

## **Press Release**

### **LCQ12: Enhancing the resilience of Hong Kong's financial system**

Wednesday, July 2, 2014

Following is a question by the Hon Ng Leung-sing and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (July 2):

Question:

The Financial System Stability Assessment report released by the International Monetary Fund (IMF) on May 22 this year has pointed out that while Hong Kong's financial system is resilient, it also faces a number of major risks: the anticipated exit from unconventional monetary policy in the United States can increase capital market volatility and reduce system-wide liquidity; any correction of property prices, which now stand at historical highs, poses risks for both borrowers and banks; the increasing economic and financial integration between Hong Kong and the Mainland offers considerable expansion opportunities for businesses, but at the same time generates significant spillover risks, especially if there is any significant financial disruption or economic slowdown on the Mainland. In this connection, will the Government inform this Council:

(1) whether the authorities have conducted any assessment on the major risks pointed out by IMF; if they have, of the assessment results; if not, the reasons for that;

(2) of the precautionary and forward-looking measures the authorities will take in respect of such major risks to enhance the resilience of Hong Kong's financial system; and

(3) whether the authorities have plans to take a new round of counter-cyclical prudential and fiscal measures in the light of the existing market situations; if they do, of the details; if not, the reasons for that?

Reply:

President,

(1) According to the Financial System Stability Assessment report released in May this year, the IMF's comprehensive assessment commended Hong Kong's financial system as very well regulated and resilient, with the capacity to withstand a diversity of shocks. The Administration's assessment on the major risks faced by Hong Kong's financial system at present is broadly in line with that of the IMF.

We share the IMF's view that the major external risk is the uncertainty concerning the pace and scale of the US Fed's tapering and the interest rate normalisation process. Any significant or adverse developments could increase volatilities in the global financial market conditions (particularly those emerging market economies with weaker fundamentals), fund flows and liquidity situations, impacting on Hong Kong's growth prospects through trade and financial channels.

Domestically, the main risk is any disorderly correction in property prices. Should there be a significant change in fund flows due to any global financial market volatility, it could impact on our property market. In this regard, the Administration and the Hong Kong Monetary Authority (HKMA) have introduced various demand-side management measures and counter-cyclical prudential measures on mortgage lending respectively to strengthen the capacity of the local economy and financial markets to withstand risks associated with the uncertainties of the external environment.

With regard to the increasing integration with the Mainland, as noted by the IMF, it offers considerable expansion opportunities for Hong Kong's financial sector. For instance, as the Mainland liberalises its policies on the use of Renminbi (RMB) in cross-border transactions, offshore RMB business in Hong Kong has been developing steadily. The RMB deposit pool, trade settlement, financing activities, foreign exchange transactions and investment products continue to grow vibrantly. That said, the HKMA is mindful of the credit risks associated with the growth of Hong Kong banks' exposures to non-bank Mainland entities in recent years, and has asked banks to manage properly the associated risks when expanding their Mainland-related business. The HKMA will continue implementing relevant risk management measures to this end.

(2) The IMF's Financial System Stability Assessment report has affirmed that Hong Kong has in place complementary structures for macroprudential and microprudential oversight to identify and manage risks of the financial sector.

The Administration and the financial regulators have been monitoring the global financial developments very closely. The financial regulators have implemented various measures in monitoring systemic risks and performed stress tests on an ongoing basis to assess the financial system's, as well as individual financial institutions', capacity to withstand shocks. In addition, financial regulators maintain regular contacts with their overseas counterparts to keep track of the operating and financial situations of foreign financial institutions, in order to identify any risks to Hong Kong's financial markets. The Administration and financial regulators will continue to remain vigilant, and improve further the existing regime in line with emerging international practice, so as to tackle challenges arising from global economic changes readily.

In relation to the risks concerning the volatility of the property market, the HKMA has introduced six rounds of counter-cyclical prudential measures on mortgage lending. These measures have strengthened banks' resilience to the risks of any property market downturn.

In light of the strong credit growth in the past few years, the HKMA has stepped up supervisory efforts on credit risk management and liquidity risk management of banks. These will ensure banks to continue maintaining credit underwriting standards stringently and managing liquidity risks prudently. Relevant regulatory measures include: (i) regular and thematic onsite examinations on banks' credit underwriting processes; (ii) regular supervisory stress-testing to assess banks' resilience to credit shocks; and (iii) introduction of a stable funding requirement since the fourth quarter of 2013 to ensure that the loan growth of banks is supported by adequate long-term funding and remains sustainable against any possible future deterioration in the liquidity situation.

(3) The introduction of the demand-side management measures by the Administration and six rounds of counter-cyclical prudential measures on mortgage lending by the HKMA has achieved positive results in stabilising the property market and strengthening banks' risk management. The Administration and the HKMA will continue to monitor closely the market situation and external environment, and will consider taking appropriate measures to safeguard the financial and banking stability in Hong Kong, in response to changes in the market cycle and having regard to relevant factors.

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