

AN INTRODUCTION TO THE  
**HONG KONG MONETARY AUTHORITY**  
2005 EDITION



Incorporating the Summary Version of the HKMA Annual Report 2004



HONG KONG MONETARY AUTHORITY  
香港金融管理局

# THE HONG KONG MONETARY AUTHORITY

Established in April 1993, the Hong Kong Monetary Authority (HKMA) is the government authority in Hong Kong responsible for maintaining monetary and banking stability. The HKMA's policy objectives are

- to maintain currency stability, within the framework of the Linked Exchange Rate system, through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary
- to promote the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorized institutions
- to enhance the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

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The first part of this booklet introduces the work and policies of the HKMA. The second part contains a summary of the HKMA's Annual Report for 2004. The full Annual Report is available on the HKMA website both in interactive form and on PDF files. Hard copies may also be purchased from the HKMA: see Reference Resources on page 47 for details.

This booklet makes reference to documents and other materials available on the HKMA website [www.hkma.gov.hk](http://www.hkma.gov.hk). These references appear as  >, followed by navigation guidance from the HKMA homepage.

All amounts in this booklet are in Hong Kong dollars unless otherwise stated.

# ABOUT THE HKMA

The Hong Kong Monetary Authority is Hong Kong's central banking institution. The HKMA has four main functions: maintaining the stability of the Hong Kong dollar; promoting the safety of Hong Kong's banking system; managing Hong Kong's official reserves; and maintaining and developing Hong Kong's financial infrastructure.

## The HKMA's legal mandate

The HKMA was established on 1 April 1993 by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. To enable the establishment of the HKMA, the Legislative Council passed amendments to the Exchange Fund Ordinance in 1992 empowering the Financial Secretary to appoint a Monetary Authority.

The powers, functions and responsibilities of the Monetary Authority are set out in the Exchange Fund Ordinance, the Banking Ordinance, the Deposit Protection Scheme Ordinance, the Clearing and Settlement Systems Ordinance and other relevant Ordinances. The division of functions and responsibilities in monetary and financial affairs between the Financial Secretary and the Monetary Authority is set out in an Exchange of Letters between the two dated 25 June 2003. This Exchange of Letters also discloses the delegations made by the Financial Secretary to the Monetary Authority under these Ordinances. The letters are public documents: copies of them may be found on the HKMA website.

The Exchange Fund Ordinance establishes the Exchange Fund under the control of the Financial Secretary. According to the

Ordinance, the Fund shall be used primarily for affecting the exchange value of the Hong Kong dollar. It may also be used for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre.

The Monetary Authority is appointed under the Exchange Fund Ordinance to assist the Financial Secretary in performing his functions under the Exchange Fund Ordinance and to perform such other functions as are assigned by other Ordinances or by the Financial Secretary. The office of the Monetary Authority is known as the HKMA, and the Monetary Authority as the Chief Executive of the HKMA.

The Banking Ordinance provides the Monetary Authority with the responsibility and powers for regulating and supervising banking business and the business of taking deposits. Under the Ordinance, the Monetary Authority is responsible, among other things, for the authorization of licensed banks, restricted licence banks, and deposit-taking institutions in Hong Kong.

The Clearing and Settlement Systems Ordinance provides a statutory regime for the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary or financial stability

of Hong Kong or to the functioning of Hong Kong as an international financial centre.

Under the Deposit Protection Scheme Ordinance the Monetary Authority is charged with implementing the decisions of the Hong Kong Deposit Protection Board, and among other things, deciding whether compensation should be paid to the depositors of a failed scheme bank pursuant to the Ordinance.

 > [About the HKMA](#) > [The HKMA](#) > [Who we are](#)

## The HKMA and the Hong Kong SAR Government

The HKMA is an integral part of the Hong Kong SAR Government, but is able to employ staff on terms different from those of the civil service in order to attract personnel of the right experience and expertise. The Chief Executive of the HKMA remains a public officer, as do his staff. In its day-to-day work the HKMA operates with a high degree of autonomy within the relevant statutory powers conferred upon, or delegated to, the Monetary Authority.

The Financial Secretary is responsible for determining the monetary policy objective and the structure of the monetary system of Hong Kong: a letter from the Financial Secretary to the Monetary Authority dated 25 June 2003 specifies that these should be currency stability defined as a stable exchange value at around HK\$7.80 to one US dollar maintained by Currency Board arrangements. The Monetary Authority is on his own responsible for achieving the monetary policy objective, including determining the strategy, instruments and operational means for doing so. He is also responsible for maintaining the stability and integrity of the monetary system of Hong Kong.

The Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, has responsibility for policies for maintaining the stability and integrity of Hong Kong's financial system and the status of Hong Kong as an international financial centre. In support of these policies, the Monetary Authority is responsible, among other things, for

- promoting the general stability and effective working of the banking system
- promoting the development of the debt market, in co-operation with other relevant bodies
- matters relating to the issuance and circulation of legal tender notes and coins
- promoting the safety and efficiency of the financial infrastructure through the development of payment, clearing and settlement systems and, where appropriate, the operation of these systems
- seeking to promote, in co-operation with other relevant bodies, confidence in Hong Kong's monetary and financial systems, and appropriate market development initiatives to help strengthen the international competitiveness of Hong Kong's financial services.

The Exchange Fund is under the control of the Financial Secretary. The Monetary Authority, under delegation from the Financial Secretary, is responsible to the Financial Secretary for the use of the Exchange Fund, and for the investment management of the Fund.

 > [About the HKMA](#) > [The HKMA](#) > [Who we are](#)

## Accountability and transparency

The autonomy given to the HKMA in its day-to-day operations, and in the methods it uses to pursue policy objectives determined by the Government, is complemented by a high degree of accountability and transparency.

The HKMA serves Hong Kong by promoting monetary and banking stability, by managing the official reserves effectively, and by developing and overseeing a robust and diverse financial infrastructure. These processes help to strengthen Hong Kong's role as an international financial centre and to foster Hong Kong's economic well-being. The HKMA must have the confidence of the community if it is to perform its duties well. The HKMA therefore takes seriously the duty of explaining its policies and work to the general public and makes every effort to address any concerns within the community relevant to the HKMA's responsibilities.

The HKMA is accountable to the people of Hong Kong through the Financial Secretary, who appoints the Monetary Authority, and through the laws passed by the Legislative Council that set out the Monetary Authority's powers and responsibilities. The HKMA also recognises a broader responsibility to promote a better understanding of its roles and objectives and to keep itself informed of community concerns. In its day-to-day operations and in its wider contacts with the community, the HKMA pursues a policy of transparency and accessibility. This policy has two main objectives:

- to keep the financial industry and the public as fully informed about the work of the HKMA as possible, subject to considerations of market sensitivity, commercial confidentiality and statutory restrictions on disclosure of confidential information
- to ensure that the HKMA is in touch with, and responsive to, the community it serves.

The HKMA seeks to follow international best practices in its transparency arrangements. It maintains extensive relations with the mass media and produces a range of regular and special publications in both English and Chinese. The HKMA's bilingual website ([www.hkma.gov.hk](http://www.hkma.gov.hk)) carries all HKMA publications, press releases, speeches and presentations, in addition to special sections on research, statistics, consumer information and other topics. The HKMA maintains an Information Centre at its offices, consisting of a library and an exhibition area, which is open to the public six days a week. The HKMA also organises an annual public education programme, which seeks to inform the public, and in particular students, about the work of the HKMA through seminars and guided tours at the Information Centre. The HKMA's weekly *Viewpoint* column, carried on the HKMA website and in several Hong Kong newspapers, informs the public about aspects of the HKMA's work. Further information on the HKMA's media work, publications and public education programmes is contained in the Chapter on Professional and Corporate Services in the full Annual Report.

 > Viewpoint

 > HKMA Information Centre

Over the years the HKMA has progressively increased the detail and frequency of its disclosure of information on the Exchange Fund and Currency Board Accounts. Since 1999 the HKMA has participated in the International Monetary Fund's Special Data Dissemination Standard project for central banks. The HKMA publishes records of meetings of the Exchange Fund Advisory Committee Currency Board Sub-Committee, along with the monthly reports on Currency Board operations. The supervisory policies and guidelines on banking have been published on the website since 1996.

 > [Information Centre > Press Releases > Exchange Fund](#)

 > [Policy Areas > Supervisory Policy Manual](#)

The relations between the HKMA and the Legislative Council play an important part in the process of accountability and transparency. There is a formal commitment from the Chief Executive of the HKMA to appear before the Legislative Council Panel on Financial Affairs three times a year to brief Members and to answer questions on the HKMA's work. At one of these briefings, usually in May, the HKMA's Annual Report is presented. In addition, staff from the HKMA attend Legislative Council Panel meetings to explain and discuss particular issues, and Committee meetings to assist Members in their scrutiny of draft legislation.

 > [Information Centre > Legislative Council Issues](#)

## Advisory and other committees

### Exchange Fund Advisory Committee

In his control of the Exchange Fund, the Financial Secretary is advised by the Exchange Fund Advisory Committee (EFAC). EFAC is established under Section 3(1) of the Exchange Fund Ordinance, which requires the Financial Secretary to consult the Committee in his exercise of control of the Exchange Fund. The Financial Secretary is ex officio Chairman of EFAC. Other members, including the Monetary Authority, are appointed in a personal capacity by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR. Members of EFAC are appointed for the expertise and experience that they can bring to the committee. Such expertise and experience includes knowledge of monetary, financial and economic affairs and of investment issues, as well as of accounting, management, business and legal matters.

EFAC advises the Financial Secretary on investment policies and strategies for the Fund and on projects, such as the development of financial infrastructure, that are charged to the Fund. Since the operating and staff costs of the HKMA are also chargeable to the Exchange Fund, EFAC advises the Financial Secretary on the HKMA's annual administration budget and on the terms and conditions of service of HKMA staff. EFAC meets regularly and on other occasions when particular advice is being sought.

*Membership (1 April 2005)*

## Chairman

**The Hon. Henry Tang Ying Yen**, GBS, JP  
The Financial Secretary

## Members

**Mr Joseph Yam**, GBS, JP  
The Monetary Authority

**Dr The Hon. David Li Kwok Po**, LLD, GBS, JP  
Chairman and Chief Executive  
The Bank of East Asia Limited

**Mr Marvin Cheung Kin Tung**, DBA Hon., SBS, JP

**Mr David Eldon**, GBS, JP  
Chairman  
The Hongkong and Shanghai Banking Corporation Limited

**Professor Richard Y C Wong**, SBS, JP  
Deputy Vice-Chancellor  
The University of Hong Kong

**Mr Christopher Cheng Wai Chee**, GBS, JP  
Chairman  
USI Holdings Limited

**Mr Victor Lo Chung Wing**, GBS, JP  
Chairman and Chief Executive  
Gold Peak Industries (Holdings) Limited

**Dr Patrick Wang Shui Chung**, JP  
Chairman and Chief Executive Officer  
Johnson Electric Holdings Limited

**Mr He Guangbei**  
Vice Chairman and Chief Executive  
Bank of China (Hong Kong) Limited

**Professor K C Chan**  
Dean of Business and Management  
Hong Kong University of Science and Technology

**Mr Henry Fan Hung-ling**, SBS, JP  
Managing Director  
CITIC Pacific Limited

**Mr Simon Ip Sik-on**, JP

**Mr Thomas Kwok Ping-kwong**, JP  
Vice-Chairman and Managing Director  
Sun Hung Kai Properties Limited

**Mr Peter Sullivan**  
Executive Director and Chief Executive Officer  
Standard Chartered Bank (Hong Kong) Limited

## Secretary

**Mr Christopher Munn**

EFAC is assisted in its work by five sub-committees, which monitor specific areas of the HKMA's work and report and make recommendations to the Financial Secretary through EFAC.

The **Governance Sub-Committee** monitors the performance of the HKMA and makes recommendations on remuneration and human resources policies, and on budgetary, administrative and governance issues.

