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SM/95/23
Supplement 1
Correction 1

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February 27, 1995

To: Members of the Executive Board
From: The Secretary
Subject: United Kingdom - Hong Kong - Staff Report for the
1994 Article IV Consultation Discussions

The following correction has been made in SM/95/23, Supplement 1
(2/13/95):

Page 32, Table 5, under Payroll for 1993: for "2.0" read "12.0"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

year, so that the impact of the budget could be expansionary and procyclical. In particular, faced with large and "unexpected" budget surpluses in recent years, the Government had provided for generous tax concessions in the FY 1994 budget. These concessions, together with accelerated spending on infrastructure projects, are expected to lead to a significant reduction in the budget surplus in FY 1994 and FY 1995.

IV. The Financial System and the Regulatory Framework in Hong Kong

Hong Kong is one of the top ten financial centers of the world, and one of the three leading centers in Asia. Its status as an international banking center is indicated by the presence of 81 of the world's 100 largest banks in Hong Kong in 1993. The financial sector makes a significant and rising contribution to Hong Kong's economy in terms of employment, payroll, value added, and foreign exchange earnings (Table 5). Until recently, the regulatory framework of Hong Kong's financial sector tended to be relatively lax. However, in response to recurrent instability in the financial sector, the authorities began a concerted effort in the late 1980s to strengthen the regulatory framework. This effort has been highly successful and most reform measures were completed in 1994. This chapter reviews recent developments in the financial system and the regulatory framework. Section 1 focuses on the banking sector and Section 2 on the securities market. Brief conclusions are provided in Section 3.

1. Banking sector

a. Structure and characteristics

Hong Kong has a three-tiered banking system. Licensed banks (LBs) take all types of deposits and dominate the sector, accounting for 94 percent of total banking assets. Restricted license banks (RLBs) and deposit-taking companies (DTCs) perform specialized functions such as merchant banking, consumer finance, and investment services. Except for deposit taking, banking regulation in Hong Kong does not restrict the types of activities in which the three different types of institutions can engage. Representative offices of foreign banks are required to confine their customer business to liaison activities. As of September 1994, there were 179 licensed banks, 61 restricted license banks, 139 deposit-taking companies, and 160 representative offices of foreign banks in Hong Kong.

Domestic banking is dominated by the Hongkong and Shanghai Banking Corporation Limited group. While it is difficult to measure the domestic market share of individual local banks in Hong Kong because they are not required to distinguish global and local assets in their balance sheets, it is estimated that the HSBC accounts for at least half of all local deposits and assets. The second largest banking group is that under the Bank of China (BOC). It is estimated that the BOC and its "12 sister" banks and their many branches account for about one fourth of local deposits. Locally

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Table 5. Hong Kong: Economic Contribution
of the Financial Sector, 1985 and 1993 1/

(In percent)

| | 1985 | 1993 |
|--|-------|---------------|
| Employment | | |
| Financial services employment as a share of total private sector employment | 3.9 | 5.5 |
| Payroll | | |
| Financial services payroll as a share of total private sector payroll | 10.3 | 12.0 |
| GDP | | |
| Value added in financial services as a share of GDP | 5.3 | 8.9 <u>2/</u> |
| Balance of payments | | |
| Net exports of financial services as a share of total net exports of services | 6.6 | 7.8 <u>2/</u> |
| Number of establishments | 4,050 | 7,337 |
| Memorandum item: | | |
| Value added in financing, insurance, real estate and other business services as a share of GDP (In percent) | 15.0 | 22.9 |

Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics, Annual Digest of Statistics, and Revised Estimates of Gross Domestic Product, 1961 to First Quarter, 1994; and staff estimates.

1/ The financial sector is defined to include only financial institutions such as banks and stockbroking firms, and does not include insurance, real estate, and other business service companies.

2/ Data for 1992.