Press release

LCQ5: Economic measures to be taken amidst the European debt crisis

Wednesday, June 27, 2012

Following is a question by Dr Hon Lam Tai-fai and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (June 27):

Question:

The European debt crisis has been deteriorating continuously and countries such as Greece, Ireland, Portugal and Spain, etc. need to seek assistance one after another from the European Union or international organisations. Some experts are worried that if the political and economic situation in Europe keeps deteriorating, a domino effect might be triggered off, sending tremendous waves to global finance and economy. Some members of the trade have relayed to me that the European debt crisis will bring about an impact far more serious than that of the outburst of the financial tsunami in 2008, and Hong Kong being a small and highly open economy definitely cannot be spared of the crisis. In this connection, will the Government inform this Council:

(a) whether the Government has learnt from past financial crises and make preparations, both psychologically and strategically, and expeditiously set up a financial expert team to conduct in-depth studies on various corresponding plans in advance so as to safeguard Hong Kong's financial market which is prone to attack from international speculators in a situation of fear and instability; if it has, of the details; if not, the reasons for that;

(b) whether it has assessed if the European debt crisis will create a more serious impact on Hong Kong than the financial tsunami in 2008; if it has, of a specific account of the possible impact on Hong Kong's financial market, commercial and industrial sectors, real estate sector, employment, inflation, fiscal reserve and exchange rates, etc.; if not, the reasons for that; and

(c) whether it has discussed with the Central Government any corresponding plan, and whether it anticipates that the State will immediately roll out some measures to support Hong Kong's economy in case Hong Kong suffers a serious economic impact; if so, of the details; if not, the reasons for that?

Reply:

President,

The still-fluid political situation in Greece after its parliament re-election and surging interest rates on the sovereign debts of Spain and Italy are causes for concern. Given the uncertainties in the global economic outlook, international capital flows may quickly reverse their courses.

The European debt crisis and the financial tsunami are different in nature. The financial tsunami was basically a problem of financial institutions, and the situation stabilised after central banks enhanced liquidity provision and governments injected capital into financial institutions and put in place deposit guarantees. On the contrary, the European debt crisis is a sovereign debt problem turning into a political issue as various governments in the same currency area are involved. To resolve the crisis, more time is therefore needed for deliberation and co-ordination. The ultimate impact of the crisis depends very much on whether Eurozone countries can come up with an effective solution. Hence, it is difficult to assess at this stage if the European debt crisis will bring about a more serious impact on Hong Kong compared with that stemming from the financial tsunami.

Notwithstanding the volatility of the global financial markets, local financial institutions in general remain resilient. Operations in the interbank market, securities market and insurance sector continue to be orderly. We will continue to monitor the situation and enhance our risk management measures.

My replies to the three sub-questions are as follows –

(a) We have been reviewing the existing regulatory regime and relevant rules and regulations from time to time in response the changing environment and market development needs. For example, we have implemented a new short position reporting regime since June 18 this year. Under the regime, those who hold reportable short positions in specific shares are required to report to the Securities and Futures Commission (SFC). At the same time, regulators have put in place stringent risk management requirements and conducted stress tests. Where necessary, regulators will introduce additional capital and liquidity requirements, implement countercyclical measures, and require financial institutions to increase capital, make appropriate contingency plans and adopt improvement measures.

On banking sector, the Hong Kong Monetary Authority (HKMA) has been requiring banks to implement prudent management on various risk factors. Since 2009, the HKMA has introduced four rounds of countercyclical prudential measures to strengthen the risk management of mortgage lending business. Last year, the HKMA also repeatedly asked banks to exercise stringent control over the potential risks posed by rapid credit growth, and required banks to raise the level of regulatory reserves. These efforts have helped enhance the resilience of the banking system against possible financial crises.

On securities and futures markets, the SFC has in place contingency plans for various emergency scenarios which might affect the normal operations of our securities and futures markets. In view of the volatility in the international financial markets of late, the SFC has strengthened the monitoring of trading activities, and advised brokers to remain vigilant to the potential risks brought about by market fluctuations and tighten their risk management. Stress tests on liquid capital and random on-site examinations are also frequently conducted to keep brokers in check. The SFC will closely monitor brokers with higher risk profiles and require them to take improvement measures.

