



HONG KONG MONETARY AUTHORITY

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

3 May 2013



DISCUSSION TOPICS

Updates on

- Financial and Economic Environment
- Currency Stability
- Banking Stability
- Financial Infrastructure
- Hong Kong as an International Financial Centre
- Investment Environment and Performance of The Exchange Fund
- Hong Kong Mortgage Corporation



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

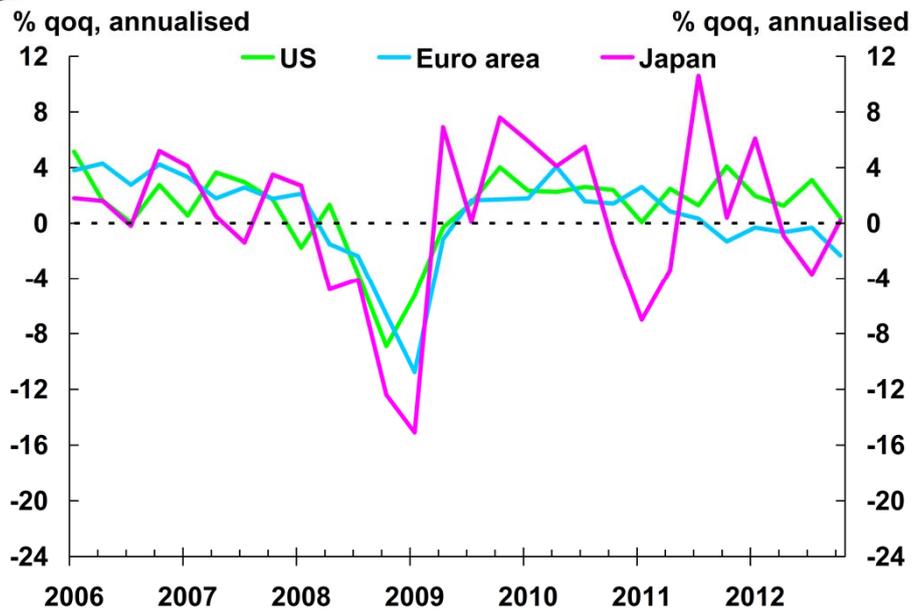
(% year-on-year)

	2012	2013 Forecasts		
		Nov 2012 FAP briefing	Feb 2013 FAP briefing	May 2013 FAP briefing
US	2.2	2.0	2.0	2.1
Euro area	-0.6	0.2	-0.1	-0.4
Japan	2.0	1.3	0.7	1.3
Asia (ex-Japan)	6.1	6.6	6.6	6.6
Mainland China	7.8	8.1	8.1	8.2
Hong Kong	1.4	3.6	3.4	3.5

Sources: Consensus Forecasts and CEIC



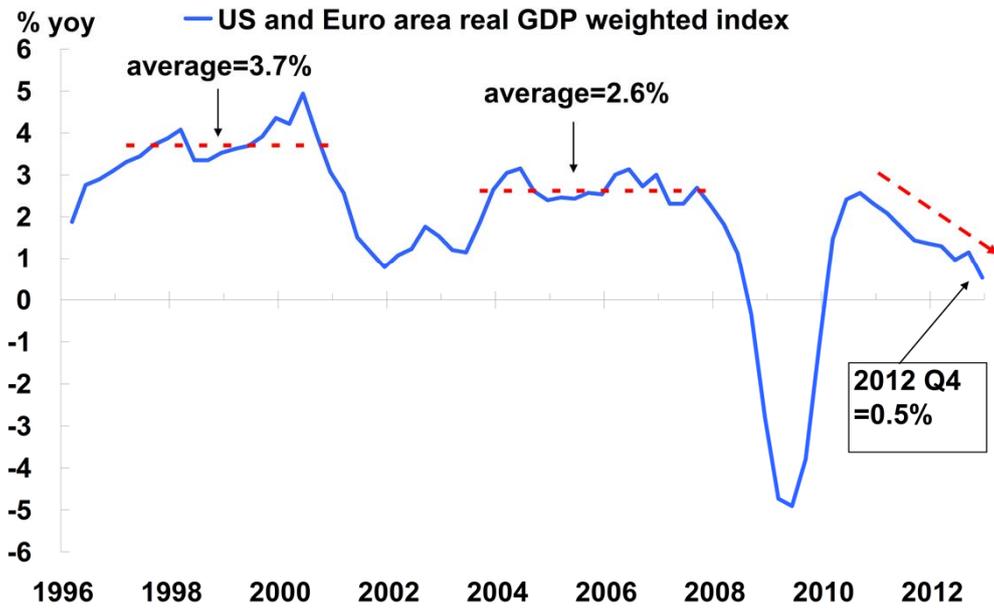
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



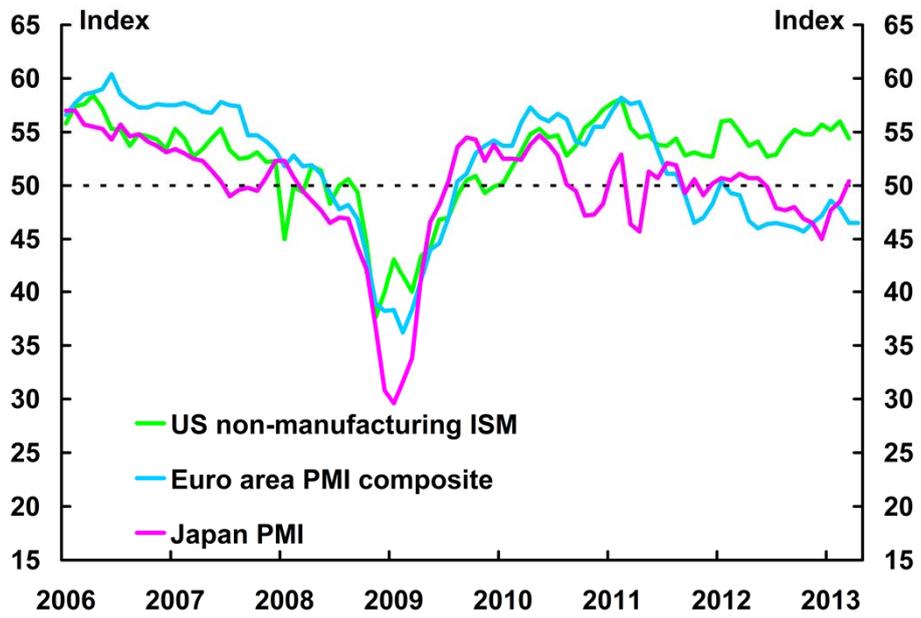
US AND EURO AREA REAL GDP GROWTH



Sources: CEIC and HKMA staff calculations



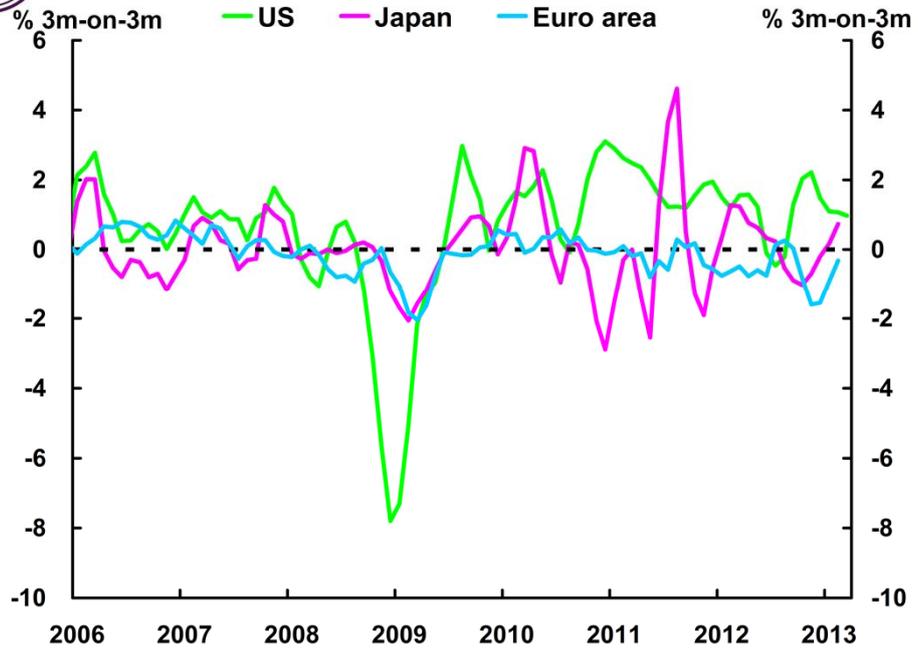
PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES



Source: Bloomberg



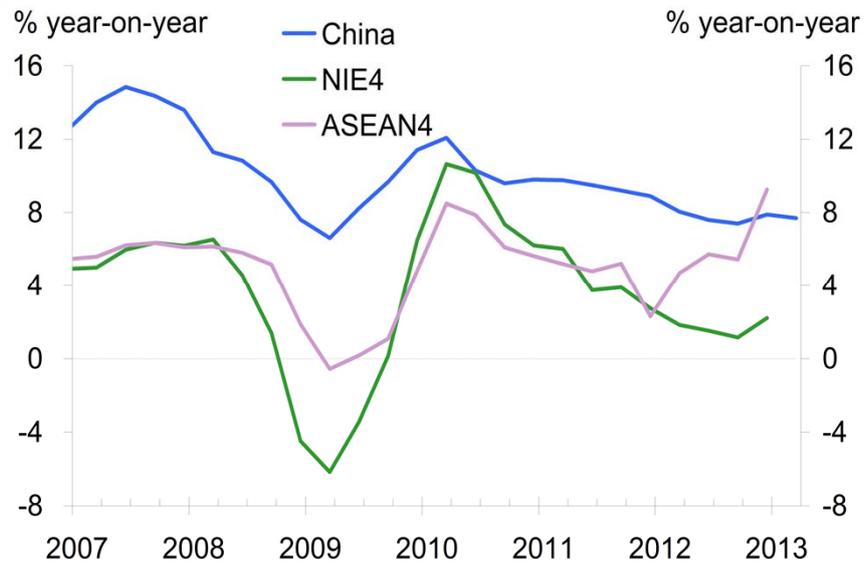
RETAIL SALES IN MAJOR ECONOMIES



Source: CEIC



ASIA: REAL GDP GROWTH



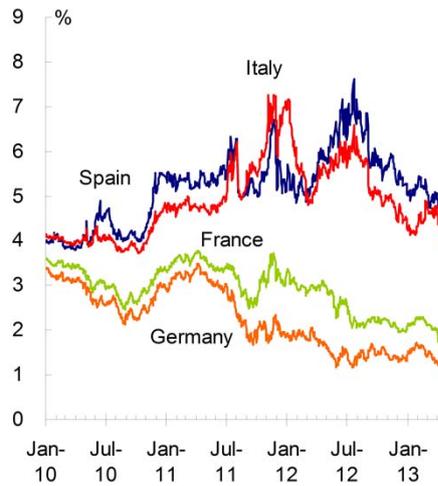
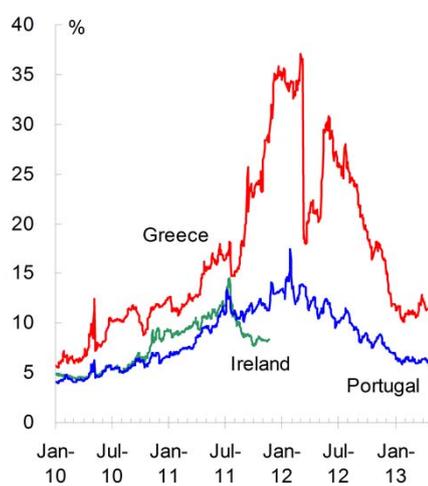
Note: NIE4 includes Hong Kong, Singapore, South Korea and Taiwan; ASEAN4 includes Indonesia, Malaysia, the Philippines and Thailand.

Sources: CEIC, IMF and HKMA staff estimates



EUROPE: SOVEREIGN BOND YIELDS

10-year sovereign bond yield

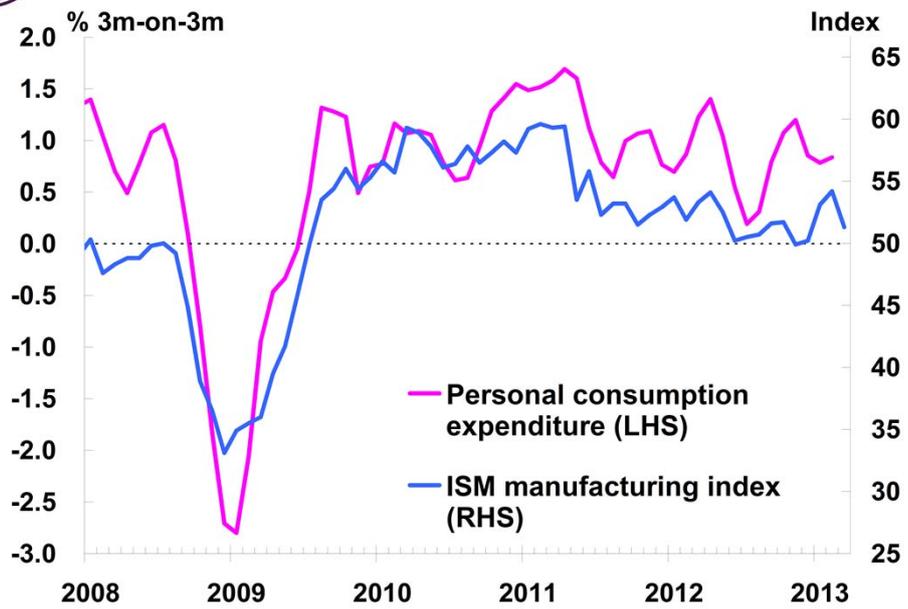


Sources: Bloomberg and EcoWin

Note: EcoWin has stopped publishing Ireland's 10-year bond yield since 22 Nov, 2011



