

CHAPTER 4 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued in the second quarter of 2014 amid the ongoing accommodative monetary policy in the United States.*
- *In the second quarter, the Hong Kong dollar spot exchange rate stayed close to the strong-side Convertibility Undertaking of 7.75 per US dollar, mainly reflecting mild portfolio inflows, and stronger short-term liquidity needs and commercial demand near the half-year end. Meanwhile, the trade-weighted Hong Kong dollar Nominal Effective Exchange Rate Index and Real Effective Exchange Rate Index both increased.*
- *The Hong Kong dollar monetary aggregates recorded accelerated growth in the second quarter. Total loans and advances continued to increase, mainly supported by the growth in loans for use in Hong Kong.*
- *The local stock market regained momentum in the second quarter, as market sentiment was underpinned by signs of a reviving Mainland economy, an improving US economy, and the Federal Reserve keeping an accommodative monetary stance. The Hang Seng Index rose by 4.7% over end-March to 23 191 at end-June, almost recouping all the loss suffered during the first quarter.*

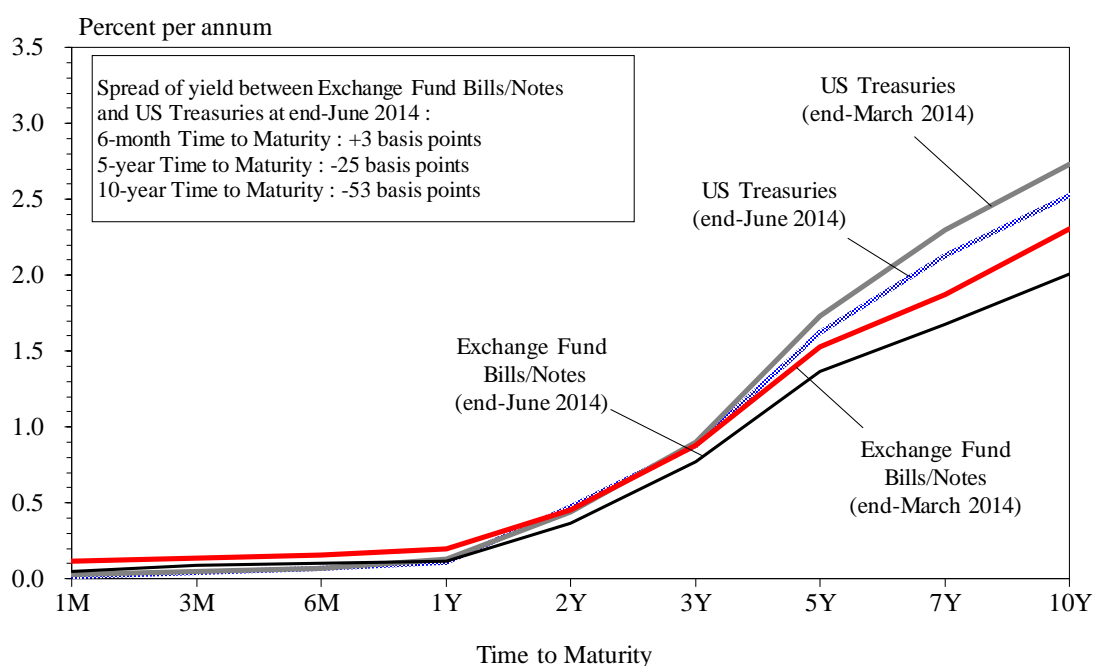
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

Interest rates and exchange rates

4.1 The low interest rate environment in Hong Kong continued in the second quarter of 2014 amid the ongoing accommodative monetary policy in the United States. With the Federal Funds Target Rate staying at 0-0.25%, the Base Rate under the Discount Window operated by the HKMA held unchanged at 0.5%⁽¹⁾. The *Hong Kong dollar interbank interest rates* (HIBOR) also hovered at low levels. The three-month HIBOR edged up by one basis point from end-March to 0.38% at end-June, while the overnight HIBOR picked up from 0.06% to 0.20%, due mainly to the temporary demand for liquidity near the half-year end.

