



HONG KONG MONETARY AUTHORITY

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

5 November 2018

[Translation]

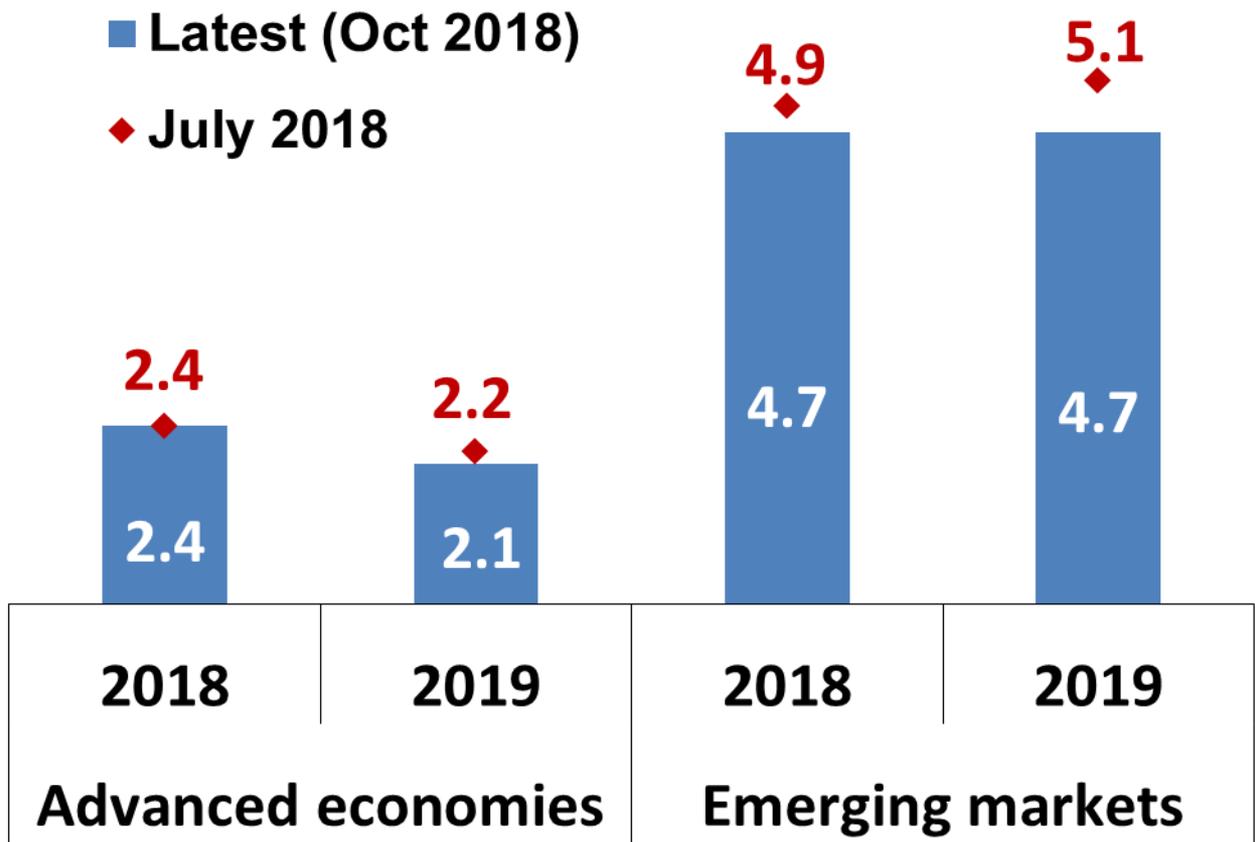


- 1. Assessment of Risk to Hong Kong's Financial Stability**
2. Banking Supervision
3. Financial Infrastructure
4. Development of Financial Market
5. Investment Performance of the Exchange Fund



GLOBAL ECONOMIC GROWTH FORECASTS DOWNGRADED

IMF Growth Forecasts (% yoy)

