



**HONG KONG MONETARY AUTHORITY**

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

**6 November 2003**



## PROGRESS IN KEY FUNCTIONS & RESPONSIBILITIES

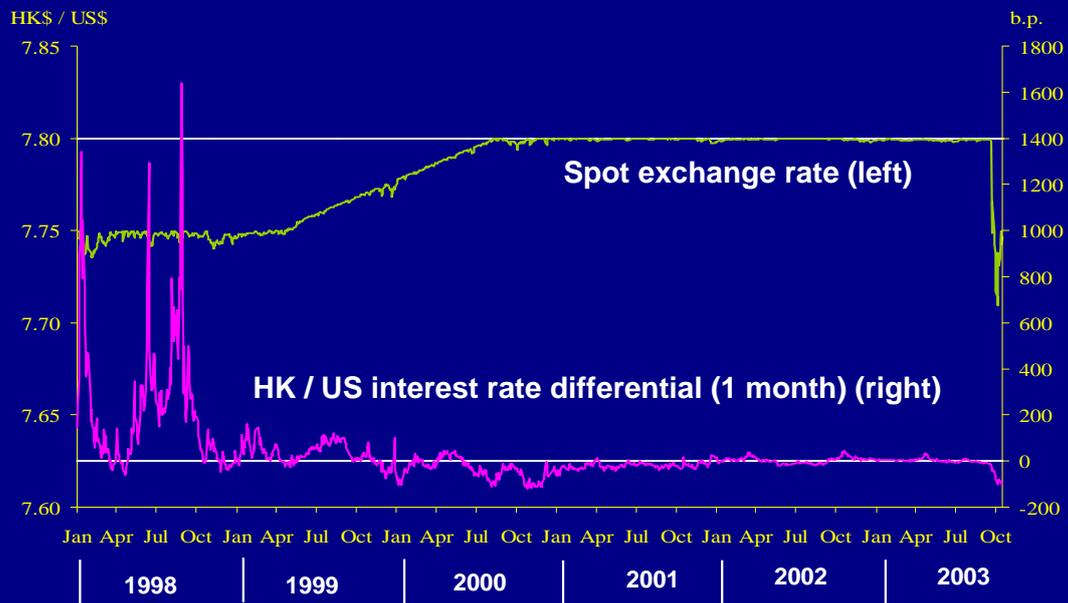
- **Currency**
- **Banking**
- **Financial infrastructure**
- **Hong Kong as an international financial centre**
- **Exchange Fund**

2

- This briefing covers the key functions and responsibilities of the HKMA:
  - to maintain currency stability within the framework of the Linked Exchange Rate system;
  - to promote the safety and stability of the banking system;
  - to promote the efficiency, integrity and development of the financial infrastructure, particularly payment and settlement arrangements;
  - to support the maintenance of the status of Hong Kong as an international financial centre; and
  - to manage the Exchange Fund in a sound and prudent manner.



## CURRENCY STABILITY (1)

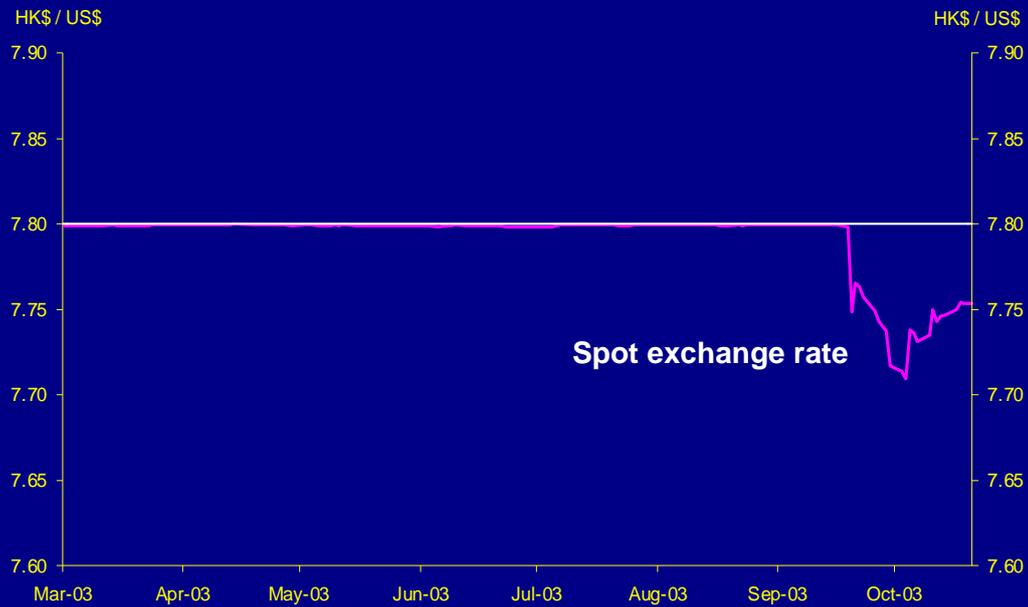


3

- The HK dollar/US dollar spot exchange rate was stable until a marked strengthening from 22 September.
- HK dollar interest rates have correspondingly fallen below US dollar rates, and the negative spread has widened since late September.



## CURRENCY STABILITY (2)



4

- The HK dollar/US dollar spot exchange rate appreciated to 7.70 at one time (in London hours), before retreating to around 7.76.



## CURRENCY - MARKET EXPECTATIONS (1)



5

- Overall, the market has remained calm by historical standards, although there was recently a marked shift of expectation from weakness to strength as illustrated by the 12-month forward exchange rate moving from a premium to a discount compared with the spot exchange rate.



## CURRENCY - MARKET EXPECTATIONS (2)

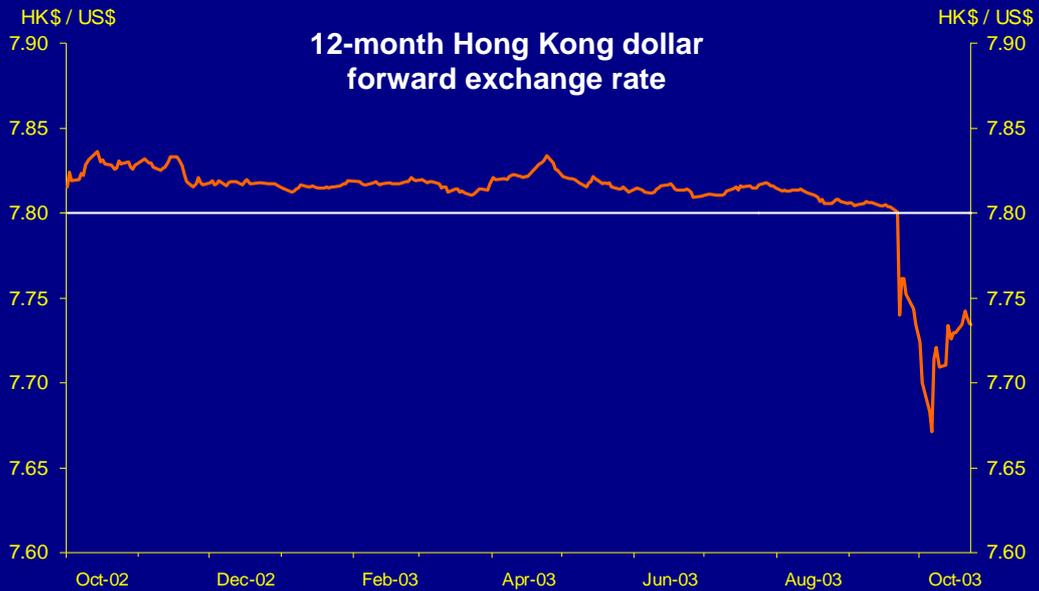


6

- Continuing concerns on high unemployment, deflation and the budget deficit, along with the outbreak of SARS, sustained a forward premium of around 200 points for the exchange rate throughout the first eight months of the year.
- As market sentiment turned in September, sparked off by a weakening US dollar and intensifying political pressure calling for a revaluation of the RMB, there was considerable covering of short Hong Kong dollar positions, quickly eliminating the premium and producing a discount of nearly 400 points. But the discount has since been narrowing.



## CURRENCY - MARKET EXPECTATIONS (3)



7

- The one-year forward exchange rate appreciated sharply to below 7.70 in early October but has since moved gradually back towards 7.80.



