



The elephant's ear, *Macaranga tanarius*, is a fast-growing evergreen tree, which can grow to a height of around five metres. It is widely distributed throughout the Asia region and is very common on beaches in Hong Kong, where it provides excellent shade.

INTERNATIONAL FINANCIAL CENTRE

In 2004 the HKMA led several initiatives to develop Hong Kong's role as an international financial centre. These included particularly the launch of renminbi banking business in Hong Kong and the further development of the Asian Bond Fund. Through participation in international financial and central banking forums and dialogues with other international financial institutions, the HKMA contributed to a better understanding in the international financial community of Hong Kong's financial and economic development.

OVERVIEW

The global financial system remained stable in 2004, despite the rise in US interest rates, the rapid increase in crude oil prices and the sharp depreciation of the US dollar. Many Asian markets, in particular China, experienced considerable capital inflows and upward pressure on their currencies, presenting challenges to central banks in the region. The robust economy of Mainland China continued to act as an engine of growth for Asia through expanding intra-regional trade. However, rapid expansion in some sectors of the Mainland economy induced the authorities to introduce macroeconomic adjustment and controls in the second quarter of 2004 to curb overheating in certain sectors and to achieve a soft landing of the economy. Against this background, the HKMA strengthened its communication with Mainland and overseas authorities with the aim of keeping abreast of the latest developments and increasing the international financial community's understanding of Hong Kong's financial and economic developments. Through co-operation with relevant authorities, the HKMA implemented several initiatives to leverage on the greater integration between financial markets on the Mainland and Hong Kong and to promote the development of domestic and regional bond markets.

In the first half of 2004, banks in Hong Kong introduced personal renminbi business, including deposit-taking, exchange, remittances and credit cards, following agreement by the People's Bank of China to provide clearing services for these forms of business. This initiative was the fruit of extensive interaction between the HKMA and the Mainland authorities. The HKMA pursued two regional initiatives during the year. The first was the structuring, design and launch of the local currency component of the Asian Bond Fund (ABF2) under the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP). The second was the successful conclusion of the APEC Initiative on Development of Securitisation and Credit Guarantee Markets, which will provide assistance to APEC member economies interested in promoting asset securitisation.



The HKMA hosts the Second High-Level Policy Dialogue of the APEC Initiative on Development of Securitisation and Credit Guarantee Markets on 22 March 2004.

REVIEW OF 2004

Development of regional bond markets

Through its chairmanship of the EMEAP Working Group on Financial Markets, the HKMA contributed significantly to the design and implementation of the local currency Asian Bond Fund (ABF2) (Box 1). In December 2004 the HKMA, together with the other 10 EMEAP central banks and monetary authorities, announced the launch of ABF2. ABF2 will have an initial size of about US\$2 billion and will be invested in by all 11 EMEAP Members. Implementation will be carried out in two phases: in Phase One, investments will be confined to EMEAP central banks; in Phase Two, the Pan-Asian Bond Index Fund (PAIF) and eight Single-market Funds will be offered to other public and

private-sector investors, through listing where appropriate. It is intended that, subject to approvals by the relevant authorities, two key components of the ABF2 – the PAIF and the Hong Kong fund – will be listed on the Stock Exchange of Hong Kong. Hong Kong was chosen as the initial place of listing for the PAIF on the basis of positive market attributes, efficiency and sophistication.

The HKMA continued to lead the Asia-Pacific Economic Cooperation (APEC) initiative on the Development of Securitisation and Credit Guarantee Markets with Thailand and Korea as co-chairs in 2004. The Initiative, launched in September 2002, was sponsored by the World Bank to assist APEC member economies in identifying market impediments and to devise proposals to remove

BOX 1

Asian Bond Fund 2: A regional initiative aimed at improving financial intermediation efficiency in Asia

The local currency-denominated Asian Bond Fund (ABF2) is an extension of the US dollar-denominated Asian Bond Fund (ABF1) launched in June 2003, with the aim of helping broaden and deepen the domestic and regional bond markets in Asia. ABF2 was announced on 16 December 2004.

ABF2 has a Pan-Asian Bond Index Fund (PAIF) and eight Single-market Funds. The PAIF is a single bond fund investing in sovereign and quasi-sovereign local currency-denominated bonds issued in all EMEAP member economies except Australia, Japan and New Zealand. The eight Single-market Funds will invest in sovereign and quasi-sovereign local currency-denominated bonds issued in the respective markets of the eight EMEAP economies. The PAIF and eight Single-market Funds will be passively managed by private-sector fund managers against a Pan-Asian bond index and relevant domestic bond indices for the eight EMEAP markets. The PAIF and the eight

Single-market Funds will offer new investment opportunities for central banks and other investors.