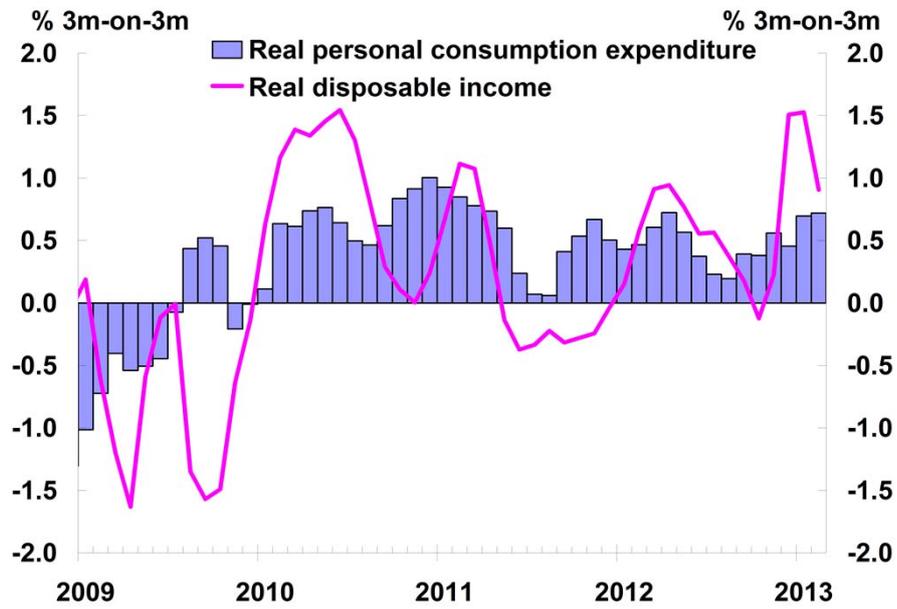
US: CONSUMPTION GROWTH & BUSINESS ACTIVITY



Source: CEIC



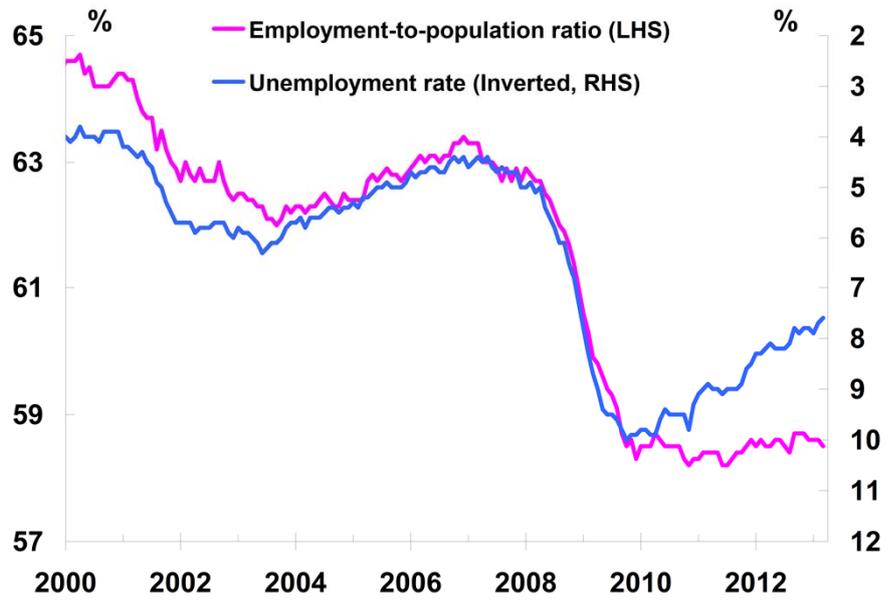
US: CONSUMPTION AND INCOME GROWTH



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



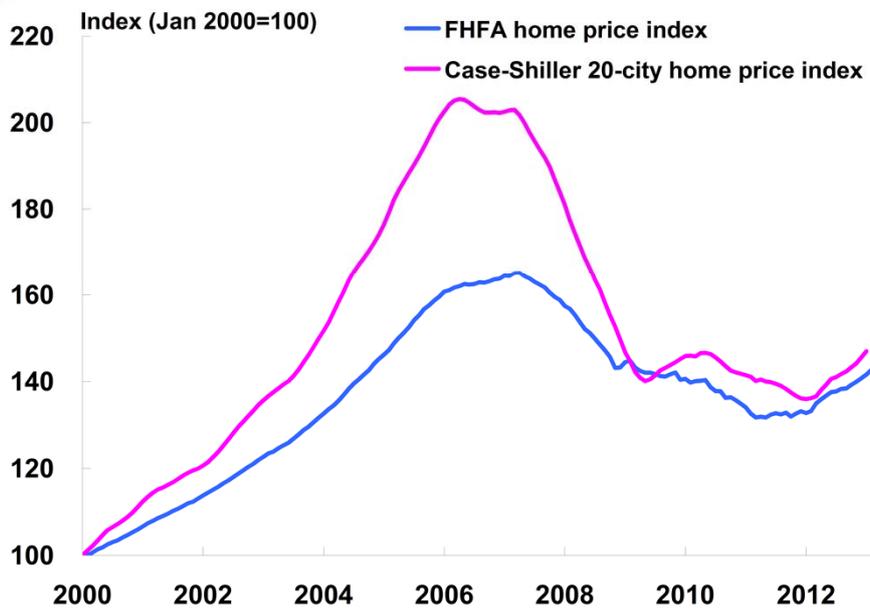
US: LABOUR FORCE PARTICIPATION



Source: CEIC



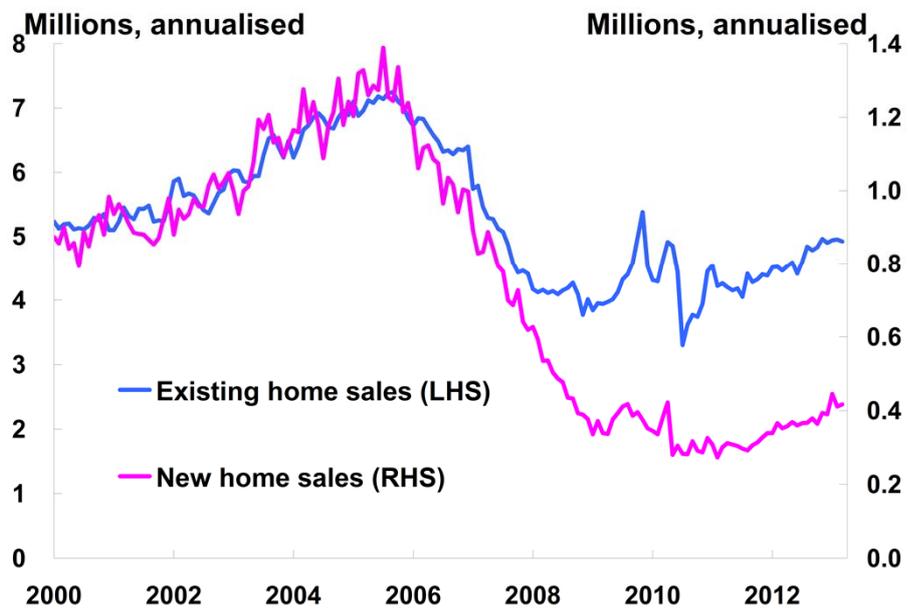
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



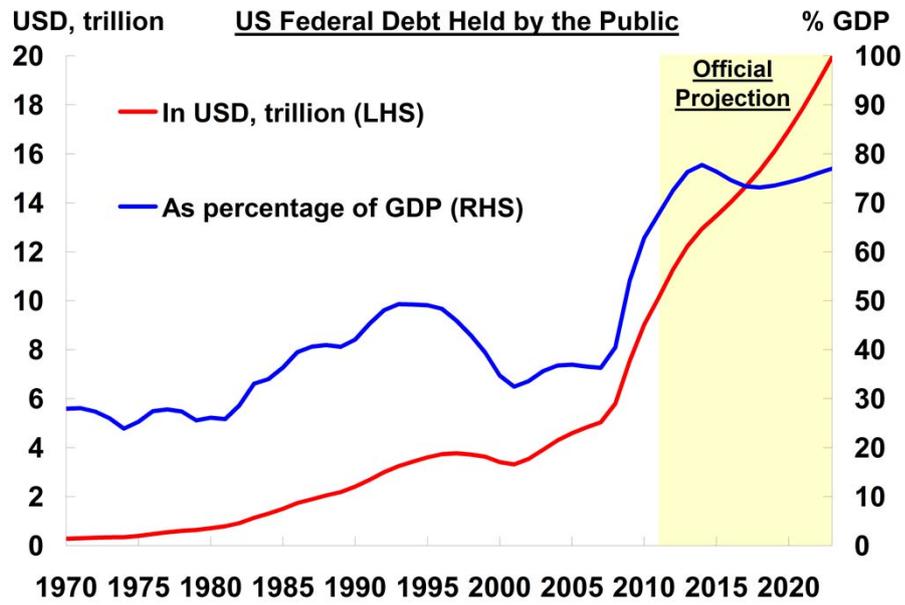
US: HOME SALES



Source: CEIC



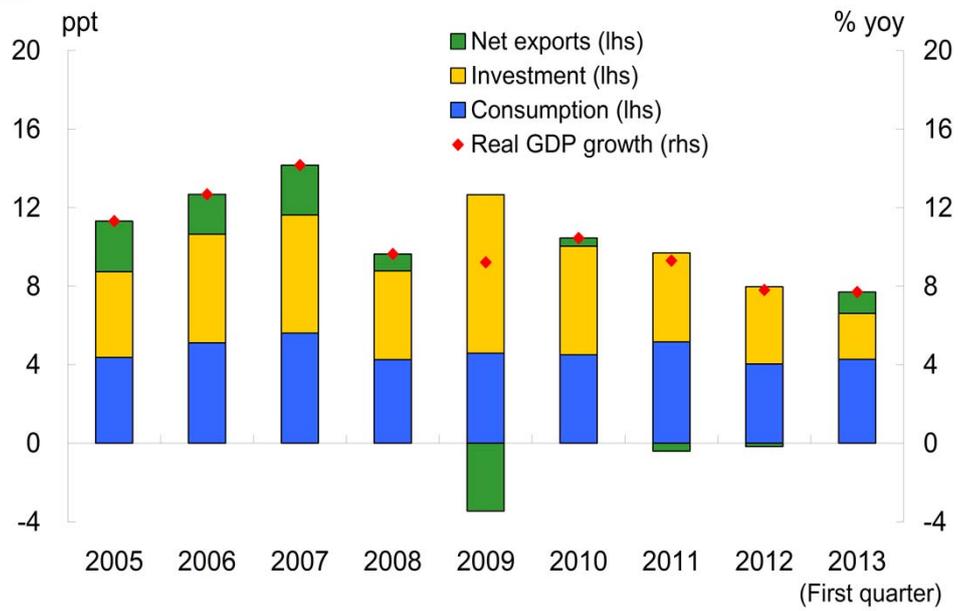
US: FEDERAL GOVERNMENT DEBT



Source : CBO



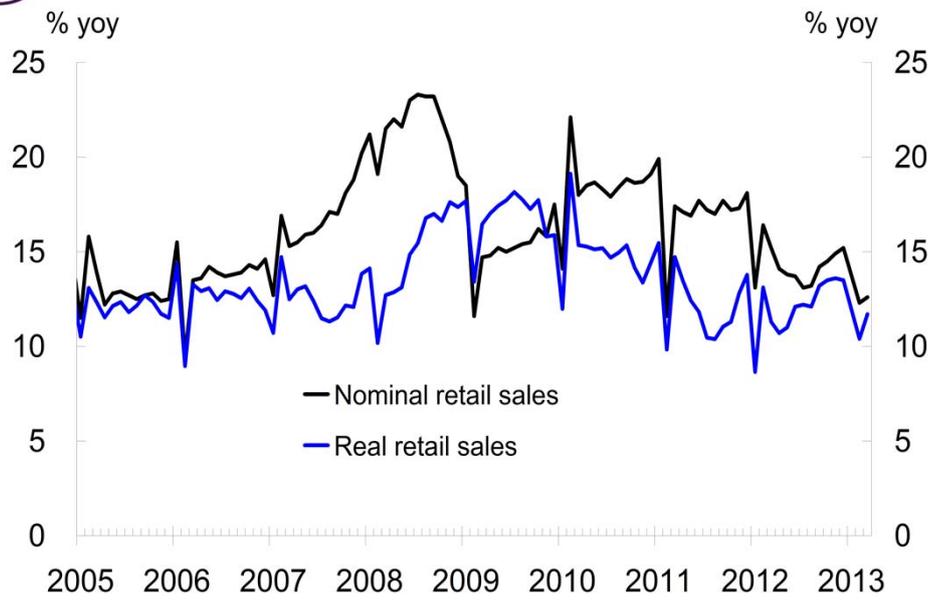
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



