CHAPTER 4 : THE FINANCIAL SECTOR[#]

Summary

- *There were signs of gradual restoration of stability in the global financial markets during the first quarter of 2009, thanks to the coordinated rescue packages implemented by the governments in various countries.*

- *Conditions in the local interbank money market likewise became more settled, following the introduction of various measures since late 2008. During the first quarter, Hong Kong dollar interbank interest rates stayed at low levels, reflecting ample liquidity and improved market sentiment.*

- *The Hong Kong dollar Effective Exchange Rate Indices generally moved higher in the quarter, broadly tracking the strengthening of the US dollar. Equity-related demand for Hong Kong dollars emerged in late March, prompting the HKMA to passively sell Hong Kong dollars against US dollars to banks.*

- *Local stock prices suffered further losses for the first quarter as a whole, despite a noticeable rebound in March. Trading remained subdued while fund raising activities were drooping.*

- *Apart from ensuring the robustness of financial infrastructure and regulatory regime under the prevailing turbulent market conditions, the Government has spared no efforts to consolidate Hong Kong's position as an international financial hub. In particular, preparatory work has been put in place to lay a solid foundation for the use of renminbi for cross-border trade settlements and further expansion of renminbi bond market in Hong Kong.*

(#) This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.

Overall situation

4.1 The problem of dislocation in the international financial markets seemed to have eased somewhat in early 2009. With the global liquidity risk premium receding, the local interest rate environment became less stringent, thereby alleviating the tightness of the credit market. Yet business had yet to return to normal completely. Market activities in respect of fund raising and sales of retail financial products, for instance, remained sluggish and subdued.

4.2 In the light of the stresses and strains in the financial system, the Government has launched a full review of the regulatory framework for the financial sector. Some of the recommendations from the regulatory bodies, including the Hong Kong Monetary Authority and the Securities and Futures Commission, have already been implemented with a view to enhancing investor protection further. While systemic stability has been in the limelight more recently, it is of paramount importance for Hong Kong to keep striving for innovation and improved competitiveness to brace itself for the challenges and opportunities ahead. Expanding the capacity for handling renminbi-denominated transactions and increasing the depth and breadth of the local debt market are some of the notable initiatives in this direction.

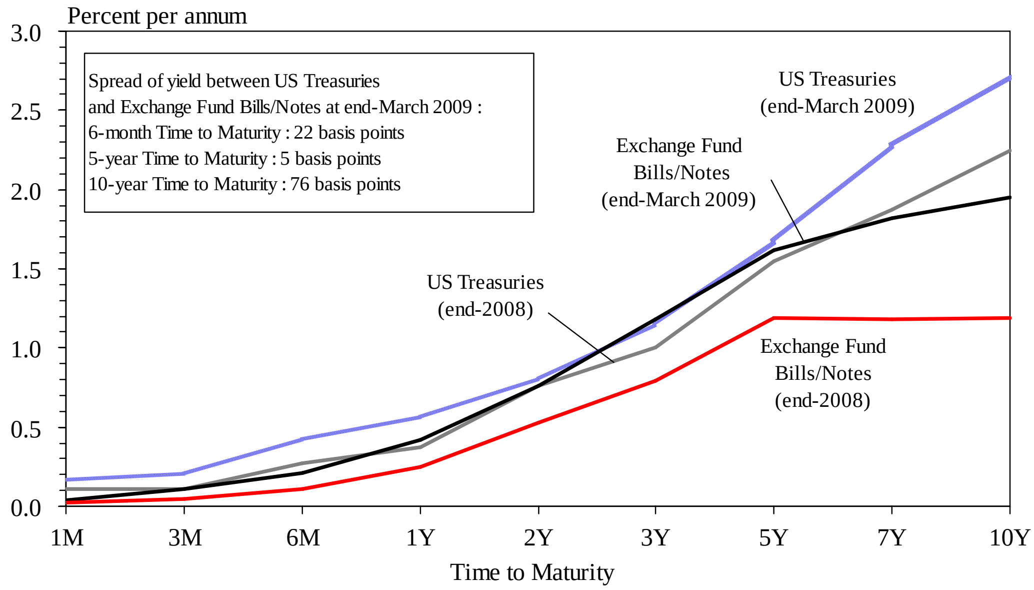
Interest rates and exchange rates

4.3 The Hong Kong dollar interest rates held broadly stable in the first quarter of 2009. The *Base Rate* under the Discount Window operated by the HKMA was intact at 0.5% during the period according to the new formula announced on 8 October 2008[(1)], as the US Federal Funds Target Rate (FFTR) steadied at 0-0.25%. Following the temporary measures introduced by the local authorities and efforts around the world to provide liquidity support, *Hong Kong dollar interbank interest rates* generally stayed at low levels in early 2009. The overnight HIBOR edged up from 0.23% at end-2008 to 0.38% at end-March 2009, while the three-month rate moved lower from 0.89% to 0.76%.

4.4 The negative differentials between the Hong Kong dollar and the US dollar interest rates were mostly range-bound during the first quarter. In particular, the discount of the three-month HIBOR to the corresponding Euro-dollar deposit rate widened from 53 basis points at end-2008 to 81 basis points at end-March 2009. Meanwhile, the *Hong Kong dollar yield curve* bounced up in tandem with its US counterpart. The negative interest rate spread between the ten-year Exchange Fund Notes and US Treasuries of the same maturity narrowed between end-2008 and end-March 2009, as the rise in yield for Exchange Fund Notes outstripped that in US Treasuries. This partly reflected the effect of the US Federal Reserve's decision to purchase long-term US Treasury Notes for the purpose of quantitative easing.