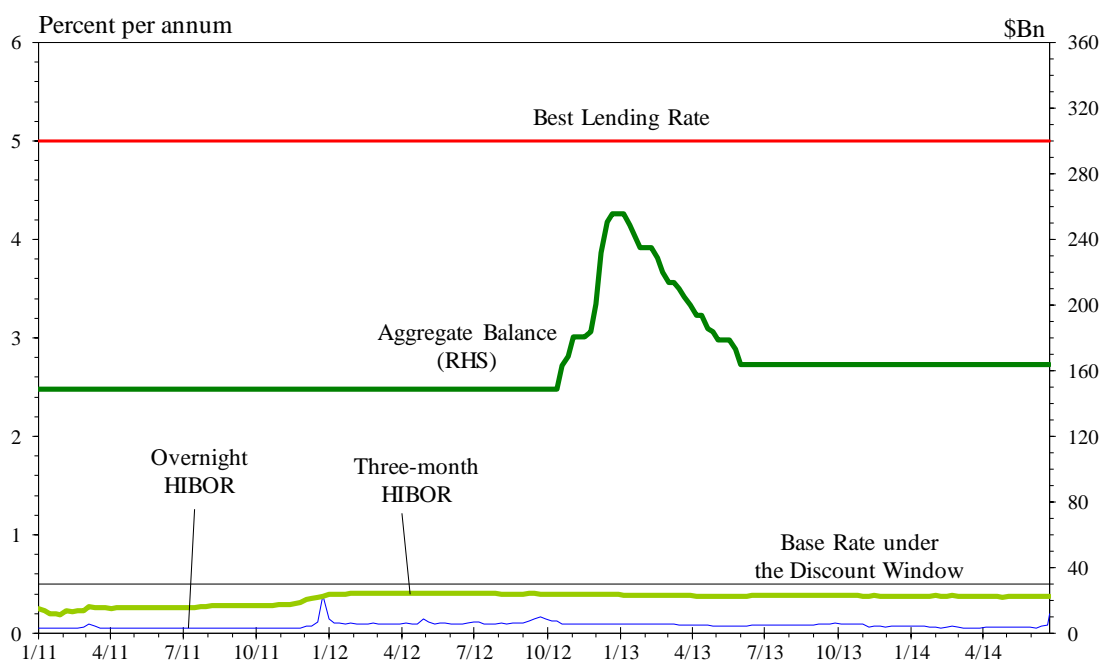
4.2 The *Hong Kong dollar* and *US dollar yield curves* both flattened in the second quarter. Reflecting the larger decline in the Hong Kong dollar yields, the positive yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills narrowed slightly from nine basis points at end-March to three basis points at end-June, while the negative yield spread between 10-year Exchange Fund Notes and 10-year US Treasury Notes widened from 43 basis points to 53 basis points.

Diagram 4.1 : The Hong Kong dollar and US dollar yield curves both flattened



4.3 Interest rates on the retail front remained low. The *Best Lending Rates* stayed unchanged at 5.00% or 5.25% through the second quarter. The *average savings deposit rate* and the *one-year time deposit rate* quoted by the major banks for deposits of less than \$100,000 also remained unchanged at 0.01% and 0.16% respectively. The *composite interest rate*⁽²⁾, which indicates the average cost of funds for retail banks, edged up from 0.41% at end-March to 0.47% at end-June.

**Diagram 4.2 : Hong Kong dollar interest rates remained low
(end for the week)**



4.4 The *Hong Kong dollar spot exchange rate* stayed close to the strong-side Convertibility Undertaking of 7.75 per US dollar throughout the second quarter, mainly reflecting mild portfolio inflows, and stronger short-term liquidity needs and commercial demand near the half-year end. As a result, the Hong Kong dollar spot exchange rate strengthened from 7.757 at end-March to 7.751 at end-June. Meanwhile, the differential between the *3-month Hong Kong dollar forward rate* and spot rate turned from -26 pips (each pip equivalent to HK\$0.0001) to +7 pips, and that between the *12-month forward rate* and spot rate from -31 pips to +8 pips.

4.5 Under the Linked Exchange Rate system, movements in the Hong Kong dollar exchange rate against other currencies closely followed those of the US dollar. With the US dollar strengthening against the euro while weakening against pound sterling and Japanese yen, the *trade-weighted Hong Kong dollar Nominal Index* and *Real Effective Exchange Rate Index*⁽³⁾ went up by 0.5% and 0.3% respectively between March and June.