## CURRENCY - RISKS & VULNERABILITIES

### External factors

- **Global economic outlook: improving**
- **Exchange rates among G3 currencies: volatile**
- **Political pressure on renminbi exchange rate policy: revaluation / greater flexibility**

8

- **The global economic outlook is improving.** The US and Japanese economies have improved notably in 2003 and recent statistics suggest that the recovery will continue for the rest of the year. The economic activity in the euro area remained weak in the first half, but forward-looking indicators point to some improvements towards the year end.
- **Exchange rates among G3 currencies have been volatile.** The US dollar weakened on concerns about the sizeable current account deficit (5% of GDP). It depreciated against both the euro and the yen, by about 10% and 9% respectively, in the first ten months of 2003.
- **International political pressure on the renminbi exchange rate policy has intensified.** There are increased calls, particularly from the US, for a revaluation of the renminbi or more flexible management of its exchange rate.



## GLOBAL ECONOMIC OUTLOOK

	GDP growth	GDP growth forecasts	
	latest available quarter	2003	2004
	% yoy	% yoy	% yoy
Mainland China	9.1 (Q3)	8.1	7.8
US	3.3 (Q3)	2.7	4.0
Eurozone	0.2 (Q2)	0.5	1.7
Japan	3.0 (Q2)	2.4	1.3
Hong Kong	-0.5 (Q2)	3.0*	4.5

Source: Bloomberg, Consensus Forecasts (October 2003)

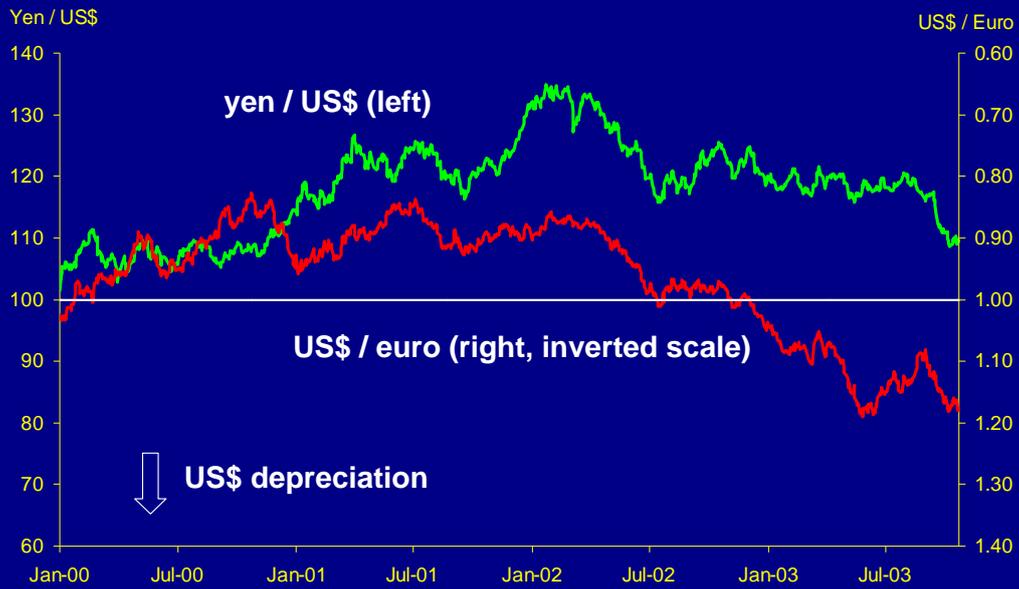
\* Forecast by HKSAR Government

9

- Consensus forecasts project an acceleration of economic growth in the US as well as the euro area. The pace of recovery in Japan is likely to remain moderate. Mainland China is expected to sustain robust growth.



## EXCHANGE RATE VOLATILITY

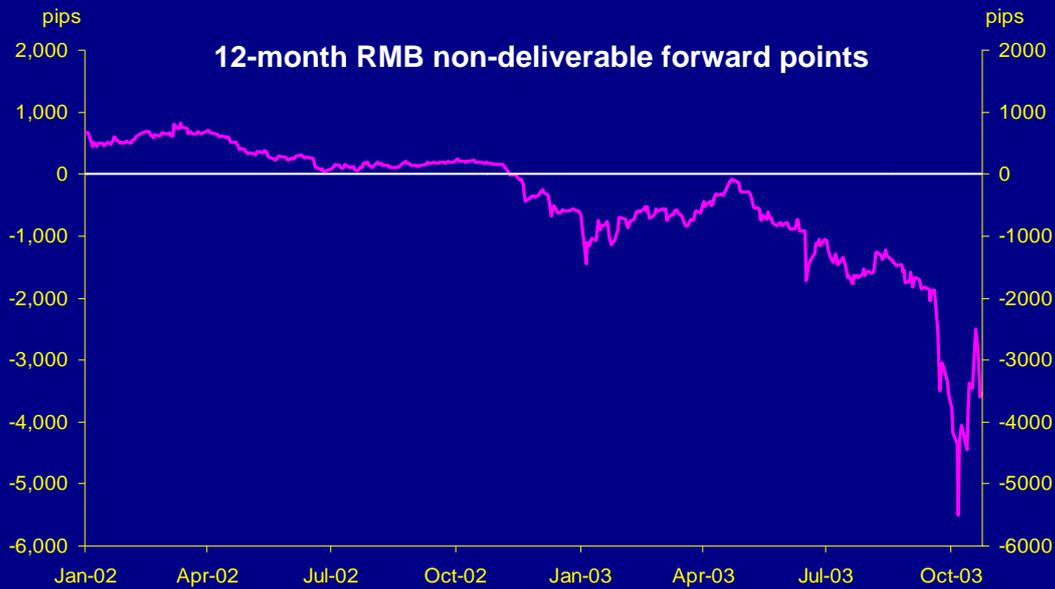


10

- The US dollar has weakened markedly against the yen and the euro since early 2002.



## RENMINBI - MARKET EXPECTATIONS

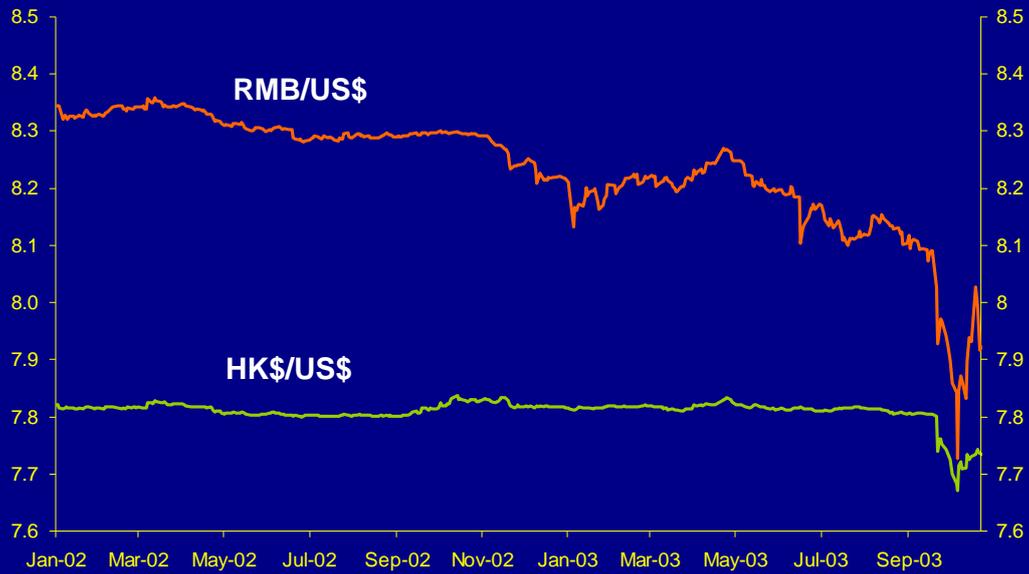


11

- The 12-month RMB non-deliverable forward points have shifted to a discount since late 2002, reflecting the strong economic fundamentals and large accumulation of foreign reserves. The discount has widened gradually since April, after the concerns about SARS receded. As international political pressure for a more flexible RMB exchange rate intensified, the discount increased markedly to 5,500 pips before returning to about 3,300 pips recently.



## 12-MONTH HONG KONG DOLLAR AND RENMINBI FORWARD EXCHANGE RATES



12

- The movements of RMB and HK dollar forward exchange rates diverged in 2002 and the first half of 2003, reflecting in part different conditions of the two economies. Nevertheless, a positive relationship between the two has re-emerged recently.



