

ASF 2014 - Hong Kong Market Report

HONG KONG ECONOMY

Economic Performance

The Hong Kong economy attained a moderate growth in 2013 amid a still challenging external environment. The growth pace, while representing a relative improvement over that in 2012, was still slower than the trend in the past ten years. For 2013 as a whole, the economy grew by 2.9% in real terms, improved from the 1.5% growth in 2012, but still below the annual average growth of 4.5% in the past decade. The Hong Kong economy slowed down further, to a mere 1.8% year-on-year growth in real terms in the second quarter of 2014, marking the slowest growth since the third quarter of 2012.

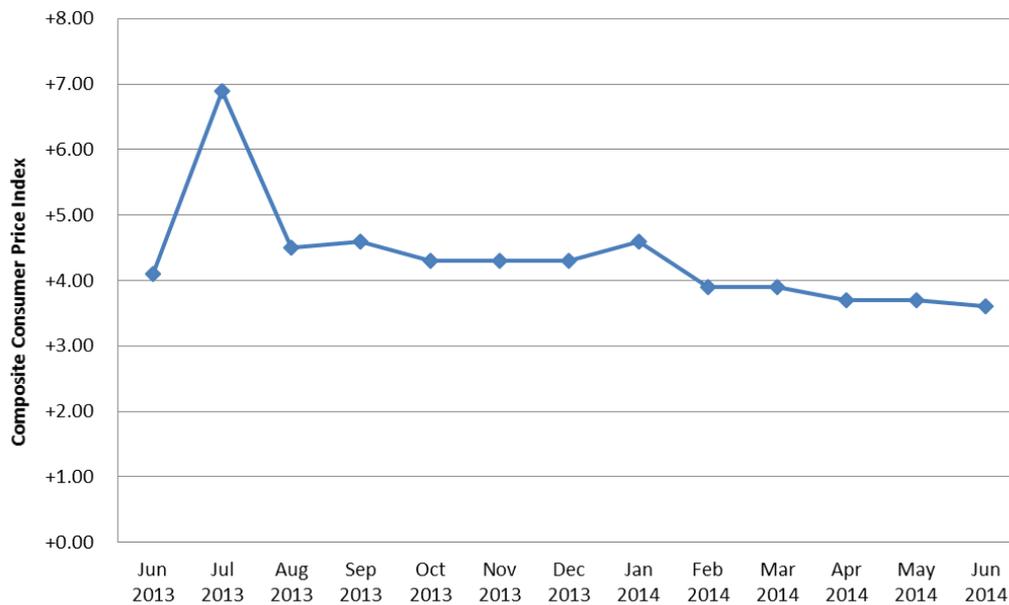
Table 1: Key Economic indicators

	2011	2012	2013	2014Q2
GDP (yoy, %)	4.9	1.5	2.9	1.8
CPI (yoy, %)	5.3	4.1	4.3	3.6
Unemployment rate (%)	3.4	3.3	3.3	3.2
Foreign reserve (US\$billion)	285.4	317.3	311.2	320.9
Balance of Payments (US\$billion)	11.13	24.22	7.42	n/a

Source: Census and Statistics Department, the HKSAR Government

In 2013, consumer price inflation was largely stable. Netting out the effects of the Government's one-off relief measures, underlying consumer price inflation actually retreated to 4.3% in 2013, down from 5.3% and 4.1% respectively in 2011 and 2012. The moderation in the underlying rate mainly reflected the benefits from subdued external price pressure while some notable upward price pressures domestically also tended to stabilise in the latter part of 2013. Consumer price inflation continued its easing trend in the first half of 2014. As a whole, composite consumer inflation averaged 3.6%, down from 4.1% in the corresponding period.

