

CHAPTER 5 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued through 2013 amid the ongoing accommodative monetary policy in the United States. Hong Kong dollar interest rates on both the interbank and retail fronts continued to hover at low levels.*
- *The Hong Kong dollar exchange rate was broadly stable against the US dollar. The trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices rose by 0.7% and 2.4% respectively during 2013, alongside the strengthening of US dollar against the Japanese yen and Australian dollar.*
- *The monetary aggregates continued to expand in 2013. Meanwhile, total loans and advances grew at a brisk pace, mainly supported by the jump in foreign currency lending.*
- *The local stock market exhibited considerable volatility in 2013. The Hang Seng index showed a sharp correction in the first half amid concerns over liquidity strains in the Mainland and market expectations of the US Federal Reserve tapering its asset purchases. It recouped the loss in the ensuing months, as sentiment revived upon improved performance of the global economy. Trading activities rebounded from a low base. Fund raising activities were subdued in most of 2013 but staged a sharp rebound in the fourth quarter.*

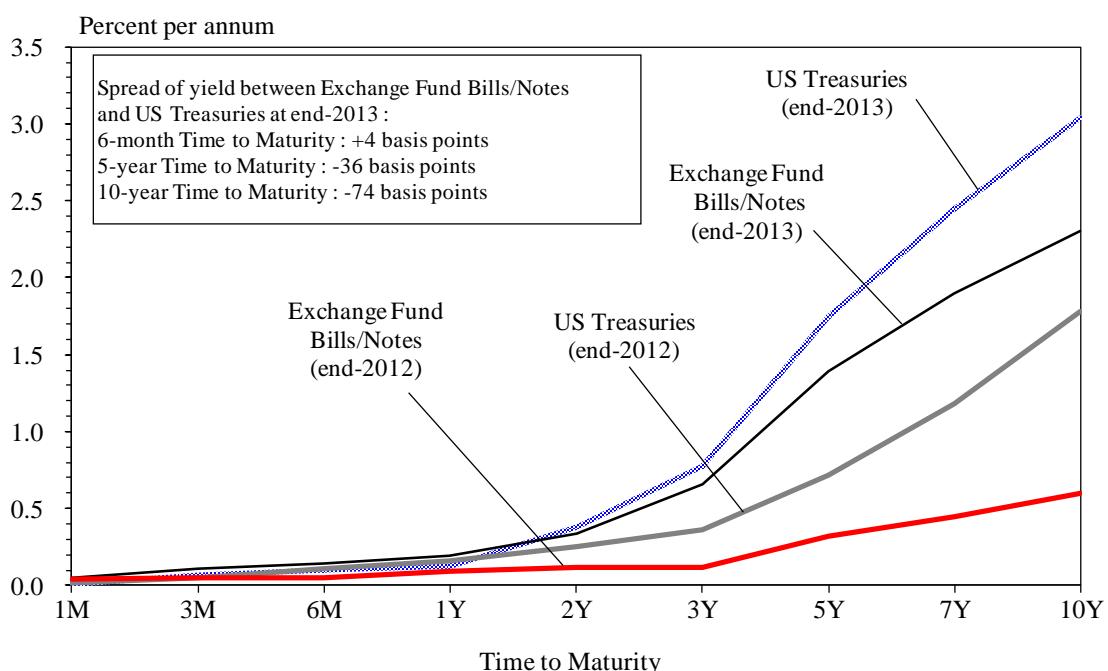
(#) This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.

Interest rates and exchange rates

5.1 The low interest rate environment in Hong Kong continued through 2013 amid the ongoing accommodative monetary policy in the United States. With the Federal Funds Target Rate staying at 0-0.25%⁽¹⁾, the *Base Rate* under the Discount Window operated by the HKMA held unchanged at 0.5% during the year. The *Hong Kong dollar interbank interest rates* also stayed low, with the overnight and three-month HIBOR fixings edging down from 0.10% and 0.40% at end-2012 to 0.08% and 0.38% at end-2013.

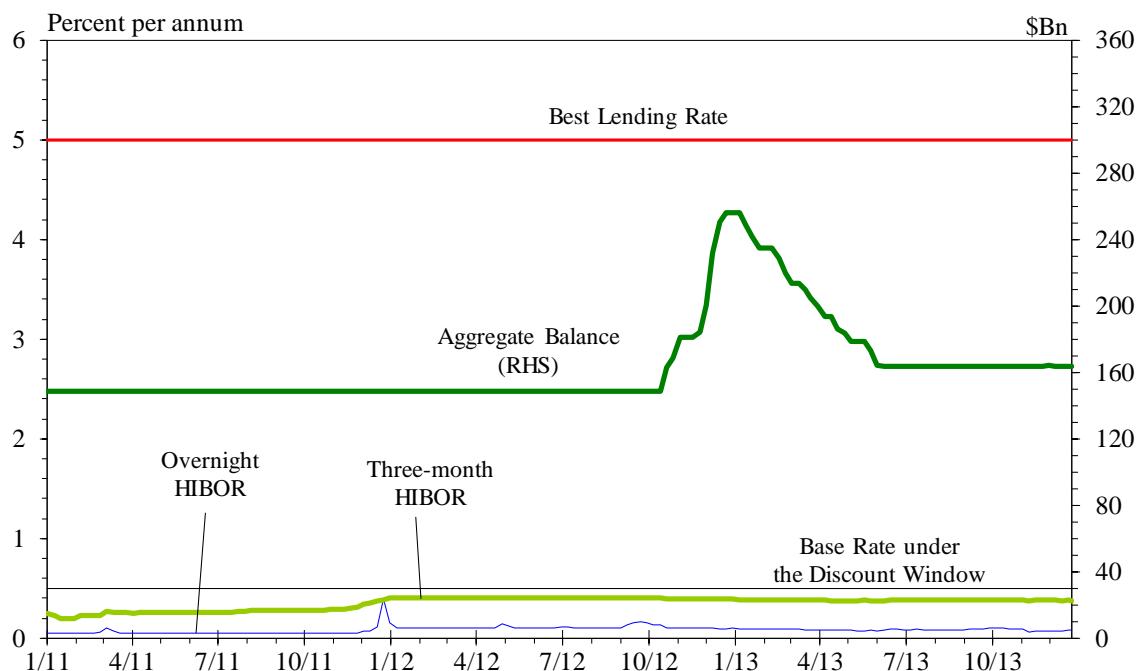
5.2 The *US dollar yield curve* and *Hong Kong dollar yield curve* steepened noticeably during 2013, mainly driven by market expectations of the US Federal Reserve tapering its asset purchases. Reflecting the bigger rise in the Hong Kong dollar yields, the yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills turned from a negative six basis points at end-2012 to a positive four basis points at end-2013, and the negative spreads between the 10-year Exchange Fund Notes and the 10-year US Treasury Notes narrowed from 118 basis points to 74 basis points.