4.5 On 26 March 2009, the HKMA announced that, after the five temporary liquidity measures expired at end-March, it would incorporate foreign exchange swap and term repo (against securities of acceptable quality to the HKMA) into its ongoing market operations to offer Hong Kong dollar liquidity assistance to banks, if needed, on a case-by-case basis. In view of the fact that the international financial markets have not completely returned to normal, these measures will provide continued assurance to banks on the availability of liquidity in case of need. With an aim to allow the functioning of interest rate adjustment under the Currency Board system as necessary, the HKMA decided that the smaller spread of 50 basis points over the US FFTR would be retained (compared to the previous spread of 150 basis points) in calculating the Base Rate, while the other leg relating to the moving averages of the relevant interbank interest rates (the "HIBOR leg") would be reinstated after a review of the appropriateness of the Base Rate formula. Meanwhile, the HKMA would also resume the previous arrangements for the Discount Window of using only Exchange Fund paper for overnight repo.

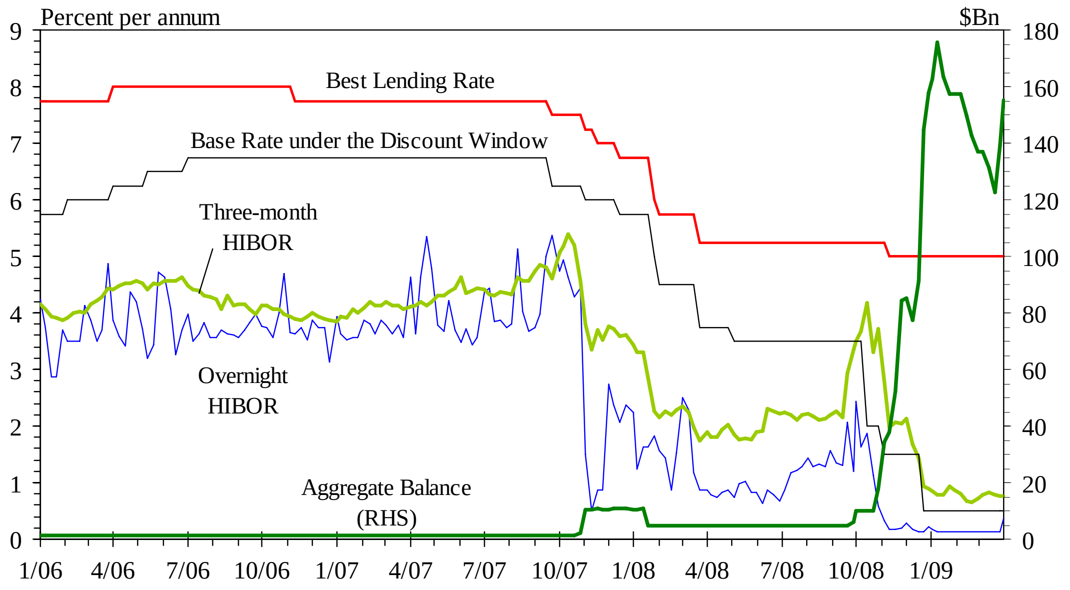
Diagram 4.1 : Hong Kong dollar yield curve rebounded in the first quarter of 2009 after easing notably during the second half of 2008



4.6 At the retail level, local banks maintained the two Best Lending Rates (BLRs) at 5.00% and 5.25% throughout the first quarter. While the average savings deposit rate quoted by major banks remained unchanged at 0.01% throughout the quarter, the average one-month time deposit rate edged down from 0.04% at end-2008 to 0.01% at end-March 2009. Concurrently, the composite interest rate(2), which indicates the average cost of funds for banks, declined from 0.68% to 0.29%. Along with the easing in funding cost, the proportion of new mortgage loans approved at rates more than 2% below the BLR jumped from 18.6% in December 2008 to 50.2% in March 2009. This was consistent with reports of certain banks becoming more aggressive in the mortgage market. Survey data also revealed that there was an increasing trend of newly approved mortgages priced with reference to HIBOR rather than BLR, as customers took advantage of the low interbank interest rates prevailing.

4.7 Interbank liquidity continued to be abundant, providing an accommodative monetary environment locally. The Aggregate Balance rose to a record of $175.5 billion in early January 2009, following the repeated triggering of the strong-side Convertibility Undertaking (CU) of the Hong Kong dollar since late 2008. Afterwards, the balance declined between January and mid March, as additional Exchange Fund Bills were issued to meet the increased demand by banks for liquidity management purposes. Yet the figure rebounded again in late March to close at $155.3 billion at the end of the month, reflecting the triggering of the strong-side CU towards the quarter-end due mainly to increased equity-related demand for Hong Kong dollars.

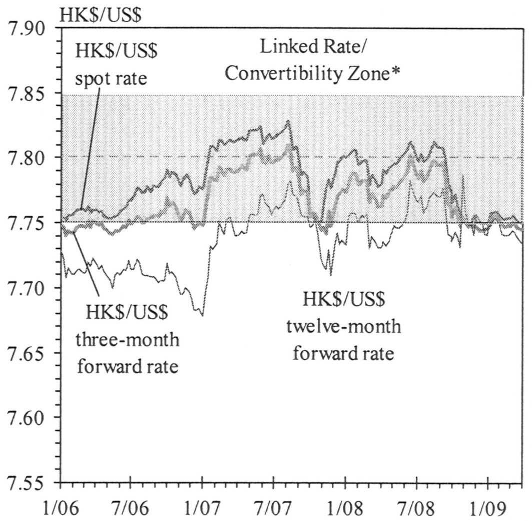
Diagram 4.2 : Hong Kong dollar interbank interest rates remained low during the first quarter amid ample liquidity (end for the week)



4.8 The Hong Kong dollar spot exchange rate hovered at levels close to the 7.75 per US dollar mark during the first quarter, with the strong-side CU being repeatedly triggered in late March. The discount of the *3-month Hong Kong dollar forward rate* to the spot rate was steady for the quarter as a whole to close at 45 pips (each pip equivalent to HK$0.0001) at end-March, whereas the discount of the *12-month forward rate* widened from 95 pips to 150 pips.

