

## CHAPTER 4 : THE FINANCIAL SECTOR<sup>#</sup>

### *Summary*

- *The low interest rate environment in Hong Kong continued in the second quarter of 2015 amid the ongoing accommodative monetary policy in the United States.*
- *The Hong Kong dollar spot exchange rate stayed close to 7.75 per US dollar in the second quarter. The strong-side Convertibility Undertaking was repeatedly triggered between 9 and 24 April, and the Hong Kong Monetary Authority (HKMA) passively purchased a total of US\$9.2 billion, leading to a corresponding increase in the Aggregate Balance.*
- *As the US dollar weakened against other major currencies, the trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices declined during the second quarter.*
- *Total loans and advances grew by a moderated 0.6% during the second quarter. Within the total, loans for use in Hong Kong decreased by 0.7%, while loans for use outside Hong Kong expanded by 3.7%.*
- *The local stock market was rather volatile in second quarter, as sentiment swung in tandem with developments in the global economy and financial markets. The Hang Seng Index (HSI) rallied in April, but lost most of the gains in May and June amid concerns about a slowing Mainland economy, the Greek debt crisis and also the marked correction of the Mainland stock market towards the quarter-end. For the quarter as a whole, the HSI still rose by 5.4% over end-March to 26 250 at end-June. Meanwhile, trading activities were generally buoyant.*

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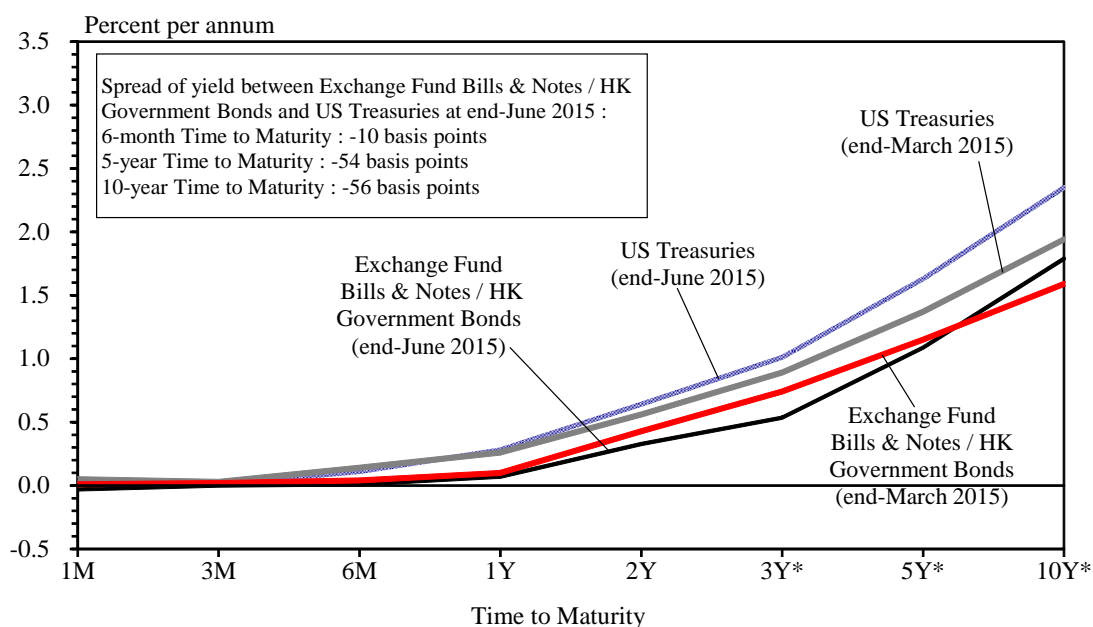
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

## Interest rates and exchange rates

4.1 The low interest rate environment in Hong Kong continued in the second quarter of 2015 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% during the quarter<sup>(1)</sup>. The *Hong Kong dollar interbank interest rates* (HIBOR) stayed at low levels. While the overnight HIBOR edged up from 0.06% at end-March to 0.11% at end-June, this was still a very low level. Meanwhile, the three-month HIBOR stayed unchanged at 0.39% at end-June.

4.2 Both the *Hong Kong dollar* and the *US dollar yield curves* steepened in the second quarter. With a smaller increase in the 10-year Hong Kong dollar yields than its US dollar counterparts, the negative yield spread between 10-year Hong Kong Government Bonds and 10-year US Treasury Notes widened further from 35 basis points at end-March to 56 basis points at end-June. On the other hand, the negative yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills remained unchanged at 10 basis points at end-June.

