non-branch channels (e.g. ATMs, internet and phone banking services), with only around 30% conducted at branch counters



BANKING SERVICES DELIVERY CHANNELS (2)

- There is still room for improvement in terms of branch coverage in some remote areas. The HKMA has required banks to:
 - Promote financial inclusion while operating on commercial principles
 - Introduce other channels (e.g. mobile branches, video teller machines and simplified ATMs) to supplement existing branch network although physical branches cannot be provided in some remote areas
- The HKMA will facilitate communication between the industry and LINK if there are difficulties for banks in finding a suitable location for branches in public housing estates
- Feedback from banks is positive



1. Assessment of Risk to Hong Kong's Financial Stability
2. Banking Supervision
- 3. Financial Infrastructure**
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



REGULATORY REGIME FOR STORED VALUE FACILITIES (SVF)

- The HKMA granted SVF licences to 5 and 8 SVF issuers on 25 August and 4 November 2016 respectively
- SVF licensees are introducing or enhancing services according to their business plans, providing the public with more choices
- In addition to supervision of SVF licensees, the HKMA has stepped up publicity effort via various channels to remind the public of points to note (including security and privacy issues) when using SVFs



LATEST FINTECH INITIATIVES

Research and application

- Roll-out of Cybersecurity Fortification Initiative
- Research on the potential of blockchain / distributed ledger technology
- Establishment of Fintech Innovation Hub

Industry liaison

- Organised various events for banks and fintech companies to explore development opportunities

Balance between regulation and development

- Launched Fintech Supervisory Sandbox for banks to speed up the process of introducing fintech products



PROGRESS OF THE CYBERSECURITY FORTIFICATION INITIATIVE

Cyber Risk Assessment Framework

- Completed industry consultation in August 2016
- Refinements to the framework underway
- Details to be announced by the end of 2016 to allow banks to conduct cybersecurity assessments

Professional Development Programme

- Completed industry consultation in August 2016
- Industry expert panel is developing the equivalent qualification framework and reviewing other recommendations collected during the consultation
- Expect to launch the programme and announce details of the equivalent qualification framework by the end of 2016

Cyber Intelligence Sharing Platform

- To be launched by the end of 2016, with participation by all licensed banks



1. Assessment of Risk to Hong Kong's Financial Stability
2. Banking Supervision
3. Financial Infrastructure
- 4. Development of Financial Market**
5. Investment Performance of the Exchange Fund



DEVELOPMENT OF OFFSHORE RMB BUSINESS IN HONG KONG

- Offshore RMB business has moderated globally this year, reflecting a more cautious outlook for the RMB exchange rate by some investors
- The offshore RMB market in Hong Kong continues to function orderly. RMB liquidity management of the Hong Kong banking sector remains robust
- As the global offshore RMB business hub, Hong Kong possesses the largest offshore RMB liquidity pool and processes some 70% of global RMB payment. Hong Kong also has the highest RMB FX turnover in the world
- Inclusion of RMB in IMF's Special Drawing Rights currency basket this October and the implementation of the Belt and Road Initiative will give further impetus to the development of offshore RMB business in Hong Kong



HONG KONG AS AN INFRASTRUCTURE FINANCING HUB

- Infrastructure Financing Facilitation Office (IFFO) was set up by HKMA on 4 July 2016
- Over 50 IFFO partners, including multilateral development banks, public and private sector investors, project developers and operators and professional service providers
- Missions of IFFO:
 - Providing a platform for information exchange and experience sharing;
 - Building capacity and knowledge on infrastructure investments and financing;
 - Promoting market and product development; and
 - Facilitating infrastructure investment and financing flows



1. Assessment of Risk to Hong Kong's Financial Stability
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
- 5. Investment Performance of the Exchange Fund**



INVESTMENT INCOME

←———— **2016** —————→ **2015** **2014**
 (unaudited)

(HK\$ billion)	Jan - Sep	Q3	Q2	Q1	Full Year	Full Year
Hong Kong equities*	13.3	16.8	2.7	(6.2)	(5.0)	6.5
Other equities	13.7	18.5	5.1	(9.9)	7.1	33.7
Bonds	50.7	6.4	19.3	25.0	15.9	47.3
Other investments@	5.6	-	4.3	1.3	11.1	9.9
Foreign exchange#	<u>3.5</u>	<u>0.8</u>	<u>(12.5)</u>	<u>15.2</u>	<u>(44.9)</u>	<u>(52.7)</u>
Investment income/(loss)	86.8	42.5	18.9	25.4	(15.8)	44.7

* Excluding valuation changes of the Strategic Portfolio

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio (LTGP). (The above figures represent valuation changes up to the end of June 2016. Valuations of these investments from July to September are not yet available.)

This is primarily the effect of translating non-US dollar foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging



INCOME AND EXPENDITURE

(HK\$ billion)	← 2016 → (unaudited)				2015	2014
	Jan - Sep	Q3	Q2	Q1	Full year	Full year
Investment income/(loss)	86.8	42.5	18.9	25.4	(15.8)	44.7
Other income	0.1	0.0	0.1	0.0	0.2	0.2
Interest and other expenses	<u>(4.5)</u>	<u>(1.6)</u>	<u>(1.7)</u>	<u>(1.2)</u>	<u>(4.8)</u>	<u>(5.2)</u>
Net income/(loss)	82.4	40.9	17.3	24.2	(20.4)	39.7
Fee payable to Fiscal Reserves*#	(17.2)	(5.5)	(5.7)	(6.0)	(46.7)	(27.5)
Fee payable to HKSAR government funds and statutory bodies*	(7.1)	(2.4)	(2.4)	(2.3)	(14.7)	(8.6)

* The rate of fee payment is 3.3% for 2016, 5.5% for 2015 and 3.6% for 2014

This does not include the 2016 fee payment to the Future Fund because such amount will only be calculated when the figures on the LTGP annual performance for 2016 are available