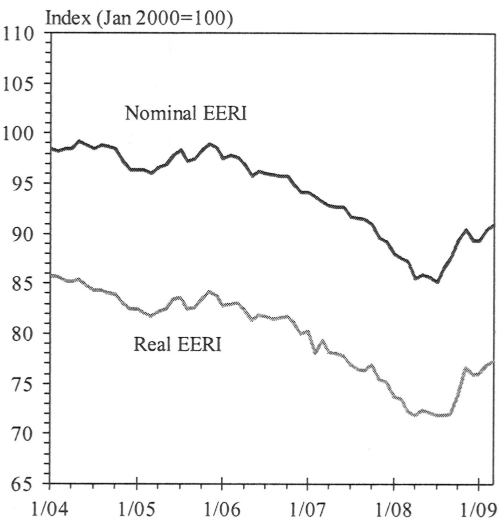
4.9 Under the Linked Exchange Rate system, movements in the Hong Kong dollar exchange rate against other currencies closely followed those in the US dollar. The Hong Kong dollar strengthened against other major currencies from January to mid March due to a broad-based appreciation of the greenback. The Hong Kong dollar softened afterwards, in line with a renewed weakening of the US dollar following the Federal Reserve's announcement of purchasing long-term US Treasury Notes. Overall, both the trade-weighted *Hong Kong dollar Nominal* and *Real Effective Exchange Rate Indices* rose by 1.7% during the first quarter[(3)].

Diagram 4.3 : Longer-tenor forward spreads widened somewhat (end for the week)



Note : (*) The shaded area represents the Convertibility Zone that was introduced in May 2005 as part of the three refinements to the Linked Exchange Rate System.

Diagram 4.4 : Trade-weighted EERIs rose in early 2009 along with a stronger US dollar (average for the month)

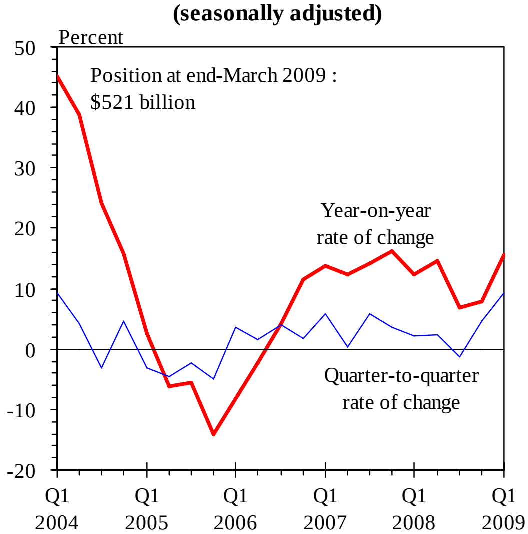


Money supply and banking sector

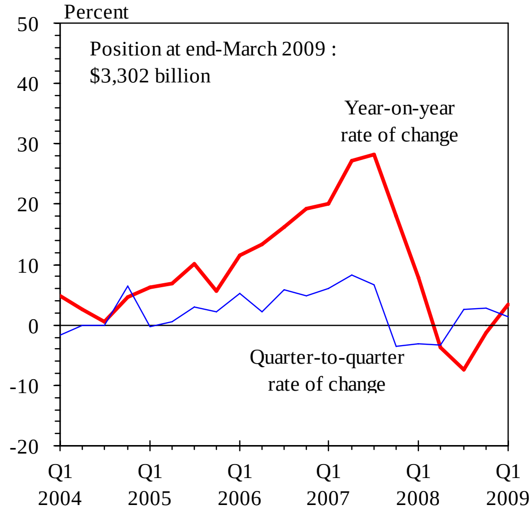
4.10 Hong Kong dollar narrow money and broad money showed divergent growth trends in the first quarter of 2009. Growth in broad *money supply* (HK$M3) slowed from 2.9% quarter-to-quarter at end-2008 to 1.3% at end-March 2009[(4)]. On the other hand, the rise in seasonally adjusted narrow money supply (HK$M1) accelerated from 4.5% to 9.4% over the same period. This was partly due to a progressive shift away from time deposits under the low interest rate environment. *Total deposits* with authorised institutions (AIs) declined by 0.6% in the first quarter[(5)], as the contraction in foreign currency deposits more than offset the increase in their Hong Kong dollar counterparts during the period. Total deposits stood at $6,022 billion at end-March, comprising Hong Kong dollar deposits of $3,078 billion and foreign currency deposits of $2,944 billion.

Diagram 4.5 : Growth in narrow money supply in early 2009 was boosted by depositors shifting their funds into more liquid positions

(a) HK$M1^ (seasonally adjusted)



(b) HK$M3#^



Notes : (^) Figures refer to the positions at end of quarter.
(#) Adjusted to include foreign currency swap deposits.

4.11 As a result of the slowdown in both domestic and external economic activities, *total loans and advances* declined by 3.6% during the first quarter, to $3,166 billion at end-March (comprising Hong Kong dollar loans of $2,323 billion and foreign currency loans of $843 billion). Declines in loan balances were across-the-board, as revealed by an analysis of loans for use in Hong Kong by economic sector. Specifically, loans for trade finance registered another quarter of double-digit drop, of 15.2% quarter-to-quarter, under the lacklustre performance in external trade. Loans to financial concerns and stockbrokers also recorded notable decreases due to the reduction in stock market activities. On the other hand, the contraction in residential mortgage loans tapered off to 0.3% alongside the revival in property market transactions. Consequently, the Hong Kong dollar loan-to-deposit ratio fell further from 77.6% at end-2008 to 75.5% at end-March 2009.