**Diagram 4.1 : Both the Hong Kong dollar and US dollar yield curves steepened in the second quarter**

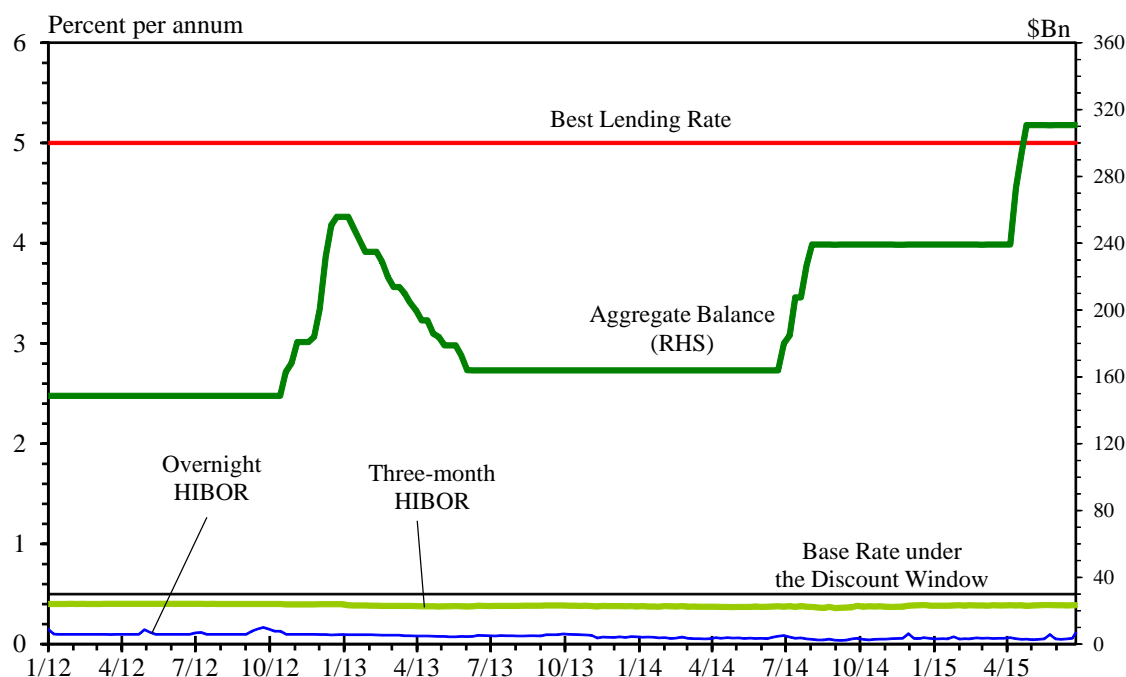


Note : (\*) With the HKMA stopping new issuance of Exchange Fund Notes of tenors of three years or above since January 2015, the Hong Kong dollar yields for tenor of 3 years and above refer to those for Hong Kong Government Bonds.

4.3 Interest rates on the retail front also stayed low. The *Best Lending Rates* remained unchanged at 5.00% or 5.25% during the second quarter. The *savings deposit rate* quoted by the major banks stayed unchanged at an average

of 0.01%, while the one-year time deposit rate (for deposits of less than \$100,000) quoted by the major banks edged down from 0.16% in March to 0.15% in June. Meanwhile, the *composite interest rate*<sup>(2)</sup>, which indicates the average cost of funds for retail banks, edged down from 0.33% at end-March to 0.29% at end-June.

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

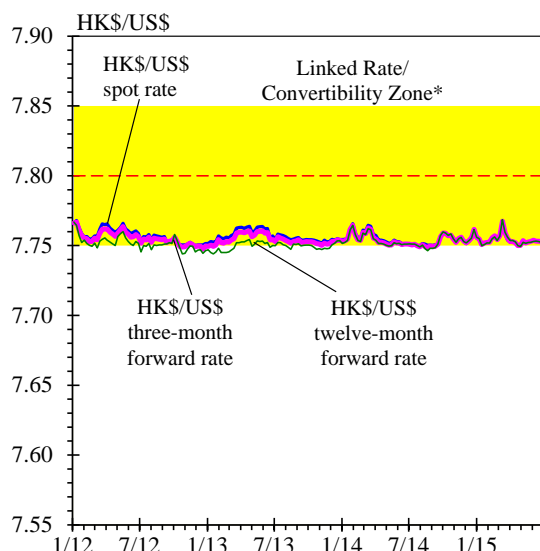


4.4 The *Hong Kong dollar spot exchange rate* stayed close to 7.75 per US dollar during the second quarter. Mainly driven by equity-related and commercial demand for the Hong Kong dollar, the strong-side Convertibility Undertaking was repeatedly triggered between 9 and 24 April, prompting the HKMA to passively purchase a total of US\$9.2 billion from banks with \$71.5 billion. This led to a corresponding increase in the Aggregate Balance from \$239.2 billion at end-March to \$310.7 billion at end-June. The spot exchange rate closed at 7.752 at end-June, compared with 7.755 at end-March. Meanwhile, the 3-month *Hong Kong dollar forward premium* declined from 11 pips (each pip equivalent to HK\$0.0001) at end-March to six pips at end-June. The 12-month Hong Kong dollar forward premium also decreased from 17 pips to zero.

