

## LCQ9: Protecting the stability of the financial system

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

Question:

It has been reported that recently, a hedge fund helmsman has publicly cast doubt if Hong Kong has foreign exchange reserves sufficient for maintaining the Linked Exchange Rate (LER) System, and pointed out that the unceasing protests will lead to a serious downturn in Hong Kong's economy, causing a large capital outflow within the coming 12 to 18 months. Moreover, recently there have been rumours from time to time that the Hong Kong Monetary Authority (HKMA) plans to enact legislation to cap the amount of cash that members of the public may withdraw daily. In this connection, will the Government inform this Council:

(1) of the factors and data based on which HKMA currently determines if the financial system remains stable, and whether HKMA will formulate a financial stability index to be published regularly; if not, of the reasons for that;

(2) whether HKMA has devised a crisis warning and response mechanism in respect of the LER System, so as to cope with the rapid changes in and challenges of the financial market; if so, of the details; if not, the reasons for that; and

(3) given that predators in the international financial market have been eyeing covetously the LER System and that there have been rumours spreading from time to time, whether the Government has devised a targeted financial information dissemination mechanism, so as to uphold the confidence of the market and the public in the financial system; if not, of the reasons for that?

Reply:

President,

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

(1) The Hong Kong Monetary Authority (HKMA) has been closely monitoring the Hong Kong dollar (HKD) market situations, including interbank rate trends, HKD spot and forward exchange rates, and option and swap transactions. The Over-the-Counter Derivatives Trade Repository is another channel through which the HKMA obtains market transaction information. The HKMA also collaborates with the Securities and Futures Commission (SFC) to conduct cross-market surveillance. The HKMA and the SFC regularly publish a series of

monetary, banking and securities and derivatives market statistics to ensure that the community is well informed of the latest financial market situations in a timely manner.

(2) 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. 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. Furthermore, the LERS is underpinned by a massive Exchange Fund, which is worth over HK\$4 trillion and equivalent to 2.5 times the Monetary Base in Hong Kong. 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.

(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.