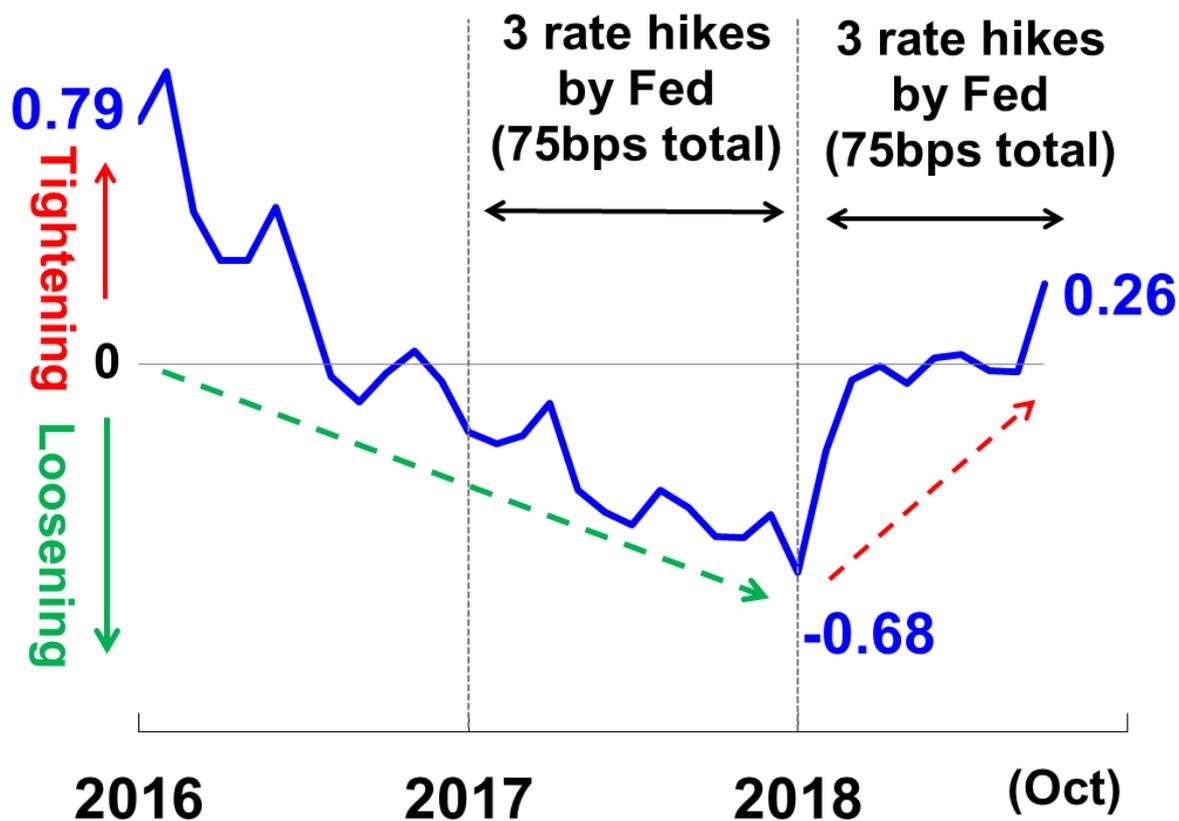


Source: International Monetary Fund



TIGHTENING FINANCIAL CONDITIONS

Bloomberg Global Financial Conditions Index



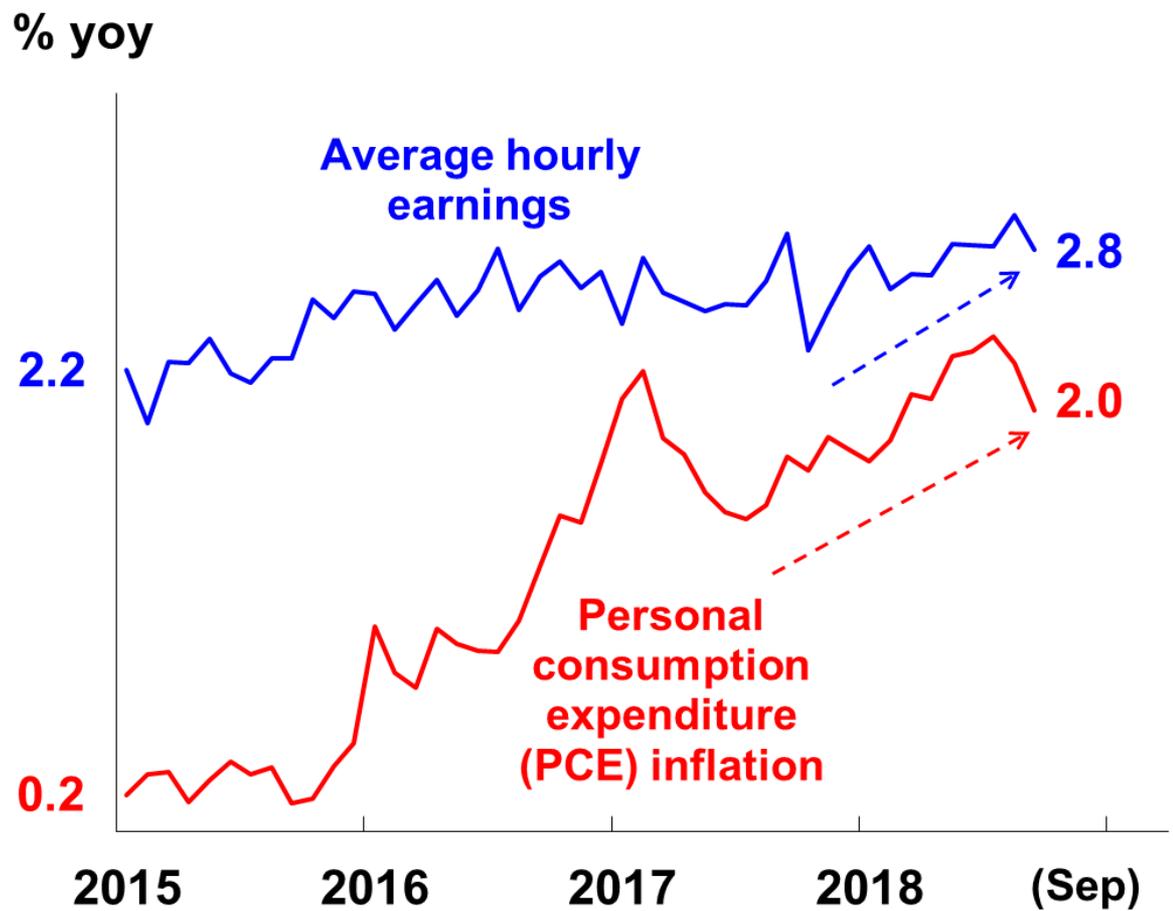
Note: Figures shown in the chart are monthly averages.

Source: Bloomberg



FURTHER FED RATE HIKES EXPECTED AMID RISING INFLATIONARY PRESSURES IN THE US

Faster wage growth drove up consumer prices



Source: CEIC



INCREASED DOWNSIDE RISKS TO THE GLOBAL ENVIRONMENT

- Emerging markets under currency depreciation and capital outflow pressure
- Worsening US-China trade war
- Lingering geopolitical risks
 - North Korea's denuclearisation
 - US sanctions on Iran
 - Brexit



EMERGING MARKETS UNDER PRESSURE: ARGENTINA

Exchange rate fell by 48% since the start of the year

	2017 (%)	2018 (latest figures) (%)	2019 projections (%)
Economic growth	2.9	-0.5	1.5
Inflation	25.7	40.3	23.6
Current account³	-4.9	-6.2	-3.3
Government account³	-6.7	-5.4 ¹	-4.9
External debt³	32.5	62.7 ²	-
Central bank interest rate	28.8	65	-

Note: 1. 2018 figure as projected by the IMF. 2. Q1 figure after recent interest rate adjustment. 3. In percent of GDP

Sources: Bloomberg, IMF, World Bank, CEIC, HKMA staff estimates



EMERGING MARKETS UNDER PRESSURE: TURKEY

Exchange rate fell by 32% since the start of the year

	2017	2018	2019
		(latest figures)	projections
	(%)	(%)	(%)
Economic growth	7.4	6.2	1.4
Inflation	11.1	24.5	17
Current account³	-5.6	-7.7	-3.4
Government account³	-2.3	-4.0 ¹	-3.2
External debt³	50.0	70.6 ²	-
Central bank interest rate	8	24	-

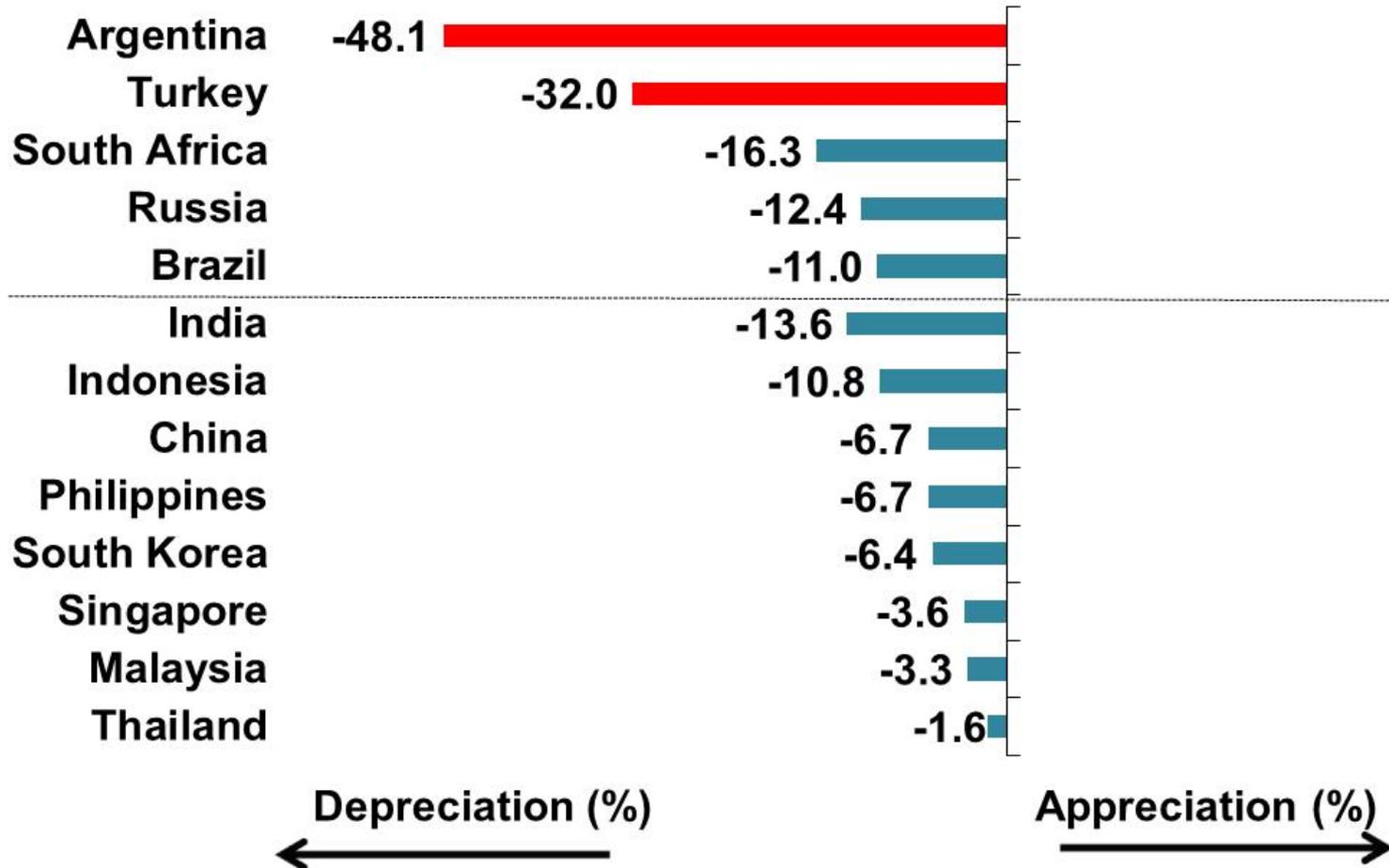
Note: 1. 2018 figure as projected by the IMF. 2. Q1 figure after recent interest rate adjustment. 3. In percent of GDP

