



HONG KONG MONETARY AUTHORITY

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

15 May 2018



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

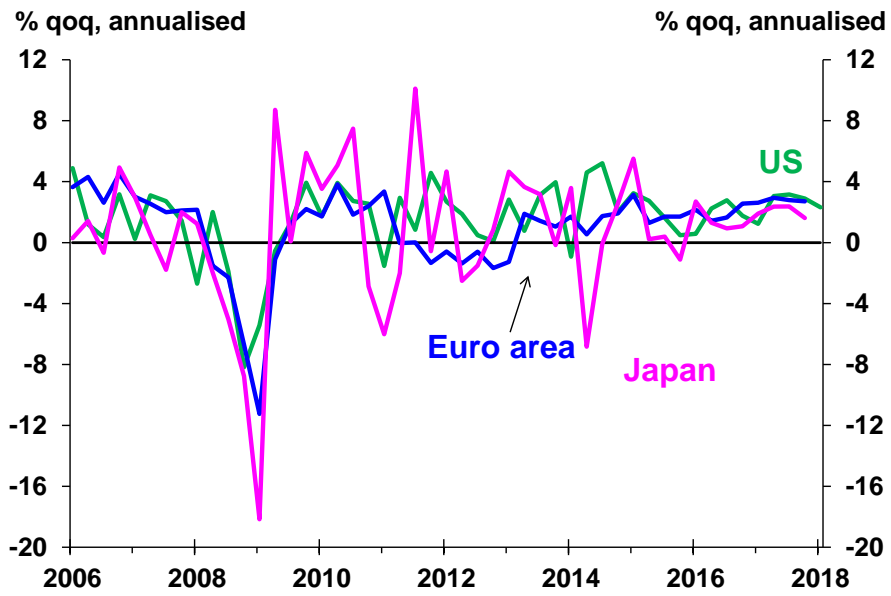
(% year-on-year)

	2017	2018 Forecasts	2019 Forecasts
US	2.3	2.8	2.6
Euro area	2.4	2.4	1.9
Japan	1.7	1.4	1.1
Asia (ex-Japan)	6.0	5.8	5.7
Mainland China	6.9	6.6	6.4
Hong Kong	3.8	3.2	2.7

Sources: April Consensus Forecasts and Official Statistics



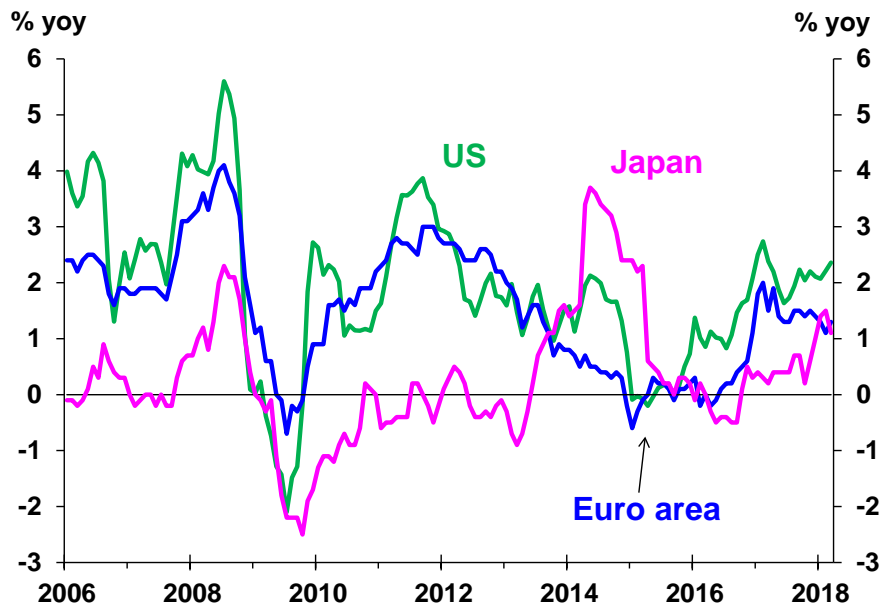
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: CEIC



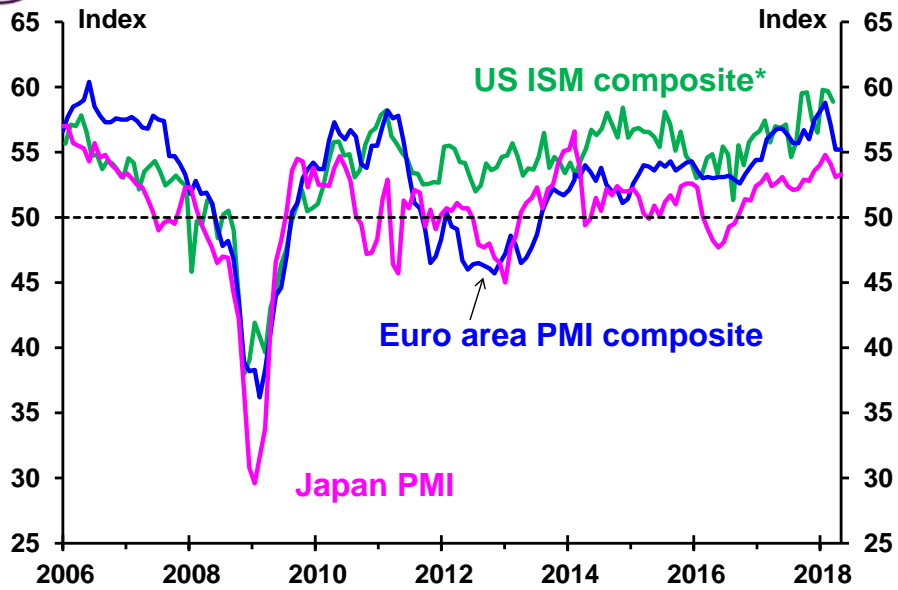
HEADLINE INFLATION IN MAJOR COUNTRIES



Source: CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

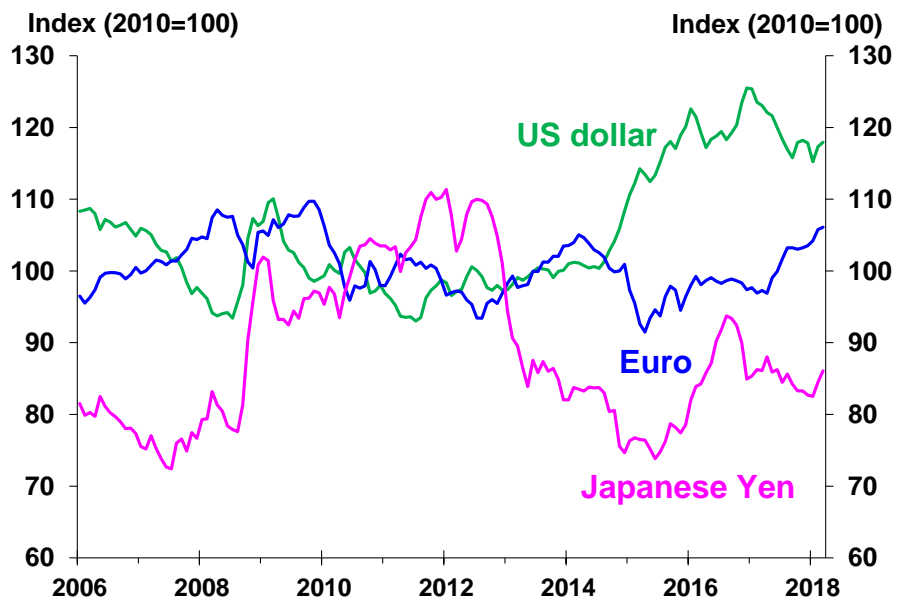


*Weighted average of the ISM manufacturing and non-manufacturing indices

Sources: Bloomberg and CEIC



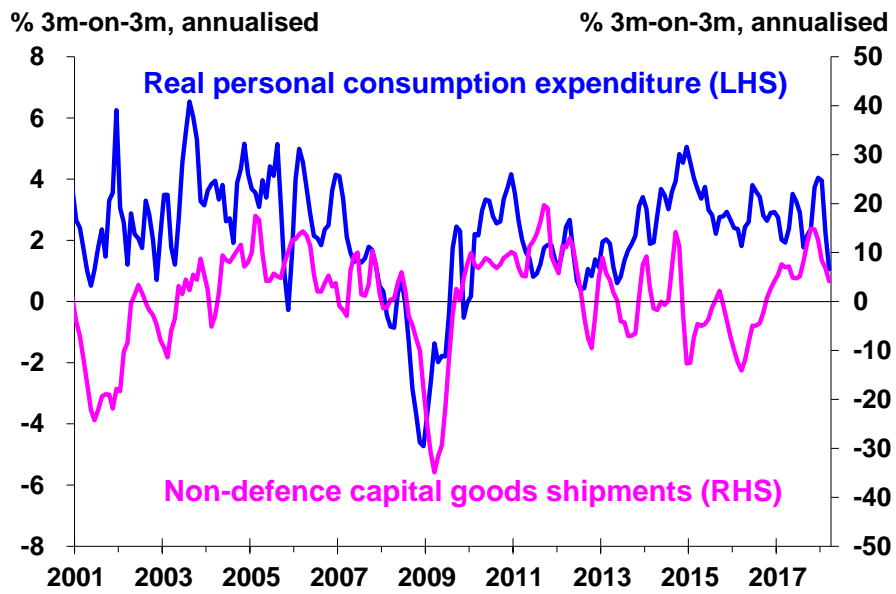
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



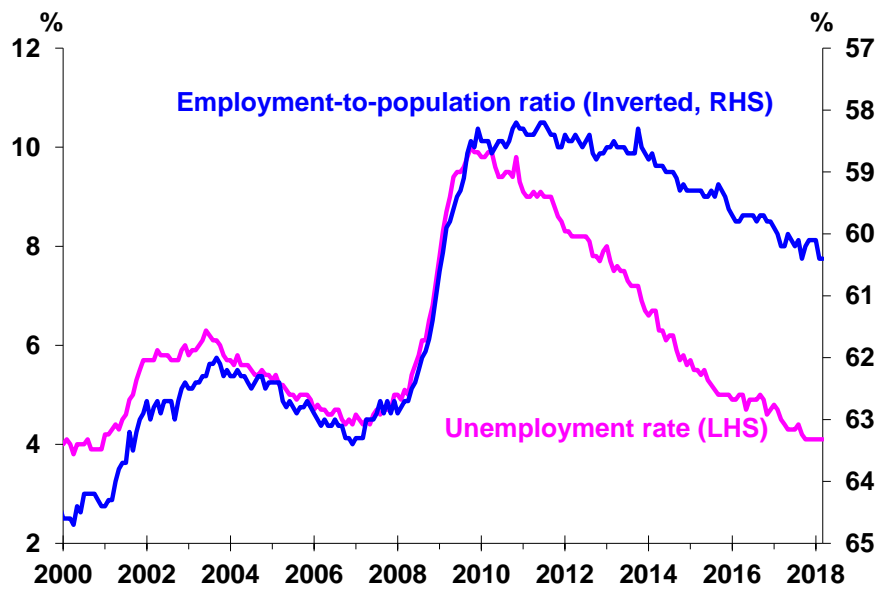
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