## CURRENCY - RISKS & VULNERABILITIES

### Domestic factors

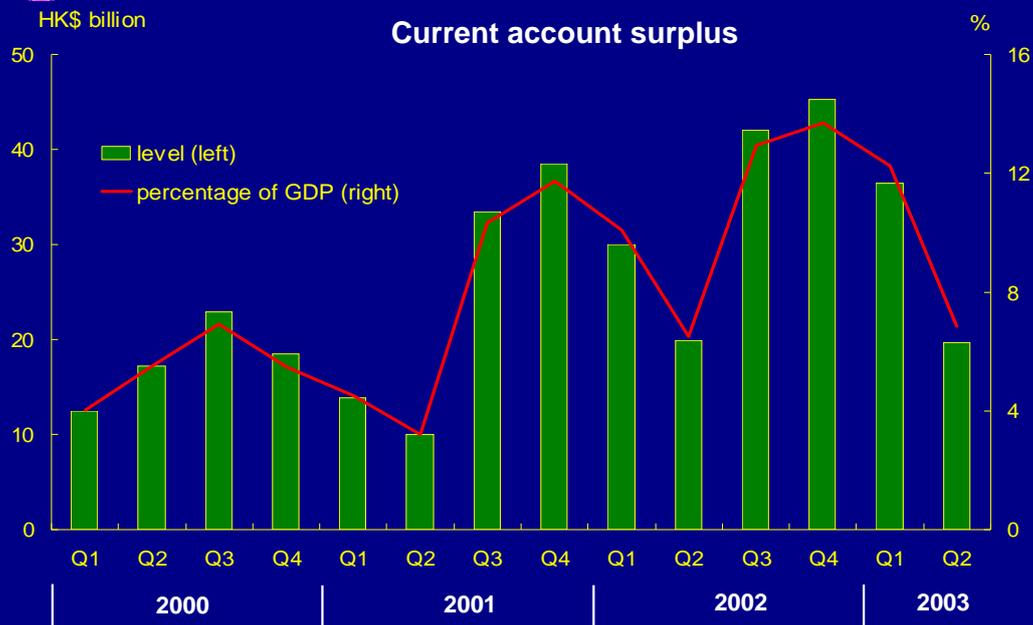
- **Economic recovery**
- **Current account surplus**
- **International investment position**
- **Public finance**
- **Unemployment**
- **Deflation**

13

- **Economic recovery** in Hong Kong has broadened in recent months, supported by a revival of demand in our main trading partners, and a rebound in in-bound tourism. Domestically, retail sales have recovered to pre-SARS levels. The unemployment rate and the number of bankruptcy petitions have declined.
- The **current account surplus** remained robust. The surplus was equivalent to about 11% of GDP for 2002 as a whole and around 10% for the first half of 2003. This reflected the improved competitiveness of the economy.
- **Net international investment position** (IIP) of Hong Kong continued to increase, as net foreign assets were accumulated alongside sizeable current account surplus. The net IIP of Hong Kong as a percentage of GDP is among the highest in the world. Notwithstanding these positive developments, the HK dollar maintained a forward premium until a shift to a discount in September.
- **Public finances** are still a concern. Investors are likely to remain watchful of the fiscal position and the policy strategy adopted by the authorities to address the imbalance.
- **Unemployment rate**, though improved, remains relatively high and may continue to restrain domestic consumption. Employment growth was sluggish, reflecting in part the shift from re-exports to offshore trade, and reduced labour demand from the property sector, in addition to the weak cyclical position of the economy.
- **Deflation** persisted, despite some stabilisation brought by the improvement in economic activities.



## BALANCE OF PAYMENTS ACCOUNT

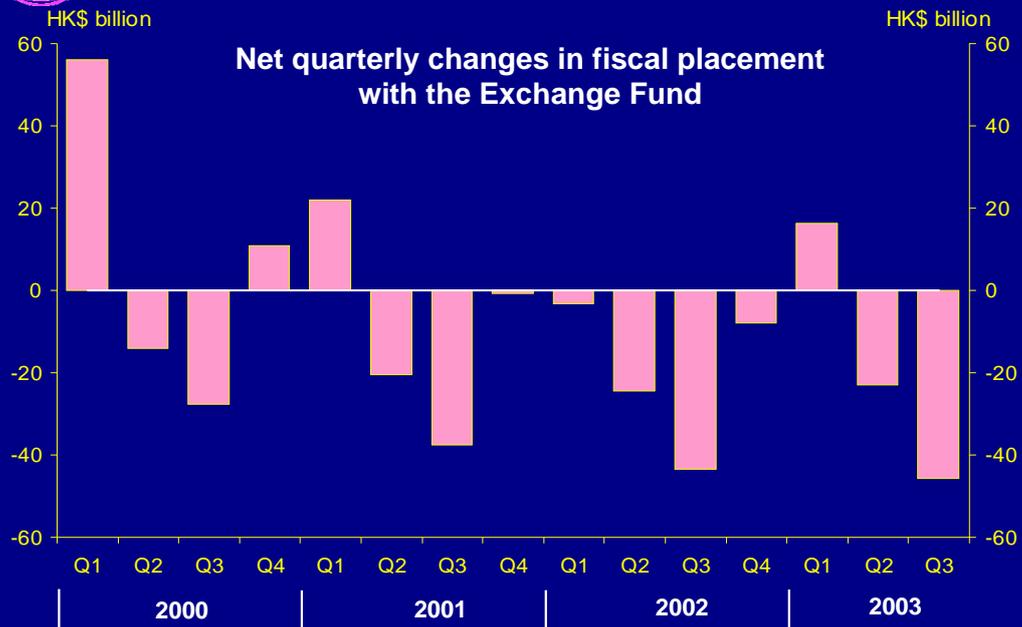


14

- The **current account surplus** remained robust. The surplus was equivalent to about 11% of GDP for 2002 as a whole and around 10% for the first half of 2003. This reflected the improved competitiveness of the economy.



## FISCAL DRAWDOWNS



15

- Fiscal drawdowns increased in the face of budget deficits. Some of the fiscal drawdowns were accommodated by the sale of foreign currency assets, thus providing some support to the HK dollar.



## INTERNATIONAL INVESTMENT POSITION

### Net IIP position as at end-2002

	<u>Amount (US\$ billion)</u>	<u>as % of GDP</u>
Hong Kong	339	210
<b>Selected economies</b>		
Japan	1,462	37
Singapore	45	50
Thailand	-46	-37
United States	-2,605	-25
United Kingdom	-41	-3

Source: IFS, HKSAR government

16

- The net IIP of Hong Kong continued to increase in 2002, reflecting the accumulation of foreign assets alongside sizeable current account surplus. The net IIP of Hong Kong as a percentage of GDP is among the highest in the world.



## **BANKING STABILITY - BACKGROUND**

- **Asian financial turmoil**
- **Currency attack**
- **Bursting of the property bubble**
- **Bursting of the IT bubble**
- **Deflation**
- **Unemployment**
- **Economic difficulties**

17

- The banking sector has managed to turn in quite a good performance in the past few years. This is notwithstanding the sector having been through a most difficult period involving the Asian financial turmoil, the bursting of the domestic property bubble and of the global IT bubble, continuing deflation and high levels of unemployment.



## BANKING STABILITY

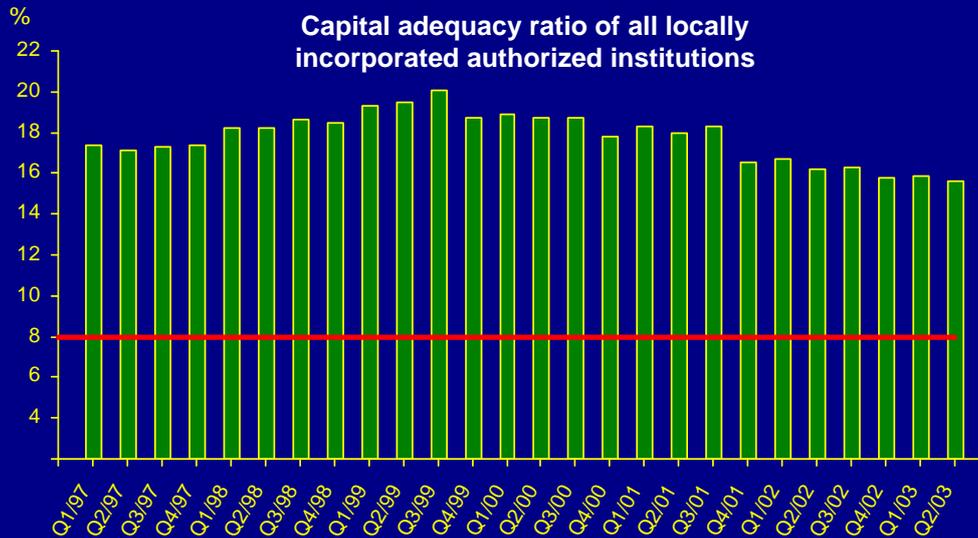
- **Capital adequacy**
- **Asset quality**
  - personal bankruptcies
  - credit cards
  - residential mortgage loans in negative equity
- **Business environment**
- **Profitability**

18

- The next few slides review the recent performance of the banking sector in a number of different areas.