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. As the US dollar weakened against the major currencies including euro, Swiss franc and pound sterling, the *trade-weighted Hong Kong dollar*

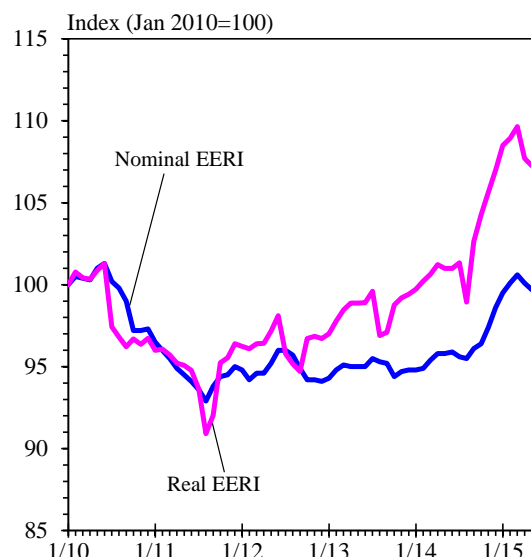
Nominal and Real Effective Exchange Rate Indices<sup>(3)</sup> declined by 0.5% and 1.8% respectively between March and June.

**Diagram 4.3 : Hong Kong dollar stayed close to 7.75 per 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.

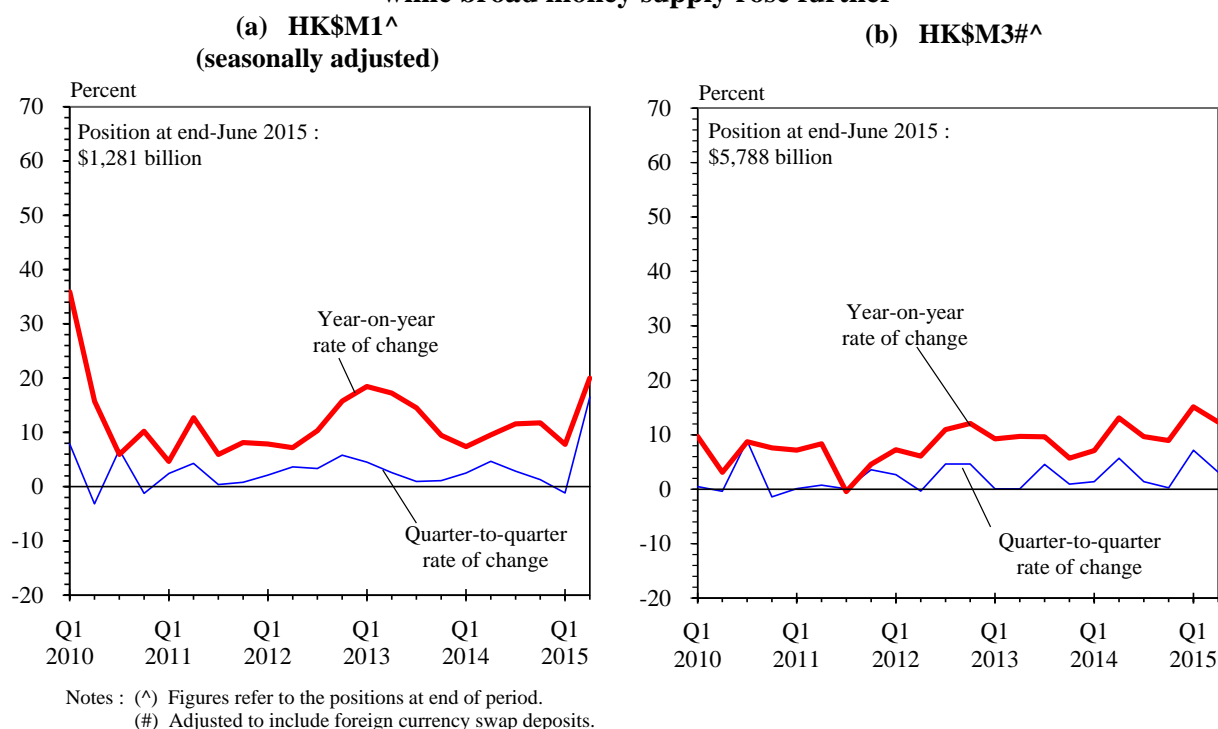
**Diagram 4.4 : The trade-weighted nominal and real EERIs declined (average for the month)**



## Money supply and banking sector

4.6 The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) rebounded by a sharp 16.5% over end-March to \$1,281 billion at end-June, while the broad money supply (HK\$M3) rose further by 3.1% to \$5,788 billion<sup>(4)</sup>. Meanwhile, *total deposits* with authorized institutions (AIs)<sup>(5)</sup> grew by 1.4% to \$10,552 billion. Within the total, Hong Kong dollar deposits went up by 3.5%, while foreign currency deposits declined by 0.7%.

