



International Financial Centre

The HKMA's involvement in a range of initiatives during 2006 helped consolidate Hong Kong's position as a leading international financial centre. A "1-3-5 financial development blueprint" was prepared to foster closer financial co-operation with the Mainland. Considerable progress was achieved in expanding renminbi business in Hong Kong, paving the way for the issuance of renminbi-denominated bonds in Hong Kong by approved Mainland financial institutions. And Hong Kong's credit rating was upgraded to the AA category, the highest rating ever assigned to Hong Kong.

OVERVIEW

Developments in Mainland China were significant for both the international financial system and the status of Hong Kong as an international financial centre. The Mainland's 11th Five-Year Plan, promulgated in March 2006, set out the policy direction for expediting financial reforms. With its foreign exchange reserves surpassing US\$1 trillion, the Mainland introduced a liberalised framework for portfolio investment outflows, known as the Qualified Domestic Institutional Investors (QDII) Scheme.

Against this backdrop, the HKMA improved its research and monitoring of regional and Mainland economic and financial issues to promote greater financial stability in Asia including Hong Kong. Its leadership of, and participation in, regional co-operation initiatives on bond market development, monitoring of cross-border fund flows and crisis management were further strengthened during the year. The HKMA developed a "1-3-5 financial development blueprint" for fostering closer financial co-operation and building bigger markets both in Hong Kong and on the Mainland. Further expansion of renminbi business was achieved through collaboration with the Mainland authorities. The participation of the HKMA in these co-operative efforts in the region and on the Mainland will help reinforce Hong Kong's position as a leading financial centre and as China's international financial centre.

REVIEW OF 2006

Regional co-operation and participation in multilateral institutions

In promoting greater monetary and financial co-operation in Asia, the HKMA contributed to regional initiatives on the development of the bond market and improving monetary and financial stability in the region. The HKMA also undertook detailed research on further strengthening the monitoring of regional issues for discussion at international and regional forums and explored initiatives for Asian financial co-operation in crisis management.

Internationally, the HKMA attended meetings of the Asia-Pacific Economic Co-operation (APEC) forum, the Financial Stability Forum and the Bank for International Settlements. Its contributions at these forums enabled delegates to understand more about monetary and financial issues in Asia and Hong Kong.

The HKMA and the World Bank co-organised a conference, *East Asian Financial Markets: the Next Frontier in Hong Kong*, in June 2006 to discuss steps to speed up the development of regional financial markets and promote greater financial integration within Asia. More than 100 representatives from regional central banks, regulatory bodies, international financial institutions and the private sector participated in the conference.

Promoting bond market development in Asia

In 2006, the Asian Bond Fund 2 (ABF2) initiative under EMEAP reached another milestone in attracting private investments. Three component funds were offered to the public — the Single-market Fund of Thailand, an exchange traded fund, and those of Korea and the Philippines, which are unlisted open-ended funds. With four previously listed component funds — the ABF Pan Asia Bond Index Fund (PAIF) and the Single-market Funds of Hong Kong, Malaysia and Singapore — seven component funds have now been launched. Private investment in these ABF2 funds now accounts for 23.7% of their total assets, which reached US\$3.0 billion by the end of 2006, representing growth of nearly 50% above the US\$2 billion seed money injected by EMEAP in the second quarter of 2005. By the end of 2006, the PAIF, which invests in local-currency denominated sovereign and quasi-sovereign bonds issued in eight EMEAP markets¹, had achieved a total return of 14.3% since its listing in Hong Kong in July 2005, outperforming similar funds during the period.

The HKMA, as chair of the EMEAP Working Group on Financial Markets, led a review of the ABF2 Initiative and published the findings in June. The review concluded that the ABF2 funds, which are structured as passively managed bond index funds with low subscription and recurrent costs, appealed especially to foreign institutional investors. The ABF2 Initiative also helped identify the key impediments to cross-border investment flows in the region and promoted the introduction of regulatory, legal and tax reforms to remove some of these impediments. Larger intra-regional capital flows, facilitated by the ABF2 Initiative, helped build bigger bond markets and promote financial stability in Asia. Following this important first step, more efforts are needed to resolve outstanding issues, such as the harmonisation of

regulatory approaches and the promotion of mutual recognition of financial intermediaries and products.

