



Monetary Policy Workshop on Strengthening
Macroprudential Frameworks

22-23 March 2012

Tokyo, Japan

**Macroprudential policies and their effectiveness –
The case of Hong Kong**

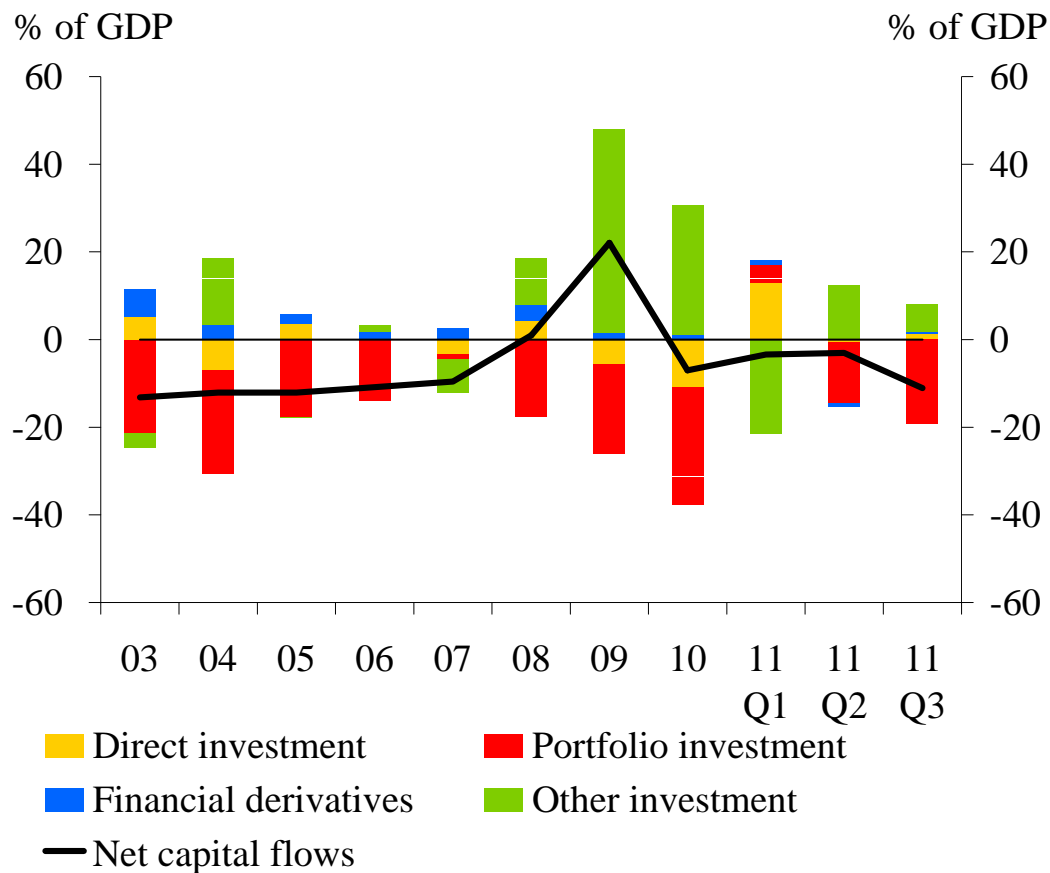
**Cho-hoi Hui
Research Department
Hong Kong Monetary Authority**

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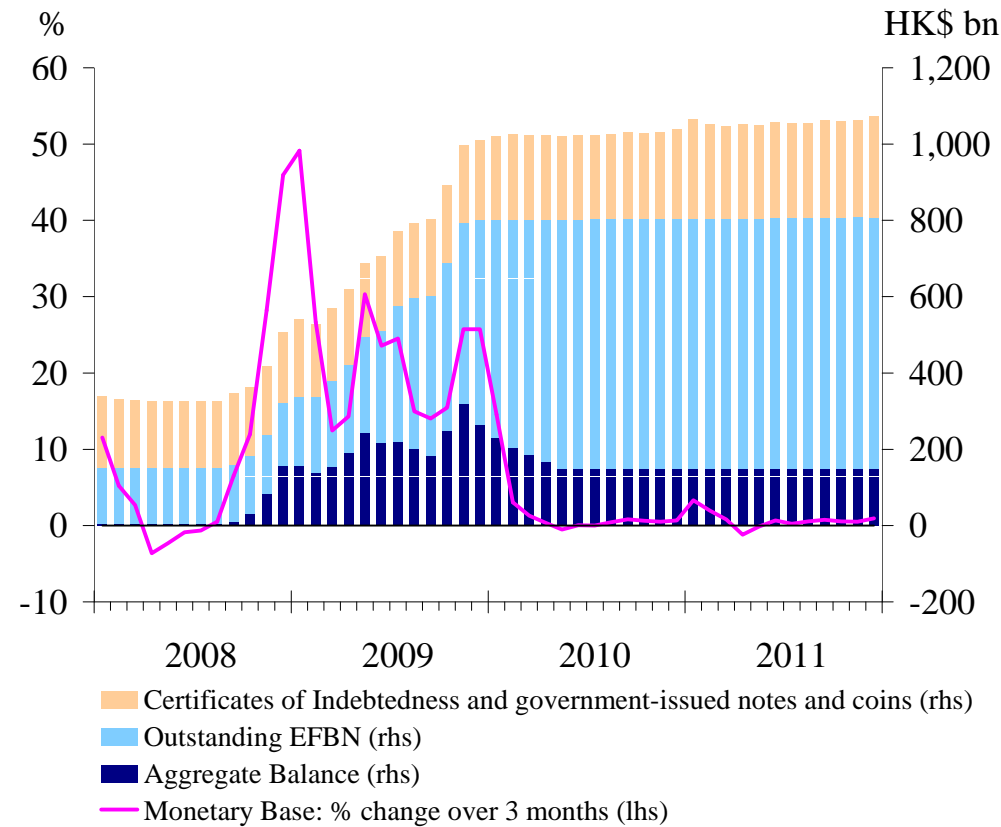