Sources: Bloomberg, IMF, World Bank, CEIC, HKMA staff estimates



ALL EMERGING ECONOMIES ARE UNDER PRESSURE, ALBEIT TO DIFFERENT EXTENT

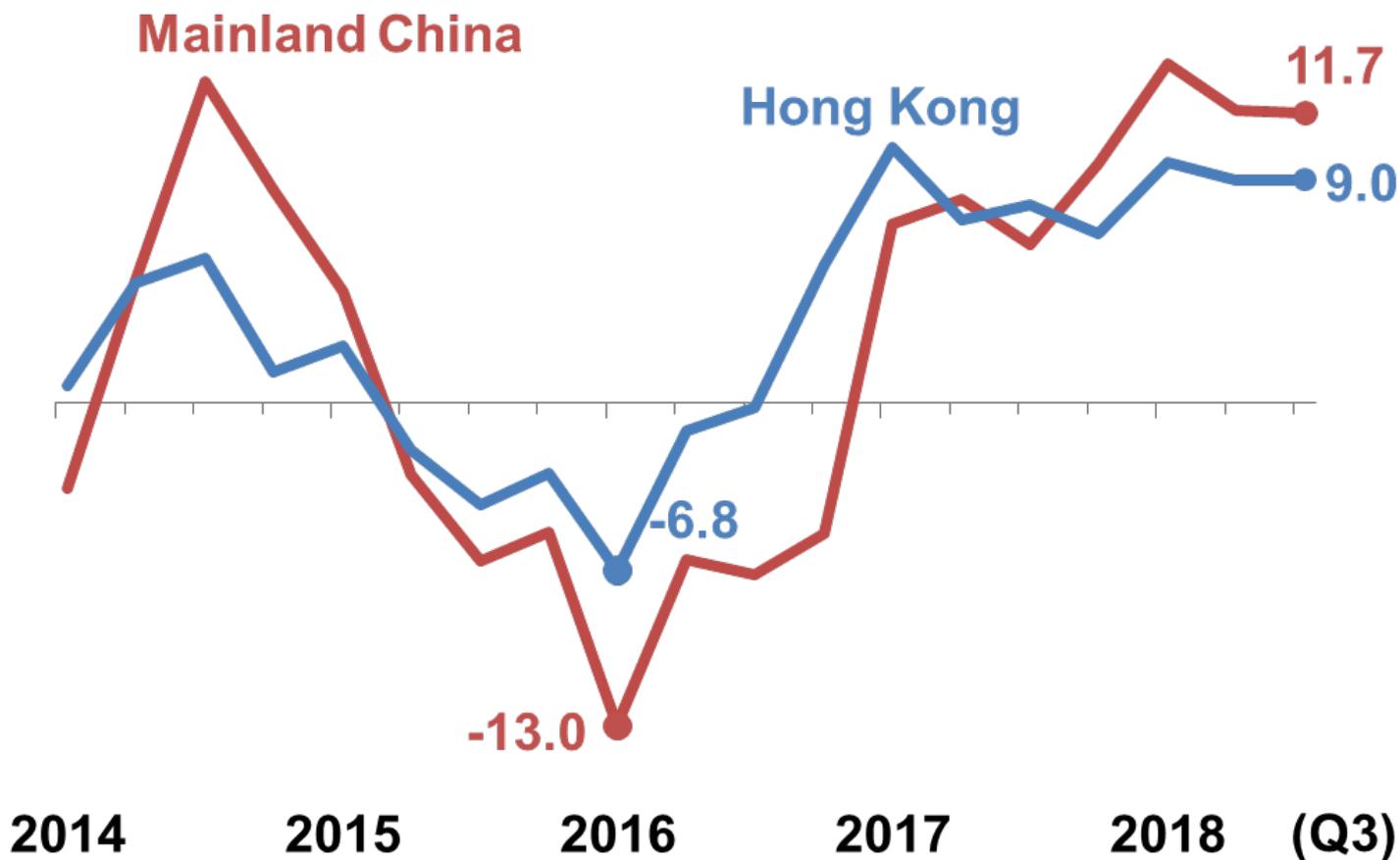
Exchange rate movements of emerging market currencies against the US dollar in 2018





EFFECTS OF THE WORSENING TRADE WAR ON EXPORTS ARE YET TO BE SEEN...

Year-on-year growth rate of exports



Note: Export figures of Mainland China are based on value of exports in USD.

Sources: National Bureau of Statistics of China and Census and Statistics Department of Hong Kong