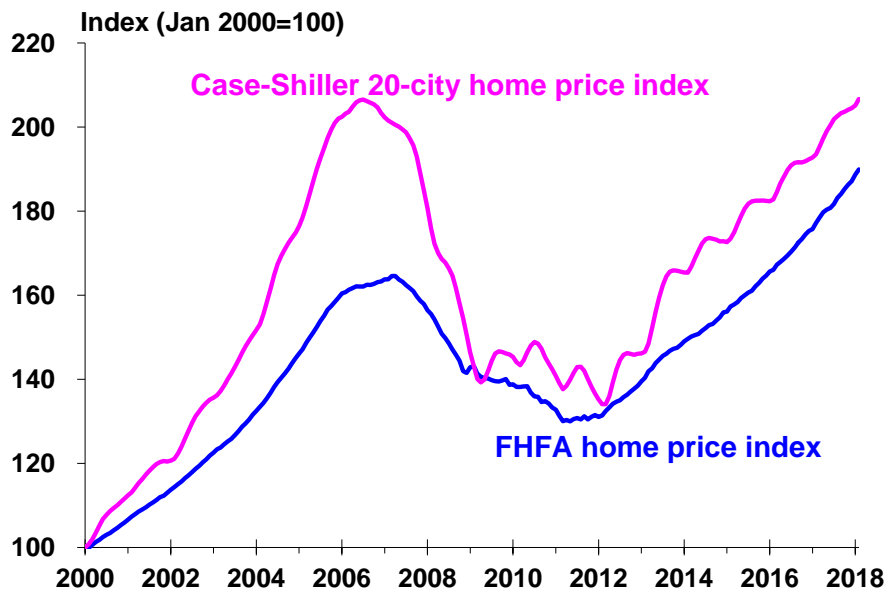
US: LABOUR FORCE PARTICIPATION



Source: CEIC



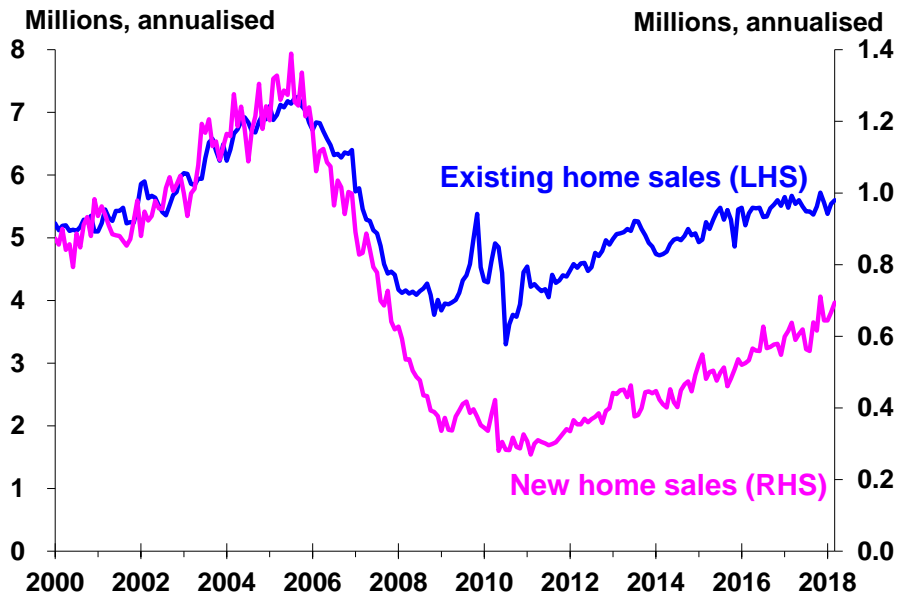
US: HOUSE PRICES



Sources: CEIC and Datastream



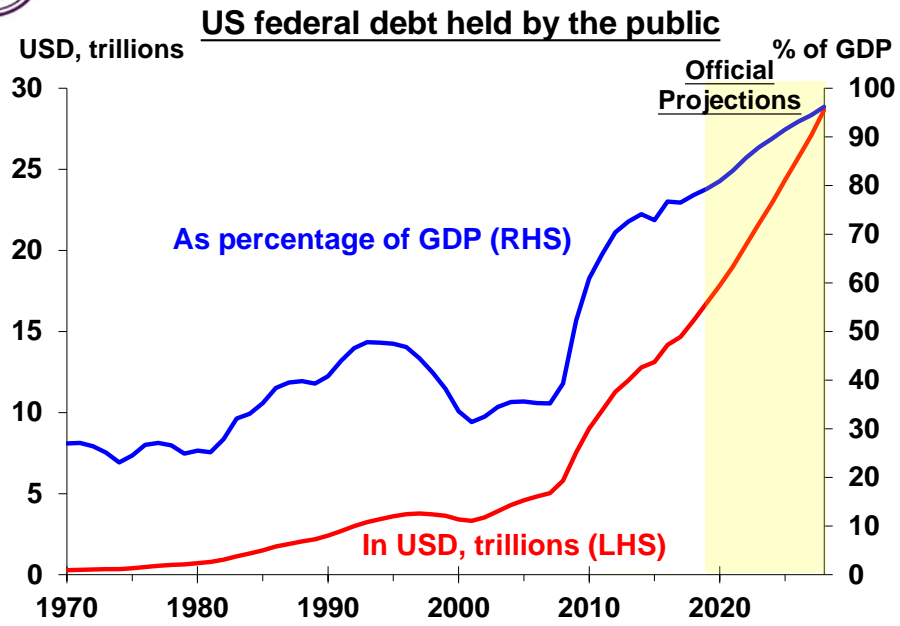
US: HOME SALES



Source: CEIC



US: FEDERAL GOVERNMENT DEBT

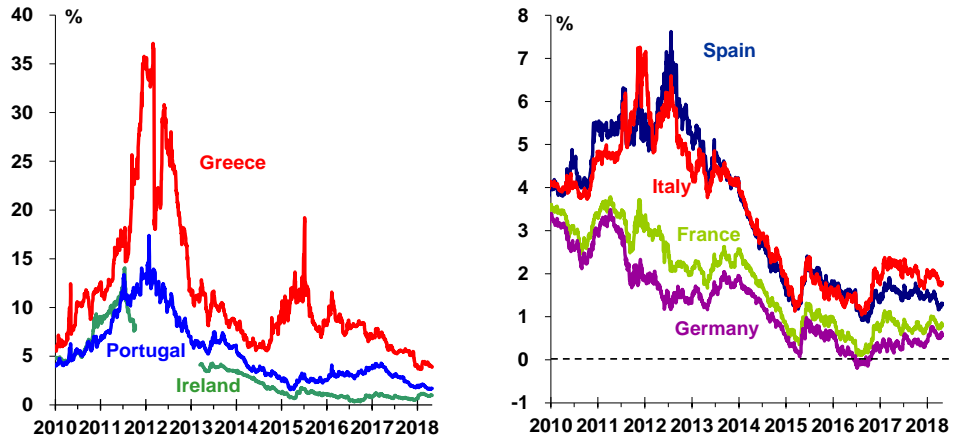


Sources: CEIC and Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

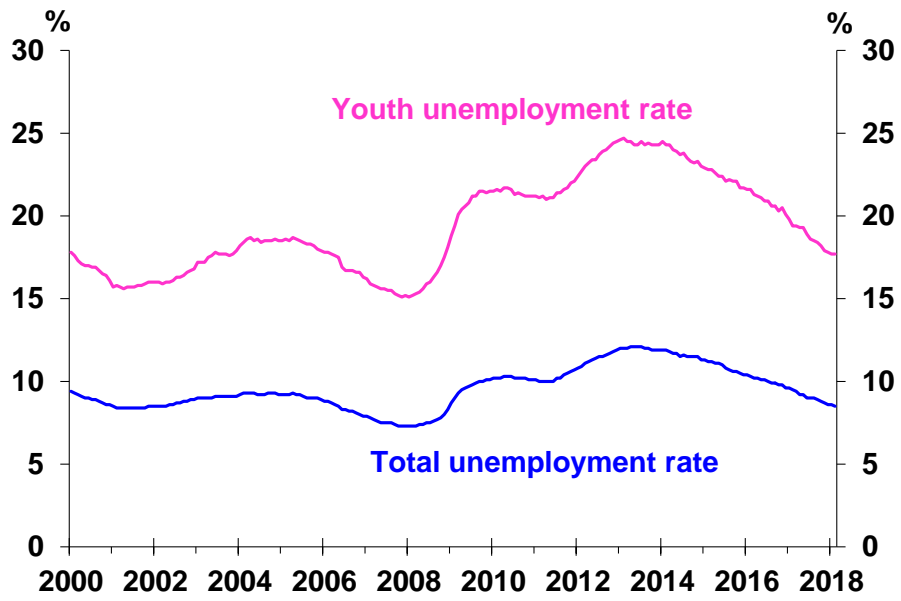
10-year sovereign bond yield



Note: 10-year Irish sovereign bond yield data is not available between 12 Oct 2011 and 14 Mar 2013
Source: Bloomberg



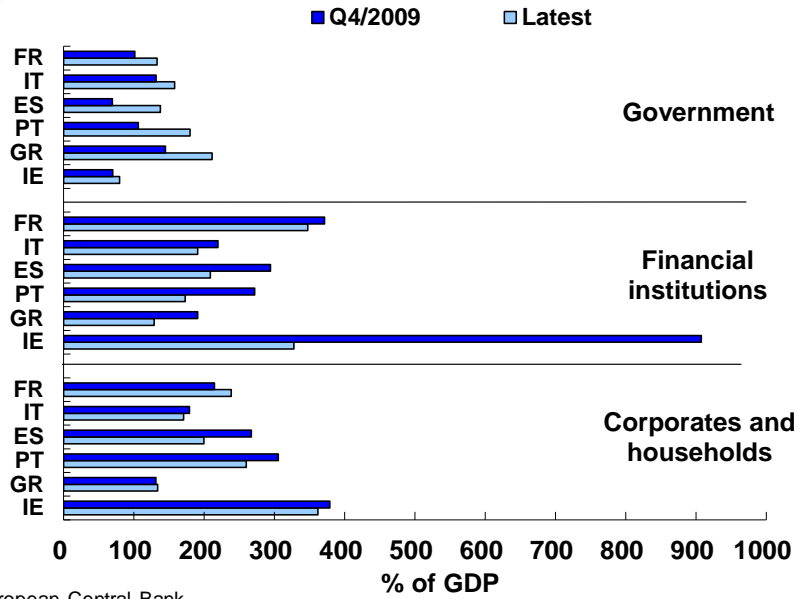
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS



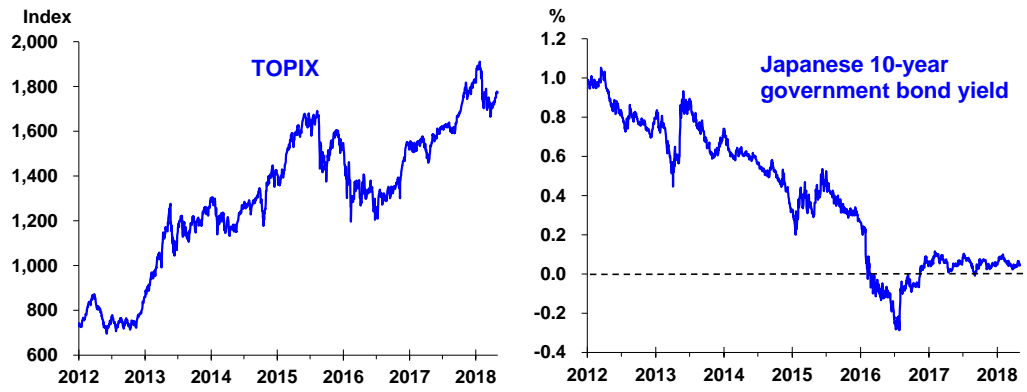
Source: European Central Bank

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

The latest figures for financial institutions for France are up to Q1/2018 whilst the rest are up to Q4/2017



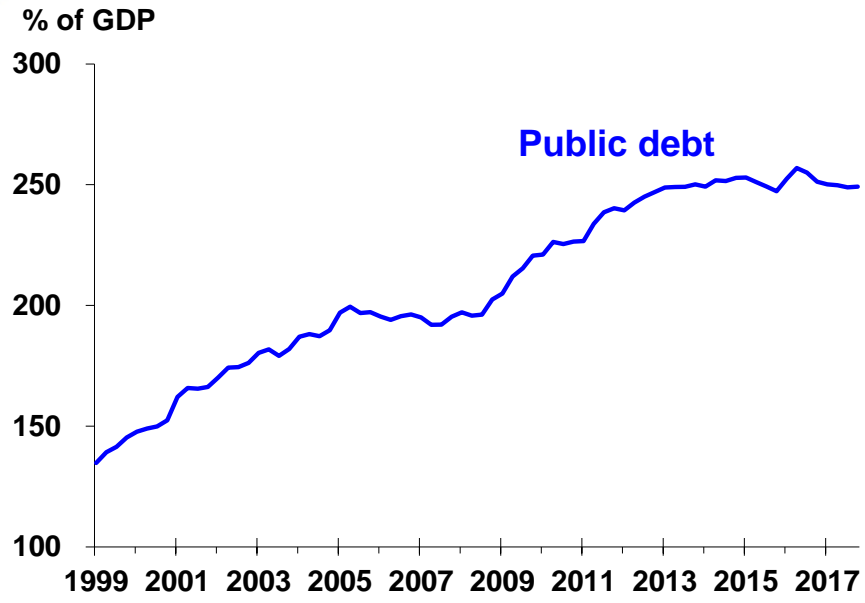
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



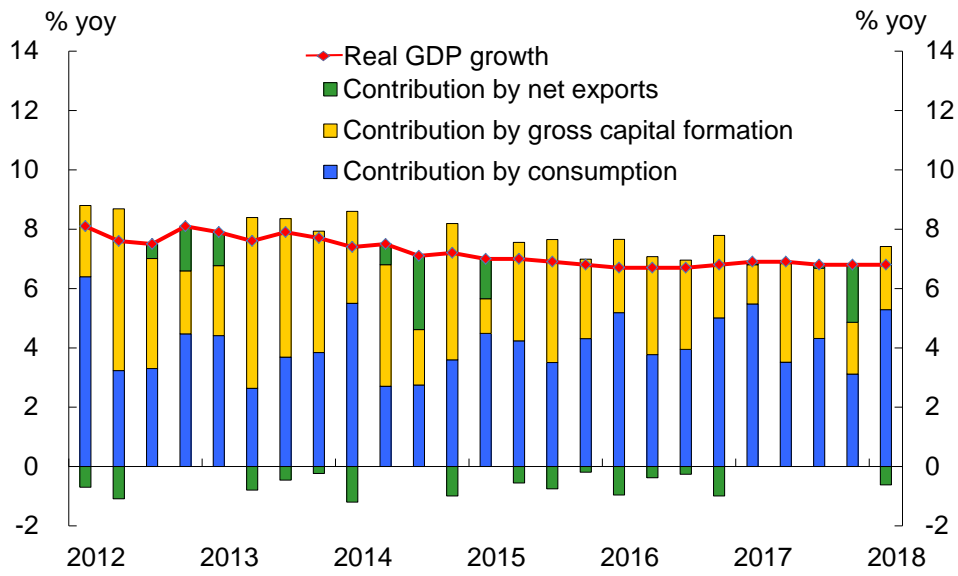
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



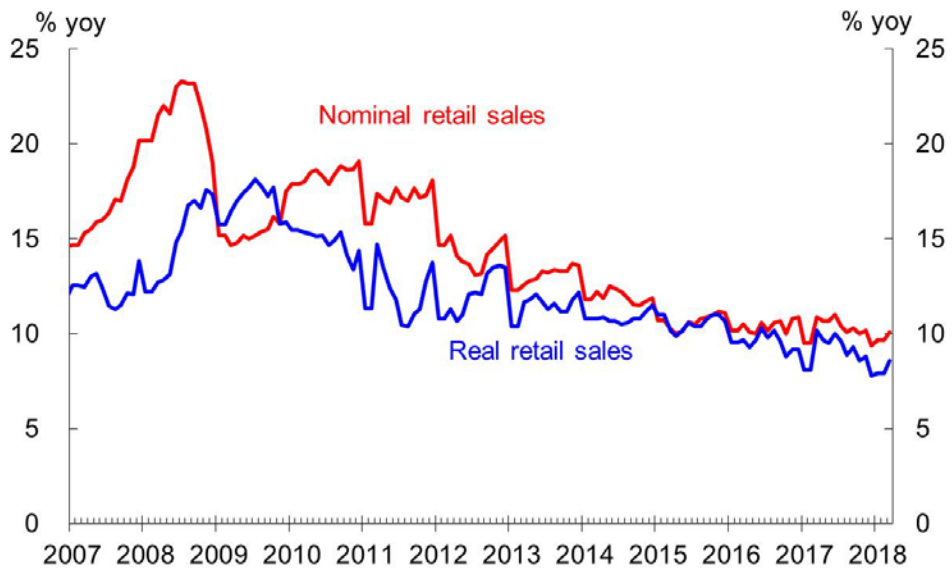
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



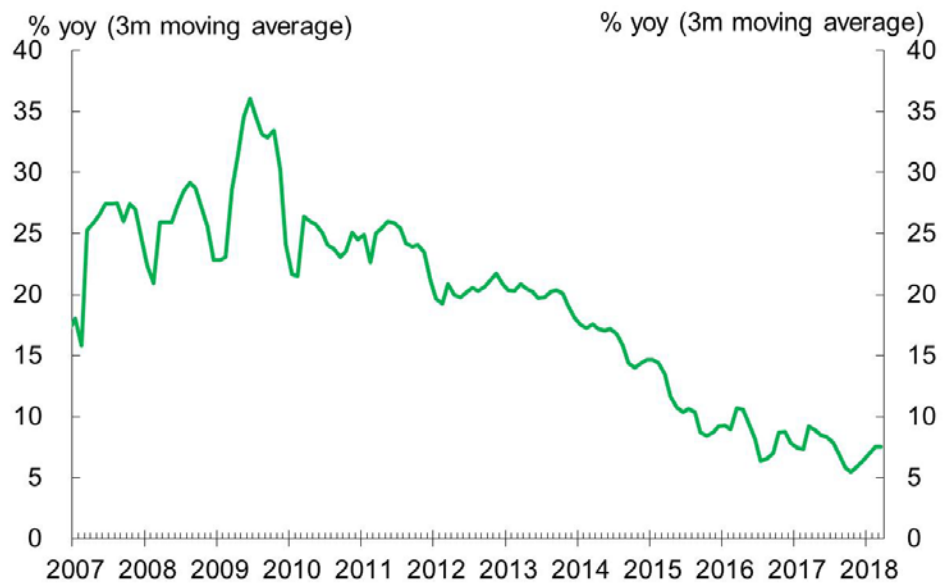
MAINLAND CHINA: RETAIL SALES



Note: January and February figures are the average annual growth rate for the first two months of the year
Sources: WIND and HKMA staff estimates



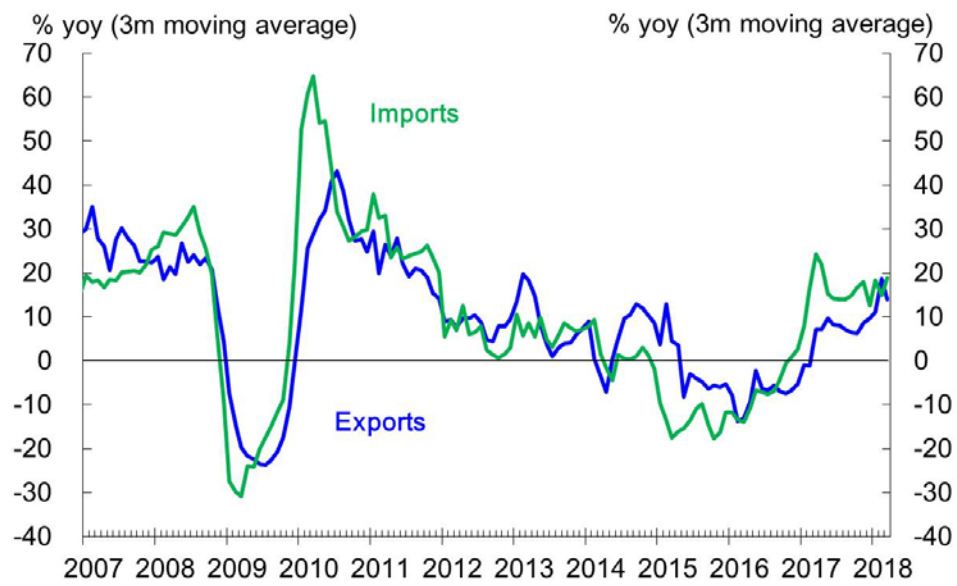
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