Capital inflows since 2009

Cross-border capital flows to Hong Kong



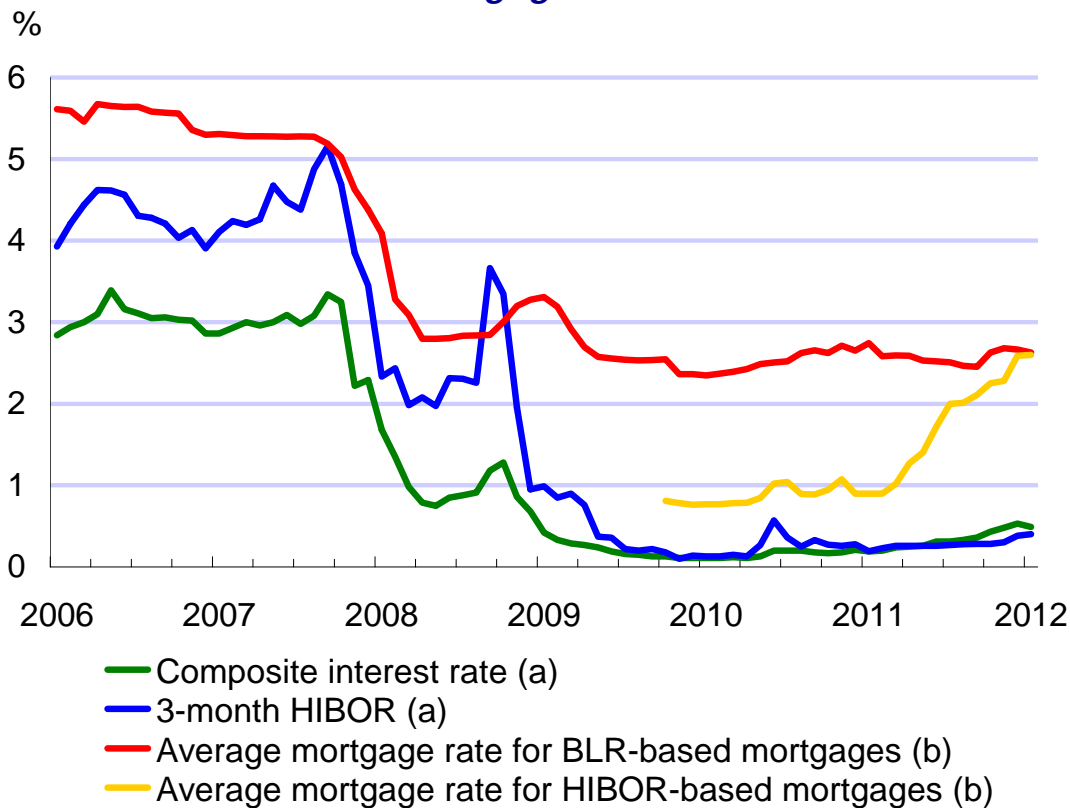
Monetary base of Hong Kong



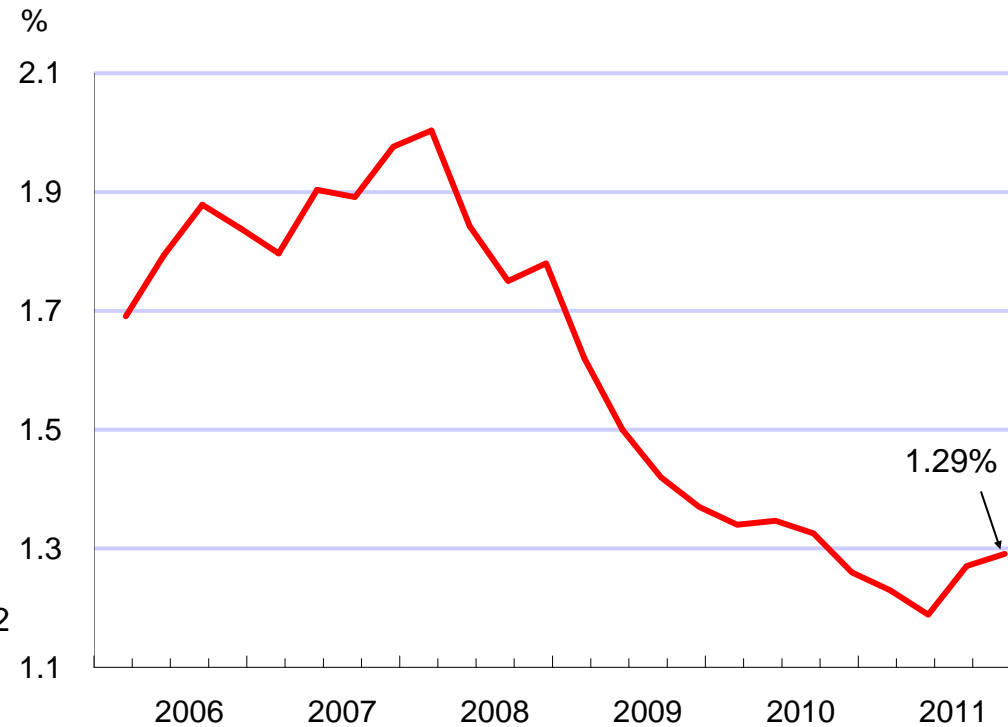


The impact on HK's banking sector

*Cost of funds, interbank interest rates,
mortgage rates*



