Hong Kong Market Report

ASF 2012

The Economy

Amid the uncertainty of the global economy caused by the European sovereign debt crisis and poor performance in the US economy in 2011, Hong Kong's economy continues its growth, recording a 5.0% up from 2010. As the Hong Kong dollar is peg against the US dollar, Hong Kong imports inflation as the US dollar devalues and interest rate in Hong Kong remains at historical low. Bank's prime rate remains at 5% and mortgage rate goes as low as slightly above 2%. Hong Kong Interbank Offered Rate traded at below 1%. (Chart1). Hong Kong has one of the world's lowest birth rate and is projected to face the problem of ageing population. The unemployment rate was recorded at a low level of 3.2% in June 2012.

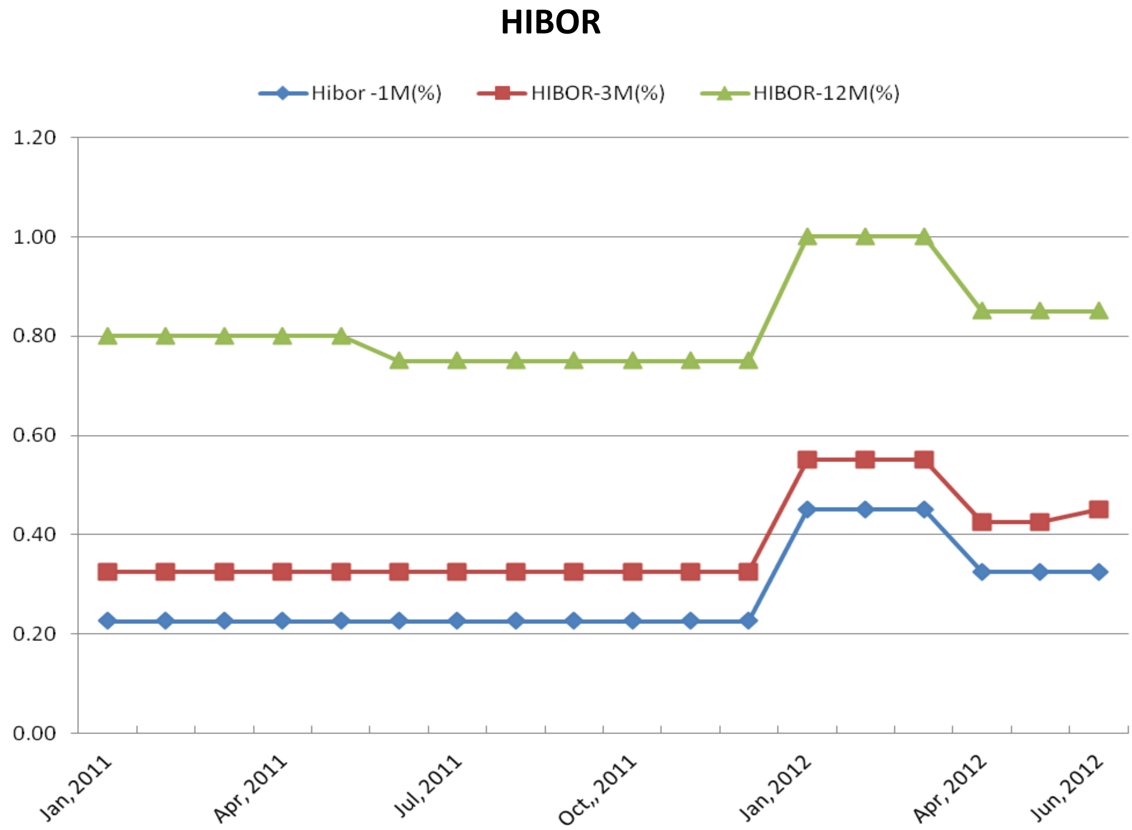
Table 1

Economic Performance

	2009	2010	2011	Q2 2012
GDP (yoy, %)	**-2.6**	**7.1**	**5.0**	**1.2**
CPI (yoy, %)	**0.5**	**2.4**	**5.3**	**3.7**
Unemployment rate (June, %)	**5.4**	**4.3**	**3.5**	**3.2**
Foreign reserve (June, US$billion)	**205.67**	**256.37**	**276.54**	**293.33**
Balance of Payments (US$billlion)	**78.53**	**7.58**	**11.13**	**7.27**

