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Statement by Mr. Bevilaqua, Mr. Saraiva, and Mr. Barroso on People's Republic of China - Hong Kong Special Administrative Region
(Preliminary)
Executive Board Meeting
May 21, 2021

We thank staff for the well-written report. We also thank Mr. Jin and Mr. Law for their informative statement.

Hong Kong SAR financial sector proved resilient to large shocks and is prepared to address vulnerabilities. We agree with staff that linkages with Mainland China, stretched asset valuations and exposure to volatile risk appetite are significant vulnerabilities. Of course, there are long-run benefits from Mainland China linkages, and authorities are well equipped to navigate the relevant tradeoffs leveraging on sound frameworks and large buffers. Nevertheless, we highly appreciate the capital and liquidity stress tests and appreciate the recommendation to improve capacity to cope with the risks.

Staff's systemic risk assessment is broadly consistent with a resilient banking system, and the recommendations to broaden monitoring and oversight are warranted. We take positive note that initial high capital buffers and profitability ensure banks remain above the CET1 regulatory minimum even in a severely adverse scenario. That said, a fall of several percentage points in capital ratios would tend to significantly reduce the banking sector risk appetite and slowdown the economic recovery. Moreover, credit risk could be worse than assumed in the baseline if premature support withdrawal turns liquidity problems in the corporate sector into solvency problems. We take note of the liquidity risk concentration in foreign branches, which rely on interbank markets for funding, even though the system is broadly resilient given the high buffers of international reserves backing the Linked Exchange Rate System (LERS) mechanism. Cross border linkages are relevant in the real estate sector, both with exposure to Mainland borrowers and foreign branch lending to the domestic segment. Mainland exposure requires better internal risk models, while foreign branch activity requires more data on sectoral links, including with non-banks that also intermediate real sector credit. In the same vein, while macroprudential policy has proper instruments to cope with systemic risk and is currently at the right stance, policymakers would benefit from more information on cross border and sectorial exposures.

Microprudential supervision and crisis management have become stronger over time and are well placed to approach emerging risks. We welcome the improvements since the 2014 FSAP, including the establishment of the Insurance Authority and strengthening of securities market supervision. We support staff's recommendation to establish de jure operational independence of the HKMA, as well as for continuing efforts to increase coordination and cooperation of home supervisors of international banks and Mainland China regulators. We take positive note of the authorities' initiative to promote Hong Kong as a fintech hub and welcome that it is well balanced with risk mitigation efforts. In this regard, we support staff's recommendation for revising the regulatory perimeter of non-bank fintech companies and close monitoring of virtual assets. Finally, we welcome the strengthening of the crisis management framework in line with FSB recommendations and support staff's call for further improvements, including cooperation with Mainland China and other resolution authorities which certainly helps in addressing vulnerabilities.