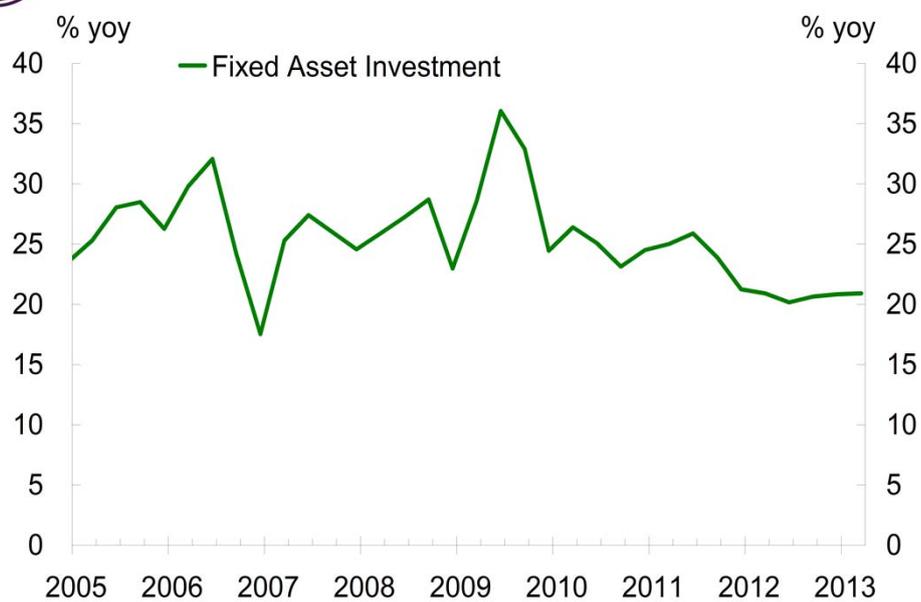
MAINLAND CHINA: RETAIL SALES



Sources: CEIC, WIND and HKMA staff estimates



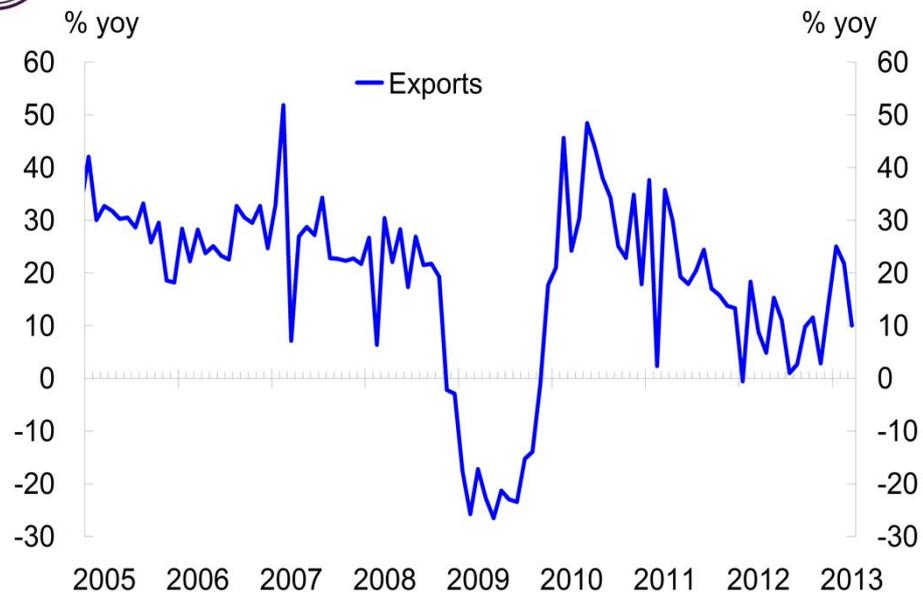
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



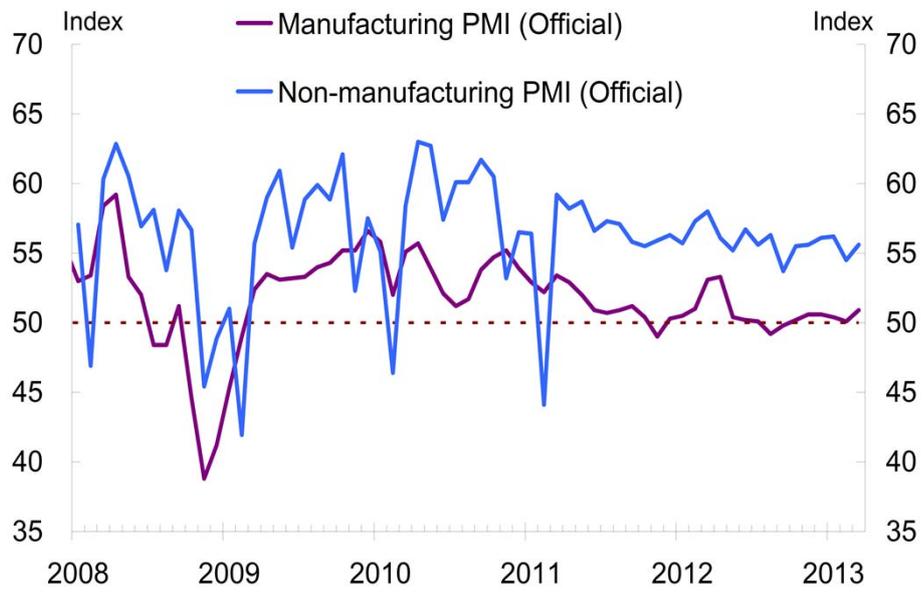
MAINLAND CHINA: EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



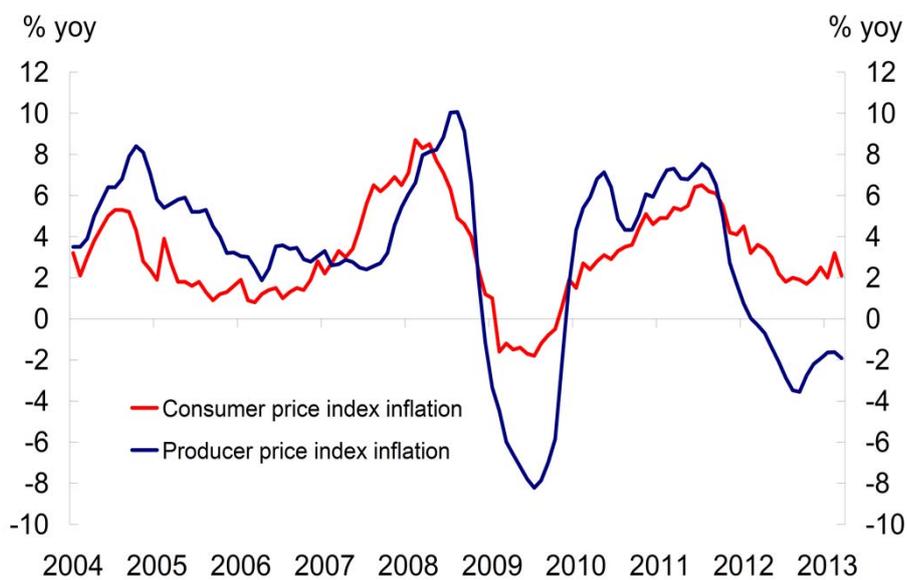
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