Source: Census & Statistics Department, The HKSAR Government

Chart 1

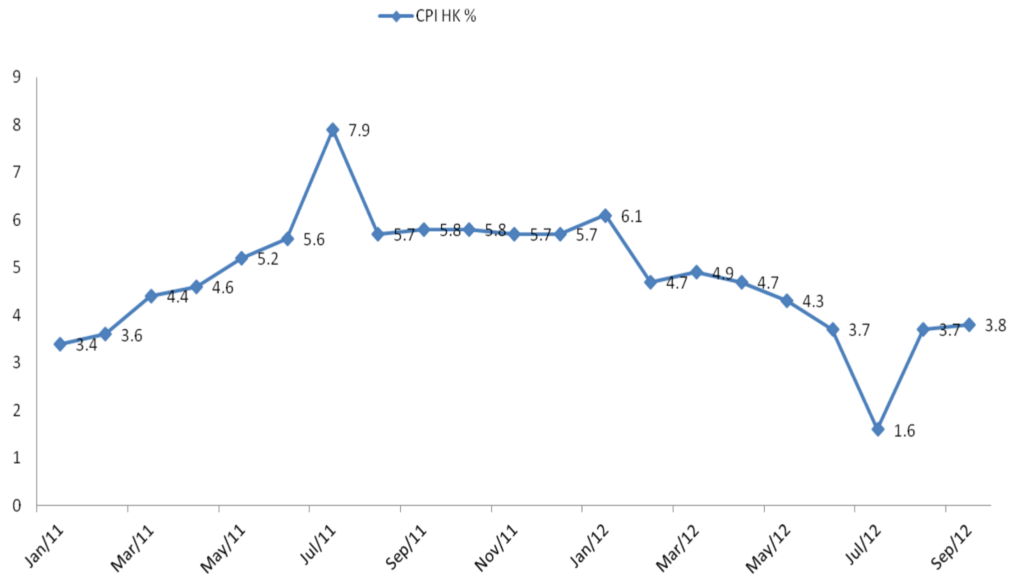


Source : Census & Statistics Department, The HKSAR Government

The extremely low interest rate, anticipation of high inflation rate, together with the low supply of land has contributed to the surge in property price. Price of residential properties increased by over 20% in 2011. In order to cool down the overheated property market, the government put forward a special stamp duty in November 2011 which was levied on properties which were resold within 24 months after the date of acquisition. However, the effect of the SSD was short lived. Abundant liquidity, low interest rate, participation by foreign investors and the U.S. Federal Reserve announcement of QE3 on 13th September 2012 caused property prices to rise sharply again. In October 2012, the Government amended the SSD to levy properties which will be resold within 36 months. The government also put forward a Buyer's Stamp Duty on residential properties acquired by non Hong Kong permanent resident at a rate of 15%.

Chart 2

Inflation rate, January 2011 – September 2012



Source : Census & Statistics Department, The HKSAR Government

Shanghai Stock Exchange Composite Index and the Shenzhen Stock Exchange Composite Index continue its downward trend throughout 2011 up to Q3 2012. China's economy shows sign of slowing down. As a result, investors lack confidence in the Hong Kong stock market. Share prices and trading volume remains low throughout the period. Most investment turns to the property market.