Diagram 5.1 : The US dollar and Hong Kong dollar yield curves steepened noticeably in 2013



5.3 Interest rates on the retail front also hovered at low levels. The *Best Lending Rates* remained unchanged at 5.00% or 5.25% during the whole of 2013. Meanwhile, the *average savings deposit rate* and the one-year *time deposit rate* quoted by the major banks (which are for deposits of less than \$100,000) stayed low, at 0.01% and 0.16% respectively at end-2013. The *composite interest rate*⁽²⁾, which indicates the average cost of funds for retail banks, edged up from 0.32% to 0.39%, still very low by historical standards.

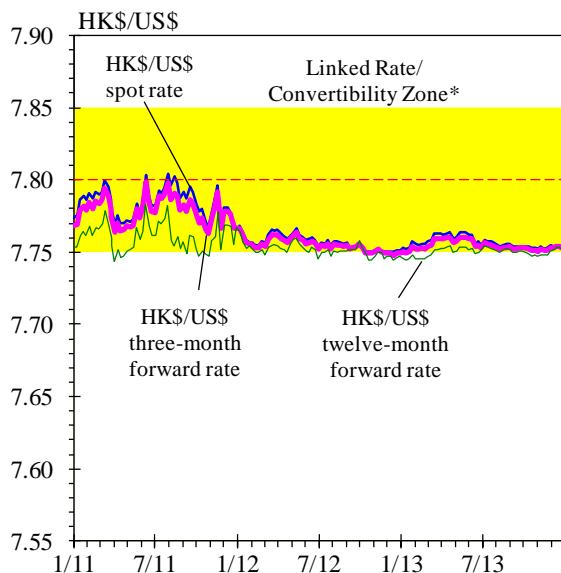
**Diagram 5.2 : Hong Kong dollar interest rates remained low through 2013
(end for the week)**



5.4 The *Hong Kong dollar spot exchange rate* was broadly stable in 2013, moving within a narrow range between 7.751 and 7.765 against the US dollar. It closed at 7.754 at end-2013, little changed from 7.751 a year earlier. Meanwhile, the discounts of the *3-month* and *12-month* *Hong Kong dollar forward rates* to the spot rates narrowed from 20 and 47 pips (each pip equivalent to HK\$0.0001) a year earlier to 8 and 17 pips at end-2013 respectively.

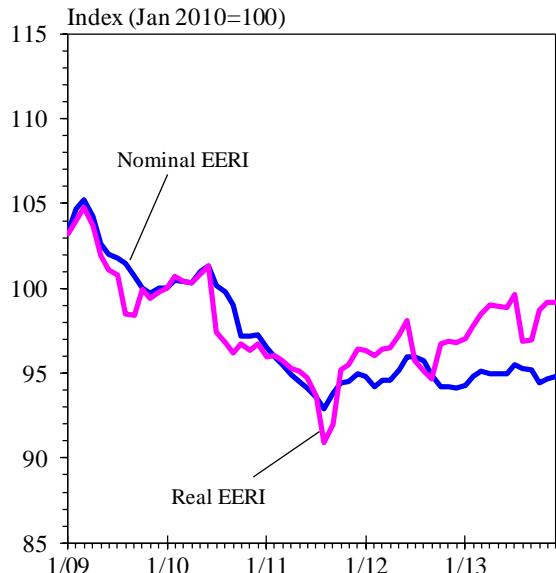
5.5 Under the Linked Exchange Rate system, movements in the Hong Kong dollar exchange rate against other currencies closely follow those of the US dollar. During 2013, the US dollar strengthened notably against the Japanese yen and Australian dollar but weakened against most other major currencies. Between end-2012 and end-2013, the trade-weighted *Hong Kong dollar Nominal Effective Exchange Rate Index*⁽³⁾ edged up by 0.7% while the *Real Effective Exchange Rate Index* increased by 2.4%.