Diagram 4.3 : Hong Kong dollar strengthened against the US dollar (end for the week)

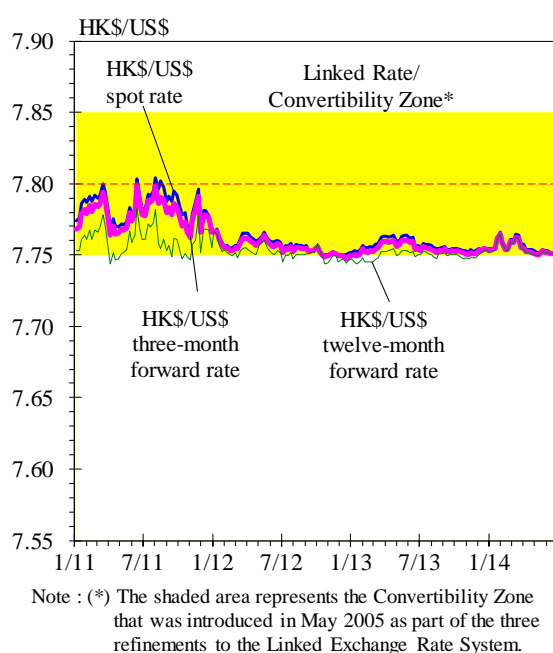
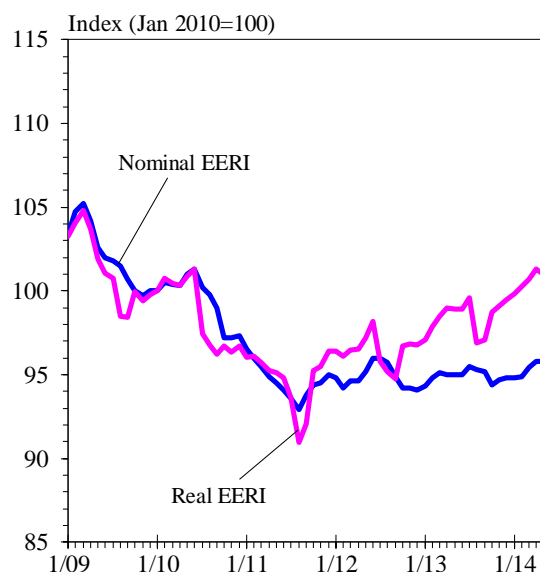


Diagram 4.4 : The trade-weighted nominal and real EERIs both increased (average for the month)



Money supply and banking sector

4.6 The monetary aggregates recorded accelerated growth in the second quarter. The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) rose by 5.3% over end-March to \$1,070 billion at end-June, and the broad money supply (HK\$M3) by 5.7% to \$5,151 billion⁽⁴⁾. Meanwhile, *total deposits* with authorized institutions (AIs)⁽⁵⁾ expanded by 4.6% to \$9,612 billion, within which Hong Kong dollar deposits rose by 6.0% and foreign currency deposits by 3.3%.

