

CHAPTER 5 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued in 2014 amid the ongoing accommodative monetary policy in the United States. The Hong Kong dollar interbank interest rates and retail level interest rates remained at low levels.*
- *The Hong Kong dollar exchange rate moved within a narrow range of \$7.750-7.766 per US dollar in 2014. The strong-side Convertibility Undertaking was repeatedly triggered between July and early August due to strong inflow of funds to meet the commercial and equity-related demand for the Hong Kong dollar, leading to an increase in the Aggregate Balance.*
- *The Hong Kong dollar monetary aggregates expanded at a slightly faster pace in 2014. Meanwhile, total loans and advances increased at a moderated yet still visible pace.*
- *The local stock market exhibited much volatility in 2014, along with the changes in external economic environment and developments on the policy front during the year. The Hang Seng Index (HSI) rallied starting May, but showed a marked correction in September and October amid renewed concerns over a slowdown in global economic recovery. The HSI closed at 23 605 at end-2014, only 1.3% higher than at end-2013. Trading activities were lacklustre in the first half of the year, but picked up noticeably in the second half.*

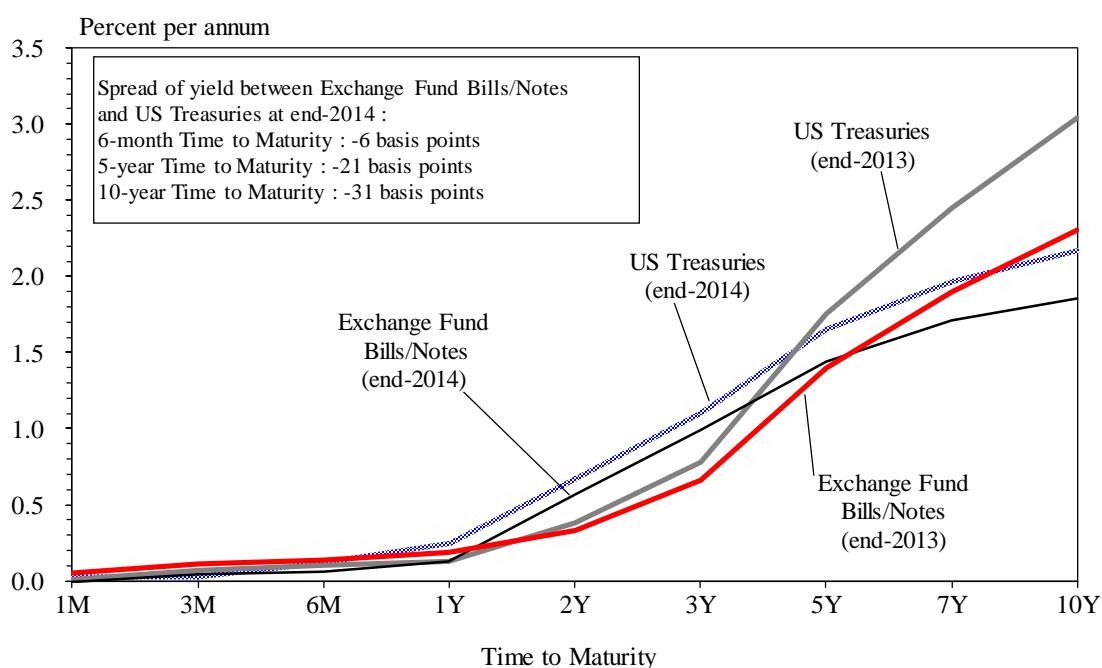
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

Interest rates and exchange rates

5.1 The low interest rate environment in Hong Kong continued in 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 remained at low levels. The overnight HIBOR edged down from 0.08% at end-2013 to 0.05% at end-2014, while the three-month HIBOR stayed unchanged at 0.38%.