Table 4.1 : Loans and advances

		All loans and advances for use in Hong Kong									
		Loans to :									
% change during the quarter		Trade finance	Manu-facturing	Whole-sale and retail trade	Building, construction, property development and investment	Purchase of residential property[(a)]	Financial concerns	Stock-brokers	Total[(b)]	All loans and advances for use outside Hong Kong[(c)]	Total loans and advances
2008	Q1	8.4	16.1	16.6	6.2	2.4	7.2	-4.2	6.3	10.4	7.0
	Q2	15.2	4.9	15.5	4.6	2.7	1.4	-19.0	4.7	10.1	5.6
	Q3	-2.9	4.5	*	4.4	0.7	8.1	-20.6	2.7	0.6	2.3
	Q4	-16.1	-5.3	-3.2	1.9	-1.4	-5.4	-10.4	-3.5	-6.7	-4.1
2009	Q1	-15.2	-1.5	-5.5	-1.0	-0.3	-14.5	-10.3	-3.8	-2.8	-3.6
Total amount at end-March 2009 ($Bn)		158	144	144	680	648	242	9	2,607	559	3,166
% change over a year earlier		-20.4	2.2	5.7	10.3	1.7	-11.4	-48.3	-0.2	0.4	-0.1

Notes : Some loans have been reclassified. As such, the figures are not strictly comparable with those of previous quarters.

(a) Figures also include loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme, in addition to those for the purchase of private residential flats.

(b) Loans to individual sectors may not add up to all loans and advances for use in Hong Kong, as some sectors are not included.

(c) Also include loans where the place of use is not known.

(*) Change of less than 0.05%

4.12 Despite the recent global financial crisis, Hong Kong's banking system remained resilient. Under the capital adequacy framework promulgated by the Basel Committee on Banking Supervision (commonly referred to as "Basel II"), the capital adequacy ratio (CAR) of the Hong Kong incorporated AIs was still high at an average of 14.8% at end-2008. All individual AIs' CARs were above the statutory minimum ratios as required by the HKMA. To address the lessons learnt from the recent global financial crisis, the Basel Committee issued a package of consultative documents in January 2009 for enhancements of the Basel II capital framework. The HKMA is supportive of the Committee's initiative in this regard and will take steps to implement the enhanced international standards in consultation with the banking industry as soon as the proposal is finalised by the Committee later this year.

4.13 Asset quality of the local banking sector remained sound by historical standards, although there were growing signs of deterioration as the impact of the global economic downturn filtered through further. The ratio of classified loans increased from 0.96% at end-September 2008 to 1.24% at end-2008. Over the same period, arrears for over three months in credit card repayment also rose from 0.31% to 0.34%. On the other hand, the delinquency ratio for residential mortgage loans was steady at 0.05% for the first quarter of 2009 as a whole.

Table 4.2 : Asset quality of retail banks*

(as % of total loans)

As at end of period		Pass loans	Special mention loans	Classified loans (gross)
2007	Q1	97.11	1.89	1.00
	Q2	97.37	1.73	0.90
	Q3	97.47	1.64	0.89
	Q4	97.59	1.57	0.85
2008	Q1	97.72	1.47	0.81
	Q2	97.75	1.38	0.88
	Q3	97.61	1.43	0.96
	Q4	96.57	2.19	1.24

Notes : Due to rounding, figures may not add up to 100.

(*) Period-end figures relate to Hong Kong offices and overseas branches. Loans and advances are classified into the following categories: Pass, Special Mention, Substandard, Doubtful and Loss. Loans in the substandard, doubtful and loss categories are collectively known as "classified loans".

4.14 Since February 2004, banks in Hong Kong have been offering renminbi services to customers including deposit-taking, currency exchange and remittance. At end-March 2009, a total of 39 licensed banks were engaged in this line of business. Compared with end-2008, outstanding renminbi deposits declined further by 5.3% to RMB53.1 billion, partly because of the increased uncertainty about the renminbi exchange rate. Nevertheless, these deposits still accounted for around 2.0% of total foreign currency deposits in Hong Kong.

Table 4.3 : Renminbi deposits in licensed banks

As at end of period		Demand and savings deposits (RMB Mn)	Time deposits (RMB Mn)	Total deposits (RMB Mn)	Interest rates on[a]: Savings deposits[b] (%)	Interest rates on[a]: Three-month time deposits[b] (%)	Number of licensed banks engaged in RMB business
2008	Q1	39,364	18,221	57,585	0.46	0.65	40
	Q2	51,242	26,398	77,640	0.46	0.65	40
	Q3	47,508	22,443	69,951	0.46	0.65	40
	Q4	38,119	17,942	56,061	0.46	0.64	39
2009	Q1	35,166	17,944	53,110	0.46	0.64	39
% change over a year earlier		-10.7	-1.5	-7.8	N.A.	N.A.	N.A.

Notes : (a) The interest rates are based on a survey conducted by the HKMA.

(b) Period average figures.

N.A. Not available.

4.15 Subsequent to the announcement in December 2008 to further expand renminbi business in Hong Kong, the Central People's Government announced in April 2009 that it has decided to introduce a pilot scheme to allow eligible Mainland and Hong Kong enterprises to use renminbi to settle trade transactions. Hong Kong has completed the necessary technical preparations for becoming the first place outside the Mainland to launch the scheme. The scheme is significant in three aspects, namely, enabling import and export enterprises to manage flexibly and thus reduce the risks arising from fluctuations in exchange rate, providing new business opportunities for the banking sector in Hong Kong and enhancing the diversification of renminbi assets in the Hong Kong banking system. Also, in servicing such activities, the capabilities of Hong Kong’s financial system in handling renminbi-denominated transactions will be strengthened, thereby solidifying Hong Kong’s status as an international financial centre.

The debt market

4.16 The Hong Kong dollar debt market expanded considerably in the first quarter of 2009 amid a strong recovery in demand for both public and private sector paper. The HKMA has increased the supply of short-dated Exchange Fund paper to meet the needs from banks for liquidity management purposes. Issuance of Exchange Fund Bills and Notes rose by 108.3% in value terms from a year earlier, accounting for 71% of all new debt issuance in the period. Taking advantage of a general shift in demand towards simpler and lower-risk financial instruments, authorised institutions, local corporations and overseas borrowers excluding the multilateral development banks issued a combined $38.0 billion worth of Hong Kong dollar debt during the first quarter, representing a 139.3% year-on-year increase. As a result of the remarkable rise in debt issuance, total outstanding balance of Hong Kong dollar debt reached a record level of $785.8 billion at end-March 2009, 8.1% higher than a year earlier(6). This was equivalent to 24% of HK$M3 or 20% of Hong Kong dollar-denominated assets of the entire banking sector(7). The private sector and multilateral development banks together accounted for 63% of the outstanding balance and the public sector for the remaining 37%.