## BANKING SECTOR PERFORMANCE



Period-end figures.

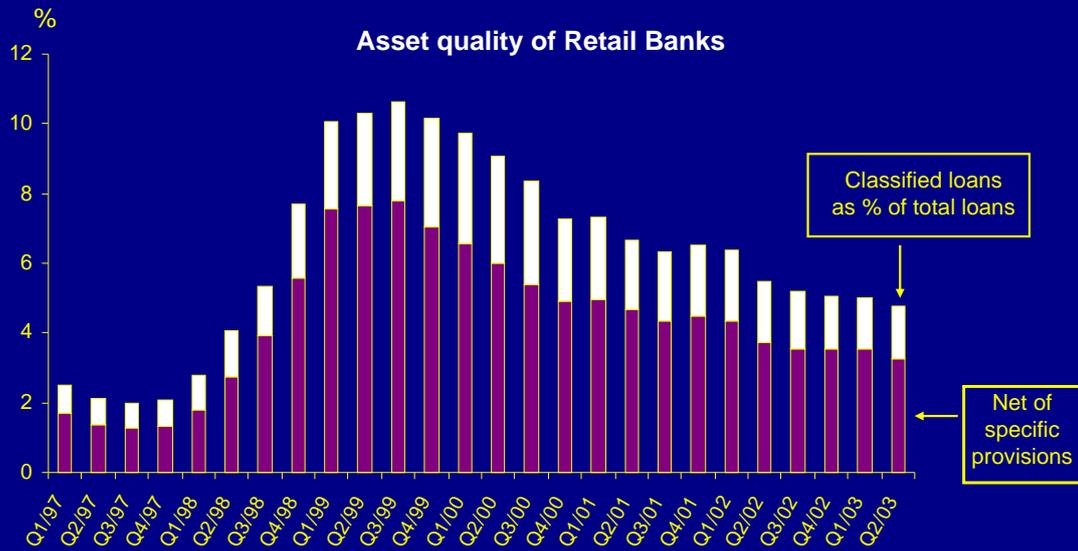
There is a break in series at end-December 2001 owing to a change in the reporting population.

19

- The average consolidated capital adequacy ratio of all locally incorporated authorized institutions declined slightly to 15.6% at end-June, from 15.9% at end-March. However, the ratio was still well above the minimum international standard of 8%.



## BANKING SECTOR PERFORMANCE



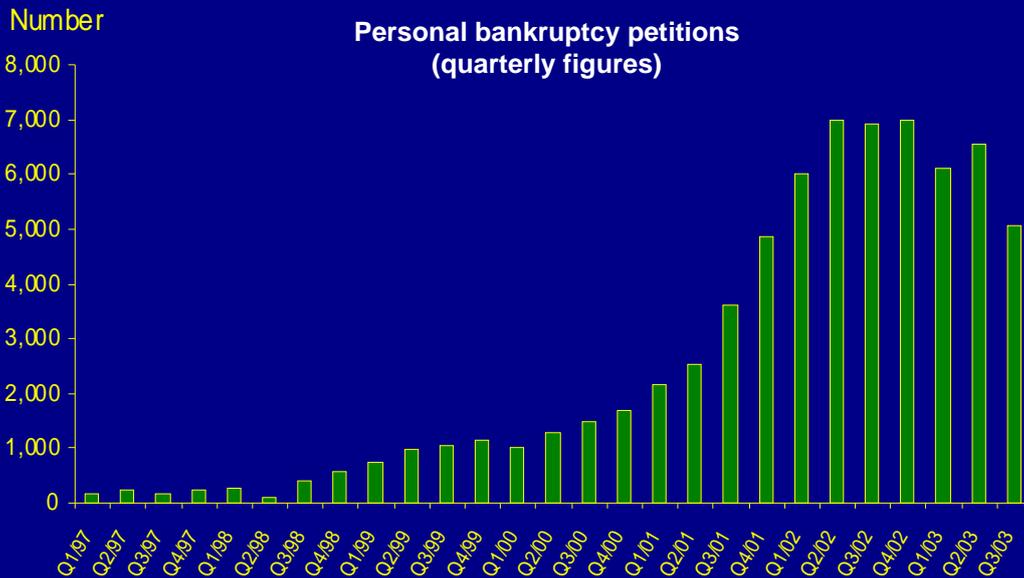
Period-end figures.

20

- Influenced largely by interim write-offs and loan repayments, retail banks' overall asset quality improved in the second quarter. The classified loan ratio decreased to 4.76% at end-June, from 5.03% at end-March.



## BANKING SECTOR PERFORMANCE

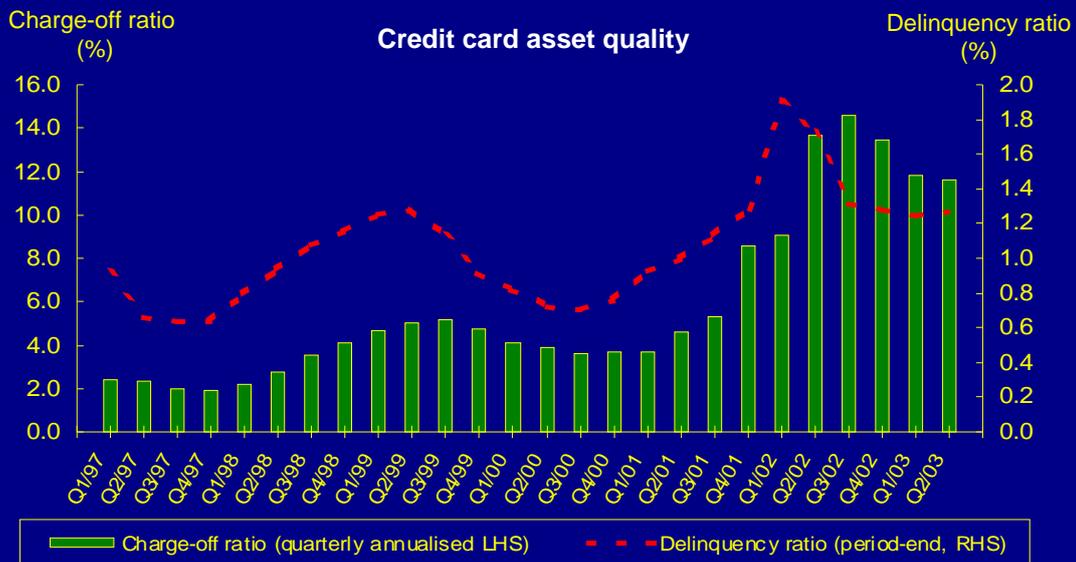


21

- The number of bankruptcy petitions decreased for the fourth straight month in September, though it remained at a high level. For the third quarter as a whole, the number of bankruptcy petitions presented was 5,080, down from 6,537 in the second quarter.



## BANKING SECTOR PERFORMANCE



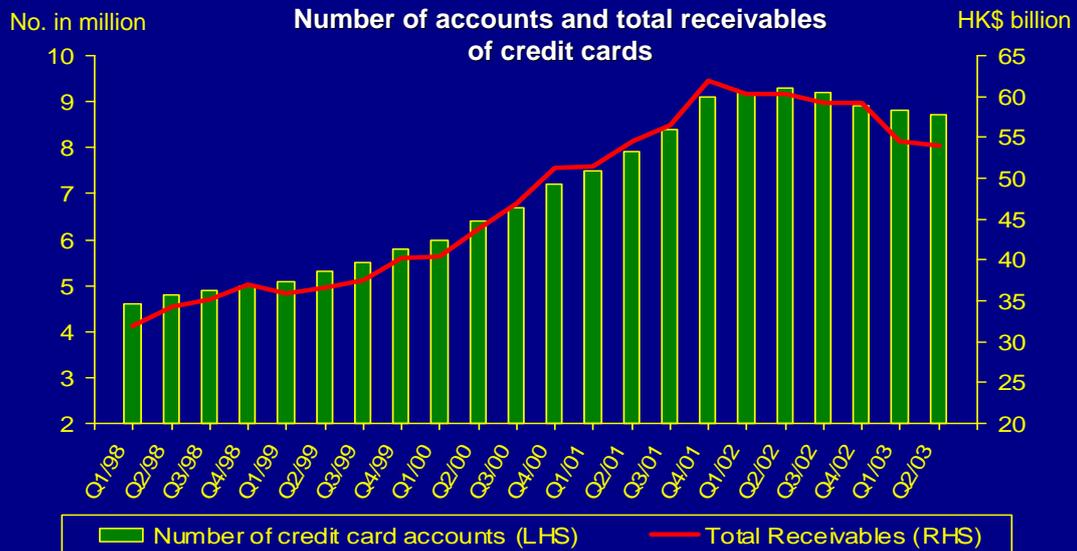
There is a break in series at Q4 2001 owing to an increase in the number of surveyed institutions.