**Diagram 4.5 : Narrow money supply rebounded sharply  
while broad money supply rose further**



**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\$<sup>^</sup></u> | <u>Total</u> | <u>HK\$<sup>(a)</sup></u> | <u>Total</u> | <u>HK\$<sup>(a)</sup></u> | <u>Total</u> |
| 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                       | 1.0          |
| 2015                                 | Q1 | -1.1                    | 13.6         | 7.2                       | 3.0          | 7.2                       | 3.0          |
|                                      | Q2 | 16.5                    | -1.3         | 3.1                       | 0.8          | 3.1                       | 0.8          |
| Total amount at end-June 2015 (\$Bn) |    | 1,281                   | 1,917        | 5,775                     | 11,436       | 5,788                     | 11,469       |
| <u>% change over a year earlier</u>  |    | 20.0                    | 17.7         | 12.3                      | 7.9          | 12.4                      | 7.9          |

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

4.7 *Total loans and advances* grew by a moderated 0.6% over end-March to \$7,676 billion at end-June. Within the total, Hong Kong dollar loans edged down by 0.5%, while foreign currency loans expanded by 2.1%. Reflecting the relative movements in deposits and loans, the loan-to-deposit ratio for Hong Kong dollar declined from 83.1% at end-March to 79.9% at end-June, while that for foreign currencies picked up from 63.7% to 65.4%.

4.8 Loans for use in Hong Kong (including trade finance) decreased by 0.7% from end-March to \$5,313 billion at end-June, while loans for use outside Hong Kong expanded by 3.7% to \$2,363 billion. Within the former, loans to wholesale and retail trade declined by 1.3% amid the sluggish performance of retail sales. Loans to stockbrokers plunged by 55.2% after a surge in the previous quarter, while loans to financial concerns rebounded by 4.4%. Trade finance grew by a decelerated 0.7% in part reflecting the weak performance of external trade. As for property-related lending, loans for purchase of residential property rose by a moderate 1.7%, while loans to building, construction, property development and investment went up by 4.0%.

**Table 4.2 : Loans and advances**

| All loans and advances for use in Hong Kong |             |            |           |           |               |                         |           |         |                      |                          |          |
|---|-------------|------------|-----------|-----------|---------------|-------------------------|-----------|---------|----------------------|--------------------------|----------|
|   |             | Loans to : |           |           |               |                         |           |         |                      |                          |          |
|   |             | Trade      | Manu-     | Wholesale | Building,     | Purchase                | Financial | Stock-  | All loans            |                          | Total    |
|   |             | finance    | facturing | and       | construction, | of                      | concerns  | brokers | and advances         | for use                  | loans    |
|   |             |            |           | retail    | property      | residential             |           |         | and advances         | outside                  | and      |
|   |             |            |           | trade     | and           | property <sup>(a)</sup> |           |         | for use              | Hong Kong <sup>(c)</sup> | advances |
|   |             |            |           |           | investment    |                         |           |         | outside              |                          |          |
| % change                                    | during      |            |           |           |               |                         |           |         |                      |                          |          |
|   | the quarter |            |           |           |               |                         |           |         | Total <sup>(b)</sup> |                          |          |
| 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        | 6.6       | 5.4       | 1.6           | 2.1                     | 3.3       | 68.2    | 4.4                  | 1.7                      | 3.6      |
|   | Q3          | 0.2        | 7.2       | 7.9       | 0.8           | 2.3                     | 1.2       | -38.9   | 1.4                  | 3.3                      | 1.9      |
|   | Q4          | -14.5      | 0.2       | -5.7      | 1.6           | 2.8                     | 1.8       | 16.8    | -0.8                 | 5.2                      | 0.9      |
| 2015  | Q1          | 4.2        | -3.8      | 0.9       | 1.3           | 2.7                     | -0.5      | 338.7   | 5.5                  | 3.2                      | 4.8      |
|   | Q2          | 0.7        | -0.4      | -1.3      | 4.0           | 1.7                     | 4.4       | -55.2   | -0.7                 | 3.7                      | 0.6      |
| Total amount at end-June 2015 (\$Bn)        |             | 570        | 255       | 472       | 1,119         | 1,076                   | 405       | 101     | 5,313                | 2,363                    | 7,676    |
| % change over a year earlier                |             | -10.0      | 3.0       | 1.4       | 7.9           | 9.9                     | 7.0       | 40.2    | 5.4                  | 16.2                     | 8.5      |

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 remains resilient. The Hong Kong incorporated AIs were well capitalised, with the total capital adequacy ratio staying high at 17.0% at end-March 2015. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III<sup>(6)</sup>.