Upgrading Hong Kong's sovereign credit rating

The HKMA worked with the Government to foster a better understanding of Hong Kong's economic and financial strengths among international credit rating agencies (CRAs). Quantitative analysis by the HKMA indicated that Hong Kong's creditworthiness viewed in isolation was comparable to that of AAA-rated economies. Rigorous stress tests using an econometric model suggested that Hong Kong could withstand significant economic shocks from the Mainland.

This strategy proved to be effective and contributed to a number of upgrades in 2006, with Hong Kong elevated to the AA category by all major international CRAs — the highest rating ever assigned to Hong Kong. The upgrades reflected international recognition of Hong Kong's strong economic fundamentals, improved public finances and growth prospects. In a comparative study published in January 2007, Standard and Poor's acknowledged that Hong Kong's credit strengths were comparable with those of many economies with AAA ratings.

Financial co-operation with the Mainland

During the year, a key focus of the HKMA's work was the formulation of a strategy to improve Hong Kong's status as an international financial centre through close co-operation with the Mainland in light of its financial developments and reforms. The HKMA prepared a "1-3-5 financial development blueprint", which was adopted as part of the report of the Focus Group on Financial Services set up under the HKSAR Chief Executive's Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong" in September.

¹ China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore and Thailand.

“1-3-5 financial development blueprint” — a proposal for closer financial co-operation between Hong Kong and the Mainland

Under the “One Country, Two Systems” arrangement, China is unique in having two different financial systems in Hong Kong and the Mainland. This provides a great deal of scope for financial co-operation. For Hong Kong, the main issue is how to play a bigger role in the Mainland’s financial development and reforms, while strengthening its status as China’s international financial centre.

What Hong Kong can offer

The Mainland’s 11th Five-Year Plan, which outlines the policies to be pursued from 2006 to 2010, was promulgated in March 2006. Chapter 33 of the Plan sets out clearly the policy direction for expediting financial reform and the related measures in four main areas: deepening the reform of financial enterprises and improving corporate governance of financial institutions; speeding up the development of direct financing channels, such as the equity and bond markets and gradually developing futures markets; enhancing the mechanisms for financial and monetary control and management, which includes developing money markets and gradually introducing renminbi convertibility for capital account items; and improving financial sector supervision.

Hong Kong, with its efficient financial platform, reliable financial infrastructure and a supervisory framework of international standard, can contribute in three main aspects. First, by gradually linking the two financial markets, Hong Kong can provide diversified financial services for the Mainland, help make the Mainland’s financial intermediation more efficient, and act as a catalyst for the development of the Mainland’s financial centres. Secondly, Hong Kong can be used as a platform for the Mainland’s policy of allowing orderly and prudent increases in capital outflows, helping the Mainland achieve better external balances. Thirdly, with Mainland China now one of the world’s largest economies, increased use of the renminbi outside the country is inevitable. Since 2004, Hong Kong has acquired experience in conducting renminbi business, and is able

to provide a robust and reliable testing ground for an increased use of the renminbi outside the Mainland.

The 1-3-5 blueprint

A blueprint was therefore developed for fostering closer financial co-operation, building bigger markets both in Hong Kong and on the Mainland and positioning Hong Kong as China’s international financial centre.

- **From a strategic perspective, one positioning:** to develop Hong Kong as the country’s international financial centre of global significance. This will provide China with an efficient financial intermediation platform to support the sustainable growth of a large economy and avoid the payment and settlement risks associated with international financial activities in different time zones. The large differences in risk attributes and appetites of market participants should facilitate risk transfer and management. With such a financial centre, China’s contribution to the formulation of global financial standards and policies should increase.
- **From an institutional perspective, three dimensions:** to establish a complementary, co-operative and interactive relationship between the financial systems of Hong Kong and the Mainland. Complementary means the respective strengths of the two financial systems are exploited and the weaknesses of one system are addressed by the other; co-operative means the two financial systems can benefit from closer collaboration in areas such as financial supervision, financial infrastructure, and risk management, through technical transfers, information exchange, qualification recognition and harmonisation of standards; interactive means the two financial systems should interact to boost China’s role in international finance, make financial intermediation more efficient and promote the development of financial markets within the country.

- **From a practical perspective, five areas:** to act as a catalyst for the development of financial centres in the Mainland through: expanding the presence of Hong Kong financial institutions on the Mainland; increasing the outward mobility of the Mainland's investors, fund-raisers, financial institutions and instruments through Hong Kong; allowing Hong Kong financial instruments to be traded on the Mainland; strengthening Hong Kong's capability to handle financial transactions denominated in renminbi; and strengthening

financial infrastructural links between Hong Kong and the Mainland.