*Membership (1 April 2005)*

## Chairman

**Mr Marvin Cheung Kin Tung**, DBA Hon., SBS, JP

## Members

**Professor Richard Y C Wong**, SBS, JP  
Deputy Vice-Chancellor  
The University of Hong Kong

**Mr Christopher Cheng Wai Chee**, GBS, JP  
Chairman  
USI Holdings Limited

**Mr Victor Lo Chung Wing**, GBS, JP  
Chairman and Chief Executive  
Gold Peak Industries (Holdings) Limited

**Dr Patrick Wang Shui Chung**, JP  
Chairman and Chief Executive Officer  
Johnson Electric Holdings Limited

**Professor K C Chan**  
Dean of Business and Management  
Hong Kong University of Science and Technology

**Mr Henry Fan Hung-ling**, SBS, JP  
Managing Director  
CITIC Pacific Limited

**Mr Simon Ip Sik-on**, JP

**Mr Thomas Kwok Ping-kwong**, JP  
Vice-Chairman and Managing Director  
Sun Hung Kai Properties Limited

## Secretary

**Mr Christopher Munn**



The **Audit Sub-Committee** reviews and reports on the HKMA's financial reporting process and the adequacy and effectiveness of the internal control systems of the HKMA. The Sub-Committee reviews the HKMA's financial statements, and the composition and accounting principles adopted in such statements. It also examines and reviews with both the external and internal auditors the scope and results of their audits.

*Membership (1 April 2005)*

## Chairman

**Mr Marvin Cheung Kin Tung**, DBA Hon., SBS, JP

## Members

**Mr David Eldon**, GBS, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

**Mr He Guangbei**

Vice Chairman and Chief Executive  
Bank of China (Hong Kong) Limited

**Mr Peter Sullivan**

Executive Director and Chief Executive Officer  
Standard Chartered Bank (Hong Kong) Limited

**Dr The Hon. David Li Kwok Po**, LLD, GBS, JP

Chairman and Chief Executive  
The Bank of East Asia Limited

## Secretary

**Mr Christopher Munn**

The **Currency Board Sub-Committee** monitors and reports on the Currency Board arrangements that underpin Hong Kong's Linked Exchange Rate system. It is responsible, among other things, for ensuring that Currency Board operations are in accordance with established policy, recommending improvements to the Currency Board system, and ensuring a high degree of transparency in

the operation of the system. Records of the Sub-Committee's meetings and the reports on Currency Board operations submitted monthly to the Sub-Committee are published.

 > [Information Centre](#) > [Press Releases](#) > [Monetary Policy](#)

*Membership (1 April 2005)*

## Chairman

**Mr Joseph Yam**, GBS, JP

The Monetary Authority

## Members

**Mr Norman Chan**, SBS, JP

Deputy Chief Executive

Hong Kong Monetary Authority

**Mr William Ryback**, JP

Deputy Chief Executive

Hong Kong Monetary Authority

**Mr Peter Pang**, JP

Deputy Chief Executive

Hong Kong Monetary Authority

**Dr The Hon. David Li Kwok Po**, LLD, GBS, JP

Chairman and Chief Executive  
The Bank of East Asia Limited

**Professor Richard Y C Wong**, SBS, JP

Deputy Vice-Chancellor

The University of Hong Kong

**Mr John Greenwood**

Group Chief Economist

INVESCO Asset Management Limited

**Professor Tsang Shu Ki**

Department of Economics

Hong Kong Baptist University

**Professor K C Chan**

Dean of Business and Management

Hong Kong University of Science and Technology

**Mr He Guangbei**

Chairman

The Hong Kong Association of Banks

## Secretary

**Mr Christopher Munn**

The **Investment Sub-Committee** monitors the HKMA's investment management work and makes recommendations on the investment policy and strategy of the Exchange Fund and on risk management and other related matters.

*Membership (1 April 2005)*

## Chairman

**Mr Joseph Yam**, GBS, JP  
The Monetary Authority

## Members

**Mr Norman Chan**, SBS, JP  
Deputy Chief Executive  
Hong Kong Monetary Authority

**Mr David Eldon**, GBS, JP  
Chairman  
The Hongkong and Shanghai Banking Corporation Limited

**Mr Christopher Cheng Wai Chee**, GBS, JP  
Chairman  
USI Holdings Limited

**Mr He Guangbei**  
Vice Chairman and Chief Executive  
Bank of China (Hong Kong) Limited

**Professor K C Chan**  
Dean of Business and Management  
Hong Kong University of Science and Technology

**Mr Henry Fan Hung-ling**, SBS, JP  
Managing Director  
CITIC Pacific Limited

**Mr Peter Sullivan**  
Executive Director and Chief Executive Officer  
Standard Chartered Bank (Hong Kong) Limited

## Secretary

**Mr Christopher Munn**

The **Financial Infrastructure Sub-Committee** monitors the work of the HKMA in relation to the development and operation of the financial infrastructure in Hong Kong and makes recommendations on measures and initiatives relating to the HKMA's responsibilities for promoting the safety, efficiency and development of Hong Kong's financial infrastructure.

*Membership (1 April 2005)*

## Chairman

**Mr Joseph Yam**, GBS, JP  
The Monetary Authority

## Members

**Mr Norman Chan**, SBS, JP  
Deputy Chief Executive  
Hong Kong Monetary Authority

**Mr Peter Pang**, JP  
Deputy Chief Executive  
Hong Kong Monetary Authority

**Dr The Hon. David Li Kwok Po**, LLD, GBS, JP  
Chairman and Chief Executive  
The Bank of East Asia Limited

**Mr David Eldon**, GBS, JP  
Chairman  
The Hongkong and Shanghai Banking Corporation Limited

**Mr Christopher Cheng Wai Chee**, GBS, JP  
Chairman  
USI Holdings Limited

**Dr Patrick Wang Shui Chung**, JP  
Chairman and Chief Executive Officer  
Johnson Electric Holdings Limited

**Mr He Guangbei**  
Vice Chairman and Chief Executive  
Bank of China (Hong Kong) Limited

**Mr Henry Fan Hung-ling**, SBS, JP  
Managing Director  
CITIC Pacific Limited

**Mr Peter Sullivan**  
Executive Director and Chief Executive Officer  
Standard Chartered Bank (Hong Kong) Limited

## Secretary

**Mr Christopher Munn**

## The Banking Advisory Committee

The Banking Advisory Committee is established under Section 4(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong SAR on matters relating to the Banking Ordinance, in particular matters relating to banks and the carrying on of banking business. The Committee consists of the Financial Secretary, who is the Chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR.

*Membership (1 April 2005)*

### Chairman

**The Hon. Henry Tang Ying Yen**, GBS, JP  
The Financial Secretary

### Ex Officio Member

**Mr Joseph Yam**, GBS, JP  
The Monetary Authority

### Members

**The Hon. Frederick Ma Si Hang**, JP  
Secretary for Financial Services and the Treasury

**Mr He Guangbei**  
Vice Chairman and Chief Executive  
Bank of China (Hong Kong) Limited  
Representing Bank of China (Hong Kong) Limited

**Mr Peter Wong Tung-shun**, JP  
Executive Director  
The Hongkong and Shanghai Banking Corporation Limited  
Representing The Hongkong and Shanghai Banking Corporation Limited

**Mr Peter Sullivan**  
Executive Director and Chief Executive Officer  
Standard Chartered Bank (Hong Kong) Limited  
Representing Standard Chartered Bank (Hong Kong) Limited

**Mrs Mignonne Cheng**  
Head of North and East Asia  
BNP Paribas

### Mrs Chan Hui Dor Lam Doreen

President and Chief Executive Officer  
Citic Ka Wah Bank Limited

### Mrs Angelina P L Lee, JP

Partner  
Woo, Kwan, Lee & Lo  
Solicitors and Notaries

### Dr The Hon. David Li Kwok Po, LLD, GBS, JP

Chairman and Chief Executive  
The Bank of East Asia Limited

### Mr Tatsuo Tanaka

Managing Director and Chief Executive Officer for China  
The Bank of Tokyo-Mitsubishi, Ltd

### Mr Samuel N Tsien

President and Chief Executive Officer  
Bank of America (Asia) Limited

### Mr David S Y Wong, JP

Chairman  
Dah Sing Bank Limited

### Ms Maria Xuereb

Financial Services Partner  
Deloitte Touche Tohmatsu

### Secretary

**Ms Ida Liu**

## The Deposit-Taking Companies Advisory Committee

The Deposit-Taking Companies Advisory Committee is established under Section 5(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong SAR on matters relating to the Banking Ordinance, in particular matters relating to deposit taking companies and restricted licence banks and the carrying on of a business of taking deposits by them. The Committee consists of the Financial Secretary, who is the Chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR.

*Membership (1 April 2005)*

## Chairman

**The Hon. Henry Tang Ying Yen, GBS, JP**  
The Financial Secretary

## Ex Officio Member

**Mr Joseph Yam, GBS, JP**  
The Monetary Authority

## Members

**The Hon. Frederick Ma Si Hang, JP**  
Secretary for Financial Services and the Treasury

**Mr Andrew Sheng, SBS, JP**  
Chairman  
Securities and Futures Commission  
Representing The Securities and Futures Commission

**Mrs Pamela Chan Wong Shui, BBS, JP**  
Chief Executive  
Consumer Council  
Representing The Consumer Council

**Mr Clifford Forster**  
Chairman  
Hong Kong Association of Restricted Licence Banks and  
Deposit-Taking Companies (The DTC Association)  
Representing The DTC Association

**Mr Mervyn Jacob**  
Partner  
Financial Services Division  
PricewaterhouseCoopers

**Mr Andrew Kuo**  
Managing Director  
JP Morgan Securities (Asia Pacific) Limited

**Dr Eric K C Li, GBS, JP**  
Senior Partner  
Li, Tang, Chen & Co  
Certified Public Accountants (Practising)

**Mr Geoffrey J Mansfield**  
Managing Director  
PrimeCredit Limited

**Mr Mok Wai-kin**  
Director  
Hang Seng Finance Limited

**Mr Poon Kwok Yuen**  
President and Chief Executive Officer  
AIG Finance (Hong Kong) Limited

**Mr Tan Yoke Kong**  
General Manager  
JCG Finance Company, Limited

**Mr Frank J Wang**  
Director and Deputy Chief Executive  
Wing Hang Finance Company Limited

## Secretary

**Ms Ida Liu**

## Chief Executive's Committee

The Chief Executive's Committee is chaired by the Chief Executive of the HKMA and consists of the Deputy Chief Executives and the Executive Directors of the HKMA. The Committee meets weekly to report to the Chief Executive on the progress of major tasks being undertaken by the various departments of the HKMA and to advise him on policy matters relating to the operations of the HKMA.

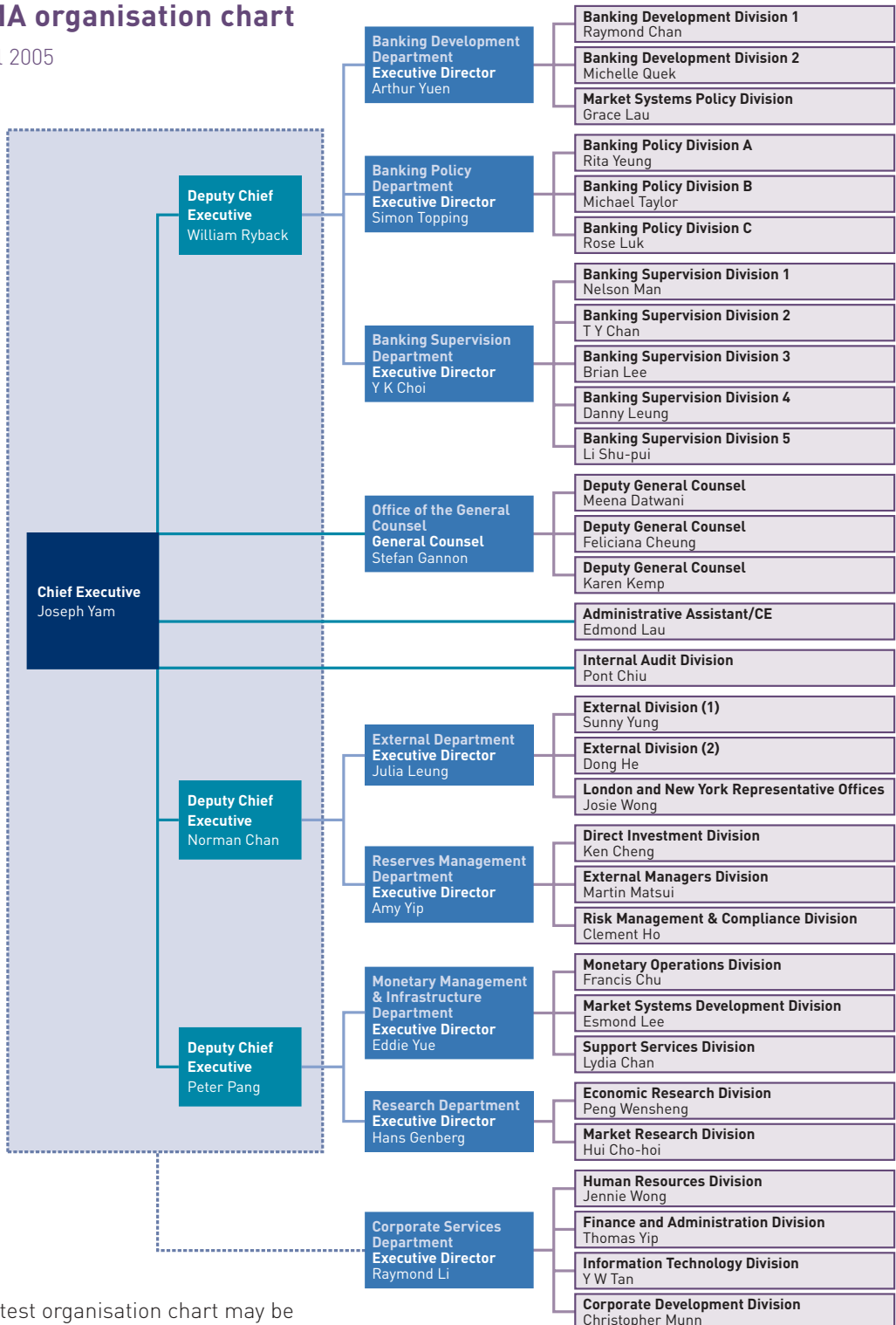
*The membership lists of the various Committees and Sub-Committees, brief biographies, and the Code of Conduct for EFAC Members may be found on the HKMA website. A Register of Members' Interests, which contains the declarations of interests by Members of EFAC, is available for public inspection during office hours (9:00 a.m. to 5:00 p.m. Monday to Friday and 9:00 a.m. to 12 noon Saturday) at the HKMA Offices, 55th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong.*