Diagram 5.3 : Hong Kong dollar remained stable against the US dollar (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 5.4 : The trade-weighted nominal and real EERIs rose in 2013 (average for the month)



Money supply and banking sector

5.6 The monetary aggregates continued to expand in 2013. The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) rose by 9.3% over a year earlier to \$994 billion at end-2013, and the broad money supply (HK\$M3) by 5.7% to \$4,806 billion⁽⁴⁾. *Total deposits* with authorised institutions (AIs)⁽⁵⁾ increased by 10.6% over the same period, within which Hong Kong dollar deposits and foreign currency deposits recorded respective growth of 5.1% and 16.2%.

Diagram 5.5 : The monetary aggregates continued to expand in 2013

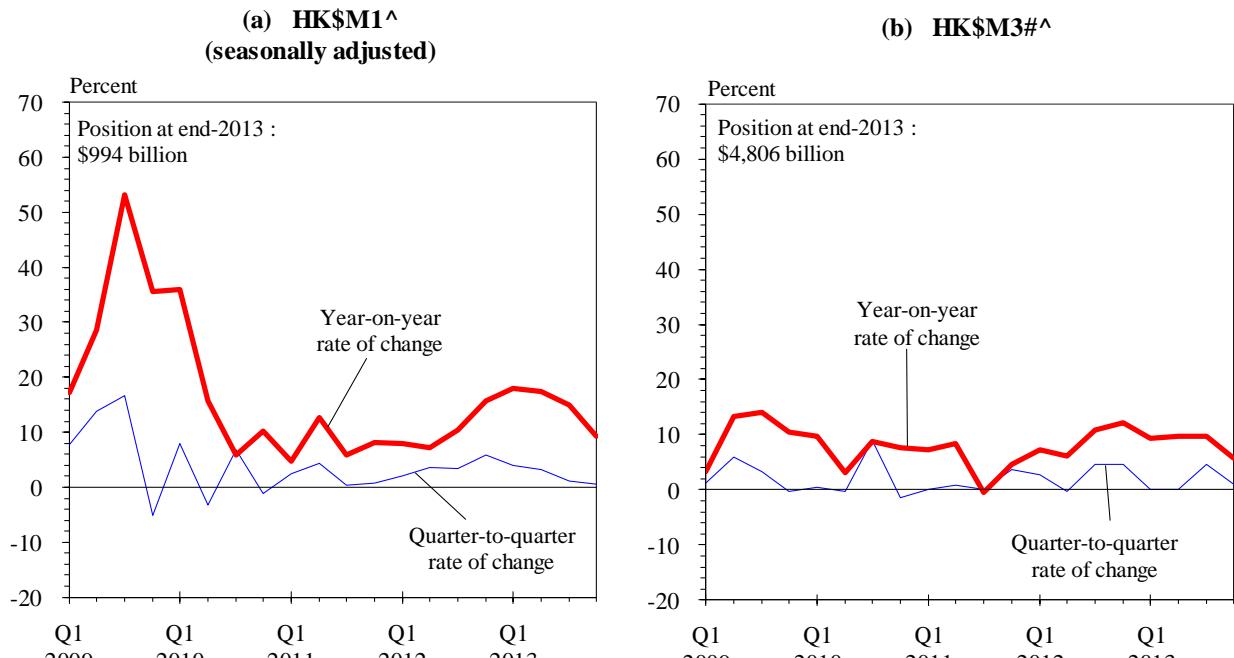


Table 5.1 : Hong Kong dollar money supply and total money supply

		<u>M1</u>		<u>M2</u>		<u>M3</u>	
% change during the quarter		<u>HK\$[^]</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>
2012	Q1	2.1	4.6	2.8	2.5	2.7	2.4
	Q2	3.6	3.2	-0.3	0.7	-0.3	0.7
	Q3	3.4	6.4	4.6	3.2	4.6	3.2
	Q4	5.8	6.4	4.6	4.3	4.7	4.3
2013	Q1	4.0	1.0	0.1	1.1	0.1	1.1
	Q2	3.3	2.7	0.0	1.9	0.1	1.9
	Q3	1.2	3.9	4.6	5.5	4.6	5.5
	Q4	0.6	1.8	0.9	3.4	0.9	3.4
Total amount at end-2013 (\$Bn)		994	1,511	4,795	10,054	4,806	10,083
% change over a year earlier		9.3	9.7	5.7	12.3	5.7	12.4

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

5.7 *Total loans and advances* expanded at a brisk pace of 16.0% over a year earlier to \$6,457 billion at end-2013. Among the total, Hong Kong dollar loans increased by 8.2%, while foreign currency loans surged by 27.6%. With loans growing faster than deposits, the Hong Kong dollar loan-to-deposit ratio

rose from 79.8% at end-2012 to 82.1% at end-2013, and the foreign currency loan-to-deposit ratio from 54.2% to 59.6%.

5.8 Reflecting strong cross-border liquidity demand, loans for use outside Hong Kong jumped by 21.5% over a year earlier to \$1,928 billion at end-2013. Loans for use in Hong Kong also rose by a notable 13.8% to \$4,530 billion. Within the latter, trade financing surged by 43.8%, while loans to manufacturing rebounded by a sharp 20.1%. Loans to wholesale and retail trade also recorded a strong growth of 18.0% amid the solid expansion in domestic consumption. Along with the rebound in fund raising activities and the pick-up in stock market trading in the fourth quarter, loans to financial concerns rose by 19.6%. Loans to stockbrokers soared by 56.0%, despite showing wide fluctuations from quarter to quarter. By comparison, loans for purchase of residential properties and loans to building, construction, property development and investment recorded moderate growth of 3.9% and 7.0% respectively amid a quiet property market.