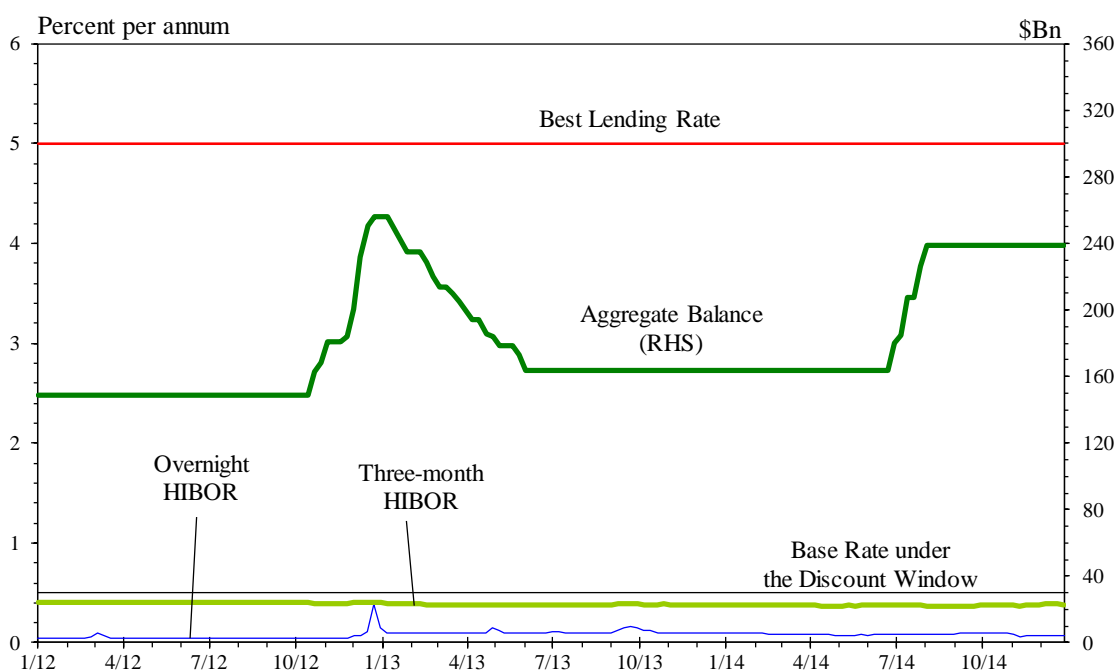
5.2 The *Hong Kong dollar* and *US dollar yield curves* flattened during 2014, with a decline in yields in the long tenor though a rise in the medium tenor (i.e. 2 to 3 years to maturity). As the decline in Hong Kong dollar long tenor yields was smaller than that in its US dollar counterparts, the negative yield spread between 10-year Exchange Fund Notes and 10-year US Treasury Notes narrowed from 74 basis points at end-2013 to 31 basis points at end-2014. Over the same period, the Hong Kong dollar yields showed a small decline in the short tenor while the US dollar yields remained steady. The yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills therefore turned from a positive four basis points to a negative six basis points.

Diagram 5.1 : The Hong Kong dollar and US dollar yield curves flattened during 2014



5.3 Interest rates on the retail front also stayed at low levels. The *Best Lending Rates* remained unchanged at 5.00% or 5.25% throughout 2014, while the *average savings deposit rate* and the *one-year time deposit rate* quoted by the major banks for deposits of less than \$100,000 stayed flat at 0.01% and 0.16% respectively. The *composite interest rate*⁽²⁾, which indicates the average cost of funds for retail banks, remained generally low. It hovered within a narrow range of 0.37% and 0.47%, and stayed unchanged from a year earlier at 0.39% at end-2014.

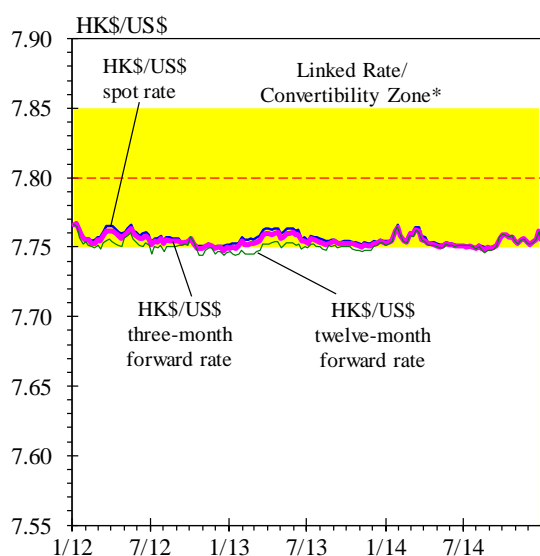
**Diagram 5.2 : Hong Kong dollar interest rates remained low
(end for the week)**



5.4 The *Hong Kong dollar spot exchange rate* moved within a narrow range of 7.750-7.766 per US dollar in 2014. After softening slightly in the early part of the year, the spot exchange rate has strengthened since April and stayed close to the 7.75 level for the rest of the year. It closed at 7.755 per US dollar at end-2014, little changed from 7.754 at end-2013. In July and early August the strong-side Convertibility Undertaking was repeatedly triggered due to strong inflow of funds amid the commercial and equity-related demand for the Hong Kong dollar. This prompted the HKMA to passively purchase a total of US\$9.7 billion from banks with HK\$75.3 billion, and led to a corresponding increase in the Aggregate Balance in accordance with the Currency Board principles. Meanwhile, the differential between *the 3-month Hong Kong dollar forward rate* and spot rate turned from -8 pips (each pip equivalent to HK\$0.0001) at end-2013 to +3 pips at end-2014, and that between the *12-month forward rate* and spot rate from -17 pips to +5 pips.