 > [About the HKMA](#) > [The HKMA](#) > [Advisory Committees](#)

 > [About the HKMA](#) > [The HKMA](#) > [The Chief Executive's Committee](#)

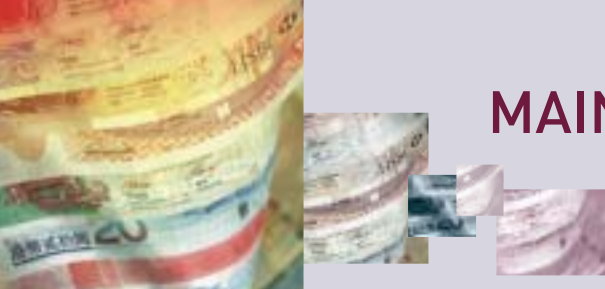
# HKMA organisation chart

1 April 2005



The latest organisation chart may be found on the HKMA website.

 > About the HKMA > The HKMA > Organisation Chart



# MAINTAINING MONETARY STABILITY

## The Linked Exchange Rate system

The monetary policy objective of Hong Kong is currency stability. This is defined as a stable external exchange value of the Hong Kong dollar in terms of its exchange rate against the US dollar at around HK\$7.80 to one US dollar. The monetary policy objective is achieved through the Linked Exchange Rate system, which has been implemented since 17 October 1983. The Linked Exchange Rate system plays an important part in supporting Hong Kong's role as a trading, service and financial centre.

## The Currency Board system

Exchange rate stability in Hong Kong is achieved through a Currency Board system. The Monetary Base is consequently fully backed by foreign currency reserves at the fixed exchange rate of HK\$7.80 to US\$1. Under the Currency Board system, any change in the Monetary Base must be fully matched by corresponding changes in foreign currency reserves.

Hong Kong's Monetary Base consists of four components:

- Certificates of Indebtedness, which back the banknotes issued by the three note-issuing banks
- government-issued currency notes and coins in circulation
- the sum of the balances on the clearing accounts maintained by banks with the HKMA (known as the Aggregate Balance)
- Exchange Fund Bills and Notes, which are issued by the HKMA to facilitate liquidity management by banks.

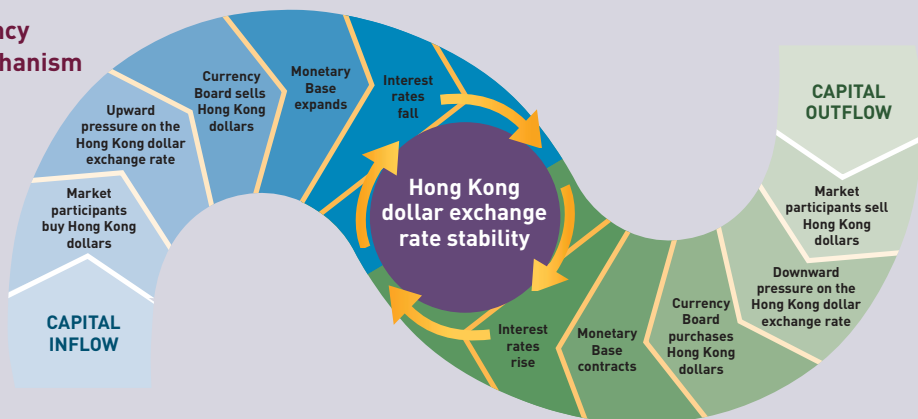
Under the Currency Board system, the stability of the Hong Kong dollar exchange rate is maintained through an interest rate adjustment mechanism.

In recent years the Currency Board system has been strengthened to make it more transparent and resilient to external shocks. In particular, the HKMA has provided a clear undertaking to all banks to convert their Hong Kong dollar clearing balances into US dollars at the convertibility rate of HK\$7.80.

[www](#) > Policy Areas > Monetary Stability > Currency Board System

[Further reading:](#)  
 HKMA Background Brief No.1 – Hong Kong's Linked Exchange Rate System  
 HKMA Annual Report 2004: Monetary Stability chapter

## The Currency Board mechanism



# PROMOTING BANKING SAFETY



The principal function of the HKMA as banking supervisor is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA seeks to ensure that banks and deposit-taking companies in Hong Kong operate in an effective, responsible, honest and business-like manner to provide a measure of protection to depositors. The HKMA derives its powers as banking supervisor from the Banking Ordinance.


## The three tiers of banking in Hong Kong


Hong Kong's banks are divided into three tiers of authorized institutions (AIs). The main distinctions lie in the deposit business each tier of institution is allowed to conduct under the Banking Ordinance.

The HKMA is the licensing authority for AIs under the Banking Ordinance. The HKMA's supervisory approach is based on a policy of

continuous supervision. This involves continuous monitoring of AIs through the use of a variety of techniques, including on-site examinations, off-site reviews, prudential meetings, meetings with boards of directors, co-operation with external auditors, and sharing of information with other supervisors. The aim is to try to ensure that any problems affecting AIs are detected and addressed at an early stage.

The HKMA uses a risk-based supervisory approach to ensure that AIs have the necessary risk management systems in place to identify, measure, monitor and control the risks inherent in their operations. This enables the HKMA to be more proactive in taking actions to pre-empt any serious threat to the stability of the banking system.

 [Policy Areas > Banking Stability](#)

 **Further reading:**  
[HKMA Background Brief No.2 – Banking Supervision in Hong Kong](#)  
[HKMA Annual Report 2004: Banking Stability chapter](#)

Three tiers of authorized institutions	Deposit business permitted
<b>Licensed banks</b>	<ul style="list-style-type: none"> <li>• Current accounts, savings deposits and time deposits of any size and maturity</li> </ul>
<b>Restricted licence banks</b>	<ul style="list-style-type: none"> <li>• Time deposits of HK\$500,000 or more for any maturity</li> <li>• Savings and current accounts are not permitted</li> </ul>
<b>Deposit-taking companies</b>	<ul style="list-style-type: none"> <li>• Time deposits of HK\$100,000 or more for at least three months</li> <li>• Savings and current accounts are not permitted</li> </ul>



# MANAGING THE EXCHANGE FUND

## The Exchange Fund

Established in 1935, the Exchange Fund is the cornerstone of monetary stability in Hong Kong. Its primary objective is to safeguard the exchange value of the Hong Kong dollar. Hong Kong's foreign currency reserves, held in the Exchange Fund, form the backing for the Linked Exchange Rate system.

The Exchange Fund is managed by the HKMA under powers delegated by the Financial Secretary to the Monetary Authority under the Exchange Fund Ordinance. The Exchange Fund Advisory Committee advises the Financial Secretary, as Controller of the Fund, on the investment policies and strategies for the Fund.

## Investment objectives

The investment objectives of the Exchange Fund are

- (a) to preserve capital;
- (b) to ensure that the entire Monetary Base at all times will be fully backed by highly liquid short-term US dollar denominated securities;
- (c) to ensure sufficient liquidity for the purpose of maintaining monetary and financial stability; and
- (d) subject to (a) – (c) above, to achieve an investment return that will preserve the long-term purchasing power of the assets.


## Investment process


The Exchange Fund is managed as two main portfolios – the Backing Portfolio and the Investment Portfolio. The Backing Portfolio is used to back the Monetary Base of Hong Kong. The Investment Portfolio is used to preserve the value and long-term purchasing power of assets.

The long-term asset allocation strategy of the Fund is governed by the investment benchmark, which is set by the Exchange Fund Advisory Committee. This defines the allocation of investments to different asset classes by country and by sector as well as the overall currency mix for the Fund.

## Use of external managers

The Exchange Fund employs global external managers to manage about one third of its total assets and all of its equity portfolios. The purpose of appointing external managers is to tap the best of the investment expertise available in the market, to capture a diverse mix of investment style within the global investment field, and to transfer market knowledge and information.

 [Policy Areas > Monetary Stability > Exchange Fund](#)

 [Further reading:](#)  
[HKMA Annual Report 2004: Reserves Management chapter](#)



# DEVELOPING FINANCIAL INFRASTRUCTURE



## Policy objective

The HKMA is committed to promoting a safe, efficient and reliable financial market infrastructure to help maintain Hong Kong's status as an international financial centre. The HKMA oversees the operation of important clearing and settlement systems in Hong Kong under the Clearing and Settlement Systems Ordinance. It also assumes a leading role in developing financial market infrastructure to accommodate the evolving needs of Hong Kong. The HKMA pays particular attention to fostering the local and regional debt markets and developing clearing systems to facilitate cross-border transfers of funds and securities. The long-term aim is for Hong Kong to be a leading centre of financial intermediation, where all types of financial transactions, initiated from whatever location or time zone and in whatever currency, whether at the wholesale or retail level, can be executed and settled in real time.

## Payment systems in Hong Kong

Since 1996, interbank funds transfers have been settled real-time through the Hong Kong dollar Real Time Gross Settlement (RTGS) system – the Clearing House Automated Transfer System (CHATS). This means that payment is processed continuously and that finality of settlement is instantaneous. The advantages are speed, efficiency and safety.

On an average business day around 407 billion Hong Kong dollars worth of transactions are settled through Hong Kong's RTGS system. Every year, the total turnover through this system amounts to some 102 trillion Hong Kong dollars, which is equivalent to more than 80 times Hong Kong's annual gross domestic product. The system processes the larger transactions between banks arising from the money and capital markets. It also handles smaller retail payment items, such as cheque and autopay transactions.

