Chief Executive's Statement

2022 was a year of making headway against headwinds.

We had a dim start to 2022, with the Omicron COVID-19 variant still weighing on global growth, while inflationary pressure continued to build. The subsequent outbreak of conflict between Russia and Ukraine spurred inflationary pressures, leading to the frontloading of major central banks' monetary tightening, amplifying volatility in global financial markets and heightening the risk of slower economic growth. Here at home, the fierce and rapid spread of the fifth wave of COVID-19 dealt a further blow to the economy, and the negative publicity surrounding the COVID-related restrictions led to misconceptions threatening the reputation of Hong Kong as an international financial centre (IFC). For the year as a whole, Hong Kong's real gross domestic product shrank by 3.5%.

Despite such headwinds, we continued to safeguard the monetary and financial stability of Hong Kong and press ahead with developmental initiatives in key strategic areas to further strengthen Hong Kong's position as an IFC. After three years of travel restrictions, we have successfully shown the world, and let visitors experience for themselves, that Hong Kong is back! Nothing speaks louder than the overwhelming response we received for the Global Financial Leaders' Investment Summit last November, with global financial leaders travelling from all over the world to attend the Summit in person.

Looking ahead, the external environment is still full of unprecedented uncertainties. Although risks appear tilted to the downside, the re-opening of the Mainland economy will bring renewed momentum to the Hong Kong economy and the region more broadly. At the HKMA, we will continue to fulfil our mandate of safeguarding monetary and banking stability in Hong Kong, and actively pursue developmental opportunities to showcase and strengthen our competitiveness as an IFC. We also remain committed to contributing to a more climate resilient and sustainable world. This year, we are publishing a standalone *Sustainability Report 2022* together with the *Annual Report 2022* to cover in more detail our initiatives in strengthening Hong Kong's role as a green and sustainable finance hub, as well as our own efforts in being a responsible investor and a sustainable organisation.

Chief Executive's Statement

Monetary and financial systems: resilience remains intact

Since its establishment in 1983, the Linked Exchange Rate System (LERS) has been through many economic cycles and weathered a variety of external shocks. The year 2022 was yet another testimony to the resilience of the LERS. Amid aggressive monetary tightening by the US Federal Reserve (Fed), the weak-side Convertibility Undertaking (CU) was triggered 41 times between May and November 2022, and in accordance with the established mechanism, the HKMA bought a total of HK$242.1 billion from the market in an orderly and transparent manner. During this time, the Hong Kong dollar exchange and money markets continued to function smoothly, reflecting the robustness of the LERS.

This confidence in the LERS is a result of the solid foundation formed over the years. As reiterated in the International Monetary Fund's *External Sector Report 2022*, the credibility of the LERS is ensured by factors including a transparent set of rules, ample foreign exchange reserves, a prudent fiscal framework, robust financial regulation and supervision, and a flexible economy.

We firmly believe that in addition to its robust mechanism, confidence in the LERS is supported by our proactive communications work in helping the public understand our systems as well as effective surveillance and contingency planning on all fronts. Our social media campaign on the LERS mechanism certainly helped maintain strong confidence in the LERS amid multiple triggering of the weak-side CU during the year. Within the HKMA, we have stepped up our market surveillance by employing data analytics to enable timely responses to emerging market issues.

Despite the macro challenges and heightened credit risk, Hong Kong's banking system remained stable throughout the year, with strong capital and liquidity positions. As at end-2022, the consolidated total capital ratio of local banks stood at 20.1%, well above the international minimum requirement of 8%. The Liquidity Coverage Ratio of large banks edged up to 162.3% as of the fourth quarter of 2022, comfortably above the statutory minimum requirement of 100%. While the asset quality of banks deteriorated modestly amid the challenging credit landscape, with the classified loan ratio rising to 1.38% as at end-2022, this level remains healthy and below the long-run historical average of 1.8% since 2000.

Banking sector: robustness underpinned by effective supervision

Three years into the pandemic, and amid a multitude of increased challenges including intensified geopolitical tensions and monetary tightening by major central banks, the Hong Kong banking sector remained resilient while continuing its critical role in supporting the economy. Such robustness is underpinned by strong risk management practices and effective supervision over the years.

