

CHAPTER 5 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued in 2015 amid the accommodative monetary policy in the United States. With the US Fed raising the Federal Funds Rate in December, the Hong Kong Monetary Authority (HKMA) accordingly adjusted upward the Base Rate from 0.5% to 0.75%.*
- *The Hong Kong dollar spot exchange rate moved within a narrow range of 7.750-7.766 per US dollar in 2015. The strong-side Convertibility Undertaking was repeatedly triggered in April, September and October, prompting the HKMA to passively purchase a total of US\$29.3 billion from banks in exchange for \$227.2 billion.*
- *As the US dollar strengthened against most major currencies including the euro, pound sterling and renminbi, the trade-weighted Hong Kong dollar Nominal and Real Effective Rate Indices rose by 5.8% and 7.1% respectively during 2015.*
- *Growth in total loans and advances slowed over the course of 2015, in part reflecting weaker corporate credit demand amid the economic slowdown. For 2015 as a whole, loans for use in Hong Kong and outside Hong Kong increased at a decelerated pace of 3.9% and 2.8% respectively, markedly slower than in 2014.*
- *The local stock market showed a strong pick-up in the first half of 2015, but then underwent a marked correction in the second half. For the year as a whole, the Hang Seng Index dropped by 7.2% from end-2014 to 21 914 at end-2015. Likewise, trading activities and fund raising activities were generally active in the first half, before showing moderation in the second half amid the stock market correction.*

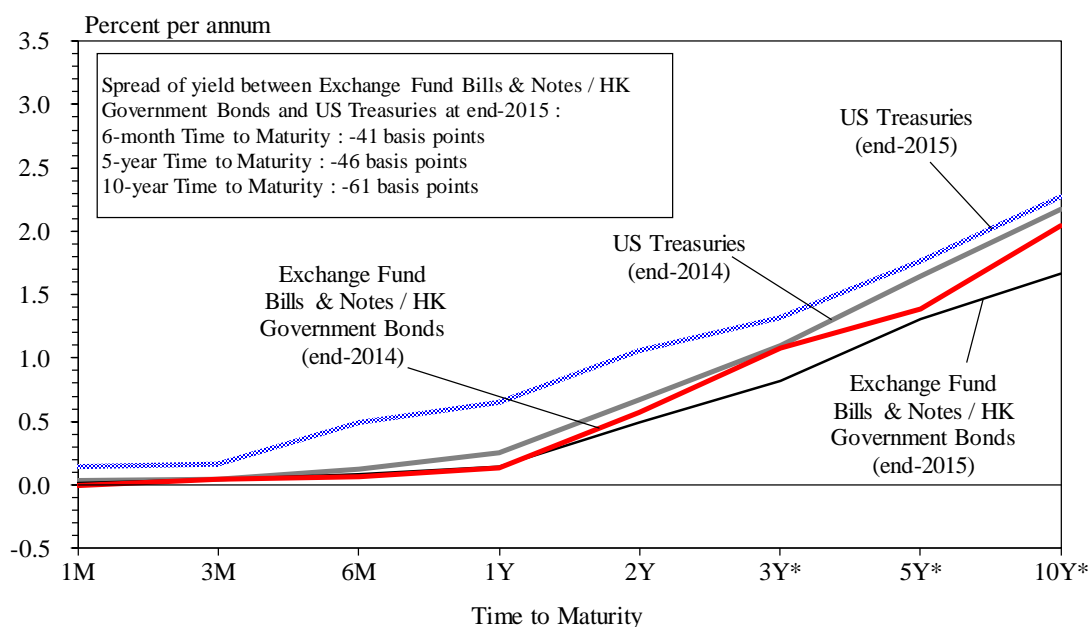
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

Interest rates and exchange rates

5.1 The low interest rate environment in Hong Kong continued in 2015 amid the accommodative monetary policy in the United States. With the US Federal Open Market Committee raising the target range for the Federal Funds Rate from 0-0.25% to 0.25-0.5% at the December meeting, the HKMA adjusted upward the *Base Rate* under the Discount Window accordingly from 0.5% to 0.75% in December⁽¹⁾. Meanwhile, the *Hong Kong dollar interbank interest rates* (HIBOR) remained at low levels. The three-month HIBOR edged up from 0.38% at end-2014 to 0.39% at end-2015, while the overnight HIBOR remained unchanged at 0.05%.

5.2 The *US dollar yield curve* shifted upward slightly during 2015, while the *Hong Kong dollar yield curve* flattened. As a result, the negative yield spread between 10-year Hong Kong Government Bonds and 10-year US Treasury Notes increased from 12 basis points at end-2014 to 61 basis points at end-2015. The negative yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills also widened from 6 basis points to 41 basis points.