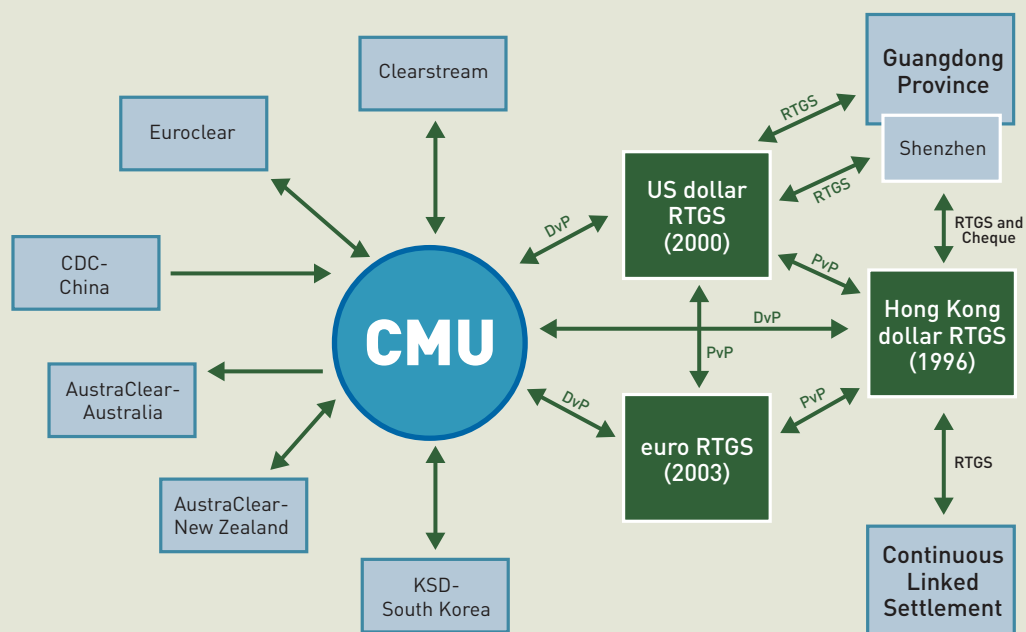
Building on the technology of the Hong Kong dollar RTGS system, the HKMA introduced a US dollar RTGS system in 2000 and a euro RTGS system in 2003.

## Central Moneymarkets Unit

The Central Moneymarkets Unit (CMU), operated by the HKMA, provides an efficient clearing, settlement and depository service for both Hong Kong dollar and other international debt securities. Since its establishment in 1990 the CMU has developed external linkages with other regional and international central securities depositories. Through these links, overseas investors can hold and settle securities lodged with the CMU.

## Hong Kong’s financial infrastructure

(clearing and settlement systems for funds and securities operated, developed or overseen by the HKMA)



Delivery-versus-Payment (DvP): A securities delivery arrangement in which the delivery of securities takes place as soon as payment is made for them and confirmed final and irrevocable.

Payment-versus-Payment (PvP): A mechanism for settling a foreign exchange transaction to ensure that a final transfer of one currency occurs only if the corresponding final transfer of the other currency or currencies also takes place at the same time.

> [Policy Areas](#) > [Financial Infrastructure](#)

Further reading:  
[HKMA Annual Report 2004: Market Infrastructure chapter](#)



# REVIEW OF 2004

Summary Version of the  
HKMA Annual Report 2004

# CHIEF EXECUTIVE'S STATEMENT



**broad and  
sustained  
recovery**

The economic recovery that began in Hong Kong in the second half of 2003 broadened and deepened in 2004. Real Gross Domestic Product grew by 8.1%, more than double the growth in 2003. Exports of goods and services grew at the highest rate in four years, and domestic consumption continued to recover. Asset markets were buoyant during the year, and the steady recovery in the property market helped bring down further the number of residential mortgages in negative equity. The unemployment rate declined from a high of 8.6% in the middle of 2003 to 6.5% in the fourth quarter of the year: this is still high by historical standards, but it should be weighed against the large number of people entering the labour market and the considerable increase in total employment, which reached a record high of 3.3 million in the last quarter of 2004.

Strong global growth, though moderating in the second half of the year, helped fuel Hong Kong's economic recovery. While the demand for goods and services from Hong Kong increased worldwide, particularly in Europe and the Asian region, it is the vitality of the Chinese economy that has continued to be the most important engine of growth in Hong

Kong. Growing numbers of visitors to Hong Kong from the Mainland boosted income from tourism. The expansion in Mainland China's external trade continued to reinforce Hong Kong's offshore trade and exports of services. Within Hong Kong, deflation came to an end, although inflation has not yet returned. Interest rates remained low. These favourable conditions, combined with a more optimistic mood in the community and among businesses, have encouraged greater private spending on consumption and investment. Economically speaking, Hong Kong had a very good year in 2004: in the absence of any unforeseen crisis, there are good reasons for expecting that the healthy and sustained progress made during the year will continue, although growth may be at a more moderate pace.

### unsettled markets

In contrast to the largely stable growth in the economy in general, financial markets in 2004 were unsettled. Equity markets throughout the world were volatile. Bond markets retreated on fears of rapid upward adjustments in US interest rates to more "normal" levels. In currency markets, the depreciation of the US dollar against other major currencies, combined with massive fund flows into Hong Kong, had a complex impact on the Hong Kong economy and presented challenges for the HKMA across its various policy areas.

The challenge in reserves management was to achieve the investment objectives of the Exchange Fund in a difficult and volatile environment. Since the Exchange Fund provides the backing for the Monetary Base and safeguards the exchange value of the Hong Kong dollar, these objectives place particular emphasis on capital preservation and high liquidity: they differentiate the Exchange Fund from many ordinary investment funds, which tend to seek maximum investment return. Despite the roller-coaster markets, and the constraints imposed by the investment objectives, the Exchange Fund earned an investment income of \$56.7 billion in 2004, and a rate of return meeting that of the investment benchmark set by the Financial Secretary on the advice of the Exchange Fund Advisory Committee. The share of investment income going to the fiscal reserves placed with the Exchange Fund was \$14.5 billion, which was \$2.2 billion more than the projected amount included in the Government's budget for the fiscal year.

**Hong Kong  
dollar stability**

The decline in the exchange value of the US dollar by a cumulative 4.6% in 2004 contributed, through the Linked Exchange Rate system, to a further decline in the effective exchange value of the Hong Kong dollar – and therefore to Hong Kong's competitiveness. An improving economy, greatly increased IPO activities, and continued market expectations of a possible revaluation of the renminbi attracted large inflows of funds into Hong Kong. These inflows supported strong liquidity in the banking system, particularly in the first and last quarters. As a result, Hong Kong dollar interest rates continued to be substantially lower than their US dollar counterparts, with differentials widening in the last quarter: short-term Hong Kong dollar interest rates rose by only about 20 basis points during the year, despite the cumulative increase of 125 basis points in the US rates.

The Hong Kong dollar stayed close to its official Linked Rate of 7.8 to the US dollar throughout the year, despite the massive fund flows, persistent speculation about a renminbi revaluation, and the decline in the US dollar. The strengthening episode that began in September 2003 worked itself out in the first four months of 2004 as the HKMA sold Hong Kong dollars in response to requests from banks. During the middle months of the year the dollar closely tracked the official rate, with repeated triggerings of the Convertibility Undertaking and the purchase of a total of \$51.5 billion worth of Hong Kong dollars by the HKMA. As a result, the Aggregate Balance declined from nearly \$55 billion in February to \$3.2 billion in September, only to begin rising again in October, as the Hong Kong dollar began to strengthen again on fund inflows and renewed renminbi speculation.

The wide variation in the size of the Aggregate Balance during 2004 and the considerable activity on both the strong and weak sides of the Linked Exchange Rate offer a lively illustration of the workings of the Currency Board system, which continues to deliver exchange rate stability for Hong Kong.

**strong and  
effective banks**

Despite a continuing squeeze on interest margins, largely as a result of the ample liquidity in the banking system, Hong Kong's banking sector saw an average 20% increase in profitability in 2004. All other main indicators showed improvement, reflecting better economic conditions and increased economic activity. Overall asset quality improved. The classified loan ratio declined. The consolidated capital adequacy ratio

of local authorized institutions remained high, at almost 16%, nearly twice the statutory minimum requirement of 8%. Loans to all sectors, particularly business, increased.

Following the full implementation of risk-based supervision in 2003, the HKMA used its supervisory resources in 2004 to focus intensively on areas of business, which, for one reason or another, might give rise to concern. Focused examinations took place of residential mortgage loans, in view of the increased competition, and of risk management and other practices in credit card business. The HKMA continued to improve the supervisory framework for preventing money laundering and terrorist financing, taking into account the latest international developments. Special emphasis was placed on banks' business continuity planning, particularly in the light of the growing dependence on technology of both banks and their customers.

A source of concern during the year was the question of the safety of banking through electronic channels. Prompt actions by the banks, the police and the HKMA early in the year helped lessen the risk of ATM frauds through tampering with machines. Internet banking fraud, however, has become a growing concern in Hong Kong, as in other parts of the world. The HKMA, together with the police and the banks, has placed particular emphasis on tackling this problem both through promoting public awareness of good security practices and through improving security-enhancing technology: by mid-2005 two-factor authentication will be introduced for high-risk Internet transactions by banks in Hong Kong providing Internet services.

The banking sector reform programme, initiated in 1999, entered its final stages in 2004 with the launch of the Commercial Credit Reference Agency in November and the enactment of the Deposit Protection Scheme Ordinance in May. The Hong Kong Deposit Protection Board was established in July, and it has since then been working on detailed plans for implementing the scheme in the second half of 2006, if prevailing conditions at the time are suitable.

As the reform programme draws to a successful conclusion, another important set of reforms involving the banking sector moves closer. In June the Basel Committee issued its revised framework on capital adequacy standards for banks, or "Basel II" as it is now usually known.

Basel II will make capital requirements more risk-sensitive, and will bring banking regulation more into line with the way that banks themselves perceive and manage risk. It will also give banks the incentive to continue to strengthen and improve their own risk management. Good progress was made in 2004 in planning for the implementation of Basel II in Hong Kong. The aim is to switch over to Basel II at the start of 2007, in line with the approach being adopted in other major international financial centres, and of the Basel Committee members themselves. We see value in being among the first in adopting Basel II, not only because of its intrinsic merits, but also because Hong Kong has one of the highest concentrations of banking institutions in the world, with a strong presence of international banking groups.

Being among the first banking centres to implement Basel II will help maintain Hong Kong's position as an international financial centre. Other initiatives taken during the year have also helped bolster this position. Thirty-eight banks in Hong Kong began offering personal renminbi deposit, remittance and exchange services during 2004. Renminbi business grew steadily during the year: at the end of December outstanding renminbi deposits in banks in Hong Kong stood at more than RMB12 billion yuan. Clearly, there is a demand for these facilities in Hong Kong, despite the modest range of services currently available: this is not surprising, given the growing integration between the Hong Kong and Mainland economies, and the considerable surge in tourists from the Mainland during the year. Since the renminbi is not yet a freely convertible currency, future development of renminbi banking business in Hong Kong will by necessity be done in a gradual and cautious way. Discussions are in progress to explore how future development may proceed, taking into account the three strategic directions outlined by the Financial Secretary in August: diversification of renminbi assets and liabilities; denomination and settlement of trade in renminbi; and debt issuance in renminbi.

Hong Kong's position as an international financial centre also benefited in 2004 from progress in the infrastructure for other currencies. Hong Kong dollar and US dollar real time gross settlement links were

**developing Hong  
Kong as an  
international  
financial centre**



introduced between Hong Kong and Guangdong province in March, extending the arrangements made between Hong Kong and Shenzhen in 2003. Joint cheque-clearing arrangements for US dollar cheques were introduced between Hong Kong and Shenzhen in July 2004. In December, the Hong Kong dollar entered the Continuous Linked Settlement (CLS) System, a global clearing and settlement system that complements Hong Kong's own multi-currency clearing systems. Entry into the CLS System was made possible by the enactment in July of the Clearing and Settlement Systems Ordinance, which came into effect in November. The Ordinance gives statutory backing to the Monetary Authority's oversight of important clearing and settlement systems, and legal certainty for settlement finality. In doing this, it will help promote the safety and robustness of Hong Kong's financial infrastructure and the financial stability of Hong Kong.

**regional and  
international  
co-operation**

Hong Kong's financial stability is dependent not just on the structures and systems that we build within Hong Kong but on the movements of markets throughout the world, and particularly on the health of the regional financial system. Memories of the Asian financial crisis in 1997-8 inevitably fade as the region in general continues to enjoy financial stability and economic growth. But the weaknesses that contributed to this crisis continue to be very much in the minds of Asian central banks, as they work together towards strengthening the regional financial system. Two regional initiatives bore fruit in 2004. 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) was announced in December. The APEC Initiative on Development of Securitisation and Credit Guarantee Markets came to a successful conclusion in September. Both of these initiatives will help stimulate the development of deep, liquid and mature regional bond markets, which can play an important role when, in times of crisis, the other channels of financial intermediation – the banks and the equity markets – falter or fail.

The HKMA played a leading role in both of these initiatives, and, because of its advantages as an international financial centre, Hong Kong has been chosen as the place of listing for two of the key

**governance of  
the HKMA**

components of ABF2. The HKMA is also contributing extensively to the work of the Bank for International Settlements (BIS), through its chairmanship of the BIS Asian Consultative Council and Central Bank Governance Steering Group, and in playing a leading role in the drafting process in the review of the Basel Core Principles for Effective Banking Supervision, which began in 2004.

