



HONG KONG MONETARY AUTHORITY

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

19 February 2019

[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

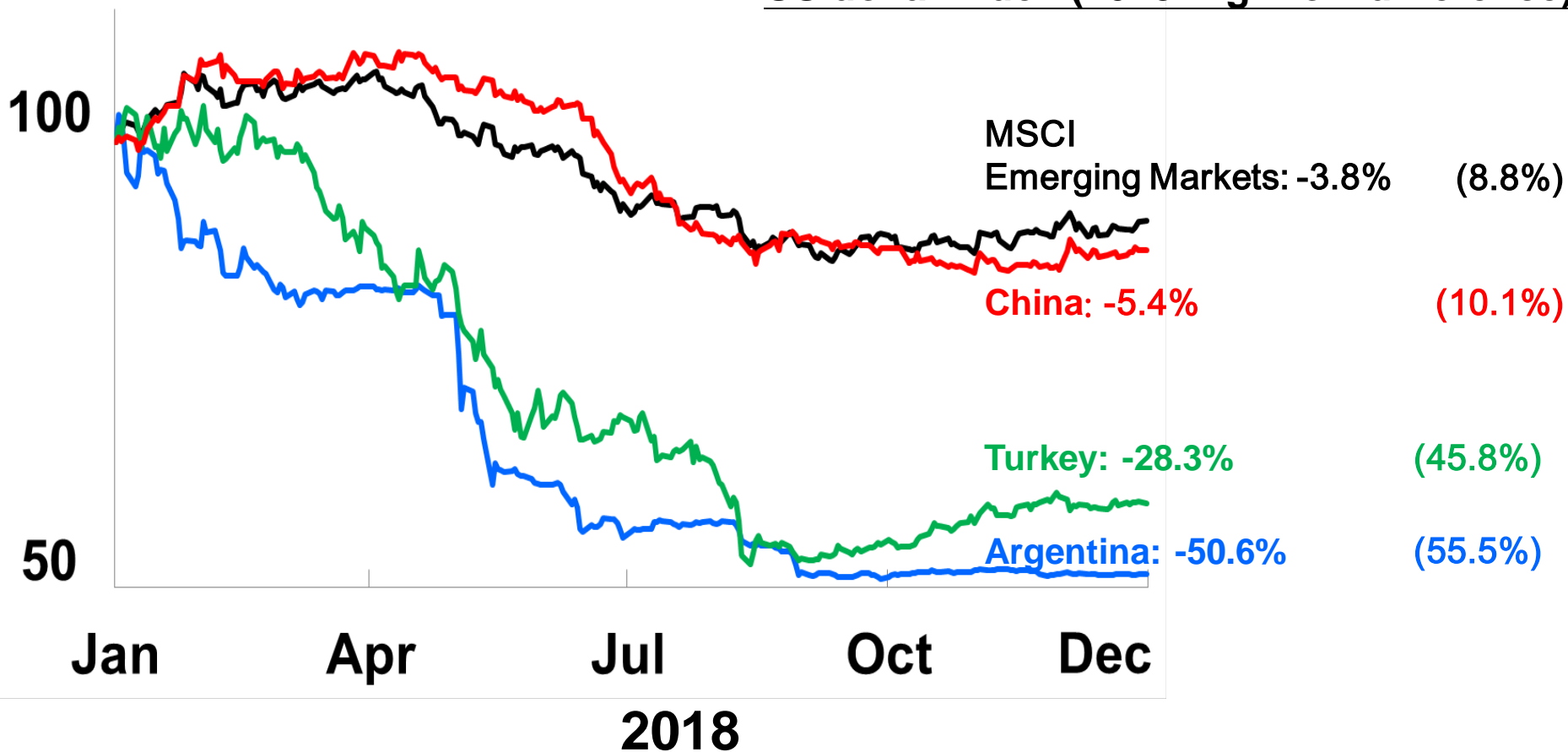


2018 IN REVIEW: EMERGING MARKETS UNDER PRESSURE

A strong US dollar

1/1/2018 = 100

US dollar Index (2018 High-low difference)