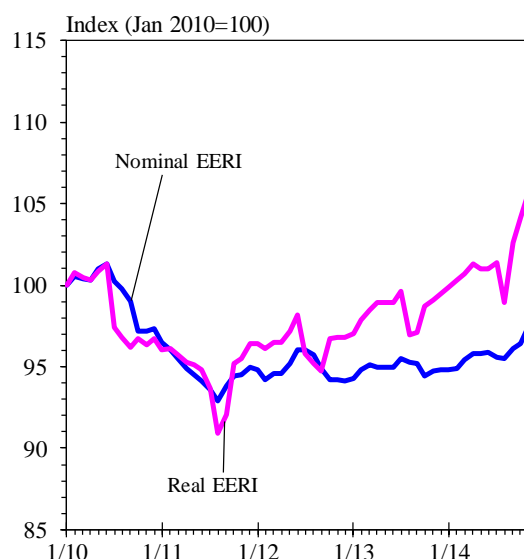
5.5 Under the Linked Exchange Rate system, movements in the Hong Kong dollar exchange rate against other currencies closely followed those of the US dollar. As the US dollar strengthened against most major currencies during 2014, including the Japanese yen, euro and pound sterling, the *trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices*⁽³⁾ rose by 4.0% and 7.6% respectively.

Diagram 5.3 : Hong Kong dollar stayed close to 7.75 per US dollar during most of 2014 (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 both rose in 2014 (average for the month)



Money supply and banking sector

5.6 The Hong Kong dollar monetary aggregates expanded at a slightly faster pace in 2014. The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) grew by 11.7% over a year earlier to \$1,112 billion at end-2014, and the broad money supply (HK\$M3) by 9.0% to \$5,236 billion⁽⁴⁾. Over the same period, *total deposits* with authorised institutions (AIs)⁽⁵⁾ increased by 9.7% to \$10,074 billion, with Hong Kong dollar deposits and foreign currency deposits growing by 9.3% and 10.1% respectively.