Chart 1: Year-on-year Rates of Change in the Consumer Price Index

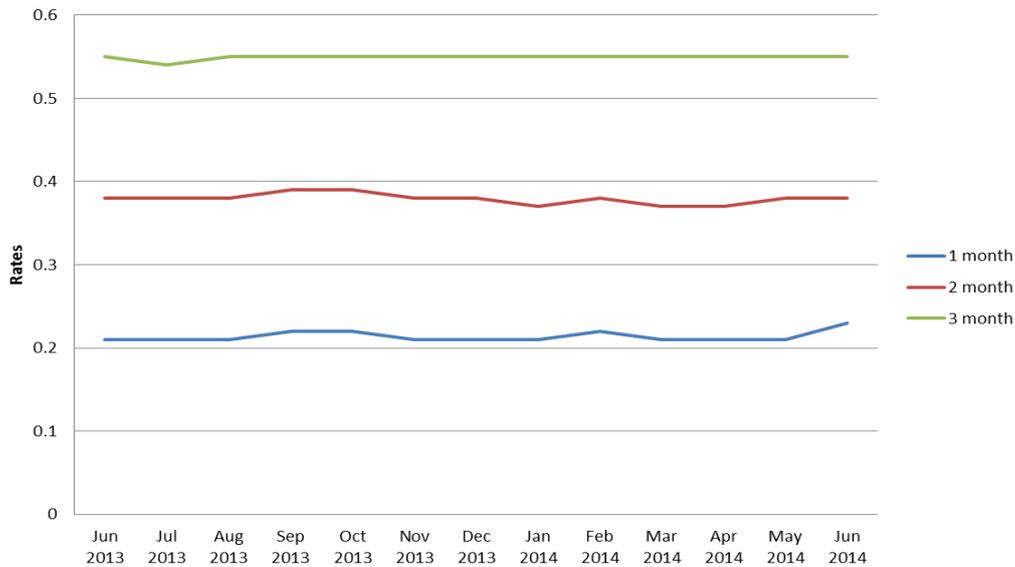


Source: Census and Statistics Department, the HKSAR Government

The labour market was in a state of full employment in 2013. Labour demand remained firm, as a result of the largely resilient domestic sector and the vibrant inbound tourism. The labour market remained broadly stable in the second quarter of 2014 with an unemployment rate at 3.2%, though showing some signs of easing towards the quarter-end amid the further economic slowdown.

The low interest rate environment in Hong Kong continued through 2013 amid the ongoing accommodative monetary policy in the United States. Hong Kong dollar interest rates on both the interbank and retail fronts continued to remain at low levels. The Hong Kong dollar best lending rates remained steady at around 5.00% for 2013 and through first half of 2014.

Chart 2: Hong Kong Dollar Interest Settlement Rates



Source: Census and Statistics Department, the HKSAR Government

Forecasts

The key sources of uncertainties for the 2014 outlook come from the US Federal Reserve's asset purchase tapering and the consequential impact on the emerging markets in terms of capital flow reversals, exchange rate fluctuations, and asset market gyrations.

The Hong Kong economy is projected to expand by 3-4% in 2014, compared to the 2.9% growth in 2013 and the average annual growth of 4.5% in the past ten years.

The Hong Kong economy slowed down further, to a mere 1.8% year-on-year growth in real terms in the second quarter of 2014, marking the slowest growth since the third quarter of 2012. The weak performance was mainly weighed down by a drop in tourist spending and moderated growth in domestic demand as a whole.

SECURITIES MARKETS

Capital Market

The Hong Kong stock market exhibited considerable volatility in 2013. Fund raising activities were subdued in most of 2013 but staged a sharp rebound in the fourth quarter of 2013. The market capitalisation of the Hong Kong stock market expanded by 9.53% to HK\$24.04 trillion at end of 2013, the highest since October 2007.

As of June 2014, a total of 1,689 companies were listed on the Stock Exchange of Hong Kong Limited (SEHK) with a total market capitalization of HK\$23.94 trillion, a 0.41% lower than at end of 2013. Mainland enterprises continued to play a dominant role in Hong Kong stock market. At end of June 2014, a total of 837 Mainland enterprises (including 194 H-share companies, 129 “Red Chips” companies and 514 private enterprises) were listed on the SEHK, accounting for 49.56% of the total number of listed companies and 56.90% of total market capitalisation. By market capitalization, Hong Kong was the sixth largest stock exchange in the world and second largest in Asia according to the World Federation of Exchanges.

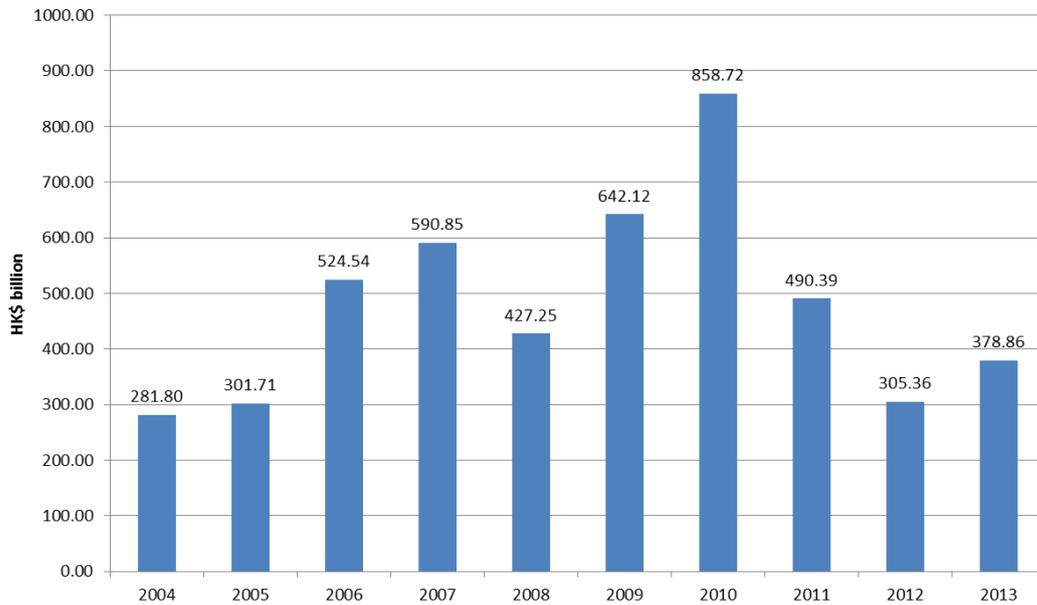
Table 2: Key statistics of securities listed on SEHK