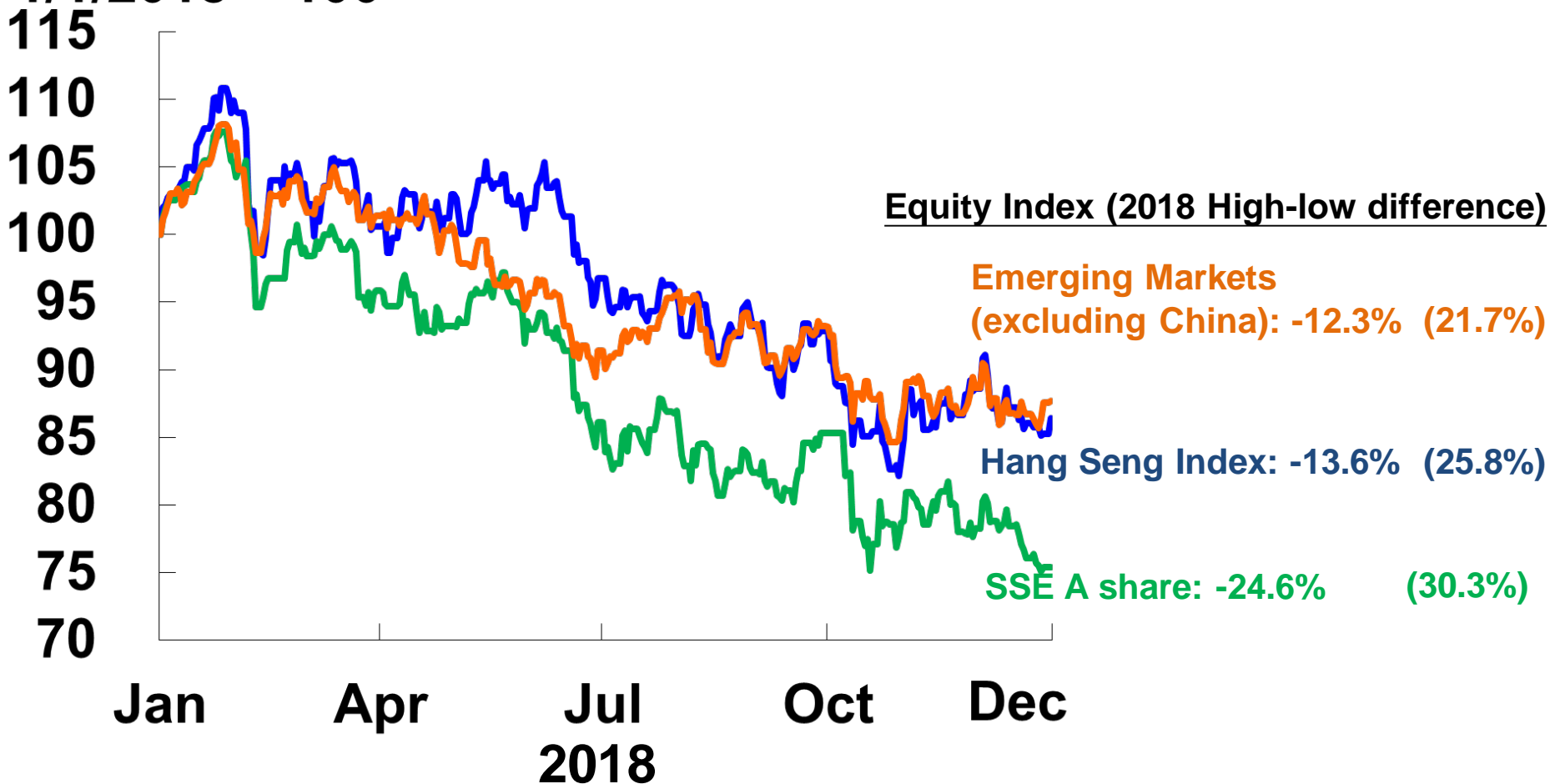




2018 IN REVIEW: EMERGING MARKETS UNDER PRESSURE

Falling equity prices

1/1/2018 = 100



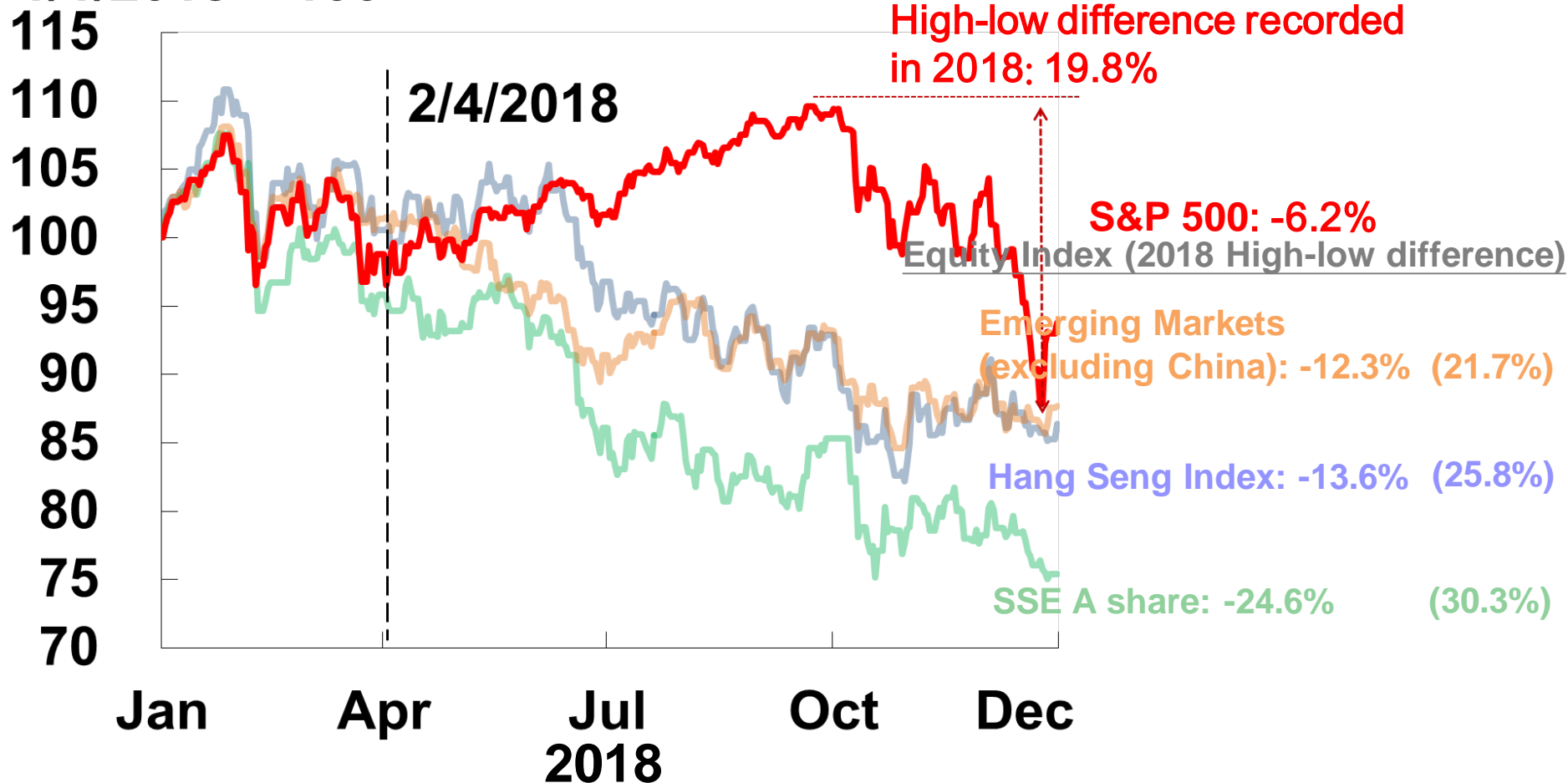
Sources: Bloomberg and HKMA staff estimates.



2018 IN REVIEW: DIVERGING PERFORMANCE OF US STOCKS AND EMERGING MARKETS

Falling equity prices

1/1/2018 = 100



Sources: Bloomberg and HKMA staff estimates.



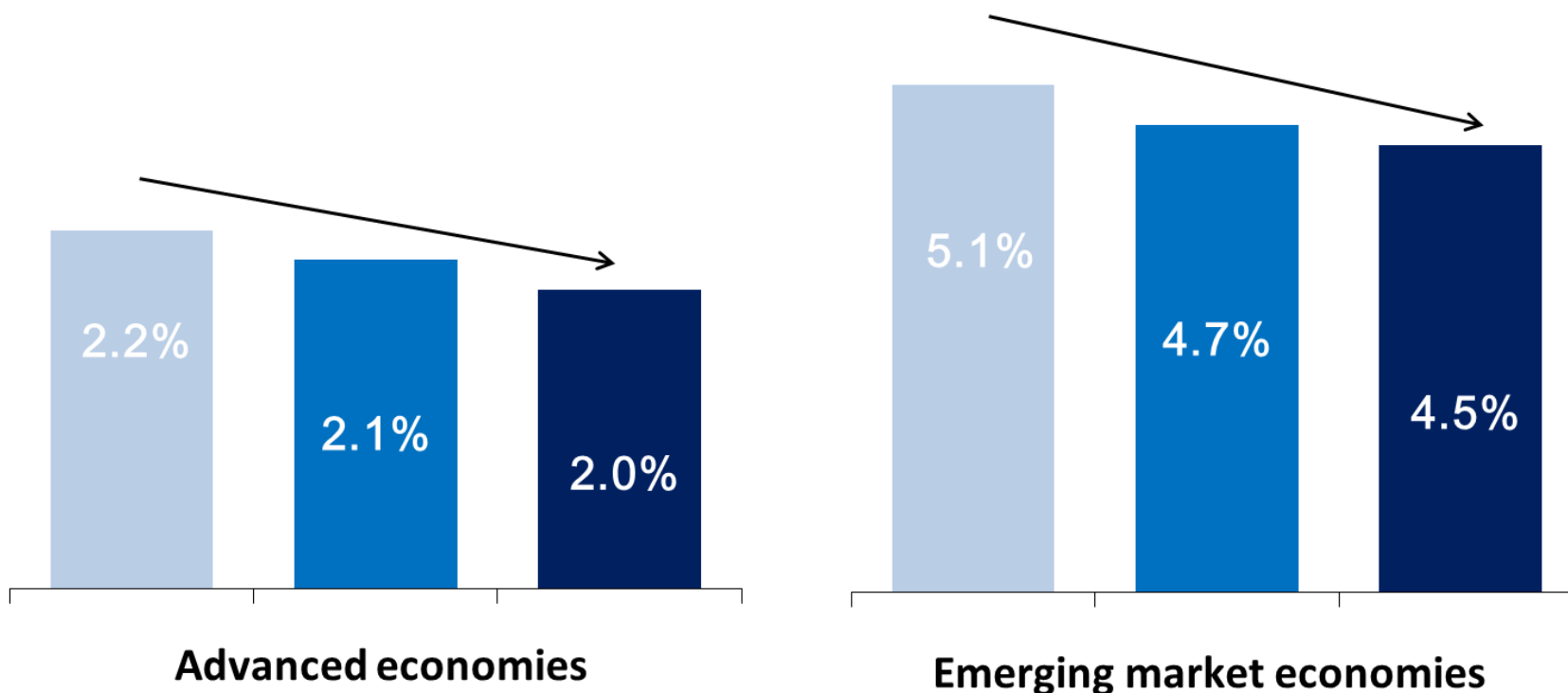
ECONOMIC OUTLOOK WORSENE

Growth forecasts for 2019

04/18

10/18

01/19

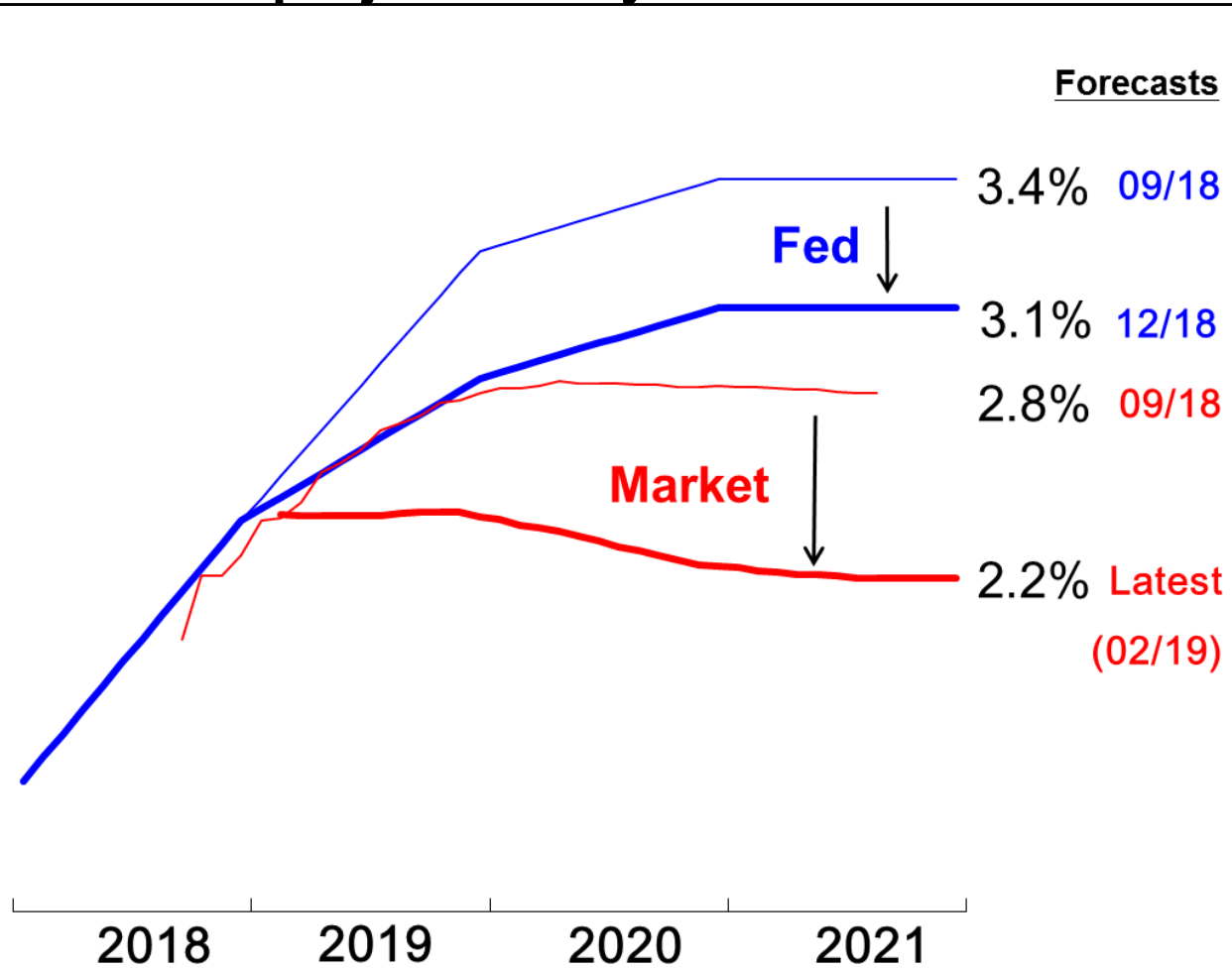


Source: International Monetary Fund (IMF).