Diagram 5.5 : The monetary aggregates expanded slightly faster in 2014

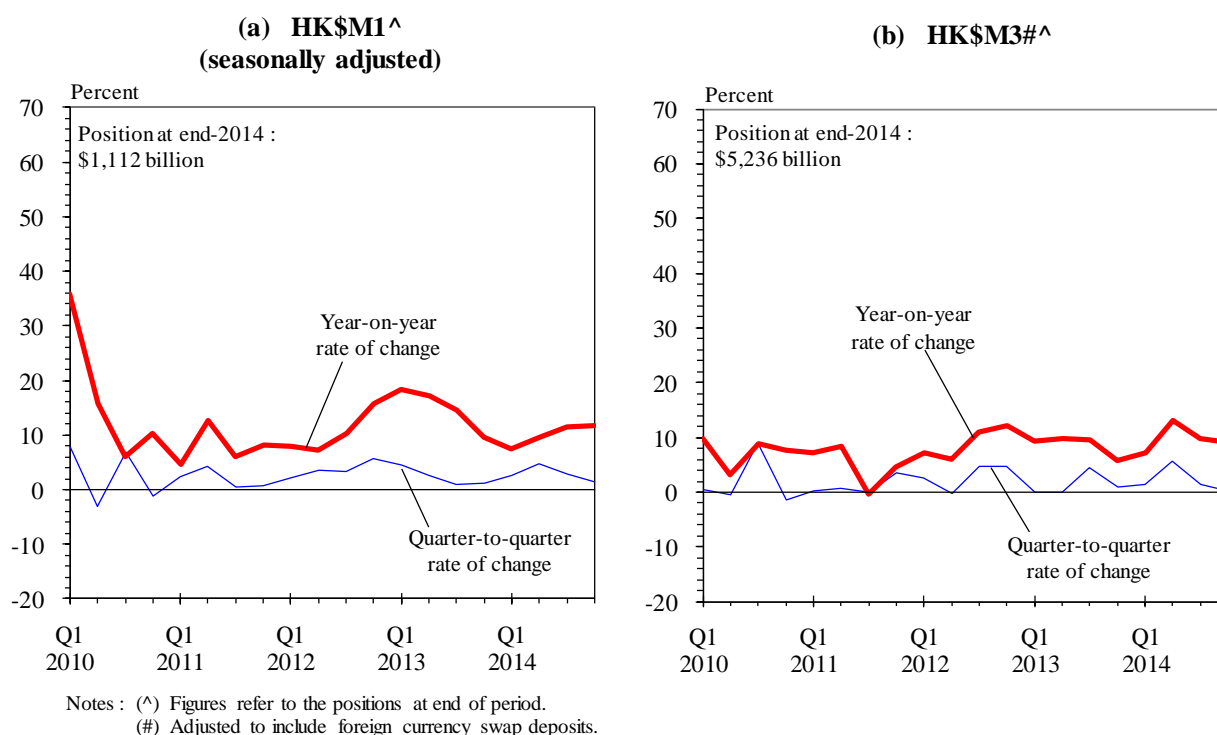


Table 5.1 : Hong Kong dollar money supply and total money supply

		<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	4.5	1.0	0.1	1.1	0.1	1.1
	Q2	2.6	2.7	#	1.9	0.1	1.9
	Q3	1.0	3.9	4.6	5.5	4.6	5.5
	Q4	1.1	1.8	0.9	3.4	0.9	3.4
2014	Q1	2.5	0.8	1.4	0.9	1.4	0.9
	Q2	4.7	6.9	5.7	4.5	5.7	4.5
	Q3	2.8	3.1	1.4	2.9	1.4	3.0
	Q4	1.3	1.8	0.3	0.9	0.3	0.9
Total amount at end-2014 (\$Bn)		1,112	1,708	5,226	11,012	5,236	11,050
% change over a year earlier		11.7	13.0	9.0	9.5	9.0	9.6

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

(#) Change of less than $\pm 0.05\%$.

5.7 Growth in *total loans and advances* decelerated noticeably through the year, from a quarter-on-quarter increase of 5.7% in the first quarter to 0.9% in the fourth quarter. Yet for the year as a whole, there was still a visible growth of 12.7% to \$7,276 billion at end-2014. Among the total, Hong Kong dollar loans and foreign currency loans expanded by 10.9% and 14.9% respectively. Reflecting the relative movements in loans and deposits, the loan-to-deposit ratios picked up in early 2014 and then levelled off. The loan-to-deposit ratio for Hong Kong dollar rose from 82.1% at end-2013 to 83.3% at end-2014, and the loan-to-deposit ratio for foreign currency from 59.5% to 62.1%.

5.8 Loans for use in Hong Kong (including trade finance) increased by 12.1% over a year earlier to \$5,075 billion at end-2014, and loans for use outside Hong Kong by 14.2% to \$2,201 billion. Within the former, loans to most economic sectors recorded visible growth. On the back of a pick-up in fund-raising and trading activities in the equity market, loans to financial concerns and stockbrokers rose notably by 19.5% and 65.7% respectively. Loans for purchase of residential property rose by an accelerated 8.4% alongside a generally active property market, while loans to building, construction, property development and investment grew by 6.8%. Loans to manufacturing and wholesale and retail trade surged by 25.0% and 13.3% respectively. Yet trade finance declined by 1.4%, dragged by a marked decline in the fourth quarter.

Table 5.2 : Loans and advances

All loans and advances for use in Hong Kong										
Loans to :										
% change during the quarter			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
	Trade finance	Manu-facturing	trade	investment	property ^(a)	concerns	brokers	Total ^(b)	Hong Kong ^(c)	advances
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	12.0	38.2	6.6	3.7	5.7
Q2	2.4	6.7	5.4	1.6	2.1	3.3	68.1	4.4	1.7	3.6
Q3	0.2	7.2	7.9	0.8	2.3	1.2	-38.8	1.4	3.3	1.9
Q4	-14.5	1.8	-5.6	1.5	2.8	2.0	16.5	-0.7	4.8	0.9
Total amount at end-2014 (\$Bn)	543	271	474	1,062	1,030	390	51	5,075	2,201	7,276
% change over a year earlier	-1.4	25.0	13.3	6.8	8.4	19.5	65.7	12.1	14.2	12.7

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. The Hong Kong incorporated AIs were well capitalised, with the total capital adequacy ratio staying high at 16.4% at end-September 2014. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III⁽⁶⁾.

