

ANNUAL REPORT



HONG KONG MONETARY AUTHORITY
香港金融管理局

THE HONG KONG MONETARY AUTHORITY

Established in April 1993, the Hong Kong Monetary Authority (HKMA) is the government authority in Hong Kong responsible for maintaining monetary and banking stability.

The HKMA's policy objectives are

- to maintain currency stability, within the framework of the Linked Exchange Rate system, through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary
- to promote the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorized institutions
- to enhance the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.


The photographs

The first half of 2003 was a time of difficulty and challenge for people in Hong Kong. The second half brought new confidence and optimism. The theme for the photographs in this year's *Annual Report* is the *Spirit of Hong Kong*. The photographs show Hong Kong people working together, as individuals and in teams, often under pressure, to overcome challenges.

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The chapter on Banking Stability in this Annual Report is the report on the working of the Banking Ordinance and the activities of the office of the Monetary Authority during 2003 submitted by the Monetary Authority to the Financial Secretary in accordance with Section 9 of the Banking Ordinance.

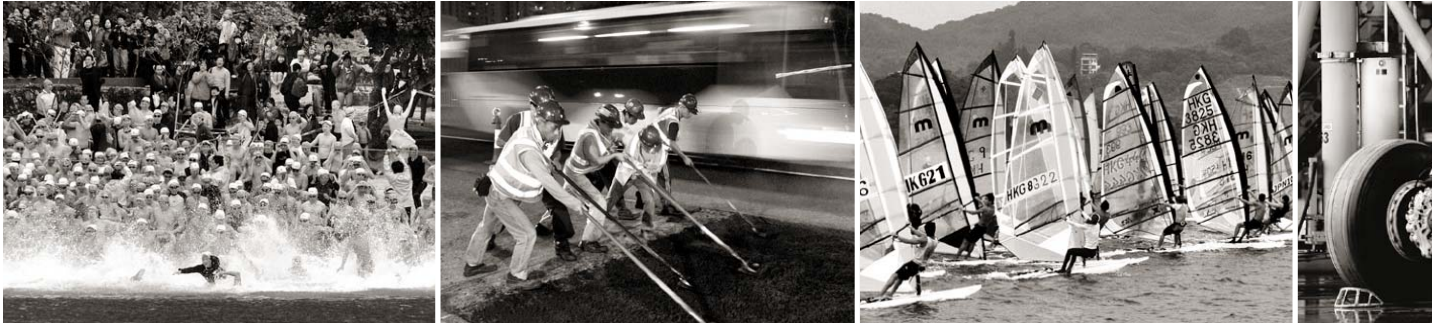
This Annual Report makes reference to documents and other materials available on the HKMA website www.hkma.gov.hk. These references appear as  > in the relevant parts of the Report, followed by navigation guidance from the HKMA homepage.

The full text of this Report is available on the HKMA website in interactive form and on PDF files.

A summary version of this Report is also available.

All amounts in this Report are in Hong Kong dollars unless otherwise stated.

HIGHLIGHTS OF 2003



ECONOMIC AND BANKING ENVIRONMENT

The economy contracts in the second quarter because of the SARS outbreak, but rebounds sharply in the second half. Real GDP grows by 3.3% in 2003.

With improved economic conditions in the second half, the banking sector ends the year with a modest growth in profitability.

New \$100 and \$500 Hong Kong banknotes with advanced security features are issued in December.

MONETARY STABILITY

The Hong Kong dollar is largely stable, despite a marked shift in market sentiment from extreme pessimism in the second quarter to optimism later in the year.

BANKING STABILITY

The HKMA completes the implementation of the risk-based supervisory approach.

Progress is made in preparing the legislation for the Deposit Protection Scheme Bill and the establishment of a Commercial Credit Reference Agency in Hong Kong.



MARKET INFRASTRUCTURE

A euro clearing system is launched in April.

A Clearing and Settlement Systems Bill is introduced to the Legislative Council in December to establish a statutory oversight regime and provide for finality of settlement.

INTERNATIONAL FINANCIAL CENTRE

The first phase of the Asian Bond Fund is launched in June with an issue size of about US\$1 billion.

In November the People's Bank of China agrees to provide clearing arrangements for personal renminbi business in Hong Kong.

RESERVES MANAGEMENT

The Exchange Fund achieves a 10.2% investment return in 2003, 70 basis points above the investment benchmark.

Hong Kong's foreign currency reserve assets stand at US\$118.4 billion at the end of 2003.

PROFESSIONAL AND CORPORATE SERVICES

A permanent HKMA Information Centre, consisting of an exhibition area and a library, is open to the public in December.

CHIEF EXECUTIVE'S STATEMENT



recovery in the second half of 2003

After six years of difficulty and uncertainty, Hong Kong's economy experienced a strong rebound in the second half of 2003. Helped by a more benign global environment, and by measures to strengthen economic ties between Hong Kong and the Mainland, this rebound continued its momentum into 2004. A broad and sustained economic recovery now appears to be in progress.

The rebound came after one of the most distressing episodes in Hong Kong's recent history: the outbreak between March and June of SARS (severe acute respiratory syndrome), which infected 1,755 people in Hong Kong, of whom 299 died. The people of Hong Kong faced this epidemic with courage and resilience, but the anxieties created by a new and virulent disease inevitably had their effects on daily life, on economic activity, and on confidence in the future. The difficulties in Hong Kong came against the background of the spread of SARS on the Mainland and in other parts of the world, uncertainties about the impact of the war in Iraq, and concerns about the performance of some of the major world economies.

Economic indicators for the second quarter of 2003 dramatically reflected the sharp decline in activity and confidence. Tourist arrivals plunged by 58% from a year earlier. Private consumption, already weak, continued to decline. The unemployment rate rose to a record high of 8.7% in the middle of the year. Deflation deepened. Residential property prices continued to decline, and by July had dropped to about a third of their value when the property market peaked in 1997. The number of residential mortgages in negative equity rose to around 106,000 in June, which was around 22% of all residential mortgages.

These were indeed troubled times. But the economic impact of SARS was short-lived, and some important sectors of the economy, such as merchandise trade, were hardly affected at all. The rebound in the second half of the year was sufficient not only to cancel the negative economic impact of SARS but also to propel Hong Kong into what appears by all signs to be a robust recovery.

This rebound has been boosted by measures taken by the authorities in Hong Kong and the Mainland to strengthen economic ties through the Closer Economic Partnership Arrangement (CEPA) and by the relaxation of restrictions on travel by individuals to Hong Kong. With the sharp turnaround in tourist visits in the third quarter, a marked revival in private consumption, and continued buoyancy in exports, Hong Kong's real GDP grew by 3.3% for the year as a whole, compared with 2.3% in 2002 and 0.5% in 2001. Asset markets stabilised in the second half of the year, and the number of residential mortgages in negative equity declined by 36% to around 67,600 by the end of the year. Deflation, if measured month on month, appears to have come to an end in around August 2003. The unemployment rate, though still high by historical standards, declined to 7.3% in the fourth quarter of 2003.

During this eventful and turbulent year the Hong Kong Monetary Authority achieved its objectives of maintaining currency stability, promoting the safety and stability of the banking system, and enhancing the efficiency, integrity and development of the financial system. Hong Kong's Exchange Fund, which is managed by the HKMA, produced an investment return of 10.2%: this was 70 basis points above the return on the benchmark set by the Financial Secretary on the advice of the Exchange Fund Advisory Committee.

*the economic impact
of SARS*

*sharp rebound supported
by deepening economic
integration with the
Mainland*

*strong investment return
on the Exchange Fund*

***a robust and effective
banking system***

Hong Kong's banking sector withstood the stresses and strains of the second quarter and came out stronger. Banks had to manage a combination of challenges brought on by persistent economic difficulty and exacerbated by SARS: sluggish loan growth, pressure on lending margins, negative equity, and a high bankruptcy rate. Like many other organisations, they also had to cope with the challenge of maintaining essential services and staff morale during a time of crisis. Not only did Hong Kong's banking system remain stable and effective: the banking sector as a whole managed to show an increase in profits for the year as a whole, thanks to the markedly improved economic conditions in the second half of the year and to their own efforts to diversify business. The HKMA continued to work with the banking sector on the planned implementation of a Commercial Credit Reference Agency in 2004, and with the Legislative Council on the bill for establishing a Deposit Protection Scheme. Since August 2003 banks have been able to share positive consumer credit data. This will help nurture a healthier credit environment and provide more competitive products for borrowers with good credit standing.

***a stable Hong Kong
dollar against volatile
world markets***

Despite the difficult second quarter and considerable volatility in the world's main currencies, the Hong Kong dollar continued to be stable under the Linked Exchange Rate system. There was a moderate rise in 12-month Hong Kong dollar forward points in April, reflecting concerns about the effects of SARS. But the most striking event of the year was the sharp strengthening of the Hong Kong dollar in late September. Forward points went into discount, and the Aggregate Balance – the most sensitive component of the Monetary Base – grew to historically high levels as the HKMA sold Hong Kong dollars to banks in response to the increased demand for Hong Kong dollar assets. Almost overnight, longstanding concerns about downward pressure on the Link gave way to complaints from some that the Hong Kong dollar was being allowed to strengthen too much.

This episode of strengthening is gradually playing itself out through the normal operation of the Currency Board arrangements, through which the Linked Exchange Rate is maintained. The causes of the strengthening were complex, but there were three main elements. Economic recovery and a rapid revival in confidence attracted a strong inflow of funds into the Hong Kong dollar. The sharp decline in the value of the US dollar against other major currencies pulled the Hong Kong dollar down with it – unjustifiably in the view of the market. Political pressure from outside for a revaluation of the renminbi encouraged the view that, if the renminbi were to be revalued, the Hong Kong dollar

would be pulled up with it. The strong inflow of funds is a matter of fact. The other two elements are an interesting example of how suddenly market sentiment can change.

A strengthening Hong Kong dollar is a much more straightforward problem than a weakening Hong Kong dollar. In addition to normal Currency Board operations, the HKMA has a range of tools – all of them consistent with Currency Board principles – that can be deployed to dampen excessive volatility in the Hong Kong dollar. Together with the Sub-Committee on Currency Board Operations of the Exchange Fund Advisory Committee, we shall continue to watch the situation carefully.

The excitement over the short-term movements of markets in the last quarter of 2003 may perhaps have obscured the longer-term view. The weakness of the US dollar has had the benign effect of moderating the pain of structural adjustment arising from the increasing economic integration between the Mainland and Hong Kong. It has helped lessen the extent of deflation necessary as part of that structural adjustment. Along with deflation, it has contributed to a decline in Hong Kong's real effective exchange rate – the true measure of an economy's competitiveness – of as much as 26% between its peak in August 1998 and the end of 2003.

Hong Kong's competitiveness as an international city has been strengthened considerably by the reductions in the cost of doing business here. But competitiveness is not just a matter of low costs. An international city must have the institutions, the talent, and the infrastructure to attract business. An important, though largely invisible, part of this infrastructure is the machinery for clearing and settling financial transactions and for linking the financial system with other financial systems.

Hong Kong has one of the world's most advanced financial infrastructures. We introduced real time gross settlement for the Hong Kong dollar in 1996 and extended this to the US dollar in 2000. In April 2003 we launched a euro clearing system, and in November, following approval from the State Council, the People's Bank of China agreed to provide clearing arrangements for personal renminbi business in Hong Kong. In February 2004, 35 banks in Hong Kong began to provide personal renminbi deposit, remittance and exchange services. These new arrangements are made on the principle of cautious and gradual change, taking into account the fact that the renminbi is not yet a fully convertible currency. Renminbi services in Hong Kong will facilitate the

*developing Hong Kong as
an international financial
centre*

*introduction of renminbi
banking in Hong Kong*

growing economic integration between Hong Kong and the Mainland. Looking further ahead, they will also help place Hong Kong in an excellent position as a centre for China's international financial transactions with the gradual liberalisation of the Mainland's monetary and financial systems in the future.

new Hong Kong banknotes

Other developments in Hong Kong's financial infrastructure in 2003 included the introduction in June of cheque imaging and truncation, which greatly reduces the need for physically delivering cheques for clearance, and the launch by the note-issuing banks in December of new \$100 and \$500 banknotes. These are the first of a new series of Hong Kong banknotes with fresh designs and improved security features: the remaining denominations in the new series will be issued later in 2004.

international standards

One of the aims of the HKMA is to ensure that Hong Kong's banking and monetary systems comply with international codes and standards. For this reason, the groundwork continued in 2003 for implementing the New Basel Capital Accord, which is targeted for implementation in late 2006. In June 2003 the joint IMF-World Bank mission under the Financial Sector Assessment Programme (FSAP) delivered its comprehensive report on Hong Kong. The report confirmed that Hong Kong complies with key international standards, that its financial system is fundamentally sound, and that its market infrastructure is robust and efficient.

operational autonomy of the HKMA

The FSAP mission made a number of recommendations for improving the regulation and transparency of Hong Kong's financial system. The great majority of these have been swiftly implemented. One of the recommendations was that the legal foundation of the HKMA should be clarified and the operational autonomy of the HKMA for the implementation of monetary policy should be explicitly recognised in a formal document. On 25 June the Financial Secretary and I, as Monetary Authority, exchanged a series of letters setting out the division between the two of us of functions and responsibilities in monetary and financial affairs. These letters, which are public documents, summarise governance and other provisions, under the Exchange Fund and Banking Ordinances, that have been in place for some years, and as such they make no change to existing arrangements.

Two aspects of this Exchange of Letters are, however, worth drawing particular attention to for the emphasis they place on the operational independence of the HKMA. First, disclosure is made in the letters, for the first time, of the details of the delegation of statutory powers from

the Financial Secretary to the Monetary Authority. The Financial Secretary makes an undertaking to disclose publicly, within three months and giving reasons, any exercise by himself of those delegated powers or any overriding of the Monetary Authority in his exercise of the delegated powers. Secondly, the Financial Secretary formally lays down, for the first time, the monetary policy objective and the structure of Hong Kong's monetary system: a stable exchange value of the Hong Kong dollar in terms of its exchange rate against the US dollar at around HK\$7.80 to US\$1 maintained by Currency Board arrangements.

These are, of course, the monetary arrangements that have been in place in Hong Kong for 20 years, and it is perhaps appropriate that, as it comes of age, the Linked Exchange Rate system, which was introduced on 17 October 1983, should be formally enunciated in this way. In April 2003 we also marked the 10th anniversary of the foundation of the HKMA. This has been a momentous decade for Hong Kong, and a time of great difficulty and anxiety. I believe, however, that the HKMA can look back on its achievements during these years with some satisfaction. In its contributions to maintaining monetary and financial stability, the HKMA has relied heavily upon its greatest asset – an excellent staff – and I pay tribute to them for their unfailing dedication and determination over the years. The HKMA has also received skilled guidance from successive Financial Secretaries and Members of the Exchange Fund Advisory Committee. And, most important of all, we have enjoyed the support and confidence of the people of Hong Kong: without this, and without the co-operation from their representatives on the Legislative Council, we could not fulfil our objectives.

Ten challenging years have taught us that there are few certainties and many surprises in this rapidly changing world. It would be unwise to try to predict what might happen in the next decade, although the prospects for Hong Kong in the coming year at least seem to be brighter than they have been for some time. The HKMA will, however, continue to do its best to ensure that Hong Kong's monetary and financial systems have the stability, the infrastructure, and the resources to manage whatever challenges, opportunities and crises that may lie ahead.



Joseph Yam
Chief Executive

*20th anniversary of the
Link, 10th anniversary
of the HKMA*

ABOUT THE HKMA

The Hong Kong Monetary Authority is Hong Kong's central banking institution. The HKMA has four main functions: maintaining the stability of the Hong Kong dollar; promoting the safety of Hong Kong's banking system; managing Hong Kong's official reserves; and maintaining and developing Hong Kong's financial infrastructure.

THE HKMA'S LEGAL MANDATE

The HKMA was established on 1 April 1993 by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. To facilitate the establishment of the HKMA, the Legislative Council passed amendments to the Exchange Fund Ordinance in 1992 empowering the Financial Secretary to appoint a Monetary Authority.

The powers, functions and responsibilities of the Monetary Authority are set out in the Exchange Fund Ordinance, the Banking Ordinance and other relevant Ordinances. The division of functions and responsibilities in monetary and financial affairs between the Financial Secretary and the Monetary Authority is set out in an Exchange of Letters between the two dated 25 June 2003. This Exchange of Letters also discloses the delegations made by the Financial Secretary to the Monetary Authority under these Ordinances. The letters are public documents: copies of them may be found on the HKMA website.

The Exchange Fund Ordinance establishes the Exchange Fund under the control of the Financial Secretary. According to the Ordinance, the Fund shall be used primarily for affecting the exchange value of the Hong Kong dollar. It may also be used for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre.

The Monetary Authority is appointed under the Exchange Fund Ordinance to assist the Financial

Secretary in performing his functions under the Exchange Fund Ordinance and to perform such other functions as are assigned by other Ordinances or by the Financial Secretary. The office of the Monetary Authority is known as the HKMA and the Monetary Authority as the Chief Executive of the HKMA.

The Banking Ordinance provides the Monetary Authority with the responsibility and powers for regulating and supervising banking business and the business of taking deposits. Under the Ordinance, the Monetary Authority is responsible, among other things, for the authorization of licensed banks, restricted licence banks, and deposit-taking institutions in Hong Kong.

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THE HKMA AND THE HONG KONG SAR GOVERNMENT

The HKMA is an integral part of the Hong Kong SAR Government, but is able to employ staff on terms different from those of the civil service in order to attract personnel of the right experience and expertise. The Chief Executive of the HKMA remains a public officer, as do his staff. In its day-to-day work the HKMA operates with a high degree of autonomy within the relevant statutory powers conferred upon, or delegated to, the Monetary Authority.

The Financial Secretary is responsible for determining the monetary policy objective and the structure of the monetary system of Hong Kong: A letter from the Financial Secretary to the

Monetary Authority dated 25 June 2003 specifies that these should be currency stability defined as a stable exchange value at around HK\$7.80 to one US dollar maintained by Currency Board arrangements. The Monetary Authority is on his own responsible for achieving the monetary policy objective, including determining the strategy, instruments and operational means for doing so. He is also responsible for maintaining the stability and integrity of the monetary system of Hong Kong.

The Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, has responsibility for policies for maintaining the stability and integrity of Hong Kong's financial system and the status of Hong Kong as an international financial centre. In support of these policies, the Monetary Authority is responsible, among other things, for

- promoting the general stability and effective working of the banking system
- promoting the development of the debt market, in co-operation with other relevant bodies
- matters relating to the issuance and circulation of legal tender notes and coins
- promoting the safety and efficiency of the financial infrastructure through the development of payment, clearing and settlement systems and, where appropriate, the operation of these systems
- seeking to promote, in co-operation with other relevant bodies, confidence in Hong Kong's monetary and financial systems, and appropriate market development initiatives to help strengthen the international competitiveness of Hong Kong's financial services.

The Exchange Fund is under the control of the Financial Secretary. The Monetary Authority, under delegation from the Financial Secretary, is responsible to the Financial Secretary for the use of the Exchange Fund, and for the investment management of the Fund.

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ACCOUNTABILITY AND TRANSPARENCY

The autonomy given to the HKMA in its day-to-day operations, and in the methods it uses to pursue policy objectives determined by the Government, is complemented by a high degree of accountability and transparency.

The HKMA serves Hong Kong by promoting monetary and banking stability, by managing the official reserves effectively, and by developing a robust and diverse financial infrastructure. These processes help to strengthen Hong Kong's role as an international financial centre and to foster Hong Kong's economic well-being. The HKMA must have the confidence of the community if it is to perform its duties well. The HKMA therefore takes seriously the duty of explaining its policies and work to the general public and makes every effort to address any concerns within the community relevant to the HKMA's responsibilities.

The HKMA is accountable to the people of Hong Kong through the Financial Secretary, who appoints the Monetary Authority, and through the laws passed by the Legislative Council that set out the Monetary Authority's powers and responsibilities. The HKMA also recognises a broader responsibility to promote a better understanding of its roles and objectives and to keep itself informed of community concerns. In its day-to-day operations and in its wider contacts with the community, the HKMA pursues a policy of transparency and accessibility. This policy has two main objectives:

- to keep the financial industry and the public as fully informed about the work of the HKMA as possible, subject to considerations of market sensitivity, commercial confidentiality and statutory restrictions on disclosure of confidential information
- to ensure that the HKMA is in touch with, and responsive to, the community it serves.

The HKMA seeks to follow international best practices in its transparency arrangements. It maintains extensive relations with the mass media

and produces a range of regular and special publications in both English and Chinese. The HKMA's bilingual website (www.hkma.gov.hk) carries all HKMA's publications, press releases, speeches and presentations, in addition to special sections on research, statistics, consumer information and other topics. The HKMA maintains an Information Centre at its offices, consisting of a library and an exhibition area, which is open to the public six days a week. The HKMA also organises an annual public education programme, which seeks to inform the public, and in particular students, about the work of the HKMA through seminars and guided tours at the Information Centre. The HKMA's weekly *Viewpoint* column, carried on the HKMA website and in about ten Hong Kong newspapers, informs the public about aspects of the HKMA's work. Further information on the HKMA's media work, publications and public education programmes is contained in the Chapter on Professional and Corporate Services on page 123.

 > [Viewpoint](#)

 > [HKMA Information Centre](#)

Over the years the HKMA has progressively increased the detail and frequency of its disclosure of information on the Exchange Fund and Currency Board Accounts. Since 1999 the HKMA has participated in the International Monetary Fund's Special Data Dissemination Standard project for central banks. The HKMA publishes records of meetings of the Exchange Fund Advisory Committee's Sub-Committee on Currency Board Operations, along with the monthly reports on Currency Board operations. The supervisory policies and guidelines on banking have been published on the website since 1996.

 > [Information Centre > Press Releases > The Exchange Fund category](#)

 > [Policy Areas > Supervisory Policy Manual](#)

The relations between the HKMA and the Legislative Council play an important part in the process of accountability and transparency. There is a formal commitment from the Chief Executive of the HKMA to appear before the Legislative Council Panel on Financial Affairs three times a year to brief Members and to answer questions on the HKMA's

work. At one of these briefings, usually in May, the HKMA's Annual Report is presented. In addition, staff from the HKMA attend Legislative Council Panel meetings to explain and discuss particular issues, and Committee meetings to assist Members in their scrutiny of draft legislation.

 > [Information Centre > Legislative Council Issues](#)

ADVISORY AND OTHER COMMITTEES

Exchange Fund Advisory Committee

In his control of the Exchange Fund, the Financial Secretary is advised by the Exchange Fund Advisory Committee (EFAC). EFAC is established under Section 3(1) of the Exchange Fund Ordinance, which requires the Financial Secretary to consult the Committee in his exercise of control of the Exchange Fund. The Financial Secretary is ex officio chairman of EFAC. Other members, including the Monetary Authority, are appointed in a personal capacity by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR. Members of EFAC are appointed for the expertise and experience that they can bring to the committee. Such expertise and experience includes knowledge of monetary, financial and economic affairs and of investment issues, as well as of accounting, management, business and legal matters.

EFAC advises the Financial Secretary on investment policies and strategies for the Fund and on projects, such as the development of financial infrastructure, that are charged to the Fund. Since the operating and staff costs of the HKMA are also chargeable to the Exchange Fund, EFAC advises the Financial Secretary on the HKMA's annual administration budget and on the terms and conditions of service of HKMA staff. EFAC meets regularly and on other occasions when particular advice is being sought.

EFAC is assisted in its work by three specialised sub-committees, which monitor specific areas of the HKMA's work and report and make recommendations to EFAC.

The Sub-Committee on Currency Board Operations monitors and reports on the Currency Board arrangements that underpin Hong Kong's Linked Exchange Rate system. It is responsible, among other things, for ensuring that Currency Board operations are in accordance with established policy, recommending improvements to the Currency Board system, and ensuring a high degree of transparency in the operation of the system. The Sub-Committee is composed of members of EFAC, a representative of the Hong Kong Association of Banks, additional members with expertise on the Currency Board system, and senior HKMA staff. Records of the Sub-Committee's meetings and the reports on Currency Board operations submitted monthly to the Sub-Committee are published.

 [Information Centre](#) > [Press Releases](#) > [Monetary Policy category](#)

The *Remuneration and Finance Sub-Committee* makes recommendations to EFAC on pay and conditions of service, human resources policy, and budgetary and administrative issues. The Sub-Committee is composed of six non-official non-banking Members of EFAC.

The *Audit Sub-Committee* reviews and reports to EFAC on the HKMA's financial reporting process and the adequacy and effectiveness of the internal control systems of the HKMA. The Sub-Committee reviews the HKMA's financial statements, and the composition and accounting principles adopted in such statements. It also examines and reviews with both the external and internal auditors the scope and results of their audits. The Sub-Committee consists of four non-executive, non-official members of EFAC. It held three meetings in 2003.

The Banking Advisory Committee

The Banking Advisory Committee is established under Section 4(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong SAR on matters relating to the Banking Ordinance, in particular matters relating to banks and the carrying on of banking business. The Committee consists of the Financial Secretary, who is the

chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR.

The Deposit-Taking Companies Advisory Committee

The Deposit-Taking Companies Advisory Committee is established under Section 5(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong SAR on matters relating to the Banking Ordinance, in particular matters relating to deposit-taking companies and restricted licence banks and the carrying on of a business of taking deposits by them. The Committee consists of the Financial Secretary, who is the chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong SAR.

Chief Executive's Committee

The Chief Executive's Committee is chaired by the Chief Executive of the HKMA and consists of the Deputy Chief Executives and the Executive Directors of the HKMA. The Committee meets weekly to report to the Chief Executive on the progress of major tasks being undertaken by the various departments of the HKMA and to advise him on policy matters relating to the operations of the HKMA.

The membership lists of the various Committees and Sub-Committees are given on pages 14 to 22. Brief biographies and the Code of Conduct for EFAC Members can be found on the HKMA website. A Register of Members' Interests, which contains the declarations of interests by Members of EFAC, is available for public inspection during office hours (9:00 a.m. to 5:00 p.m. Monday to Friday and 9.00 a.m. to 12 noon Saturday) at the HKMA, 55th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong.

 [About the HKMA](#) > [Advisory Committees](#)

ADVISORY COMMITTEES



Mr Patrick Wang

Mr Victor Lo

Professor Richard Wong

Mr Mervyn Davies

Mr Marvin Cheung

Mr Joseph Yam

THE EXCHANGE FUND ADVISORY COMMITTEE

Chairman

The Hon. Henry Tang Ying Yen, GBS, JP

The Financial Secretary
(from 4 August 2003)

The Hon. Antony Leung, GBS, JP

The Financial Secretary
(until 16 July 2003)

Members

Mr Joseph Yam, GBS, JP

The Monetary Authority

Dr The Hon. David Li Kwok Po, LLD, GBS, JP

Chairman and Chief Executive
The Bank of East Asia Limited

Mr Marvin Cheung Kin Tung, DBA Hon., SBS, JP

Mr David Eldon, JP

Chairman
The Hongkong and Shanghai Banking Corporation Limited





Mr Henry Tang

Dr David Li

Mr David Eldon

Dr James Kung

Mr Christopher Cheng

Mr Robert Tang

Mr He Guangbei

Mr E Mervyn Davies

Group Chief Executive
Standard Chartered PLC

Dr James Z M Kung, GBS

Chairman
Chekiang First Bank Limited

Professor Richard Y C Wong, SBS, JP

Dean, Faculty of Business and Economics
The University of Hong Kong

Mr Christopher Cheng Wai Chee, JP

Chairman
USI Holdings Limited

Mr Victor Lo Chung Wing, GBS, JP

Chairman and Chief Executive
Gold Peak Industries (Holdings) Limited

Mr Robert C Tang, SC, JP

Barrister-at-Law

Mr Patrick Wang Shui Chung, JP

Chairman and Chief Executive Officer
Johnson Electric Holdings Limited

Mr He Guangbei

Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
(from 26 June 2003)

Dr Liu Jinbao

Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
(until 28 May 2003)

Secretary

Mr Christopher Munn

THE EXCHANGE FUND ADVISORY COMMITTEE SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS

Chairman

Mr Joseph Yam, GBS, JP
The Monetary Authority

Members

Mr Norman Chan, SBS, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr William Ryback
Deputy Chief Executive
Hong Kong Monetary Authority
(from 27 August 2003)

Mr David Carse, SBS, JP
Deputy Chief Executive
Hong Kong Monetary Authority
(until 30 September 2003)

Dr The Hon. David Li Kwok Po, LLD, GBS, JP
Chairman and Chief Executive
The Bank of East Asia Limited

Mr Marvin Cheung Kin Tung, DBA Hon., SBS, JP

Professor Richard Y C Wong, SBS, JP
Dean, Faculty of Business and Economics
The University of Hong Kong

Mr John Greenwood
Group Chief Economist
INVESCO Asset Management Limited

Professor Tsang Shu Ki
Department of Economics
Hong Kong Baptist University

Mr Raymond C F Or
Chairman
The Hong Kong Association of Banks

Secretary

Mr Christopher Munn

THE EXCHANGE FUND ADVISORY COMMITTEE REMUNERATION AND FINANCE SUB-COMMITTEE

Chairman

Mr Marvin Cheung Kin Tung, DBA Hon., SBS, JP

Members

Professor Richard Y C Wong, SBS, JP
Dean, Faculty of Business and Economics
The University of Hong Kong

Mr Christopher Cheng Wai Chee, JP
Chairman
USI Holdings Limited

Mr Victor Lo Chung Wing, GBS, JP
Chairman and Chief Executive
Gold Peak Industries (Holdings) Limited

Mr Robert C Tang, SC, JP
Barrister-at-Law

Mr Patrick Wang Shui Chung, JP
Chairman and Chief Executive Officer
Johnson Electric Holdings Limited

Secretary

Mr Christopher Munn

THE EXCHANGE FUND ADVISORY COMMITTEE AUDIT SUB-COMMITTEE

Chairman

Mr Marvin Cheung Kin Tung, DBA Hon., SBS, JP

Members

Mr David Eldon, JP
Chairman
The Hongkong and Shanghai Banking Corporation Limited

Mr E Mervyn Davies
Group Chief Executive
Standard Chartered PLC

Mr He Guangbei
Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
(from 26 June 2003)

Dr Liu Jinbao
Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
(until 28 May 2003)

Secretary

Mr Christopher Munn

THE BANKING ADVISORY COMMITTEE

Chairman

The Hon. Henry Tang Ying Yen, GBS, JP

The Financial Secretary
(from 4 August 2003)

The Hon. Antony Leung, GBS, JP

The Financial Secretary
(until 16 July 2003)

Ex Officio Member

Mr Joseph Yam, GBS, JP

The Monetary Authority

Members

The Hon. Frederick Ma Si Hang, JP

Secretary for Financial Services and the Treasury

Mr He Guangbei

Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
Representing Bank of China (Hong Kong) Limited
(from 29 May 2003)

Mr Raymond C F Or

General Manager
The Hongkong and Shanghai Banking Corporation Limited
Representing The Hongkong and Shanghai Banking Corporation Limited

Mr Peter T S Wong, JP

Director
Standard Chartered Bank
Representing Standard Chartered Bank

Mr Didier Balme

Head of North & East Asia
BNP Paribas

Mrs Chan Hui Dor Lam Doreen

President & Chief Executive Officer
Citic Ka Wah Bank Limited

Mrs Angelina P L Lee, JP

Partner
Woo, Kwan, Lee & Lo
Solicitors and Notaries

Dr The Hon. David Li Kwok Po, LLD, GBS, JP

Chairman and Chief Executive
The Bank of East Asia Limited

Mr Tatsuo Tanaka

Director and Chief Executive Officer for China
The Bank of Tokyo-Mitsubishi, Ltd.
(from 8 July 2003)

Mr Samuel N Tsien

President and Chief Executive Officer
Bank of America (Asia) Limited

Mr David S Y Wong, JP

Chairman
Dah Sing Bank Limited

Ms Maria Xuereb

Financial Services Partner
Deloitte Touche Tohmatsu

Mr Tomonori Kobayashi

Executive Officer and General Manager
Hong Kong Branch
Mizuho Corporate Bank, Ltd
(until 1 April 2003)

Dr Liu Jinbao

Vice Chairman & Chief Executive
Bank of China (Hong Kong) Limited
Representing Bank of China (Hong Kong) Limited
(until 28 May 2003)

Secretary

Ms Carman Chiu

THE DEPOSIT-TAKING COMPANIES ADVISORY COMMITTEE

Chairman

The Hon. Henry Tang Ying Yen, GBS, JP

The Financial Secretary
(from 4 August 2003)

The Hon. Antony Leung, GBS, JP

The Financial Secretary
(until 16 July 2003)

Ex Officio Member

Mr Joseph Yam, GBS, JP

The Monetary Authority

Members

The Hon. Frederick Ma Si Hang, JP

Secretary for Financial Services and the Treasury

Mr Andrew Sheng, SBS, JP

Chairman
Securities and Futures Commission
Representing The Securities and Futures Commission

Mrs Pamela Chan Wong Shui, BBS, JP

Chief Executive
Consumer Council
Representing The Consumer Council
(from 1 June 2003)

Mr Clifford Forster

Chairman
Hong Kong Association of Restricted Licence Banks and
Deposit-Taking Companies (The DTC Association)
Representing The DTC Association

Mr Mohan Kohli

Partner
Financial Services Division
PricewaterhouseCoopers

Mr Andrew Kuo

Managing Director
J.P. Morgan Securities (Asia Pacific) Limited
(from 1 June 2003)

The Hon. Eric K C Li, GBS, JP

Senior Partner
Li, Tang, Chen & Co
Certified Public Accountants

Mr Geoffrey J. Mansfield

Director and Chief Executive
PrimeCredit Limited
(from 1 June 2003)

Mr Mok Wai-kin

Director
Hang Seng Finance Limited

Mr Poon Kwok Yuen

President & Chief Executive Officer
AIG Finance (Hong Kong) Limited
(from 9 December 2003)

Mr Tan Yoke Kong

General Manager
JCG Finance Company, Limited

Mr Frank J. Wang

Deputy Chief Executive
Wing Hang Finance Company Limited
(from 1 June 2003)

Mr Jackson Cheung

Chief Executive
Société Générale Asia Limited
(until 31 May 2003)

Mr Randolph Sullivan

Managing Director
Dao Heng Finance Limited
(until 31 May 2003)

Mr Kotaro Takamori

Managing Director
ORIX Asia Limited
(until 1 September 2003)

Secretary

Ms Carman Chiu

CHIEF EXECUTIVE'S COMMITTEE



CHIEF EXECUTIVE

Joseph Yam, GBS, JP

Joseph Yam has served as Chief Executive of the HKMA since its establishment in April 1993. Mr Yam began his civil service career in Hong Kong as a Statistician in 1971, and became an Economist in 1976. His involvement in monetary affairs in Hong Kong started when he was appointed as Principal Assistant Secretary for Monetary Affairs in 1982. He helped put together Hong Kong's Linked Exchange Rate system in 1983. He was subsequently appointed Deputy Secretary for Monetary Affairs in 1985 and Director of the Office of the Exchange Fund in 1991.



DEPUTY CHIEF EXECUTIVE

Norman Chan, SBS, JP

Norman Chan has responsibility for monetary management, financial infrastructure, research, reserves management and international finance. He has been with the HKMA since its establishment in 1993. Mr Chan joined the Hong Kong Government as an Administrative Officer in 1976. In 1991 he was appointed Deputy Director (Monetary Management) of the Office of the Exchange Fund. He became an Executive Director of the HKMA when it was established in 1993 and was made a Deputy Chief Executive in 1996.



DEPUTY CHIEF EXECUTIVE

William Ryback

William Ryback is in charge of the full range of banking policy, development and supervision issues. Prior to joining the HKMA in August 2003, Mr Ryback was Senior Associate Director of the Division of Bank Supervision at the Board of Governors of the Federal Reserve System in Washington, D.C. He was also Chairman of the Board of Directors of the Association of Bank Supervisors of the Americas. He was the Board of Governors representative on the Basel Committee on Banking Supervision from 1986 to 1994.



DEPUTY CHIEF EXECUTIVE

David Carse, SBS, JP

David Carse joined the HKMA in 1993 as Deputy Chief Executive with responsibilities for banking policy, development and supervision issues. He left the HKMA in September 2003.



GENERAL COUNSEL

Stefan Gannon, JP

Stefan Gannon has been General Counsel of the HKMA since its establishment in 1993. A barrister, Mr Gannon was the Legal Adviser to the Monetary Affairs Branch of the Hong Kong Government from 1987 to 1993.



EXECUTIVE DIRECTOR (MONETARY MANAGEMENT AND INFRASTRUCTURE)

James H Lau Jr, JP

James Lau is responsible for monetary management and market infrastructure. He was appointed Head (Monetary Policy) on the establishment of the HKMA in 1993 and became Executive Director (External) in 1994. Mr Lau joined the Hong Kong Government as an Administrative Officer in 1979. He was Hong Kong's Deputy Permanent Representative to the GATT in Geneva from 1986 to 1990 before joining the Office of the Exchange Fund as Assistant Director (Monetary Management) in 1991.



EXECUTIVE DIRECTOR (BANKING SUPERVISION)

Y K Choi, JP

Y K Choi is responsible for banking supervision. He has been with the HKMA since 1993. Mr Choi joined the Office of the Commissioner of Banking in 1974 and became Assistant Commissioner of Banking in 1990 after a one-year secondment to the Bank of England. In 1990 he was seconded to the Office of the Exchange Fund for three years and was appointed Head (Banking Policy) at the HKMA in 1993. He became the HKMA's Head (Administration) in 1994 and was appointed to his present position in 1995.



EXECUTIVE DIRECTOR (BANKING DEVELOPMENT)

Raymond Li, JP

Raymond Li is responsible for banking reform and development issues as well as licensing and specialised supervision such as e-banking. Mr Li joined the Hong Kong Government as an Administrative Officer in 1982 and became Principal Assistant Secretary (Monetary Affairs) in 1990. He was appointed Head (Banking Development) at the HKMA in 1993 and took up the post of Head (Administration) in 1995. He was promoted to Executive Director (Banking Policy) in 1996 and appointed Executive Director (Corporate Services) in September 2000. Mr Li was appointed to his present position in June 2001.



EXECUTIVE DIRECTOR (RESERVES MANAGEMENT)

Amy Yip, BBS, JP

Amy Yip is responsible for the investment management of the Exchange Fund. Prior to joining the HKMA in 1996, Ms Yip worked at JP Morgan, Rothschild Asset Management and Citibank.



EXECUTIVE DIRECTOR (EXTERNAL)

Julia Leung, JP

Julia Leung is responsible for international affairs relating to multilateral agencies and central bank co-operation, the HKMA overseas offices, and China research and relations. Ms Leung joined the HKMA in 1994 as Senior Manager in charge of press and publications matters. She was promoted to Division Head in 1996, and appointed to her present position in April 2000.



**EXECUTIVE DIRECTOR
(BANKING POLICY)**

Simon Topping, JP

Simon Topping is responsible for the development of banking supervisory policies. He joined the HKMA in 1995 as a Division Head in the Banking Supervision Department and was appointed to his present position in September 2000. Prior to joining the HKMA he worked for the Bank of England and the International Monetary Fund.



**EXECUTIVE DIRECTOR
(RESEARCH)**

Stefan Gerlach

Stefan Gerlach is in charge of research matters. He is also Director of the Hong Kong Institute for Monetary Research. Dr Gerlach joined the HKMA in 2001. He has extensive experience in the research and policy fields. Prior to joining the HKMA, he worked in the Bank for International Settlements since 1992, where he was the Head of Monetary Policy and Exchange Rates, Research and Policy Analysis Group of the Monetary and Economic Department.



**EXECUTIVE DIRECTOR
(CORPORATE SERVICES)**

Eddie Yue, JP

Eddie Yue is responsible for matters relating to corporate development, human resources, administration, finance and information technology. Mr Yue began his career as an Administrative Officer in the Hong Kong Government in 1986. He joined the HKMA in 1993 as a Senior Manager, and was subsequently promoted to Division Head in 1994. He has worked in a number of divisions, including Monetary Management, External Relations, and Banking Development, and has served as Administrative Assistant to the Chief Executive of the HKMA. Mr Yue was appointed to his present position in June 2001.