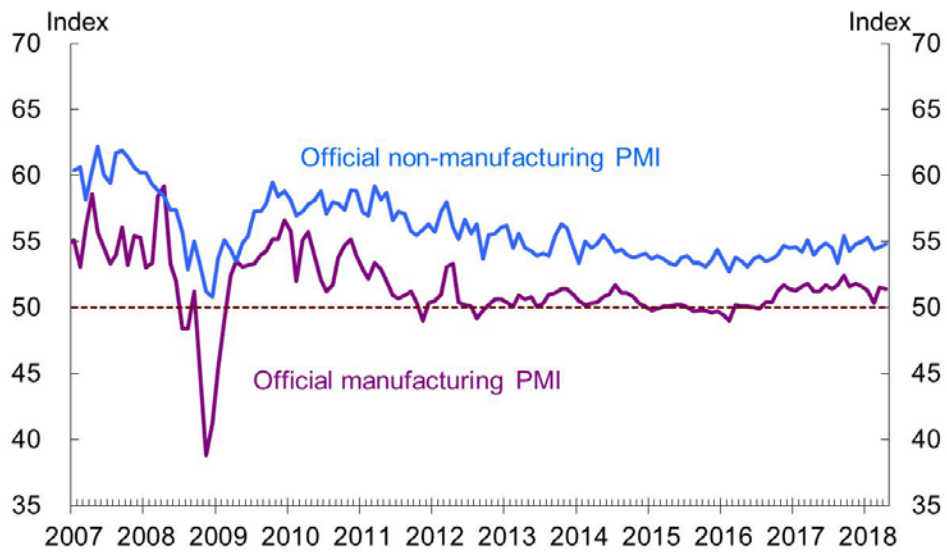
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



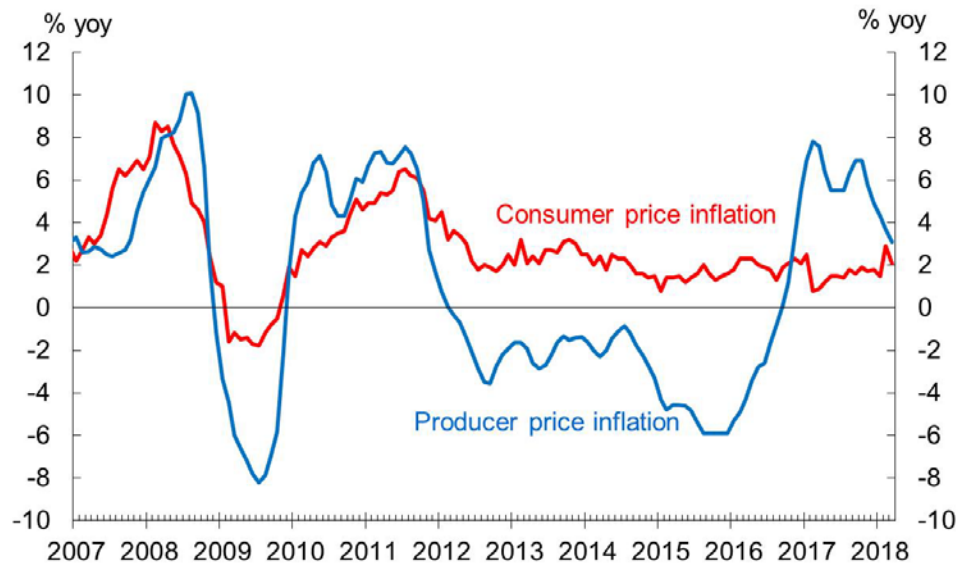
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



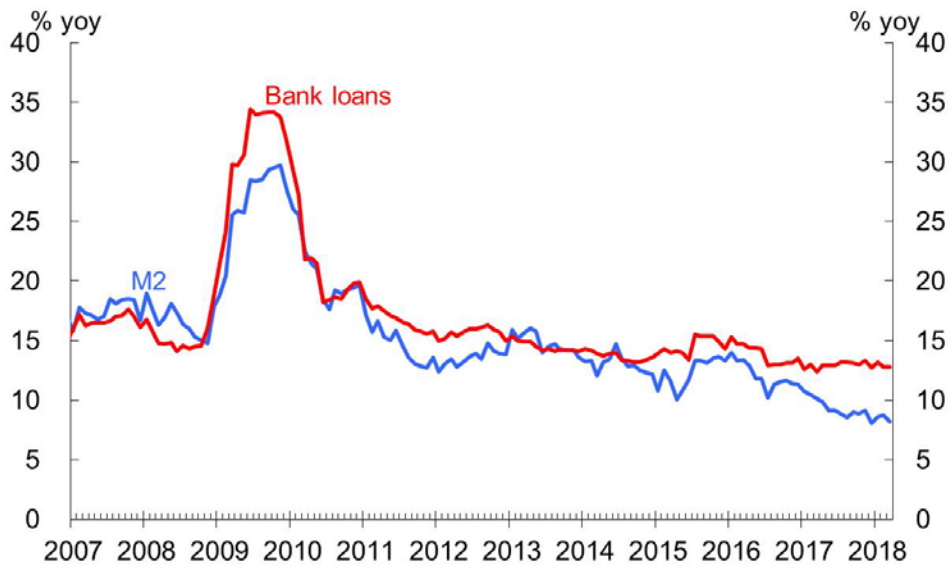
MAINLAND CHINA: INFLATION



Source: CEIC



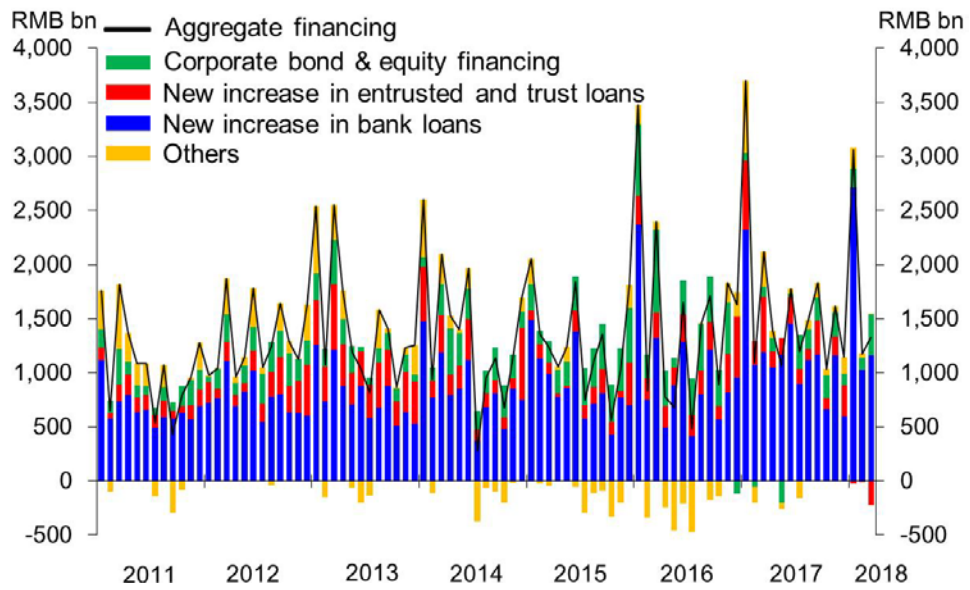
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



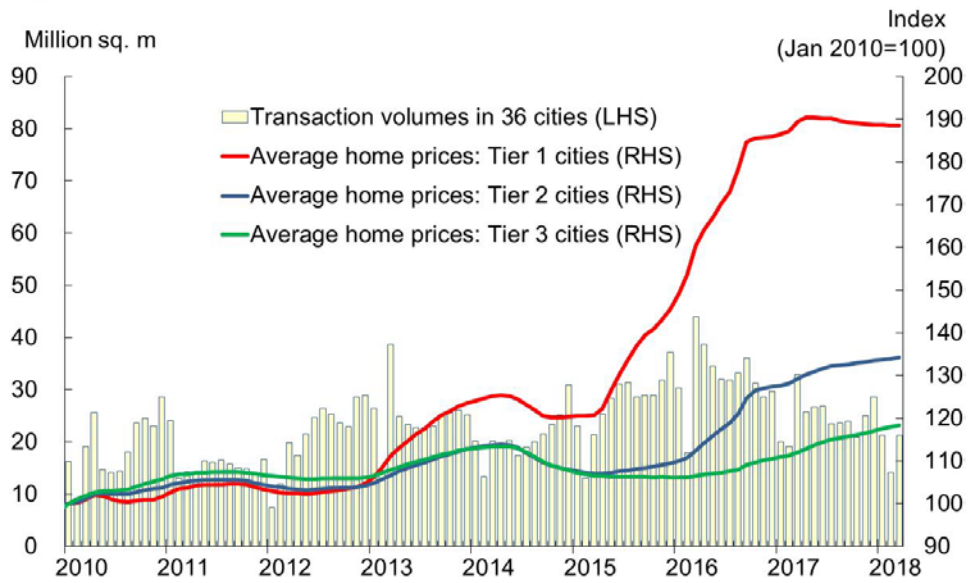
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



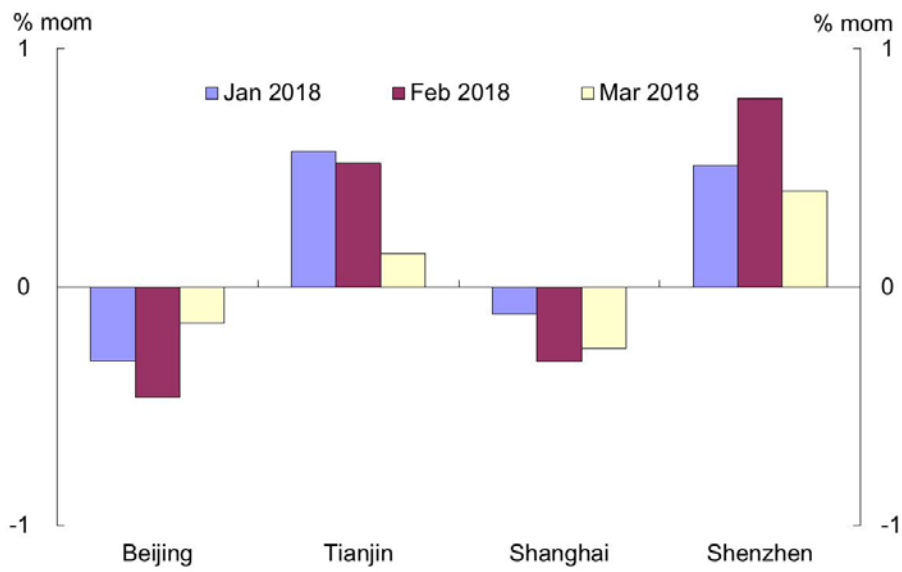
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



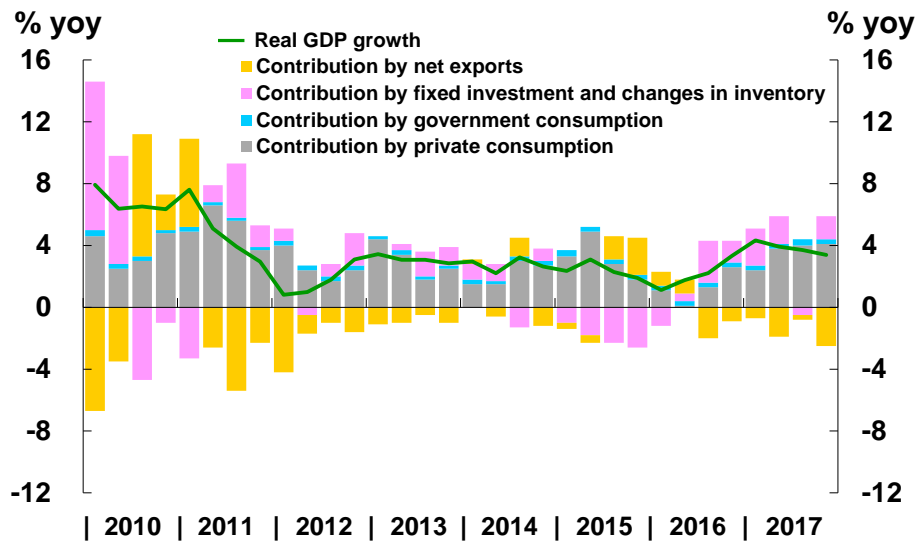
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



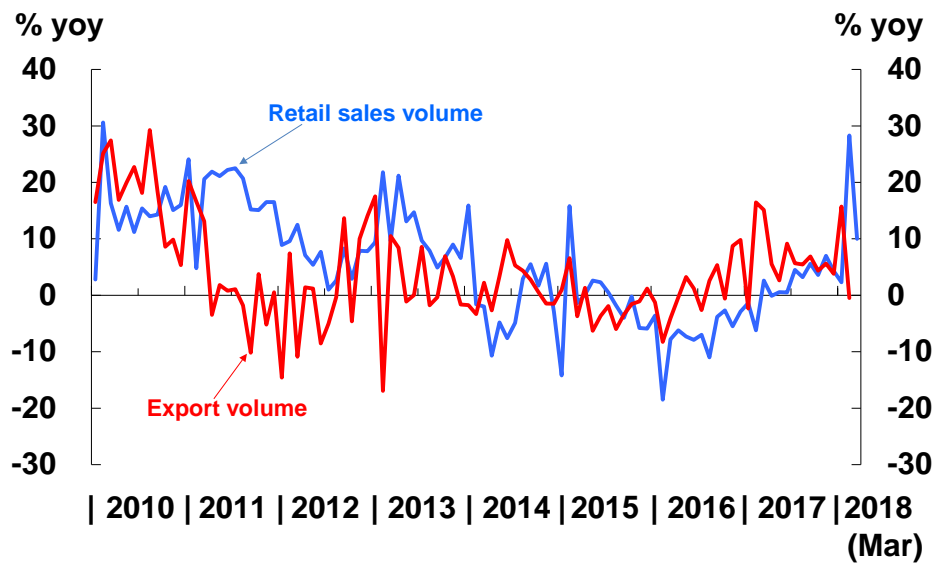
HONG KONG: REAL GDP GROWTH



Source: C&SD



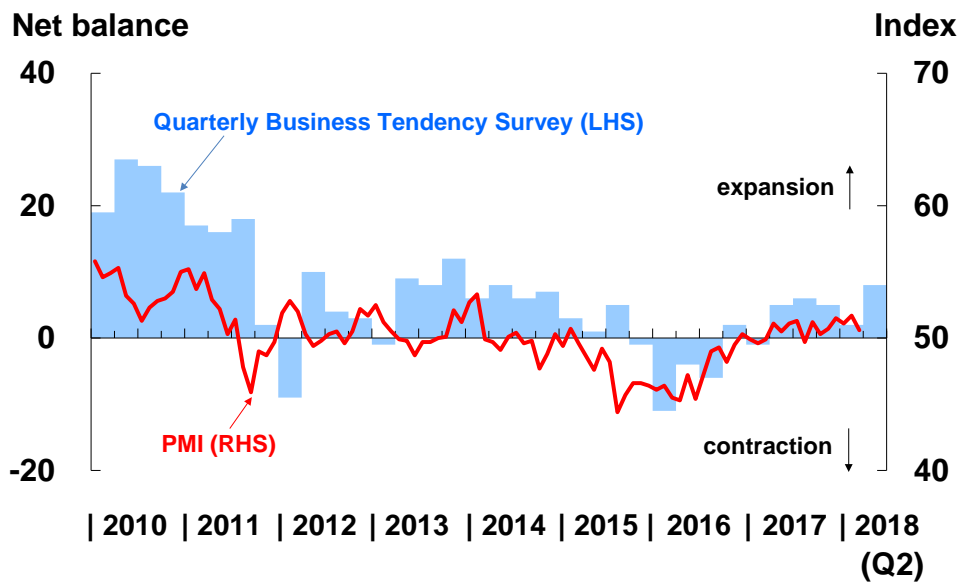
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