	2011	2012	2013	2014 (June)
Number of listed companies	1,496	1,547	1,643	1,689
Total market capitalization (HK\$Bil)	17,537	21,950	24,042	23,944
Number of listed securities	6,723	6,903	8,522	9,265
Number of equity warrants	15	11	8	5
Number of derivatives warrants	4,027	3,747	4,715	5,054
Number of Callable Bull/Bear Contracts	901	1,214	1,620	1,846
Number of mutual funds	88	111	129	136
Number of debt securities	169	269	403	531

Source: HKEx

Total equity capital raised for 2013, comprising initial public offerings (IPOs) and post-listing capital raising increased by 23.07% to HK\$378.86 billion. Total equity capital raised in first six months of 2014 increased to HK\$217.90 billion from HK\$133.57 billion of the same period in 2013.

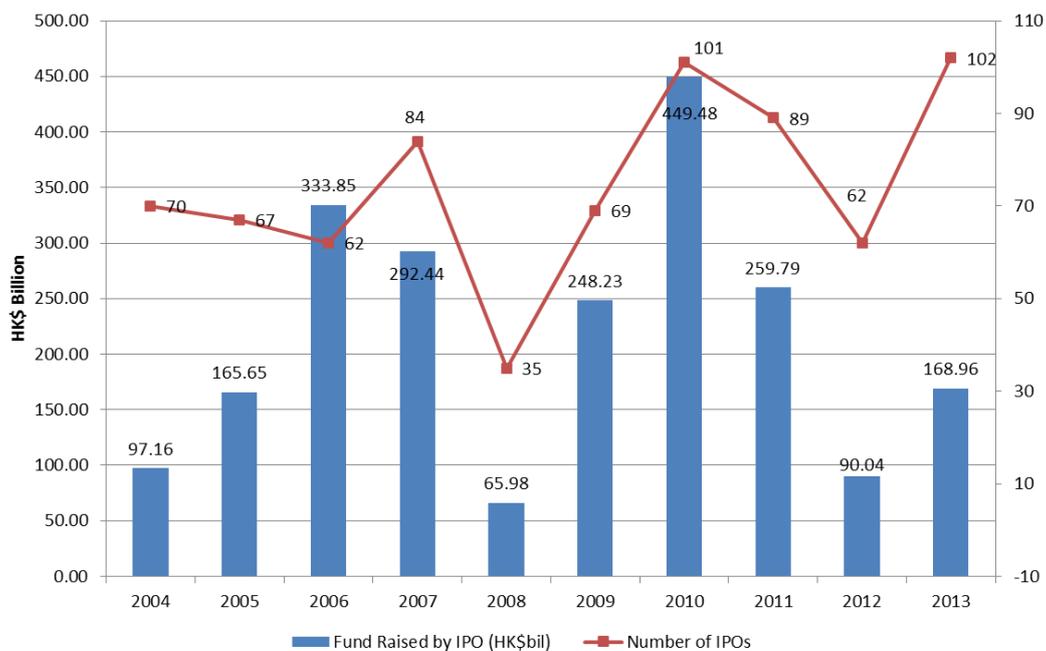
Chart 3: Total Fund Raised-Equity Capital Market



Source: HKEx

The amount of funds raised through IPOs for 2013 also increased by 87.64% to HK\$168.96 billion (US\$21.77 billion). The amount of funds raised through IPOs for first six months in 2014 amounted to HK\$39.49 billion.