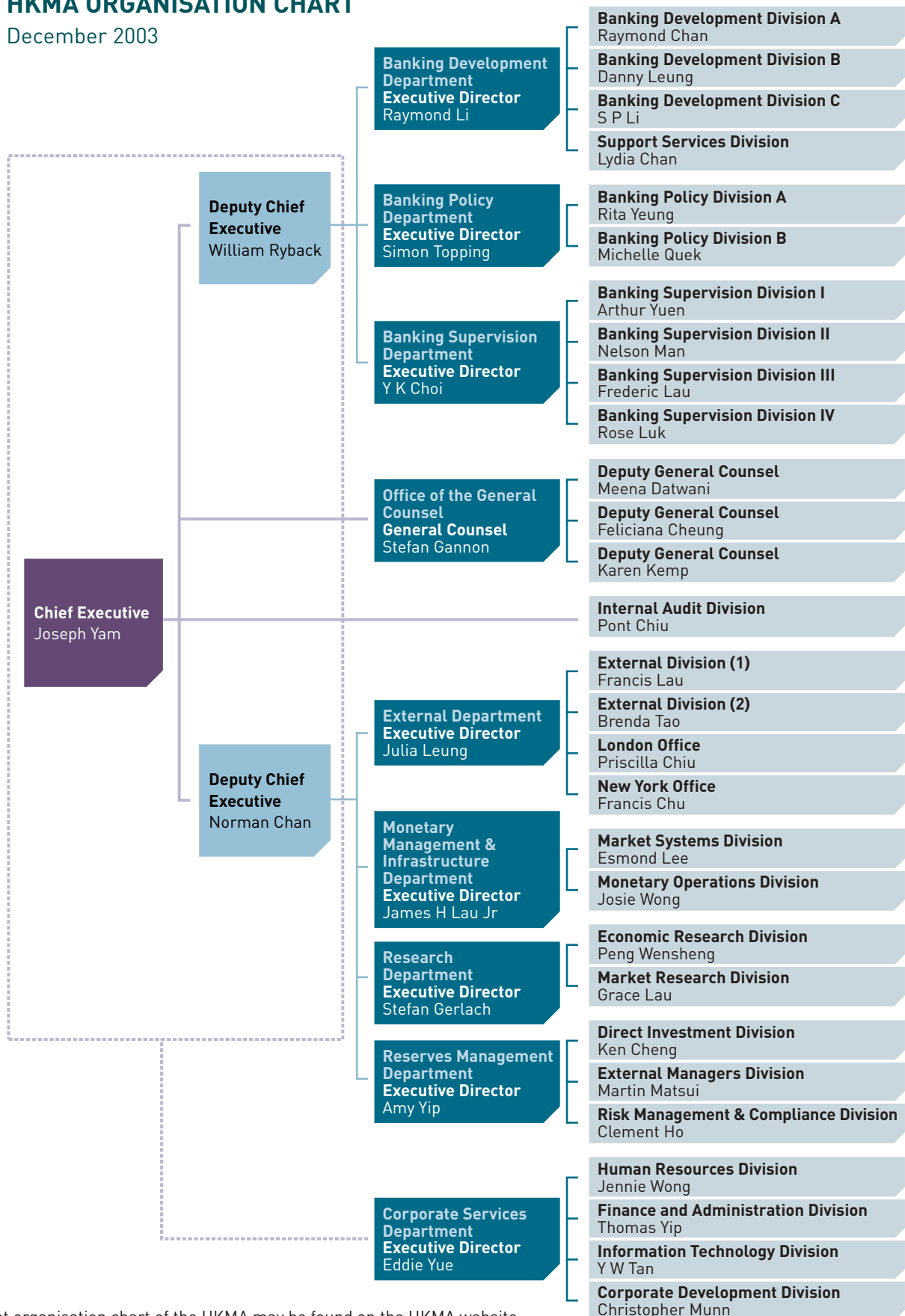
**CHIEF EXECUTIVE OFFICER
(HONG KONG MORTGAGE
CORPORATION)**

Peter Pang, JP

Peter Pang has been the Chief Executive Officer of the Hong Kong Mortgage Corporation since December 1997. Mr Pang joined the HKMA as Executive Director (Banking Policy) in 1994 and was appointed as Executive Director (Monetary Policy and Markets) in 1996. He started his civil service career as an Administrative Officer in 1979 and served as Assistant Director General of Trade and Assistant Commissioner of Banking before joining the HKMA.

HKMA ORGANISATION CHART

December 2003



The current organisation chart of the HKMA may be found on the HKMA website.

[About the HKMA](#) > [The HKMA](#) > [Organisation Chart](#)

THE HKMA : THE FIRST 10 YEARS

The Hong Kong Monetary Authority marked its 10th anniversary on 1 April 2003. The decade between 1993 and 2003 was a period of political transition, culminating in Hong Kong's establishment as a Special Administrative Region of the People's Republic of China on 1 July 1997. This was also a decade of economic change and stress. Hong Kong's economy became more closely integrated with that of the Mainland of China. Following the Asian financial crisis in 1997, Hong Kong experienced a period of prolonged economic difficulty.

The HKMA was formed with the aim of placing under one authority the official responsibilities for maintaining monetary and financial stability and for developing an efficient and robust financial infrastructure. The decision to establish the HKMA in 1993 took into account the growing importance of Hong Kong as an international financial centre, the need to ensure monetary stability during a period of political and economic transition, and the increasing risks posed by the globalisation of finance.

THE HKMA'S POLICY OBJECTIVES

- to maintain currency stability, within the framework of the Linked Exchange Rate system, through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary
- to promote the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorized institutions
- to enhance the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

Hong Kong's economy developed between 1993 and 2003. Over the decade

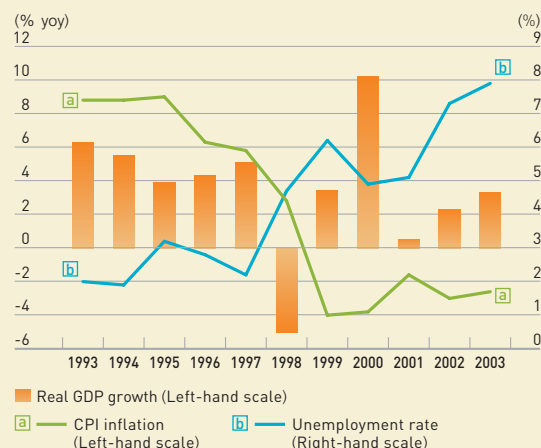
- real gross domestic product grew by an average rate of 3.3% per year, while nominal gross domestic product increased from US\$118 billion to US\$159 billion
- per capita gross national product rose from HK\$157,000 to HK\$187,000
- the workforce expanded from 2.9 million to 3.5 million
- real private consumption increased by one-fifth, recording an average annual increase of 1.9%
- real exports of goods and services almost doubled, increasing by an average of 6.6% a year
- broad money, in terms of Hong Kong dollar M3, grew by an average of 8.5% a year, from HK\$939 billion to HK\$2,123 billion
- the share of the value-added of the service sector in gross domestic product rose from 81% to 88% between 1993 and 2002.

These positive figures must, however, be set against indicators that reflect the difficulties of the second half of the decade:

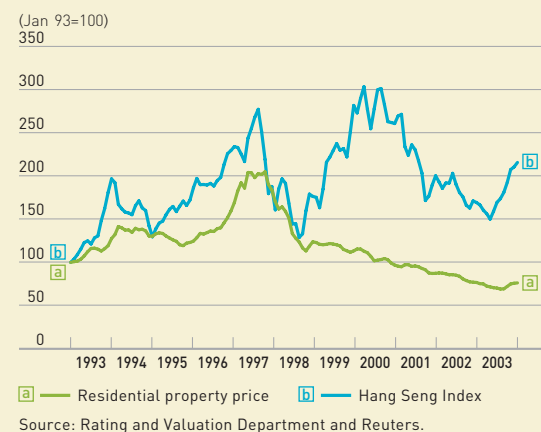
- the unemployment rate rose from 2.4% in January 1998 to 7.3% in December 2003
- the Composite Consumer Price Index declined by about 16% from its peak in May 1998
- residential property prices declined by about two-thirds from their peak in October 1997.

The charts on this page illustrate the stresses and volatilities during these years.

ECONOMIC DEVELOPMENT



ASSET PRICES



Economic distress and financial crisis placed strains and burdens on the whole community of Hong Kong. Extreme conditions and speculative attacks presented challenges that tested the HKMA's ability to achieve its aims and which, in retrospect, amply justified the decision to establish the HKMA in 1993.

During its first decade the HKMA fully delivered on its policy objectives and was able to promote development in the financial sector and in Hong Kong's financial infrastructure. In the process, the HKMA became more transparent in the information it makes available to the markets and in its accountability to the community.

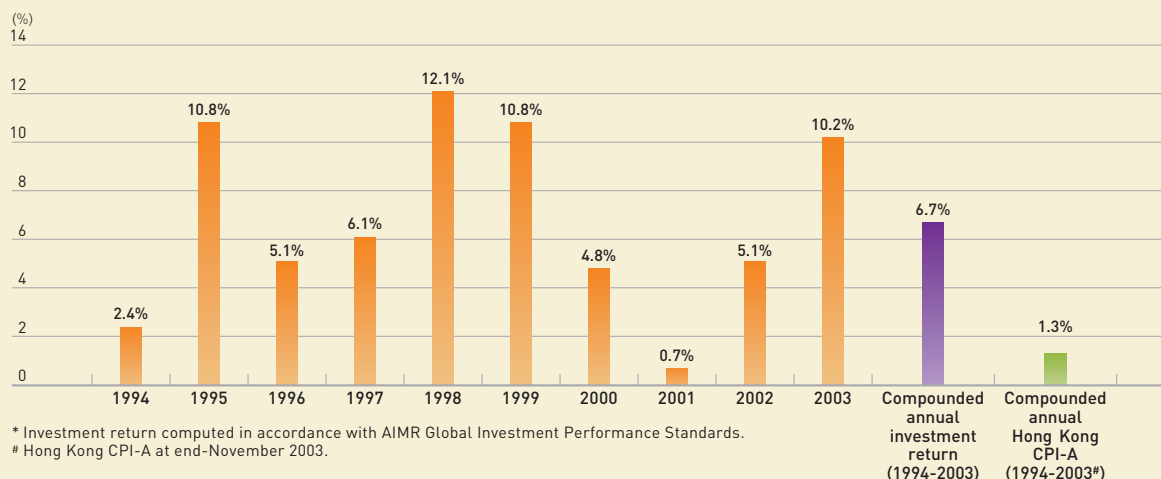
Currency stability

- the market exchange rate of the Hong Kong dollar stayed close to the official Linked Exchange Rate of HK\$7.80 to one US dollar throughout the decade
- following the Asian financial crisis a series of reforms and refinements were made to the Currency Board system to ensure smooth functioning in periods of stress.

Exchange Fund

- between January 1994 and December 2003 the Exchange Fund achieved an annual compounded rate of return of 6.7%, which was consistently higher than the investment benchmark and the Consumer Price Index
- the Accumulated Surplus of the Exchange Fund increased from about HK\$127.5 billion at the end of 1993 to over HK\$380 billion at the end of 2003.

INVESTMENT RETURN* OF THE EXCHANGE FUND



Banking stability

- the total assets of the banking sector grew by 7.3% between 1993 and 2003
- the total capital adequacy ratio of Hong Kong's banking sector remained above 15% throughout the decade
- the supervisory framework for the banking sector was brought into line with international standards, and reforms were made to increase competitiveness while maintaining safety and stability.

Financial infrastructure

- real time gross settlement was introduced for the Hong Kong dollar in 1996, for the US dollar in 2000 and for the euro in 2003
- Exchange Fund paper was further developed to facilitate liquidity management and the growth of the debt market

- linkages for clearing and settling securities were established with five jurisdictions outside of Hong Kong
- Hong Kong dollar and US dollar clearing and settlement arrangements were extended to Guangdong Province.

International financial centre

- the HKMA became a member of the Bank for International Settlements in 1996
- Hong Kong hosted the World Bank/IMF Annual Meetings in 1997
- Hong Kong played a prominent role in regional and international initiatives for promoting financial stability and developing the regional and domestic bond markets
- approval was given in 2003 for banks in Hong Kong to conduct personal renminbi business.

MAJOR EVENTS 1993–2003

1993

April 1993

The Hong Kong Monetary Authority is established with responsibility for monetary and banking stability, reserves management, and financial infrastructure.



May 1993

The Government starts to replace the Queen's Head coins with the new bauhinia design.

July 1993

The Government announces the sale of Overseas Trust Bank for HK\$4,457 million. The sale of the bank, taken over in June 1985, marks the end of the Government's efforts to rescue banks in the 1980s.



July 1993

Hong Kong becomes the first city in the world to have a completely digital telephone network.



November 1994

Hong Kong issues its first bimetallic coin – the bauhinia \$10 coin.

1994

May 1994

The Bank of China issues its first Hong Kong banknotes.



June 1994

The Government announces a package of measures to dampen property speculation.

August 1994

The Hang Seng China Enterprises Index is launched to serve as an indicator of the overall performance of Hong Kong-listed, state owned enterprises of the People's Republic of China.

September 1994

The first issue of five-year Exchange Fund Notes is launched. The issue helps extend the benchmark yield curve for Hong Kong dollar debt to the five year area.

October 1994

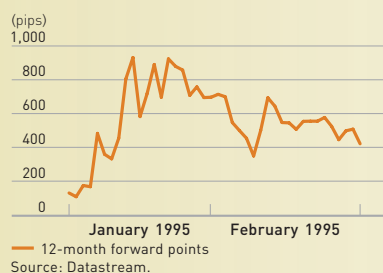
The interest rate cap on time deposits is lifted in phases. This marks the beginning of a relaxation of Interest Rate Rules in Hong Kong.

1995

January 1995

In the aftermath of the Mexican peso crisis, the Hong Kong dollar comes under selling pressure along with other Asian currencies.

Hong Kong dollar forward exchange rate



May 1995

Hong Kong Interbank Clearing Limited is established to provide interbank clearing functions in Hong Kong.



HONG KONG INTERBANK CLEARING LIMITED
香港銀行同業結算有限公司

June 1995

The HKMA becomes the licensing authority of three types of authorized institutions, following the enactment of the Banking (Amendment) Ordinance 1995.

July 1995

The Companies Ordinance is amended so that depositors are entitled to receive priority payment in the liquidation of banks.

November 1995

The Government decides to publish the size of Hong Kong's foreign exchange reserves (i.e. foreign currency assets of the Exchange Fund) every quarter instead of every six months.

November 1995

The first issue of seven-year Exchange Fund Notes is launched.

1997 – 1998

Financial crisis in several Asian countries including South Korea, Indonesia and Thailand.

1996

January 1996

The Exchange Fund acquires the De La Rue banknote printing plant in Tai Po, which is renamed "Hong Kong Note Printing Limited".



September 1996

The HKMA is invited to join the Bank for International Settlements, the Swiss-based forum promoting co-operation among central banks.

October 1996

The first issue of ten-year Exchange Fund Notes is launched.

December 1996

Real Time Gross Settlement is launched in Hong Kong, enabling interbank payments to be settled real time.

1997

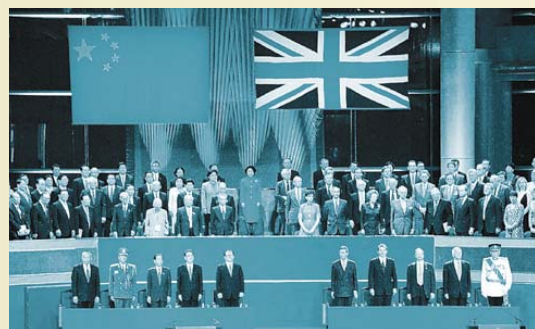
March 1997



The Hong Kong Mortgage Corporation is established. It will buy mortgage loans for its own portfolio and issue mortgage-backed securities.

July 1997

Hong Kong becomes a Special Administrative Region of the People's Republic of China.



July 1997

The assets of the Land Fund are handed over to Hong Kong SAR Government with a net value of HK\$197 billion. From July 1997 to October 1998 these assets are managed by the HKMA as a separate fund within the fiscal reserves. On 1 November 1998 the assets of the Land Fund are merged with the Exchange Fund and managed as part of the investment portfolio of the Exchange Fund.

September 1997

World Bank/IMF Annual Meetings are held in Hong Kong. Central bank and finance ministry officials from some 180 countries attend the meetings.



July 1997

The *Code of Banking Practice* is issued to improve the transparency and quality of banking services in Hong Kong.



September 1997

The Octopus card appears in Hong Kong. This contact-free stored value card is used for transport fares and retail purchases. By 2003, there are around nine million Octopus cards in circulation in Hong Kong (or 1.3 for every resident) and over seven million daily Octopus transactions.



1997 – 2003

Economic Downturn in Hong Kong. After the Asian financial crisis Hong Kong experiences a period of prolonged economic difficulty, relieved only by a brief recovery in 2000. A series of external shocks, coupled with sharp declines in asset prices, result in high unemployment, deflation and fiscal deficits.

1998

July 1998

Hong Kong International Airport opens at Chek Lap Kok.



July 1998

The Bank for International Settlements opens its representative office for Asia and the Pacific in Hong Kong.

August 1998

Using HK\$118 billion out of the Exchange Fund, the Hong Kong SAR Government launches a stock market operation to frustrate manipulation of the money and stock markets.

September 1998

The HKMA introduces seven technical measures to strengthen the Currency Board arrangements.



October 1998

Exchange Fund Investment Limited is established to manage the portfolio of Hang Seng Index constituent stocks acquired by the Exchange Fund in the market operation of August.

1999

January 1999

The foreign currency assets and the balance sheet data of the Exchange Fund are published monthly, in line with the standard set by the International Monetary Fund.

August 1999

Exchange Fund Notes commence listing on the Hong Kong Stock Exchange.

August 1999

The Hong Kong Institute for Monetary Research is established.

November 1999

The Tracker Fund of Hong Kong is established as a vehicle for gradually disposing of the majority of the stocks acquired by the Exchange Fund in the 1998 market operation.



2000

August 2000

Hong Kong processes its first transaction through the new US dollar clearing system.

October 2000

Hong Kong is selected as President for 2001-2002 of the Financial Action Task Force on Money Laundering, an international body.

December 2000

Hong Kong's Mandatory Provident Fund System comes into full operation after years of preparation.



2001

January 2001

The International Monetary Fund opens a sub-office in Hong Kong.

April 2001

The Government approves in principle the proposal to introduce a deposit protection scheme in Hong Kong.

July 2001

Interest Rate Rules are completely deregulated. Banks are free to set interest rates for all types of deposits.

November 2001

All restrictions on the number of branches of foreign banks are lifted.

December 2001

China enters the World Trade Organisation.

2002

March 2002

The Securities and Futures Ordinance is passed by the Legislative Council. The Ordinance consolidates and modernises 10 existing ordinances into a single piece of legislation to govern financial and investment products, regulate the securities and futures markets, and protect investors.

May 2002

The Government endorses the HKMA's proposals to relax certain market entry criteria for the banking sector.

September 2002

The Government issues new \$10 currency notes.



2003

March to June 2003

Outbreak of Severe Acute Respiratory Syndrome (SARS). 1,755 people in Hong Kong are infected and 299 people die.

June 2003

Exchange of letters between the Financial Secretary and the Monetary Authority on functions and responsibilities in monetary and financial affairs.

November 2003

The HKMA moves its offices to permanent premises at Two International Finance Centre.

November 2003

Following approval from the State Council, the People's Bank of China agrees to provide clearing arrangements for banks in Hong Kong to conduct personal renminbi business on a trial basis. The scope of the business to be conducted includes deposit-taking, exchange, remittances and debit and credit cards.

December 2003

The three note-issuing banks issue new \$100 and \$500 notes with additional security features.



April 2003

Hong Kong processes its first transaction through its new euro clearing system.

June 2003

The Mainland and Hong Kong sign the Closer Economic Partnership Arrangement (CEPA).





More than 2,000 swimmers brave chilly waters to take part in the 27th International New Year Winter Swimming Championships held on the south side of Hong Kong Island to welcome the New Year in 2003.

ECONOMIC AND BANKING ENVIRONMENT

After the severe disruption by the outbreak of SARS (severe acute respiratory syndrome) in the second quarter of 2003, Hong Kong's economy rebounded sharply in the second half of the year. The overall asset quality of the banking sector improved. With improved economic conditions in the second half, the banking sector ended the year with a modest growth in profitability.

THE ECONOMY IN REVIEW

Overview

Hong Kong experienced very difficult economic conditions in the first half of 2003 reflecting, in particular, the effects of the outbreak of SARS in the second quarter. Growth returned in the second half of the year and Hong Kong emerged as a strong-performing economy in the region. Real GDP rose by 3.3% in 2003, compared with 2.3% in 2002. Exports of goods and trade-related services were largely unaffected by the SARS outbreak. Exports of tourism-related services showed a sharp turnaround in the second half of 2003, boosted by a relaxation of travel restrictions on

Mainland visitors to Hong Kong. Private consumption also picked up markedly as consumer confidence recovered. Investment spending on machinery, equipment and computers started to recover in the second half, but spending on building and construction remained weak (Table 1).

Monetary conditions eased further during the year, with declines in both Hong Kong dollar interest rates and the real effective exchange rate. Broad money growth picked up moderately alongside the recovery in economic activity. Narrow money growth was strong, owing to low interest rates and an increase in transaction demand resulting, in part, from robust stock market activity.

TABLE 1 Contributions to GDP growth by components (%)

	2002 ¹					2003 ²				
	Q1	Q2	Q3	Q4	Overall	Q1	Q2	Q3	Q4	Overall
Private Consumption Expenditure	0.0	-1.5	-0.5	-0.7	-0.7	-1.1	-2.1	0.9	2.0	0.0
Government Consumption Expenditure	0.2	0.3	0.3	0.1	0.2	0.1	0.0	0.1	0.5	0.2
Gross Domestic Fixed Capital Formation	-3.4	0.0	-1.2	-0.2	-1.2	0.9	-1.5	-0.1	0.6	0.0
Change in Inventories	-1.2	-0.1	1.3	2.3	0.6	1.8	0.1	-1.0	1.0	0.5
Net Exports of Goods	2.2	-0.5	0.3	-0.5	0.3	-1.0	3.3	2.1	-1.9	0.6
Net Exports of Services	1.6	2.8	3.3	4.2	3.0	3.9	-0.3	2.1	2.8	2.1
GDP	-0.6	0.8	3.4	5.1	2.3	4.5	-0.5	4.0	5.0	3.3

¹ Revised figures

² Preliminary figures

Reviving domestic demand

Private consumption was weak in the early part of 2003 but recovered strongly in the second half of the year. Consumer confidence rose, as a result of improvements in the global economy and a decline in unemployment and more stable asset markets at home. One important source of optimism was the policy initiatives designed to facilitate closer economic integration between Hong Kong and the Mainland. These include the Closer Economic Partnership Arrangement (CEPA), the relaxation of travel restrictions on Mainland visitors to Hong Kong, and approval for Hong Kong banks to undertake personal renminbi banking business on a trial basis. Spending on durable goods and services registered particularly strong growth in the second half. For the year as a whole, private consumption expenditure was little changed in 2003, after a decline of 1.2% in 2002 (Chart 1).

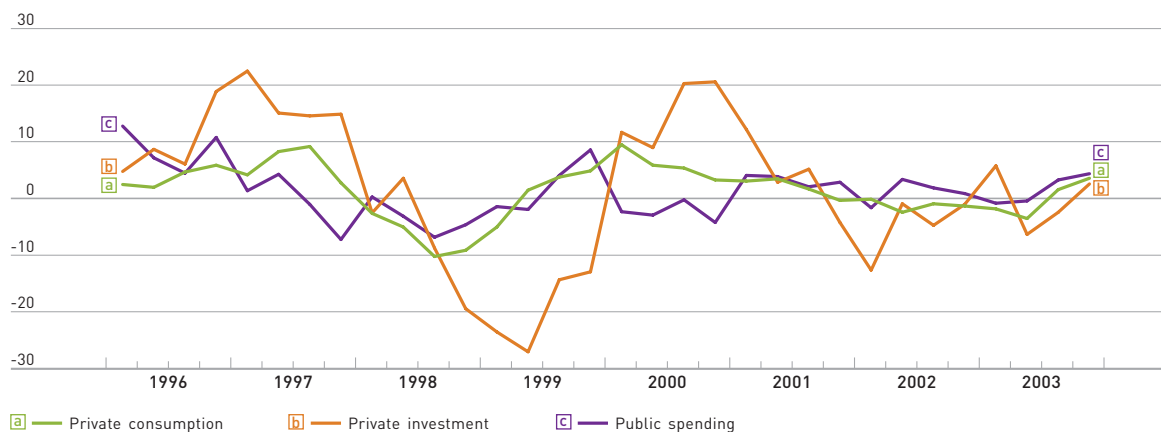
Despite the improvement in the economy in the second half of 2003, investment remained weak. Private investment continued to decline, by 0.3%,

largely owing to lower expenditure on building and construction, although at a more moderate rate than in the preceding year. Investment in machinery, equipment and computer software by the private sector recorded a rise of 6.9%. Public investment rose slightly as a number of new infrastructure projects came on stream in the second half of the year (Chart 1).

Buoyant external trade

Exports of goods recorded double-digit growth rates throughout the year, supported by robust growth of Mainland exports, and improved competitiveness as a result of the depreciation of the US dollar (to which the Hong Kong dollar is linked). The rush by Chinese exporters to ship products ahead of the pre-announced reduction in VAT rebates, due to be implemented on the Mainland in January 2004, also contributed to particularly strong growth of merchandise exports in the fourth quarter of the year. Among the major markets, exports to East Asia and to the European Union grew strongly, while export performance to

CHART 1 Domestic demand (percentage change over a year ago in real terms)



the United States was somewhat weak (Table 2). Along with a buoyant re-export trade, imports of goods rose by 13.1% in 2003 compared with 2002. The merchandise trade deficit widened to \$45.0 billion in 2003, from \$39.4 billion in 2002 (Chart 2), reflecting faster growth of goods exports relative to imports.

Trade-related exports of services also grew strongly, partly owing to vibrant merchandise exports. By contrast, tourism-related earnings,

affected by the SARS outbreak, fell sharply in the second quarter. Earnings bounced back very sharply in the second half of the year helped by the relaxation of travel restrictions on Mainland visitors, making the tourism industry an important driver of growth in the economy. The recovery in imports of services was more modest. The overall trade surplus, goods and services combined, amounted to \$116.1 billion, or 9.4% of GDP.

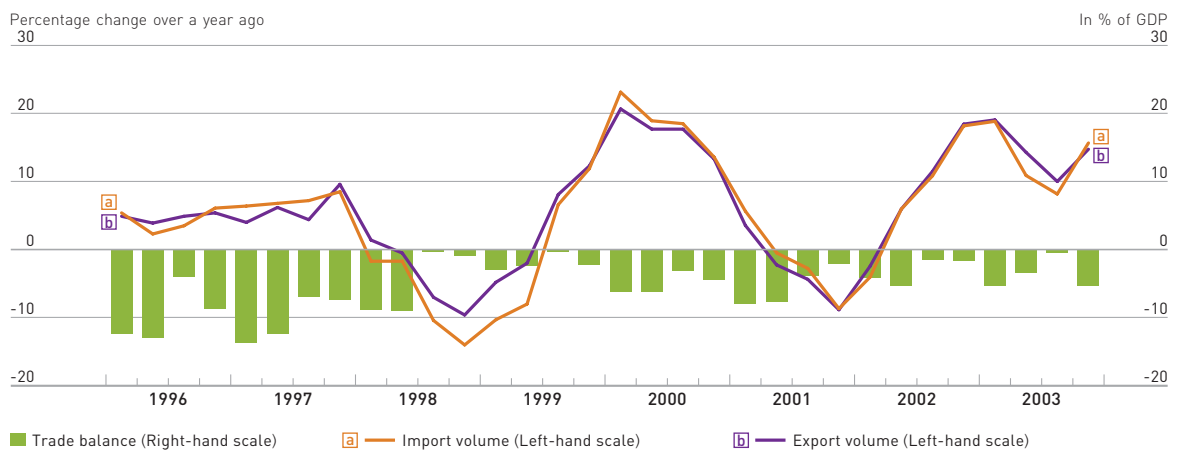
TABLE 2 Exports to major trading partners¹

	Share %	2002					2003				
		Q1	Q2	Q3	Q4	Overall	Q1	Q2	Q3	Q4	Overall
Mainland China	43	3	8	13	25	12	27	21	16	21	21
United States	19	-15	1	6	9	1	7	-5	-7	-3	-3
European Union	13	-15	-7	1	7	-3	16	17	8	8	12
Japan	5	-14	-10	-2	7	-4	14	17	11	9	12
ASEAN5 ² + Korea	7	4	10	20	22	14	9	11	7	10	9
Taiwan	2	-10	-7	11	-2	-2	25	17	15	32	22
Others	10	-7	3	6	13	4	10	6	-2	6	5
Total	100	-6	3	8	16	5	18	12	7	11	12

¹ Figures are percentage changes over a year ago except for major export markets' shares in Hong Kong's total exports.

² ASEAN5 includes the Philippines, Malaysia, Indonesia, Singapore and Thailand.

CHART 2 External merchandise trade



Easing deflationary pressures

Deflationary pressures intensified in the first half of 2003, but eased markedly towards the year's end. The Composite Consumer Price Index (CCPI) recorded the sharpest falls during May and July, reflecting the impact of SARS. Since then, prices appeared to stabilise, as economic growth recovered, with the seasonally adjusted CCPI rising slightly month on month since August. For 2003 as a whole, the CCPI fell by 2.6% compared with 2002. Import prices declined by 0.4%, less than the 3.9% fall in 2002, owing to a weaker US dollar and firmer world commodity prices.

Improving labour market conditions

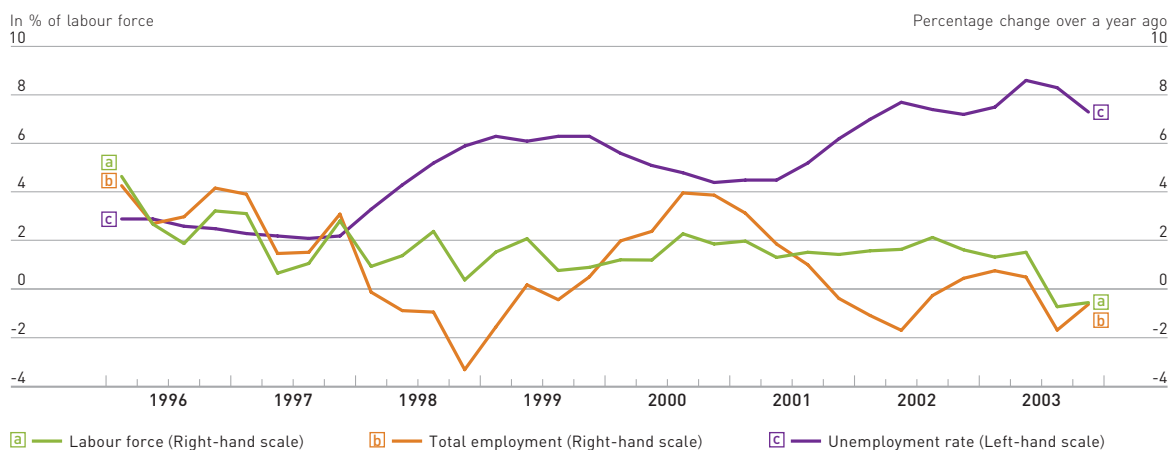
Labour market conditions lagged behind the economic recovery but improved in the last quarter of 2003 after a substantial deterioration in the first half of the year. The unemployment rate reached a record high of 8.7% in the three months to July, partly owing to the impact of the outbreak of SARS, but it subsequently fell to 7.3% in the three months to December as growth recovered (Chart 3). The improvement was broadly based, but consumption and tourism-related sectors did particularly well. Labour income, however, has yet to recover. The

nominal index of payroll per person engaged was 2.1% lower in the first three quarters of the year compared with the same period a year earlier, while median household income fell by 6.1% in 2003.

Recovery in asset markets

The Hang Seng Index started the year on a weak note in line with developments in other major stock markets, which were affected by the uncertainties surrounding the war in Iraq. The Hong Kong stock market was also affected by SARS, and fell sharply to a low of around 8,400 in late April even as US and European markets rallied. Market sentiment started to improve in May, as SARS was progressively brought under control. Investor confidence was also boosted by the series of measures designed to facilitate economic integration with the Mainland. These measures are expected to help the structural adjustment of the Hong Kong economy and develop its competitiveness. They are thought to have increased investors' appetite for domestic assets, especially for stocks likely to benefit directly. As a result, the Hang Seng Index rebounded strongly to close the year at 12,576, or 35% higher than at the end of 2002.

CHART 3 Labour market



The property market was also hit hard by SARS, but the economic recovery, new supply restraint measures introduced in November 2002, and an associated rise in consumer optimism, coupled with low funding costs, led to a revival of the market in the last few months of 2003. The number of transactions increased by 1.6% during the year. Residential property prices rose by 10.3% between their trough in July and the end of year, although they were still lower in 2003 as a whole compared with 2002.

MONETARY CONDITIONS

Monetary conditions continued to ease in 2003 as a result of further declines in interest rates and in the effective exchange value of the Hong Kong dollar. Hong Kong dollar interest rates declined to almost zero per cent in the fourth quarter of the year, owing to a surge in capital inflows. These reflected the recovery in growth as well as confidence about economic prospects stemming from the series of measures undertaken to facilitate economic integration with the Mainland. The trade-weighted real effective exchange rate fell in 2003, reflecting a significant US dollar depreciation against other major international currencies.

Recovery of narrow and broad money growth

Monetary aggregates increased in 2003. Hong Kong dollar narrow money (seasonally adjusted) rose sharply during the year, by 35.8%, while broad money growth recovered in mid-2003 and grew by 5.9% in the year to December 2003. The strong growth of narrow money can be attributed to lower interest rates and the significant rebound in stock market activity during the second half of the year. The growth of broad money reflected the revival in economic activity more generally.

Notes and coins

At the end of 2003 the total value of banknotes in circulation was \$134,215 million, an increase of 13.3% on a year earlier (Charts 4, 5, 6). The total value of Government-issued notes and coins in

CHART 4 Banknotes in circulation at end of year

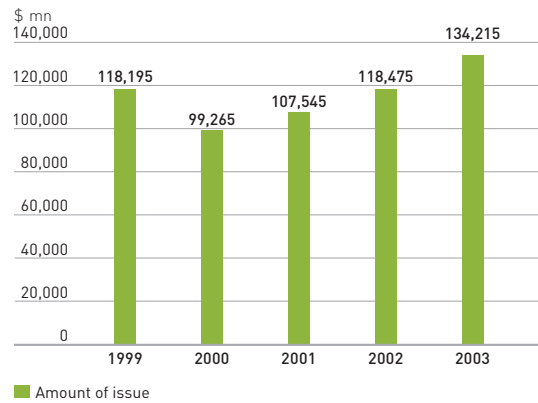


CHART 5 Distribution of banknotes in circulation at the end of 2003

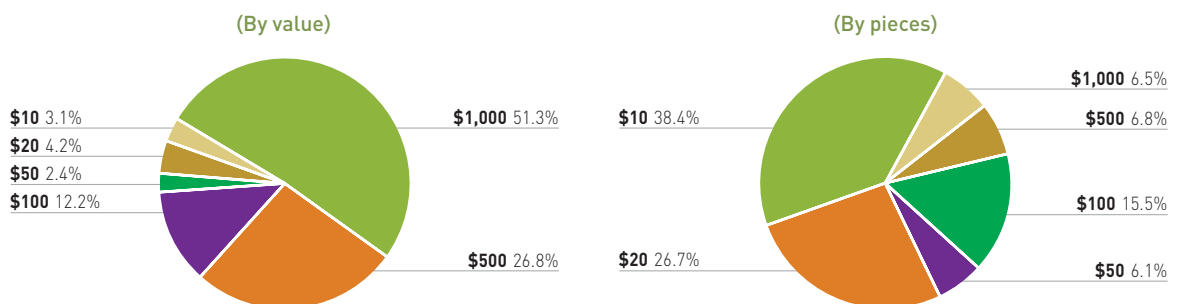


CHART 6 Banknotes in circulation by note-issuing banks at the end of 2003

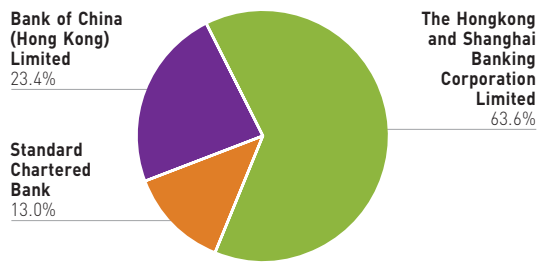


CHART 7 Government-issued notes and coins in circulation at end of year

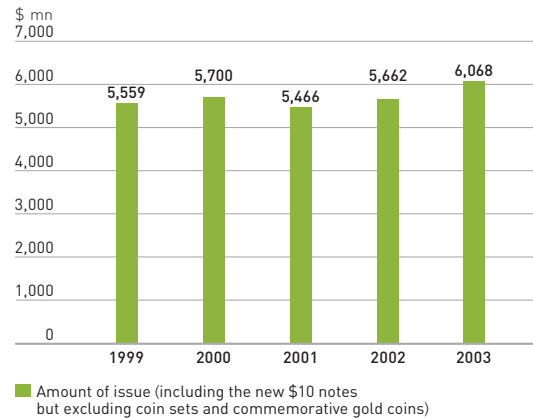
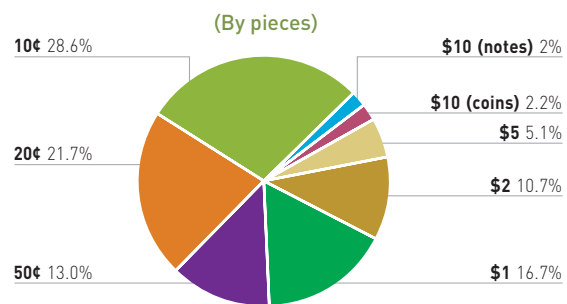
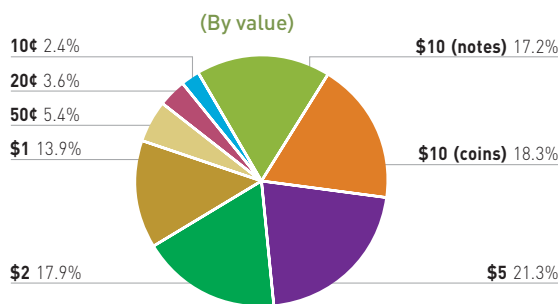


CHART 8 Distribution of Government-issued notes and coins in circulation at the end of 2003



circulation was \$6,068 million, an increase of 7.2% on a year earlier (Charts 7 and 8). The value of \$10 notes in circulation was \$1,042 million, an increase of 109.2% on a year earlier.

New Hong Kong banknotes

The three note-issuing banks (NIBs) put into circulation new \$100 and \$500 Hong Kong banknotes in December 2003. The remaining three denominations of banknotes, \$20, \$50 and \$1,000, will be issued in the last quarter of 2004. Additional security features have been incorporated in these new notes. These features include the use of optical variable ink for denomination numerals, fluorescent machine-readable barcodes, a 4mm-wide windowed thread, and iridescent

images. Security features and colour schemes have also been standardised for banknotes issued by the three NIBs to make it easier for the public to recognise them.

[New Hong Kong Banknotes](#)



Chief Executive Joseph Yam introduces the new security features for the new series of Hong Kong banknotes at a press conference on 3 September 2003.

Coin replacement programme

The programme to withdraw coins bearing the Queen's Head continued throughout the year. In 2003, 39 million coins were removed from circulation.

 [Consumer Information > Notes and Coins](#)

OUTLOOK FOR THE ECONOMY

Recovery to gather momentum

The economic recovery is expected to gather momentum and become more broad-based during 2004. The growth of external trade is expected to remain buoyant as exports from Hong Kong and the Mainland continue to take an increasing share of trade in major world markets. Tourism is expected to continue to be an important source of earnings as the number of Mainland visitors increases as a result of the relaxation of restrictions on travel. Private consumption is expected to pick up further, supported by increased optimism brought about by improving labour market conditions, more stable asset prices, and opportunities arising from closer integration with the Mainland. As economic recovery takes a firmer hold, stronger profits growth and an increase in business optimism should lead to higher private investment. Structural changes arising from policy initiatives, such as CEPA and permission for banks to undertake personal renminbi banking business, should help to boost growth in the medium to long term.

Deflation and labour market conditions to improve

Continued economic recovery in Hong Kong together with an expected re-emergence of inflation on the Mainland, should work to ease deflationary pressures in Hong Kong in 2004. This

should be helped by continued improvement in labour market conditions as, among other factors, an increase in tourism underpins job growth in consumer and tourism-related sectors. A sustained economic recovery and a return to profit growth is also likely to help employment in other business sectors, while CEPA and the expansion of personal renminbi banking business might create new employment opportunities over the medium term. Nevertheless, labour market conditions are likely to remain difficult, especially for lower-skilled workers, as companies relocate to the Mainland to take advantage of lower costs.

Risks

There are a number of risks surrounding the economic prospects. On the upside, it is possible that the economic recovery in the major economies will become more synchronised and robust than expected. Growth on the Mainland may also turn out stronger than predicted by the consensus forecast without affecting price stability. Domestically, closer integration with the Mainland may provide a stronger boost to the economy than currently expected. But there are a number of downside risks as well. First, any disorderly adjustment of exchange rates between the major currencies could be disruptive to the US and global economy. Secondly, if inflation pressures build up more rapidly on the Mainland and in other major economies, and the authorities respond more quickly and forcefully than expected, this will probably lead to lower global growth. Thirdly, a re-emergence of SARS or an increase in the incidence of avian influenza, if not contained swiftly, could adversely affect growth given Hong Kong's reliance on tourism-related expenditure. Overall, however, the balance of risks appears to be on the upside.

PERFORMANCE OF THE BANKING SECTOR

A combination of negative factors set the scene for a difficult start to the year for the banking sector: the prolonged global and domestic economic sluggishness, continuing deflation and declining property prices, and historically high unemployment and personal bankruptcies. Conditions were aggravated by the SARS outbreak, which hit Hong Kong and the region in the second quarter.

In the second half of the year, however, conditions started to pick up. The general economy improved, which, in turn, strengthened consumer and business sentiment. Banks' lending to most sectors grew, particularly in the fourth quarter. Firmer property prices helped ease the collateral erosion in banks' mortgage portfolios, and the problem of negative equity. An improving labour market and declining bankruptcies, combined with banks' efforts to restructure debts for borrowers in financial difficulties, helped improve the quality of the consumer lending portfolio and banks' overall asset quality. The banking sector ended the year with a modest growth in profitability.

Interest rate trends

Declining interbank and deposit rates

Reflecting diminished competition for funds amid sluggish loan demand and a highly liquid banking sector, Hong Kong dollar interest rates fell during 2003 to a new low. The fall was most evident in the fourth quarter, when the high liquidity brought about by strong capital inflows resulted in lower domestic interest rates. One-month HIBOR fell to an annual average of 0.92% compared with 1.74% in 2002, and the one-month time deposit rate fell to 0.07% from 0.35% (Table 3). Despite a 25 basis point cut in the US Fed funds target rate in the second quarter, the best lending rate in Hong Kong remained unchanged at 5.00%, resulting in a widening in interest rate spreads. The spread between the average best lending rate and average one-month HIBOR widened to 408 basis points, compared with 337 basis points in 2002; while the spread between the best lending rate and the average one-month time deposit rate was 493 basis points, compared with 477 basis points in 2002.