4.10 Hong Kong has been following the international timeline in implementing the Basel III framework. The implementation of the second phase<sup>(7)</sup> of the Basel III standards commenced in 2015, with the rules on capital buffers and liquidity coverage ratio coming into effect on 1 January, and the disclosure requirements associated with these standards and with the leverage ratio on 31 March. As part of the second phase of implementation of the capital standards, the HKMA also announced the phasing in of a Countercyclical Capital Buffer (starting with 0.625% in accordance with the Basel III transitional arrangement) with effect from 1 January 2016, and the designation of five authorized institutions as domestic systemically important institutions and thus adoption of higher loss absorbency capital requirement.

4.11 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans remained low at 0.46% at end-March 2015, compared with 0.45% at end-2014. While the delinquency ratio for credit card lending edged up from 0.20% to 0.26%, this was still a low level by historical standards. Meanwhile, the delinquency ratio for residential mortgage loans stayed at a low level of 0.03% 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</u><br>(gross) |
|----------------------------|----|-------------------|------------------------------|------------------------------------|
| 2014                       | Q1 | 98.42             | 1.12                         | 0.46                               |
|                            | Q2 | 98.50             | 1.05                         | 0.46                               |
|                            | Q3 | 98.53             | 1.04                         | 0.43                               |
|                            | Q4 | 98.56             | 0.99                         | 0.45                               |
| 2015                       | Q1 | 98.39             | 1.14                         | 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 Most segments of the *offshore renminbi (RMB) business* in Hong Kong recorded further growth in the second quarter of 2015. Total RMB deposits (including customer deposits and outstanding certificates of deposit) increased by 4.5% over end-March to RMB1,108.8 billion at end-June. Meanwhile, RMB trade settlement transactions handled by banks in Hong Kong declined by 3.5% from the first quarter to RMB1,569.7 billion in the second quarter, though representing a growth of 9.2% over a year earlier.

4.13 As to RMB bond issuance, total dim sum bond issuance, including the RMB14 billion sovereign bond issuance by the Ministry of Finance, amounted to RMB35.5 billion in the second quarter, compared with RMB6.9 billion in the preceding quarter. Outstanding RMB bank loans also rose by 5.6% over end-March to RMB236.3 billion at end-June.

**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<sup>(a)</sup></u>         |                                  |                                   |  |   | <u>Number of AIs engaged in RMB business</u> | <u>Amount of cross-border RMB trade settlement<sup>(c)</sup></u><br>(RMB Mn) |
|----------------------------------|----|--|----------------------------------|-----------------------------------|--|---|--|--|
|                                  |    | <u>Demand and savings deposits</u><br>(RMB Mn) | <u>Time deposits</u><br>(RMB Mn) | <u>Total deposits</u><br>(RMB Mn) | <u>Savings deposits<sup>(b)</sup></u><br>(%) | <u>Three-month time deposits<sup>(b)</sup></u><br>(%) |  |  |
| 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  |
| 2015                             | Q1 | 157,444  | 794,550                          | 951,994                           | 0.25   | 0.53  | 147  | 1,626,122  |
|                                  | Q2 | 180,445  | 812,479                          | 992,924                           | 0.25   | 0.53  | 146  | 1,569,670  |
| % change in 2015 Q2 over 2014 Q2 |    | 19.7   | 4.8                              | 7.2                               | N.A.   | N.A.  | N.A.   | 9.2  |
| % change in 2015 Q2 over 2015 Q1 |    | 14.6   | 2.3                              | 4.3                               | N.A.   | N.A.  | N.A.   | -3.5   |

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 As to the debt market, total gross issuance of *Hong Kong dollar debt* increased by 3.0% over the preceding quarter to \$590.7 billion in the second quarter, of which 91.6% were new debts issued by the Exchange Fund. Within the total, public sector debt issuance rose by 9.1%, with the increase in new debts issued by the Exchange Fund more than offsetting the fall in issuance by the Government and statutory bodies/government-owned corporations. Meanwhile, dragged by a decline in issuance by AIs and local corporations, private sector debt issuance plunged by 41.2%<sup>(8)</sup>. With more debt maturing than debts issued, the total outstanding amount of Hong Kong dollar debt edged down by 0.7% from end-March to \$1,430.1 billion at end-June. This was equivalent to 24.7% of HK\$M3 or 21.0% of Hong Kong dollar-denominated assets of the banking sector<sup>(9)</sup>.

4.15 As to Government Bond (“GB”), a total of \$4.7 billion institutional GBs were issued through tenders in the second quarter of 2015. At end-June, the total outstanding amount of Hong Kong dollar bonds under the GB Programme amounted to \$92.6 billion, comprising 12 institutional issues totaling \$72.6 billion and two retail issues (iBonds) totaling \$20 billion. Separately, the fifth issuance of iBond, with a maximum issuance of \$10 billion, was made available for subscription on 21 July 2015.

4.16 Following the success of the inaugural sukuk in 2014, the HKMA assisted the Government to issue the second sukuk in June 2015, at an issuance size of US\$1 billion with tenor of 5 years. The sukuk was in Wakalah structure, with one-third of assets underpinned by selected units in an office building in Hong Kong and two-thirds of assets underpinned by shariah-compliant commodities. The use of different sukuk structure demonstrated the flexibility of Hong Kong’s issuance platform. The deal was well-received, attracting orders of US\$2 billion (i.e. twice of the issuance size) from a diverse group of 49 international conventional and Islamic investors.