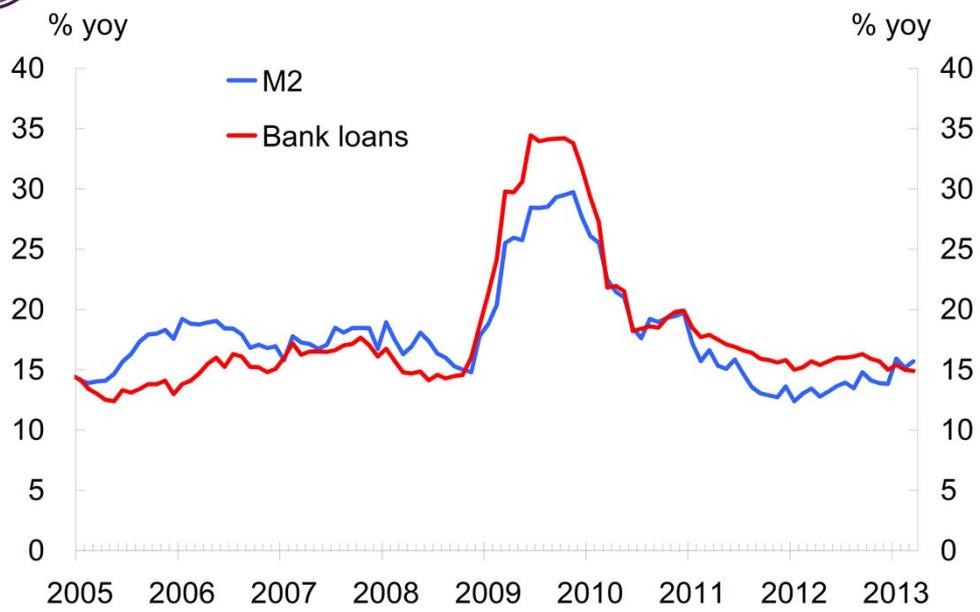
MAINLAND CHINA: INFLATION



Source: CEIC



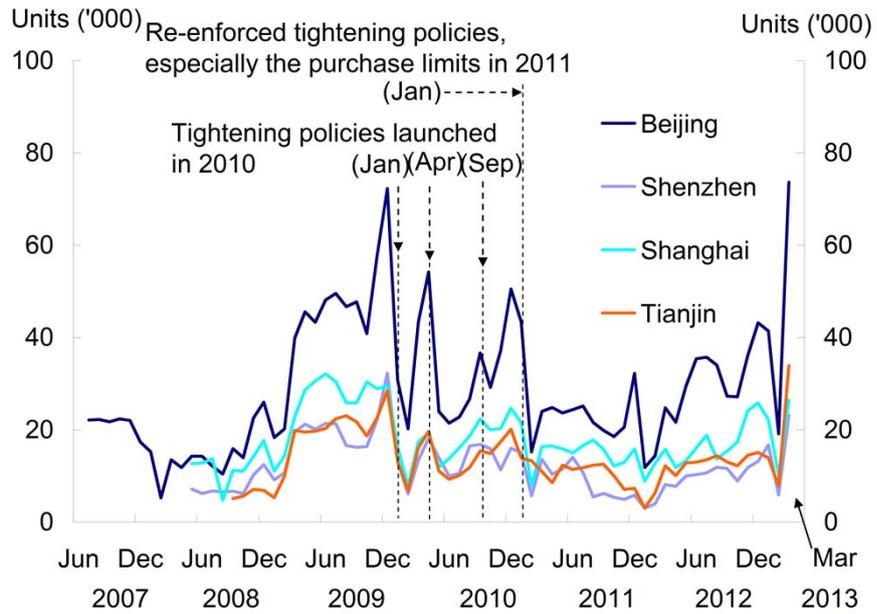
MAINLAND CHINA: MONEY AND LOAN GROWTH



Sources: CEIC and HKMA staff estimates

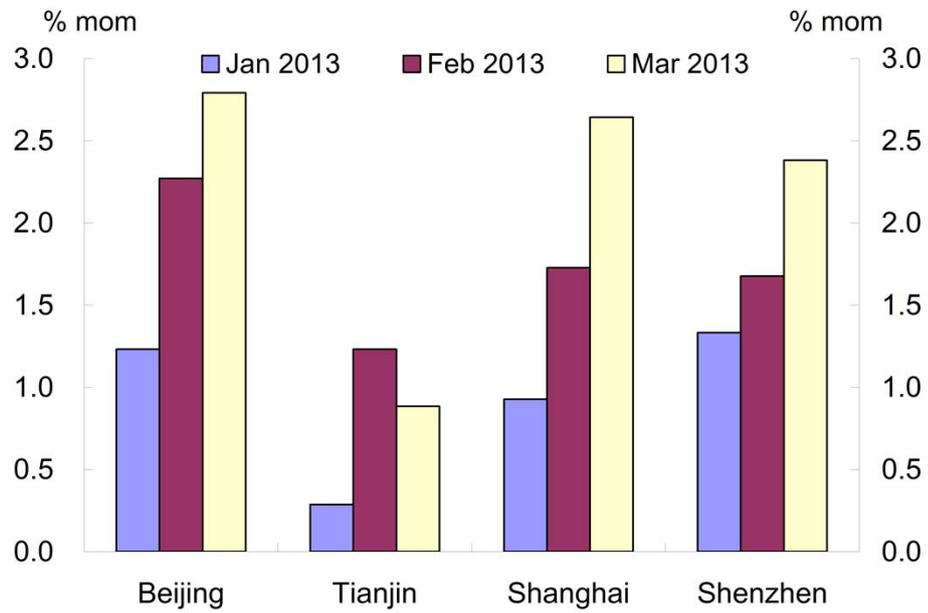


MAINLAND CHINA: PROPERTY TRANSACTION VOLUME IN MAJOR CITIES





MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES

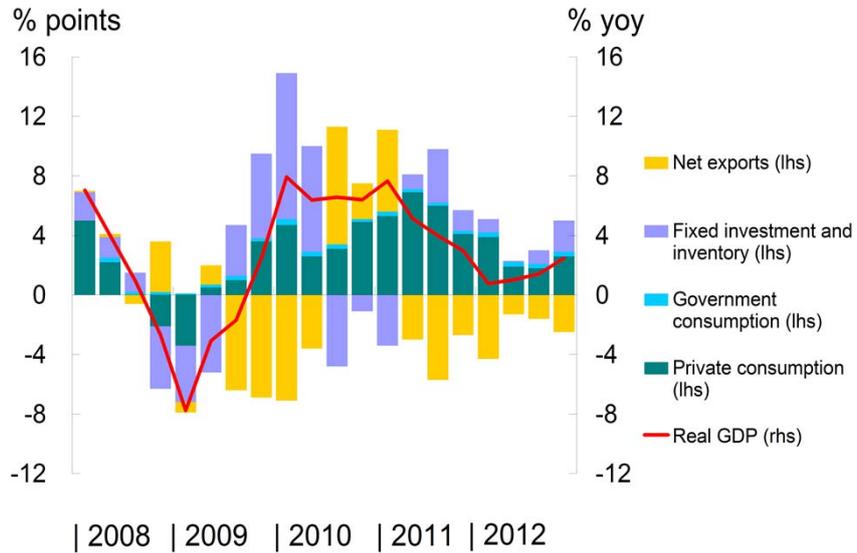


Sources: CEIC, WIND and HKMA staff estimates



HONG KONG: REAL GDP GROWTH

Changes in Real GDP and contributions by major components

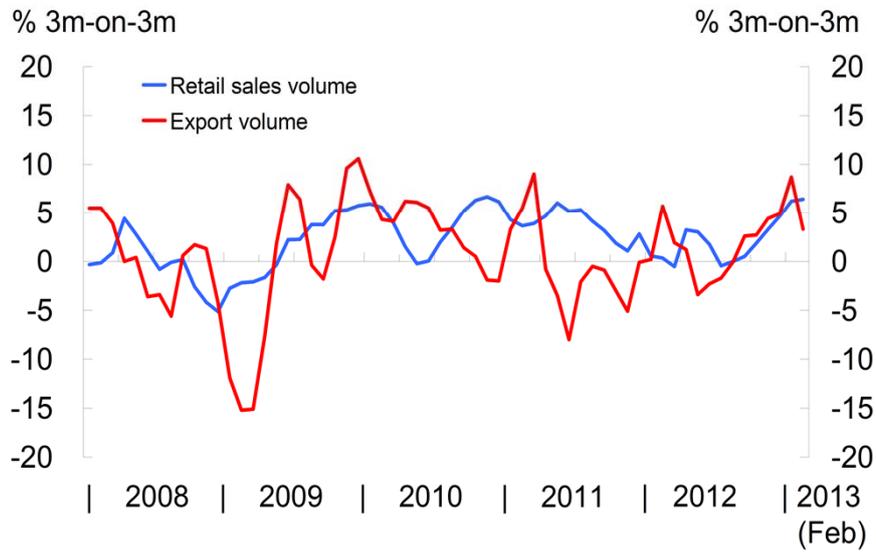


Source: C&SD



HONG KONG: ECONOMIC ACTIVITY

Retail Sales and Exports

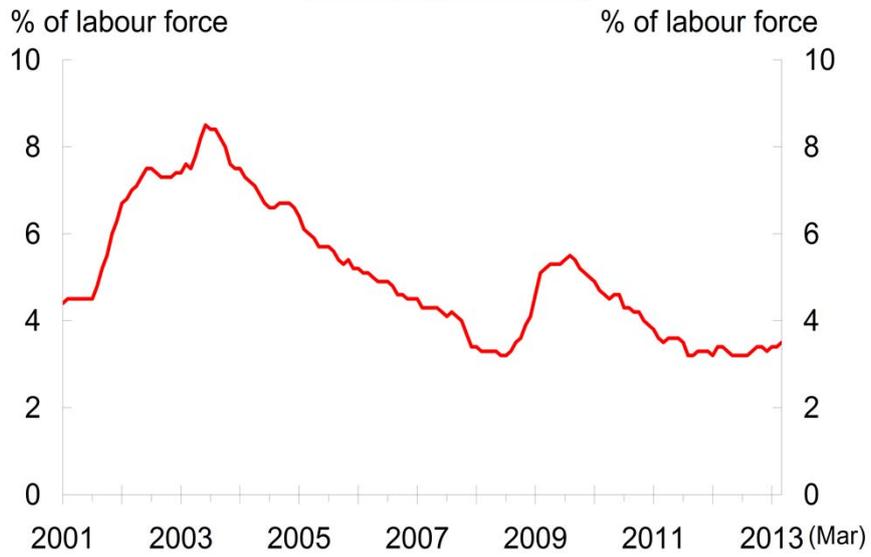


Source: C&SD



HONG KONG: LABOUR MARKET

Unemployment rate

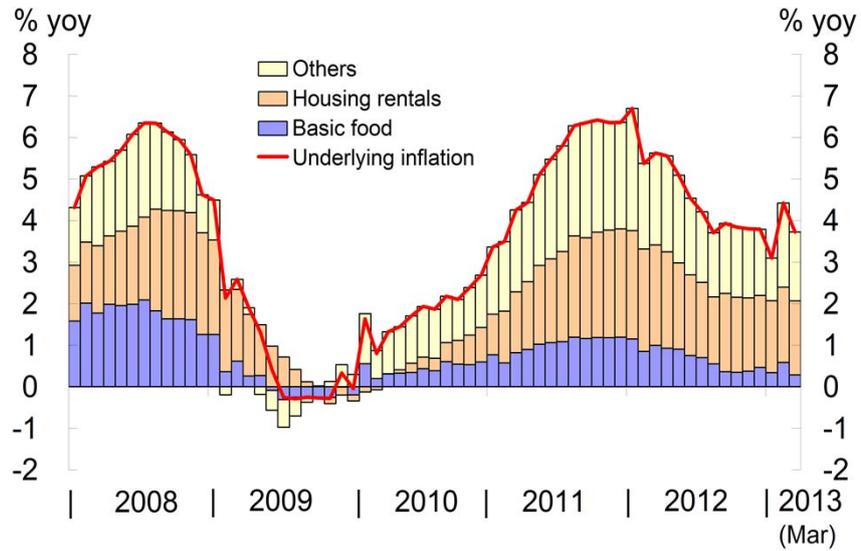


Source: C&SD



HONG KONG: INFLATION

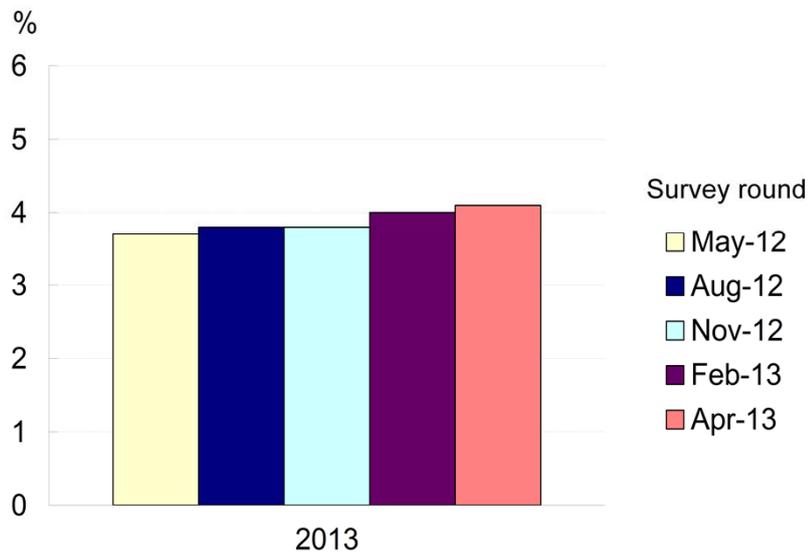
Underlying inflation and contributions of its components



Underlying inflation: Netting out the effects of all Government's one-off relief measures from headline inflation
Sources: C&SD and HKMA staff estimates



HONG KONG: INFLATION FORECASTS

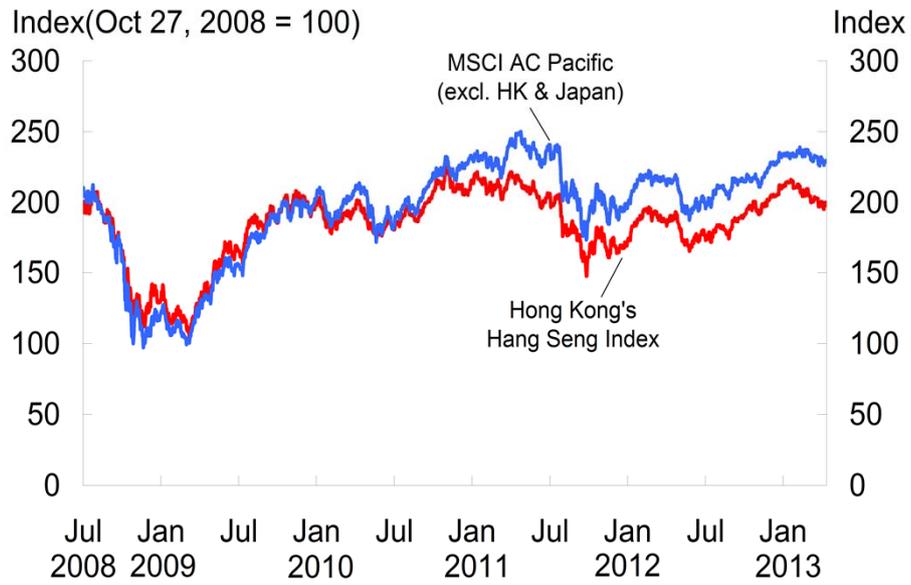


Source: Consensus Forecasts (May, Aug, Nov 2012 and Feb, Apr 2013)



HONG KONG: EQUITY MARKET

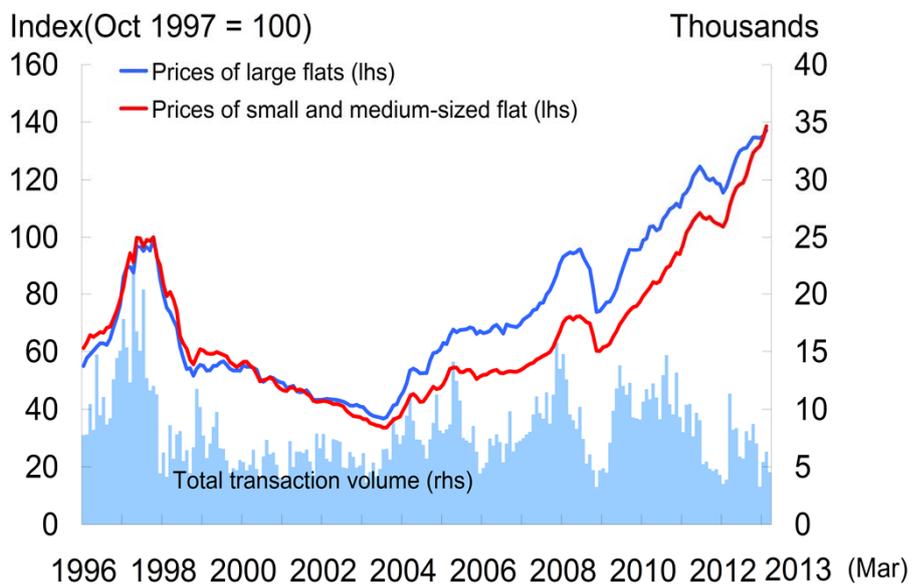
Hong Kong and Asia Pacific equity market performance