Table 5.2 : Loans and advances

All loans and advances for use in Hong Kong										
		Loans to :								
% change during the quarter			Building, construction, property development and investment			Purchase of residential property ^(a)			All loans and advances for use outside Hong Kong ^(b)	Total loans and advances
	Trade finance	Manu- facturing	Whole- sale and retail trade	and investment	development	Financial concerns	Stock- brokers	Total ^(b)	Hong Kong ^(c)	
2012 Q1	7.3	-0.1	2.9	-1.5	0.1	3.1	-14.6	1.4	4.5	2.3
Q2	5.0	-2.8	3.0	-0.9	2.3	-3.4	-1.4	1.6	4.4	2.3
Q3	5.6	-1.7	4.4	1.9	2.0	-2.5	-16.1	1.6	2.6	1.9
Q4	-8.2	-0.3	2.0	1.7	2.9	6.5	36.7	2.4	3.6	2.8
2013 Q1	19.3	2.6	1.1	-0.7	1.7	3.2	26.2	2.9	3.3	3.0
Q2	23.9	9.3	8.9	4.2	1.3	3.3	17.2	7.1	4.3	6.3
Q3	7.8	6.2	5.5	4.3	0.5	3.9	125.7	3.6	8.5	5.0
Q4	-9.7	0.8	1.6	-0.8	0.3	7.9	-53.3	-0.3	3.9	0.9
Total amount at end-2013 (\$Bn)	550	217	418	993	950	327	31	4,530	1,928	6,457
% change over a year earlier	43.8	20.1	18.0	7.0	3.9	19.6	56.0	13.8	21.5	16.0

Notes : Some loans have been reclassified. As such, the figures are not strictly comparable with those of previous quarters. Figures might not add up to the corresponding totals due to rounding.

- (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.

5.9 The Hong Kong banking sector remains resilient, with the capital positions of the Hong Kong incorporated AIs staying strong. The total capital ratio of these AIs stayed high at an average of 16.1% at end-September 2013. Given that all AIs are well capitalised, so far they have no difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III framework⁽⁶⁾.

5.10 The HKMA has been implementing the Basel III framework promulgated by the Basel Committee on Banking Supervision in accordance with the transitional timetable set by the Basel Committee, and targets to fully phase in all the standards set out therein by 1 January 2019. The first phase of Basel III standards, which covers revised minimum capital requirements calculated based on a stricter definition of capital base and a wider risk coverage, came into operation with the Banking (Capital) (Amendment) Rules 2012 taking effect on 1 January 2013.

5.11 In December 2013, the HKMA launched the industry consultation on proposals for implementing the counter-cyclical capital buffer in Hong Kong, which aims at designing a Hong Kong specific approach to making buffer decision consistent with the Basel standards. The approach would be based on assessments of appropriate indicators which, in addition to the Basel Committee's baseline credit-to-GDP ratio gap, may serve as a signal for excessive credit growth with potentially undesirable systemic implications (the condition for activating buffer buildup), or for either acute materialisation or gradual dissipation of latent systemic risk (the condition for triggering buffer release).

5.12 To implement the Basel Committee's disclosure requirements associated with the first phase of Basel III capital standards, the Banking (Disclosure) (Amendment) Rules 2013 came into force on 30 June 2013. The HKMA will further amend the Banking (Disclosure) Rules, with the aim of implementing other disclosure requirements relating to the leverage ratio and capital buffers in 2015.

5.13 On the liquidity standards, the Basel Committee published a package of revisions to the Liquidity Coverage Ratio (LCR) in January 2013. Taking into account these revisions and the comments received from the two previous consultations, the HKMA subsequently updated its policy proposals for local implementation of the LCR, and launched the industry consultation on the revised proposals in July. Having considered the comments, the HKMA has finalised the liquidity proposals, and will submit a set of Banking (Liquidity) Rules to the Legislative Council in 2014 for implementation on 1 January 2015.

5.14 The HKMA continues to participate in the Basel Committee's implementation monitoring process (IMP) and carry out its local IMP on an expanded sample of AIs to assess both the impact of the Basel III requirements and the implementation progress of AIs. As the Basel III capital standards have taken effect in Hong Kong since 1 January 2013, the scope of the latest local IMP is confined to monitoring implementation of the liquidity standards. Based on the local IMP results to date, AIs in Hong Kong are generally not expected to encounter major difficulties in complying with the new liquidity standards, though some AIs may need to adjust their liquidity profiles or liquid asset composition to satisfy the requirements.

5.15 The HKMA continues to monitor closely AIs' management of liquidity and credit risks, funding strategy, mortgage lending, Mainland-related business and other areas of supervisory concern to ensure the resilience of the banking sector against any abrupt deterioration in the external macroeconomic environment. In October 2013, the HKMA introduced Stable Funding Requirement to ensure that AIs could maintain stable business operations continuously when market liquidity comes under significant stress. Under the requirement, AIs with loan growth of 20% or above in 2013 are required to maintain specific level of stable funds starting 2014.

5.16 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans stayed at 0.48% at end-September 2013, virtually unchanged from the level at end-2012. The delinquency ratio for credit card lending remained low by historical standards, notwithstanding the marginal rise from 0.20% at end-2012 to 0.22% at end-September 2013. The delinquency ratio for residential mortgage loans also stayed low at 0.02% at end-2013.