4.17 With a view to promoting the sustainable development of the local bond market, the Financial Secretary in the 2009-10 Budget announced a plan to implement a Government Bond Programme, under which Government bonds will be issued in a systematic and consistent manner. The Executive Council approved on 28 April 2009 the proposal to implement the Government Bond Programme and introduce into the Legislative Council the resolutions to authorise the Government to borrow and set up a fund to manage the sums raised under the Programme. The sums thus raised are proposed to be credited to a Bond Fund, which will be managed separately from the general revenue and will not be treated as part of the fiscal reserves. The HKMA will be tasked to co-ordinate the bond offerings under the Programme and manage the Bond Fund.

4.18 By implementing the Programme, the Government seeks to increase the depth, breadth and liquidity of the local bond market. The more robust debt market would complement the banking and equity markets as an effective channel of financial intermediation, and hence further consolidate Hong Kong's status as an international financial centre. It is expected that, at the initial stage, Hong Kong dollar bonds with tenors of two to ten years will be issued under the Programme for both institutional and retail investors. Subject to market demand, bonds of longer tenors, say 15 years or above, may be issued to help develop a more complete yield curve. Initial views from market participants indicated that the market may be able to absorb up to $10 billion to $20 billion of Government bonds in the first year. As a long-term target over a period of five to ten years, the Programme will be subject to a proposed borrowing ceiling of $100 billion, which should provide investors with an indication of the potential scale and long-term nature of the Programme, thus encouraging more active participation. The Government will consult the relevant stakeholders and make necessary adjustments in the course of implementation having regard to prevailing market conditions.

Table 4.4 : New issuance and outstanding value of Hong Kong dollar debt securities ($Bn)

		Exchange Fund paper	Statutory bodies/government-owned corporations	Government	Public sector total	AIs[a]	Local corporations	Non-MDBs overseas borrowers[b]	Private sector total	MDBs[b]	Total
New issuance											
2008	Annual	285.9	24.3	-	310.2	45.2	14.3	51.6	111.2	3.0	424.4
	Q1	62.8	5.5	-	68.2	8.6	1.2	6.1	15.9	-	84.1
	Q2	77.2	8.7	-	85.9	15.4	8.4	22.3	46.2	-	132.0
	Q3	67.3	3.5	-	70.8	14.7	4.1	15.8	34.6	-	105.3
	Q4	78.6	6.7	-	85.3	6.5	0.6	7.5	14.5	3.0	102.8
2009	Q1	130.7	8.6	-	139.4	5.6	2.8	29.6	38.0	5.8	183.1
% change over a year earlier		108.3	58.0	N.A.	104.2	-35.0	132.6	386.3	139.3	N.A.	117.7
Outstanding (as at end of period)											
2008	Q1	143.3	60.3	7.7	211.3	121.4	60.8	320.7	502.9	12.5	726.7
	Q2	144.3	64.5	7.7	216.5	106.5	68.4	318.6	493.5	12.5	722.4
	Q3	145.0	62.7	5.0	212.7	103.8	67.5	320.2	491.6	12.4	716.6
	Q4	157.7	64.6	5.0	227.3	95.1	67.0	313.0	475.1	14.3	716.6
2009	Q1	218.9	63.5	5.0	287.4	86.2	67.7	325.2	479.1	19.3	785.8
% change over a year earlier		52.8	5.3	-35.1	36.0	-29.0	11.3	1.4	-4.7	54.4	8.1

Notes : Figures may not add up to the corresponding totals due to rounding.

(a) AIs : Authorised institutions.

(b) MDBs : Multilateral Development Banks.

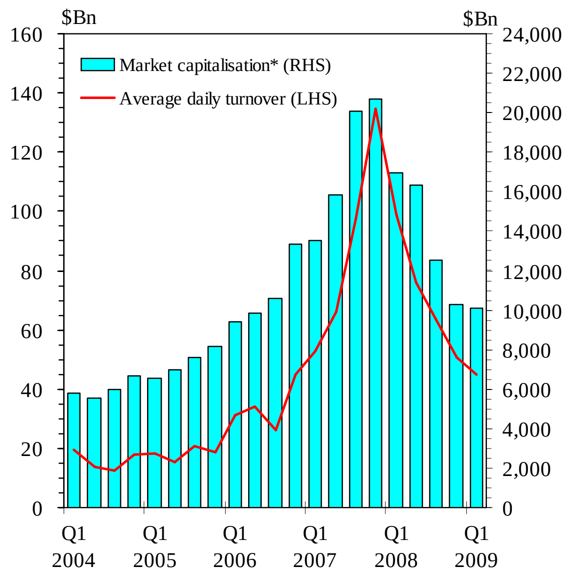
N.A. Not available.

The stock and derivatives markets

4.19 In the first quarter of 2009, the *local stock market* slid further amid mounting concerns about the generally poor financial results from the listed companies. This notwithstanding, signs of recovery started to emerge in March. For the first quarter as a whole, the *Hang Seng Index* (*HSI*) was down by 5.6% to close at 13 576, having plunged to as low as 11 345 on 9 March. For the same quarter, the *daily turnover* averaged at $44.7 billion, representing a sharp decline of 54.7% from a year earlier. Yet regardless of the high volatility of share price movements, the stock market continued to operate smoothly in overall terms ***(Box 4.1)***.