Diagram 4.5 : The monetary aggregates recorded accelerated growth

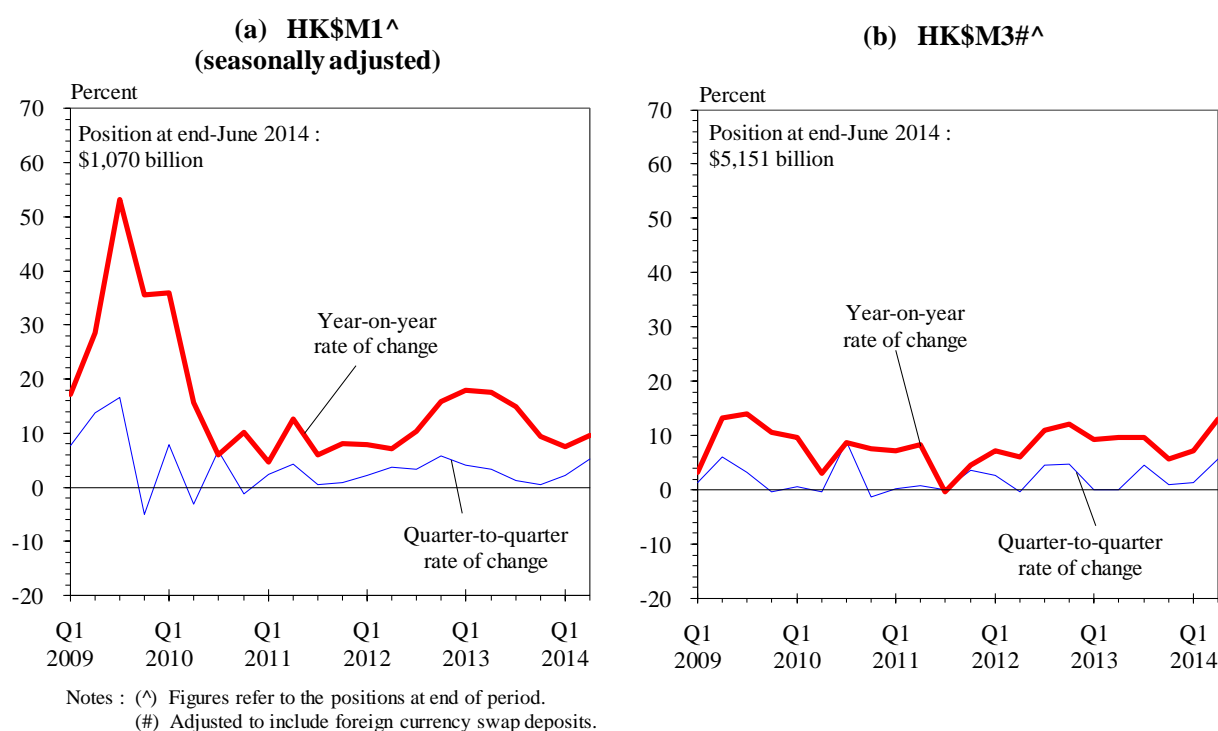


Table 4.1 : Hong Kong dollar money supply and total money supply

		<u>M1</u>		<u>M2</u>		<u>M3</u>	
<u>% change during the quarter</u>		<u>HK\$[^]</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>
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
2014	Q1	2.2	0.8	1.4	0.9	1.4	0.9
	Q2	5.3	6.9	5.7	4.5	5.7	4.5
Total amount at end-June 2014 (\$Bn)		1,070	1,628	5,140	10,599	5,151	10,632
% change over a year earlier		9.6	14.0	13.1	15.0	13.1	15.0

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

4.7 Total loans and advances increased by 3.6% over end-March to \$7,074 billion at end-June. Within the total, Hong Kong dollar loans and foreign currency loans rose by 3.8% and 3.4% respectively. Reflecting the movements in deposits and loans, the loan-to-deposit ratio for Hong Kong

dollar declined from 84.3% at end-March to 82.5% at end-June, while that for foreign currency was little changed at 65.0%.

4.8 Loans for use in Hong Kong (including trade finance) expanded by 4.5% over end-March to \$5,041 billion at end-June, while loans for use outside Hong Kong increased by a milder 1.7% to \$2,033 billion. Within the former, loans to major economic sectors recorded increases of different extents. Loans to manufacturing and wholesale and retail trade rose notably, by 6.7% and 5.2% respectively. Trade financing recorded a decelerated 2.2% growth. As for property-related lending, loans to building, construction, property development and investment increased by 1.6%, while loans for purchase of residential property rose by an accelerated 2.1% alongside the revival of the property market.

Table 4.2 : Loans and advances

All loans and advances for use in Hong Kong											
Loans to :									All loans and advances for use outside Hong Kong ^(c)		Total loans and advances
% change during the quarter		Trade finance	Manu- facturing	Wholesale and retail trade	Building, construction, property development and investment	Purchase of residential property ^(a)	Financial concerns	Stock- brokers	Total ^(b)		
2013	Q1	19.3	2.5	1.1	-0.7	1.7	5.1	26.3	3.1	2.9	3.0
	Q2	23.9	9.3	8.8	4.2	1.3	3.3	17.3	7.0	4.3	6.3
	Q3	7.9	4.4	6.7	4.3	0.5	3.5	125.5	3.6	8.5	5.0
	Q4	-9.8	0.8	1.6	-0.8	0.3	6.5	-53.2	-0.5	4.3	0.9
2014	Q1	12.4	7.4	5.5	2.7	1.0	11.6	38.2	6.5	3.7	5.7
	Q2	2.2	6.7	5.2	1.6	2.1	3.7	68.0	4.5	1.7	3.6
Total amount at end-June 2014 (\$Bn)		631	248	464	1,037	979	378	72	5,041	2,033	7,074
% change over a year earlier		11.7	20.5	20.4	8.0	3.9	27.6	145.2	14.8	19.3	16.0

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.