Diagram 5.1 : The US dollar yield curve shifted upward slightly while the Hong Kong dollar yield curve flattened during 2015

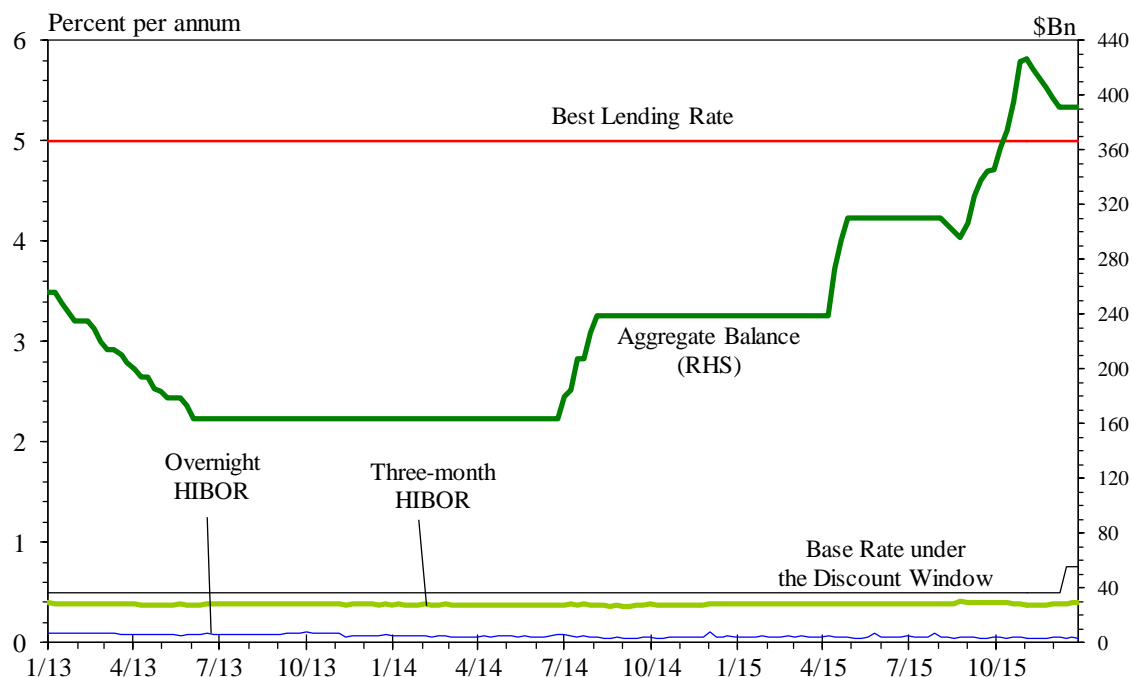


Note : (*) With the HKMA stopping new issuance of Exchange Fund Notes of tenors of three years or above since January 2015, the Hong Kong dollar yields for tenor of 3 years and above refer to those for Hong Kong Government Bonds.

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 2015, 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 low at 0.01% and 0.14% respectively at end-2015. The *composite interest rate*⁽²⁾, which indicates the average funding cost for retail banks, decreased from 0.39% a year earlier to 0.26% at end-2015.

**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 2015. After softening slightly in the first quarter, the Hong Kong dollar exchange rate strengthened against the US dollar and stayed close to 7.750 per US dollar in the rest of the year. The spot exchange rate closed at 7.751 at end-2015, compared with 7.756 at end-2014. The strong-side Convertibility Undertaking was triggered several times during 2015, mainly driven by equity-related demand for the Hong Kong dollar in April, and conversions of the offshore renminbi into the Hong Kong dollar in September and October. As such, the HKMA passively purchased a total of US\$29.3 billion from banks in exchange for \$227.2 billion. The Aggregate Balance rose by a lesser extent, from \$239.2 billion at end-2014 to \$391.3 billion at end-2015, as the increase was partly offset by the HKMA's additional issuances of Exchange Fund Bills to meet the strong demand by banks for liquidity management.

5.5 The *Hong Kong dollar forward rates* showed some fluctuations during 2015. The differential between the 3-month Hong Kong dollar forward rate and spot rate reverted from +3 pips (each pip is equivalent to HK\$0.0001) at

end-2014 to -51 pips at end-2015, while that between the 12-month forward rate and spot rate rose from +5 pips at end-2014 to as high as +345 pips in late August before dipping to -125 pips at end-2015.