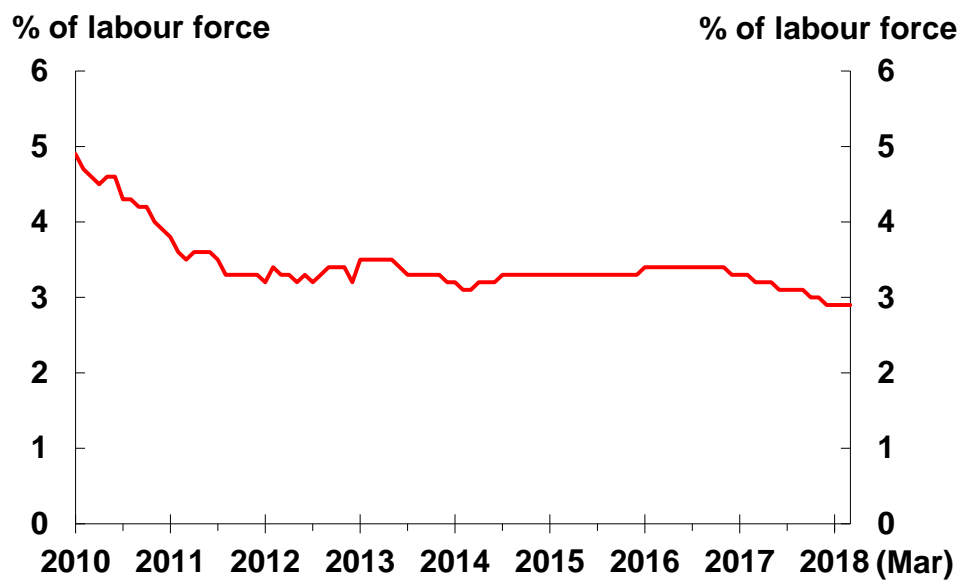
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



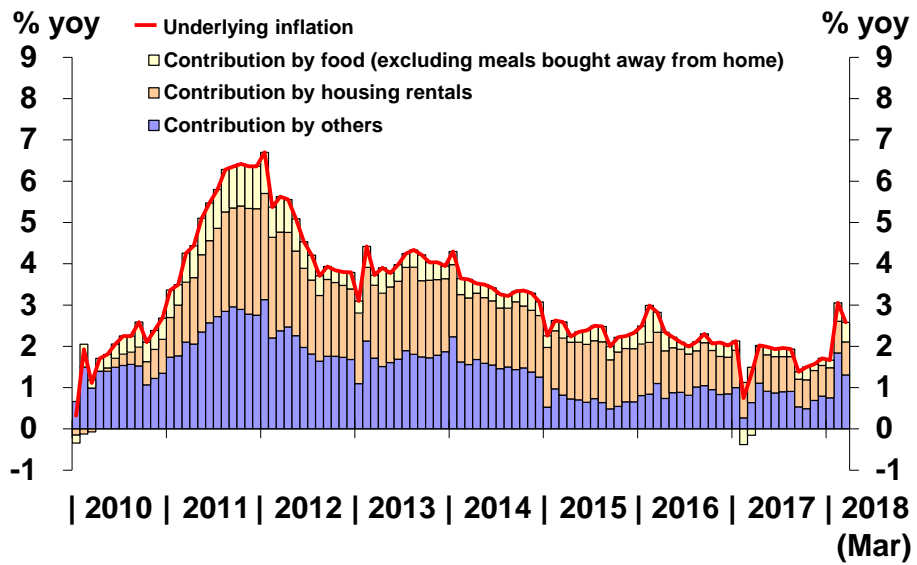
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



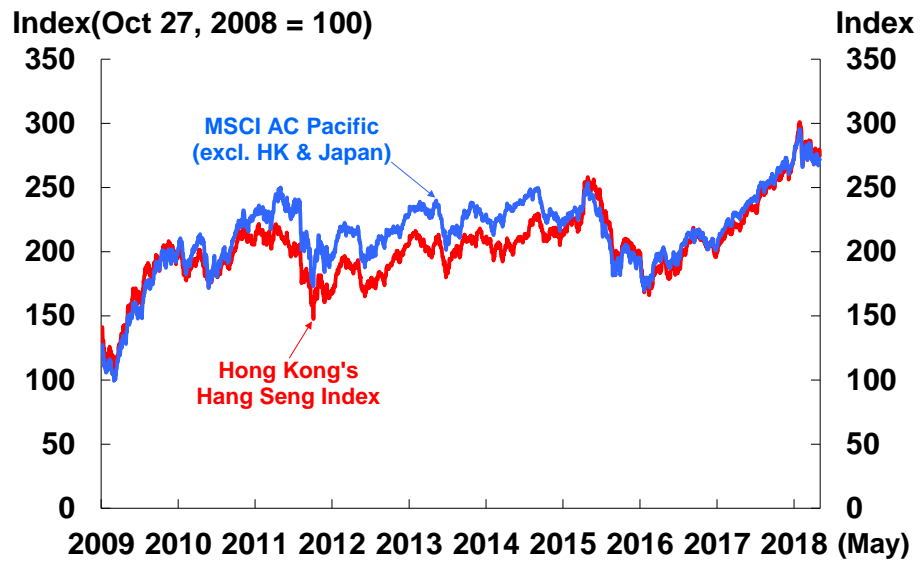
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



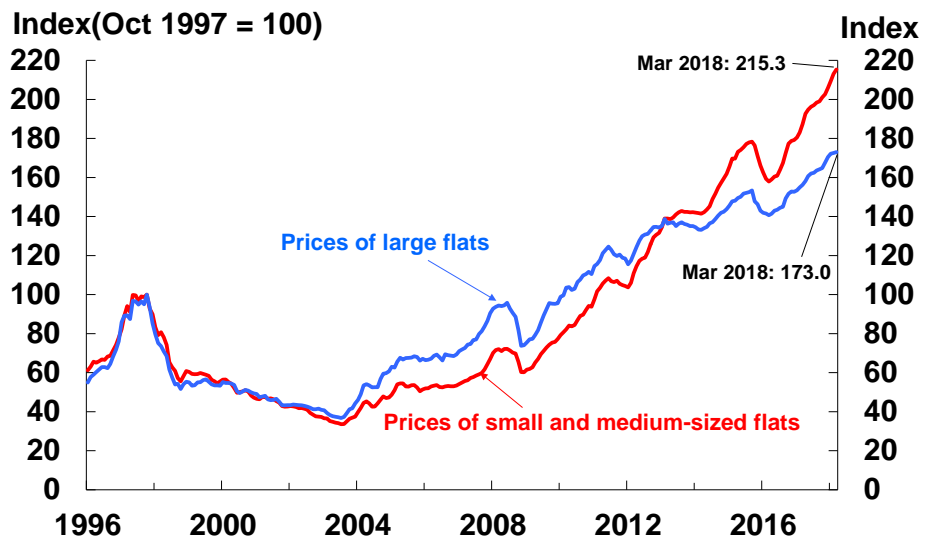
HONG KONG: EQUITY MARKET



Source: Bloomberg



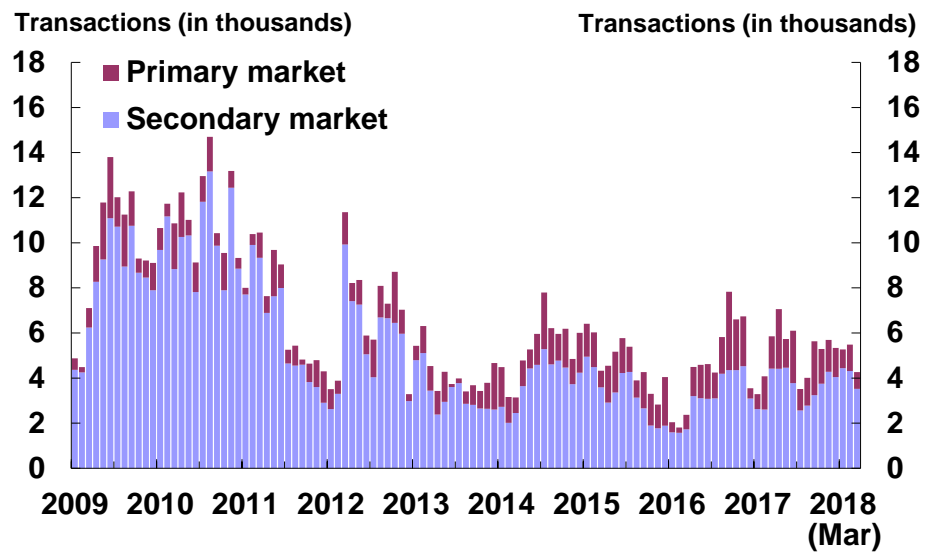
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



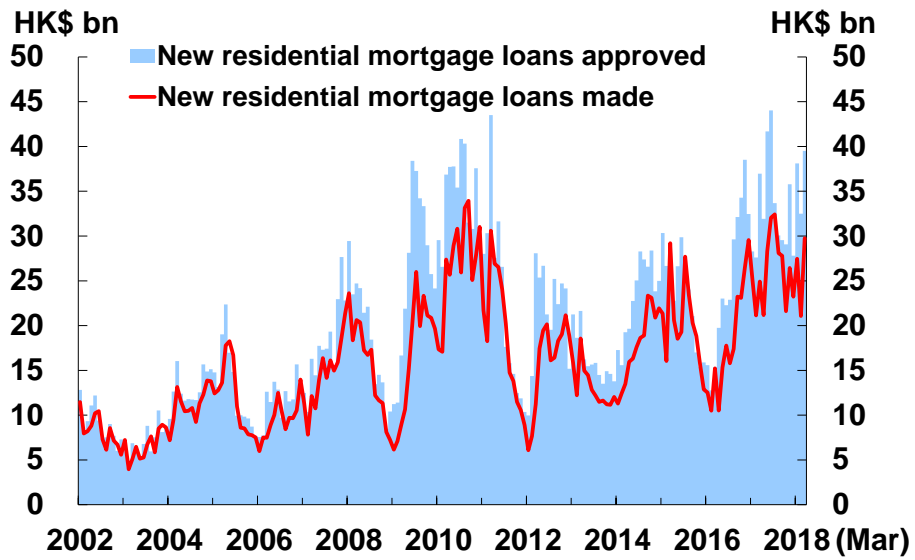
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

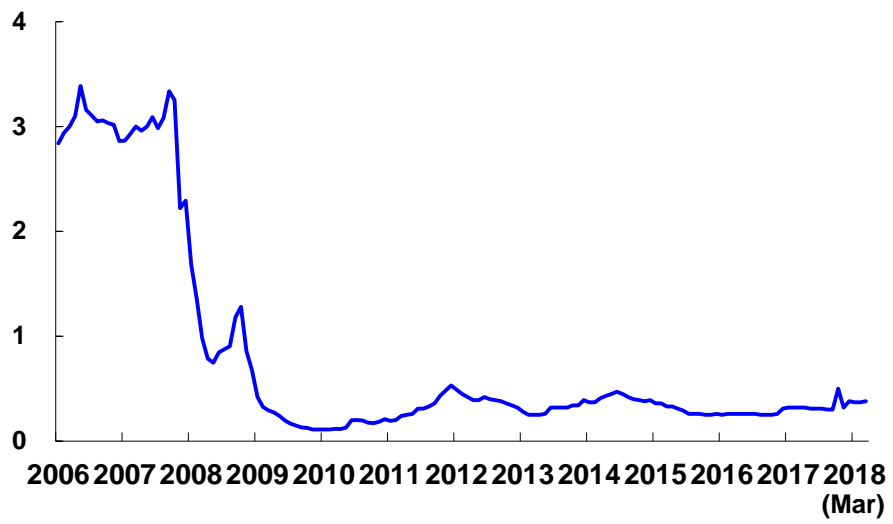


Source: HKMA



HONG KONG: COMPOSITE INTEREST RATE

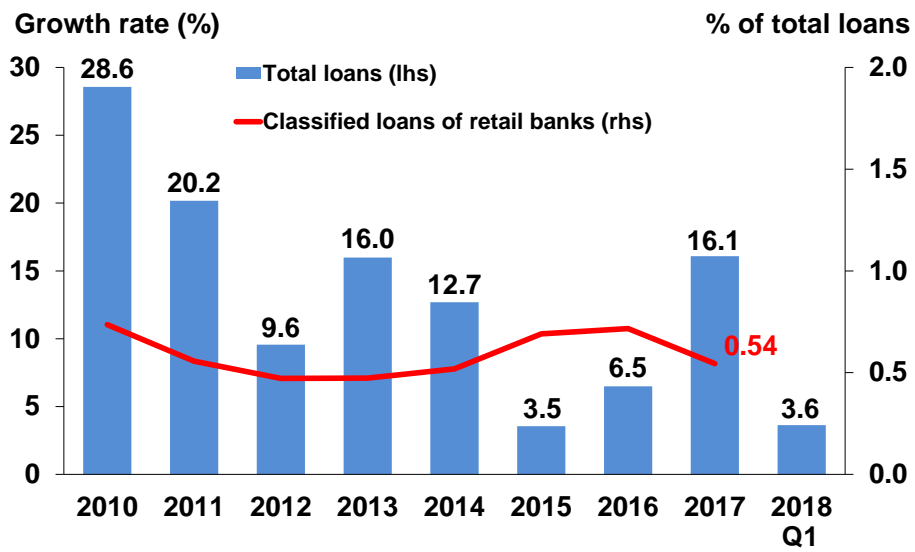
% p.a.



Source: HKMA



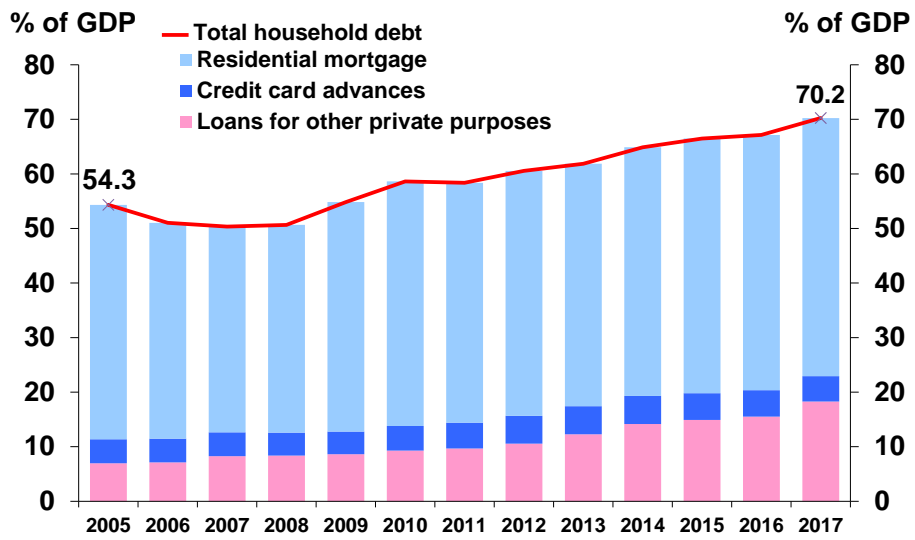
HONG KONG: LOAN GROWTH AND ASSET QUALITY