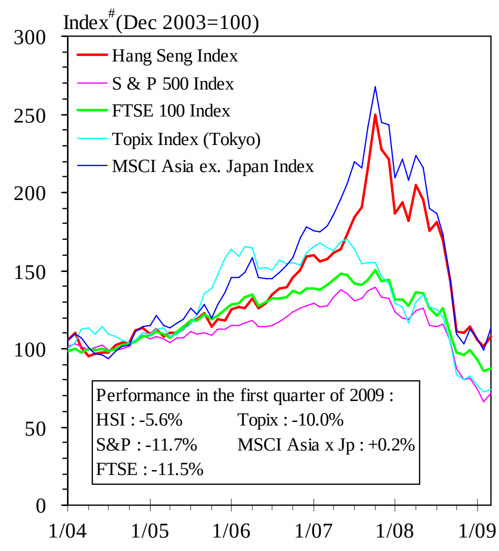
4.20 Concurrently, the *market capitalisation* also declined, albeit by a smaller magnitude of 1.7% to $10.1 trillion at end-March 2009. Despite this, the Hong Kong stock market was still the seventh largest in the world and the third largest in Asia at end-March, according to the *World Federation of Exchanges*(8). Fund raising activities were mostly paltry during the quarter. Total equity capital raised through new share flotation and post-listing arrangements on the Main Board and the GEM amounted to only $15.9 billion, markedly down by 79.1% from a year earlier(9). The *initial public offerings* (*IPOs*) market, in particular, raised a mere $1.6 billion in the same period.

Diagram 4.6 : The local stock market trended further down in early 2009



Note : (*) Position at end of quarter.

Diagram 4.7 : Continued volatility was observed for major international stock markets



Note : (#) Position at end of month.

Box 4.1

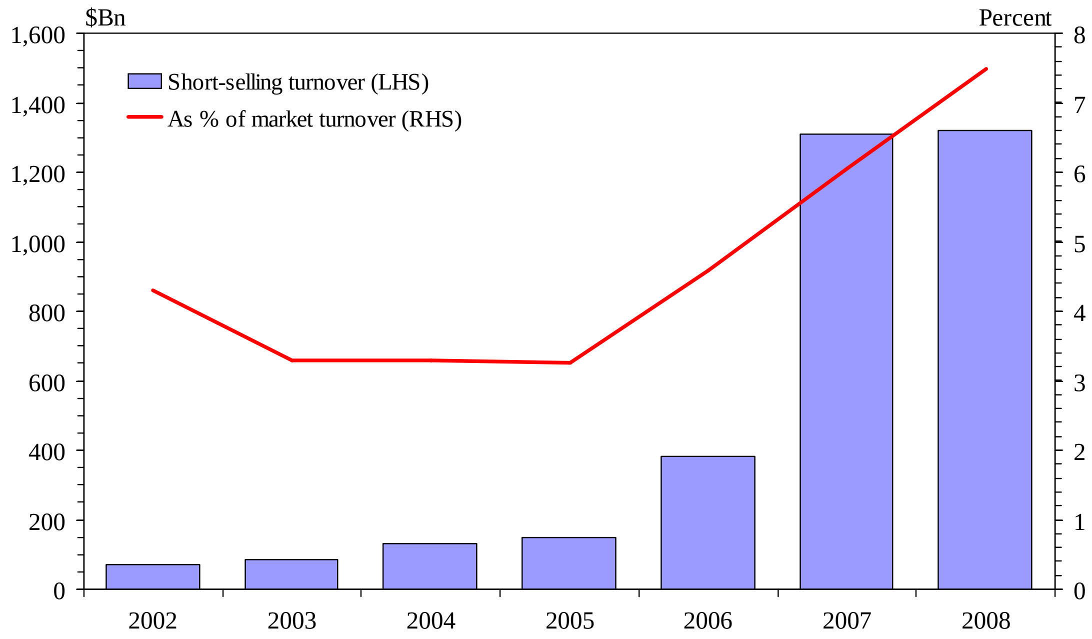
Equity short-selling[1] activity in Hong Kong

Short-selling helps price discovery, encourages trading and adds to market depth in the equity market. The more liquid the market, the narrower the bid-ask spreads can normally be found. In the past several years, short-selling has grown robustly in Hong Kong. But in the aftermath of the global financial turmoil, some overseas jurisdictions have introduced temporary measures to restrict or suspend such activity. The Securities and Futures Commission (SFC) has published two reports examining short-selling activity in the Hong Kong stock market, in October 2008 and April 2009 respectively, and this box article summarises some of the key findings in the reports and other recent developments.

Overview

Between 2002 and 2007, short-selling turnover jumped from $71 billion to $1,310 billion, boosting its share in total market turnover from 4.3% to 6.0%. Amongst other factors, the growth was underpinned by market making activity and the listing of Mainland enterprises in Hong Kong. Market makers' share of short-selling turnover for all stocks has surged from 4% in 2002 to 23% in 2007. Meanwhile, for the 57 newly listed H-shares in Hong Kong during 2004 to 2007, their aggregate share of the market's short-selling leaped from below 2% in 2004 to 24% in 2007. Despite the difficult environment in 2008, short-selling turnover still managed to edge up further to $1,319 billion, accounting for 7.5% of overall turnover for the whole year.

Short-selling has been distinctly on the increase in the past several years



[1] Short-selling refers to the selling of a security that the seller does not own.

Box 4.1 (Cont'd)

Unlike the other financial centres, Hong Kong has not introduced any temporary measures to restrict short-selling. There has been no strong evidence as yet indicating a flow of short-selling activity into Hong Kong after the imposition of relevant restrictions overseas. As a matter of fact, short-selling as a percentage of the total market turnover declined from 8.5% during 1 July to 18 September 2008 (before the short-selling ban was imposed on US financial stocks) to 6.7% during 19 September to 31 December 2008. In January and February 2009, the ratio was broadly similar at 7.4% and 8.0% respectively. It appears, therefore, that the ban on short-selling in the US and the UK has not given rise to any material impact on short-selling activity in Hong Kong.