5.6 Under the Linked Exchange Rate System, movements in the Hong Kong dollar exchange rate against other currencies closely followed that of the US dollar. As the US dollar strengthened against most major currencies including the euro, pound sterling and renminbi, the *trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices*⁽³⁾ rose by 5.8% and 7.1% respectively during 2015.

Diagram 5.3 : Hong Kong dollar stayed close to 7.75 per US dollar during most of 2015
(end for the week)

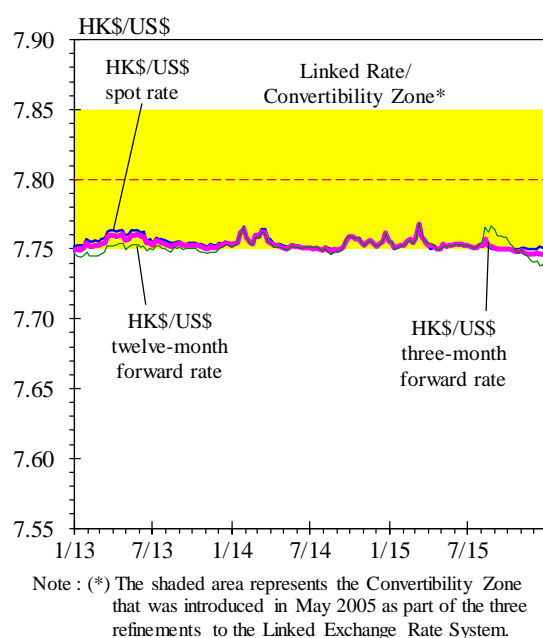
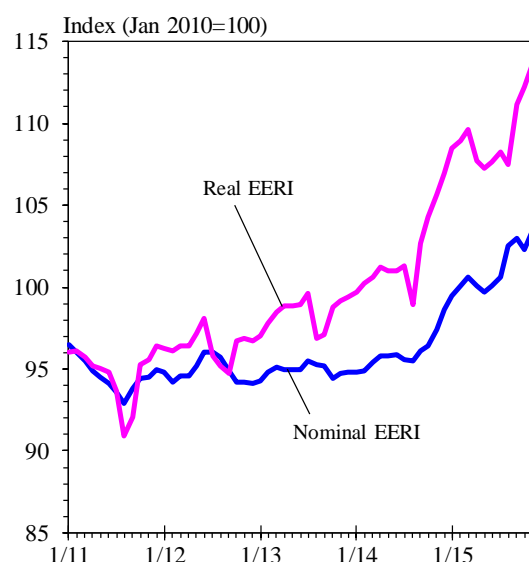


Diagram 5.4 : The trade-weighted nominal and real EERIs rose during 2015
(average for the month)



Money supply and banking sector

5.7 The monetary aggregates expanded further in 2015, though the growth momentum has decelerated visibly over the course of the year. The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) still rose by 13.4% over a year earlier to \$1,262 billion at end-2015, and the broad money supply (HK\$M3) grew by 10.4% to \$5,779 billion⁽⁴⁾, with most of the growth occurring in the first half. Over the same period, *total deposits* with authorised institutions (AIs)⁽⁵⁾ expanded by 6.7% to \$10,750 billion, within which Hong Kong dollar deposits and foreign currency deposits increased by 10.7% and 3.1% respectively.

Diagram 5.5 : The monetary aggregates continued to expand further in 2015, though the momentum decelerated over the course of the year

