INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/186

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

2023 ARTICLE IV CONSULTATION DISCUSSIONS—PRESS RELEASE AND STAFF REPORT

May 2023

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of 2023 Article IV consultation discussions with People's Republic of China—Hong Kong Special Administrative Region, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 17, 2023, following discussions that ended on March 31, 2023, with the officials of People's Republic of China—Hong Kong Special Administrative on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 1, 2023.
- An **Informational Annex** prepared by the IMF staff.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

PRESS RELEASE

IMF Executive Board Concludes 2023 Article IV Consultation Discussions with the People's Republic of China—Hong Kong Special Administrative Region

FOR IMMEDIATE RELEASE

Washington, DC – May 31, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation discussions[1] with the People's Republic of China—Hong Kong Special Administrative Region (SAR) and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

The economic recovery in Hong Kong SAR stalled in 2022 following a major COVID outbreak and U.S. monetary policy tightening. But in 2023, real GDP is projected to grow by 3.5 percent. Exports of tourism services and domestic economic activity, in particular private consumption, are expected to normalize as border control and other COVID-related restrictions have been lifted in both Hong Kong SAR and Mainland China. With moderate wage pressure, CPI inflation is expected to gradually rise to about 2¼ percent by the end of 2023.

The financial system remains resilient and continues to serve as an international financial center, supported by strong institutional frameworks and substantial capital and liquidity buffers. The Linked Exchange Rate System continues to function smoothly, providing a solid anchor to the economy and the financial system, allowing the latter to perform its role as an international financial center. Housing prices,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. At the request or with the consent of the member, IMF staff may hold separate discussions with respect to territories or constituent parts of a member. These Article IV consultation discussions form a part of the member's Article IV consultation. In such cases, a staff team visits the territory or constituent part, collects economic and financial information, and discusses with officials the territory's or constituent part's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board, which in turn constitutes an integral part of the member's AIV consultation for the relevant cycle.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

which declined by about 16 percent by end-2022 from the peak in September 2021, have started to recover in early 2023.

Near-term risks to the growth outlook are balanced, with systemic risk in the financial sector manageable given significant buffers. A sharper-than-expected global growth slowdown as well as escalation of regional conflicts and resulting disruptions in trade could derail the recovery. A sharp rise in global risk premia amid renewed stress in the global banking system and further tightening of monetary policy in major advanced economies could have adverse spillovers through financial channels. On the upside, transition to the post-pandemic new normal in both Hong Kong SAR and Mainland China could be smoother and more rapid than anticipated with strong pent-up demand, leading to a faster-than-expected economic recovery including inbound tourism.

Executive Board Assessment

In concluding the 2023 Article IV consultation discussions with Hong Kong Special Administrative Region (SAR), Executive directors endorsed staff appraisal as follows:

The Hong Kong SAR economy is recovering strongly with post-COVID normalization of economic activity. Exports of tourism services and domestic economic activity, in particular private consumption, are expected to normalize as border control and other COVID-related restrictions have been lifted in both Hong Kong SAR and Mainland China. On a preliminary basis and adjusting for remaining transitory pandemic-related factors, the external position in 2022 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies.

Near-term risks to the growth outlook are balanced, with systemic risk in the financial sector manageable, given significant buffers. A sharper-than-expected global growth slowdown as well as escalation of regional conflicts and resulting disruptions in trade could derail the recovery. While the financial system remains resilient, a sharp rise in global risk premia amid renewed stress in the global banking system and further tightening of monetary policy in major advanced economies could have adverse spillovers through financial channels. On the upside, transition to the post-pandemic new normal in both Hong Kong SAR and Mainland China could be smoother and more rapid than anticipated with strong pent-up demand, leading to a faster-than-expected economic recovery including inbound tourism.

With remaining slack in the economy, gradual fiscal consolidation would help secure a sustained and inclusive recovery. Pandemic-era measures to support vulnerable households and affected SMEs could be unwound gradually, while additional household support could be provided in a targeted manner to low-income households. Expanding social safety nets, for example by further increasing the adequacy and coverage of social assistance benefits and introducing a dedicated unemployment benefit system, would help enhance the automatic stabilizer role of fiscal policy. A comprehensive tax reform over the medium term to broaden the tax base is imperative to provide a stable source of revenue to meet long-term spending needs while ensuring fiscal sustainability.

Amid renewed stress in the global banking system, the robust regulatory and supervisory framework should be further strengthened to maintain financial sector resilience. As credit risk will likely continue to materialize after years of domestic economic contractions, rising interest rates, and the ongoing stress in Mainland China's real estate sector, the supervisory focus should continue to be on ensuring banks' proper credit loss recognition and provisioning. A comprehensive and risk-based regulatory framework related to virtual assets is critical to safeguard financial stability and ensure investor protection.

Increasing housing supply is critical to resolving the structural supply-demand imbalance. Housing-related macroprudential measures should be maintained and can be recalibrated in the event housing-related stress materializes. The BSD and NRSD, assessed to be CFM/MPMs, need to be phased out once systemic risk from non-resident and speculative demands dissipates.

Promoting innovation and technological development can provide additional growth engines and boost economic resilience amid geoeconomic fragmentation. A newly launched investment fund set up by the government should operate with a clear mandate and strict standards for governance, accounting, and public reporting to minimize potential capital misallocation while effectively supporting the development of new innovative industries and fostering business dynamism.

Hong Kong SAR. Selected Economic Indicators

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
NATIONAL ACCOUNTS											
Real GDP (percent change)	2.8	-1.7	-6.5	6.4	-3.5	3.5	3.1	2.9	2.8	2.7	2.7
Private consumption	5.3	-0.8	-10.6	5.6	-1.0	5.8	2.4	2.8	2.9	2.9	2.9
Government consumption	4.2	5.1	7.9	5.9	8.1	-1.0	-2.8	0.1	1.7	1.7	1.6
Gross fixed capital formation	1.7	-14.9	-11.1	8.3	-8.5	-6.9	8.5	5.8	4.2	4.1	4.1
Inventories (contribution to growth)	0.0	-0.5	1.8	-1.9	-1.0	0.7	0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-1.5	2.1	0.2	2.4	-1.4	0.2	0.3	0.1	-0.1	-0.2	-0.2
Output gap (in percent of potential GDP)	0.1	-2.5	-7.3	-2.3	-3.9	-2.1	-1.7	-1.1	-0.7	-0.3	0.0
LABOR MARKET 1/											
Employment (percent change)	1.4	-0.3	-4.7	-0.6	-1.6	0.8	0.3	0.3	0.3	0.3	0.3
Unemployment rate (percent, period average)	2.8	2.9	5.8	5.2	4.3	3.4	3.3	3.3	3.2	3.1	3.0
Real wages (percent change)	1.0	0.1	2.5	-0.5	-1.4	0.7	1.3	1.3	1.3	1.3	1.3
PRICES											
Inflation (percent change)											
Consumer prices	2.4	2.9	0.3	1.6	1.9	2.3	2.4	2.4	2.5	2.5	2.5
GDP deflator	3.7	2.0	0.6	0.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2
GENERAL GOVERNMENT 1/											
Consolidated budget balance (percent of GDP) 2/	2.4	-0.6	-9.4	0.0	-6.7	-4.0	-1.0	0.2	0.6	1.3	1.3
Revenue	21.2	20.8	21.1	24.2	22.0	21.5	23.2	24.0	24.2	24.6	24.6
Expenditure	18.8	21.4	30.5	24.2	28.7	25.5	24.3	23.8	23.6	23.2	23.2
Fiscal reserves (as of end-March, percent of GDP)	41.3	40.8	34.7	33.4	29.5	26.1	25.1	25.0	25.9	27.4	28.3
FINANCIAL											
Interest rates (percent, period average)											
Best lending rate	5.0	5.1	5.0	5.0	5.1	...	...	...	...	...	...
Three-month HIBOR	1.8	2.1	1.1	0.2	2.1	...	...	...	...	...	...
10-year Treasury bond yield	2.2	1.6	0.7	1.2	2.8	...	...	...	...	...	...
MACRO-FINANCIAL											
Loans for use in Hong Kong SAR (excl. trade financing)	5.0	7.4	2.3	4.3	0.9	2.5	8.3	8.6	8.4	8.1	7.9
House prices (year-on-year percent change for last quarter)	5.8	3.4	-0.1	3.7	-13.6	1.0	5.7	7.3	5.8	5.3	5.3
Credit-to-GDP gap 3/	12.5	21.2	23.9	11.5	3.2	-14.5	-11.3	-7.4	-3.9	-1.5	0.1
EXTERNAL SECTOR											
Merchandise trade (percent change)											
Export value	7.3	-4.1	-1.5	26.3	-8.6	-4.5	9.9	6.0	4.3	4.2	4.2
Import value	8.4	-6.5	-3.3	24.3	-7.2	-2.9	10.4	6.0	4.3	4.3	4.3
Current account balance (percent of GDP)	3.7	5.9	7.0	11.8	10.7	8.0	6.5	6.0	5.5	5.0	4.5
Foreign exchange reserves											
In billions of U.S. dollars (end-of-period)	425	441	492	497	424	420	432	443	455	464	471
In percent of GDP	117	121	143	135	117	110	107	104	102	99	96
Net international investment position (percent of GDP)	354	432	615	574	486	468	451	434	419	404	390
Exchange rate											
Market rate (HK$/US$, period average)	7.839	7.836	7.757	7.774	7.832	...	...	...	...	...	...
Real effective rate (period average, 2010=100)	113.2	117.7	117.2	111.8	115.4	...	...	...	...	...	...

Sources: BIS,CEIC; HKSAR Census and Statistics Department; and IMF staff estimates.
1/ Estimated values for 2022.
2/ Before issuance and repayment of government bonds and notes.
3/ Based on loans for use in Hong Kong SAR, excluding trade financing.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

May 1, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION DISCUSSIONS

KEY ISSUES

Overview: After coping with another year of large COVID-related disruptions, economic activity is normalizing with the re-opening of the border, including with Mainland China. Strong fiscal policy support has helped the economy navigate through multiple shocks over the last few years, while strong institutional frameworks and financial buffers have allowed the financial system to remain resilient and continue to operate smoothly, including the Linked Exchange Rate System. The economy is facing macro-financial challenges amid rising interest rates, spillovers from strains in Mainland China's real estate sector, adjustment in the local property market, and global economic slowdown.

Policies. Securing a sustainable recovery and fortifying the status as an international financial center while safeguarding financial stability requires:

- *Promoting balanced recovery*. With remaining slack in the economy and softening external demand, a gradual pace of fiscal consolidation to return to a balanced budget in the medium term would help secure a sustained and inclusive recovery.
- *Maintaining financial system resilience*. The robust regulatory and supervisory framework should be maintained and adjusted as needed to ensure financial sector resilience amid rising global interest rates and increasing financial links with Mainland China. Virtual asset-related activities should be subject to a comprehensive regulatory framework to safeguard financial stability while not stifling innovation.
- *Facilitating orderly adjustment in the housing market.* Housing supply should be accelerated to resolve the structural supply-demand imbalance. Macroprudential measures should be maintained and any recalibration needs to be commensurate with the extent that housing-related downside risks have materialized.
- *Bolstering long-term growth prospects.* Deepening the links with other economies, regionally and globally, and promoting innovation and technological developments would not only provide additional growth engines but also boost economic resilience amid risks of greater geoeconomic fragmentation.

Approved By
Thomas Helbling and Guillaume Chabert

Discussions took place in Hong Kong SAR during March 20-31, 2023. The team comprised Joong Shik Kang (head), Henry Hoyle, Leni Hunter (all APD), and Phakawa Jeasakul (resident Representative, MCM). Thomas Helbling (APD) joined the concluding meetings. The mission met Financial Secretary Paul Chan, HKMA Chief Executive Eddie Yue, and other senior officials. Steven Lam (OED) joined the official meetings. Vatsal Nahata, Alessandra Balestieri (all APD), Daisy Wong (COM), Atis Lee and Hong Xiao (Resident Representative Office) provided support to the mission.

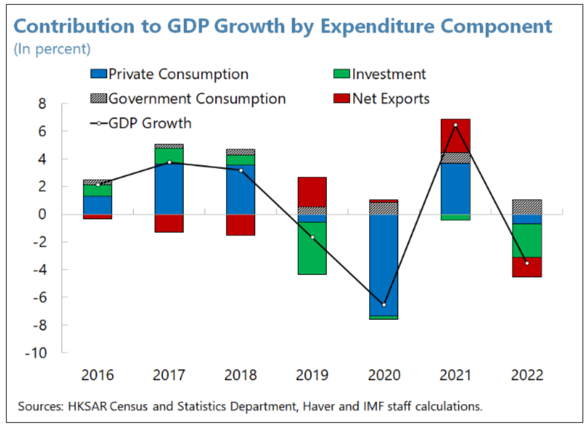
CONTENTS

TABLES

APPENDICES

CONTEXT: COPING WITH NEW CHALLENGES

1. **The Hong Kong SAR economy is sailing through another round of economic headwinds, but with still strong buffers.**[1] After a strong rebound in 2021 from two years of recession amid social unrest, U.S.-China tensions, and the pandemic, the economy faced a large setback in 2022 following a major COVID outbreak and U.S. monetary policy tightening, which raises domestic interest rates under the currency board arrangement (Linked Exchange Rate System, LERS). While economic activity is normalizing with the reopening of the border with the rest of the world, the economy is facing additional headwinds against a backdrop of a challenging global macro-financial environment. But ample policy buffers and the strong external position, which have been accumulated through a history of sound macroeconomic and prudential policies, have been helping the economy to cope with a series of global challenges.



2. **The financial system remains resilient and continues to serve as an international financial center.** Amid challenging macro-financial conditions, the financial system has remained stable supported by strong institutional frameworks, in particular, high-quality financial sector oversight and substantial capital and liquidity buffers. The LERS continues to function smoothly, providing a solid anchor to the economy and the financial system, allowing the latter to perform its role as an international financial center.[2]

3. **The new administration has prioritized policies to secure the recovery and promote sustainable growth, while tackling socio-economic problems.** In the near term, the key priority is to support a balanced recovery while maintaining financial stability amid rising global interest rates. Over the medium term, the authorities aim to enhance Hong Kong SAR's competitiveness by developing technology-driven and innovative industries and attracting enterprises and talents, while increasing land and housing supply to improve housing affordability.

NAVIGATING THROUGH GLOBAL HEADWINDS

A. Emerging from the Pandemic

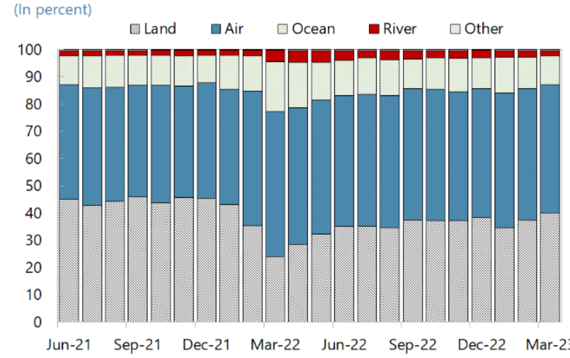
4. **The economic recovery stalled in 2022 amid recurrent disruptions from renewed COVID outbreaks and a challenging global environment.** Following strong GDP growth of 6.3

[1] These consultation discussions form part of the Article IV consultation with the People's Republic of China.

[2] FX reserves at around 117 percent of GDP or around 1.7 times the monetary base, together with a large net international investment position of about 486 percent of GDP as of end-2022, provide a strong buffer against external shocks.

percent in 2021, economic momentum was derailed in the first quarter of 2022 by a large COVID outbreak. Despite a gradual easing of COVID containment measures and policy support to boost domestic demand afterwards, the subsequent recovery was tepid amid lingering outbreaks and tightening financial conditions. Trade activity fell sharply in the second half because of declining external demand partly due to Russia's war in Ukraine, as well as customs delays and disruptions at the border with Mainland China amid large COVID outbreaks in both economies.[3] As a result, the economy contracted again in 2022, the third time in four years, by 3.5 percent.

Merchandise Trade, By Transport Mode
(In percent)



Sources: HKSAR CSD/CEIC.

5. Policy support has been extended to provide additional relief to households and businesses amid the economic contraction.

- *Fiscal measures.* The government ramped up its policy support to 7 percent of GDP in 2022 to help mitigate the impact of the adverse shocks. Key measures included: (i) disbursing a second round of electronic consumption vouchers; (ii) extending an employment support scheme; and (iii) one-off relief measures to households and enterprises such as salary tax reduction.

Text Table. Key Fiscal Policy Responses to the COVID-19
(In percent of GDP)

List of Measures 1/	Size		
	2020	2021	2022
Total	**11.0**	**5.2**	**7.0**
Support for household income and consumption	**2.7**	**1.3**	**2.4**
Cash payout to eligible residents	2.7	-	-
Digital consumption vouchers to eligible residents	-	1.3	2.4
Support for employment	**3.4**	**0.4**	**1.8**
Employment support scheme (ESS, funded through the AEF)	3.4	-0.01	1.5
Temporary job creation scheme	0.0	0.4	0.2
Temporary unemployment relief	0.00	-	0.1
Health-related spending on anti-epidemic efforts and vaccination	**0.7**	**0.3**	**1.3**
Other relief measures	**4.2**	**3.2**	**1.5**
Relief measures for households and enterprises 2/	2.6	2.0	0.6
Loan guarantee schemes 3/	0.4	0.5	-
Reducing salaries tax and other personal assessments	0.7	0.4	0.5
Subsidizing rates for residential properties	0.5	0.4	0.4

Sources: Hong Kong SAR government; and IMF staff calculations.
Note: 1/ Table is based on budget estimates and expenditures, and Anti-epidemic Fund (AEF) financial statements, year-ended March 2022. 2020 includes AEF Round 1. AEF expenditure for 2022, and temporary job creation scheme expenditure in 2022 are IMF staff estimates. 2/ Includes subsidy schemes, one-off grants, and others. 3/ Amounts represent the funding provision to Hong Kong Mortgage Corporation Insurance Ltd., for the purchase of loans and fee payments.

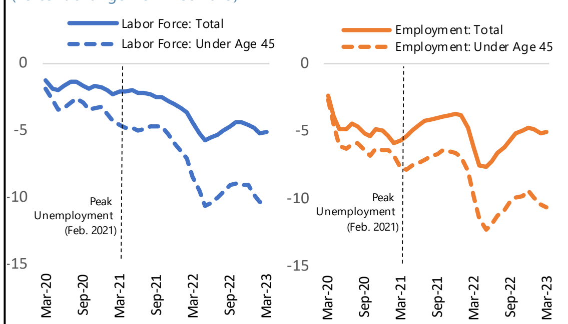
- *Financial measures.* Amid recurrent COVID outbreaks, existing support measures have been extended to help businesses and individuals manage temporary financial difficulties. The Pre-

[3] The value of trade by land transport (vis-à-vis Mainland China), which accounted for about 45 percent of total trade in December 2021, declined to 38 percent in December 2022 due to COVID-related disruptions at the border with Mainland China.

approved Principal Payment Holiday scheme for SMEs was extended until end-July 2023,[4] while additional principal payment deferrals have also been allowed for certain businesses and households.[5] The low-interest financing schemes with full government guarantee to qualifying individuals and SMEs were extended until end-April 2023 and end-March 2024, respectively.

6. **Economic challenges have broadened to labor markets, with talent shortage becoming a prominent concern.** The unemployment rate has declined to 3.1 percent for the three months ending March 2023, down from the peak of 7.2 percent in the three months ending February 2021. However, total employment has increased only 0.9 percent during this period, implying that more unemployed people have left the labor market than have found jobs. A large decline in the labor force during this period (-2.9 percent) also reflects the combined impacts of structural factors such as population aging, and short-term factors related to the pandemic such as limited inflows of foreign workers. Employment losses have been concentrated in younger-age workers, with the share of workers under age 45 falling from 53.5 to 51.3 percent over this period.

Change in Selected Labor Indicators, by Age Cohort
(Percent change from Dec-2019)

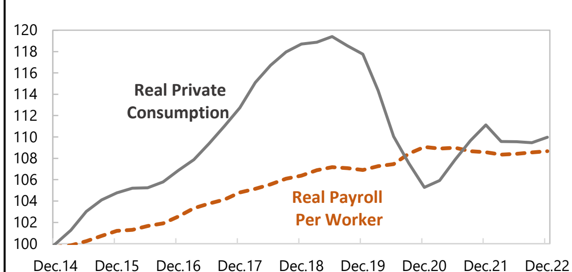


Source: Haver Analytics; and IMF staff calculations.

7. **Remaining slack in the economy has kept domestic inflation pressures low.** Despite strong policy support over the last few years against a series of domestic and external shocks, real GDP as of 2022Q4 remained 7 percent below its quarterly average level in 2018.

- The recovery in private consumption remains very weak, reflecting low growth in real household incomes and consumer caution amid persistent disruptions to contact-intensive activity and inbound tourism. Private investment[6] also fell sharply amid a worsening external demand outlook, rising interest rates, elevated uncertainty from COVID policies and slowing growth momentum in Mainland China, falling by almost 40 percent below its 2018 level.

Real Private Consumption and Household Wages
(Index: 100=2014)



Source: CEIC, IMF staff calculations.
Note: Data shown are four quarter moving sums.

- CPI inflation remains muted at 1.7 percent (y/y) as of March 2023 with large slack in the economy. Falling housing rental costs have helped offset modest pressures from imported

[4] In April 2023, the scheme was extended albeit only for trade loans until end-July 2023.

[5] These include SME borrowers under the SME Financing Guarantee schemes and mortgage borrowers under the Subsidized Sale Flats scheme.

[6] Excluding changes in inventories and costs of ownership transfer.

inflation on foods and goods, while non-housing service prices have remained subdued, reflecting weak domestic demand.

8. Financial conditions have tightened, while credit growth remains weak.

- Overall financial conditions tightened significantly in 2022 due to higher funding costs, widening risk premia, heightened uncertainty, and falling asset prices. On the back of Mainland China's reopening, the stock market rebounded in late 2022.

- Credit growth has been weak, reflecting limited credit demand. Bank lending for use inside Hong Kong SAR grew just 0.9 percent (y/y) in 2022 and loan growth was weak across sectors, especially consumer financing which contracted in 2022. As a result, the credit-to-GDP gap narrowed to about 3 percent as of 2022Q3, from the peak of 33 percent in 2020Q3.

- On the back of weak economic activity, rising interest rates, as well as limited emigration flows amid tight COVID-related controls, residential property sales have declined by about a quarter relative to pre-crisis levels and house prices have declined, as of end-2022, by about 16 percent from the peak in September 2021, before recovering somewhat in early 2023.

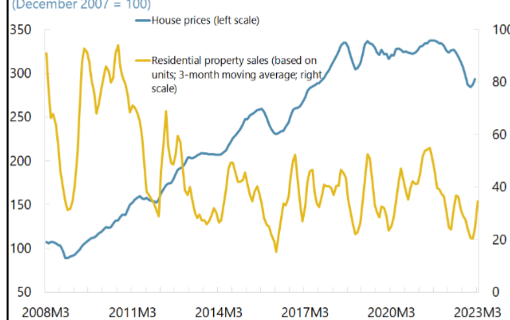
Financial Conditions

A higher value means tighter financial conditions; 3-month moving average

Note: Financial conditions are estimated using the principal component analysis of various categories of financial indicators: funding costs, asset prices, risk sentiment, and foreign exchange pressures.

House Prices and Residential Property Sales

(December 2007 = 100)

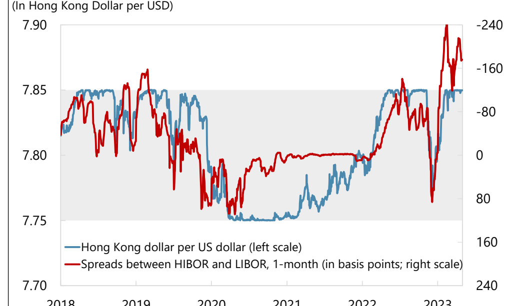


Sources: CEIC; and IMF staff calculations.

9. The Linked Exchange Rate System (LERS) continues to function smoothly. Under the currency board arrangement, Hong Kong dollar (HKD) interest rates have increased amid U.S. monetary policy tightening. More recently, the HKD has been volatile, largely driven by changes in interest rate differentials between HKD and USD. After the year-end demand for HKD liquidity eased, HKD interest rates have fallen below USD counterparts, driving HKD back into the weak side of the convertibility undertaking. Market adjustments in response to U.S. monetary policy tightening have been orderly so far, with no signs of funding stress, reflecting market depth and prudent management of leverage and liquidity within the system.

Hong Kong Dollar Dynamics

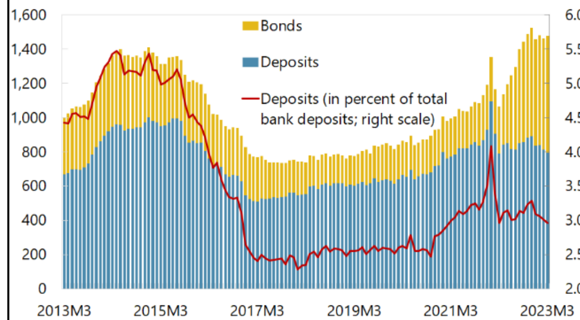
(In Hong Kong Dollar per USD)



Sources: Bloomberg; and IMF staff calculations.

10. Financial linkages with Mainland China continue to deepen, reinforcing Hong Kong SAR's status as a key financial gateway vis-à-vis Mainland China. The Stock Connect scheme was expanded to include exchange-traded funds (ETFs) in July 2022, and the scope of eligible stocks was broadened in March 2023. In July 2022, the Swap Connect scheme was announced to complement the Bond Connect scheme, which would allow overseas investors to trade interest rate swaps in Mainland China's interbank market via Hong Kong SAR, enabling them to manage their bond exposures to interest rate fluctuations. In addition, Hong Kong SAR's role as a leading offshore renminbi (RMB) center continues rising, with combined RMB deposits and bonds reaching a new high. The deepening financial linkages with Mainland China present both business opportunities as well as financial stability risks, especially in light of rising geoeconomic fragmentation.

Renminbi Assets
(In billions of renminbi)



Note: For bonds, only including those lodged with the Central Moneymarkets Unit (CMU).
Sources: CEIC; and IMF staff calculations.

Authorities' Views

11. The authorities agreed that large fiscal and financial buffers helped the economy navigate through another difficult year in 2022. They noted that the buffers allowed them to deploy large fiscal stimulus in a swift manner to mitigate the negative impact of a major COVID outbreak on households and businesses. The authorities stressed that the financial system has been resilient amid multiple shocks (social unrest, U.S.-China tensions, and COVID) in the last four years and has been largely unaffected by recent global banking stress and tightening US dollar funding conditions. They viewed that strong balance sheets of households and banks have facilitated orderly adjustment of the housing market.

B. Sailing into Headwinds

12. Real GDP is projected to grow by 3.5 and 3.1 percent in 2023 and 2024, respectively. Despite slowing growth and tightening financial conditions around the world in 2023, exports of tourism and domestic economic activity are expected to normalize with the full opening of the border. The subsequent global economic recovery will support robust growth in 2024, offsetting somewhat the effects of a planned fiscal consolidation.