Table 5.3 : Asset quality of retail banks^{*}

(as % of total loans)

<u>As at end of period</u>		<u>Pass loans</u>	<u>Special mention loans</u>	<u>Classified loans (gross)</u>
2012	Q1	98.17	1.27	0.57
	Q2	98.19	1.28	0.52
	Q3	98.19	1.31	0.50
	Q4	98.16	1.36	0.48
2013	Q1	98.32	1.22	0.46
	Q2	98.42	1.11	0.47
	Q3	98.25	1.27	0.48

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".

5.17 Offshore renminbi (RMB) business gathered further momentum in 2013. *RMB trade settlement handled by banks in Hong Kong* surged by 46% to RMB3,841 billion. The total outstanding *RMB deposits* and *certificates of deposit* likewise surged, by 46% over a year earlier to RMB1,053 billion at end-2013. Meanwhile, reflecting the buoyant RMB financing activities, the *outstanding amount of RMB loans* soared from RMB79 billion at end-2012 to RMB116 billion at end-2013, while *RMB bond issuance* increased from RMB112 billion in 2012 to RMB117 billion in 2013.

5.18 Several policy initiatives introduced by the Central Government in 2013 have contributed to the continued growth of offshore RMB business in Hong Kong. The expansion of the RMB Qualified Foreign Institutional Investor (RQFII) scheme in March, which entails a broader range of eligible institutions and relaxed investment restrictions, has facilitated the launch of more RMB financial products in Hong Kong. In July the Mainland authorities also streamlined the requirements for cross-border RMB transactions, increasing the flexibility for corporates to move RMB funds between the onshore and offshore markets.

Table 5.4 : Renminbi deposits and cross-border renminbi trade settlement in Hong Kong

		Interest rates on ^(a)						Number of AIs engaged in RMB business	Amount of cross-border RMB trade settlement ^(c) (RMB Mn)
<u>As at end of period</u>	Demand and savings depo sits (RMB Mn)	Time deposits (RMB Mn)	Total depos its (RMB Mn)	Savings deposits ^(b) (%)	Three-month time deposits ^(b) (%)				
2012	Q1	156,788	397,528	554,317	0.25	0.52	135	571,176	
	Q2	136,616	421,094	557,710	0.25	0.52	133	641,907	
	Q3	118,997	426,703	545,701	0.25	0.52	136	716,946	
	Q4	123,542	479,453	602,996	0.25	0.52	139	702,474	
2013	Q1	144,314	523,744	668,058	0.25	0.52	140	830,955	
	Q2	127,512	570,447	697,959	0.25	0.53	140	864,366	
	Q3	135,217	594,801	730,018	0.25	0.53	143	921,282	
	Q4	151,055	709,417	860,472	0.25	0.53	146	1,224,349	
% change over a year earlier		22.3	48.0	42.7	N.A.	N.A.	N.A.		74.3

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

(b) Period average figures.

(c) Figures during the period.

N.A. Not available.

The debt market

5.19 On the back of a rise in public sector issuance, the Hong Kong dollar *debt market* expanded further in 2013. Total gross issuance of Hong Kong dollar debt securities rose by 10.6% to \$2,356.8 billion. Within the total, public sector issuance jumped by 14.5% to \$2,164.1 billion, due to the leap in the issuance of Exchange Fund papers, which accounted for 98% of the total public issuance. By contrast, private sector issuance⁽⁷⁾ plummeted by 20.1% to \$191.7 billion, with the decline in new debt issued by AIs and local corporations more than offsetting the mild increase in that by non-MDBs overseas borrowers. At end-2013, the total outstanding balance of Hong Kong dollar debt securities grew by 8.5% over a year earlier to a record level of \$1,419.4 billion, equivalent to 29.5% of HK\$M3 or 24.5% of Hong Kong dollar-denominated assets of the entire banking sector⁽⁸⁾.

5.20 As to the Government Bond (“GB”) Programme, a total of \$20 billion institutional GBs, with tenors ranging from two to ten years, were issued in 2013. For the retail part, in June 2013 the Government issued another \$10 billion of inflation-linked retail bonds (i.e. iBonds) in accordance with the 2013-14 Budget. At end-2013, the outstanding size of bonds issued under the GB Programme amounted to \$90 billion, including ten institutional issues for \$60 billion, and three retail issues (iBonds) for \$30 billion.

5.21 The HKMA has devised two liquidity enhancement measures for the institutional GB market, namely the switch tender and bond swap facility, which would be introduced in 2014. These measures will enhance the effectiveness of market-making activities and liquidity management on the part of the Primary Dealers, and facilitate end-investors to trade more efficiently in the market.

Table 5.5 : New issuance and outstanding value of Hong Kong dollar debt securities (\$Bn)