THE FED REVISED ITS VIEW ON PACE OF FUTURE RATE HIKES

Interest rate projections by the Fed and the markets



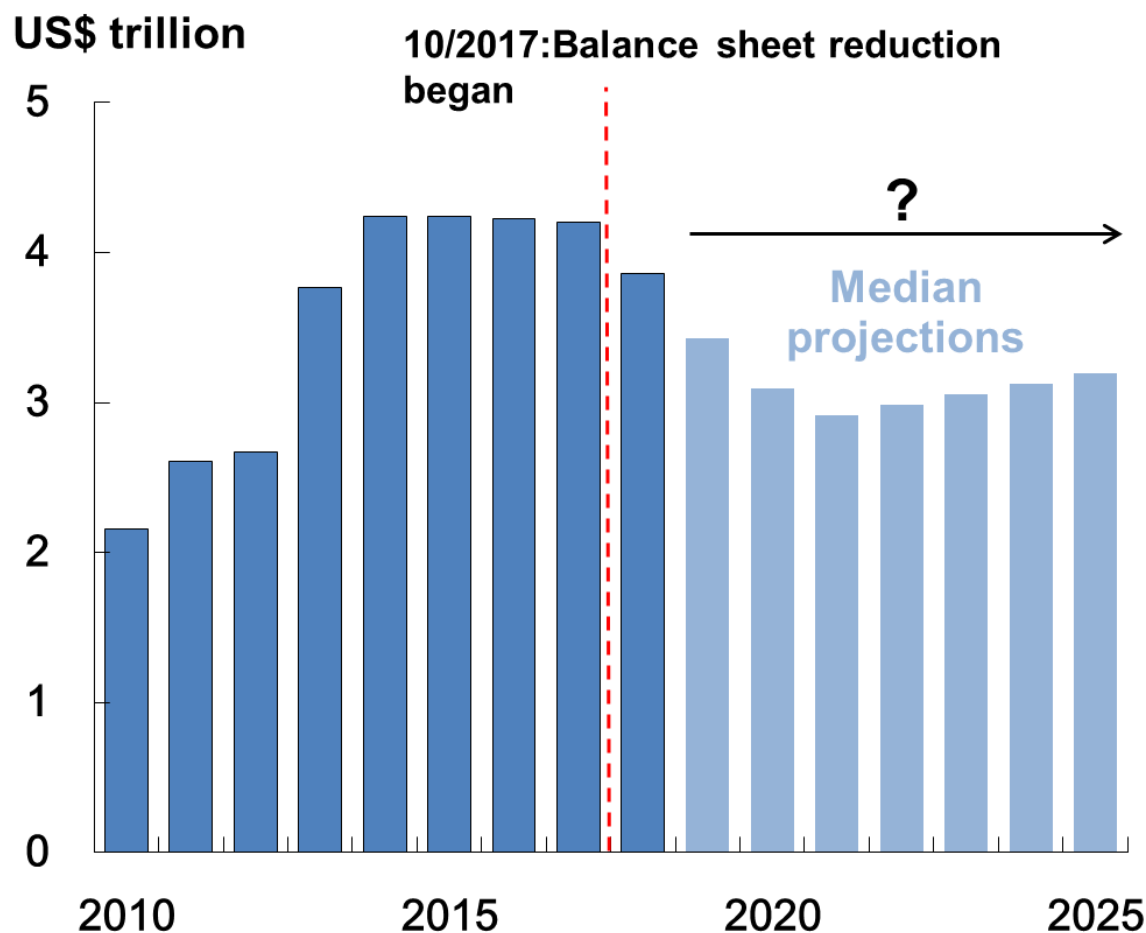
Note: Market projections in September refer to those implied by the Fed funds futures contracts one day after that month's FOMC meeting (i.e. 27 September).

Sources: Datastream and the Fed.



FED MAY END BALANCE SHEET NORMALISATION EARLIER

Securities holdings by the Fed



Note: Projections shown in the chart are those published by the New York Fed in July 2017.

Source: New York Fed.

Fed's recent change in tone about balance sheet reduction:

19/12/2018 – Powell: “balance sheet reduction on automatic pilot”

30/1/2019 – Fed: “... prepared to adjust any of the details for completing balance sheet normalisation in light of economic and financial developments”



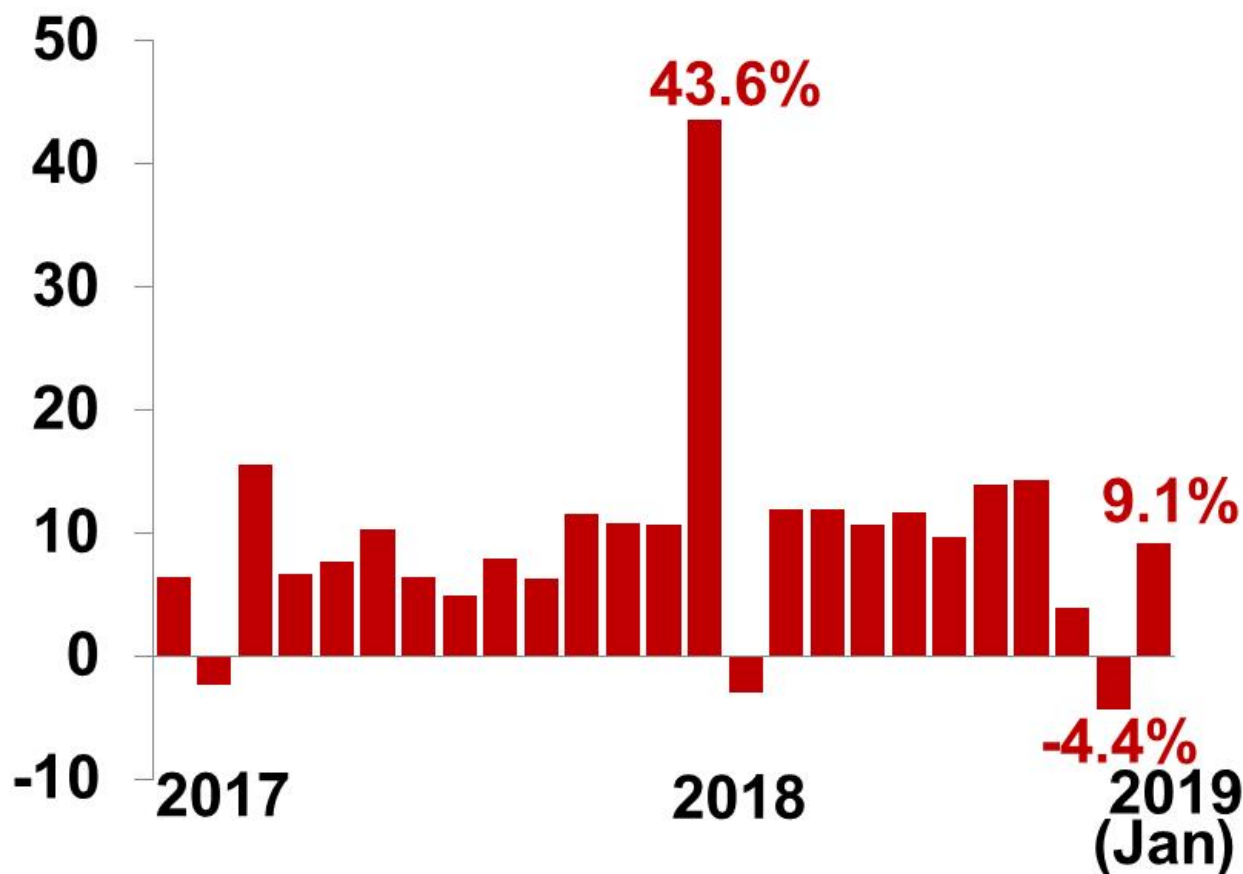
OUTLOOK FOR 2019

- Moderating global economic growth
- A possible slowdown in the pace of interest rate hikes and balance sheet reduction by the Fed
- Possible easing of US dollar strength, bringing some relief to the pressure facing emerging market economies
- Major downside risks to the economy this year:
 - Continuing or worsening China-US trade conflict
 - Hard Brexit
 - US federal budget impasse
 - Heightened geopolitical risks



IMPACT OF TRADE WAR ON THE MAINLAND BEGAN TO EMERGE

Year-on-year change of Mainland China's exports (%)