Enabling active participation by Hong Kong in the various international bodies and initiatives was one of the reasons for establishing the HKMA in 1993 as a central banking organisation with a clear identity and mission. Although it is an agency of the Government, the HKMA, following general central banking principles, is separate from the main organs of government in its ability to employ staff on terms different from those of the civil service and in its funding arrangements. These arrangements enable the HKMA to operate with flexibility, in response to rapidly changing conditions, and to maintain a level of resource independence sufficient to enable it to carry out its responsibilities without political influence. This measure of autonomy in the HKMA's operations is balanced by an apparatus of accountability, to the Financial Secretary through the Exchange Fund Advisory Committee (EFAC), and to the community, both directly and through its elected representatives on the Legislative Council.

During 2004 the governance arrangements of the HKMA were strengthened with an expansion of the EFAC sub-committee system. A new Governance Sub-Committee was created, replacing the old Remuneration and Finance Sub-Committee, with the task of monitoring the performance of the HKMA and making recommendations to the Financial Secretary, through EFAC, on the full range of remuneration, human resources, budgetary, administrative and governance issues affecting the HKMA. This Sub-Committee is composed of the non-official, non-banking Members of EFAC. Two new sub-committees – one on investment, the other on financial infrastructure – were formed at the end of 2004 and held their first meetings in early 2005. These two new sub-committees will enable Members to focus more on the technical details of these important areas of the HKMA's work.

The HKMA continued in 2004 to develop its policy of transparency and accessibility. The HKMA's *Half-Yearly Monetary and Financial Stability Report*, first issued in December 2003, has become well established as the main channel of clear and systematic information on the HKMA's view of the main forces acting upon Hong Kong's monetary and financial systems. The HKMA's Information Centre, which opened towards the end of 2003, received nearly 50,000 visitors of all ages and walks of life in 2004. Increasing numbers of people are using our enquiries service and visiting our website. During 2004 the HKMA also mounted an extensive campaign of seminars and visits to inform members of the public about the new \$20, \$50 and \$1,000 banknotes, which went into circulation in October: in all, some 93,000 people were reached during this campaign. At no time has the HKMA been in direct contact with so many people. In helping people better understand Hong Kong's monetary and banking systems, these initiatives have, we believe, helped contribute to Hong Kong's monetary and financial stability. They have also provided further informal channels for keeping ourselves abreast of public views on the policies we pursue.

The work of the HKMA has increased in volume and complexity over the past few years, as new responsibilities and new issues have emerged. Despite this, our staff establishment has remained stable, and our staff strength actually declined in 2004. I take this opportunity to pay tribute to the staff of the HKMA for their hard work and resourcefulness during another busy year. My colleagues and I are also grateful to the Financial Secretary and to Members of EFAC for their continued guidance and support.

A handwritten signature in black ink, appearing to be 'J. Yam', with a long horizontal flourish extending to the right.

**Joseph Yam**  
Chief Executive

# THE ECONOMIC AND BANKING ENVIRONMENT IN 2004



*Ficus microcarpa*

## Economic performance

The recovery in Hong Kong's economy gathered momentum and became more broad-based in 2004, following a strong rebound in the second half of 2003. Real GDP grew by 8.1%, reflecting a marked pick-up in domestic demand, which was supported by appreciating asset prices, improving labour market conditions and rising household income. Exports of goods and services also increased, driven by robust global growth, an expansion in Mainland China's external trade, and a revival in inbound tourism.

## Prospects for 2005

The economic recovery is expected to continue in 2005, but the pace of expansion is likely to be slower than in 2004 because of an expected slowdown in global growth. With the upturn in Hong Kong's economic activity, inflation is likely to pick up moderately, while labour market conditions should continue to improve. The main external uncertainties are the prospects for the US dollar and interest rates, volatility in oil prices, and macroeconomic and financial conditions in Mainland China.

## Performance of the banking sector

The banking sector performed well in 2004, benefiting from the broad-based recovery and closer ties with Mainland China under the Closer Economic Partnership Arrangement.

Reflecting the improving economy, domestic loans grew by 7.2% in 2004, reversing the contraction in 2003. This helped contribute to strong profit growth, particularly in the retail and private banking sector, and greater revenue from treasury business. With the unemployment rate falling and property prices rising, asset quality continued to improve.

Banks' profit margins, however, again came under pressure. Although 2004 saw rising interest rates in the United States, the rates in Hong Kong remained low, because of the high level of liquidity in the banking sector. Competition for new business, particularly for residential mortgages, led to a reduction in margins.

## Prospects for the banking sector in 2005

Buoyant exports and the revival in consumer spending should continue to underpin domestic economic growth in 2005. These conditions should lead to a further improvement in banks' asset quality. If the steady increase in property prices in 2004 continues, negative equity problems for homeowners will be lessened and households' balance sheets will strengthen.

However, uncertainties persist in the global economic environment, including the impact of macroeconomic realignment initiatives in Mainland China and the pace and depth of the economic recovery in the United States. Domestically, banks are facing risks arising from the uncertain direction of capital flows.

## Currency

The three note-issuing banks began circulating the remaining three denominations of the new series Hong Kong banknotes (\$20, \$50 and \$1,000) in October 2004. Additional security features have been incorporated in the new series:

- denomination numerals in optical variable ink
- a fluorescent machine-readable barcode
- a four-millimetre-wide windowed thread
- iridescent images.

Security features and colour schemes have also been standardised among the banknotes to enable easy recognition by the public.

 > [Consumer Information](#) > [Notes and Coins](#)



*Student ambassadors explain to retailers the security features of new banknotes.*



## Hong Kong's economy in 2004

	2003	2004
<b>Economic Growth and Inflation</b>		
Real growth in Gross Domestic Product (%),	3.2	<b>8.1</b> <sup>(a)</sup>
of which:		
Real growth in private consumption expenditure (%)	-0.3	<b>6.7</b> <sup>(a)</sup>
Real growth in gross domestic fixed capital formation (%)	0.1	<b>4.5</b> <sup>(a)</sup>
Real growth in exports (%)	12.7	<b>15.2</b> <sup>(a)</sup>
Real growth in imports (%)	11.3	<b>13.8</b> <sup>(a)</sup>
Composite Consumer Price Index (annual change, %)	-2.6	<b>-0.4</b>
<b>Labour Market</b>		
Employment (annual change, %)	-0.4	<b>2.1</b>
Unemployment rate (annual average, %)	7.9	<b>6.8</b>
<b>Money Supply (annual change, %)</b>		
Hong Kong money supply (M1)	36.8	<b>16.3</b>
Hong Kong money supply (M2) <sup>(b)</sup>	6.2	<b>4.8</b>
Hong Kong money supply (M3) <sup>(b)</sup>	5.9	<b>4.6</b>
<b>Interest Rates (end of year, %)</b>		
Savings deposit rate	0.01	<b>0.01</b>
Best lending rate	5.00	<b>5.00</b>
Three-month interbank rate	0.07	<b>0.28</b>
<b>Exchange Rates (end of year)</b>		
Hong Kong dollar/US dollar	7.763	<b>7.774</b>
Trade-weighted effective exchange rate index (Jan 2000=100)	98.8	<b>96.0</b>
<b>Hang Seng Index (end of year)</b>	12,576	<b>14,230</b>

(a) The estimates are preliminary.

(b) Adjusted to include foreign currency swap deposits.

## Performance ratios of Hong Kong's banking sector in 2004

	2003 %	<b>2004</b> %	2003 %	<b>2004</b> %
	<b>All AIs</b>		<b>Retail banks*</b>	
<b>Profitability<sup>(a)</sup></b>				
Growth of pre-tax operating profit	N.A.	<b>N.A.</b>	5.72	<b>20.31</b>
Return on assets (operating profit before tax)	0.93	<b>1.06</b>	1.36	<b>1.51</b>
Return on assets (post-tax profit)	0.81	<b>0.97</b>	1.18	<b>1.38</b>
Net interest margin	1.41	<b>1.18</b>	1.91	<b>1.65</b>
Bad debt charge to average total assets	0.24	<b>0.01</b>	0.29	<b>-0.02</b>
<b>Business Profile<sup>(a)</sup></b>				
Growth in loans to customers	-2.0	<b>5.9</b>	-0.6	<b>8.3</b>
Growth in customer deposits (all currencies)	7.5	<b>8.4</b>	7.4	<b>7.4</b>
Hong Kong dollar loan to deposit <sup>(b)</sup> ratio	81.5	<b>82.6</b>	71.6	<b>73.2</b>
<b>Asset Quality<sup>(c)</sup></b>				
Classified loans <sup>(d)</sup> as percentage of total loans	3.74	<b>2.11</b>	3.94	<b>2.24</b>
Non-performing loans <sup>(e)</sup> as percentage of total loans	2.95	<b>1.56</b>	3.17	<b>1.62</b>
			<b>All locally incorporated AIs</b>	
<b>Capital Adequacy Ratio</b> (consolidated)			15.3	<b>15.4</b>

Note:

- (a) Figures relate to Hong Kong office(s) only.
- (b) Includes swap deposits.
- (c) Figures relate to Hong Kong office(s) and in the case of local AIs include overseas branches.
- (d) Denotes loans graded as "substandard", "doubtful" or "loss".
- (e) Denotes loans on which interest has been placed in suspense or on which interest accrual has ceased.

\* This comprises all the locally incorporated banks plus a number of the larger foreign banks which are not locally incorporated but whose operations are similar to those of the locally incorporated banks, in that they operate a branch network and are active in retail banking.



*Cinnamomum camphora*

# MONETARY CONDITIONS IN 2004

The Linked Exchange Rate system operated smoothly during the year, despite the depreciation of the US dollar, market speculation about revaluation of the renminbi, and significant fund flows in Hong Kong. The exchange rate remained stable, with a modest strengthening in the fourth quarter to 7.7745 at the end of 2004 (Chart 1).

In response to changes in market conditions, the HKMA conducted a number of operations on both the strong side and the weak side of the Link. The Convertibility Undertaking was repeatedly triggered during the year. For the year as a whole, the HKMA purchased a net total of \$16.6 billion worth of Hong Kong dollars. As a result, the Aggregate Balance declined from \$29.5 billion to \$15.8 billion during the year (Chart 2).

With a cumulative increase of 125 basis points in the US federal funds target rate during the year, Hong Kong dollar interbank interest rates rose between April and September. However interest rates started to ease in October because of increased liquidity in the face of capital inflows. This led to an increase in the negative spread between Hong Kong dollar interest rates and their US dollar counterparts (Chart 3).

## Activities at the HKMA

The EFAC Currency Board Sub-Committee continued to examine issues affecting monetary and financial stability in Hong Kong. The records of discussion of the meetings of the Sub-Committee and reports on the operations of the Currency Board system are published in the HKMA's *Quarterly Bulletin* and on the HKMA website. Many of the papers the Sub-Committee considers are published in the *Quarterly Bulletin* as research articles or on the HKMA website as research memoranda.

The Hong Kong Institute for Monetary Research published 24 working papers in 2004 and organised numerous workshops and conferences on strategic issues affecting monetary and financial developments in Hong Kong and the region.