5.10 The HKMA conducted a consultation on the proposal for establishing and implementing a local regulatory and supervising framework for systemically important AIs in Hong Kong during March to May. Widely supported by the industry, the HKMA is in the process of developing a new Supervisory Policy Manual module. Separately, HKMA has been working on the implementation of the second phase of the Basel III standards which encompass the liquidity coverage ratio, the capital buffers (i.e. the “capital conservation buffer”, the “countercyclical capital buffer”, and for systemically important banks, the “higher loss absorbency requirements”), and the

requirements for disclosure by banks that are associated with these standards as well as the Basel III Leverage Ratio. To this end, legislative changes (in the form of amendments to the Banking (Capital) Rules and a new set of Banking (Liquidity) Rules) have been introduced for taking effect on 1 January 2015. Preparation of draft amendments to the Banking (Disclosure) Rules is likewise in progress, which are targeted to take effect at the AIs' first interim or annual financial period ending in 2015.

5.11 The HKMA continues to monitor closely AIs' management of credit and liquidity risks, funding strategy, mortgage lending, Mainland-related business, and other areas of supervisory concerns to ensure the resilience of the banking sector against shocks in the external and domestic macro-financial environment. The Stable Funding Requirement (SFR), which requires AIs to hold sufficient stable funds to support their lending business, came into effect in January 2014. To streamline the SFR's operation and alleviate AI's reporting burden, some refinements of the SFR were announced in November 2014 for taking effect in January 2015. These included, among others, a change in loan filter from banks with loan book exceeding \$5 billion and annualised year-to-date loan growth exceeding 20% to AIs with total loans of at least \$10 billion and annualised average loan growth in the latest eight quarters exceeding 15%, and a change in the frequency of review and report submission from a monthly to a quarterly basis.

5.12 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans declined from 0.48% at end-2013 to 0.43% at end-September 2014. The delinquency ratio for credit card lending remained at a low level by historical standards, though edging up from 0.20% at end-2013 to 0.22% at end-September 2014. The delinquency ratio for residential mortgage loans stayed low at 0.03% at end-2014.

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>
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
	Q2	98.50	1.05	0.46
	Q3	98.53	1.04	0.43

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”.

5.13 *Offshore renminbi (RMB) business* registered further notable expansion in 2014. RMB trade settlement transactions handled by banks in Hong Kong surged by 63% to RMB6,258 billion in 2014. Reflecting the strong need for RMB financing, outstanding RMB bank loans soared by 63% over a year earlier to RMB188 billion at end-2014. While the issuance of RMB bonds expanded sharply by 69% to RMB197 billion in 2014, the outstanding amount of RMB bonds grew by 23% over a year earlier to RMB381 billion at end-2014. Meanwhile, total RMB deposits (including customer deposits and outstanding certificates of deposit) increased by 10% to RMB1,158 billion.

5.14 The HKMA introduced several measures to strengthen Hong Kong’s market infrastructure for offshore RMB business development in the fourth quarter. In October, seven banks were designated by the HKMA as Primary Liquidity Providers. With access to a dedicated repo facility provided by the HKMA, the Primary Liquidity Providers pledged to expand their market-making activities in Hong Kong for various offshore market instruments, and use the Hong Kong platform in promoting their global offshore RMB business. In November, the HKMA started offering intraday RMB funds to authorised institutions participating in RMB business in Hong Kong, which helps banks to better manage their RMB liquidity and facilitates efficient payment flows. Separately, the daily RMB conversion limit for Hong Kong residents was removed in early November, making it more convenient for Hong Kong residents to participate in RMB financial transactions.

Table 5.4 : 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
	Q3	144,306	800,168	944,473	0.25	0.53	149	1,609,298
	Q4	176,967	826,590	1,003,557	0.25	0.53	149	1,722,857
% change over a year earlier		17.2	16.5	16.6	N.A.	N.A.	N.A.	40.7

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

5.15 The Hong Kong dollar *debt market* was steady in 2014. Total issuance increased by 3.1% to \$2,430.0 billion, of which 89.6% was Exchange Fund papers. Within the total, new debts issued by the public sector rose by 2.5%, underpinned by a modest growth in debts issued by the Exchange Fund and the Government. New debts issued by the private sector recorded a faster growth of 10.0%, reflecting a visible increase in new debts issued by both local corporations and non-MDBs overseas borrowers⁽⁷⁾. Nevertheless, as there were more debts maturing than being issued during the year, the outstanding balance of Hong Kong dollar debt edged down by 0.7% over a year earlier to \$1,409.8 billion at end-2014. This was equivalent to 26.9% of HK\$M3 or 22.4% of Hong Kong dollar-denominated assets of the entire banking sector⁽⁸⁾.