TABLE 3 Hong Kong dollar interest rate movements (period average figures)

(% per annum)	Time deposits			HIBOR			Saving deposits	Best lending rate
	1-month	3-month	12-month	1-month	3-month	12-month		
Q4 2002	0.22	0.26	0.34	1.66	1.67	1.82	0.09	5.05
Q1 2003	0.09	0.09	0.19	1.31	1.33	1.47	0.03	5.00
Q2 2003	0.08	0.09	0.14	1.26	1.26	1.32	0.03	5.00
Q3 2003	0.08	0.08	0.10	0.99	1.03	1.27	0.03	5.00
Q4 2003	0.02	0.02	0.05	0.12	0.24	0.92	0.02	5.00
2002*	0.35	0.40	0.75	1.74	1.79	2.21	0.14	5.11
2003*	0.07	0.07	0.12	0.92	0.96	1.24	0.03	5.00

* annual average figures.

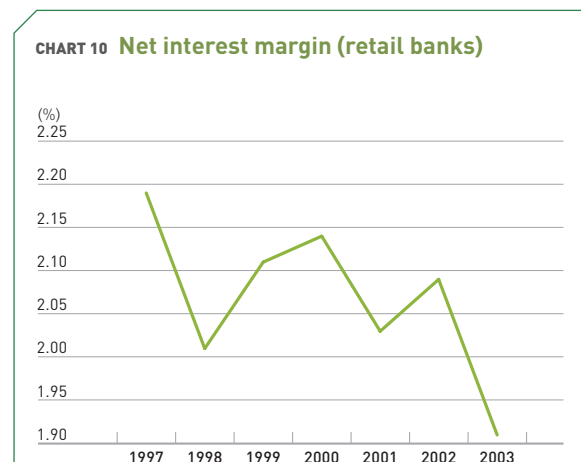
Profitability trends

Bank profits declined in the first half of 2003 because of the difficult operating conditions. But the improved economic climate and the receding effects of SARS in the second half helped retail banks increase aggregate pre-tax operating profits for their Hong Kong offices by 5.3% for the year as a whole. This followed a rise of 11.7%^r in 2002 (Chart 9). The increase was largely due to gains in treasury operations (in particular in foreign exchange trading in the fourth quarter), increased income from fees and commissions, and reduced bad debt provisions and operating expenses, which outweighed the effect of reduced net interest income.

Net interest income continued to fall despite a decline in interest costs. Loan contraction, the continued squeeze on lending margins caused by fierce competition and refinancing, particularly for

the residential mortgage market, and lower yield on free funds resulted in the retail banks' net interest margin falling to 1.91% in 2003 from 2.09%^r in 2002 (Chart 10).

Pressure on interest spreads prompted many banks to focus increasingly on their non-interest income. In particular, most retail banks recorded strong performance in treasury business. Recovery in stock market activity in the second half of the year, strong trade financing and an increased awareness of wealth management products, as investors sought better returns in a low interest rate environment, helped drive the increase in income from fees and commissions. As a consequence, retail banks' other operating (or non-interest) income rose and accounted for about 34% of total operating income, compared with 30% in 2002. The share of income from treasury operations to total non-interest income increased to 19.8% from 15.4% in 2002.



^r Figure revised.

Continued synergy from previous consolidations and business integration, together with reduced rental expenses, helped bring down total operating costs. As a result, the average cost-to-income ratio dropped to 38.7% in 2003 from 39.3%^r in 2002 (Chart 11).

Retail banks' overall bad debt charge fell to 0.29% of average total assets, from 0.34% in 2002, the lowest level since the Asian financial crisis (Chart 12). The decline was most apparent in the fourth quarter, when both the employment and personal bankruptcy situations improved.

The industry-wide post-tax return on assets fell marginally to 1.17%, from 1.18% in 2002 (Chart 13) owing to the increase in average assets.

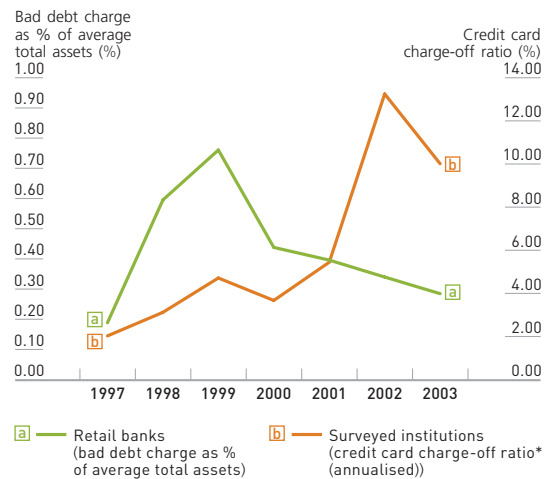
Balance sheet trends

Capital inflows, stimulated by the improved economic outlook and the buoyant Hong Kong stock market in the fourth quarter, contributed to a rise in retail banks' deposit liabilities by 7.4%, having risen

by only 0.7% in 2002. The banks' total assets rose by 8.9%, with the increase on the asset side coming in higher yielding securities and interbank lending.

After contracting for five consecutive years, total assets of the banking sector increased by 8.5%, principally in interbank lending and the holding of debt securities.

CHART 12 Charge-off ratios



* There is a break in series in December 2001 owing to an increase in the number of surveyed institutions.

CHART 11 Cost-income ratio (retail banks)

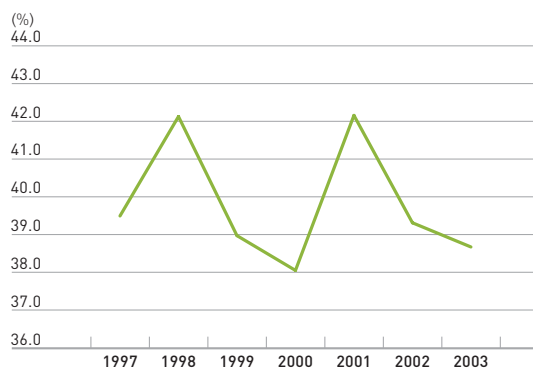
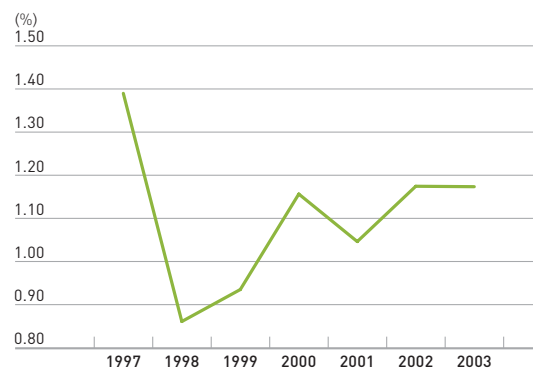


CHART 13 Return on assets (post-tax profit) (retail banks)



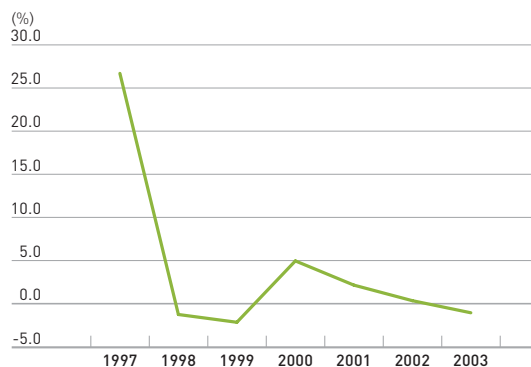
^r Figure revised.

Domestic loan demand on the way up

Retail banks' total lending fell modestly by 0.6% in 2003. Although total loans to customers outside Hong Kong increased by 18.2%, this was from a very small base of 2.2% of total lending. Domestic lending decreased by 1.0%, having increased by 0.4% in 2002. Much of the decline was attributable to the contraction in property-related lending (Chart 14). The fourth quarter, however, saw a pick-up in lending to most sectors with the recovery in business sentiment and the general economy.

Property lending reversed an increase of 1.4% in 2002 to record a decrease of 2.0% in 2003. Within this, loans for property development and residential mortgage loans decreased by 11.0% and 1.4% compared with increases of 0.8% and 2.2% in 2002 respectively, although the latter recorded an increase in the fourth quarter. Loans for property investment, however, rose by 0.3% following a decrease of 0.4%. Loans for the purchase of flats under the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme fell by 12.1% as sales of flats under these schemes ceased.

CHART 14 Growth of loans to customers inside Hong Kong* (year on year) (retail banks)



* Defined as loans for use in Hong Kong plus trade financing loans.

Lending by retail banks to other major economic sectors was mixed in 2003. Aided by robust external trade growth, trade financing loans rose by 11.7%, compared with a 4.0% increase in 2002. Loans to the manufacturing sector rose by 12.1% up from 1.2% in 2002, and to the transport and transport equipment sector by 9.6% up from 4.9%. Driven by the buoyant stock market activity in the fourth quarter, loans to financial concerns rose by 14.3%, after contracting by 10.3% in 2002. Loans to stockbrokers also increased strongly by 13.4%, up from 1.1%. However, loans to non-stockbroking companies and individuals to purchase shares fell by 9.5% against an increase of 18.4% in 2002 despite an increase in the fourth quarter. Similarly, lending to the wholesale and retail trade sector and the electricity, gas and telecommunications sector decreased by 7.7% and 10.0% respectively, against increases of 1.6% and 12.2% in 2002. The decrease in loans to the latter was due to a sharp decline of 35.6% in loans to the telecommunications sector as a result of loan repayments.

Amid the high level of personal bankruptcies and high unemployment rate, aggravated by the SARS outbreak, consumer lending, particularly in the credit card business, contracted further in 2003 despite an increase in the fourth quarter. According to the regular survey of authorized institutions active in credit card businesses, total credit card receivables declined further by 5.0% after a decline of 4.5% in 2002.

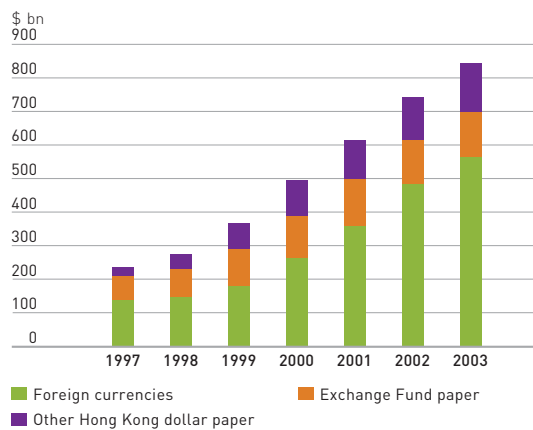
Total outstanding exposure to non-bank Chinese entities increased slightly in 2003, largely attributable to more trade-related contingencies. Retail banks' exposure increased by 1.3% to \$103.3 billion at the end of 2003, accounting for 2.3% of their total assets.

Rising level of negotiable debt instruments

The holding of negotiable debt instruments (NDIs), excluding negotiable certificate of deposits (NCDs), by retail banks continued to record double-digit growth in 2003, albeit at a slower pace of 13.3% compared with 20.8% in 2002. Holdings of NDIs by retail banks accounted for 21.7% of their total assets at the end of 2003, compared with 20.9% a year earlier. The increase was largely in corporate debt instruments and floating rate notes denominated in foreign currencies. Foreign currency NDIs grew by 16.7%, while Hong Kong dollar denominated NDIs rose by 7.1% (Chart 15). Of the NDIs, 54.9% were issued by corporates, 25.7% by governments, and 19.4% by banks (Chart 16).

In light of the historically low yield on savings and time deposits, the demand for NCDs by retail customers continued in 2003. This was reflected by the 17.3% rise in outstanding NCDs issued, following the 21.7% surge in 2002. With increased holdings of NCDs by retail customers, the proportion of outstanding NCDs held by retail banks dropped to 35% at the end of 2003, compared with 38% in 2002.

CHART 15 Negotiable debt instruments held (retail banks) by currency breakdown



Growing customer deposits

Retail banks' total customer deposits grew by 7.4% after two years of weak growth or decline (Chart 17). The growth was strong despite all-time-low interest rates, reflecting the improving economy and an external inflow of funds, particularly in the fourth quarter.

CHART 16 Negotiable debt instruments (retail banks) by counterparty breakdown

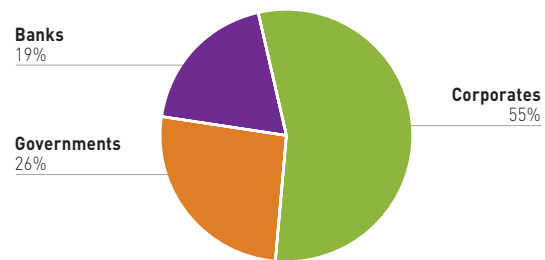
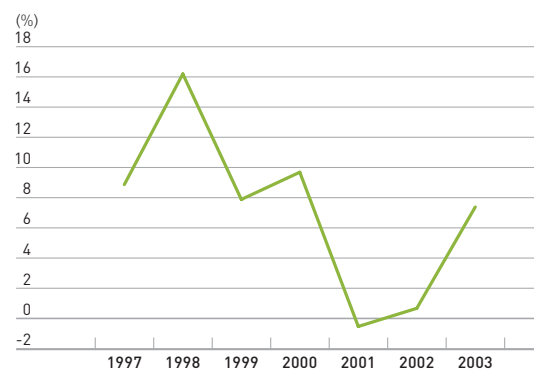


CHART 17 Growth of total customer deposits (year on year) (retail banks)



With Hong Kong dollar and foreign currency deposits growing at a similar rate of about 7.4% (Chart 18), the proportion of Hong Kong dollar deposits to total deposits remained stable at 61.0% in 2003. Of particular interest was the migration of deposits from time to savings and demand deposits during the year. Time deposits fell by 12.3% in 2003, whereas savings and demand deposits increased by 35.2% and 52.9% respectively. As a consequence, savings and demand deposits at the end of 2003 accounted for 50.4% of total deposits, a sharp rise compared with 29.0% three years before. Much of the increase in savings and demand deposits occurred in the fourth quarter, reflecting, in part, the rise in transaction demand for money given the strong rebound in the stock market.

High liquidity

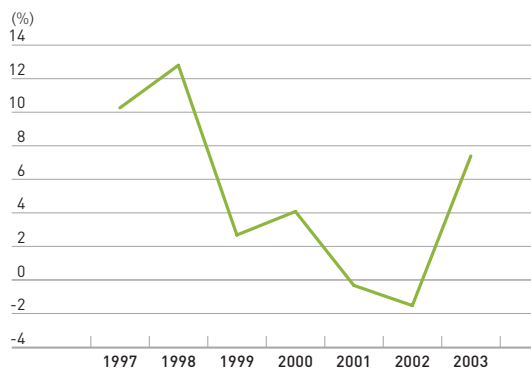
The liquidity of retail banks remained high, as indicated by the decrease in the loan-to-deposit ratios. With deposits increasing and lending decreasing, retail banks' loan-to-deposit ratios in all currencies and in Hong Kong dollars fell

significantly. While the former dipped to a new low of 49.6% at the end of 2003, from 53.5% at the end of 2002, the latter fell to 71.6% from 78.6%.

Overall asset quality improves

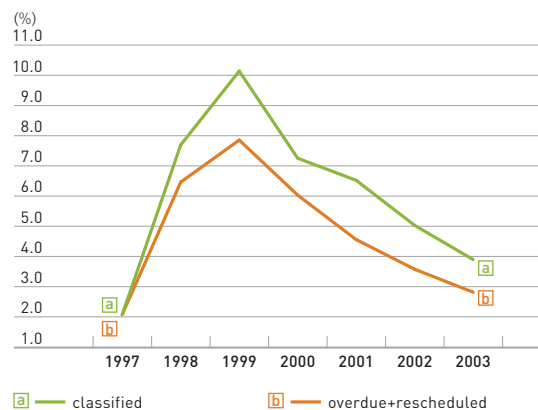
The asset quality of banks improved in 2003, benefiting from various factors, including the economic upturn and the recovering labour market. These factors, together with a persistently low interest rate environment, helped support borrowers' repayment ability, and contributed to the sharp declines in personal bankruptcies and credit card charge-offs. Reflecting this, the problem loan ratios of retail banks declined to almost pre-Asian-financial-crisis levels. The ratio of loans overdue for more than three months dropped to 2.05% from 2.77%^r at the end of 2002. Coupled with a decrease in the rescheduled loan ratio to 0.79%, the combined ratio of overdue and rescheduled loans improved to 2.83% from 3.59%^r. The classified and non-performing loan ratios also dropped to 3.91% and 3.16% from 5.04%^r and 3.94%^r at the end of 2002 respectively (Chart 19).

CHART 18 Growth of Hong Kong dollar deposits* (year on year) (retail banks)



* Including swap deposits.

CHART 19 Gross classified loans and combined overdue and rescheduled loans as a percentage of total loans (retail banks)



^r Figure revised.

The delinquency ratio of the residential mortgage portfolio dropped to 0.86% at the end of 2003 from 1.06% at the end of 2002 (Chart 20). Banks' continued support for borrowers in financial difficulties to restructure their problem mortgage loans, led to an increase in the rescheduled loan ratio to 0.52% at the end of 2003, from 0.46% in 2002.

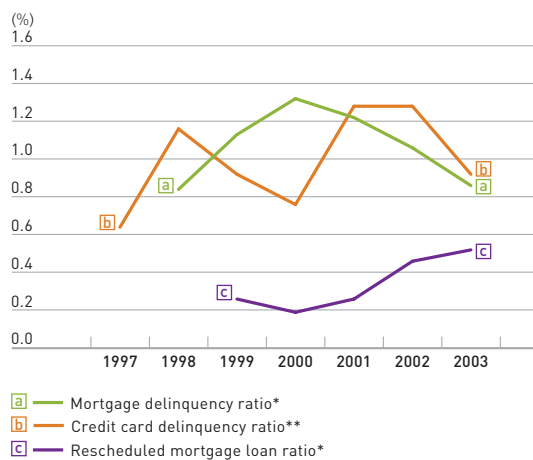
Consumer credit quality, in the form of credit card lending, showed an improvement, with the credit card charge-off ratio for the year, dropping to 10.02%, from 13.25% in 2002 (Chart 12), and the credit card delinquency ratio falling to 0.92%. The improvements were helped in part by the transfer of some rescheduled receivables outside the credit card portfolio. Taking into account outstanding rescheduled credit card receivables amounting to \$166 million or 0.3% of total receivables within the card portfolio, the delinquent and rescheduled ratio stood at 1.22% at the end of the year.

[Information Centre > Press Releases > Credit Card Lending Survey Results category](#)

In tandem with the economic recovery and a revival in property prices, particularly in the fourth quarter, there was an easing in the amount of negative equity in the residential mortgage portfolio. Survey results from banks active in mortgage financing indicate that about 67,600 cases within the banking sector (or 14% of total mortgage borrowers) were in negative equity at the end of the year, the problem having peaked at 106,000 cases in mid-2003 (see box). With an average loan-to-value ratio of 128%, the unsecured portion of these loans was estimated at about \$23 billion or roughly 5% of the total residential mortgage portfolio. The quality of the negative equity mortgages also improved, as indicated by the decline in the delinquency ratio of the negative equity mortgage loans to 2.11% at the end of the year, from 2.62% in 2002.

[Information Centre > Press Releases > Residential Mortgage Survey Results category](#)

CHART 20 Asset quality of credit card and mortgage lending (surveyed institutions)



* There is a break in series in December 2000 owing to an increase in the number of surveyed institutions.

** There is a break in series in December 2001 owing to an increase in the number of surveyed institutions.

Residential mortgage loans in negative equity¹

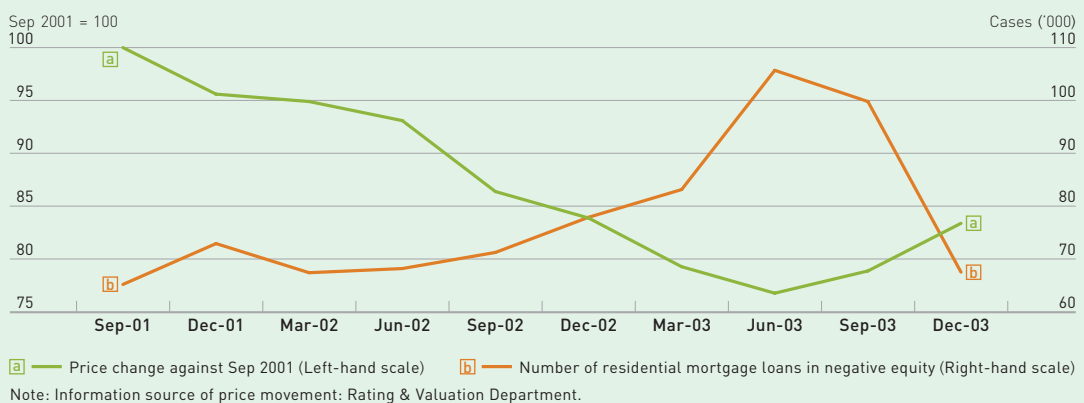
Property prices in Hong Kong have fallen by an average of 65% since the Asian financial crisis triggered the bursting of the asset bubble in 1997. This sharp fall raised concerns about negative equity in banks' residential mortgage loan portfolios.

Chart A tracks the relationship between property prices and the number of negative equity loans in the residential mortgage loan portfolio of the banking sector. This is an inverse relationship. The economic downturn, exacerbated by SARS in the second quarter of 2003, led to an increase in negative equity as property prices continued to decline. According to the figures obtained from banks active in residential mortgage loans, the number of these loans in negative equity within the banking sector alone rose to a peak of 106,000 cases at the end of June 2003, from 76,700 cases at the end of 2002. The problem eased notably in the second half of the year, along with the recovery in property prices arising from the improved domestic economy. At the end of 2003 there were 67,600 negative equity residential mortgage loans (Chart B). The amount involved was estimated at \$107 billion.

Notwithstanding the high level of personal bankruptcies in March 2003, the three-month delinquency ratio of residential mortgage loans in negative equity continued to fall to 2.11% at the end of 2003 (Chart C). This reflects the efforts made by negative equity homeowners to service their mortgage loans. The improvement in the asset quality of negative equity mortgage loans can also be attributed, in part, to the responsiveness of banks in reducing the repayment burden on negative equity homeowners by lowering their interest rates. This factor is highlighted by the continued decline in the average mortgage rate paid by negative equity homeowners, from 0.27% below the best lending rate in September 2001 to 0.94% below in December 2003 (Chart D).

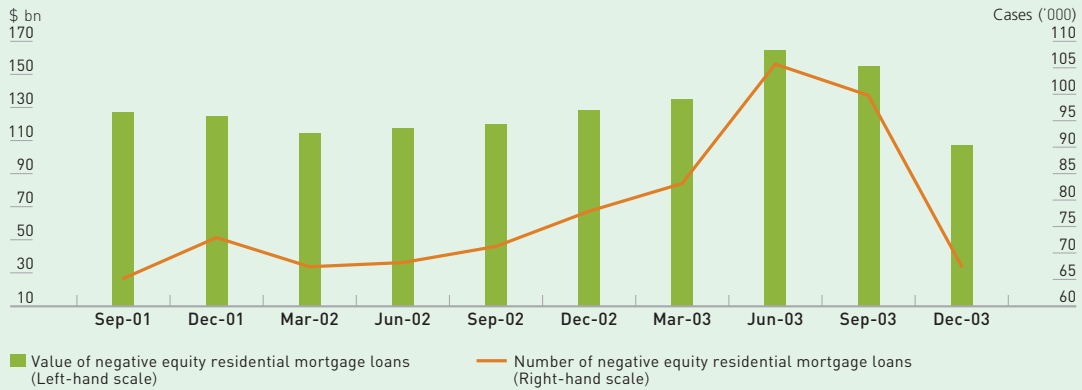
Sentiment towards the property market has become more positive, particularly in the latter part of 2003. According to the Rating & Valuation Department's property price index in December, prices had risen by about 10% from the trough in July 2003. If this recovery is maintained, the negative equity problem should ease further.

CHART A Relationship between price movement of territory-wide private domestic units and number of residential mortgage loans in negative equity



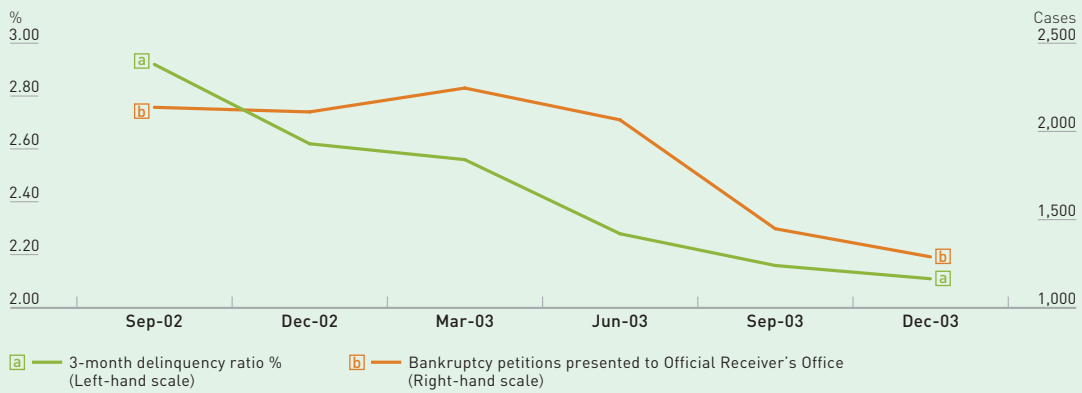
¹ A residential mortgage loan in negative equity is defined as a loan with an outstanding value that exceeds the current market value of the mortgaged property on the basis of first mortgages and which the relevant authorized institution knows to be in negative equity. Second mortgages from developers and other financial sources outside of the banking sector are not included in this definition.

CHART B Residential mortgage lending in negative equity



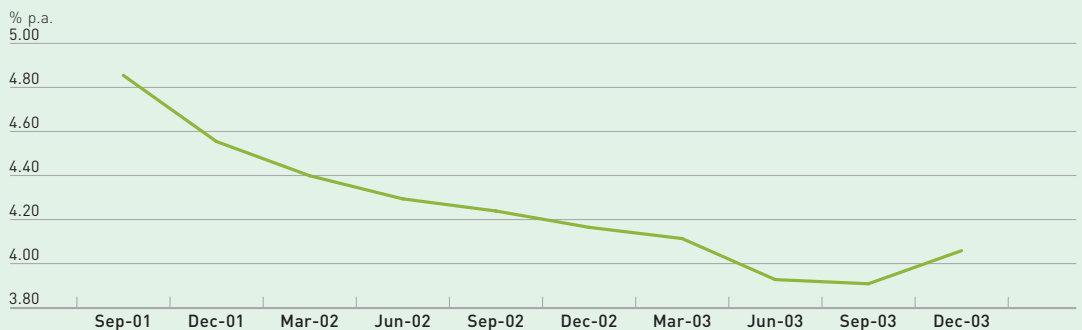
Note: Period-end outstanding figures.

CHART C Relationship between bankruptcy petitions and delinquency ratio for residential mortgage loans in negative equity



Notes: Delinquency refers to outstanding value of residential mortgage loans in negative equity overdue for more than three months. Information source of bankruptcy petitions: Official Receiver's Office.

CHART D Weighted average mortgage rate for residential mortgage loans in negative equity

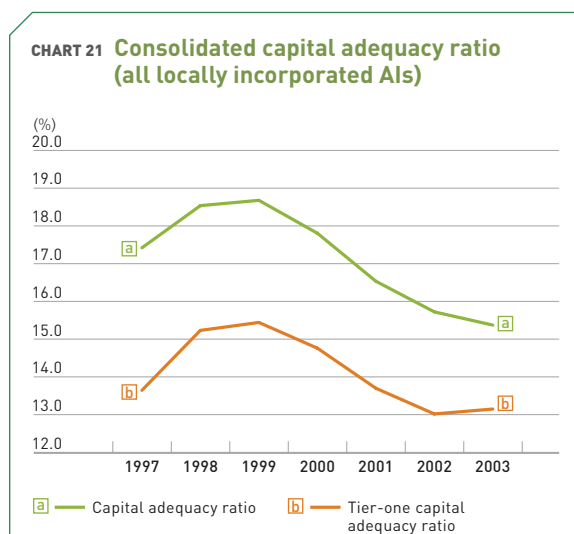


Note: Weighted average mortgage rate refers to weighted average mortgage rate with reference to the best lending rate.

Strong capital ratio

The capital adequacy ratio of all locally incorporated AIs declined to 15.3% from 15.7%^r at the end of 2002 (Chart 21). The decline was due to an increase in risk-weighted assets, namely in claims on banks.

The tier 1 capital ratio stood at 13.1%, marginally higher than the 13.0%^r at the end of 2002 (Chart 21).



PROSPECTS FOR 2004

Domestic economic growth is expected to continue to gather pace. Barring any unforeseen external factors, loan growth prospects are positive with the recovery in employment, consumption, domestic demand and tourism. The launch of the positive data sharing credit bureau may prompt banks to repackage or introduce new consumer products with price differentiation to better reflect customer credit risks.

The implementation of programmes under CEPA is also expected to usher in more business opportunities for the banking sector in Hong Kong through easier access to the Mainland banking sector. The introduction of personal renminbi business in early 2004 will broaden banks' revenue sources. The use of renminbi cards in Hong Kong is likely to help tourist spending and boost business income for the tourist-related sectors as well as potentially increasing fee income for the banks.

While embracing the new business opportunities ahead, banks will face challenges in competing to maintain their market positions and expand their market share. Continuing pressure on interest spreads will spur their search for new businesses, such as insurance and securities brokerages. Risk management skills in the areas of interest rates and market risks will also need to be improved as banks grow their NDIs. In view of the competitive operating environment, consolidation and branch rationalisation are expected to continue as banks seek to achieve synergies and rein in costs. Given the robust and sound banking system in Hong Kong, banks are adequately equipped to accept the challenges and turn them into opportunities.

^r Figure revised.



Highways Department staff work at night against tight deadlines to ensure that Hong Kong's roads are smooth and safe.

MONETARY STABILITY

The Linked Exchange Rate system continued to function smoothly throughout 2003 despite a marked shift in market sentiment from extreme pessimism during the SARS outbreak to optimism in the later part of the year. The Linked Exchange Rate system provides a stable monetary environment that is crucial to maintaining financial and economic stability in Hong Kong.

OBJECTIVES

The primary monetary policy objective of Hong Kong is currency stability, defined as a stable exchange value of the currency of Hong Kong, in terms of its exchange rate in the foreign exchange market against the US dollar, at around HK\$7.80 to US\$1. The structure of the monetary system is characterised by currency board arrangements, which require the Hong Kong dollar Monetary Base to be at least fully backed by, and changes in it to be fully matched by corresponding changes in, US dollar reserves held in the Exchange Fund at the fixed exchange rate of HK\$7.80 to US\$1.

Hong Kong's Monetary Base consists of four components:

- Certificates of Indebtedness (CIs), which are used to back the banknotes issued by the three note-issuing banks
- Government-issued currency notes and coins in circulation
- the sum of the balances on the clearing accounts maintained by banks with the HKMA (known as the Aggregate Balance)
- Exchange Fund Bills and Notes, which are issued by the HKMA on behalf of the Government.

The stability of the Hong Kong dollar exchange rate is maintained through an automatic interest rate adjustment mechanism. Specifically, when there is a decrease in the demand for Hong Kong dollars, and the exchange rate weakens to the convertibility rate of HK\$7.80 per US dollar, the HKMA stands ready to purchase Hong Kong dollars from banks. The Aggregate Balance (as part of the Monetary Base) will fall. Interest rates then rise, creating the monetary conditions conducive to inflows of funds to maintain exchange rate stability. Conversely, if there is an increase in the demand for Hong Kong dollars, leading to a strengthening of the exchange rate, the HKMA may sell Hong Kong dollars for US dollars. The Aggregate Balance will accordingly expand, exerting downward pressure on interest rates and thus discouraging continued inflows.

A REVIEW OF 2003

The exchange and money markets were largely stable during the year, despite a marked shift in market sentiment from extreme pessimism during the SARS outbreak to optimism in the later part of the year. The Hong Kong dollar exchange rate stayed close to the convertibility rate of 7.80 in the first eight months of 2003. However, it appreciated markedly in late September, triggered by US dollar weakness and increased pressures for a renminbi

appreciation, reaching a high of 7.70 at one point (during London hours on 22 September) (Chart 1). The movement in the exchange rate was probably exacerbated by an unwinding of substantial short positions in the Hong Kong dollar that had been accumulated earlier. The strength of the Hong Kong dollar persisted in the fourth quarter, reflecting an improvement in the economic fundamentals of Hong Kong, and portfolio re-allocations arising in part from Hong Kong's large current account surpluses and large international investment position. Economic prospects brightened following the introduction of

a number of policy measures designed to deepen economic integration between Hong Kong and the Mainland: these included relaxations of travel restrictions on Mainland visitors to Hong Kong, the conclusion of CEPA, and the agreement between Hong Kong and the Mainland to launch a personal renminbi business scheme in Hong Kong.

The Hong Kong dollar forward points shifted from a premium to a significant discount during the year. The 12-month forward points rose during April, largely because of concerns about the adverse effect of SARS (Chart 2). As SARS was brought

CHART 1 Market exchange rate and convertibility rate, January – December 2003

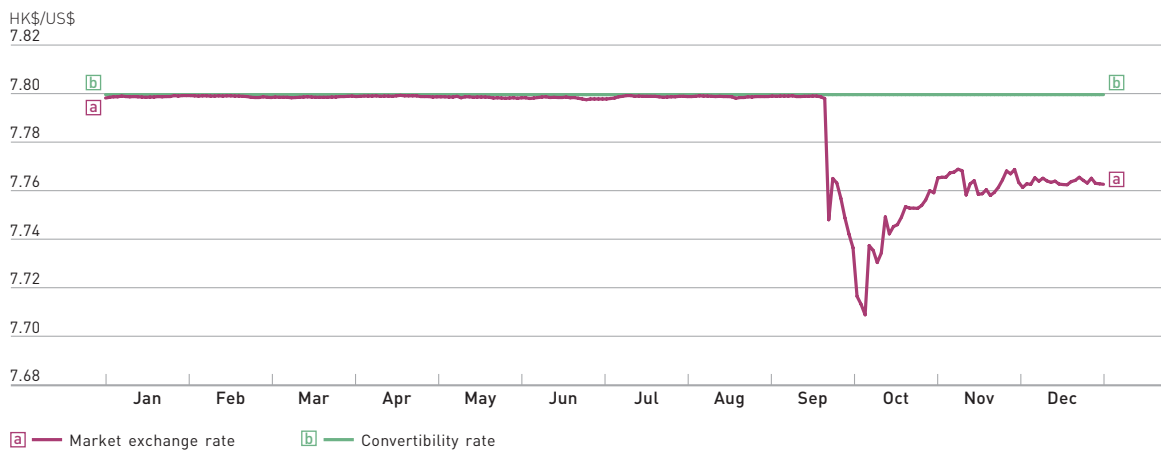
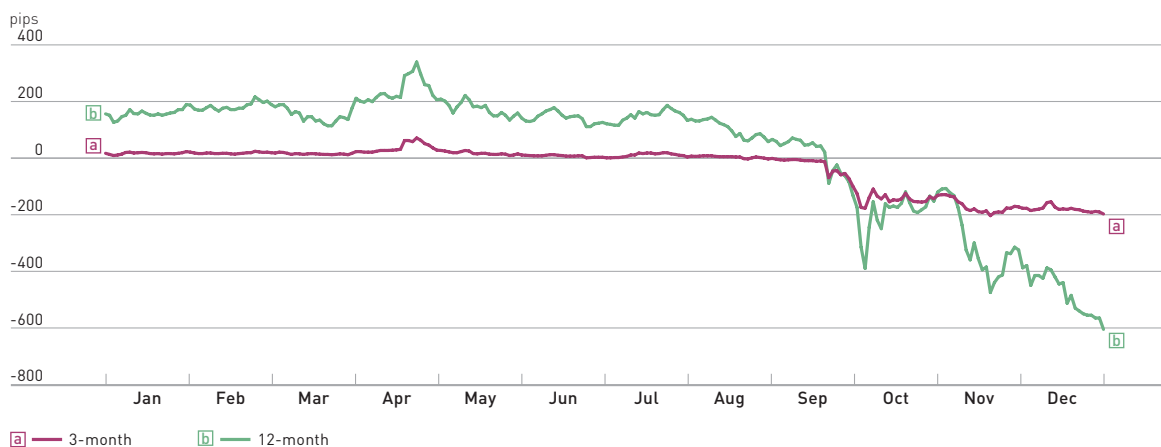


CHART 2 Hong Kong dollar forward points, January – December 2003



under control and signs of economic recovery emerged, the Hong Kong dollar forward points decreased gradually. The 12-month forward points declined to a discount in September, and reached a level of -600 pips at the end of the year.

Hong Kong dollar interest rates eased during the year, mainly reflecting an increase in inflows of funds in the fourth quarter (Chart 3). Domestic interest rates dropped significantly below US rates in September (Chart 4). The Aggregate Balance rose from less than \$1 billion in early September to

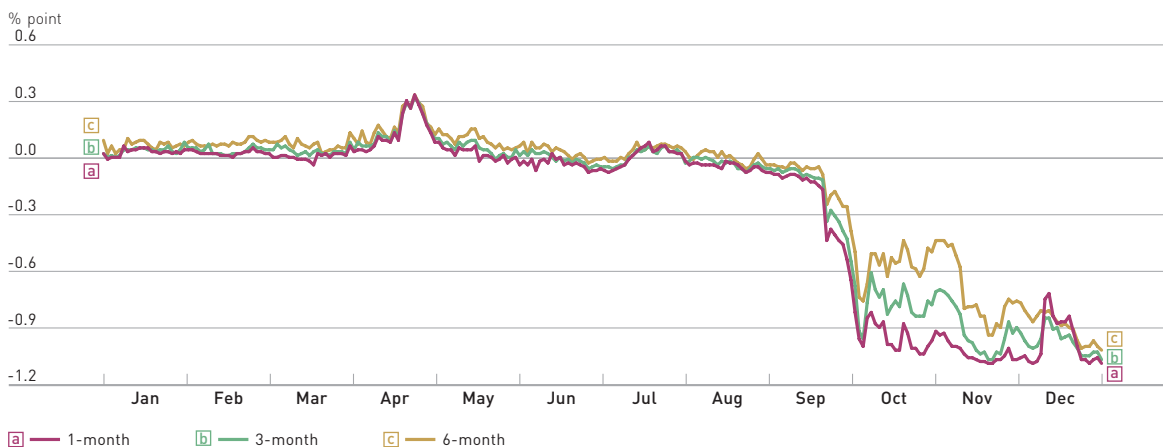
\$28.3 billion at the end of 2003, as the HKMA sold Hong Kong dollars to banks in response to the increase in demand for Hong Kong dollar assets (Chart 5).

Interest rate volatility, as measured by the standard deviation of daily changes in the one-month interbank rate, remained at low levels throughout the year. This reflected the smooth operations of the Discount Window in absorbing liquidity shocks. Overnight interbank interest rate rarely rose above the Base Rate of the Discount Window.

CHART 3 HIBORs, January – December 2003



CHART 4 Hong Kong dollar – US dollar interest rate differentials, January – December 2003



Specific assets of the Exchange Fund have been earmarked to back the Monetary Base since October 1998 to increase the transparency of the Currency Board Account. The Backing Ratio, defined as the ratio of Backing Assets to the Monetary Base, decreased from 112.0% to 110.1% in 2003 (Chart 6). A large part of the decrease occurred in the fourth quarter, owing to a revaluation loss on the Backing Assets associated with an appreciation of the Hong Kong dollar against the US dollar. The expansion of the Aggregate Balance also exerted a downward

influence on the ratio: while the Backing Assets increased by the same magnitude as the Monetary Base, the fractional increase was smaller in the former because of its larger size.

