

International Financial Centre

While the world economic recovery is expected to strengthen in 2010, challenges remain in supporting strong, sustainable and balanced growth. And more actions are needed to build a sound and more resilient international financial system. The HKMA has been involved through regional surveillance and co-operation to promote financial stability; participating in international discussions on reforms to the global financial system; and strengthened research on Mainland developments. Renminbi business in Hong Kong further expanded in 2009, including renminbi trade settlement and renminbi bonds offered by a wider range of issuers. The outlook for Hong Kong's credit rating was upgraded by Moody's to "Positive" from "Stable".

OVERVIEW

The world economy and global financial markets stabilised in 2009 on strong support by individual governments and the international financial community. Regional economies, led by Mainland China, were firmly on the path to recovery in the second half of 2009, and major industrial economies showed increasing signs of improving economic prospects towards the end of the year. Financial markets were also slowly returning to normal.

Nevertheless, promoting financial stability in the region was still challenging, and the HKMA remained fully committed to the task. It hosted the 14th Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)¹ Governors' Meeting from 21 to 23 July 2009, which endorsed the HKMA's continuing role in co-ordinating the macro-monitoring for the Monetary and Financial Stability Committee (MFSC). The HKMA also took part in meetings and forums of multilateral organisations, notably the Financial Stability Board (FSB)², which is playing an increasingly important role in the reform of the international financial system. As part of its efforts to foster financial co-operation in the region, the HKMA has been involved in the development of a regional joint-defence mechanism against financial instability, known as the "Chiang Mai Initiative Multilateralisation" (CMIM), under the aegis of ASEAN+3.³ Hong Kong participates in this framework of mutual assistance to provide short-term US dollar support to participants facing liquidity shortages.

The HKMA's co-operation on financial initiatives with the Mainland has included implementation of the Action Agenda on "China's 11th Five-Year Plan and the Development of Hong Kong". Significant progress has also been made in other areas, such as the additional issuance of renminbi bonds in Hong Kong, especially renminbi sovereign bonds by the Ministry of Finance; further expansion of renminbi business in Hong Kong to cover settlement of trade transactions; the establishment of a swap facility between the HKMA and the People's Bank of China (PBoC) to facilitate liquidity support to banks and to promote trade settlement in the renminbi; and a new measure under the Closer Economic Partnership Arrangement (CEPA) to facilitate Hong Kong banks' expansion of branch networks in Guangdong Province (see *separate box on Financial co-operation with the Mainland for details*). Research on economic and financial developments in Mainland China has also been strengthened.

REVIEW OF 2009

Regional co-operation and participation in multilateral institutions

With increasing globalisation, and closer economic and financial integration in Asia, the HKMA organises and participates in international and regional initiatives and discussions on a wide range of issues.

The HKMA attended meetings of the Asia-Pacific Economic Co-operation (APEC) organisation, the FSB and the Bank for International Settlements. These forums provide useful

¹ EMEAP is a co-operative forum of 11 central banks and monetary authorities in the East Asia and Pacific region comprising the Reserve Bank of Australia, the People's Bank of China, the Hong Kong Monetary Authority, Bank Indonesia, the Bank of Japan, the Bank of Korea, Bank Negara Malaysia, the Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, the Monetary Authority of Singapore and the Bank of Thailand.

² The FSB was established in April 2009 as the successor to the Financial Stability Forum to address vulnerabilities in global financial systems, and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. Its membership comprises senior representatives of national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance), international financial institutions, standard-setting bodies, and committees of central bank experts.

³ ASEAN+3 comprises the 10 ASEAN member countries (Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam), together with China, Japan and Korea.

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channels for the exchange of views with the international community and promote a better understanding of monetary and financial issues, particularly from a policy perspective, in Asia and Hong Kong.

In 2009 much of the work of the international financial community was devoted to promoting strong, sustainable and balanced global growth, and strengthening and reforming the international financial system. The initiative, led principally by the Group of Twenty (G20), has made great achievements in areas such as providing fiscal stimuli to restore growth, increasing the resources of international financial institutions, and enhancing financial regulation.⁴ Hong Kong actively participates in international forums and groups that play a central role in carrying out the G20's initiatives and recommendations. This includes the HKMA's participation as the Hong Kong representative on FSB Plenary, and Standing Committees on Assessment of Vulnerabilities and on Supervisory and Regulatory Co-operation.⁵ In 2009 the HKMA became a member of the Basel Committee on Banking Supervision, an international forum for co-operation on banking supervisory matters.