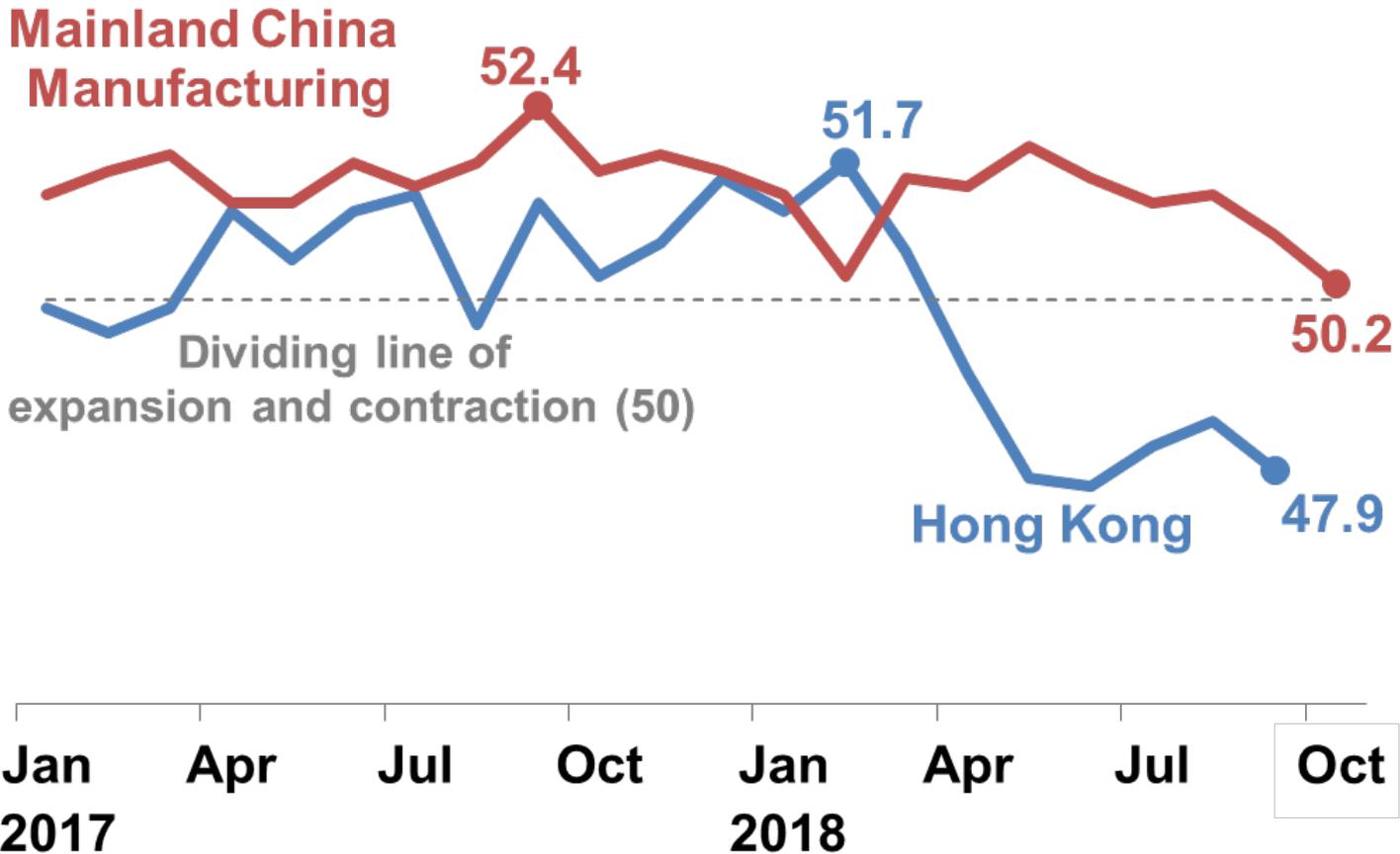
...BUT NEGATIVE IMPACT ON FINANCIAL MARKETS IS CLEARLY VISIBLE

Beginning of the year to
October





... PURCHASING MANAGERS' INDEXES IN MAINLAND CHINA AND HONG KONG HAVE DETERIORATED

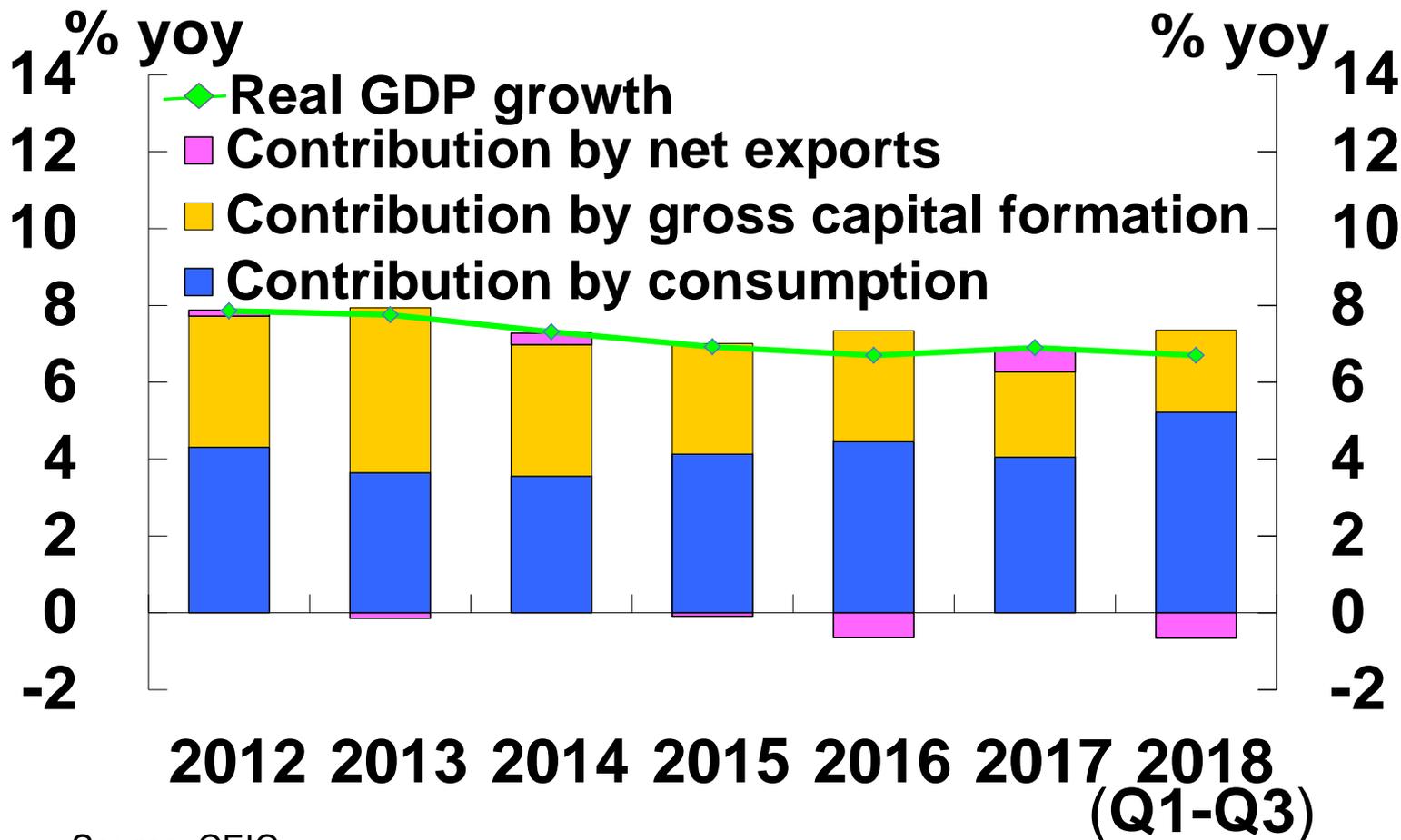


Sources: National Bureau of Statistics of China and Markit



MAINLAND CHINA: THE ECONOMY IS UNDERGOING STRUCTURAL CHANGE

Growth is supported by consumer demand

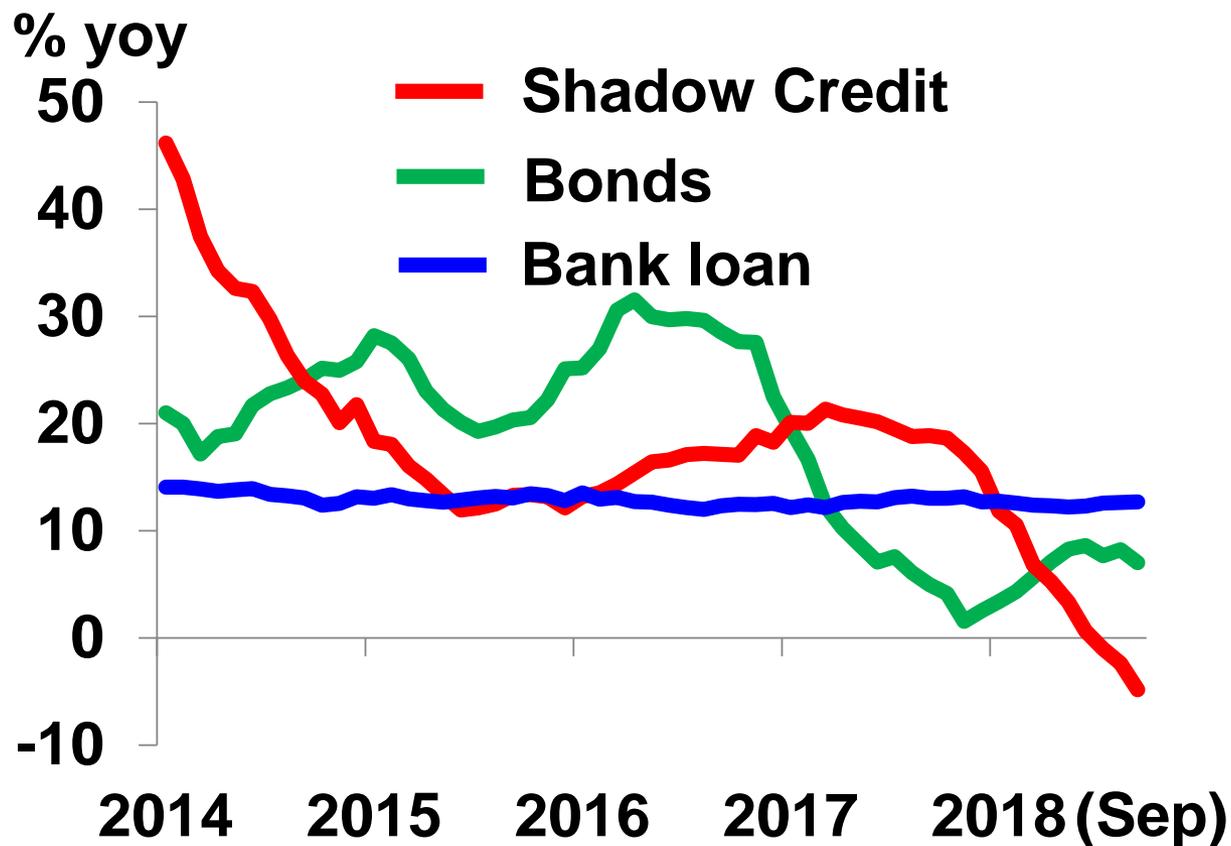


Source: CEIC



MAINLAND CHINA: FINANCIAL DELEVERAGING

Components of outstanding aggregate financing





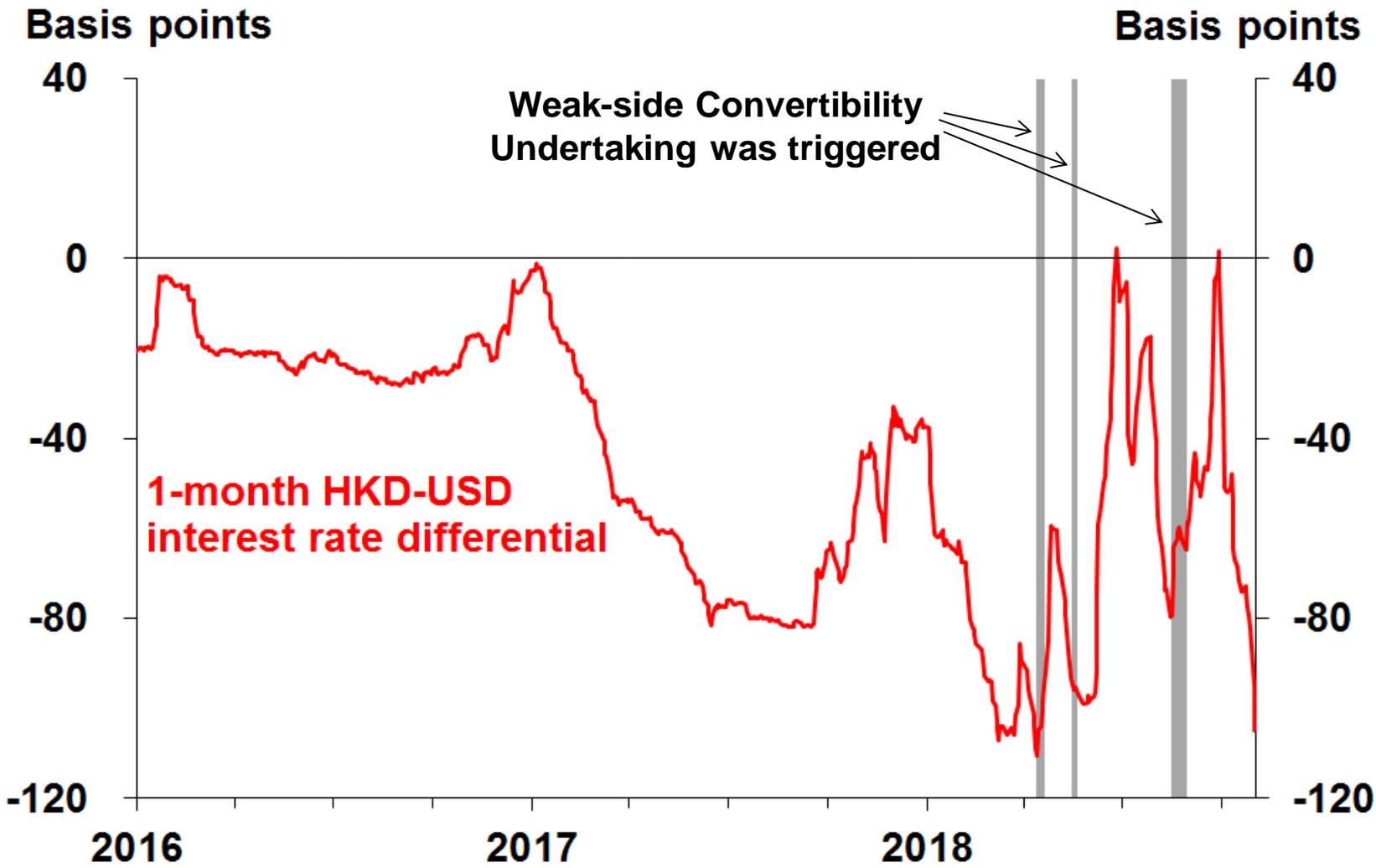
