

ASF 2013 - Hong Kong Market Report

HONG KONG ECONOMY

Economic Performance

The Hong Kong economy saw a modest growth in 2012, despite a difficult external global economic environment characterised by the unsettled euro debt crisis and weak recovery of the major advanced economies. Domestic demand however showed resilient throughout 2012. For the year 2012 as a whole, the economy grew by 1.4%, down from the above-trend growth of 4.9% in 2011. The Hong Kong economy grew moderately in the second quarter of 2013, by 3.3% in real terms over same period of 2012.

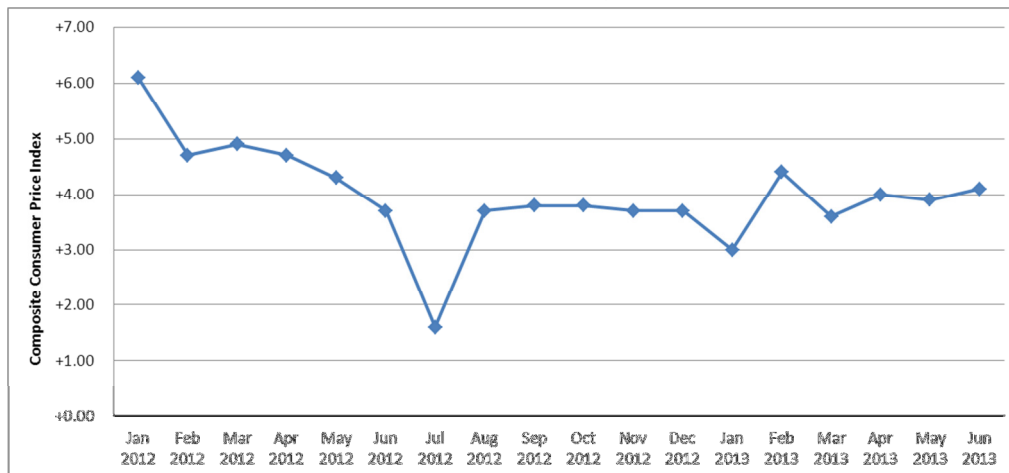
Table 1: Key Economic indicators

	2010	2011	2012	2013Q2
GDP (yoy, %)	6.8	4.9	1.4	3.3
CPI (yoy, %)	2.4	5.3	4.1	4.1
Unemployment rate (%)	4.3	3.4	3.3	3.3
Foreign reserve (US\$billion)	268.74	285.4	317.3	303.58
Balance of Payments (US\$billion)	7.58	11.13	24.22	n/a

Source: Census and Statistics Department, the HKSAR Government

In 2012 inflation averaged at 4.1%, down from 5.3% in 2011. This general easing trend during 2012 was resulted from the stabilisation of private housing rentals since the earlier part of 2012. Consumer price inflation held largely stable in the second quarter of 2013 at 4.1% over same period in 2012.