	Statutory Exchange Fund paper	bodies/govern ment-owned corporations	Govern ment	Public sector total	AIs ^(a)	Local corpo rations	Non-MDBs overseas bor rowers ^(b)	Private sector total	MDBs ^(b)	Total
New Issuance										
2012 Annual	1,851.6	12.0	26.0	1,889.6	190.1	27.7	22.2	240.0	0.8	2,130.4
Q1	455.6	3.4	5.0	464.0	66.9	10.0	5.4	82.2	0.4	546.6
Q2	462.3	2.9	14.5	479.7	40.8	4.1	8.3	53.1	0.4	533.2
Q3	464.6	3.7	3.5	471.9	48.4	8.8	2.7	59.9	-	531.7
Q4	469.0	2.0	3.0	474.0	34.0	4.8	5.9	44.7	-	518.8
2013 Annual	2,123.4	10.7	30.0	2,164.1	143.0	25.6	23.1	191.7	0.9	2,356.8
Q1	508.9	3.5	7.0	519.4	32.5	11.6	6.1	50.3	-	569.7
Q2	537.6	5.0	13.0	555.6	39.5	2.2	7.5	49.2	-	604.7
Q3	532.0	1.1	7.0	540.1	43.2	6.6	2.4	52.2	0.9	593.2
Q4	545.0	1.1	3.0	549.1	27.8	5.2	7.1	40.0	-	589.1
% change in 2013 over 2012	14.7	-11.3	15.4	14.5	-24.8	-7.6	4.1	-20.1	19.0	10.6
Outstanding (as at end of period)										
2012 Q1	655.9	50.6	51.0	757.5	250.7	102.3	157.8	510.8	12.4	1,280.7
Q2	656.4	46.8	65.5	768.8	245.4	104.8	151.4	501.5	10.6	1,280.9
Q3	656.8	45.8	65.5	768.1	258.4	112.1	150.7	521.2	10.6	1,299.8
Q4	657.4	45.2	68.5	771.0	263.4	116.2	147.7	527.3	10.3	1,308.6
2013 Q1	708.6	45.7	72.0	826.4	249.7	123.0	145.8	518.5	10.2	1,355.1
Q2	750.1	43.2	85.0	878.3	250.9	117.0	149.0	516.9	9.9	1,405.0
Q3	750.6	40.1	88.5	879.2	248.1	122.9	148.1	519.2	10.4	1,408.7
Q4	751.2	39.8	91.5	882.5	250.1	127.9	148.7	526.7	10.2	1,419.4
% change over a year earlier	14.3	-11.8	33.6	14.5	-5.1	10.1	0.7	-0.1	-0.6	8.5

Notes : Figures may not add up to the corresponding totals due to rounding and may be subject to revisions.

(a) AIs : Authorized Institutions.

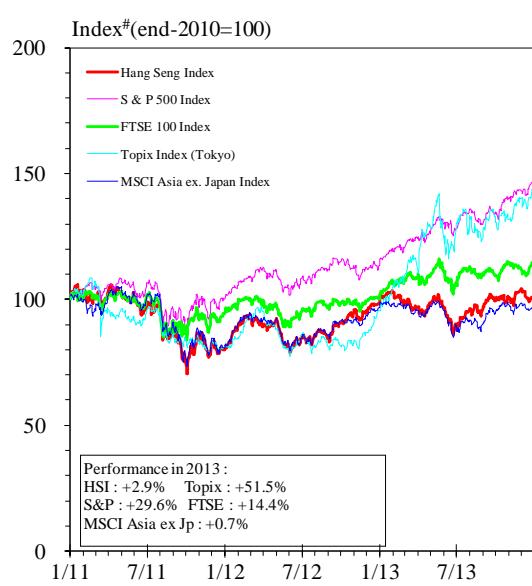
(b) MDBs : Multilateral Development Banks.

The stock and derivatives markets

5.22 The *local stock market* exhibited considerable volatility in 2013, marked by sharp swings in market sentiment as developments in the external environment unfolded. Concerns over liquidity strains in the Mainland and market expectations of the US Federal Reserve tapering its asset purchases sent the Hang Seng Index (HSI) to a low of 19 814 in June. It recouped the loss in the ensuing months and reached a high of 24 039 in December, mainly supported by the improved performance of the global economy, in particular the United States and the Mainland. The HSI closed the year at 23 306, 2.9% higher than end-2012. In tandem, the *market capitalisation* of the Hong Kong stock market rose by 9.5% to \$24.0 trillion. It remained the sixth largest stock exchange in the world and second largest in Asia according to the World Federation of Exchanges⁽⁹⁾.

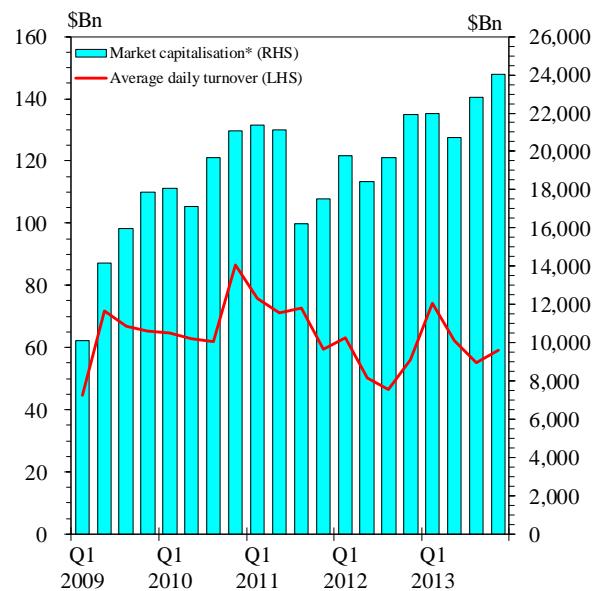
5.23 After an uptick in the first quarter, trading activities quietened down in the subsequent quarters. For 2013 as a whole, *average daily turnover* in the securities market rebounded by 16.2% from the low base of last year to \$62.6 billion. As to *derivatives products*, the average daily trading volume of futures and options⁽¹⁰⁾ expanded by 9.2%, with mixed performance across different products. Trading of H-shares Index futures and stock options grew by 31.9% and 9.1% respectively, while that of HSI futures and HSI options fell by 3.2% and 6.2%. By contrast, average daily trading value of securitised derivatives products declined by 2.8%, with the plunge of 16.2% in callable bull/bear contracts more than offsetting the increase of 9.6% in derivative warrants.