22

- The annualised quarterly charge-off ratio dropped to 11.60% in the second quarter, down from 11.82% in the first quarter. The improvement in the charge-off situation partly reflects the precautionary measures taken by the banks, as well as the continuing impact of debt restructuring arrangements. During the quarter, another HK\$198 million or 0.4% of total credit card receivables was restructured, of which about 68% was transferred outside the credit card portfolio.



## BANKING SECTOR PERFORMANCE



Period-end figures.

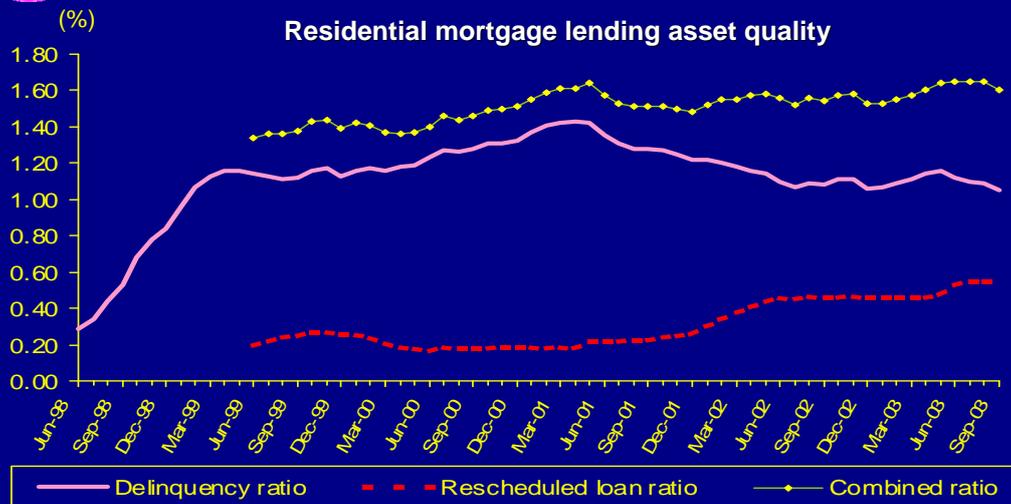
There is a break in series at Q4 2001 owing to an increase in the number of surveyed institutions.

23

- The number of credit card accounts continued to decline in the second quarter, in part due to the transfer of restructured card receivables out of the card portfolio by some authorized institutions and in part due to write-offs. Between the first and second quarter, the total number of credit card accounts declined slightly by 0.8%, while the decline in total receivables moderated to 1.1%.



## BANKING SECTOR PERFORMANCE



Period-end figures.

There is a break in series at December 2000 owing to an increase in the number of surveyed institutions.

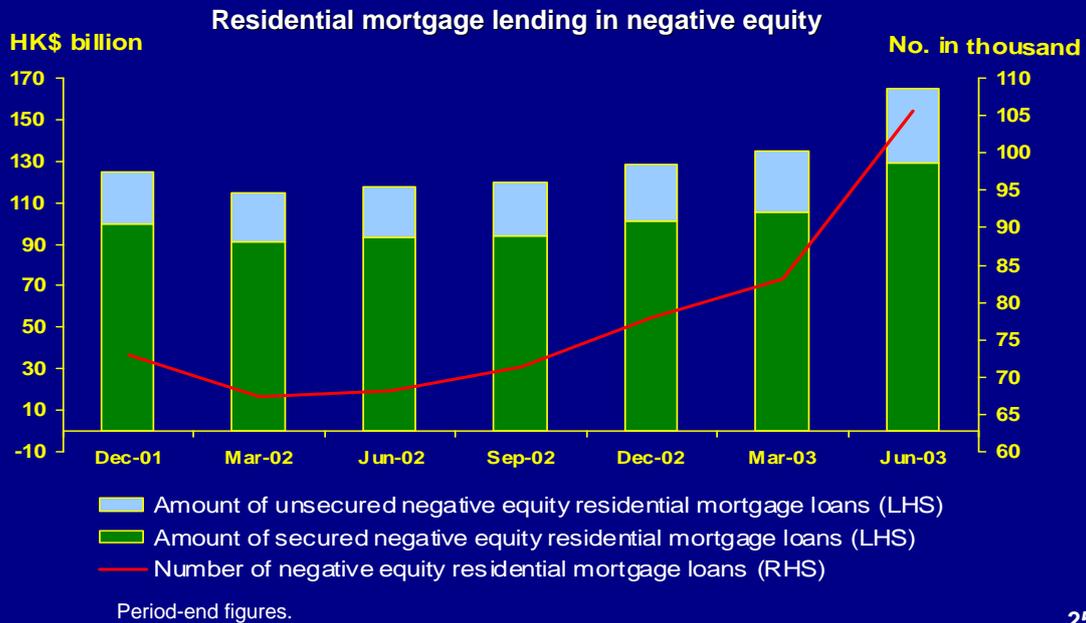
Combined ratio is the sum of delinquency ratio and the rescheduled loan ratio.

24

- On the back of improved economic conditions and property market sentiment, the asset quality of residential mortgage loans strengthened generally. The mortgage delinquency ratio improved for the fourth consecutive month to 1.05% in September, from 1.09% in August. With the rescheduled loan ratio remaining unchanged at 0.55%, the combined ratio improved to 1.60%.



## BANKING SECTOR PERFORMANCE

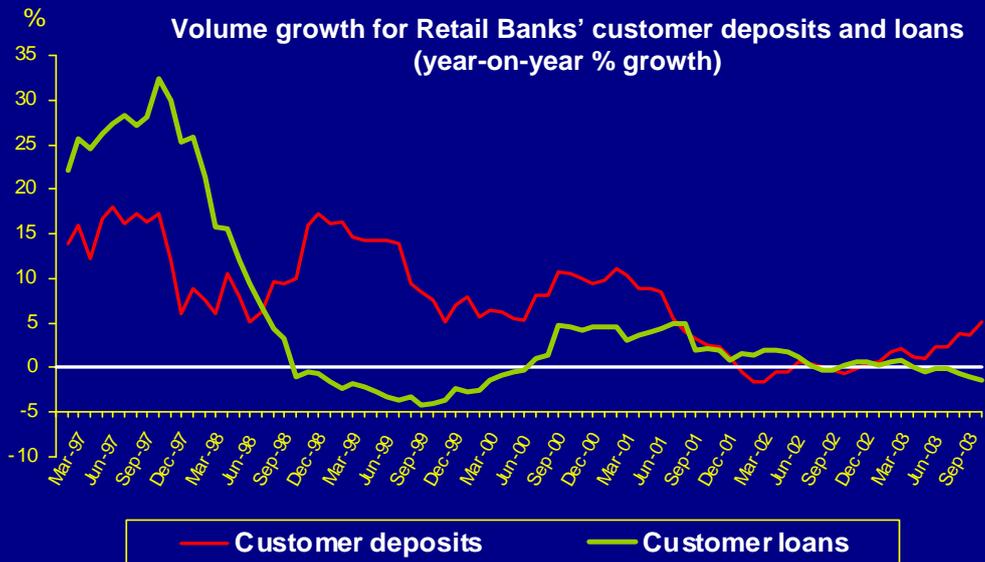


25

- Although the number and amount of mortgage loans in negative equity are still a potential threat to banking stability, improved economic conditions have helped ease the problem. The unsecured portion of these loans is estimated at HK\$36 billion, or 6.8% of the total mortgage lending of the banking sector at end-June. This provides an indication of the risk exposure of the banking sector. The delinquency ratio of negative equity mortgage loans is still not unduly high at 2.28% at end-June.
- The HKMA is collating the end-September 2003 figures.



