Chief Executive's Statement

In 2016, there were no lack of "black swans" in global political and economic arenas. While the results of the Brexit referendum and the US presidential election turned various opinion polls into laughing stocks, the reaction of the financial markets was even more surprising. Take the US presidential election as an example. The news of Donald Trump's victory led to an immediate plunge in the three major US stock futures before the market opened. Yet the stock indexes rallied shortly after the market opened and have since been trending upward and hitting new highs. These events highlight the limitations of conventional wisdom and mindsets in predicting market trends. They also suggest that the global outlook will remain highly uncertain.

Last year, various major financial data reflected that market sentiment was extraordinarily sensitive. After falling to a historical low of 1.36% in July, the 10-year US Treasury yield surged to 2.6% in mid-December after the US presidential election. The US dollar index, reflecting the movements of the US dollar against a basket of major currencies, rose to its highest level in 14 years at the end of the year. Meanwhile, crude oil futures prices in New York rebounded to US$54 a barrel at the end of 2016 from a low of US$26 at the beginning of the year. In Hong Kong, the Hang Seng Index recorded a slight increase of 86 points in 2016 as a whole, but the peak-valley difference during the year was more than 6,000 points. The extremely volatile external environment underscores the importance of maintaining financial stability, in particular monetary and banking stability.

In January 2016, rumours of international hedge funds planning an attack on the renminbi and the Hong Kong dollar spread quickly. To quell the speculation, the HKMA promptly communicated to the markets with a clear and loud message that the HKMA was confident and capable of defending the Linked Exchange Rate System and maintaining Hong Kong's financial stability. The timely assurance quickly restored market confidence. Throughout the year, the Hong Kong dollar exchange rate stayed close to the strong-side Convertibility Undertaking. As there was ample liquidity in the banking system, interest rate hikes by the US Federal Reserve in December last year and March this year had no immediate noticeable impact on Hong Kong dollar interest rates or exchange rate.

Chief Executive's Statement

The banking sector in Hong Kong continued to grow steadily. Total loans grew moderately by 6.5% in 2016, while asset quality remained sound with the classified loan ratio staying at a healthy level of 0.85%, well below the long-run historical average of about 2% since 2000. The capital adequacy ratios and liquidity ratios of the banking sector remained at high levels, well above the relevant statutory minimum requirements. As for mortgage lending business, after seven rounds of countercyclical prudential measures, the average loan-to-value ratio for new residential mortgage loans declined to 51% at the end of 2016 from 64% in September 2009. The average debt servicing ratio also dropped to 34% at the end of 2016 from 41% in August 2010. This provides necessary buffer for the banking system to withstand shocks arising from a reversal of the property market cycle. The HKMA will continue to closely monitor developments in the property market and implement appropriate measures in the light of the developments of market cycle to ensure banking stability.

There was encouraging progress last year in the legislative work to further promote banking stability. Two bills aimed at enhancing the Deposit Protection Scheme and dealing with the "too big to fail" risk of financial institutions were enacted by the end of the previous term of the Legislative Council. The former bill sought to further strengthen depositors' confidence in the banking system by streamlining and expediting the payout process. The latter provided a legal basis for establishing a resolution regime for financial institutions, including banks, to guard against systemic risks posed by failing financial institutions and avoid the use of public funds to bail them out. The HKMA set up a Resolution Office on 1 April 2017 to implement the relevant statutory requirements and follow-up work.

The banking sector plays a pivotal role in our economic activities, providing essential channels for deposit-taking and payment services, and serving as an important source of funding for both the real economy and the general public. During the year, there were comments from the representatives of some small and medium-sized enterprises (SMEs) about difficulty in obtaining loans. The HKMA promptly communicated with banks and impressed upon them that, while maintaining their prudent risk management, banks should as far as possible continue to provide funding support for the operation and development of SMEs. We also stepped up the promotion of the Government's SME Financing Guarantee Scheme to the business sector via our subsidiary the Hong Kong Mortgage Corporation (HKMC). At the same time, the HKMC worked closely with banks to address their concerns and clarify misunderstanding, and streamlined the claim process for default cases with a view to motivating banks to participate in the scheme. Our multi-pronged approach has been effective. According to the results of our survey with banks, the total credit facility limits granted to SMEs remained stable last year with over 90% of the enterprises seeing their credit limits unchanged or raised. Meanwhile, the total number of applications received under the SME Financing Guarantee Scheme also increased notably.