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

|  | Exchange<br>Fund paper | Statutory<br>bodies/govern<br>ment-owned<br>corporations | Govern<br>-ment | Public<br>sector<br>total | AIs <sup>(a)</sup> | Local<br>corporations | Non-MDBs<br>overseas<br>borrowers <sup>(b)</sup> | Private<br>sector<br>total | MDBs <sup>(b)</sup> | Total   |
|--|------------------------|--|-----------------|---------------------------|--------------------|-----------------------|--|----------------------------|---------------------|---------|
| <b>New Issuance</b>                                    |                        |  |                 |                           |                    |                       |  |                            |                     |         |
| 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   |
| 2015 Q1  | 491.9                  | 4.3  | 7.9             | 504.1                     | 54.4               | 4.4                   | 10.6   | 69.4                       | 0.0                 | 573.5   |
| Q2   | 541.2                  | 4.0  | 4.7             | 550.0                     | 23.2               | 2.1                   | 15.5   | 40.8                       | 0.0                 | 590.7   |
| % change in<br>2015 Q2 over<br>2014 Q2                 | 0.3                    | 2,415.6  | 23.7            | 1.2                       | 0.1                | -67.8                 | -25.1  | -19.0                      | N.A.                | -0.5    |
| % change in<br>2015 Q2 over<br>2015 Q1                 | 10.0                   | -6.4   | -40.5           | 9.1                       | -57.3              | -52.0                 | 45.5   | -41.2                      | N.A.                | 3.0     |
| <b>Outstanding (as at end of period)<sup>(c)</sup></b> |                        |  |                 |                           |                    |                       |  |                            |                     |         |
| 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 |
| 2015 Q1  | 752.8                  | 43.5   | 105.9           | 902.2                     | 249.7              | 140.3                 | 142.4  | 532.4                      | 6.1                 | 1,440.7 |
| Q2   | 753.0                  | 43.2   | 94.1            | 890.3                     | 245.9              | 140.1                 | 148.5  | 534.5                      | 5.3                 | 1,430.1 |
| % change in<br>2015 Q2 over<br>2014 Q2                 | 0.1                    | 16.4   | -4.5            | 0.3                       | 7.4                | 12.6                  | 0.3  | 6.6                        | -22.6               | 2.4     |
| % change in<br>2015 Q2 over<br>2015 Q1                 | *                      | -0.8   | -11.1           | -1.3                      | -1.5               | -0.1                  | 4.3  | 0.4                        | -13.1               | -0.7    |

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

N.A. Not available.

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

(a) AIs : Authorised institutions.

(b) MDBs : Multilateral Development Banks.

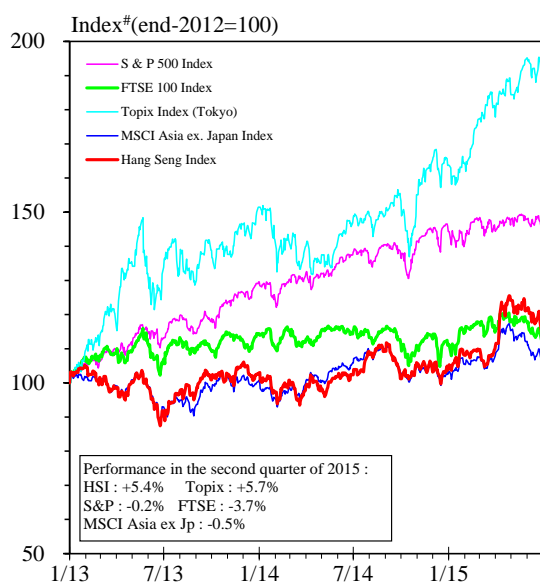
(c) Figures on AIs and hence the total have been revised downwards since more early redemption data have recently been available.

## The stock and derivatives markets

4.17 The *local stock market* was rather volatile in the second quarter, as sentiment swung in tandem with developments in the global economy and financial markets. Boosted by the rally in the Mainland stock market, the Hang Seng Index (HSI) surged to 28 443 on 28 April, the highest level since December 2007. Then it lost most of the gains in May and June, first hit by concerns about a slowing Mainland economy, then the re-emergence of the Greek debt crisis and also the marked correction of the Mainland stock market towards the quarter-end. For the quarter as a whole, the HSI still rose by 5.4% over end-March to 26 250 at end-June. In parallel, the *market capitalisation* expanded further by 8.7% to \$29.1 trillion. According to the World Federation of Exchanges, the local stock market was the sixth largest stock exchange in the world and fourth largest in Asia<sup>(10)</sup> as at end-June.