"Continuing to promote financial co-operation between Hong Kong, Macao and the Mainland" was specified as one of the important tasks by the National Finance Working Meeting, which concluded in January 2007. Discussions will be held with the Mainland authorities to work out implementation proposals based on the "1-3-5 financial development blueprint".

Renminbi business in Hong Kong, which was launched in early 2004, is part of the "1-3-5 financial development blueprint". At the end of 2006, renminbi deposits totalled RMB22.7 billion yuan in more than 450,000 accounts. Renminbi banking services are now offered by 38 banks, representing almost all retail banks in Hong Kong.

Considerable progress was made during the year with the Mainland authorities on proposals to further expand renminbi business in Hong Kong. On 10 January 2007, the State Council announced its agreement for Mainland financial institutions, after obtaining approval, to issue renminbi-denominated bonds in Hong Kong. This will create a new asset class for renminbi depositors in Hong Kong to invest in. It will also be the first time that non-Mainland individuals are able to invest directly in renminbi-denominated bonds. Banks in Hong Kong will be able to diversify their renminbi assets and enjoy new business opportunities for the sale and distribution of renminbi bonds. The issuance of renminbi bonds in Hong Kong will also serve as a pilot for the use of renminbi for financial transactions outside the Mainland.

Co-operation with Mainland financial regulators was strengthened in 2006. The Joint Meeting on Bank QDII (offshore wealth management services by banks on the Mainland) between the China Banking Regulatory Commission (CBRC), the State Administration of Foreign Exchange, the HKMA and the Securities and Futures Commission was convened for the first time in

December. The meeting discussed issues relating to product development and supervisory co-operation.

Strengthening research on Mainland economic and financial issues

Closer economic and financial integration means that developments in the Mainland will have increasing implications for Hong Kong in both financial stability and its role as an international financial centre. A dedicated research series, *China Economic Issues*, was introduced in 2006 to build on existing in-house monitoring and analytical work as well as research exchanges with Mainland academics and think-tanks. The series provides detailed analysis of economic and financial market issues on the Mainland. Various topics were studied, including the Mainland's interest rate structure, development of renminbi derivatives and commodity futures markets, the impact of renminbi exchange rate movements on the macroeconomy, and the role of exchange rates in macroeconomic control.

 > [China Economic Issues](#)

Training

Training programmes for officials of the People's Bank of China, the CBRC and other Mainland authorities in Hong Kong and on the Mainland continued to expand in 2006, both in scope and numbers of people involved. These courses covered financial stability, banking supervision, accounting management, market analysis, financial risk management, prevention of money laundering and

human resources management. Twenty courses, or 2,743 man-days of training, were provided to 1,389 Mainland officials.

The HKMA also provided training on request to other external parties, including courses for Mainland government officials and Mainland commercial banks, and a regional course on Fundamentals of Interest Rate Risk Management under the APEC financial regulators' training initiative. More than 200 participants attended these seminars in 2006.

PLANS FOR 2007 AND BEYOND

The HKMA will further strengthen its research and monitoring on monetary and financial developments in Asia, particularly the Mainland, and will ensure the views and concerns of Hong Kong are heard in central banking and international financial forums. Participation in regional co-operative and market development initiatives will remain a priority in 2007 to promote financial stability in Asia and strengthen Hong Kong's status as the leading financial centre in the region.

Having pursued a number of rating upgrades in 2006, the HKMA will refine its focused strategy towards the international CRAs to secure further upgrades of Hong Kong's credit ratings. The key objective is to make sure that the CRAs have a balanced and up-to-date view of Hong Kong.

Hong Kong is likely to play a more prominent role in financial matters on the Mainland, and in positioning itself as China's international financial centre of global significance as integration of the two economies intensifies. The HKMA, together with the Government, will continue to work with the Mainland authorities in implementing the "1-3-5 blueprint". With the recent agreement to introduce renminbi-denominated financial bonds in Hong Kong, the HKMA will launch a renminbi Real Time Gross Settlement system to facilitate the new business. Monitoring the economic, financial and monetary developments on the Mainland and understanding the implications for Hong Kong will be an important task for the HKMA. The HKMA will continue to strengthen co-operation with Mainland regulators and organise training seminars and courses for the staff of Mainland authorities and other external parties.

 > [Monetary Stability](#) > [International Relations](#)

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