Chief Executive's Statement

The HKMA is fully committed to promoting financial inclusion, as basic banking services have become indispensable to businesses and individuals. Last year, when it came to our attention that some foreign companies and start-ups had difficulty in opening bank accounts in Hong Kong, we took immediate actions to follow up and liaise with various international chambers of commerce and SME associations. We also had in-depth discussions with banks to address the issue head-on. Last September, I issued a circular to all banks in Hong Kong to provide guidance on how to interpret the HKMA's "risk-based" supervisory approach in combating money laundering and terrorist financing activities, and how to apply this approach to account-opening applications and due diligence procedures for existing customers. We emphasised that banks should not adopt a one-size-fits-all approach by applying a single standard of requirements and procedures to all customers. There have been some improvements in the situation after our liaison with banks and the business sector. Yet there is still room for further improvement, and this will be one of our work priorities this year.

The coverage of banks' branch networks is also part of financial inclusion. The HKMA has been urging banks that, in addition to making profit, they should also cater for the public's need for basic banking services. The advancement in fintech has helped diversify the channels for delivering banking services. Apart from the increasingly popular internet banking, several banks last year also launched mobile bank branches or video teller machines to provide more targeted and comprehensive banking services than traditional automatic teller machines. With our encouragement, several banks also plan to set up physical branches in some remote areas to enhance their services for residents.

The continued development of a financial centre is, to borrow a Chinese proverb, sailing against the current. Over the years, the HKMA has always been looking for new opportunities and exploring new frontiers to promote the development of Hong Kong's financial industry. Remarkable achievements were made in 2016, especially with regard to fintech and infrastructure financing.

On fintech, Hong Kong's retail payment services entered a new era in 2016 with the granting of 13 stored value facility licences. The licensing and supervisory regime has helped create a conducive business environment for retail payment services. This, coupled with a series of public education campaigns, enables consumers to enjoy the benefits and convenience brought by new technology and affords reasonable protection to their rights and interests.

Chief Executive's Statement

In addition, the HKMA established the Fintech Facilitation Office in March 2016 to promote the development of fintech related to the banking industry. Within a few months, we have introduced several new initiatives, including the Cybersecurity Fortification Initiative, which is a new platform comprising three pillars — cybersecurity risk assessment, intelligence sharing, and talent development — to enhance the cyber resilience of the banking system. In collaboration with the Hong Kong Applied Science and Technology Research Institute (ASTRI), we embarked on a specialised research project on distributed ledger technology to explore its potential for application in the local banking industry, and established the Fintech Innovation Hub at ASTRI premises to provide technical support for the banking and fintech sectors. The HKMA's Banking Supervision Department also initiated the Fintech Supervisory Sandbox (FSS) for banks to conduct pilot trials of the applications of new technology in a smaller and controlled environment, which would facilitate speedier development of new products and services. From September 2016 to March 2017, 14 pilot trials of fintech initiatives had been conducted through the FSS by six banks. Some of these initiatives have been rolled out to the market, providing the public with more new fintech products.

There is increasing demand for infrastructure financing globally. Echoing the Belt and Road Initiative, infrastructure financing has attracted much attention. As an international financial centre in Asia, Hong Kong has unparalleled strength in the infrastructure financing arena. Last July, the HKMA set up the Infrastructure Financing Facilitation Office (IFFO) to provide a new, unique platform that brings together more than 60 world-class multilateral organisations, institutional investors, banks, insurance companies and other financial institutions, infrastructure project developers and operators, and various professional firms. The platform seeks to facilitate information exchange, experience sharing and collaboration in infrastructure investment and financing. Since the launch of IFFO, more than ten large-scale conferences, seminars and workshops have been organised. The HKMA also concluded Memorandums of Understanding with International Finance Corporation, Global Infrastructure Hub, China Development Bank and the Export-Import Bank of China respectively to jointly promote infrastructure investment and financing. While still in its infancy, IFFO has helped lay a solid foundation for developing Hong Kong into an infrastructure investment and financing centre.