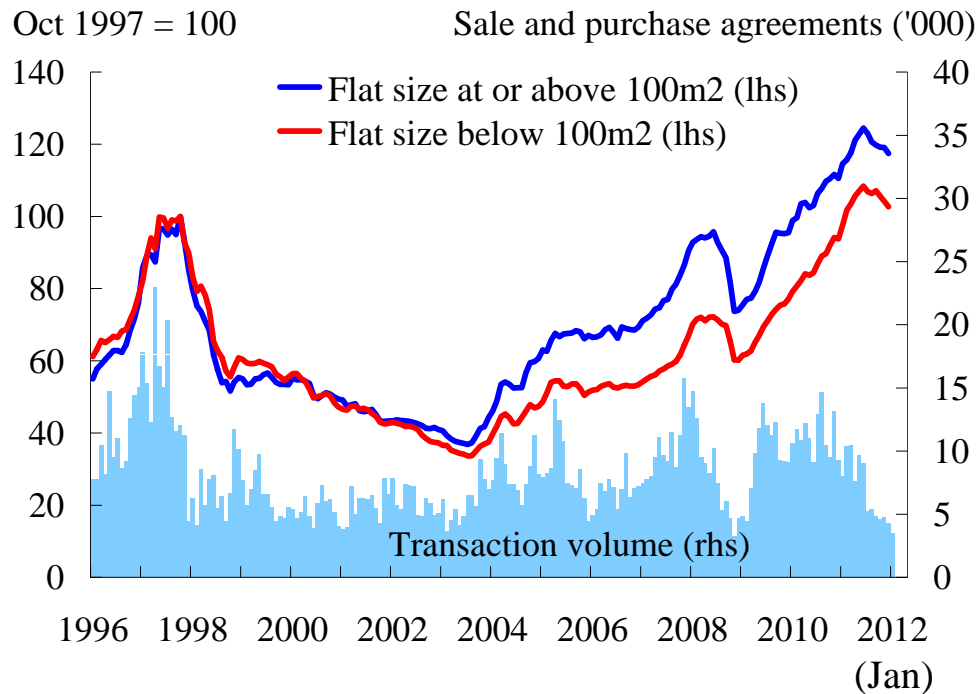
Net Interest margins



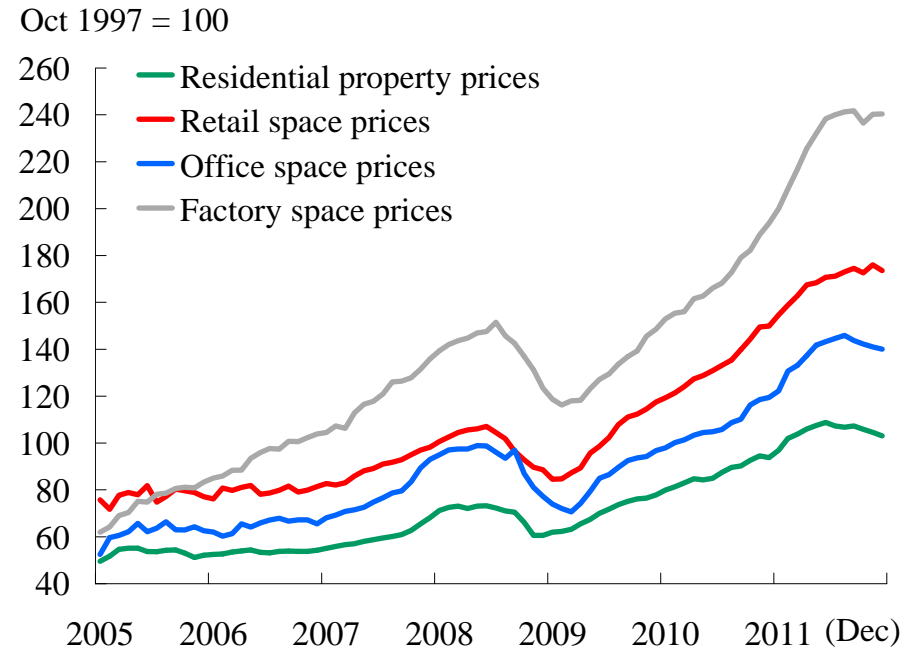


The impact on HK's property market

Residential property prices and transaction volumes



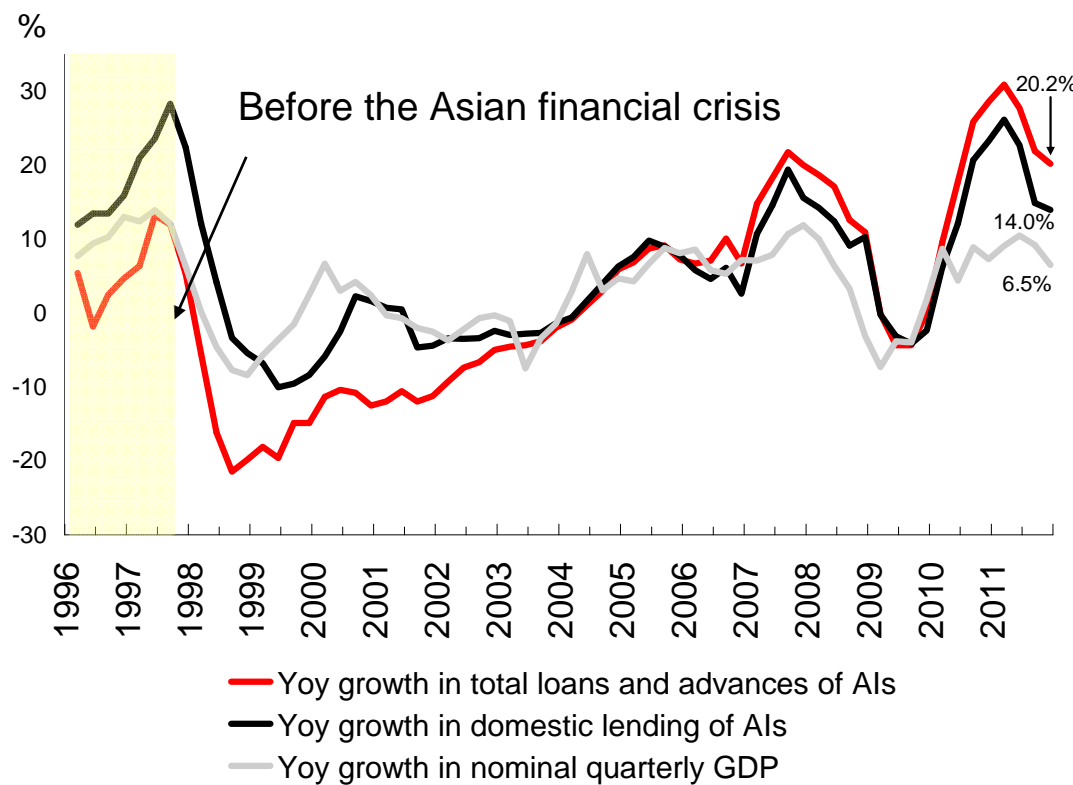
Property prices by property type