MOVEMENT OF HONG KONG DOLLAR THIS YEAR

- Weak-side Convertibility Undertaking has been triggered 27 times since 12 April
- The HKMA has purchased a total of HK\$103.5 billion under the weak-side Convertibility Undertaking
- The Aggregate Balance fell to HK\$76.4 billion recently from HK\$179.8 billion in early April
- Fund outflows so far accounted for around one-tenth of past inflows



HONG KONG DOLLAR INTEREST RATE NORMALISATION IS UNDERWAY

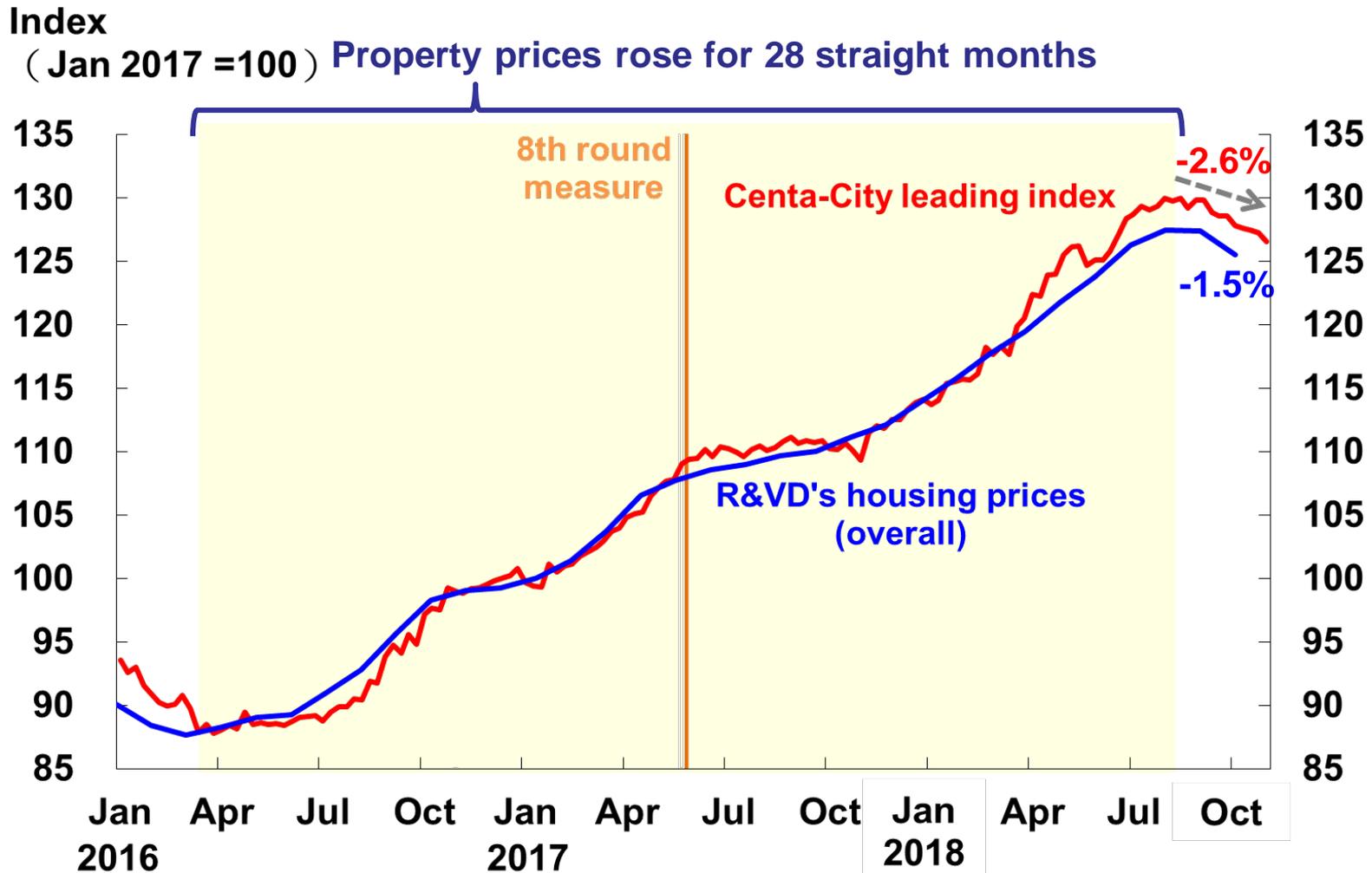
One-month HKD-USD interest rate differential





ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Property prices have declined since August