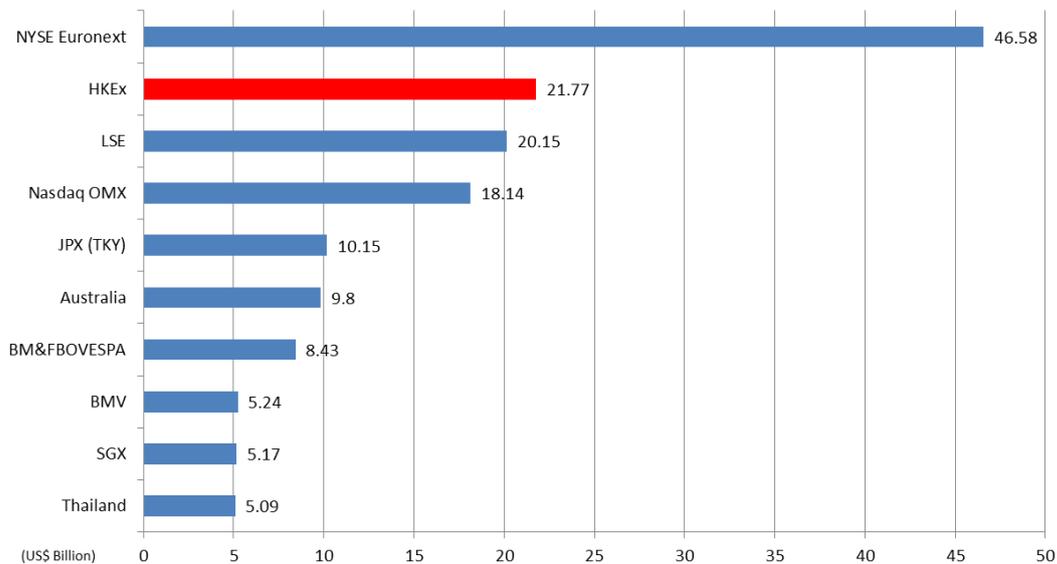
Chart 4: Number of IPOs and Fund Raised



Source: HKEx

IPO funds raised by Chinese enterprises accounted for 91% of the market total during 2013. Hong Kong, SEHK moved up to the 2nd place from 4th position globally in terms of funds raised through IPOs in 2013.

Chart 5: 2013 Global IPO league table by equity funds raised

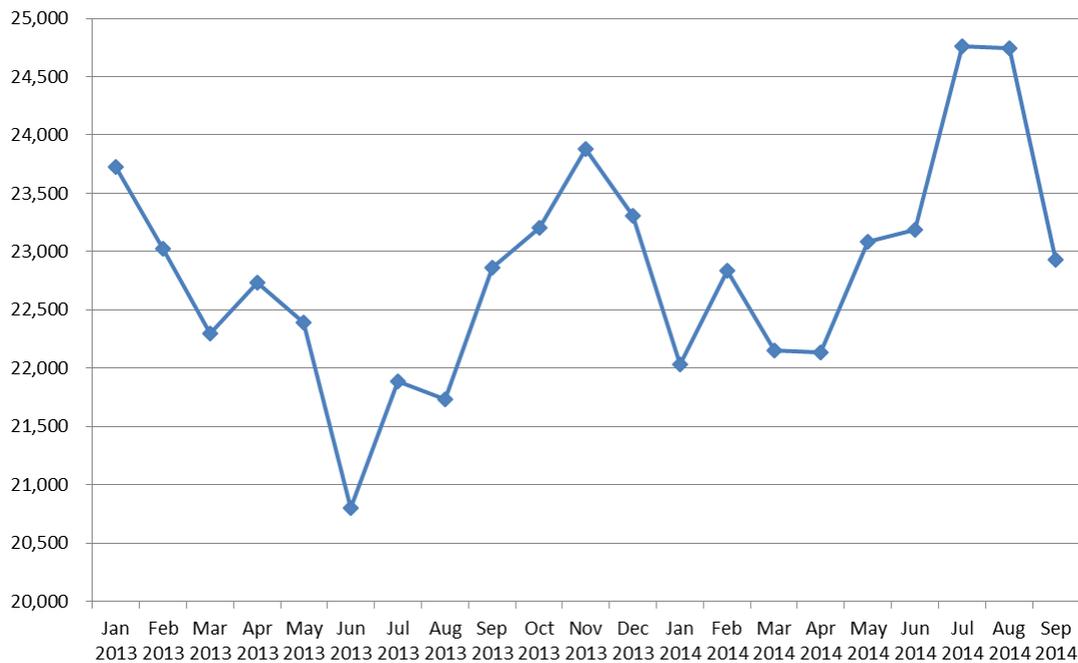


Source: HKEx

Equities Market

The Hang Seng Index (HSI) reached a 21-month high of about 23,800 points in late January 2013 on solid Mainland economic data. Yet, the market later retreated amid worries over a credit crunch on Mainland China. Concerns over a tapering of stimulus policy in the US and geopolitical tension on the Korean Peninsula also weighed on the market. The HSI once fell to a nine month low of below 20,000 points in late June 2013.