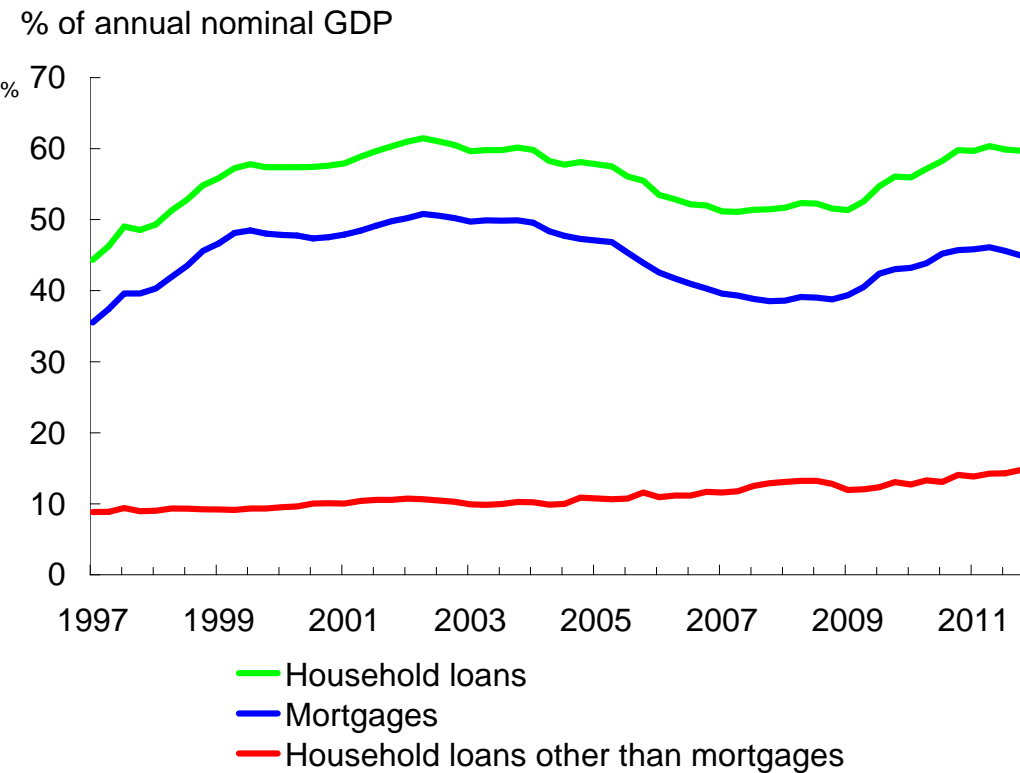


Risks to the banking sector

Strong credit growth amid the capital inflows

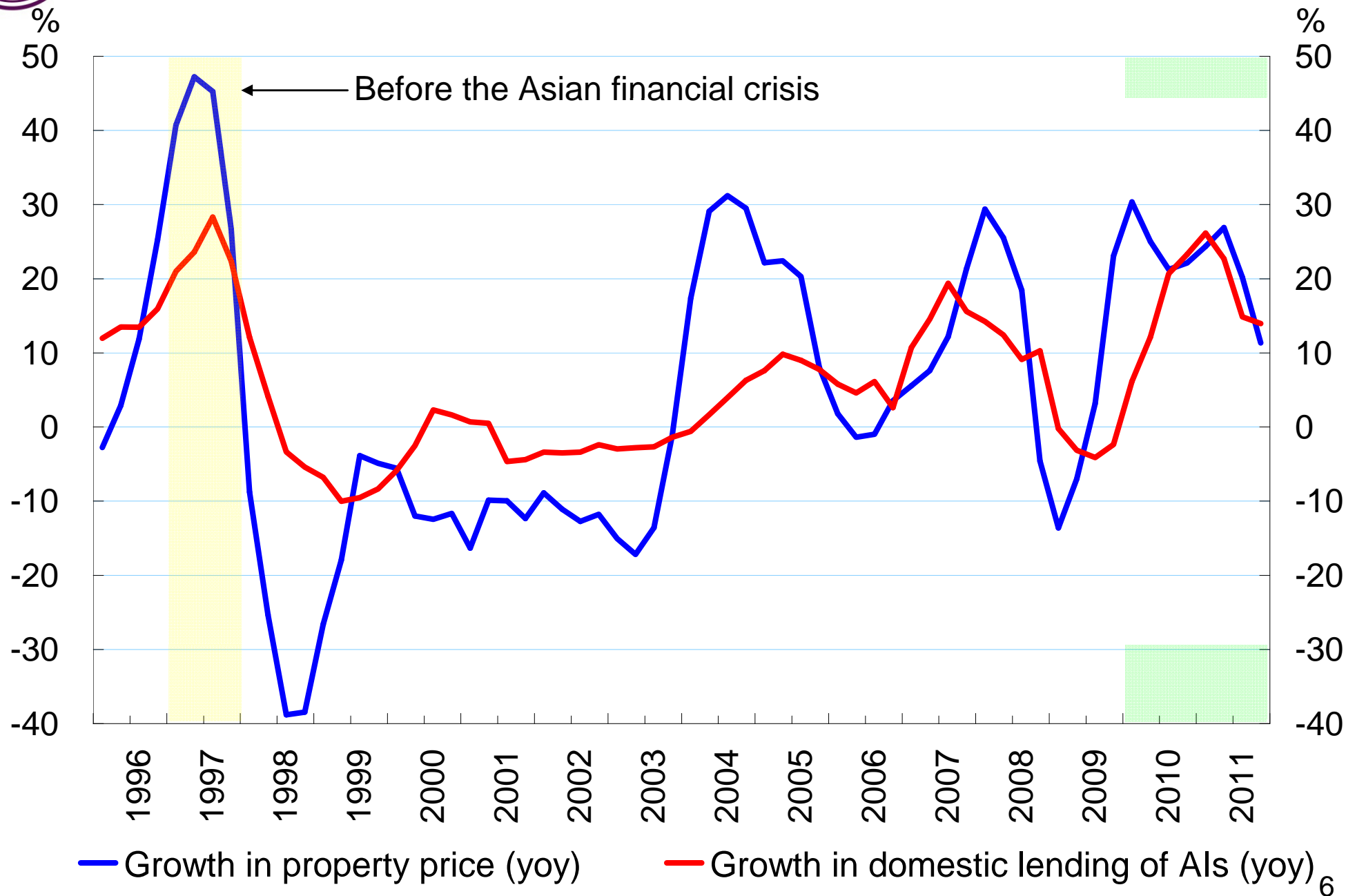


Increasing household leverage





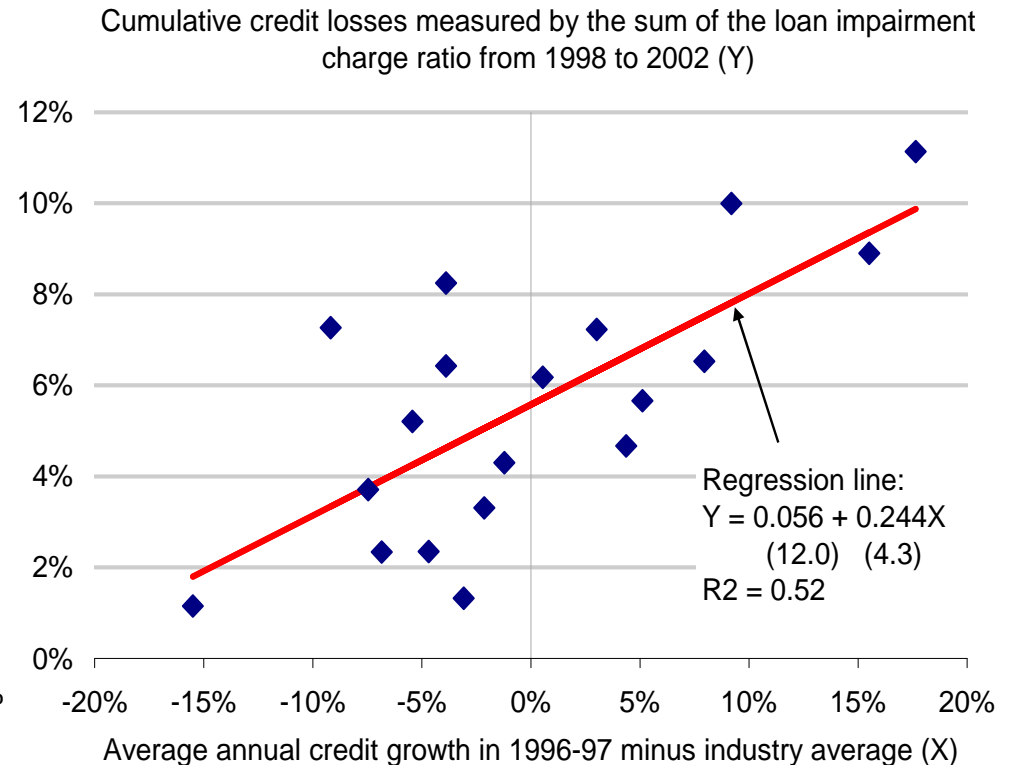
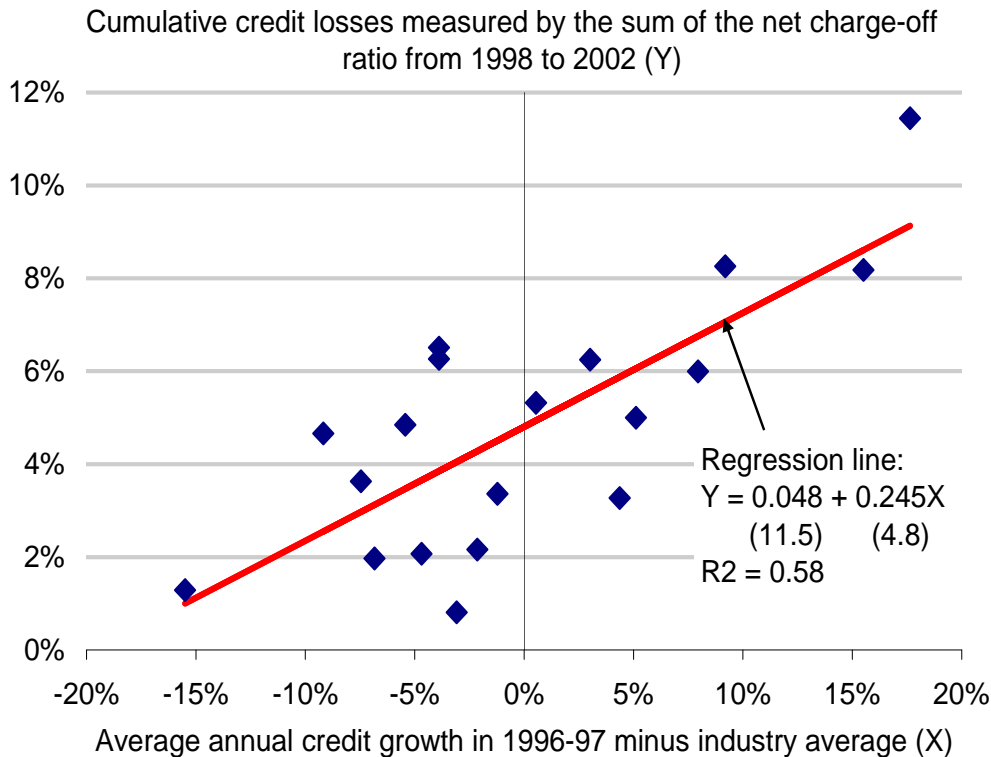
Risk of credit-asset price spirals