## BANKING SECTOR PERFORMANCE



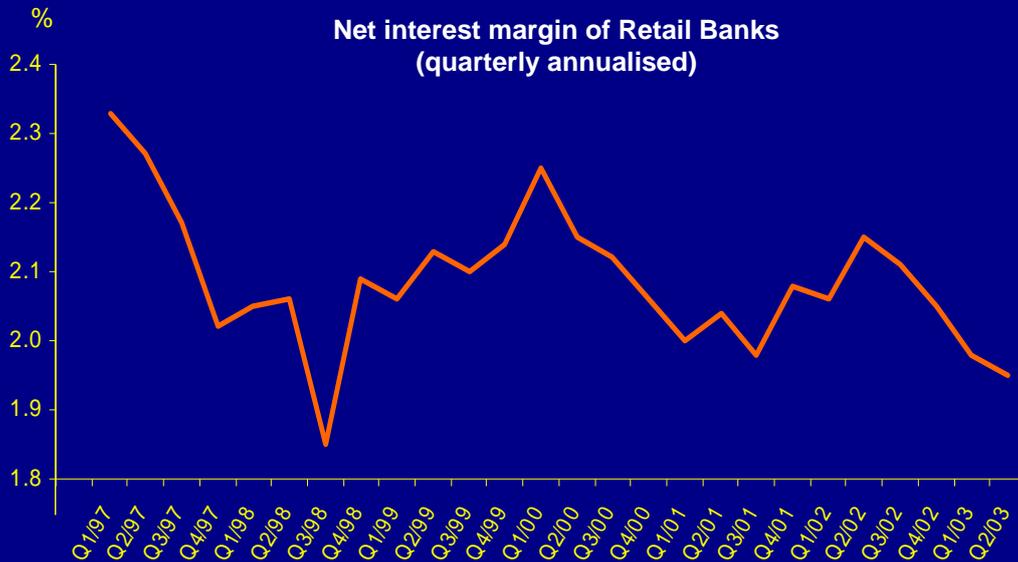
Month-end figures.

26

- Retail banks' customer deposits rose by 5.06% over the year to end-September, compared with an increase of 2.27% at end-June. Both HK dollar and foreign currency deposits rose, by 4.11% and 6.60% respectively, compared with an increase of 0.51% and 5.16% in the preceding quarter. The proportion of HK dollar deposits to total deposits remained unchanged at 61%.
- Retail banks' customer loans fell by 1.37% over the year to end-September, compared with a decline of 0.15% at end-June. The fall was mainly contributed by loans to telecommunication sector and property related lending (private residential loans, property development and investment).



## BANKING SECTOR PERFORMANCE

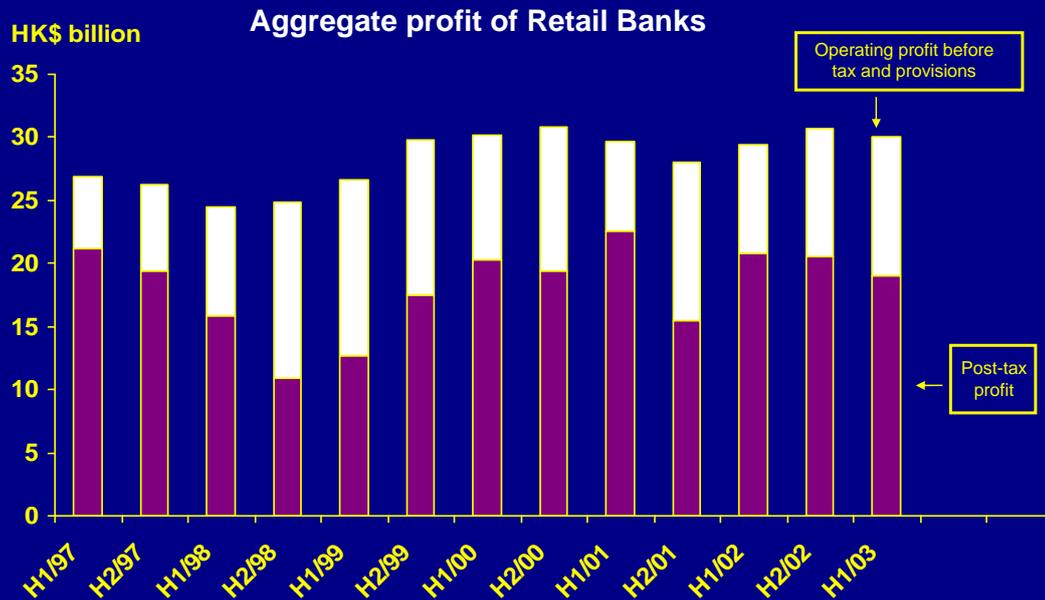


27

- Reflecting the difficult operating conditions, aggravated by the SARS outbreak towards the end of the first quarter, most retail banks registered a decline in profit in the first half of the year compared with the same period last year. For the retail banks as a whole, aggregate profits fell by 8.7% compared with the first half of last year. The fall was particularly evident in the second quarter. However, taking out the effects of property revaluation deficits charged to the profit and loss accounts by some banks in the first half of the year, retail banks' aggregate pre-tax operating profit declined by a more modest 2.5%. The effect of SARS on the profitability of the retail banking sector, thus, appeared to be relatively mild, but this was helped to some extent by good treasury performance (including both foreign exchange and securities trading), which partly offset the effects of higher bad debt provisions and lower net interest income.
- Net interest income declined on the back of narrowed margins on residential lending and lower yield on free funds. As a result, the annualised net interest margin fell to 1.97% in the first half of the year from 2.11% for the same period last year.



## BANKING SECTOR PERFORMANCE



28

- Retail banks' aggregate operating profit (before tax and provisions) increased modestly by 2.27% to HK\$30.1 billion in H1/2003 compared with the corresponding period in H1/2002 but decreased by 1.81% when compared with H2/2002.
- However, post-tax profit of retail banks declined by 8.69% to HK\$19 billion in H1/2003 compared with H1/2002 and by 7.16% compared with H2/2002. The decline was mainly due to an increase in provisions (namely in consumer lending) and the effect of property revaluation deficits charged to the profit and loss accounts by some banks.



## INITIATIVES / WORK PROGRESS

- **Deposit protection scheme**
  - under the scrutiny of a Bills Committee
- **Consumer credit data sharing**
  - issued a statutory guideline to specify the minimum standards that authorized institutions should observe in the sharing and use of consumer credit data through a credit reference agency

29

### Deposit protection scheme

- The Deposit Protection Scheme Bill was introduced into the Legislative Council on 30 April. It is currently under the scrutiny of a Bills Committee.

### Consumer credit data sharing

- The HKMA issued on 30 May a statutory guideline to require authorized institutions to have clear and comprehensive policies and procedures for the sharing and use of consumer credit data through a credit reference agency to ensure compliance with the requirements of the Code of Practice on Consumer Credit Data.
- The HKMA will regularly assess the extent to which the benefits which are expected to flow from the sharing of positive consumer credit data are achieved.



## INITIATIVES / WORK PROGRESS

- **Commercial credit reference agency**
  - **consulting the banking industry on a statutory guideline on the sharing and use of commercial credit data through a commercial credit reference agency, expected to be launched in the 3rd quarter of 2004**
- **Insurance activities of authorized institutions**
  - **signed Memorandum of Understanding with Insurance Authority**

30

### Commercial credit reference agency (CCRA)

- The HKMA issued a supervisory letter on 11 August, reiterating its expectation that all authorized institutions involved in SME lending should participate as far as possible in the CCRA scheme. The HKMA has also set out the minimum standards that authorized institutions should observe in relation to the sharing and use of commercial credit data through a CCRA. These minimum standards are currently under consultation with the banking industry.
- The industry's working group is now working with the service provider to finalise the operational details, including systems and reporting requirements of the scheme. If everything goes smoothly, it is expected that the CCRA will be up and running in the third quarter of 2004.

### Insurance activities of authorized institutions

- The Monetary Authority and the Insurance Authority signed a Memorandum of Understanding (MoU) on 19 September. Under the MoU, the Monetary Authority and the Insurance Authority agree to work together:
  - to co-ordinate the supervision of the insurance-related activities of authorized institutions and authorized insurers that are connected to authorized institutions; and
  - to promote information exchange and sharing, as permitted under the Banking Ordinance and the Insurance Companies Ordinance, between the Monetary Authority and the Insurance Authority in order to assist each other to exercise their respective statutory functions.