Activities at the HKMA

Established in August 1998, the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations is responsible for supervising the operations of the Currency Board system in Hong Kong. The Sub-Committee continued to monitor the Currency Board arrangements and to examine

CHART 5 Aggregate Balance, January – December 2003

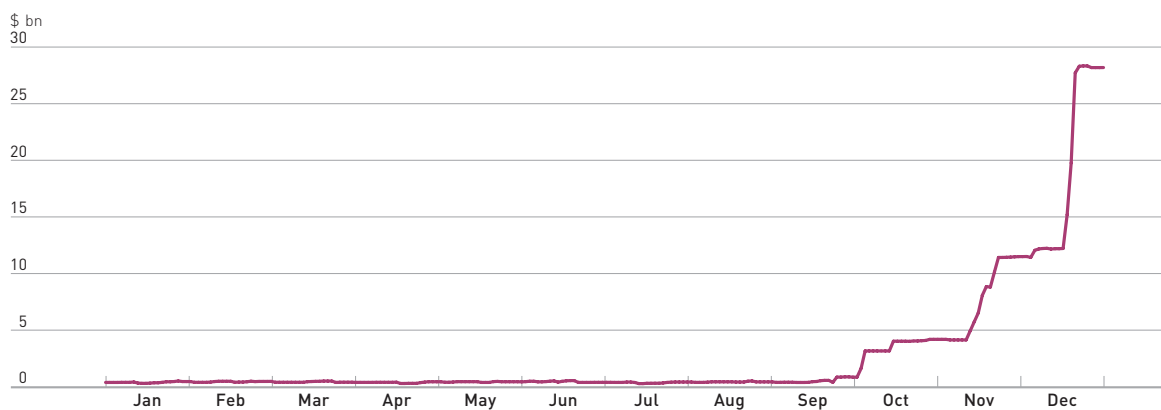
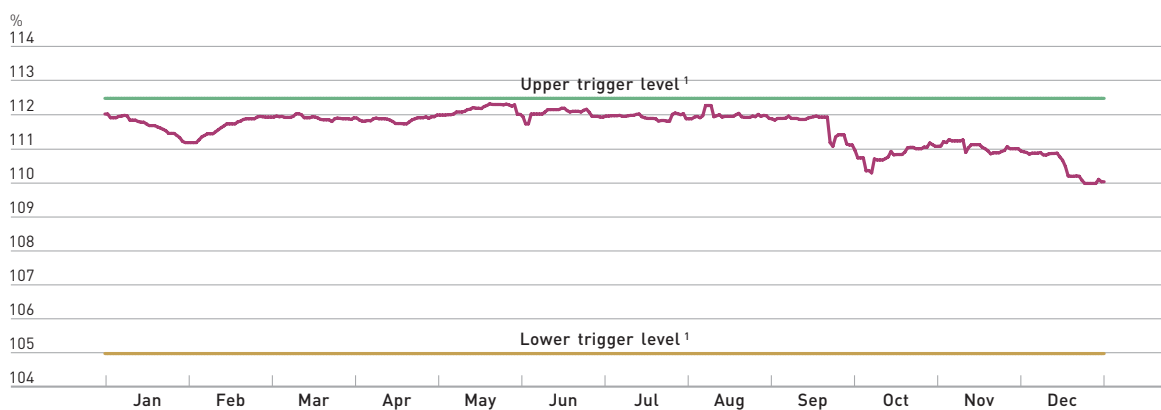


CHART 6 Daily movement of the backing ratio, January – December 2003



¹ Under the arrangements for transferring assets between the backing portfolio and the investment portfolio of the Exchange Fund, when the backing ratio reaches 112.5% (the upper trigger point), sufficient assets will be transferred from the backing portfolio to the investment portfolio to reduce the ratio to 110%. Should the backing ratio drop to 105% (the lower trigger point), sufficient assets will be transferred from the investment portfolio to the backing portfolio to restore the ratio to 107.5%.

issues that may affect monetary and financial stability in Hong Kong in 2003. These issues included the economic impact of SARS on Asian economies, prospects for a re-emergence of inflation in Hong Kong, the macroeconomic effects arising from maintaining the Linked Exchange Rate system, the determinants of banking performance in Hong Kong, and an analysis of the balance of payments in 2002.

 > [Information Centre > Press Releases > Monetary Policy category](#)

 > [Information Centre > Research Memoranda](#)

The Hong Kong Institute for Monetary Research, established in August 1999, has sponsored research in the fields of monetary policy, banking and finance. In 2003 the Institute hosted 18 full-time and three part-time research fellows, and published 24 working papers. The research agenda and projects were determined and approved by the Institute's Council of Advisers which comprise internationally prominent academics and analysts from Hong Kong and overseas.

The Institute hosted the eighth Annual Australasian Macroeconomics Workshop in Hong Kong in September. Thirty-three papers were presented from participants from various universities and central banks. In addition, the Institute co-organised a two-day conference entitled "Deflation, Pegs and Capital Flows" in December with the Hong Kong Institute of Economics and Business Strategy of the University of Hong Kong and the Centre for Economic Policy Research of the United Kingdom. In addition, 33 public seminars were organised during the year covering a broad range of economic and monetary issues.

 > [About the HKMA > Useful Links > HKMA-related Organisations](#)



Windsurfers compete in the Hong Kong Windsurfing Circuit in Sai Kung. The Circuit attracted around 100 competitors from Hong Kong and overseas.

BANKING STABILITY

One of the main policy objectives of the HKMA is to promote the safety and stability of the banking system through the regulation of banking and deposit-taking business and the supervision of authorized institutions. A priority of banking supervision in 2003 was to ensure authorized institutions had adequate risk management procedures and contingency measures to deal with the impact of the SARS epidemic on their operation and asset quality. On the policy side, the main focus was to develop a road map for the implementation of Basel II. Good progress was also made in preparing the legislation for the Deposit Protection Scheme Bill and the establishment of a Commercial Credit Reference Agency in Hong Kong.

OBJECTIVES

Responsibility for promoting the safety and soundness of the banking system is shared among three departments within the HKMA:

- the *Banking Supervision Department* handles the day-to-day supervision of authorized institutions (AIs)¹
- the *Banking Policy Department* formulates supervisory policies to promote the safety and soundness of the banking sector
- the *Banking Development Department* formulates policies to promote the development of the banking industry.

REVIEW OF 2003

Operational supervision

The HKMA conducted 247 on-site examinations on AIs' operations in 2003, including 76 risk-focused, nine treasury and 18 securities examinations. The on-site examinations also included 21 focused

examinations of AIs' equitable mortgage loan, credit card and public light bus financing operations in the light of the weak economic conditions in the first half of 2003; and 10 special examinations on AIs' lending policies and practices. The decrease in on-site examinations (down from 285 in 2002) mainly reflected the precautionary measures taken by AIs and the HKMA during the SARS outbreak in the second quarter of the year to reduce physical interaction. With the increasing popularity of electronic banking (e-banking) services, the HKMA continued with its efforts to review the controls on AIs' e-banking activities and the specialised examination teams conducted 28 e-banking and IT related examinations and 20 on-site reviews of AIs' business continuity planning during the year.

¹ Institutions authorized under the Banking Ordinance to carry on banking business or the business of taking deposits. Authorized institutions are divided into three tiers: licensed banks, restricted licence banks (RLBs) and deposit-taking companies (DTCs).

Pending the issuance of the revised *Supplement to the Guideline on the Prevention of Money Laundering* and a set of guidance notes to assist AIs in implementing the requirements, the HKMA focused primarily on tier-one examinations covering high-level reviews of AIs' controls on prevention of money laundering during the year. In 2003 the regular teams and specialised money laundering examination teams together conducted 74 tier-one examinations as part of the routine inspections, and five tier-two examinations covering more thorough checking of the implementation and effectiveness of the laid down procedures.

The number of off-site reviews and tripartite meetings conducted in 2003 remained largely the same as in 2002, despite the reduced number of AIs resulting from mergers and acquisitions (224 AIs at the end of 2002 and 215 AIs at the end of 2003).

The HKMA continued to maintain regular dialogue with the board of directors of locally incorporated AIs and met the boards of 11 banks and five deposit-taking companies. Both the HKMA and the boards found this arrangement useful in strengthening their communication and improving their understanding of the state of affairs, financial position and strategic direction of the AIs.

The Banking Supervision Review Committee considered 12 cases during 2003 relating to the licensing of AIs and money brokers. A total of 310 applications to become controllers, directors, chief executives and alternate chief executives of AIs were approved. Details of the operational supervisory work performed in 2003 are set out in Table 1.

On four occasions in 2003, the HKMA used the powers under Section 59(2) of the Banking Ordinance to require AIs to commission external auditors to review internal control issues and report their findings to the HKMA. A total of five such reports were submitted by the AIs concerned.

During 2003 no AI breached the requirements of the Banking Ordinance relating to the capital adequacy ratio and liquidity ratio. There were two breaches of the requirements relating to large exposures under Section 81 and 15 breaches of the requirements relating to connected lending under Section 83. All these breaches, which were technical and unintentional in nature, were promptly rectified and did not result in any risk to the interests of depositors or creditors. No use was made of the powers under Section 52 of the Banking Ordinance during the year.

Special examinations

A series of events in May 2003 connected with a certain loan made by a large bank to a Mainland-based borrower raised public concerns about the effectiveness of the bank's risk management procedure. As banking supervisor, the main concern of the HKMA was to understand the nature and scope of the problem, to ascertain whether any irregularity had been committed by any of the bank

TABLE 1 Operational supervision*

	2002	2003
1. On-site examinations including those on	285	247
- treasury	(11)	(9)
- securities	(10)	(18)
- e-banking	(30)	(28)
- review of business continuity plans	(20)	(20)
- overseas examinations	(12)	(9)
2. Off-site reviews and prudential interviews	215	216
3. Tripartite meetings	78	77
4. Meetings with boards of directors of AIs	21	16
5. Approval of applications to become controllers, directors, chief executives, alternative chief executives of AIs	318	310
6. Reports commissioned under Section 59(2) of the Banking Ordinance	0	5
7. Cases considered by the Banking Supervision Review Committee	10	12

* Further details on the banking supervisory approach of the HKMA are given in *HKMA Background Brief No.2 – Banking Supervision in Hong Kong*.

staff, to identify remedial action that the bank should take to rectify any weaknesses revealed in the incident, and to ascertain whether other AIs might have similar weaknesses in their lending practices.

Under Section 59(2) of the Banking Ordinance, the HKMA required the bank to appoint two independent external auditors to separately review and report on the bank's exposures to the borrower in question and the bank's high level controls, credit approval processes, credit risk management, internal control mechanism and asset quality. At the same time, the board of the bank took the initiative to set up a Special Committee to review, among other things, the credit approval, credit risk management and related internal control mechanisms for the bank's corporate lending. The board also commissioned a full audit of the bank's interim results for the first half of 2003.

On 5 September the board of the bank released the full Special Committee's Report, the major findings of the two Section 59(2) reports and the bank's interim results for the six months to 30 June 2003. In the Report, the bank announced that it would implement a series of measures to improve its management capability, credit approval procedures, risk management function and high level controls.

The HKMA conducted specialised examinations on 10 AIs during June and July to ascertain whether prudent lending policies, practices and procedures were being followed by these institutions. They were selected for examination based on the HKMA's assessment of their business operations and associated risks. Apart from some minor deficiencies which were correctable in the normal course of business, the examinations did not reveal any material exceptions.

Impact of the SARS epidemic on the banking sector

A major challenge confronting the banking industry in 2003 was the SARS epidemic, which began affecting AIs, particularly the retail banks, towards

the end of the first quarter. During the SARS outbreak, the demand for bank loans, which was already quiet, declined further; credit card spending fell sharply as consumers cut back on shopping and entertainment, and tourism declined. Branch traffic slowed, hampering the efforts of the banks to market their products.

During this period, the HKMA kept in close touch with AIs and provided guidance on contingency measures to ensure continuity of their operations in the event of confirmed or suspected cases of infection among their staff. In helping AIs to draw up their contingency measures, the HKMA issued a circular in April, sharing with them the measures generally adopted by most institutions. Recognising that the SARS outbreak was having adverse effects on both corporate and personal customers, the HKMA issued another circular to all AIs in May urging them to adopt a sympathetic attitude towards requests for relief arrangements made by borrowers who had encountered repayment difficulties as a result of SARS. AIs were generally co-operative in this area. The HKMA also maintained frequent contacts with bank management to ascertain the impact of SARS on banks' asset quality and profitability. Fortunately, the impact receded by mid-May, when SARS was brought under control. The economic environment and consumer sentiment after the outbreak improved quickly and AIs generally reported that the overall impact on the 2003 results was mild.

 [Information Centre](#) > [Guidelines and Circulars](#)

Risk-based supervision

The HKMA achieved full implementation of the risk-based supervisory approach in 2003. The approach now encompasses all off-site reviews and on-site examinations of both local and foreign AIs. Under this approach, risk-based documentation is produced through off-site reviews. This in turn helps define the scope of on-site examinations depending on the assessment of the specific risk areas to which individual AIs are exposed. The latest development

is to devise a database to capture information about the risk management systems of each AI, further facilitate the preparation and updating of risk-based documentation, and the identification of focused areas in on-site examinations.

During the year the Quality Assurance Unit completed the first cycle of review of risk-based documentation to ensure a high level of work standardisation and consistency. The Unit also updated the internal guidance to staff throughout the risk-based review cycle.

Industry consolidation

The global trend of consolidation in the banking industry continued in 2003. Locally, the merger of Dao Heng Bank Limited, Overseas Trust Bank, Limited and DBS Kwong On Bank, Limited into DBS Bank (Hong Kong) Limited, and the merger of East Asia Credit Company Limited and East Asia Finance Company, Limited with the Bank of East Asia, Limited, were completed during the year. In September 2003, Wing Hang Bank Limited acquired the entire share capital of Chekiang First Bank Limited from Mizuho Corporate Bank, Limited. The number of locally incorporated banks dropped from 26 at the end of 2002 to 23 at the end of 2003.

Taxi loans and public light bus loans

The HKMA continued to monitor closely the market situation for taxi financing and the asset quality of Als' taxi loan portfolio. In accordance with the arrangement set out in the Guidance Note on Taxi Financing issued in December 2000, the HKMA conducted quarterly surveys covering a group of active lenders and two taxi associations regarding the taxi licence value, the income level of taxi operators and the problem loan level of taxi financing. It was noted that the operating income of taxi operators and the taxi licence value were adversely affected by SARS during the second quarter of the year. However, the situation stabilised quickly after the outbreak subsided and the market rebounded to the pre-SARS level in the

third and fourth quarters. The overdue and rescheduled loan ratio of the taxi loan portfolio (for both urban and New Territories taxis) of the surveyed lenders followed a similar pattern: the ratio deteriorated during the SARS outbreak, but started to ease from the third quarter of the year. At the end of December 2003, the ratio stood at 3.30%, which was higher than the level at the end of 2002 (1.68%).

Using the experience gained during the SARS period, the HKMA commenced a review of the operation of the Guidance Note. The major problem was that any adjustments to the cap on taxi licence loan amounts, based on the income of taxi operators, would be procyclical in terms of its impact on the taxi licence value. The HKMA therefore consulted the banking industry on proposals to improve the situation, including the removal of the Note or the replacement of the loan cap with a maximum loan-to-value ratio requirement. The industry, however, failed to reach a consensus and the HKMA decided to maintain the status quo for the time being.

During the year, the HKMA also conducted special on-site visits to Als that were active in public light bus financing to ascertain whether the market continued to adopt prudent lending practices. The outcome showed that the Als concerned had established appropriate internal lending policies and procedures for this line of business.

Personal renminbi business

It was formally announced in November 2003 that the People's Bank of China had agreed to provide clearing arrangements for licensed banks in Hong Kong to conduct personal renminbi business. To enable effective monitoring of these activities, the HKMA consulted the banking industry in December on the introduction of a new return to collect the requisite data from the banks concerned on a monthly basis. The HKMA also made plans to cover personal renminbi business in its ongoing off-site review and on-site examinations of the banks offering these services to customers.

Insurance-related activities of Als

Als in Hong Kong have become more active over the past few years in selling insurance products to customers. While the volume of insurance-related business of the banking industry remains low, it is likely to increase in the years ahead. In light of this, the HKMA discussed with the Insurance Authority (IA) ways to improve the supervisory co-ordination and co-operation between the two agencies in relation to the insurance business of Als.

These efforts culminated in the signing of a Memorandum of Understanding (MoU) between the HKMA and the IA in September. The MoU addressed one of the recommendations arising from the Financial Sector Assessment Programme² (FSAP) Report on Hong Kong conducted by the International Monetary Fund earlier in the year. The recommendation called for increased supervisory co-operation among financial regulators in supervising the cross-market activities of financial institutions.

The HKMA, after consultation with the Hong Kong Association of Banks (HKAB) and the DTC Association, introduced a new return in December 2003 to collect information half-yearly about the insurance intermediary activities of Als. The HKMA will also conduct on-site examinations of Als that are active in insurance related business to check their compliance with the codes of conduct governing the sale of insurance products to their customers.

Co-operation with other supervisors

The HKMA continues to maintain a close working relationship with other regulators in Hong Kong, including the Securities and Futures Commission (SFC), the IA, and the Mandatory Provident Fund Schemes Authority (MPFA). The HKMA also co-operates closely with law enforcement authorities in Hong Kong in preventing or handling fraud cases affecting the banking industry or potential bank customers, and with other

government agencies in countering money laundering and terrorist financing activities.

The HKMA also continues to maintain a close working relationship with supervisors outside Hong Kong. The newly established China Banking Regulatory Commission and the HKMA signed a Memorandum of Understanding on 25 August 2003, which establishes a formal framework for supervisory co-operation and sharing of supervisory information. On 7 July 2003 the HKMA also formalised a similar arrangement with the Commission Bancaire of France. During the year meetings were held in Hong Kong and overseas with regulators from the Mainland, the USA, the UK, Singapore, India, Taiwan, Iran and Macau to discuss supervisory issues of common interest.

Equitable and building mortgages

The Gold-Face incident, in which the developer failed to complete and deliver flats to home buyers who financed their purchase by taking out equitable mortgages, raised concerns about the adequacy of banks' controls over equitable and building mortgages. As a result, the HKMA conducted special visits to a number of Als to review their practices and measures for managing the risks associated with equitable and building mortgages. The results of the review indicated that the risk management and internal controls adopted by the selected Als for this type of lending were in general acceptable although there was room for improvement in the case of some of the Als visited.

Following the visits, the HKMA held discussions with the Als to remind them of the need for adequate controls to mitigate the risks associated with these types of business. In particular, Als are expected to fully evaluate the developer's ability to complete the development project before participating as an equitable mortgage lender. Als are expected to establish appropriate caps to limit their exposure to individual projects and those commenced by the same developer. They are also expected to implement proper measures to ensure that equitable mortgage loan proceeds are paid to

² A joint IMF-World Bank initiative designed to promote financial stability and assess compliance with key international codes and standards covering various financial sectors.

a stakeholder approved by the lending banks that provide the building mortgage loan. Als engaging in building mortgage financing are expected to take appropriate steps to ensure that the loan proceeds are properly applied to finance the project. They should also have adequate control procedures to monitor the construction cost disbursement and the progress of the construction, and to ascertain that sale proceeds arising from pre-completion sales are paid into designated accounts.

Asset quality

Credit card business and personal bankruptcies

The recovery in the domestic economy and the improvement in the unemployment rate helped to reduce the level of bankruptcies in 2003. The number of petitions for bankruptcy fell from 26,922 in 2002 to 22,092 in 2003. Credit card delinquency and annualised charge-off ratios also improved from 1.28% and 13.25% in 2002 to 0.92% and 10.02% respectively in 2003. Apart from the general economic recovery, the improvement in the quality of the credit card portfolio was also helped by banks' willingness to help cardholders in financial difficulties to restructure their card liabilities. With the introduction of the sharing of positive credit data in June 2003 and the prospects for continuing economic recovery, the quality of the credit card portfolio is expected to improve further.

In a follow-up to the special on-site examinations in 2002 on 23 card issuing Als, the HKMA conducted another round of short examinations of 14 small-to-medium size credit card issuers in the first quarter of 2003. These were designed to check that the recommendations arising from the 2002 examinations had been implemented, and to ensure that Als continued to adopt effective risk management procedures and to safeguard the quality of their card portfolios.

 [Information Centre > Press Releases > Credit Card Lending Survey Results category](#)

Residential mortgage lending

Residential mortgage loans by Als shrank in the first three quarters of 2003 as a result of the

economic impact of the SARS outbreak. Moderate growth was recorded in the fourth quarter alongside the economic recovery close to the end of the year. However, the total outstanding value of residential mortgages at the end of 2003 was still less than at the end of 2002, by 2.4%.

Despite the weak economic environment in the first nine months of the year, the asset quality of Als' mortgage portfolio was stable, with the mortgage delinquency ratio hovering around 1% and finally dipping to 0.86% at the end of the year. The problem of negative equity in the mortgage portfolio also eased considerably with the pick-up in property prices in the final quarter of the year.

For a detailed analysis of the asset quality of the banking sector, please refer to the chapter on Economic and Banking Environment on page 33.

 [Information Centre > Press Releases > Residential Mortgage Survey Results category](#)

CEPA

The full implementation of the Closer Economic Partnership Arrangement (CEPA) on 1 January 2004 has taken the economic relationship between the Mainland and Hong Kong into a new phase. CEPA offers greater market access and flexibility for qualifying Hong Kong incorporated Als to conduct business on the Mainland and increase their growth potential.

Under CEPA, Hong Kong's banking sector can enjoy a number of benefits:

- the asset requirement for Hong Kong banks setting up branches on the Mainland is reduced from US\$20 billion to US\$6 billion. Up to seven small to medium-sized banks are expected to benefit immediately from the relaxed asset size requirement.
- the criteria for qualifying Mainland branches of Hong Kong incorporated banks to conduct renminbi business have been relaxed. The minimum number of years of operation has been reduced from three to two and assessment of profitability will be based on the overall position

of all branches of the same bank on the Mainland instead of only the branch that makes the application to conduct such business.

By the end of 2003, four Hong Kong banks had taken advantage of CEPA and submitted applications to set up branches on the Mainland. The HKMA is also aware that some foreign banks are considering turning their branches in Hong Kong into subsidiaries.

Initial public offerings (IPOs)

With the revived public interest in the IPO market in the fourth quarter of 2003, the HKMA issued a circular to all AIs in December reminding them to have appropriate procedures to ensure compliance with all relevant regulatory requirements for IPO business. In particular, AIs were reminded to observe prudent credit standards in financing subscriptions for new share issues and to limit total lending for individual IPOs to an amount which was well within the AI's ability to obtain funding to meet its obligations on the day of settlement. AIs acting as receiving banks for individual IPOs were reminded to have appropriate contingency plans and adequate systems and human resources to cope with any unexpected level of interest in the issue. The HKMA also wrote to a number of AIs active in serving as IPO receiving banks drawing their attention to lessons learnt from a couple of heavily over-subscribed IPO cases in late 2003.

 [Information Centre > Guidelines and Circulars](#)

Banking reform

During the year, the HKMA continued to implement the remaining policy initiatives contained in the banking sector reform programme: the establishment of a deposit protection scheme (DPS) and a commercial credit reference agency (CCRA) in Hong Kong.

(a) Deposit protection scheme

With the endorsement of the Executive Council, a Bill for implementing the DPS was introduced into the Legislative Council in April. The first reading took place on 30 April and a Bills



*Executive Director (Banking Development)
Raymond Li attends a meeting of the Legislative
Council Bills Committee on the Deposit Protection
Scheme Bill.*

Committee was formed in May to scrutinise the Bill. During the year, the Bills Committee held nine meetings. It completed its deliberation of the policy issues underlying the Bill and proceeded to examine the individual clauses. The Bills Committee generally supported the HKMA's recommendations in relation to the key features of the scheme, such as the establishment of an independent Deposit Protection Board to oversee the management of the scheme and the setting of the coverage limit at HK\$100,000 per depositor per bank. With the assistance of the Department of Justice, some refinements to the Bill were made to take into account comments received from Committee Members and other interested parties, including the Consumer Council, the Law Society of Hong Kong and the Hong Kong Bar Association.

(b) Commercial credit reference agency

Progress was made in 2003 towards the establishment of a CCRA in Hong Kong. The industry working party reached consensus on the key features of the scheme. In June the HKMA, the Hong Kong Association of Banks and the DTC Association jointly announced the scheme. In August the HKMA issued a circular letter requiring all AIs engaged in lending to small and medium-sized enterprises (SMEs) to participate in the scheme and setting out the ground rules to be followed by AIs in seeking SME customers' consent to disclosure of their

data to the CCRA. A supervisory guideline to AIs on the use and protection of commercial credit data was also developed and is being refined to take into account the comments of the industry associations. The industry working party has appointed a service provider to operate the CCRA and, together with the company, is finalising the implementation details.

Consumer credit data sharing

In June 2003 the Privacy Commissioner relaxed the Code of Practice on Consumer Credit Data to extend the scope of credit data to be shared among credit providers to cover more positive data. In conjunction with this, the HKMA issued a supervisory guideline requiring AIs to participate fully in the sharing of positive data and to maintain adequate controls to safeguard customer data privacy. With all the preparations in place, credit providers started sharing positive consumer credit data in August. To check AIs' compliance with the guideline, the HKMA began a round of special on-site examinations covering AIs that were active in consumer credit business in December 2003.

The HKMA believes that the sharing of positive data will contribute to the creation of a healthier credit environment. It will help to avoid the problem of multiple indebtedness, which underlies the sharp increase in personal bankruptcies in the past few years. In fact, there are increasing signs that the benefits of positive data sharing are being realised.



New products offered by AIs in response to the launch of positive data sharing: interest is charged based on individual customers' creditworthiness.

Since August, a number of AIs have introduced new products that charge interest based on the creditworthiness of individual customers. This will benefit borrowers with good credit standing.

In addition, a number of AIs active in consumer lending say that positive data sharing has helped to strengthen their credit risk management systems so that they can offer more competitive products to customers.

Consumer protection

(a) Code of Banking Practice

The HKMA continued to participate in the Code of Banking Practice Committee convened by the Hong Kong Association of Banks. Following a detailed review, the Committee introduced new provisions to the Code requiring AIs to provide a prospective surety with an option to choose whether the guarantee or third party security should be limited or unlimited in amount. Where the guarantee or third party security is unlimited in amount, AIs are required to give notice to the surety as soon as practicable when further facilities are extended to the borrower. These new provisions came into effect in February.

The overall state of compliance with the *Code of Banking Practice* improved further in 2003, as shown in the second self-assessment conducted by AIs covering the period between June 2002 and May 2003. Virtually all AIs (99%) reported either full or almost full compliance (i.e. less than five instances of non-compliance) with the Code, compared with 90% in 2002. Where non-compliant areas were identified, AIs were required to take prompt action to rectify the situation.

(b) Customer complaints

In 2003 the HKMA received a total of 536 complaints in relation to banking services. Compared with the second half of 2002, when the HKMA's complaint handling procedures were streamlined, the number of cases received

in 2003 was slightly higher (Chart 1). The rise was mainly due to an increased number of complaints in relation to credit card borrowing, ATM frauds and new deposit products.

Starting from March 2002, all AIs have been required to submit a quarterly return on the number of complaints received against the debt collection agencies (DCAs) that they employ. Since the survey was introduced, the number of

DCA related complaints received by AIs has continued to decline, from 374 cases in the second quarter of 2002 to 139 cases in the fourth quarter of 2003 (Chart 2). The results suggest that AIs have tightened their monitoring of DCAs to ensure they comply with the standards specified in the *Code of Banking Practice*.

 [Consumer Information](#)

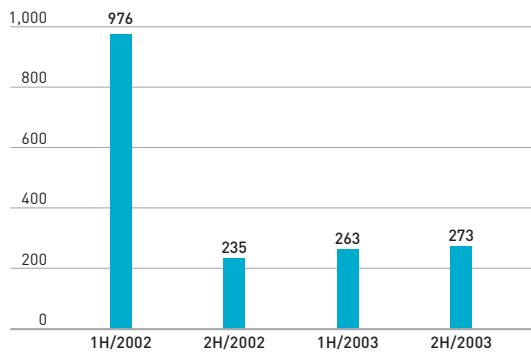
Supervision of AIs' securities and MPF activities

The commencement of the Securities and Futures Ordinance (SFO) and the accompanying Banking (Amendment) Ordinance 2002 on 1 April 2003 brought a new securities supervisory regime into operation. The role of the HKMA as front-line supervisor in relation to AIs' securities activities was reinforced with new responsibilities and powers. An on-line register containing the names and relevant particulars of AIs' securities staff was launched for public inspection on 1 April 2003 on the HKMA website. AIs have started to migrate to the new regime, as required under the law. During April to December 2003, the HKMA processed six applications from AIs for registration under the SFO and granted consent to 15 executive officers (responsible for supervising securities activities) of AIs under the Banking Ordinance. To fulfil its commitment under the new supervisory framework, the HKMA expanded the size of its specialised securities teams and arranged for them to attend SFC training programmes.

 [HKMA Register of Securities Staff of Authorized Institutions](#)

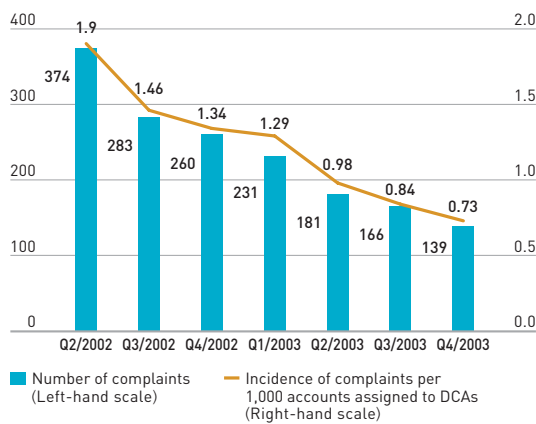
Under the new regime, the HKMA is vested with disciplinary powers to suspend or withdraw the registration of AIs' securities staff and to recommend that the SFC exercise other disciplinary powers over AIs or their securities staff. Since 1 April 2003 the HKMA has put in place procedures to deal with and, if necessary, to investigate matters concerning AIs' securities activities that may trigger disciplinary sanctions. Two separate internal committees, each chaired by

CHART 1 Customer complaints received by the HKMA



Note: In July 2002 the HKMA streamlined its complaint handling procedures. Since then, complainants have been encouraged to resolve their disputes through AIs' internal procedures before reporting to the HKMA. These procedures have resulted in a substantial reduction in the number of complaints received by the HKMA.

CHART 2 Debt collection agency complaints received by AIs



Note: Starting from the second quarter of 2002, all AIs have been required to submit a quarterly return on the number of complaints received against the DCAs that they employ.

a member of the senior management of the HKMA, were established to decide whether to open cases for disciplinary investigation and to make recommendations on the exercise of disciplinary powers. These procedures are similar to those of the SFC. Between April and December 2003, 18 incidents with potential grounds for discipline were reviewed by the responsible committee, which decided to open four cases for investigation. Another case was referred to the SFC for further action.

Specific guidance on compliance with the new statutory and regulatory requirements was provided by the HKMA through a number of circulars to Als in 2003. These covered a range of issues, including restrictions on unsolicited calls, the HKMA public register on Als' securities staff, and applications under the SFO. A module of the HKMA *Supervisory Policy Manual* on the approach towards the supervision of Als' securities business was issued in March 2003. Practical guidance to Als was also provided throughout 2003 in the *HKMA Quarterly Bulletin*. The HKMA revised the prudential return on Als' securities-related activities to reflect the relevant changes under the new regime and collect additional information to facilitate the HKMA's supervision.

 > [Information Centre > Guidelines and Circulars](#)

 > [Policy Areas > Supervisory Policy Manual](#)

 > [Information Centre > Publications](#)

In order to maintain an open market with a level playing field for all intermediaries in the securities industry of Hong Kong, the HKMA and the SFC maintained close supervisory co-operation within the framework set out in the revised MoU between the two regulators. In all, five meetings were held in 2003 under the MoU's established mechanism. The HKMA also refined its on-site examination approach on Als' securities activities to achieve

coherence with the SFC's approach towards other securities intermediaries. Another area of co-operative effort in 2003 was the development of the disclosure regime for fees and charges of securities-related services, which will be finalised by the SFC in 2004. The two regulators also set up a working group in the final quarter of 2003 to start reviewing the implementation of the SFO and studying the need for amendments to the law and regulatory requirements in light of experience.

 > [Policy Areas > Banking Stability > Banking Policy and Supervision > Supervisory Co-operation](#)

The HKMA is also responsible for supervising the MPF-related activities of Als. Regular on-site examinations were carried out to ascertain the adequacy of Als' internal control systems for compliance with regulatory requirements and ensuring the fitness and propriety of staff engaged in MPF intermediary activities. The HKMA also monitored Als' adherence to provisioning and capital charge requirements for the guarantees they provide for the investment return of MPF products.

Electronic banking and technology risk management

In view of the growing acceptance of e-banking services and the increasing dependence of Als on the use of technology to deliver their banking services, the HKMA continued to improve its e-banking and technology risk management supervisory framework. The HKMA introduced an automated control self-assessment process to 40 Als and completed 28 on-site specialist examinations on e-banking and technology risk assessment in 2003. We also issued a guidance note on general principles for technology risk management and a series of circulars to Als to help strengthen their information technology (IT) control environment.

In early 2003 the HKMA noted a spate of fake bank website and e-mail cases overseas. In anticipation of possible similar fraudulent schemes targeting Hong Kong, the HKMA issued a circular in May recommending that AIs take certain preventive and detective measures against similar fraud cases. The HKMA, the Hong Kong Police Force and the HKAB have been co-operating since February 2003 to launch a multi-channel consumer education programme to promote awareness of e-banking security precautions among the general public.

 [Consumer Information](#) > [Internet Banking](#)

In the second half of 2003 ten schemes were detected deploying fake websites and e-mails attempting to defraud Hong Kong bank customers. The HKMA, the police and the banking sector responded quickly to these incidents. Press releases were issued to warn members of the public. Fortunately, no bank customers reported any financial loss through these schemes.

The HKMA received a number of reports of suspected ATM fraud cases in the second half of 2003. In response, the HKMA issued a circular in October setting out its expectations on the precautionary measures that should be undertaken by AIs and the way in which customer complaints should be handled. By the end of 2003 AIs had settled most reported cases and had also made satisfactory progress in improving precautionary measures for their ATMs.

Business continuity planning

The HKMA reviewed the business continuity plans of 20 AIs in 2003. In helping AIs to handle the outbreak of SARS in March and to prepare for another possible outbreak later in the year, the HKMA issued two circulars in April and October on business continuity planning considerations relating to SARS. These circulars recommended certain best practices to AIs in handling an outbreak of SARS or any similar communicable diseases.

Prevention of money laundering and terrorist financing

In 2003 the HKMA further strengthened its supervisory efforts in the prevention of money laundering and terrorist financing. A forum comprising representatives of the industry associations and the HKMA was formed early in the year to further the work on the *Supplement to the Guideline on the Prevention of Money Laundering*. A set of *Interpretative Notes* was produced to provide practical guidance on implementing the requirements of the *Supplement* and explains the risk-based approach to be adopted. The revised *Forty Recommendations* were finalised and issued by the Financial Action Task Force on Money Laundering in June. The revised *Supplement* was issued together with the accompanying *Interpretative Notes* for industry consultation in December 2003.

During the year, the HKMA continued to issue a number of circulars to update the list of Non-cooperative Countries and Territories and to alert them to the new lists of terrorist suspects published in the Gazette under the relevant local legislation, as well as those designated under the US President's Executive Order.

 [Information Centre](#) > [Guidelines and Circulars](#)

Hong Kong's anti-money laundering and terrorist financing regime was assessed by the International Monetary Fund (IMF) in early 2003 as part of its FSAP on Hong Kong. The report, issued in April, indicated that the general regulatory framework for the prevention of money laundering and terrorist financing in the banking sector was adequate, and that the relevant requirements on customer identification and ongoing monitoring of accounts and transactions had been implemented effectively.

Development of supervisory policies

The following policy guidelines were developed during the year as modules of the *Supervisory Policy Manual*.

Reporting requirements relating to authorized institutions' external auditors under the Banking Ordinance

This guidance note specifies on the reporting obligations of AIs' external auditors under the Banking Ordinance. It covers, among other things, requirements on auditors to report on the accuracy of banking returns, the adequacy of systems of control and any matter that, in their opinion, adversely affects an AI's financial position to a material extent or constitutes, on the part of a registered AI, a failure to comply with certain provisions or rules made under the Securities and Futures Ordinance.

The sharing and use of consumer credit data through a credit reference agency

This statutory guideline sets out the minimum standards the HKMA expects AIs to observe in the sharing and use of consumer credit data through a credit reference agency. It requires all AIs involved in consumer lending business to participate fully in the sharing and use of consumer credit data within the limits laid down by the *Code of Practice on Consumer Credit Data* and to maintain adequate controls to safeguard customer data privacy.

The sharing and use of commercial credit data through a commercial credit reference agency (under consultation)

This statutory guideline sets out the minimum standards AIs should observe in sharing and using commercial credit data through a commercial credit reference agency (CCRA).

The guideline requires all AIs involved in lending to SMEs to participate in the scheme and to have adequate systems of control to protect the data of their SME customers. It also requires AIs to only use the services of a CCRA which has taken appropriate steps to safeguard the security and accuracy of the data it holds.

General principles for technology risk management

As AIs increase their dependency on technology to deliver banking services, improper use of technology resources may have significant risk implications. This guidance note sets out the general principles that AIs are expected to consider in managing technology-related risks.

Supervision of e-banking

The development of e-banking services brings considerable benefit to consumers as well as significant challenges to AIs. The HKMA has been issuing a series of guidance notes and circulars since 1997 to cover various aspects of risk management and operations of e-banking. In order to provide a better organised and structured supervisory framework for e-banking, the HKMA has consolidated and updated its guidance notes and circulars issued on e-banking into a new guidance note "Supervision of e-banking". This note sets out the HKMA's supervisory approach to AIs' e-banking services and provides AIs with guidance on the general principles for e-banking risk management.

 > [Policy Areas > Supervisory Policy Manual](#)

Financial reporting and disclosure and regulatory reporting

Financial reporting and disclosure

As a result of the harmonisation of the Hong Kong and international accounting standards, two standards, modelled on International Accounting Standard (IAS) No.39 on *Financial Instruments: Recognition and Measurement* and IAS No.32 on *Financial Instruments: Disclosure and Presentation* are expected to take effect in Hong Kong for annual financial statements of periods beginning on or after 1 January 2005, subject to the final decision of the Hong Kong Society of Accountants. The two standards will introduce, among other things, greater use of fair values in accounting for financial instruments, stringent requirements on the use of hedge accounting and the use of expected cash flow discounting for loan provisioning. They are expected to have significant implications on the accounting and financial reporting by financial institutions and, in particular, the banks. Because of the complexity of the two standards and the time constraint for implementation by the banks, the HKMA conducted a survey of the locally incorporated licensed banks in the fourth quarter of 2003 to raise their level of awareness and to understand the potential impact of the standards on them. The survey results showed that many banks are still studying the requirements, with only a few in the process of developing plans for implementing the standards. It was evident that much more work would have to be done to educate the users to prepare them for implementation.

The HKMA continued to keep abreast of accounting and disclosure developments for areas of improvement. Pending the finalisation of Pillar 3 of the New Basel Capital Accord and the finalisation of the Hong Kong Accounting Standards, which are expected to entail significant changes in disclosure requirements, no revisions were made in 2003 to the financial disclosure guidelines issued by the HKMA.

Regulatory reporting

Further to the comprehensive review of the regulatory returns in 2002, the revised regulatory returns, together with the completion instructions, will become effective for the reporting of positions at the end of March 2004. Work on preparing the systems for the revised reporting was done in 2003.

International supervisory developments

New Basel Capital Accord

In April 2003 the Basel Committee released for comments the third consultative paper on the New Capital Accord (CP3). After considering the comments received, the Committee announced in October its commitment to resolve the outstanding issues for the finalisation of the New Accord by no later than mid-year 2004. The target implementation date of the end of 2006 remained unchanged.

The HKMA completed the third Quantitative Impact Study (QIS 3) on a number of selected local banks to gauge the potential impact of CP3 on the local banking sector. Based on the results of QIS 3 and the capital requirements under the CP3, the HKMA issued in July 2003 for industry consultation preliminary proposals for implementing the New Accord in Hong Kong. The HKMA will take into account comments received subsequently from the industry, and any further changes in the New Accord to be firmed up by the Basel Committee, when finalising the implementation proposals.

In recognition of the fact that the flexibility available to banks and their national supervisors under the New Accord could potentially give rise to inconsistencies in application and level playing-field issues, the HKMA has stepped up contacts with other overseas supervisors for the sharing of views and experience in an attempt to harmonise the implementation process in a cross-border setting.

International co-operation

The HKMA continued to play an active role in promoting interaction among regional banking supervisors, principally through chairing the South-East Asia, New Zealand and Australia (SEANZA) Forum of Banking Supervisors for 2002 and 2003. In December 2003 the HKMA hosted a workshop on the practical application of the New Accord in Asia for the SEANZA Forum in collaboration with the BIS Financial Stability Institute. Altogether, 35 participants from 19 supervisory authorities in the SEANZA economies attended the workshop. The HKMA also continued to participate in other regional and international forums for banking supervisors, which include the Core Principles Liaison Group established by the Basel Committee, the EMEAP Working Group on Banking Supervision, and the Offshore Group of Banking Supervisors.

Core Principles assessment

The FSAP country report on Hong Kong confirmed that the banking regulatory system and supervisory practices in Hong Kong are strong, with a high degree of observance with the *Basel Core Principles for Effective Banking Supervision*. Based on the results of the assessment, the HKMA has devised an internal work plan to address the relevant issues identified for further improvement.



Deputy Chief Executive William Ryback (second from left) reviews the banking sector's performance in 2003 and outlines the HKMA's work for 2004. With him are (from left) Executive Directors Raymond Li, Y.K. Choi and Simon Topping.

PLANS FOR 2004 AND BEYOND

Risk-based supervision

The HKMA will continue to develop the risk-based supervisory process to keep pace with changes in the banking industry and new activities undertaken by AIs. The HKMA will devote more effort to further improving the on-site examination procedures by establishing checklists for new banking products, such as those for AIs' insurance-related activities, private banking activities and personal renminbi business. Special on-site examinations will be conducted in 2004 on AIs that are involved in these areas.

The Quality Assurance Unit will review examination reports and working papers prepared by on-site examiners. The purpose of the review is to ensure consistency of standards and quality of examination reports among supervisory staff. Appropriate guidance will be issued to staff, where necessary, to further improve the quality and efficiency of the risk-based approach. A series of training and refresher programmes, some with the help of the Federal Reserve Bank of New York, will also be arranged in 2004 to improve the skills of supervisory staff in carrying out their work in this field.

Asset quality

Asset quality will remain a main supervisory focus for 2004. The HKMA will seek to ensure that banks' underwriting standards for loans will continue to be prudent. In particular, the HKMA will monitor carefully with the aim of seeking to ensure that banks do not lower their underwriting standards in order to expand their loan portfolio and reduce their surplus liquidity and that they make appropriate use of positive credit data in their consumer credit business.

Interest rate and market risk

There is a general market expectation that interest rates will rise in 2004. This would have an impact on banks with significant portfolios of fixed income securities. A major supervisory focus of the HKMA in 2004 is, therefore, to ensure that AIs have

adequate controls to manage their interest rate risk and market risk arising from adverse changes in interest rate movements and to monitor the impact of such movements on their profitability.

Banking reform

The establishment of the deposit protection scheme and the CCRA will remain a key focus of the HKMA in 2004.