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

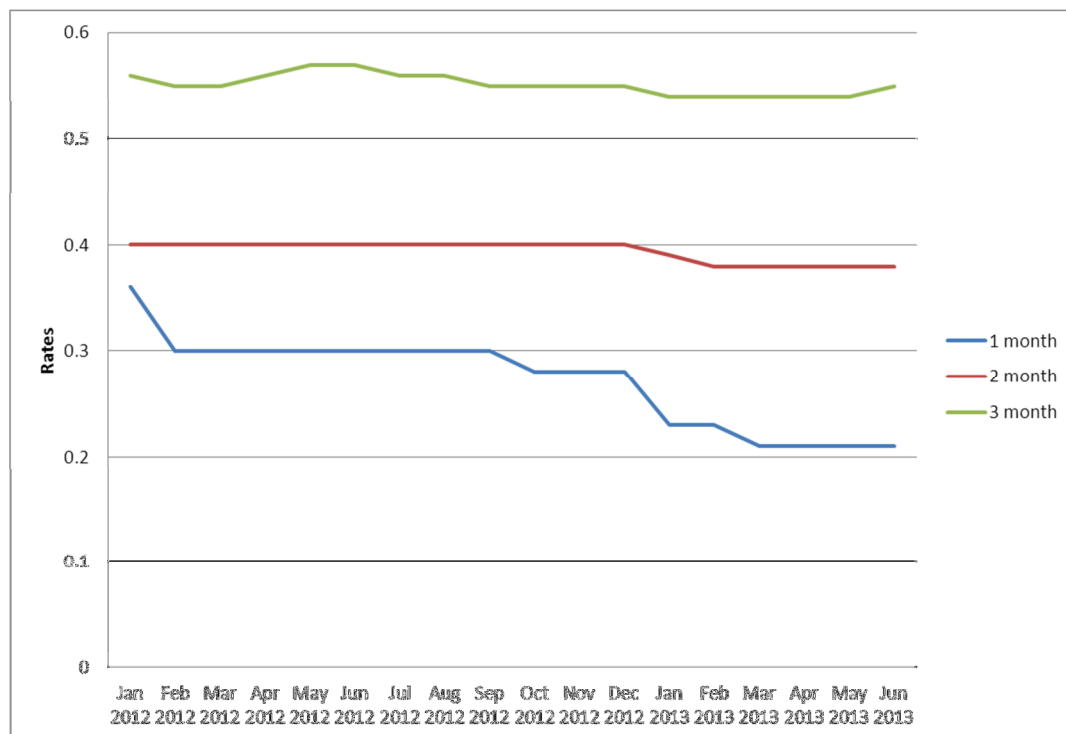


Source: Census and Statistics Department, the HKSAR Government

The labour market continued to enjoy broad-based improvements for the third consecutive year due to the buoyant domestic economic activity and labour demand remained robust. The unemployment rate remained at low level, finishing the year at 3.3%. Labour market conditions remained generally tight as the pace of job creation kept up with its strong trend matching the growth in labour supply in the first half of 2013. Overall, the unemployment situation held broadly stable, with the number of unemployed persons remaining virtually unchanged in the second quarter of 2013.

The low interest rate environment in Hong Kong continued through 2012 and also in the first half of 2013 amid the ongoing accommodative monetary policy in the United States. The Hong Kong dollar best lending rates remained steady at around 5.00% for 2012 and through first half of 2013.

Chart 2: Hong Kong Dollar Interest Settlement Rates



Source: Census and Statistics Department, the HKSAR Government

The development of offshore renminbi (RMB) centre is encouraging. The total outstanding amount of RMB deposits and certificates of deposit issued rose by 9% over 2011 to RMB720 billion at end of 2012. RMB financing activities also showed distinct growth with the total RMB bond issuance increased from RMB108 billion in 2011 to RMB112 billion in 2012.

Offshore RMB business also recorded broad-based growth in first half of 2013. The offshore RMB liquidity pool also expanded, with the outstanding amount of RMB deposits and certificates of deposit issued increased by 25.9% to RMB861 billion at end of June 2013 over the same period last year.

Forecasts

The prospects for the Hong Kong economy remain positive. Riding on the economic strength of the region, Hong Kong will continue to deepen its economic integration with Mainland China while striving to maintain and enhance its competitive edge as a knowledge-based, high value-added economy. The trend GDP growth rate in real terms is forecast at 4% per annum from 2014 to 2017, and the trend rate of underlying consumer price inflation at 3.5% per annum.

SECURITIES MARKETS

Capital Market

Performance of stock market in 2012 largely tracked the developments of the global financial market and external economic environment in 2012. The market capitalisation of the Hong Kong stock market expanded by 25.16% to HK\$21.95 trillion at end of 2012, the highest since October 2007.

As of June 2013, a total of 1,567 companies were listed on the Stock Exchange of Hong Kong Limited (SEHK) with a total market capitalization of HK\$20.71 trillion, a 5.67% lower than at end of 2012. Hong Kong was still the sixth largest stock exchange in the world and second largest in Asia according to the World Federation of Exchanges.

