Chief Executive's Statement

2010 was a very unique year filled with uncertainties, challenges and opportunities for the HKMA.

Towards the end of 2009, there was widespread view that the worst of the Global Financial Crisis was behind us and the world was back on track to a sustained recovery, thanks to the unprecedented and unconventional monetary and fiscal measures pursued by the advanced economies and some key Emerging Market Economies. However, this view was soon proved to be overly optimistic. In January 2010, the eruption of the sovereign debt crisis in Europe unsettled the global financial markets. By the middle of last year, the US seemed to be losing steam on its economic recovery, which aroused renewed concerns and volatility in the financial markets. It was not until late August when the US Federal Reserve Chairman Bernanke announced in Jackson Hole the Fed's preparedness to undertake further quantitative easing (QE2) that public sentiment and the equities in the US began to pick up again.

In this uncertain and turbulent time, the most important challenge for Hong Kong was the risk arising from the very low interest rates in the US and other advanced economies and the excess global liquidity resulting therefrom. With domestic interest rates at near zero since early 2009 and rising inflation, the risk of a credit fuelled housing bubble in Hong Kong intensified in 2010, notwithstanding the launch of the first round of tightening on mortgage lending in late October 2009.

In order to safeguard banking stability, the HKMA undertook two further rounds of tightening on the underwriting standards of mortgage lending by banks in August and November last year. I would like to stress that the purpose of these measures, sometimes known as macro-prudential or countercyclical measures, is not to target specific price level or transaction volume of the property market. There are many factors other than the supply and price of credit that affect the conditions of the property market and investors' expectations on property prices in the future. What the HKMA seeks to achieve is to reduce the speed and/or scale of the up-swing in a boom phase by requiring home buyers to put down higher down-payments and to prove that they have sufficient income to repay the mortgage loans. As these are countercyclical measures, they have to be forward looking, and be deployed and adjusted as and when the cycle of the property market evolves. These measures would not serve any useful purpose if we had waited too long, e.g. after the market has turned or when losses in the mortgage loan portfolio have started to rise.

If there is only one lesson that we can learn from the Global Financial Crisis, it is how important it is to maintain financial stability. We have witnessed how devastating it can become if an economy loses financial stability. No one can and should take financial stability and economic prosperity for granted: they require very hard work over many years, if not decades, and constant vigilance by all concerned to guard against complacency.

2010 was also a year of opportunities for Hong Kong. During this year, Hong Kong made very encouraging progress in strengthening its position as the International Financial Centre of Asia. Clearly the rapid development of Hong Kong as the RMB Offshore Centre tops the list of accomplishments in this regard.

With the strong support from the Central Government, the HKMA has worked closely with the People's Bank of China and other Mainland authorities to broaden and deepen the use of RMB for cross border trade settlement. Over 70% of all trade settled in RMB in 2010 was conducted through Hong Kong and our RMB deposits, which grew sharply from just over RMB62 billion in January to RMB315 billion in December, created the largest RMB liquidity pool outside Mainland China. This rapidly expanding liquidity pool, together with an efficient financial infrastructure, made it possible for 16 issuers to tap, with great success, the RMB bond market in Hong Kong, with a total issuance amounting to RMB36 billion in 2010, more than doubling the amount issued in 2009. The rapid development of Hong Kong as the offshore RMB centre has, once again, underscored Hong Kong's importance as the gateway and springboard for the trade and investment links between the Mainland and the rest of the world.

Meanwhile, the upgrading by Standard & Poor's of Hong Kong's rating to the highest level of AAA in December last year was a clear demonstration of the international recognition of the financial strength and resilience of Hong Kong. Globally, Hong Kong was the only economy receiving an upgrading to AAA rating in 2010.

On the performance of the Exchange Fund, a total profit of HK$79.4 billion or an investment return of 3.6% was recorded in 2010. The first half of 2010 was a turbulent period in which the global equity markets were affected by the eruption of the European sovereign debt crisis. This led to a small negative return of HK$1.0 billion as at the end of June 2010. The European debt crisis subsided in the second half of the year, with a significant rebound of the equity markets in the US and Europe following the Jackson Hole pre-announcement of QE2 in late August. In assessing the investment performance of the Exchange Fund in 2010, it should be borne in mind that about half of the Exchange Fund comprised the Backing Portfolio, which under the Currency Board regime must be held in highly liquid and short-term US papers of the highest credit quality. The holding of such a large Backing Portfolio, which was at least HK$640 billion more than the normal level due to the net inflow into Hong Kong dollars in late 2008 and 2009, had inevitably brought down the overall investment return of the Exchange Fund. Not counting the Backing Portfolio, the Investment Portfolio, which accounted for HK$1.1 trillion, achieved a much higher return of 6% in 2010.

Looking forward in the year 2011, the macro imbalances in the global financial system are unlikely to be fully redressed and will thus remain a source of tensions and volatilities. There still exist considerable uncertainties that affect the global economy and financial markets. Just to name a few examples: the sustainability of the advanced economies in their economic recovery and their ability to continue with excessively accommodating monetary policies without causing a pick up in inflationary pressure, the ability of the Emerging Market Economies to achieve a soft landing in their combat against inflation and asset price bubbles, the aftermath of the earthquake, tsunami and radiation leak in Japan and the geopolitical tensions in the Middle East and North African area. The list can go on and on. The crucial issue for Hong Kong is that we cannot afford to become complacent and the HKMA will do what it can to help identify and mitigate risks that may threaten the systemic stability of Hong Kong's banking and financial systems. At the same time, we must not allow unique opportunities that can make Hong Kong a more competitive and attractive centre of business and finance to slip through our fingers. All of us must work extra hard if we wish to fulfil our aspirations to stay ahead in this highly uncertain and yet fiercely competitive environment.

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