Source: HKMA



HONG KONG: HOUSEHOLD DEBT



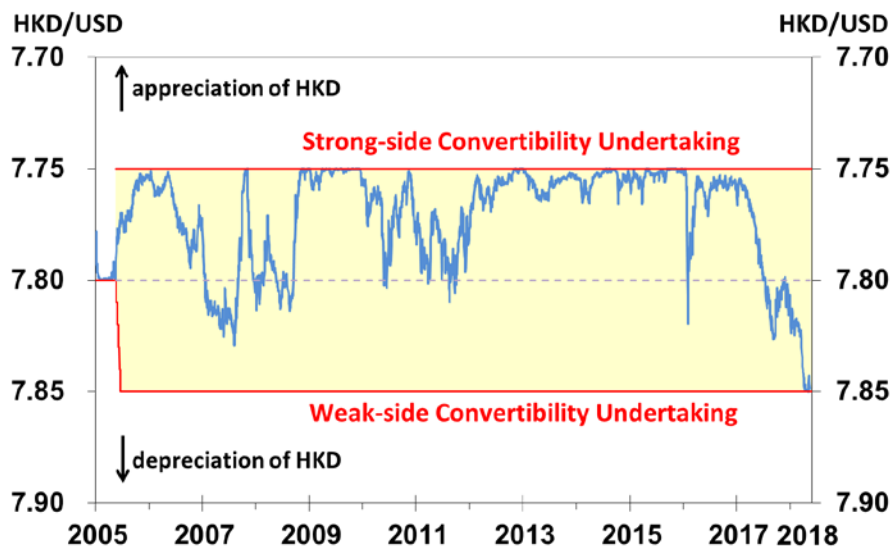
Source: HKMA



CURRENCY STABILITY

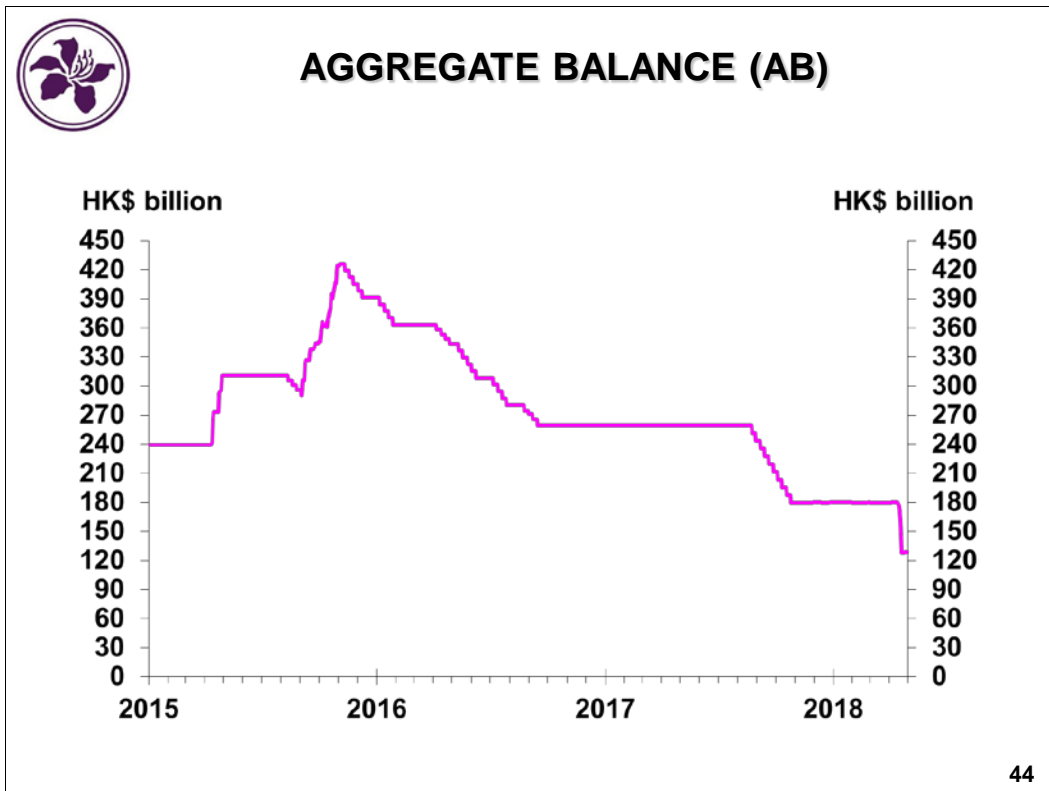


HONG KONG DOLLAR SPOT EXCHANGE RATE



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- In view of the widening interest rate differential between the HKD and USD, there have been carry trades involving buying USD and selling HKD. As such, the HKD exchange rate has moved gradually lower since the beginning of the year. Specifically, the HKD weakened from around HK\$7.81 to US\$1 in early-2018 to HK\$7.85 to US\$1 on 11 April.
- As part of the design of Hong Kong's Linked Exchange Rate System (LERS), the weak-side Convertibility Undertaking (CU) was first triggered during London trading hours on 12 April. The HKMA purchased Hong Kong dollars at the rate of HK\$7.85 to US\$1 to maintain the currency peg. The weak-side CU was triggered multiple times in subsequent days. As at 20 April 2018, the HKMA bought a total of HK\$51.3 billion upon request from banks. Although the 7.85 weak-side CU was triggered for the first time since it was set at this level in 2005, the CU transactions were conducted in an orderly manner and the market was functioning normally. There is no sign of large-scale short-selling of the HKD or attacks of any sort.
- Every time the weak-side CU is triggered and the HKMA buys HKD from the market, the Aggregate Balance will contract by the same amount. The HKD-USD interest rate spreads will gradually narrow, hence reducing the incentive and scale of funds flowing out of the HKD. The HKD exchange rate will stabilise as a result.
- Between 19 April and the end of April, the weak-side CU had not been triggered again. As at end-April, the HKD closed at 7.8488 against the USD.



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- Following the HKMA's purchases of the HK\$51.3 billion under the weak-side Convertibility Undertaking, the AB gradually shrank from around HK\$179.8 billion to HK\$128.5 billion (as at 20 April). The level of AB remained steady at around this level thereafter.
- It is worth noting that the AB – funds used by local banks to settle daily payments – is one of the Monetary Base (MB) components. It is only part of the HKD liquidity of the banking system in Hong Kong. The highly liquid Exchange Fund Bills and Notes (EFBNs) are also part of the MB in Hong Kong. Under the Discount Window arrangement, banks may use the EFBNs as collaterals to borrow overnight HKD funds at a pre-set discount rate from the HKMA to meet their settlement and payment obligations as needed. Currently, the outstanding value of EFBNs exceeds HK\$1 trillion, the majority of which were held by banks. When there are fund outflows, the EFBNs provide ample buffer that help reduce excessive volatility in local interest rates.



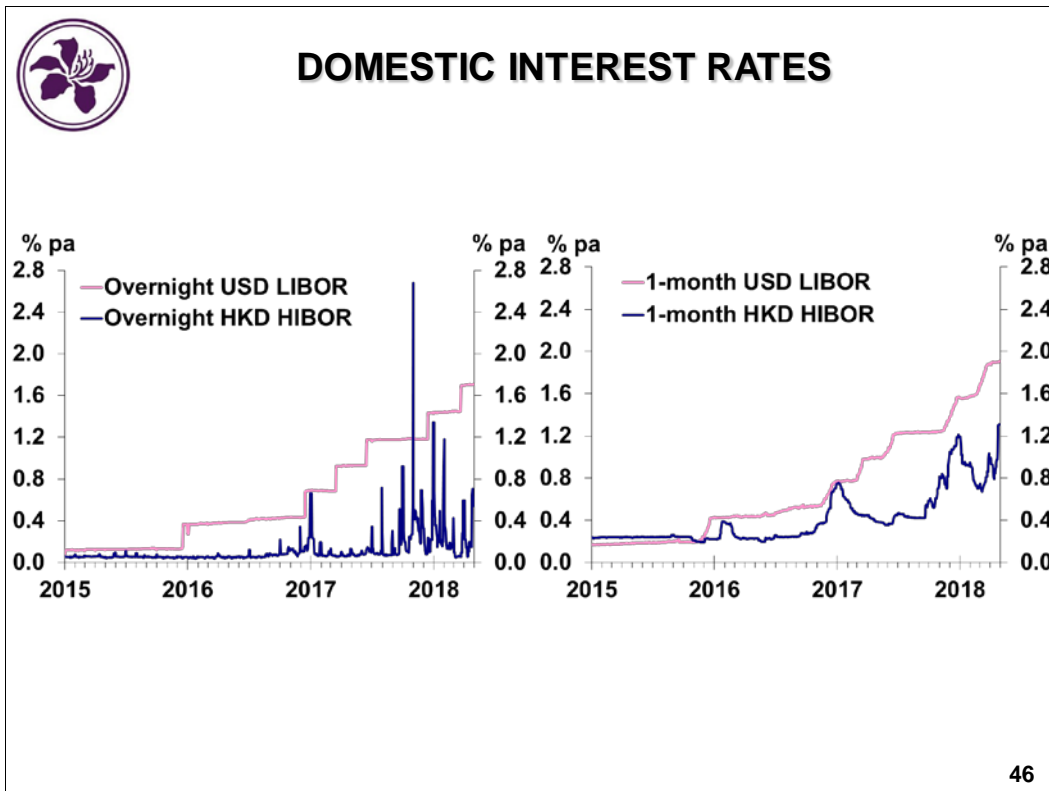
HONG KONG'S RESILIENCE SIGNIFICANTLY ENHANCED

Monetary statistics (HK\$ bn)	end-1998	As of 20 April 2018 (changes)
Aggregate Balance	2.5	128.5 (+50.4 times)
Exchange Fund Bills and Notes	97.5	1,049.1 (+9.8 times)
Monetary Base	192.5	1,661.0 (+7.6 times)
Foreign currency reserve assets (US\$ bn)	89.6	432.7 (+3.8 times) end-March
Hong Kong stock market capitalisation	2,661.7	34,387.2 (+11.9 times)

Banking statistics	end-1997	end-2017
Capital adequacy ratio	17.5%	19.1%
Loan-to-deposit ratio	152.1% (HKD: 112.3%)	73.0% (HKD: 82.7%)
Liquid assets held by banks (including Exchange Fund Bills and Notes)	~ HK\$600 bn	~ HK\$4,000 bn

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- Compared to 1997/98, Hong Kong's resilience to shocks has been enhanced significantly. For instance, the Aggregate Balance, the HKD Monetary Base, and the foreign currency assets of the Exchange Fund are now multiple times bigger than those 20 years ago. Besides, international financial reforms and more rigorous supervision have been put in place after the global financial crisis in 2008. Under Basel III and various regulations, speculators will find it much harder to borrow as much HKD liquidity as they did 20 years ago in a bid to short-sell the HKD. In addition, the Hong Kong stock market is now twelve times bigger than it was back then. To repeat their previous "double play" in the currency and stock markets, speculators will have to be armed with hundreds of billions of Hong Kong dollars.
- While our resilience to shocks has been enhanced significantly, the HKMA will stay vigilant as always to ensure Hong Kong's monetary and financial stability.



- The reduction in HKD supply, as a result of the multiple triggerings of the weak-side Convertibility Undertaking (CU), has pushed up local interbank interest rates, i.e. the Hong Kong Interbank Offered Rates (HIBORs). As of 30 April, the overnight and 1-month HIBOR fixings rose to 0.62% and 1.31%, up by 56 and 52 basis points respectively from 12 April. The triggering of the weak-side CU and capital outflows are the necessary process in the normalisation of local interest rates. This is exactly how the Linked Exchange Rate System (LERS) is designed to operate.
- In line with the US Federal Reserve's indication that it will lift interest rates gradually, the market generally expects a continued pick-up in US interest rates. Under the mechanism of the LERS, local interest rates should follow their US counterparts to rise gradually. However, local interest rates could experience short-term surge as a result of sharp increases in demand for the HKD owing to month-end or quarter-end effects, or large-scale initial public offerings.



- Movements in the Hong Kong dollar forwards were broadly similar to those of the HKD-USD interest rate spreads. Subsequent to the triggering of the weak-side Convertibility Undertaking (CU), the HKD-USD interest rate spreads narrowed. The discount of 12-month forward points also narrowed from about 600 pips to around 400 pips after the repeated triggerings of the weak-side CU.

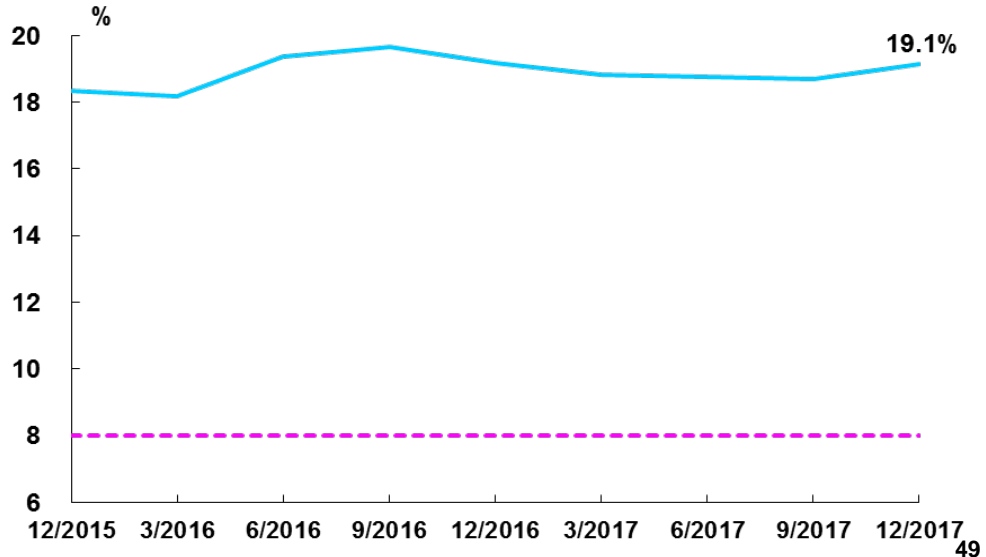


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Capital position of locally incorporated authorized institutions (AIs) continued to be strong

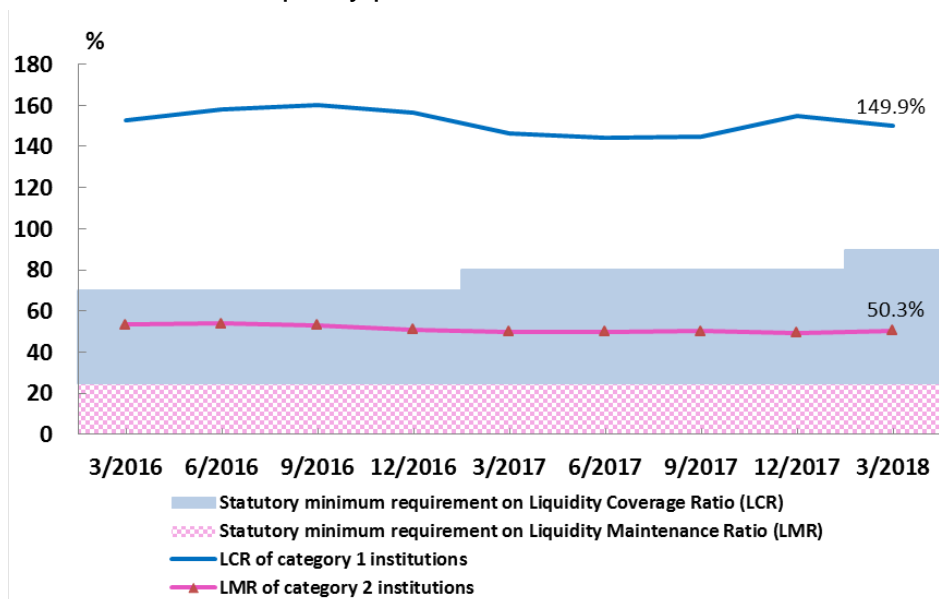


- The banking sector continued to be well capitalised. The consolidated capital adequacy ratio of locally incorporated AIs remained strong at 19.1% at end-December 2017, well above the international minimum requirement of 8%.