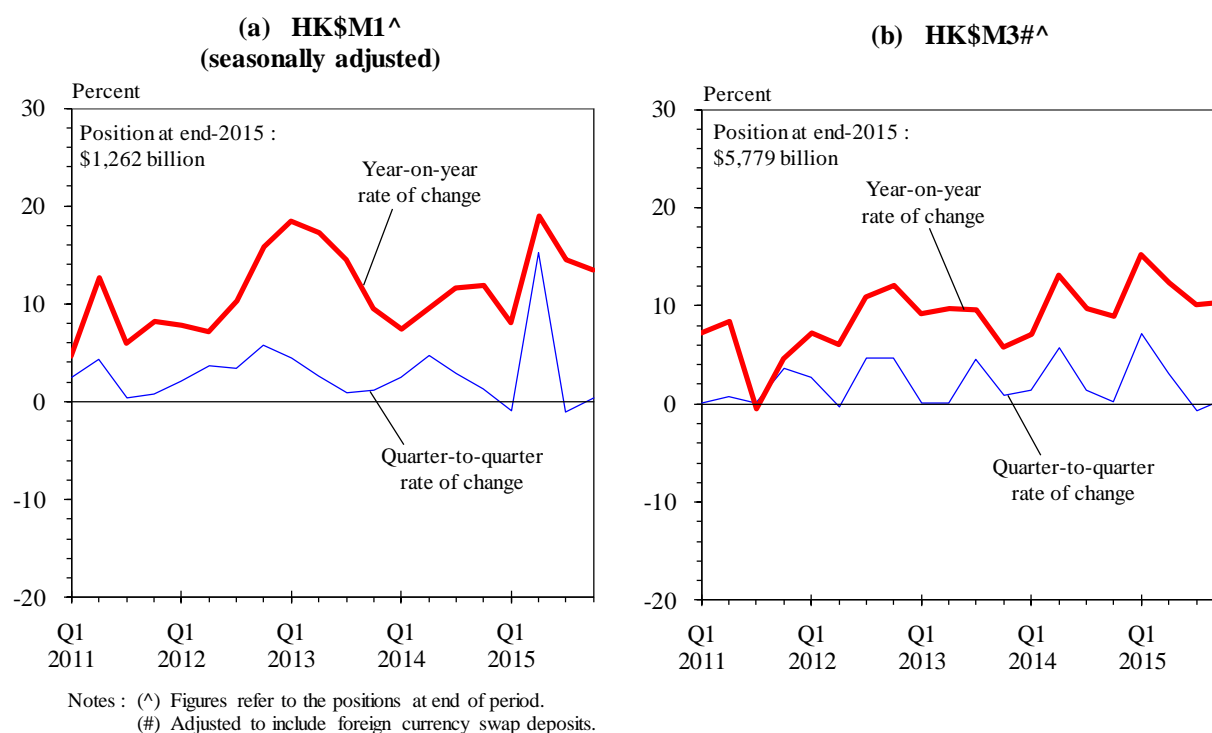


Table 5.1 : Hong Kong dollar money supply and total money supply

		<u>M1</u>		<u>M2</u>		<u>M3</u>	
% change during the quarter		<u>HK\$[^]</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>
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
2015	Q1	-0.9	13.6	7.2	3.0	7.2	3.0
	Q2	15.2	-1.3	3.1	0.8	3.1	0.8
	Q3	-1.1	5.3	-0.6	0.1	-0.7	0.1
	Q4	0.4	-2.4	0.5	1.5	0.5	1.5
Total amount at end-2015 (\$Bn)		1,262	1,971	5,766	11,618	5,779	11,655
% change over a year earlier		13.4	15.4	10.3	5.5	10.4	5.5

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

5.8 Growth in *total loans and advances* slowed down markedly in 2015, in part reflecting weaker corporate credit demand amid the economic slowdown. With the modest growth in the first half turning into a decline in the second half, total loans and advances rose by only 3.5% over a year earlier to \$7,535 billion at end-2015, the slowest growth since 2009 when the economy

was hit hard by the Global Financial Tsunami. Analysed by currency, Hong Kong dollar loans and foreign currency loans increased by 3.8% and 3.2% respectively. With Hong Kong dollar loans growing slower than Hong Kong dollar deposits, the Hong Kong dollar loan-to-deposit ratio decreased from 83.3% a year earlier to 78.2% at end-2015, the lowest level since end-2010. The foreign currency loan-to-deposit ratio stayed at 62.2% at end-2015, little changed from 62.1% at end-2014.

5.9 Loans for use in Hong Kong (including trade finance) increased by a decelerated 3.9% over a year earlier to \$5,254 billion at end-2015, and loans for use outside Hong Kong by 2.8% to \$2,280 billion. Among loans for use in Hong Kong, trade finance plunged by 16.3% amid the sluggish external trade performance, while loans to wholesale and retail trade declined by 6.1%, in tandem with the slack in retail business. On the other hand, loans to financial concerns and stockbrokers rose notably by 16.6% and 8.1% respectively. As for property-related lending, loans to building, construction, property development and investment expanded by 7.4%. Loans for purchase of residential property also grew by 8.7% during the year, yet the pace of increase has slowed in the fourth quarter amid the property market consolidation.