A major supervisory challenge in the past year was to ensure the banking sector continued to provide needed relief to customers in the wake of the fifth wave of COVID-19 infections and lingering uncertainties surrounding the economy, while at the same time maintaining sound credit risk management. The Pre-approved Principal Payment Holiday Scheme was further extended, but with the introduction of an added voluntary partial repayment option that allowed borrowers to repay part of the principal, helping customers prepare for an eventual resumption of normal repayment.

Another main supervisory effort in 2022 was increased surveillance of banks' market and liquidity risk exposures, in light of the heightened market volatilities brought about by the aggressive tightening of monetary policy amongst the major economies. We carried out in-depth assessment of the likely impacts of synchronised monetary tightening on banks and introduced new scenarios into stress tests to assess banks' resilience to cope with prolonged liquidity stress.

At the same time, we continued to take forward-looking action to promote effective risk management in several areas. On operational and cyber resilience, we provided guidance to support banks in developing an integrated and holistic framework to become operationally resilient, and we also provided detailed supervisory guidance on specific areas of banking operations, such as the use of cloud computing in light of growing cloud adoption. Meanwhile, we stepped up efforts in tackling phishing scams, as well as consumer and investor protection more broadly amid increasing digitalisation.

Chief Executive's Statement

While working to maintain the resilience of the banking sector, we also endeavour to promote financial inclusion and enhance access to banking services. Banks have responded positively to our call for the provision of basic banking services, and have set up new branch and self-service facilities at large-scale public housing estates in new development areas. In view of the difficulty faced by many customers in Hong Kong in accessing their Mainland accounts due to COVID-related travel restrictions, we worked closely with the relevant parties to facilitate reactivation of about half a million Mainland bank accounts without the need for the affected account holders to visit the Mainland in person.

Another important strategic area for the continued development of the banking sector is capacity building. The banking sector continued to have strong demand for talented professionals to cater for business expansion. Building on its talent development strategy, "Connecting Talent to the Future", the HKMA implemented a number of initiatives in the past year to help attract, develop and retain talent for the banking sector, focusing on upskilling and reskilling the existing workforce, and grooming the younger generation to build a sustainable pipeline of future talent.

International financial centre: Hong Kong is back!

In 2022, we devoted substantial effort to restoring Hong Kong to the centre stage after the prolonged period of COVID-related travel restrictions. The Global Financial Leaders' Investment Summit in November brought over 200 international and regional leaders from global financial institutions to Hong Kong in person, and attracted attention and enthusiasm from around the world. The success of the Summit — despite taking place amid the first No. 8 typhoon signal in November in 50 years — sent a powerful message to the world that Hong Kong is back, stronger and better than ever. We are happy to see that the Summit has created positive ripple effects and many global financial institutions and international organisations are now hosting or planning to host their events in Hong Kong.

In addition to bringing people back to Hong Kong, recognising the power of face-to-face connection, we at the HKMA, myself included, have been taking every opportunity to physically represent Hong Kong at key international meetings. This enables us to make active contributions to global policy discussions and, riding on the occasion presented by these overseas visits, to meet with the group management of global financial institutions to promote Hong Kong and update them on Hong Kong's robust financial system and the opportunities it can provide under "one country, two systems".

To make sure Hong Kong stays competitive as an IFC, we continued to push boundaries for market development across our key strategic focus areas of fintech, Mainland opportunities and green and sustainable finance. We also further enhanced our financial platform to provide leading services to attract more businesses to Hong Kong. For details of our efforts relating to green and sustainable finance, readers may refer to the *Sustainability Report 2022*.

Chief Executive's Statement

Fintech

Building on the "Fintech 2025" strategy unveiled in June 2021, we made notable progress across the five focus areas under this strategy during 2022.