BANKING SECTOR PERFORMANCE

Liquidity position remained sound



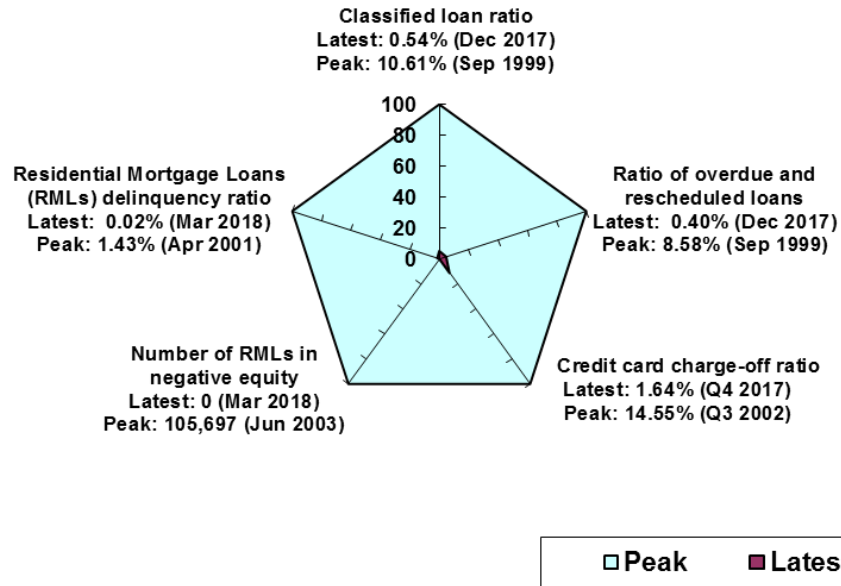
50

- In the first quarter of 2018, the quarterly average Liquidity Coverage Ratio of category 1 institutions was 149.9%, well above the 90% statutory minimum requirement applicable for 2018. For category 2 institutions, their quarterly average Liquidity Maintenance Ratio was 50.3%, also well above the 25% statutory minimum requirement.



BANKING SECTOR PERFORMANCE

Asset quality stayed healthy



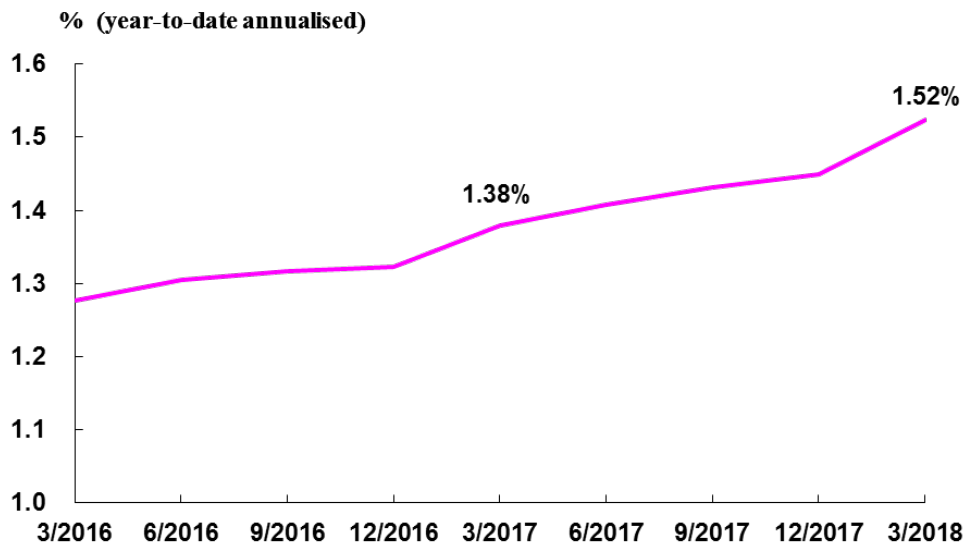
51

- The asset quality of retail banks continued to improve. Their classified loan ratio declined to 0.54% at end-December 2017 from 0.62% a quarter earlier, well below the long-run historical average of 2.2% since 2000. Similarly, the classified loan ratio of the whole banking sector fell to 0.67% from 0.79% during the same period.



BANKING SECTOR PERFORMANCE

Net interest margin continued to widen



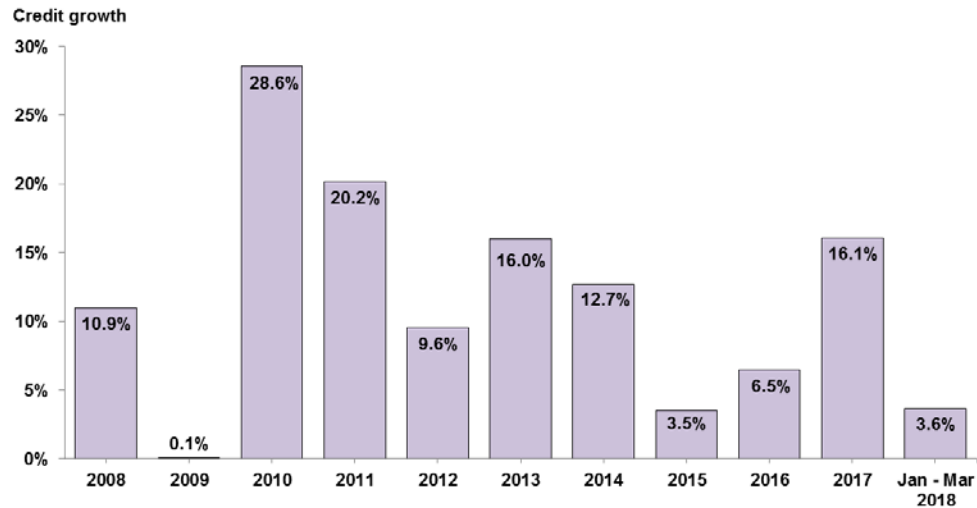
52

- The net interest margin of retail banks' Hong Kong offices widened to 1.52% in the first quarter of 2018 from 1.38% in the same period last year.



BANKING SECTOR PERFORMANCE

Credit growth momentum continued



Source: HKMA

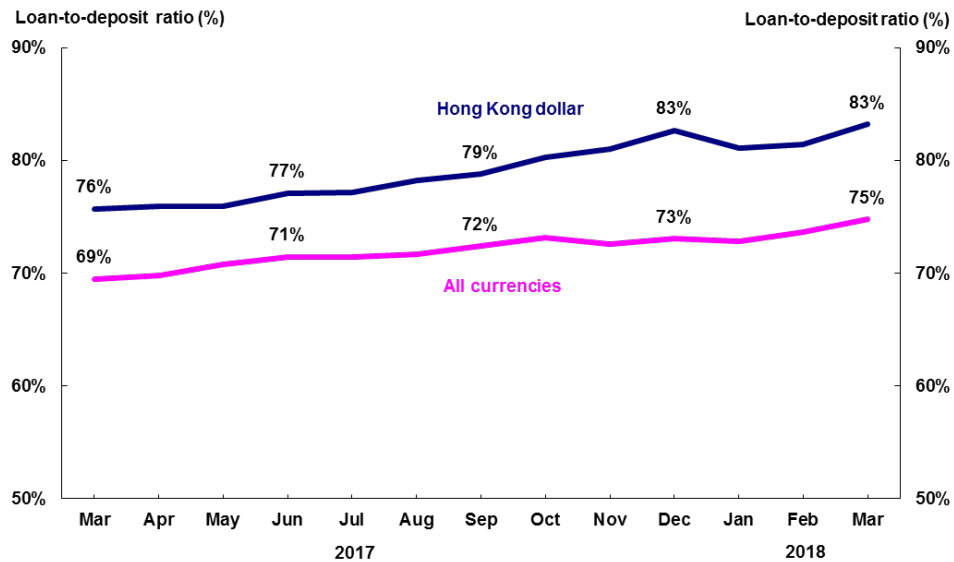
53

- Credit growth momentum continued. Total loans grew by 3.6% in the first quarter of 2018 (or +14.5% on an annualised basis), as compared to the 16.1% growth in 2017.
- In the first quarter of 2018, loans for use outside Hong Kong (+3.7% on quarter-on-quarter basis), loans for use in Hong Kong (+3.4% on quarter-on-quarter basis) and trade finance (+5.7% on quarter-on-quarter basis) all recorded a significant growth.



BANKING SECTOR PERFORMANCE

All currencies loan-to-deposit ratio trended up



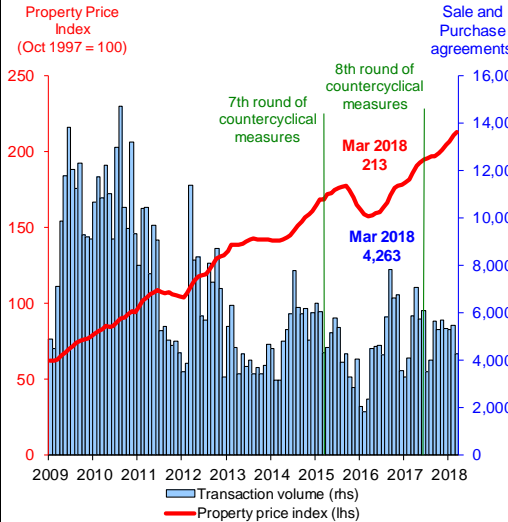
54

- All currencies loan-to-deposit ratio increased to 75% at end-March 2018 from 73% at end-December 2017.
- Hong Kong-dollar loan-to-deposit ratio stood at 83% at end-March 2018, the same level as that at end-December 2017.



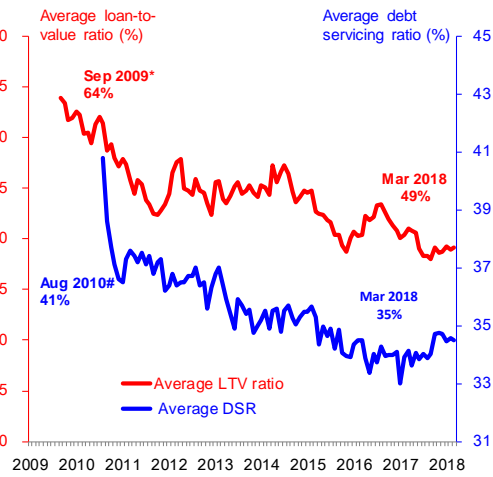
RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

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 countercyclical measures was introduced

When the tighter requirement on debt servicing ratio was introduced by the HKMA

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Latest statistics on residential mortgage loans (RMLs)

	Monthly average in 2016	Monthly average in 2017	Oct 2017	Nov 2017	Dec 2017	Jan 2018	Feb 2018	Mar 2018
Number of sale and purchase agreements	4,558	5,133	5,289	5,694	5,337	5,270	5,482	4,263
Number of new RML applications	10,294	11,947	11,280	12,265	10,520	14,179	11,166	13,716
Number of new RMLs approved	7,290	8,699	7,841	9,323	7,135	9,680	8,250	9,734

Latest statistics on residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	3/2018	213.1
	Recent peak	3/2018	213.1
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	22/4/2018	180.0
	Recent peak	22/4/2018	180.0
	Peak in 1997	19/10/1997	102.9



INTERNATIONAL STANDARDS IMPLEMENTATION

- Banking (Exposure Limit) Rules 2018
- Banking (Disclosure) (Amendment) Rules 2018
- Banking (Capital) (Amendment) Rules 2018
- Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018

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The HKMA is proceeding with the legislative amendments to give effect to several international regulatory standards within this year or from the start of next year. These include:

- Banking (Exposure Limit) Rules 2018 (provisional title) - the first batch of the rules will replace the outdated equity exposure provision (section 87). We aim to submit these rules to the Legislative Council (LegCo) before its summer recess. Other new rules to implement the new Basel Committee on Banking Supervision (BCBS) large exposures framework will be submitted later in the year.
- Banking (Disclosure) (Amendment) Rules (BDAR) 2018 – the rules were tabled at LegCo on 9 May for negative vetting with a view to bringing them into effect from 30 June. The main purpose of the proposed amendments is to implement the BCBS's second phase of revised disclosure requirements (further to the implementation of the first phase last year) covering those associated with the Basel III framework that have already been in force.
- Banking (Capital) (Amendment) Rules 2018 – the rules were currently being prepared to reflect, inter alia,
 - the BCBS standard on capital treatment of banks' holdings of instruments issued by other banks to meet the total loss-absorbing capacity requirements for resolution purposes;
 - certain enhancements to the existing securitisation framework (i.e. to incorporate the “Internal Assessment Approach”); and

- capital treatment to address concentration risk in sovereign exposures, etc.

The HKMA intends to submit the proposed amendments to LegCo in the early part of the fourth quarter, with a view to bringing them into effect from 1 January 2019.

- Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018 – it was tabled at LegCo on 9 May (i.e. together with the BDAR 2018). The amendment notice proposes to add the Asian Infrastructure Investment Bank to the current list of "Multilateral Development Banks" within the meaning of the Banking Ordinance to align with the BCBS list as updated from October 2017.



HONG KONG RESOLUTION REGIME

- Financial Stability Board confirmed that with the coming into force of the Financial Institutions (Resolution) Ordinance (FIRO) last year, Hong Kong has a fully cross-sectoral resolution regime
- Rules will be developed pursuant to the FIRO to prescribe loss-absorbing capacity (LAC) requirements for authorized institutions (AIs). Public consultation was closed in March 2018. It is expected that the LAC rules and consequential Inland Revenue Ordinance amendment bill will be introduced into LegCo in the second half of 2018

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- The main provisions of the FIRO came into force on 7 July 2017. The FSB has recently conducted a peer review of Hong Kong's resolution regime, publishing its report on 28 February 2018. The report found that Hong Kong has legal powers and safeguards related to resolution that are consistent with those required under the FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions*. The resolution regime applies to a wide range of financial institutions, making Hong Kong one of the few FSB jurisdictions with a fully cross-sectoral resolution regime.
- The current legislative priority on resolution is the development of rules to be made by the Monetary Authority as a resolution authority under the FIRO to set LAC requirements for AIs (including implementing the Financial Stability Board standard on total loss-absorbing capacity).
- To clarify the uncertainties of tax treatment of LAC instruments arising from their loss-absorbing characteristics, the IRO is proposed to be amended to afford debt-like profits tax treatment for the instruments, and exempt transfers of the instruments from stamp duty.
- A public consultation covering both legislative proposals was closed in March 2018.



SMART BANKING

Fintech Supervisory Sandbox 2.0

- Launched in November 2017 and operating smoothly

Introduction of Virtual Banking

- Public consultation was completed on 15 March
- Comments received from the consultation are being studied
- A number of local and overseas firms expressed interest to submit application

Banking Made Easy

- Engaging the banking industry and tech sector



FINANCIAL INCLUSION

Banking services delivery channels

- More physical branches for underserved areas
- Cash withdrawal service by the elderly without the need to make purchase
- The banking industry issued the Practical Guideline on Barrier-free Banking Services

Bank account opening and maintenance

- Conducting mystery shopping programme and thematic reviews
- Exploring the use of new technology to enhance efficiency of customer due diligence process
- On-going communication with the industry, business community and relevant stakeholders

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- Banks have actively responded to the HKMA's call for more physical branches for underserved areas. As of the end of March, seven branches already started operations in Tin Shui Wai North, Sha Tin and Kwai Chung respectively, and three additional mobile branches have also been put into service for 15 public housing estates.
- Encouraged by the HKMA, the Hong Kong Association of Banks (HKAB) introduced a pilot scheme in March for the elderly to withdraw cash at convenience stores without the need to make purchases. Hongkong Post has also launched a new service in April to allow cash withdrawal by the elderly at seven Post Offices mainly on outlying islands and in the New Territories via EPS service without the need to make purchases to enhance the accessibility of cash withdrawal service to the elderly in remote areas.
- The HKAB issued in March the Practical Guideline on Barrier-free Banking Services which includes a total of 19 barrier-free measures for bank branches, ATMs, on-line banking, telephone banking, etc. to enhance accessibility of banking services by customers with physical disabilities, visual impairment or hearing impairment. At the same time, the HKMA issued a circular to require banks to implement the measures as set out in the Practical Guideline, and to provide proper training and guidance to frontline staff to ensure the needs of customers with disabilities are addressed and to promote effective communication with the customers.
- Through legislative amendments (effective from 1 March), the HKMA allows greater flexibility for banks to remotely process accounts opening and update customers' information. Meanwhile, we are working with HKAB to explore how a know-your-customer utility can potentially be used to introduce greater efficiencies to customer due diligence processes and as a result improve customer experience. HKAB has gathered market interests and ideas on potential solutions available and the review is in progress.