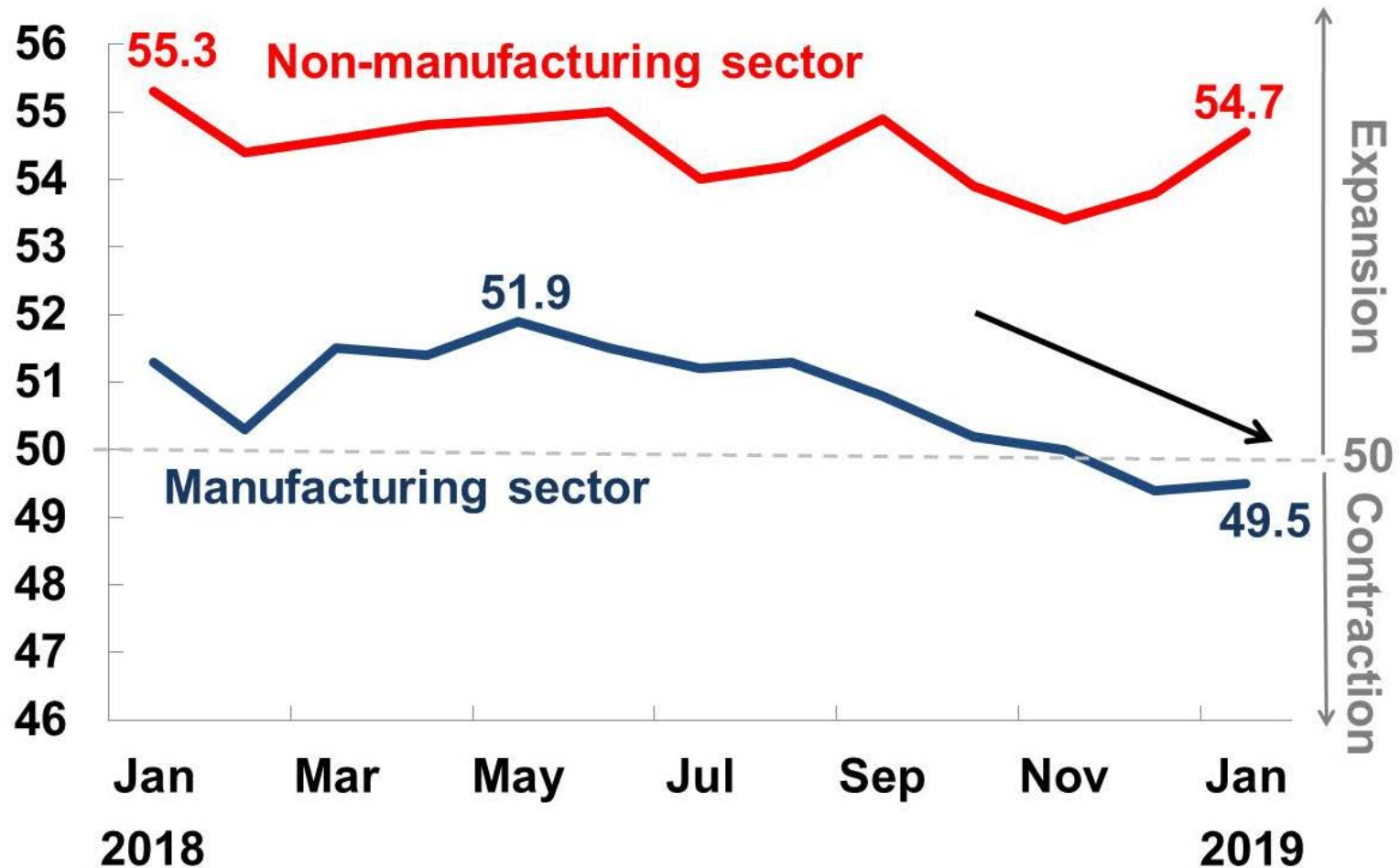
Note: Export figures of Mainland China are based on the values of exports in USD.

Source: CEIC.



MAINLAND ECONOMY IS UNDER PRESSURE

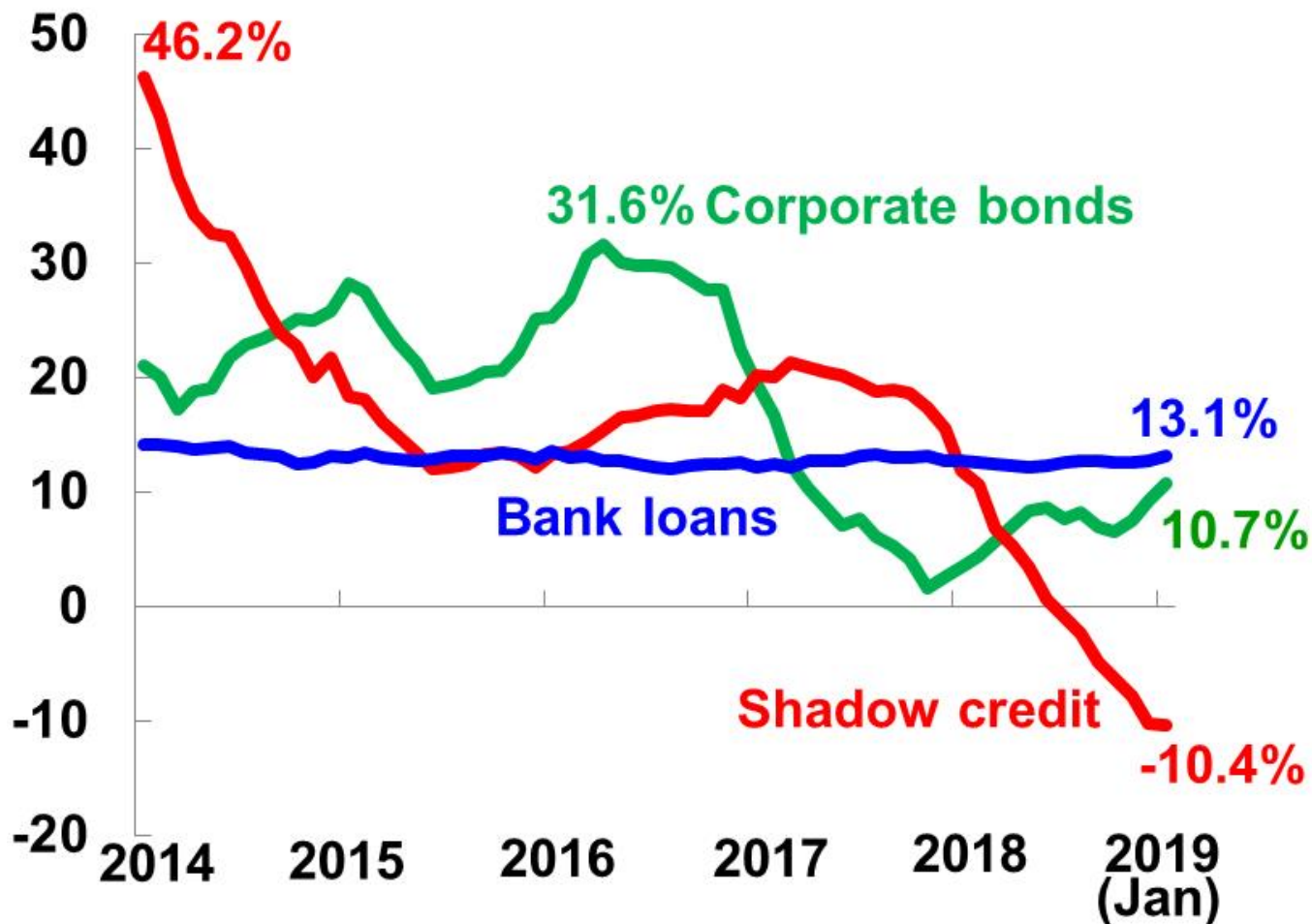
Mainland China's purchasing managers' indexes





FINANCIAL DELEVERAGING IN THE MAINLAND CONTINUED

Year-on-year change of outstanding aggregate financing (%)

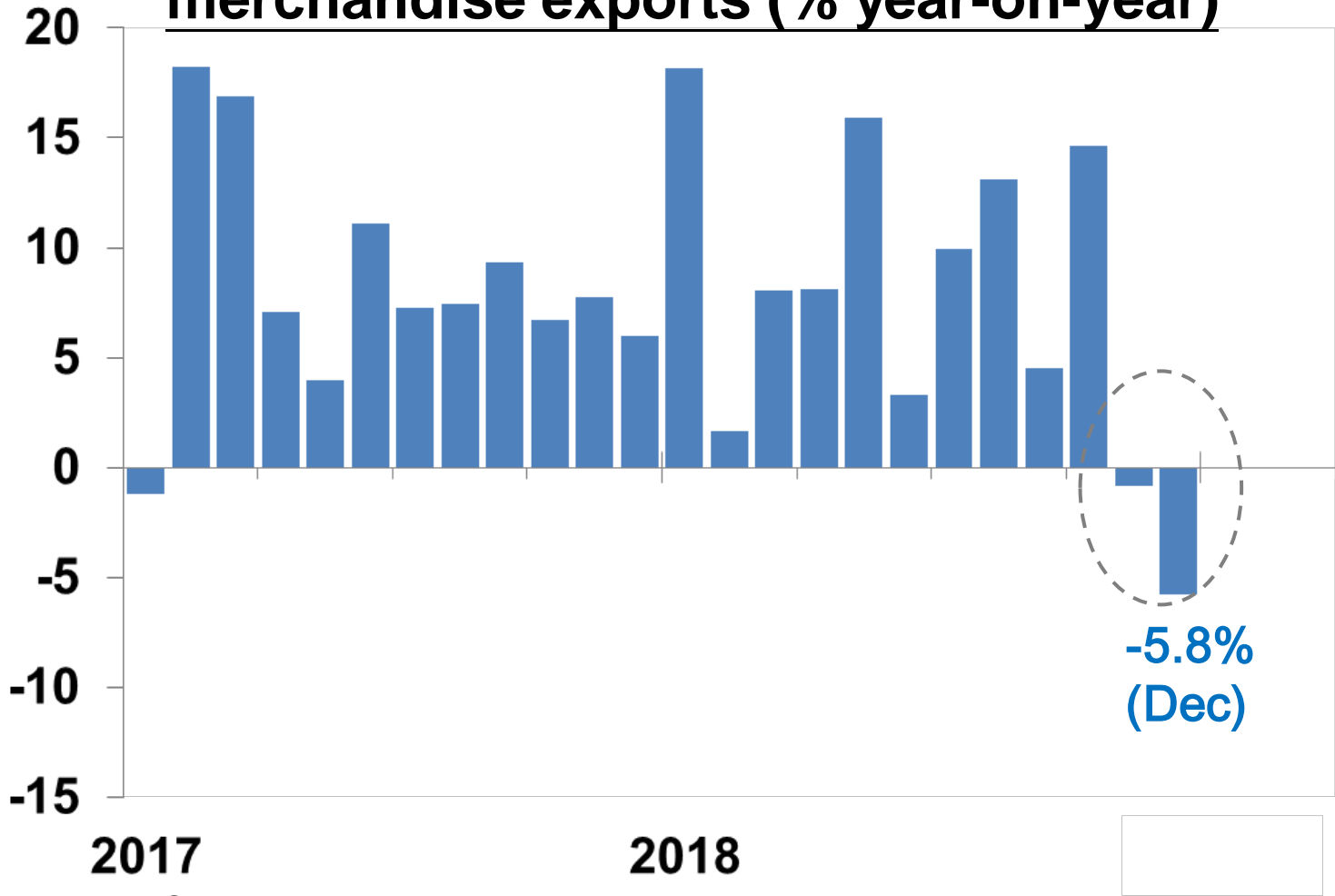


Sources: CEIC and HKMA staff estimates.