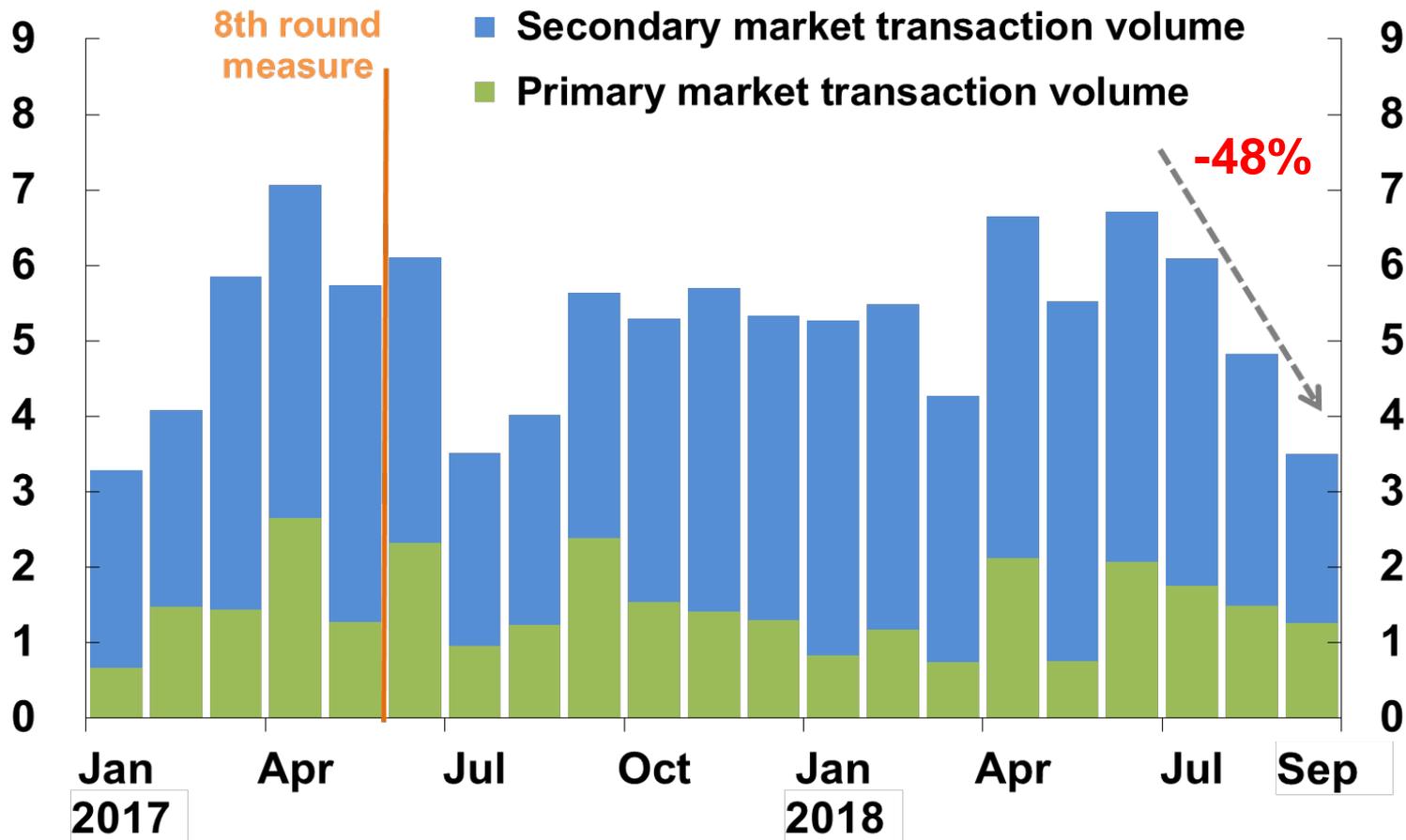




ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: PROPERTY MARKET

Transaction volume dropped significantly in recent months

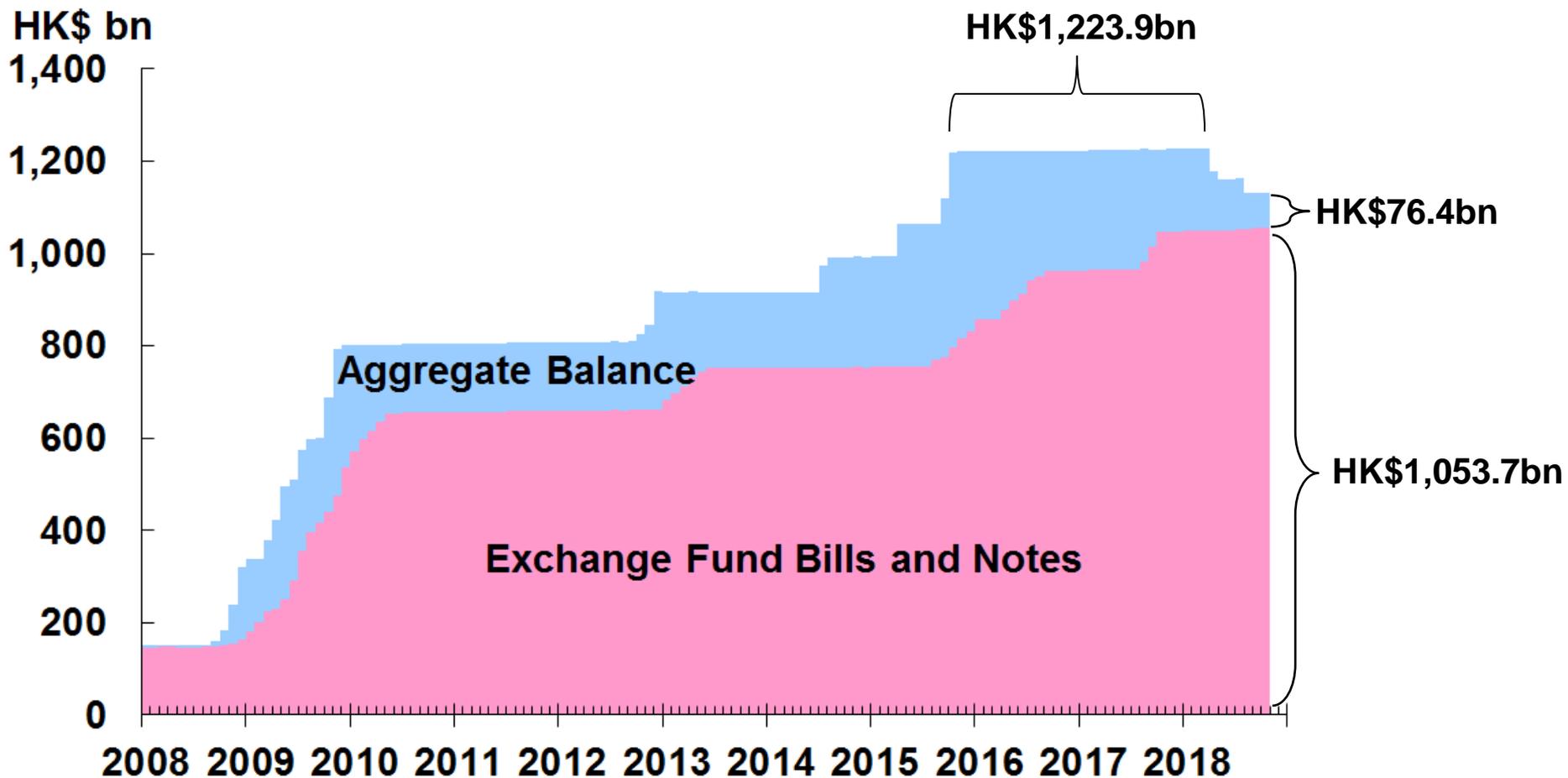
Number of transactions ('000)





HONG KONG'S RESILIENCE: MONETARY BASE

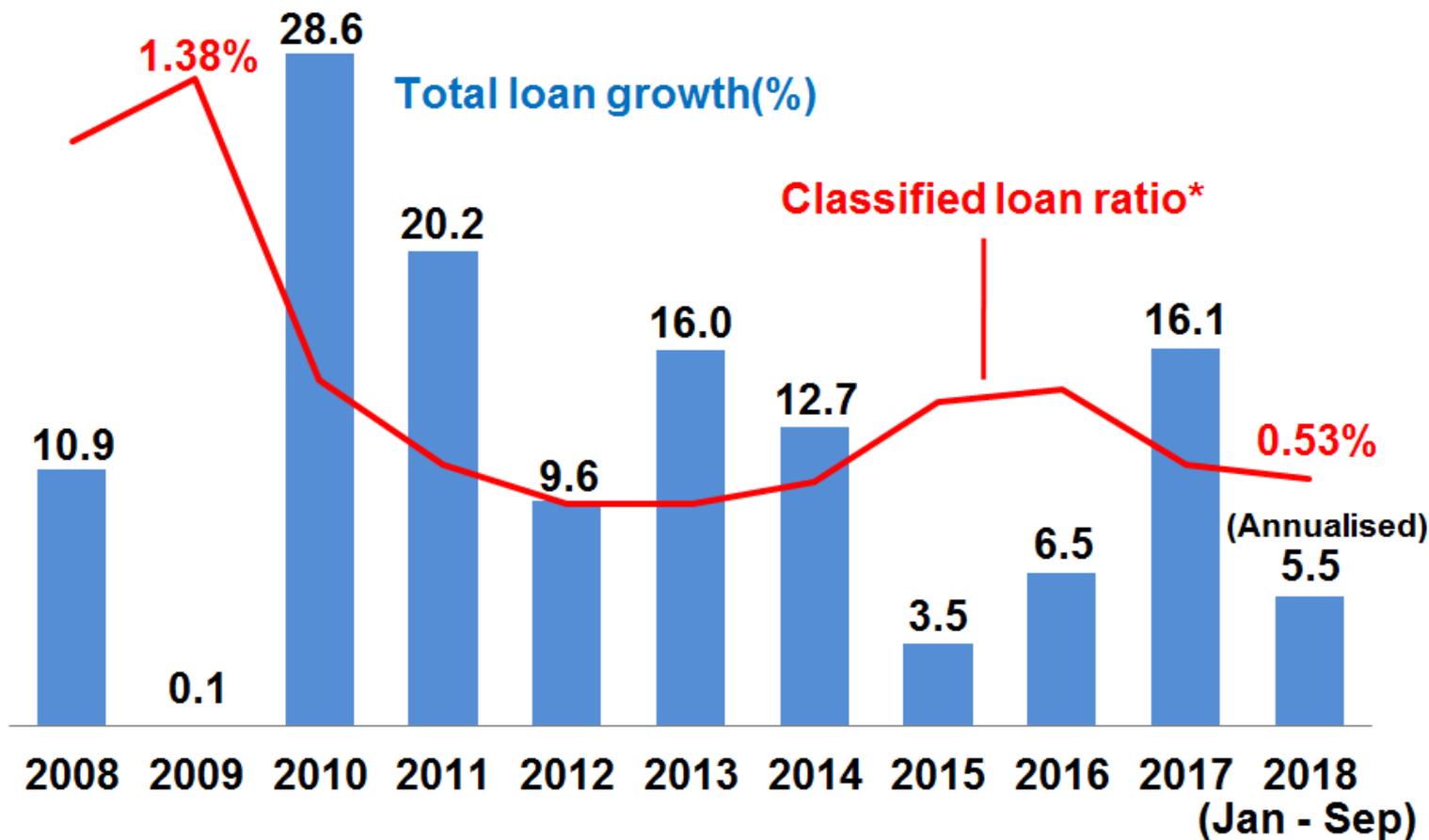
Fund outflows this year only accounted for a small portion of past inflows





HONG KONG'S RESILIENCE: BANKS

Moderate credit growth with asset quality staying at a healthy level



Note: * Classified loan ratio covers retail banks only. The classified loan ratio of 2018 is Q2 figure.