With "All banks go fintech", we achieved positive results with extensive and growing adoption of fintech by the Hong Kong banking sector across different business areas and technology types, according to the findings of the Tech Baseline Assessment. It is encouraging to see that our work since 2017 to progressively promote and support digitalisation has been well received by banks and continues to bear fruit. We will continue to closely engage with the industry to further promote developments in selected fintech business areas and technology types based on the results of the Assessment.

Important milestones were reached during the year on our Central Bank Digital Currencies (CBDCs) journey. The Multiple CBDC Bridge (mBridge) project entered the pilot phase and is among the first of its kind to successfully settle real-value, cross-border transactions on behalf of corporates. On the retail front, technical testing of the cross-boundary use of the e-CNY has entered the second phase, centering on the use of the FPS to top up the e-CNY wallet. For e-HKD, we have designed a three-rail approach to pave the way for possible future issuance and launched a Rail 2 Pilot to invite industry to dive into use cases.

Fintech relies on data to unlock its full potential, and the launch of Commercial Data Interchange (CDI) in October is a big step forward in this respect. CDI provides a consent-based common data infrastructure that enables financial institutions to more easily access enterprises' commercial data, and in turn, facilitates easier access to finance by corporates especially small and medium-sized enterprises (SMEs). As at end-2022, CDI had facilitated over 1,000 SME loans amounting to more than HK$1.9 billion.

Last but not least, while embracing the benefits of financial innovation, we are always cognisant of the need to monitor and tackle possible risks. We are closely following developments in the virtual asset space and contributing to international discussions on relevant regulatory issues. Having considered the feedback from public consultation and international standards, we will adopt a risk-based, "same risk, same regulation" approach[1] in developing a regulatory regime for stablecoins and in scoping in stablecoin structures for regulation under the proposed regime. As a priority, we will start with regulating stablecoins that purport to reference to one or more fiat currencies, given the higher and more imminent monetary and financial stability risks that they may pose. We believe that with the right guardrails in place, the industry can explore the potential of digital finance in a safe and healthy manner.

Technology is re-shaping our future. We and the banking sector are actively gearing up for this "new normal". We are confident that this fintech ecosystem we are building will help us unlock the full potential of fintech and contribute to enhancing our competitiveness as an IFC.

Mainland opportunities

Hong Kong's unique edge in offshore renminbi business has been a key feature of Hong Kong as an IFC. In the past year, we have made significant progress in the continued development of the offshore renminbi market in Hong Kong. First, in July, the People's Bank of China and the HKMA enhanced the currency swap agreement to a long-standing arrangement with expanded size, differentiating Hong Kong from other jurisdictions in terms of being the only one whose arrangement is not subject to renewal, and also having the largest swap size. This has reinforced Hong Kong's firm foothold as a renminbi hub and will facilitate the expansion of market activities and products. On the back of this, we enhanced our Renminbi Liquidity Facility, which will further support market liquidity and enable market players to offer a more comprehensive range of products and services.

[1] This means that authorities should focus on the functions performed and risks posed by an activity, and apply the appropriate regulatory framework in the same manner as they would apply it to entities performing the same functions or activities, and posing the same risks. For more details, see *inSight* on *Crypto-assets and stablecoins* (https://www.hkma.gov.hk/eng/news-and-media/insight/2022/01/20220112/).

Chief Executive's Statement

Apart from enhancing offshore renminbi liquidity, we have further enhanced our mutual market access schemes with the Mainland, which will help facilitate the development of more diverse renminbi products in Hong Kong. Swap Connect, announced in July 2022, will expand the financial co-operation between Hong Kong and the Mainland into the derivatives market, namely interest rate swap markets, creating synergy with Bond Connect to facilitate global investors' management of interest rate risks for their bond investment on the Mainland. It will also strengthen Hong Kong's status as a risk management centre. We are now actively taking forward the development work to prepare for its launch this year. Others in our family of Connect schemes are performing well with robust market uptake and various enhancements in the pipeline including expansion of the eligible product scope of the Cross-boundary Wealth Management Connect.

The third important area relates to our own financial infrastructure. We have devised a multi-year plan to modernise the Central Moneymarkets Unit into a major international central securities depository in Asia. This will better support the growing connectivity between the Mainland and international financial markets.