Evidence from the AFC: The impact of rapid credit growth on latent credit risk

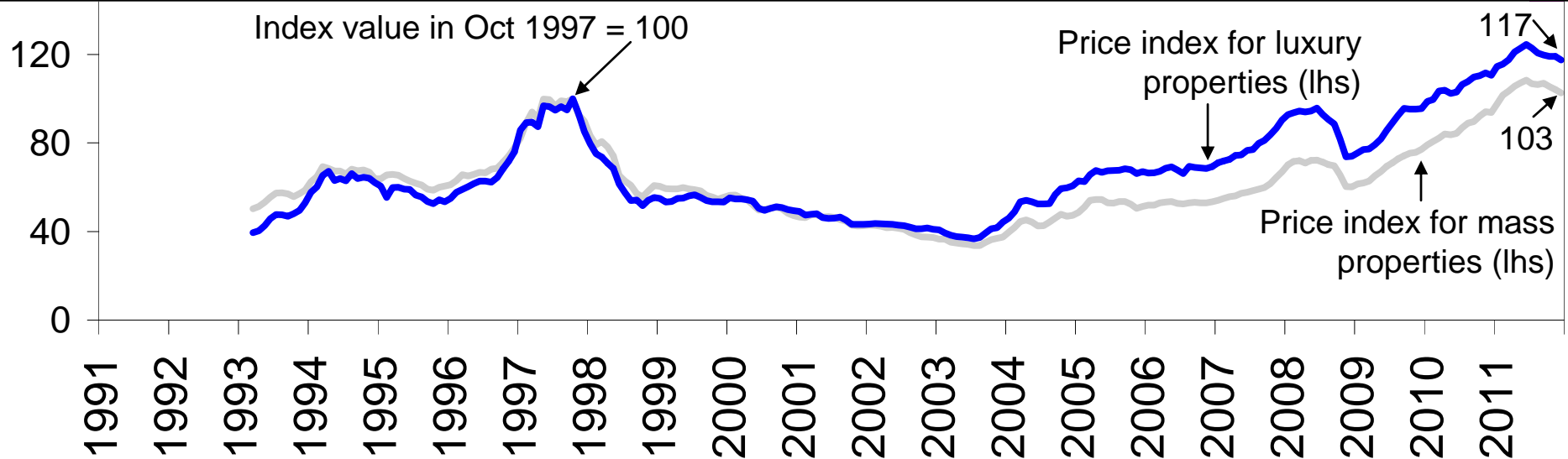
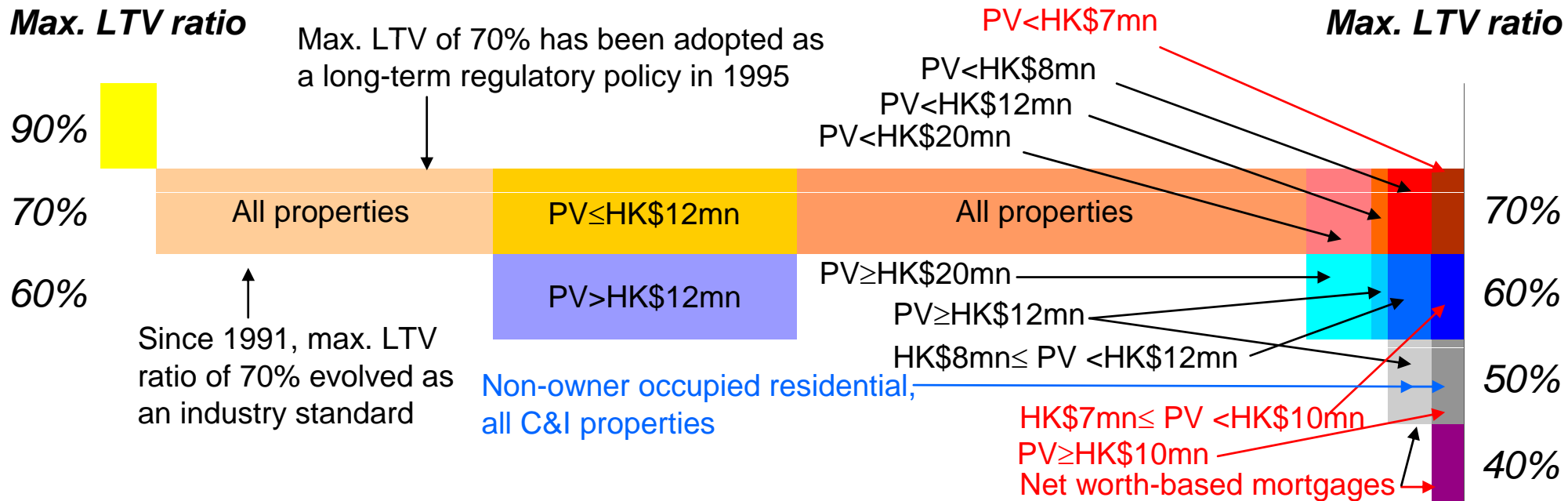
Strong bank-level evidence of a positive relationship between rapid credit growth and credit losses