4.9 The Hong Kong banking sector remained resilient. The Hong Kong incorporated AIs were well capitalised, with the total capital adequacy ratio staying high at 15.9% at end-March 2014. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III⁽⁶⁾.

4.10 The first round of industry consultation on the proposals for establishing and implementing a local regulatory and supervising framework for systemically important AIs in Hong Kong, with reference to the Basel Committee's principles, was closed in May. Through the application of a range of prudential and supervisory requirements to these designated AIs, the proposals would help reduce the probability of failure and the extent or impact of failure of these AIs, thereby ensuring the resilience of the financial sector of Hong Kong. The HKMA would consider the comments received, and develop the regulatory and supervisory framework in due course.

4.11 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans edged down from 0.48% at end-2013 to 0.46% at end-March 2014. The delinquency ratio for credit card lending increased slightly from 0.20% to 0.22%, still a relatively low level. The delinquency ratio for residential mortgage loans continued to stay at a low level of 0.02% at end-June.

Table 4.3 : 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>
2013	Q1	98.32	1.22	0.46
	Q2	98.42	1.11	0.47
	Q3	98.25	1.27	0.48
	Q4	98.33	1.20	0.48
2014	Q1	98.42	1.12	0.46

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".

4.12 Renminbi (RMB) business maintained good growth momentum. *RMB trade settlement handled by banks in Hong Kong* amounted to RMB1,437 billion in the second quarter, 66.3% higher than a year earlier though 3.5% lower than the high base in the preceding quarter. Also, RMB bond issuance reached a new high of RMB70 billion in the second quarter. Taking the first half as a whole, the amount of RMB bonds issued reached RMB130 billion, already exceeding the annual total of RMB117 billion in 2013.

4.13 Meanwhile, the *outstanding amount of RMB loans* surged by 15.5% from end-March to about RMB139 billion at end-June. Yet *total RMB deposits* (including customer deposits and outstanding certificates of deposit) edged down from a high of RMB1,158 billion to RMB1,125 billion over the period.

Table 4.4 : Renminbi deposits and cross-border renminbi trade settlement in Hong Kong

<u>As at end of period</u>		<u>Interest rates on^(a)</u>					<u>Number of AIs engaged in RMB business</u>	<u>Amount of cross-border RMB trade settlement^(c)</u> (RMB Mn)
		<u>Demand and savings deposits</u> (RMB Mn)	<u>Time deposits</u> (RMB Mn)	<u>Total deposits</u> (RMB Mn)	<u>Savings deposits^(b)</u> (%)	<u>Three-month time deposits^(b)</u> (%)		
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
2014	Q1	167,082	777,828	944,910	0.25	0.53	147	1,488,813
	Q2	150,696	775,218	925,914	0.25	0.53	148	1,437,291
% change over the preceding quarter		-9.8	-0.3	-2.0	N.A.	N.A.	N.A.	-3.5
% change over a year earlier		18.2	35.9	32.7	N.A.	N.A.	N.A.	66.3

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

4.14 The Hong Kong dollar debt market showed steady performance in the second quarter. The total gross issuance edged up by 0.1% from the preceding quarter to \$593.8 billion. Within the total, private sector debt issuance⁽⁷⁾ declined by 10.7%, with the plunges in new debts issued by AIs and local corporations more than offsetting the growth in new debts issued by non-MDBs overseas borrowers. By comparison, public sector debt issuance increased by 1.5%. At end-June, the total outstanding balance of Hong Kong dollar debt declined by 2.2% from end-March to \$1,396.7 billion. This was equivalent to 27.1% of HK\$M3 or 23.2% of Hong Kong dollar-denominated assets of the banking sector⁽⁸⁾.

4.15 As to the Government Bond (“GB”) Programme, two bond tenders were held in the second quarter of 2014, which included the new issuance of \$3 billion institutional GBs in April and the switch tender⁽⁹⁾ of \$0.8 billion institutional GBs in May. As at end-June, the outstanding size of bonds issued amounted to \$97 billion, including 11 institutional issues for \$67 billion, and three inflation-linked bond (iBond) issues for \$30 billion. Separately, the fourth issuance of iBond, with a maximum issuance of \$10 billion, was made available for subscription on 23 July 2014.