(a) Deposit protection scheme

The HKMA will continue to assist the Legislative Council Bills Committee in its examination of the DPS bill. If the Bill is enacted in the first half of 2004, the Deposit Protection Board will be established to oversee the progress of the whole project. Since there is still a large volume of preparatory work to be completed, it is expected the scheme will only be ready to provide protection towards the end of 2005, at the earliest. The Government will take into account all relevant factors, including the prevailing interest rate environment, in determining the appropriate time to start the scheme.

(b) Commercial credit reference agency

The HKMA will participate in the industry working party to ensure the smooth implementation of the CCRA. The supervisory guideline which sets out the minimum standards to be observed by AIs in the sharing and use of commercial credit data will be finalised prior to the launch of the scheme. If everything goes smoothly, the CCRA is expected to be running in the second half of 2004.

Consumer credit data sharing

As agreed with the Consumer Council, the HKMA will monitor a set of indicators to assess the benefits from the sharing of positive consumer credit data, including greater differentiation in interest rates, reduction in default rates and reduced level of over-indebtedness. To ensure that AIs have put in place adequate controls to

safeguard customer data privacy, the HKMA will conduct a series of on-site reviews covering all AIs active in consumer lending. The reviews were started in December 2003 and will be completed in 2004.

Legal and regulatory framework

The HKMA plans to introduce a Banking Amendment Bill in 2005. The main purpose of the bill will be to implement the new Basel Capital Accord in Hong Kong, but the opportunity will also be taken to improve the working of the Banking Ordinance in some areas in the light of latest market developments. The preparatory work for the bill will commence in 2004.

Consumer protection

The HKMA will continue to promote self-regulation and improvement in the standard of banking practices through participation in the Code of Banking Practice Committee. It will monitor AIs' compliance with the Code through the annual self-assessment exercise and the handling of customer complaints against AIs.

Supervision of AIs' securities and MPF activities

The HKMA will continue to maintain a close working relationship with the SFC in accordance with the MoU between the two regulators. The HKMA will provide input as the AIs' front-line supervisor and consult the banking industry throughout the process of any formulation of new or revised legal and regulatory requirements as well as good industry practices that are applicable to AIs' securities activities. Relevant items include the SFC Guidelines on Good Disclosure of Securities Services-Related Fees and Charges (to be effective in 2004), amendments to the SFO as well as related rules, codes and guidelines (where the need arises), and the possible introduction of measures to improve the refund process in initial public offerings. The HKMA will also co-ordinate with the SFC to extend the Commission's annual survey on fund management activities to cover AIs.

The HKMA will process Als' applications for migration under the SFO, and monitor the schedule for such applications to ensure they will be lodged with the SFC by the end of the two-year transitional period – the end of March 2005.

A reciprocal secondment programme between the SFC and the HKMA commenced in 2004 with the aim of improving staff training. The programme currently covers officers in the area of supervision but will be extended to enforcement functions. The secondment programme will help improve the understanding of the two regulators of each other's supervisory practices, as well as facilitate knowledge and experience transfer between them.

The HKMA will maintain its current supervisory efforts of Als' MPF business. The supervision will be in line with the framework underpinned by the revised MoU signed by the HKMA, the MPFA, the SFC and the IA in January 2004. The HKMA will work with the other financial regulators in developing a uniform regulatory approach to MPF intermediaries.

Electronic banking and technology risk management

The HKMA will continue to review and monitor the rapid development of e-banking services and technology, improve its supervisory framework, and issue further guidance to Als when necessary. The HKMA plans to extend the control self-assessment on e-banking and technology risk management from 40 to 50 Als. The HKMA will also continue its on-site specialist examination programme and conduct approximately 20 such examinations in 2004.

Through the Electronic Banking Working Group of the HKAB, the HKMA, the banking industry and the Hong Kong Police Force will review and monitor the increasing number of reported cases of fake

bank websites and e-mails in Hong Kong. The Working Group will focus on improving measures to detect the operations of fake bank websites and e-mails and also prevent members of the public from being deceived (for example by disclosing their personal information to fraudsters). These measures will include improved consumer education and better security controls over e-banking services.

The HKMA will work with the banking industry to monitor and ensure that Als fully and adequately implement appropriate precautionary measures in relation to their ATMs in the first quarter of 2004. The HKMA will continue to explore with the industry, the ATM network service provider, the vendors of ATM machines and the police other possible measures to prevent similar frauds from happening in Hong Kong.

Prevention of money laundering and terrorist financing

The HKMA will further improve its supervisory efforts in combating money laundering and terrorist financing and keep in line with the international standards.

The HKMA aims at finalising and issuing a revised *Supplement* and its *Interpretative Notes* in the second quarter of 2004. Following that, we shall conduct examinations on Als' systems of controls over the prevention of money laundering and terrorist financing based on the revised requirements.

As a supplement to the on-site examinations, the HKMA intends to develop a structured self-assessment framework to facilitate Als' regular assessment of the extent of their compliance with the relevant regulatory requirements. This will also help the HKMA identify risk indicators and develop supervisory guidance in the longer term.

Development of supervisory policies

Key policies and guidelines to be developed in 2004 will cover the following areas:

- foreign exchange risk management
- liquidity risk management
- internal risk rating systems
- credit cards
- internal audit, legal and compliance functions.

Foreign exchange risk management

The HKMA's supervisory guideline on foreign exchange risk was issued in 1990. Since 2003, the HKMA has been considering an improved foreign exchange risk supervisory framework to incorporate the latest international standards and best practices. We intend to issue a revised guideline to Als in 2004. This will help Als evaluate the adequacy and effectiveness of their foreign exchange risk management, including effective systems for monitoring market risk, settlement risk and credit risk arising from foreign exchange transactions. In developing the revised guideline, the HKMA will also take into account relevant recommendations in the FSAP report and the experience from the Asian financial crisis.

Review of liquidity regime

The HKMA has undertaken a review of the existing liquidity regime, first introduced in 1994, and is in the process of developing a new *Supervisory Policy Manual* module on liquidity risk management that will incorporate the latest international standards and best practices. In particular, more supervisory emphasis will be placed on Als' liquidity risk management systems and controls, including their ability to adequately manage cash-flow positions and conduct scenario analysis. The HKMA will consult the industry about the new module by mid-2004.

Financial reporting and disclosure

The HKMA will continue to keep abreast of accounting and disclosure developments. We shall also work, in collaboration with the banks to understand the impact of International Accounting Standard No.39 and No.32 on the banking industry.

International co-operation

New Capital Accord

A key priority in 2004 is to decide on the legislative process for translating the lengthy and complex capital requirements under the New Accord into legislation, as well as the approach for implementing the New Accord in Hong Kong having regard to the costs and benefits various options will involve. Where necessary, the HKMA will undertake further consultations with the industry when finalising the relevant proposals, to make them both practicable and appropriate for all types of Als. These will take into account the particular features of the Hong Kong market. In addition, given the importance of cross-border supervisory co-operation to the implementation of the New Accord, the HKMA will continue to maintain dialogue with other overseas supervisors on relevant practical issues. The HKMA also intends to release revised banking returns on capital adequacy and associated guidelines for industry consultation by stages from 2004 onwards.

International co-operation

In promoting Hong Kong's status as an international financial centre, the HKMA will continue to participate in international and regional supervisory forums, including the Core Principles Liaison Group, the EMEAP Working Group on Banking Supervision and the SEANZA Forum of Banking Supervisors. As in previous years, the HKMA will co-host with the Financial Stability Institute a supervisory workshop for the SEANZA Forum in late 2004.



Engineering staff provide maintenance services to ensure aircraft safety at Hong Kong International Airport. Aircraft maintenance in Hong Kong uses the most technically advanced methods available and generates more than 1.5 million working hours of maintenance every year.

MARKET INFRASTRUCTURE

A robust financial infrastructure is essential to Hong Kong's effectiveness as an international financial centre. One of the HKMA's key policy objectives is to promote the development of a safe and efficient financial market infrastructure in Hong Kong, with particular emphasis on its clearing and settlement arrangements for funds and securities. In addition to ensuring the safe and efficient operation of the existing systems in 2003, the HKMA worked on a draft law that will provide for a regulatory oversight regime for important clearing and settlement systems in Hong Kong.

OBJECTIVES

The HKMA is committed to promoting a safe and efficient financial market infrastructure, which is the foundation of all leading international financial centres. As well as overseeing the efficient operation of the interbank payment and clearing systems in Hong Kong, the HKMA is involved in developing infrastructure to accommodate the evolving needs of Hong Kong. The HKMA pays particular attention to fostering the development of the local and regional debt markets and clearing systems to facilitate cross-border transfers of funds and securities.

REVIEW OF 2003

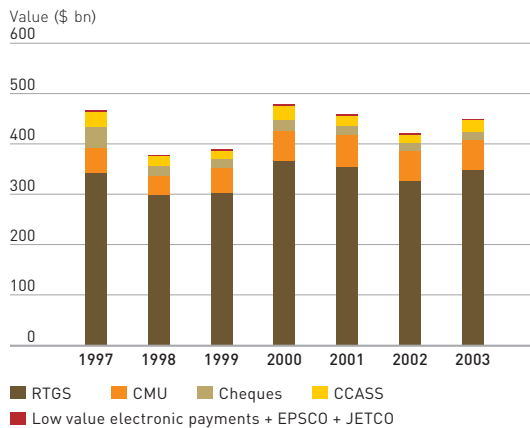
Hong Kong dollar interbank payment system

Structure and characteristics

The Clearing House Automated Transfer System (CHATS) is Hong Kong's Real Time Gross Settlement (RTGS) system introduced in 1996. It provides Hong Kong with a safe and efficient interbank payment system with the following features:

- (a) a robust and single-tier system in which all licensed banks maintain settlement accounts with the HKMA;
- (b) interbank payments settled using central banking funds across the books with the HKMA;
- (c) intraday liquidity provided through highly automated intraday repo facility using Exchange Fund Bills and Notes;
- (d) seamless interface with the Central Moneymarkets Unit (CMU – a debt securities clearing and settlement system operated by the HKMA) which makes it possible to offer real time delivery-vs-payment (DvP) and end-of-day DvP functions;
- (e) a central queuing system for unsettled payment messages, which can only be cancelled, resequenced or amended by the paying banks; and
- (f) a capability for developing payment-vs-payment (PvP) links with other payment systems to reduce settlement risk in foreign exchange transactions.

CHART 1 Hong Kong dollar payment system daily average turnover



Hong Kong Interbank Clearing Limited (HKICL), jointly and equally owned by the HKMA and the Hong Kong Association of Banks (HKAB), was formed in 1995. It serves as the system operator for CHATS and other related payment services. Its track record in the provision of Hong Kong dollar interbank payment services has been excellent and reliable. In 2003, the HKICL processed a daily average value of \$348 billion (13,721 items in volume) CHATS transactions and \$21.1 billion (138 items in volume) CMU secondary market transactions. The system also provided for the smooth settlement of the four daily bulk clearings – the money settlement of stock market transactions (CCASS), low-value bulk electronic payment items (EPSCO), cheques and low-value ATM transfers (JETCO) (Chart 1). Reflecting an increase in stock market and IPO activities, the volume of CHATS transactions and cheque turnover increased substantially in December 2003.

During the year, banks made good use of their Exchange Fund Bills and Notes to obtain interest-free intraday liquidity through conducting intraday repo transactions with the HKMA for settlement of interbank payments. On average, \$37 billion worth

of intraday repo transactions were done daily to facilitate payment flows. This represented about 35% of the \$106 billion Exchange Fund paper held by banks in December 2003.

Cheque imaging and truncation

With the support of the HKMA, HKAB commissioned HKICL to implement the Cheque Imaging and Truncation System (CITS) on an industry-wide basis. This new system began operating in June 2003. In implementing CITS, the Bills of Exchange Ordinance was amended in March 2003 to allow banks to present electronic images of cheques for payment.

CITS has transformed the clearing process for cheques. Under CITS, low-value cheques are exchanged and cleared on the basis of an electronic presentation of cheque images and the relevant cheque data. This reduces the need for banks to physically deliver low-value cheques for clearing and settlement. Higher value cheques, and special items (such as suspicious cheques) regardless of their value, are still presented physically together with their images to the paying banks.

With cheque imaging and truncation, the data and images taken from cheques are cheaper to handle and store and can be retrieved almost instantaneously from the image database through computer workstations.

Hong Kong dollar clearing and settlement arrangements between Hong Kong and Guangdong

With the support of the HKMA and the Guangzhou branch and Shenzhen sub-branch of the People's Bank of China (PBoC), the joint clearing facilities for Hong Kong dollar cheques were fully implemented in June 2002. This has reduced the clearing time to two working days for Hong Kong dollar cheques drawn on banks in Hong Kong and

presented in Guangdong, or vice versa. In 2003, around 253,000 cheques, with a value of \$22.3 billion, were cleared through these joint clearing facilities.

The HKMA and Shenzhen sub-branch of the PBoC introduced a scheme in December 2002 for the Shenzhen Financial Electronic Settlement Centre to operate a Hong Kong dollar RTGS system in Shenzhen. The scheme marked another milestone in the development of cross-border financial infrastructure, and should expedite Hong Kong dollar payments between banks in Hong Kong and Shenzhen. In 2003 the scheme handled around 3,400 transactions, with a total value of over \$18 billion. The scheme was further extended in November 2003 to enable banks to make US dollar RTGS payments between banks in Hong Kong and Shenzhen.

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Foreign currency payment systems

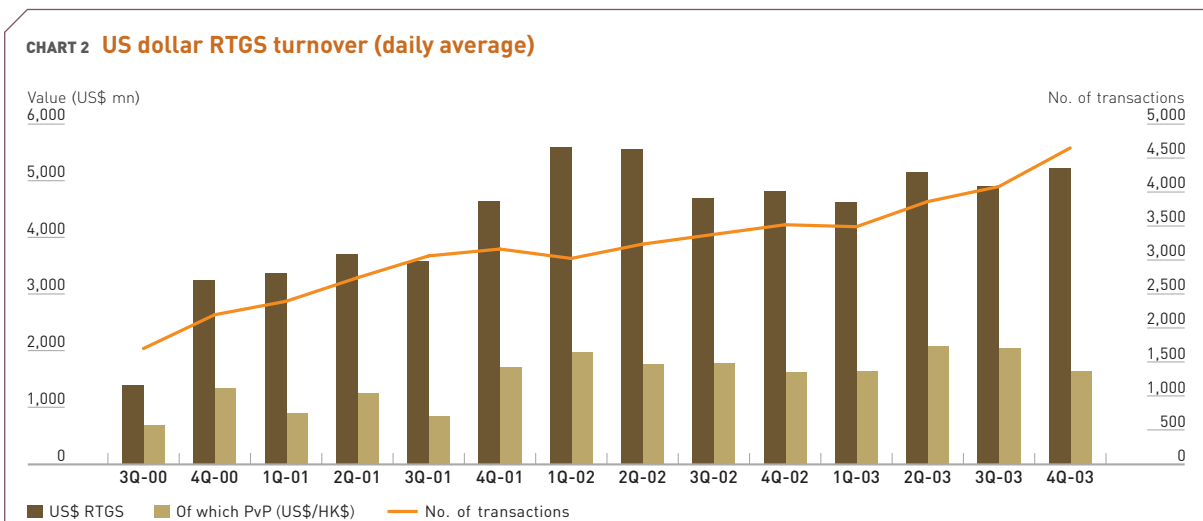
To enable efficient settlement of US dollar and euro transactions in Hong Kong during Asian business hours, the HKMA introduced a US dollar clearing system in Hong Kong in August 2000 and a euro clearing system in April 2003. The HKMA appointed The Hongkong and Shanghai Banking Corporation Limited and the Standard Chartered Bank as the

settlement institutions for the US dollar and euro clearing systems respectively, with HKICL as the operator of these two systems (in addition to the Hong Kong dollar RTGS system).

These two foreign currency systems offer a range of advanced clearing functions similar to those of the Hong Kong dollar payment system to satisfy the needs of banks, corporate and individuals for real-time payment in the US dollar and euro in the Asian time zone. Users of these systems can achieve substantial benefits through streamlining their day-to-day operations and better management of liquidity.

US dollar clearing

The US dollar clearing system has operated efficiently since its implementation in August 2000. By the end of 2003 there were 67 direct and 160 indirect participants in the system, including 113 indirect participants from outside Hong Kong. Despite the slowdown in the local economy, turnover of the system grew steadily. In the fourth quarter of 2003, the system handled an average 4,600 transactions a day with a total value of over US\$5.2 billion (Chart 2). In December 2003 an average of more than 2,600 US dollar cheques were processed daily, with a total value of over US\$87 million.



Euro clearing

The euro clearing system operated smoothly in its first year. By the end of 2003, there were 23 direct and 22 indirect participants, including nine indirect participants from outside Hong Kong. In the fourth quarter of 2003 the system handled an average 30 transactions a day with a total value of over €740 million.

Reduction in settlement risk

Delivery-versus-payment of debt securities transactions

Through seamless interfaces with the Hong Kong dollar, US dollar and euro RTGS systems, the CMU offers DvP settlement, during Asian business hours, of debt instruments denominated in these three currencies (Chart 3). The DvP mechanism substantially eliminates the settlement risk by ensuring that the payment in Hong Kong dollars, US dollars or euros for the debt securities transaction is undertaken simultaneously with, and conditional on, the securities transfer.

Payment-versus-payment settlement of foreign exchange transactions

The interface between the Hong Kong dollar, US dollar and euro payment systems offers PvP

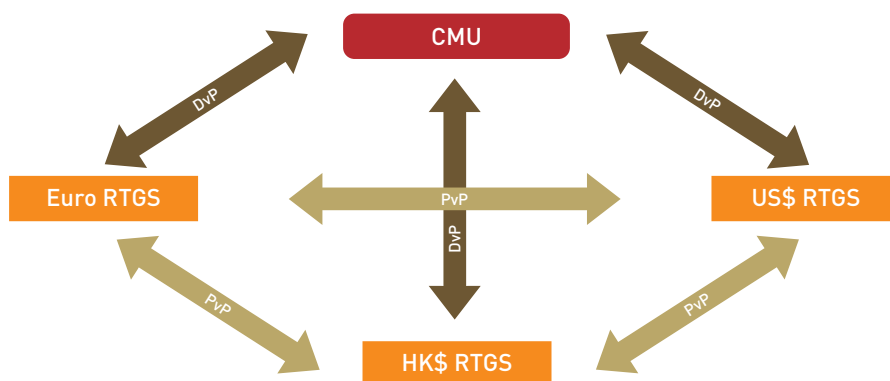
settlements for US dollar/Hong Kong dollar, euro/US dollar and euro/Hong Kong dollar foreign exchange transactions (Chart 3). Use of PvP has become increasingly popular in Hong Kong and accounted for about a third of US dollar and euro RTGS turnover, by value, in 2003.

The PvP mechanism eliminates Herstatt risk (risk arising from settlement of the two legs of a foreign exchange transaction in different time zones) by ensuring that the two legs of a foreign exchange transaction are settled simultaneously. Liquidity management is also improved, as the traded currencies can be recycled immediately in their respective clearing systems. This should particularly benefit small and medium-sized banks and enable them to participate more actively in the foreign exchange market by being less constrained by counterparty credit limits.

CMU external linkages

The CMU provides an efficient clearing, settlement and depository service for both Hong Kong dollar and other international debt securities. Since its establishment in 1990, the CMU has developed external linkages with other regional and international central securities depositories.

CHART 3 DvP and PvP clearing facilities for multiple currencies



Through these links, overseas investors can hold and settle securities lodged with the CMU. In 1994 the CMU set up one-way in-bound links with Euroclear and Clearstream (formerly Cedel) and these links became two-way (both in-bound and out-bound) in November 2002 for Euroclear and January 2003 for Clearstream. The establishment of out-bound links allows investors in Hong Kong and other parts of Asia to hold and settle international securities directly through CMU members (most of which are banks in Hong Kong) in a safe and secure DvP environment. In addition to facilitating cross-border holdings and trading of international securities, the CMU offers Hong Kong and Asian investors a one-stop service to clear, settle and hold domestic and international securities through CMU members.

Formal oversight regime for the important clearing and settlement systems

The International Monetary Fund (IMF) undertook a Financial Sector Assessment Programme (FSAP) examination for Hong Kong in the second half of 2002, and published a summary report in June 2003. The IMF report concluded, among other things, that the market infrastructure in Hong Kong had all the necessary characteristics to support the efficient functioning of financial markets. The payment systems, in particular, were singled out as efficient and supportive of the smooth operation of the wholesale markets for money, foreign exchange and securities transactions.

However, the IMF recommended that consideration should be given to the introduction of statutory backing for the responsibilities currently assumed by the HKMA in overseeing the clearing and settlement systems in Hong Kong. It also recommended that, as a matter of priority, appropriate legislation should be introduced to ensure finality of settlements and to underpin netting systems.

In this connection, a Clearing and Settlement Systems (CSS) Bill was introduced into the Legislative Council on 10 December 2003 to provide for a statutory oversight regime and settlement finality for important clearing and settlement systems in Hong Kong.

The CSS Bill will also facilitate the admission of Hong Kong dollar transactions into the Continuous Linked Settlement (CLS) system – a global clearing and settlement system for cross-border foreign exchange transactions. Many major international currencies have already been admitted to the system (the Australian dollar, Canadian dollar, Danish krone, euro, Japanese yen, Norwegian krone, pound sterling, Singapore dollar, Swedish krona, Swiss franc and US dollar). As in other jurisdictions, the CLS system requires, as a pre-condition for entry, that the laws of Hong Kong provide for settlement finality for both transactions through the CLS and the underlying RTGS system in Hong Kong.

Under the proposed framework set out in the CSS Bill, the HKMA will be empowered to designate any clearing and settlement system to be subject to the oversight of the HKMA if the system is, or is likely to become, a system whose proper functioning is material to the monetary or financial stability of Hong Kong, or to the functioning of Hong Kong as an international financial centre. The Bill also provides for the granting of statutory protection from the insolvency regime to designated clearing and settlement systems to ensure settlement finality. The power to designate will not apply to any clearing and settlement system that is, or is operated by a company recognised as, a clearing house for the purpose of section 37 of the Securities and Futures Ordinance (SFO). This is to avoid regulatory overlap with the Securities and Futures Commission under the SFO.

Debt market development in Hong Kong

Gross issuance of Hong Kong dollar debt declined slightly in 2003, by 3% to \$384 billion. Following a sharp increase of 28% in 2002, debt issuance by non-Multilateral Development Bank (MDB) overseas borrowers rose in 2003, by 17% to \$86 billion. However, this was more than offset by a strong decline in domestic private-sector debt issuance, which fell by 15% and 38% for authorized institutions (AIs) and local corporates respectively. Debt issuance activity by the Exchange Fund, statutory bodies/government-owned corporations and MDBs also moderated.

Despite the fall in gross issuance, the value of outstanding Hong Kong dollar debt rose to \$558 billion at the end of 2003 as total new issuance during the year outstripped maturing securities by \$25 billion. Net issuance (gross issuance minus debt matured) by non-MDB overseas borrowers reached \$42 billion in 2003: they replaced AIs as the largest debtor, accounting for almost one-third of outstanding Hong Kong dollar debt. At the same time, possibly reflecting ample liquidity in the banking sector and hence little need for external funds, AIs reduced their total outstanding debt by \$11 billion to \$138 billion.

In 2003 the overall market continued to deepen, with more structured products bearing yield enhancement features, and an increase in sales of longer-term debt securities. However, the demand for retail bonds weakened, in part because of a rebound in Hong Kong stock and residential property prices in the second half of 2003. It is estimated that a total of \$12 billion of retail bonds and certificates of deposits were issued in Hong Kong in 2003, a decline of around 50% from the previous year.

The HKMA continued to work closely with market participants and the Government to promote the development of the local debt market. Frequent and regular dialogue was maintained with various industry bodies, including the Hong Kong Capital Markets Association and ACI – The Financial Markets Association of Hong Kong. The HKMA also participated in working groups and committees led by the Government to develop policy initiatives conducive to debt market development. Examples of these are the relaxation of maturity requirements and an increase in tax concessions for qualified debt securities, as announced by the Financial Secretary in his Budget Speech in March 2003.

Exchange Fund Bills and Notes programme

Efforts were made to improve the liquidity and credibility of the benchmark Hong Kong dollar yield curve by rebalancing the maturity mix of the Exchange Fund Bills and Notes (EFBN) portfolio. This was done through shifting issuance from short term Exchange Fund Bills to Exchange Fund Notes (EFN), streamlining the EFBN portfolio through reopening 5-year EFN for tender, promoting active participation of market makers in the EFBN market through regularly reviewing the performance of the market makers and enhancing pricing transparency of EFBN through publishing daily a set of official fixings on prices and yields.

 [What's New > Daily Updates > Exchange Fund Bills and Notes Fixings](#)

In helping to broaden the investor base of EFN and Hong Kong dollar debt securities in general, the HKMA introduced a one-year pilot scheme (the Retail Scheme) in August 2003 to facilitate retail investment in EFN. Under the Scheme, a portion of each quarterly issue of 2-year and 3-year EFN is set aside for non-competitive tender by retail

investors through the Retail Exchange Fund Notes Distributors – the Bank of East Asia, DBS Bank (Hong Kong) and Wing Lung Bank. The first three non-competitive tenders, conducted in August, October and November 2003, allocated \$241 million of EFN to retail investors. In addition to providing a non-competitive tender service, the Distributors also agreed to adhere to a number of unified standards in the distribution of EFN to retail investors in the secondary market, to increase pricing transparency for retail investors. A new section, “Exchange Fund Notes: Information for Investors”, was also added to the HKMA website to educate retail investors on bond investment. A pamphlet on EFN was issued for distribution to the public to promote awareness of the retail EFN programme.

 [Exchange Fund Notes: Information for Investors](#)



Hong Kong cyclists take part in the 9th All China Games, held in Guangzhou. Cyclists from Hong Kong have made a name for themselves in both national and international competitions. In this race Hong Kong takes the gold medal.

INTERNATIONAL FINANCIAL CENTRE

The HKMA continued to play a leading role in promoting regional co-operation in 2003, particularly in the development of the Asian bond market. The HKMA's participation in financial and central banking forums contributed to a better understanding by the international financial community of Hong Kong's financial and economic development and its position as an international financial centre.

OVERVIEW

Despite the uncertainties presented by geopolitical conflicts, terrorism and the sharp weakening of the US dollar, the global financial system remained largely stable in 2003 under a benign inflation environment and low interest rates. In Asia, however, the outbreak of SARS in the second quarter of 2003 and strong capital inflows in the latter part of the year, presented substantial challenges to central banks in the region. Against this background, the HKMA strengthened its co-operation with international and regional financial organisations with the aim of improving financial stability and promoting bond market development in the region, raising Hong Kong's profile among international financial institutions and investors, and enhancing Hong Kong's position as an international financial centre.

As chairman of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) Working Group on Financial Markets, the HKMA contributed significantly to the design and launch of the Asian Bond Fund (ABF). The HKMA led the Asia-Pacific Economic Co-operation (APEC) Initiative on Development of Securitisation and Credit Guarantee Markets, along with Thailand and Korea as co-chairs. The HKMA also worked closely with the People's Bank of China (PBoC) and State Administration of Foreign Exchange in the launch of personal renminbi banking business in Hong Kong.

REVIEW OF 2003

Regional monetary co-operation and participation in multilateral institutions

The HKMA contributed significantly to policy dialogues in international and regional forums and played a significant role in regional monetary co-operation in 2003. The HKMA participated actively in the meetings of the APEC forum, the Financial Stability Forum (FSF)¹ and the Bank for International Settlements (BIS), and in regional central banking co-operation, including chairing the EMEAP Working Group on Financial Markets and the EMEAP Forum on Foreign Exchange Markets.² HKMA Chief Executive, Mr Joseph Yam, was elected as the Chairman of the BIS Asian Consultative Council (ACC) in March for a term of two years. The ACC comprises the Governors of

¹ The FSF was established in April 1999, at the initiative of G7 Finance Ministers and Central Bank Governors, to promote international financial stability. Members of the FSF include national financial authorities from G7, Australia, Hong Kong, the Netherlands and Singapore; the European Central Bank; international financial institutions; international regulatory and supervisory groupings; and committees of central bank experts.

² The Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) Group comprises 11 central banks and monetary authorities in the East Asia and Pacific region. These are central banks of Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand.

BIS member central banks in the Asia-Pacific region.³ It was established in 2001 to provide a vehicle for communication between these central banks and the BIS Board and Management on matters of interest and concern to the Asian central banking community.

With the aim of furthering regional monetary co-operation, the HKMA continued to maintain close contacts with the regional central banks. During the year, the HKMA held bilateral meetings with the Monetary Authority of Singapore and the Bank of Thailand.

Compliance with international codes and standards

The HKMA acted as the co-ordinator for Hong Kong's participation in the Financial Sector Assessment Programme (FSAP), a joint IMF-World Bank initiative designed to promote financial stability. An FSAP Mission, comprising experts from the IMF, the World Bank and collaborating institutions (such as the UK Financial Services Authority and Banque de France), conducted assessments of Hong Kong's compliance with eight key international standards, covering the banking, securities, insurance and other financial sectors in the second half of 2002 and the first quarter of 2003. The findings and recommendations of the Mission were published in the Financial System Stability Assessment (FSSA) report in June 2003. The Mission confirmed that Hong Kong complies with key international standards, its financial system is fundamentally sound, and its market infrastructure is robust and efficient.

³ The BIS member central banks represented in the ACC are those of Australia, China, Hong Kong SAR, India, Japan, Korea, Malaysia, Singapore and Thailand. In addition, the Governors of central banks of Indonesia, New Zealand and the Philippines have also been invited to the ACC meetings.

Hong Kong's international credit ratings

Since July 2003, the HKMA has been playing a key role in the adoption of a more pro-active approach towards Hong Kong's international credit ratings. The main purpose of this approach is to ensure a balanced view on Hong Kong through more effective communication between the international credit rating agencies and the relevant authorities in Hong Kong. In October 2003, Moody's decoupled Hong Kong's sovereign rating from that of China's by upgrading Hong Kong's foreign currency rating by two notches to A1.

Financial market integration with the Mainland

Extensive interaction between the HKMA and Mainland authorities improved mutual understanding and brought positive results in 2003. The Chief Executive of the Hong Kong Special Administrative Region announced on 18 November that, following approval from the State Council, the PBoC had agreed to provide clearing arrangements for personal renminbi business in Hong Kong. The scope of such renminbi business includes deposit-taking, exchange, remittances and debit and credit cards. This arrangement signifies an important step forward for the development of the banking sector in Hong Kong. It opens a new channel for the flow of renminbi funds between Hong Kong and the Mainland through the banking system. On 19 November, the HKMA and PBoC signed a Memorandum of Cooperation in Beijing to facilitate enhanced co-operation between the two institutions, including the exchange of information relating to personal renminbi business in Hong Kong.

During the year, the HKMA took steps to increase its understanding of Mainland financial issues through continued co-operation in research projects with Mainland academics and think-tanks and through inviting Mainland officials and academics to visit Hong Kong to exchange views on issues of common interest.

Training

A series of training programmes was designed for officials of PBoC, China Banking Regulatory Commission (CBRC) and other Mainland authorities, both in Hong Kong and Shenzhen, to share the HKMA's expertise in the area of banking supervision and its experience in FSAP. These included a four-week banking supervision course for PBoC supervisors; a two-week financial supervision seminar for its senior officials from different areas; a one-week FSAP seminar for officials from various Mainland authorities; and two specialised courses for CBRC's bank supervisors and Mainland commercial bankers. Overall, five courses, or 1,322 days of training, were provided to 258 Mainland officials in 2003. The HKMA will continue to organise similar seminars and courses for the staff of the Mainland authorities in 2004.

The HKMA also provided training on request to other external parties, including Mainland commercial banks and the Hong Kong Independent Commission Against Corruption. A total of 227 participants attended the seminars in 2003.



The HKMA holds its Sixth Distinguished Lecture on 18 September 2003. From left: Governor Zhou Xiaochuan of the People's Bank of China, Chief Executive Joseph Yam, and Gerald Corrigan, Managing Director of Goldman, Sachs & Co. Dr Zhou speaks on "Reform Gradualism and Evolution of Exchange Rate Regime in Mainland China".

Development of regional bond markets

During the year the HKMA took the lead in the design and launch of the ABF under the EMEAP forum. The first phase, the US dollar-denominated ABF (or ABF1), was launched in June 2003, with an issue size of about US\$1 billion. All 11 central bank members of EMEAP invested in ABF1. The aim of ABF1 is to help promote the efficiency of financial intermediation in the region and facilitate the channelling of a small portion of the sizeable official reserves held by the Asian economies back into the region. The EMEAP Working Group is now studying the feasibility of the second phase of ABF, the local currency-denominated ABF (or ABF2), in order to broaden and deepen bond markets in the region.

In addition, the HKMA is co-chairing, with Korea and Thailand, an APEC Initiative on the Development of Securitisation and Credit Guarantee Markets. The initiative, sponsored by the World Bank, is to assist APEC member economies in identifying market impediments and to devise proposals to remove them. The first panel visits to three APEC economies, i.e. China, Thailand and Mexico, took place in 2003, and the first high level policy dialogue under the APEC Initiative was held in Seoul in April 2003.

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Green volunteers plant shrubs during a campaign in the Tai Po Waterfront Park in September 2003. Hong Kong currently has over 1,000 Green Volunteers, all of whom are trained to nurture and care for trees and plants and to promote the greening of Hong Kong.

RESERVES MANAGEMENT

Global financial markets were volatile in 2003. The Fed funds target rate fell to a 45-year low of 1%. Global equity markets rebounded sharply and the US dollar fell further against the euro and the yen. The HKMA managed to steer through these financial headwinds by adopting a prudent investment approach in managing Hong Kong's official reserves. The Exchange Fund outperformed its investment benchmark and achieved an investment return of 10.2%.

THE EXCHANGE FUND

The Exchange Fund plays a central role in maintaining Hong Kong's monetary and financial stability. Since its establishment in 1935, the Fund has held the backing to the banknotes issued in Hong Kong. In 1976 the backing for coins issued and the bulk of the foreign currency assets held in the Government's General Revenue Account were also transferred to the Fund. At the end of 2003, the Fund's assets amounted to \$1,011.6 billion.

The Exchange Fund's primary objective is to safeguard the exchange value of the Hong Kong currency and to maintain the stability and integrity of the monetary and financial systems. At 31 December 2003 the foreign currency reserves held by the Exchange Fund amounted to HK\$919.1 billion or US\$118.4 billion. It is also the investment objective of the Fund to maintain the long-term purchasing power of the reserves, which represent a store of value for the people of Hong Kong.

The high volatility in the financial markets in recent years has highlighted not only the importance of prudent investment management but also the need

to diversify into various markets and instruments. The management of the reserves by the HKMA is in line with international best practices.

Asset allocation of the Exchange Fund

The Exchange Fund Advisory Committee endorsed, with effect from January 2003, some modifications to the investment benchmark for the Fund's long-term strategic asset allocation. Under the revised investment benchmark, 77% of the Fund is allocated to bonds and 23% to equities and related investments. In terms of currencies, 88% is allocated to the US dollar bloc (which includes Hong Kong dollar) and the remaining 12% to other currencies. The benchmark, which directs the Exchange Fund's long term asset allocation strategy, is derived from the Fund's investment objectives. Since 1999, the investment benchmark is reviewed regularly to ensure that it consistently meets the investment objectives. The recent review suggested some modifications in light of the changing financial landscape and the extremely high market volatility. This revised benchmark is expected to help improve the risk-adjusted return in the medium to long term.

Compared with the previous strategic asset allocation, the new investment benchmark has a lower allocation to non-US dollar currencies. With these modifications, the strategic investment benchmark is expected to continue to meet the Fund's long-term investment objectives. These objectives are

- (a) to preserve capital;
- (b) to ensure that the entire Monetary Base at all times will be fully backed by highly liquid short-term US dollar denominated securities;
- (c) to ensure sufficient liquidity for the purpose of maintaining monetary and financial stability; and
- (d) subject to (a) – (c) above, to achieve an investment return that will preserve the long-term purchasing power of the assets.

The investment process

The Exchange Fund is managed as two distinct portfolios – the Backing Portfolio and the Investment Portfolio. In September 1998, the Monetary Base was redefined to include Exchange Fund Bills and Notes in addition to Certificates of Indebtedness, coins in circulation and the aggregate clearing balance maintained by banks with the HKMA. At the time, the Backing Portfolio was established to hold highly liquid US dollar denominated assets to fully back the Monetary Base.

The balance of the Exchange Fund assets that constitute the Investment Portfolio is predominantly invested in OECD bond and equity markets to preserve the value and long-term purchasing power of these assets.

The Fund's long-term asset allocation strategy is governed by the investment benchmark. This defines the allocation of investments to different asset classes by country and by sector as well as the overall currency mix for the Fund. To qualify as an approved investment, a new market or financial instrument must meet the minimum credit, security and liquidity requirements of the Exchange Fund.

The strategic investment strategy is determined by the Exchange Fund Advisory Committee, while the day-to-day management of the Exchange Fund is conducted by the Reserves Management Department of the HKMA. In discharging its responsibilities, the Department operates within the investment guidelines approved by the Exchange Fund Advisory Committee. By means of fundamental analyses of different economies and assessments of market development and trends, the investment professionals determine the allocations to asset classes by country and by sector as well as the appropriate timing for market entries and exits. These professionals also engage in the selection of specific securities within each market.

Stringent controls and investment guidelines have been established to monitor the risks arising from increasing volatility in the financial markets. The HKMA also conducts detailed performance attribution analyses to make the most effective use of the investment skills of both internal and external managers.

Use of external managers

The Exchange Fund employs global external managers located in 13 financial centres to manage about one third of its total assets and all of its equity portfolios. The purpose of appointing external managers is to tap the best of the investment expertise available in the market, to capture a diverse mix of investment styles within the global investment field, and to transfer market knowledge and information. The Exchange Fund's diversification into different asset classes, management styles, and markets has increased the number and types of specialist managers employed. Looking ahead, the Exchange Fund intends to continue this diversification.

Externally managed portfolios are subjected to the same stringent controls, investment guidelines and performance attribution analyses as the internally managed portfolios. They are held with several major global master custodians.

Hong Kong equity portfolios

With effect from January 2003, the management of the Hong Kong equity portfolio was transferred to the HKMA from Exchange Fund Investment Limited. The HKMA manages this portfolio exclusively through external fund managers.

Risk management and compliance

The Risk Management and Compliance (RMC) Division is responsible for the risk control functions of the Exchange Fund. It monitors the market, price, credit and operational risks arising from the investment process. The Division is also responsible for the selection of investment

benchmarks and evaluation of investment performance. Externally and internally managed portfolios are evaluated against the assigned benchmark. The Division engages in detailed performance attribution analysis to identify the skills of investment managers to improve effective asset allocation. In addition to traditional risk control tools, value-at-risk and scenario stress testing is used to quantify the market risks in the portfolios under normal and extreme adverse market conditions.

The RMC Division continuously strengthens and upgrades its internal diagnostic and analytical capabilities in line with best market practices to keep pace with the changes in the investment approach of the Exchange Fund.

PERFORMANCE OF THE EXCHANGE FUND

The financial markets in 2003

The financial markets were turbulent in 2003. An extremely accommodative monetary policy stance in the US was evident in a 45-year low Fed funds target rate of 1%. By mid-year, sentiment turned positive. The end of hostilities in Iraq coincided with strong economic data, and equity markets staged an impressive rebound. The US dollar continued to weaken against the euro and the yen. As the US dollar weakened, commodity prices surged. Gold rose almost 20% to close the year at a 7½-year high of US\$415 per ounce.

Chief Executive Joseph Yam and Executive Director (Reserves Management) Amy Yip announce the results of the Exchange Fund for 2003.



TABLE 1 2003 market returns

Currencies	
Appreciation against the US dollar	
euro	20.2%
yen	10.7%
Bond markets	
JP Morgan US Government Bond (1-7 years) Index	2.3%
Equity markets	
Standard & Poor's 500 Index	+26.4%
Hang Seng Index	+34.9%

The performances of major bond, equity and currency markets are set out in Table 1.

The Exchange Fund's performance in 2003

The investment strategy for the Exchange Fund steered a steady course in 2003 through an extremely difficult investment environment by adopting a defensive policy and increasing allocation to non-US dollar currencies and to equity markets. In 2003 the Exchange Fund recorded foreign exchange gains of \$22.9 billion, mainly owing to the appreciation of the euro against the US dollar. Investment gains from Hong Kong equities and foreign equities were \$21.2 billion and \$26.8 billion respectively. Total income from bonds, at \$18.8 billion, was substantially lower than previous years because of the very low interest rate environment. The investment strategy produced an overall investment income of \$89.7 billion, or an investment return of 10.2%.

TABLE 2 Gross investment return of the Exchange Fund (in US dollar terms)¹

	Return on total assets	Return on investment benchmark ²	CPI(A) ³
2003	10.2%	9.5%	-1.2%
2002	5.1%	3.9%	+1.0%
1993 – 2003 cumulative	105.3%	N/A	24.0%
1993 – 2003 annualised	6.8%	N/A	2.0%

¹ For the Annual Reports in 2000 and preceding years, return on total assets and return on investment benchmark is in Hong Kong dollar terms.

² Established in January 1999.

³ December year-on-year percentage change in the HK-CPI(A) index. CPI(A) is calculated based on the 1999/2000 base new series.

TABLE 3 Currency mix of the Exchange Fund's assets (at 31 December 2003) – including forward transactions

	HK\$ billion	%
US dollar bloc		
US dollar ¹	786.2	77.7
Hong Kong dollar	77.9	7.7
Non-US dollar bloc	147.5	14.6
Total	1,011.6	100.0

¹ Included US dollar bloc foreign currencies such as Canadian dollar, Australian dollar and New Zealand dollar.