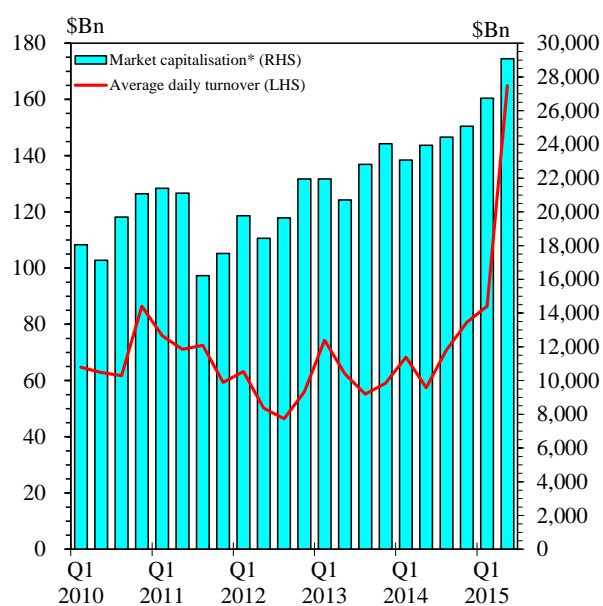
4.18 Trading activities were generally buoyant in the second quarter. *Average daily turnover* in the securities market jumped by 90.8% over the preceding quarter or 187.0% over a year earlier to \$164.9 billion, with transactions reaching an all-time high of \$293.9 billion on 9 April. As to *derivatives products*<sup>(11)</sup>, the average daily trading volume of futures and options soared by 40.7% over the preceding quarter or 90.6% over a year earlier. Within the total, the trading of stock options, H-shares Index futures, HSI options and HSI futures leapt by 44.2%, 42.1%, 26.7% and 26.7% respectively over the preceding quarter. The average daily trading value of securitised derivatives products also surged by 71.5% over the preceding quarter. Within the total, while trading of derivative warrants jumped by a sharp 95.0%, that of callable bull/bear contracts also rose by 16.1%.

**Diagram 4.6 : The local stock market was rather volatile in the second quarter**



Note : (#) Position at end of month.

**Diagram 4.7 : Market capitalisation rose further, and trading activities were buoyant**



Note : (\*) Position at end of quarter.

**Table 4.6 : Average daily turnover of derivatives products of the Hong Kong market**

|  |        | Hang Seng<br>Index<br><u>futures</u> | Hang Seng<br>Index<br><u>options</u> | H-shares<br>Index<br><u>futures</u> | Stock<br><u>options</u> | Total<br>futures and<br>options<br><u>traded*</u> | Derivative<br>warrants<br><u>(\$Mn)</u> | Callable<br>bull/bear<br>contracts<br><u>(\$Mn)</u> | Total<br>securitised<br>derivatives<br>traded<br><u>(\$Mn)^</u> |
|--|--------|--------------------------------------|--------------------------------------|-------------------------------------|-------------------------|---|---|---|---|
| 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  |
| 2015                                   | Q1     | 64 351                               | 27 727                               | 108 774                             | 363 322                 | 672 678   | 14,715                                  | 6,226   | 20,941  |
|  | Q2     | 81 541                               | 35 129                               | 154 553                             | 523 860                 | 946 336   | 28,693                                  | 7,228   | 35,921  |
| % change in<br>2015 Q2 over<br>2014 Q2 |        | 25.6                                 | 21.9                                 | 99.1                                | 108.4                   | 90.6  | 348.0                                   | 77.4  | 242.8   |
| % change in<br>2015 Q2 over<br>2015 Q1 |        | 26.7                                 | 26.7                                 | 42.1                                | 44.2                    | 40.7  | 95.0                                    | 16.1  | 71.5  |

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.

4.19 Fund raising activities were buoyant in the first half of 2015. *Total equity capital raised*, comprising new share floatations and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)<sup>(12)</sup>, jumped by 225% over a year earlier to \$708.9 billion. Within the total, the amount of funds raised through IPOs leapt by 58% to \$129.4 billion. In the first half of 2015, Hong Kong ranked the first globally in terms of the amount of funds raised through IPO.

4.20 Mainland enterprises continued to play a prominent role in the Hong Kong stock market. At end-June 2015, a total of 906 Mainland enterprises (including 210 H-share companies, 143 “Red Chips” companies and 553 private enterprises) were listed on the Main Board and GEM, accounting for 51% of the total number of listed companies and 63% of total market capitalisation. In the second quarter, Mainland-related stocks accounted for 73% of equity turnover and 60% of total equity fund raised on the Hong Kong stock exchange.