BANKING CONSUMER AND INVESTOR PROTECTION

- Shared with the banking industry observations and good practices on distribution of fixed income and structured products
- Continued to conduct joint thematic reviews with Securities and Futures Commission (SFC) on managing conflicts of interest in financial groups
- Working with Insurance Authority (IA) to implement the new statutory regime for regulating insurance intermediaries

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- In February 2018, the HKMA shared with the banking industry some observations and good practices it noted from the on-going supervision of authorized institutions' (AIs) distribution of fixed income and structured products, including bonds listed under Chapter 37 of the Main Board Listing Rules, loss-absorbing debt instruments and accumulators.
- Conflicts of interest are one of the major regulatory focuses for both the HKMA and the SFC. The HKMA and the SFC continued to conduct joint thematic review on the sale of in-house products by intermediaries within the same financial group to assess the effectiveness of the group's management of conflicts of interest.
- The HKMA is working with the newly established IA to prepare for the implementation of the statutory regime under the new Insurance Ordinance for regulating insurance intermediaries, including a collaboration framework for inspection and investigation of insurance intermediary activities of AIs.



ENHANCED COMPETENCY FRAMEWORK (ECF) FOR BANKING PRACTITIONERS

- Launched the ECF professional level module on anti-money laundering and counter-financing of terrorism in the first quarter of 2018
- To develop the ECF module on credit risk management and consult the industry

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- With the support from the banking industry and relevant professional bodies, the HKMA launched the professional level module of ECF on anti-money laundering/counter-financing of terrorism for more experienced practitioners in the first quarter of 2018. The module helps enhance capacity building and talent development in this professional area.
- In 2018, the HKMA will continue to collaborate with the relevant parties to develop the ECF on credit risk management. The HKMA will consult the industry before roll-out.



CONSUMER EDUCATION PROGRAMME

- Launched digital promotion on smart use of credit cards and ATM cards around Chinese New Year
- Arranged a new series of publicity for the campaigns on digital financial services and credit card chargeback protection
- Co-organised the “Hong Kong Liberal Studies Financial Literacy Championship 2018” to enhance secondary school students’ financial knowledge



Poster of the Championship

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- The HKMA launched digital promotion on smart use of credit cards and ATM cards via popular websites and smartphone apps around Chinese New Year.
- The HKMA also arranged a new series of publicity for the campaigns on digital financial services and credit card chargeback protection. The former campaign conveyed usage tips on using online and mobile payment, as well as P2P funds transfer via smartphones. The latter aimed at enhancing the public awareness and understanding of the credit card chargeback protection.
- The HKMA co-organised the “Hong Kong Liberal Studies Financial Literacy Championship 2018” with various stakeholders to enhance secondary school students’ financial and wealth management knowledge. The first phase in the form of an online quiz was completed, and the grand final would be held as a live competition.



DEPOSIT PROTECTION SCHEME (DPS)

- Completed installation of new payout system hardware that saved 30% of system processing time to enhance payout efficiency
- Disseminated multi-language information leaflets and conducted community education activities targeting non-Chinese speaking ethnic communities to inculcate the knowledge of the DPS

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- The payout system modernisation project of the Hong Kong Deposit Protection Board is making satisfactory progress. Following installation of the new hardware, the development of system application will be completed by the end of 2018.
- To inculcate the knowledge of the DPS into the non-Chinese speaking ethnic communities, a multi-language DPS information leaflet was distributed via extensive network of Social Welfare Department's integrated family service centres, respective Consulates and the non-governmental organisations serving non-Chinese speaking ethnic communities. Community education activities including bun-making classes and board games were also conducted.



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Maintain the safety and efficiency of financial infrastructure
- Ensure smooth operation of Bond Connect and promote Bond Connect to overseas investors
- Further refine the over-the-counter derivatives trade repository (TR) according to the relevant local and international standards

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Bond Connect

- Since the launch of Bond Connect on 3 July 2017, related settlement operations performed by the Central Moneymarkets Unit has been smooth.
- The HKMA has participated in roadshows in major financial centres including Asia, Europe and North America to actively promote Bond Connect to overseas investors.

Over-the-counter derivatives trade repository

- Since the reporting function of the TR was launched in July 2013, reporting by banks to the TR has been smooth.



FASTER PAYMENT SYSTEM

To be launched in September 2018

- Full connectivity among banks and Stored Value Facilities (SVFs)
- Payment and settlement on a real-time basis
- 24x7 operation
- Multi-currency: Covering Hong Kong dollar and renminbi
- Support mobile numbers or email addresses for receiving payments
- Covering both individuals and merchants
- System development work completed and system testing underway
- A single common QR code standard to be implemented for accepting different payment schemes

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Faster Payment System

- Upon its commencement of service in September 2018, the system will cover real-time credit transfer, real-time direct debit, addressing service (which allows a payer to use the payee's bank account proxy, including mobile number and email address, to make a payment) and electronic direct debit authorisation (which enables users of SVF to link their bank accounts with the SVF accounts for conducting e-commerce transactions or SVF account top-up).
- Around 20 banks and eight SVF operators have indicated interest to participate in providing real-time payment services at the initial launch.

QR Code Standard

- A working group on common QR code standard, which comprises major credit card scheme operators, banks, SVF licensees and merchant acquirers, has been established.
- A common QR code standard enables a merchant to use a single QR code to accept QR code payment solutions from multiple payment service providers. Consumers would find it more convenient in making QR code payments.
- The working group has finalised the technical specification for common QR code standard at the end of December 2017 and is now working out the implementation arrangements.



LATEST FINTECH INITIATIVES

Open Application Programming Interface (Open API)

- Industry consultation completed, and feedback being reviewed with an aim to finalising the framework by mid-2018

Distributed Ledger Technology (DLT)-based Trade Finance Platform

- Development of Hong Kong Trade Finance Platform in progress
- Tendering of Global Trade Connectivity Network between Hong Kong and Singapore underway

Cross-border collaboration

- Fintech co-operation agreements signed with 6 financial supervisory authorities

Upgraded version of Fintech Career Accelerator Scheme (FCAS 2.0)

- To provide various training opportunities for 250 students 67

Open API

- Open API allows banks' internal data and system to be accessed by third-parties so that product comparison and consolidated information of accounts kept in several banks may be available through third-party apps or websites to customers.
- The HKMA started an industry consultation on the proposed Open API framework on 11 January 2018, with a view to implementing Open API in the banking industry by the end of 2018. The consultation ended on 15 March 2018. The HKMA is studying the responses and aims to finalise the framework by mid-2018.

Implementation of DLT-based Trade Finance Platform

- The development of the Hong Kong Trade Finance Platform is now in progress. It is expected to commence service in the third quarter of 2018.
- The tendering of the Global Trade Connectivity Network is now underway. It is expected to commence service in the first quarter of 2019.

Cross-border collaboration

- The HKMA signed cooperation agreements with six financial supervisory authorities to enhance fintech collaboration, the latest of which was the signing of a Memorandum of Understanding with the Polish Financial Supervision Authority in March 2018.

FCAS 2.0

- In January 2018, the HKMA announced the launch of FCAS 2.0, with a view to enlarging the fintech talent pool in Hong Kong to meet the growing demands from the industry. To cater for the different needs of young talents who are at various stages of career development, the HKMA will collaborate with its strategic partners in offering four fintech talent building programmes:
 1. entrepreneurship summer boot camp (applications now open with 60 places available)
 2. Shenzhen summer internship programme (50 interns selected from more than 200 applicants)
 3. gap year full-time placement programme (Around 120 six-month/one-year full-time positions offered by 20 banks and the HKMA. The interview and selection processes are underway)
 4. full-time graduate programme (Cyberport and Hong Kong Science and Technology Parks will encourage their tenants with fintech-related businesses to employ fresh or recent graduates full-time. The quota for the scheme is around 20).



REGULATORY REGIME FOR STORED VALUE FACILITIES (SVFs) AND RETAIL PAYMENT SYSTEMS (RPSs)

- SVF licensees are actively expanding service and customer reach. In the fourth quarter of 2017, the total number of SVF accounts in use was 46.73 million, representing a 4.2% increase from the previous quarter. The total number of SVF transactions in the quarter was around 1.5 billion and the total transaction value was HK\$38.7 billion, representing an increase of 5% and 12% respectively from the previous quarter
- The HKMA continued to oversee the four designated RPSs in accordance with the Payment Systems and Stored Value Facilities Ordinance



REGULATORY DEVELOPMENT OF THE OVER-THE-COUNTER (OTC) DERIVATIVES MARKET

- Following the enactment of the Securities and Futures Ordinance 2014 which provides for the regulatory regime for the OTC derivatives market, we continue to develop specific regulatory requirements covering different aspects
- The second phase rules for the reporting and related record keeping obligations came into effect on 1 July 2017
- As of end-March 2018, the Hong Kong Trade Repository contained 1.18 million outstanding trades on standard OTC derivatives products, with a total notional value of US\$30.5 trillion



HONG KONG FINANCIAL BENCHMARK

- Participating in the Financial Stability Board (FSB) Official Sector Steering Group (OSSG) and liaising with other OSSG members on reforming interest rate benchmarks of major currencies
- Working with the Treasury Markets Association (TMA) to strengthen TMA-administered interest rate benchmarks
- Enhancing Hong Kong's financial benchmark regime according to international standards

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- In July 2013, the FSB established the OSSG, which comprises senior officials from central banks and regulatory agencies, to focus on work regarding interest rate benchmarks. OSSG recommendations include: (1) calculating interest reference rates from transacted prices to the extent possible; and (2) developing alternative reference rates.



COIN COLLECTION PROGRAMME

- Extend the Coin Collection Programme until September 2020
- From April 2018 onwards, the public may choose to upload the counted coins to five different e-wallets

GOVERNMENT BOND PROGRAMME

- To issue the third batch of Silver Bond in the third quarter of 2018, targeting Hong Kong residents aged 65 or above

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Coin Collection Programme

- Two Coin Carts collect coins from members of the public in 18 districts of Hong Kong on a rotational basis.
- 416,000 people were served and 348 million pieces of coins with a total face value of HK\$465 million were collected between October 2014 and March 2018.

Government Bond Programme

- Institutional part – outstanding as at end-March 2018:
 - Twelve Government bonds totalling HK\$72.3 billion.
 - Three Islamic bonds totalling US\$3 billion.
- Retail part – outstanding as at end-March 2018:
 - Two iBonds and two Silver Bonds totalling HK\$25.9 billion.

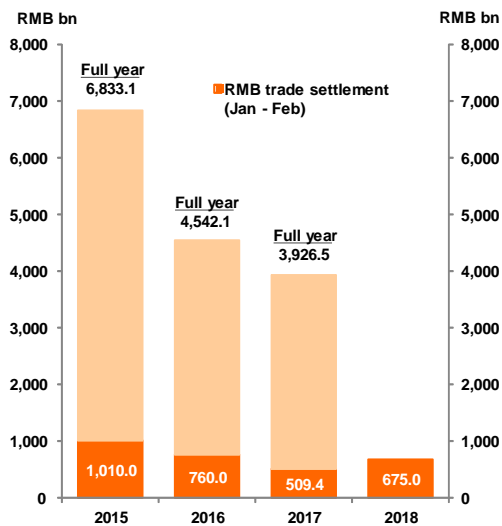


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

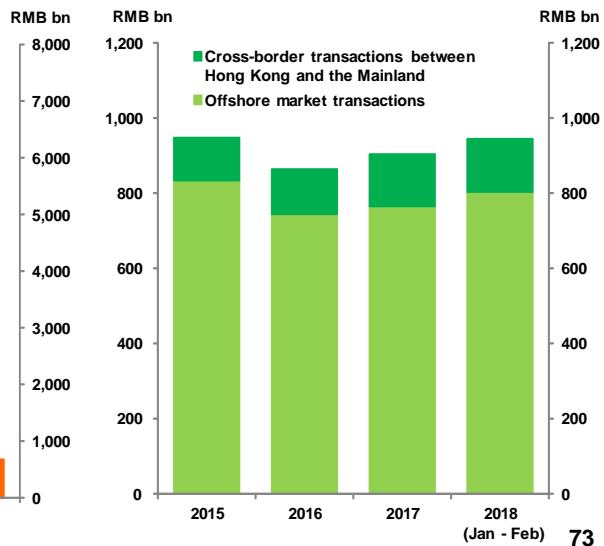


RMB TRADE SETTLEMENT AND PAYMENT

**RMB trade settlement
handled by banks in Hong Kong**



**Average daily turnover of Hong Kong
RMB RTGS System**

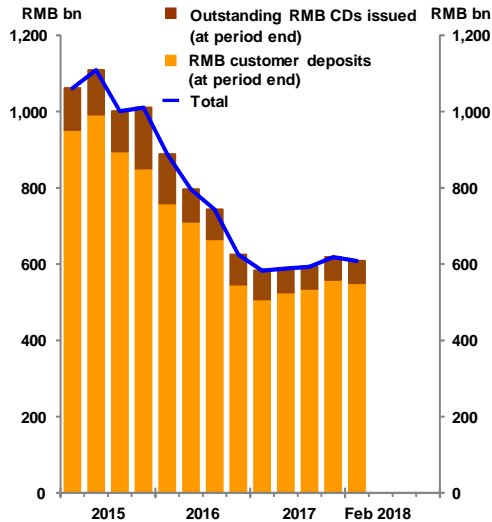


- In the first two months of 2018, RMB trade settlement handled by banks in Hong Kong totalled RMB675 billion.
- In the first two months of 2018, the average daily turnover of Hong Kong RMB Real Time Gross Settlement (RTGS) system stood at RMB944.2 billion.

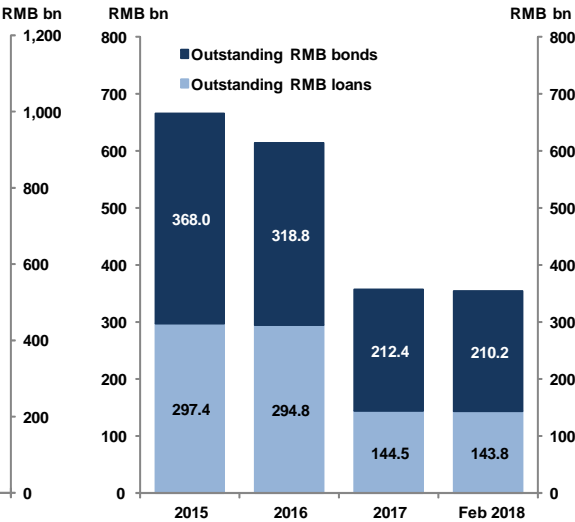


RMB LIQUIDITY POOL AND FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end-February 2018, RMB customer deposits and outstanding RMB CDs amounted to RMB550.4 billion and RMB57.9 billion respectively, totalling RMB608.3 billion.
- At end-February 2018, outstanding RMB loans amounted to RMB143.8 billion. Outstanding dim sum bonds amounted to RMB210.2 billion. The dim sum bond issuance totalled RMB3.8 billion for the first two months of 2018.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	<u>Feb 2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
No. of participating banks of Hong Kong's RMB clearing platform	203	203	210	217
Of which:				
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	177	178	184	192
Amount due to overseas banks (RMB billion)	93.8	95.4	69.0	105.7
Amount due from overseas banks (RMB billion)	149.4	131.3	91.6	132.1

- The HKMA maintained and deepened ongoing collaborative dialogues with other offshore RMB centres, including Australia, London, Paris and Switzerland, and continued our marketing efforts through participation in industry events to promote Hong Kong's RMB business platform and our unique role as a springboard between Mainland China and the rest of the world.



INFRASTRUCTURE FINANCING FACILITATION OFFICE (IFFO)

- The number of IFFO partners have grown to 87
- IFFO hosted a two-day executive workshop on “Private Participation in Infrastructure Project Finance and Risk Mitigation” in March 2018, co-organised by International Finance Corporation and Multilateral Investment Guarantee Agency

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- As of January 2018, IFFO has organised and participated in over 20 large-scale conferences, seminars and workshops on infrastructure investment and financing, and the number of IFFO partners has grown from 41 at inception to 87.
- The two-day executive workshop hosted by IFFO was attended by over 40 senior professionals from a diverse mix of background across Mainland China, Hong Kong and overseas including multilateral financial agencies, banks, insurance companies, asset managers and infrastructure project developers and operators. Participants discussed the implications of current macro-economic situation for infrastructure investments in emerging markets, and ways to improve project bankability and risk mitigation.