- The recovery of private consumption will gather momentum as border control and other COVID-related restrictions have been lifted in both Hong Kong SAR and Mainland China, easing policy uncertainty. This will also support a rebound in labor supply and bring a rebound in cross-border activities such as tourism and transportation. The rebound in spending will be dampened by continued tightening in financial conditions and associated increases debt servicing costs for households and enterprises. Private investment is expected to recover only gradually on the back of slowing global growth and high interest rates.

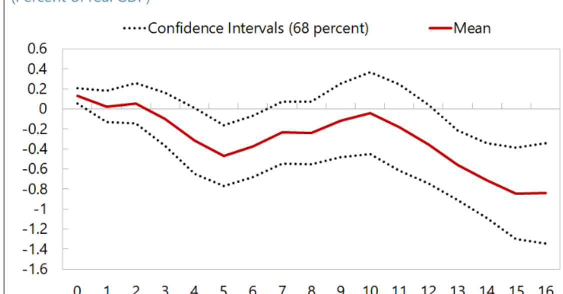
- The growth projection assumes that a large fiscal consolidation of more than 6 percentage points of GDP takes place over about two years, mainly due to a scaling back of the discretionary stimulus measures as envisaged in the government's budget.

- The negative output gap is expected to narrow to about 2 percent of potential GDP in 2023. Large slack in the economy will keep wage pressures moderate while housing rental costs are likely to remain soft as the property market stabilizes after the recent large adjustment. Together with easing imported inflation, inflation pressure would remain muted with CPI inflation gradually rising to about 2¼ percent by end-2023.

13. The current account surplus is expected to narrow in 2023 with the recovery in domestic demand. The current account surplus narrowed to 10.7 percent of GDP in 2022 largely due to a smaller trade surplus driven by a sharp decline in exports. On a preliminary basis and adjusting for transitory pandemic-related factors, the external position in 2022 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The current account surplus is projected to further narrow to 8 percent of GDP in 2023 as the merchandise trade deficit widens further amid normalizing domestic demand, more than offsetting a modest improvement in the services trade surplus due to the border reopening.

14. Against a backdrop of aging population, elevated debt, and Mainland China's secular growth slowdown, GDP growth is forecast to slow below 3 percent over the medium term. Potential output growth is likely to slow amid demographic pressures, which may have been exacerbated during the pandemic[7], and headwinds to private investment from elevated corporate debt levels and Mainland spillovers.[8] Adverse shocks to economic activity in Mainland China would generate persistent negative effects on economic activity in Hong Kong SAR through strong spillovers to private investment.[9] This implies that the projected secular slowdown in Mainland China would have significant impact on Hong Kong SAR's growth over the medium to long term. But the ongoing economic integration with Mainland China (especially the Greater Bay Area) may avert the deceleration in potential growth.

Response of Hong Kong SAR GDP to China Activity Shock
(Percent of real GDP)



Sources: IMF staff calculations, Federal Reserve Bank of San Francisco, and Haver.
Note: Data shows estimated cumulative impact of shock to the China Cyclical Activity Tracker (Fernald et al., 2021) using a structural vector autoregression model. The shock is scaled to be equivalent to 1 percentage point decline in Mainland China GDP. For more details, see Chapter 1 "Outlook for Asai and Pacific: Sailing into Headwinds" in Asia and Pacific Regional Economic Outlook, October 2022.

---

[7] The rapid shift in labor demographics could further increase in the old-age dependency ratio and negatively affect overall labor productivity. See Aiyar et al. "The Impact of Workforce Aging on European Productivity." IMF Working Paper 16/238, 2016

[8] An IMF staff analysis found that more indebted firms in Asia invest around five percent less than less indebted peers following recessions. See Copestake, et al., "Medium-Term Output Losses after COVID-19 in Asia: The Role of Corporate Debt and Digitalization," IMF Regional Economic Outlook: Asia and Pacific, October 2022.

[9] See Copestake, Alex, Melih Firat, Davide Furceri, and Chris Redl, "China Spillovers: Aggregate- and Firm-Level Evidence" IMF Working Paper (forthcoming), 2023.

15. Near-term risks to the growth outlook are balanced.

- *Downside.* A sharper-than-expected global growth slowdown, in particular recessions in major trading partners, as well as escalation of regional conflicts and resulting disruptions in trade could derail the recovery. A sharp rise in global risk premia amid renewed stress in the global banking system and further tightening of monetary policy in major advanced economies could have adverse spillovers through financial channels.

- *Upside.* Transition to the post-pandemic new normal in both Hong Kong SAR and Mainland China could be smoother and more rapid than anticipated with strong pent-up demand, leading to a faster-than-expected economic recovery including inbound tourism.

16. Financial vulnerabilities remain substantial, but with significant buffers, systemic risk in the financial sector is manageable. Key domestic financial vulnerabilities include stretched property price valuation and elevated private sector indebtedness. Despite recent adjustment, staff estimate that house prices are still overvalued by about 13 percent as of end-2022. Credit to nonfinancial corporates stood at 279 percent of GDP in 2022Q3, though falling by about 9 percentage points over the past year,[10] while households' bank debt (mostly mortgage borrowing) also remained elevated at 96 percent of GDP in 2022Q4. Furthermore, global risk sentiment, which could be influenced by geopolitical tensions, could affect Hong Kong SAR's financial system and trigger and/or amplify financial stress.

17. Deepening geoeconomic fragmentation poses downside risks in the medium to long term. While this will adversely affect all economies around the world, as Hong Kong SAR is one of the most open economies as a regional trading hub, an international financial center, and a financial gateway vis-à-vis Mainland China, the economic consequences of geoeconomic fragmentation could weigh on the economy through various channels such as trade, labor and capital flows, and elevated uncertainty.[11] For example, recurring geopolitical stresses could lead to further de-globalization and fragmentation of capital markets, payment systems, and trade patterns. This could limit the growth of Hong Kong SAR's cross-border financial services offerings or even lead to macro-financial instability.[12]

Authorities' Views

18. The authorities broadly agreed with staff's assessment that post-COVID normalization would drive strong growth in 2023. They viewed that, despite slowing global growth, visitor arrivals had been rebounding sharply and private consumption was on track for a strong recovery,

[10] The "total" figure may overstate Hong Kong SAR's firms' leverage since it includes many multinational and non-local firms that borrow funds to finance their operations outside Hong Kong SAR.

[11] See "Geoeconomic Fragmentation and the Future of Multilateralism." IMF Staff Discussion Note No. 2023/001.

[12] Under the Hong Kong Autonomy Act, the U.S. can impose sanctions on individuals and entities whose actions it determined as having reduced Hong Kong SAR's high degree of autonomy. The U.S. can impose secondary sanctions on foreign financial institutions that conduct significant transactions with the sanctioned individuals and entities.

underpinning the government's forecast of 3.5 to 5.5 percent growth in 2023. The authorities concurred that inflation pressure will remain moderate given still large slack in the economy. In the medium term, they noted that the ongoing economic integration with Mainland China (especially the Greater Bay Area), the active promotion of technological development locally, and the government's efforts in grooming local talents and attracting global talents and enterprises may avert the deceleration in potential growth. The authorities concurred with staff's preliminary external sector assessment for 2022.

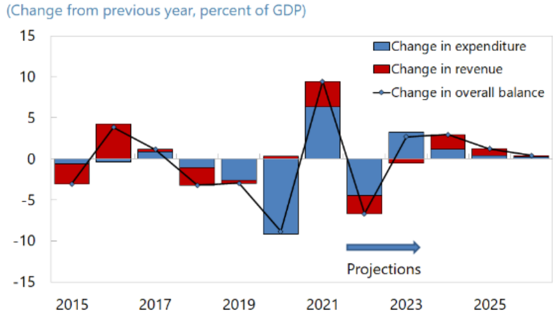
19. The authorities noted that the impact of geoeconomic fragmentation on the Hong Kong SAR economy needs to be monitored. While an open economy such as Hong Kong SAR will inevitably be affected, the magnitude of its impact might not be readily predicted. The authorities stressed that de-globalization had not had severe negative impacts (i.e., on trade, FDI, or fund flows) for Hong Kong SAR and that financial de-coupling had not been observed thus far. They expected global investors to further increase their investments into Mainland China's financial assets for diversification purposes and saw even greater potential from Mainland Chinese investment abroad. The authorities emphasized the need for multilateral solutions to resolve potential conflicts to safeguard global macro-financial stability.

FOSTERING A RESILIENT AND INCLUSIVE RECOVERY

A. Underwriting a Resilient Recovery

20. The COVID-related increase in the fiscal deficit should be unwound gradually in a growth friendly manner to secure a sustained recovery. Despite the ongoing strong recovery, there remains large slack in the economy while fiscal space remains ample with fiscal reserves of 27.4 percent of GDP as of end-2022. A gradual pace of fiscal consolidation to return to a balanced budget in the medium term would help ensure a solid and balanced recovery.[13] Pandemic-related measures to support vulnerable households and affected SMEs could be unwound gradually to help promote an inclusive recovery. Additional household support should be more targeted to low-income households to increase the effectiveness of fiscal policy in stimulating growth, especially private consumption.

Drivers Of Changes In Overall Balance
(Change from previous year, percent of GDP)

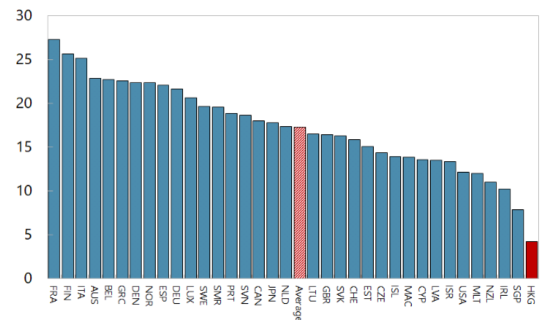


Sources: CEIC and IMF staff calculations.
Note: A positive value denotes an increase in revenue and a decrease in expenditure, respectively.

[13] There are some flexibilities in the principle underlying the government's management of public finance—enshrined in Hong Kong SAR's Basic Law—to keep expenditure within the limits of revenues to achieve a fiscal balance and ensure that the budget is commensurate with the growth rate of GDP.

21. Expanding social safety nets would help enhance the automatic stabilizer role of fiscal policy. As Hong Kong SAR maintains a tax regime combining low tax rates and a non-contributory social welfare system, the level of social welfare spending stood at 4.2 percent of GDP in 2020, well below the average of about 17 percent for advanced economies. Amid limited automatic stabilizers arising from relatively weak social safety nets, the government had to introduce various one-off support measures during the pandemic crisis.

Expenditure on Social Protection, 2020
(Advanced economies, In percent of GDP)



Sources: IMF Government Financial Statistics Database.

- *The adequacy and coverage of social assistance benefits could be further increased*. Key areas to strengthen the current system include better protecting the unemployed by: (i) strengthening the share of unemployed people covered by the Comprehensive Social Security Assistance (CSSA) Scheme; (ii) easing the eligibility rules so that an income replacement is provided to individuals before they reach very low income levels, for instance by adjusting the asset test; and (iii) assessing the level of the benefit so that it allows an adequate living standard in comparison with the rest of society. As the crisis abates, such measures could be conditioned on participation in active labor market programs.

- *The introduction of a dedicated unemployment benefit system would better protect the labor force and vulnerable households against idiosyncratic and systemic shocks.* Support for the unemployed is currently provided through severance payment/long service payment and a means-tested social safety net, but its coverage was limited against the surge in unemployment during the pandemic.[14] Such an unemployment benefit system could comprise of: (i) an unemployment insurance program financed from contributions, which can be capped at a given level; and (ii) a mean-tested unemployment assistance program financed by government revenues for those who have either not contributed sufficiently to be entitled to unemployment insurance or have exhausted their insurance benefits.[15] Such benefits could be set at a level high enough to ensure a higher living standard than social assistance, but also limited enough compared to labor incomes to maintain incentives to work.[16]

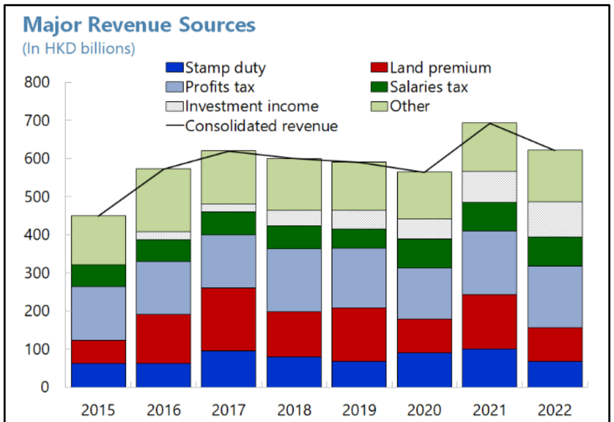
22. Comprehensive tax reform over the medium term is imperative to provide a stable source of revenues to meet long-term spending needs while ensuring fiscal sustainability. The current taxation regime of a narrow tax base and low tax rates has supported the city's competitiveness in the financial and service industries but resulted in a low tax revenue-to-GDP ratio of around 14 percent. Consolidated revenues also heavily rely on volatile property-related sources

[14] "Unemployment Benefits," Appendix V of 2022 A4 SR by Céline Thévenot and Yu Ching Wong.

[15] IMF, Fiscal Monitor, April 2020.

[16] Coady, David, et al., "Guaranteed Minimum Income Schemes in Europe: Landscape and Design," IMF Working Paper 21/179.

(land premium and stamp duties), which accounted for more than one-thirds of overall revenues before the pandemic and contributed to a large decline in overall revenues during the pandemic crisis. A comprehensive tax reform that broadens the tax base is needed to provide a stable source of revenue to meet the long-term spending needs while maintaining fairness and international competitiveness. A reform could start with raising excise taxes and increasing the progressivity of personal income tax by raising the tax rates on top brackets, followed by the introduction of a VAT over the medium term.[17]



Sources: Financial Services and Treasury Bureau/CEIC.

Authorities' Views

23. The authorities noted that returning to a balanced budget in about two years strikes a balance between supporting a recovery and rebuilding fiscal buffers. They viewed that, after drawing down fiscal reserves by about 14 percentage points of GDP over the last four years, it would be desirable to rebuild fiscal buffers as early as possible by unwinding pandemic-related support measures given that private demand is expected to rebound strongly in the near term. While not seeing a need to introduce a new unemployment benefit given the support from recently enhanced procedures of the Protection of Wages on Insolvency Fund, the authorities stressed that public housing, accommodating about 45 percent of population, is another key pillar of the social safety net. They also noted that the introduction of minimum top-up taxation for multinational enterprises under the implementation of the global minimum tax will bring in a steady revenue stream in the medium to long term.

B. Unwinding Exceptional Financial Support

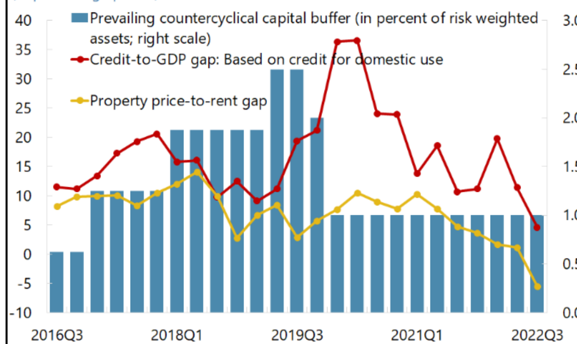
24. Financial relief measures should be phased out to facilitate necessary post-crisis debt restructuring. As economic activity normalizes post-pandemic, moratorium on principal payments should not be further extended. An exit strategy (e.g., partial principal repayments) should be implemented in a way to facilitate the resumption of repayments.[18] Banks should be encouraged to restructure loans of borrowers with financial difficulty and proactively recognize credit losses in line with strict prudential norms that have been maintained throughout the crisis. The government's full credit guarantee schemes should be unwound as they expire to safeguard robust market-based credit underwriting practices. The authorities can continue providing partial credit guarantees as in the pre-crisis period with proper backing of fiscal resources.

[17] "People's Republic of China—Hong Kong Special Administrative Region: Selected Issues", IMF Country Report No. 18/17.

[18] Currently, the participation rate of the Pre-approved Principal Payment Holiday Scheme for SMEs was about 1 percent, down from 16 percent at the launch.

25. The countercyclical capital buffer (CCyB) should be maintained against the backdrop of weak credit growth. At the onset of the pandemic in March 2020, the Hong Kong Monetary Authority (HKMA) lowered the CCyB from 2 percent to 1 percent and has kept it at that level since then. Staff welcomes the HKMA's intention to introduce a positive CCyB in a risk-neutral environment. While the indicative buffer guide—a metric based on the credit-to-GDP gap and property price-to-rent gap—based on data as of September 2022 suggested a zero CCyB, staff recommends keeping the CCyB at 1 percent to help maintain the banking system's resilience against impending macro-financial headwinds as soft credit growth is largely driven by weak credit demand despite ample banks' capital. Going forward, the HKMA should stand ready to adjust the CCyB based on updated systemic risk assessment.

Countercyclical Capital Buffer
(In percentage points)



Sources: HKMA.

Authorities' Views

26. The authorities agreed with the need to unwind financial relief measures as the economic recovery takes hold. However, they still saw the need to maintain the credit guarantee scheme for another year for small businesses as well as firms in the transportation and tourism sectors to ensure adequate financing for their business recovery. They also expected that credit risk related to the principal payment moratoriums would be manageable given the low usage of such schemes. The authorities agreed that a positive CCyB should be maintained in a risk-neutral environment so that some capital buffer could be released at times of stress.

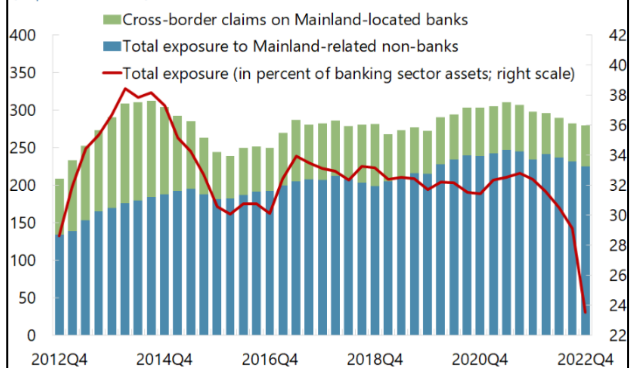
SAFEGUARDING FINANCIAL STABILITY

A. Maintaining the Financial System's Resilience

27. The banking system remains strong despite years of a challenging macro-financial environment. Reflecting years of economic contractions, banks' impairment expenses have increased but remain low, with nonperforming loans (NPLs) and special-mention loans accounting for 1.4 and 2.2 percent of total loans, respectively, as of 2022Q4. Banks' capital positions also remain strong, with the system-wide common equity tier-1 capital ratio at 16.2 percent, well above the Basel requirements. The system-wide Liquidity Coverage Ratio (LCR) of 162.3 percent and Net Stable Funding Ratio (NSFR) of 137.7 percent point to overall ample liquidity buffers and stable funding profiles in the banking system.

28. Banks should continue to maintain adequate capital buffers to absorb potential credit losses arising in the challenging macro-financial environment. The 2021 FSAP found that banks would remain adequately capitalized even in a severely adverse scenario with a marked slowdown of Mainland China's economy, a significant tightening of financial conditions, and a large housing market correction. Staff welcomes the HKMA's conservative approach of having not relaxed prudential norms during the pandemic. As credit risk will likely continue to materialize after years of domestic economic contractions, rising interest rates, and the ongoing stress in Mainland China's real estate sector, the supervisory focus should continue to be on ensuring banks' proper credit loss recognition and appropriate provisioning. The intensive banking supervision proportional to major macro-financial risks is welcome and should continue to be complemented with the use of Pillar 2 capital requirements as needed. As banks' progress on addressing credit risk is uneven, banks that lag behind peers should be subject to greater supervisory scrutiny. A proactive approach to preserve banks' healthy balance sheets could help facilitate debt structuring and/or bankruptcy proceedings of financially weak borrowers and ensure an efficient credit allocation post-crisis.

Banking Sector Exposure to Mainland China
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

29. Proactive management of risks arising from the stress in Mainland China's real estate sector and the impact of weak economic activity during the pandemic is warranted. Hong Kong SAR banks' exposures to Mainland China's nonbanks are sizeable at about 24 percent of banking sector assets (or 225 percent of GDP) as of 2022Q4, with exposures to the real estate sector among the largest. Hong Kong SAR banks' cross-border claims on Mainland China-located banks also amounted to additional 5.7 percent of banking sector assets. As of 2022Q4, the NPL ratio for Mainland-related lending was 2.7 percent, largely reflecting the deterioration of credit quality related to Mainland China's real estate sector.

- *A more comprehensive cross-sectoral approach to monitor Mainland China exposures would be important to ensure that risks can be detected and managed.* The HKMA has closely monitored and reviewed banks' exposures to nonbank Mainland Chinese entities and developed a granular database, which enables the loan-level monitoring of bank lending to large Mainland Chinese borrowers. As financial stability risks could span beyond bank lending—e.g., due to holdings of securities and their use as funding collateral given Hong Kong SAR's role as a leading marketplace for Mainland Chinese securities—, it is important to enhance the risk monitoring to gauge the financial system's overall exposure to Mainland China.

- *Adequate bank capital buffers for Mainland China exposures could help mitigate systemic risk.* Staff welcomes the HKMA's continued efforts to ensure that banks' internal credit risk models to determine capital charges for exposures to Mainland Chinese entities are sufficiently forward-looking. Given non-negligible default risks of Mainland Chinese corporates under severe macro-financial conditions as noted by the FSAP analysis, the HKMA should continue to ensure that banks appropriately price risks related to Mainland China, potentially through additional capital requirements based on banks' risk-taking behavior.

30. The authorities should continue close monitoring of liquidity risks of banks and investment funds amid more volatile global risk sentiment. While overall nonbank financial intermediation is large in Hong Kong SAR, risky activities (according to the Financial Stability Board (FSB)'s framework) such as collective investment vehicles susceptible to runs and financial intermediation dependent on short-term funding are relatively small based on an international comparison, amounting to about 38 percent of GDP in 2021.[19] However, the FSAP identified some pockets of liquidity-related vulnerabilities such as some foreign bank branches relying on unsecured interbank funding and some investment funds gearing towards riskier asset classes. While banks' system-wide unrealized losses from rising interest rates appear low, as the duration of bond holding is relatively short, the HKMA should remain vigilant against liquidity risks following recent strains in global banking markets, particularly with respect to less stable deposits,[20] and continue to ensure that banks have appropriate asset-liability management. Building on recent efforts by the Securities and Futures Commission (SFC) to strengthen the data collection framework, the monitoring and stress testing of investment funds' liquidity should be integrated into the supervisory framework as recommended by the FSAP.

31. Rising risks from geoeconomic fragmentation require more comprehensive efforts to step up risk monitoring and build resilience. As Hong Kong SAR is at a forefront of rising geoeconomic fragmentation as a financial gateway vis-à-vis Mainland China, it is important that associated financial stability risks are well understood, monitored, and managed. Analysis covering a wide range of scenarios could be useful to help formulate actionable supervisory guidelines and contingency plans.

32. The LERS remains the appropriate arrangement for Hong Kong SAR as an anchor for macro-financial stability. Several factors, including the mechanism's transparency, ample foreign reserves, a prudent fiscal policy framework, robust financial regulation and supervision, and the economy's flexibility, have helped ensure the credibility of the LERS.

Authorities' Views

33. The authorities agreed that systemic risk is manageable, given strong financial sector oversight and ample capital and liquidity buffers. They noted that the duration of bonds held by Hong Kong SAR banks is relatively short, limiting potential losses related to their holding of securities measured at amortized cost in case of a sale before maturity at a lower price. Banks' regulatory capital fully reflects unrealized losses related to securities measured at fair value through

[19] Based on the FSB data, total assets amounted to 222 percent of GDP for insurers and pension funds and 99 percent of GDP for other financial intermediaries.

[20] Under the deposit protection scheme, deposits are insured up to HK$500,000 per depositor for each bank.

other comprehensive income, which lowered the system-wide capital ratio only by about 0.6 percentage point in 2022 due to higher interest rates, while banks' liquidity risk is mitigated by the stable and diversified deposit base. The authorities stressed that their proactive approach to ensure banks' proper loss recognition helps mitigate asset quality concerns.

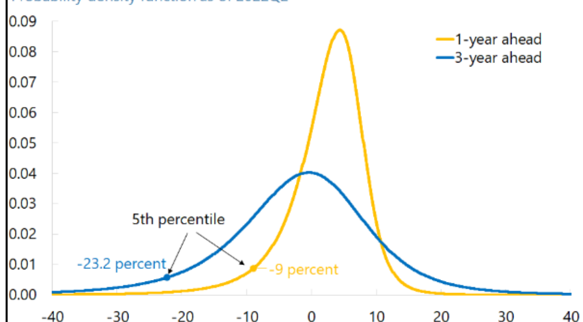
34. The authorities highlighted the importance of intensive supervision in containing financial stability risks. They noted that a thematic review in 2022 had revealed that banks' internal credit risk models are sufficiently forward-looking, and banks do not have concentrated exposures to financially weak property developers in Mainland China. Though not seeing the need for jurisdiction-specific and/or sectoral capital requirements, the authorities indicated that Pillar 2 capital requirements have already been used to address institution-specific risks. They viewed that further strengthening Hong Kong SAR's status as an international financial center would help mitigate rising geoeconomic fragmentation risks and reiterated their plan to continue to rely on supervisory buffers (i.e., intensive supervision, stress testing, and contingency planning) to help maintain confidence and credibility of the system and prepare for worst case scenarios.

B. Facilitating Orderly Adjustment of Housing Market

35. While the housing market corrected in 2022, a further adjustment in the property market could still pose risks to the economy.

- *House prices may still be substantially overvalued.* While normalization of economic activity is expected to help the housing market stabilize, staff's house price-at-risk analysis suggests that prices could fall further in a downside scenario. There is a 5-percent probability that real house prices could fall by 9 percent over the next year and by 23 percent over the next three years, largely reflecting a still sizeable price misalignment with fundamentals such as income.

House Price at Risk
Probability density function as of 2022Q2



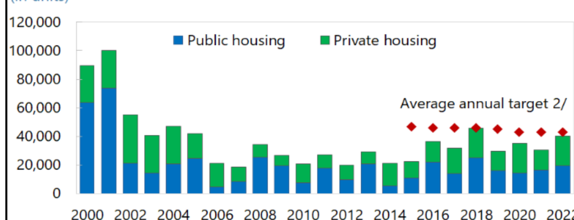
Note: Baed on the methodology discussed in IMF WP 2020/11.
Sources: CEIC; and IMF staff calculations.

- *Financial stability risks have been mitigated by existing macroprudential measures.* Hong Kong SAR has imposed one of the most restrictive loan-to-value (LTV) and debt service-to-income (DSTI) requirements (Appendix III). For new mortgages in 2022, average LTV and DSTI were at about 56 percent and about 37 percent, respectively, and borrowers have been stress-tested to ensure their ability to service debt at higher interest rates. Existing macroprudential measures thus help limit potential nonperforming loans as well as banks' potential credit losses once defaults materialize.