**Table 4.5 : New issuance and outstanding value of
Hong Kong dollar debt securities (\$Bn)**

	Exchange Fund paper	Statutory bodies/govern- ment-owned corporations	Govern- ment	Public sector total	Als	Local corporations	Non-MDBs overseas borrowers [^]	Private sector total	MDBs [^]	Total
New Issuance										
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
2014 Q1	525.4	2.5	7.5	535.4	33.3	9.8	13.3	56.4	1.3	593.1
Q2	539.5	0.2	3.8	543.5	23.2	6.5	20.6	50.3	0.0	593.8
% change in 2014 Q2 over 2013 Q2	0.4	-96.8	-70.8	-2.2	-41.3	199.2	175.8	2.3	-	-1.8
% change in 2014 Q2 over 2014 Q1	2.7	-93.5	-49.3	1.5	-30.3	-33.4	55.0	-10.7	-	0.1
Outstanding (as at end of period)										
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
2014 Q1	751.5	40.1	95.5	887.1	249.0	130.4	150.9	530.3	11.1	1,428.4
Q2	752.0	37.1	99.3	888.4	228.9	124.4	148.1	501.5	6.9	1,396.7
% change over a year earlier	0.3	-14.0	16.8	1.2	-8.7	6.3	-0.6	-3.0	-30.5	-0.6
% change over the preceding quarter	0.1	-7.4	4.0	0.1	-8.1	-4.6	-1.9	-5.4	-38.0	-2.2

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

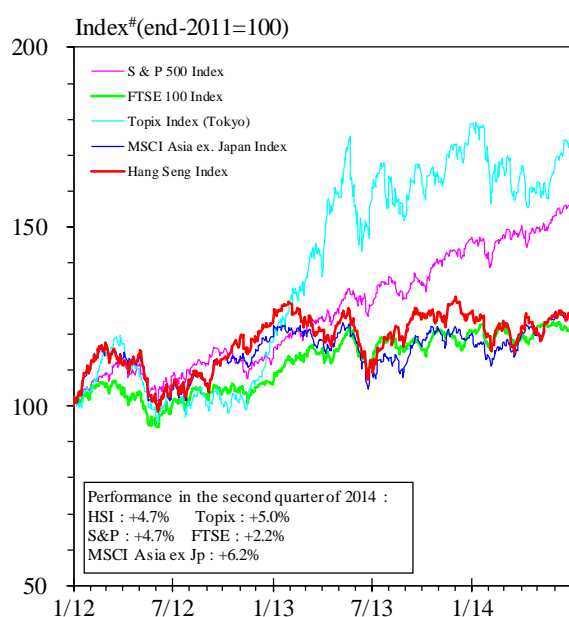
([^]) MDBs : Multilateral Development Banks.

The stock and derivatives markets

4.16 The *local stock market* regained momentum in the second quarter of 2014, as market sentiment was underpinned by signs of a reviving Mainland economy, an improving US economy, and the Federal Reserve keeping an accommodative monetary stance. Alongside the uptrend in the major overseas stock markets, the Hang Seng Index (HSI) rose by 4.7% over end-March to 23 191 at end-June, almost recouping all the loss suffered during the first quarter. In tandem, the *market capitalisation* of the Hong Kong stock market rose by 3.8% to \$23.9 trillion. According to the World Federation of Exchanges, the local stock market was the sixth largest stock exchange in the world and second largest in Asia⁽¹⁰⁾.

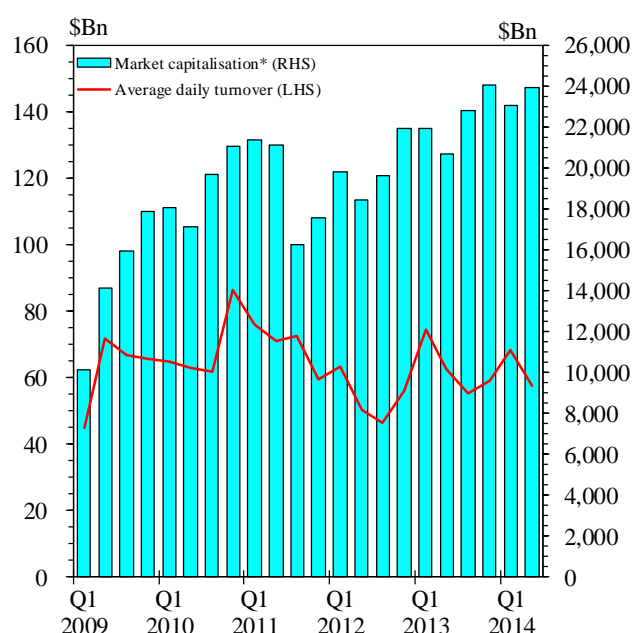
4.17 Yet trading activities quietened down. *Average daily turnover* in the securities market fell by 15.9% from the preceding quarter or 7.8% from a year earlier to \$57.5 billion in the second quarter. Trading of *derivatives products*⁽¹¹⁾ also contracted. The average daily trading volume of futures and options fell by 10.5% from the preceding quarter, with trading of HSI options, stock options, HSI futures and H-shares Index futures down by 0.1%, 8.5%, 9.4% and 16.2% respectively. The average daily trading value of securitised derivatives products went down by 13.9%, with trading of derivative warrants and callable bull/bear contracts dropping by 9.5% and 20.0% respectively.