The investment return of the Exchange Fund relative to the investment benchmark and domestic inflation rate for the period from 1993 to 2003 is set out in Table 2. Since 1999, the Exchange Fund has achieved a compounded 6.3% annual return, or an annual out-performance of 1.7% above the investment benchmark's compounded 4.6% annual return for the same period. Since 1993, the Exchange Fund has generated a compounded annual return of 6.8%, which compares favourably with the compounded annual inflation rate of 2.0% over the same period. The currency mix of the Fund's assets at 31 December 2003 is set out in Table 3.

Transparency

Four press releases on Exchange Fund data are issued by the HKMA each month. Three of these releases disseminate monetary data in accordance with the International Monetary Fund's (IMF) Special Data Dissemination Standard. The International Reserves constitute the official currency reserves of Hong Kong and the analytical accounts of the central bank comprise specifically prescribed balance sheet data. The template on international reserves and foreign currency liquidity provides a comprehensive account of the IMF participant's foreign currency assets and drains on such resources arising from various foreign currency liabilities and commitments. The fourth release, on the Exchange Fund's Abridged Balance Sheet and Currency Board Account, is made in accordance with the HKMA's policy of maintaining a high level of transparency. This high standard of transparency was maintained throughout 2003 and helped promote public understanding of the Exchange Fund's operating results and financial position.

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THE EXCHANGE FUND

- Report of the Director of Audit to the Financial Secretary
- Exchange Fund – Income and Expenditure Account
- Exchange Fund – Balance Sheet
- Exchange Fund – Statement of Changes in Equity
- Exchange Fund – Cash Flow Statement
- Exchange Fund – Notes on the Accounts

REPORT OF THE DIRECTOR OF AUDIT TO THE FINANCIAL SECRETARY

I have audited the statement of the accounts on pages 94 to 121 which has been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of the Monetary Authority and the Director of Audit

The directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance (Cap. 66) requires the Monetary Authority to sign the statement of the accounts. In preparing the statement of the accounts, the Monetary Authority has to select appropriate accounting policies and to apply them consistently.

It is my responsibility to form an independent opinion, based on my audit, on that statement of the accounts and to report my opinion to you.

Basis of opinion

I certify that I have audited the statement of the accounts referred to above in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance and the Audit Commission auditing standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the statement of the accounts. It also includes an assessment of the significant estimates and judgements made by the Monetary Authority in the preparation of the statement of the accounts, and of whether the accounting policies are appropriate to the Exchange Fund's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance as to whether the statement of the accounts is free from material misstatement. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the statement of the accounts. I believe that my audit provides a reasonable basis for my opinion.

Opinion

In my opinion the statement of the accounts gives a true and fair view of the state of affairs of the Exchange Fund as at 31 December 2003 and of its surplus and cash flows for the year then ended and has been properly prepared in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance.

Audit Commission
Hong Kong
25 March 2004

(Benjamin Tang)
Director of Audit

EXCHANGE FUND – INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 December 2003

(Expressed in millions of Hong Kong dollars)

	Notes	2003	2002
INCOME			
Interest income			
Interest income on debt securities		23,103	29,662
Other interest income		2,410	3,608
Total interest income		25,513	33,270
Dividend income from listed equity securities		3,751	3,237
Dividend income from subsidiaries		140	-
Net realised and revaluation gains/(losses) on other investments in securities		29,384	(6,542)
Other net realised and revaluation gains/(losses)		7,960	(10,184)
Net exchange gains		22,900	27,241
Bank licence fees		130	134
Others		49	33
TOTAL INCOME		89,827	47,189
EXPENDITURE			
Interest expense	3(a)	29,847	21,169
Operating expenses	3(b)	1,179	1,162
Note and coin expenses	3(c)	229	273
TOTAL EXPENDITURE		31,255	22,604
SURPLUS BEFORE DEFICIT ON REVALUATION OF PREMISES			
Deficit on revaluation of premises	12(c)	876	-
SURPLUS FOR THE YEAR		57,696	24,585

The notes on pages 98 to 121 form part of these accounts.

EXCHANGE FUND – BALANCE SHEET

as at 31 December 2003

(Expressed in millions of Hong Kong dollars)	Notes	2003	2002
ASSETS			
Cash and money at call		19,143	15,956
Placements with banks and other financial institutions	4	41,549	35,475
Investment securities	5	300	300
Other investments in securities	6	931,737	878,838
Gold	7	217	179
Thailand financing package	8	-	1,058
Other assets	9	13,503	19,678
Investments in subsidiaries	10	2,145	2,145
Fixed assets	12	3,051	1,436
TOTAL ASSETS	13	1,011,645	955,065
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	14	134,215	118,475
Government-issued currency notes and coins in circulation	14	6,297	5,891
Balance of the banking system	15	28,277	525
Exchange Fund Bills and Notes	16	123,520	122,925
Placements by banks and other financial institutions	17	44,542	36,270
Placements by other Hong Kong Special Administrative Region government funds	18	252,296	301,669
Placements by Hong Kong statutory bodies		164	4,279
Other liabilities	19	37,455	37,857
Total liabilities		626,766	627,891
Accumulated surplus	20	384,870	327,174
Premises revaluation reserve	20	9	-
Fund equity		384,879	327,174
TOTAL LIABILITIES AND FUND EQUITY		1,011,645	955,065

Joseph Yam

Monetary Authority

25 March 2004

EXCHANGE FUND – STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2003

(Expressed in millions of Hong Kong dollars)

	Notes	2003	2002
Total equity at 1 January		327,174	302,589
Surplus for the year		57,696	24,585
Surplus on revaluation of premises	12(c)	9	-
Total equity at 31 December	20	384,879	327,174

EXCHANGE FUND – CASH FLOW STATEMENT

for the year ended 31 December 2003

(Expressed in millions of Hong Kong dollars)

	Notes	2003	2002
Net cash from operating activities	22(a)	60,037	2,115
Cash flows from investing activities			
Purchase of fixed assets		(2,544)	(771)
Repayment of loan by associate		-	7
Dividends received from subsidiaries		140	-
Net cash used in investing activities		(2,404)	(764)
Net increase in cash and cash equivalents		57,633	1,351
Cash and cash equivalents at 1 January		120,339	118,153
Effect of foreign exchange rate changes		198	835
Cash and cash equivalents at 31 December	22(b)	178,170	120,339

The notes on pages 98 to 121 form part of these accounts.

EXCHANGE FUND – NOTES ON THE ACCOUNTS

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

1. Principal Activities

The Monetary Authority, under delegated authority from the Financial Secretary as Controller of the Exchange Fund (“the Fund”), manages the Fund in accordance with the provisions of the Exchange Fund Ordinance. The principal activities of the Fund are the safeguarding of the exchange value of the currency of Hong Kong and the maintaining of the stability and integrity of Hong Kong’s monetary and financial systems.

The principal activities of the subsidiaries are shown in Note 10.

2. Principal Accounting Policies

(a) Basis of preparation

- (i) Group accounts are not prepared in view of the insignificant amounts involved in the subsidiaries and associate.
- (ii) These accounts have been prepared using the fair value measurement basis, as modified by the use of historical cost for investment securities, other assets, investments in subsidiaries and associate, fixed assets other than premises, placements by other Hong Kong Special Administrative Region (“HKSAR”) government funds for which interest is payable at rates determined by reference to the investment income of the Fund and other liabilities, and in accordance with accounting principles generally accepted in Hong Kong, and comply with all applicable Statements of Standard Accounting Practice and Interpretations issued by the Hong Kong Society of Accountants. Fair value of a financial instrument represents its market price where there is a published price quotation in an active securities market. Where such a market price is not available, fair value of a financial instrument represents its valuation according to a price matrix of discounted cash flows using applicable interest rates for discounting.
- (iii) The accounting policies used in the preparation of these accounts are consistent with those used in the previous year except for the accounting policy with respect to premises. In prior years, premises were stated at cost less accumulated depreciation. With effect from 1 January 2003, premises are stated at valuation less accumulated depreciation (see Note 2(j)). In accordance with Statement of Standard Accounting Practice (“SSAP”) 2 “Net profit or loss for the period, fundamental errors and changes in accounting policies”, this change in accounting policy is dealt with as a revaluation of the premises.

(b) Investments

- (i) Investments in securities

Investments in debt and equity securities, except those held as investments in subsidiaries and associate, are accounted for as follows.

Investments in securities are recognised as assets from the date on which the Fund is bound by the contract which gives rise to them. They are classified as investment securities and other investments in securities.

Investment securities

Investment securities are securities which are intended to be held on a continuing basis, and which are held for an identified long term purpose documented at the time of acquisition or change of purpose and are clearly identifiable for the documented purpose.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Investment securities are included in the balance sheet at cost less provision for any diminution in value which is other than temporary.

Other investments in securities

Other investments in securities are those which are not classified as investment securities and are stated at fair value at the balance sheet date.

Changes in fair value of these investments are recognised in the income and expenditure account in “Net realised and revaluation gains/(losses) on other investments in securities” as they arise.

Gains and losses on sale of these investments are accounted for in the income and expenditure account in “Net realised and revaluation gains/(losses) on other investments in securities” in the period in which the disposal occurs as the difference between the net sales proceeds and the carrying amount of the securities.

(ii) Investments in subsidiaries and associate

Investments in subsidiaries and associate are stated at cost less provision for any diminution in value which is other than temporary.

The results of subsidiaries and associate are accounted for by the Fund on the basis of dividend income.

(c) Placements with banks and other financial institutions

Placements with banks and other financial institutions are valued in the balance sheet according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in “Other net realised and revaluation gains/(losses)”.

(d) Exchange Fund Bills and Notes

Where Exchange Fund Bills and Notes have been issued at a premium or discount, those premiums and discounts are amortised over the period from the date of issue to the date of redemption and are included in the income and expenditure account in “Interest expense”. Exchange Fund Bills and Notes are stated in the balance sheet at market value. Changes in market value of Exchange Fund Bills and Notes are recognised in the income and expenditure account in “Other net realised and revaluation gains/(losses)” as they arise.

On redemption of the Exchange Fund Bills and Notes, the resulting gains and losses, being the difference between the redemption amount and the carrying amount, are recognised in the income and expenditure account in “Other net realised and revaluation gains/(losses)” in the period in which the redemption takes place.

(e) Placements by other HKSAR government funds and other placements

Placements by other HKSAR government funds for which interest is payable at market-based rates are valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in “Other net realised and revaluation gains/(losses)”. In the balance sheet, these placements are stated at the principal amounts payable at the balance sheet date with the revaluation differences included in “Other liabilities”.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Placements by other HKSAR government funds for which interest is payable at rates determined by reference to the investment income of the Fund are stated at the principal amounts payable at the balance sheet date.

Placements by banks, other financial institutions and Hong Kong statutory bodies are valued in the balance sheet according to a price matrix of discounted cash flows using applicable interest rates for discounting. Changes in value of these placements are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(f) Repurchase and resale agreements

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Placements by banks and other financial institutions". Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in "Placements with banks and other financial institutions". At the balance sheet date consideration received or paid under repurchase and resale agreements is valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Gains or losses arising from revaluation are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(g) Securities lending agreements

Where securities are loaned with the receipt of cash or securities collateral, they remain on the balance sheet. Where cash collateral is received, a liability is recorded in respect of the cash received in "Placements by banks and other financial institutions". At the balance sheet date, this liability is valued according to a price matrix of discounted cash flows using applicable interest rates for discounting. Gains or losses arising from revaluation are included in the income and expenditure account in "Other net realised and revaluation gains/(losses)".

(h) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. Exchange gains and losses on foreign currency translation are included in the income and expenditure account in "Net exchange gains/(losses)".

Certificates of Indebtedness, government-issued currency notes and coins in circulation, all of which are denominated in Hong Kong dollars but are issued and redeemed in US dollars at the linked exchange rate of US\$1=HK\$7.80, are stated in the accounts at their Hong Kong dollar face value. At the balance sheet date the difference between their Hong Kong dollar face value and the market value of the US dollars required for their redemption is included in "Other assets".

Foreign currency income and expenditure are translated into Hong Kong dollars at the exchange rates prevailing at the transaction dates.

(i) Off-balance sheet financial instruments

Forward foreign exchange contracts are marked to market at the balance sheet date with the resultant revaluation gains and losses being included in the income and expenditure account in "Net exchange gains/(losses)".

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Interest rate swap contracts are marked to market at the balance sheet date with the resultant revaluation gains and losses being included in the income and expenditure account in “Other net realised and revaluation gains/(losses)”.

Revaluation gains or losses on forward foreign exchange contracts and interest rate swap contracts are included in the balance sheet as “Other assets” or “Other liabilities” as appropriate.

Stock index futures contracts and bond futures contracts are marked to market at the balance sheet date with the unsettled amounts of revaluation gains or losses being included in the balance sheet as “Other assets” or “Other liabilities” as appropriate. The resultant revaluation gains and losses are included in the income and expenditure account in “Other net realised and revaluation gains/(losses)”.

(j) Fixed assets

Premises are stated at valuation less accumulated depreciation, except for freehold land which is not depreciated. Valuations are carried out by independent professionally qualified valuers with sufficient regularity to ensure that the carrying amount does not differ materially from the fair value at the balance sheet date. Surpluses arising on revaluation are credited firstly to the income and expenditure account to the extent of any deficits arising on revaluation previously charged to the income and expenditure account in respect of the same premises, and are thereafter taken to the “Premises revaluation reserve”. Deficits arising on revaluation are firstly set off against any previous revaluation surpluses included in the “Premises revaluation reserve” in respect of the same premises, and are thereafter taken to the income and expenditure account. Leasehold land is depreciated on a straight-line basis over the unexpired terms of the leases. Buildings are depreciated on a straight-line basis over their estimated useful lives or the unexpired terms of the leases, whichever the shorter.

Other fixed assets, including furniture, fixtures and equipment, motor vehicles, personal computers and capitalised systems development costs, are stated at cost less accumulated depreciation. These assets are depreciated on a straight-line basis over their respective estimated useful lives of between 3 and 5 years.

Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Fund. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

Gain or loss arising from the disposal of a fixed asset is determined as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in the income and expenditure account. On disposal of premises, any related revaluation surplus included in the “Premises revaluation reserve” is transferred directly to “Accumulated surplus”.

(k) Revenue recognition

Interest income is recognised on an accrual basis.

Dividend income from listed equity securities is recognised when the share price goes ex-dividend. Dividend income from unlisted equity securities is recognised when the shareholder’s right to receive payment is established.

Premiums and discounts on acquisition of debt securities are dealt with in the income and expenditure account in “Net realised and revaluation gains/(losses) on other investments in securities” in the process of marking to market of such securities at the balance sheet date.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Bank licence fees are fees receivable from Authorised Institutions under the Banking Ordinance and are accounted for in the period when receivable.

Other income includes income from sale of withdrawn coins and Central Moneymarkets Unit fees. Other income is accounted for in the period when receivable.

(l) Interest expense

Interest expense is recognised on an accrual basis. Discounts and premiums relating to borrowings are amortised on a straight-line basis over the respective remaining lives of the instruments. For a majority portion of the placements by other HKSAR government funds, interest is payable at rates determined by reference to the investment income of the Fund. For the rest of such placements, interest is payable at market-based rates.

(m) Related parties

For the purposes of these accounts, parties are considered to be related to the Fund if the Fund has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Fund and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

(n) Cash and cash equivalents

Cash and cash equivalents are cash and money at call, placements with banks and other financial institutions and short-term highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value, having been within three months of maturity when placed or acquired.

(o) Staff retirement schemes

The Hong Kong Monetary Authority ("HKMA") operates two defined contribution schemes, the Provident Fund Scheme and the Mandatory Provident Fund Scheme. Under the schemes, contributions applicable each year are charged to the income and expenditure account. The assets of the staff retirement schemes are held separately from the Fund.

(p) Operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the income and expenditure account on a straight-line basis over the period of the relevant leases.

(q) Segment reporting

The activities of the Fund managed by the HKMA comprise four business segments. These are management of funds under the Currency Board Account, management of funds representing the general reserve assets of the Fund, banking supervision and monetary management. As the assets, revenue and overall results of banking supervision and monetary management are not significant, these two segments are combined with the segment for management of funds representing the general reserve assets of the Fund. Details on this combined segment are disclosed in Note 23 together with the Currency Board Account segment. There is no disclosure of geographic segments as the HKMA operates predominantly in one location. In line with the normal practice of central banking institutions, further breakdown of the investments by currencies or geographic markets is not disclosed.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**3. Expenditure****(a) Interest expense**

	2003	2002
Interest on placements by other HKSAR government funds:		
With interest at market-based rates	92	228
With interest at rates determined by reference to the investment income of the Fund	25,700	15,648
Other interest expense	4,055	5,293
TOTAL	29,847	21,169

(b) Operating expenses

	2003	2002
Staff costs		
Salaries and other staff costs	437	523
Retirement benefit costs	25	24
Premises and equipment expenses		
Depreciation charges	62	52
Operating lease charges	55	63
Other premises and equipment expenses	48	43
Other operating expenses	552	457
TOTAL	1,179	1,162

The number of senior staff (Executive Directors and above) of the HKMA whose emoluments fell within the following bands were:

HK\$	2003	2002
500,000 or below	1	-
1,500,001 to 2,000,000	1	-
2,500,001 to 3,000,000	1	1
3,000,001 to 3,500,000	5	3
3,500,001 to 4,000,000	1	4
4,000,001 to 4,500,000	2	1
5,000,001 to 5,500,000	1	-
5,500,001 to 6,000,000	1	1
6,000,001 to 6,500,000	-	1
6,500,001 to 7,000,000	-	1
8,500,001 to 9,000,000	1	1
	14	13

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

The aggregate emoluments of senior staff (Executive Directors and above) were as follows:

	2003	2002
Fixed pay	42.8	48.3
Variable pay	7.4	6.4
Other benefits	2.7	3.9
	52.9	58.6

Other benefits shown above include provident funds, medical and life insurance, and annual leave accrued during the year. There are no other allowances or benefits-in-kind.

- (c) **Note and coin expenses** represent reimbursements to the note-issuing banks in respect of note-issuing expenses, and expenses incurred directly by the Fund in issuing government-issued currency notes and coins.

4. Placements with Banks and other Financial Institutions

	2003	2002
Placements with banks and other financial institutions in respect of resale agreements	4,770	4,910
Other placements with banks and other financial institutions	36,779	30,565
TOTAL	41,549	35,475

5. Investment Securities

	2003	2002
Unlisted shares, at cost	300	300

Investment securities comprise 3,000 shares of the Bank for International Settlements with a nominal value of 5,000 Special Drawing Rights (SDRs) each (25% paid). During 2003, the Bank for International Settlements changed its unit of account from Swiss gold franc to SDR, which is an international unit of account based on a basket of major currencies. As a result, the nominal value of the shares changed from 2,500 Swiss gold francs to 5,000 SDRs each.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**6. Other Investments in Securities**

At fair value	2003	2002
Debt securities		
Treasury bills and commercial papers		
Listed outside Hong Kong	744	15,724
Unlisted	243,509	194,800
Certificates of deposit		
Unlisted	388	22,744
Other debt securities		
Listed		
In Hong Kong	2,630	4,540
Outside Hong Kong	369,051	436,103
Unlisted	144,744	90,907
Total debt securities	761,066	764,818
Equity securities		
Listed		
In Hong Kong	71,229	50,891
Outside Hong Kong	99,442	63,129
Total equity securities	170,671	114,020
TOTAL	931,737	878,838

7. Gold

	2003	2002
Gold, at market value		
66,916 ounces (2002 - 66,916 ounces)	217	179

8. Thailand Financing Package

The loan to Thailand in the form of outstanding currency swaps with the Bank of Thailand (“BOT”) was fully repaid in July 2003. The repayment was completed a year earlier than the original repayment schedule specified in the Currency Swap Agreement (“the Agreement”) between the BOT and a number of Asian central banks and multinational institutions, including the HKMA and the International Monetary Fund (“IMF”).

On 21 September 1997, the HKMA participated in a financing package organised for Thailand by the IMF. Under the Agreement, the HKMA entered into swap transactions to exchange US dollars for Thai Baht up to a maximum of US\$1 billion for a maximum period of five years. At the end of the agreed period for each swap transaction, the exchange of currencies was reversed and the US dollars received by the HKMA was equivalent to the original principal swapped plus interest at market rate. The transaction was accounted for as a US dollar loan to reflect its economic substance. Since the first drawdown made in October 1997, the HKMA had released a total of US\$862 million under the Agreement. In October 1999, the BOT gave notice that it would not draw down on the remaining US\$138 million. Since April 2001, the BOT had been repaying the loan by instalments according to the terms and conditions of the Agreement. In January 2003, the BOT approached the HKMA with an early repayment schedule starting from February 2003, resulting in full repayment of the loan in July 2003.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

9. Other Assets

	2003	2002
Staff housing loans	324	331
Revaluation gains on off-balance sheet items which are marked to market	1,471	6,798
Revaluation difference on Certificates of Indebtedness, government-issued currency notes and coins in circulation	656	26
Prepayments, receivables and other assets	11,052	12,523
TOTAL	13,503	19,678

10. Investments in Subsidiaries

	2003	2002
Unlisted shares, at cost	2,145	2,145

The following is a list of the subsidiaries as at 31 December 2003 and 2002:

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Exchange Fund's interest in equity capital
Hong Kong Note Printing Limited	Hong Kong	Banknotes printing	HK\$255,000,000	55%
The Hong Kong Mortgage Corporation Limited	Hong Kong	Investment in mortgages, mortgage securitisation and guarantee	HK\$2,000,000,000	100%
Exchange Fund Investment Limited	Hong Kong	Dormant	HK\$5,000,000	100%
Hong Kong Institute for Monetary Research	Hong Kong	Research	HK\$2	100%

With effect from January 2003, the management of the Fund's long-term Hong Kong equity portfolio was transferred to the HKMA from the Exchange Fund Investment Limited, which became inactive.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

Net aggregate amounts attributable to the Fund of profits less losses of the subsidiaries that are not dealt with in these accounts are as follows:

	2003	2002
Profit/(Loss) for the year:		
Hong Kong Note Printing Limited	23.7	33.5
The Hong Kong Mortgage Corporation Limited	403.1	267.3
Exchange Fund Investment Limited	-	-
Hong Kong Institute for Monetary Research	0.1	(0.2)
	426.9	300.6
Retained Earnings/(Accumulated Losses) at 1 January:		
Hong Kong Note Printing Limited	236.0	202.5
Less: Dividends declared and paid during the year	(139.7)	-
	96.3	202.5
The Hong Kong Mortgage Corporation Limited	1,118.8	851.5
Exchange Fund Investment Limited	-	-
Hong Kong Institute for Monetary Research	(1.9)	(1.7)
	1,213.2	1,052.3
TOTAL	1,640.1	1,352.9

Net aggregate amounts due from/(to) the subsidiaries are as follows:

	2003	2002
Hong Kong Note Printing Limited	0.4	0.3
The Hong Kong Mortgage Corporation Limited	0.3	0.3
Exchange Fund Investment Limited	(4.9)	(12.6)
Hong Kong Institute for Monetary Research	4.0	1.9
TOTAL	(0.2)	(10.1)

- (a) The Hong Kong Mortgage Corporation Limited ("HKMC") has unissued authorised share capital of HK\$1 billion (2002 - HK\$1 billion) which is callable from the Fund.
- (b) Under the Mortgage Insurance Programme, the HKMC offers mortgage insurance that covers approved sellers for credit loss up to 20% of the property value of a mortgage loan when the loan amount has exceeded 70% of the property value at origination. Under the Home Owner Mortgage Enhancement Programme, the HKMC provides mortgage insurance to cover credit loss in excess of 90% and up to 140% of the property value at the time of refinancing. Under these programmes, the HKMC reinsures the risk exposure with the approved reinsurers. As at 31 December 2003, the total risk-in-force assumed by the HKMC was HK\$1.09 billion (2002: HK\$0.78 billion).

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

- (c) Under the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme and the Bauhinia Mortgage-Backed Securitisation Programme, the HKMC sells mortgages to two Special Purpose Companies which issue mortgage-backed securities (“MBS”) to investors. The HKMC provides guarantee on the timely payment of principal and interest in respect of the MBS. As at 31 December 2003, the aggregate security principal balance guaranteed by the HKMC under the two programmes was HK\$5.26 billion (2002: HK\$2.32 billion).
- (d) A summarised balance sheet of the HKMC is shown below:

	2003	2002
Assets:		
Mortgage portfolio, net	34,581.7	28,257.7
Other assets	6,342.6	3,933.3
	40,924.3	32,191.0
Liabilities:		
Debt securities	36,630.3	28,615.0
Other liabilities	772.1	457.2
	37,402.4	29,072.2
Shareholder's Equity:		
Share capital	2,000.0	2,000.0
Retained earnings	1,521.9	1,118.8
	3,521.9	3,118.8
	40,924.3	32,191.0

11. Investment in Associate

Investment in associate comprises unlisted shares of Hong Kong Interbank Clearing Limited at a cost of HK\$5,000 (2002 - HK\$5,000). Details of the associate are as follows:

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Exchange Fund's interest in equity capital
Hong Kong Interbank Clearing Limited	Hong Kong	Interbank clearing	HK\$10,000	50%

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

12. Fixed Assets

(a)	Premises	Other Fixed Assets	Total
Cost or valuation			
At 1 January 2003	1,311	443	1,754
Additions	2,517	27	2,544
Elimination of accumulated depreciation on revalued premises	(16)	-	(16)
Net deficit on revaluation	(867)	-	(867)
Reclassifications	18	(18)	-
Disposals	-	(67)	(67)
At 31 December 2003	2,963	385	3,348
Accumulated depreciation			
At 1 January 2003	1	317	318
Charge for the year	15	47	62
Elimination of accumulated depreciation on revalued premises	(16)	-	(16)
Written back on disposal	-	(67)	(67)
At 31 December 2003	-	297	297
Net book value			
At 31 December 2003	2,963	88	3,051
At 31 December 2002	1,310	126	1,436

Additions include payments for the new office premises in Hong Kong amounting to HK\$2,517 million (2002 - HK\$746 million). Depreciation charges have been made after completion of relocation to the new office premises during 2003.

(b) The net book value of premises comprises:

	2003	2002
Held in Hong Kong		
Medium-term leasehold (between 10 and 50 years)	2,930	1,304
Held outside Hong Kong		
Freehold	33	6
TOTAL	2,963	1,310

Premises were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, on open market value basis at 31 December 2003. The valuations were carried out by qualified valuers who are members of the Hong Kong Institute of Surveyors.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

- (c) The net deficit on revaluation of premises was HK\$867 million, comprising a deficit of HK\$876 million charged to the income and expenditure account and a surplus of HK\$9 million credited to the premises revaluation reserve.
- (d) The net book value of premises at 31 December 2003 would have been HK\$3,830 million had they been stated at cost less accumulated depreciation.

13. Total Assets

	2003	2002
Foreign currency assets	929,625	891,632
Hong Kong dollar assets	82,020	63,433
TOTAL	1,011,645	955,065

The Fund holds Hong Kong dollar and foreign currency assets. A large proportion of the Fund's foreign currency assets is held in US dollars. Apart from the US dollar assets, the Fund also holds assets denominated in fully convertible foreign currencies.

The Fund's assets are held in deposit, trustee and safe-keeping accounts with banks, central banks and custodial organisations situated in Hong Kong and other major financial centres.

14. Certificates of Indebtedness, Government-Issued Currency Notes and Coins in Circulation

As backing for the banknote issues, each note-issuing bank is required to hold a non-interest bearing Certificate of Indebtedness issued by the Financial Secretary. Payments for the issuance and redemption of notes against these Certificates are made in US dollars at the fixed exchange rate of US\$1=HK\$7.80. Consistent with the requirement for backing banknote issuance with US dollars, the issuance and the withdrawal of government-issued currency notes and coins are conducted against US dollars at the fixed exchange rate of US\$1=HK\$7.80.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**15. Balance of the Banking System**

Under the interbank payment system based on Real Time Gross Settlement principles, all licensed banks maintain a Hong Kong dollar clearing account with the HKMA for the account of the Fund. The aggregate balance in these accounts represents the total level of liquidity in the interbank market. Under the Convertibility Undertaking, the HKMA undertakes to convert Hong Kong dollars in the clearing accounts maintained by licensed banks with the HKMA into US dollars at the fixed exchange rate of US\$1=HK\$7.80.

16. Exchange Fund Bills and Notes

	2003	2002
Exchange Fund Bills	68,350	72,152
Exchange Fund Notes	55,170	50,773
TOTAL	123,520	122,925

Exchange Fund Bills are issued by the Fund for maturities not exceeding one year. Exchange Fund Notes are issued by the Fund with 2-year, 3-year, 5-year, 7-year and 10-year maturities.

17. Placements by Banks and other Financial Institutions

	2003	2002
Placements by banks and other financial institutions in respect of securities lending	893	1,551
Other placements by banks and other financial institutions	43,649	34,719
TOTAL	44,542	36,270

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

18. Placements by other HKSAR Government Funds

	2003	2002
Placements with interest payable at market-based rates		
General Revenue Account	362	1,007
Capital Investment Fund	2,093	3,305
Loan Fund	4,976	5,937
Capital Works Reserve Fund	498	263
Innovation and Technology Fund	68	93
Lotteries Fund	170	-
	8,167	10,605
Placements with interest payable at rates determined by reference to the investment income of the Fund		
General Revenue Account	66,447	22,747
Land Fund	140,615	247,334
Capital Works Reserve Fund	16,569	4,766
Civil Service Pension Reserve Fund	12,376	11,746
Disaster Relief Fund	35	35
Innovation and Technology Fund	4,250	4,436
Lotteries Fund	3,837	-
	244,129	291,064
TOTAL	252,296	301,669

Placements by other HKSAR government funds are not permanently appropriated for the use of the Fund, but are principally repayable on demand when they are required to meet the obligations of the fiscal reserves.

Prior to 1 April 2003, placements by the Lotteries Fund were included in placements by Hong Kong statutory bodies. With effect from 1 April 2003, placements by the Lotteries Fund are included in placements by other HKSAR government funds.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**19. Other Liabilities**

	2003	2002
Interest payable on placements by other HKSAR government funds at rates determined by reference to the investment income of the Fund	25,700	17,109
Revaluation losses on off-balance sheet items which are marked to market	3,724	1,962
Accrued interest and other liabilities	8,031	18,786
TOTAL	37,455	37,857

20. Fund Equity

	2003	2002
Accumulated surplus		
At 1 January	327,174	302,589
Surplus for the year	57,696	24,585
At 31 December	384,870	327,174
Premises revaluation reserve		
At 1 January	-	-
Surplus on revaluation of premises (Note 12(c))	9	-
At 31 December	9	-
TOTAL	384,879	327,174

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

21. Maturity Profile

	2003						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	
Assets							
Cash and money at call	19,143	-	-	-	-	-	19,143
Placements with banks and other financial institutions	-	41,549	-	-	-	-	41,549
Investment securities	-	-	-	-	-	300	300
Other investments in securities	-	247,486	72,986	264,487	176,107	170,671	931,737
Gold	-	-	-	-	-	217	217
	19,143	289,035	72,986	264,487	176,107	171,188	992,946
Liabilities							
Certificates of Indebtedness	134,215	-	-	-	-	-	134,215
Government-issued currency notes and coins in circulation	6,297	-	-	-	-	-	6,297
Balance of the banking system	28,277	-	-	-	-	-	28,277
Exchange Fund Bills and Notes	-	50,569	31,277	33,024	8,650	-	123,520
Placements by banks and other financial institutions	-	33,271	11,271	-	-	-	44,542
Placements by other HK SAR government funds	246,399	5,897	-	-	-	-	252,296
Placements by Hong Kong statutory bodies	-	164	-	-	-	-	164
	415,188	89,901	42,548	33,024	8,650	-	589,311

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

	2002						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets							
Cash and money at call	15,956	-	-	-	-	-	15,956
Placements with banks and other financial institutions	-	35,475	-	-	-	-	35,475
Investment securities	-	-	-	-	-	300	300
Other investments in securities	-	193,412	133,557	245,624	192,225	114,020	878,838
Gold	-	-	-	-	-	179	179
Thailand financing package	-	366	421	271	-	-	1,058
	15,956	229,253	133,978	245,895	192,225	114,499	931,806
Liabilities							
Certificates of Indebtedness	118,475	-	-	-	-	-	118,475
Government-issued currency notes and coins in circulation	5,891	-	-	-	-	-	5,891
Balance of the banking system	525	-	-	-	-	-	525
Exchange Fund Bills and Notes	-	51,116	32,038	32,221	7,550	-	122,925
Placements by banks and other financial institutions	-	33,870	2,400	-	-	-	36,270
Placements by other HKSAR government funds	292,921	8,166	582	-	-	-	301,669
Placements by Hong Kong statutory bodies	3,269	1,010	-	-	-	-	4,279
	421,081	94,162	35,020	32,221	7,550	-	590,034

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

22. Notes to the Cash Flow Statement

(a) Reconciliation of surplus before deficit on revaluation of premises to net cash from operating activities

	2003	2002
Surplus before deficit on revaluation of premises	58,572	24,585
Interest income	(25,513)	(33,270)
Interest expense	29,847	21,169
Dividend income	(3,891)	(3,237)
Amortisation of premiums and discounts on Exchange Fund Bills and Notes	661	1,339
Depreciation	62	52
Change in placements with banks and other financial institutions	(4,015)	-
Change in other investments in securities	(314)	25,066
Change in gold	(38)	(34)
Change in Thailand financing package	1,058	3,091
Change in other assets	5,713	(3,502)
Change in Certificates of Indebtedness, government-issued currency notes and coins in circulation	16,146	11,130
Change in balance of the banking system	27,752	(146)
Change in Exchange Fund Bills and Notes	(66)	3,429
Change in placements by banks and other financial institutions	8,272	(10,852)
Change in placements by other HKSAR government funds	(49,373)	(78,933)
Change in placements by Hong Kong statutory bodies	(4,115)	(845)
Change in other liabilities	(8,910)	10,801
Elimination of exchange differences	(198)	(835)
Interest received	26,218	35,669
Interest paid	(21,338)	(5,760)
Dividend received	3,507	3,198
Net cash from operating activities	60,037	2,115

(b) Analysis of the balances of cash and cash equivalents

	2003	2002
Cash and money at call	19,143	15,956
Placements with banks and other financial institutions	37,534	35,475
Treasury bills and commercial papers	121,105	62,555
Certificates of deposit	388	6,353
TOTAL	178,170	120,339

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**23. Segment Reporting**

The business activities of the Fund managed by the HKMA comprise:

- Management of funds under the Currency Board Account (a)
- Management of funds representing the general reserve assets of the Fund
- Banking supervision
- Monetary management

As the assets, revenue and overall results of the latter two activities are not significant, they are presented as part of the assets, revenue and results of management of funds representing the general reserve assets of the Fund.

	Currency Board Account		Reserve Management and Other Activities		Re-allocation(c)		Total of the Fund	
	2003	2002	2003	2002	2003	2002	2003	2002
Income	2,924	6,888	86,903	40,301	-	-	89,827	47,189
Expenditure								
Interest expense	3,218	3,985	26,629	17,184	-	-	29,847	21,169
Other expenses(b)	-	-	1,408	1,435	-	-	1,408	1,435
	3,218	3,985	28,037	18,619	-	-	31,255	22,604
Surplus/(Deficit) before deficit on revaluation of premises	(294)	2,903	58,866	21,682	-	-	58,572	24,585
Deficit on revaluation of premises	-	-	876	-	-	-	876	-
Surplus/(Deficit) for the year	(294)	2,903	57,990	21,682	-	-	57,696	24,585

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

	Currency Board Account		Reserve Management and Other Activities		Re-allocation (c)		Total of the Fund	
	2003	2002	2003	2002	2003	2002	2003	2002
Assets								
Backing Assets								
Investment in designated US dollar assets	321,467	283,936	-	-	-	-	321,467	283,936
Interest receivable on designated US dollar assets	620	922	-	-	-	-	620	922
Net accounts payable	-	(9,067)(c)(i)	-	-	-	9,067	-	-
Other investments	-	-	673,624	648,957	-	-	673,624	648,957
Other assets	-	- (c)(ii)	15,749	18,931	185	2,319	15,934	21,250
TOTAL ASSETS	322,087	275,791 (A)	689,373	667,888	185	11,386	1,011,645	955,065
Liabilities								
Monetary Base								
Certificates of Indebtedness	134,215	118,475	-	-	-	-	134,215	118,475
Government-issued currency notes and coins in circulation	6,297	5,891	-	-	-	-	6,297	5,891
Balance of the banking system	28,277	525	-	-	-	-	28,277	525
Exchange Fund Bills and Notes	123,520	122,925	-	-	-	-	123,520	122,925
Interest payable on Exchange Fund Notes	548	609	-	-	-	-	548	609
Net accounts receivable	(185)	(2,319)(c)(ii)	-	-	185	2,319	-	-
Placements by banks and other financial institutions	-	-	44,542	36,270	-	-	44,542	36,270
Placements by other HKSAR government funds	-	-	252,296	301,669	-	-	252,296	301,669
Placements by Hong Kong statutory bodies	-	-	164	4,279	-	-	164	4,279
Other liabilities	-	- (c)(i)	36,907	28,181	-	9,067	36,907	37,248
	292,672	246,106 (B)	333,909	370,399	185	11,386	626,766	627,891
Accumulated surplus								
Balance brought forward	29,685	26,829	297,489	275,760	-	-	327,174	302,589
Surplus/(Deficit) for the year	(294)	2,903	57,990	21,682	-	-	57,696	24,585
Transfer between Currency Board Account and general reserves(d)	24	(47)	(24)	47	-	-	-	-
	29,415	29,685	355,455	297,489	-	-	384,870	327,174
Premises revaluation reserve	-	-	9	-	-	-	9	-
TOTAL LIABILITIES AND FUND EQUITY	322,087	275,791	689,373	667,888	185	11,386	1,011,645	955,065
Backing Ratio [(A)/(B)] x 100%	110.05%	112.06%						

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

- (a) Starting from 1 October 1998, specific US dollar assets of the Fund have been designated to back the Monetary Base, which comprises Certificates of Indebtedness, government-issued currency notes and coins in circulation, the balance of the banking system and Exchange Fund Bills and Notes. While specific assets of the Fund have been earmarked for backing the Monetary Base, all the Fund assets have continued to be available for the purpose of supporting the Hong Kong dollar exchange rate under the Linked Exchange Rate system.
- (b) Other expenses have not been allocated to the Currency Board Account as the amounts involved are not material.
- (c) For the purposes of the Currency Board Account, certain assets and liabilities of the Fund's accounts need to be included in the Monetary Base and Backing Assets respectively but as negative amounts. Such presentation is necessary to allow proper computation of the backing ratio. As at 31 December 2003, these negative amounts comprised:
- (i) "Other liabilities", Nil (2002 - HK\$9,067 million) representing accounts payable included in the Backing Assets to offset the corresponding investments purchased but not yet settled;
 - (ii) "Other assets" of HK\$185 million (2002 - HK\$2,319 million) included in the Monetary Base, which consisted of three components:
 - Nil (2002 - HK\$2,110 million) representing accounts receivable to offset the corresponding Exchange Fund Bills and Notes issued on tender date but not yet settled;
 - HK\$9 million (2002 - HK\$5 million) representing interests receivable on Hong Kong dollar interest rate swaps used as a means to manage the cost of issuing Exchange Fund Notes; and
 - HK\$176 million (2002 - HK\$204 million) representing receivables pertaining to revaluation gains on Hong Kong dollar interest rate swaps used as a means to manage the cost of issuing Exchange Fund Notes.
- (d) In accordance with an arrangement approved by the Financial Secretary in January 2000, assets can be transferred between the backing and general reserve portfolios when the backing ratio reaches either the upper trigger point (112.5%) or the lower trigger point (105%). This arrangement allows transfer of excess assets out of the backing portfolio to maximise their earning potential while ensuring that there are sufficient liquid assets in the backing portfolio.

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)

24. Commitments**(a) Capital commitments**

Capital expenditure authorised but not provided for in these accounts amounted to:

	2003	2002
Contracted	73	2,455
Not contracted	27	183
TOTAL	100	2,638

(b) Loan to the International Monetary Fund

On 27 January 1997, the HKMA participated in the New Arrangements to Borrow ("NAB"), a standby credit facility to the IMF for coping with instability in the international monetary system. In respect of this, the HKMA undertakes to lend foreign currencies to the IMF up to HK\$3,922 million equivalent as at 31 December 2003 (2002 - HK\$3,605 million equivalent), in the form of a term loan of five year maturity bearing prevailing market interest rates. As at 31 December 2003, there was no outstanding balance due from the IMF under the NAB (2002 - Nil).

(c) Lease commitments

Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analysed as follows:

	2003	2002
Premises		
Not later than one year	8	56
Later than one year and not later than five years	2	19
TOTAL	10	75

EXCHANGE FUND – NOTES ON THE ACCOUNTS (cont.)**25. Off-Balance Sheet Items**

	2003	2002
Spot and forward foreign exchange contracts		
Outstanding contract amount	106,736	115,761
Gross replacement costs	159	2,199
Interest rate swap contracts		
Notional principal	10,400	27,997
Gross replacement costs	1,290	4,638
Stock index futures contracts		
Notional principal	30,298	38,209
Gross replacement costs	915	56
Bond futures contracts		
Notional principal	1,005	494
Gross replacement costs	-	3

26. Contingent Liabilities

The Fund has a contingent liability up to 11.25 million SDRs or HK\$130 million equivalent as at 31 December 2003 (2002 - 5.6 million Swiss gold francs or HK\$140.3 million equivalent), in respect of the uncalled portion of its 3,000 shares held in the Bank for International Settlements.

27. Material Related Party Transactions

The Fund takes placements from other HKSAR government funds and Hong Kong statutory bodies, as shown on the balance sheet. During the year, interest expenses on placements from other HKSAR government funds and Hong Kong statutory bodies amounted to HK\$25,792 million (2002 - HK\$15,876 million) and HK\$15 million (2002 - HK\$77 million) respectively.

Transactions with related parties are conducted at rates determined by the Monetary Authority taking into account the nature of each transaction on a case-by-case basis.