- *A further market adjustment could suppress private consumption.* In the face of rising mortgage rates, households may be able and willing to continue meet their debt obligations.[21] However, higher interest payments could account for a sizeable portion of household income, estimated to be nearly 7 percent of income for a 1 percentage point increase in mortgage rates.[22] Higher debt servicing burden, as well as negative wealth effects in the case of a sharp decline in house prices, could be a significant drag on private consumption.

36. Increasing housing supply is critical to resolve the structural supply-demand imbalance. Annual housing supply has increased on average by about 30 percent since 2015 compared to the previous decade, but the expansion has still fallen short of target by about 25 percent on average, partly due to limited land supply (including delay in land preparation) and lengthy statutory and administrative procedures. Staff welcomes the new administration's more coordinated approach to boost housing and residential land supply by identifying more land and streamlining statutory and administrative procedures. Plans for additional investments in public housing to increase the supply by 50 percent over the next five years are warranted given the structural supply pressures in housing markets. In addition, fiscal measures could be employed to incentivize a more efficient use of the housing stock.

Housing Production 1/
(In units)



Sources: Housing Authority, Hong Kong SAR; Housing Society, Hong Kong SAR; Rating and Valuation Department, Hong Kong SAR; and IMF staff calculations.
1/ Public Housing includes both rental and subsidized sale flats; Rental flats include those completed under Hong Kong Housing Authority (HKHA) and Hong Kong Housing Society; Subsidized sale flats include those completed under HKHA and Hong Kong Housing Society, and do not include the 322 subsidized sale flats provided by the Urban Renewal Authority in 2015/16 and those in 2020/21. Private flats from 2003 onwards exclude village houses; 2004 figures include subsidized flats converted to private during the year; 2015 figures include flats completed and designated as subsidized sale flats in the year but sold to the public in the open market at prevailing market prices in 2017; 2019 figures include flats completed and designated to be sold to the public in the open market at prevailing market prices but eventually sold at a discounted price as Starter Homes flats in 2020.
2/ The average annual target for housing production is the average annual target for the ten-year period announced in the 2014-19 Long Term Housing Strategy Annual Progress Reports.

37. Housing-related macroprudential measures should be maintained and can be recalibrated in the event housing-related stress materializes. As the principal objective of these macroprudential measures is to safeguard financial stability, any relaxation of LTV and DSTI requirements should be commensurate with the extent that housing-related downside risks have materialized such as falling house prices and rising interest rates. Under this objective, in September 2022, the DSTI stress rest requirement was relaxed to an increase of interest rates by 200 basis points (previously, 300 basis points) as mortgage rates had increased by 80 basis points. Meanwhile, the authorities should remain vigilant to ensure that potential macroprudential policy leakages caused by nonbank lenders (for example, property developers and money lenders) remain mitigated.[23]

[21] The majority of mortgages are floating rate. While money market rates have increased notably (e.g., about 4.6 percentage points for 1-month HIBOR), the increase in mortgage rates has been about 1.3 percentage points on average as of December 2022, the magnitude that is within the DSTI stress test requirement. The share of mortgages (in terms of total outstanding value) with negative equity dropped to 1.9 percent in March 2023 from 3.7 percent in December 2022 based on the HKMA's estimates. Strategic defaults are less likely given that banks have a recourse to defaulted borrowers.

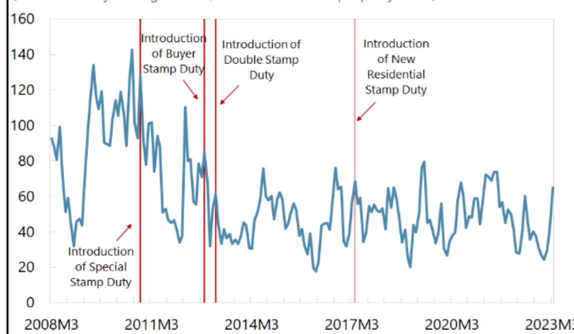
[22] The analysis considers median income for households with private housing (HK$ 39 thousand) and average mortgage size (HK$5 million).

[23] The share of new residential mortgage lending from nonbank lenders has declined since 2018 (about 8 percent in 2021), reflecting the regulatory tightening via banks and the enhancement of the Mortgage Insurance Program.

38. Stamp duties need to be adjusted if the systemic risks arising from speculative demand dissipates. Three types of stamp duties[24] have been effective in limiting speculative transaction, contributing to curbing house price increases and containing household leverage and systemic risks. In October 2022, as part of the effort to attract foreign talents, the government adjusted the rules so that nonresidents who have entered Hong Kong SAR under designated talent admission schemes could get a refund for both Buyer's Stamp Duty (BSD) and New Residential Stamp Duty (NRSD) upon obtaining Hong Kong SAR permanent residency. Amid the economic normalization and the reopening of the border, the authorities should carefully monitor the systemic risk arising from speculative demand by both residents and non-residents and stand ready to adjust relevant stamp duties. In particular, BSD and NRSD, which are assessed to be capital flow management and macroprudential measures (CFM/MPMs) under the IMF's Institutional View on capital flows, need to be phased out once systemic risks from nonresident and speculative demand dissipate.

Residential Property Transactions

(2007 monthly average = 100, based on units of property sales)



Sources: CEIC; and IMF staff calculations.

Authorities' Views

39. The authorities concurred that increasing public housing supply is a policy priority to tackle the structural supply-demand imbalances and improve housing affordability. While confident that the envisaged housing supply can meet the long-term demand over the next decade, the authorities highlighted the importance of Light Public Housing in closing the demand gap for the next five years. The authorities agreed that maintaining macroprudential measures is important for ensuring the financial system's resilience to property-related risks and assessed that stamp duties are effective in reducing speculative demand and in allocating the limited housing stock toward Hong Kong SAR residents.

C. Further Enhancing Financial Sector Oversight

40. Ongoing efforts to further strengthen financial sector oversight and the financial sector safety net are welcome (Appendix V). The FSAP found that the oversight of the financial system is modernized and strong in Hong Kong SAR.

- *Systemic risk oversight.* The high-level cross-sectoral setup of the Council of Financial Regulators and the Financial Stability Committee has enabled to identify and analyze systemic risk by leveraging on expertise of the HKMA and other financial regulators. Such efforts should be complemented by enhanced communication about systemic risk with the public. Building on recent efforts to utilize trade repository data and granular bank lending data, which help monitor the leverage of certain nonbank financial institutions (such as securities intermediaries

[24] Special Stamp Duty (SSD) on resale of residential properties within 36 months of purchases, Buyer's Stamp Duty (BSD) on purchases by nonresidents, and New Residential Stamp Duty (NRSD) on all residential property purchases except for primary residences of permanent residents who do not own other property.

and hedge funds) and their connection with banks, the authorities should continue to collect more comprehensive data on cross-sectoral and cross-border exposures to improve systemic risk surveillance.[25]

- *Oversight of the banking sector.* The FSAP noted that the group-wide supervisory approach could be further strengthened, particularly in the areas of corporate governance, risk concentration, and intra-group transactions. The HKMA's thematic examination of banking groups with both subsidiaries and branches should continue to ensure their proper risk management of concentrated exposures and limit potential opportunities for regulatory arbitrage.

- *Oversight of the insurance sector.* Hong Kong SAR's insurance sector is large and well-developed, with its assets amounting to around 170 percent of GDP. The sector also sells insurance products to other countries in the region and hosts one of the world's largest insurers. The Insurance Authority should ensure sufficient supervisory resources to implement the group-wide supervision framework, which was adopted in March 2021, and advance work on recovery and resolution planning of systemically important insurers. In addition to the risk-based capital regime that is set to come into effect in 2024, more efforts to enhance systemic risk monitoring are also warranted to ensure insurers' financial soundness, especially in light of rapid increase in interest rates and heightened credit risk (e.g., from low-rated debt securities and private assets).

41. The authorities continue to adjust the regulatory regime in response to the evolving virtual asset ecosystem. Recognizing the potential benefit of technology underpinning virtual asset development, the authorities plan to develop financial services across the virtual asset value chain, including issuance of virtual assets, tokenization, trading and settlement platforms, financing and asset management, and custody, with an aim to embrace technology to improve the efficiency of financial intermediation and to support the transition to a digital economy. For example, the Hong Kong SAR government issued the tokenized sovereign green bond in February 2023, the first instance globally.

- The authorities have taken a proactive albeit cautious approach to regulate virtual asset-related activities to safeguard investor protection and financial stability under the principle of "same activity, same risks, and same regulation." The authorities, using the risk-based approach, continue to adjust the regulatory and supervisory frameworks for virtual assets and their related activities to ensure fair and transparent market activities and proper risk management of regulated financial institutions' exposure to virtual assets. (Box 1)

- A regulatory regime for virtual asset service providers is set to come in effect in June 2023 to align their regulatory requirements regarding AML/CFT and investor protection to those currently applicable to traditional financial institutions. Furthermore, the HKMA plans to introduce the regulatory framework for stablecoins in 2023-24.

[25] See Appendix V for progress on FSAP recommendation to enhance data collection of intersectoral claims with a focus on claims of the nonbank financial institutions.

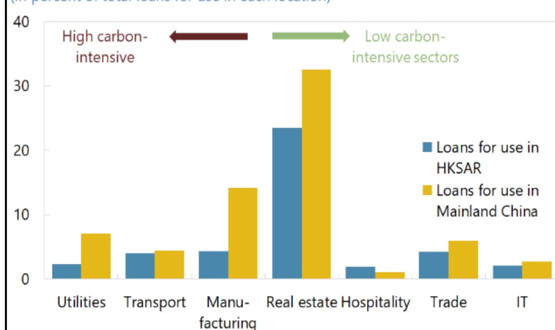
42. A comprehensive and risk-based regulatory framework related to virtual assets is critical to safeguard financial stability and ensure investor protection. Staff welcomes the authorities' efforts to supervise regulated financial institutions' exposures to virtual asset-related activities. Strong and agile regulatory and supervisory frameworks should be put in place to mitigate financial stability risks while promoting market development and fintech innovation.

- As the virtual asset ecosystem continues to evolve, the authorities should stand ready to refine and expand the regulatory regime, guided by the applicable international standards.[26] Adopting a risk-based approach to develop a regulatory regime for stablecoins could help address risks related to macro-financial stability, consumer protection, financial integrity, and fair competition.

- A cross-sectoral approach is important to limit regulatory arbitrage as virtual asset-related activities tend to cut across the sectoral boundaries of traditional financial services. Enhanced monitoring of virtual asset-related activities could help guide the regulatory design and support systemic risk surveillance. Supervisors should continue ensuring that financial institutions appropriately manage credit, liquidity and operational risks related to virtual assets.

43. Climate-related financial risks should continue to be carefully monitored and proactively managed. The HKMA has incorporated climate-related risks into its prudential policy framework, while the SFC has set supervisory expectations for asset managers and investment funds.[27] Similar efforts should also be applied to the insurance sector given that the investment of long-term insurance business could be exposed to stranded assets, while physical effects of climate change could significantly affect general insurance business. Overall, the authorities should continue monitoring of financial institutions' progress on managing climate-related risks and adapting their businesses as the economy transitions towards carbon neutrality. They should also continue to enhance the capacity for climate-related financial risk analysis, including by improving data collection and assessment methodology.

Bank Loans by Sectors, End-2022
(In percent of total loans for use in each location)



Note: Data on carbon intensity is based on the FSAP analysis; IT=Information technology.
Sources: HKMA; IMF, Country Report No. 21/102; and IMF staff calculations.

44. The authorities should continue to enhance the AML/CFT regime to mitigate emerging risks. The authorities recently updated the ML/TF/PF risk assessment and amended the primary AML/CFT law to introduce a licensing regime for virtual asset service providers and enhance customer due diligence measures in the banking sector. To safeguard the integrity of Hong Kong SAR's financial system further, the authorities should ensure that entities providing services covered under the FATF standards other than virtual asset trading platforms are also made subject to the AML/CFT regulation and supervision, continue robust risk-based supervision of financial institutions

[26] Also see IMF's recent Board Paper "Elements of Effective Policies for Crypto Assets".

[27] See Selected Issues for the 2022 Article IV consultation (Country Report No. 2022/070) for more details.

and trust and company service providers, and strengthen cooperation with international counterparts to identify and combat ML threats posed by foreign proceed-generating crimes.

Authorities' Views

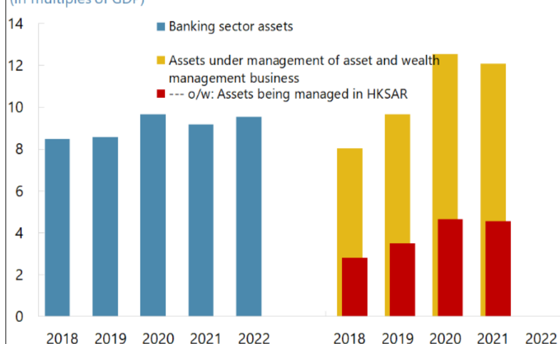
45. The authorities assessed that systemic risk oversight was effective, benefiting from effective cross-agency coordination and improved risk monitoring. They highlighted the benefit of using trade repository data for OTC derivative transactions and granular bank lending data to identify risks that are typically not visible to regulators—for example, potential buildups of positions and leverage of non-bank financial intermediaries and their connection with banks. Regarding virtual asset-related activities, in view of continued interest in distributed ledger technologies and the market potential; the authorities viewed that a comprehensive and risk-based regulatory regime balancing between market development and investor protection would provide a suitable foundation to facilitate further development.

BOLSTERING LONG-TERM GROWTH PROSPECTS

A. Fortifying the International Financial Center Status

46. Hong Kong SAR's financial system has continued expanding and maintained its role as a major international financial center. Hong Kong SAR is a leading business hub of global and regional banks, with total banking sector assets amounting to 9.5 times GDP as of 2022Q4, growing by 10.5 percent during the pandemic. Its banking sector plays an essential role in facilitating cross-border financing, trade, and treasury activities. Hong Kong SAR is also a leading wealth management center with total assets under management of 12.4 times GDP as of 2021, growing by 23.6 percent during the pandemic, with most of the funding being sourced from international investors. Financial links with Mainland China's capital markets can be further expanded, for instance via tools to help foreign investors better manage their onshore financial exposures (e.g., Mainland government bond futures) and support Mainland investors' ability to invest and manage risk abroad. While this will bring additional risks that must be managed, it will help further fortify Hong Kong SAR's competitiveness as an international financial center.

Size of Banking and Asset Management
(In multiples of GDP)



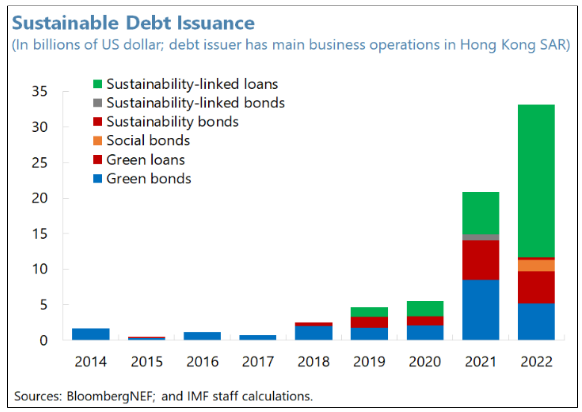
Sources: CEIC; SFC; and IMF staff calculations.

47. The free flow of capital should continue to underpin Hong Kong SAR's competitiveness as an international financial center. Any disruption to the free flow of capital into and out of Hong Kong SAR, including in USD, could destabilize the global financial system with repercussions on the global economy. The authorities should continue to preserve the rule of law and the common law system, enhance high-quality financial regulation and supervision, and attract talents to provide world-class financial and other related professional services.

48. Fostering the development of climate finance could help maintain Hong Kong SAR's competitive position.

- The Green and Sustainable Finance Cross-Agency Steering Group launched a climate-related data repository in June 2022 and is developing a local green classification framework consistent with the Common Ground Taxonomy and enhancing climate disclosures particularly for SMEs. In October 2022, HKEX launched Core Climate, an international marketplace for voluntary carbon trading, in which carbon credits from internationally certified projects (including carbon avoidance, reduction and removal) from around the world are traded.

- To further foster the development of the climate finance ecosystem, the authorities should continue their efforts to strengthen the climate information architecture—i.e., data, definition, and disclosures—including making preparation for the adoption of the forthcoming international standards on sustainability-related disclosures.[28] Given substantial demand for transition finance in the Asia-Pacific region, the authorities should consider the transition finance aspect when developing the taxonomy.[29]



49. The adoption of central bank digital currencies (CBDCs) could help enhance the efficiency of both cross-border and local payments. During August-September 2022, the HKMA completed a successful pilot of a platform to settle cross-border payments and foreign exchange transactions using CBDCs under the mBridge project in cooperation with the BIS Innovation Hub and three other central banks. The HKMA along with its partners plans to develop the mBridge platform into a minimum viable product stage. (Box 1) While not committing to issue a retail CBDC yet, the HKMA has started the groundwork for possible e-HKD implementation by adopting a three-pronged approach that encompasses preparing for legislative amendments, examining user cases and design issues under a two-tier system, and developing a launch plan. In addition, another trial on the cross-boundary use of e-CNY in Hong Kong SAR was conducted with a focus on how to link Hong Kong SAR's Faster Payment System (FPS) to the e-CNY wallet.[30] The authorities should ensure that the envisaged use of e-CNY would not result in a surge in the use of RMB for local payments to safeguard macro-financial stability.

Authorities' Views

---

[28] The standards are being developed by the International Sustainability Standards Board.

[29] The G20 Sustainable Finance Working Group developed a framework for transition finance; see its report for more details.

[30] As the FPS is an HKD-based system, dollarization risk is not an issue.

50. The authorities remained committed to further strengthening Hong Kong SAR's leading international financial center status. They believed that Hong Kong SAR can and will continue playing a role in facilitating two-ways fund flows between Mainland China and the rest of the world, supported by the expansion and enhancement of the Connect schemes, the development of derivatives products for risk management, and the trading of stocks in RMB. The authorities saw the benefit of fostering the development of the climate finance ecosystem, including the introduction of carbon trading, to support climate mitigation, adaptation and transition efforts in the region. In addition, they acknowledged strong potential use cases for wholesale CBDCs, which can enhance the efficiency of large-value payment systems, including for cross-border payments, by reducing settlement risks.

B. Building New Growth Drivers

51. Deepening Hong Kong SAR's links with regional and global economies will boost its growth potential. Continued pursuit of deeper trade, investment, and human capital ties with member countries of the Regional Comprehensive Economic Partnership (RCEP) will help solidify Hong Kong SAR's competitiveness as a regional trade hub. The authorities have continued to advance linkages throughout the Greater Bay Area (GBA), for instance by boosting intra-GBA venture capital and other services for HKSAR individuals and firms located in Shenzhen and Qianhai. The further strengthening of infrastructure and commercial linkages within the GBA should remain a priority for the authorities.

52. Promoting innovation and digitalization can provide additional growth engines and boost economic resilience amid geoeconomic fragmentation. The authorities recently launched a new drive to boost local innovation and technology development, with support from a new investment fund set up by the government (Hong Kong Investment Corporation, HKIC) and special talent acquisition and immigration schemes. Continued efforts to promote digitalization of services can help boost the competitiveness of the fintech sector and strengthen public management measures and services, supporting financial inclusion among low-income groups, the elderly, and SMEs. HKIC can play a constructive role in boosting innovation and should operate with a clear mandate and strict standards for governance, accounting, and public reporting to minimize potential capital misallocation. Supporting the development of innovative new industries and fostering business dynamism can help attract younger workers. Along with trading partner diversification, such measures can also help mitigate the risks of geoeconomic fragmentation. Well-targeted policy efforts to support commercialization of technological development could also improve Hong Kong SAR's status as an innovation hub in fields where local universities have strong research capabilities.

53. Hong Kong SAR should continue to strengthen its competitiveness in attracting human capital. The authorities have signaled the launch of a range of efforts to bring in talented foreign workers and investors, including new expedited immigration schemes for talented workers and those working in innovative industries and a new investment-based migration scheme. Additional education and job training, with a focus on digital-related technologies, would help support the supply of labor needed for the transition to a digitalized and technology-driven economy. Recent enhancements to overseas talent attraction programs are welcome and those programs could be enlarged and made more generous and efficient with faster and more streamlined application processing. Shortening the qualification period for permanent residency from the current seven years could also help Hong Kong SAR better compete for international talent and investment.

54. The use of fintech could help improve the efficiency of financial intermediation and enhance financial inclusion, including for financing of small businesses. The HKMA launched the Commercial Data Interchange (CDI) in October 2022, which enables data providers (e.g., payment services providers and business partners) to share commercial data with banks via a single platform upon the consent from data owners (e.g., SMEs). Banks could employ innovative applications to digitalize and streamline their financial processes such as know-your-customer and credit assessment. At the initial phase, the CDI aims to enable more efficient credit intermediation and enhance financial inclusion for SMEs. Going forward, as the financial sector increasingly adopts fintech, it is important to ensure data privacy, technology robustness (including cybersecurity resiliency), fair competition, consumer protection, and financial integrity.

Authorities' Views

55. The authorities plan to boost Hong Kong SAR's growth potential through regional integration, talent attraction, and technological development. They expected that planned large public investment in the Northern Metropolis area, just south of Mainland China, will help further integrate with the Greater Bay Area and enhance the flow of people, goods, and capital across the region. The authorities noted that a more proactive role of the government in supporting the development of four key areas (life and health technology, AI/data science, fintech, advanced manufacturing and new energy technology) and attracting talent and leading firms from overseas will help ensure that Hong Kong SAR has the capacity and diversified economy needed to weather future shocks and challenges. Regarding the CDI, the authorities emphasized that data privacy concerns are mitigated by that fact that the CDI does not involve personal information and requires consent from data owners.

STAFF APPRAISAL

56. The Hong Kong SAR economy is recovering strongly with post-COVID normalization of economic activity. Exports of tourism services and domestic economic activity, in particular private consumption, are expected to normalize as border control and other COVID-related restrictions have been lifted in both Hong Kong SAR and Mainland China. On a preliminary basis and adjusting for remaining transitory pandemic-related factors, the external position in 2022 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies.

57. Near-term risks to the growth outlook are balanced, with systemic risk in the financial sector manageable, given significant buffers. A sharper-than-expected global growth slowdown as well as escalation of regional conflicts and resulting disruptions in trade could derail the recovery. While the financial system remains resilient, a sharp rise in global risk premia amid renewed stress in the global banking system and further tightening of monetary policy in major advanced economies could have adverse spillovers through financial channels. On the upside, transition to the post-pandemic new normal in both Hong Kong SAR and Mainland China could be smoother and more rapid than anticipated with strong pent-up demand, leading to a faster-than-expected economic recovery including inbound tourism.

58. With remaining slack in the economy, gradual fiscal consolidation would help secure a sustained and inclusive recovery. Pandemic-era measures to support vulnerable households and affected SMEs could be unwound gradually, while additional household support could be provided in a targeted manner to low-income households. Expanding social safety nets, for example by further increasing the adequacy and coverage of social assistance benefits and introducing a dedicated unemployment benefit system, would help enhance the automatic stabilizer role of fiscal policy. A comprehensive tax reform over the medium term to broaden the tax base is imperative to provide a stable source of revenue to meet long-term spending needs while ensuring fiscal sustainability.

59. Amid renewed stress in the global banking system, the robust regulatory and supervisory framework should be further strengthened to maintain financial sector resilience. As credit risk will likely continue to materialize after years of domestic economic contractions, rising interest rates, and the ongoing stress in Mainland China's real estate sector, the supervisory focus should continue to be on ensuring banks' proper credit loss recognition and provisioning. A comprehensive and risk-based regulatory framework related to virtual assets is critical to safeguard financial stability and ensure investor protection.

60. Increasing housing supply is critical to resolving the structural supply-demand imbalance. Housing-related macroprudential measures should be maintained and can be recalibrated in the event housing-related stress materializes. The BSD and NRSD, assessed to be CFM/MPMs, need to be phased out once systemic risk from non-resident and speculative demands dissipates.

61. Promoting innovation and technological development can provide additional growth engines and boost economic resilience amid geoeconomic fragmentation. A newly launched investment fund set up by the government should operate with a clear mandate and strict standards for governance, accounting, and public reporting to minimize potential capital misallocation while effectively supporting the development of new innovative industries and fostering business dynamism.

62. It is recommended that the next Article IV consultation discussions take place on the standard 12-month cycle.

Box 1. Project mBridge: Using CBDCs to Enhance Cross-Border Payments[1]

Project mBridge aims to develop a multi-CBDC platform to settle wholesale cross-border payments.[2,3] In 2022Q3, the project conducted a pilot to facilitate international trade settlement, the first business use case (out of identified 15 potential use cases), in which 20 commercial banks from the four jurisdictions settled real-value transactions on behalf of their clients directly on the platform. During the pilot, the four central banks issued CBDCs equivalent to over US$12 million in total, and over 160 payment and FX payment-versus-payment (PvP) transactions in a total value of more than US$22 million were settled.

The successful pilot of Project mBridge demonstrates the potential of using CBDCs in enhancing cross-border payment settlements and facilitating international trade flows. Currently, cross-border payments are typically made through a network of correspondent banks, with the settlement carrying credit and liquidity risks due to the use of commercial bank credits. Furthermore, FX settlement risk has increased on the back of a falling share of global settlements using PvP mechanisms, and many non-major currencies are not supported by existing arrangements. Project mBridge can facilitate cross-border payments in a more efficient manner in multiple aspects. First, the use of CBDCs to settle payments eliminate counterparty risk. Second, peer-to-peer payments can be conducted directly on the platform without the need to involve additional intermediaries, helping to save time, reduce costs and improve efficiency. Third, the ease with which the mBridge platform integrates with domestic wholesale payment systems can allow for straight-through processing. Fourth, the platform can foster the development of low-cost settlement of international trade in local currency.

Project mBridge is looking into incorporating additional features as it continues to progress towards a production ready system. One important lesson from the pilot is that the lack of FX price discovery and matching mechanisms constrained the platform's ability to settle FX PvP transactions as FX rates were determined off-bridge. Furthermore, most FX PvP transactions took place between participating commercial banks with existing business relationships that can provide liquidity to support the settlement—particularly, banks requested foreign currency against pre-existing balances in their nostro accounts. A number of legal and regulatory issues have also been identified, including the legal categorization of CBDC, settlement finality, and AML-CFT and privacy issues. Project mBridge plans to make further progress in achieving automated interoperability with domestic payment systems, integrating FX price discovery and matching mechanisms into the platform, introducing liquidity management tools, and considering the role of central banks in providing liquidity. Project mBridge will also work on expanding the scope of use cases and involving more jurisdictions.

The development of a muti-CBDC platform requires careful policy considerations to safeguard macro-financial stability. While Project mBridge already adheres to the five evaluation criteria on CBDC, which include "do no harm",[4] a key consideration for a further development of the platform is about how to safeguard monetary and financial stability as the adoption of the mBridge platform could provide a way for both domestic and foreign banks to circumvent existing regulations. Main concerns include currency substitution in jurisdictions with weak economic fundamentals, volatile capital flows, and competition against existing local payment systems. In view of these challenges, the pilot only allowed domestic banks to issue or redeem CBDCs against their respective central banks' reserves. For the purpose of the pilot, cross-border transactions denominated in a third-jurisdiction currency were considered out of scope. As the project development advances, a relaxation of these restrictions would require measures to mitigate risks such as setting parameters on the value limit for each currency local banks are allowed to keep under custody.