5.16 As to the Government Bond (“GB”) programme, a total of \$20 billion institutional GBs with tenors ranging from two to ten years were issued through tenders in 2014. Separately, \$10 billion inflation-linked retail bonds (i.e. iBonds) were issued in August in accordance with the 2014-15 Budget. In September, a sukuk with an issuance size of US\$1 billion and a tenor of five years was issued. The total outstanding amount of Hong Kong dollar bonds

under the Government Bond (“GB”) Programme was \$96.5 billion at end-2014. This comprised 12 institutional issues totaling \$66.5 billion and three retail issues (iBonds) totaling \$30 billion.

5.17 In December 2014 the HKMA announced two measures to further promote the development of the local Hong Kong dollar bond market. *First*, the issuance of Exchange Fund Notes (EFNs) and GBs were streamlined to minimise overlap in tenors, so as to establish a single benchmark yield curve. Specifically, with effect from January 2015, the HKMA has stopped new issuance of EFNs of tenors of three years or above, though it will issue additional EFNs of these tenors to replace those maturing as necessary. New issuance of two-year GBs has ceased at the same time. New issuances of GBs will only be for tenors of three years and above, and the amount of these GBs will be suitably increased to meet investors’ demand for longer term high-quality Hong Kong dollar bonds. *Second*, the HKMA introduced a discount facility for GBs so as to provide greater flexibility for banks to manage liquidity. The facility provides up to a total of \$10 billion overnight liquidity against a sale and repurchase of GBs. The HKMA would obtain funding from the market to maintain the size of the Aggregate Balance as needed.

Table 5.5 : 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	AIs ^(a)	Local corporations	Non-MDBs overseas borrowers ^(b)	Private sector total	MDBs ^(b)	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	0.0	569.7
	Q2	537.6	5.0	13.0	555.6	39.5	2.2	7.5	49.2	0.0	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	0.0	589.1
2014	Annual	2,177.3	9.6	30.8	2,217.7	127.1	33.3	50.5	210.9	1.3	2,430.0
	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
	Q3	533.6	4.9	16.5	555.1	32.2	8.3	5.6	46.2	0.0	601.3
	Q4	578.7	2.1	3.0	583.8	38.4	8.7	10.9	58.0	0.0	641.8
% change in 2014 over 2013		2.5	-9.5	2.7	2.5	-11.1	30.1	118.5	10.0	42.2	3.1
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	98.5	887.6	228.9	124.4	148.1	501.5	6.9	1,395.9
	Q3	752.2	41.5	105.0	898.7	223.0	132.3	142.5	497.8	6.9	1,403.4
	Q4	752.6	41.0	98.0	891.6	232.8	137.6	141.7	512.1	6.1	1,409.8
% change over a year earlier		0.2	2.9	7.1	1.0	-6.9	7.6	-4.7	-2.8	-40.3	-0.7

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

(a) AIs : Authorised institutions.

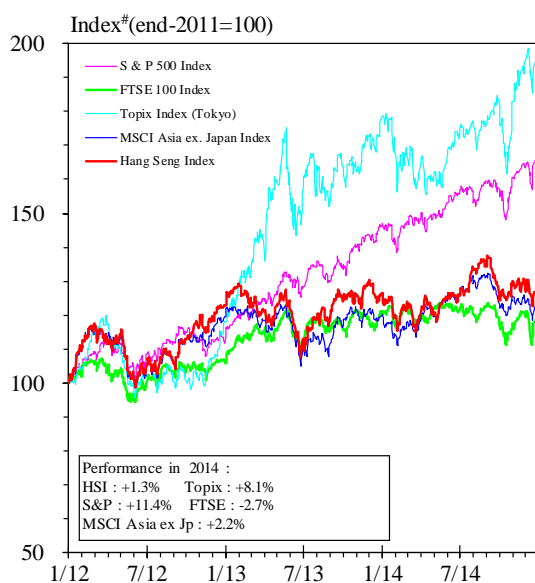
(b) MDBs : Multilateral Development Banks.

The stock and derivatives markets

5.18 The *local stock market* exhibited much volatility in 2014, along with the changes in external economic environment and developments on the policy front during the year. Supported by the announcement of the Shanghai-Hong Kong Stock Connect, as well as improved global economic growth and ongoing accommodative monetary policy in the United States, the Hang Seng Index (HSI) rallied starting May, and reached a high of 25 318 in early September. It showed a marked correction in the ensuing months, in tandem with the global stock market slide amid renewed concerns over a slowdown in global economic recovery. The HSI closed at 23 605 at end-2014, only 1.3% higher than at end-2013. The *market capitalisation* made a modest gain of 4.3% to reach \$25.1 trillion in parallel. According to the World Federation of Exchanges, the local stock market was the seventh largest stock exchange in the world and third largest in Asia⁽⁹⁾.