HONG KONG: IMPACT OF TRADE CONFLICT BEGAN TO EMERGE

Growth in value of Hong Kong's
merchandise exports (% year-on-year)

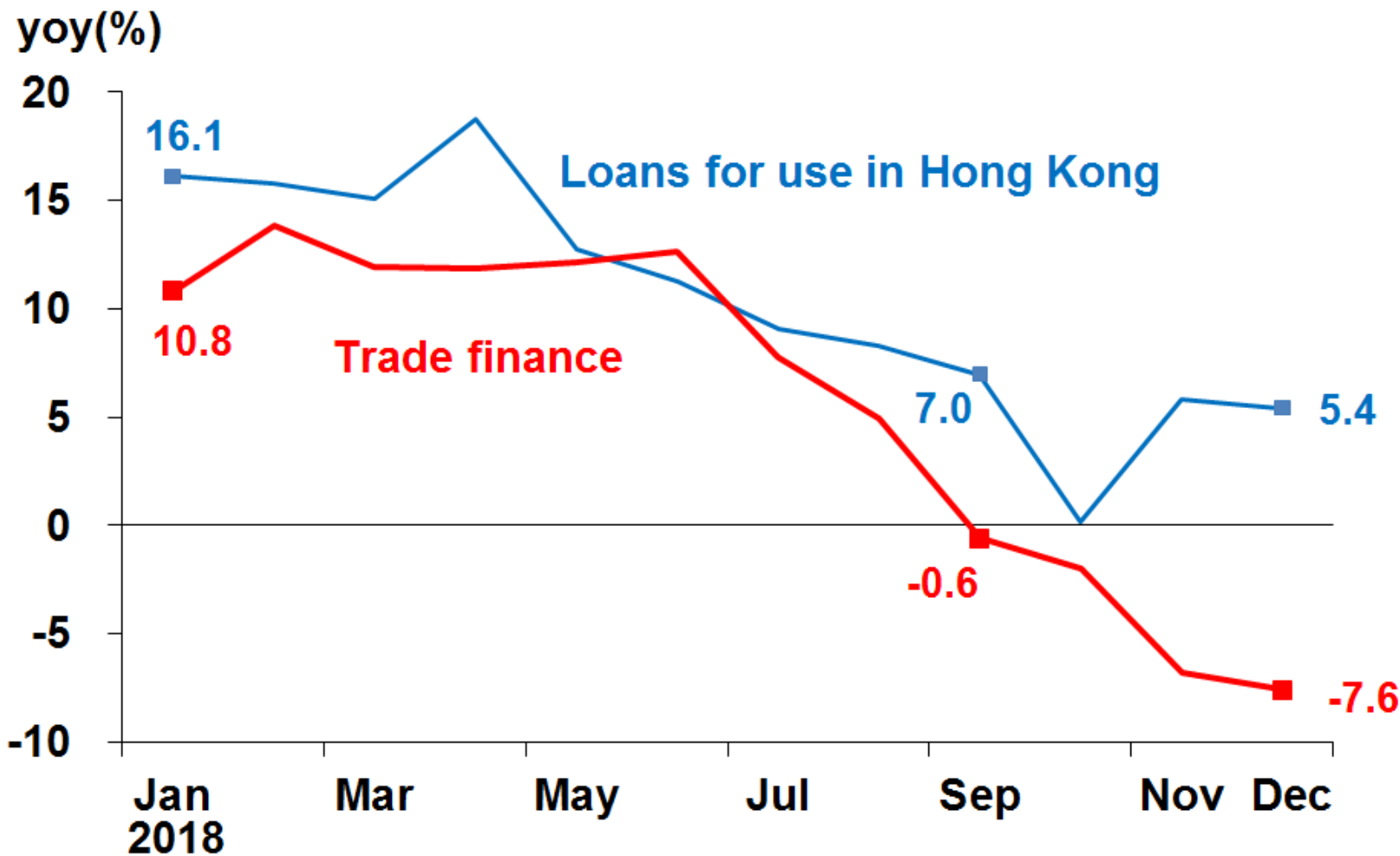


Source: Census and Statistics Department.