---

[1] Prepared by Phakawa Jeasakul and Hong Xiao.

[2] The project was jointly carried out by the BIS Innovation Hub, the Digital Currency Institute of the People's Bank of China, the Hong Kong Monetary Authority, the Bank of Thailand, and the Central Bank of the United Arab Emirates.

[3] For more details on Project mBridge, see the report "Project mBridge: Connecting Economics through CBDC".

[4] See more discussion about the five overarching CBDC principles in the report to the G20 "Options for access to and interoperability of CBDCs for cross-border payments".

Box 2. Hong Kong SAR's Regulatory Approach to Virtual Assets[1]

The authorities have taken a proactive and measured approach to regulate virtual asset-related activities. With the primary objective of ensuring financial stability and investor protection, the authorities have been steadily adjusting the regulatory and supervisory frameworks for virtual asset-related activities in response to the evolving virtual asset ecosystem. The authorities also adopt various strategies based on the existing regulatory regime under the "same activity, same risks, and same regulation" principle.

- **Security-like virtual assets.** The SFC would regulate virtual assets with features of securities or futures contracts—e.g., security tokens—in the same way as traditional securities. Market and investment activities related to such assets are regulated according to the existing regulatory regime.
- **Asset management of virtual assets.** The SFC brought virtual asset-related asset management activities under the regulatory perimeter even if such virtual assets are not securities (November 2018). Firms that distribute virtual asset funds in HKSAR and licensed asset managers whose virtual assets account for more than 10 percent of their assets under management are subject to the existing regulatory regime.
- **Virtual asset trading platforms.** The SFC introduced a licensing regime for centralized virtual asset trading platforms using a voluntary opt-in approach (November 2019) and set the regulatory requirements comparable to those for securities market intermediaries and automated trading platforms, including adopting stringent criteria for virtual assets being traded on the platform and putting in place a safe custody arrangement. Regulated financial institutions can only partner with SFC-licensed virtual asset trading platforms in providing virtual asset dealing services to clients (January 2022).
- **Restricted access to virtual assets.** Currently, virtual assets and their related investment products are considered complex products and could only be sold to professional investors, with few exceptions. The SFC is considering allowing retail investors some access to virtual assets with certain safeguards.
- **Banks' exposure to virtual assets.** While there are no outright restrictions, banks are expected to put in place appropriate risk control measures (e.g., prudent limits), apply conservative loan-to-value when accepting virtual assets as collateral, and ensure sufficient capital for virtual asset-related exposures (Jan 2022). Banks that intend to conduct virtual asset-related activities should first consult with the HKMA and obtain the feedback on their risk control arrangements.

A bespoke regulatory regime for virtual asset service providers will come in effect in June 2023. The new mandatory licensing regime, initially only for centralized virtual asset trading platforms, aims to align the regulatory requirements regarding AML/CFT and investor protection with those currently applicable to traditional financial institutions. From June 1, 2023, all centralized virtual asset trading platforms operating in Hong Kong SAR or actively marketing their services to Hong Kong SAR investors will need to be licensed by the SFC. A 12-month transitional arrangement has been provided for virtual asset trading platforms which have been carrying on business before the new regulatory regime comes in effect. Licensed virtual asset trading platforms would be subject to regulatory requirements such as safecustody of client assets. The licensing regime is expected to enhance credibility of virtual asset trading platforms and thus expand business opportunities.

The HKMA plans to introduce a regulatory regime for stablecoins referenced to fiat currencies in 2023-24. The focus on such stablecoins reflects the potential that they can have broad and frequent interconnection with the mainstream financial system and day-to-day economic and financial activities, thus posing higher and more imminent monetary and financial stability risks. The HKMA intends to implement a comprehensive regulatory framework to regulate certain stablecoin activities. Stablecoins will be subject to certain requirements, including full backing and redemption at par. Only stablecoins that are backed by high-quality, liquid reserve assets would be allowed.

The authorities are open to further refine the regulatory regime for virtual assets. The authorities will review property rights for tokenized assets and the legality of smart contracts to provide a solid legal foundation for further development of virtual assets, while also considering the appropriate regulatory treatment for tokenized deposits.

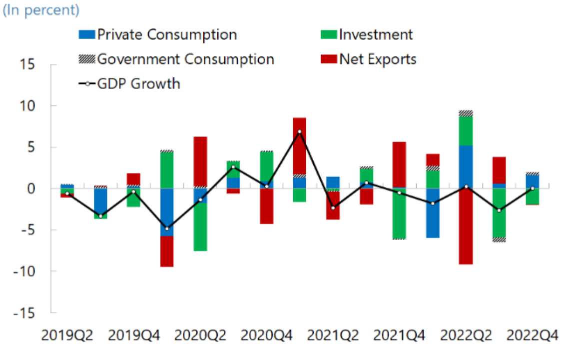
[1] Prepared by Phakawa Jeasakul and Hong Xiao.

Figure 1. Hong Kong SAR: Large Economic Setback in 2022 Due to COVID Outbreaks

The recovery faltered in 2022 as private expenditure slumped in Q1 following a new COVID outbreak ….

Contribution to GDP Growth by Expenditure Component

(In percent)

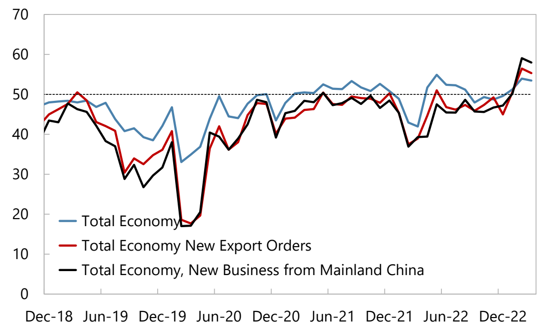


Sources: HKSAR Census and Statistics Department, Haver and IMF staff calculations.

The economy rebounded in Q2 but was chilled in the second half as trade activity weakened notably…

Purchasing Managers Index (SA, 50+ = Expansion)

(Index)

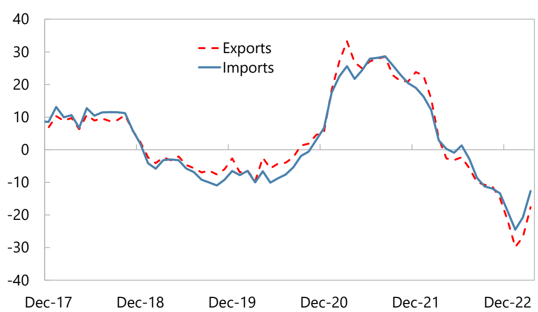


Source: Haver Analytics.

…due to global demand slowdown and disruptions at the border with Mainland China amid large COVID outbreaks.….

External Trade: Merchandise

(Three month moving average, year-on-year percent change)

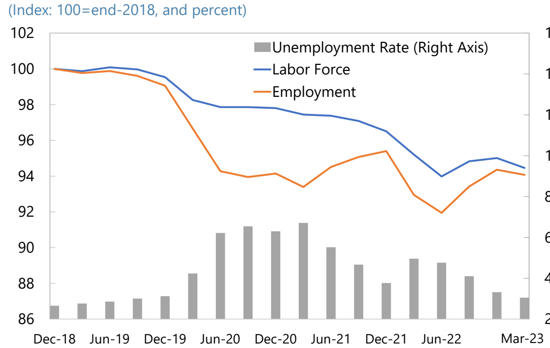


Sources: Haver Analytics; and IMF staff calculations.

The unemployment rate has trended downwards since Q1 2021, but in large part due to a shrinking labor force…

Labor Market Indicators

(Index: 100=end-2018, and percent)

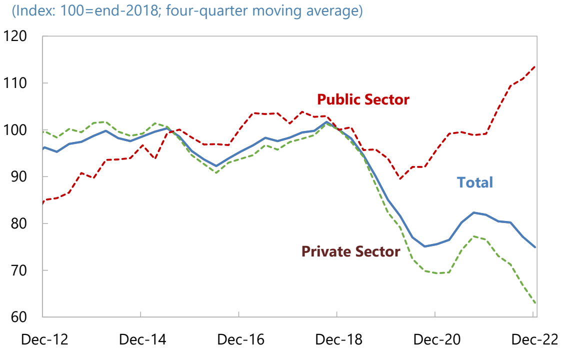


Sources: Haver Analytics, IMF staff calculations.

Private investment fell amid rising interest rates and weak economic activity in Mainland China.

Real Investment by Sector

(Index: 100=end-2018; four-quarter moving average)

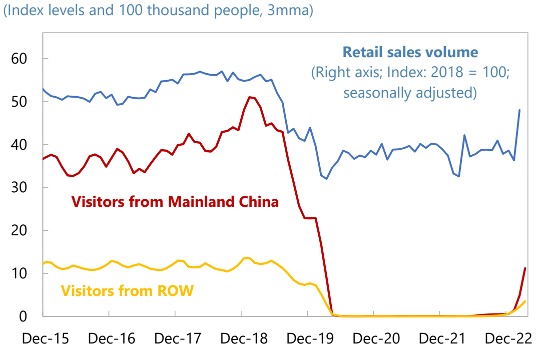


Sources: Haver Analytics, IMF staff calculations.

There are some signs of retail sales recovery in early 2023 with the re-opening of Mainland China.

Retail Sales and Visitor Arrivals

(Index levels and 100 thousand people, 3mma)

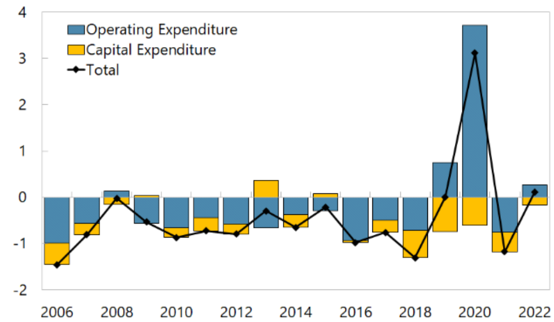


Sources: Haver Analytics; and IMF staff calculations.

Figure 2. Hong Kong SAR: Another Large Fiscal Stimulus in 2022

Government expenditures are expected to have increased significantly again in 2022...

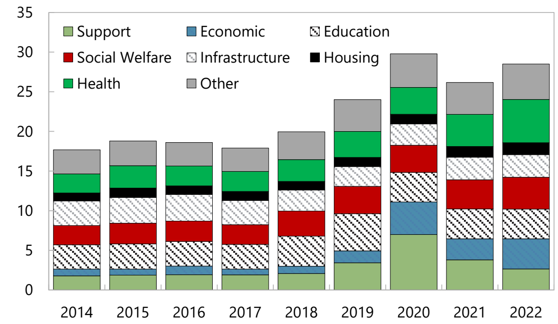
Discrepancy Between Actual and Budgeted Expenditures
(In percent of GDP)



Sources: Budget statements, IMF.

...led by another round of large COVID-19 relief measures.

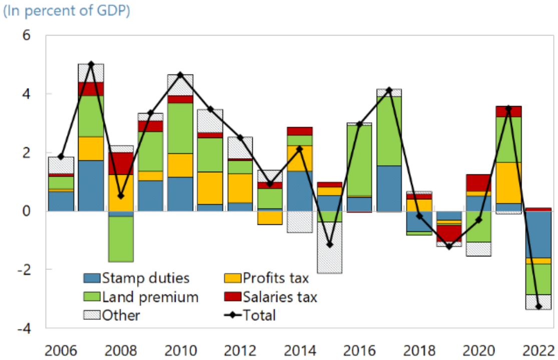
Public Expenditure By Policy Area
(In percent of GDP)



Sources: CEIC and IMF staff calculations.

Revenues are also expected to have declined amid weak economic activity...

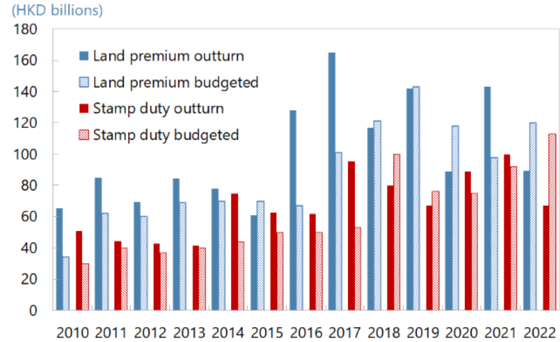
Discrepancy Between Actual and Budgeted Revenues
(In percent of GDP)



Sources: Budget statements, IMF.

...partly driven by a lower-than-budgeted land premium.

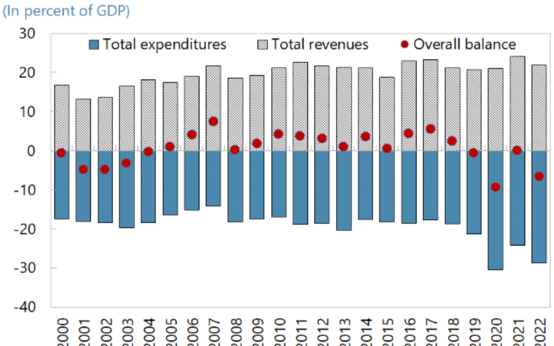
Fiscal Revenues: Real Estate-Related
(HKD billions)



Sources: CEIC, government budget statements, and IMF staff calculations.

As a result, the fiscal deficit is estimated to have increased sharply again in 2022...

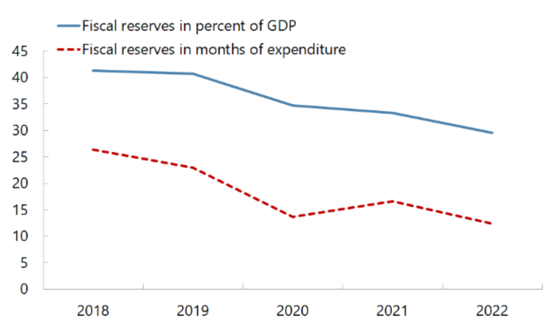
Fiscal Revenues, Expenditure, and Balance
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

... while fiscal reserves declined to around 27.4 percent of GDP by end-2022.

Fiscal Reserves
(In percent of GDP and months of expenditure)



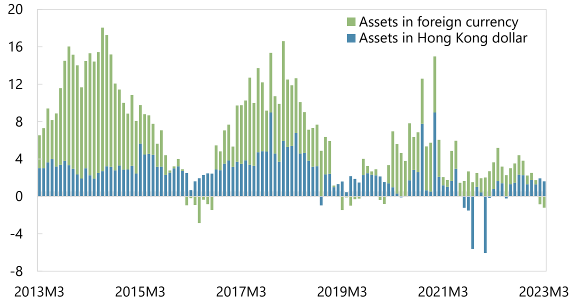
Sources: Hong Kong SAR government, IMF staff calculations.

Figure 3. Hong Kong SAR: The Banking System Remains Strong with Large Buffers

Bank balance sheets continued to expand during the crisis, albeit at a slower pace than the pre-crisis period.

Contribution to Growth of Bank Balance Sheet

(In percentage points)

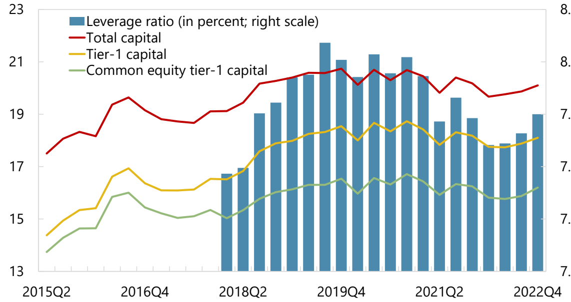


Sources: CEIC; and IMF staff calculations.

Banks' capital adequacy ratio has remained relatively stable, well above the regulatory requirements.

Capital Adequacy and Leverage

(In percent of risk weighted assets)

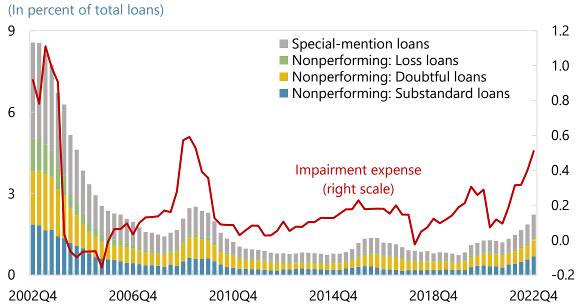


Sources: HKMA; and IMF staff calculations.

Nonperforming and special-mention loans have increased, but asset quality remains decent by historical standards.

Retail Banks: Problem Loans

(In percent of total loans)

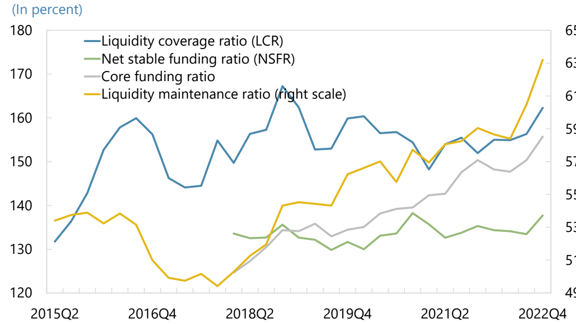


Note: Retail banks refer to banks that offer deposits to retail clients.
Sources: CEIC; and IMF staff calculations.

Banks have plenty of liquidity buffers, underpinning by a relatively stable funding profile.

Liquidity Ratios

(In percent)

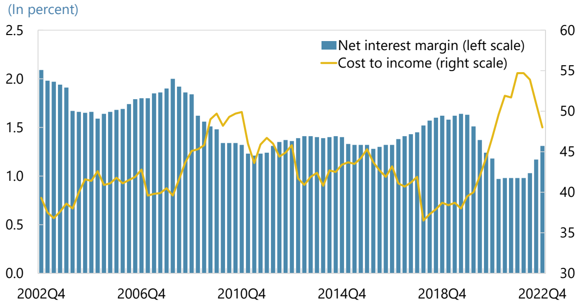


Sources: HKMA; and IMF staff calculations.

HKSAR Banks have seen compressed net interest margins, reducing their profitability in recent years …

Retail Banks: Earnings

(In percent)

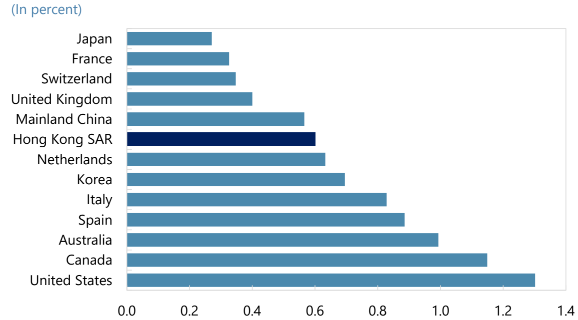


Note: Retail banks refer to banks that offers deposits to retail clients.
Sources: CEIC; and IMF staff calculations.

… and are no longer highly profitable compared with international peers.

Selected Economies: Return on Assets, 2022Q3 or Latest

(In percent)



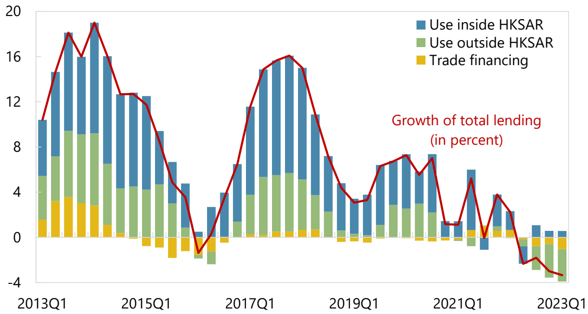
Sources: IMF, Financial Soundness Indicators database; and IMF staff calculations.

Figure 4. Hong Kong SAR: Private Sector Indebtedness Remains Elevated

Overall bank lending growth turned negative, largely driven by lending for use outside Hong Kong SAR.

Contribution to Total Bank Lending

(In percentage points; year-on-year)

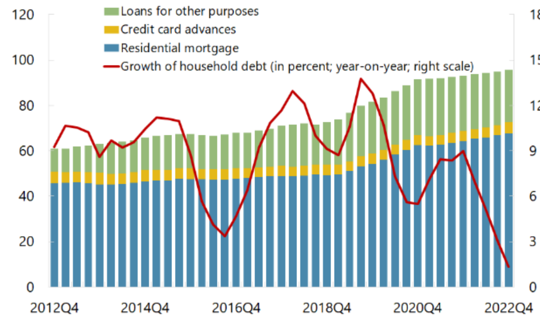


Sources: CEIC; and IMF staff calculations.

Household debt continued to increase during the crisis albeit at a slower pace …

Household Debt

(In percent of GDP)

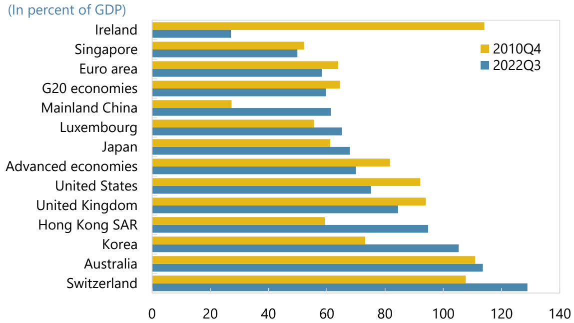


Sources: CEIC; and IMF staff calculations.

… making Hong Kong SAR households among the most indebted in the world.

Selected Economies: Household Debt

(In percent of GDP)

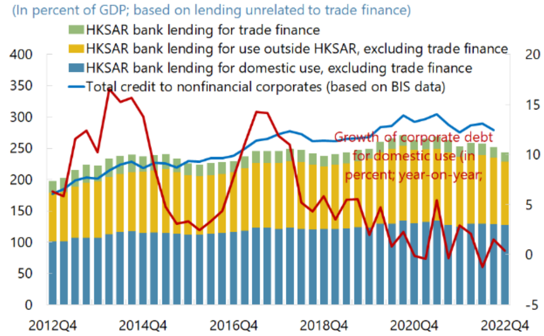


Sources: Haver; and IMF staff calculations.

Corporate debt is also growing, but less than half is for domestic use.

Nonfinancial Corporate Debt

(In percent of GDP; based on lending unrelated to trade finance)

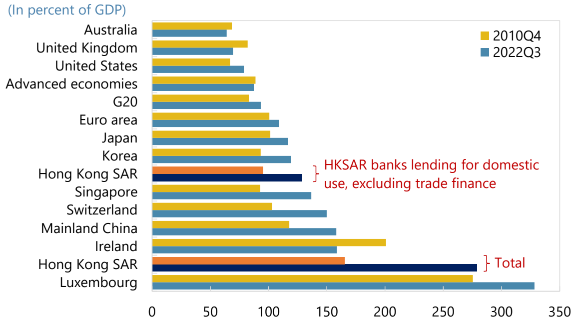


Sources: CEIC; Haver; and IMF staff calculations.

Even considering only debt for domestic use, corporate debt is relatively high among international peers.

Nonfinancial Corporate Debt

(In percent of GDP)

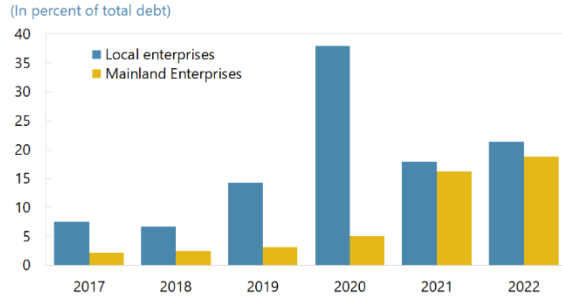


Sources: CEIC; Haver; and IMF staff calculations.

Risky corporate debt of Hong Kong SAR-listed firms has increased for both local and Mainland enterprises.

Listed Firms: Risky Corporate Debt

(In percent of total debt)



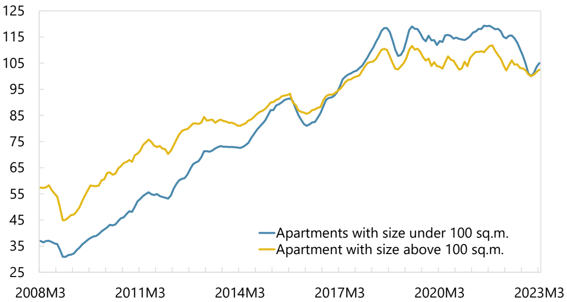
Sources: WIND; and IMF staff estimates.

Note: Debt of firms with earnings before interest and taxes insufficient to cover net interest expenses are deemed risky. In addition, debt of Mainland Chinese real estate firms that have defaulted are deemed risky. For firms whose 2022 annual data are not available, 2022H1 data are used.

Figure 5. Hong Kong SAR: Financial Stability Is Preserved Despite Housing Market Correction

House prices, which declined between July 2021 and December 2022, have recovered in early 2023.

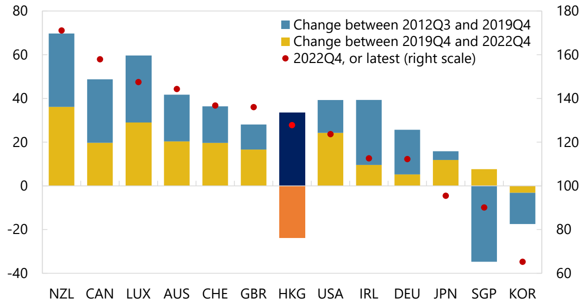
House Prices
(December 2022 = 100)



Sources: CEIC; and IMF staff calculations.

Unlike most advanced economies, Hong Kong SAR did not experience a housing market boom during the pandemic.

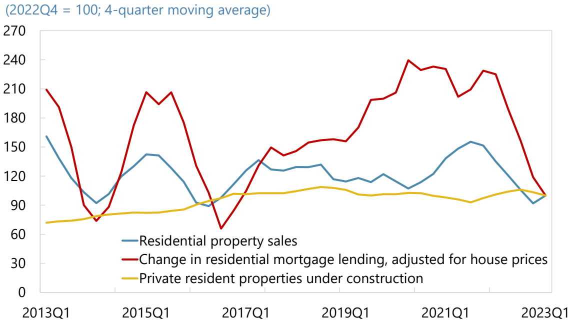
Selected Economies: House Price to Income
(Average for 1990-2022 = 100)



Sources: CEIC; OECD; and IMF staff estimates.

Home sales have declined sharply, but private residential property construction remains relatively stable.

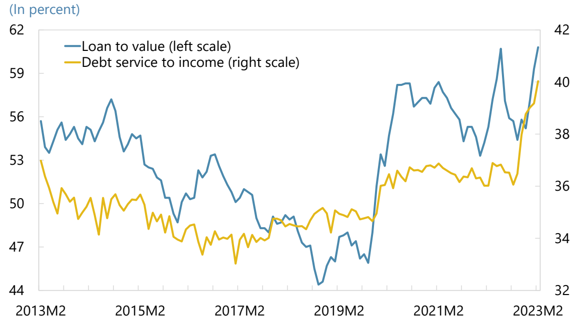
Housing Market Activities
(2022Q4 = 100; 4-quarter moving average)



Sources: CEIC; and IMF staff calculations.