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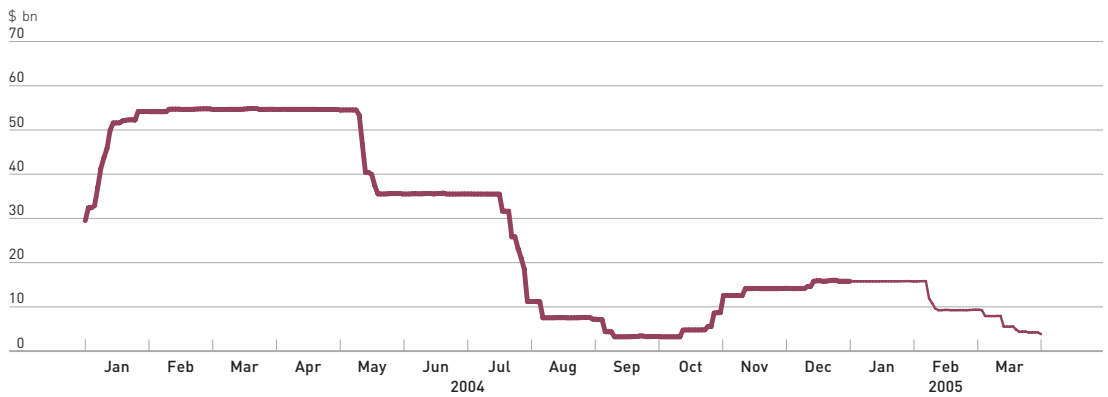
> [Information Centre](#) > [Research Memoranda](#)



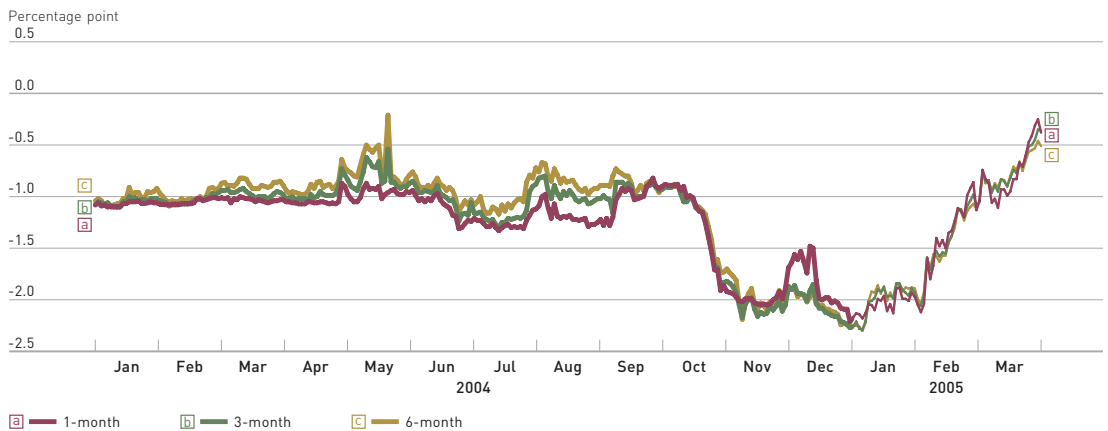
**CHART 1 Market exchange rate and Convertibility Rate**



**CHART 2 Aggregate Balance**



**CHART 3 Hong Kong dollar - US dollar interest rate differentials**





*Heritiera littoralis*

# BANKING POLICY AND SUPERVISORY ISSUES IN 2004

## Operational supervision

Full implementation of the risk-based supervisory approach in 2004 enabled the HKMA to use its resources more effectively according to the specific risk areas to which individual authorized institutions (AIs) are exposed. The HKMA conducted 247 on-site examinations, including 78 risk-focused, 11 treasury, and seven securities examinations. There were 36 focused examinations to assess AIs' compliance with the restrictions on personal renminbi business, which was launched in February 2004. Details of the operational supervisory work in 2004 are in Table 1.

## Supervision of banks

In promoting the safety and soundness of AIs in 2004, the HKMA

- issued a circular in December reminding AIs to adhere to sound internal control principles when undertaking operations involving customer assets
- worked closely with the Securities and Futures Commission in the supervision of AIs' securities activities
- held the first bilateral meeting with the Insurance Authority in June to discuss current and evolving supervisory issues
- signed an Memorandum of Understanding with the Bundesanstalt für Finanzdienstleistungsaufsicht of Germany in

**TABLE 1 Operational supervision**

	2003	2004
1. On-site examinations	247	<b>247</b>
Including those on:		
- treasury	9	<b>11</b>
- securities	18	<b>7</b>
- e-banking	28	<b>24</b>
- review of business continuity plan	20	<b>17</b>
- review of personal renminbi business	-	<b>36</b>
- overseas examinations	9	<b>20</b>
2. Off-site reviews and prudential interviews	216	<b>183</b>
3. Tripartite meetings	77	<b>66</b>
4. Meetings with boards of directors or board-level committees of AIs	16	<b>8</b>
5. Approvals of applications to become controllers, directors, chief executives, alternative chief executives of AIs	310	<b>376</b>
6. Reports commissioned under Section 59(2) of the Banking Ordinance	5	<b>1</b>
7. Cases considered by the Banking Supervision Review Committee	12	<b>9</b>

January 2004 to establish a formal framework for supervisory co-operation and the sharing of supervisory information

- recommended a set of precautionary measures to prevent ATM skimming fraud cases in Hong Kong

- launched a multi-channel consumer education programme on Internet banking security and issued a Supervisory Policy Manual module on Supervision of e-Banking and conducted 24 on-site examinations of Internet banking and IT-related controls.

## Banking reform

Further progress was made on the two remaining policy initiatives in the HKMA's banking sector reform programme:

- the Deposit Protection Scheme Ordinance was enacted in May, and the Hong Kong Deposit Protection Board was formed in July to oversee the project for establishing the Deposit Protection Scheme
- the Commercial Credit Reference Agency was launched in November.

## Basel II

Scheduled for implementation on 1 January 2007, the New Basel Capital Accord (or "Basel II") is a more risk-sensitive framework for regulating the capital adequacy of banks. During 2004 the HKMA

- established a Basel II Consultation Group<sup>1</sup> to meet regularly to discuss implementation proposals
- briefed the Legislative Council Panel on Financial Affairs on the HKMA's plans to implement the revised capital framework in Hong Kong

- released detailed proposals for public consultation during August and September 2004
- maintained close contact with individual banks to understand their readiness to meet the revised framework's requirements
- worked with the Department of Justice and the Financial Services and Treasury Bureau in drafting the Banking (Amendment) Bill 2005 to provide for the implementation of the Basel II requirements.

## Consumer issues

The HKMA issued a circular requiring all AIs to make appropriate changes to their safe deposit box agreements by 31 March 2005 with a view to improving the use of exemption clauses by AIs. In parallel, the Code of Banking Practice Committee, of which the HKMA is a member, amended the Code to make it clear that AIs should have due regard to the Control of Exemption Clauses Ordinance, Unconscionable Contracts Ordinance and the Supply of Services (Implied Terms) Ordinance in drawing up terms and conditions of banking services. Overall, the level of compliance with the Code remained high, with 99% of AIs reporting either full, or largely full, compliance in the past two years.

<sup>1</sup> The Basel II Consultation Group comprises representatives from the HKMA, the banking industry, the accounting profession and other interested groups.

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 > [Information Centre](#) > [Guidelines and Circulars](#)

 > [Policy Areas](#) > [Supervisory Policy Manual](#)

 > [Consumer Information](#)



*Bauhinia blakeana*

# MARKET INFRASTRUCTURE IN 2004

## Payment systems in Hong Kong

The Hong Kong dollar payment system and the two foreign currency payment systems operated smoothly and efficiently in 2004.

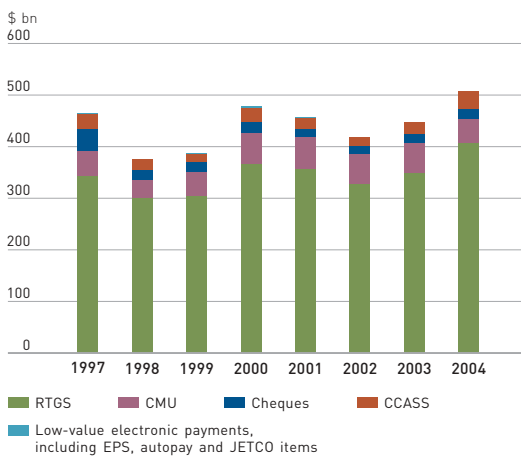
Hong Kong Interbank Clearing Limited processed a daily average value of \$407 billion (14,736 items in volume) Clearing House Automated Transfer System (CHATS) transactions, and \$17.1 billion (122 items in volume) Central Moneymarkets Unit (CMU) secondary market transactions. The system also provided for the smooth settlement of the four daily bulk clearings – the money settlement of stock market transactions (Central Clearing and Settlement System or CCASS), cheques, low-value bulk electronic payment items (EPS and autopay) and low-value ATM transfers (JETCO) (Chart 1).

The CHATS Optimiser, a system mechanism that settles paper cheques and large-value CHATS payments simultaneously and in an offsetting manner, was introduced to the Hong Kong dollar payment system in June 2004. CHATS Optimiser has been widely used by banks. It enables them to better manage their liquidity, facilitates the recycling of liquidity to the market, and smoothes payment flows, in particular at times of large fund flows associated with initial public offerings.

At the end of 2004 there were 68 direct and 164 indirect participants in the US dollar clearing system, including 119 indirect participants from outside Hong Kong. The system handled on average 5,033 transactions a day in 2004 with a total value of over US\$5.51 billion.

At the end of 2004 the euro clearing system had 23 direct and 21 indirect participants, including 11 indirect participants from outside Hong Kong. The system handled an average of 37 transactions a day with a total value of €923 million.

**CHART 1 Hong Kong dollar payment system daily average turnover**



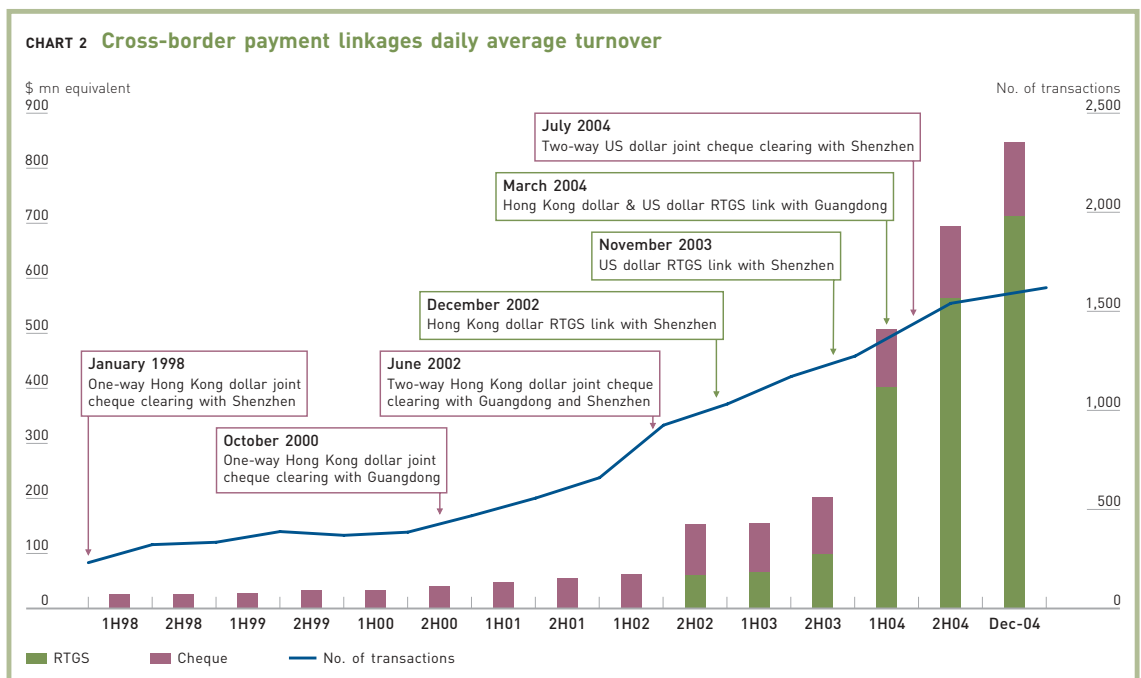
> [Policy Areas](#) > [Financial Infrastructure](#) > [Infrastructure](#)

## Payment linkages with Mainland China

In 2004 two new links with the Mainland were implemented. In March the HKMA and the Guangzhou branch of the People's Bank of China introduced cross-border system linkages for Hong Kong dollar and US dollar Real Time Gross Settlement (RTGS) payments between banks in Hong Kong and Guangdong

Province. In July the existing Hong Kong dollar joint cheque clearing facilities between Shenzhen and Hong Kong were extended to cover US dollar cheques.

The average daily turnover through all payment linkages with Mainland China increased rapidly to the equivalent of \$850 million in December 2004 (Chart 2).



## Oversight of clearing and settlement systems

The Clearing and Settlement Systems Ordinance became effective in November 2004. The Ordinance establishes a statutory regime for the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong, or to the functioning of Hong Kong as an international financial centre. It also provides statutory backing to the finality of settlement for transactions made through systems designated under the Ordinance by protecting the settlement finality from insolvency laws or any other laws. The legislation contributes to the transparency of the HKMA's central bank operations.