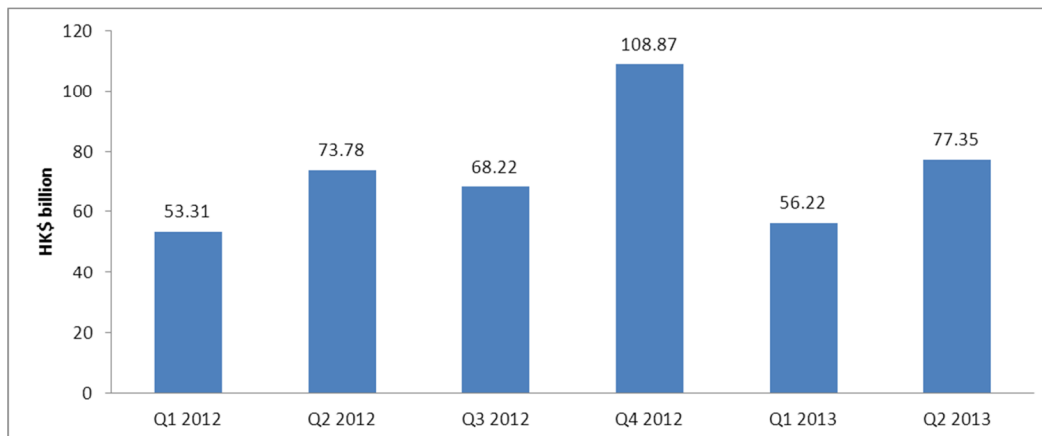
Table 2: Key statistics of securities listed on SEHK

	2010	2011	2012	2013 (June)
Number of listed companies	1,413	1,496	1,547	1,567
Total market capitalization (HK\$Bil)	21,077	17,537	21,950	20,706
Number of listed securities	7,900	6,723	6,903	8,174
Number of equity warrants	23	15	11	10
Number of derivatives warrants	5,148	4,027	3,747	4,895
Number of Callable Bull/Beqr Contracts	1,064	901	1,214	1,222
Number of mutual funds	79	88	111	121
Number of debt securities	169	169	269	355

Source: HKEx

Total equity capital raised for 2012, comprising initial public offerings (IPOs) and post-listing capital raising plunged by 37.7% to HK\$305.36 billion, the lowest level since 2005. Total equity capital raised in first six months of 2013 amounted to HK\$133.57 billion down from HK\$133.76 billion of the same period in 2012.

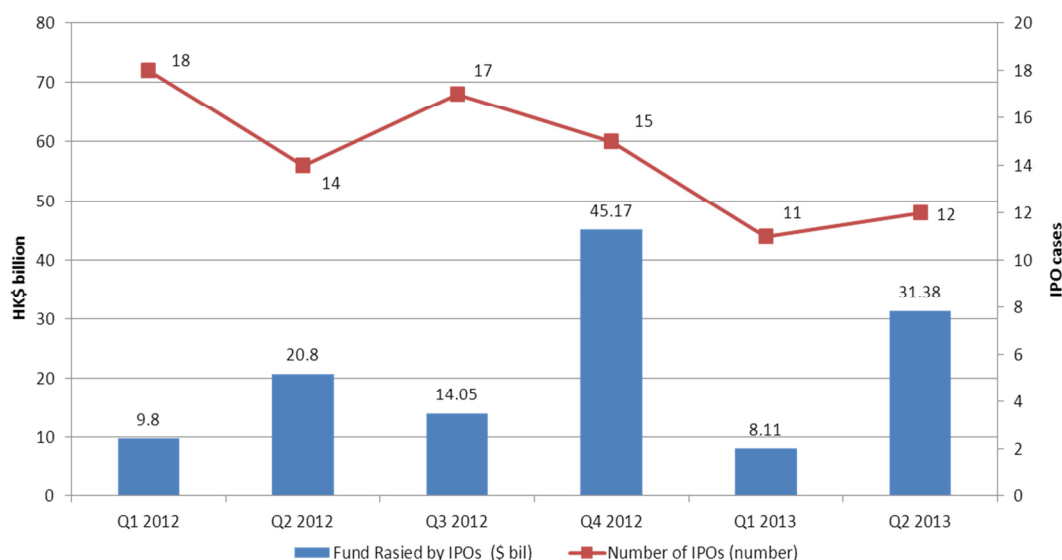
Chart 3: Total Fund Raised-Equity Capital Market