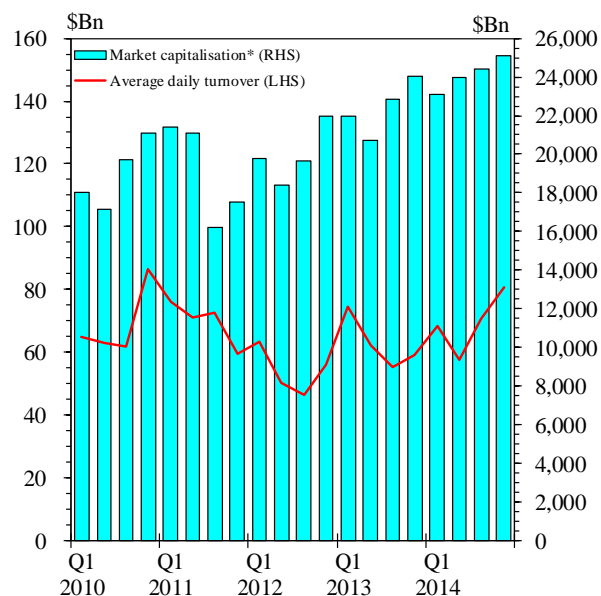
5.19 Trading activities were lacklustre in the first half of 2014, but picked up noticeably in the second half. For the year as a whole, *average daily turnover* in the securities market rose to \$69.5 billion, 11% higher than in 2013. Trading of *derivatives products*⁽¹⁰⁾ also increased. The average daily trading volume of futures and options expanded by 8.2%, though performance of different products varied. Trading of stock options and H-share Index Futures grew by 21.1% and 4.1% respectively, while trading of HSI futures and HSI options shrank by 13.9% and 13.7% respectively. Meanwhile, the average daily trading value of securitised derivatives products recorded a modest growth of 6.0%, within which the 13.3% rise in trading of derivative warrants more than offset the 4.3% decline in trading of callable bull/bear contracts.

Diagram 5.6 : The local stock market exhibited much volatility in 2014



Notes : (#) Position at end of month.

Diagram 5.7 : Market capitalisation made a modest gain while trading activities increased



Note : (*) Position at end of quarter.

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

		Hang Seng Index <u>futures</u>	Hang Seng Index <u>options</u>	H-shares Index <u>futures</u>	Stock <u>options</u>	Total futures and options <u>traded*</u>	Derivative warrants <u>(\$Mn)</u>	Callable bull/bear contracts <u>(\$Mn)</u>	Total securitised derivatives traded <u>(\$Mn)^</u>
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	Annual	69 098	30 440	89 005	301 797	579 676	8,277	4,980	13,257
	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
	Q3	66 730	29 887	79 181	304 098	556 968	9,791	5,290	15,081
	Q4	73 141	34 162	106 657	374 821	696 281	9,709	5,426	15,135
% change in 2014 Q4 over 2013 Q4		5.1	19.4	19.6	51.2	35.4	67.9	31.2	52.6
% change in 2014 over 2013		-13.9	-13.7	4.1	21.1	8.2	13.3	-4.3	6.0

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.

5.20 Fund raising activities showed notable growth in 2014, with most of the activities occurring in the second half. For 2014 as a whole, *total equity capital raised*, comprising new share floatations and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)⁽¹¹⁾, surged by 147% to a record-high of \$935.8 billion. Within the total, the amount of funds raised through initial public offerings rose by a sharp 34.8% to \$227.7 billion. Hong Kong's global ranking in the amount of funds raised through IPO remained unchanged at the second place in 2014.

5.21 Mainland enterprises continued to play a dominant role in the Hong Kong stock market. A total of 876 Mainland enterprises (including 202 H-share companies, 133 "Red Chips" companies and 541 private enterprises) were listed on the Main Board and GEM, accounting for 50% of the total number of listed companies and 60% of total market capitalisation at end-2014. Mainland-related stocks accounted for 71% of equity turnover and 74% of total equity fund raised in the Hong Kong stock exchange in 2014.

5.22 The Shanghai-Hong Kong Stock Connect, a pilot programme for establishing mutual stock market access between Shanghai and Hong Kong⁽¹²⁾, was announced in April and subsequently launched on 17 November 2014. The aggregate quota was initially set at RMB 300 billion for Northbound trading and RMB 250 billion for Southbound trading. The programme would strengthen the strategic co-operation and interaction between the two securities markets and enhance Hong Kong's position as an offshore RMB centre.