Source: Bloomberg



HONG KONG: RESIDENTIAL PROPERTY PRICES AND TRANSACTION VOLUME

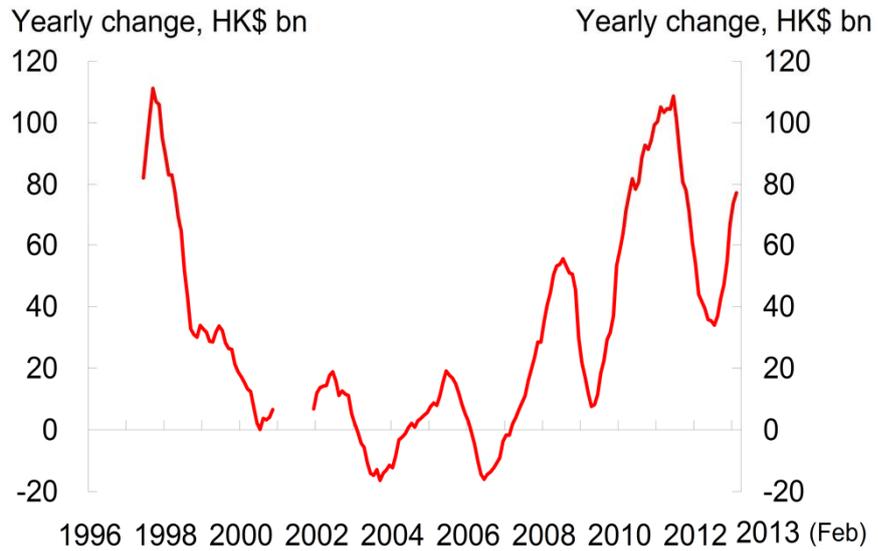


Source: Rating and Valuation Department



HONG KONG: OUTSTANDING MORTGAGE LOANS

Changes in outstanding mortgage loans

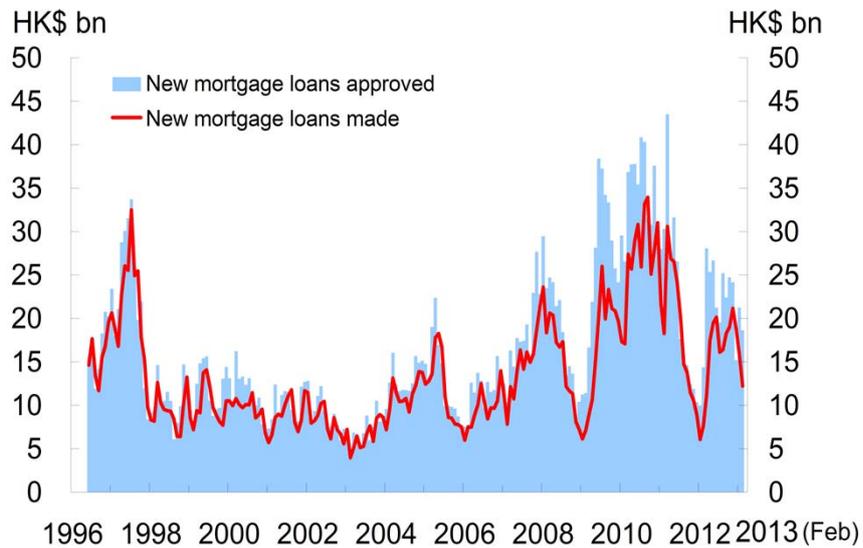


* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



HONG KONG: NEW MORTGAGE LOANS

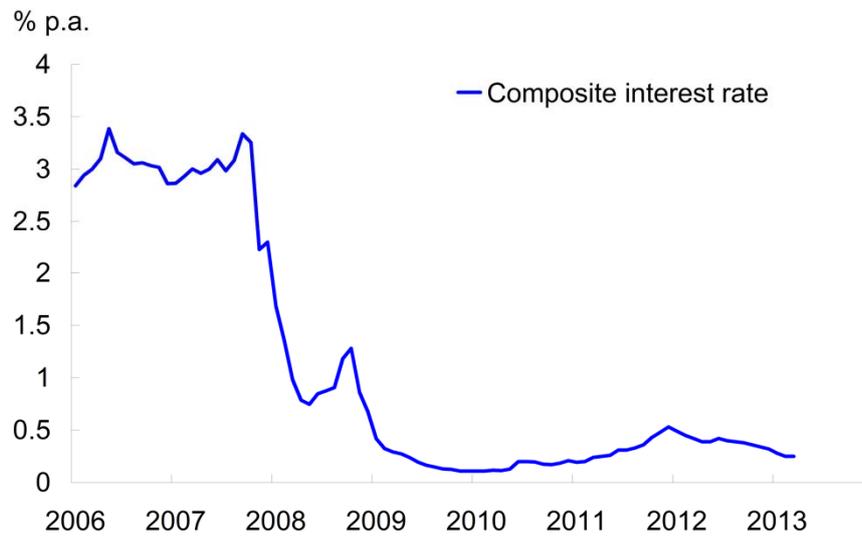
New mortgage loans made and approved



* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA

37

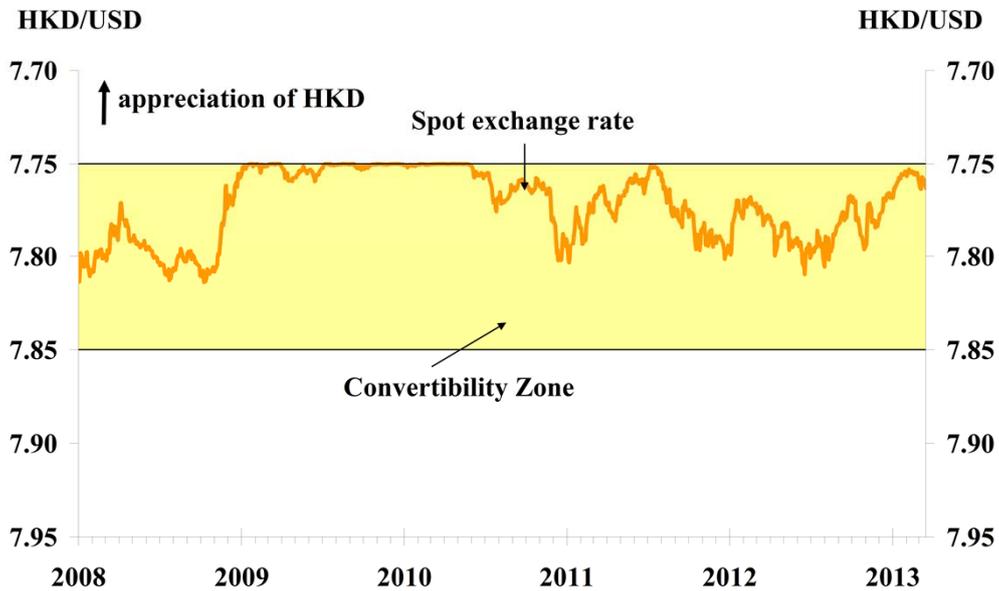
- Notes: The composite interest rate is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong dollar non-interest bearing demand deposits on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.



CURRENCY STABILITY

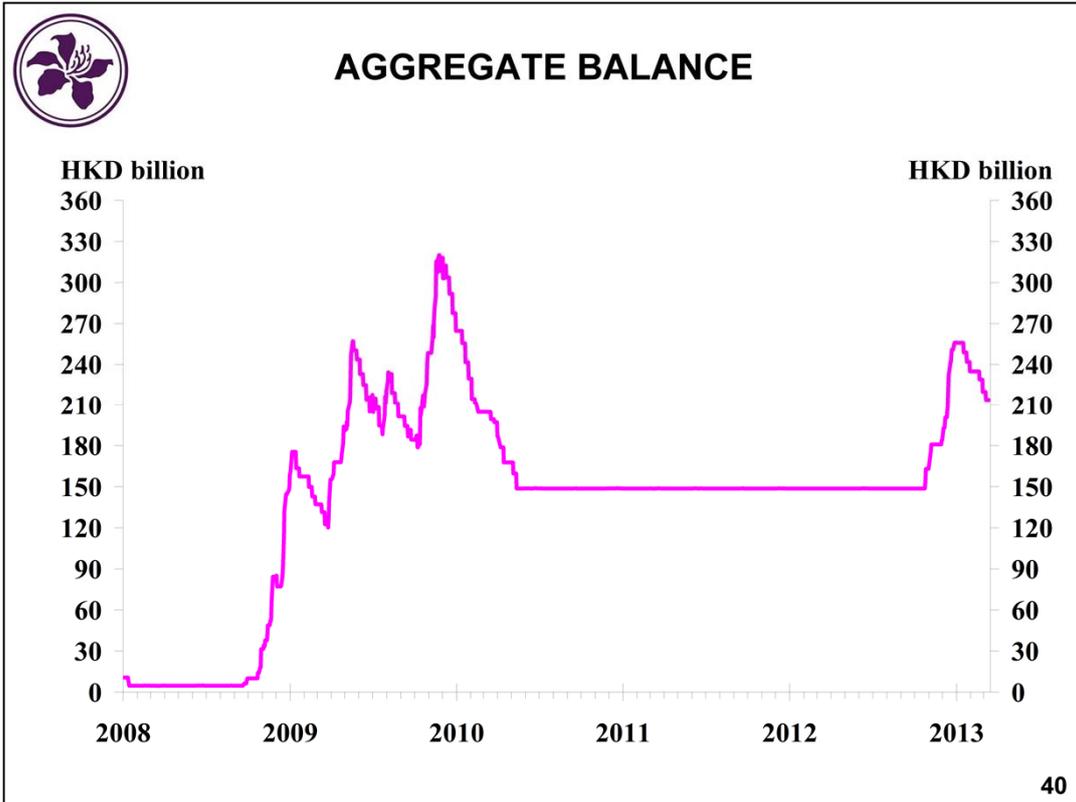


HONG KONG DOLLAR SPOT EXCHANGE RATE



39

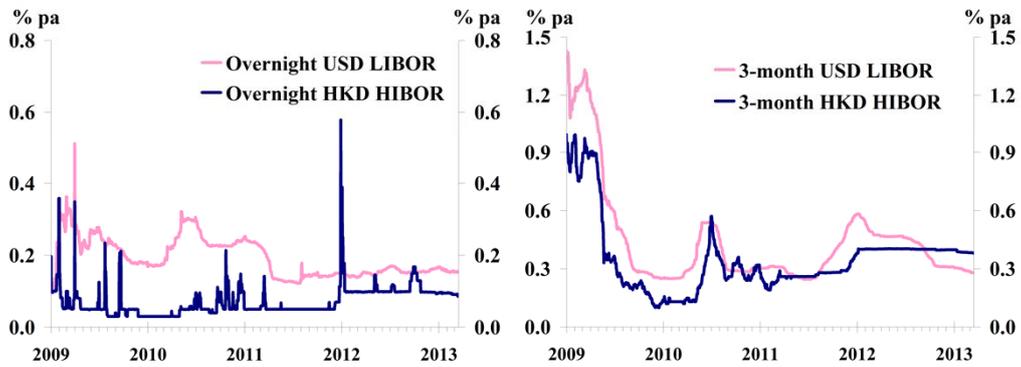
- The Hong Kong dollar spot exchange rate traded in a softer tone against the USD since the beginning of 2013 alongside weaker Asian currencies and stock markets on increased uncertainty in the euro area.
- There has been no triggering of the strong-side Convertibility Undertaking (CU) so far this year.



- Liquidity remained abundant in the interbank market.
- The Aggregate Balance declined to HK\$204.9 billion by the end of March 2013, as more Exchange Fund Bills were issued to meet the continued strong demand for short-dated papers.



DOMESTIC INTEREST RATES



41

- Short-term Hong Kong dollar interbank interest rates remained steady at near zero levels.



HONG KONG DOLLAR FORWARD EXCHANGE RATE



42

- The 12-month Hong Kong dollar forward discounts have been largely stable so far this year.



YIELDS OF EXCHANGE FUND BILLS

- To meet the increased demand of banks for EFBs for liquidity management as manifested in the lower yields of short-dated papers in the aftermath of inflow of funds, the HKMA has issued more EFBs since January 2013



43

- Issuance of additional EFBs:
 - January 2013: HK\$21 billion
 - February – early March 2013: HK\$21 billion
 - Mid-March – early April 2013: HK\$20 billion

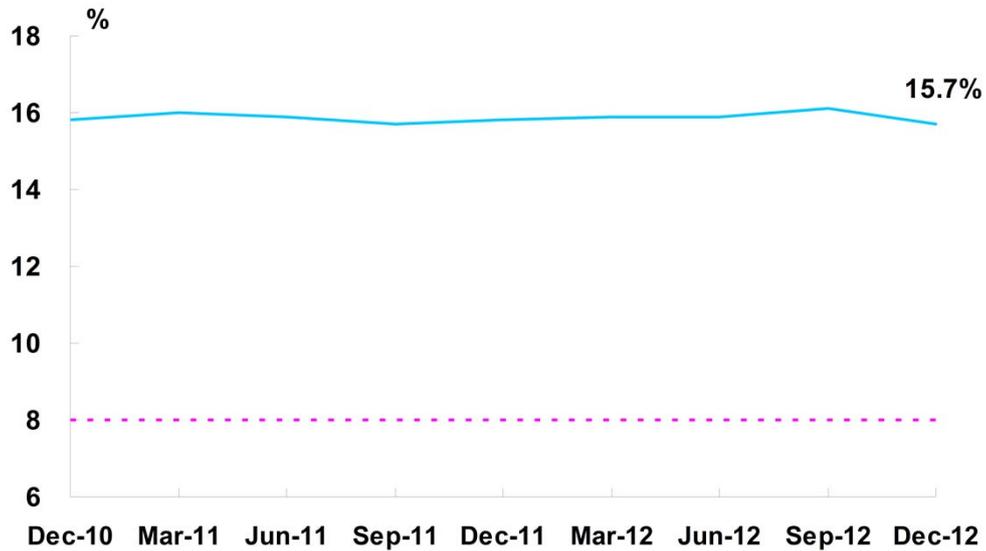


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



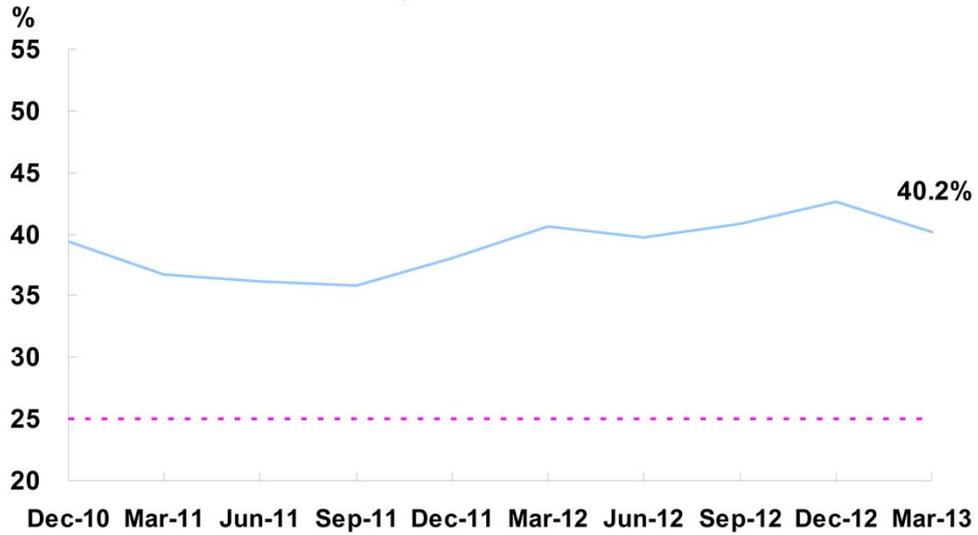
45

- The consolidated capital adequacy ratio of locally incorporated AIs stood at 15.7% at end-December 2012, and remained well above the international standard of 8%.



BANKING SECTOR PERFORMANCE

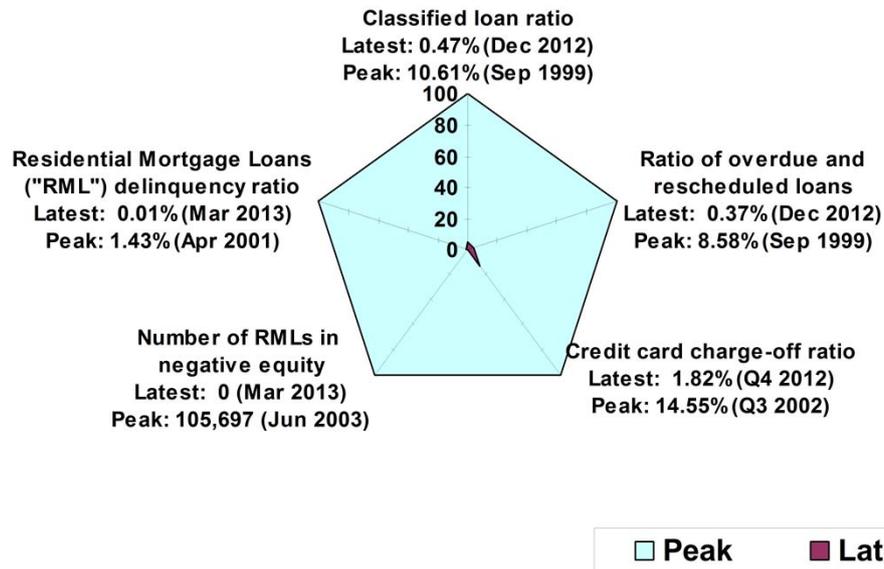
Liquidity ratio of retail banks remained well above statutory minimum of 25%





BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards

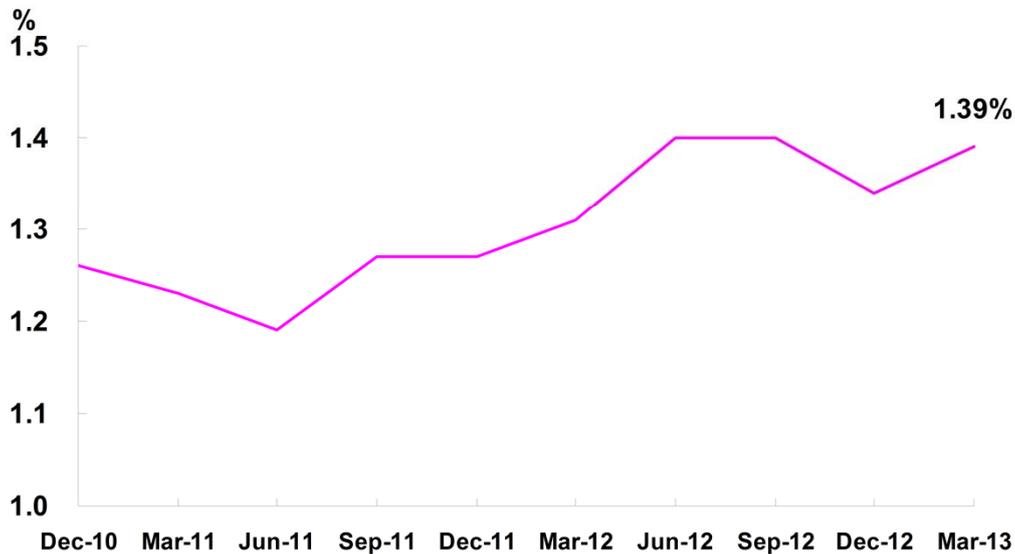


- The HKMA will continue to monitor closely the asset quality of retail banks' loan portfolios.