Source: HKEx

The amount of funds raised through IPOs for 2012 also plummeted by 65.3% to HK\$90.04 billion (US\$11.54 billion), the lowest level since 2008. The amount of funds raised through IPOs for first six months amounted to HK\$39.49 billion. Despite an increase of 27.96% from HK\$30.86 billion for the same period last year, the amount of IPO capital raised was a low level by historical standards.

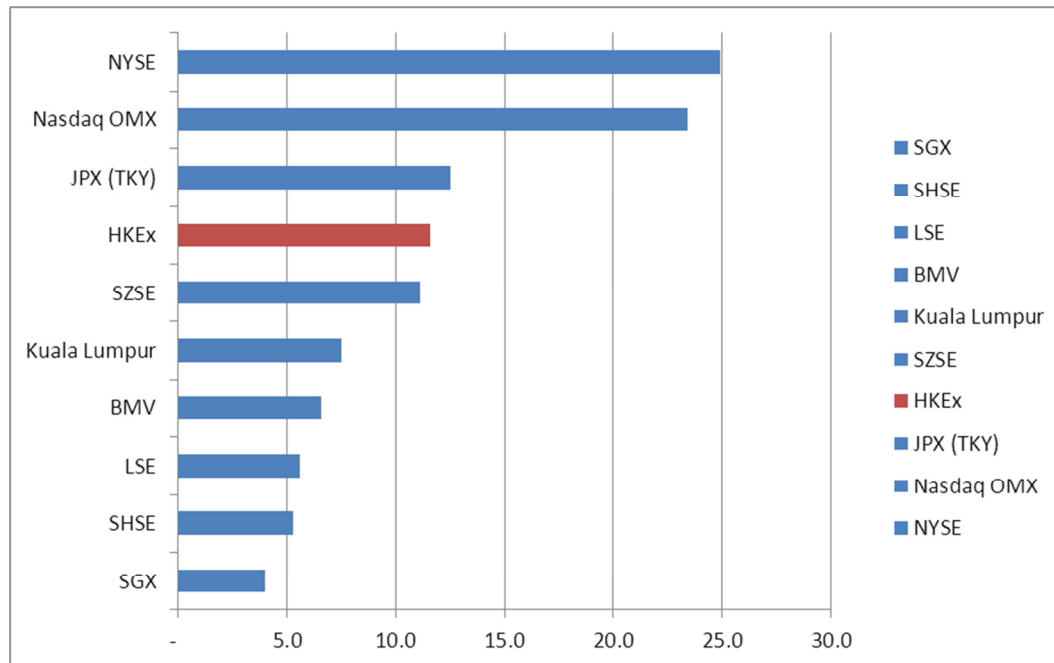
Chart 4: Number of IPOs and Fund Raised



Source: HKEx

Notwithstanding the challenging market conditions, SEHK remained in the top five globally in terms of funds raised through IPOs in 2012 after staying in the first place in the previous three years.