Source: HKMA



HONG KONG'S RESILIENCE: BANKS

Robust Banking System

	1997	2007	June 2018
Capital adequacy ratio	17.5%	13.4%	19.4%
Loan-to-deposit ratio	152.1%	50.5%	75.7%
<i>HKD</i>	<i>112.3%</i>	<i>71.0%</i>	<i>85.4%</i>
Classified loan ratio	1.23%	0.75%	0.61%
<i>of which: Retail banks</i>	<i>2.09%</i>	<i>0.85%</i>	<i>0.53%</i>
Liquid assets (HK\$)	0.6 trn	1.6 trn	4 trn



HONG KONG'S RESILIENCE: HOUSEHOLDS

Robust Households Balance Sheets

	2009-11	2018 Q2
Proportion of mortgage-free owner-occupier households	60% ¹	66% ⁴
Average loan-to-value ratio of newly approved mortgages	64% ²	47%
Debt servicing ratio of newly approved mortgages	41% ³	34%
Household deposits-to-liabilities ratio	306% ³	319% ⁴

Note: ¹ 2011; ² 2009; ³ 2010; ⁴ 2016

Sources: Census and Statistics Department, HKMA and staff estimates



HONG KONG'S RESILIENCE: INTERNATIONAL INVESTMENT POSITION

Sizeable Net Positive International Investment Position

Economies	External Assets	External Liabilities	Net Value
USD (As a multiple of GDP)			
Hong Kong	5.6 trillion (15.8 times)	4.2 trillion (11.8 times)	1.4 trillion (4.0 times)
Singapore	3.7 trillion (11.1 times)	2.9 trillion (8.6 times)	0.8 trillion (2.5 times)
Japan	9.2 trillion (1.8 times)	6.3 trillion (1.3 times)	2.9 trillion (0.6 times)

Notes: Data as at end-June 2018

Sources: Census and Statistics Department of Hong Kong and statistics agencies of selected economies.



ASSESSMENT OF RISKS TO HONG KONG'S FINANCIAL STABILITY: CONCLUSION

- Should the US-China trade war persist, financial market volatilities will continue to increase
- Normalisation of Hong Kong dollar interest rates is underway, and interest rate upcycle has begun
- Though the uncertainties and downside risks facing the economy and asset markets are increasing, Hong Kong's financial system is sound, well-prepared and resilient
- The public should manage risks more prudently and be prepared for market volatilities

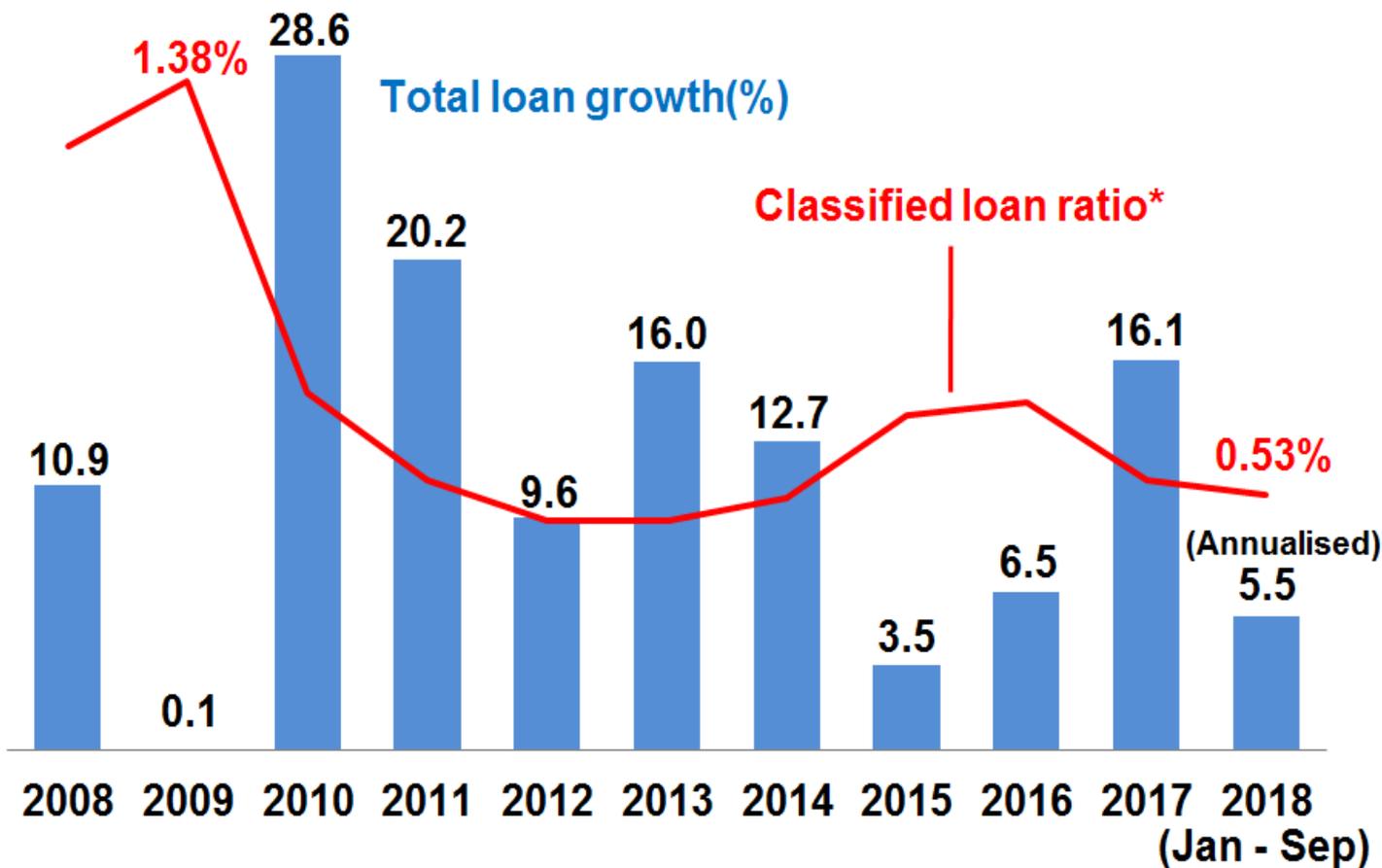


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BANKING SECTOR PERFORMANCE

Moderate credit growth with asset quality staying at a healthy level



Note: * Classified loan ratio covers retail banks only. The classified loan ratio of 2018 is Q2 figure.