28. Approval of Accounts

The accounts were approved by the Exchange Fund Advisory Committee on 25 March 2004.



Medical staff from the Prince of Wales Hospital meet the world on their discharge from hospital on 29 March 2003 after having recovered from SARS.

PROFESSIONAL AND CORPORATE SERVICES

In-house professional and corporate services enable the HKMA to fulfil its statutory obligations in maintaining monetary and banking stability in Hong Kong. Greater efficiency resulted in cost saving. Services were improved to keep pace with developments in banking and related activities, and advances in information technology. Other measures were implemented to make the HKMA more accessible to the public.

THE HKMA IN THE COMMUNITY

As the central banking institution in Hong Kong, the HKMA places great emphasis on promoting an understanding of its policies and work among the public. This policy of transparency and accessibility is realised through a number of channels:

- extensive contacts with the media
- regular and special publications
- a large and comprehensive bilingual website
- public access to the HKMA Information Centre
- an annual education programme for students and community groups
- frequent meetings with legislators
- a public enquiry service staffed nine hours a day.

These services are co-ordinated by the Corporate Development Division within the Corporate Services Department. The Division is responsible for providing media, publications and public relations services to the HKMA. It also supplies

translation and drafting services and secretarial support to the Exchange Fund Advisory Committee (EFAC) and its sub-committees.

Media relations

The news media play an essential role in the effective communication between the HKMA and the community. To promote transparency of its policies, the HKMA continued to maintain its ties with the print and electronic media in 2003.

Ten press conferences were held and 259 press releases were issued during the year. An average of 40 press enquiries was received by the HKMA every day. Educational briefings were arranged for reporters and editors on the topic of deflation.

The HKMA has strengthened the disclosure of information in its press announcements. For example, the disclosure of statistics relating to residential mortgage lending was improved through additional disclosure of the loans written off over the past 12 months, as well as the number of new loans approved in the primary, secondary and refinancing markets.

 [Information Centre > Press Releases](#)

Publications

The HKMA produces a variety of publications on monetary, banking and economic issues to provide information and data, and promote greater understanding of the work of the HKMA.

The *HKMA Annual Report 2002*, published together with its summary booklet and interactive website version, won the silver award in the Hong Kong Management Association's Best Annual Reports Award: the Report was commended for its comprehensiveness and good disclosure of corporate governance and future plans.

The *HKMA Quarterly Bulletin* and on-line *Monthly Statistical Bulletin* were redesigned with expanded content in early 2003. They continued to be a regular source of HKMA information, policy explanation and research findings. The *Quarterly Bulletin* included the HKMA's first *Half-Yearly Monetary and Financial Stability Report* in its December 2003 issue. The Report provides descriptions and analyses of external and domestic factors that have a bearing on Hong Kong's monetary and financial stability. It represents the HKMA's view of the main forces acting upon the Hong Kong economy, paying particular attention to the implications for the monetary and financial systems.



Selected HKMA publications published in 2003.

The second in a series of HKMA background briefs – *Banking Supervision in Hong Kong* – was published in March 2003. This booklet introduces and explains the main features of Hong Kong's banking system and the HKMA's supervisory approach. The HKMA also published information leaflets on security features for the new Hong Kong banknotes, safety procedures for Internet banking, and investor information on Exchange Fund Notes.

[Information Centre > Publications](#)

The HKMA on-line

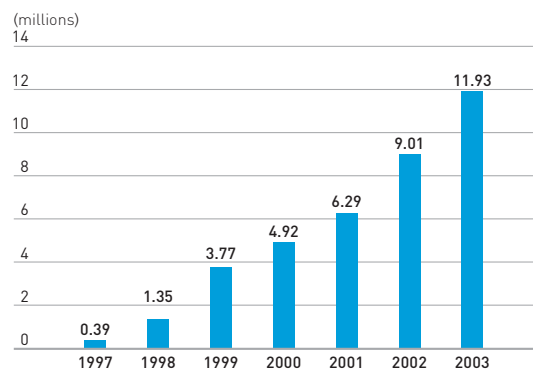
The HKMA website www.hkma.gov.hk is a comprehensive source of HKMA news and information instantly accessible to people throughout the world. In 2003, annual website page views reached almost 12 million (Chart 1), a 32% increase over 2002. Around 1,850 subscribers now receive the latest HKMA news through a daily e-mail news service.

In April, the HKMA website launched a new on-line public register containing specified particulars of the staff of authorized institutions engaged in securities business.

Information sections were launched during the year to introduce the newly opened HKMA Information Centre, new Hong Kong banknotes and investor information on Exchange Fund Notes.

[What's New > HKMA News Update E-Mail Service](#)

CHART 1 Page views of the HKMA website



Public education programme

A permanent HKMA Information Centre was opened on the 55/F of Two International Finance Centre in December 2003. The Centre, which consists of an exhibition area and a library, introduces the work of the HKMA and houses over 20,000 books, journals and other texts on central banking and related subjects. The Centre is open to the public six days a week.

Using interactive presentations and video montage as well as the more traditional panels and material exhibits, the Centre's exhibition area displays the history of money and banking in Hong Kong and the key policy objectives of the HKMA. The exhibition area is divided into four main sections. A *currency section* traces the development of money and banking in Hong Kong and shows examples of coins and notes used over the years in and around Hong Kong. A *policy section* explains the work of the HKMA. A *topical section* focuses on issues of current interest. A *timeline*, outlining Hong Kong's monetary and banking history, runs along the whole length of the main wall of the exhibition area.

The library, situated just beyond the exhibition area, contains research materials for detailed study of Hong Kong's monetary, banking and financial affairs and of central banking topics elsewhere in the world. The main elements of the collection are



Visitors learn about monetary history and security features on new banknotes at the HKMA Information Centre.



publications by the HKMA, other central banks and international organisations, books and journals on monetary, banking, economics, finance and related subjects as well as an electronic register of authorized institutions in Hong Kong, maintained under section 20 of the Banking Ordinance. An on-line catalogue is available at the terminals inside the library and on the HKMA website.

Daily guided tours are organised for visitors and groups. In December, a total of 2,002 visitors and 21 schools, community groups and other organisations visited the Centre.

 [HKMA Information Centre](#)



The library



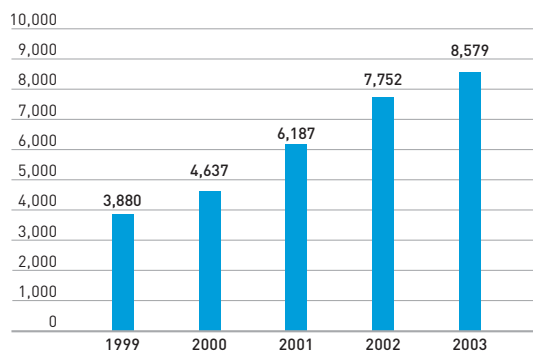
The exhibition area

The HKMA continued to organise its annual education programme for students, teachers and other groups. During the year, 15 seminars were organised for more than 4,000 students, teachers and members of various organisations. The Linked Exchange Rate system, monetary development in Hong Kong and the new banknotes were the main themes for the seminars. Since the launch of the education programme in 1998, more than 24,000 students and teachers have participated in the seminars.

Public enquiries

The number of public enquiries to the HKMA reached a record high in 2003. The HKMA received a total of 8,579 public enquiries during the year (Chart 2), representing an increase of 11% over 2002. These enquiries, which were received mainly by telephone, consisted for the most part of requests for statistical or background information on banking, monetary and HKMA-related issues from researchers, industry professionals, students and the general public: they also included complaints and suggestions. The HKMA is committed to delivering a speedy and informed response to all enquirers.

CHART 2 Total number of public enquiries



HUMAN RESOURCES

The Human Resources Division provides the human resources support and associated framework to facilitate the HKMA in meeting its policy objectives and day-to-day operations.

Organisational changes

With the departure of Mr Tony Latter, former Deputy Chief Executive (Development) in January 2003, the responsibilities of the post were temporarily taken over by the Deputy Chief Executive (Monetary), except for the Support Services Division, which was put under the schedule of Deputy Chief Executive (Banking) with direct supervision from the Executive Director (Banking Development). The opportunity was taken to reshuffle the duties among some departments:

- (a) Work relating to the development of Hong Kong's financial market was transferred from the Research Department to the Monetary Policy and Markets Department, which was retitled Monetary Management and Infrastructure Department (MID);
- (b) The two HKMA Representative Offices in New York and London were grouped under the External Department instead of MID to enable the adoption of a more proactive approach in supporting the HKMA's liaison efforts and research into international financial issues;
- (c) The Research Department expanded its role in research on the domestic and international economic environment to assist the HKMA's surveillance work and investment activities; and
- (d) The Reserves Management Department took over from the former Exchange Fund Investment Limited (EFIL) the management of the long-term Hong Kong equity portfolio.

Staffing

In early 2003, when the operations of EFIL were wound down, the 21 staff on secondment to EFIL were returned to the HKMA. In accommodating these staff, the overall establishment of the HKMA increased from 583 to 604. These staff provided the necessary resources for the management of the long-term Hong Kong equity portfolio and various new or expanded activities planned in 2003.

The establishment of the HKMA at the end of 2003 is shown in Table 1. In line with the HKMA's continuing efforts for cost efficiencies, savings were achieved by freezing the posts of a Deputy Chief Executive and an Executive Director, as well as six other posts in the supporting ranks, through natural attrition and work reprioritisation.

TABLE 1 HKMA establishment

Post	Establishment	
	2002	2003
Chief Executive	1	1
Deputy Chief Executive	3	3
Executive Director	9	10
Division Head	31	31
Senior Manager	71	74
Manager	143	147
Manager Trainee	6	6
Assistant Manager	94	94
Technical Officer	103	111
Clerk	43	45
Secretary	69	72
Office Assistant	10	10
Total	583	604

Remuneration of senior executives

In 2003 the HKMA continued to implement the framework approved by the Financial Secretary, on the advice of EFAC and its Remuneration and Finance Sub-Committee, as a result of the review conducted by the Hay Group Limited for the Government on the remuneration of senior executives of statutory and other bodies.

The pay adjustments for 2003 took the form of cuts in Fixed Pay of 2.11% for the Executive Directors, 3.14% for the Deputy Chief Executives, with the agreement of the individuals concerned. For the Chief Executive of the HKMA, the Fixed Pay was reduced by 5.24% in 2003; this was in addition to his voluntary cut of 10% in October 2001. The Variable Pay awarded to individual senior staff varies, as usual, according to performance.

Table 2 shows the remuneration packages of HKMA senior executives in 2003.

TABLE 2 Remuneration packages of HKMA senior executives in 2003

HK\$'000	Chief Executive	Deputy Chief Executive (average)	Executive Director (average)
Number of staff	1	4	9
Fixed pay	6,583	4,686	2,902
Variable pay	1,725	740	350
Other benefits	428	124	215

Notes:

- (a) Except for annual leave accrued, the actual remuneration received by staff not serving a full year is annualised for the purpose of calculating the average annual package of the rank.
- (b) The number of staff at the Deputy Chief Executive (DCE) rank reflects the departure of two DCEs and the arrival of one DCE during the year. The number of DCEs since January 2003 is two.
- (c) Other benefits include provident funds, medical and life insurance and annual leave accrued during the year. The provision of these benefits varies among senior staff depending on individual terms of service.

Training and development

The new training framework implemented since 2002 continued to work well. Staff members were provided with horizontal and vertical training in line with career development and organisational needs. Horizontal training, which is centrally co-ordinated by the Human Resources Division, caters for the needs common to staff of the same rank, and vertical training is initiated by departments to meet their specific needs.

In working out the training plan for 2003, the original intention was to attach equal weight to horizontal and vertical training. Following the outbreak of SARS, however, some overseas vertical training programmes were cancelled. To catch up with the lost training opportunities, some of the budget was reallocated to conducting in-house horizontal training programmes. A total of 3,741 training days was provided for HKMA staff in 2003, with 2,555 days on horizontal training. On average, each staff member received 6.39 days of training.

For the purpose of horizontal training, various training consultants were commissioned during the year to run tailor-made programmes for staff at different levels to improve their core competencies in the areas of personal effectiveness, leadership, communication and PC skills.

Vertical training programmes covered various topics on bank supervision to update staff on the current supervisory issues and banking operations and products. Most of these programmes were conducted by line staff, and topics included risk-based supervision, the New Capital Accord, stress testing, money laundering, deposit protection, credit reference agency and securities activities. Other programmes were on IT security, credit card operations and personal loans, which were delivered by guest speakers from commercial banks or corporations. On top of in-house training,

arrangements were made for staff to attend courses on central banking, economics, banking regulation and investment offered by other central banks, multilateral organisations and financial institutions.

Staff activities and voluntary work

HKMA staff participated in various community events and fund-raising activities during the year. An HKMA team participated in, and raised funds for, the Hong Kong Marathon and the Green Power Hike, which were both held in February. The Hong Kong Red Cross blood donation day in July was supported by 55 staff. Staff also participated in other fund-raising activities, such as the Community Chest's Skip Lunch Day, Green Day and Dress Casual Day.

The HKMA Volunteer Team participated in the Marine Park Ambassador Scheme and undertook more than 300 hours of voluntary service after office hours. The HKMA bought suitable office supplies from a workshop staffed by people with physical disabilities.



An HKMA Corporate Team participates in the Green Power Hike in February 2003.

FINANCE AND ADMINISTRATION

The Finance and Administration Division aims at achieving an efficient allocation of resources within the HKMA. One of the Division's major tasks during the year was to manage the relocation of the HKMA to its new office at Two International Finance Centre in November. The move was completed smoothly in November 2003 without any interruptions to normal operations.

During the SARS outbreak, the HKMA activated contingency arrangements and maintained split-team operations at both the main office and the back-up site from 8 April to 19 May 2003. The experience gained from the SARS outbreak has provided useful input in updating and improving the contingency plans.

Since the HKMA's Environmental Policy was issued in late 2001, a number of green office measures have been implemented and staff awareness of environmental issues has increased (Table 3). The HKMA continued to support and encourage recycling. Waste paper was collected for recycling. Obsolete personal computers and other computer equipment and peripherals were donated to charitable organisations. Regular campaigns were held to collect unwanted clothes, toys and other reusable items from colleagues for donation to people in need.

INFORMATION TECHNOLOGY

The Information Technology Division provides reliable and efficient IT services to all business units in the HKMA. During 2003 the Division continued its efforts to strengthen the HKMA's IT systems and infrastructure to facilitate all its operations.

Reserves and Monetary Management System

The Reserves and Monetary Management System project was initiated in 2000 to develop a fully integrated transaction system linking all major business processes covering front, middle and back office functions for the operation and management of the Exchange Fund. The new system went live in August 2003 and has been operating smoothly.

Relocation to Two International Finance Centre

A new computer centre and new network infrastructure were built in the new premises at Two International Finance Centre. The computer centre was designed to operate around the clock, comply with the Hong Kong Government's security standard (level 2) and achieve a very high reliability – an uptime of 99.99 per cent. The new network infrastructure was built with the latest proven technology, providing a highly reliable and secure

TABLE 3 A more environmentally-friendly office

Item	Unit	2001 Usage	2002 Usage	2003 Usage	Percentage change from 2002 to 2003	Remarks
Paper	ream	15,000	14,630	14,500	-0.9%	Increased use of single-side used paper and electronic communications
Christmas card	item	3,100	2,700	2,600	-3.7%	Increased use of electronic greeting cards
Paper cup	item	91,000	46,000	42,000	-8.7%	Increased awareness in reducing paper consumption
Waste paper collected	kg	36,595	28,789	46,901	+62.9%	Increased awareness in collecting waste paper for recycling

metropolitan network connecting Two International Finance Centre, the Quarry Bay Office and back-up offices. Both projects began in July and were completed in time for the relocation scheduled for November 2003.

In the first half of 2003 extensive discussions were held with business units to develop a plan for relocating servers, PCs and printers with minimal disruption to the HKMA's daily operations. Taking advantage of the new office layout, printers were re-shuffled to improve usability and efficiency while obsolete printers were retired to keep down the cost of maintenance. Contingency plans of all IT systems were reviewed and tested before the relocation. All IT systems were relocated smoothly in November 2003, providing a continuous and stable IT infrastructure for the HKMA's operations.

Use of Hong Kong Post e-cert in the Submission Through Electronic Transmission (STET)

Following the launch of the enhanced STET system in October 2002, which allows the use of digital certificates issued by Hong Kong Post's Certification Authority for electronic submission of banking returns, migration of all authorized institutions to the new system was completed in June 2003.

OFFICE OF THE GENERAL COUNSEL

The Office of the General Counsel (OGC) advises the HKMA on the legal aspects of all of its activities. The practice of the HKMA is to involve the OGC's lawyers at an early stage in the planning and implementation of projects, initiatives and operations.

On top of its general operational workload, the OGC was involved in a number of important projects in 2003, including the drafting of the Clearing and Settlement Systems Bill and Deposit Protection Scheme Bill and the preparation of the euro clearing system in Hong Kong. The OGC helped in the preparation of Memoranda of Understanding with other banking supervisors and in the amendments to the Banking Ordinance to prepare for the new supervisory regime for authorized institutions engaged in securities and futures activities. The OGC advised on a number of other projects, including personal renminbi business in Hong Kong, the New Basel Capital Accord, the creation of a commercial credit reference agency and several important bank mergers.

The OGC advised on these substantial projects from their inception, all of which involved complex issues of financial, regulatory and administrative law.

Lawyers from the OGC participated in meetings and conferences of interest for central bankers and their legal advisors to keep abreast of topical developments in major international financial centres. These functions covered issues such as money laundering, electronic financial infrastructure and payment and clearing systems. They took part in a series of teleconferences, and corresponded, with their counterparts from central banks and international legal think-tanks to clarify and resolve topics of current concern.

Presentations were also made at professional seminars on subjects ranging from corporate governance issues for banks, banking supervision, anti-money laundering measures and the prevention of terrorist financing.

INTERNAL AUDIT

The Internal Audit Division (IAD) was established in 1995 to assist management in controlling risks, monitoring compliance and improving the efficiency and effectiveness of control systems and procedures within the HKMA. The Chief Executive of the HKMA has granted an Internal Audit Charter to the IAD to formalise its role, mission and authority. The Division reports directly to the Chief Executive of the HKMA and the EFAC Audit Sub-Committee (ASC). Together they approve the annual audit plan prepared by the IAD, meet regularly with the Division and receive reports on the progress and results of its work.

 > [About the HKMA](#) > [Internal Audit](#)

Audit results in 2003

With the support of the HKMA Chief Executive and of the ASC, the IAD continued to operate independently throughout the year. The results of the audits conducted in 2003 were satisfactory. Recommendations for improvement put forward by the IAD were well received by auditees. Co-operation and assistance from the auditees and other HKMA staff contributed to another year of success for the work of the IAD.

The internal audits carried out during the year covered the HKMA's key functions, including monetary operations, reserves management, settlement operations, and finance and administration. Apart from the audits of internal control systems of individual business units, the IAD also reviewed the security management of various IT systems and advised on IT systems development projects such as the new Reserves and Monetary Management System. In addition, the IAD worked jointly with a professional accounting firm on a Value-for-Money audit to

assess the economy, efficiency and effectiveness of the use of resources within the organisation. The IAD continued to deploy various audit software, where applicable, in operational audits and system security reviews to increase the efficiency and effectiveness of its work.

To further improve risk-based management in the HKMA, the IAD developed a Risk Assessment Methodology (RAM) to provide management with a framework to systematically identify and assess risks and the corresponding internal controls. The HKMA's RAM was developed after a detailed study of the risk assessment models used by other central banks and professional firms and a trial application in a pilot risk assessment exercise. The RAM was launched for organisation-wide implementation in August 2003. With the input and support from management, the implementation exercise was largely completed by the end of 2003. It is expected that individual business units will complete the risk assessment exercise in the first quarter of 2004, followed by a review and consolidation exercise by the IAD.

The IAD attaches great importance to keeping abreast of the development of internal audit standards in the industry and the practices adopted by other central banks. During the year, the IAD met with internal auditors of the State Administration of Foreign Exchange, China and other regulatory authorities and institutions in the banking and financial industries to exchange views on risk management and internal audit approaches and to share practical experience. Training courses and seminars on audit techniques and language skills were arranged for the IAD's professional staff to facilitate their performance of audits and career development.

CALENDAR OF EVENTS 2003

JANUARY

27 The direct link from the HKMA's Central Moneymarkets Unit (CMU) to the settlement system of Clearstream Banking Luxembourg commences live operation, allowing CMU Members to clear, settle and hold Clearstream-eligible securities through their CMU accounts.

FEBRUARY

25 The International Monetary Fund Staff Mission to Hong Kong for the Article IV Consultation, in its concluding statement, expects the Hong Kong economy to grow by 3 per cent in 2003. The faster growth in 2003 is based on strengthening external demand, supported by robust growth on the Mainland. The Mission strongly supports the Linked Exchange Rate system, which remains robust.

MARCH

28 The HKMA issues a statutory guideline on its approach to supervising the regulated activities of authorized institutions that are registered with the Securities and Futures Commission under the Securities and Futures Ordinance (SFO). The guideline upholds one of the primary objectives of the SFO of maintaining a level playing field for all securities intermediaries.

APRIL

1 The HKMA launches a new public register containing specified particulars of the staff of authorized institutions engaging in securities business, following the commencement of the Securities and Futures Ordinance and Banking (Amendment) Ordinance 2002.

16 The Chief Executive-in-Council has approved the Deposit Protection Scheme Bill for introduction into the Legislative Council on 30 April 2003. The Bill contains the HKMA's proposals on how the deposit protection scheme (DPS) in Hong Kong should be structured, including the establishment of a Deposit Protection Board and a DPS Fund.

28 Hong Kong processes its first transaction through the new euro clearing system, allowing financial institutions in Hong Kong and in the region to settle euro transactions real-time in the Asian time zone.

MAY

30 The HKMA issues a statutory guideline specifying the minimum standards that authorized institutions should observe in the sharing and use of consumer credit data through a credit reference agency.

JUNE

2 EMEAP (the Executives' Meeting of East Asia-Pacific Central Banks) Group, of which the HKMA is a member, launches the Asian Bond Fund. The Fund will have an initial size of about US\$1 billion, and will be invested in a basket of US dollar denominated bonds issued by major Asian Economies. All 11 members of the EMEAP Group will invest in the Fund at its launch.

16 The HKMA, the Hong Kong Association of Banks and the DTC Association announce plans for the establishment of a commercial credit reference agency in Hong Kong in 2004. The agency will collect credit data of small and medium-sized enterprises and make this information available to authorized institutions.

21 The new Cheque Imaging and Truncation System (CITS) commences operation. With the CITS, the new image-based cheque clearing method transforms the current clearing process driven by physical exchange of cheques.

25 The Financial Secretary and the Monetary Authority exchange letters setting out the division of functions and responsibilities between the two. A further, accompanying letter from the Financial Secretary to the Monetary Authority specifies the monetary policy objective and the structure of the monetary system of Hong Kong.

27 The International Monetary Fund publishes its Financial System Stability Assessment, concluding that the financial system in the HKSAR is resilient, sound and overseen by a comprehensive supervisory framework.

AUGUST

1 A pilot scheme to facilitate retail access to Exchange Fund Notes is launched. Under the scheme, a portion of each quarterly issue of 2-year and 3-year Notes is made available for non-competitive tender by retail investors.

25 The HKMA and the China Banking Regulatory Commission sign a Memorandum of Understanding, which provides for the sharing of supervisory information and co-operation in the area of banking supervision.

27 Mr William Ryback is appointed Deputy Chief Executive of the HKMA. He will succeed Mr David Carse, who will leave the HKMA in September.

SEPTEMBER

18 The HKMA holds its Sixth Distinguished Lecture. The People's Bank of China Governor Zhou Xiaochuan, speaks on "Reform Gradualism and Evolution of Exchange Rate Regime in Mainland China".

19 The Monetary Authority and the Insurance Authority sign a Memorandum of Understanding, which aims at increasing the co-operation, exchange of information and mutual assistance between the two authorities.

OCTOBER

14 The HKMA issues a circular to all authorized institutions in Hong Kong on suspected ATM frauds setting out its expectation on the precautionary measures that should be undertaken and the way in which customer complaints in this relation should be handled.

NOVEMBER

18 The Chief Executive of the Hong Kong Special Administrative Region announces that, following approval from the State Council, the People's Bank of China has agreed to provide clearing arrangements for banks in Hong Kong to conduct personal renminbi business on a trial basis. The scope of renminbi business to be offered will be confined to transactions that facilitate personal spending, including deposit-taking, exchange, remittances, and renminbi cards, but do not involve investment and other capital account transactions.

DECEMBER

15 The new series of \$100 and \$500 banknotes is put into circulation. New notes for the remaining three denominations of \$20, \$50 and \$1,000 are to go into circulation in the second half of 2004. A number of advanced security features have been added to the new banknotes to enhance their anti-counterfeiting capabilities. All existing banknotes continue to be legal tender and to circulate along with the new banknotes.

23 The results of the 2002/03 annual self-assessment conducted by authorized institutions on their compliance with the *Code of Banking Practice* are announced: the overall state of compliance has significantly improved, with 99% of AIs reporting either full or almost full compliance with the Code.

24 The HKMA announces that it has been notified by the People's Bank of China of its decision, following a selection process, to appoint Bank of China (Hong Kong) Limited as the Clearing Bank for renminbi business in Hong Kong. The term of appointment is three years.

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ANNEX: AUTHORIZED INSTITUTIONS AND LOCAL REPRESENTATIVE OFFICES AT 31.12.2003**Licensed Banks*****Incorporated in Hong Kong***

Asia Commercial Bank Limited
 Bank of America (Asia) Limited
 Bank of China (Hong Kong) Limited
 Bank of East Asia, Limited (The)
 Chekiang First Bank Limited
 Chiyu Banking Corporation Limited
 CITIC International Financial Holdings Limited *
 CITIC Ka Wah Bank Limited
 Dah Sing Bank Limited

DBS BANK (HONG KONG) LIMITED
 (formerly known as Dao Heng Bank Limited)
 DBS Kwong On Bank, Limited *
 Hang Seng Bank, Limited
 Hongkong & Shanghai Banking Corporation Limited (The)
 Industrial and Commercial Bank of China (Asia) Limited
 International Bank of Asia Limited
 Jian Sing Bank Limited

Liu Chong Hing Bank Limited
 MEVAS Bank Limited
 Nanyang Commercial Bank, Limited
 Overseas Trust Bank, Limited *
 Shanghai Commercial Bank Limited
 Standard Bank Asia Limited
 Tai Sang Bank Limited
 Tai Yau Bank, Limited
 Wing Hang Bank, Limited
 Wing Lung Bank Limited

Incorporated outside Hong Kong

Abbey National Treasury Services plc *
 ABN AMRO Bank N.V.
 Agricultural Bank of China
 American Express Bank Limited
 Australia & New Zealand Banking Group Limited
 Baden-Württembergische Bank Aktiengesellschaft
 BANCA DI ROMA, SOCIETA' PER AZIONI
 Banca Intesa S.p.A.
 also known as:
 Intesa S.p.A.
 (formerly known as Banca Intesa
 Banca Commerciale Italiana S.p.A.
 also known as:
 IntesaBci S.p.A.
 Banca Intesa Comit S.p.A.)
 Banca Monte dei Paschi di Siena S.p.A.
 Banca Nazionale del Lavoro S.p.A.
 Banco Bilbao Vizcaya Argentaria S.A.
 Bangkok Bank Public Company Limited
 Bank Melli Iran
 Bank of America, National Association
 Bank of China
 Bank of Communications
 Bank of India

Bank of Montreal
 Bank of New York (The)
 Bank of Nova Scotia (The)
 BANK OF TAIWAN
 Bank of Tokyo-Mitsubishi, Ltd. (The)
 Bank One, National Association
 Bank SinoPac
 Barclays Bank plc
 Bayerische Hypo-und Vereinsbank Aktiengesellschaft
 Bayerische Landesbank
 BNP PARIBAS
 BNP PARIBAS PRIVATE BANK
 Canadian Imperial Bank of Commerce
 CATHAY UNITED BANK COMPANY, LIMITED
 (formerly known as United World Chinese Commercial Bank, Ltd.)
 Chang Hwa Commercial Bank Ltd.
 Chiba Bank, Ltd. (The)
 China Construction Bank
 China Merchants Bank Co., Ltd.
 Chinatrust Commercial Bank, Ltd.
 Chugoku Bank, Ltd. (The)
 Citibank, N.A.
 Commerzbank AG

Commonwealth Bank of Australia
 Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.
 Coutts Bank (Schweiz) AG
 also known as:
 Banque Coutts (Suisse) SA
 Coutts Bank (Switzerland) Ltd
 Credit Agricole Indosuez
 Credit Lyonnais
 Credit Suisse
 DBS BANK LTD.
 (formerly known as Development Bank of Singapore Ltd. (The))
 Deutsche Bank Aktiengesellschaft
 Dresdner Bank AG
 DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main
 E.Sun Commercial Bank, Ltd. #
 EFG Private Bank SA
 Equitable PCI Bank, Inc.
 Erste Bank der oesterreichischen Sparkassen AG
 First Commercial Bank, Ltd
 (formerly known as First Commercial Bank)
 Fleet National Bank
 Fortis Bank

Addition in 2003

* Deletion in 2003

ANNEX: AUTHORIZED INSTITUTIONS AND LOCAL REPRESENTATIVE OFFICES AT 31.12.2003 (cont.)

FORTIS BANK ASIA HK also known as: WA PEI FU TONG YIN HANG	Juroku Bank, Ltd. (The) *	State Bank of India
Governor and Company of the Bank of Scotland (The)	KBC Bank N.V.	State Street Bank and Trust Company
Hachijuni Bank, Ltd. (The)	Korea Exchange Bank	Sumitomo Mitsui Banking Corporation
HANA BANK (formerly known as SEOULBANK)	Malayan Banking Berhad	Svenska Handelsbanken AB (publ)
HSBC BANK INTERNATIONAL LIMITED	Mitsubishi Trust and Banking Corporation (The)	TAIPEIBANK Co., Ltd.
HSBC Bank plc	Mizuho Corporate Bank, Ltd.	TAISHIN INTERNATIONAL BANK CO., LTD #
HSBC Bank USA	Natexis Banques Populaires	Taiwan Business Bank
HSBC Republic Bank (Suisse) SA	National Australia Bank Limited	Toronto-Dominion Bank (The)
HSH Nordbank AG (formerly known as Hamburgische Landesbank Girozentrale)	National Bank of Pakistan	UBS AG also known as: UBS SA UBS Ltd
Hua Nan Commercial Bank, Ltd.	Oversea-Chinese Banking Corporation Limited	UCO Bank
Indian Overseas Bank	Philippine National Bank	UFJ Bank Limited
Industrial and Commercial Bank of China (The)	PT. Bank Negara Indonesia (Persero) Tbk.	UniCredito Italiano Societa' per Azioni
INTERNATIONAL BANK OF TAIPEI #	Public Bank Berhad #	UNITED COMMERCIAL BANK #
INTERNATIONAL COMMERCIAL BANK OF CHINA CO., LTD. (THE)	Royal Bank of Canada #	United Overseas Bank Ltd.
ING Bank N.V.	Royal Bank of Scotland public limited company (The)	Wells Fargo Bank, National Association
Iyo Bank, Ltd. (The)	SANPAOLO IMI S.p.A.	WestLB AG
JPMORGAN CHASE BANK	Shiga Bank, Ltd. (The)	Westpac Banking Corporation
	Shinkin Central Bank	Woori Bank
	Shizuoka Bank, Ltd. (The)	Yamaguchi Bank, Ltd. (The)
	Societe Generale	
	Standard Chartered Bank	

Addition in 2003

* Deletion in 2003

ANNEX: AUTHORIZED INSTITUTIONS AND LOCAL REPRESENTATIVE OFFICES AT 31.12.2003 (cont.)**Restricted Licence Banks*****Incorporated in Hong Kong***

ABSA BANK (ASIA) LIMITED (formerly known as ABSA Asia Limited)	East Asia Finance Company, Limited *	MIZUHO CORPORATE ASIA (HK) LIMITED
AIG Finance (Hong Kong) Limited	GE Capital (Hong Kong) Limited	N.M. Rothschild & Sons (Hong Kong) Limited
ALLIED BANKING CORPORATION (HONG KONG) LIMITED	Hang Seng Finance Limited	ORIX Asia Limited
BA Asia Limited	Indover bank (Asia) Limited	Pacific Finance (Hong Kong) Limited
BNP International Financial Services (Hong Kong) Limited *	Industrial and Commercial International Capital Limited	SCOTIABANK (HONG KONG) LIMITED
Bank of Baroda (Hong Kong) Limited	J. P. MORGAN SECURITIES (ASIA PACIFIC) LIMITED	Shinhan Finance Limited
BOCI Capital Limited	KDB Asia Limited	Societe Generale Asia Limited
Canadian Eastern Finance Limited	Kookmin Finance Hong Kong Limited	UBAF (Hong Kong) Limited
Citicorp Commercial Finance (H.K.) Limited	Manhattan Card Company Limited	
Citicorp International Limited	Mitsubishi Securities (HK), Limited (formerly known as Tokyo-Mitsubishi International (HK) Limited)	

Incorporated outside Hong Kong

Bank of Ayudhya Public Company Limited	KorAm Bank	Thanakharn Kasikorn Thai Chamkat (Mahachon) also known as: KASIKORNBANK PUBLIC COMPANY LIMITED (formerly known as Thai Farmers Bank Public Company Ltd. (The))
Bank of Bermuda, Limited (The)	Lloyds TSB Bank Plc	Thai Military Bank Public Company Limited
Bank of N.T. Butterfield & Son Ltd. (The) *	Mashreq Bank - Public Shareholding Company # also known as: Mashreqbank psc	Union Bank of California, National Association
Bumiputra-Commerce Bank Berhad	NEDBANK LIMITED	Wachovia Bank, National Association
Citibank International	PT. Bank Mandiri (Persero)	
Dexia Banque Internationale à Luxembourg #	Public Bank Berhad †	
E.Sun Commercial Bank, Ltd. †	Siam Commercial Bank Public Company Limited (The)	
Industrial Bank of Korea		
International Bank of Taipei †		

† Upgraded to a Licensed bank

Addition in 2003

* Deletion in 2003

ANNEX: AUTHORIZED INSTITUTIONS AND LOCAL REPRESENTATIVE OFFICES AT 31.12.2003 (cont.)**Deposit-taking Companies*****Incorporated in Hong Kong***

ACB Finance Limited *	First Metro International Investment Company Limited	Kincheng-Tokyo Finance Company Limited
Argo Enterprises Company Limited	Gunma Finance (Hong Kong) Limited	Korea First Finance Limited
BCA Finance Limited	Habib Finance International Limited	Liu Chong Hing Finance Limited
BCOM Finance (Hong Kong) Limited	Hachijuni Asia Limited	Mashreq Asia Limited
BII Finance Company Limited	Hang Seng Credit Ltd.	Michinoku Finance (Hong Kong) Limited
BPI International Finance Limited	HBZ Finance Limited	OCTOPUS CARDS LIMITED
C.F. Finance Company Limited	Henderson International Finance Limited	Orient First Capital Limited
Chau's Brothers Finance Company Limited	HKCB Finance Limited	PrimeCredit Limited
Chohung Finance Limited	Hung Kai Finance Company Limited	Shacom Finance Limited
Commonwealth Finance Corporation Limited	IBA Credit Limited	Standard London (Asia) Limited *
Corporate Finance (D.T.C.) Limited	Inchroy Credit Corporation Limited	Sumitomo Trust Finance (H.K.) Limited (The)
Dao Heng Finance Limited *	Indo Hong Kong International Finance Limited	Vietnam Finance Company Limited
DBS Kwong On Finance Limited *	Iyo Finance (Hong Kong) Limited *	Wing Hang Finance Company Limited
Delta Asia Credit Limited	JCG Finance Company, Limited	Wing Lung Finance Limited
East Asia Credit Company Limited *	Ka Wah International Merchant Finance Limited	
Edward Wong Credit Limited		

Incorporated outside Hong Kong

NIL

Local Representative Offices

Abbey National Treasury International Limited *	Banca del Gottardo	Banca Popolare di Sondrio Soc. Coop. a r.l.
AIG Private Bank Ltd.	Banca Popolare dell'Emilia Romagna Soc. Coop. a r.l.	Banca Popolare di Vicenza Soc. Coop. a r.l.
ANTWERPSE DIAMANTBANK NV also known as: ANTWERP DIAMOND BANK NV	Banca Popolare di Ancona Societa' per azioni	Banco Atlantico S.A.
Arab Bank plc	Banca Popolare di Bergamo S.p.A. #	Banco do Brasil S.A.
Asahi Bank, Ltd. (The) *	Banca Popolare di Bergamo-Credito Varesino Soc. Coop. a r.l. *	Banco Popolare di Verona e Novara S.c.r.l.
Banca Antoniana-Popolare Veneta S.C.A R.L.	Banca Popolare di Novara - Societa' per Azioni #	Banco Popular Español, S.A.

Addition in 2003

* Deletion in 2003

ANNEX: AUTHORIZED INSTITUTIONS AND LOCAL REPRESENTATIVE OFFICES AT 31.12.2003 (cont.)

Banco Santander Central Hispano, S.A.	Fiduciary Trust Company International	Nanto Bank, Ltd. (The)
Bank für Arbeit und Wirtschaft Aktiengesellschaft	Fuhwa Commercial Bank Co., Ltd.	National Bank of Canada
Bank Julius Baer & Co. Ltd. *	GERRARD PRIVATE BANK (JERSEY) LIMITED #	National Bank of New Zealand Limited (The) *
Bank Leumi Le-Israel B.M.	Grand Commercial Bank *	Nedship Bank N.V.
Bank of Fukuoka, Ltd. (The)	GUANGDONG DEVELOPMENT BANK CO., LTD.	Nishi-Nippon Bank, Ltd. (The)
Bank of Kyoto, Ltd. (The)	(formerly known as Guangdong Development Bank)	Norinchukin Bank (The)
Bank of New York - Inter Maritime Bank, Geneva	Habib Bank A.G. Zurich	Ogaki Kyoritsu Bank, Ltd. (The)
Bank of Scotland Offshore Limited *	Hokkoku Bank, Ltd. (The) *	Oita Bank, Ltd. (The)
Bank of Yokohama, Ltd. (The)	HSBC Bank Australia Limited	P.T. Bank Central Asia
Banque Cantonale Vaudoise	HSBC Bank Canada	P.T. Bank Rakyat Indonesia (Persero)
Banque Privee Edmond de Rothschild S.A.	HSBC Guyerzeller Bank AG	Raiffeisen Zentralbank Osterreich AG
Banque Sudameris S.A. *	HSBC Trinkaus & Burkhardt (International) S.A.	Resona Bank, Limited (formerly known as The Daiwa Bank, Limited)
BRADFORD & BINGLEY INTERNATIONAL LIMITED #	IKB Deutsche Industriebank AG *	Rothschild Bank AG
BSI Ltd.	Investec Bank Limited	Schroder & Co Bank AG also known as: Schroder & Co Banque SA Schroder & Co Banca SA Schroder & Co Bank Ltd Schroder & Co Banco SA
CARIPRATO - Cassa di Risparmio di Prato S.p.A. #	Japan Bank for International Cooperation	Shanghai Pudong Development Bank Co., Ltd.
Cathay Bank	Juroku Bank, Ltd. (The) #	Shenzhen Development Bank Co., Ltd.
China Development Bank	Kagoshima Bank Ltd. (The)	Shoko Chukin Bank (The)
China Everbright Bank Co., Ltd	Korea Development Bank (The)	Standard Bank of South Africa Ltd. (The)
China International Trust and Investment Corporation	Kredietbank S.A. Luxembourgeoise	STANDARD CHARTERED GRINDLAYS (OFFSHORE) LTD
Chinese Bank (The)	Land Bank of Taiwan	Taishin International Bank *
Clariden Bank	Landesbank Hessen - Thuringen Girozentrale *	Taiwan Cooperative Bank
Clearstream Banking	LGT Bank in Liechtenstein AG also known as: LGT Bank in Liechtenstein Ltd. LGT Banque de Liechtenstein S.A. LGT Banca di Liechtenstein S.A.	UFJ Bank (Schweiz) AG also known as: UFJ Bank (Switzerland) Ltd. UFJ Banque (Suisse) SA UFJ Banca (Svizzera) SA
Comerica Bank	Lloyds TSB Bank (Isle of Man) Limited # *	Union Bank of Taiwan
Credit Industriel et Commercial	LLOYDS TSB OFFSHORE TREASURY LIMITED #	United Commercial Bank *
Credito Bergamasco S.p.A.	Mashreq Bank P.S.C. *	Veneto Banca S.C.A.R.L.
D.A.H. Hambros Bank (Channel Islands) Limited	Merrill Lynch Bank (Suisse) S.A.	Yamanashi Chuo Bank, Ltd.
DePfa Investment Bank Limited #	Merrill Lynch International Bank Limited	
Dexia Banque Internationale à Luxembourg *	Metropolitan Bank and Trust Company	
Euroclear Bank		
Export-Import Bank of Korea (The)		
F. van Lanschot Bankiers N.V.		
Far Eastern International Bank		

Addition in 2003

* Deletion in 2003

TABLE A: MAJOR ECONOMIC INDICATORS

	1999	2000	2001	2002	2003	2004 ^(a)
I. Gross Domestic Product						
Real GDP growth (%)	3.4	10.2	0.5	2.3	3.3^(b)	6.0
Nominal GDP growth (%)	-2.6	3.4	-1.4	-0.8	-2.0^(b)	2.8
Real growth of major expenditure components of GDP (%)						
– Private consumption expenditure	1.3	5.9	2.0	-1.2	0.0^(b)	6.0
– Government consumption expenditure	3.1	2.0	6.1	2.4	1.9^(b)	1.5
– Gross domestic fixed capital formation of which	-16.6	11.0	2.6	-4.3	-0.1^(b)	7.1
– Building and construction	-15.5	-7.6	-1.1	1.2	-6.9^(b)	1.5
– Machinery, equipment and computer software	-18.2	27.0	6.2	-9.1	6.1^(b)	11.0
– Exports	4.0	16.6	-1.8	9.3	12.7^(b)	8.9
– Imports	-0.2	16.8	-1.5	7.1	11.3^(b)	9.1
GDP at current market prices (US\$ billion)	160.6	165.4	162.8	161.5	158.6^(b)	162.8
Per capita GDP at current market prices (US\$)	24,313	24,811	24,213	23,800	23,312^(b)	23,654
II. External Trade (HK\$ billion)						
Merchandise trade ^(c)						
– Domestic exports of goods	170.6	181.0	153.5	131.1	122.1^(b)	118.5
– Re-exports of goods	1,178.4	1,391.7	1,327.5	1,431.0	1,627.0^(b)	1,738.1
– Total imports of goods	1,373.5	1,636.7	1,549.2	1,601.5	1,794.1^(b)	1,952.6
– Merchandise trade balance	-24.5	-64.0	-68.2	-39.4	-45.0^(b)	-96.0
Services trade						
– Exports of services	265.5	301.8	307.7	337.9	350.3^(b)	406.7
– Imports of services	184.1	191.5	192.5	193.4	189.2^(b)	213.3
– Services trade balance	81.5	110.3	115.2	144.5	161.1^(b)	193.4
III. Fiscal Expenditure and Revenue (HK\$ million, fiscal year)						
Total government expenditure	223,043	232,893	238,890	239,177	252,860^(b)	266,118
Total government revenue	232,995	225,060	175,559	177,489	203,837^(b)	223,471
Consolidated surplus/deficit	9,952	-7,833	-63,331	-61,688	-49,023^(b)	-42,647
Reserve balance as at end of fiscal year ^(d)	444,254	430,278	372,503	311,402	266,448^(b)	223,801
IV. Prices (annual change, %)						
Consumer Price Index (A)	-3.3	-3.0	-1.7	-3.2	-2.1	N.A.
Composite Consumer Price Index	-4.0	-3.8	-1.6	-3.0	-2.6	-1.0
Trade Unit Value Indices						
– Domestic exports	-2.4	-1.0	-4.7	-3.3	0.2	N.A.
– Re-exports	-2.8	-0.1	-2.0	-2.7	-1.5	N.A.
– Imports	-2.0	0.8	-3.1	-3.9	-0.4	N.A.
Property Price Indices						
– Residential flats	-15	-10	-12	-11	-12^(b)	N.A.
– Office premises	-26	-10	-12	-13	-9^(b)	N.A.
– Retail premises	-22	-6	-7	-2	-1^(b)	N.A.
– Flatted factory premises	-24	-9	-10	-9	-4^(b)	N.A.