Hong Kong stays focus on its development as the offshore RMB centre and asset management hub. A series of products has been introduced by the exchange (which will be discussed later in this paper) to collaborate with this strategic development. China's Central Government supports these initiatives by announcing in August 2011 by the Vice Premier a series of policies in supporting Hong Kong's development as an offshore RMB business centre and the internationalization of RMB. These included: (i) introducing Mainland exchange-traded funds (ETFs) on Hong Kong stocks; (ii) developing channels to facilitate the cycling of RMB between Hong Kong and the Mainland; and (iii) the RMB Qualified Foreign Institutional Investor (RQFII) scheme. As it is expected that RMB exchange rate is near equilibrium, the growth of RMB deposit in HK starts to stabilize. RMB certificates of deposit and bank deposits reaches RMB683 billion by end June 2012.

Capital Market

As of June 2012, a total of 1,519 companies were listed in Hong Kong with a total market capitalization of over US$2,362 billion. Trading in derivatives warrants and Callable Bull Bear Contracts remains active.

Table 2

Listed shares (as at late June 2012 on the main and GEM boards)

	June 2012	June 2011	June 2010	June 2009
Number of listed companies	1,519	1,448	1,344	1,273
Total market capitalization (HK$ Bil)	18,429	21,104	17,131	14,148
Number of listed securities	6,926	7,276	6,737	5,859
Number of equity warrants	16	17	26	31
Number of derivatives warrants	4,032	4,836	4,114	2,726
Number of CBBCs	1,021	711	1,020	1,620
Number of mutual funds	103	87	72	39
Number of debt securities	231	173	158	167

Source: HKEx *US$1 = HK$7.8*

A total of 84 IPOs were recorded between July 2011 and June 2012. Although number of IPO has dropped compared with the same period last year, Hong Kong's securities market led the world in fundraising through IPO for the third consecutive year in 2011. HK market raised US$36.1 billion versus 2nd place NYSE at US$31.4 billion (Table 3). It was the 10th consecutive year the market was among the world's top five in IPO fundraising.

Table 3

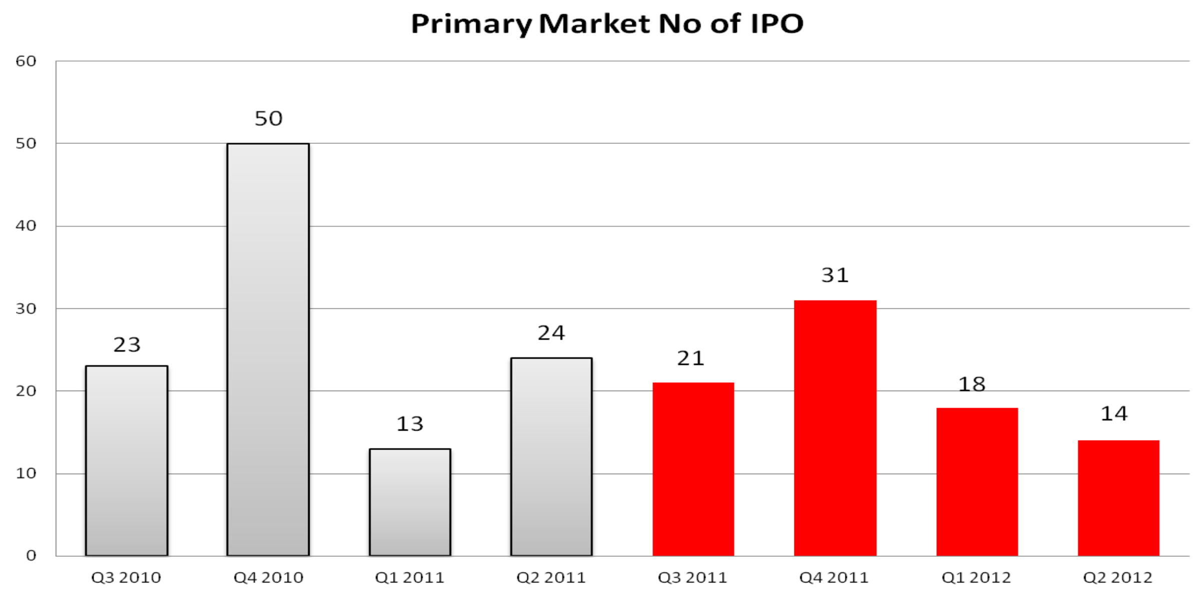
IPO Fundraising in 2011
Exchange Deal Value (US$ billion)