Chart 6: Movements of Hang Seng Index



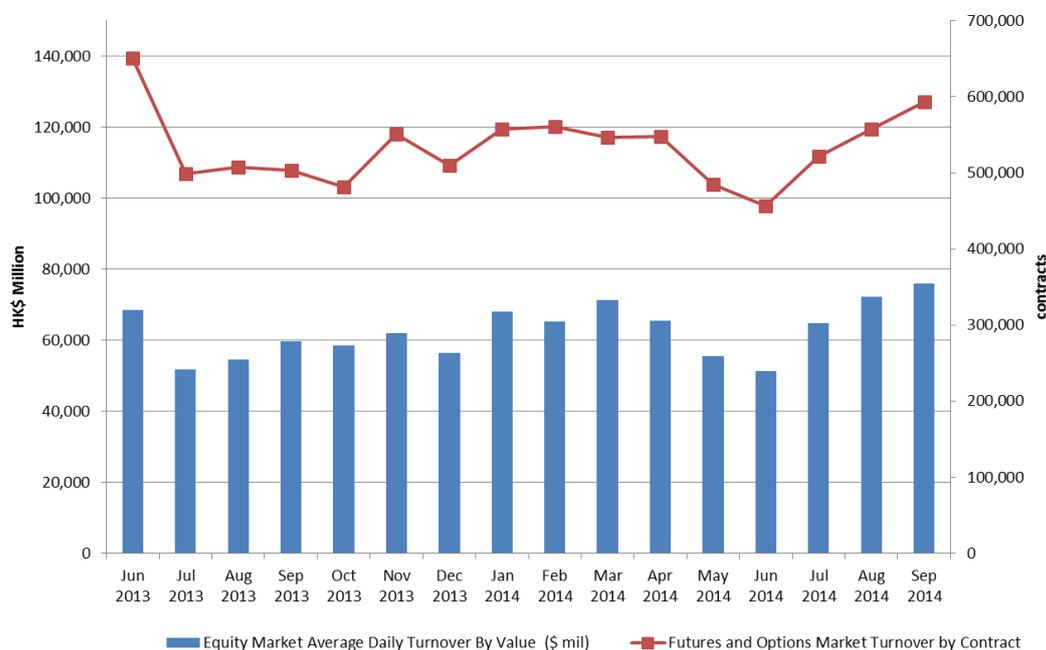
Source: HKEx

In July, the market rebounded on easing worries over liquidity conditions on the Mainland and an early exit of the QE programme in the US. Sentiment improved after the release of detailed reform policies on Mainland China. Mainland China financial stocks paced gains, given optimism about reform plans in the sector. Upbeat Mainland China and US economic data, such as manufacturing and economic growth data, also provided support.

During the first half of 2014, the volatility of the Hong Kong market remained low, but the market continued to face risks stemming from overseas and the Mainland markets. While the US and European markets rose to historical or multi-year highs, investor sentiment was fragile due to worries about the tapering of quantitative easing by the US Federal Reserve Bank and the uncertain outlook for the euro zone economies. The bearish market performance and signs of possible economic slowdown in the Mainland also weighed on the Hong Kong market. During the period, the Hang Seng Index dropped 0.5% and the Hang Seng China Enterprises Index fell 4.4%. The HSI started a hike starting in July and reached 25,293 points on early September 2014, the highest point for the past 4 and half years but ended 22,932 at the end of September 2014 as the “Occupy Central” incident started to emerge.

Total securities market turnover in 2013 was HK\$15.26 trillion, up 14.74% from HK\$13.30 trillion in 2012. The average daily turnover for the securities market in 2013 was HK\$62.56 billion, 16.17% higher from HK\$53.85 billion in 2012. Chinese enterprises stocks remained the most actively traded stocks. Mainland enterprises' share of total market turnover increased to 71.6% from 69.6% in 2012.

Chart 7: Trading statistics



Source: HKEx

Equity trading activity was moderate during the first half of 2014. The average daily turnover for the first six months of 2014 was HK\$62.90 billion, increased by 10% from HK\$57.10 billion in same period of 2013.

Futures and Options Market

The Hong Kong Exchanges and Clearing Limited (HKEx) futures and options market in 2013 recorded a total annual trading volume of 130.03 million contracts, up 8.5% from annual trading volume of 119.80 million contracts in 2012 and an average daily trading volume of futures of 532,905 contracts, up 9.2% from 487,994 contracts in 2012.

The average daily turnover of futures and options for the first six months of 2014 was 525,816 contracts, a decrease of 5.80% from 558,218 contracts when compared with the same period last year.