In contributing to the reform of the international financial system, the HKMA is pursuing the implementation in Hong Kong of the relevant recommendations and best practices that are appropriate to local circumstances.

Promoting monetary and financial stability in Asia

The HKMA hosted the 14th EMEAP Governors' Meeting in July. The HKMA's role in co-ordinating macro surveillance for the MFSC was highly regarded, and the Governors agreed the HKMA should continue with this role, and to expand the MFSC's bi-annual Macro-Monitoring Report to cover economic trends, development and stability issues in regional economies. The HKMA has further

developed its multi-region dynamic stochastic general equilibrium model to study the risks and vulnerabilities in EMEAP economies. As chair of the EMEAP Working Group on Banking Supervision, the HKMA co-ordinated the Group's efforts in monitoring implementation of the G20's recommendations that are relevant to banking supervision in the region, and assessing how the regulatory systems and standards could be further improved.

In the margins of the EMEAP Governors' Meeting, the HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore established a tripartite working group to map out a co-ordinated strategy for the scheduled exit from the full deposit guarantees in their respective jurisdictions by the end of 2010.

In December 2009 the Finance Ministers and Central Bank Governors of the ASEAN+3 countries and the Monetary Authority announced the signing of the CMIM Agreement – an advanced framework for regional emergency liquidity support. Effective in March 2010 and with a total amount of US\$120 billion, the CMIM will supplement existing international financial arrangements and help guard against financial contagion in the region. Hong Kong has undertaken to commit up to US\$4.2 billion on a callable basis. Hong Kong's participation in this initiative is a demonstration of its autonomy in international financial affairs under the "One Country, Two Systems" principle.

Upgrading Hong Kong's sovereign credit ratings

The HKMA works closely with the Government to present a balanced assessment of Hong Kong's economic and financial developments to international credit rating agencies (CRAs). A better sovereign credit rating helps lower funding costs for Hong Kong debt issuers and increase market confidence in the Linked Exchange Rate system and financial stability in Hong Kong.

⁴ Hong Kong participates in the G20 as a member of the China delegation.

⁵ The Standing Committee on Assessment of Vulnerabilities is responsible for assessing and monitoring vulnerabilities in the financial system and proposing action plans needed to address them. The Standing Committee on Supervisory and Regulatory Co-operation is responsible for addressing co-ordination issues among supervisors and regulators. It is also involved in issues pertaining to cross-border crisis management.

In 2009 the focus of discussions with CRAs was Hong Kong's resilience during the global financial crisis. Through comparative analyses, Hong Kong was shown to possess AAA credit qualities, and outperform the AAA-median economy in key rating variables including fiscal strengths and external positions. It was also demonstrated that Hong Kong's out-performance of some AAA economies was likely to grow after it emerged well from the global financial crisis underpinned by its strong economic fundamentals, sound banking system, and the Mainland's robust growth and supportive measures to Hong Kong. Quantitative and qualitative analyses also suggest that the risks from the Mainland are unlikely to have a significantly adverse impact on Hong Kong, while

the upside potential of the Mainland benefitting Hong Kong is tremendous.

These efforts contributed to Moody's decision to upgrade the outlook for Hong Kong's local and foreign currency ratings (both at Aa2) from "Stable" to "Positive". This reflected the agency's recognition of Hong Kong's credit strengths, particularly its strong external asset position and healthy public finances. Moody's also acknowledged the positive impact of the Mainland on Hong Kong, and noted that the hypothetical risk emanating from Mainland China had lessened. Other major international CRAs affirmed Hong Kong's ratings (in the range of AA to AA+).

Financial co-operation with the Mainland

Communications and co-operation between the HKMA and PBoC and other Mainland authorities were strengthened during the year.

The pilot scheme for cross-border trade settlement in the renminbi permits selected companies in certain Mainland regions to settle trade among Hong Kong, Macau and ASEAN economies in renminbi. Authorized institutions (AIs) in Hong Kong can offer a range of renminbi banking services to enterprises, including deposit-taking, currency exchange, remittance, trade finance, and interbank transactions. The scheme represents a significant step in expanding the scope and base of renminbi banking services in Hong Kong, which previously comprised mainly personal banking business. The PBoC and the HKMA signed a supplementary Memorandum of Co-operation on the scheme in June.