Financial stability risks related to mortgage lending are mitigated by restrictive macroprudential measures.

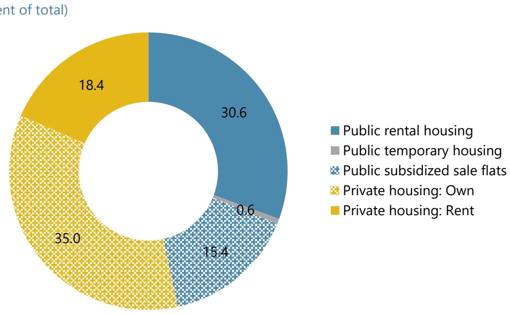
Underwriting Standards of New Mortgages
(In percent)



Sources: CEIC; and IMF staff calculations.

While public rental housing provides significant support to low-income households, ...

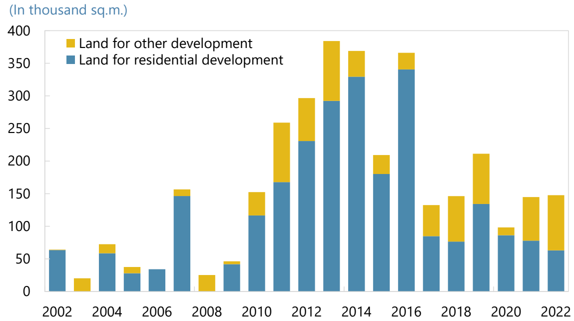
Housing Market Structure, 2021
(In percent of total)



Sources: CEIC; Hong Kong SAR authorities; and IMF staff calculations.

... a substantial decline in land sale for private housing points to a limited private housing supply in the future.

Government Land Sale for Private Housing
(In thousand sq.m.)

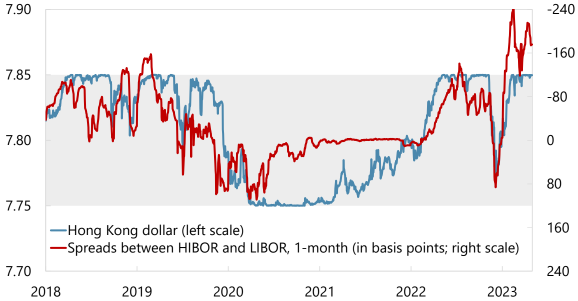


Sources: CEIC; and IMF staff calculations.

Figure 6. Hong Kong SAR: Linked Exchange Rate System Continues to Function Smoothly

The dynamics of the HKD has been largely driven by the differential between HKD and USD interest rates.

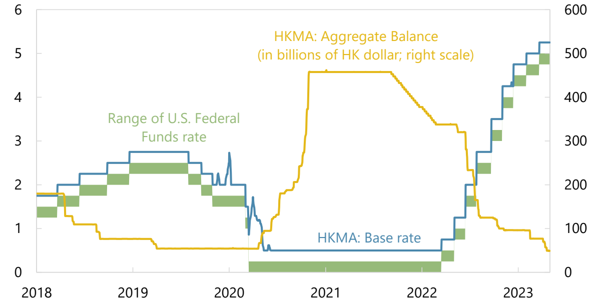
Hong Kong Dollar and Convertibility Zone
(Hong Kong dollar per U.S. dollar)



Sources: Bloomberg; and IMF staff calculations.

Under the currency peg arrangement, HKD interest rates have largely followed USD interest rates.

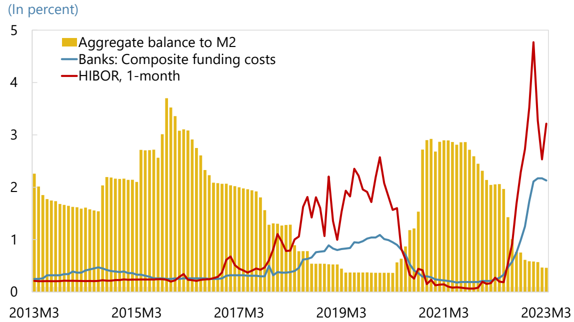
HKMA: Policy Rate and Aggregate Balance
(In percent)



Sources: Bloomberg; and IMF staff calculations.

HKD interest rates started to rise after the Aggregate Balance fell to a certain level, …

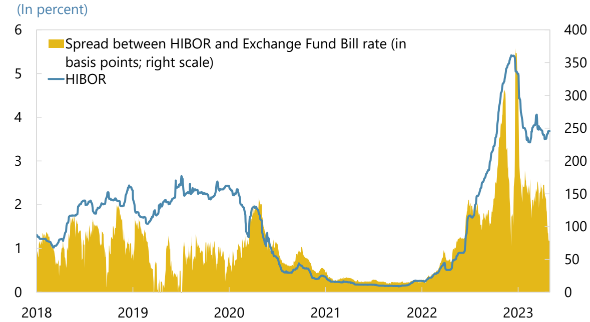
Liquidity Conditions, Interest Rates, and Bank Funding Costs
(In percent)



Sources: CEIC; and IMF staff calculations.

… and widening spreads between bank funding costs and risk-free rates show some signs of liquidity pressure.

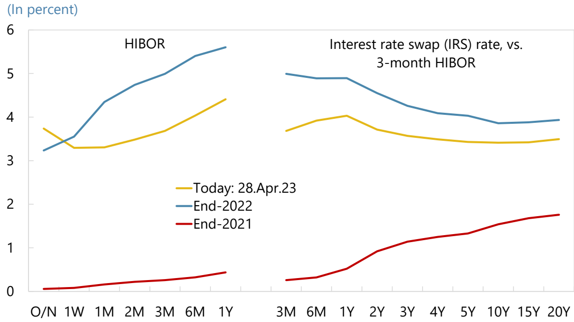
Money Market Rates, 3-month
(In percent)



Sources: Bloomberg; and IMF staff calculations.

HKD interest rates have declined since end-2022 as the US inflation started to stabilize.

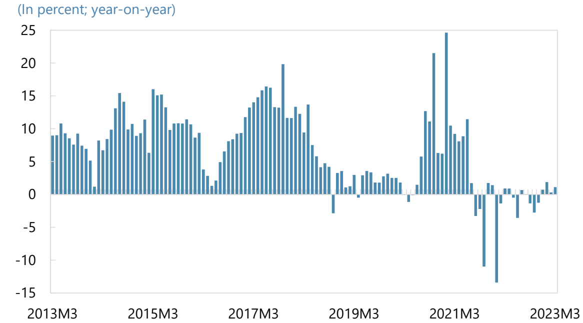
Yield Curve of Hong Kong Dollar Funding Markets
(In percent)



Sources: Bloomberg; and IMF staff calculations.

Growth of HKD deposits has not been strong amid weak economic and capital market (e.g., IPO) activities.

Growth of Hong Kong Dollar Deposits
(In percent; year-on-year)

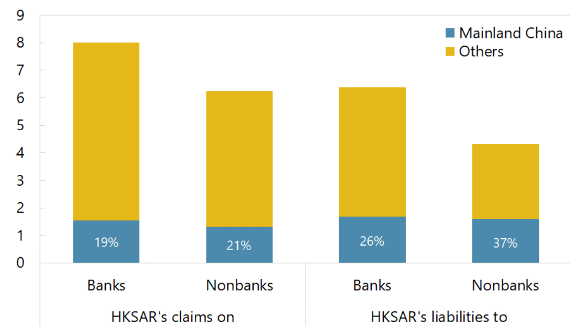


Sources: CEIC; and IMF staff calculations.

Figure 7. Hong Kong SAR: Financial Linkages with Mainland China Continue to Deepen

Mainland China accounts for a sizeable portion of HKSAR's external claims and liabilities.

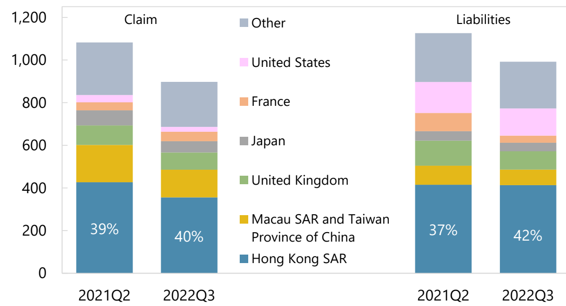
External Claims and Liabilities, End-2022
(In trillion of Hong Kong Dollars)



Sources: CEIC; and IMF staff calculations.

HKSAR banks play a leading role in intermediating cross-border financing for Mainland China, …

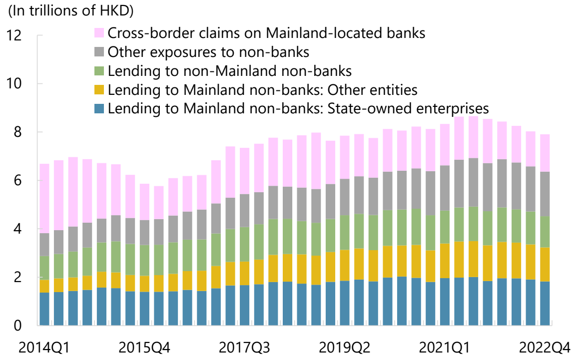
International Banks' Cross-border Position vis-à-vis Chinese Residents
(In billions of US dollar)



Sources: BIS; and IMF staff calculations.

…by maintaining lending to Mainland-related non-banks while unwinding some of claims on Mainland banks.

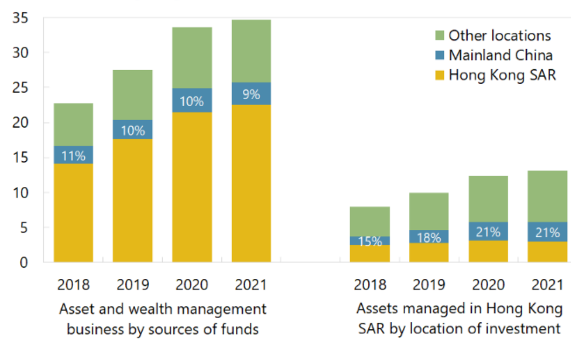
Banking Sector Exposure Related to Mainland China
(In trillions of HKD)



Sources: CEIC; and IMF staff calculations.

Mainland China is one of important funding sources and investment destinations for HKSAR's asset management business.

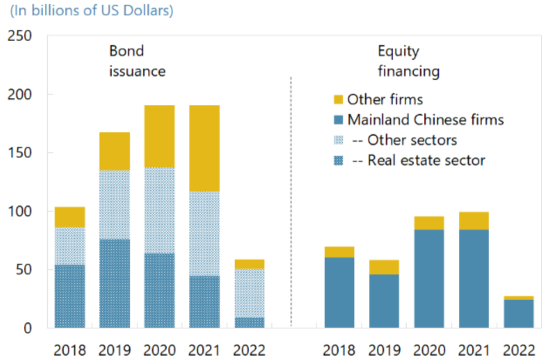
Asset and Wealth Management Business
(In trillions of Hong Kong Dollars)



Sources: SFC; and IMF staff calculations.

Bond and equity fund raising activity declined sharply in HKSAR in 2022 as deals from Mainland firms dried up.

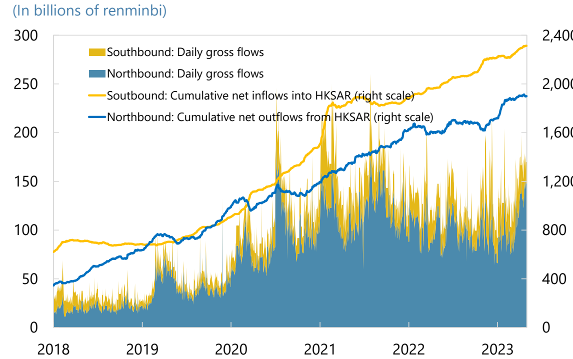
Bond and Equity Fund Raising
(In billions of US Dollars)



Sources: Bloomberg; HKEX; and IMF staff calculations.

The stock connect scheme is the main channel for foreign investors to invest in Mainland equities.

Stock Connect Flows
(In billions of renminbi)



Sources: Bloomberg; and IMF staff calculations.

Table 1. Hong Kong SAR: Selected Economic and Financial Indicators, 2018-28

	2018	2019	2020	2021	2022	Projections 2023	2024	2025	2026	2027	2028
NATIONAL ACCOUNTS											
Real GDP (percent change)	2.8	-1.7	-6.5	6.4	-3.5	3.5	3.1	2.9	2.8	2.7	2.7
Private consumption	5.3	-0.8	-10.6	5.6	-1.0	5.8	2.4	2.8	2.9	2.9	2.9
Government consumption	4.2	5.1	7.9	5.9	8.1	-1.0	-2.8	0.1	1.7	1.7	1.6
Gross fixed capital formation	1.7	-14.9	-11.1	8.3	-8.5	-6.9	8.5	5.8	4.2	4.1	4.1
Inventories (contribution to growth)	0.0	-0.5	1.8	-1.9	-1.0	0.7	0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-1.5	2.1	0.2	2.4	-1.4	0.2	0.3	0.1	-0.1	-0.2	-0.2
Output gap (in percent of potential GDP)	0.1	-2.5	-7.3	-2.3	-3.9	-2.1	-1.7	-1.1	-0.7	-0.3	0.0
LABOR MARKET 1/											
Employment (percent change)	1.4	-0.3	-4.7	-0.6	-1.6	0.8	0.3	0.3	0.3	0.3	0.3
Unemployment rate (percent, period average)	2.8	2.9	5.8	5.2	4.3	3.4	3.3	3.3	3.2	3.1	3.0
Real wages (percent change)	1.0	0.1	2.5	-0.5	-1.4	0.7	1.3	1.3	1.3	1.3	1.3
PRICES											
Inflation (percent change)											
Consumer prices	2.4	2.9	0.3	1.6	1.9	2.3	2.4	2.4	2.5	2.5	2.5
GDP deflator	3.7	2.0	0.6	0.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2
GENERAL GOVERNMENT 1/											
Consolidated budget balance (percent of GDP) 2/	2.4	-0.6	-9.4	0.0	-6.7	-4.0	-1.0	0.2	0.6	1.3	1.3
Revenue	21.2	20.8	21.1	24.2	22.0	21.5	23.2	24.0	24.2	24.6	24.6
Expenditure	18.8	21.4	30.5	24.2	28.7	25.5	24.3	23.8	23.6	23.2	23.2
Fiscal reserves (as of end-March, percent of GDP)	41.3	40.8	34.7	33.4	29.5	26.1	25.1	25.0	25.9	27.4	28.3
FINANCIAL											
Interest rates (percent, period average)											
Best lending rate	5.0	5.1	5.0	5.0	5.1	...	...	...	...	...	...
Three-month HIBOR	1.8	2.1	1.1	0.2	2.1	...	...	...	...	...	...
10-year Treasury bond yield	2.2	1.6	0.7	1.2	2.8	...	...	...	...	...	...
MACRO-FINANCIAL											
Loans for use in Hong Kong SAR (excl. trade financing)	5.0	7.4	2.3	4.3	0.9	2.5	8.3	8.6	8.4	8.1	7.9
House prices (year-on-year percent change for last quarter)	5.8	3.4	-0.1	3.7	-13.6	1.0	5.7	7.3	5.8	5.3	5.3
Credit-to-GDP gap 3/	12.5	21.2	23.9	11.5	3.2	-14.5	-11.3	-7.4	-3.9	-1.5	0.1
EXTERNAL SECTOR											
Merchandise trade (percent change)											
Export value	7.3	-4.1	-1.5	26.3	-8.6	-4.5	9.9	6.0	4.3	4.2	4.2
Import value	8.4	-6.5	-3.3	24.3	-7.2	-2.9	10.4	6.0	4.3	4.3	4.3
Current account balance (percent of GDP)	3.7	5.9	7.0	11.8	10.7	8.0	6.5	6.0	5.5	5.0	4.5
Foreign exchange reserves											
In billions of U.S. dollars (end-of-period)	425	441	492	497	424	420	432	443	455	464	471
In percent of GDP	117	121	143	135	117	110	107	104	102	99	96
Net international investment position (percent of GDP)	354	432	615	574	486	468	451	434	419	404	390
Exchange rate											
Market rate (HK$/US$, period average)	7.839	7.836	7.757	7.774	7.832	...	...	...	...	...	...
Real effective rate (period average, 2010=100)	113.2	117.7	117.2	111.8	115.4	...	...	...	...	...	...

Sources: BIS,CEIC; HKSAR Census and Statistics Department; and IMF staff estimates.
1/ Estimated values for 2022.
2/ Before issuance and repayment of government bonds and notes.
3/ Based on loans for use in Hong Kong SAR, excluding trade financing.

Table 2. Hong Kong SAR: Balance of Payments, 2018-28

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections					
	(In billions of U.S. dollars)										
Current account	13.5	21.3	24.1	43.7	38.6	30.6	26.2	25.3	24.7	23.3	21.9
Goods balance	-32.3	-15.4	-5.3	3.2	-5.8	-15.3	-19.4	-20.7	-21.8	-23.4	-25.4
Services balance	31.5	21.0	12.0	17.4	20.6	24.8	29.6	32.0	33.3	34.8	36.5
Income balance	14.3	15.6	17.5	23.1	23.7	21.0	16.1	14.0	13.3	11.9	10.8
Capital and financial account 1/	-22.3	-30.3	-31.5	-48.1	-37.0	-30.6	-26.2	-25.3	-24.7	-23.3	-21.9
Capital account	-0.2	-0.1	0.0	-1.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-22.1	-30.2	-31.5	-46.7	-37.1	-30.6	-26.2	-25.3	-24.7	-23.3	-21.9
Net direct investment	22.0	20.5	34.0	43.7	14.1	34.0	36.0	37.8	39.3	40.8	42.7
Portfolio investment	-78.7	-27.5	-68.1	-79.8	-52.9	-54.6	-48.7	-51.4	-53.8	-56.3	-59.0
Financial derivatives	4.2	0.2	2.4	5.8	17.7	5.7	6.0	6.4	6.7	7.1	7.4
Other investment	31.3	-24.6	34.1	-17.6	-62.9	-20.0	-6.9	-7.2	-5.2	-5.4	-5.9
Reserve assets (net change)	-1.0	1.1	-33.9	1.2	46.8	4.3	-12.6	-10.9	-11.8	-9.5	-7.2
Net errors and omissions	8.8	9.1	7.4	4.4	-1.6	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:											
Nominal GDP	361.7	363.1	345.0	368.9	361.0	382.9	403.5	424.5	445.9	468.0	491.0
	(In percent of GDP)										
Current account	3.7	5.9	7.0	11.8	10.7	8.0	6.5	6.0	5.5	5.0	4.5
Goods balance	-8.9	-4.2	-1.5	0.9	-1.6	-4.0	-4.8	-4.9	-4.9	-5.0	-5.2
Services balance	8.7	5.8	3.5	4.7	5.7	6.5	7.3	7.5	7.5	7.4	7.4
Income balance	4.0	4.3	5.1	6.3	6.6	5.5	4.0	3.3	3.0	2.5	2.2
Capital and financial account 1/	-6.2	-8.3	-9.1	-13.0	-10.3	-8.0	-6.5	-6.0	-5.5	-5.0	-4.5
Capital account	-0.1	0.0	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-6.1	-8.3	-9.1	-12.7	-10.3	-8.0	-6.5	-6.0	-5.5	-5.0	-4.5
Net direct investment	6.1	5.6	9.9	11.8	3.9	8.9	8.9	8.9	8.8	8.7	8.7
Portfolio investment	-21.8	-7.6	-19.7	-21.6	-14.7	-14.2	-12.1	-12.1	-12.1	-12.0	-12.0
Financial derivatives	1.2	0.0	0.7	1.6	4.9	1.5	1.5	1.5	1.5	1.5	1.5
Other investment	8.7	-6.8	9.9	-4.8	-17.4	-5.2	-1.7	-1.7	-1.2	-1.2	-1.2
Reserve assets (net change)	-0.3	0.3	-9.8	0.3	13.0	1.1	-3.1	-2.6	-2.6	-2.0	-1.5
Net errors and omissions	2.4	2.5	2.1	1.2	-0.4	0.0	0.0	0.0	0.0	0.0	0.0

Sources: CEIC and HKSAR Census and Statistics Department; and IMF staff estimates.

1/ Sign convention as per BPM5: Negative = net lending (net outflow); Positive = net borrowing (net inflow).

Table 3. Hong Kong SAR: Consolidated Government Account, 2018-28

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Proj.						
	(In percent of GDP, unless stated otherwise)										
Consolidated revenue	21.2	20.8	21.1	24.2	22.0	21.5	23.2	24.0	24.2	24.6	24.6
Operating revenue	16.0	15.2	17.2	18.4	17.5	18.0	19.3	19.8	19.6	20.0	20.0
Capital revenue	5.1	5.5	3.9	5.8	4.6	3.5	4.0	4.2	4.5	4.5	4.5
Taxes	13.8	12.4	14.1	14.9	13.6	14.6	14.5	14.5	14.5	14.5	14.5
Nontax	7.4	8.4	7.0	9.3	8.4	6.9	8.7	9.6	9.7	10.1	10.1
Of which:											
Land premium	4.1	5.0	3.3	5.0	3.2	2.8	3.6	3.6	3.6	3.6	3.6
Investment income	1.4	1.7	2.0	2.8	3.3	2.2	1.7	1.8	1.5	1.4	1.4
Consolidated expenditure	18.8	21.4	30.5	24.2	28.7	25.5	24.3	23.8	23.6	23.2	23.2
Operating expenditure	15.3	18.4	26.9	20.6	24.4	21.1	19.4	19.0	18.9	18.8	18.8
Of which : Personnel related (including pensions)	4.4	4.8	5.3	5.0	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Capital expenditure	3.5	3.0	3.6	3.6	4.2	4.4	4.8	4.8	4.7	4.4	4.4
Of which:											
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.1	0.3	0.2	0.3	0.3	0.3
Overall balance	2.4	-0.6	-9.4	0.0	-6.7	-4.0	-1.0	0.2	0.6	1.3	1.3
Overall balance, authorities' definition 2/	2.4	-0.4	-8.7	1.0	-4.3	-1.8	0.3	1.2	2.1	2.7	2.2
Memorandum items:											
Operating balance 3/	0.8	-3.1	-9.7	-2.1	-7.0	-3.1	-0.2	0.8	0.8	1.2	1.2
Primary balance 4/	1.0	-2.3	-11.4	-2.8	-9.9	-6.0	-2.5	-1.3	-0.6	0.2	0.2
Cyclically adjusted primary balance (in percent of potential GD	1.0	-1.3	-7.4	-1.7	-7.9	-5.0	-1.7	-0.8	-0.3	0.4	0.2
Fiscal impulse 5/	3.8	2.3	6.1	-5.7	6.1	-2.9	-3.3	-0.9	-0.5	-0.7	0.2
Fiscal reserves	41.3	40.8	34.7	33.4	29.5	26.1	25.1	25.0	25.9	27.4	28.3
(Months of spending)	26.4	22.9	13.6	16.6	12.4	12.3	12.4	12.6	13.2	14.1	14.6
Gross general government debt	0.1	0.3	1.0	2.0	4.3	6.3	7.3	7.9	9.0	10.0	10.0
(Including issuance under the Government Bond Program)	3.4	3.2	5.5	8.0	11.5	10.7	11.7	12.4	13.4	14.4	14.5
Assets of the Government Bond Fund 6/	4.9	4.3	5.7	7.3	9.3	7.5	7.5	7.5	7.5	7.5	7.5
Net general government debt 7/	-42.8	-41.8	-34.9	-32.7	-27.4	-22.9	-20.8	-20.1	-19.9	-20.4	-21.3

Sources: Annual Report of the Director of Accounting Services; The Treasury, CEIC; and IMF staff estimates.

1/ Fiscal year begins April 1.

2/ The authorities' definition includes issuance and repayment of government bonds.

3/ Operating balance, as defined by the authorities, is akin to the current balance.

4/ Overall balance excluding investment income and interest expenditure.

5/ Change in cyclically adjusted primary balance. A positive value corresponds to an expansionary fiscal stance.

6/ The Bond Fund was established in connection with the implementation of the Government Bond Program. The Fund does not form part of the fiscal reserves or government debt and is managed separately from the other Government accounts.

7/ Gross general government debt including issuance under the Government Bond Program minus fiscal reserves and assets of the Government Bond Fund. A negative sign indicates net assets.

Table 4. Hong Kong SAR: Monetary Survey, 2018-23

						Projection
	2018	2019	2020	2021	2022	2023
	(In billions of Hong Kong dollars)					
Net foreign assets	7855	8147	8459	8590	8807	9613
Monetary authorities	3326	3439	3814	3875	3310	3613
Banks	4529	4708	4645	4716	5497	6000
Domestic credit 1/	6320	6787	6932	7227	7290	7475
Other items (net)	174	-188	215	455	439	439
M2	14348	14746	15607	16273	16536	17527
Of which:						
Deposits in HKD 2/	6796	6941	7381	7469	7515	…
Deposits in foreign currencies 2/	7086	7307	7685	8229	8440	…
Notes and coins in circulation	467	497	541	575	581	…
	(Annual percentage change)					
Domestic credit 1/	5.0	7.4	2.1	4.3	0.9	2.5
M2	4.3	2.8	5.8	4.3	1.6	6.0
	(Contribution to M2 growth, in percent)					
Net foreign assets	2.8	2.0	2.1	0.8	1.3	4.9
Domestic credit 1/	2.2	3.3	1.0	1.9	0.4	1.1
Other items (net)	-0.6	-2.5	2.7	1.5	-0.1	0.0
	(In percent of GDP)					
Net foreign assets	277.0	286.4	316.1	299.5	311.5	321.6
Domestic credit 1/	222.9	238.5	259.1	252.0	257.9	250.0
Other items (net)	6.1	-6.6	8.0	15.9	15.5	14.7
M2	506.0	518.3	583.3	567.4	584.9	586.3

Sources: IMF, International Financial Statistics; Haver Analytics, and IMF staff calculations.
1/ Domestic credit measures loans for use in Hong Kong SAR (excluding trade financing).
2/ Includes savings, time, demand deposits, and negotiable certificates of deposits issued by licensed banks.