Chart 5: 2012 Global IPO league table by equity funds raised

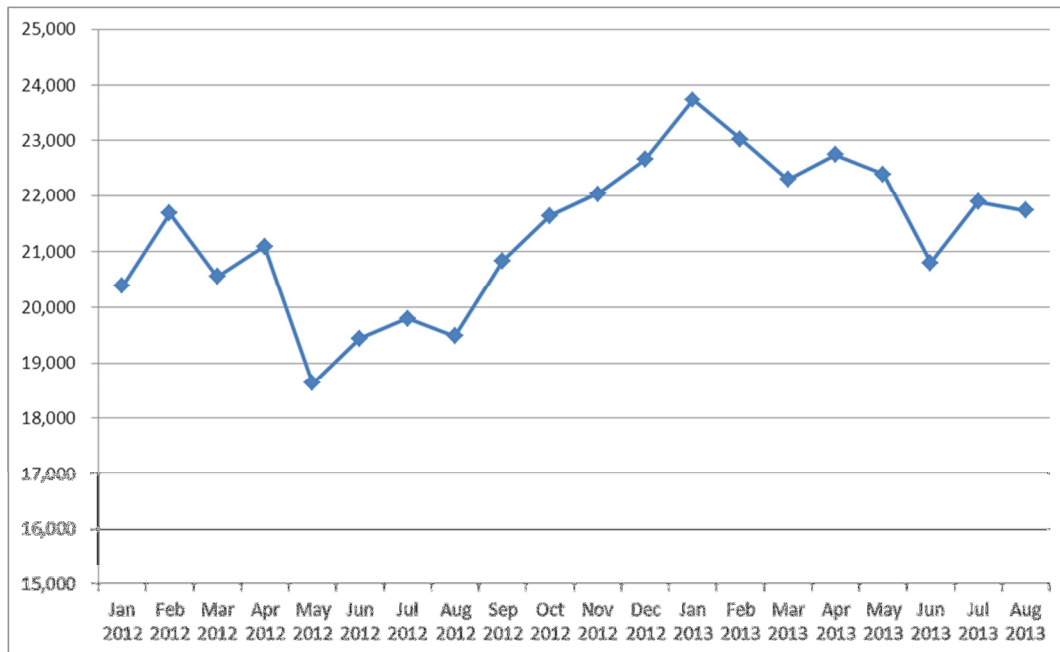


Source: HKEx

Equities Market

The Hong Kong stock market largely tracked the developments of the global financial market and external economic environment in 2012. The Hang Seng Index (HSI) stayed range-bound in the first seven months, trading between a low of 18,186 and a high of 21,680. HSI picked up in late July in tandem with the stabilisation of the eurozone debt crisis, and received a boost in September upon another round of monetary easing measures in the major advanced economies. Closing at 22,657 at end of 2012, the HSI recorded a gain of 22.9% over a year earlier. After a volatile first quarter, the Hong Kong stock market underwent a correction in the second quarter of 2013. The HSI has suffered a major setback since mid-May 2013, from 23,493 on 20 May to 20,803 at end of June 2013, mainly due to concerns over the possible tapering of asset purchases in the United States later this year and the liquidity strains in the Mainland.