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks rebounded



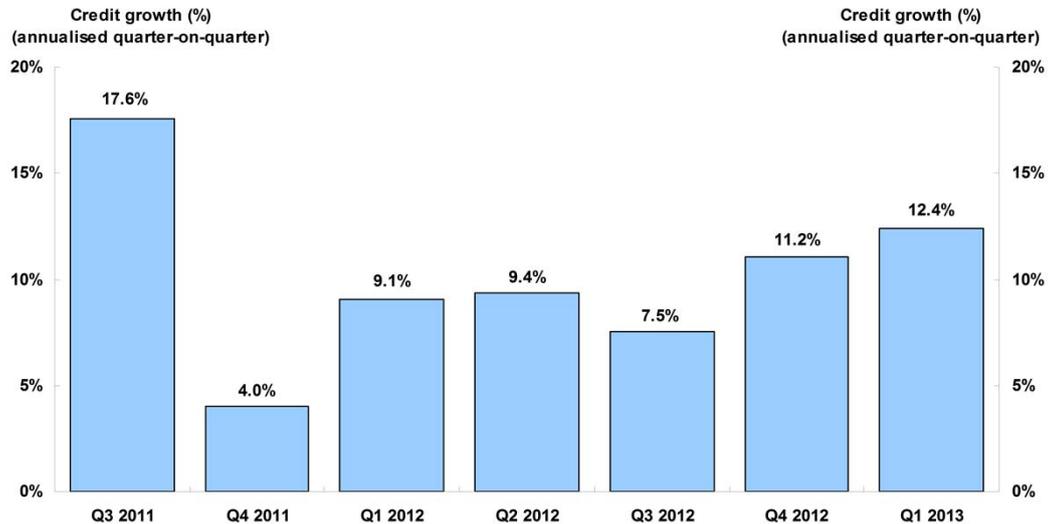
48

- The quarterly annualised net interest margin of retail banks rebounded to 1.39% in Q1/2013 from 1.34% in Q4/2012. The rebound in net interest margin was mainly due to a 6% increase in retail banks' net interest income during the quarter.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in Q1/2013 increased by 21.8% compared with Q1/2012. Benign increases in both net interest income (+12%) and in non-interest income (+17%) contributed to the profit growth.



CREDIT GROWTH

Credit growth remained at a moderate level in the first quarter of 2013



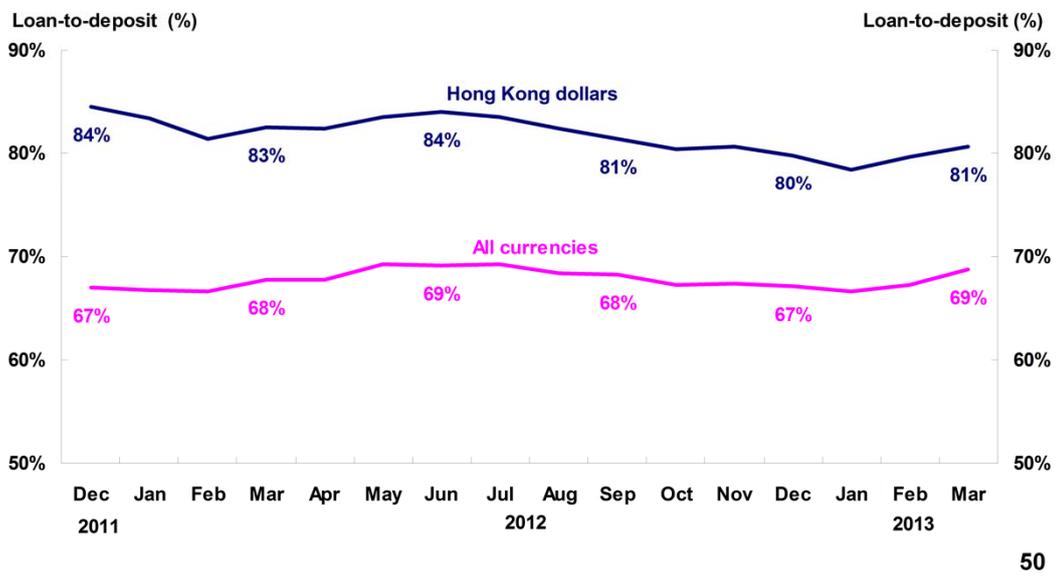
49

- In 2012, credit growth was 9.6%. It is much slower than the 20.2% growth recorded in 2011.
- In the first quarter of 2013, credit growth was 3.1% or 12.4% on an annualised basis. The accelerated credit growth was mainly contributed by trade finance and loans for use outside Hong Kong.
- The HKMA will continue to monitor the credit growth of the banking sector.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong increased slightly



- Hong Kong dollar loan-to-deposit ratio increased slightly to 81% at end-March 2013.
- The HKMA will continue to monitor the movement of the loan-to-deposit ratio.



Risk Management of Property Mortgage Loans

HKMA's macroprudential measures introduced in Feb 2013

- Stress test on repayment ability:
 - Interest rate hike assumption increased to at least 300 basis points from at least 200 basis points
- Loan-to-value (LTV) ratio cap:
 - Maximum applicable LTV ratio caps for non-residential property mortgages lowered by 10 percentage points
- Risk weight floor:
 - 15% risk weight floor for residential mortgage loans granted by banks using Internal Ratings-Based approach after 22 Feb 2013

51

Maximum LTV ratios for non-residential property mortgage loans

Types of mortgage loan applicants	Maximum LTV ratios	
	Applicants without outstanding mortgage	Applicants with outstanding mortgage(s)
Applicants' income mainly derived in HK	50% → 40%	50% → 40%
Applicants' income mainly derived from outside HK	40% → 30%	30% → 20%
Net-worth-based lending	40% → 30%	30% → 20%

Comparison of regulatory capital required for banks using internal-ratings based ("IRB") approach and standardized ("STC") approach

	IRB banks	STC banks
New RMLs approved	HK\$1 million	
Risk weight	< 10% → 15%	35%
Risk weighted assets*	< HK\$100,000 → HK\$150,000	HK\$350,000
Regulatory capital required if the bank has to meet 10% CAR requirement	< HK\$10,000 → HK\$15,000	HK\$35,000

* For simplicity, the effect of scaling factor is excluded in the analysis.

Currently, there are 8 banks using IRB approach to calculate credit risk. They are BEA, BoCHK, Chiyu, DBSHK, Hang Seng, HSBC, Nanyang and StanChart. These 8 banks account for 83% of total market shares.



Risk Management of Property Mortgage Loans

Latest developments in the residential mortgage market:

New residential mortgage loans (“RMLs”):

- Average loan-to-value ratio declined from 64% in September 2009 to 54% in March 2013
- Average debt servicing ratio declined from 41% in August 2010 to 36% in March 2013
- Number of sale and purchase agreements in March 2013 decreased by 28% from February 2013
- The HKMA will continue to closely monitor mortgage market developments and introduce appropriate measures as and when necessary to safeguard banking stability

52

Latest developments in the residential mortgage market

	2011 Mthly Avg	2012 Mthly Avg	12/2012	1/2013	2/2013	3/2013
Number of new RML applications	12,644	11,634	7,449	11,932	9,013	10,291 (+14%)
Number of new RMLs approved	9,224	8,210	5,583	7,738	6,498	7,526 (+16%)
Number of sale and purchase agreements	7,039	6,778	3,286	5,430	6,307	4,534 (-28%)

() month-on-month change



Basel III Implementation Progress

- Capital standards
 - Banking (Disclosure) (Amendment) Rules / Banking (Capital) (Amendment) Rules
 - Phase 2 implementation
- Liquidity standards
 - Liquidity Coverage Ratio

53

Capital standards

- Banking (Disclosure) (Amendment) Rules 2013 (“BDAR”) and Banking (Capital) (Amendment) Rules 2013 (“BCAR”) tabled at LegCo for negative vetting on 17 April. These Rules are respectively to:
 - BDAR – prescribe new Basel disclosure requirements associated with first phase of capital standards already in effect in Hong Kong from 1 January. (The Rules are intended to take effect from 30 June 2013 in accordance with the BCBS timetable, which recognises the fact that jurisdictions and banks need time to implement new disclosure standards BCBS released in June 2012, a year after the BCBS issued the finalized and revised Basel III capital standards.)
 - BCAR – incorporate miscellaneous refinements principally to align rules with latest Basel guidance (for counterparty credit risk weighting). Going forward refinements / updates of similar nature may be needed on regular basis.
- Second phase of capital standards – covering two capital buffer requirements – which is scheduled for implementation from 2016 – policy proposals being developed for industry consultation re (i) mechanism to operationalise the two buffer requirements and (ii) framework for application of “higher loss absorbency” capital requirements for domestic systemically important banks.

Liquidity standards

- In early January, the Basel Committee published a package of revisions to the Liquidity Coverage Ratio (LCR). The HKMA is developing policy proposals for local implementation of the LCR taking into account these latest revisions and local circumstances. We intend to conduct a new round of industry consultation on the liquidity proposals within the second quarter of this year.



INVESTOR AND CONSUMER PROTECTION

- Introduced enhanced regulatory measures applicable to sale of investment-linked assurance schemes
- Developing an enhanced competency framework for private wealth management practitioners
- Continue to participate in the work of the OECD Task Force on Financial Consumer Protection to support the implementation of the G20 High-Level Principles on Financial Consumer Protection

54

- Different from other insurance policies and investment products, investment-linked assurance scheme (ILAS) is a long term investment-cum-insurance product and in many cases with long lock-in period (with early redemption charges during this period) and complex structure of fees and charges. In view of the unique features of ILAS, the HKMA has worked closely with the other regulators and the industry practitioners, and issued a circular in April 2013 to introduce enhanced regulatory measures to increase the transparency of some important facts about ILAS products, including disclosure of commission receivable by the intermediary from the insurance company.
- With a view to raising the competence and ethics of industry practitioners and to developing and maintaining a pool of professional talents for the private wealth management (PWM) industry in Hong Kong, the HKMA has been providing advice and assistance to the industry and the local professional bodies to develop an enhanced competency framework covering the requisite level of competence and on-going professional development of PWM practitioners. The Hong Kong Institute of Bankers, the Hong Kong Securities and Investment Institute and the Treasury Markets Association have completed industry consultation on a high level proposal in April. They are working on the details of the proposed framework for further industry consultation.
- The HKMA is a member of the Task Force on Financial Consumer Protection of the OECD (the Task Force) which is tasked to develop high-level principles on financial consumer protection. The G20 High-Level Principles on Financial Consumer Protection were published in October 2011. The next step is for the Task Force to develop effective approaches to support the implementation of the High-Level Principles. Three principles (namely, "Disclosure and Transparency", "Responsible Business Conduct of Financial Services Providers and Authorised Agents", and "Complaints Handling and Redress") were identified as having priority over the other principles for the development of effective approaches. The Task Force has conducted surveys on the effective practices and country examples related to the three principles, and aims to finalise a progress report on the development of effective approaches for implementing the three principles in May 2013 for submission to the G20 Summit in September 2013. HKMA together with the relevant financial regulators will consider how to implement the three principles when the effective approaches are endorsed by the G20.



DEPOSIT PROTECTION

- Completed review of self assessment reports on compliance by banks with the Representation Rules. Results were satisfactory
- Implementing the payout reform plan
- Developing revisions to information system guideline to tighten information submission requirements
- Requested selected banks to submit an audit report to certify the correctness of their calculation of amount of relevant deposits for the purpose of contribution assessment

55

- The self-assessment review of banks' compliance with the DPS Representation Rules for 2011-12 was completed. From April 2012 to March 2013, the HKMA has completed 12 on-site examinations for monitoring banks' compliance with the Representation Rules in greater detail. The results reveal that the overall compliance level is satisfactory in general.
- A full-scope rehearsal to test the capability of the Hong Kong Deposit Protection Board and its payout agents was completed in October 2012. Taking into account the results of the Core Principles review and the experience of the rehearsal exercise, an implementation plan is formulated to improve payout efficiency and enhance the readiness to deal with the challenges faced in promptly compensating depositors should the DPS be triggered.
- Consultation with the banking industry is being conducted to tighten the requirements on submission of depositor information by banks and enhance the scope of compliance program to ensure that a complete set of accurate depositor records can be obtained from a failed bank efficiently. Payout system has been tuned to handle different crisis scenarios.
- The amount of contribution payable by banks is calculated on the basis of the amount of relevant deposits reported in the returns of relevant deposits and the supervisory ratings assigned by the Monetary Authority to each bank. To ensure that the amount of relevant deposits reported in the returns are accurate, 35 banks have been selected and required to conduct an audit review by April 2013.



FINANCIAL INFRASTRUCTURE



REFORMING OTC DERIVATIVES MARKET

G20 Commitments

- All standardised OTC derivative contracts should be traded on exchanges/electronic trading platforms and cleared through central counterparties
- OTC derivative contracts should be reported to trade repositories

Implementation

- **Regulation:**
 - Aim to introduce the Securities and Futures (Amendment) Bill into the Legislative Council in Q2 2013 to implement the clearing and reporting requirements
- **Central Counterparty:**
 - HKEx is building a local central counterparty for OTC derivatives, which is expected to commence operation in Q2 2013
- **Trade Repository:**
 - The HKMA is building a trade repository (TR) to facilitate the reporting of OTC derivatives transactions. The matching and confirmation functions of the TR to support clearing at HKEx's central counterparty was launched in December 2012. The reporting function of the TR is targeted to be launched by mid-2013

57

- Following the public consultation on the proposed regulatory regime for the OTC derivatives market in October 2011, the HKMA and SFC published the consultation conclusions to respond to the comments received from the consultation and issued a supplemental consultation paper on the proposed scope of new/expanded regulated activities and the oversight of systemically important participants in July 2012. The supplemental consultation was closed on 31 August 2012. The HKMA and SFC are studying the feedbacks received from the supplemental consultation.
- The detailed requirements of the new regulatory regime will be set out in the subsidiary legislation in the form of rules. The HKMA and SFC aim to conduct a public consultation on the draft subsidiary legislation in summer 2013.
- The local TR will be launched in two stages – the first stage was launched in December 2012 to support central clearing; the second stage is targeted to be launched by mid-2013 to support mandatory reporting.