Table 5. Hong Kong SAR: Financial Soundness Indicators, 2018-22

	2017	2018	2019	2020	2021	2022Q2
Banking sector						
Capital adequacy and leverage						
Total capital to risk-weighted assets	19.1	20.3	20.7	20.7	20.2	19.8
Tier-1 capital to risk-weighted assets	16.6	17.9	18.5	18.7	18.2	17.7
Common equity tier-1 capital to risk-weighted assets	15.3	16.0	16.5	16.7	16.2	15.8
Leverage ratio (per Basel III)	...	8.0	8.2	8.2	7.9	7.7
Asset quality						
Nonperforming loans to total loans	0.7	0.5	0.6	0.9	0.9	1.1
Profitability and earnings						
Return on assets	1.0	1.0	1.0	0.7	0.6	0.6
Return on equity	12.6	13.1	11.7	8.1	6.5	5.7
Net interest income to gross income	51.1	56.2	57.1	50.6	48.4	50.3
Trading income to gross income	6.2	8.1	9.2	9.1	9.2	12.4
Non-interest expense to gross income	45.7	44.7	44.8	49.4	54.7	54.8
Liquidity and funding						
Liquid assets to total assets	19.6	20.4	21.3	23.4	23.1	21.5
Liquid assets to short-term liabilities	182.2	187.5	176.1	179.9	165.3	176.9
Liquidity coverage ratio (per Basel III)	154.8	167.3	159.9	154.4	151.9	154.9
Net stable funding ratio (per Basel III)	...	135.6	131.6	138.2	135.3	134.1
Loans to deposits	73.0	72.6	75.3	72.3	71.8	72.1
Foreign-currency liabilities to total liabilities	59.6	59.5	58.2	59.4	60.5	59.9
Selected exposures						
Net open position in foreign exchange to capital	0.5	0.0	-0.2	3.3	0.9	0.2
Residential real estate loans to total loans	13.0	13.5	13.8	15.1	15.9	16.1
Commercial real estate loans to total loans	6.1	6.1	6.0	6.2	6.1	6.1
Mainland-related exposures to total assets	33.1	33.2	31.7	31.4	32.4	30.5
Insurance sector: Long-term business						
Profitability and earnings						
Return on equity	...	...	...	...	...	...
Net claims to net premiums	...	...	...	...	...	...
Expenses to net premiums	...	...	...	...	...	...
Investment income to investment assets	...	...	...	...	...	...
Insurance sector: General business						
Profitability and earnings						
Return on equity	...	...	...	...	...	...
Net claims to net premiums	54.1	57.5	57.0	50.3	52.1	47.0
Expenses to net premiums	37.4	35.4	34.3	33.2	31.6	29.4
Reinsurance						
Net premiums to gorss premiums	68.5	65.4	68.0	67.6	67.3	63.9
Securities intermediaries sector						
Leverage						
Equity to assets	27.8	32.3	31.4	25.7	31.8	29.6
Profitability and earnings						
Return on equity	10.0	10.0	6.2	10.8	13.1	8.1
Liquidity and funding						
Liquid assets to short-term liabilities	110.6	125.5	114.7	105.8	126.9	119.4
Selected exposures						
Proprietary positions to total assets	10.4	7.3	10.1	11.7	9.0	7.5
Nonfinancial sector						
Indebtedness						
Household debt to GDP	71.0	72.7	81.7	91.6	93.1	94.6
Corporate debt to GDP						
Total credit	226.9	221.5	233.0	247.8	236.1	239.3
Credit for domestic use	121.6	120.7	122.7	130.4	125.1	129.8

Sources: CEIC; HKMA; IMF, Financial Soundness Indicators database; SFC; and IMF staff calculations.

Appendix I. External Sector Assessment

<table>
<tr><td colspan="2">Overall Assessment: On a preliminary basis, the external position in 2022 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA surplus (in percent of GDP) narrowed in 2022 as the goods balance turned into a deficit due to weaker external demand and disruptions at the border with Mainland China amid large COVID outbreaks, partially offset by continued recovery in the services surplus. The CA surplus is expected to gradually decline over the medium term with the recovery in domestic demand. Under the Linked Exchange Rate System (LERS), short-term movements in the REER largely reflect US dollar developments. The credibility of the currency board arrangement has been ensured by a transparent set of rules governing the arrangement, large fiscal and FX reserves, strong financial regulation and supervision, the flexible economy, and a prudent fiscal framework.[1]

Potential Policy Responses: A gradual pace of fiscal consolidation in the near term to secure a balanced recovery, while taking measures to ensure fiscal sustainability over the medium to long term given the rapidly aging population, would help ensure that the external position will remain broadly in line with fundamentals. Maintaining policies that support wage and price flexibility is crucial to preserving competitiveness under the currency board arrangement. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the LERS have worked well, and continuation of these policies will help keep the external position broadly in line with fundamentals.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td>Background. The net international investment position (NIIP) decreased to 486 percent of GDP in 2022 from 574 percent in 2021. This was driven by a significant decrease in gross assets (by 63 percentage points of GDP), and a large increase in gross liabilities (25 percentage points of GDP). Both gross assets and liabilities are high, reflecting Hong Kong SAR's status as an international financial center. Valuation effects in 2022 were sizable as the change in the NIIP (-88 percentage points of GDP) far exceeded the financial account balance (-10 percent of GDP).

Assessment. Vulnerabilities are low given the positive and sizable NIIP and its favorable composition. FX reserves remain large (117 percent of GDP at the end of 2022) and direct investments account for a large share of gross assets and liabilities (36 and 51 percent, respectively) while only 12 percent of gross liabilities are portfolio investments.</td></tr>
<tr><td>2022 (% GDP)</td><td><table><tr><td>NIIP: 486</td><td>Gross Assets: 1678</td><td>Debt Assets: 596</td><td>Gross Liab.: 1192</td><td>Debt Liab.: 420</td></tr></table></td></tr>
<tr><td>Current Account</td><td>Background. The CA surplus narrowed to 10.7 percent of GDP in 2022 from 11.8 percent in 2021. The goods balance turned into a deficit driven by a sharp decline in exports due to declining external demand as well as customs delays and disruptions at the border with Mainland China amid large COVID outbreaks in both economies, leading to a decline in the overall trade surplus despite the continued recovery in the service surplus. The income balance remained broadly stable. The CA development in 2022 reversed a widening trend between 2015 and 2021, arising from a notable decline in private investment as the economy faced multiple domestic and external shocks including social unrest, U.S.-China tensions, and the COVID-19 pandemic. The CA balance is projected to continue to gradually decline over the medium term with the recovery in domestic demand.

Assessment. After adjusting for cyclical factors and factoring in the transitory impact of the COVID-19 crisis on the CA in relation to travel services including tourism equivalent to 0.9 percent of GDP (transport adjustor is at 0 percent), the CA surplus is estimated to be 11.4 percent of GDP in 2022, which is within the IMF staff-assessed CA norm range of 9.1 to 12.1 percent of GDP (midpoint of 10.6 percent). The IMF staff-assessed CA gap range is hence between-0.7 to 2.3 percent of GDP, with a midpoint of 0.8 percent. Since Hong Kong SAR is not in the EBA sample, the CA norm was estimated by applying EBA-estimated coefficients to Hong Kong SAR and was adjusted for measurement issues related to the large valuation effects in the NIIP and the discrepancies between stocks and flows.[2]</td></tr>
<tr><td>2022 (% GDP)</td><td><table><tr><td>CA: 10.7</td><td>Cycl. Adj. CA: 10.5</td><td>EBA Norm: –</td><td>EBA Gap: –</td><td>COVID-19 Adj.: 0.9</td><td>Other Adj.: –</td><td>Staff Gap: 0.8</td></tr></table></td></tr>
<tr><td>Real Exchange Rate</td><td>Background. Under the currency board arrangement, REER dynamics are largely determined by US dollar developments and inflation differentials between the United States and Hong Kong SAR. The REER, which had depreciated by about 5 percent in 2021, appreciated by around 3.2 percent in 2022 compared to its 2021 average.

Assessment. The IMF staff assesses the REER gap, based on the staff-assessed CA gap range, to be in the range of -5.9 to 1.7 percent, with a midpoint of -2.1 percent (based on the average CA-REER elasticity of about 0.4).[3]</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td>Background. As an international financial center, Hong Kong SAR has an open capital account. Nonreserve financial flows recorded a larger net outflow of US$84 billion in 2022, up from net outflows of US$49 billion in 2021, driven by other investment and portfolio investment outflows. The financial account is typically very volatile, reflecting financial conditions in Hong Kong SAR and Mainland China (transmitted through growing cross-border financial linkages),[4] shifting expectations of U.S. monetary policy, and related arbitraging in the FX and rates markets.

Assessment. Large financial resources, proactive financial supervision and regulation, and deep and liquid markets should help limit the risks from potentially volatile capital flows and the war in Ukraine. The greater financial exposure to Mainland China could also pose risks to the financial sector through real sector linkages, particularly trade and tourism, credit exposures of the banking sector, and fundraising by Chinese firms in local financial markets. However, Hong Kong SAR's banking system, with its high capital buffers and profitability, is assessed to be broadly resilient to macro-financial shocks.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td>Background. The HKD has continued to trade in a smooth and orderly manner within the Convertibility Zone during the COVID-19 crisis. As the HKD depreciated to the weak side of the convertibility undertaking several times in 2022, the HKMA conducted FX operations as part of the currency board operations, selling USD 30.8 billion. Total reserve assets decreased to 117 percent of GDP at the end of 2022 (or 1.7 times the monetary base) from 135 percent of GDP at the end of 2021.

Assessment. FX reserves are currently adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Despite a large fiscal deficit in 2022, Hong Kong SAR still holds significant fiscal reserves (about 27.4 percent of GDP at the end of 2022) built up through strong fiscal discipline in previous years.</td></tr>
</table>

[1] A final assessment will be provided in the 2023 External Sector Report.
[2] Hong Kong SAR is not in the EBA sample as it is an outlier along many dimensions of EBA analysis, thus one possibility-though with obvious drawbacks-is to use EBA-estimated coefficients and apply them to Hong Kong SAR. Following this approach, the CA norm in 2022 is estimated to be about 21.8 percent of GDP, implying a CA gap of -11 percent, which is almost entirely explained by the model residuals. The EBA CA gap is overstated as it does not properly reflect the measurement issues that are relevant for Hong Kong SAR, so three adjustments are made which reduce the CA norm by 11.2 ppt of GDP to 10.6 percent (midpoint of staff-assessed norm range). First, a deduction of 5.7 ppt of GDP (midpoint of an estimated 4.7-6.7 ppt range) is made to the EBA model's implied contribution of the NIIP position. This is because the positive NIIP contribution in EBA captures average income effects that are less relevant for Hong Kong SAR since the income balance relative to its NIIP is systematically lower than other peer economies, due to a persistently higher share of debt instruments on the asset side than on the liability side. Second, a deduction of 4¼ ppt of GDP (midpoint of an estimated 4-4½ ppt range) is made to account for a decline in the gold trade balance that does not reflect changes in wealth but rather the increased physical settlement of gold futures contracts resulting from the opening of a Precious Metals Depository. Third, a deduction of 1¼ ppt of GDP (midpoint of an estimated 1-1½ ppt midpoint range) is made to account for Mainland China's increased onshoring which led to a decline in logistics and trading activities in Hong Kong SAR, but did not result in lower consumption because it is viewed as temporary and to be replaced with increased provision of high value-added services as Hong Kong SAR's own economy rebalances in response to Mainland demand. See "People's Republic of China—Hong Kong Special Administrative Region: Selected Issues" (Country Report No. 17/12) for more details.
[3] The range is calculated by applying the average semi-elasticities of Hong Kong SAR and similar economies.
[4] The financial linkages with the Mainland have deepened in recent years with the increase in cross-border bank lending, capital market financing, and the internationalization of the RMB. As of end- 2022, banking system claims on Mainland non-bank entities amounted to HK$6.4 trillion, or about 225 percent of GDP, down by about 9 ppt from end-2021.

Appendix II. Risk Assessment Matrix[1]

Source of Risk	***Likelihood***	***Expected Impact and Policy Advice***
	Conjunctural	
1. Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflict(s) and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	***High***	***High.*** Widening sanctions and conflict-related economic disruptions could create negative spillovers to Hong Kong SAR's highly open and interconnected economy. Macroeconomic policy should step in the event of a strong drag on domestic growth. Hong Kong SAR has fiscal space to revert to an expansionary stance if needed, with the composition of fiscal stimulus decisively shifting to targeted support for vulnerable and low-income households.
2. Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation.	***Medium***	***High.*** Higher-for-longer interest rates due to monetary policy developments in the U.S. could create strong growth pressures while cyclical tailwinds from China's economic reopening prove weaker than expected due to property market stress or a bumpy reopening from strict COVID containment policies. Macroeconomic policy should step up if growth falters. Hong Kong SAR has fiscal space to revert to an expansionary stance if needed, with the composition of fiscal stimulus decisively shifting to targeted support for vulnerable and low-income households. Financial stability should be ensured through macro-prudential measures and liquidity provision.
• *U.S.*: Amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and "hard landing".	***Medium***	
• *China*: Greater-than-expected economic disruptions from COVID resurgence, rising geopolitical tensions, and/or a sharper-than-expected slowdown in the property sector disrupt economic activity.	***Medium***	
3. Systemic financial instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	***Medium***	***High.*** A sharp rise in global risk premia compounded by U.S.-China tensions, large capital outflows, large housing market corrections, and a potential shift in market confidence for Hong Kong SAR as a major international financial center could potentially affect the flow of capital and threaten financial stability and growth. Targeted fiscal support should be provided as needed. Financial stability should be ensured through macro-prudential measures and liquidity provision.
4. *Disorderly* correction of house prices. A disorderly house price correction could trigger an adverse feedback loop between house prices, debt service ability of households, and lower consumption, with weakening growth leading to a second-round effects on banks' balance sheets.	***Medium***	***High.*** Relax macroprudential measures and provide targeted fiscal support if needed. Safeguard financial stability and stand ready to provide liquidity through existing facilities.
	Structural	
5. Deepening geoeconomic fragmentation. Broader and deeper conflict(s) and weakened international cooperation lead to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	***High***	***High.*** Renewed escalation in U.S.-China trade tensions or accelerating decoupling in finance, technology, or other key fields between the two countries could create negative spillovers to Hong Kong SAR's economy and financial stability, negatively affecting its growth potential over a longer time horizon. The authorities should provide targeted fiscal stimulus with continued efforts on medium-term reforms and safeguard financial stability through macro-prudential measures and liquidity provision. Further strengthen the regulatory and prudential frameworks to address pockets of vulnerabilities.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10-30 percent, and "high" a probability between 30-50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short-term (ST)" and "medium-term (MT)" are meant to indicate that the risk could materialize within one year and three years, respectively.

Appendix III. Summary of Property Market Measures Introduced Since 2009

Date	LTV Measures 1/			Other Measures
	Price Range	LTV Cap	Max Loan Amount	
October 2009	Greater than or equal to HK$20mn	60 percent (previously 70 percent)		
	Less than HK$20mn	Remains 70 percent	HK$12mn	
August 2010	Greater than or equal to HK$12mn	60 percent (previously 70 percent for properties valued between HK$12mn and HK$20mn)		• Debt-service-to-income ratio (DSR) capped at 50 percent for all income groups (previously was 60 percent for high income groups) • The stressed DSR would not exceed 60 percent, were mortgage rates to go up by 2 percentage points
	Less than HK$12mn	Remains 70 percent	HK$7.2mn	
	Not owner-occupied, any price range	60 percent (previously 70 percent)		
November 2010	Greater than or equal to HK$12mn	50 percent (previously 60 percent)		Special Stamp Duty set at • 15 percent for residential properties resold within first six months of purchase • 10 percent if resold between six and 12 months • 5 percent if resold between 12 and 24 months
	Greater than or equal to HK$8mn and less than HK$12mn	60 percent (previously 70 percent)	HK$6mn	
	Less than HK$8mn	Remains at 70 percent	HK$4.8mn	
	LTV cap of 50 percent (previously 60 percent) for all non-owner-occupied residential properties, properties held by a company and industrial and commercial properties, and net worth-based property mortgage loans.			
June 2011	Greater than or equal to HK$10mn	50 percent		
	Greater than or equal to HK$7mn and less than HK$10mn	60 percent (previously 70 percent for properties valued less than HK$8mn)	HK$5mn	
	Less than HK$7mn	Remains at 70 percent	HK$4.2mn	
	LTV cap lowered by further 10 percentage points for borrowers with main income derived from outside Hong Kong SAR for residential and non-residential properties. LTV cap for net-worth based mortgage loans lowered from 50 percent to 40 percent, irrespective of property value for residential and non-residential properties.			

Date	LTV Measures 1/			Other Measures
	Price Range	LTV Cap	Max Loan Amount	
September 2012	Greater than or equal to HK$10mn	Remains at 50 percent		• For applicants with multiple properties under mortgages (including residential, industrial and commercial properties), (i) Base DSR capped at 40 percent for all income groups (previously was 50 percent) (ii) Stressed DSR would not exceed 50 percent were mortgage rates to go up by 2 percentage points (previously was 60 percent) • Mortgage applicants for residential and non-residential properties without outstanding mortgages were not subject to the DSR limits reduction, i.e., with base DSR cap of 50 percent and stressed DSR cap of 60 percent (by 2 percentage points hike assumption) • Maximum tenor of all new property mortgage loans capped at 30 years
	Greater than or equal to HK$7mn and less than HK$10mn	Remains at 60 percent	HK$5mn	
	Less than HK$7mn	Remains at 70 percent	HK$4.2mn	
	Not owner-occupied, any price range	Remains at 50 percent		
	For applicants who have already borrowed or guaranteed outstanding property mortgage loans for one or more (i.e., with multiple properties under mortgages) at the time of a mortgage application (including residential, industrial, and commercial properties), (i) LTV cap lowered by further 20 percentage points for borrowers with main income from outside Hong Kong SAR (ii) LTV cap for net-worth based mortgage loans lowered from 40 percent to 30 percent, irrespective of property value			
October 2012				• Buyer's Stamp Duty set at 15percent for all residential property transactions except local (i.e., Hong Kong SAR permanent resident) buyer • Special Stamp Duty raised to 20 percent for residential properties resold within first six months of purchase, 15 percent if resold between six and 12 months, 10 percent if resold between 12 and 36 months
February 2013	Greater than or equal to HK$10mn	Remains at 50 percent		• For applicants with multiple properties under mortgages, DSR capped at 40 percent for all income groups; the stressed DSR would not exceed 50 percent were mortgage rates to go up by 3 percentage points (previously was by 2 percentage points) for all types of properties including residential as well as commercial and industrial properties.
	Greater than or equal to HK$7mn and less than HK$10mn	Remains at 60 percent	HK$5mn	
	Less than HK$7mn	Remains at 70 percent	HK$4.2mn	
	Not owner-occupied, any price range	Remains at 50 percent		

<table>
<tr><th rowspan="2">Date</th><th colspan="3">LTV Measures 1/</th><th rowspan="2">Other Measures</th></tr>
<tr><th>Price Range</th><th>LTV Cap</th><th>Max Loan Amount</th></tr>
<tr><td>February 2013 (continued)</td><td colspan="3">LTV cap for industrial and commercial properties mortgage loans at 40 percent; previous was 50 percent
LTV cap for standalone car park spaces set at 40 percent with maximum tenor at 15 years</td><td>Mortgage applicants for residential and non-residential properties without outstanding mortgage were not subject to the DSR limits reduction—i.e., with base DSR cap of 50 percent and stressed DSR cap of 60 percent (by 3 percentage points hike assumption increased from previously 2 percentage points)
Risk weight floor of 15 percent introduced on new residential mortgages for banks using IRB approach
Ad valorem Stamp Duty raised from the scale of $100 to 4.25 percent to the scale of 1.5 percent to 8.5 percent, applicable to both residential and non-residential properties, except local buyers who do not own any other residential property in Hong Kong SAR at the time of purchase or whose purchase is to replace their only residential property in Hong Kong SAR</td></tr>
<tr><td rowspan="4">February 2015</td><td>Greater than or equal to HK$10mn</td><td>Remains at 50 percent</td><td></td><td rowspan="4">DSR for borrowers who buy a second residential property for self-use and for all non-self-use properties, including residential properties, commercial and industrial properties and car park spaces, capped at 40 percent; the stressed DSR would not exceed 50 percent were mortgage rates to go up by 3 percentage points; self-occupied or replacement and without outstanding mortgage were exempted from reduction in existing DSR caps
Risk weight floor of 15 percent introduced on all new and existing residential mortgages for banks using IRB approach by Jun 2016; 10 percent for existing mortgage by Jun 2015; previously risk weight only introduced on new mortgages</td></tr>
<tr><td>Greater than or equal to HK$7mn and less than HK$10mn</td><td>Remains at 60 percent</td><td>HK$5mn</td></tr>
<tr><td>Less than HK$7mn</td><td>60 percent (previously 70 percent)</td><td></td></tr>
<tr><td>Not owner-occupied, any price range</td><td>Remains at 50 percent</td><td></td></tr>
</table>

Date	LTV Measures 1/			Other Measures
	Price Range	LTV Cap	Max Loan Amount	
November 2016				• Ad valorem Stamp Duty on residential properties raised to a flat rate of 15 percent (also known as the New Residential Stamp Duty) except local buyers who do not own any other residential property in Hong Kong SAR at the time of purchase or whose purchase is to replace their only residential property in Hong Kong SAR
April 2017				• New Residential Stamp Duty applied to purchases of multiple residential properties under a single instrument
May 2017	Greater than or equal to HK$10mn	Remains at 50 percent		• LTV cap lowered by 10 percent points for applicants with multiple properties under mortgages (including residential, industrial and commercial properties). • For self-occupied or without outstanding mortgage, DSR ratio capped at 50 percent; the stressed DSR would not exceed 60 percent were mortgage rates to go up by 3 percentage points • DSR caps lowered by 10 percent points for pre-existing mortgages or non-self-occupied. • DSR caps lowered by 10 percent points for applicants whose income is mainly derived from outside Hong Kong SAR. • Risk weight floor of 25 percent (previously 15 percent) for all new residential mortgages and 15 percent for all existing residential mortgages for banks using IRB approach.
	Less than HK$10mn	Remains at 60 percent	HK$5mn	
	Not owner-occupied, any price range	Remains at 50 percent		

Date	LTV Measures 1/			Other Measures
	Price Range	LTV Cap	Max Loan Amount	
August 2020	Greater than or equal to HK$10mn	Remains at 50 percent		• LTV caps for mortgage loans on non-residential properties are adjusted upward by 10 percentage points, from 40 percent to 50 percent for general cases.
	Less than HK$10mn	Remains at 60 percent	HK$5mn	
	Not owner-occupied, any price range	Remains at 50 percent		
September 2022				• The stressed DSR would be based on an increase in mortgage rates by 2 percentage points (previously, 3 percentage points), with the cap of stressed DSR still at 60 percent.
October 2022				• Eligible incoming talents who purchase residential property in Hong Kong SAR can apply for a refund of the Buyer's Stamp Duty and the New Residential Stamp Duty after becoming a HKSAR permanent resident.
1/ Refer to residential properties, unless otherwise indicated.				

Appendix IV. Debt Sustainability Analysis

Appendix IV. Figure 1. Hong Kong SAR: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stress is low, reflecting low vulnerability across the near-term and medium-, and long-term horizons. Hong Kong SAR's debt is negative in net terms, as shown in Table 3.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low, as the low signal from the GFN outweighs the moderate signal from the fan chart, which reflects the recent volatility in indicators as a result of COVID-19.
Fanchart	Low	…	
GFN	Low	…	
Stress test	…	…	
Long term	…	Low	While long-term risks are low, aging-related expenditures on health and social security are expected to feed into debt dynamics.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Hong Kong SAR is at a low overall risk of sovereign stress and debt is sustainable. Net debt is negative. Gross debt is expected to rise in the baseline, albeit at a very low level, due to issuance of Green and Infrastructure Bonds to finance capital expenditure. Medium-term liquidity risks as analyzed by the GFN Financeability Module are low. Over the longer run, Hong Kong SAR should continue with reforms to tackle risks arising from population aging. However, the long time horizon at which these risks would materialize and the authorities' planned measures will help contain risks.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Appendix IV. Figure 2. Hong Kong SAR: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

					Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	Fiscal data is for
				2	Extra budgetary funds (EBFs)	Yes	the Consolidated
				3	Social security funds (SSFs)	Yes	Government Account.
				4	State governments	No	
				5	Local governments	No	
				6	Public nonfinancial corporations	No	
				7	Central bank	No	
				8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-government Debt Holdings

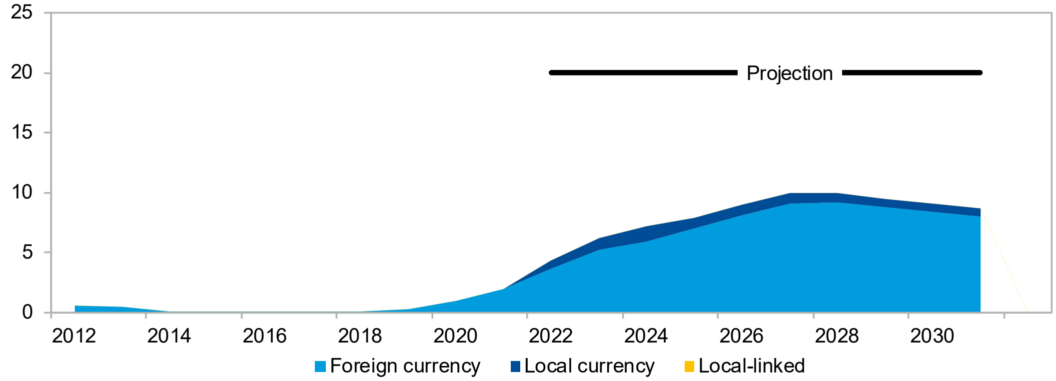
					Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt									0
				2	Extra-budget. funds									0
				3	Social security funds									0
				4	State govt.									0
				5	Local govt.									0
				6	Nonfin pub. corp.									0
				7	Central bank									0
				8	Oth. pub. fin. corp									0
					Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary:

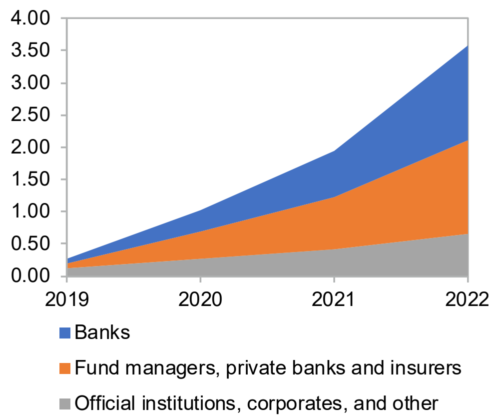
Appendix IV. Figure 3. Hong Kong SAR: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



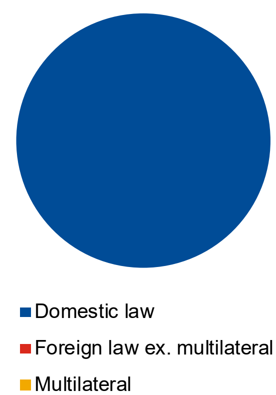
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



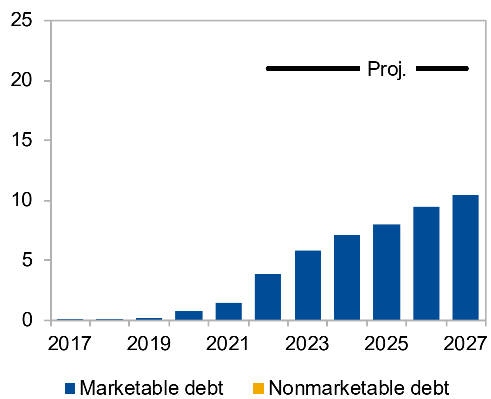
Note: Excludes local currency retail bonds. The perimeter shown is general government.

