Exchange Fund Position at end-December 2020

The following is issued on behalf of the Hong Kong Monetary Authority:

The Hong Kong Monetary Authority (HKMA) today (January 27) published the unaudited financial position of the Exchange Fund at end-December 2020.

The Exchange Fund recorded an investment income of HK$197.8 billion in 2020. The main components were:

- gains on bonds of HK$92.5 billion;
- gains on Hong Kong equities of HK$4.0 billion;
- gains on other equities of HK$69.0 billion;
- positive currency translation effect of HK$9.6 billion on non-Hong Kong dollar assets (Note 1); and
- gains on other investments of HK$22.7 billion (Note 2).

Fees on placements by the Fiscal Reserves and placements by Hong Kong Special Administrative Region Government funds and statutory bodies were HK$32.6 billion (Note 3) and HK$11.5 billion respectively in 2020, with the rate of fee payment at 3.7 per cent for 2020. After deducting all expenses and fees, the Accumulated Surplus of the Exchange Fund recorded an increase of HK$103.7 billion (Annexes 1 & 2).

The Abridged Balance Sheet shows that the total assets of the Exchange Fund increased by HK$294.1 billion, from HK$4,206.7 billion at the end of 2019 to HK$4,500.8 billion at the end of 2020. The increase was mainly attributable to the investment income in 2020 and an increase in the balance of the banking system, which were partly offset by the reduction in Fiscal Reserves placements.

The Exchange Fund recorded an investment return of 4.4 per cent in 2020 (Note 4). Specifically, the Investment Portfolio achieved a rate of return of 7.8 per cent, while the Backing Portfolio gained 1.6 per cent. The Long-Term Growth Portfolio (LTGP) recorded an annualised internal rate of return of 12.5 per cent since its inception in 2009 up to the end of September 2020.

Commenting on the performance of the Exchange Fund in 2020, Mr Eddie Yue, Chief Executive of the HKMA, said, "To many investors, 2020 was a year full of unexpected twists and turns. The novel coronavirus has posed significant challenges to the world economy. However, driven by the ultra-loose monetary policies implemented by major central banks and a series of relief measures launched by various governments, asset markets rebounded quickly from sharp corrections, with a number of equity markets reaching record highs during the year. For the year as a whole, the Exchange Fund achieved a decent return on its equity and bond investments."

Mr Yue said, "The main focus for 2021 will be the timing and pace of recovery of different economies. Global recovery is in sight but the evolving pandemic will still have a bearing on the global economic outlook. In addition, geopolitical risks remain a cause for concern. The foreign policy direction of the new US administration, developments of the China-US relations, as well as implementation of the Brexit agreement will all have impact on the financial markets.

It is worth noting that the global equity markets have recorded substantial gains for two consecutive years, owing to the persisting low interest rate environment. However, it is still uncertain whether the lofty valuations can be sustained. An ultra-low interest rate environment will also bring about significant challenges to our substantial bond holding. On the one hand, low interest rates will have significant negative impact on interest income from bonds. Furthermore, the limited room for further decrease in bond yields (i.e. rise in bond prices) will also significantly weaken the effectiveness of risk diversification in the portfolio mix of bonds and equities during market turbulence. The situation will worsen further should the prolonged low interest rate environment and the massive fiscal stimulus launched by various governments lead to rising inflationary pressure in the future, resulting in surging bond yields and major corrections in the global asset markets, thereby exerting downward pressure on the valuations of the Exchange Fund's assets.

Despite this ever-changing and complex global investment environment, the HKMA will continue to manage the Exchange Fund prudently and remain flexible. We will also implement defensive measures as appropriate and maintain a high degree of liquidity to deal with possible financial disruptions. The Exchange Fund will continue to serve its purpose of maintaining monetary and financial stability in Hong Kong in an effective manner."

Note 1: This is primarily the effect of translating foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging.
Note 2: This is the valuation change of investments held by investment holding subsidiaries of the Exchange Fund. This figure represents valuation changes up to the end of September 2020. Valuations of these investments from October to December are not yet available.
Note 3: This does not include the 2020 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2020 is available.
Note 4: This return excludes the performance of the Strategic Portfolio and only includes the performance of LTGP up to the end of September 2020. The audited full year return will be disclosed in the 2020 annual report to be released later this year.