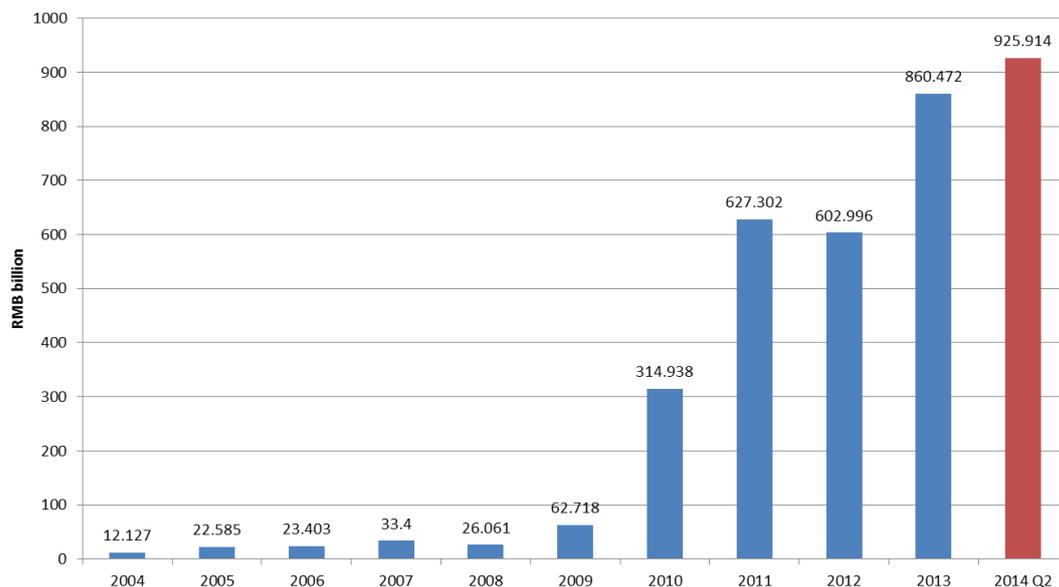
The Hong Kong Futures Exchange introduced after hours future trading (AHFT) in April 2013 with HSI and H-shares Index Futures. AHFT added an additional session with trading hours from 5:00 pm to 11:00 pm. From 8 April to 31 December, the average daily turnover of the HSI and Hang Seng China Enterprise Index (HSCEI) futures during the AHFT session amounted to 3,240 contracts and 3,396 contracts, which were about 4.2% and 4.0% respectively of the trading during the daytime trading session. Trading during the AHFT session continued to grow during the first half year of 2014. Three products, namely the Mini-Hang Seng Index (Mini-HSI) Futures, Mini H-shares Index (Mini-HSCEI) Futures and the RMB currency futures, were added to the AHFT session during the period.

MAJOR MARKET DEVELOPMENTS

Offshore Renminbi Centre

Offshore Renminbi (RMB) business gathered further momentum in 2013. The total outstanding RMB customer deposits surged by 42.70% over 2012 to RMB860.47 billion at end of 2013. Meanwhile, reflecting the buoyant RMB financing activities, the outstanding amount of RMB loans soared from RMB79 billion at end of 2012 to RMB116 billion at end of 2013, while RMB bond issuance increased from RMB112 billion in 2012 to RMB117 billion in 2013.

Chart 8: Renminbi deposits in Hong Kong



Source: Census and Statistics Department, the HKSAR Government

The Offshore RMB business maintained good growth momentum in half of 2014. The offshore RMB liquidity continued to expand with an outstanding amount of RMB customer deposits increased to RMB925.91 billion at end of June 2014 while the amount of RMB bonds issued reached RMB130 billion in half of 2014, already exceeding the annual total of RMB117 billion in 2013.