Table 5.2 : Loans and advances

All loans and advances for use in Hong Kong

		Loans to :									
		Trade	Manu-	Whole-	Building,	Purchase	Financial	Stock-		All loans	Total
		finance	facturing	sale	construction,	of	concerns	brokers		and advances	loans
				and	property	residential				for use	and
				retail	development	of				outside	advances
				trade	and	property ^(a)				Hong Kong ^(c)	
					investment				Total ^(b)		
% change	during										
	the quarter										
2014	Q1	12.4	7.4	5.5	2.6	1.0	11.9	39.4	6.6	3.7	5.7
	Q2	2.4	6.6	5.4	1.6	2.1	3.4	66.7	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	0.0	-5.8	1.5	2.8	1.4	16.8	-1.0	5.6	0.9
2015	Q1	4.2	-3.8	1.0	1.3	2.7	-0.5	338.7	5.6	3.2	4.8
	Q2	0.7	-0.2	-1.5	4.1	1.7	4.8	-55.2	-0.5	3.4	0.6
	Q3	-11.6	0.0	-2.1	2.5	3.0	0.3	-53.3	-1.3	-2.0	-1.5
	Q4	-9.8	-4.3	-3.6	-0.6	1.0	11.5	17.8	0.2	-1.6	-0.3
Total amount at end-2015 (\$Bn)		454	244	444	1,139	1,119	453	55	5,254	2,280	7,535
% change over a year earlier		-16.3	-8.2	-6.1	7.4	8.7	16.6	8.1	3.9	2.8	3.5

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.

5.10 The Hong Kong banking sector remains resilient. The Hong Kong incorporated AIs were well capitalised, with the total capital adequacy ratio staying high at 18.1% at end-September 2015. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III⁽⁶⁾.

5.11 Hong Kong has been following the international timeline in implementing the Basel III framework. The implementation of the second phase⁽⁷⁾ 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 in accordance with the Basel III transitional arrangement (starting with 0.625% from 1 January 2016 and increasing to 1.25% from 1 January 2017), and the designation of five authorised institutions

as domestic systemically important authorised institutions on which the higher loss absorbency capital requirement will start to apply from March 2016.

5.12 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans stayed at a low level, though edging up from 0.46% at end-2014 to 0.56% at end-September 2015. While the delinquency ratio for credit card lending also rose marginally from 0.20% to 0.24%, the ratio remained low by historical standards. The delinquency ratio for residential mortgage loans also stayed low at 0.03% at end-2015, unchanged from 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>
2014	Q1	98.42	1.12	0.46
	Q2	98.50	1.05	0.46
	Q3	98.53	1.04	0.43
	Q4	98.44	1.10	0.46
2015	Q1	98.39	1.14	0.46
	Q2	98.23	1.28	0.49
	Q3	98.08	1.36	0.56

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 The development of *offshore renminbi (RMB) business* in Hong Kong during 2015 has been much affected by the contraction of the offshore RMB liquidity pool, particularly in the second half of the year. Reflecting this, total RMB deposits (including customer deposits and outstanding certificates of deposit) dropped from \$1,158 billion a year earlier to RMB1,010 billion at end-2015. RMB bond issuance also fell from RMB197 billion in 2014 to RMB75 billion in 2015.

5.14 Meanwhile, RMB trade settlement and bank lending maintained steady growth during 2015. RMB trade settlement transactions handled by banks in Hong Kong rose by 9.2% over a year earlier to RMB6,833 billion. RMB bank lending jumped by 58.2% to RMB297 billion at end-2015. Average daily turnover in the RMB Real Time Gross Settlement system reached RMB947 billion in 2015, a rise of 29.2% over 2014.

5.15 Hong Kong maintained its status as the global offshore RMB business

hub with a market of considerable depth and breadth. A significant development during the year was the implementation of the Mainland-Hong Kong Mutual Recognition of Funds initiative, which has expanded Hong Kong's RMB product offering (see paragraph 5.27). In November, the International Monetary Fund decided to include the RMB in its Special Drawing Rights currency basket. The decision reaffirmed the status of the RMB as a freely usable currency, and would add impetus to the internationalisation of the RMB as well as the further development of Hong Kong's offshore market.

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

As at end of period		Interest rates on ^(a)					Number of AIs engaged in RMB business	Amount of cross-border RMB trade settlement ^(c) (RMB Mn)
		Demand and savings deposits (RMB Mn)	Time deposits (RMB Mn)	Total deposits (RMB Mn)	Savings deposits ^(b) (%)	Three-month time deposits ^(b) (%)		
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
	Q3	165,849	729,516	895,365	0.25	0.53	145	2,050,107
	Q4	160,908	690,198	851,106	0.25	0.53	145	1,587,184
% change over a year earlier		-9.1	-16.5	-15.2	N.A.	N.A.	N.A.	-7.8

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

5.16 The Hong Kong dollar *debt market* expanded further in 2015 on the back of a steady growth in public sector issuance. With the modest increase in new debts issued by the public sector more than offsetting the slight decline in private sector debt issuance⁽⁸⁾, total gross issuance increased by 2.6% over a year earlier to \$2,494.0 billion, of which 89.9% was Exchange Fund papers. In parallel, the outstanding Hong Kong dollar debt securities grew considerably by 8.1% to a record level of \$1,524.6 billion at end-2015, equivalent to 26.4% of HK\$M3 or 22.2% of Hong Kong dollar-denominated assets of the entire

banking sector⁽⁹⁾.