Diagram 5.6 : The Hang Seng Index exhibited considerable volatility in 2013



Notes : (#) Position at end of month.

Diagram 5.7 : Market capitalisation expanded further while trading activities rebounded from a low base



Note : (*) Position at end of quarter.

Table 5.6 : Average daily turnover of derivatives products of the Hong Kong market

		Hang Seng Index futur es	Hang Seng Index optio ns	H-shares Index futur es	Stock options	Total futures and options tra ded*	Derivative warrants (\$Mn)	Callable bull/bear contracts (\$ Mn)	Total securitised derivatives traded (\$M n) [^]
2012	Annual	82 905	37 597	64 863	228 438	487 994	6,666	6,207	12,873
	Q1	84 278	35 475	63 286	238 445	493 555	8,621	7,612	16,234
	Q2	88 614	43 634	65 131	225 266	501 374	6,274	6,317	12,590
	Q3	77 549	36 050	60 055	211 479	454 782	5,558	5,748	11,307
	Q4	81 372	35 255	71 281	239 438	503 888	6,264	5,174	11,438
2013	Annual	80 247	35 252	85 538	249 295	532 905	7,309	5,202	12,510
	Q1	82 570	38 464	77 111	278 115	552 686	10,268	6,032	16,301
	Q2	91 137	43 304	87 653	256 162	563 658	7,150	5,433	12,583
	Q3	78 192	31 109	87 853	217 169	503 305	6,190	5,250	11,441
	Q4	69 587	28 614	89 157	247 867	514 398	5,783	4,138	9,920
% change in 2013 Q4 over 2012 Q4		-14.5	-18.8	25.1	3.5	2.1	-7.7	-20.0	-13.3
% change in 2013 over 2012		-3.2	-6.2	31.9	9.1	9.2	9.6	-16.2	-2.8

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

(^) Comprising derivative warrants and callable bull/bear contracts. Figures may not add up to the corresponding totals due to rounding.

5.24 Fund raising activities remained subdued in most part of 2013 but staged a sharp rebound in the fourth quarter. *Total equity capital raised*, comprising new share floatations and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)⁽¹¹⁾, soared by 24.1% over the low base in 2012 to \$378.9 billion in 2013. Yet this was still a low level compared with the annual average of \$463.6 billion in the past ten years. Within the total, the amount of funds raised through Initial Public Offerings (IPOs) surged by 87.6% to \$169.0 billion, \$109.1 billion of which took place in the last quarter. In terms of fund raised through IPOs, Hong Kong's global ranking rose to the second place in 2013.

5.25 Mainland enterprises continued to play a dominant role in the local stock market. At end-2013, a total of 797 Mainland enterprises (including 182 H-share companies, 122 "Red Chips" companies and 493 private enterprises) were listed on the Main Board and GEM, accounting for 49% of the total number of listed companies and 57% of total market capitalisation. In 2013, Mainland-related stocks also accounted for a notable 72% of equity turnover and an even higher 82% of total equity fund raised in the Hong Kong stock exchange.

5.26 Following the launch of the After-Hours Future Trading (AHFT) in April 2013, the Hong Kong Exchanges and Clearing Limited (HKEx) published its review results on market activities in November. The results indicated that trading during the AHFT session was orderly, bid/offer spread was tight, and the clearing and settlement processes were smooth. Considering the development needs of AHFT and feedbacks from the market, subsequently in January 2014 the HKEx introduced Mini HSI Futures, Mini H-shares Index Futures and its Block Trading Facility to the AHFT session, on top of the existing HSI Futures and H-shares Index Futures. This would further enable market participants to hedge or adjust their market positions in response to latest news and events during the European and US business days. HKEx would continue to monitor the development of AHFT, and would consider offering more products and extending the ending time of AHFT as and when appropriate.

Fund management and investment funds

5.27 Most segments of the fund management industry showed a robust performance in 2013. Reflecting the upsurge in the first half, gross retail sales of *mutual funds* soared by 29.6% to a record-high of US\$71.1 billion in 2013⁽¹²⁾. Aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹³⁾ also leapt by 16.9% over end-2012 to \$514.1 billion at end-2013. Yet the amount of net assets managed by *retail hedge funds* declined further⁽¹⁴⁾.

Insurance sector

5.28 The *insurance sector*⁽¹⁵⁾ expanded further in the first three quarters of 2013. Gross premium income from long-term business soared by 19.8% over a year earlier. Within the total, premium income from non-investment linked and investment-linked plans jumped by 19.7% and 20.7% respectively. As to general business, gross and net premium income grew by 9.1% and 11.3% respectively.

Table 5.7 : Insurance business in Hong Kong* (\$Mn)

	General business			Premium for long-term business^						Gross premium from long-term business and general business
	Gross premium	Net premium	Underwriting profit	Individual annuity (non-linked)	Individual life and annuity (linked)	Other individual business	Non-retirement scheme group business	All long-term business		
2012 Annual	39,312	27,008	2,215	60,339	17,122	104	279	77,844	117,156	
Q1	10,924	7,608	853	15,056	3,961	16	79	19,112	30,036	
Q2	9,328	6,593	735	14,697	3,924	28	50	18,699	28,027	
Q3	10,264	6,930	464	15,351	3,998	26	115	19,490	29,754	
Q4	8,796	5,877	163	15,235	5,239	34	35	20,543	29,339	
2013 Q1	12,359	8,759	657	17,527	4,919	36	53	22,535	34,894	
Q2	10,428	7,446	864	17,570	5,597	40	61	23,268	33,696	
Q3	10,512	7,314	671	18,910	3,831	40	50	22,831	33,343	
% change in 2013 Q1-Q3 over 2012 Q1-Q3	9.1	11.3	6.8	19.7	20.7	65.7	-32.8	19.8	16.1	

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

(^) Figures refer to new business only. Retirement scheme business is excluded.