## INITIATIVES / WORK PROGRESS

- **Consumer protection**
  - reviewing the self-assessment reports by authorized institutions on their compliance with the Code of Banking Practice
- **ATM fraud**
  - issued a circular to authorized institutions on implementation of precautionary measures to prevent and address ATM fraud cases

31

### Consumer protection

- The total number of customer complaints received by the HKMA fell from 137 in the first quarter to 126 in the second quarter. In particular, complaints related to debt collection declined more significantly, from 61 to 44 in the corresponding period.
- Starting from 2002, authorized institutions have been required to carry out a self-assessment of their compliance with the Code of Banking Practice. The second self-assessment covering the period from 1 June 2002 to 31 May 2003 was due on 1 September 2003. The HKMA is currently reviewing the assessment reports submitted by the authorized institutions.

### ATM fraud

- The HKMA has been liaising with authorized institutions and the Police since the first suspected ATM fraud case came to our notice in July. The HKMA recently issued a circular to set out its expectation of how authorized institutions should handle customer complaints and what precautionary measures authorized institutions may put in place in relation to the recent suspected ATM fraud cases. The recommended measures include enhanced security safeguards of ATMs, installation of CCTVs, more frequent patrol of ATMs and enhanced customer education on the protection of cards and PINs. Authorized institutions are also required to put in place a mechanism whereby transactions made through counterfeit cards can be quickly identified.
- Authorized institutions are required to handle customers' complaints in this relation quickly. Full and prompt internal investigations should be conducted in parallel with the Police's investigation.



## FINANCIAL INFRASTRUCTURE FOR DOMESTIC FINANCIAL ACTIVITIES

- **Oversight framework for clearing and settlement systems**
  - **Clearing and Settlement Systems Bill to be introduced into Legislative Council**
  - **entry of Hong Kong dollar into the Continuous Linked Settlement system expected to be in late 2004**
- **Retail payments**
  - **new HK\$500 and HK\$100 banknotes to go into circulation in December 2003**

32

### Oversight framework for clearing and settlement systems

- The HKMA is working on a Clearing and Settlement System Bill to empower the Monetary Authority to designate important clearing and settlement systems to be subject to oversight by the Monetary Authority; and to grant such designated systems statutory protection from the insolvency regime to ensure settlement finality. We consulted the Panel on Financial Affairs in May 2003. The Bill is expected to be introduced into the Legislative Council in December.
- The proposed legislation would also cater for the HK dollar's participation in the Continuous Linked Settlement (CLS) system. CLS is an international system for settlement of foreign exchange transactions. Given Hong Kong's role as an international financial centre, HK dollar should enter the CLS system, even though this could well pose a degree of competition to the US dollar and euro clearing systems in Hong Kong.

### Retail payments

- The new HK\$500 and HK\$100 banknotes, the designs for which were unveiled in September, will be put into circulation in December 2003. The remaining three denominations, HK\$20, HK\$50 and HK\$1,000, are expected to go into circulation in the second half of 2004.
- An important feature of the design is the standardisation of security features, and, in particular of their location on the banknotes. A number of advanced security features have been added to the new banknotes to enhance their anti-counterfeiting capabilities.



## FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

- **Hong Kong as a regional settlement hub**
  - **two-way linkages between CMU and Euroclear / Clearstream**
  - **US dollar and euro RTGS clearing systems in Hong Kong**

33

### Two-way linkages between CMU and Euroclear / Clearstream

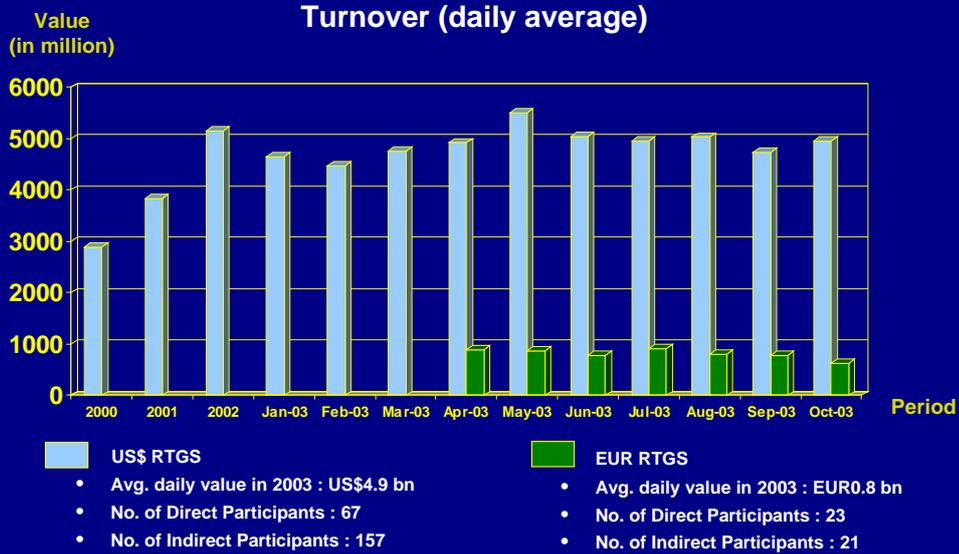
- The HKMA has established linkages with important global debt securities clearing systems, such as Euroclear and Clearstream. Members of these systems can hold and settle debt securities lodged with the CMU. The current value of debt securities held in the CMU through the linkages with Euroclear and Clearstream amount to around HK\$23 billion (including both outbound and inbound).

### US dollar and euro RTGS clearing systems in Hong Kong

- The new euro clearing system commenced operation on 28 April. This is the second foreign currency clearing system in Hong Kong after the US dollar clearing system implemented in August 2000. These services allow financial institutions in Hong Kong and in the region to settle US dollar and euro transactions real-time in the Asian time zone.



## US DOLLAR & EURO RTGS CLEARING SYSTEMS IN HONG KONG



34

- In the first ten months of 2003, the US dollar and euro RTGS clearing systems handled on average US\$4.9 billion and 0.8 billion euro daily respectively.



## FINANCIAL INFRASTRUCTURE FOR INTERNATIONAL FINANCIAL ACTIVITIES

- **Infrastructural linkages with the Mainland**
  - **joint Hong Kong dollar cheque clearing between Hong Kong and Guangdong (including Shenzhen)**
  - **Hong Kong dollar / US dollar RTGS linkages between Hong Kong and Shenzhen**
  - **one-way linkage from the Mainland's Government Securities Book-Entry System to CMU**

35

### Joint Hong Kong dollar cheque clearing

- The joint Hong Kong dollar cheque clearing service between Hong Kong and Guangdong (including Shenzhen) helps facilitate payment flows between Hong Kong and the Mainland. The daily turnover of this service amounts to HK\$92 million.

### Hong Kong dollar / US dollar RTGS linkages

- The daily turnover of the Hong Kong dollar RTGS linkage between Hong Kong and Shenzhen amount to HK\$68 million. Plans are underway for the establishment of a US dollar RTGS linkage between Hong Kong and Shenzhen. It is expected to be operational in late 2003.

### One way linkage with Government Securities Book-Entry System

- Another linkage being developed is that between the Mainland's Government Securities Book-entry System and the CMU. This is a facility to enable authorized financial institutions in the Mainland to clear, settle and hold CMU eligible securities.



## HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

### Renminbi business proposal

- **Helps facilitate economic and financial integration between Hong Kong and the Mainland**
- **Central Government to actively consider allowing banks in Hong Kong to trial run personal renminbi business, including deposits, remittances, exchange and credit card business**
- **HKMA in close discussion with the People's Bank of China on the detailed technical design of a scheme**

36

- Following the announcement by the Chief Executive on 25 July that the Central Government would actively consider allowing banks in Hong Kong to trial run personal renminbi business, including deposits, remittances, exchange and credit card business, discussions between the HKMA and the People's Bank of China have intensified on working out a detailed scheme.
- The proposal to develop renminbi business in Hong Kong is to facilitate the growing economic and financial integration between Hong Kong and the Mainland. With the continued promotion of cross-border tourism, more retail shops in Hong Kong start accepting renminbi cash brought along by Mainland tourists. On the other hand, Hong Kong residents travelling to the Mainland generate a demand for renminbi cash in Hong Kong. It is important to provide an efficient channel for legitimate renminbi flows across the border, and to gradually build up the infrastructure for renminbi in Hong Kong to capture any intermediation activities in the future as the Mainland liberalises its capital markets.



## HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

- **APEC Initiative on Development of Securitisation and Credit Guarantee Markets**
  - offering technical assistance to China, Thailand, the Philippines and Mexico to identify and remove impediments to developing securitisation and credit guarantee markets
- **Asian Bond Fund**
  - led the EMEAP group in the structuring of the US dollar denominated Asian Bond Fund I, which was launched in June 2003. Conducting feasibility study on Asian Bond Fund II, which extends the ABF I concept to local currency denominated Asian bonds

37

### APEC Initiative on Development of Securitisation and Credit Guarantee Markets

- Together with Korea and Thailand, the HKMA is leading an APEC initiative on the Development of Securitisation and Credit Guarantee markets. Expert panels have been formed to visit economies interested in receiving expert advice. The first panel visits to Thailand and China have been launched in June and July respectively, while the visit to Mexico will be made in the later part of this year.

### Asian Bond Fund

- As the Chair of the EMEAP Working Group for Financial Markets, the HKMA took the lead in developing the Asian Bond Fund (ABF). The US dollar ABF (ABF1) was launched on 2 June. All 11 EMEAP central banks and monetary authorities have participated in ABF1. With an initial size of about US\$1 billion, the Fund invests in a basket of US dollar denominated bonds issued by Asian sovereign and quasi-sovereign issuers in EMEAP economies (except Japan, Australia and New Zealand). The investment activities have not caused any market disturbance during the bond accumulation period.
- The Working Group is now proceeding to study the second phase of the ABF (ABF2), which is to extend the ABF concept to include bonds denominated in local currencies in the region.



## HONG KONG'S CREDIT RATING

- **Better credit rating for Hong Kong enhances cost effectiveness of Exchange Fund borrowing**
- **Joint Rating Advisors appointed in July 2003 to assist in formulating an effective communication strategy to engage the international credit rating agencies.**
- **With help from other parts of Government, the HKMA has produced a comprehensive Hong Kong credit story, and deployed it in meetings with the agencies.**

38

- The sovereign ratings on Hong Kong have a major impact not only on international confidence in Hong Kong, but also on the funding costs of Hong Kong borrowers, including the Exchange Fund, which issues the Exchange Fund Bills and Notes amounting to over HK\$110 billion.
- With approval of the Exchange Fund Advisory Committee, the HKMA has appointed two commercial entities as Joint Rating Advisors in July this year. Their roles are to assist in crafting a Hong Kong credit story to address the credit rating agencies' concerns and to present Hong Kong's credit strengths; and formulating an effective communication strategy to proactively approach the rating agencies.
- With help from other parts of the Government and the Joint Rating Advisors, the HKMA has produced a comprehensive Hong Kong credit story. As part of the communication strategy, the HKMA has met with the rating agencies to address their main concerns, and to explain Hong Kong's credit strength.



## HONG KONG'S CREDIT RATING

### Long-term Sovereign Credit Ratings

	Foreign Currency			Local Currency		
	S&P's	Moody's	Fitch	S&P's	Moody's	Fitch
<b>China</b>	BBB (positive)	A2 (stable)	A- (positive)	Not Rated	Not Rated	A (stable)
<b>Hong Kong</b>	A+ (stable)	A1 (stable)	AA- (negative)	AA- (negative)	Aa3 (stable)	AA+ (negative)

( ) rating outlook

**Note:** On 16 October, Moody's upgraded Hong Kong's sovereign rating for long-term foreign currency from A3 to A1, and China's from A3 to A2.

39

- The efforts are beginning to bear fruits. On 16 October, Moody's upgraded Hong Kong's sovereign rating for long-term foreign currency by two notches from A3 to A1, with a stable outlook. It also upgraded China's sovereign rating for long-term foreign currency by one notch from A3 to A2.
- The upgrade has provided a more favourable condition for Hong Kong debt issuers, including the private sector issuers.
- Our discussions with the rating agencies are an on-going process. We will continue to work with the rating agencies to ensure that their ratings on Hong Kong fully reflect our economic and credit strengths.



## EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	30 Sep 03 <sup>2</sup>	30 Jun 03 <sup>2</sup>	31 Dec 02 <sup>1</sup>
<b>ASSETS</b>			
Deposits	63.8	67.2	51.5
Debt securities	745.8	760.0	764.8
Hong Kong equities	62.9	53.1	50.9
Other equities	83.5	70.7	63.1
Other assets	<u>23.9</u>	<u>28.9</u>	<u>24.8</u>
<b>Total assets</b>	<b>979.9</b>	<b>979.9</b>	<b>955.1</b>
<b>LIABILITIES AND ACCUMULATED SURPLUS</b>			
Certificates of Indebtedness	127.5	124.4	118.5
Government-issued currency notes & coins in circulation	6.0	6.1	5.9
Balance of the banking system	1.0	0.9	0.5
Exchange Fund Bills and Notes	126.4	126.1	122.9
Placements by other HKSAR government funds	249.6	295.2	301.7
Other liabilities	<u>107.2</u>	<u>70.1</u>	<u>78.4</u>
<b>Total liabilities</b>	<b>617.7</b>	<b>622.8</b>	<b>627.9</b>
<b>Accumulated Surplus</b>	<b><u>362.2</u></b>	<b><u>357.1</u></b>	<b><u>327.2</u></b>
<b>Total liabilities and Accumulated Surplus</b>	<b>979.9</b>	<b>979.9</b>	<b>955.1</b>

1 Audited figures; 2 Unaudited figures

40

- The Accumulated Surplus of the Exchange Fund increased by HK\$29.9 billion, from HK\$327.2 billion at the end of December 2002 to HK\$357.1 billion at the end of June 2003. The total assets of the Exchange Fund increased by HK\$24.8 billion, from HK\$955.1 billion at the end of December 2002 to HK\$979.9 billion at the end of June 2003.
- Between end-December 2002 and end-June 2003, the fiscal reserves placed with the Exchange Fund declined by HK\$6.5 billion.
- *Figures as at end-September will be tabled at the briefing on 6 November.*



## EXCHANGE FUND PERFORMANCE

(HK\$ billion)	2003 Jan-Sep <sup>2</sup>	2003 Jul-Sep <sup>2</sup>	2003 Jan-Jun <sup>2</sup>	2002 Full year <sup>1</sup>
Gain / (Loss) on HK equities*	13.0	10.1	2.9	(11.8)
Gain / (Loss) on other equities*	13.6	2.8	10.8	(22.7)
Exchange gain / (loss)	11.3	(3.6)	14.9	27.2
Total return from bonds, etc	<u>18.3</u>	<u>(0.9)</u>	<u>19.2</u>	<u>54.3</u>
Investment income	56.2	8.4	47.8	47.0

\* including dividends

<sup>1</sup> Audited figures; <sup>2</sup> Unaudited figures

41

- The Exchange Fund recorded investment income of HK\$47.8 billion in the first half of 2003. The main components of this income were:
  - a profit of HK\$19.2 billion from bonds and other investments
  - an exchange gain of HK\$14.9 billion, mainly due to the appreciation of the euro against the US dollar
  - a gain of HK\$2.9 billion on the Hong Kong equities portfolio
  - a gain of HK\$10.8 billion on other equities.
- *Figures for the third quarter of 2003 will be tabled at the briefing on 6 November.*



## EXCHANGE FUND CHANGE IN ACCUMULATED SURPLUS

(HK\$ billion)	2003 Jan-Sep <sup>2</sup>	2003 Jul-Sep <sup>2</sup>	2003 Jan-Jun <sup>2</sup>	2002 Full year <sup>1</sup>
Investment income/(loss)	56.2	8.4	47.8	47.0
Other income	0.1	0.0	0.1	0.2
Interest and expenses	<u>(4.2)</u>	<u>(1.3)</u>	<u>(2.9)</u>	<u>(7.0)</u>
Net investment income/(loss)	52.1	7.1	45.0	40.2
Treasury's share	<u>(17.1)</u>	<u>(2.0)</u>	<u>(15.1)</u>	<u>(15.6)</u>
Increase/(Decrease) in EF accumulated surplus	35.0	5.1	29.9	24.6

1 Audited figures; 2 Unaudited figures

42

- After deducting HK\$2.8 billion of interest and other costs and HK\$15.1 billion representing the sharing of investment income with the fiscal reserves placed with the Exchange Fund, the Accumulated Surplus registered an increase of HK\$29.9 billion.
- The investment return accruing to the fiscal reserves placed with the Exchange Fund, under the profit-sharing arrangement, amounts to HK\$15.1 billion in the first half of the calendar year. This already exceeds the budget figure of HK\$12.1 billion by HK\$3 billion.
- *Figures for the third quarter of 2003 will be tabled at the briefing on 6 November.*



**HONG KONG MONETARY AUTHORITY**

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

**6 November 2003**

43