From a market development perspective, the ABF2 initiative is expected to yield important benefits:

- 1. Promoting new products:** In contrast to the US and Europe, listed bond funds are uncommon in Asia, and the PAIF and the eight Single-market Funds represent a new product of its kind for the respective markets. For instance, the Hong Kong fund would be the first ever fixed-income Exchange-Traded Fund (ETF) to be listed on the Stock Exchange of Hong Kong. The PAIF and eight Single-market Funds are expected to provide a catalytic effect in the development of innovative products in Asia.
- 2. Improving market infrastructure:** In setting up the PAIF and the eight Single-market

them. During the two-year term of the Initiative, two panel visits were made each to Thailand, China and Mexico. The expert panels advised and assisted national authorities in drawing up action plans and taking concrete steps to identify impediments to the development of asset securitisation markets, and to remove them. A policy dialogue attended by senior finance and central bank officials, practitioners and academics in Asia was held in Hong Kong in March 2004 to discuss progress made on the panel visits. While the Initiative was concluded at the September APEC Finance Ministers' Meeting, following the expiry of its two-year term, some follow-up work may continue into 2005 in the light of the strong drive to develop the securitisation and credit guarantee markets in the region.

Regional monetary co-operation and participation in multilateral institutions

The HKMA contributed to policy dialogues in international and regional forums and played an active role in regional monetary co-operation in 2004. The Chief Executive of the HKMA, Mr Joseph Yam, was appointed Chairman of the Bank for International Settlements (BIS) Asian Consultative Council (ACC) for a term of two years beginning in March 2003.¹ Mr. Yam is also the Chairman of the

¹ The Asian Consultative Council (ACC) was established in March 2001 by the BIS to provide a vehicle for communication between the Asian and Pacific members of the BIS and the BIS Board and Management on matters of interest and concern to the Asian central banking community. The ACC currently has 12 members, including central banks and monetary authorities of Australia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, New Zealand, The Philippines, Singapore and Thailand.

Funds, EMEAP and the relevant member central banks have sought to improve market infrastructure through various means. For instance, EMEAP has taken the opportunity to develop, in collaboration with the International Index Company, a set of transparent, replicable and credible bond market indices covering the eight EMEAP markets using a multiple-contributor pricing model, which will be by itself an important piece of market infrastructure for Asia. The indices are based on prices provided by a number of active market makers, and accordingly can better reflect the prevailing market for the underlying bonds. It is envisaged that the indices would be widely adopted by private sector fund managers as benchmark indices for their own fixed income products, and derivatives products would also be structured around these indices.

3. Minimising regulatory hurdles in the relevant

EMEAP markets: The process of developing the PAIF, and the eight Single-market Funds in particular, has helped accelerate tax and regulatory reform at both regional and domestic levels. At the regional level, some

EMEAP economies are currently reviewing or changing their tax and regulatory regimes to facilitate cross-border investment. For instance, Malaysia has opened up its domestic market to issuances by multilateral development banks and multilateral financial institutions, and has exempted non-resident investors from withholding tax on the interest income received from investment in ringgit-denominated debt securities. At the domestic level, some EMEAP economies are actively developing the relevant regulations to facilitate listing of bond funds or fixed income ETF in their respective markets.

In the near term, ABF2 will help raise investor awareness and interest in Asian bonds by providing innovative, low-cost and efficient products in the form of passively managed bond funds. With the continuing efforts in developing better market infrastructure and removing regulatory impediments so initiated, the efficiency of bond market as a channel of financial intermediation will be increased over time, thereby contributing to greater financial stability in the region in the future.

BIS Central Bank Governance Steering Group, which conducts detailed research on central bank governance issues. The HKMA, representing the Hong Kong SAR Government, participated in the review of the use of funds of the Asian Development Fund (ADF), a concessionary lending facility of the Asian Development Bank for the poorest economies in the region, and took part in the negotiation of the Eighth Replenishment of the ADF. In December 2004 the Finance Committee of the Legislative Council approved Hong Kong's contribution of \$149.7 million (or US\$19.19 million) to the Eighth Replenishment. In November the HKMA jointly organised with the International Monetary Fund (IMF) a regional conference in Hong Kong on managing procyclicality of financial systems.

Upgrading of Hong Kong's sovereign credit rating

The HKMA has been playing a pivotal role in the adoption of a more proactive approach towards international credit rating agencies on Hong Kong's credit ratings. Through more effective communication between the international credit rating agencies and the relevant authorities, the HKMA aims at ensuring that the agencies maintain a more balanced view on Hong Kong. Amid improved economic prospects in Hong Kong, these efforts have paid off. Between April and June, Standard & Poor's, Fitch Ratings, and Rating and Investment Information all upgraded the outlook on Hong Kong's sovereign rating from negative to stable.