Loan-to-value policy in HK

A tool to mitigate the amplification of credit-asset price spiral and to protect banks from the disruptive effects





A summary of recent tightening of LTV caps

- Oct 2009: LTV cap lowered from 70% to 60% for properties valued \geq HK\$20mn
- Aug 2010:
 - LTV cap of 60% for properties valued \geq HK\$12mn
 - LTV cap maintained at 70% for properties valued $<$ HK\$12mn but loan amount capped at HK\$7.2mn
 - LTV cap for non-owner-occupied properties lowered to 60%
- Nov 2010:
 - LTV cap lowered to 50% for properties valued \geq HK\$12mn
 - LTV cap lowered to 60% for residential properties valued HK\$8mn-12mn, with a max. loan amount of HK\$6mn
 - LTV cap for residential properties valued $<$ HK\$8mn maintained at 70% but max. loan amount capped at HK\$4.8mn
 - LTV lowered to 50% for all non-owner-occupied residential properties, properties held by a company, and industrial and commercial properties.



A summary of recent tightening of LTV caps (continued)

- June 2011:
 - LTV cap lowered to 50% for residential properties valued \geq HK\$10mn
 - LTV cap lowered to 60% for residential properties valued HK\$7mn-10mn, with a max. loan amount of HK\$5mn
 - LTV cap maintained at 70% for residential properties valued <HK\$7mn, with max. loan amount capped at HK\$4.2mn
 - LTV cap lowered from 50% to 40% for properties under the net worth-based mortgage
 - LTV cap lowered by 10 percentage points for mortgage loan applicants with principal income not derived from HK



An empirical assessment on the effectiveness of LTV policy

- Mortgage delinquency ratios for economies with LTV policy are found to be less responsive to property price shocks
- Mixed evidence of the dampening effect of tightening of LTV caps on property market activities
 - For Hong Kong, although we find that tightening of LTV caps would reduce property price growth, the policy effect on the property price gap (from the trend) and property transactions is statistically insignificant
- However, there is strong empirical evidence that tightening of LTV caps would reduce household leverage
- For details, see Wong et al. (2011), “Loan-to-value ratio as a macroprudential tool – Hong Kong’s experience and cross-country evidence”, HKMA Working Paper 01/2011

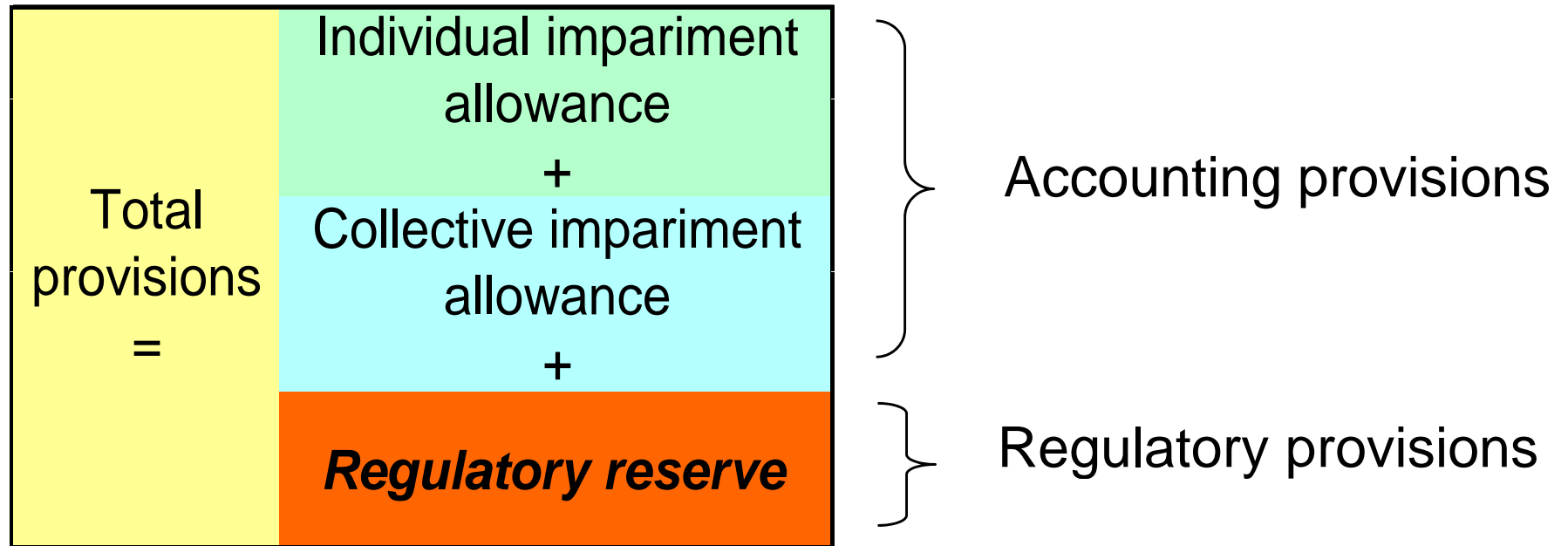


Other macroprudential policies:

- 40% limit on banks' residential mortgage loans as a fraction of their total loans (introduced in 1994 and had been removed in 1998)
- 50-60% limit on debt servicing ratio (loan repayment to income). In 2010, standardise the limit to 50% and require banks to stress test borrowers repayment ability (by assuming a 2% increase in mortgage rates)
- Regulatory reserves