1	Hong Kong	36.1	6	NASDAQ	10.7
2	New York	31.4	7	Singapore	7.6
3	Shenzhen	26.2	8	Spain	5.3
4	London	19.2	9	Brazil	4.4
5	Shanghai	16.3	10	Korea	3.6

Source: Dealogic

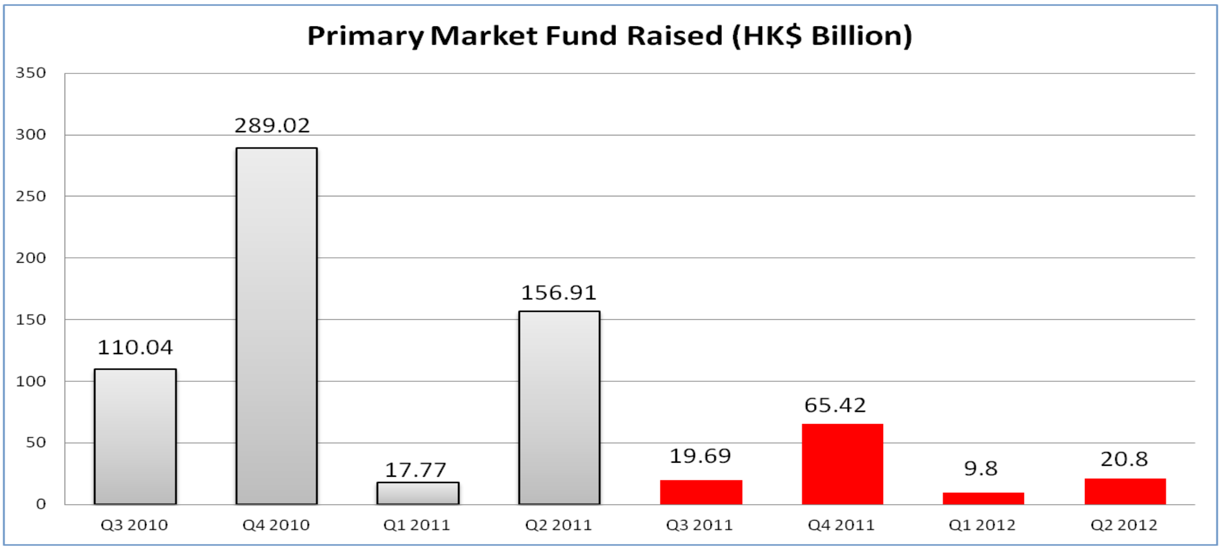
Acceptable jurisdiction in respect of listing of issuers reached 19. Hong Kong's securities market had listings from several overseas economies for the first time in 2011. They included the first Hong Kong Depository Receipts (HDR) listings by companies incorporated in Japan and the US. Also listing by a Kazakhstan and Italian company (Prada S.p.A) and also a company headquartered in Switzerland (Glencore International Plc). Melco Crown Entertainment Ltd was listed by way of introduction as the first NASDAQ listed company listed in Hong Kong.

Chart 3



Source: HKEx

Chart 4



Source: HKEx *US$1 = HK$7.8*

On 22 November, the People's Bank of China (PBOC) and the HKMA signed a renewed currency swap agreement of RMB400 billion for a term of another three years to facilitate the development of Hong Kong's offshore RMB business.