4.21 In May the Government gazetted the subsidiary legislations under the Securities and Futures (Amendment) Ordinance 2014 to implement the mandatory reporting and related record-keeping obligations under the first phase of the new over-the-counter (OTC) derivatives regulatory regime. Under the new regulatory regime, the reporting obligation covers certain types of interest rate swaps and non-deliverable forwards, and applies to authorised institutions, approved money brokers, licensed corporations and central counterparties that provide clearing services to persons in Hong Kong. The new regulatory regime would help increase the transparency of the OTC derivatives market and is therefore conducive to the financial stability of Hong Kong. The subsidiary legislations were subsequently passed by the Legislative Council and took effect in July 2015.

### **Fund management and investment funds**

4.22 Along with the buoyant local stock market, most segments of the fund management business showed further pick-up in the second quarter. Gross retail sales of *mutual funds* surged by 19.4% over the first quarter to US\$25.6 billion in the second quarter<sup>(13)</sup>. The aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*<sup>(14)</sup> also expanded by 4.3% over end-March to \$620 billion at end-June. Yet the amount of net assets managed by *retail hedge funds* continued to decline<sup>(15)</sup>.

4.23 To deepen Mainland-Hong Kong financial co-operation and promote the joint development of capital markets in the two places, the China Securities Regulatory Commission and the Securities and Futures Commission (SFC) announced the Mainland-Hong Kong Mutual Recognition of Funds (MRF) initiative in May, which was subsequently implemented in July. Through allowing Mainland and Hong Kong funds that meet the eligibility requirements to follow streamlined procedures to obtain authorization or approval for offering to retail investors in each other's market, the MRF enhances the mutual capital market access between the Mainland and Hong Kong and is an important element in the opening up of the Mainland's capital market.

## Insurance sector

4.24 The *insurance sector*<sup>(16)</sup> continued to record solid growth in the first quarter of 2015. Gross premium income from long-term business surged by another 33.3% over a year earlier, within which premium income from non-investment linked plans and that from investment-linked plans rose sharply by 34.9% and 25.5% respectively. Meanwhile, gross and net premium from general business grew modestly, by 3.1% and 4.4% respectively.

**Table 4.7 : Insurance business in Hong Kong\* (\$Mn)**

|                                  |        | General business |             |                     | Premium for long-term business <sup>^</sup> |                                      |                           |                                      |                        | 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 |  |
| 2014                             | Annual | 43,896           | 30,299      | 3,010               | 97,357                                      | 16,052                               | 176                       | 451                                  | 114,036                | 157,932  |
|                                  | 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   |
|                                  | Q4     | 9,169            | 5,998       | 619                 | 25,744                                      | 4,138                                | 50                        | 98                                   | 30,030                 | 39,199   |
| 2015                             | Q1     | 12,939           | 9,053       | 645                 | 32,060                                      | 4,249                                | 52                        | 121                                  | 36,482                 | 49,421   |
| % change in 2015 Q1 over 2014 Q1 |        | 3.1              | 4.4         | -28.5               | 34.9  | 25.5                                 | 33.3                      | -32.8                                | 33.3                   | 23.8   |

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

4.25 In May the Government issued the consultation conclusions on the proposed enhancements to the Deposit Protection Scheme (DPS). To accelerate the process of making deposit compensation to depositors in case of a bank crisis, the Government proposes to adopt the “gross payout” approach to determine DPS compensation (i.e. a depositor will be compensated an amount up to the protection limit without the need to set-off the depositor’s liabilities in the same bank at the time of payout), to provide more certainty for determining the quantification date used for calculating the compensation amount, and to enable the use of electronic communication channels under certain circumstances to notify depositors of the compensation arrangements and other details. In light of the positive responses received during the consultation, the Government is drafting a bill to amend the Deposit Protection Scheme Ordinance for introduction into the Legislative Council later this year.

### 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 2015, there were 157 licensed banks, 23 restricted licence banks and 20 deposit-taking companies in Hong Kong. Altogether, 200 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, and for banks classified as systemically important (either globally or domestically), a Higher Loss Absorbency requirement ranging from 1% to 3.5%, all to be met by common equity. The rules implementing the buffers became effective on 1 January 2015, while the buffer requirements will come into effect on 1 January 2016. 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, with implementation dates of 1 January 2015 and 1 January 2018 respectively.
- (7) 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.
- (8) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (9) 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.

- (10) 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.
- (11) At end-June 2015, there were 82 classes of stock options contracts and 40 classes of stock futures contracts.
- (12) At end-June 2015, there were 1 580 and 213 companies listed on the Main Board and GEM respectively.
- (13) 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 2015, the survey covered a total of 1 164 active authorised funds.
- (14) At end-June 2015, there were 19 approved trustees. On MPF products, 35 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 457 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 275 000 employers, 2.56 million employees and 207 000 self-employed persons have participated in MPF schemes.
- (15) At end-June 2015, there were three SFC-authorised retail hedge funds with combined net asset size of US\$131 million. The amount of net assets under management dropped by 9% from the end-March 2015 level, and represented a decrease of 18% of that at end-2002, the year when the hedge funds guidelines were first issued.
- (16) At end-June 2015, 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 come from 23 countries and territories (including Hong Kong).