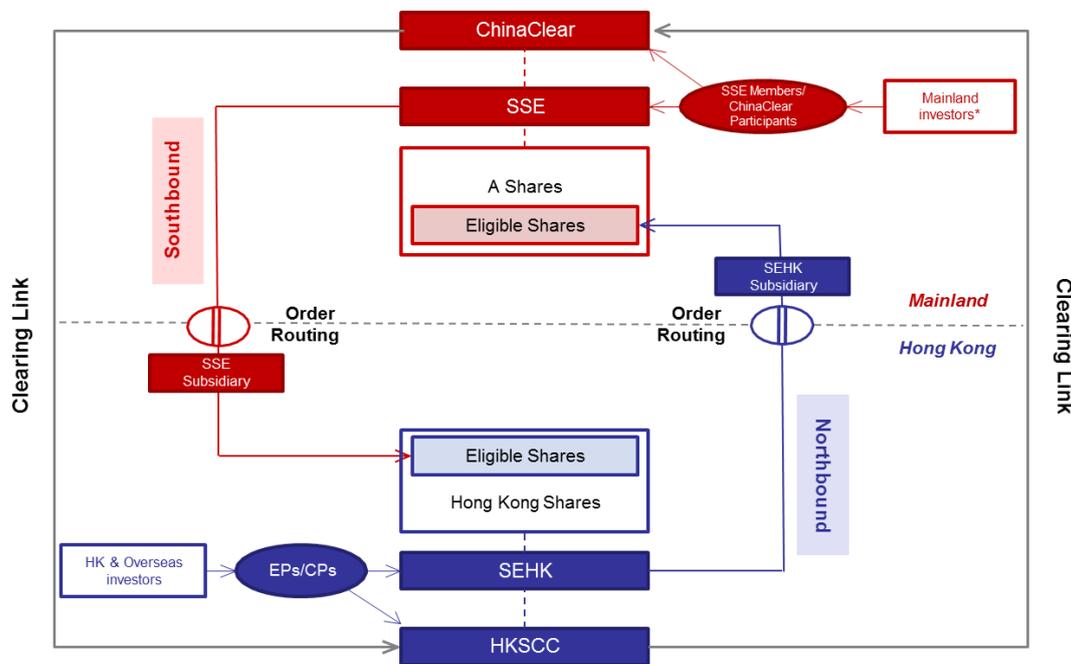
Several policy initiatives introduced by the Chinese Central Government in 2013 have contributed to the continued growth of offshore RMB business in Hong Kong. The expansion of the RMB Qualified Foreign Institutional Investor (RQFII) scheme in March 2013, which entails a

broader range of eligible institutions and relaxed investment restrictions, has facilitated the launch of more RMB financial products in Hong Kong. In July 2013 the Mainland Chinese authorities also streamlined the requirements for cross-border RMB transactions, increasing the flexibility for corporates to move RMB funds between the onshore and offshore markets. The endeavour of developing Hong Kong into a leading offshore RMB business centre has made visible progress and the efforts will continue, realising the role laid out in the dedicated chapter of National 12th Five Year Plan.

Shanghai-Hong Kong Stock Connect

In April 2014, HKEx and Shanghai Stock Exchange (SSE) jointly announced Shanghai-Hong Kong Stock Connect pilot scheme which will allow Hong Kong and Mainland Chinese investors to directly participate in each other's securities markets. The programme will allow Hong Kong and international investors to access the Shanghai stock market (Northbound Trading), while qualified Mainland Chinese investors will be able to tap the Hong Kong stock market (Southbound Trading).

Chart 9: Key Features of Shanghai-Hong Kong Stock Connect



Source: HKEx

The Trading Links

SSE, the SSE subsidiary, SEHK and the SEHK subsidiary have entered into an agreement to establish (i) an order-routing arrangement to enable Northbound Investors to trade in SSE Securities on SSE through the SEHK subsidiary by placing orders with its exchange participants; and (ii) an order-routing arrangement to enable Southbound Investors to trade in SEHK Securities on SEHK through the SSE subsidiary by placing orders with SSE members.

Table 4: Shares eligible to be traded through the Trading Link

	Northbound: SSE Securities	Southbound: SEHK Securities
Index Constituent Stocks	SSE180 SSE380	HS LargeCap HS MidCap
A+H	SSE-SEHK A+H	SSE-SEHK A+H
Excluding	<ul style="list-style-type: none"> • Shares under risk alert board • Shares that are not traded in RMB 	<ul style="list-style-type: none"> • A+H on other Mainland exchange Shares that are not traded in HKD • H Share with corresponding SSE A Share under risk alert board
Total No of Stocks*	568	266

* No. of stocks as of 10 April 2014

For any SSE – listed shares not accepted as an eligible SSE – listed shares upon launch due to its being under risk alert board, if it is subsequently removed from the risk alert board, it will be accepted as an SSE – listed shares if it falls under any of the selection criteria

Source: HKEx

Northbound Trades

SSE will accept as SSE Securities for trading by Northbound Investors all the constituent stocks of the SSE 180 Index and SSE 380 Index, and all the SSE Securities that are not included as constituent stocks of the SSE 180 and 380 Indices but which have corresponding shares accepted for listing and trading on SEHK, except that the following will not be accepted as SSE Securities upon the launch of operation of Shanghai-Hong Kong Stock Connect:

- (a) SSE Securities which are not traded in RMB; and
- (b) SSE Securities which are under “risk alert”.