HONG KONG: DEMAND FOR TRADE FINANCE SOFTENED

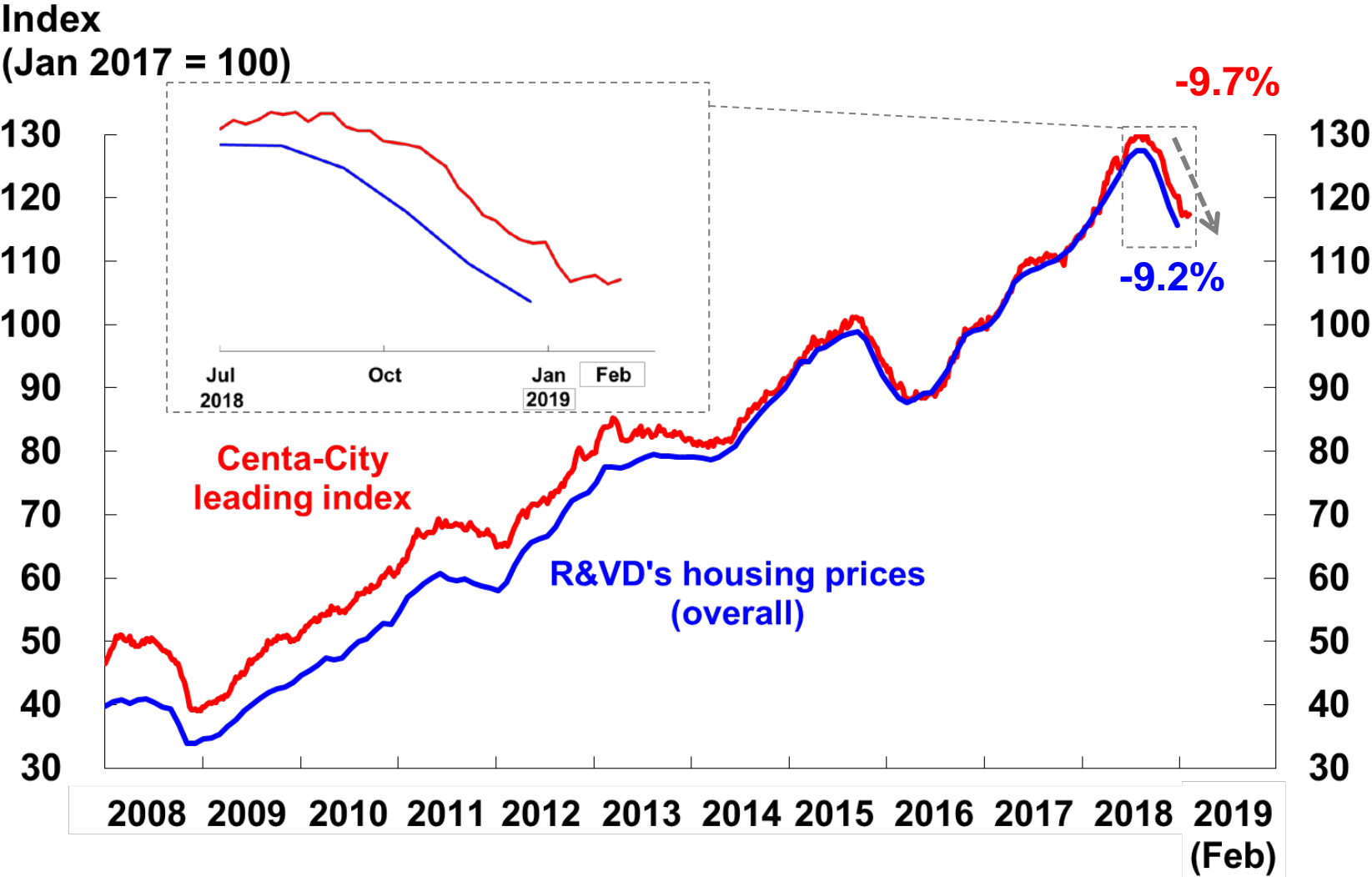
Loan growth





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

Corrections in property prices



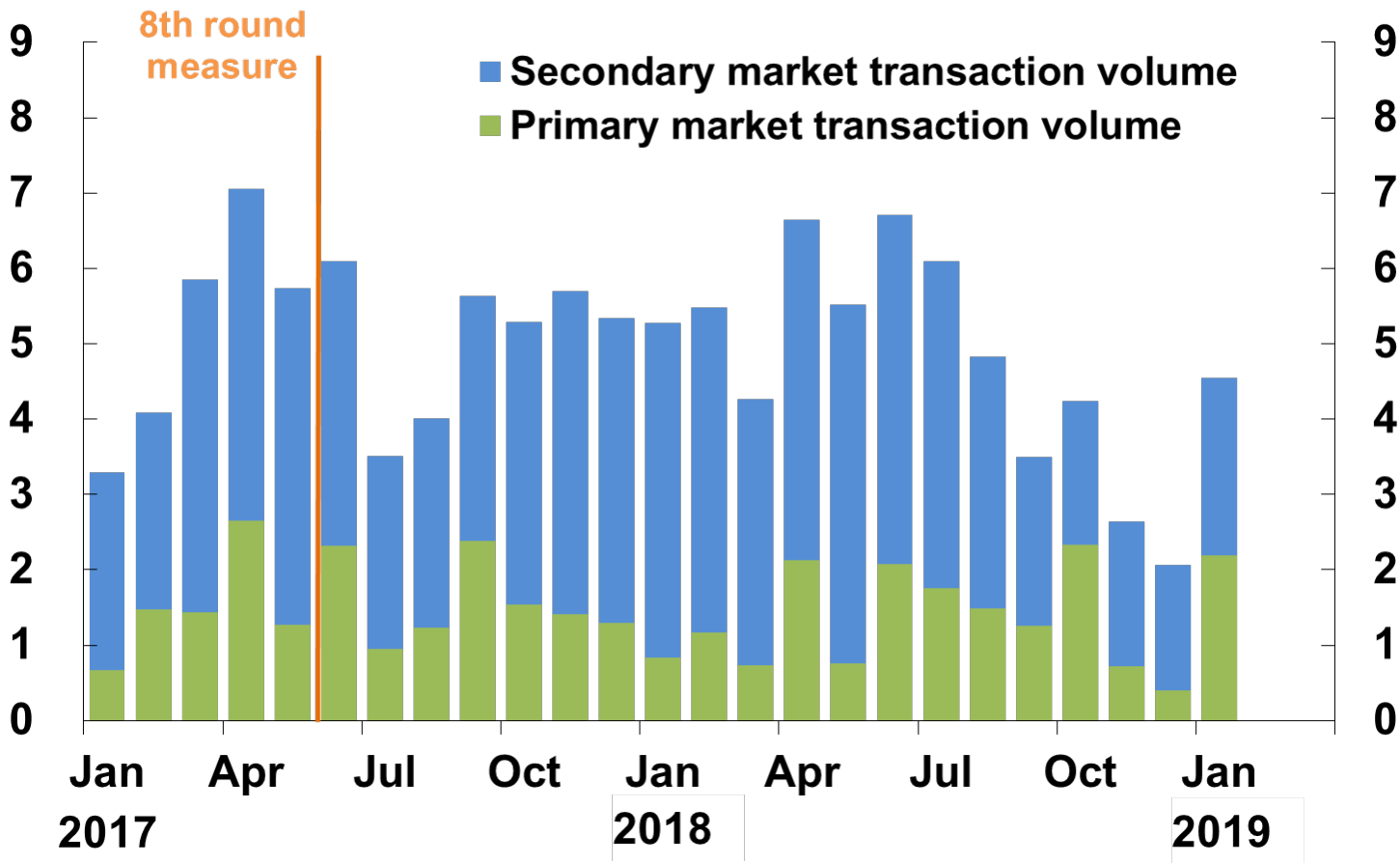
Sources: Rating & Valuation Department and Centaline Property Agency Limited.



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

Transaction volume picked up

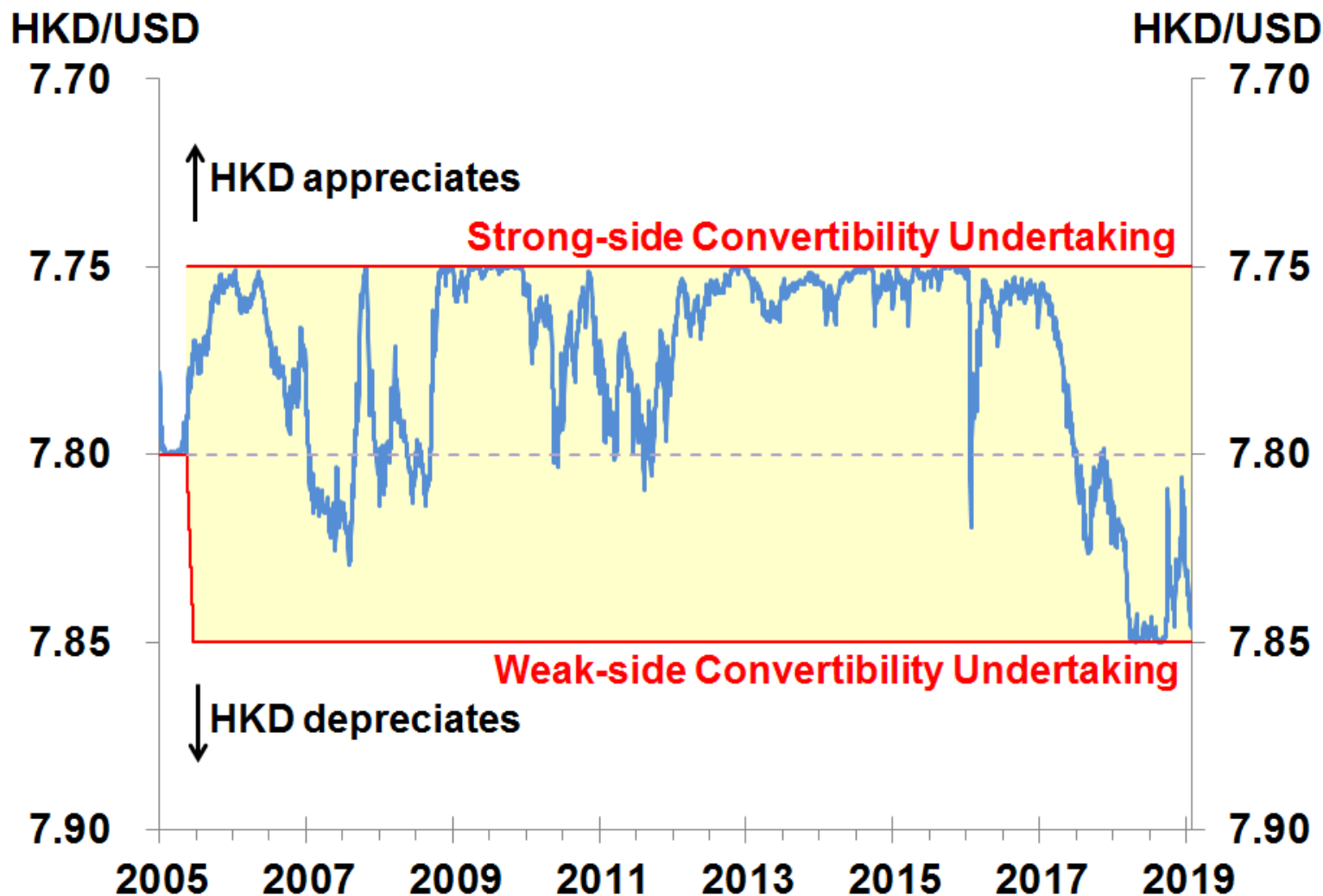
Number of transactions ('000)





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

The Hong Kong dollar traded at around 7.84 recently





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

- Global economic growth is slowing, uncertainties and downside risks are increasing
- Market volatility may continue even if the pace of US rate hike slows
- While Hong Kong's economy and asset markets will also be affected, our financial system is sound and resilient
- There have been corrections in the property market, but more observation is required before it becomes certain that the property market has entered a downward cycle
- The public should manage risks more prudently amid possible market volatilities