Chart 6: Movements of Hang Seng Index



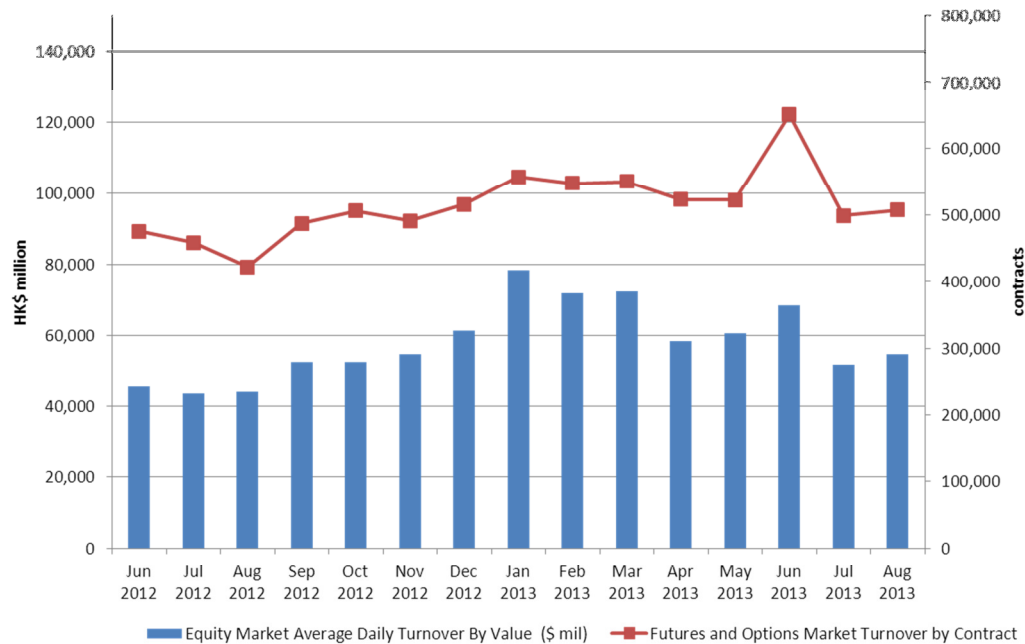
Source: HKEx

Total securities market turnover in 2012 was HK\$13.30 trillion, down 22.45% from HK\$17.15 trillion in 2011. The average daily turnover for the securities market in 2012 was HK\$53.85 billion, decreased by 22.77% from HK\$69.73 billion in 2011. The average daily turnover for the first six months of 2013 was HK\$68.28 billion, increased by 16.32% from HK\$58.70 billion in same period of 2012.

The HKEx futures and options market in 2012 recorded a total annual trading volume of 119.80 million contracts and an average daily trading volume of futures of 487,994 contracts, both down 14.73% from annual trading volume of 140.49 million contracts and average daily trading volume of 572,275 contracts in 2011.

The average daily turnover of futures and options for the first six months of 2013 was 558,218 contracts, an increase of 12.21% from 497,465 contracts when compared with the same period last year. On 25 June, the turnover of futures and options reached a record high of 1,448,209 contracts.

Chart 7: Trading statistics



Source: HKEx

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. Since its launch, AHFT trading volume has been approximately 3 per cent of the day session’s on average.

Mainland enterprises continued to play a dominant role in Hong Kong stock market. At end of June 2013, a total of 743 Mainland enterprises (including 176 H-share companies, 121 “Red Chips” companies and 446 private enterprises) were listed on the SEHK, accounting for 47% of the total number of listed companies and 56% of total market capitalisation. Mainland-related stocks also accounted for 71% of equity turnover and 75% of total equity fund raised in SEHK in the second quarter of 2013.

Fund management and investment funds

In tandem with the revival of the equity market in the second half of 2012, the fund management business generally recorded solid growth in 2012. Supported by the spectacular growth in September to December, gross retail sales of mutual funds surged by 46.1% to US\$54.9 billion for 2012 as a whole, the highest level since the record started in 2005. In

parallel to the rise in equity prices, aggregate net asset value of the approved constituent funds under the Mandatory Provident Fund (MPF) schemes expanded by a sharp 23.5% over end of 2011 to US\$440 billion at end of 2012. Yet the amount of net assets managed by retail hedge funds declined.

Hong Kong has experienced a rapid development of its ETF market during period. The average daily turnover of ETFs for the first six months of 2013 was HK\$4.5 billion, an increase of 166 per cent when compared with same period last year. The total number of ETFs reached 110 at the end of June 2013, up from 100 at the end of 2012. These included 7 RMB denominated ETFs and 3 bond ETFs.

In tandem with the develop Hong Kong's offshore RMB centre, the SEHK has developed a wide range of RMB products. At end of June 2013, a total of 88 RMB products were traded on the SHEK. These products include bonds, REITs, ETFs, equity and derivatives warrants.