Diagram 4.6 : The Hang Seng Index re-gathered some momentum in the second quarter of 2014



Notes : (#) Position at end of month.

Diagram 4.7 : Market capitalisation rose but trading activities quietened down



Note : (*) Position at end of quarter.

**Table 4.6 : Average daily turnover of derivatives 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) [^]
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
2014	Q1	71 607	28 842	92 576	274 757	554 700	7,077	5,090	12,167
	Q2	64 897	28 810	77 613	251 375	496 449	6,404	4,074	10,478
% change in 2014 Q2 over 2013 Q2		-28.8	-33.5	-11.5	-1.9	-11.9	-10.4	-25.0	-16.7
% change in 2014 Q2 over 2014 Q1		-9.4	-0.1	-16.2	-8.5	-10.5	-9.5	-20.0	-13.9

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.

4.18 Fund raising activities slowed down in the first half of 2014, though showing some signs of pick-up in June. *Total equity capital raised*, comprising new share floatations and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)⁽¹²⁾, declined by 10.8% from the second half of 2013 to \$215.8 billion, though soaring by 57.5% over the low base a year earlier. Within the total, the amount of funds raised through initial public offerings dwindled by 37.2% from the second half of 2013 to \$81.1 billion.

4.19 Mainland enterprises continued to play a dominant role in the Hong Kong stock market. At end-June 2014, a total of 837 Mainland enterprises (including 194 H-share companies, 129 “Red Chips” companies and 514 private enterprises) were listed on the Main Board and GEM, accounting for 50% of the total number of listed companies and 57% of total market capitalisation. In the second quarter, Mainland-related stocks accounted for 69% of equity turnover and 63% of total equity fund raised in the Hong Kong stock exchange.

4.20 In early June the Hong Kong Exchanges and Clearing Limited announced to extend the closing time of its After-hours Futures Trading (AHFT) from 11:00 pm to 11:45 pm with effect from 3 November 2014. The arrangement will further increase AHFT's overlap with the business hours in key European and North American markets, including London and New York, thereby strengthening market participants' capability to hedge or adjust their position in response to latest news and overseas events.

Fund management and investment funds

4.21 Different segments of the fund management business showed a mixed performance in the second quarter. In parallel to the rebound in the equity market, the aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹³⁾ rose by 5.1% over end-March 2014 to \$543 billion at end-June. Gross retail sales of *mutual funds* edged down by 0.2% from the preceding quarter to US\$20.6 billion in the second quarter, though increasing by 2.1% over a year earlier⁽¹⁴⁾. The amount of net assets managed by *retail hedge funds* showed a modest decline⁽¹⁵⁾.

4.22 In late June, the Government and the Mandatory Provident Fund Schemes Authority (MPFA) jointly launched a three-month public consultation on the proposal to introduce a "core fund", which would serve as the default fund of all MPF schemes. The "core fund" would adopt a life cycle or target date investment strategy that automatically reduces investment risks as scheme members approach retirement age, and would be subject to fee control at a level not exceeding 0.75% of the fund assets under management. The "core fund" would help manage the long-term risks associated with investment of retirement savings. It could also become a benchmark in MPF fees and performance, thereby enhancing competition and driving down management fees for other MPF funds. Depending on the outcome of the consultation, the Government and the MPFA will follow up on the legislative and implementation issues, with a view to launching the "core fund" in 2016.