Any SSE Security which is not accepted as an eligible SSE Security upon the launch of operation of Shanghai-Hong Kong Stock Connect due to its being

under “risk alert” will be accepted as such if it subsequently ceases to be under “risk alert”, provided that it remains as a constituent stock of the relevant indices or if its corresponding H Share continues to be traded on SEHK (as appropriate).

Where any eligible SSE Security subsequently ceases to be a constituent stock of the relevant indices, and/or where the corresponding H Share of any SSE Security subsequently ceases to be traded on SEHK, and/or where any SSE Security is subsequently under “risk alert” (as the case may be), only sale orders (but not buy orders) from Northbound Investors will be allowed

Southbound Trades

Eligible SEHK Securities for trading by Southbound Investors include (i) all the constituent stocks of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, and (ii) all the H Shares that are not included as constituent stocks of the relevant indices but which have corresponding shares in the form of SSE Securities, except that the following will not be accepted as eligible SEHK Securities (a) Hong Kong shares that are not traded in HKD; and (b) H Shares which have corresponding shares traded on any exchange in Mainland China other than SSE.

Where any eligible SEHK Securities subsequently ceases to be a constituent stock of the relevant indices, and/or where its corresponding SSE Security ceases to be traded on SSE, and/or where the shares of any issuer of H Shares that have been accepted as SEHK Securities are subsequently listed on an exchange in Mainland China other than SSE (as the case may be), only sale orders (but not buy orders) from Southbound Investors will be allowed

The scope of the eligible SSE Securities and the SEHK Securities may be amended as agreed by SSE and SEHK after consulting each other and after obtaining the consent of the relevant regulatory bodies

Eligible investors

Table 5: Eligible Investors

Northbound	All Hong Kong and overseas institutional investors	All Hong Kong and overseas individual investors
Southbound	All Mainland institutional investors	Qualified individual investors (with minimum securities and cash asset value of RMB500,000)

Source: HKEx

SEHK exchange participants and their clients will be accepted as Northbound Investors. Chinese institutional investors and those individual investors who hold an aggregate balance of not less than RMB500,000 in their securities and cash accounts will be accepted as Southbound Investors.

Eligible exchange participants

Table 6: Eligible Exchange Participants

Northbound	All SEHK Participants	All HKSCC Participants
Southbound	All SSE Members	All ChinaClear Participants

Source: HKEx

SEHK exchange participants who satisfy such information technology capability, risk management and other requirements as may be specified by SEHK will be accepted to trade through the Northbound Trading Link; and SSE members who satisfy such information technology capability, risk management and other requirements as may be specified by SSE will be accepted to trade through the Southbound Trading Link.

Applicable trading currencies

Northbound Investors will trade SSE Securities and settle the trades in RMB only; and Southbound Investors will trade SEHK Securities quoted in HKD only and shall settle the trades with China Securities Depository and Clearing Co., Ltd (ChinaClear) or its clearing participants in RMB.

Applicable rules

All orders submitted to or executed on SSE through the Northbound Trading Link will be subject to the rules and procedures of SSE and the applicable law of Mainland China; and all orders submitted to or executed on SEHK through the Southbound Trading Link will be subject to the rules and procedures of SEHK and the applicable law of Hong Kong.

The Clearing Links

ChinaClear and Hong Kong Securities Clearing Limited (HKSCC) have entered into an agreement to establish: (i) clearing and settlement arrangements for the purpose of clearing and settling trades executed on SSE through the Northbound Trading Link, and on SEHK through the Southbound Trading Link; (ii) arrangements for providing registration, depository and nominee services for Northbound Investors in respect of SSE Securities, and for providing depository and nominee services for Southbound Investors in respect of SEHK Securities; and (iii) arrangements for the provision of other services as ChinaClear and HKSCC may agree.

Eligible clearing participants

Direct clearing participants and general clearing Participants of HKSCC who satisfy such information technology capability, risk management and other requirements as may be specified by HKSCC will be permitted to participate in the Northbound Clearing Link.

Clearing participants of ChinaClear who satisfy such information technology capability, risk management and other requirements as may be specified by ChinaClear will be permitted to participate in the Southbound Clearing Link.

Quotas

Table 7: Trading Quotas

	Northbound Trading SSE Securities	Southbound Trading SEHK Securities
Maximum Aggregate Quota	RMB 300 billion	RMB 250 billion
Daily Quota	RMB 13 billion	RMB 10.5 billion

Source: HKEx

In the initial phase of operation of Shanghai-Hong Kong Stock Connect, the Northbound Trading Link will be subject to a daily quota of RMB13 billion and an aggregate quota of RMB300 billion and the Southbound Trading Link will be subject to a daily quota of RMB10.5 billion and an aggregate quota of RMB250 billion. Quotas may be adjusted in the future