Major market and regulatory developments

Mutual market access between Hong Kong and Mainland China: In July 2012 the SFC authorized the world's first RMB Qualified Foreign Institutional Investors Scheme (RQFII) A-share ETF for listing in Hong Kong thus allowing local and international investors an alternative to directly invest in the A-share market. These ETFs enjoy market making facility, short-selling tick rule, Securities and Futures Commission (SFC) authorised fund status and stamp duty exemptions.

On the other hand, the China Securities Regulatory Commission (CSRC) approved two Hong Kong Stock ETFs. The two ETFs were subsequently listed on Shenzhen Stock Exchange and Shanghai Stock Exchange separately on 22 October 2012 hence allowing Mainland investors to gain indirectly access to the Hong Kong market.

Dual-counter trading: In October 2012 first dual counter security commenced its trading on SEHK. A dual counter security offers two counters denominated in different currencies e.g RMB and Hong Kong dollar. The two currency counters of the same stock are inter-transferrable for trading and settlement. A major benefit of a dual

counter security for investors is the convenience of being able to trade in either one of the currencies. Currently there are seven dual counter securities including RQFII A-Shares and RMB Bond ETFs and one equity securities are traded in both Hong Kong dollar and RMB.

Regulating ATS and dark pools: From October 2012, SEHK participants are required to flag trades executed in dark pools by labelling them as alternative liquidity pools (ALP) on trades in Hong Kong listed securities executed in dark pools. SEHK has also started publishing on its website an aggregate ALP trade percentage figure on a monthly basis. With the new requirement and information, SFC has been able to monitor more closely the local development of dark pools. From April 2012 to March 2013, ALP trades accounted for about 2.2% of the total turnover in the Hong Kong securities market. On the other hand, the number of corporations that are licensed to provide automated trading services (ATS) remained at 22 as at 31 March 2013, including 13 dark pool operators.

Implementing risk control of clearing houses: In November 2012, HKEx implemented improvement in the risk management controls of its clearing houses and thus their overall soundness. Key measures include introducing a margin requirement and a dynamic guarantee fund in the securities market, strengthening stress testing assumptions for all clearing houses and implementing measures that help alleviate the financial burden of clearing participants.

Reporting short positions in stocks: To increase market transparency, SFC began in September 2012 weekly publication of the aggregate reported short positions in specific shares. The new reporting regime enables the SFC to better monitor potential risks or concentrations in our markets and also gives market participants useful information.

Transfer of B-shares listed on Mainland exchanges to H-shares listing in Hong Kong: In December 2012, the B-shares of China International Marine Containers (Group) Co, Ltd were successfully converted to list as H-shares by introduction on SEHK.

Statutory backed disclosure regime for listed companies: With effect from 1 January 2013, all listed companies are required by law to disclose important developments in a timely manner. Previously disclosure regime was governed by Listing Rules of SEHK. Breaches of this statutory requirement can result in sanctions imposed by the Market Misconduct Tribunal.

HKEx's acquisition of LME: HKEx completed its the acquisition of London Metal Exchange (LME) in December 2012. The acquisition of the LME, the world's leading exchange for the trading of base metals futures and options contracts, enhances HKEx's position as China's link to international markets and investors. The LME also gives HKEx new multi-asset-class capabilities and accelerates its expansion into commodities, currency and fixed income.

RMB denominated MM Fund: In January 2013, SFC authorized the first RMB-denominated money market fund which is also available for investment by mandatory provident fund schemes.

Next Generation Data Centre: In January 2013, HKEx opened its Next Generation Data Centre to further strengthening HKEx's technological infrastructure. The new Data Centre is among the first Exchange built data centres in the Asia-Pacific region to reach the internationally recognised Tier 4 standard and is the centerpiece of HKEx Orion Technology Initiatives. The new Data Centre enables high capacity trading and ultra-low latency price information with a suite of market data products, giving market participants more options for trading and data services.