4.23 Separately, the Mandatory Provident Fund (MPF) Schemes (Amendment) Bill 2014 was gazetted in June and was subsequently introduced into the Legislative Council in July. The Bill provides for, among others, phased withdrawal of accrued benefits as an additional option for scheme members upon retirement and early retirement. The accrued benefits withdrawn in phases, as is the case for lump-sum withdrawal, will be tax-exempted. The proposal would facilitate the management of MPF accrued benefits to meet their needs after retirement.

Insurance sector

4.24 Business in the *insurance sector*⁽¹⁶⁾ was generally good in the first quarter of 2014. Gross premium income from long-term business soared by 21.5% over a year earlier, though the different underlying business segments recorded a mixed performance. Premium income from non-investment linked plans jumped by 35.6% while that from investment-linked plans plunged by 31.1%. Meanwhile, gross premium for general business increased by a modest 1.6%, but the net premium declined by 1.0%.

4.25 The Insurance Companies (Amendment) Bill 2014, which provides for a legal framework for establishing an independent Insurance Authority (IA) and a statutory licensing regime for insurance intermediaries, was introduced to the Legislative Council in April. Through establishing an insurance regulator that is independent of the industry and the Government, the Bill marks a major step forward in modernising the regulatory infrastructure of the insurance industry, and will provide better protection for policyholders and facilitate the sustainable development of the industry. To ensure a smooth and seamless transition, the Government has set up a Working Group on Transition comprising members from the Hong Kong Federation of Insurers, the three self-regulatory organisations and insurance intermediaries to work out the detailed arrangements.

Table 4.7 : 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 life and annuity (non-linked)	Individual life and annuity (linked)	Other individual business	Non-retirement scheme group business	All long-term business	
2013	Annual	42,120	29,179	3,038	73,015	19,132	156	285	92,588	134,708
	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
	Q4	8,821	5,660	846	19,008	4,785	40	121	23,954	32,775
2014	Q1	12,551	8,668	902	23,770	3,387	39	180	27,376	39,927
% change in 2014 Q1 over 2013 Q1		1.6	-1.0	37.3	35.6	-31.1	8.3	239.6	21.5	14.4

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

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

Highlights of policy and market developments

4.26 The Securities and Futures (Levy) (Amendment) Order 2014, which provides for a 10% reduction of the levy payable for trading in securities and futures/options contracts, was gazetted on 6 June. The proposal could bring cost-savings to both the general investing public and the financial industry. The Order will take effect on 1 November 2014.

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-June 2014, there were 159 licensed banks, 20 restricted licence banks and 23 deposit-taking companies in Hong Kong. Altogether, 202 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 under modification by the Basel Committee, while the timetable for this standard to take effect remains unchanged on 1 January 2018. 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, took effect in Hong Kong with the amendments to the Banking (Capital) Rules (by way of the Banking (Capital) (Amendment) Rules 2012) coming into operation since 1 January 2013. To implement the Basel Committee's disclosure requirements associated with these standards, amendments were introduced in the Banking (Disclosure) Rules (by way of the Banking (Disclosure) (Amendment) Rules 2013) which took effect from 30 June 2013.
- (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 HKMA implemented two liquidity enhancement measures in the first half of 2014 to promote liquidity of the institutional bond market. Following the introduction of bond swap facility in February, the first switch tender was held in May. Switch tender allows the Government to initiate a tender for Primary Dealers to bid for the permanent switching from a pre-announced off-the-run GB into another pre-announced benchmark GB under a competitive tender mechanism.

- (10) 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. The statistics on London Stock Exchange Group are as of December 2013.
- (11) At end-June 2014, there were 74 classes of stock options contracts and 41 classes of stock futures contracts.
- (12) At end-June 2014, there were 1 495 and 194 companies listed on the Main Board and GEM respectively.
- (13) At end-June 2014, 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 269 000 employers, 2.49 million employees and 211 000 self-employed persons have participated in MPF schemes.
- (14) 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-June 2014, the survey covered a total of 1 183 active authorised funds.
- (15) At end-June 2014, there were three SFC-authorised retail hedge funds with combined net asset size of US\$245 million. The amount of net assets under management dropped by 5.4% from the end-March level, and represented an increase of 1.5 times of that at end-2002, the year when the hedge funds guidelines were first issued.
- (16) At end-June 2014, there were 158 authorised insurers in Hong Kong. Within this total, 44 were engaged in long-term insurance business, 94 in general insurance business, and 20 in composite insurance business. These authorised insurers come from 23 countries and territories (including Hong Kong).