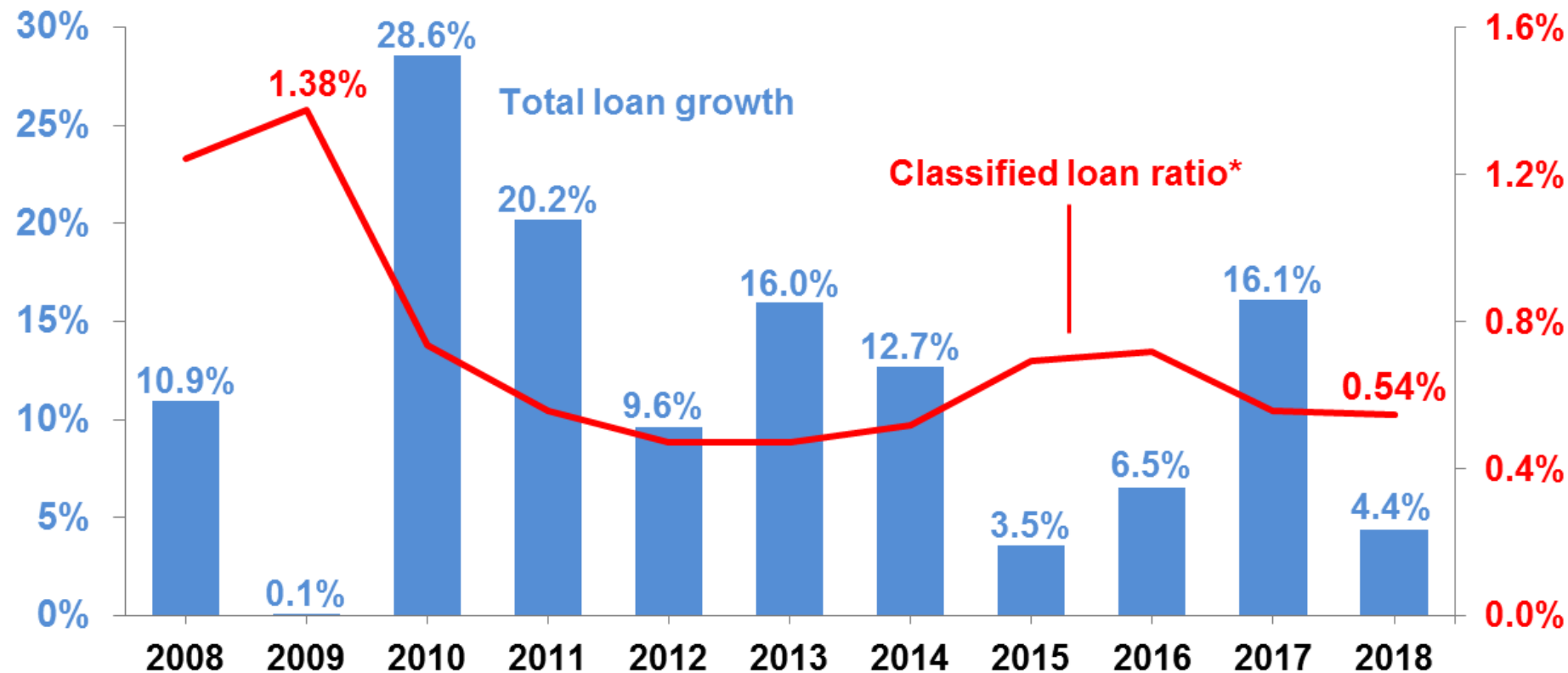


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BANKING SECTOR PERFORMANCE

Moderate credit growth,
asset quality staying at a healthy level



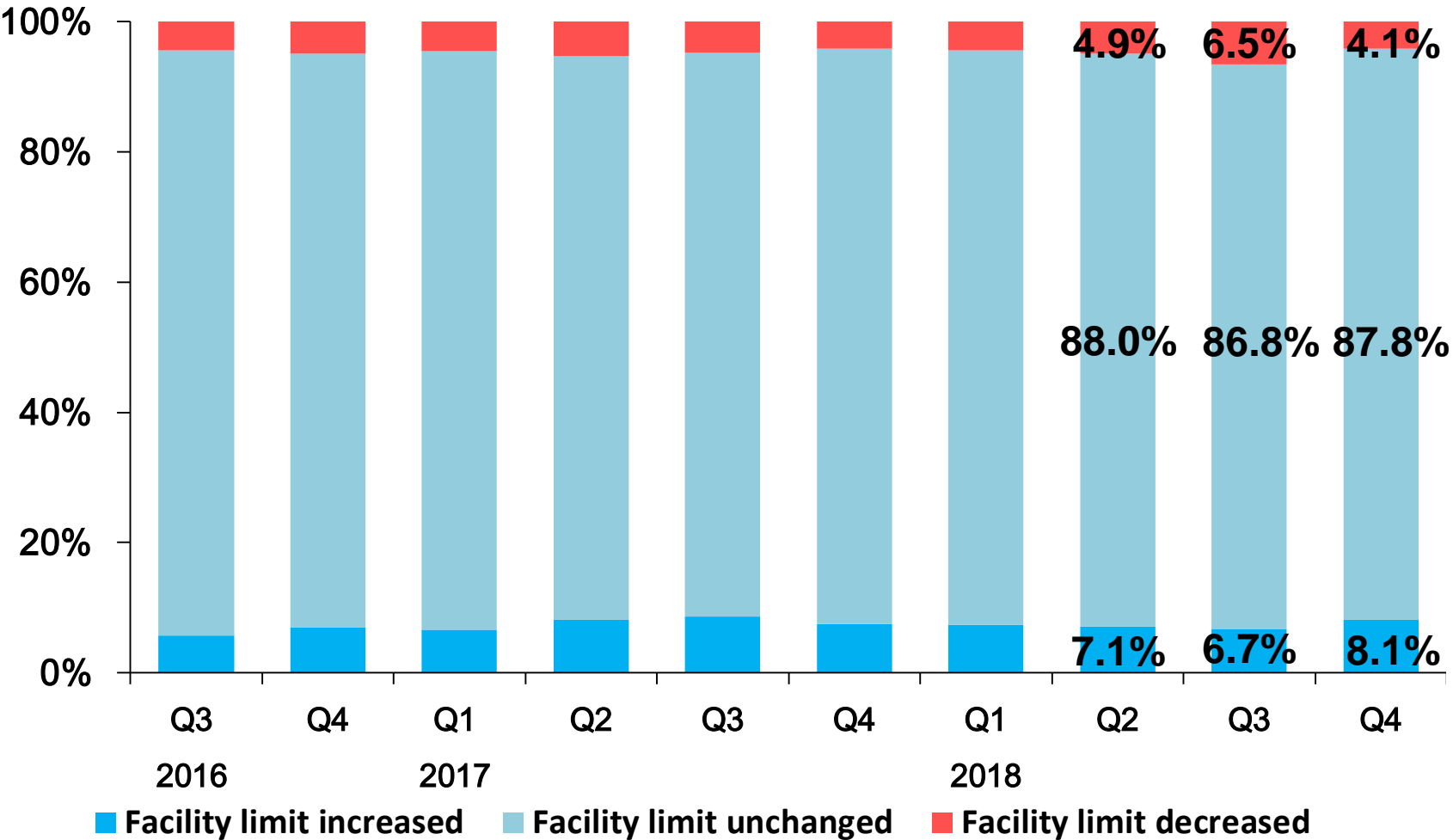
Note: * Classified loan ratio covers retail banks only. The classified loan ratio of 2018 is Q3 figure.

Source: Hong Kong Monetary Authority



SMEs LENDING

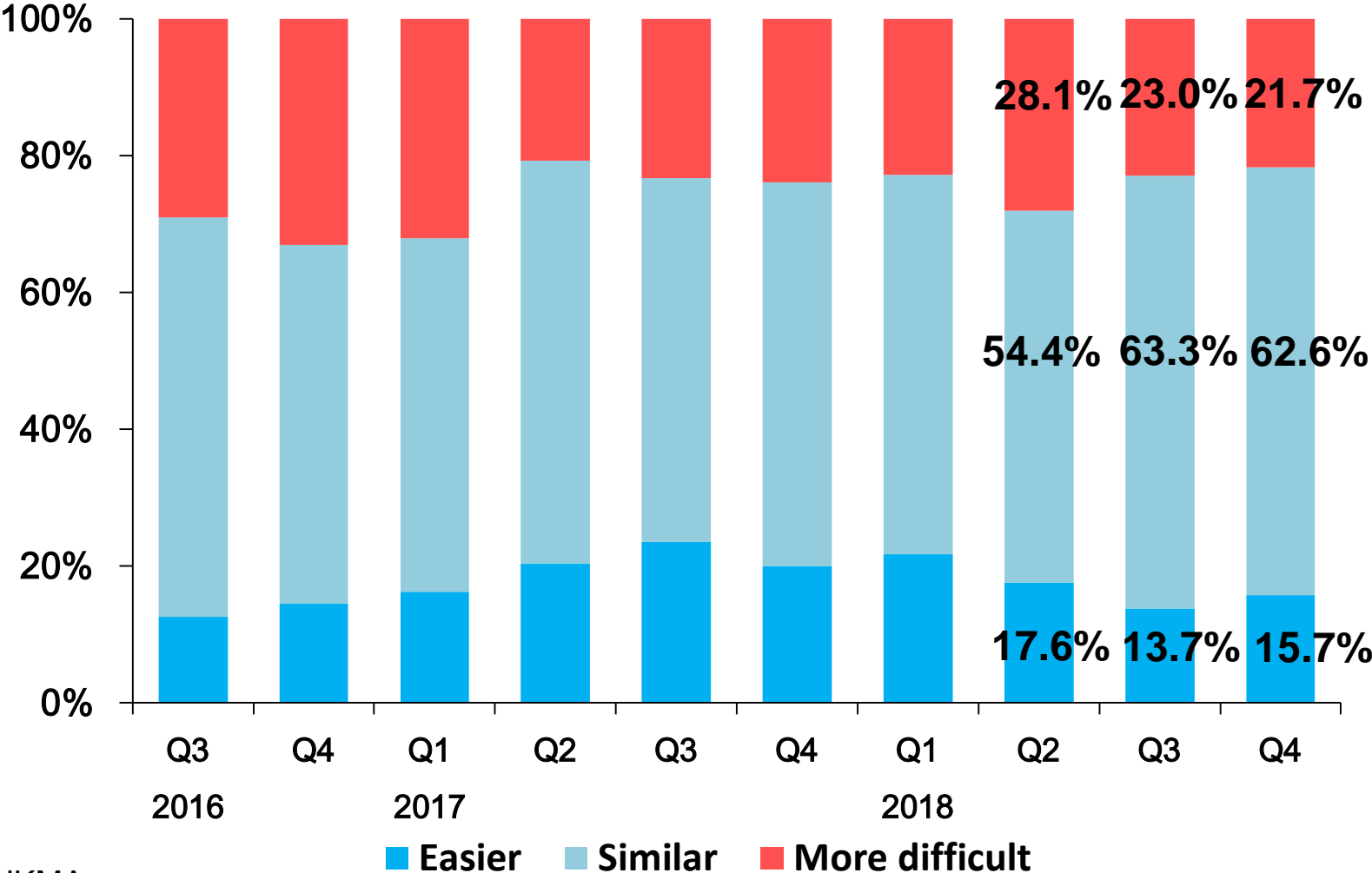
Bank lending to SMEs





SMES' CREDIT CONDITIONS

Perceived Banks' Credit Approval Stance (Relative to 6 months ago)