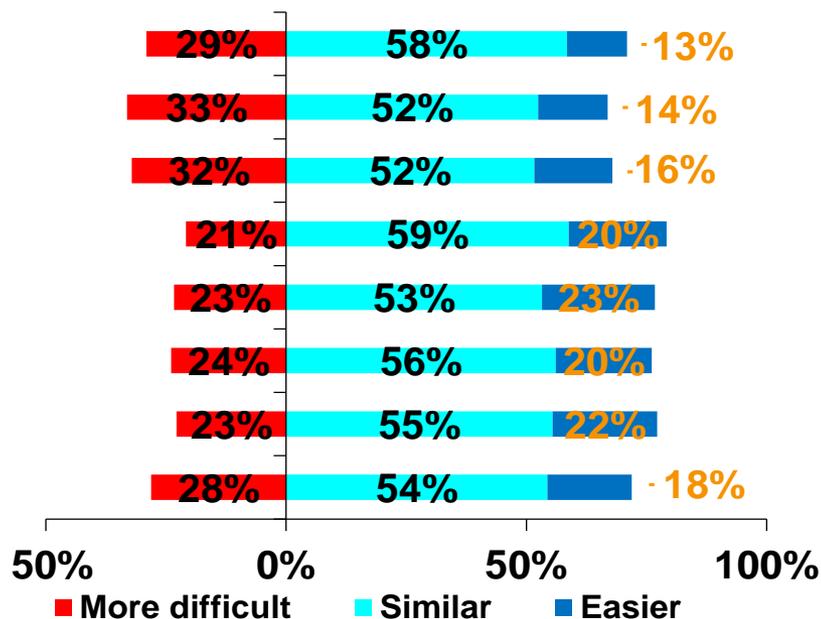
Source: HKMA



SMEs CREDIT ENVIRONMENT

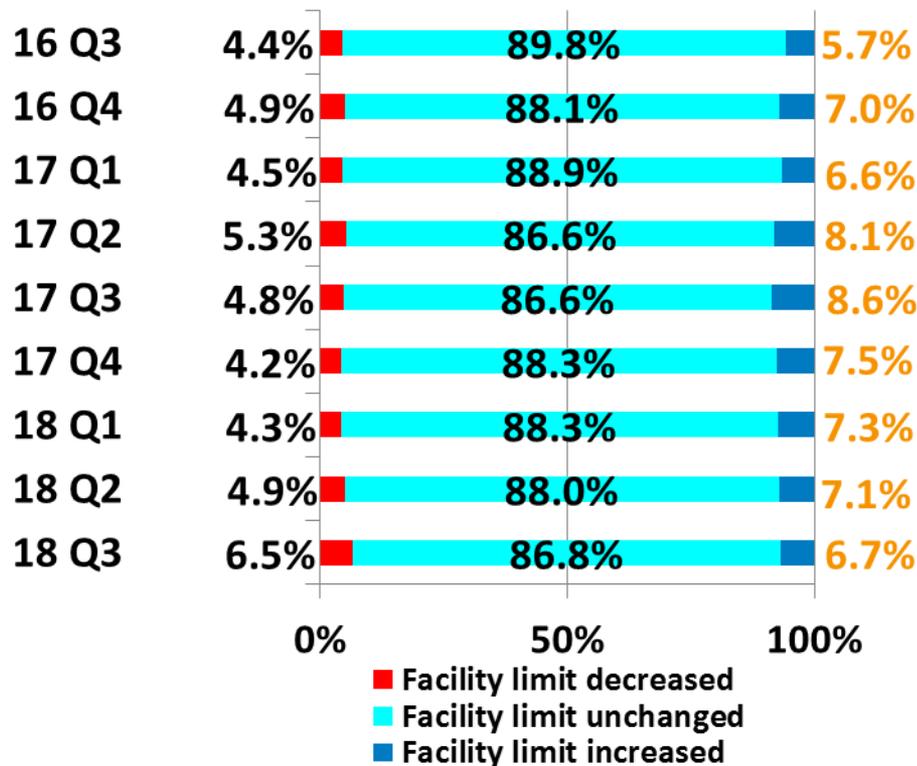
SMEs perspective

Banks' credit approval stance
perceived by surveyed SMEs
 (comparison relative to 6 months ago)



Banks perspective

Bank lending to SMEs



Source: HKMA



INTERNATIONAL STANDARDS IMPLEMENTATION

- Banking (Exposure Limit) Rules 2018
- Banking (Capital) (Amendment) Rules 2018
- Banking (Disclosure) (Amendment) (No.2) Rules
2018



RESOLUTION REGIME

- The rules on loss-absorbing capacity (LAC) requirements were introduced into Legislative Council on 24 October, and the related Inland Revenue Ordinance (Amendment) Bill was introduced on 31 October
- The draft code of practice chapter, under the aegis of Financial Institutions (Resolution) Ordinance, providing further guidance on the above LAC rules was issued for consultation on 19 October



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FASTER PAYMENT SYSTEM

- Registration of mobile phone number or email address started from 17 September. Full launch on 30 September
- Simple and convenient to use. Supports Hong Kong dollar and renminbi with full connectivity among banks and stored value facilities
- Over 1.4 million registrations and over 1.2 million transactions totalling over HK\$23.7 billion as of 22 October
- Launched on 17 September the world's first mobile application for converting multiple QR codes into a single QR code



E-WALLET TOP-UP INCIDENTS

- There were reports on theft of personal information for setting up e-wallet accounts and direct debit authorization for account top-up
- More than 10 suspected cases, involving over HK\$400,000
- Bank customers would not be liable for the unauthorised transactions, and would not bear financial losses as a result
- The incidents were not related to the security of the Faster Payment System, but the authentication controls of e-wallets should be strengthened
- E-wallets are required to strengthen their security controls, including requiring customers to make one-time credit transfer from bank account to e-wallet or verification of customer identities via two-factor authentication with banks. Top-up service of e-wallets is being resumed gradually



LATEST FINTECH INITIATIVES

Open Application Programming Interface (Open API) for the Hong Kong banking sector

- Framework published in July
- Phases I and II to be implemented by end January and October 2019 respectively

Distributed Ledger Technology (DLT)-based trade finance platform

- Launched eTradeConnect in September
- Exploring opportunities to facilitate eTradeConnect's connection with other regions

Fintech Career Accelerator Scheme (FCAS) 2.0

- Over 200 students benefited from the four programmes under FCAS



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CROSS-BORDER RMB BUSINESS

- Bond Connect is operating smoothly. Over 400 investors registered, with daily turnover of RMB3-4 billion. Major enhancements were made in August with positive feedback from the industry, including:
 - Full implementation of Delivery versus Payment (DvP) settlement model
 - Launch of Block Trade Functionality
 - State Council's announcement on tax exemption for offshore investors investing in Mainland's onshore bond market
- Implementing financial facilitation measures in the Guangdong-Hong Kong-Macao Bay Area, including the pilot use of Hong Kong e-wallets on the Mainland since October, while continuing to study the implementation of other measures, such as simplifying bank account opening process by Hong Kong residents on the Mainland and satisfying the need for cross-border wealth management



DEVELOPING HONG KONG'S FINANCIAL PLATFORM

Developing Hong Kong's Bond Market

- The Pilot Bond Grant Scheme has come into operation since 10 May, and received favourable response

Promoting Green Finance

- Carrying out early preparatory work in relation to the inaugural Government Green Bond issuance, with a view to arranging issuance as soon as possible after the completion of the legislative process
- In June, co-hosted two conferences with the International Capital Market Association and the Research Bureau of the People's Bank of China respectively to promote green finance awareness and development



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INVESTMENT INCOME

← 2018 → 2017 2016

(unaudited)

(HK\$ billion)

Jan - Sep Q3 Full Year Full Year

Bonds	29.2	9.7	34.4	33.1
Hong Kong equities*	(8.1)	(4.7)	58.3	5.3
Other equities	10.1	12.8	80.4	28.6
Foreign exchange#	(11.2)	(16.2)	53.5	(15.8)
Other investments@	<u>16.7</u>	<u>-</u>	<u>37.4</u>	<u>16.9</u>
Investment income	36.7	1.6	264.0	68.1

* Excluding valuation changes of the Strategic Portfolio.

This is primarily the effect of translating foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging.

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio. This figure represents valuation changes up to the end of June 2018. Valuations of these investments from July to September are not yet available.



INCOME AND EXPENDITURE

	← 2018 →		2017	2016
	(unaudited)			
(HK\$ billion)	Jan - Sep	Q3	Full year	Full year
Investment income	36.7	1.6	264.0	68.1
Other income	0.1	-	0.2	0.2
Interest and other expenses	<u>(12.3)</u>	<u>(5.0)</u>	<u>(9.9)</u>	<u>(6.4)</u>
Net income/(loss)	24.5	(3.4)	254.3	61.9
Fee payment to Fiscal Reserves**	(32.9)	(10.7)	(46.2)	(33.1)
Fee payment to HKSAR government funds and statutory bodies*	(10.3)	(3.4)	(8.6)	(9.6)

* The rate of fee payment is 4.6% for 2018, 2.8% for 2017 and 3.3% for 2016.

This does not include the 2018 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2018 is available.

(The composite rate was 9.6% for 2017 and 4.5% for 2016. Fee payable to the Future Fund was HK\$22.7 billion for 2017 and HK\$10.1 billion for 2016.)



INFRASTRUCTURE INVESTMENT (1)

- **Exchange Fund (EF)'s Long-Term Growth Portfolio (LTGP):**
 - Invests primarily in private equity and real estate, and started to invest in infrastructure in recent years
 - Since-inception annualised internal rate of return at 13.7% as of end-2017
 - Total market value amounted to HK\$235.6 billion, or about 5.9% of the EF's total assets as at end-2017
- **Infrastructure Investment:**
 - Generates relatively stable cash flows with low loss ratios
 - Returns less affected by economic cycles, lower correlation with returns of traditional assets
 - Enhances portfolio resilience to adverse economic shocks and reduces volatility of overall return



INFRASTRUCTURE INVESTMENT (2)

- **Risk management measures:**
 - Stay prudent with appropriate risk management measures
 - Allocate only a small portion of the LTGP to infrastructure and ensure a diversified portfolio to avoid undue concentration
 - Ensure commercial viability of investment projects. Conduct rigorous pre-investment due diligence and maintain stringent post-investment monitoring on all invested projects
 - Engage independent advisors and partner with reputable and experienced institutional investors and asset managers to capitalise on their broad and deep expertise
 - Ensure each project (irrespective of its location or business partnership) goes through the established mechanism and processes that underpin our robust, professional and objective due diligence and risk management