 > [Policy Areas](#) > [Financial Infrastructure](#) > [Oversight](#)

## Debt market development

To promote development of the debt market, the HKMA

- improved the liquidity and credibility of the Hong Kong dollar benchmark yield curve by continually rebalancing the maturity mix of the Exchange Fund Bills and Notes (EFBN) portfolio, and by increasing transparency in the daily fixings of the EFBN
- reviewed the one-year pilot scheme to facilitate retail investment in Exchange Fund Notes

- worked closely with industry associations and the Government on initiatives, such as the simplification of bond issuance procedures and the introduction of “dual prospectus” structure, and the launch of the facility operated by the CMU to facilitate settlement of Hong Kong dollar repo transactions
- deepened retail bond market development with Hong Kong Mortgage Corporation's issue of Asia's first retail mortgage-backed securities.

 > [Policy Areas](#) > [Financial Infrastructure](#) > [Debt Market Development](#)

## Treasury Markets Forum

The Treasury Markets Forum (TMF) was established among industry associations and market professionals in March 2004 to better co-ordinate efforts at raising the professionalism of practitioners and the overall competitiveness of treasury markets in Hong Kong. During the year the TMF introduced accreditation and training programmes, participated in the Financial Services Expo in Shanghai, visited Mainland financial regulators, and reviewed market practices, codes and standards.

 > [Information Centre](#) > [Press Releases](#) > [Hong Kong Market Infrastructure](#)



*Macaranga tanarius*

# INTERNATIONAL FINANCIAL CENTRE

## The HKMA and the international financial community

The HKMA continued to strengthen its contacts with the international central banking and financial community in 2004, enabling it to

- promote international understanding of, and confidence in, Hong Kong's monetary and financial systems
- promote the development of regional bond markets
- share information with other central banks about financial developments so as to facilitate the proper oversight of the markets and the prudential supervision of financial institutions
- improve understanding of international economic and financial trends
- strengthen the sharing of technical expertise between the HKMA and major central banks and multilateral institutions
- promote the understanding of other central banks, international financial institutions, and investors on Hong Kong's monetary, financial and economic developments.

## Development of regional bond markets

Through its Chairmanship of EMEAP (Executives' Meeting of East Asia and Pacific Central Banks) Working Group on Financial

Markets, the HKMA co-ordinated the important regional initiative of the local currency Asian Bond Fund (ABF2), the launch of which was announced in December. ABF2 includes a Pan-Asian Bond Index Fund (PAIF) and eight single-market funds. It will be invested in by all 11 EMEAP central banks and will help promote the development of domestic and regional bond markets in Asia. During the year, the HKMA continued to lead the Asia-Pacific Economic Co-operation (APEC) initiative on the Development of Securitisation and Credit Guarantee Markets with Thailand and Korea as co-chairs.

## Regional monetary co-operation

The HKMA continued to contribute to policy dialogues in international and regional forums and to play a role in regional monetary co-operation in 2004. The Chief Executive of the HKMA, Mr Joseph Yam, chaired the Asian Consultative Council of the Bank for International Settlements in 2004. 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 negotiations on the Eighth Replenishment of the ADF. In December 2004, the Legislative Council's Finance Committee approved Hong Kong's contribution of \$149.7 million (US\$19.19 million) to the Eighth Replenishment.

## Upgrading of Hong Kong's sovereign credit ratings

The HKMA has been playing a key role in the adoption of a more pro-active approach towards Hong Kong's international credit ratings. Between April and June, Standard & Poor's, Fitch Ratings, and Rating and Investment Information all upgraded their outlook on Hong Kong's sovereign rating from negative to stable.

## Financial market integration with the Mainland

Personal renminbi banking services were introduced in Hong Kong in February 2004. At the end of 2004 outstanding renminbi deposits totalled RMB12.1 billion yuan. The signing of Closer Economic Partnership Arrangement (CEPA II) on 27 October 2004 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.

The HKMA continued to engage in research co-operation with Mainland academics and think-tanks to develop its understanding of financial and economic issues in the Mainland. A number of Mainland officials and academics were also invited to Hong Kong to exchange views on issues of common interest. Training programmes were provided to 833 Mainland officials in 2004.

 > [Policy Areas](#) > [Monetary Stability](#) > [External Relations](#)

 > [Information Centre](#) > [Press Releases](#) > [International Relations](#)





*Bombax ceiba (B. malabaricum)*

# EXCHANGE FUND PERFORMANCE IN 2004

Financial markets were volatile in 2004 (Table 1). The Exchange Fund recorded income of

- \$25 billion from bonds
- \$12 billion from Hong Kong equities
- \$11.2 billion from foreign equities
- \$8.5 billion from foreign exchange gains.

The investment strategy resulted in an overall income of \$56.7 billion, or a return on investment of 5.7%, which was in line with the benchmark for the year.

The investment return on the Exchange Fund relative to the investment benchmark and domestic inflation rate from 1993 to 2004 is shown in Table 2. The currency mix of the Fund's assets at 31 December 2004 is in Table 3.

 > [Policy Areas](#) > [Monetary Stability](#) > [Exchange Fund](#)

 > [Information Centre](#) > [Press Releases](#) > [Exchange Fund](#)

**TABLE 1 Market returns**

	2004	2003
<b>Currencies</b>		
Appreciation against US dollar		
euro	+7.8%	+20.2%
yen	+4.6%	+10.7%
<b>Bond markets</b>		
JP Morgan US Government Bond (1-3 years) Index	+0.9%	+2.0%
<b>Equity markets</b>		
Standard & Poor's 500 Index	+9.0%	+26.4%
Hang Seng Index	+13.2%	+34.9%

**TABLE 2 Gross investment return of the Exchange Fund (in Hong Kong dollar terms)<sup>1</sup>**

	Return on total assets	Return on investment benchmark <sup>2</sup>	CPI(A) <sup>3</sup>
2004	5.7%	5.7%	+0.4%
2003	10.2%	9.5%	-1.2%
1993 – 2004 cumulative	117.0%	N.A.	24.5%
1993 – 2004 annualised	6.7%	N.A.	1.8%

<sup>1</sup> For the Annual Reports from 2001 to 2003, return on total assets and return on investment benchmark are in US dollar terms.

<sup>2</sup> Established in January 1999.

<sup>3</sup> December year-on-year percentage change in the HK-CPI(A) index. CPI (A) is calculated based on the 1999/2000 base new series.

**TABLE 3 Currency mix of the Exchange Fund's assets at 31 December 2004 (including forward transactions)**

	HK\$ billion	%
<b>US dollar bloc</b>		
US dollar <sup>1</sup>	835.3	78.7
Hong Kong dollar	92.5	8.7
<b>Non-US dollar bloc</b>		
	134.1	12.6
<b>Total</b>	<b>1,061.9</b>	<b>100.0</b>

<sup>1</sup> Include US dollar bloc foreign currencies such as Canadian dollar, Australian dollar and New Zealand dollar.

# THE EXCHANGE FUND

The financial position of the Exchange Fund and the Group in 2004 is shown below in the Income and Expenditure Account and Balance Sheet, which are extracted from the *HKMA Annual Report 2004*. The audited full statement of accounts of the Exchange Fund for 2004 may be found on pages 92 to 125 of the full Annual Report.

## EXCHANGE FUND – INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 December 2004

(Expressed in millions of Hong Kong dollars)	Group		Fund	
	2004	2003	2004	2003
<b>INCOME</b>				
Interest income				
Interest income on debt securities	<b>21,534</b>	23,253	<b>21,380</b>	23,103
Other interest income	<b>3,064</b>	3,271	<b>2,194</b>	2,410
Total interest income	<b>24,598</b>	26,524	<b>23,574</b>	25,513
Dividend income from listed equity securities	<b>4,556</b>	3,751	<b>4,556</b>	3,751
Dividend income from subsidiaries	-	-	<b>17</b>	140
Net realised and revaluation gains on other investments in securities	<b>19,538</b>	29,384	<b>19,538</b>	29,384
Other net realised and revaluation gains	<b>582</b>	7,977	<b>582</b>	7,960
Net exchange gains	<b>8,469</b>	22,886	<b>8,474</b>	22,900
Bank licence fees	<b>129</b>	130	<b>129</b>	130
Others	<b>353</b>	238	<b>70</b>	49
<b>TOTAL INCOME</b>	<b>58,225</b>	90,890	<b>56,940</b>	89,827
<b>EXPENDITURE</b>				
Interest expense	<b>(18,066)</b>	(30,233)	<b>(17,856)</b>	(29,847)
Operating expenses	<b>(1,523)</b>	(1,508)	<b>(1,251)</b>	(1,179)
Note and coin expenses	<b>(182)</b>	(229)	<b>(182)</b>	(229)
<b>TOTAL EXPENDITURE</b>	<b>(19,771)</b>	(31,970)	<b>(19,289)</b>	(31,255)
<b>SURPLUS BEFORE PREMISES     REVALUATION AND ASSOCIATE</b>	<b>38,454</b>	58,920	<b>37,651</b>	58,572
Surplus/(Deficit) on revaluation of premises	<b>876</b>	(876)	<b>876</b>	(876)
Share of profit of associate	<b>4</b>	10	-	-
<b>SURPLUS BEFORE TAXATION</b>	<b>39,334</b>	58,054	<b>38,527</b>	57,696
Taxation of subsidiaries and share of taxation of associate	<b>(110)</b>	(58)	-	-
<b>SURPLUS AFTER TAXATION</b>	<b>39,224</b>	57,996	<b>38,527</b>	57,696
Minority interests	<b>(21)</b>	(24)	-	-
<b>SURPLUS FOR THE YEAR</b>	<b>39,203</b>	57,972	<b>38,527</b>	57,696

## EXCHANGE FUND – BALANCE SHEET

as at 31 December 2004

(Expressed in millions of Hong Kong dollars)	Group		Fund	
	2004	2003	2004	2003
<b>ASSETS</b>				
Cash and money at call	<b>20,759</b>	19,168	<b>20,738</b>	19,143
Placements with banks and other financial institutions	<b>48,178</b>	43,823	<b>42,747</b>	41,549
Investment securities	<b>300</b>	300	<b>300</b>	300
Other investments in securities	<b>977,746</b>	931,737	<b>977,746</b>	931,737
Held-to-maturity securities	<b>4,130</b>	3,574	-	-
Mortgage loans	<b>34,938</b>	34,582	-	-
Gold	<b>228</b>	217	<b>228</b>	217
Other assets	<b>14,510</b>	14,095	<b>13,914</b>	13,503
Investments in subsidiaries	-	-	<b>2,145</b>	2,145
Investment in associate	<b>23</b>	20	-	-
Fixed assets	<b>4,286</b>	3,309	<b>4,036</b>	3,051
<b>TOTAL ASSETS</b>	<b>1,105,098</b>	1,050,825	<b>1,061,854</b>	1,011,645
<b>LIABILITIES AND EQUITY</b>				
Certificates of Indebtedness	<b>146,775</b>	134,215	<b>146,775</b>	134,215
Government-issued currency notes and coins in circulation	<b>6,351</b>	6,297	<b>6,351</b>	6,297
Balance of the banking system	<b>15,789</b>	28,277	<b>15,789</b>	28,277
Exchange Fund Bills and Notes	<b>125,860</b>	123,520	<b>125,860</b>	123,520
Other debt securities	<b>35,495</b>	36,620	-	-
Placements by banks and other financial institutions	<b>39,087</b>	44,542	<b>39,087</b>	44,542
Placements by other Hong Kong Special Administrative Region government funds	<b>280,091</b>	252,296	<b>280,091</b>	252,296
Placements by Hong Kong statutory bodies	-	164	-	164
Other liabilities	<b>29,645</b>	38,284	<b>24,310</b>	37,455
Total liabilities	<b>679,093</b>	664,215	<b>638,263</b>	626,766
Minority interests	<b>167</b>	160	-	-
Accumulated surplus	<b>425,644</b>	386,441	<b>423,397</b>	384,870
Premises revaluation reserve	<b>194</b>	9	<b>194</b>	9
Total equity	<b>425,838</b>	386,450	<b>423,591</b>	384,879
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>1,105,098</b>	1,050,825	<b>1,061,854</b>	1,011,645

# MAJOR EVENTS 1993 - 2004

1993

## April 1993

The Hong Kong Monetary Authority is established with responsibility for monetary and banking stability, reserves management, and financial infrastructure.

## May 1993

The Government starts to replace the Queen's Head coins with the new bauhinia design.