5.17 As to the Government Bond (“GB”) programme, a total of \$20.4 billion institutional GBs with tenors ranging from three to fifteen years were issued through tenders during 2015. Separately, in June a sukuk with an issuance size of US\$1 billion and a tenor of five years was issued. In August, \$10 billion inflation-linked retail bonds (i.e. iBonds) were issued as announced in the 2015-16 Budget. At end-2015, the total outstanding amount of Hong Kong dollar bonds under the GB programme was \$98.9 billion, comprising 13 institutional issues totaling \$68.9 billion and three retail issues (iBonds) totaling \$30 billion. In addition, there were two outstanding US dollar sukuks under the programme, each with the issuance size of US\$1 billion.

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

		<u>Exchange Fund paper</u>	<u>Statutory bodies/govern ment-owned corporations</u>	<u>Govern -ment</u>	<u>Public sector total</u>	<u>AIs^(a)</u>	<u>Local corporations</u>	<u>Non-MDBs overseas borrowers^(b)</u>	<u>Private sector total</u>	<u>MDBs^(b)</u>	<u>Total</u>
New Issuance											
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	Annual	2,242.2	12.0	30.4	2,284.6	136.4	14.2	58.9	209.4	0.0	2,494.0
	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
	Q3	599.9	0.8	10.6	611.3	14.8	2.8	12.0	29.6	0.0	641.0
	Q4	609.1	2.9	7.2	619.2	44.0	4.9	20.7	69.6	0.0	688.8
% change in 2015 over 2014		3.0	24.5	-1.3	3.0	7.3	-57.4	16.5	-0.7	-100.0	2.6
Outstanding (as at end of period) ^(c)											
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
	Q3	773.2	43.2	104.7	921.1	230.7	141.1	152.2	524.1	5.3	1,450.5
	Q4	828.4	44.1	100.4	972.9	242.6	141.7	162.1	546.4	5.3	1,524.6
% change in 2015 over 2014		10.1	7.5	2.4	9.1	4.2	2.9	14.4	6.7	-13.1	8.1

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

N.A. Not available.

(a) AIs : Authorised institutions.

(b) MDBs : Multilateral Development Banks.

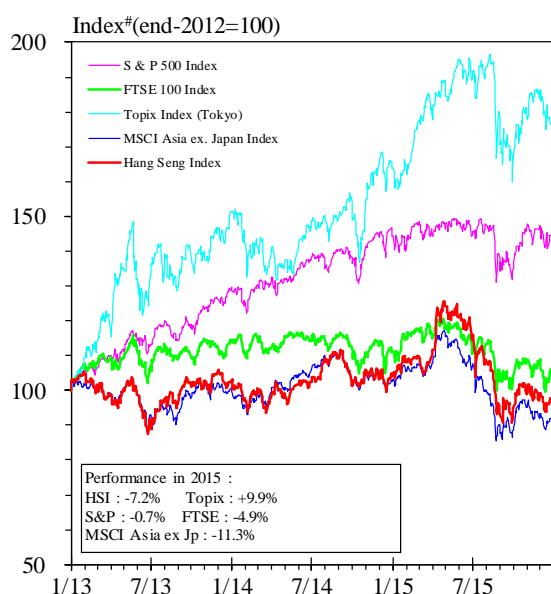
(c) Figures on AIs and hence the total have been revised downwards since more early redemption data have recently been available.

The stock and derivatives markets

5.18 The *local stock market* staged a strong rally in the first few months of 2015, but underwent a marked correction in the second half. Mainly driven by further monetary easing and stock market boom in the Mainland, the Hang Seng Index (HSI) went successively higher during the first four months, reaching a 7-year high of 28 443 on 28 April. It lost most of the gains in June and July and plunged further in the ensuing months in face of increasing concerns over a US interest rate hike and the slide in the Mainland stock market. For the year as a whole, the HSI dropped by 7.2% from end-2014 to 21 914 at end-2015. In parallel, the *market capitalisation* declined by 1.5% to \$24.7 trillion. The local stock market was the eighth largest stock exchange in the world and fourth largest in Asia⁽¹⁰⁾.