DEVELOPING HONG KONG AS A CORPORATE TREASURY CENTRE (CTC) HUB

- Attracting multinational and Mainland enterprises to set up their CTCs in Hong Kong will bring more banking, financing and risk management activities to Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong
- The HKMA has been actively engaging the industry to promote Hong Kong's CTC platform
- After launching the tax measures in June 2016, we have reached out to over 300 corporates, more than 40 of which are actively planning to set up or have set up their CTC operations in Hong Kong

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- Developing Hong Kong into a regional hub for CTCs has been one of the important areas of work of the HKMA in recent years. With their vast global business networks, some multinational corporations process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing, risk management, etc. to be centralised to facilitate management of these corporate treasury functions. The development of Hong Kong as a CTC hub would complement many of Hong Kong's existing strengths, such as the largest global offshore RMB business hub, capital formation, banking networks, etc., thereby reinforcing Hong Kong's status as an international financial centre and promoting the development of headquarters economy in Hong Kong.
- The HKMA has been working closely with the private sector and other Government agencies in organising various marketing activities to promote Hong Kong as a preferred regional destination for CTCs.



DEVELOPING AN ONSHORE PRIVATE EQUITY (PE) FUND PLATFORM

- At present, PE fund activities in Hong Kong are robust. The total capital under management by PE funds in Hong Kong reached US\$135 billion as of end-December 2017
- PE funds active in Hong Kong generally exist in the form of offshore limited partnerships (LPs), because the legal framework for LPs was legislated before the PE fund industry emerged, and its stipulations do not cater for PE fund operations. Relevant tax treatments in Hong Kong also pale in comparison with some other jurisdictions
- As initiated by the HKMA, the Financial Services and the Treasury Bureau has set up a taskforce to review Hong Kong's fund platform with a view to attracting more PE funds to set up locally. Discussion on tax treatment has been concluded and an industry consultation was also completed on 2 May



PROMOTING GREEN FINANCE

- The international green finance market has developed rapidly in recent years. In the Mainland in particular, rising income and growing environmental awareness are driving the investments in green and renewables. Mainland China was one of the world's largest green bond market in terms of issuance in 2017
- The Chief Executive has identified green finance as a major development area in her 2017 Policy Address. The HKMA has been taking steps to promote green finance in Hong Kong, including:
 - Working with the Government to study the issuance of a Government green bond
 - A large-scale international conference on green bond and a joint seminar with the Research Bureau of the People's Bank of China to be held in June to explore green finance opportunities and promote Hong Kong's international profile on green finance



PROMOTING HONG KONG'S BOND MARKET

- Asian bond market has grown rapidly in recent years, with more than US\$4,700 billion worth of bonds issued in Asian economies (excluding Japan) last year. Hong Kong is the third largest bond issuance centre in Asia (excluding Japan), second only to Mainland China and Korea
- 2018-19 Budget announced new measures to encourage more investors and issuers to participate in the Hong Kong bond market
- Working on the implementation of the three-year Pilot Bond Grant Scheme which covers eligible enterprises issuing bonds in Hong Kong for the first time
- Working with the Government on the legislative changes of Qualifying Debt Instrument Scheme

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Pilot Bond Grant Scheme

- The amount of grant for each bond issuance is equivalent to half of the issue expenses, with a cap of HK\$2.5 million. Each enterprise can apply for a grant for two bond issuances at most.

Enhancement of Qualifying Debt Instrument Scheme

- In addition to instruments lodged and cleared by the Central Moneymarkets Unit of the HKMA, debt securities listed on the Stock Exchange of Hong Kong will also become eligible for tax exemption. The Government also plans to extend the scope of tax exemption from debt instruments with an original maturity of not less than seven years to instruments of any duration.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

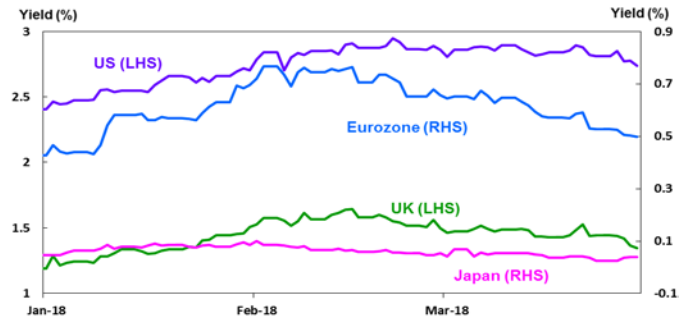


INVESTMENT ENVIRONMENT IN Q1 2018

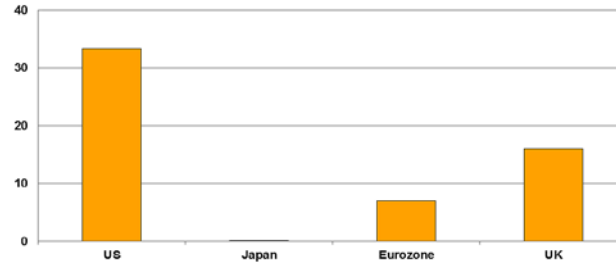
- **Interest rates:** Longer-dated bond yields rose broadly at the start of the first quarter on concerns about rising inflation, but eased gradually amid escalating trade tensions between China and the US
- **Equity markets:** Major equity markets corrected sharply after reaching multi-year highs at the end of January amid rising bond yields. Market sentiment weakened again in March on fears of an outbreak of trade war between China and the US. The Hang Seng Index ended slightly higher in the first quarter while other major equity indices recorded a decline
- **Exchange rates:** The US dollar weakened against major currencies in January, and stayed within a narrow range for the remainder of the quarter



CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1 2018



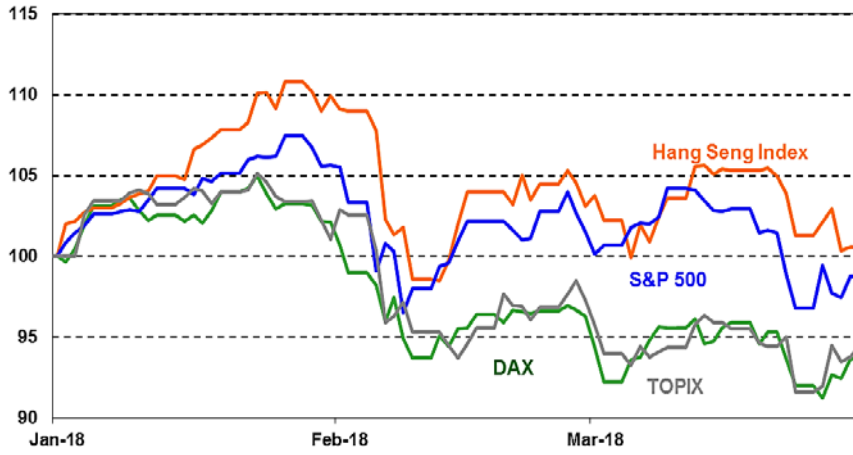
2018 Q1 bond yield change (bps)





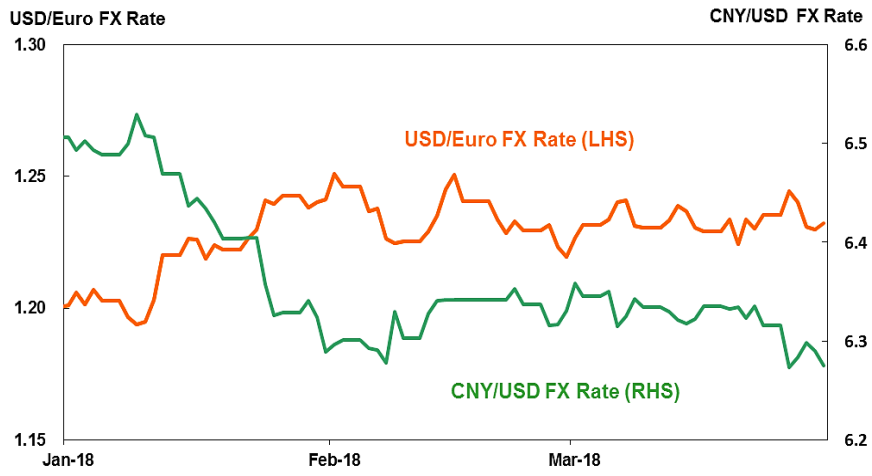
EQUITY MARKETS IN Q1 2018

Normalised Index Level (2017 year-end = 100)





CURRENCY MARKETS IN Q1 2018





INVESTMENT INCOME

	2018	2017	2016
	(unaudited)		
(HK\$ billion)	Q1	Full Year	Full Year
Hong Kong equities*	1.7	58.3	5.3
Other equities	(7.4)	80.4	28.6
Bonds	5.5	34.4	33.1
Foreign exchange#	26.3	53.5	(15.8)
Other investments@	-	37.4	16.9
Investment income	26.1	264.0	68.1

* Excluding valuation changes of the Strategic Portfolio.

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

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio. Valuations of these investments for the first quarter of 2018 are not yet available.



INCOME AND EXPENDITURE

	2018	2017	2016
	(unaudited)		
(HK\$ billion)	Q1	Full Year	Full Year
Investment income	26.1	264.0	68.1
Other income	-	0.2	0.2
Interest and other expenses	<u>(3.1)</u>	<u>(9.9)</u>	<u>(6.4)</u>
Net income	23.0	254.3	61.9
Fee payment to Fiscal Reserves*#	(11.1)	(46.2)	(33.1)
Fee payment to HKSAR government funds and statutory bodies*	(3.4)	(8.6)	(9.6)

* The rate of fee payment is 4.6% for 2018, 2.8% for 2017 and 3.3% for 2016.

This does not include the 2018 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2018 is available.

(The composite rate was 9.6% for 2017 and 4.5% for 2016. Fee payable to the Future Fund was HK\$22.7 billion for 2017 and HK\$10.1 billion for 2016.)



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Mar 2018 (Unaudited)	At 31 Dec 2017	At 31 Dec 2016
ASSETS			
Deposits	320.7	346.9	386.7
Debt securities	2,907.3	2,761.6	2,466.1
Hong Kong equities*	206.0	204.2	147.3
Other equities	532.8	507.5	429.3
Other assets [#]	<u>183.3</u>	<u>195.1</u>	<u>189.3</u>
Total assets	<u>4,150.1</u>	<u>4,015.3</u>	<u>3,618.7</u>
LIABILITIES AND EQUITY			
Certificates of Indebtedness	490.9	456.7	405.4
Government-issued currency notes & coins in circulation	12.6	12.2	11.9
Balance of the banking system	179.7	179.8	259.6
Exchange Fund Bills and Notes issued	1,047.5	1,045.8	961.0
Placements by banks and other financial institutions	59.4	59.4	56.1
Placements by Fiscal Reserves [®]	1,117.4	1,073.8	914.6
Placements by HKSAR government funds and statutory bodies	301.3	305.1	302.5
Other liabilities	<u>226.7</u>	<u>169.4</u>	<u>161.1</u>
Total liabilities	<u>3,435.5</u>	<u>3,302.2</u>	<u>3,072.2</u>
Accumulated Surplus	714.0	713.1	546.5
Revaluation Reserve	<u>0.6</u>	-	-
Total equity	<u>714.6</u>	<u>713.1</u>	<u>546.5</u>
Total liabilities and equity	<u>4,150.1</u>	<u>4,015.3</u>	<u>3,618.7</u>

* Including shares of the Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio.

[#] Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$142.2 billion at 31 Mar 2018. (HK\$135.2 billion at 31 Dec 2017 and HK\$118.8 billion at 31 Dec 2016)

[®] Including placements by the Future Fund of HK\$224.5 billion.



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**	44.7	6.1	(17.8)	43.3	13.1
2015**	(15.8)	21.0	(63.8)	18.7	8.3
2016**	68.1	(23.3)	47.1	18.9	25.4
2017**	264.0	66.0	61.8	71.3	64.9
2018* (unaudited)	N/A	N/A	N/A	N/A	26.1

* Excluding valuation changes of the Strategic Portfolio.

Including valuation changes of private equity and real estate investments held under the LTGP.



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since its launch in March 1999, the MIP has helped over 135,700 families attain home ownership
- In the first three months of 2018, the total number of loans drawdown and aggregate loan amount under the MIP were 2,451 cases and HK\$9.2 billion respectively, as compared to 1,896 cases and HK\$6.9 billion in the corresponding period last year
- About 92% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME (RMP)

- As at end-March 2018, 2,485 applications had been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$15,000
 - Payment terms: 10-year (27%), 15-year (17%), 20-year (13%), life (44%)
 - Average property value: HK\$5.1 million
 - Average property age: 30 years

- With HKMC's educational and publicity efforts, the public awareness on retirement planning products including the RMP and annuity continued to grow

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- Note: Figures in percentage for individual items may not add up to 100% due to rounding.



SME FINANCING GUARANTEE SCHEME (SFGS)

- SMEs and banks responded positively to the promotion and communication effort of the HKMC on the SFGS
- Following the refinements rolled out in 2017, the HKMC launched and implemented a series of measures again in February 2018 to relax the eligibility criterion for refinancing of guaranteed loans and further refine the application workflow and claim process
- As at end-March 2018, 13,252 applications had been approved, involving a total loan amount of around HK\$52.8 billion. Key data of the approved applications are as follows:

Average guarantee period	4.6 years	Average loan size	HK\$3.99 million
Proportion of application from manufacturing and non-manufacturing industries	22% and 78% (in terms of no. of applications approved)	Average loan interest rate and average guarantee fee rate	4.85% p.a. 0.49% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	7,767 enterprises and 197,896 employees

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

Manufacturing sector –	22.1%
– Textiles and clothing	4.2%
– Electronics	2.1%
– Plastics	1.7%
– Printing and publishing	1.6%

Non-manufacturing sector –	77.9%
– Trading	45.9%
– Wholesale and retail	9.4%
– Engineering	3.2%
– Construction	3.2%



MICROFINANCE SCHEME

- Launched in June 2012, trial period up to 2018 and maximum aggregate loan amount up to HK\$200 million
- As at end-March 2018, the Scheme had received 433 formal loan applications. Out of the vetted applications, 200 had been approved with a total loan amount of about HK\$49.7 million. The approval rate was 49%
- For the approved applications, the average loan size was about HK\$249,000 and the average loan tenor was 4.5 years

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- Industry types for the approved micro business start-up loans and self-employment loans (excluding 2 self-enhancement loans):

Some approved applications are classified as more than one of these industry types.

- Services	127 cases (47%)
- Retail	72 cases (27%)
- Wholesale	39 cases (15%)
- Manufacturing	21 cases (8%)
- IT related	8 cases (3%)



PREMIUM LOAN INSURANCE SCHEME (PLIS)

- PLIS was launched in September 2015 to provide subsidised housing owners aged 50 or above with an additional financing option to settle land premium payment
- After settling land premium payment, borrowers will have greater flexibility in letting or selling their properties in the open market
- The scheme can help release under-utilised flats and promote market circulation of subsidised housing properties
- As at end-March 2018, over 3,000 enquiries and 11 applications had been received



LIFE ANNUITY SCHEME (LAS)

- Preparatory work on LAS is making good progress. Details for subscription will be announced in July 2018 pending authorisation by the Insurance Authority
- Given the expected strong demand for LAS, all retail banks have been invited to be the agency banks to facilitate subscription by customers. Banks' reaction has been positive
- Public education campaign has been launched to enhance the public awareness of the suitability and associated risks of LAS as a retirement planning tool through TV, radio, and social media
- The amount offered for subscription will be subject to a quota, tentatively up to HK\$10 billion for the first tranche, with the actual sale amount subject to subscription demand and prudent risk management considerations