Remarks by Mr Eddie Yue,

Chief Executive of the Hong Kong Monetary Authority

on 30 January 2023

at the announcement of

Exchange Fund's investment results for 2022

Review of the Investment Environment and Performance of the Exchange Fund in 2022

Financial markets experienced an exceptionally volatile year. The Russia-Ukraine conflict at the beginning of the year sent energy and commodity prices significantly higher, while the ongoing pandemic situation further disrupted global supply chains and caused inflation to rise in major economies, prompting major central banks to tighten their monetary policies. Successive sharp interest rate hikes for a total of 425 basis points by the US Federal Reserve within the year have led to sharp falls in the global bond and equity markets, which registered a notable fall of 16.2% and 19.8%[1] respectively for the year. This investment environment not only undermined the conventional complementary effects of bonds and equities, but has also marked 2022 as the only year in almost half a century during which returns from equities, bonds and major currencies against the US dollar all recorded negative returns simultaneously.

2. With the concurrent fall in bonds and equities and the sharp depreciation of major currencies against the US dollar, the Exchange Fund, as with other investors, inevitably suffered significant losses. For the year as a whole, the Exchange Fund

[1] Based on the Bloomberg Global Aggregate Total Return Index and the MSCI All Country World Index as measured in US dollar terms.

recorded an investment loss of HK$202.4 billion in 2022. Specifically, our bond holdings recorded an investment loss of HK$53.3 billion, while our equity holdings recorded an investment loss of HK$80.7 billion, including losses of HK$61.2 billion from foreign equities and losses of HK$19.5 billion from Hong Kong equities. On foreign exchange (FX), as the US dollar strengthened against major currencies during the year, the Exchange Fund recorded a negative currency translation effect of HK$40.1 billion on its non-US dollar assets. Nevertheless, on a quarterly basis, the performance of the Exchange Fund improved in the fourth quarter and recorded an investment income of HK$76.4 billion, with equities, bonds and FX all posting gains, partly offsetting the overall investment loss for the whole year. Stepping into January this year, with risk factors in the market easing slightly, the Exchange Fund has also recorded gains across various investment portfolios.

3. As for other investments, the Long-Term Growth Portfolio (LTGP) recorded an investment loss of HK$28.3 billion up to end-September last year. The market value of investment and undrawn commitment of the LTGP totalled HK$480.8 billion and HK$277.1 billion respectively. The annualised internal rate of return of the LTGP from 2009 to the end of September 2022 was 13%.

4. The Exchange Fund recorded a negative investment return of 4.4% in 2022. As compared to the sharp losses of 16-18% suffered by the majority of mixed-asset funds in the market in 2022, the Exchange Fund's overall performance shows that our diversified long-term asset allocation and the defensive measures in response to changes in the external environment have been effective in mitigating the destructive impact of market storms. Specifically, the Investment Portfolio recorded a negative

rate of return of 8.6% and the Backing Portfolio a negative rate of return of 0.4%. According to the sharing arrangement between the Government and the Exchange Fund, fees on placements by the Fiscal Reserves and placements by HKSAR government funds and statutory bodies were HK$35.0 billion and HK$22.1 billion respectively in 2022. These figures do not include the fee payable to the Future Fund in 2022. The amount will be announced in the HKMA Annual Report 2022 to be published later this year when the composite rate for 2022 is available.

Outlook for 2023

5. Looking ahead in 2023, financial markets will continue to face significant uncertainties and asset prices are expected to remain volatile. The monetary policies of major central banks will continue to dominate the investment outlook, and financial markets will pay close attention to peak policy rates set by major central banks. The path of inflation will be key to all these developments. Although there were signs indicating inflation may have peaked towards the end of 2022, it is still well above the targets set by major central banks. Recent minutes of the Federal Open Market Committee meetings also pointed out that containing inflation remains the policy focus, and it is anticipated that ongoing increases in the target range for the federal funds rate would be appropriate. With uncertainties surrounding the paths of inflation and interest rates, asset prices will inevitably experience swings or adjustments in the event that the actual situation deviates substantially from market expectations.

6. Moreover, the continued tightening of monetary policy has posed headwinds to global economic growth. Many institutions have lowered their global economic growth forecasts for this year, and certain major economies may even slide

into recession. In addition, the potentially destructive forces of unresolved geopolitical tensions, such as effect of the Russian-Ukraine conflict on energy prices and trade relationships among major economies, may further impact global economic growth and heighten risk-off sentiments in the market.

7. Nevertheless, on a more positive note, with the relaxation of COVID-prevention measures and the introduction of economic stimulus measures in Mainland China, the Mainland economy may rebound strongly this year. At the same time, amid market expectation of slowing inflation and therefore more gradual rate hikes, bond investments have become more appealing. With yields of major Government bonds currently at multi-year high levels, investing in bonds would give investors a higher interest income.

8. Despite the complicated and challenging investment environment, the Exchange Fund will remain committed to the principle of "capital preservation first while maintaining long-term growth". The HKMA will continue to manage the Exchange Fund prudently. We will remain flexible, implement defensive measures as appropriate, and maintain a high degree of liquidity. We will continue to diversify investments to strive for higher long-term returns for the Exchange Fund. We will also monitor market developments closely to ensure that the Exchange Fund will continue to serve its purpose of maintaining monetary and financial stability in Hong Kong in an effective manner.