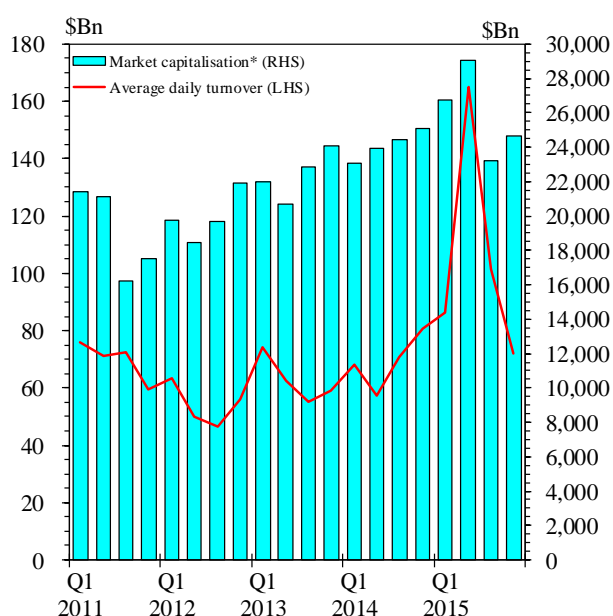
5.19 Trading was very active in the first half of 2015, before showing a visible moderation in the second half. *Turnover* in the securities market reached an all-time high of \$293.9 billion on 9 April. Notwithstanding the quieter trading in the second half, average daily turnover for 2015 as a whole still amounted to \$105.6 billion, a rampant 52.1% higher than in 2014. As to *derivatives products*⁽¹¹⁾, the average daily trading volume of futures and options soared by 33.3% in 2015, within which trading of H-shares Index futures, HSI futures and stock options grew by 51.8%, 24.4% and 24.0% respectively, while trading of HSI options recorded little change. In parallel, the average daily trading value of securitised derivatives products soared by 93.6%, within which trading of derivative warrants and callable bull/bear contracts surged by 120.3% and 49.3% respectively.

Diagram 5.6 : The local stock market underwent a marked correction in the second half of 2015



Note : (#) Position at end of month.

Diagram 5.7 : Market capitalisation edged down, while trading activities were generally active



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 (\$Mn)	Callable bull/bear contracts (\$Mn)	Total securitised derivatives traded (\$Mn)^
2014	Annual	69 098	30 440	89 005	301 797	576 676	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	Annual	85 991	30 427	135 139	374 346	768 520	18,235	7,437	25,672
	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
	Q3	82 744	33 238	152 006	375 780	819 085	17,312	8,255	25,567
	Q4	114 430	25 752	125 310	241 192	641 404	12,607	7,990	20,597
% change in 2015 Q4 over 2014 Q4		56.5	-24.6	17.5	-35.7	-7.9	29.9	47.2	36.1
% change in 2015 over 2014		24.4	#	51.8	24.0	33.3	120.3	49.3	93.6

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.

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

5.20 Similarly, tracking closely the change in the market situation, fund raising activities were likewise buoyant in the first half of 2015, but also cooled off in the second half amid the stock market correction. For the year as a whole, *total equity capital raised*, comprising new share floatation and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)⁽¹²⁾, rose by another 18.3% to a record-high of \$1,116 billion. Within the total, the amount of funds raised through Initial Public Offerings (IPOs) went up by 13.1% to \$263.1 billion. Hong Kong regained its top global ranking in the amount of funds raised through IPOs in 2015.

5.21 Mainland enterprises continued to play a dominant role in the Hong Kong stock market. At end-2015, a total of 951 Mainland enterprises (including 229 H-share companies, 145 “Red Chips” companies and 577 private enterprises) were listed on the Main Board and GEM, accounting for 51% of the total number of listed companies and 62% of total market capitalisation. Mainland-related stocks accounted for 73% of equity turnover and 59% of total equity fund raised in the Hong Kong stock exchange in 2015.

5.22 In October, Hong Kong Futures Exchange Limited (HKFE), HKFE Clearing Corporation Limited (HKCC), the London Metal Exchange (LME) and LME Clear Limited (LME Clear) signed a non-binding memorandum of understanding for the proposed development of a trading link between HKFE and the LME and a clearing link between HKCC and LME Clear, to be named “London-Hong Kong Connect”. The “London-Hong Kong Connect” would enable HKFE’s eligible Exchange Participants to trade LME products, and HKCC’s eligible Clearing Participants to clear those trades. It would help enhance the market access of the Hong Kong’s securities market and support the development of Hong Kong as a commodities trading centre. Subject to regulatory approval and discussion over the operational details (e.g. involved products, operational model), the “London-Hong Kong Connect” will be implemented at a later stage.