Short-selling tightens bid-ask spreads, encourages trading and enhances market depth

SFC analysed the sell orders for 16 stocks[2] during the fourth quarter of 2008. It was found that market making short-selling orders have notable contribution to tighter bid-ask spreads as over 80% of them were placed at best-ask prices or lower. In particular, 34% of the market making short-selling orders were made at the bid price, thereby having a direct effect of boosting trading. Both ratios compared favourably to those for long sell orders (that is, selling of stocks that the seller owns), where 59% were placed at best-ask prices or lower and 29% at the bid price. Short-selling orders not relating to market making, of which 59% were placed at the best-ask prices, also helped adding to the market depth.

Comparison with overseas markets

While short-selling has been increasing as a share of Hong Kong's market turnover, the figure remained much lower than the ratios prevailing in New York and London, where reportedly the corresponding figures for 2007 were 25-30%. The lower ratio for Hong Kong could be attributable to more prudent short-selling regulations than those which were in place in many overseas markets prior to their implementation of the temporary measures. For instance, only "covered" short-selling in securities meeting certain eligibility requirements are permitted in Hong Kong. Moreover, short sales are required to have full audit trails and are subject to the tick rule (except market making related orders). The SFC will continue to keep a vigilant eye on global developments related to short-selling, but will also remain attuned to the specific needs of the Hong Kong market when considering any changes to short-selling regulations.

[2] These 16 stocks accounted for 55% of market capitalisation in Hong Kong at end-2008 and 51% of both overall and short-selling turnover during that year. Please see SFC's "Research Paper No. 44: How short-selling activity affects liquidity of the Hong Kong stock market" for more details.

4.21 The Mainland enterprises continued to be principal players on the Hong Kong stock market. At end-March, there were 470 Mainland enterprises (including 150 H-share companies, 96 "Red Chips" companies and 224 private enterprises) listed on the local bourse, accounting for 37% of the total number of listed companies and 61% of the total market capitalisation. For the first quarter as a whole, the Mainland-related stocks accounted for 72% of equity turnover and 83% of the total equity capital raised in the market.

4.22 By comparison, the *derivatives* market stayed relatively robust, even though the average daily trading volume for futures and options contracts was reduced by 17.4% year-on-year in the first quarter[(10)]. Among the major derivative products, only the Hang Seng Index (HSI) options posted a year-on-year gain of 13.9% in turnover. Trading volume for HSI futures and H-share index futures however fell by about 10%. Meanwhile, trading in securitised derivatives, which accounted for 25% of total market turnover, suffered a larger plunge of 60.7% in value terms. Nevertheless, the value traded did show some signs of stabilisation in the latest period, as the transaction level for the first quarter of 2009 was roughly similar to that for the fourth quarter of 2008. As for specific items, trading in derivative warrants bounced up by 5.4% quarter-to-quarter to average at $5.2 billion per day, whereas trading in callable bull / bear contracts shrank by 5.3% to a daily average of $5.9 billion.

Table 4.5 : Average daily turnover of derivative products of the Hong Kong market

		Hang Seng Index futures	Hang Seng Index options	H-shares Index futures	Stock options	Total futures and options traded*	Derivative warrants ($Mn)	Callable bull / bear contracts ($Mn)	Total securitised derivatives traded ($Mn)^
2008	Annual	89 368	15 723	59 428	225 074	432 126	14,015	4,243	18,258
	Q1	89 686	15 072	61 088	266 199	472 052	26,851	1,395	28,247
	Q2	78 668	13 890	50 653	212 191	388 939	15,715	2,886	18,601
	Q3	95 335	18 381	58 217	220 110	435 527	8,964	6,394	15,359
	Q4	93 607	15 476	67 742	202 782	432 561	4,972	6,183	11,155
2009	Q1	80 094	17 167	54 785	194 279	389 778	5,240	5,856	11,096
% change over a year earlier		-10.7	13.9	-10.3	-27.0	-17.4	-80.5	319.7	-60.7

Notes : (*) Turnover figures for individual futures and options may not add up to the total futures and options traded, as some products are not included.

(^) Including derivative warrants and callable bull / bear contracts.

4.23 The Hong Kong Exchanges and Clearing Limited (HKEx) continued to devote considerable efforts in widening the catchment area of the local securities market. In February 2009, the Hong Kong Futures Exchange Limited (HKFE), a wholly-owned subsidiary of HKEx, has received no-action relief from the US Commodity Futures Trading Commission, which enables HKFE Exchange Participants to offer the exchange's Hang Seng Index and Hang Seng China Enterprises Index mini futures contracts in the US. In early April, HKEx signed a Closer Co-operation Agreement with Shenzhen Stock Exchange, committing the two exchanges to work together more closely towards the common goal of meeting the domestic and international fund raising needs of Mainland enterprises.

Fund management and investment funds

4.24 Fund management business remained generally slack, as investors stayed on the sideline amid the unsettling financial conditions. Gross retail sales of *mutual funds* in the first quarter of 2009(11), whilst reviving modestly from the low levels seen in late 2008, were still sharply down by 75.5% from a year earlier to US$1.8 billion. On the other hand, the aggregate net asset of the approved constituent funds under the *MPF schemes* rose slightly from $209 billion at end-2008 to $218 billion at end-March 2009(12). Operating environment for retail hedge funds, though, continued to be challenging under the unfavourable market conditions(13).

Insurance sector

4.25 Gross premium income from new long-term business for the *insurance sector* shrank by 24.9% in 2008(14), with premium from investment-linked plans dropping more visibly by 39.9% as policy buyers tended to switch to low-risk financial products amid the uncertain and turbulent conditions in the financial markets. For the fourth quarter of 2008 alone, total premium for long-term business decreased even more by 75.6% year-on-year. As regards gross premium for general business, there was an increase of 12.3% for 2008 as a whole. Also noteworthy was a distinct reduction in underwriting profit by 34.4%, mainly attributable to the poor performance in the second and third quarters of the year.