GOVERNMENT BOND PROGRAMME

Institutional Bond Issuance Programme:

- 14 issues totalling HK\$64.5 billion were outstanding
- A yield curve from two years to ten years is established to form the basis for other issuers to price their issues

Retail Bond Issuance Programme:

- Two iBonds totalling HK\$20 billion were outstanding
- The HKMA is co-ordinating the issuance of the third iBond

Expansion of the Government Bond Programme:

- The 2013-14 Budget Speech proposed to expand the size of the Programme from HK\$100 billion to HK\$200 billion to provide room for issuance for another 5 years
- The Government will seek for necessary approval from LegCo

58

- The primary objective of the GBP is to promote the further and sustainable development of Hong Kong's bond market through systematic issuance of government bonds. It can also help promote financial stability by making our debt market an effective channel of financial intermediation, complementing the equity markets and the banking sector.
- The GBP is a long-term programme comprising an Institutional Bond Issuance Programme and a Retail Bond Issuance Programme.
- By enlarging the investor base over time, the GBP is expected to improve liquidity and attract more issuers to raise funds via the bond market. This will help increase the breadth and depth of our bond market, thereby consolidating our role as an international financial centre.
- Subsequent to the two very successful HK\$10 billion issuances of iBonds in 2011 and 2012, the Financial Secretary (FS) announced in his 2013-14 Budget Speech that up to HK\$10 billion of a third iBond will be issued to Hong Kong residents to maintain the growth momentum. The HKMA is co-ordinating the issuance. Details will be announced in due course.
- The FS announced in the 2013-14 Budget Speech that it is his intention to expand the size of the GBP from HK\$100 billion to HK\$200 billion in order to meet the sustained growth in demand.
- The proposed expansion is a further step towards the goal of bringing the Hong Kong dollar bond market into the major global bond benchmark indices, thereby attracting more global investors to participate in the market.



PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector to explore ways to strengthen the competitiveness of Hong Kong's asset management industry and reinforce Hong Kong's position as a leading asset management centre
- Stepping up marketing efforts to proactively promote Hong Kong's financial platform to overseas and Mainland asset managers and investors. Promotional campaigns have so far covered Abu Dhabi, Beijing, Boston, Dubai, Dublin, Edinburgh, Frankfurt, Geneva, Guangzhou, Korea, London, Lugano, Luxembourg, Montreal, New York, Paris, San Francisco, Singapore, Shanghai, Shenzhen, Toronto and Zurich
- Building on the feedback from our regular dialogues with industry players, we continue to improve our platform and keep pace with the latest developments in the asset management industry

59

- With the promising growth prospects of the Asian region, there has been increasing interest for overseas asset managers to expand into Asia. To capitalise on this trend and attract more asset managers into Hong Kong, the HKMA is working in conjunction with other Government agencies and market players to promote Hong Kong's asset management business, thereby reinforcing Hong Kong's role as a premier international financial centre.
- To this end, the HKMA is taking part in a joint Government campaign, along with the FSTB and the SFC, in holding a series of promotional roadshows in leading global financial centres. Since November 2010, the campaign has visited Geneva, London, Lugano, Luxembourg, New York and Zurich, during which the HKMA also took the opportunities to meet with key asset managers based in their financial centres to promote the financial platform in Hong Kong and listen to their business plans in Asia and their views on potential hurdles for their operations in Hong Kong.
- At the same time, the HKMA has also been reaching out to market players in Abu Dhabi, Beijing, Boston, Dubai, Dublin, Edinburgh, Frankfurt, Guangzhou, Korea, Montreal, Paris, San Francisco, Singapore, Shanghai, Shenzhen and Toronto to explain the opportunities and advantages presented by Hong Kong as an asset management centre and to highlight Hong Kong's latest positive developments to overseas business decision makers.



DEVELOPMENT OF ISLAMIC FINANCE

- Supporting the Financial Services and the Treasury Bureau in its work on a legislative proposal to amend Hong Kong's tax laws to provide a comparable tax regime for some common types of Islamic bonds vis-à-vis conventional bonds
- The amendment bill was introduced into LegCo for First Reading on 9 January 2013 and a Bills Committee has been formed to scrutinise the bill
- Organised a series of Islamic finance seminars in collaboration with Bank Negara Malaysia for market players to promote market knowledge of Islamic finance



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Developing a trade repository for over-the-counter derivatives trades to enhance market surveillance and transparency, and bring Hong Kong in line with international standards

61

Operation of financial infrastructure

- The HKD, USD, EUR and RMB Real Time Gross Settlement (RTGS) systems and the Central Moneymarkets Unit (CMU) have been operating smoothly.

Trade Repository

- The development of the trade repository (TR) has been progressing as scheduled. To prepare for the commencement of central clearing of OTC derivatives transactions, the matching and confirmation function of the TR was launched in December 2012. The reporting function of the TR is targeted to be launched by mid-2013.



LONG-TERM DEVELOPMENT OBJECTIVES OF NFC MOBILE PAYMENT

- Ability to download multiple payment services onto a single NFC-enabled phone
- Payment service continuity despite switching from one mobile network operator to another
- Payment service continuity despite changing one's NFC-enabled phone
- High level of security in line with international standards and relevant regulatory requirements

62

Long-term development objectives of NFC mobile payment

- A press conference was held on 27 March 2013 to announce the findings and recommendations of the consultancy study on the development of NFC mobile payment infrastructure in Hong Kong.
- The consultancy study was conducted last year and has interviewed 19 stakeholders during the process, including banks and non-bank payment service providers, mobile network operators, card associations, merchant acquirers and handset manufacturers.
- The objective of the study is to identify the appropriate approach for establishing a safe and effective mobile payment infrastructure that will achieve interoperability among all NFC mobile payment services along four development objectives:
 - Ability to download multiple payment services onto a single NFC-enabled phone
 - Payment service continuity despite switching from one mobile network operator to another
 - Payment service continuity despite changing one's NFC-enabled phone
 - High level of security in line with international standards and relevant regulatory requirements



WAY FORWARD OF DEVELOPING NFC MOBILE PAYMENT

Development of common standards and guidelines

- A draft set of common standards and guidelines have been developed by a consultant based on the international standards
- A working group will be established by the HKMA and HKAB to discuss and finalise the common standards and guidelines

Infrastructure development

- Shared infrastructure being developed by certain card associations to speed up launches of NFC service
- The HKMA supports a market-driven approach for shared infrastructure development and will promote market development through a set of common standards

63

- The HKMA will support the development of NFC mobile payment through a market-driven approach and facilitate the industry to develop a set of common standards and guidelines:
 - **Common standards and guidelines**
 - The standards and guidelines will cover three aspects, including interoperability requirements between devices and systems, operation guidelines of NFC mobile payment services, and security measures on mobile wallet protection and payment transaction processing.
 - The industry working group under the Hong Kong Association of Banks will immediately kick start the discussions, with a view to finalising the standards and guidelines by the second half of 2013.
 - **Infrastructure development**
 - The HKMA supports a market-driven approach for shared infrastructure development as it suits the Hong Kong market. A shared infrastructure enables services to be launched more quickly and is more receptive to various stakeholders.
 - The HKMA will continue to monitor developments in the market to facilitate relevant infrastructure developments and to ensure that the four development objectives can be achieved.

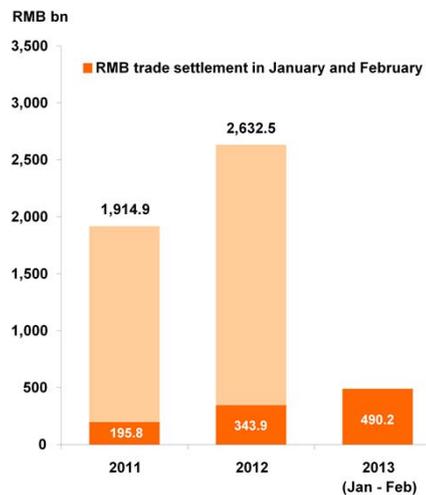


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

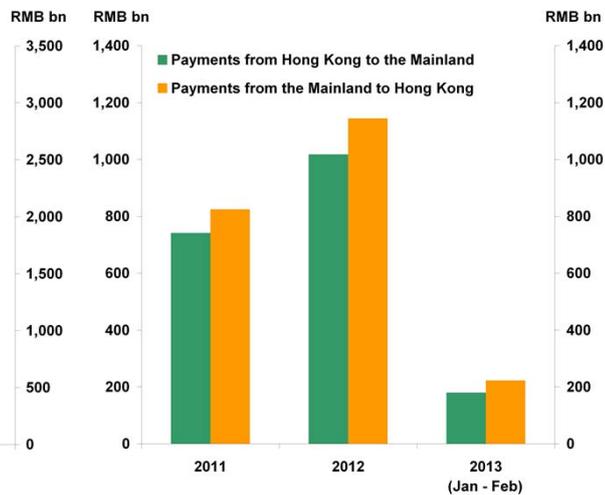


Continued growth in RMB trade settlement

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



**Flows of RMB trade settlement
between Hong Kong and the Mainland**



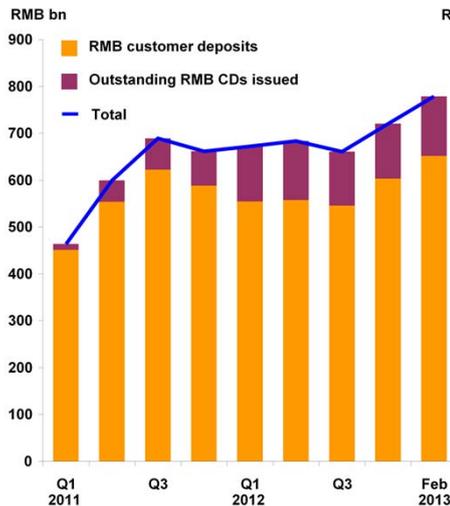
65

- In the first two months of 2013, RMB trade settlement handled by banks in Hong Kong amounted to RMB490.2 billion, a 43% growth compared with the same period of last year. Meanwhile, the payment flows to and from the Mainland were largely balanced.

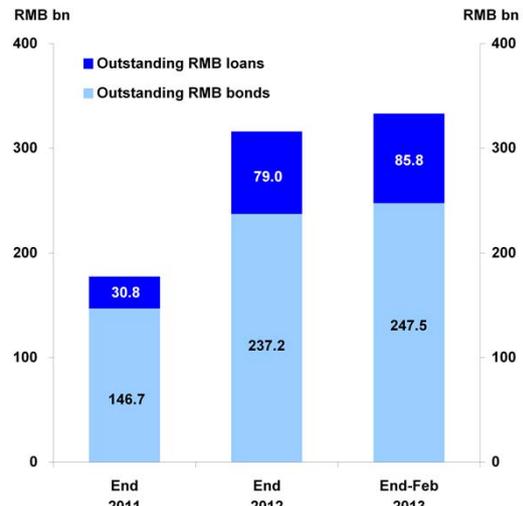


RMB financing activities remaining vibrant

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



66

- At end February 2013, RMB customer deposits and outstanding RMB certificates of deposits amounted to RMB651.7 billion and RMB127.5 billion respectively, totaling RMB779.2 billion, a 8% growth from RMB720.2 billion at the end of 2012.
- Meanwhile, over 38,000 accounts were opened by non-resident personal customers, with deposits exceeding RMB7 billion yuan.
- RMB dim sum bond market remained vibrant, with issuances totaling RMB12.9 billion in the first two months of 2013. At end February 2013, outstanding amount of RMB bonds amounted to RMB247.5 billion. RMB lending grew further, with outstanding amount of RMB loans increasing to RMB85.8 billion at end February 2013, a 9% growth from the end of last year.



Continued development of Hong Kong's role in supporting offshore RMB business overseas

	Feb 2013	2012	2011
1 No. of participating banks of Hong Kong's RMB clearing platform	207	204	187
Of which:			
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	183	181	165
2 No. of RMB correspondent accounts set up by overseas banks at Hong Kong banks	1,492	1,402	968
3 Amount due to overseas banks (RMB billion)	127.5	99.1	116.4
4 Amount due from overseas banks (RMB billion)	146.4	117.1	121.7
5 Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB billion)	359.7	213.7	121.4

67

- The HKMA co-facilitated the inaugural meeting of the Australia-Hong Kong RMB Trade and Investment Dialogue in Sydney on 12 April 2013 with the Australian Treasury and the Reserve Bank of Australia.
- The meeting served to foster closer collaboration between Australia and Hong Kong on RMB trade settlement, the development of RMB-denominated products and closer RMB banking and financial links. Discussions focused on the benefits and practical issues in transacting in RMB, the role of the offshore RMB market in Hong Kong, and RMB investment and financing opportunities both in mainland China and in offshore markets. A group of senior representatives from the Hong Kong and Australian banking sectors also discussed practical ways of encouraging RMB trade and investment between the two markets.