Public Debt by Governing Law, 2021 (percent)



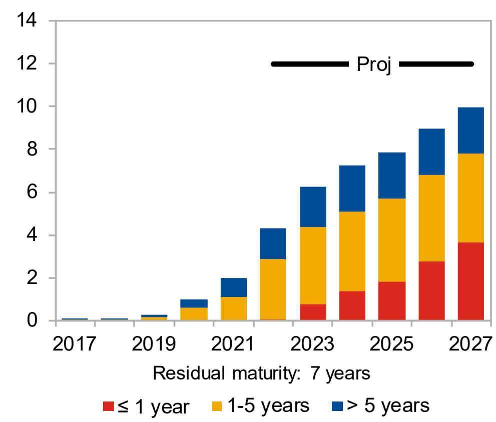
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: The "Public debt by holder" chart represents primary issuance in categories shown in the absence of more detailed information. "Other" category includes central banks, sovereign wealth funds, supranationals, international organisations, official institutions, and corporates.

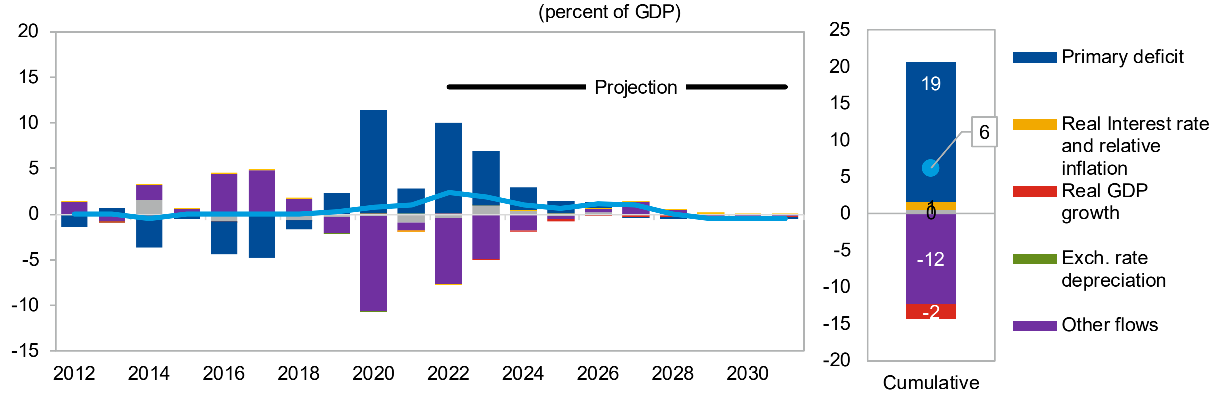
Appendix IV. Figure 4. Hong Kong SAR: Baseline Scenario

(percent of GDP unless indicated otherwise)

	Actual	Medium-term Projection						Extended Projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	2.0	4.3	6.2	7.2	7.9	9.0	10.0	10.0	9.5	9.1	8.7
Change in public debt	1.0	2.4	1.9	1.0	0.6	1.1	1.0	0.0	-0.4	-0.4	-0.4
Contribution of identified flows	1.9	2.8	1.0	0.6	0.8	0.9	1.0	0.1	-0.3	-0.3	-0.3
Primary deficit	2.8	9.9	6.0	2.5	1.3	0.6	-0.2	-0.2	-0.2	-0.2	-0.2
Noninterest revenues	21.4	18.7	19.3	21.5	22.3	22.7	23.1	23.1	23.1	23.1	23.1
Noninterest expenditures	24.2	28.6	25.3	24.0	23.6	23.3	22.9	22.9	22.9	22.9	22.9
Automatic debt dynamics	0.0	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Real interest rate and relative inflation	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.1	0.1
Real interest rate	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-0.1	0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.2	-0.2
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.8	-7.2	-4.9	-1.7	-0.4	0.4	1.3	0.4	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.8	-7.2	-4.9	-1.7	-0.4	0.4	1.3	0.4	0.0	0.0	0.0
Contribution of residual	-1.0	-0.4	0.9	0.4	-0.1	0.2	0.0	-0.1	-0.1	-0.1	-0.1
Gross financing needs	0.0	6.7	4.0	1.7	1.1	1.2	1.3	2.2	3.0	3.3	3.3
of which: debt service	0.0	0.0	0.1	0.9	1.6	2.0	3.0	3.8	4.6	4.9	5.0
Local currency	0.0	0.0	0.0	0.0	0.7	0.3	0.3	0.3	0.3	0.3	0.2
Foreign currency	0.0	0.0	0.1	0.9	0.9	1.7	2.6	3.5	4.3	4.7	4.7
Memo:											
Real GDP growth (percent)	6.4	-3.5	3.5	3.1	2.9	2.8	2.7	2.7	2.7	2.7	2.7
Inflation (GDP deflator; percent)	0.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Nominal GDP growth (percent)	7.2	-1.4	5.7	5.4	5.2	5.0	5.0	4.9	4.9	4.9	4.9
Effective interest rate (percent)	1.7	2.0	2.6	2.9	3.3	3.5	3.6	3.6	3.6	3.5	3.5

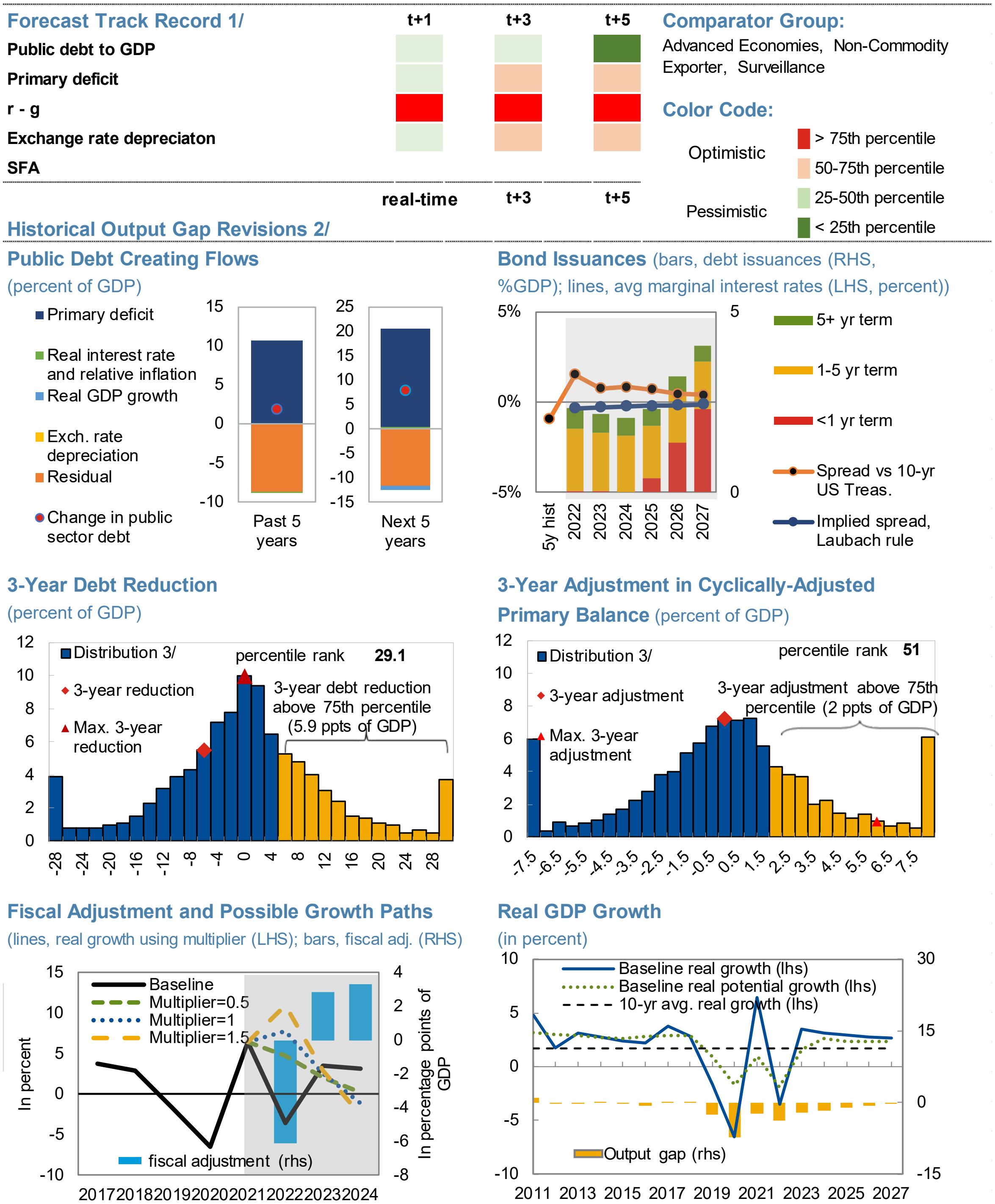
Contribution to Change in Public Debt

(percent of GDP)



Staff commentary: Public debt remains low but will rise as Green and infrastructure bonds are issued. "Other transactions" includes the use of fiscal reserve buffers to finance expenditure, and investment income. The first year of projection is 2022 (FY2022/23), in line with Table 3.

Appendix IV. Figure 5. Hong Kong SAR: Realism of Baseline Assumptions

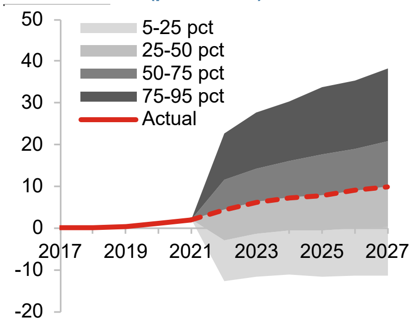


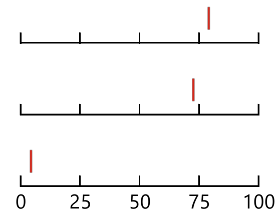
Commentary: The recovery from COVID-19 will impart complicated effects on the growth path. However, realism analysis does not point to major concerns: past forecast errors do not reveal any systematic biases.

Appendix IV. Figure 6. Hong Kong SAR: Medium-term Risk Assessment

	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	49.6	0.7	
Probability of debt non-stabilizaiton *(percent)*	21.0	0.2	
Terminal debt-to-GDP x institutions index	1.8	0.0	
Debt fanchart index (DFI)		0.9	
Risk signal: 3/		Low	

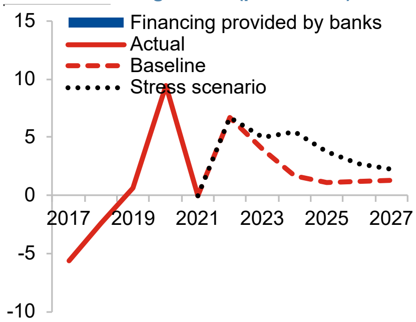
Final Fanchart (pct of GDP)

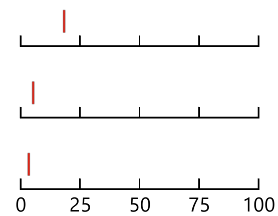




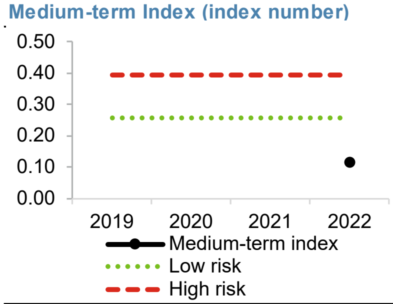
	Value	Contrib 1/	Percentile in peer group 2/
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	2.7	0.9	
Banks' claims on the gen. govt *(pct bank assets)*	1.0	0.3	
Chg. In banks' claims in stress *(pct banks' assets)*	0.0	0.0	
GFN financeability index (GFI)		1.2	
Risk signal: 4/		Low	

Gross Financing Needs (pct of GDP)





Medium-term Index (index number)



Medium-term risk analysis

	Value	Weight	Contribution
Debt fanchart index (normalized)	0.2	0.5	0.1
GFN finaceability index (normalized)	0.0	0.5	0.0
Medium-term index	0.1		
Risk signal: 5/	Low		
Final assessment:	Low		

Prob. of missed crisis, 2022-2027, if stress not predicted: 0.0 pct.

Prob. of false alarms, 2022-2027, if stress predicted: 87.5 pct.

Commentary: The wide bands seen in the fan chart reflect historical variance in the data, and have been affected by unusual volatility due to COVID-19.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is emerging market, non-commodity exporting countries, with Fund-supported programs.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

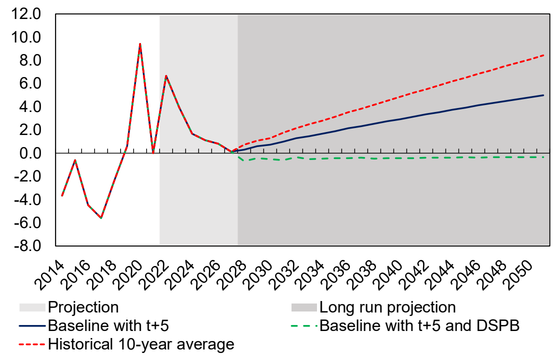
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Appendix IV. Figure 7. Hong Kong SAR: Long-term Risk Analysis

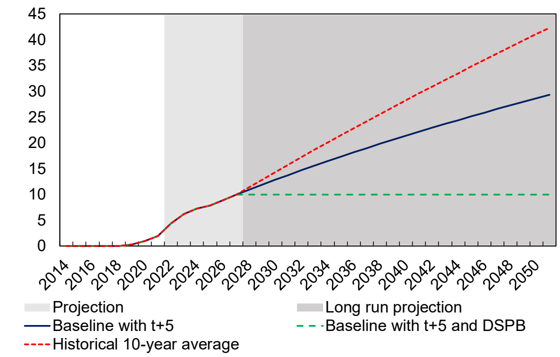
Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Overall Risk Indication		

GFN-to-GDP ratio



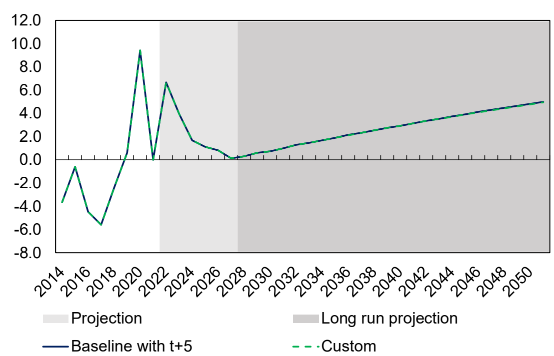
Total Public Debt-to-GDP ratio



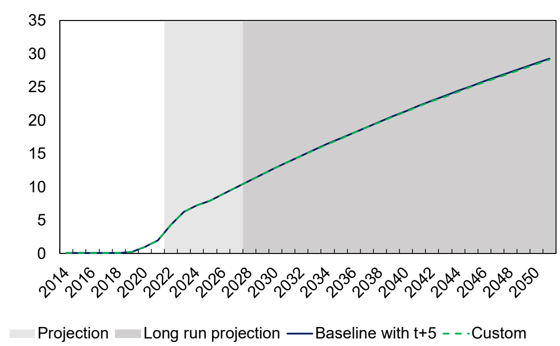
Custom

	Baseline Extension of Fifth Projection Year	Custom Baseline
Real GDP growth	2.7%	2.7%
Primary Balance-to-GDP	0.2%	0.2%
Real depreciation	-2.2%	-2.2%
Inflation (GDP deflator)	2.2%	2.2%

GFN-to-GDP ratio



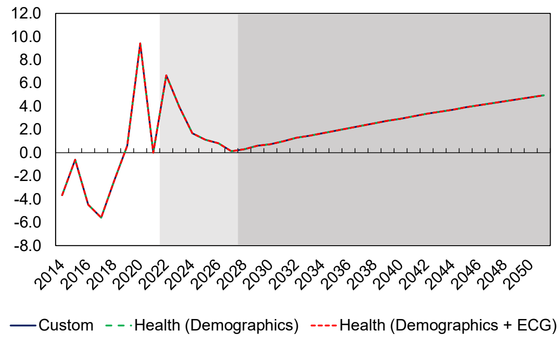
Total Public Debt-to-GDP ratio



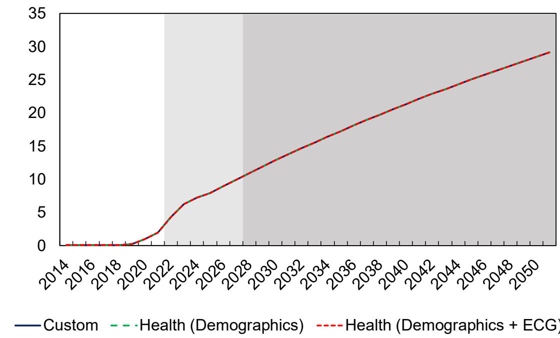
Appendix IV. Figure 7. Hong Kong SAR: Long-term Risk Analysis (concluded)

Demographics: Health

GFN-to-GDP ratio



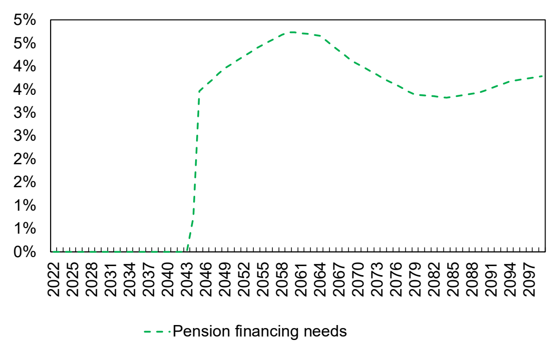
Total Public Debt-to-GDP Ratio



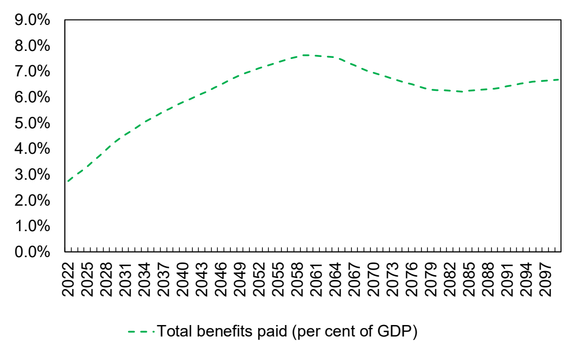
Demographics: Pension

Permanent Adjustment Needed in the Pension System (pp of GDP per year)	To keep pension assets positive for:		
	30 years	50 years	Until 2100
	0.90%	2.30%	2.70%

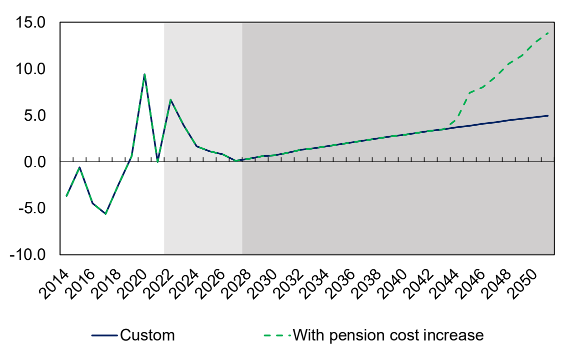
Pension Financing Needs



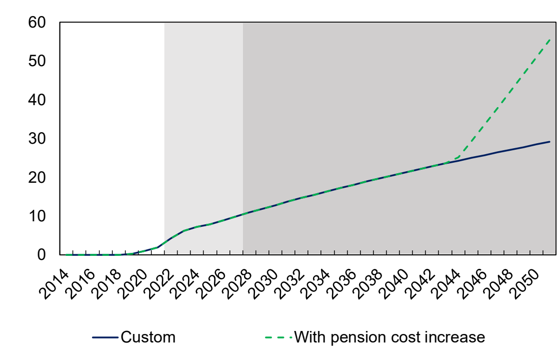
Total Benefits Paid



GFN-to-GDP ratio



Total Public Debt-to-GDP Ratio



Commentary: While the long-run projection shows a rising debt-to-GDP ratio, the projection assumes a surplus primary balance and the debt is matched by increasing financial assets. The large amortization result reflects little bond issuance and amortization in previous years. The healthcare module estimates how aging can increase pressures on the budget, whereas the pensions module considers how aging could increase budgetary pressures. The pensions module uses net assets from the Mandatory Provident Fund Schemes Authority (MPFA) and Civil Service Pension Reserve Fund, and contributions data from the MPFA. Over the long-run, Hong Kong SAR has meaningful risks from population aging. Fiscal reforms and economic diversification to identify new sources of fiscal revenues and growth will be critical.

Appendix V. Updates on Implementation of FSAP Recommendations[1]

Recommendations	Status
Strengthening Systemic Risk Monitoring	
Continue to monitor Authorized Institutions' concentrated exposures to non-bank mainland China entities, particularly of banking groups with foreign bank branches and subsidiaries. [HKMA]	**Progress: On track** The HKMA has all along devoted substantial supervisory resources to banks' non-bank Mainland China exposures, by putting in place rigorous surveillance and analysis framework and conducting regular onsite reviews of banks' systems and practices in the relevant lending business. In the past year or so, in light of the heightened credit risk from the property sector in Mainland China, the HKMA had stepped up the monitoring of the relevant exposures and conducted deep-dive reviews of some banks' portfolios to ensure that the risk is being properly managed. So far, the risk is assessed to be manageable with no particular concentration. Regarding banking groups with foreign bank branches and subsidiaries in Hong Kong, the HKMA has conducted a round of thematic examinations in 2022 on the relevant banking groups' operation in Hong Kong to assess their control with respect to large exposures and credit concentration, as well as any potential signs of regulatory arbitrage. No major deficiencies were identified. The HKMA will continue to carry out supervisory activities on the banking groups concerned as needed.
Reassess the need for amending the regulatory perimeter to monitor non-deposit-taking finance companies and leakages to macroprudential policy. [HKSAR Authorities]	**Progress: On track** The Registrar of Money Lenders conducts annual surveys to monitor the landscape of the licensed money lenders sector. One of the indicators under close watch is the amount of personal loans secured by residential properties for financing the purchase of the properties, which amounted to about $21 billion as at end-2021, 9.4% lower than as at end-2020. Furthermore, compared to the amount of loans made by banks for the same purpose in 2021, the portion of loans made by money lenders was not significant (around 1.2%). The systemic risk posed by the licensed money lending sector to the financial system remained generally low. Meanwhile, the Government has enhanced regulation of money lenders in recent years. New and revised licensing conditions have been imposed on licensed money lenders since 16 March 2021 requiring them

[1] Information provided by Hong Kong SAR authorities.

Recommendations	Status
	to assess borrower's repayment ability prior to granting unsecured personal loans, and strengthening the regulation over money-lending advertisements and enhancing protection of the information of loan referees. Further, interest rate cap and extortionate rate threshold under the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong) were respectively lowered from 60% per annum to 48% per annum, and from 48% per annum to 36% per annum since 30 December 2022. We will continue to closely monitor the sector. In co-ordination with the FSTB and other regulatory authorities where necessary, the SFC has been responding proactively to changing markets and new regulatory challenges with a view to (a) identifying, assessing and managing risks in a timely manner; (b) continuing reviewing the effectiveness and relevance of its past regulatory decisions, and (c) determining whether additional measures at the sectoral level are needed, or even to bring in previously unregulated activity into the perimeter of regulation.
Ensure sufficiently forward-looking internal risk models for capital charge for mainland China real estate borrowers with low credit ratings. [HKMA]	**Progress: On track** The HKMA continues to ensure that banks' internal risk models used to determine the capital charge for potential high-risk Mainland borrowers are sufficiently forward-looking during model reviews and approval. In light of the IMF's recommendation, the HKMA conducted a thematic review in 2022 to assess the forward-looking capability of IRB banks' internal risk models. The review focused on examining the extent and effectiveness of the adoption of various model components with forward-looking elements in the internal risk models. The results of the review indicated that the IRB banks' internal risk models were in general sufficiently forward-looking. In particular, a wide range of forward-looking risk factors, including both quantitative and qualitative ones, were considered in their internal models. In addition, the IRB banks would conduct ad hoc reviews to ensure abrupt changes in borrowers' creditworthiness could be timely reflected in the internal ratings assigned to the borrowers. They also put in place effective model override mechanisms to appraise aspects that might affect borrowers' creditworthiness but were not sufficiently captured by the models' risk factors from a forward-looking perspective.
Integrate all bank liquidity stress tests, streamline reporting, and enhance monitoring of liquidity	**<u>Integrate all bank liquidity stress tests and streamline reporting</u>**

Recommendations	Status
position of foreign branches that appear more vulnerable. [HKMA]	**Progress: On track** HKMA is enhancing the reporting requirements on the supervisory liquidity stress testing and targets to launch the revised return in mid-2024. **<u>Enhance monitoring of liquidity position of foreign branches that appear more vulnerable</u>** **Progress: Implemented** A 3-month supervisory liquidity stress testing (SLST) scenario has been implemented starting from the position of Dec 2021. Pilot run results were largely in line with those of FSAP stress tests with a few banks (mostly foreign bank branches) being identified as more vulnerable. The HKMA has shared the stress test results with the relevant banks and has been maintaining an open dialogue with them. Given the novelty of the new scenario, the HKMA will keep banks' performance in view and, after having gained more implementation experience, devise an approach on how to make use of the stress test results in our supervision of banks' liquidity risk in 2023.
Integrate monitoring and stress testing of investment funds' liquidity in the supervisory framework and increase granularity of data collation. [SFC]	**Progress: Under consideration and on track with data collection** The SFC has been requiring fund managers to implement adequate liquidity risk management policies and procedures. In particular, managers of SFC-authorized funds are required to perform ongoing liquidity risk assessment to assess the liquidity profile of their funds' liabilities and assets on a regular basis and perform liquidity stress tests on their funds on an ongoing basis. The SFC reviews compliance during inspections. The SFC also continues to monitor fund managers' implementation and conducts ad hoc enquiries with specific fund managers for more granular data in response to latest market development. In view of the international regulatory development, starting from 2022, the SFC has expanded the data collection framework to collect more granular data (e.g. detailed breakdown of liquidity profile, credit ratings, currency exposure, etc.) from fund managers for supervisory and monitoring purpose.
Monitor non-mortgage household debt; ensure consistency of risk guidelines among regulators on investment credit to high-net-worth individuals. [HKMA/SFC]	**Progress: Implemented** The HKMA has been closely monitoring the trend of household indebtedness regularly, including gathering data and analyzing different components of household debts. To step up monitoring of loans to wealth management customers, the HKMA has introduced a new survey on collateralized lending