## July 1993

The Government announces the sale of Overseas Trust Bank for HK\$4,457 million. The sale of the bank, taken over in June 1985, marks the end of the Government's efforts to rescue banks in the 1980s.



## July 1993

Hong Kong becomes the first city in the world to have a completely digital telephone network.

1994

## May 1994

The Bank of China issues its first Hong Kong banknotes.



## June 1994

The Government announces a package of measures to dampen property speculation.

## August 1994

The Hang Seng China Enterprises Index is launched to serve as an indicator of the overall performance of Hong Kong-listed, state owned enterprises of the People's Republic of China.

## September 1994

The first issue of five-year Exchange Fund Notes is launched. The issue helps extend the benchmark yield curve for Hong Kong dollar debt to the five year area.

## October 1994

The interest rate cap on time deposits is lifted in phases. This marks the beginning of a relaxation of Interest Rate Rules in Hong Kong.

## November 1994

Hong Kong issues its first bimetallic coin – the bauhinia \$10 coin.

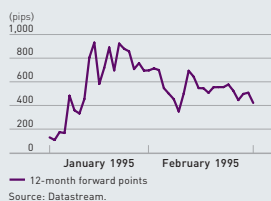


1995

## January 1995

In the aftermath of the Mexican peso crisis, the Hong Kong dollar comes under selling pressure along with other Asian currencies.

**Hong Kong dollar forward exchange rate**



## May 1995

Hong Kong Interbank Clearing Limited is established to provide interbank clearing functions in Hong Kong.



HONG KONG INTERBANK CLEARING LIMITED  
香港銀行同業結算有限公司

## June 1995

The HKMA becomes the licensing authority of three types of authorized institutions, following the enactment of the Banking (Amendment) Ordinance 1995.

## July 1995

The Companies Ordinance is amended so that depositors are entitled to receive priority payment in the liquidation of banks.

## November 1995

The Government decides to publish the size of Hong Kong's foreign exchange reserves (i.e. foreign currency assets of the Exchange Fund) every quarter instead of every six months.

## November 1995

The first issue of seven-year Exchange Fund Notes is launched.

### January 1996

The Exchange Fund acquires the De La Rue banknote printing plant in Tai Po, which is renamed "Hong Kong Note Printing Limited".



### September 1996

The HKMA is invited to join the Bank for International Settlements, the Swiss-based forum promoting co-operation among central banks.

### October 1996

The first issue of ten-year Exchange Fund Notes is launched.

### December 1996

Real Time Gross Settlement is launched in Hong Kong, enabling interbank payments to be settled real time.

### March 1997



The Hong Kong Mortgage Corporation is established. It will buy mortgage loans for its own portfolio and issue mortgage-backed securities.

### July 1997

Hong Kong becomes a Special Administrative Region of the People's Republic of China.



### July 1997

The assets of the Land Fund are handed over to Hong Kong SAR Government with a net value of HK\$197 billion. From July 1997 to October 1998 these assets are managed by the HKMA as a separate fund within the fiscal reserves. On 1 November 1998 the assets of the Land Fund are merged with the Exchange Fund and managed as part of the investment portfolio of the Exchange Fund.



### July 1997

The *Code of Banking Practice* is issued to improve the transparency and quality of banking services in Hong Kong.

### September 1997



The Octopus card appears in Hong Kong. This contact-free stored value card is used for transport fares and retail purchases.



### September 1997

World Bank/IMF Annual Meetings are held in Hong Kong. Central bank and finance ministry officials from some 180 countries attend the meetings.

# MAJOR EVENTS 1993 - 2004 (cont.)

1998

## July 1998

Hong Kong International Airport opens at Chek Lap Kok.



## July 1998

The Bank for International Settlements opens its representative office for Asia and the Pacific in Hong Kong.

## September 1998

The HKMA introduces seven technical measures to strengthen the Currency Board arrangements.



## August 1998

Using HK\$118 billion from the Exchange Fund, the Hong Kong SAR Government launches a stock market operation to frustrate manipulation of the money and stock markets.

## October 1998

Exchange Fund Investment Limited is established to manage the portfolio of Hang Seng Index constituent stocks acquired by the Exchange Fund in the market operation of August.

1999

## January 1999

The foreign currency assets and the balance sheet data of the Exchange Fund are published monthly, in line with the standard set by the International Monetary Fund.

## August 1999

Exchange Fund Notes commence listing on the Hong Kong Stock Exchange.

## August 1999



The Hong Kong Institute for Monetary Research is established.

## November 1999

The Tracker Fund of Hong Kong is established as a vehicle for gradually disposing of the majority of the stocks acquired by the Exchange Fund in the 1998 market operation.



2000

## August 2000

Hong Kong processes its first transaction through the new US dollar clearing system.

## October 2000

Hong Kong is selected as President for 2001-2002 of the Financial Action Task Force on Money Laundering, an international body.

## December 2000

Hong Kong's Mandatory Provident Fund System comes into full operation after years of preparation.

2001

## January 2001

The International Monetary Fund opens a sub-office in Hong Kong.

## April 2001

The Government approves in principle the proposal to introduce a deposit protection scheme in Hong Kong.

## July 2001

Interest Rate Rules are completely deregulated. Banks are free to set interest rates for all types of deposits.

## November 2001

All restrictions on the number of branches of foreign banks are lifted.

## December 2001

China enters the World Trade Organisation.

**March 2002**

The Securities and Futures Ordinance is passed by the Legislative Council. The Ordinance consolidates and modernises 10 existing ordinances into a single piece of legislation to govern financial and investment products, regulate the securities and futures markets, and protect investors.

**May 2002**

The Government endorses the HKMA's proposals to relax certain market entry criteria for the banking sector.

**September 2002**

The Government issues new \$10 currency notes.

**March to June 2003**

Outbreak of Severe Acute Respiratory Syndrome (SARS). 1,755 people in Hong Kong are infected and 299 people die.

**April 2003**

Hong Kong processes its first transaction through its new euro clearing system.

**June 2003**

Exchange of letters between the Financial Secretary and the Monetary Authority on functions and responsibilities in monetary and financial affairs.

**June 2003**

The Mainland and Hong Kong sign the Closer Economic Partnership Arrangement (CEPA).

**November 2003**

The HKMA moves its offices to permanent premises at Two International Finance Centre.

**November 2003**

Following approval from the State Council, the People's Bank of China agrees to provide clearing arrangements for banks in Hong Kong to conduct personal renminbi business on a trial basis. The scope of the business to be conducted includes deposit-taking, exchange, remittances and debit and credit cards.

**December 2003**

The three note-issuing banks issue new \$100 and \$500 notes with additional security features.

**February 2004**

Over 30 banks in Hong Kong introduce renminbi deposit, exchange, remittance, and debit and credit card services.

**May 2004**

The Deposit Protection Scheme Ordinance is enacted.

**June 2004**

The Basel Committee on Banking Supervision issues a revised framework on capital standards.

**July 2004**

The Clearing and Settlement Systems Ordinance is enacted.

**October 2004**

The three note-issuing banks issue new \$20, \$50 and \$1000 notes with additional security features.

**November 2004**

The Commercial Credit Reference Agency is launched.

# ABBREVIATIONS

ABF2	– Local currency denominated Asian Bond Fund
ADF	– Asian Development Fund
AI	– Authorized institution
APEC	– Asia-Pacific Economic Co-operation
ATM	– Automated teller machine
BIS	– Bank for International Settlements
bn	– billion
CCASS	– Central Clearing and Settlement System
CDC	– China Government Securities Depository Trust & Clearing Co. Ltd.
CEPA	– Closer Economic Partnership Arrangement
CHATS	– Clearing House Automated Transfer System
CLS	– Continuous Linked Settlement
CMU	– Central Moneymarkets Unit
CPI	– Consumer Price Index
DvP	– Delivery-versus-Payment
EFAC	– Exchange Fund Advisory Committee
EFBN	– Exchange Fund Bills and Notes
EMEAP	– Executives’ Meeting of East Asia-Pacific Central Banks
EPS	– Easy Pay System
GDP	– Gross Domestic Product (in real terms unless otherwise stated)
HK	– Hong Kong
HKMA	– Hong Kong Monetary Authority
HKSAR	– Hong Kong Special Administrative Region
IMF	– International Monetary Fund
IPO	– Initial Public Offering
JETCO	– Joint Electronic Teller Company Limited
KSD	– Korea Securities Depository
mn	– million
N.A.	– not applicable
PAIF	– Pan-Asian Bond Index Fund
PvP	– Payment-versus-Payment
RMB	– Renminbi
RTGS	– Real Time Gross Settlement
SAR	– Special Administrative Region
TMF	– Treasury Markets Forum
US	– United States of America



# REFERENCE RESOURCES

The *HKMA Annual Report* is published in April or May each year. A number of other HKMA publications provide explanatory and background information on the HKMA's policies and functions. These include

## **HKMA Quarterly Bulletin**

(published in March, June, September and December each year)

## **HKMA Monthly Statistical Bulletin (on-line publication)**

(published in two batches on the third and sixth business days of each month)

## **Guide to Hong Kong Monetary and Banking Terms (Second Edition)**

## **HKMA Background Brief No. 1 – Hong Kong's Linked Exchange Rate System**

## **HKMA Background Brief No. 2 – Banking Supervision in Hong Kong**

## **Money and Banking in Hong Kong: A Historical Timeline**

## **Money in Hong Kong: A Brief Introduction**

## **Educational leaflets on various topics including notes and coins and banking issues**

HKMA publications may be purchased or obtained from the **HKMA Information Centre**, 55th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. The HKMA Information Centre consists of an Exhibition Area and a Library. The Centre introduces the work of the HKMA and houses books, journals and other texts on central banking and related subjects. The Centre is open to the public six days a week.

 [> The HKMA Information Centre](#)

Most HKMA publications are also available for download free of charge from the HKMA website ([www.hkma.gov.hk](http://www.hkma.gov.hk)). A mail order form for the purchase of print publications can be found on the website.

 [> Information Centre > Publications](#)

The main texts of the regular briefings by the HKMA to the Legislative Council Panel on Financial Affairs are available online.

 [> Information Centre > Legislative Council Issues](#)

The HKMA website contains detailed and extensive information on the whole range of the HKMA's work. This information includes press releases, statistics, speeches, guidelines and circulars, research memoranda, and features on topical issues.

### The photographs

The theme photographs in this Annual Report show some of the trees commonly found in Hong Kong. Despite its small land area, Hong Kong has some 400 species of trees. Further information on Hong Kong trees can be found in *Tree Lovers' Companion* (Friends of the Country Parks, Hong Kong, 2004) and at <http://resources.ed.gov.hk/trees>.



The Chinese banyan, *Ficus microcarpa*, one of Hong Kong's most popular native trees, provides shade and windbreaks for streets and neighbourhoods. Its extensive roots enable it to grow in almost any location.



The camphor tree, *Cinnamomum camphora*, is often planted as a fung shui tree in village groves, and as a shade tree in parks and gardens. Camphor is obtained from the tree for medicinal and other uses, and the wood of the tree is prized for its insect-repelling properties.



One of the largest of the mangrove trees, the *Heritiera littoralis* (or looking-glass mangrove) can withstand submergence in the sea for several hours a day and yet still grow to the height of a three-storey building. Its strong buttress roots enable it to remain upright in loose soil and strong winds. It is found throughout South-East Asia and among the islands and coastlines of the Indian Ocean and the South Pacific.



The *Bauhinia blakeana* (or Hong Kong orchid tree), discovered on Hong Kong Island in the late nineteenth century, is Hong Kong's regional emblem, and its flower appears on Hong Kong's regional flag and on its currency. The flower also forms part of the emblem of the HKMA. Its two-lobed leaf, with its prominent veins, is known in Hong Kong as the "clever leaf" and is often used as a bookmark.



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.



The cotton tree, *Bombax ceiba* (*B. malabaricum*), can grow to 25 metres or more in height. Its magnificent red flowers appear in spring before the new season's leaves, making it one of the most attractive of Hong Kong's roadside trees. The dried flowers are used in herbal preparations to reduce inflammation, and the cotton-like substance in its seed capsules is traditionally used for stuffing pillows and cushions.

Acknowledgements:

Edward Stokes

FormAsia Books Ltd.

[hktree.com](http://hktree.com)

Hong Kong Herbarium

Design: Format Limited

This booklet is printed on environmental paper

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