On 27 June, the Treasury Markets Association (TMA) launched the fixing of spot US dollars against RMB in Hong Kong as a benchmark for the market exchange rates of US dollars against offshore RMB in Hong Kong

Equities Market

The stock market generally remains bearish for the period as there was no sign of economic recovery in the US and Europe, the European sovereign debt crisis sees no sign of being solved, coupled with the fear that China has lost momentum in growth. It was not until the end of Q3 when the US Fed launches QE3, HK market saw a strong rebound of over 1600 index points or over 18% in 2 months. The average dividend yield for stocks reached 3.31% in 2011, a very attractive yield compared with 0.01% savings deposit rate at banks. Average P/E ratio at 9.68 times and average book value ratio at 1.41 times.

Chart 5

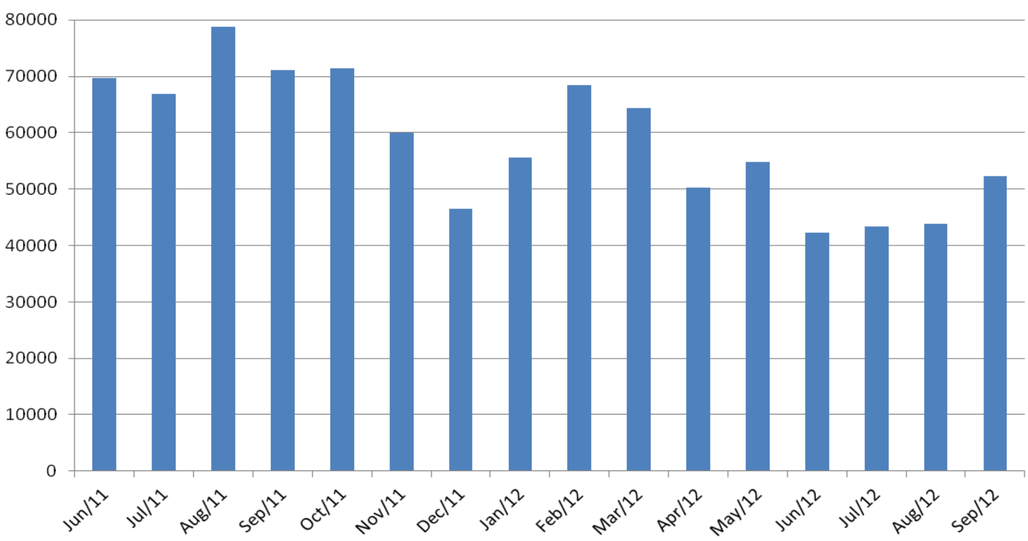
Hang Seng Index Nov 2011 – Nov 2012

Source: ET Net

Compared with an average daily turnover of over HK$69 billion in 2010 and 2011, daily turnover dropped below HK$50 billion for many of the months in 2012. The business environment for brokers is critical as the commission rate has dropped significantly due to price war. Commission for each securities transaction goes as low as US$0.50. As of Q3 2012, there were 506 Stock Exchange brokers and 185 Futures Exchange brokers.

Chart 6

Average Daily Equities Market Turnover (HK$ million)