After-Hours Futures Trading (AHFT): The AHFT session on Hong Kong Futures Exchange Limited commenced trading on 8 April 2013. The HSI and HSCEI futures contracts are available for trading during 5:00-11:00 pm (HK time). From 8 April to 30 June, the average daily turnover of the HSI and HSCEI futures during the AHFT session amounted to 3,277 contracts and 2,574 contracts respectively, which were about 3.9% and 3.3% of the trading during normal trading sessions. More than 100 brokers have participated in the AHFT trading, including both local and international brokers.

Establishment of a clearing house for OTC derivatives (OTC Clear): In April 2013, HKEx established a new clearing house with 12 other financial institutions for the clearing of deliverable and non-deliverable RMB-denominated OTC derivatives. The OTC Clear is designed to capitalise on Hong Kong's offshore RMB centre. The OTC Clear is expected to commence operation within 2013 upon receiving the regulatory approvals.

The Hong Kong Mercantile Exchange Ltd (HKMEx) ceased trading: The short lived commodities exchange commenced its business in March 2009 for the trading of commodity futures, options and other financial derivatives. Due to insufficient revenue to support its operating expenses, HKMEx ceased trading from 17 May 2013.

Enhanced IPO Sponsor regime: The new regulatory requirements will apply to listing applications submitted from 1 October 2013. The new rules focus on the need for IPO sponsors to thoroughly understand the companies seeking a listing in the Hong Kong stock market before a listing application is made. The new regime emphasises early, comprehensive due diligence and a properly drafted prospectus to accompany the application.

Prospects

Offshore RMB centre: Hong Kong is crucial to the process of transforming the RMB into an internationally accepted and widely used currency. As mainland China continues to open its financial markets, it is envisage greater opportunities for the investment of offshore RMB on the Mainland China.

Broadening scope of RMB products: In the past year, Hong Kong's positioning as a premier offshore RMB centre has strengthened its role in driving the process of transforming the RMB into an internationally accepted and widely used currency. A number of key milestones in broadening the scope of authorized RMB products have been achieved. Since the rollout of the RQFII scheme in December 2011, SFC and Mainland China authorities have been maintaining a close dialogue to facilitate the expansion of the regime with a view to enable more market

players to set up in Hong Kong to participate in the scheme and to allow more flexibility in the underlying investments and product design of RQFII funds.

Mutual recognition of funds: Hong Kong and Mainland China securities regulators are studying the possibility of mutual recognition of funds between Hong Kong and the Mainland China. Under this proposal, it is envisaged that qualified SFC authorized funds domiciled in and operating from Hong Kong would be “recognised Hong Kong funds” and qualified Mainland funds would be recognised Mainland funds.” These funds could then obtain authorizations and be sold directly in each other’s markets.

Open-ended investment company structure: To complement the existing Hong Kong unit trust regime, the Government and SFC are working on legal and regulatory framework to allow an open-ended investment company structure for investment funds to domicile in Hong Kong.

The HKEx Orion Central Gateway: is the second building block in the HKEx's next generation platform roadmap, and will be rolled out for HKEx’s securities market in the fourth quarter of 2013.

Electronic trading regulations: In tandem with global regulatory developments, new measures will be implemented in 1 January 2014 to enhance the existing regulatory framework for electronic trading. The new measures require licensed or registered persons to put in place appropriate and specific policies, procedures and controls to ensure that their electronic trading activities will not pose undue risks to the market.

OTC derivatives regulation: The Securities and Futures (Amendment) Bill 2013, which is mainly concerned with over-the-counter (OTC) derivatives and their regulation pursuant to agreements reached amongst the G20 countries following the global financial crisis, was introduced to the Legislative Council in July 2013. It is anticipated that, subject to the enactment of necessary legislation, a new regulatory regime governing the conduct of OTC derivatives business will be introduced in 2014.

Alternative liquidity pools: In response to global and local growth of ALPs (commonly referred to as “dark pools”), SFC is reviewing the regulatory requirements and the standards of conduct expected of operators of off exchange trading platforms. Relevant regulations in connection with dark pools are expected to be introduced in the future.