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Financial Stability Board (FSB)

- HKMA attended the FSB Plenary Meeting held on 28 January 2013. At the meeting, the FSB was formally established as an association under Swiss law and the HKMA became a founding member. Members also discussed, amongst other issues, OTC derivatives market reforms, recommendations to strengthen oversight and regulation of shadow banking and factors impacting long-term investment financing

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

- HKMA chaired the EMEAP Monetary and Financial Stability Committee (MFSC) Meeting held on 26 April 2013. Based on the MFSC's half-yearly Macro-Monitoring Report prepared by the HKMA, the Committee reviewed recent economic and financial developments in the region and their policy implications. The Committee also held a roundtable discussion with senior representatives from key financial institutions and international financial institutions to review the financing conditions and long-term investment finance in the region



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND



INVESTMENT ENVIRONMENT IN Q1 2013

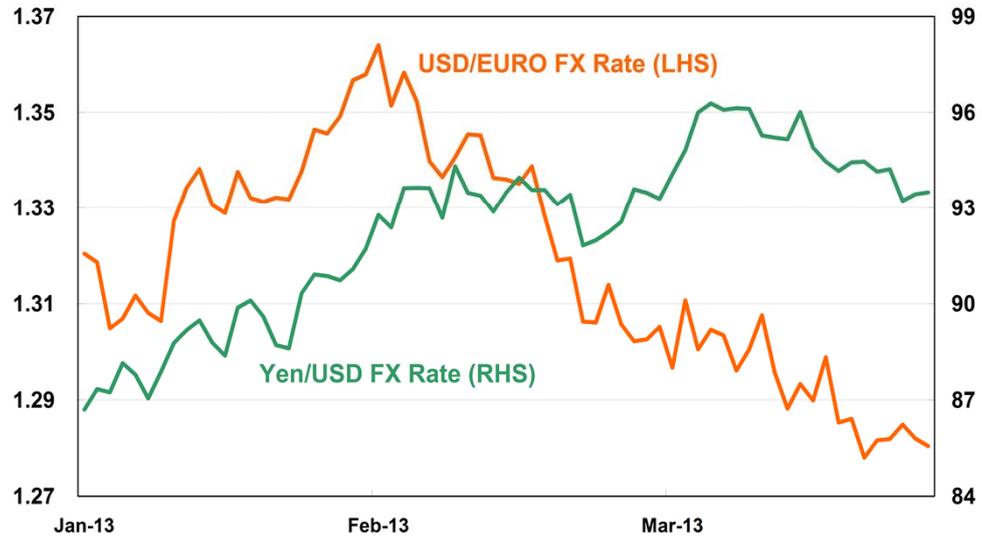
- **Exchange rates:** The Euro dropped against the dollar as confidence in the Euro was hurt by contagion fears from the debt crisis in Cyprus and the hung parliament in Italy. The Yen weakened against the dollar on expectation of aggressive monetary easing
- **Equity markets:** Major stock markets posted gains in Q1 due to improving risk appetite and investors searching for higher investment returns. Emerging market equities however lagged behind the performance of developed market equities
- **Interest rates:** US Treasury yields moved higher in Q1 on improving economic fundamentals and talks of rotation from bonds into equities



CURRENCY MARKETS

USD/Euro FX Rate

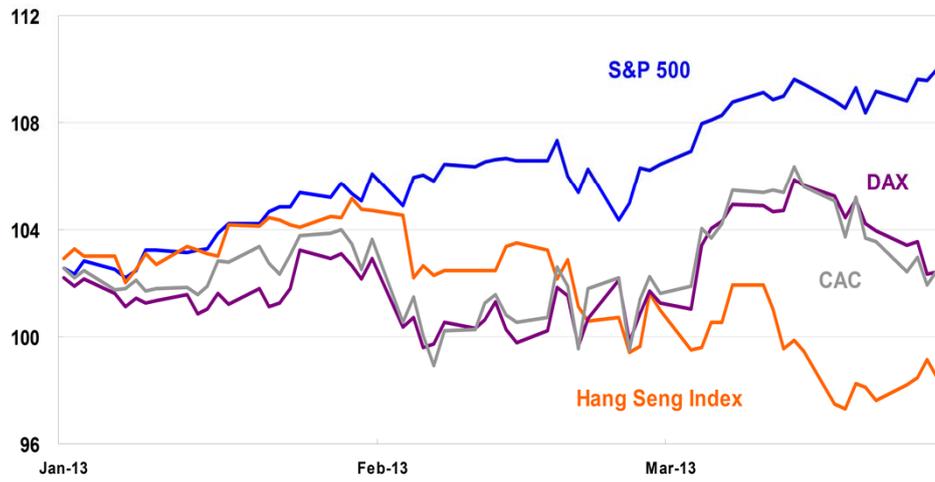
Yen/USD FX Rate





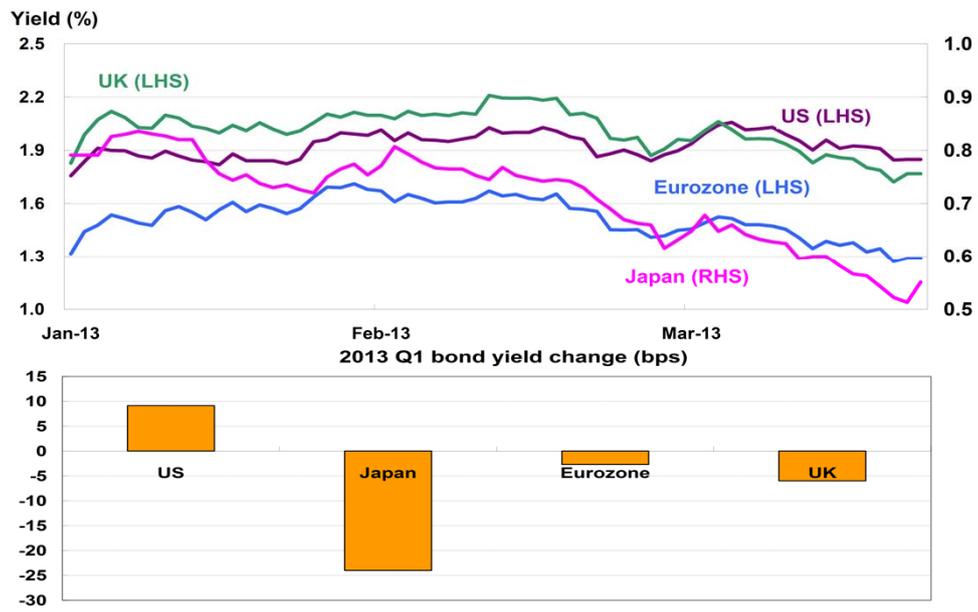
EQUITY MARKETS

Normalized Index Level (2012 year-end = 100)





CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS





INVESTMENT INCOME

	2013	2012	2011	2010
(HK\$ billion)	Q1*	Full Year	Full Year	Full Year
Hong Kong equities^{^@}	(1.4)	30.7	(24.2)	11.6
Other equities[^]	24.9	42.8	(12.2)	27.1
Bonds[#]	2.8	33.1	71.9	42.1
Other investments^{&}	0.6	6.4	0.7	1.7
Foreign exchange	<u>(9.8)</u>	<u>(1.4)</u>	<u>(9.1)</u>	<u>(3.1)</u>
Investment income^{@&}	17.1	111.6	27.1	79.4

* Unaudited figures

[^] Including dividends

[@] Excluding valuation changes in Strategic Portfolio

[#] Including interest

[&] Including valuation changes of investment held by EF's investment holding subsidiaries



CHANGE IN INVESTMENT INCOME, PAYMENT TO FISCAL RESERVES AND ACCUMULATED SURPLUS

(HK\$ billion)	2013	2012				
	Q1*	Full year	Q4	Q3	Q2	Q1
Investment income/(loss)	17.1	111.6	30.3	42.4	(5.6)	44.5
Other income	-	0.2	-	0.1	0.1	-
Interest and other expenses	<u>(0.9)</u>	<u>(4.4)</u>	<u>(1.0)</u>	<u>(1.1)</u>	<u>(1.4)</u>	<u>(0.9)</u>
Net investment income/(loss)	16.2	107.4	29.3	41.4	(6.9)	43.6
Payment to Fiscal Reserves#	(9.3)	(37.8)	(9.3)	(9.2)	(9.6)	(9.7)
Payment to HKSAR government funds and statutory bodies#	(2.1)	(8.0)	(2.2)	(2.1)	(1.9)	(1.8)
Valuation change of Strategic Portfolio less valuation change of investment held by EF's investment holding subsidiaries^	<u>(0.6)</u>	<u>(5.6)</u>	<u>(2.1)</u>	<u>(0.7)</u>	<u>(1.7)</u>	<u>(1.1)</u>
Increase/(Decrease) in EF Accumulated Surplus	4.2	56.0	15.7	29.4	(20.1)	31.0

* Unaudited figures

The fixed rate of fee payment is 5.0% for 2013 and 5.6% for 2012

^ Including dividends



HISTORICAL INVESTMENT INCOME

(HK\$ billion)

Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009* ^{&}	107.7	10.6	71.9	58.7	(33.5)
2010* ^{&}	79.4	5.9	74.5	(12.1)	11.1
2011* ^{&}	27.1	22.1	(41.4)	21.6	24.8
2012* ^{&}	111.6	30.3	42.4	(5.6)	44.5
2013* ^{&} [#]	N/A	N/A	N/A	N/A	17.1

* Excluding valuation changes in the Strategic Portfolio

Unaudited figures

[&] Including valuation changes of investment held by EF's investment holding subsidiaries

N/A: Not Applicable



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Mar 2013*	At 31 Dec 2012	At 31 Dec 2011
ASSETS			
Deposits	292.2	188.3	221.7
Debt securities	2,044.0	2,048.5	1,844.4
Hong Kong equities	145.8	148.0	120.6
Other equities	310.3	283.3	238.2
Other assets#	<u>93.8</u>	<u>113.0</u>	<u>63.1</u>
Total assets	<u>2,886.1</u> =====	<u>2,781.1</u> =====	<u>2,488.0</u> =====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	314.8	289.8	258.7
Government-issued currency notes & coins in circulation	10.5	9.9	9.9
Balance of the banking system	205.7	255.9	148.7
Exchange Fund Bills and Notes	707.7	688.5	655.8
Placements by banks and other financial institutions	49.5	-	24.5
Placements by Fiscal Reserves	746.0	717.5	663.5
Placements by HKSAR government funds and statutory bodies	171.9	167.9	126.2
Other liabilities	<u>51.9</u>	<u>27.7</u>	<u>32.8</u>
Total liabilities	<u>2,258.0</u>	<u>2,157.2</u>	<u>1,920.1</u>
Accumulated Surplus	<u>628.1</u>	<u>623.9</u>	<u>567.9</u>
Total liabilities and fund equity	<u>2,886.1</u> =====	<u>2,781.1</u> =====	<u>2,488.0</u> =====

* Unaudited figures

Including investment in EF's investment holding subsidiaries amounted to HK\$53.6 billion at 31 Dec 2012



HONG KONG MORTGAGE CORPORATION



Reverse Mortgage Programme

- By end-March 2013, 357 applications have been approved:
 - Average age of borrowers: 70 years old
 - Average monthly payout: HK\$13,400
 - Payment terms: 10-year (34%), 15-year (19%), 20-year (13%), life (34%)
 - Average property value: HK\$3.9 million
 - Average property age: 30 years

79

3 enhancements were launched in November 2012:

- Lowering the minimum age of borrowers from 60 to 55.
- Increasing the maximum specified property value for payout calculation from HK\$8 million to HK\$15 million.
- Increasing the maximum lump-sum payout amount.

Market response to the 3 enhancements

- Since the launch of the 3 enhancements in November 2012, there were 17 applications involving applicants aged below 60 as of end-March 2013 (accounting for about 25% of the total applications during the period).
- Separately, there was 1 application which took out the maximum lump-sum payout (i.e. receiving no monthly payouts) for repaying the existing mortgage loan.
- There were 5 applications with appraised property value over \$8 million (accounting for about 7.5% of the total applications during the period).



SME Financing Guarantee Scheme (“SFGS”)

- The Financial Secretary announced in the 2013-14 Budget Speech the extension of application period of the 80% loan guarantee product for one year up to 28 February 2014
- The 80% loan guarantee product has been well received by the market. As at end-March 2013:
 - more than 6,400 applications were approved
 - total loan amount was about HK\$28 billion
 - average loan interest rate and guarantee fee rate were 4.6% p.a. and 0.5% p.a. respectively
- Over 4,600 SMEs involving approximately 120,000 employees have benefitted from the Scheme

80

- Industry type of approved cases for 80% loan guarantee product:

<u>Manufacturing</u>	<u>1,788 cases</u>	<u>(28%)</u>
1) Textiles and clothing	366 cases	(6%)
2) Electronics	168 cases	(3%)
3) Plastics	127 cases	(2%)
4) Others	1,127 case	(17%)

<u>Non-manufacturing</u>	<u>4,619 cases</u>	<u>(72%)</u>
1) Trading	2,880 cases	(45%)
2) Wholesale and retail	545 cases	(9%)
3) Construction	153 cases	(2%)
4) Others	1,041 case	(16%)

- Taking into consideration feedbacks from enterprises, in early March 2013, the 80% guarantee product was enhanced with regard to applications from Related Entities – the handling of applications related to Related Entities has been relaxed. The HKMC will take into account the business nature of a borrower and its group of related companies in determining whether the application can be considered separately to better meet the financing needs of enterprises.



Microfinance Scheme

- Launched in June 2012 for a trial period of 3 years with a tentative aggregate loan amount of HK\$100 million
- 6 banks and 5 non-governmental organisations have joined
- As of end-March 2013, the Scheme received over 2,000 hotline enquiries and 99 formal loan applications, out of which 63 have been approved with the total loan amount of HK\$17.45 million
- For the approved applications, the average loan size was about HK\$277,000 and the average loan tenor was close to 4.5 years

81

1) MF applications (as of 31 March 2013)

- 63 approved + 28 rejected + 4 withdrawn + 4 in progress \Rightarrow 99 received apps
- Approval rate: 69% (= 63 / (63 approved + 28 rejected))
- Around 90% approved applications are Type 1 – micro business startup loans (max loan size. \$300,000)
- Around 10% approved applications are Type 2 – self-employment loans (max loan size. \$200,000)

2) Industry type for the approved cases

– Servicing	29 cases	(46%)
– Retailing	19 cases	(30%)
– Wholesales	9 cases	(14%)
– IT related	3 cases	(5%)
– Manufacturing	2 cases	(3%)
– Others	1 case	(2%)