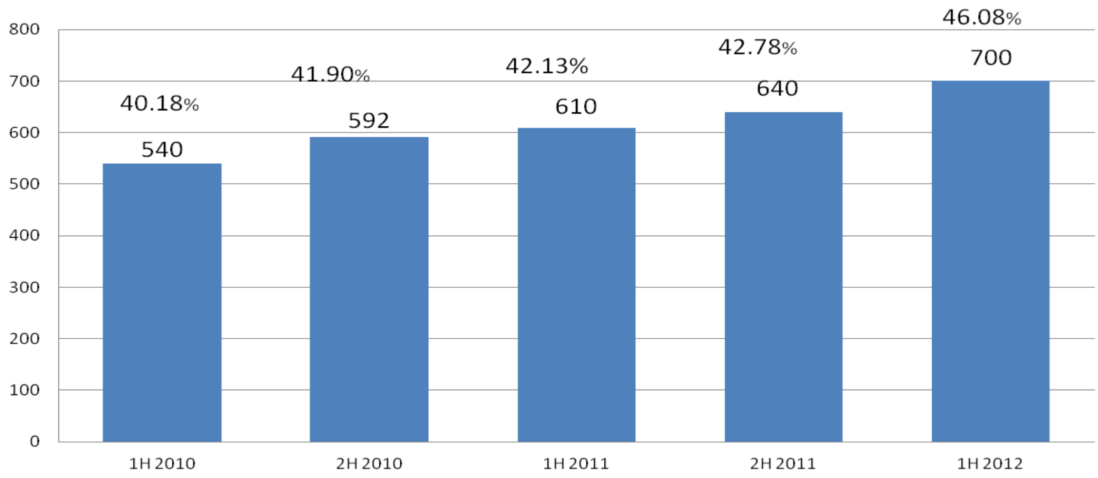
Source: HKEx

Derivatives market experiences significant growth in recent years. Contract volume on all futures and options products grow from 98,538,258 contracts in 2009 to 116,054,377 contracts in 2010 and 140,493,472 contracts in 2011.

The HKEx has continued to introduce different RMB products. As of the end of June 2012, 27 RMB debt securities, one RMB REIT and one RMB ETF had been listed. China related stocks continue to be one of the most significant segments of the Hong Kong equities market both in terms of market capitalization and contribution to turnover. Out of the 1,519 listed companies in June 2012, 700 companies or 46.08% are Mainland Enterprises (Chart 7) defined as H share companies, red-chip companies and non-H share Mainland private enterprises. The 46.08% Mainland Enterprises accounts for 57.60% of market capitalization of the whole stock market and 70.10% of trading turnover. (Chart 8)

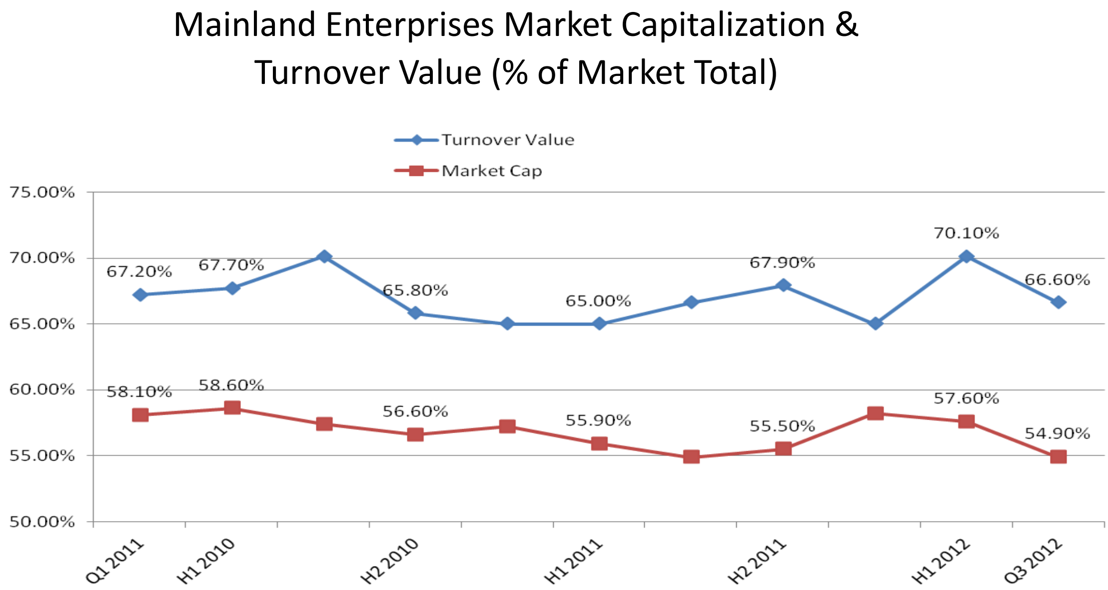
Chart 7

Number of Mainland Enterprises & its % to Total Listed Companies



Source: HKEx

Chart 8



Source: HKEx

Major Events

On 10 August 2011, HKEx's designated website for disseminating issuer information was disrupted by outside hacking attacks. Price sensitive announcements were unable to be posted on the website and 7 stocks had been suspended as a result. Subsequently, the exchange introduced a series of precautionary measures to ensure investors' access to issuer information, including new online bulletin boards, and clarified trading arrangements upon system disruption.