5.23 The Hong Kong Exchanges and Clearing Limited (HKEx) has extended the closing time of its After-hours Futures Trading (AHFT) from 11:00 pm to 11:45 pm since 3 November 2014. The arrangement will further strengthen market participants' capability to hedge or adjust their position in response to latest news and overseas events. Separately, the HKEx introduced its first Asia commodities contracts, namely London Aluminium Mini Futures, London Zinc Mini Futures and London Copper Mini Futures, in December. Denominated in RMB, these commodity contracts will help enhance both the availability of asset classes and the range of RMB products in the Hong Kong financial market, thereby promoting the further development of Hong Kong as an offshore RMB centre.

5.24 In November, the HKMA and the Securities and Futures Commission (SFC) published their conclusions on the joint consultation on the draft Securities and Futures (Over-the-counter (OTC) Derivative Transactions – Reporting and Record Keeping) Rules (the Reporting Rules), which set out the

precise ambit and details of the reporting and related record keeping obligations under the OTC derivative regulatory regime. The HKMA and the SFC have conducted further joint consultation on specific matters in relation to the reporting and related record keeping obligations in November 2014. They are finalising the first batch of subsidiary legislation for tabling before the Legislative Council. This would mark an important step of the new OTC derivative regulatory regime and would help increase the transparency of the OTC derivative market.

Fund management and investment funds

5.25 Performance of the fund management business was generally solid in 2014. The aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹³⁾ rose notably by 9.9% over a year earlier to \$565.0 billion at end-2014. The gross retail sales of *mutual funds* also went up by 9.4% to US\$77.7 billion⁽¹⁴⁾ for the year. Meanwhile, the amount of net assets managed by *retail hedge funds* declined⁽¹⁵⁾.

Insurance sector

5.26 The *insurance sector*⁽¹⁶⁾ recorded accelerated growth in the third quarter of 2014. Gross premium income from long-term business surged by 27.6% over a year earlier, within which premium income from non-investment linked plans rose by a sharp 30.4% and that from investment-linked plans by 12.7%. As to general business, gross premium and net premium rose by 9.7% and 8.5% 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 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
	Q2	10,642	7,697	636	23,191	4,210	40	53	27,494	38,136
	Q3	11,534	7,936	853	24,652	4,317	47	120	29,136	40,670
% change in 2014 Q3 over 2013 Q3		9.7	8.5	27.1	30.4	12.7	17.5	140	27.6	22.0

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

5.27 The Stamp Duty (Amendment) Bill 2014 was gazetted in December 2014 and subsequently introduced to the Legislative Council. The bill seeks to waive stamp duty for the transfer of shares or units of all exchange traded funds (ETFs) with their registers of holders maintained in Hong Kong. Previously only ETFs that track indices comprising not more than 40% Hong Kong stocks could enjoy stamp duty waiver. Through reducing the transaction costs of ETFs, the proposed waiver would further enhance the development and trading of ETFs and strengthen Hong Kong's position as a leading international financial centre.

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-2014, there were 159 licensed banks, 21 restricted licence banks and 23 deposit-taking companies in Hong Kong. Altogether, 203 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 has already been in place since 1 January 2015 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. The revision to the standard concluded in October 2014. 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 ranking is made by the World Federation of Exchanges, a global trade association for the securities exchange industry. Its membership comprises 64 securities exchanges, covering almost all globally recognised stock exchanges.
- (10) At end-2014, there were 80 classes of stock options contracts and 41 classes of stock futures contracts.
- (11) At end-2014, there were 1 548 and 204 companies listed on the Main Board and GEM respectively.
- (12) For details, see 4.25 and footnote (13) of chapter 4 in the First Quarter Economic Report 2014.
- (13) At end-2014, there were 19 approved trustees. On MPF products, 35 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 458 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 271 000 employers, 2.51 million employees and 208 000 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-2014, the survey covered a total of 1 177 active authorised funds.
- (15) At end-2014, there were three SFC-authorised retail hedge funds with combined net asset size of US\$163 million. The amount of net assets under management dropped by 36.6% over a year earlier, and represented an increase of 1.9% of that at end-2002, the year when the hedge funds guidelines were first issued.
- (16) At end-2014, there were 158 authorised insurers in Hong Kong. Within this total, 44 were engaged in long-term insurance business, 95 in general insurance business, and 19 in composite insurance business. These authorised insurers came from 23 countries and territories (including Hong Kong).