The renminbi bond market in Hong Kong continued to grow, with six issues of renminbi bonds during the year, totalling RMB16 billion. This brought the total amount of renminbi bonds issued in Hong Kong to RMB38 billion. The Ministry of Finance issued RMB6 billion worth of sovereign bonds in October, the first such issuance outside the Mainland. The issuance of sovereign bonds set the stage for the development of benchmark interest rates on the renminbi, making the pricing of other renminbi financial products more efficient.

Renminbi business in Hong Kong continued to operate smoothly. At the end of 2009, renminbi deposits totalled RMB62.7 billion and the number of accounts reached 1.3 million. Sixty AIs in Hong Kong were offering renminbi banking services.

In January 2009 the HKMA and the PBoC entered into a RMB200 billion (HK\$227 billion) currency swap agreement to provide short-term liquidity support to the Mainland operations of Hong Kong banks and the Hong Kong operations of Mainland banks in case of need. The arrangement not only enhances financial stability in the region, but also helps promote the development of renminbi-denominated trade transactions between Hong Kong and the Mainland.

A new measure for the banking sector was added under the Sixth Supplement of CEPA. With effect from 1 October 2009, Hong Kong banks, through their branches or wholly owned subsidiaries on the Mainland, can apply to establish "cross-location" sub-branches (in locations different from the municipality where the original branch is opened) within Guangdong Province. This measure enables Hong Kong banks to expand their branch networks in Guangdong in a more cost-effective way.

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Strengthening research on Mainland economic and financial issues

With financial-market liberalisation gathering pace in Mainland China, the HKMA has strengthened research into related policy issues, while continuing to closely monitor economic and financial developments. A number of research projects were conducted in 2009 to study the prospects of wider external use of the renminbi, particularly in cross-border trade settlement, and its implications for Hong Kong. These studies demonstrated the potential demand for the renminbi as the trade settlement currency, even though it will take time to develop the required financial infrastructure and for merchants to switch currencies. An international conference held in October discussed the nexus between financial liberalisation and currency internationalisation in Mainland China, and the role Hong Kong could play in increasing the external use of the renminbi. The conference, involving researchers and policymakers from research institutes, central banks and international organisations across the globe, was well received. Other Mainland-related studies included the impact of exports on the Mainland's economic growth and compilation of different monetary measures to accurately assess the Mainland's monetary policy. These reports are published in the *China Economic Issues* section of the HKMA website.

The HKMA also examined the potential role of Hong Kong in supporting the financial liberalisation of Mainland China and the prospects of further expansion of renminbi business in Hong Kong and other possible areas of financial co-operation. These studies are aimed at identifying key policy areas to facilitate financial intermediation between the Mainland and the rest of the world through Hong Kong, and to use Hong Kong as a platform to increase the use of renminbi outside the Mainland.

Training

Training programmes are conducted in Hong Kong and the Mainland for officials of the PBoC and the China Banking Regulatory Commission. During the year 857 officials from the Mainland attended 17 courses (2,436 man-days) covering monetary policy, financial stability, banking supervision, human resources management, internal control management, accounting management, macroeconomic analysis, financial risk management, and prevention of money laundering.

The HKMA also provided training on request to other external parties, including a regional course on bank fraud detection under the APEC financial regulators' training initiative, and other courses for Mainland commercial banks and regulators in the region. A total of 201 participants attended these seminars in 2009.

PLANS FOR 2010 AND BEYOND

The expectation of further volatility in global financial markets in 2010 again highlights the importance of regional co-operation for improving financial stability and surveillance. The HKMA will continue to spearhead the macro-monitoring work for the EMEAP MFSC, including expanding the Macro-Monitoring Report and strengthening the macroeconomic model. The HKMA will also host the EMEAP MFSC and Deputies' Meetings in the second half of 2010. Participation in central banking and international financial forums remains a priority of the HKMA to ensure Hong Kong's views and concerns are heard, and to keep abreast of the latest developments. The HKMA will also pursue further upgrades of Hong Kong's credit ratings.

To further strengthen financial co-operation between Hong Kong and the Mainland, the HKMA will continue to discuss with Mainland authorities relevant proposals set out in the Action Agenda on "China's 11th Five-Year Plan and the Development of Hong Kong". Liaising with Mainland authorities on the further expansion of renminbi business in Hong Kong remains a major task of the HKMA in 2010; while the monitoring of economic, financial and monetary developments in Mainland China, and their implications for Hong Kong, will be strengthened. Training courses for staff of Mainland authorities and other external parties will continue to strengthen technical support in the region.