INTERNATIONAL STANDARDS IMPLEMENTATION

- Banking (Liquidity) (Amendment) Rules 2019
- Banking (Capital) (Amendment) Rules 2019 / 2020



RESOLUTION REGIME

- The rules on loss-absorbing capacity requirements (LAC Rules) for authorized institutions (AIs) came into operation in December 2018. The Inland Revenue (Amendment) Ordinance 2019 has been gazetted on 15 February
- The HKMA expects to finalise Financial Institutions (Resolution) Ordinance (FIRO) code of practice chapter in the first quarter of 2019
- Continue to operationalise the FIRO by progressing other subsidiary legislation



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FASTER PAYMENT SYSTEM (FPS)

- FPS has been widely used by the public since its launch in September 2018. As of end-2018:
 - Registrations: Over 2 million
 - Transaction value: HK\$104 billion
 - Transaction number: 4.8 million
 - Average daily transaction value: HK\$1.1 billion
 - Average daily transaction number: 50,000



STORED VALUE FACILITIES (SVFs) AND RETAIL PAYMENT SYSTEMS (RPSs)

- Usage continued to grow in Q3 2018:
 - Accounts in use: 54.1 million (+20.6% year-on-year)
 - Average daily transaction number: 16.5 million (+6.9% year-on-year)
 - Average daily transaction value: HK\$490 million (+29.7% year-on-year)
 - Average value per transaction: HK\$29 (+21.3% year-on-year)
- SVF licensees continue to extend their business reach to different sectors, e.g. cross-border remittance, public transportation and small merchants
- e-Wallets are gradually resuming bank direct debit authorisation service
- Continue to oversee six designated RPSs



LATEST FINTECH INITIATIVES

Open Application Programming Interface (Open API) for the banking industry

- Over 500 Open APIs launched by banks since Phase I of Open API implemented in January 2019

Distributed Ledger Technology (DLT)-based trade finance platform, eTradeConnect

- Proof-of-Concept on connecting with a platform in Europe underway

Enhanced cross-border collaboration

- 18 jurisdictions attended Hong Kong Fintech Roundtable hosted by HKMA in January 2019



INTEREST RATE BENCHMARKS

- Participating in the Financial Stability Board (FSB) Official Sector Steering Group (OSSG) on the reform of interest rate benchmarks
- Enhancing the administration of interest rate benchmarks in Hong Kong (HKD HIBOR and CNH HIBOR) through the Treasury Markets Association (TMA)
- Closely monitoring the development of other major currencies' interest rate benchmarks (e.g. LIBOR), and work with the industry in preparation for changes in the future



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CROSS-BORDER RMB BUSINESS

- Bond Connect is operating smoothly. Over 500 investors registered, with daily turnover of RMB3-4 billion. Further enhancement was made last November to include additional international e-trading platform, offering more choices to investors
- RMB deposit pool expanded by about 6% in 2018 to around RMB660 billion. The RMB trade settlement handled by Hong Kong banks amounted to RMB4.2 trillion in 2018, up 7.5% compared to the year before. Daily average turnover recorded by RMB RTGS system stayed at a high level of about RMB1 trillion
- Progressively launch financial facilitation measures under the Guangdong-Hong Kong-Macao Bay Area, including pilot use of Hong Kong e-wallets in the Mainland, and continuing to study simplification of Mainland bank account opening process by Hong Kong residents and satisfying the need for cross-border wealth management



PROMOTING GREEN FINANCE

- Taking forward the preparatory work related to the inaugural green bond offering under the Government Green Bond Programme
- Co-organised with the Research Bureau of the People's Bank of China and the Hong Kong Green Finance Association a promotional event on green bond issuance in Hong Kong for potential Mainland issuers on 13-15 January



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INVESTMENT INCOME

	← 2018 →			2017	2016
	(unaudited)				
(HK\$ billion)	Full year	2H	1H	Full year	Full year
Bonds	57.4	37.9	19.5	34.4	33.1
Hong Kong equities*	(20.7)	(17.3)	(3.4)	58.3	5.3
Other equities	(38.3)	(35.6)	(2.7)	80.4	28.6
Foreign exchange[#]	(9.0)	(14.0)	5.0	53.5	(15.8)
Other investments[@]	<u>24.5</u>	<u>7.9</u>	<u>16.6</u>	<u>37.4</u>	<u>16.9</u>
Investment income/(loss)	13.9	(21.1)	35.0	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 September 2018. Valuations of these investments from October to December are not yet available. **34**



INVESTMENT DIVERSIFICATION

As of end-September 2018 (unaudited)

Asset Classes	Market Value HK\$ billion	Annualised IRR (Since inception from 2009 till end-Sep 2018)
Private Equity	190.9	13.8%
Real Estate	87.4	
Total	278.3	

Note: Outstanding investment commitments at the end of 2018 amounted to HK\$200 billion



INCOME AND EXPENDITURE

	<div> <div>←</div> <div>2018</div> <div>→</div> </div>			2017	2016
	(unaudited)				
(HK\$ billion)	Full year	2H	1H	Full year	Full year
Investment income/(loss)	13.9	(21.1)	35.0	264.0	68.1
Other income	0.2	0.1	0.1	0.2	0.2
Interest and other expenses	<u>(18.1)</u>	<u>(10.8)</u>	<u>(7.3)</u>	<u>(9.9)</u>	<u>(6.4)</u>
Net (loss)/income	(4.0)	(31.8)	27.8	254.3	61.9
Fee payment to Fiscal Reserves ^{*#}	(43.8)	(21.6)	(22.2)	(46.2)	(33.1)
Fee payment to HKSAR government funds and statutory bodies [*]	(13.8)	(6.9)	(6.9)	(8.6)	(9.6)

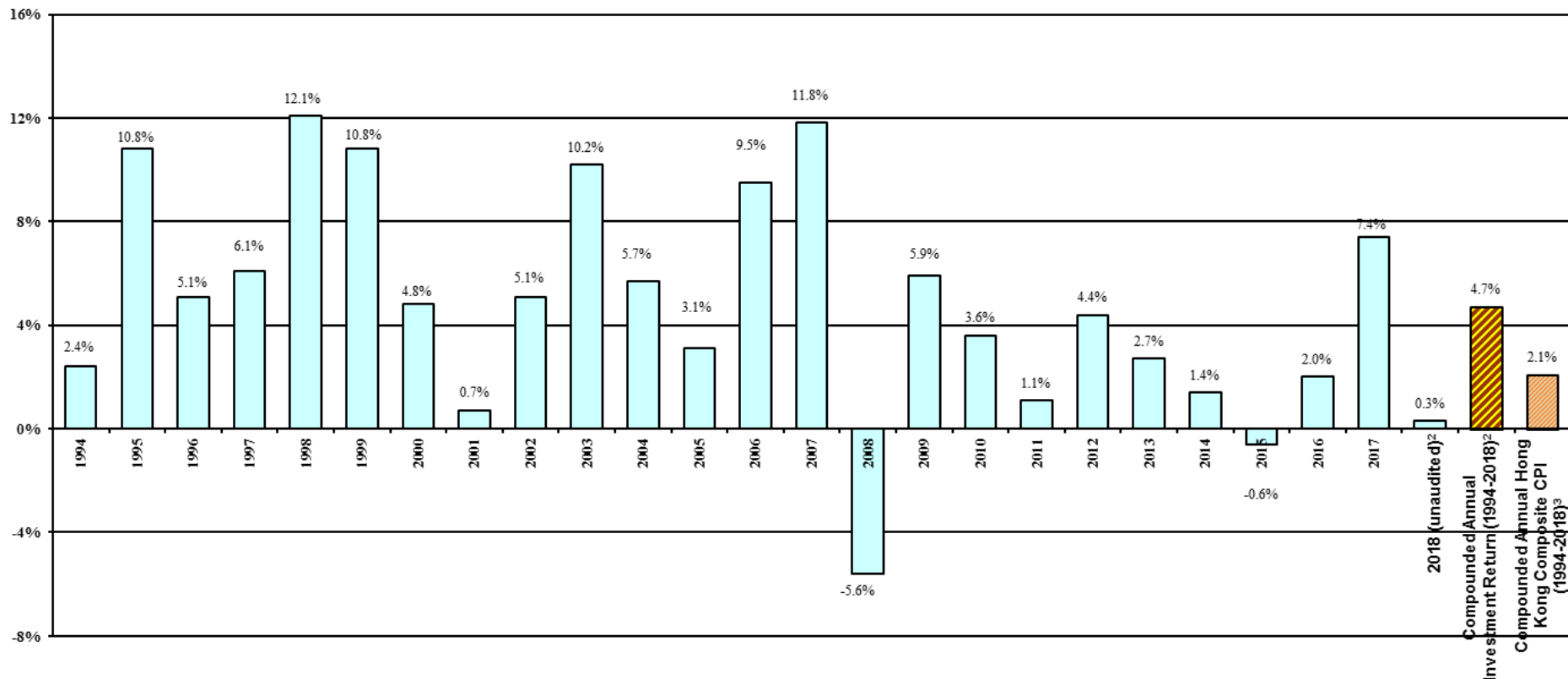
* The rate of fee payment is 4.6% for 2018, 2.8% for 2017 and 3.3% for 2016.

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).



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2018)¹



¹ Investment return calculation excludes the holdings in the Strategic Portfolio.

² The return includes the performance of LTGP up to the end of September 2018. The audited full year return will be disclosed in the annual report of 2018 to be released later this year.

³ Composite CPI is calculated based on the 2014/2015-based series.