As a leading offshore renminbi hub, the year 2022 continued to see remarkable growth in renminbi businesses including bank deposits, trade settlement, payments and offshore bond issuance. The Bank for International Settlements 2022 Triennial Survey of Foreign Exchange and Derivatives Market Turnover reaffirmed Hong Kong as the largest offshore renminbi foreign exchange and interest rate derivatives market, with the average daily turnover of renminbi foreign exchange transactions growing by 78% compared with the last survey conducted three years ago.

Building on these solid achievements, we will continue to work closely with our Mainland counterparts and market participants to enhance existing schemes and step up co-operation on different fronts, which will help strengthen Hong Kong's position as an offshore renminbi hub, as an important underpinning of our status as an IFC.

Hong Kong's financial platform

Apart from staying on course with our strategic focus areas above, we have continued to work diligently in strengthening the competitiveness of our financial platform. I would like to share with you some of our progress made on this front.

To enhance our attractiveness as a family office hub in the region, we have worked with other Government agencies and the financial industry to develop a facilitating environment for family offices to set up and operate in Hong Kong, including the introduction of legislative amendment last year to provide more facilitative tax arrangements for family offices operating in Hong Kong.

On bond market development, we have arranged the inaugural issuance of the longest tenor, 20-year Hong Kong dollar Government Bonds in May 2022, and assisted the Government to issue the world's first tokenised government green bond in February 2023, marking a significant step towards realising the full potential of distributed ledger technology in the bond market. We also started to see the footprint of local government issuers. The governments of the Shenzhen municipality and Hainan province debuted their offshore bond issuances during 2021 and 2022 respectively. These issuances included blue bonds, green bonds and sustainability bonds, enriching the range of renminbi financial products available in the Hong Kong market.

Chief Executive's Statement

Exchange Fund: investing prudently for long-term growth

The investment environment in 2022 was exceptionally volatile, being the only time in almost half a century that simultaneous losses were recorded across bonds, equities, and major currencies against the US dollar. While the Exchange Fund could not stay unscathed, the investment loss of -4.5% sustained in 2022 was relatively mild as compared to the performance of major market indices and multi-asset funds. Our diversified long-term asset allocation portfolio, as well as defensive measures and strategic adjustments in response to changes in the external landscape, have played a role in mitigating the destructive impact of the significant market turbulence during the year. Meanwhile, the Long Term Growth Portfolio achieved an annualised internal rate of return of 12.6% since its inception in 2009 up to the end of 2022.

The global investment environment in 2023 is likely to be clouded by uncertainties surrounding the path of monetary tightening by major central banks and geopolitical tensions, among others. Committed to the principle of "capital preservation first while maintaining long-term growth", the HKMA will continue to navigate the complex investment environment in a prudent and agile manner. We will also step up efforts in incorporating ESG considerations in our investment approach and moving towards the target of net-zero greenhouse gas emissions by 2050 for the Investment Portfolio. Details on our progress in the responsible investment journey can be found in the *Sustainability Report 2022*.

HKMA: serving Hong Kong with commitment

The year 2022 was a bumpy ride, but the relaxation of anti-pandemic measures in Hong Kong and the re-opening of the Mainland economy should have some stabilising effect on the Hong Kong economy. In the face of the significant uncertainties ahead, the HKMA will stay vigilant and respond rapidly to emerging risks. As always, at the HKMA we will continue to strengthen our capabilities and keep pace with the fast-evolving financial landscape, in order to effectively safeguard monetary and financial stability. At the same time, we will pursue market development initiatives to ensure Hong Kong remains competitive as an IFC.

This year marks the 30th anniversary of the establishment of the HKMA. Over these 30 years, we have come a long way from an infant central banking institution to an integral part of the global central banking community. Indispensable to this achievement is the professionalism, hard work and dedication of many generations of the HKMA team. We will continue to serve Hong Kong with the same commitment going forward. While we may encounter some turbulence ahead, I am confident that together we will ride it out and Hong Kong's role as an IFC will go from strength to strength in the years to come.

Eddie Yue
Chief Executive