Local financial regulators have also been regularly exchanging information and views on various aspects on the sector and maintaining close contact with overseas regulators to keep track of the latest conditions of foreign financial institutions. The Financial Secretary and the Financial Services and the Treasury Bureau are also monitoring the market through relevant cross-regulator co-ordination platforms. In addition, regular market contingency exercises are conducted by the Government, financial regulators and the Hong Kong Exchanges and Clearing Limited, with a view to testing and ensuring that all parties are able to tackle market contingencies and enhancing their communication and co-operation in handling various emergency scenarios.

(b) In respect of the European debt crisis, the risk exposures of local banks to Greece accounted for less than 0.01% of the total assets of the banking sector, while the exposures to Ireland, Italy, Portugal and Spain accounted for only 0.45%. The shares of European banks (excluding British banks) in the local banking sector's total lending to and deposits from customers are 7.5% and 4.7% respectively. To date, the European debt crisis has not caused any credit crunch in the local loan market. The Hong Kong dollar exchange rate and interest rates have remained stable.

Due to the European debt crisis, some investment products are indeed facing counterparty risk to European market ratings and financial institutions. In view of this, the SFC has introduced a number of measures, including monitoring authorised products' risk exposure to major international financial institutions, requiring domestic synthetic exchange-traded funds to top-up the collateral level to achieve at least 100% collateralisation, and strengthening its communication with major product issuers, arrangers and fund management companies.

Regarding commercial and industrial sectors, the European Union, being the largest economy in the world, is an important export market for Hong Kong and accounts for around 11% and 19% of our total exports of goods and services respectively. In fact, our export volume to Europe dipped by 9% year-on-yaer in the first four months of this year, while new export orders weakened again recently. Therefore, Hong Kong's near-term export outlook remains bleak. Fortunately, other domestic-oriented sectors in Hong Kong have held up relatively well. This, coupled with the continued growth in the tourism sector, should render some buffering effect to the performance of our economy.

In respect of such livelihood issues as employment and inflation, unemployment rate has remained low at 3.2% amid the sturdy domestic demand. However, given the difficult external environment, some worsening in the local employment situation may be seen in the coming months. The Government will closely monitor the related developments. Regarding prices, local inflation is gradually easing off. Nevertheless, as international food and commodity prices have been rather volatile, we will keep an eye on the upside risks to inflation.

As for the real estate sector, the property market is now caught between two opposing forces, namely a sluggish external economy and exceptionally low interest rates, which together may lead to substantial price fluctuations. The Government has all along been vigilant on the development in the property market. A number of measures have been introduced since early 2010 and have achieved some results. The Government will keep a close eye on the market, and where necessary adjust the strength of the measures in response to the economic conditions to ensure healthy and stable development in the property market.

Given the bleak economic prospects in Europe and the US, the Financial Secretary introduced in his Budget this February measures worth nearly $80 billion to better support our people and enterprises. These measures, together with other expenditure, would help stimulate the economy by around 1.5 percentage points in 2012. With our sound fiscal position, we will continue our efforts to ensure the structural integrity of public finances and maintain adequate fiscal reserves for future challenges.

In short, the Government will stay vigilant against the uncertainties in external environment and get prepared to tide over any adverse external shocks whenever necessary.

(c) Facing instabilities in the global backdrop, Hong Kong, as an open economy, will continue to leverage the advantage of having the Mainland as our hinterland and foster our economic ties with emerging markets to meet possible external challenges.

Last August, Vice-Premier Li Keqiang announced a series of financial, economic and trade measures during his visit to Hong Kong. These measures, coupled with the liberalisation and co-operation measures in these areas rolled out under the Mainland and Hong Kong Closer Economic Partnership

Arrangement (CEPA), will help promote sustainable development and co-operation in the financial, economic and trade sectors in the Mainland and Hong Kong, thereby enabling both places to cope with the gyrations in the external economic environment with concerted effort.

To better prepare Hong Kong for future challenges and opportunities, the relevant bureaux and departments of the Government will capitalise on the positive prospects brought about by the National 12th Five-Year Plan. They will endeavour to assist our service industries in tapping the Mainland market and help businesses of the two places to diversify their portfolio by expanding CEPA and opening up new areas of co-operation through discussions with the Mainland authorities, and putting into implementation the various measures under CEPA.

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