Table 4.6 : Insurance business in Hong Kong* ($Mn)

	General business			Premium for long-term business^					
	Gross premium	Net premium	Underwriting profit	Individual life and annuity (non-linked)	Individual life and annuity (linked)	Other individual business	Non-retirement scheme group business	All long-term business	Gross premium from long-term business and general business
2007 Annual	24,057	17,008	2,301	20,314	60,040	261	162	80,777	104,834
Q1	6,792	4,904	441	5,982	10,122	62	45	16,211	23,003
Q2	6,156	4,451	598	3,307	13,189	62	50	16,608	22,764
Q3	5,861	4,122	744	5,028	16,445	76	40	21,589	27,450
Q4	5,248	3,531	518	5,997	20,284	61	27	26,369	31,617
2008 Annual	27,019	19,158	1,510	24,054	36,107	256	218	60,635	87,654
Q1	7,640	5,478	638	8,212	13,308	64	49	21,633	29,273
Q2	6,618	4,773	188	6,089	13,345	67	58	19,559	26,177
Q3	6,676	4,723	-12	5,937	6,949	63	73	13,022	19,698
Q4	6,085	4,184	696	3,816	2,505	62	38	6,421	12,506
% change in 2008 Q4 over 2007 Q4	15.9	18.5	34.4	-36.4	-87.7	1.6	40.7	-75.6	-60.4
% change in 2008 over 2007	12.3	12.6	-34.4	18.4	-39.9	-1.9	34.6	-24.9	-16.4

Notes : (*) Figures are based on provisional statistics of the Hong Kong insurance industry.

(^) Figures refer to new businesses only. Retirement scheme businesses are excluded.

Notes :

(1) Prior to 9 October 2008, the Base Rate was set at either 150 basis points above the prevailing US Federal Funds Target Rate (FFTR) or the average of the five-day moving averages of the overnight and one-month HIBORs, whichever was higher. Between 9 October 2008 and 31 March 2009, this formula for determination of the Base Rate was changed by reducing the spread of 150 basis points above the prevailing FFTR to 50 basis points and by removing the other leg relating to the moving averages of the relevant interbank interest rates.

(2) In December 2005, the HKMA published a new data series on composite interest rate, reflecting movement in various deposit rates, interbank and other interest rates to closely track the average cost of funds for banks. The published data enable the banks to keep track of changes in funding cost and thus help improve interest rate risk management in the banking sector.

(3) The trade-weighted Nominal Effective Exchange Rate Index (EERI) is an indicator of the overall exchange value of the Hong Kong dollar against a fixed basket of other currencies. Specifically, it is a weighted average of the exchange rates of the Hong Kong dollar against some 14 currencies of its major trading partners, with the weights adopted being the respective shares of these trading partners in the total value of merchandise trade for Hong Kong during 1999 and 2000.

The Real EERI of the Hong Kong dollar is obtained by adjusting the Nominal EERI for relative movements in the seasonally adjusted consumer price indices of the respective trading partners.

(4) The various definitions of the money supply are as follows:

M1 : Notes and coins with the public, plus customers' demand deposits with licensed banks.

M2 : M1 plus customers' savings and time deposits with licensed banks, plus negotiable certificates of deposit (NCDs) issued by licensed banks, held outside the monetary sector as well as short-term Exchange Fund placements of less than one month.

M3 : M2 plus customers' deposits with restricted licence banks and deposit-taking companies, plus NCDs issued by such institutions and held outside the monetary sector.

Among the various monetary aggregates, more apparent seasonal patterns are found in HK$M1, currency held by the public, and demand deposits.

(5) Authorised institutions (AIs) include licensed banks, restricted licence banks and deposit-taking companies. At end-March 2009, there were 142 licensed banks, 26 restricted licence banks and 27 deposit-taking companies in Hong Kong. Altogether, 195 AIs (excluding representative offices) from 30 countries and territories (including Hong Kong) had a presence in Hong Kong.

(6) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.

(7) Assets of the banking sector include notes and coins, amount due from authorised institutions in Hong Kong as well as from banks abroad, loans and advances to customers, negotiable certificates of deposit (NCDs) held, negotiable debt instruments other than NCDs held, and other assets. Certificates of indebtedness issued by Exchange Fund and the counterpart bank notes issued are nevertheless excluded.

(8) The ranking is made by the World Federation of Exchanges, a global trade association for the stock exchange industry. Its membership comprises 51 securities exchanges (as of 28 April 2009), covering almost all globally recognised stock exchanges.

(9) At end-March 2009, there were 1 092 and 174 companies listed on the Main Board and GEM respectively.

(10) At end-March 2009, there were 49 classes of stock options contracts and 42 classes of stock futures contracts.

(11) These figures are obtained from the Sales and Redemptions Survey conducted by the Hong Kong Investment Funds Association on their members, and cover only the active authorised funds that have responded to the survey. To provide a more accurate picture of the retail fund market in Hong Kong, the survey has been revamped with effect from 2005, such that it would cover only retail transactions (including switching) and exclude institutional transactions. At end-March 2009, there were 1 323 authorised funds, according to the survey.

(12) At end-March 2009, there were 19 approved trustees. On MPF products, 34 master trust schemes, two industry schemes and two employer sponsored schemes, comprising altogether 340 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 237 000 employers, 2.20 million employees and 266 000 self-employed persons have participated in MPF schemes.

(13) At end-March 2009, there were 14 SFC-authorised retail hedge funds with combined net asset size of US$648 million. This amount of net assets under management represented a 15.8% decrease from end-2008 level, although it was still about 4 times of that at end-2002, the year when the hedge funds guidelines were first issued.

(14) At end-March 2009, there were 175 authorised insurers in Hong Kong. Within this total, 46 were engaged in long-term insurance business, 110 in general insurance business, and 19 in composite insurance business. These authorised insurers come from 23 countries and territories (including Hong Kong).