LCQ13: Linked Exchange Rate System

Following is a question by the Hon Paul Tse and a written reply by the Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (November 6):

Question:

Recently, the founder of a hedge fund cast doubt on whether Hong Kong's foreign exchange reserves are sufficient to maintain the Linked Exchange Rate System. He also forecast that the System would naturally expire in 2047, and suggested investors to convert their Hong Kong dollar assets into US dollar assets as early as possible. On the other hand, some members of the private banking sector have relayed that in recent months, the number of applications for opening offshore bank accounts by their clients (especially those Hong Kong people with liquid assets of value ranging between several million and 10 million to 20 million Hong Kong dollars, and Mainlanders whose foreign assets are based in Hong Kong) has substantially increased, as these clients feel that it is safer to hold their assets in overseas places (e.g. Singapore) than in Hong Kong. In this connection, will the Government inform this Council:

(1) of the new measures put in place to ensure that Hong Kong has sufficient foreign exchange reserves to defend the Linked Exchange Rate System;

(2) whether it has assessed the situation of capital outflow from Hong Kong (particularly transfer of funds to Singapore) in recent months; if so, of the details; if not, the reasons for that; and

(3) of the measures put in place by the Government, in the light of the ongoing political turmoil and social unrest in Hong Kong in recent months, to maintain the confidence of local and overseas investors as well as members of the public in the Linked Exchange Rate System, Hong Kong dollars and Hong Kong dollar assets?

Reply:

President,

My reply to the various parts of the question is as follows:

(1) Hong Kong has ample reserves which provide a powerful safeguard for financial stability. The Exchange Fund, over 80 per cent of which being foreign exchange reserves, is worth over HK$4 trillion and equivalent to 2.5 times the Monetary Base in Hong Kong. The Linked Exchange Rate System (LERS) has served Hong Kong well through many economic cycles in the past 36 years, and has been operating smoothly even in times of massive fund flows. The Hong Kong dollar (HKD) exchange rate stays steady under the effective operation of the LERS and the HKD market has been operating in a smooth and orderly

manner. Hong Kong has over the years built up massive buffers and resilience in the financial and banking systems. The banking sector is robust with ample liquidity. At the end of June 2019, the banking sector had total assets of HK$24 trillion. The average total capital ratio of locally incorporated banks exceeded 20 per cent and liquidity coverage ratio of the major banks exceeded 150 per cent; both have far surpassed international regulatory requirements. The asset quality of banks remains sound, with the classified loan ratio staying at a low level of 0.56 per cent.

(2) Although the Hong Kong Monetary Authority (HKMA) has learnt from banks that enquiries about opening offshore accounts had increased in recent months, there have been no noticeable fund outflows from HKD or Hong Kong's banking system. According to the latest deposit and money supply statistics and financial market conditions, total deposits of the banking system and the HKD exchange rate have remained steady in recent months. Indeed, it is not unusual for funds flowing in and out of an international financial centre like Hong Kong. Hong Kong has over the years built up massive buffers and resilience in the financial and banking systems. Banks have sufficient liquidity to cope with outflow of deposits even if it were to happen. Coupled with the strong underpinning of the LERS by the massive Exchange Fund, Hong Kong is fully capable of safeguarding the stability of its monetary and financial systems.

The HKMA will continue to closely monitor the movements of the foreign exchange and local currency markets, with a view to maintaining the stability of HKD through the LERS.

(3) The Basic Law stipulates that no foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region. The HKD shall be freely convertible, and the free flow of capital within, into and out of Hong Kong is safeguarded. The Government has reiterated time and again that it has no intention to change the LERS, which has served Hong Kong well over the years. The International Monetary Fund has repeatedly reaffirmed its support for the LERS, considering it the most appropriate exchange rate arrangement for Hong Kong and an anchor of stability for the economy. The HKD exchange rate stays steady under the effective operation of the LERS and the HKD market has been operating in a smooth and orderly manner. Interbank business such as lending and borrowing, foreign exchange transactions and clearing and settlement activities are conducted as usual. The HKMA will clarify mistaken comments and dispel unfounded rumours as necessary in a timely manner. The HKMA will also maintain close communication with the financial industry, the media and the general public, including through regular publication of a series of monetary and banking statistics, to ensure that the community is well informed of updated and accurate financial market situations, and to maintain the international and local markets' confidence in Hong Kong's financial system and the LERS.