Financial market integration with the Mainland

The successful launch and smooth running of personal renminbi banking services in Hong Kong in 2004 was one of the results of the close co-operation between Hong Kong and Mainland China (Box 2). The launch of renminbi business provided a new range of services for customers in Hong Kong, helped diversify banking business, and facilitated cross-border spending and economic integration between Hong Kong and the Mainland. The services have been well received, with total outstanding

renminbi deposits at RMB 12.1 billion yuan by the end of December. In addition, the signing of CEPA II (Closer Economic Partnership Arrangement) on 27 October helped expand the business scope of Hong Kong banks on the Mainland. CEPA II allows Mainland branches of Hong Kong banks to act as agents for insurance products after obtaining approval from relevant authorities with effect from 1 November 2004.

To develop its understanding of financial and economic issues on the Mainland, the HKMA continued to engage in research co-operation with Mainland academics and think-tanks. During the year a number of Mainland officials and academics were invited to Hong Kong to exchange views on issues of common interest.

Training

A series of training programmes was designed for officials of the People's Bank of China (PBoC), China Banking Regulatory Commission (CBRC) and other Mainland authorities, both in Hong Kong and on the Mainland, to share HKMA's expertise in the areas of financial stability, banking supervision and accounting management. These included

- three banking supervision courses for senior officials from the CBRC
- four specialised courses for CBRC bank supervisors held in different cities
- two financial stability courses for senior officials from the PBoC
- a bank accounting management course for PBoC accounting officials
- one course for securities regulators of the China Securities Regulatory Commission.

In total, 11 courses, or 2,248.5 days of training, were provided to 833 Mainland officials in 2004.

The HKMA also provided training on request to other external parties. These included one seminar for Mainland commercial banks, and a regional

BOX 2**Renminbi business in Hong Kong**

Following the approval of the State Council in 2003, the People's Bank of China (PBoC) agreed to provide clearing arrangements for personal renminbi business in Hong Kong. The first phase of the renminbi business was launched on 18 January 2004, when shops and ATM machines in Hong Kong began to accept debit and credit cards issued by Mainland banks. The second phase of renminbi business started on 25 February 2004, when banks in Hong Kong began to offer renminbi deposit-taking, currency exchange and remittance services to their customers. The third phase of personal renminbi business, which began on 30 April 2004, allowed banks in Hong Kong to issue renminbi debit and credit cards to Hong Kong residents for use on the Mainland.

The response to the launch of personal renminbi services has been positive. Renminbi deposits have increased gradually since the launch of the business. By the end of December 2004, the total amount of renminbi deposits outstanding reached RMB12.1 billion yuan, with 38 licensed banks

providing this service. There has been a steady increase in the use of renminbi debit and credit cards by Mainland tourists in Hong Kong. By the end of 2004, Mainland tourists spent a total of \$2,152 million using renminbi debit and credit cards in Hong Kong and withdrew a total of \$782 million from ATM machines in Hong Kong. The average size of credit/debit card spending was \$2,989 per transaction, significantly higher than the average transaction size by overseas tourists in Hong Kong.

The HKMA has maintained dialogues with relevant parties to improve the services and to explore further development opportunities for renminbi business in Hong Kong. To this end, the Financial Secretary outlined in August three strategic directions: diversification of renminbi assets and liabilities; denomination and settlement of trade in renminbi; and debt issuance in renminbi. The HKMA will work on specific proposals along these strategic directions.

course on Risk-focused Supervision and Risk Assessment under the APEC financial regulators' training initiative. A total of 65 participants attended the two seminars in 2004.

PLANS FOR 2005 AND BEYOND

Given the new challenges in the global financial markets, the HKMA will continue to monitor closely latest developments and their implications for Hong Kong. We will ensure that the views and concerns of Hong Kong on important issues affecting financial stability are heard in the central banking and international financial forums.

As part of our effort to reinforce Hong Kong's status as a premier international financial centre, the HKMA will work with regional economies to implement current initiatives, such as ABF2, and will continue to support the Hong Kong SAR

Government's proactive strategy in promoting a deeper understanding of Hong Kong's economic and financial strength to the major international credit rating agencies.

Following the launch of personal renminbi banking business in Hong Kong and the full implementation of CEPA I and II, integration between Hong Kong and the Mainland is expected to strengthen further in coming years. The HKMA will continue to maintain close dialogue with Mainland authorities to further promote Hong Kong's role in facilitating fund flows and serving the financial needs of the Mainland. The HKMA will continue to organise training seminars and courses for the staff of Mainland authorities and other external parties in 2005.

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