5.29 The Inland Revenue (Amendment) (No.3) Bill 2013 was gazetted in December 2013 and subsequently submitted to the Legislative Council in January 2014. With a view to attracting more enterprises to establish their captive insurers for underwriting risks of companies within the same group to which they belong in Hong Kong, the profits tax on offshore risks insurance business of captive insurers would be reduced by 50%. This would help form a cluster of captive insurers, and thus attract the development of other related business, including reinsurance, legal and actuarial services in Hong Kong.

Highlights of policy and market developments

5.30 The Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 came into operation on 19 July 2013, providing a comparable taxation framework for some common types of Islamic bonds (sukuk) vis-à-vis conventional bonds. The Loans (Amendment) Bill 2014 was then submitted to the Legislative Council in January 2014 to further promote the development of sukuk market in Hong Kong by enabling the issuance of sukuk under the GB Programme. These would help promote the further development of the local bond market and diversify the financial products and services in the market, thereby enhancing the competitiveness of Hong Kong as an international financial centre and asset management centre.

5.31 In January 2014, the Government and the financial regulators, namely the HKMA, the Securities and Futures Commission and the Insurance Authority, launched a three-month public consultation on proposals for establishing an effective resolution regime to address the systemic and moral hazard risks posed by the failure of systemically important and “too-big-to-fail” financial institutions in Hong Kong. Currently, Hong Kong’s statutory framework does not provide for all of the powers that the Financial Stability Board (FSB) of the Group of Twenty considers necessary for an effective resolution regime. The proposed regime in the public consultation seeks to meet the standards set by the FSB, including in relation to the scope of the regime, governance arrangements, resolution powers and options, safeguards, funding, cross-border co-operation and information sharing. The Government and the financial regulators aimed to conduct the second stage of public consultation later in 2014 on the specific details and operation of the resolution regime, with a view to introducing the legislative proposals into the Legislative Council in 2015.

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 temporarily 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. After a review of the appropriateness of the new Base Rate formula, the narrower 50 basis point spread over the FFTR was retained while the HIBOR leg was re-instated in the calculation of the Base Rate after 31 March 2009.
- (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 15 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 2009 and 2010.

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) AIs include licensed banks, restricted licence banks and deposit-taking companies. At end-2013, there were 156 licensed banks, 21 restricted licence banks and 24 deposit-taking companies in Hong Kong. Altogether, 201 AIs (excluding representative offices) from 31 countries and territories (including Hong Kong) had a presence in Hong Kong.
- (6) Basel III was introduced by the Basel Committee in December 2010 (and subsequently revised in June 2011) to strengthen the resilience of banks and banking systems in the

light of lessons drawn from the global financial crisis. It tightens the definition of regulatory capital and increases the minimum common equity requirement from 2% to 4.5% of risk-weighted assets and the Tier 1 capital from 4% to 6% (with the total capital ratio remaining at 8%); requires banks to hold a Capital Conservation Buffer of 2.5% during good times and a Countercyclical Capital Buffer in the range of 0% to 2.5% (or higher at national discretion) at times of excessive credit growth, both to be met by common equity. It introduces a supplementary leverage ratio as a backstop to risk-weighted capital measures and enhances the transparency of the capital base. In addition, Basel III introduces two liquidity standards i.e. the Liquidity Coverage Ratio (LCR) to promote short term liquidity resilience and the Net Stable Funding Ratio (NSFR) to encourage more stable funding structures. The LCR is scheduled to take effect from 1 January 2015, starting with a minimum required level of 60% which is to be stepped up by 10 percentage points annually until achieving 100% by 1 January 2019. The NSFR is scheduled to take effect from 1 January 2018.

- (7) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (8) Assets of the banking sector include notes and coins, amount due from AIs 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.
- (9) The ranking is made by the World Federation of Exchanges, a global trade association for the securities exchange industry. Its membership comprises 60 securities exchanges, covering almost all globally recognised stock exchanges.
- (10) At end-2013, there were 74 classes of stock options contracts and 41 classes of stock futures contracts.
- (11) At end-2013, there were 1 451 and 192 companies listed on the Main Board and GEM respectively.
- (12) 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. At end-2013, the survey covered a total of 1 201 active authorised funds.
- (13) At end-2013, there were 19 approved trustees. On MPF products, 38 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 477 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 264 000 employers, 2.49 million employees and 212 000 self-employed persons have participated in MPF schemes.
- (14) At end-2013, there were three SFC-authorised retail hedge funds with combined net asset size of US\$257 million. The amount of net assets under management was 59.2% lower than the end-2012 level, though still representing an increase of more than 1.5 times of that at end-2002, the year when the hedge funds guidelines were first issued.
- (15) At end-2013, there were 155 authorised insurers in Hong Kong. Within this total, 44 were engaged in long-term insurance business, 92 in general insurance business, and 19 in composite insurance business. These authorised insurers come from 22 countries and territories (including Hong Kong).