TABLE A: MAJOR ECONOMIC INDICATORS (cont.)

	1999	2000	2001	2002	2003
V. Labour					
Labour force (annual change, %)	1.3	1.6	1.6	1.8	0.4
Employment (annual change, %)	-0.3	3.1	1.4	-0.6	-0.3
Unemployment rate (annual average, %)	6.2	4.9	5.1	7.3	7.9
Underemployment rate (annual average, %)	2.9	2.8	2.5	3.0	3.5
Employment ('000)					
– Manufacturing	354	334	326	290	272
– Financing, insurance, real estate and business services	438	453	478	474	470
– Wholesale, retail and import/export trades, restaurants and hotels	935	982	981	983	993
VI. Money Supply (HK\$ billion)					
HK\$ money supply					
– M1	205.3	204.0	229.8	259.4	354.8
– M2 ^(e)	1,923.5	1,988.0	1,998.8	1,984.0	2,107.3
– M3 ^(e)	1,935.5	2,002.4	2,016.6	2,004.2	2,122.9
Total money supply					
– M1	225.2	243.8	258.1	295.6	413.4
– M2	3,386.2	3,649.5	3,550.1	3,518.3	3,813.4
– M3	3,434.5	3,692.8	3,594.1	3,561.9	3,858.0
VII. Interest Rates (end of period, %)					
Three-month interbank rate	5.69	5.75	1.88	1.41	0.07
Savings deposit	3.75	4.75	0.15	0.03	0.01
One-month time deposit	4.36	5.03	0.54	0.13	0.01
Banks' 'Best lending rate'	8.50	9.50	5.13	5.00	5.00
VIII. Exchange Rates (end of period)					
HK\$/US\$	7.771	7.796	7.797	7.798	7.763
Trade-weighted Effective Exchange Rate Index (Jan 2000=100)	100.1	102.9	105.9	102.0	98.8
IX. Foreign Currency Reserve Assets (US\$ billion) ^(f)					
	96.3	107.6	111.2	111.9	118.4
X. Stock Market (end of period figures)					
Hang Seng Index	16,962	15,096	11,397	9,321	12,576
Average price/earning ratio	26.7	12.8	12.2	14.9	19.0
Market capitalisation (HK\$ billion)	4,727.5	4,795.2	3,885.3	3,559.1	5,477.7

(a) Forecast as at March 2004.

(b) The estimates are preliminary.

(c) Includes non-monetary gold.

(d) Includes changes in provision for loss in investments with the Exchange Fund.

(e) Adjusted to include foreign currency swap deposits.

(f) Excludes unsettled forward transactions but includes gold.

N.A. not available

TABLE B: PERFORMANCE RATIOS OF THE BANKING SECTOR ^(a)

	All AIs						
	1997	1998	1999	2000	2001	2002	2003
Asset Quality ^(b)	%	%	%	%	%	%	%
As % of total credit exposures ^(c)							
Total outstanding provisions	0.85	1.79	2.32	2.03	1.73	1.40	1.14
Classified ^(d) exposures:							
Gross	1.08	4.52	5.52	4.34	3.71	2.77	2.23
Net of specific provisions	0.72	3.29	3.69	2.86	2.47	1.85	1.52
Net of all provisions	0.22	2.72	3.20	2.31	1.98	1.37	1.09
Non-performing exposures ^(e)	N.A.	N.A.	3.85	3.18	2.62	1.98	1.65
As % of total loans							
Total outstanding provisions	1.03	2.17	3.14	2.98	2.82	2.39	1.98
Classified ^(d) loans:							
Gross	1.23	5.27	7.24	6.08	5.73	4.53	3.71
Net of specific provisions	0.82	3.79	4.79	3.96	3.75	2.98	2.51
Net of all provisions	0.20	3.09	4.10	3.11	2.92	2.13	1.73
Non-performing loans ^(e)	N.A.	N.A.	5.34	4.72	4.37	3.46	2.94
Overdue > 3 months and rescheduled loans	1.07	4.18	5.72	5.12	4.16	3.41	2.78
Profitability							
Return on assets (operating profit)	0.69	0.36	0.42	0.84	0.85	0.94	0.93
Return on assets (post-tax profit)	0.60	0.28	0.39	0.77	0.76	0.81	0.81
Net interest margin	1.08	1.13	1.34	1.43	1.45	1.52	1.41
Cost-income ratio	45.9	48.3	44.2	45.5	47.2	46.3	45.8
Bad debt charge to total assets	0.13	0.45	0.64	0.26	0.23	0.24	0.24
Liquidity							
Loan to deposit ratio (all currencies)	152.1	110.1	86.5	69.8	64.1	62.6	57.1
Loan to deposit ^(f) ratio (Hong Kong dollar)	112.3	99.7	90.6	89.3	88.8	88.5	81.5

Asset Quality

Delinquency ratio of residual mortgage loans
Credit card receivables ^(g)
 Delinquency ratio
 Charge-off ratio

Profitability

Operating profit to shareholders' funds
Post-tax profit to shareholders' funds

Capital adequacy

Equity to assets ratio ^(b)

Capital adequacy ratio (consolidated)

- (a) Figures relate to Hong Kong office(s) only except where otherwise stated.
(b) Figures relate to Hong Kong office(s) and for the locally incorporated AIs included therein, also their overseas branches.
(c) Credit exposures include loans and advances, acceptances and bills of exchange held, investment debt securities issued by others, accrued interest, and commitments and contingent liabilities to or on behalf of non-banks.
(d) Denotes loans or exposures graded as "substandard", "doubtful" or "loss".
(e) Denotes loans or exposures on which interest has been placed in suspense or on which interest accrual has ceased.
(f) Includes swap deposits.
(g) There is a break in series in 2001 owing to an increase in the number of surveyed institutions.
N.A. not available

Retail banks

1997	1998	1999	2000	2001	2002	2003
%	%	%	%	%	%	%
1.59	2.53	2.68	2.16	1.76	1.41	1.13
1.63	6.11	6.72	4.70	4.03	3.02	2.30
1.03	4.48	4.72	3.25	2.85	2.15	1.65
0.04	3.57	4.04	2.54	2.27	1.61	1.16
N.A.	N.A.	4.68	3.52	2.92	2.17	1.72
2.14	3.34	4.25	3.52	3.04	2.49	2.05
2.09	7.70	10.14	7.26	6.53	5.04	3.91
1.30	5.57	7.02	4.93	4.51	3.53	2.74
-0.06	4.35	5.89	3.74	3.48	2.55	1.85
N.A.	N.A.	7.60	5.87	5.16	3.94	3.16
2.09	6.47	7.86	6.04	4.57	3.59	2.83
1.62	0.98	0.98	1.33	1.17	1.35	1.36
1.39	0.86	0.94	1.16	1.05	1.18	1.17
2.19	2.01	2.11	2.14	2.03	2.09	1.91
39.5	42.1	39.0	38.1	42.2	39.3	38.7
0.19	0.60	0.76	0.44	0.40	0.34	0.29
72.3	61.2	55.2	52.6	53.7	53.5	49.6
83.4	73.8	71.7	73.3	77.2	78.6	71.6

Surveyed institutions

1997	1998	1999	2000	2001	2002	2003
%	%	%	%	%	%	%
N.A.	0.84	1.13	1.32	1.22	1.06	0.86
0.64	1.16	0.92	0.76	1.28	1.28	0.92
2.05	3.14	4.92	3.88	5.46	13.25	10.02

Locally incorporated banks

1997	1998	1999	2000	2001	2002	2003
%	%	%	%	%	%	%
17.9	11.0	12.6	17.0	15.4	16.2	16.6
15.7	9.5	11.6	14.7	14.1	14.0	14.4
9.9	9.1	8.9	8.6	10.5	10.6	10.5

All locally incorporated AIs

1997	1998	1999	2000	2001	2002	2003
%	%	%	%	%	%	%
17.4	18.5	18.7	17.8	16.5	15.7	15.3

TABLE C: AUTHORIZED INSTITUTIONS: DOMICILE AND PARENTAGE

	1999	2000	2001	2002	2003
Licensed Banks					
(i) Incorporated in Hong Kong	31	31	29	26	23
(ii) Incorporated outside Hong Kong	125	123	118	107	111
Total	156	154	147	133	134
Restricted Licence Banks					
(i) Subsidiaries of licensed banks:					
(a) incorporated in Hong Kong	2	2	2	2	1
(b) incorporated outside Hong Kong	12	11	11	12	11
(ii) Subsidiaries or branches of foreign banks which are not licensed banks in Hong Kong	34	29	30	26	24
(iii) Bank related	6	3	3	3	3
(iv) Others	4	3	3	3	3
Total	58	48	49	46	42
Deposit-taking Companies					
(i) Subsidiaries of licensed banks:					
(a) incorporated in Hong Kong	17	16	15	14	9
(b) incorporated outside Hong Kong	18	8	5	4	3
(ii) Subsidiaries of foreign banks which are not licensed banks in Hong Kong	23	23	21	15	15
(iii) Bank related	2	2	2	2	2
(iv) Others	11	12	11	10	10
Total	71	61	54	45	39
All Authorized Institutions	285	263	250	224	215
Local Representative Offices	127	118	111	94	87

TABLE D: AUTHORIZED INSTITUTIONS: REGION/ECONOMY OF BENEFICIAL OWNERSHIP

Region/Economy	Licensed Banks					Restricted Licence Banks					Deposit-taking Companies				
	99	00	01	02	03	99	00	01	02	03	99	00	01	02	03
Asia & Pacific															
Hong Kong	15	16	14	12	13	2	2	2	2	1	15	16	15	14	13
Australia	4	4	4	4	4	-	-	-	-	-	-	-	-	-	-
Mainland China	19	19	19	13	12	3	2	2	2	2	10	3	3	3	3
India	4	4	4	4	4	-	-	-	1	1	3	3	3	2	2
Indonesia	3	2	2	1	1	2	2	2	2	2	9	7	4	2	2
Japan	25	22	20	15	13	7	5	5	4	4	9	8	7	7	5
Malaysia	3	3	1	1	2	3	2	2	2	1	2	2	1	1	1
Pakistan	1	1	1	1	1	-	-	-	-	-	2	2	2	2	2
Philippines	2	2	2	2	2	1	1	1	1	1	5	5	4	3	3
Singapore	5	5	7	6	4	1	1	1	-	-	2	2	3	2	-
South Korea	3	3	3	3	3	6	6	6	5	5	4	2	2	1	1
Taiwan	5	6	7	10	13	1	1	1	2	-	-	-	-	-	-
Thailand	1	1	1	1	1	4	4	4	4	4	-	-	-	-	-
Vietnam	-	-	-	-	-	-	-	-	-	-	1	1	1	1	1
Sub-Total	90	88	85	73	73	30	26	26	25	21	62	51	45	38	33
Europe															
Austria	3	2	2	1	1	-	-	-	-	-	-	-	-	-	-
Belgium	4	4	4	3	3	-	-	-	-	-	-	-	-	-	-
Denmark	1	1	-	-	-	-	-	-	-	-	-	-	-	-	-
France	8	6	5	6	6	3	3	3	3	2	1	1	-	-	-
Germany	9	9	9	9	9	1	1	1	-	-	-	-	-	-	-
Italy	6	7	6	6	6	-	-	-	-	-	-	-	-	-	-
Netherlands	3	3	3	3	3	1	-	-	-	-	-	-	-	-	-
Spain	2	1	1	1	1	-	-	-	-	-	-	-	-	-	-
Sweden	2	2	1	1	1	-	-	-	-	-	-	-	-	-	-
Switzerland	2	3	3	3	3	1	1	1	1	1	-	-	-	-	-
United Kingdom	7	8	10	10	9	3	2	2	2	2	-	-	-	-	-
Sub-Total	47	46	44	43	42	9	7	7	6	5	1	1	-	-	-
Middle East															
Bahrain	1	1	1	1	1	-	-	-	-	-	1	1	1	1	1
Iran	1	1	1	1	1	-	-	-	-	-	-	-	-	-	-
U.A.E.	-	-	-	-	-	1	-	-	-	1	1	1	1	1	1
Sub-Total	2	2	2	2	2	1	-	-	-	1	2	2	2	2	2
North America															
Canada	5	5	5	4	5	1	1	2	2	2	-	-	-	-	-
United States	12	13	10	10	11	13	10	9	9	9	4	5	5	3	3
Sub-Total	17	18	15	14	16	14	11	11	11	11	4	5	5	3	3
South Africa	-	-	1	1	1	2	2	3	2	2	1	1	1	1	-
Bermuda	-	-	-	-	-	2	2	2	2	1	-	-	-	-	-
Others	-	-	-	-	-	-	-	-	-	1	1	1	1	1	1
Grand Total	156	154	147	133	134	58	48	49	46	42	71	61	54	45	39

TABLE E: PRESENCE OF WORLD'S LARGEST 500 BANKS IN HONG KONG

Positions at 31.12.2003	Number of Overseas Bank ^(b)					Licensed Banks ^(c)				
	99	00	01	02	03	99	00	01	02	03
World Ranking^(a)										
1-20	20	20	20	20	20	24	28	28	30	30
21-50	25	26	24	23	23	20	23	23	22	21
51-100	33	33	32	30	32	29	27	26	27	27
101-200	46	49	47	42	44	29	27	25	21	22
201-500	62	58	53	53	51	15	12	12	15	18
Sub-total	186	186	176	168	170	117	117	114	115	118
Others	91	75	73	51	44	39	37	33	18	16
Total	277	261	249	219	214	156	154	147	133	134

(a) Top 500 banks/banking groups in the world ranked by total assets less contra items.
Figures are extracted from The Banker, July 2003 issue.

(b) The sum of the number of licensed banks, restricted licence banks, deposit-taking companies and local representative offices is greater than the number of banks with a presence in Hong Kong because of the multiple presence of some banks.
The figures exclude banks incorporated in Hong Kong.

(c) Including restricted licence banks and deposit-taking companies which are subsidiaries of overseas banks, classified in accordance with the world ranking of these overseas banks.

Restricted Licence Banks ^(c)					Deposit-Taking Companies ^(c)					Local Representative Offices				
99	00	01	02	03	99	00	01	02	03	99	00	01	02	03
13	13	11	12	11	5	7	6	4	3	12	11	8	7	7
8	4	5	3	4	1	-	-	-	-	5	5	8	7	4
1	2	3	4	4	1	3	3	5	2	7	11	11	6	6
3	4	4	2	3	9	9	6	5	5	12	17	17	19	23
14	12	14	13	10	10	6	7	8	7	32	35	30	24	22
39	35	37	34	32	26	25	22	22	17	68	79	74	63	62
19	13	12	12	10	45	36	32	23	22	59	39	37	31	25
58	48	49	46	42	71	61	54	45	39	127	118	111	94	87

TABLE F: BALANCE SHEET: ALL AUTHORIZED INSTITUTIONS AND RETAIL BANKS**All Authorized Institutions**

(HK\$ bn)

	1997			1998			1999		
	HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total
Assets									
Loans to customers	1,742	2,379	4,122	1,695	1,609	3,304	1,607	1,206	2,813
Inside Hong Kong ^(a)	1,706	525	2,230	1,665	444	2,110	1,584	349	1,933
Outside Hong Kong ^(b)	37	1,854	1,891	30	1,165	1,195	23	857	880
Interbank lending	712	2,368	3,081	578	2,364	2,942	511	2,414	2,925
Inside Hong Kong	517	254	771	411	218	629	359	177	536
Outside Hong Kong	195	2,114	2,310	167	2,146	2,312	152	2,237	2,389
Negotiable certificates of deposit (NCD)	122	50	173	106	38	144	103	35	138
Negotiable debt instruments, other than NCD	187	448	635	204	342	546	261	322	583
Other assets	170	217	387	169	150	318	200	125	326
Total assets	2,934	5,463	8,397	2,752	4,503	7,254	2,682	4,102	6,784
Liabilities									
Deposits from customers ^(c)	1,552	1,159	2,710	1,700	1,300	3,000	1,773	1,477	3,251
Interbank borrowing	811	3,942	4,753	646	2,780	3,426	539	2,191	2,731
Inside Hong Kong	521	251	772	414	208	622	360	168	529
Outside Hong Kong	290	3,691	3,981	232	2,572	2,803	179	2,023	2,202
Negotiable certificates of deposit	172	48	220	163	46	209	164	36	199
Other liabilities	386	328	714	365	254	619	405	198	604
Total liabilities	2,921	5,476	8,397	2,874	4,380	7,254	2,882	3,903	6,784

Retail Banks

(HK\$ bn)

	1997			1998			1999		
	HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total
Assets									
Loans to customers	1,171	260	1,431	1,168	239	1,407	1,166	203	1,369
Inside Hong Kong ^(a)	1,156	213	1,369	1,154	198	1,352	1,154	170	1,323
Outside Hong Kong ^(b)	15	47	62	14	41	55	12	34	46
Interbank lending	553	543	1,096	476	790	1,266	412	877	1,289
Inside Hong Kong	408	86	495	345	120	466	299	101	399
Outside Hong Kong	145	456	601	131	670	801	113	777	890
Negotiable certificates of deposit (NCD)	44	10	54	42	10	52	48	10	58
Negotiable debt instruments, other than NCD	98	137	236	127	149	275	188	180	369
Other assets	134	70	205	133	46	180	168	50	218
Total assets	2,001	1,020	3,021	1,946	1,234	3,180	1,982	1,321	3,303
Liabilities									
Deposits from customers ^(c)	1,404	574	1,978	1,583	716	2,299	1,627	854	2,481
Interbank borrowing	262	294	556	194	232	426	162	187	349
Inside Hong Kong	72	31	103	46	39	85	50	33	82
Outside Hong Kong	190	263	453	148	193	341	112	155	267
Negotiable certificates of deposit	120	19	139	116	21	137	112	14	126
Other liabilities	265	83	348	258	60	318	312	34	346
Total liabilities	2,050	971	3,021	2,151	1,029	3,180	2,212	1,091	3,303

(a) Defined as loans for use in Hong Kong plus trade financing loans.

(b) Includes "others" (i.e. unallocated)

(c) Hong Kong dollar customer deposits include swap deposits.

2000			2001			2002			2003		
HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total
1,652	809	2,461	1,648	537	2,185	1,616	461	2,076	1,573	462	2,035
1,626	339	1,965	1,626	252	1,879	1,591	243	1,834	1,542	267	1,809
26	470	496	21	285	306	25	218	243	31	195	226
533	2,469	3,002	397	2,231	2,628	332	1,983	2,315	438	2,175	2,614
380	171	551	287	182	468	236	159	395	295	177	472
153	2,297	2,450	111	2,049	2,160	96	1,823	1,919	144	1,998	2,142
98	37	135	87	40	128	90	44	134	86	58	144
329	427	756	355	553	908	395	715	1,109	397	800	1,197
202	106	307	231	74	306	255	110	365	305	212	516
2,814	3,847	6,661	2,718	3,436	6,154	2,687	3,312	5,999	2,799	3,707	6,506

1,851	1,677	3,528	1,855	1,552	3,407	1,825	1,493	3,318	1,931	1,636	3,567
601	1,694	2,295	454	1,474	1,929	384	1,404	1,788	428	1,489	1,918
380	163	543	290	180	470	236	157	394	285	185	470
221	1,530	1,752	164	1,295	1,459	147	1,246	1,394	143	1,305	1,448
151	26	178	135	37	172	138	73	211	132	110	242
447	213	661	473	173	646	509	173	683	496	284	779
3,051	3,610	6,661	2,917	3,237	6,154	2,856	3,143	5,999	2,987	3,519	6,506

2000			2001			2002			2003		
HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total	HK\$	F/CY	Total
1,242	189	1,431	1,304	150	1,454	1,307	151	1,459	1,279	172	1,450
1,227	163	1,390	1,292	128	1,420	1,296	130	1,426	1,266	146	1,412
14	26	41	12	22	33	11	22	33	12	26	39
446	987	1,433	307	881	1,188	245	765	1,010	330	836	1,166
325	107	432	239	109	348	190	107	297	247	110	357
121	881	1,002	68	772	840	56	658	713	83	726	809
57	20	77	56	18	74	61	21	82	58	38	96
232	262	494	256	360	616	259	484	744	278	565	843
162	40	202	183	38	221	208	61	269	249	78	327
2,139	1,498	3,637	2,106	1,447	3,553	2,081	1,483	3,564	2,194	1,689	3,883

1,693	1,029	2,722	1,688	1,020	2,708	1,663	1,063	2,726	1,786	1,141	2,927
204	221	425	122	207	329	78	213	291	90	265	354
57	29	86	39	20	58	24	31	55	31	26	58
147	192	339	83	188	271	54	182	236	58	238	296
105	13	118	85	28	113	86	52	138	82	80	162
327	45	372	359	44	402	365	44	409	362	78	440
2,330	1,308	3,637	2,254	1,299	3,553	2,193	1,372	3,564	2,319	1,564	3,883

TABLE G: MAJOR BALANCE SHEET ITEMS BY REGION/ECONOMY OF BENEFICIAL OWNERSHIP OF AUTHORIZED INSTITUTION

(HK\$ bn)		Mainland China	Japan	US	Europe	Others	Total
Total Assets	2002	1,016	630	494	1,427	2,432	5,999
	2003	1,079	624	552	1,580	2,671	6,506
Deposits from Customers	2002	754	196	218	445	1,705	3,318
	2003	784	177	238	489	1,879	3,567
Loans to Customers	2002	451	220	123	359	924	2,076
	2003	453	152	118	378	934	2,035
Loans to Customers Inside Hong Kong^(a)	2002	427	101	117	296	893	1,834
	2003	427	81	109	295	897	1,809
Loans to Customers Outside Hong Kong^(b)	2002	24	119	6	63	31	243
	2003	26	71	8	83	37	226

(a) Defined as loans for use in Hong Kong plus trade financing loans.

(b) Includes "others" (i.e. unallocated).

TABLE H: FLOW OF FUNDS: ALL AUTHORIZED INSTITUTIONS AND RETAIL BANKS**All Authorized Institutions**

(HK\$ bn)	2002			2003		
	HK\$	F/CY	Total	HK\$	F/CY	Total
Increase/(Decrease) in						
Assets						
Loans to customers	(32)	(77)	(109)	(43)	1	(41)
Inside Hong Kong ^(a)	(36)	(9)	(45)	(49)	24	(25)
Outside Hong Kong ^(b)	4	(67)	(64)	6	(22)	(16)
Interbank lending	(65)	(248)	(313)	106	193	299
Inside Hong Kong	(51)	(22)	(73)	59	18	76
Outside Hong Kong	(15)	(226)	(240)	48	175	223
All other assets	66	201	267	48	201	249
Total assets	(31)	(123)	(155)	112	395	507
Liabilities						
Deposits from customers ^(c)	(30)	(59)	(89)	106	144	249
Interbank borrowing	(70)	(71)	(141)	44	86	130
Inside Hong Kong	(54)	(22)	(76)	49	28	76
Outside Hong Kong	(17)	(48)	(65)	(4)	58	54
All other liabilities	39	36	75	(20)	147	128
Total liabilities	(61)	(94)	(155)	130	377	507
Net interbank borrowing/(lending)	(5)	177	172	(62)	(107)	(169)
Net customer lending/(borrowing)	(2)	(17)	(20)	(148)	(142)	(291)

Retail Banks

(HK\$ bn)	2002			2003		
	HK\$	F/CY	Total	HK\$	F/CY	Total
Increase/(Decrease) in						
Assets						
Loans to customers	4	1	5	(29)	20	(8)
Inside Hong Kong ^(a)	5	1	6	(30)	16	(14)
Outside Hong Kong ^(b)	(1)	0	(1)	2	4	6
Interbank lending	(62)	(116)	(177)	85	71	156
Inside Hong Kong	(50)	(2)	(51)	58	3	60
Outside Hong Kong	(12)	(114)	(126)	27	68	96
All other assets	34	150	184	56	115	171
Total assets	(25)	36	12	112	206	319
Liabilities						
Deposits from customers ^(c)	(25)	43	18	123	78	201
Interbank borrowing	(43)	6	(38)	11	52	63
Inside Hong Kong	(15)	11	(3)	7	(4)	3
Outside Hong Kong	(29)	(5)	(34)	4	56	60
All other liabilities	7	24	31	(8)	62	54
Total liabilities	(61)	73	12	127	192	319
Net interbank borrowing/(lending)	19	121	140	(74)	(19)	(93)
Net customer lending/(borrowing)	28	(42)	(13)	(152)	(58)	(210)

(a) Defined as loans for use in Hong Kong plus trade financing loans.

(b) Includes "others" (i.e. unallocated)

(c) Hong Kong dollar customer deposits include swap deposits.

TABLE I: LOANS TO AND DEPOSITS FROM CUSTOMERS BY CATEGORY OF AUTHORIZED INSTITUTION

(HK\$ bn)	Loans to Customers				Deposits from Customers			
	HK\$	F/CY	Total	%	HK\$	F/CY	Total	%
1997								
Licensed banks	1,557	2,319	3,876	94	1,536	1,108	2,644	98
Restricted licence banks	127	37	163	4	9	43	52	2
Deposit-taking companies	59	24	82	2	6	8	15	1
Total	1,742	2,379	4,122	100	1,552	1,159	2,710	100
1998								
Licensed banks	1,522	1,565	3,087	93	1,689	1,265	2,954	98
Restricted licence banks	121	29	150	5	6	31	36	1
Deposit-taking companies	52	15	67	2	5	5	10	-
Total	1,695	1,609	3,304	100	1,700	1,300	3,000	100
1999								
Licensed banks	1,456	1,178	2,633	94	1,763	1,447	3,210	99
Restricted licence banks	108	23	130	5	6	29	35	1
Deposit-taking companies	44	5	49	2	4	2	6	-
Total	1,607	1,206	2,813	100	1,773	1,477	3,251	100
2000								
Licensed banks	1,502	788	2,291	93	1,839	1,652	3,491	99
Restricted licence banks	108	18	126	5	9	22	31	1
Deposit-taking companies	41	3	44	2	3	2	6	-
Total	1,652	809	2,461	100	1,851	1,677	3,528	100
2001								
Licensed banks	1,507	521	2,028	93	1,838	1,528	3,367	99
Restricted licence banks	108	15	122	6	12	21	33	1
Deposit-taking companies	32	2	35	2	4	2	6	-
Total	1,648	537	2,185	100	1,855	1,552	3,407	100
2002								
Licensed banks	1,491	446	1,937	93	1,806	1,470	3,276	99
Restricted licence banks	99	13	112	5	15	21	36	1
Deposit-taking companies	26	2	27	1	4	2	6	-
Total	1,616	461	2,076	100	1,825	1,493	3,318	100
2003								
Licensed banks	1,465	448	1,913	94	1,916	1,608	3,524	99
Restricted licence banks	85	12	97	5	12	27	38	1
Deposit-taking companies	24	1	25	1	3	2	5	-
Total	1,573	462	2,035	100	1,931	1,636	3,567	100

A "-" sign denotes a figure of less than 0.5.

TABLE J: LOANS TO CUSTOMERS INSIDE HONG KONG BY ECONOMIC SECTOR

All Authorized Institutions														
(HK\$ bn)	1997		1998		1999		2000		2001		2002		2003	
Sector	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%
Hong Kong's visible trade	193	9	149	7	114	6	104	5	89	5	91	5	100	6
Manufacturing	111	5	95	4	80	4	74	4	71	4	71	4	84	5
Transport & transport equipment	96	4	106	5	103	5	105	5	102	5	104	6	106	6
Building, construction & property development and investment	440	20	416	20	384	20	398	20	389	21	379	21	360	20
Wholesale and retail trade	206	9	180	9	144	7	120	6	101	5	100	5	94	5
Financial concerns (other than authorized institutions)	260	12	234	11	189	10	170	9	142	8	125	7	147	8
Individuals:														
to purchase flats in the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme	60	3	74	4	76	4	91	5	107	6	99	5	87	5
to purchase other residential property	480	22	515	24	532	28	536	27	540	29	542	30	529	29
other purposes	154	7	143	7	138	7	148	8	150	8	143	8	137	8
Others	230	10	196	9	173	9	220	11	188	10	178	10	164	9
Total^(a)	2,230	100	2,110	100	1,933	100	1,965	100	1,879	100	1,834	100	1,809	100
Retail Banks														
(HK\$ bn)	1997		1998		1999		2000		2001		2002		2003	
Sector	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%	HK\$	%
Hong Kong's visible trade	128	9	107	8	85	6	78	6	69	5	72	5	80	6
Manufacturing	61	4	55	4	49	4	47	3	46	3	47	3	53	4
Transport & transport equipment	33	2	42	3	43	3	48	3	58	4	63	4	68	5
Building, construction & property development and investment	289	21	276	20	272	21	294	21	307	22	311	22	301	21
Wholesale and retail trade	110	8	103	8	87	7	76	5	68	5	70	5	65	5
Financial concerns (other than authorized institutions)	69	5	71	5	72	5	63	5	63	4	56	4	65	5
Individuals:														
to purchase flats in the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme	37	3	44	3	45	3	56	4	69	5	65	5	57	4
to purchase other residential property	385	28	431	32	458	35	482	35	497	35	508	36	501	35
other purposes	112	8	105	8	105	8	114	8	116	8	111	8	104	7
Others	144	11	119	9	106	8	132	9	126	9	122	9	117	8
Total^(a)	1,369	100	1,352	100	1,323	100	1,390	100	1,420	100	1,426	100	1,412	100

(a) Defined as loans for use in Hong Kong plus trade financing loans.

TABLE K: DEPOSITS FROM CUSTOMERS

(HK\$ bn)	All AIs				Retail banks			
	Demand	Savings	Time	Total	Demand	Savings	Time	Total
Hong Kong Dollar (including swap deposits)								
1997	108	336	1,108	1,552	97	329	978	1,404
1998	97	414	1,188	1,700	88	408	1,087	1,583
1999	106	452	1,216	1,773	97	445	1,085	1,627
2000	112	493	1,246	1,851	101	486	1,106	1,693
2001	128	614	1,113	1,855	117	608	963	1,688
2002	146	674	1,004	1,825	134	668	861	1,663
2003	227	936	768	1,931	203	927	656	1,786
Foreign Currency (excluding swap deposits)								
1997	20	155	984	1,159	15	136	424	574
1998	19	169	1,112	1,300	14	149	553	716
1999	20	192	1,266	1,477	15	168	671	854
2000	40	203	1,433	1,677	20	181	828	1,029
2001	28	238	1,286	1,552	20	214	786	1,020
2002	36	272	1,184	1,493	24	245	794	1,063
2003	59	341	1,236	1,636	38	307	796	1,141
Total								
1997	128	491	2,092	2,710	112	465	1,401	1,978
1998	116	583	2,300	3,000	102	557	1,640	2,299
1999	126	644	2,481	3,251	111	613	1,756	2,481
2000	152	696	2,680	3,528	121	667	1,934	2,722
2001	156	851	2,399	3,407	137	822	1,749	2,708
2002	182	946	2,189	3,318	158	913	1,656	2,726
2003	286	1,278	2,004	3,567	241	1,234	1,452	2,927

TABLE L: GEOGRAPHICAL BREAKDOWN OF NET EXTERNAL CLAIMS/(LIABILITIES) OF ALL AUTHORIZED INSTITUTIONS

(HK\$ bn) Region/Economy	2002			2003		
	Net Claims on/ (Liabilities to) Banks Outside Hong Kong	Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	Total Net Claims/ (Liabilities)	Net Claims on/ (Liabilities to) Banks Outside Hong Kong	Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	Total Net Claims/ (Liabilities)
Asia & Pacific	332	36	368	411	(38)	373
Japan	160	114	274	134	78	212
Australia	155	27	182	166	24	190
Singapore	147	(40)	106	163	(38)	125
South Korea	27	16	43	24	16	40
Malaysia	4	6	10	13	8	21
New Zealand	9	3	12	14	3	17
India	0	5	5	6	7	13
Brunei	(1)	0	(1)	(1)	0	(1)
Vanuatu	0	(1)	(1)	(1)	(1)	(2)
Pakistan	(2)	0	(2)	(2)	0	(2)
Vietnam	(3)	0	(4)	(2)	(1)	(2)
Thailand	(4)	(3)	(7)	(5)	1	(4)
Indonesia	(6)	(3)	(9)	(4)	(3)	(7)
Philippines	3	(7)	(4)	(2)	(5)	(7)
Taiwan	7	(36)	(30)	17	(42)	(25)
Macau SAR	(38)	(5)	(44)	(41)	(6)	(48)
Mainland China	(126)	(35)	(162)	(70)	(77)	(147)
Others	0	(1)	(1)	0	(1)	(2)
North America	71	106	177	141	125	266
United States	51	90	141	110	108	218
Canada	20	16	35	31	17	48
Caribbean	0	(40)	(40)	(10)	(57)	(67)
Bermuda	0	4	4	0	2	2
Panama	0	2	2	0	0	0
Netherlands Antilles	1	(11)	(10)	1	(6)	(5)
Bahamas	7	(5)	3	(2)	(3)	(6)
Cayman Islands	(8)	(39)	(47)	(9)	(46)	(55)
Others	0	9	9	0	(3)	(4)
Africa	(1)	(1)	(2)	0	(1)	(1)
South Africa	0	0	0	0	1	0
Mauritius	(1)	0	(2)	1	0	0
Liberia	0	0	0	0	(1)	(1)
Others	0	0	0	0	0	0

TABLE L: GEOGRAPHICAL BREAKDOWN OF NET EXTERNAL CLAIMS/(LIABILITIES) OF ALL AUTHORIZED INSTITUTIONS (cont.)

(HK\$ bn) Region/Economy	2002			2003		
	Net Claims on/ (Liabilities to) Banks Outside Hong Kong	Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	Total Net Claims/ (Liabilities)	Net Claims on/ (Liabilities to) Banks Outside Hong Kong	Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	Total Net Claims/ (Liabilities)
Latin America	0	(2)	(2)	1	(1)	(1)
Chile	0	0	0	0	1	1
Brazil	0	(1)	0	0	(1)	0
Venezuela	0	(1)	(1)	0	(1)	(1)
Others	0	0	0	0	0	0
Eastern Europe	0	0	0	(1)	1	(1)
Western Europe	570	46	616	668	65	733
United Kingdom	273	13	287	310	17	327
Netherlands	65	11	76	79	14	94
France	25	8	32	56	17	73
Germany	62	8	70	46	3	49
Switzerland	14	(2)	12	38	(2)	36
Italy	32	2	33	25	6	31
Belgium	23	1	24	24	2	26
Sweden	17	2	20	21	3	24
Norway	12	1	13	14	1	15
Republic of Ireland	16	1	16	14	1	15
Austria	10	0	10	12	1	12
Denmark	9	1	11	9	0	10
Luxembourg	6	0	6	10	0	10
Finland	2	1	3	6	0	6
Spain	3	2	5	4	1	5
Portugal	2	0	2	1	0	1
Iceland	1	0	1	1	0	1
Greece	0	1	1	(1)	1	0
Others	(2)	(4)	(6)	(2)	(1)	(3)
Middle East	(6)	1	(5)	(2)	0	(2)
Bahrain	(3)	0	(3)	2	0	2
Republic of Yemen	0	1	1	0	0	0
Kuwait	(1)	0	(1)	0	0	0
Israel	0	0	0	(1)	0	(1)
Egypt	0	0	0	(1)	0	(1)
United Arab Emirates	(2)	0	(2)	(2)	0	(2)
Others	0	0	0	0	0	0
Others	0	55	55	0	44	44
Overall Total	966	201	1,167	1,207	138	1,345

ABBREVIATIONS USED IN THIS REPORT

ABF	– Asian Bond Fund	HIBOR	– Hong Kong Interbank Offer Rate
ABF1	– US dollar-denominated Asian Bond Fund	HK	– Hong Kong
ABF2	– Local currency-denominated Asian Bond Fund	HKAB	– Hong Kong Association of Banks
ACC	– BIS Asian Consultative Council	HKICL	– Hong Kong Interbank Clearing Limited
AI	– Authorized institution	HKMA	– Hong Kong Monetary Authority
APEC	– Asia-Pacific Economic Co-operation	HKSAR	– Hong Kong Special Administrative Region
ASC	– Audit Sub-Committee	IA	– Insurance Authority
ATM	– Automated teller machine	IAS	– International Accounting Standard
BIS	– Bank for International Settlements	IMF	– International Monetary Fund
bn	– billion	IPOs	– Initial Public Offerings
CBRC	– China Banking Regulatory Commission	IT	– Information technology
CCASS	– Central Clearing and Settlement System	JETCO	– Joint Electronic Teller Company Limited
CCPI	– Composite Consumer Price Index	MDB	– Multilateral Development Bank
CCRA	– Commercial Credit Reference Agency	mn	– million
CEPA	– Closer Economic Partnership Arrangement	MoU	– Memorandum of Understanding
CHATS	– Clearing House Automated Transfer System	MPF	– Mandatory Provident Fund
CI	– Certificate of Indebtedness	MPFA	– Mandatory Provident Fund Schemes Authority
CITS	– Cheque Imaging and Truncation System	NCD	– Negotiable certificate of deposit
CLS	– Continuous Linked Settlement	NDI	– Negotiable debt instrument
CMU	– Central Moneymarkets Unit	NIB	– Note-issuing bank
CP3	– New Capital Accord	OECD	– Organisation for Economic Co-operation and Development
CPI	– Consumer Price Index	p.a.	– per annum
CSS	– Clearing and Settlement Systems	PBoC	– People’s Bank of China
DCAs	– Debt collection agencies	PvP	– Payment-versus-Payment
DPS	– Deposit Protection Scheme	QIS 3	– Third Quantitative Impact Study
DTCs	– Deposit-taking Companies	RAM	– Risk Assessment Methodology
DvP	– Delivery-versus-Payment	RLBs	– Restricted Licence Banks
e-banking	– electronic banking	RMC	– Risk Management and Compliance
EFAC	– Exchange Fund Advisory Committee	RTGS	– Real Time Gross Settlement
EFBN	– Exchange Fund Bills and Notes	SARS	– Severe Acute Respiratory Syndrome
EFIL	– Exchange Fund Investment Limited	SEANZA	– Central Banking Group of South East Asia, New Zealand and Australia
EFN	– Exchange Fund Notes	SFC	– Securities and Futures Commission
EMEAP	– Executives’ Meeting of East Asia-Pacific Central Banks	SFO	– Securities and Futures Ordinance
EPSCO	– Electronic Payment Services Company (HK) Limited	SMEs	– Small and medium-sized enterprises
FSAP	– Financial Sector Assessment Programme	STET	– Submission Through Electronic Transmission
FSF	– Financial Stability Forum	UK	– United Kingdom
FSSA	– Financial System Stability Assessment	US	– United States of America
GDP	– Gross Domestic Product (in real terms unless otherwise stated)		

REFERENCE RESOURCES

The *HKMA Annual Report* is published in April or May each year. A number of other HKMA publications provide explanatory and background information on the HKMA's policies and functions. These include

HKMA Quarterly Bulletin

(published in March, June, September and December each year)

HKMA Monthly Statistical Bulletin (on-line publication)

(published in two batches on the third and sixth business days of each month)

Guide to Hong Kong Monetary and Banking Terms (Second Edition)

HKMA Background Brief No. 1 – Hong Kong's Linked Exchange Rate System

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