Regulatory reserves

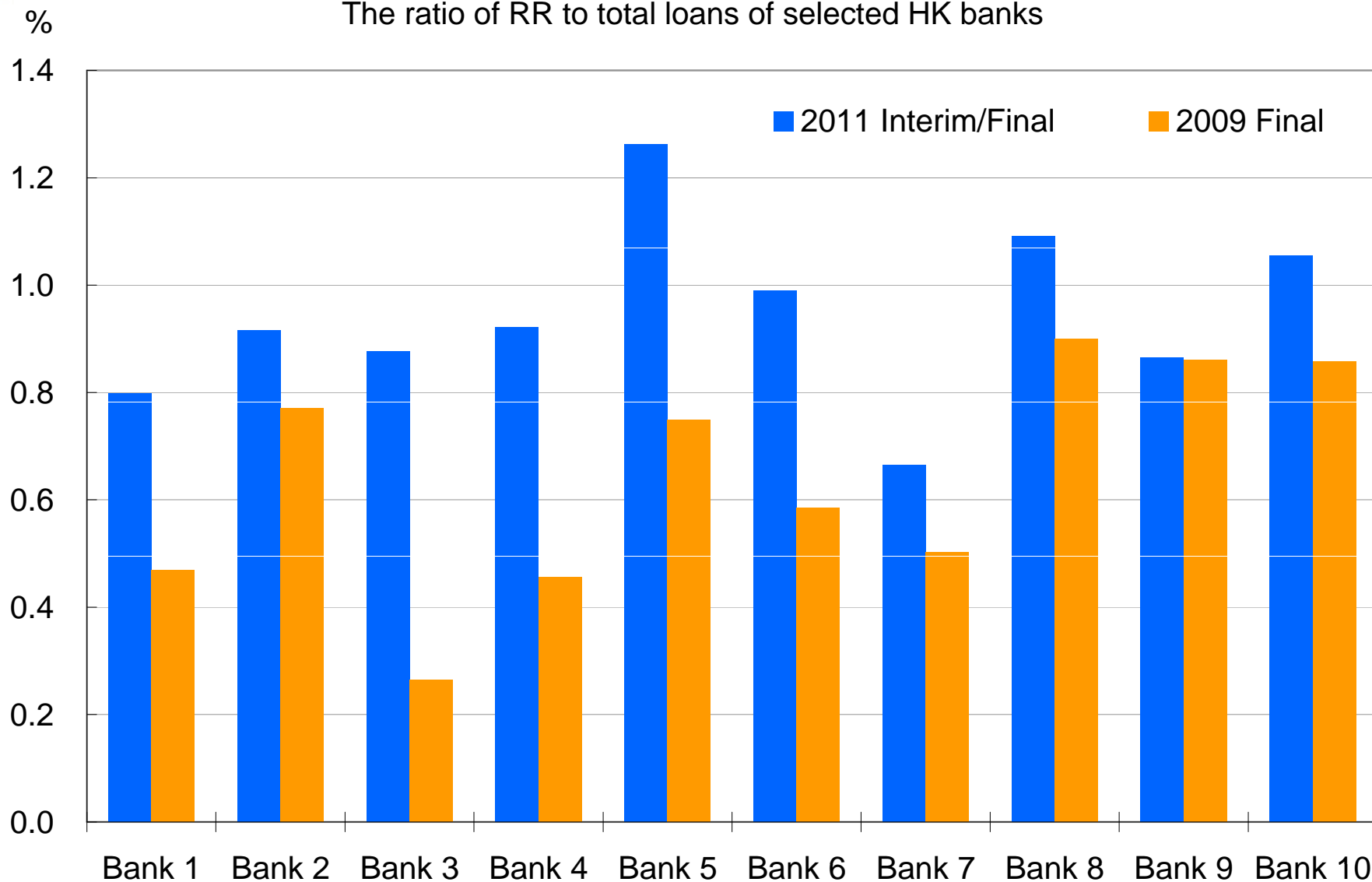


- Regulatory reserve (RR) is a non-distributable reserve earmarked or appropriated against the retained earnings of banks.
- RR ranges between 0.5% and 1% of total loans, depending on historical loss experience and HKMA's consent.
- RR must be disclosed by banks in their financial reports.



Regulatory reserve amid the current credit boom

The ratio of RR to total loans of selected HK banks



- Source: Banks' financial disclosures.



Other policies: Special Stamp Duty

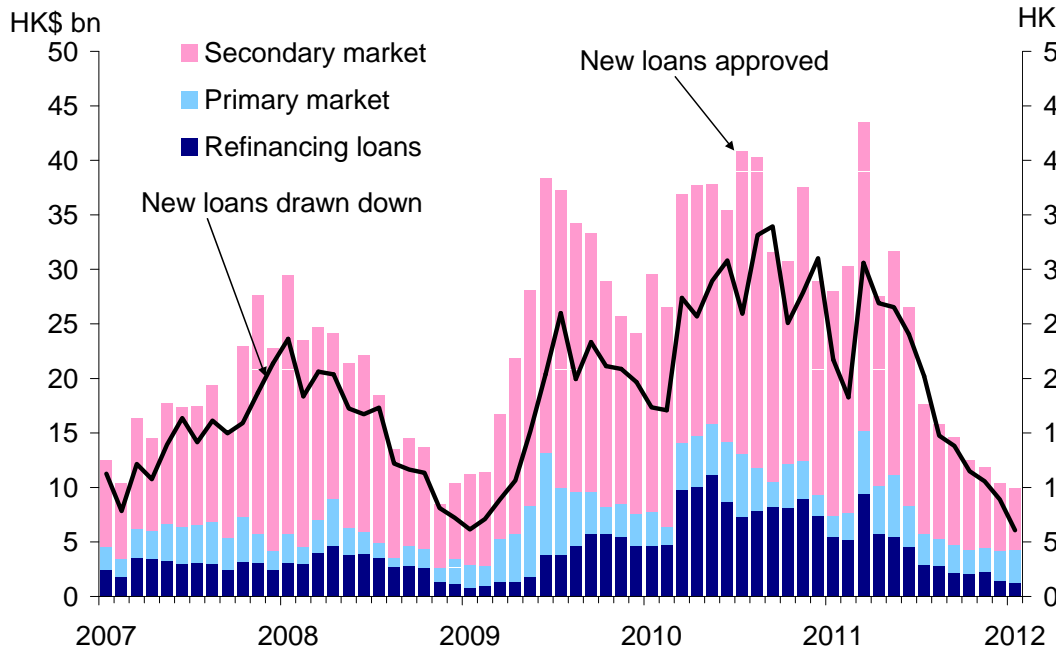
- In Nov 2010, Special Stamp Duty (SSD) was introduced on residential properties to curb speculation.
- On top of the basic progressive stamp duty of up to 4.25% of property value, SSD is imposed on residential properties which are acquired on or after 20 Nov 2010 and held within 24 months.