HKEx's RMB Equity Trading Support Facility (TSF) system was operationally ready on 24th October 2011 as a backup facility for the trading of RMB stocks on the stock exchange. Where a client is unable to secure RMB for settlement for purchase of RMB denominated stocks, before placing the buy order, client can pre-arrange the exchange of RMB currency on settlement day through TSF participating brokers.

On 29 November, HKT Trust was listed on the Stock Exchange of Hong Kong as the first listed business trust in Hong Kong.

On 5 December, HKEx upgraded the Third Generation Automatic Order Matching and Execution System (AMS/3) to version 3.8. The system's processing capacity was increased from 3,000 orders per second to 30,000 and the latency was reduced from 0.15 second to 2 milliseconds. The market data broadcast rate has been increased as well, doubling from 1,000 to 2,000 stock page updates per second.

To provide more means for investment RMB deposited in Hong Kong, the RQFII scheme was formalized in December 2011 as the Mainland Government and the Hong Kong Government signed Supplement VIII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA8). The RMB Qualified Foreign Institutional Investor is a program that allows licensed foreign investors using RMB deposited in Hong Kong to buy and sell A shares in Shanghai and Shenzhen.

On 14 February 2012, HKEx listed the first ETF traded in RMB, the Hang Seng RMB Gold ETF.

HKEx introduced VHSI futures (volatility index) in February, being the first volatility futures introduced in Asia. The VHSI futures provide an instrument for investors to trade or hedge their exposure to volatility in the stock market.

On 30 March 2012, exchanges from the BRICS economies including BM&FBOVESPA (BVMF) from Brazil, Open Joint Stock Company MICEX-RTS (MICEX-RTS) from Russia, BSE Limited (BSE) from India and JSE Limited (JSE) from South Africa, and HKEx of Hong Kong —cross-list their benchmark equity index derivatives on each other's trading platforms. The BRICS economies accounted for 18.2% of the world's GDP in 2010. In the long run, the alliance plans to create composite products of the BRICS economy.

The Financial Dispute Resolution Centre commenced operation in June 2012. As part of the market infrastructure enhancement after the

Lehman Brothers mini-bond incident, the Hong Kong Government introduced the Financial Dispute Resolution Scheme where all licensed banks and Securities and Futures Commission registered institutions must become members of the scheme. Investors with monetary claims under the amount of HK$500,000 can apply for mediation at the FDRC where financial institutions must enter into such mediation with the client.

On July 25 2012, London Metal Exchange shareholders vote in favor of acquisition by HKEx with an acquisition price of GDP1,100 million. Asia's growing metals consumption, with China particularly being the major consumer in base metals and LME being the premier exchange for base metals such as copper, the acquisition provides a platform for significant long term growth through the expansion of the LME's business and operations into Asia market by leveraging HKEx's resources, infrastructure and network in the region.

In expanding the RMB product range of HKEx, On 17 September 2012, RMB currency futures contract trading started. It is the world's first deliverable RMB currency futures contract ever listed.

On 29 October 2012, the first "dual counter" stock was traded in Hong Kong. Hopewell Highway Infrastructure Limited shares being traded in HK dollars and RMB at different counters.

30 October 2012, China Exchanges Services Company launches. It is a joint venture among Hong Kong Exchanges and Clearing Limited (HKEx), Shanghai Stock Exchange (SHSE) and Shenzhen Stock Exchange (SZSE) for the development and franchising index-linked and other equity derivatives; compilation of cross-border indices based on products traded on the three markets.