Removing barriers is the key to enhancing competitiveness. During the year, the HKMA actively participated in and supported the Government's work in amending the tax law to create a conducive tax environment for multinational companies to base their corporate treasury centres in Hong Kong. We also actively reached out to these companies and encouraged them to develop or expand their corporate treasury activities here, thereby further strengthening Hong Kong's financial services.

Chief Executive's Statement

The offshore renminbi market underwent a period of consolidation in 2016. Weighed by volatilities and market expectations about renminbi exchange rate, the global offshore renminbi liquidity pool generally shrank in size. This notwithstanding, Hong Kong firmly maintained its lead as the global offshore renminbi business hub with the world's largest renminbi liquidity pool. Its renminbi settlement system continued to register a high level of turnover, averaging about RMB860 billion daily. To further enhance the liquidity facility for Hong Kong's offshore renminbi (CNH) market, we increased the number of Primary Liquidity Providers (PLPs) from seven to nine and expanded the total PLP facility from RMB14 billion to RMB18 billion in October to facilitate two-way fund flows. These measures help ensure the orderly operation of the CNH market in times of liquidity stress. The launch of Shenzhen-Hong Kong Stock Connect last December added further impetus to Hong Kong's renminbi business. The HKMA is also working with the Mainland authorities on the Bond Connect initiative, with a view to further facilitating Mainland and Hong Kong investors' access to each other's bond market and improving linkages in bond market infrastructures.

Despite the various uncertainties surrounding the global investment landscape in 2016, the Exchange Fund recorded an investment income of HK$68.1 billion, due partly to a series of defensive measures deployed by us over the years. The compounded annual investment return of the Exchange Fund since 1994 was 4.8%, higher than the local inflation rate of 2.1% during the same period.

The Exchange Fund will continue to pursue investment diversification through expanding into more asset classes and increasing holdings of credit assets, inflation-linked investment products and emerging market assets. As the flagship of our diversification strategy, the Long-Term Growth Portfolio (LTGP) invests in alternative assets, such as private equity and real estate projects. Its performance has been encouraging, achieving an annualised internal rate of return of about 12% since its inception in 2009. As part of the Government's Future Fund was allocated to the LTGP, we have quickened the pace of investment under the LTGP. As a result, the asset size of the LTGP increased to about HK$181.8 billion and outstanding investment commitments amounted to about HK$133.8 billion at the end of 2016. The Exchange Fund will continue to adhere to the investment objective of "Capital Preservation First, Long-Term Growth Next", striving to maintain ample liquidity and sufficient resources, while pursuing a stable return over a long-term horizon.

Chief Executive's Statement

Clouded by a host of uncertainties, the global economic and political outlook is expected to be even more complex in 2017. The UK has formally triggered the Brexit process, while several European countries are set to hold national elections. The future paths of the UK and the European Union are subject to many variables. There are great uncertainties in the new US administration's economic and fiscal policies. There are also questions as to whether globalisation and liberalisation, which have steered the global economic order for decades, will pull back, and whether structural adjustments in the Mainland economy can proceed smoothly and related financial risks can be duly managed. All these could have a huge impact on small and open economies like Hong Kong. Under the Linked Exchange Rate System, the pace of US interest rate normalisation will have a direct impact on the speed of fund outflows from Hong Kong. Accumulated fund inflows of US$130 billion into the Hong Kong dollar since 2008 will start to reverse course sooner or later. By then the Hong Kong dollar will weaken, triggering the weak-side Convertibility Undertaking, and local interest rates will rise gradually along with their US counterparts. We should expect to see increasing risk of correction in Hong Kong's asset markets, including the property market, although the extent, timing and pace of such a reversal are hardly predictable.

2017 marks the 20th anniversary of the establishment of the Hong Kong Special Administrative Region (HKSAR). There will be a new administration on 1 July. My colleagues and I will, as always, use our best endeavours to perform our duties and render our full support to the HKSAR Government in further consolidating and strengthening Hong Kong's role and competitiveness as an international financial centre.

Norman T.L. Chan
Chief Executive