Resold after the property has been held for:	SSD as % of property value
≤6 months	15%
6-12 months	10%
12-24 months	5%

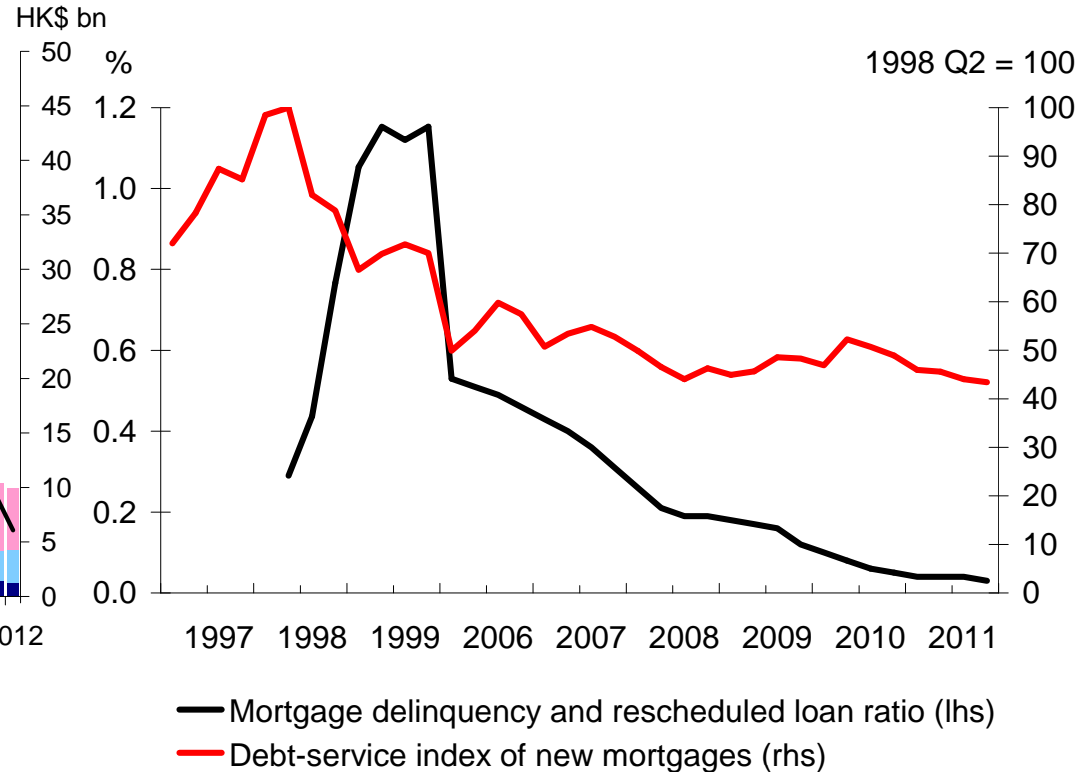


Policy effects: mortgage lending and debt-servicing burden

Mortgage lending



Debt-servicing index of new mortgages

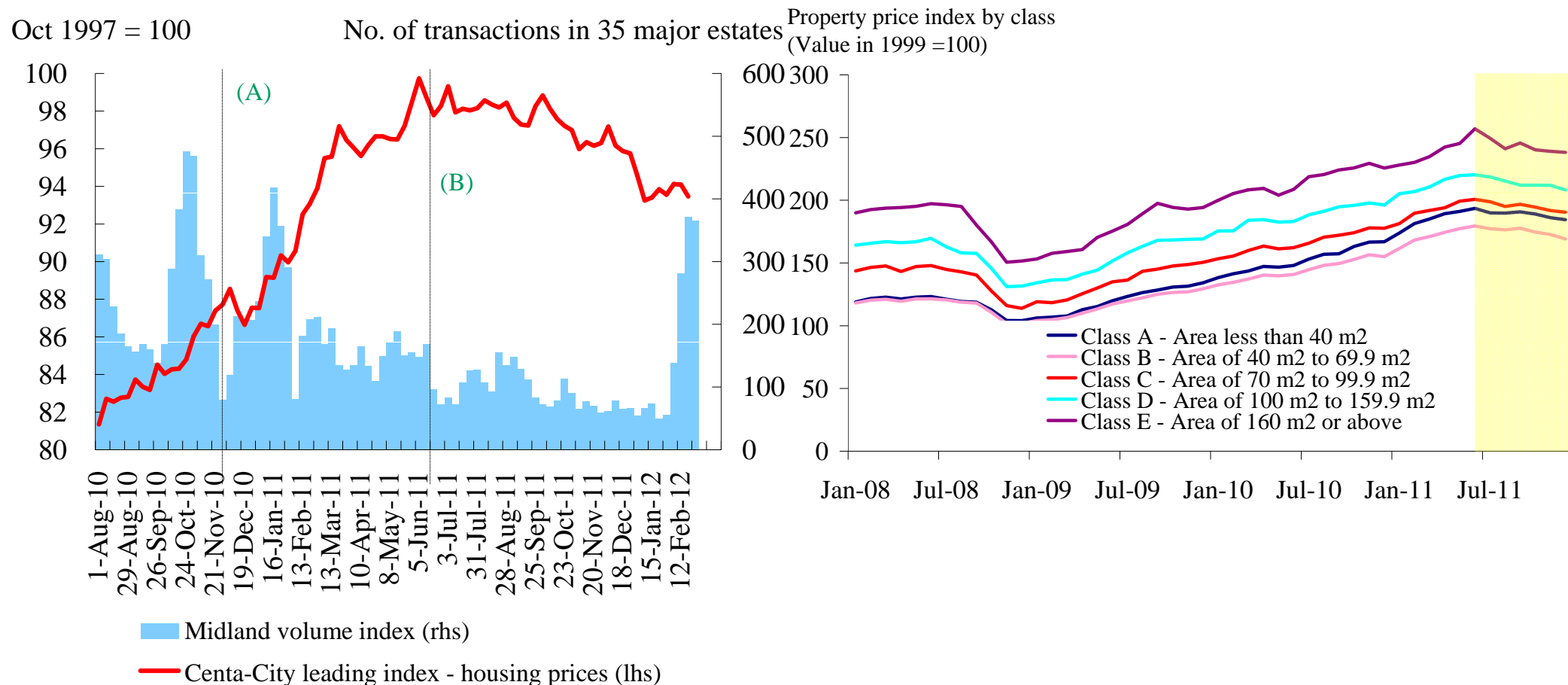




Policy effects: property market activity

Transactions

Property prices



(A) - introduction of SSD and macro-prudential measures

(B) - further round of macro-prudential measures



Conclusion

1. Financial stability in Hong Kong is largely dependent on the external environment.
2. The unusually low interest rate environments and capital inflows in the region are prone to credit-asset price spirals.
3. In the absence of independent monetary policy, macroprudential policy takes a pivotal role in safeguarding banking stability in Hong Kong.
4. While the various macroprudential measures were introduced in a relatively short period of time, some of their effects can be observed. Property lending growth has appeared to slow down somewhat in recent months and the property market also has shown declines in transaction volume and prices moderately.