Prospects

RMB Offshore Center

Hong Kong continues its development and strengthens its position as "the" RMB offshore centre by expanding the range of RMB products traded in Hong Kong including issuing more RMB bonds. It is expected the RQFII quota will increase. As there become more avenues for offshore RMB to invest through the Hong Kong platform, it is expected that RMB deposited in other parts of Asia, as a result of trade surplus with China, will be attracted to Hong Kong.

Asset Management Center

Development into an asset management centre will be one of the main focuses of Hong Kong. As described earlier in this paper, the market has widened its product range by introducing products of different currencies (HK$ and RMB), different markets (BRICS, LME) and different class (Volatility index, currency futures). The government is in the process of changing legislation (tax law) to accommodate Islamic products.

Improve market infrastructure

The HKEx launches the "Orion" project, which is a HK$3 billion (over US$384 million) project to revolutionize IT infrastructure. The implementation of the new infrastructure will be in stages over 3 years. Upgrade in infrastructure includes: 1) improve network by higher bandwidth to support future market growth. 2) Data Centre owned and operated by HKEx. 3) Hosting Services which provides low latency access to HKEx platforms.

Improvement in Securities platform includes: 1) Lower latency and higher capacity for future growth. The trading system's order processing capacity has been increased by about 10-fold to 30,000 orders per second, which can be further scaled up to at least 150,000 orders per second. In addition, trading system latency has been reduced to 2 milliseconds on an average trading day, about 70 times faster than before. 2) HKEx anticipates (Next generation market data system) the NGMDS will reduce market data latency to 100 microseconds from the current level of about 100 milliseconds. The NGMDS is targeted to be rolled out by mid-2013 for securities market and by late 2013 for the derivatives market.

After-Hours Trading

The HKEx is preparing to introduce after-hours trading for Hang Seng Index futures and Gold Futures**.** The additional session will be from 5:00pm to 11:00pm HK time, which will cover most of the European time zone. It is hotly debated by local brokers whether the introduction of after-hours trading is beneficial to the market as a whole considering the extra resources and potential risks involved.

Market expansion

Establishment of Financial Services Development Council is an initiative by the government to have a central body to coordinate the overall development of the financial industry which includes securities, banking and insurance.

Synergy between HKEx and LME is expected after the completion of acquisition. Although trading in financial futures is successful in Hong Kong, Hong Kong lacks the interest and experience in commodities futures trading. Through the acquisition, HKEx will have more opportunity in the involvement of commodities trading operations. On the other hand, LME will gain easier access to the Asian market.

Although each of Hong Kong, Shanghai and Shenzhen has its own flagship index, China Exchanges Services Company jointly owned by the three exchanges may ultimately develop an index representing Greater China economy.

Following the success of introducing companies such as Prada SpA, Coach Inc, Glencore International Plc and Kazakhmys PLC, HKEx continues its effort to position itself as Asia’s leading listing venue for natural resources companies and luxury goods companies along as the premier international market for listing China’s Mainland enterprises.

To support with the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission regulatory regime for Hong Kong’s over-the-counter (OTC) derivatives market, which required centralized trade reporting and clearing of OTC derivatives transactions, HKEx plans to establish a clearing house by the end of 2012 for derivatives traded in Hong Kong’s OTC market.

The State Council gave approval to the Overall Development Plan on Hong Kong/Shenzhen Co-operation on Modern Service Industries in Qianhai Area (Qianhai Development Plan) back in 2010. According to the views of the State Council in its approval, the Qianhai Development Plan should fully capitalize on Hong Kong's strengths and explore a system that is conducive to the development of modern service industries, with a view to providing a new experience for the whole nation and playing a pilot role, as well as setting up a co-ordination mechanism led by the National Development and Reform Commission with the involvement of Hong Kong and Shenzhen to resolve the problems encountered in developing the Qianhai Area. Financial services industry will be a fundamental ingredient to this plan. The basic infrastructure of the site is expected to be completed in the following 2 years.