5.23 In November, the Securities and Futures Commission (SFC) launched a one-month consultation on the proposal to expand the scope of short position reporting. The existing short position reporting regime, introduced in June 2012, applied only to constituents of HSI and Hang Seng China Enterprises Index and other financial stocks specified by the SFC. The SFC proposed to extend the reporting requirement to all securities that can be short sold under the rules of The Stock Exchange of Hong Kong Limited and to collective investment schemes. The expanded regime would help improve monitoring and enhance market transparency, and thus be conducive to the long-term development of the financial industry.

5.24 The Hong Kong Exchanges and Clearing Limited (HKEx) introduced three more London Metal Mini Futures, namely London Nickel Mini Futures, London Tin Mini Futures and London Lead Mini Futures contracts, for trading in its derivatives market in December 2015. The new contracts are denominated in RMB, which complemented the RMB-traded London Aluminium Mini Futures, London Zinc Mini Futures and London Copper Mini Futures contracts HKEx introduced in December 2014. These commodity contracts would help enhance the range of RMB products in the Hong Kong financial market.

Fund management and investment funds

5.25 The fund management business made a good start in the early part of 2015, and was likewise affected by the slide of the local stock market in the latter part of the year. The monthly average gross retail sales of *mutual funds* in January-November 2015 fell by 6.0% from a year earlier to US\$6.3 billion⁽¹³⁾. The aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹⁴⁾ rose to \$620.0 billion at end-June before declining to \$591.3 billion at end-2015, still a gain of 4.6% over a year earlier. The amount of net assets managed by *retail hedge funds* shrank further⁽¹⁵⁾.

Insurance sector

5.26 Following a few years of continued growth since 2012, the *insurance sector*⁽¹⁶⁾ turned quieter in the third quarter of 2015. Gross premium income from long-term business edged down by 0.9% from a year earlier, as the plunge in premium income from investment-linked plans more than offset the rise in premium income from non-investment linked plans. As to general business, gross premium edged up by 0.5% while net premium edged down by 0.5%.

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	
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
	Q2	10,943	7,888	58	28,909	3,210	42	80	32,241	43,184
	Q3	11,592	7,900	803	27,356	1,328	43	145	28,872	40,464
% change in 2015 Q3 over 2014 Q3		0.5	-0.5	-5.9	11.0	-69.2	-8.5	20.8	-0.9	-0.5

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 Mainland-Hong Kong Mutual Recognition of Funds (MRF) initiative was implemented in July, allowing Mainland and Hong Kong funds that met the eligibility requirements to follow streamlined procedures to obtain authorisation or approval for offering to retail investors in each other's market. The MRF opened up a new frontier for the Mainland and Hong Kong asset management industries and made available a wider selection of fund products to investors in both markets. The first batch of authorised funds under the MRF was announced in December⁽¹⁷⁾.

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-2015, there were 157 licensed banks, 24 restricted licence banks and 18 deposit-taking companies in Hong Kong. Altogether, 199 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. In addition, Basel III introduces a supplementary leverage ratio as a backstop to risk-weighted capital measures and the 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.

- (7) The Basel III standards have started being phased in since 1 January 2013 and are scheduled to be fully implemented on 1 January 2019 according to the Basel III implementation timeline. 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 based on the figures compiled by the World Federation of Exchanges and the London Stock Exchanges Group.
- (11) At end-2015, there were 84 classes of stock options contracts and 74 classes of stock futures contracts.
- (12) At end-2015, there were 1 644 and 222 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-November 2015, the survey covered a total of 1 166 active authorised funds.
- (14) At end-2015, there were 19 approved trustees. On MPF products, 35 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 459 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 276 000 employers, 2.55 million employees and 205 000 self-employed persons have participated in MPF schemes.
- (15) At end-2015, there were three SFC-authorised retail hedge funds with combined net asset size of US\$85 million. The amount of net assets under management represented

a 47.9% decrease over a year earlier, and a 46.9% decrease from end-2002, the year when the hedge funds guidelines were first issued.

- (16) At end-2015, there were 157 authorised insurers in Hong Kong. Within this total, 45 were engaged in long-term insurance business, 93 in general insurance business, and 19 in composite insurance business. These authorised insurers came from 23 countries and territories (including Hong Kong).
- (17) Four Mainland funds and three Hong Kong funds were approved by the SFC and the China Securities Regulatory Commission respectively on 18 December 2015 as the first batch of authorised funds for public sale under the Mainland-Hong Kong Mutual Recognition of Funds initiative.