Recommendations	Status
	secured by financial assets in 2022. The HKMA will continue to conduct onsite examinations on banks' retail lending business and lending to private banking and wealth management customers. The HKMA has maintained regular and close communications with the SFC in relation to supervisory standards on investment loans to private banking customers with a view to comparing approaches and ensuring consistency. For example, in reviewing the credit risk management of share margin financing, the HKMA had worked closely with SFC to ensure consistency before the revised HKMA guideline on credit risk management of share margin financing was promulgated in October 2021. The SFC has issued guidelines to provide guidance on risk management standards expected of brokers conducting securities margin financing activities. The guidelines, which took effect on 4 October 2019, set out qualitative requirements and quantitative benchmarks for margin lending policies and key risk controls.
Monitor the household debt repayment capacity at a disaggregated level.	**Progress: On track** The HKMA is using transaction-level data collected from banks under the Granular Data Reporting initiative to, among other things, monitor the debt servicing ratio of mortgage borrowers.
Consider incorporating non-financial corporates in the stress testing framework and communicate the key findings in HKMA's Monetary and Financial Stability Reports.	**Progress: On track** Work is underway to develop and incorporate the non-financial corporate sector in the stress testing framework. The results will be reported in the HKMA's Monetary and Financial Stability Reports.
Enhance oversight over banking groups that have both foreign branches and local subsidiaries in HKSAR.	**Progress: Implemented** Please refer to the update on the first item (i.e., "Continue to monitor Authorized Institutions' concentrated exposures to non-bank mainland China entities, particularly of banking groups with foreign bank branches and subsidiaries") above. HKMA has strengthened the group-wide supervisions by issuing revised HKMA Supervisory Policy Manual module CS-1 on "Group-wide approach to supervision of locally incorporated AIs" in July 2021 to incorporate the relevant requirements and international standards on the supervision of financial conglomerates, including those with both branches and subsidiaries in Hong Kong.
Heighten monitoring of liquidity risk at the group and entity level for banks that operate with multiple group entities.	**Progress: Implemented** The thematic review was completed in October 2022. As noted from the thematic reviews, all reviewed

Recommendations	Status
	banking groups adhere to supervisory requirements for intragroup liquidity risk management set out in the HKMA's Supervisory Policy Manual module LM-2 on "Sound Systems and Controls for Liquidity Risk Management". Proper monitoring and control mechanisms, such as intragroup liquidity metrics and limits, have been established and adhered to for managing and mitigating the risk of contagion from other group entities.
Stress test banks' large exposures separately from their total loan books.	**Progress: Implemented** Stress testing enhancement has been implemented under the HKMA's Top-down solvency stress test framework since Q2 2022.
Macroprudential Policy Framework	
Strengthen the systemic risk monitoring and data collection framework; Continue leveraging analytical expertise of the HKMA/other regulators in CFR/FSC. [FSTB/HKMA/SFC/IA]	**Progress: Implemented** The existing high-level and cross-sectoral setup of the CFR and FSC, with direct oversight by the Financial Secretary and the Secretary for Financial Services and the Treasury, already allows the government to monitor and discuss cross-sectoral issues of regulatory concerns or systemic implications with financial regulators and relevant government agencies. The HKMA's most recent research, benefiting from its enhanced data collection framework, has used transactional big data to better monitor activities of non-deposit-taking finance companies in both the residential and non-residential mortgage markets, which may have implications on leakages to macroprudential policy. The analysis on the residential mortgage market can be found in Box 4 of the March 2022 issue of the HKMA's Monetary and Financial Stability Report, and the analysis on the non-residential mortgage market can be found in the Box 3 of the September 2021 issue of the same Report. The HKMA has used these transactional big data to enhance the systemic risk monitoring on an ongoing basis. Besides, the HKMA continues to implement its monitoring framework for Hong Kong SAR's financial and monetary stability with input from different data sources (trade repository data, granular data on bank loans, textual analysis) which will be expanded as and when needed. Discussion with other regulators is also held from time to time to assess possible cross-sectoral matters with financial and monetary stability implications. On the insurance front, work is in progress to enhance the supervisory review process by including

Recommendations	Status
	"outward risk" as part of the qualitative risk assessment in the annual Company Review Cycle. Criteria, indicators and thresholds for the risk assessment will be developed. An initial approach was rolled out in 2022 to elaborate a methodology for assessing and identifying systemically important insurers.
Enhance data collection of intersectoral claims with a focus on claims of the nonbank financial institutions to better gauge the importance of intersectoral linkages. [FSTB/HKMA/SFC/IA]	**Progress: On track** The authorities note that the non-bank financial sector, including non-bank lending, is already covered in their monitoring. The government and the financial regulators will consider further measures to enhance monitoring of financial systemic risks and the need to expand the macroprudential regulatory regime to cover non-bank financial institutions ("NBFIs") as necessary having regard to any systemic risks identified. On the insurance front, sector-wide monitoring data set under IAIS Holistic Framework is being collected from authorized insurers on an annual basis. The data collection template covers, amongst others, the intersectoral linkages (i.e., inter-connectedness) with other financial institutions of an authorized insurer.
Enhance communication through a comprehensive and dedicated financial stability report.	**Progress: On track** Monthly Reports of the FSC are submitted to the Financial Secretary's Office to strengthen communication and co-ordination.
Financial Sector Supervision	
Update legislation to reflect HKMA's de facto operational independence in the law; in the interim, consider specifying circumstances where Chief Executive may give directions to Monetary Authority. [Government]	**Progress: No intention to implement** Section 10 of Banking Ordinance (BO) reserves a right to the Chief Executive of the Hong Kong SAR Government (CESAR) to give to the Financial Secretary and the Monetary Authority such directions as the CESAR thinks fit with respect to the exercise of their respective functions under the BO. The power vested in the CESAR to issue directions to the HKMA under Section 10 of BO reflects the HKSAR Government's ultimate responsibility to formulate monetary and financial policies and supervise financial markets as enshrined in the Basic Law. Given that the power is included in the BO, it is to be exercised in accordance with the objectives and functions of the BO and in practice would only be used as a tool of last resort to implement specific remedial measures in the most critical and extreme circumstances. The power in fact has never been exercised. There is a deeply embedded constitutional and political convention of restraint that the power

Recommendations	Status
	would not be exercised lightly. These considerations, together with the institutional arrangements put in place to ensure a high degree of operational autonomy of the HKMA, provide strong backing for the Monetary Authority to exercise supervisory power in an independent and professional manner.
Implement group-wide supervision and risk-based capital requirements as planned. [IA]	**Progress: On track** The group-wide supervision framework commenced on 29 March 2021, with the designation of three insurance holding companies under the framework since 14 May 2021. For the risk-based capital regime, we are preparing the enabling legislative amendments for introduction into the Legislative Council in the 2023 legislative session, with the target of the regime coming into effect in 2024.
Assess systemic risk of individual insurers (potential FIRO designation), and cross-sector risks. [IA]	**Progress: On track** The IA has been continuously working on enhancing its macroprudential supervisory tools and methodologies, including the assessment of systemic risk of individual insurers for potential FIRO designation and inward/outward risks. These tools and methodologies are in addition to the supervision work already being undertaken by the IA.
Enhance surveillance and monitoring of OTC trades. [SFC]	**Progress: On track** The HKMA will continue to explore the proposed initiative: "giving HKMA's oversight responsibility over HKCC's liquidity and settlement risks" with the SFC, which is the regulator for the HKCC. The SFC issued a consultation paper in December 2020 to consult the public on a proposal to introduce an OTC securities transactions reporting regime for certain activities relating to shares listed on the stock market operated by the HKEX with a view to enhancing the surveillance of OTC trades. The consultation conclusions paper was issued in August 2021. Subject to the market readiness, the SFC plans to launch the OTC securities transactions reporting regime in the second half of 2023.
Expand enforcement powers over recognized exchange companies and clearing houses, and Part III Automated Trading System providers. [SFC]	**Progress: Under consideration** In relation to the recommendation for expansion of enforcement powers (similar to the powers that the SFC has over Part V ATS providers) over recognized exchanges and Part III ATS providers, in particular the ability to impose monetary penalties, the SFC would need to consider further whether such additional enforcement powers would assist in achieving credible deterrence in the Hong Kong SAR market.

Recommendations	Status
	The SFC has a wide range of regulatory powers that can be exercised in its supervision of recognized exchanges and Part III ATS providers, and the SFC addresses any relevant issues with the recognized exchanges and Part III ATS providers through the regular supervisory activities. For example, the SFC can make a suspension order on the functions of the board of directors of the recognized exchanges. In addition, the SFC has been supervising recognized exchanges and Part III ATS providers to strengthen corporate governance framework to achieve better compliance of relevant rules and procedures. The SFC and other law enforcement agencies also conduct enforcement actions against any employee of recognized exchanges and Part III ATS providers committing criminal offences under the Securities and Futures Ordinance and other relevant ordinances. Imposing monetary penalties on recognized exchanges and Part III ATS providers might not provide additional benefits in achieving the regulatory objectives in the short run.
Strengthen the current governance of the HKCC by setting up a proper HKCC board, an independent risk management committee, and decentralized key functions. [HKEX]	**Progress: Not applicable** The HKEX Board engaged an independent consultant to help conduct a comprehensive review of the HKEX group risk governance. The review was completed in 2021. The SFC notes that the key recommendations of the risk review related to the HKCC include bolstering the ability of risk management to influence decision-making, investing in adequate resources and tools for risk management, restructuring and upgrading the compliance function to improve regulatory engagement and internal controls, developing a structured framework to ensure proper subsidiary governance, and enhancing the HKEX Board's oversight by clarifying its roles and responsibilities and improving interaction and information flows with management. Since 2021, the HKEX has made good progress in implementing the recommendations from consultant. Most recommendations have been addressed and the HKEX targets to complete addressing all outstanding issues this year. The SFC has noted improved quality of risk analysis in the HKEX's recent proposals and daily operations. The HKEX's risk and compliance units now have more authority to influence the decision-making process. The SFC expects that the full implementation of the recommendations would significantly improve the independence and effectiveness of the HKEX's risk and conflict of interest management thereby

Recommendations	Status
	addressing the IMF's concerns. The SFC is of the view that it is not necessary to make any changes to the HKCC's governance structure in view of the implementation of the review recommendations.
Adopt a framework to ensure that its prudential mandate is not compromised by development initiatives.	**Progress: Implemented** The HKMA's objectives and functions are clearly focused on the effective working and general stability of the banking system (Banking Ordinance s. 7) and the stability and integrity of the monetary and financial systems (Exchange Fund Ordinance s. 3(1A)) of the Hong Kong SAR. There is a strong tradition and commitment within the organization, communicated publicly, of recognizing such stability as a prerequisite and cornerstone for the maintenance of the Hong Kong SAR's position as an international financial centre. To the extent that action can be taken by the HKMA, using the resources of the Exchange Fund, under the Exchange Fund Ordinance "with a view to maintaining Hong Kong SAR as an international financial centre", it must still be for the purpose of maintaining the stability and the integrity of the monetary and financial systems of the Hong Kong SAR. Therefore, the healthy development of the banking system is consistent with the maintenance of stability. For example, whilst technologically advanced financial infrastructure may be developed, or action taken to increase the depth and breadth of the local debt markets, the underlying objective in each case remains the effective working and, by extension, the stability of the local financial system. Within the HKMA, there is clear delineation of responsibilities among departments the work of which contribute to the overall stability and development of the Hong Kong SAR's financial system. The banking departments of the HKMA are primarily responsible for the prudential supervision and conduct supervision of banks, while other departments are undertaking macro-surveillance, liquidity support, and market operations functions to ensure monetary stability. All in all, in planning for developmental work, an overarching consideration for the HKMA is the implications of the initiatives on monetary and financial stability.
Enhance the risk management framework of the HKCC, including giving HKMA's oversight responsibility over HKCC's liquidity and settlement risks and strengthening HKCC's capacity to manage credit and operational risks.	**Progress: Not applicable** See the above response.

Recommendations	Status
Improve the AML/CFT regime, including enhancing prosecution of the laundering of proceeds from foreign offenses, increasing risk understanding, and strengthening supervision of certain nonfinancial sectors.	**Progress: Implemented** The HKSAR Government attaches great importance to the AML/CFT system of Hong Kong and seeks to improve the system continuously – As captured in the Risk Assessment Report, Hong Kong as an international financial centre is exposed to ML threats arising from both internal and external predicate offences. The HKSAR Government has stepped up efforts on enhancing prosecution of the laundering of proceeds from foreign offences. Between 2018-2022, 57.2% of the overall ML-related investigations by the Hong Kong Police Force originated from foreign predicate offences. In investigating and prosecuting such cases, law enforcement agencies make use of various channels (e.g., mutual legal assistance (MLA), Court-to-Court process under the Evidence Ordinance (Cap. 8), or other forms of international co-operation such as exchanges between financial intelligence units) to obtain necessary information / evidence. Between 2018 and 2022, Hong Kong made 21 MLA requests to other jurisdictions related to ML investigation and/or prosecution. On understanding of ML/TF risk, the HKSAR Government published the second Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report (HRA) in July 2022, The 2022 HRA covers data spanning from 2016 to 2020 and updates the ML/TF threats and vulnerabilities from both the territory-wide and sectoral perspectives. Drawing on our experience in the 2018 HRA and the recommendations of the FATF in relation to ML/TF risk understanding, the HKSAR Government has expanded the 2022 HRA to include more in-depth assessment, namely (a) risk assessment on proliferation financing in Hong Kong; (b) in-depth analysis on the stored value facility and virtual asset service provider sectors; (c) highlights of the latest developments in various sectors, e.g. virtual banks; (d) inclusion of financial leasing, non-bank credit card businesses and credit unions; (e) detailed and focused assessment on threats with foreign or international elements; and (f) expanded coverage of analysis over legal persons and legal arrangements. The HKSAR Government is following up on the risks identified through a multi-pronged approach. On strengthening supervision of non-financial sector, the FATF has approved Hong Kong's regular follow-up report (FUR) through written process. Hong Kong has made good progress in addressing the technical

Recommendations	Status
	compliance deficiencies identified in its Mutual Evaluation Report, and the FATF has upgraded Hong Kong's rating on R.28 Regulation and supervision of DNFBPs, in particular for estate agents, accounting professionals, legal professionals, and dealers in precious metals and stones.
Crisis Management and Financial Safety Nets	
Update the deposit protection scheme, including expanding the scope of depositor preference, extending the mandate of the Deposit Protection Board to allow it to contribute to resolution costs, and reviewing the size of the Deposit Protection Scheme fund and flexibility of levies. [FSTB/HKMA]	**Progress: On track/Under consideration** The Deposit Protection Board has completed the review of the modalities of the Deposit Protection Scheme (DPS) with the support of an external consultant. Based on the findings of the review, the Board has proposed some policy recommendations on enhancing the DPS and will launch a public consultation to solicit views and comments on the proposed DPS enhancements around Q2 2023.
Enhance the implementation of the resolution framework, including resolution planning for non-systemically important banks, close monitoring of Loss-Absorbing Capacity, ex-post resolution levies, resources of nonbank resolution authorities (particularly, for CCPs), and cross-border cooperation.	**Progress: On track** Regarding resolution policy, the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules (Stay Rules) came into operation in August 2021. A Code of Practice (CoP) providing guidance on the operations of the Stay Rules was published in December 2021. In addition, two other CoP chapters respectively setting out the expectations in relation to operational continuity, and liquidity and funding needs, were published in November 2021 and July 2022. The development of a further CoP chapter on continuity of access to financial market infrastructure is underway. On resolution planning, as of January 2023, all domestic systemically important banks (D-SIBs) built up a new layer of loss-absorbing capacity (LAC) resources and met their applicable LAC requirements, representing a milestone in enhancing the resolvability of these banks. The HKMA also advanced the determination of preferred resolution strategies and implementation of LAC requirements for non-D-SIBs. In addition, the implementation of new resolution policy standards has commenced and the HKMA has continued to oversee banks' development and testing of resolution capabilities. In relation to resolution execution capability, a Resolution Advisory Framework was established in 2020-21 to support efficient engagement of external advisors as needed. The development of a memorandum of understanding to support coordination between resolution authorities in Hong Kong was progressed in 2022.

Recommendations	Status
	As for international and cross-border cooperation, the HKMA led the regional resolution planning for a global systemically important bank (G-SIB) and participated in Crisis Management Groups and Resolution Colleges for 14 G-SIBs. In addition, the HKMA is actively involved in international resolution policy development and monitoring through its membership at relevant Financial Stability Board ("FSB") steering and working groups. Regionally, the HKMA chaired and served as the secretariat of the Executives' Meeting of East Asia-Pacific Central Banks Study Group on Resolution, and took part in the design and execution of a cross-border crisis simulation exercise in 2022 organized by the BIS's Financial Stability Institute involving 10 authorities in the Asia-Pacific region. In relation to central counterparties (CCPs), the SFC is considering possible areas of enhancement including the need to provide more specific powers and tools in relation to CCP resolution taking account of the latest global developments. The SFC continues to participate in the work of FSB Cross Border Crisis Management for FMIs. The IA is developing a resolution framework for relevant insurers which outlines an overarching approach and principles governing the use of resolution powers and addresses proportionality as well as scope of application. The FIRO and the FIRO designation methodology being developed shall provide an orderly resolution regime for specific insurers. To meet one of the ComFrame requirements, as Group-wide supervisor, the IA is also coordinating with host regulators in Crisis Management Group for resolution and recovery planning of an IAIG. **<u>Enhance the implementation of the resolution framework for ex-post resolution levies</u>** **Progress: Under consideration** The FSTB has invited all resolution authorities (RAs) to consider and develop views in relation to the guidelines of imposing ex post levy for their respective sector/cross-sectoral groups, taking into account the specificities (including international development) of the sector. The HKMA has included details on their views on the levy framework in the issue of HKMA's Quarterly Bulletin published in September 2019. Having regard to the views and recommendations of the RAs, the FSTB will suitably consider developing and publishing a draft framework for the conditions and pace of post-

Recommendations	Status
	resolution levies to ensure that market participants are well-informed.
Provide greater clarification on governance and risk management of emergency liquidity assistance.	**Progress: On track** The HKMA has communicated and restated the framework for the provision of liquidity, incorporating certain refinements to prior arrangements so as to foster a better understanding of the liquidity facilities framework and to also introduce the Resolution Facility. Further to the publication of the framework, the HKMA has been working internally to operationalize the Contingent Term Facility and Resolution Facility. The subject involves a number of functional areas of the HKMA and the work is ongoing.
Fintech and Financial Innovation	
Promote consistency and facilitate information sharing across financial sectors with respect to cyber risk supervision; review and compare incident reporting frameworks across sectors and apply best practices to other sectors. [HKMA/SFC/IA]	**Progress: Implemented** The HKMA, the SFC and the IA have regular meetings on matters related to cyber risk supervision, including feasibility of extending the Hong Kong Association of Banks' cyber threat intelligence platform to other sectors and sharing of information on cyber incident reporting frameworks across sectors. The authorities are considering putting in place more structured exchange on cyber risk supervision, commensurate with the threat landscape. In addition, any significant cybersecurity incidents will also be discussed on an anonymous basis at the meetings so that any lesson learned, and best practices can be shared. The HKMA continues to participate in the Financial Stability Board's working group on cyber incident reporting. The HKMA will compare notes with the SFC and IA upon the issuance of the final report in the first half of 2023. The HKMA and the IA have agreed to link up the insurance sector and banking sector platforms in the CISP to facilitate cross-sectoral cybersecurity intelligence sharing. The feature went live on 23 December 2022, enabling banks and insurers to exchange cyber threat intelligence in a secure and convenient manner.
Consider undertaking exercise to map network interdependencies. [HKMA/SFC/IA]	**Progress: On track.** The HKMA has agreed with the FSTB, the SFC and the IA to appoint an external consultant to take forward the cyber mapping exercise following the HKMA's procurement rules, with the HKMA acting as the main interface throughout the engagement.

Recommendations	Status
	The HKMA will continue to work with the FSTB, the SFC and the IA to complete the vendor selection and carry out the cyber mapping exercise in 2023.
Strengthen systematic data collection of entities to enhance monitoring of holdings of virtual assets; monitor virtual assets trading activities continuously; increase investor education. [HKMA/SFC/IA]	**Progress: Implemented** On data collection, the HKMA has been collecting the relevant statistics from registered institutions on their virtual asset (VA)-related intermediary activities through regular surveys since July 2022. VA trading platforms licensed by the SFC are placed in the SFC Regulatory Sandbox, which enables the SFC to closely supervise and monitor the activities of the platform operators and readily identify concerns relevant to their operations. The SFC also requires the platform operators to submit monthly reports on VA trading activities to the SFC. These requirements have been incorporated into and will continue to apply under the new licensing regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO). The new regime will take effect on 1 June 2023, under which all centralized virtual asset trading platforms carrying on business in Hong Kong or actively marketing to Hong Kong investors will need to be licensed with the SFC. By end-2023, SFC-licensed corporations will be required to report in their periodic statutory returns their proprietary positions in VA; licensed VA fund managers will also need to report assets under management in respect of funds adopting VA strategies. Licensed corporations' holding of VA cannot be counted towards their liquid assets when assessing the adequacy of these corporations' regulatory capital. Besides, the SFC and HKMA collect data from intermediaries on their selling of non-exchange traded investment products (including VA funds and other investment products with VA as underlying) to non-institutional investors via the annual SFC/HKMA joint product surveys. On investor education, the HKMA published social media posts in June 2022, reminding investors to carefully consider the relevant risks of VAs and related products before making investment. In January and February 2023, the HKMA published further social media posts to alert the public to some common scam tactics including, among others, crypto scam. The HKMA has also worked closely with the SFC to enhance investor education on VA-related products leveraging the Investor and Financial Education Council (IFEC)'s website "The Chin Family", which has issued a series of articles on various VA

Recommendations	Status
	subjects reminding investors of the risks associated with VA. The SFC has also been working closely with the IFEC to promote investors' understanding of VA and related products or services. In October 2022 and March 2023, the SFC (together with the FSTB) joined two webinars hosted by the IFEC to explain to the public the risks involved in investing in VA and VA-related products as well as the importance of regulation. The SFC also reminds investors from time to time of the need to take heed of risks such as price volatility, cybersecurity, and possible fraud and scams when investing in VA. The SFC will continue to step up publicity and promotional efforts upon implementation of the new licensing regime under the AMLO.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

May 1, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION DISCUSSIONS—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 1, 2023)

Membership Status

As a Special Administrative Region of the People's Republic of China, Hong Kong SAR is not a member of the Fund. However, annual consultation discussions have been held with the Hong Kong SAR authorities since October 1990, and the staff also holds discussions with the authorities in connection with the Fund's multilateral surveillance reports. STA has provided Hong Kong SAR with technical assistance in the area of balance of payments statistics and Hong Kong SAR officials have attended IMF courses on statistics, financial programming, and other macro-financial surveillance topics. The mandatory Financial Stability Assessment under the FSAP was concluded by the Executive Board of the IMF on May 21, 2021.

Exchange Rate Arrangement

The Hong Kong dollar has been linked to the U.S. dollar under a currency board arrangement, the Linked Exchange Rate System (LERS), since October 1983 at a rate of HK$7.8/US$1. The Hong Kong Monetary Authority (HKMA) refined the operations of the LERS in May 2005—the first changes since September 1998. For the first time since the introduction of the LERS in 1983, the HKMA explicitly committed to sell Hong Kong dollar at a preannounced price (set at HK$7.75/US$), which is referred to as the strong-side Convertibility Undertaking. Previously, the HKMA had only committed to buy Hong Kong dollar at a preannounced rate (the weak-side Convertibility Undertaking introduced in October 1998) and could sell Hong Kong dollar at any price. Along with this two-way Convertibility Undertaking, the HKMA also introduced a symmetric trading band of 0.6 percent around a central parity of HK$7.8/US$. There are no restrictions on current or capital account transactions in Hong Kong SAR, and the Hong Kong dollar is freely convertible. The People's Republic of China accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on December 1, 1996. The exchange regime is free of restrictions and multiple currency practices.

Resident Representative

The Hong Kong SAR sub-office of the Beijing Resident Representative's office was opened on September 23, 2000. Phakawa Jeasakul is the current Resident Representative.

STATISTICAL ISSUES

(As of May 1, 2023)

I. Assessment of Data Adequacy for Surveillance	
General: The economic database is generally comprehensive and of high quality, and data provision is adequate for surveillance.	
National Accounts: Hong Kong SAR compiles and disseminates GDP statistics under the production and expenditure approaches. The expenditure measure of GDP which is more well established, is adopted as the single measure of GDP. The production and expenditure approaches are also compiled in chained volume terms. The statistical discrepancies are explicit under to the production approach in current terms. Quarterly GDP is available by expenditure components (current values and volume) as well as by industry value added (in volume only). GDP compilation closely follows the 2008 SNA.	
Price Statistics: The monthly CPI covers the "expenditure" of all households in Hong Kong SAR, excluding only (i) marine population, (ii) households receiving public assistance, (iii) collective households such as those living in hospitals, prisons and homes for the aged, and (iv) households in the highest or lowest expenditure brackets which together accounted for some 10 percent of households. It includes 920 items. The weights are based on the Household Expenditure Surveys which is conducted once every five years. The index is disseminated with a lag no longer than 23 days after the end of the reference month. The national PPI covers the industrial sector (manufacturing industries and sewerage, waste management and remediation activities), including about 700 primary products. Weights are updated annually from the Annual Survey of Economic Activities. The index is compiled quarterly. Both price indices follow international standards.	
Government Finance Statistics: Hong Kong SAR reports both cash and accrual-based annual data for the general government according to the Fund's Government Finance Statistics Manual (GFSM 1986 and GFSM 2001, respectively). No sub-annual data are provided for publication in the IFS.	
Monetary and Financial Statistics: The HKMA reports monetary data for the central bank and banking institutions to STA on a regular monthly basis, which are published in the *IFS*. In late 2009, the HKMA submitted quarterly monetary data (test-data) using Standardized Report Forms (SRFs) that present data consistent with the Monetary and Financial Statistics Manual.	
Financial Sector Surveillance: Hong Kong SAR participates in regular reporting of Financial Soundness Indicators (FSIs) to the IMF for dissemination on the FSI website. The reported data are quarterly and cover all core FSIs and 12 additional FSIs for the deposit takers sector.	
External sector statistics: Hong Kong SAR publishes comprehensive balance of payments data and international investment position statistics for 2000 onwards. Hong Kong SAR disseminates the international reserves and foreign currency liquidity data template, submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS).	
II. Data Standards and Quality	
Hong Kong SAR subscribes to the Fund's Special Data Dissemination Standard since 1996, and is fully compliant with its requirements.	A data ROSC was disseminated in 1999.

Table 1. Hong Kong SAR: Common Indicators Required for Surveillance
(As of May 1, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[5]	Frequency of Reporting[5]	Frequency of Publication[5]
Exchange rates	May 2023	May 2023	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	Mar. 2023	Apr. 2023	M	M	M
Reserve/base money	Mar. 2023	Apr. 2023	M	M	M
Broad money	Mar. 2023	Apr. 2023	M	M	M
Central bank balance sheet	Mar. 2023	Apr. 2023	M	M	M
Consolidated balance sheet of the banking system	Mar. 2023	Apr. 2023	M	M	M
Interest rates[2]	May 2023	May 2023	D	D	D
Consumer price index	Mar. 2023	Apr. 2023	M	M	M
Revenue, expenditure, balance and composition of financing[3]−central government	Mar. 2023	Apr. 2023	M	M	M
Stocks of central government and central government-guaranteed debt[4]	Mar. 2023	Apr. 2023	M	M	M
External current account balance	Q4/2022	Mar. 2023	Q	Q	Q
Exports and imports of goods and services	Q4/2022	Feb. 2023	Q	Q	Q
GDP/GNP	Q4/2022	Feb. 2023	Q	Q	Q
Gross external debt	Q4/2022	Mar. 2023	Q	Q	Q
International investment position	Q4/2022	Mar. 2023	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Including currency and maturity composition.
[5] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).