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Hong Kong - Contingent Bank Capital Facility

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Abstract

On October 14, 2008, the Hong Kong Monetary Authority (HKMA) announced that it would use Hong Kong's Exchange Fund to set up a fund to provide standby capital to banks should the need arise. (October 14 Press Release). The so-called Contingent Bank Capital Facility (CBCF) would be available until the end of 2010 to shore up depositor and investor confidence in the local banking sector and was introduced in parallel with a broader set of announced measures including a consumer bank deposit guarantee and a number of liquidity initiatives. Twenty-three locally incorporated "Authorized Institutions" would be eligible to access CBCF capital upon request (Annual Report 2008, 197; October 14 Press Release). The provisioning of CBCF capital would be accompanied by oversight from the HKMA. When it announced the creation of the CBCF, the Hong Kong government refrained from formalizing the structure or terms of any CBCF capital, leaving it up, instead, to the discretion of future HKMA staff. (Two Measures, p3). The CBCF was never accessed. The program was initially scheduled to expire at the end of 2010 and government kept to this commitment. (Expiry of CBCF).

Keywords: Capital injection, Hong Kong,

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Contingent Bank Capital Facility

At a Glance

Even in the midst of the Global Financial Crisis (GFC) October 2008, Hong Kong's domestic financial sector remained in fairly strong shape. Capital levels at an industry-wide level were at 14%, well over the 8% capital cushion that Basel II mandated. Nevertheless, the Hong Kong Monetary Authority, cognizant of the indispensable role that the banking sector played in the domestic Hong Kong economy, resolved to take a number of precautionary measures in order to preempt any distress.

In addition to a number of other interventions including a temporary guarantee of all consumer deposits, and five temporary liquidity provisions, The Financial Secretary announced on October 14, 2008 that the Exchange Fund would be used to provide stand-by capital to banks should the need to arise under a program known as the Contingent Bank Capital Facility (CBCF). Locally incorporated "Authorized Institutions" would be able to request capital from the CBCF on an as-needed basis.

Summary of Key Terms	
Purpose: "To further enhance confidence in the local banking system and maintain banking stability" (November 21 Testimony, p21) by "making available additional capital to locally incorporated licensed banks, on request and subject to supervisory scrutiny should this become necessary." (October 14 Press Release).	
Announcement Date	October 14, 2008 (October 14 Press Release)
Operational Date	October 14, 2008 (October 14 Press Release)
Sunset Date	December 31, 2008 (Expiry of CBCF)
Program Size	Not specified. Maximum size would be the total size of the Exchange Fund
Usage	None (Expiry of CBCF)
Outcomes	
Notable Features	

The HKMA refrained from formalizing the structure or terms of any CBCF capital. As the HKMA originally anticipated, the CBCF was never accessed. The program was allowed to expire at the end of 2010.

Summary Evaluation

No CBCF capital was ever deployed and for perhaps this reason, there has been no scholarly analysis into the effectiveness of the facility. There is, however, that the announcement of the CBCF, in concert with the announcement of other programs both in Hong Kong and globally had an effect in global markets. Equity markets, particularly financials surged on the news, and interbank lending rates dropped. (Stocks Surge). However, it is hard to disentangle any effects that CBCF might have had from other programs.

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I. Overview

Background

As an international financial center, home to many of the largest global banks, Hong Kong was affected by the 2008 global financial crisis (GFC). However, compared to many other developed economies, Hong Kong's domestic financial sector weathered the onset of the GFC quite well. (Work of HKMA, 7). Hong Kong has historically had a very vibrant real estate sector with some of the highest real estate prices in the world. And while residential real estate prices dropped by 11% in 2008 (Annual Report 2008, 7), Hong Kong's NPL ratio, which had been below 1% prior to the crisis, increased only very slightly to just a little over 1% at the end of 2008. (Work of HKMA, 7) bank balance sheets, therefore, did not suffer significant asset depreciation. Furthermore, the Hong Kong banking sector, in aggregate, was well-capitalized and well-poised to absorb any significant asset depreciation, should it occur. While Basel II lay out international standards of an 8% capital cushion, Hong Kong banks at an industry-wide level, had a capital cushion of over 14%. (Viewpoint CBCF).

Nevertheless, the Hong Kong government, cognizant of the central role that the banking sector played in Hong Kong's economy, was concerned about the possible impact that the GFC might have on Hong Kong's economy. As a result, after the fall of Lehman Brothers, the Hong Kong Monetary Authority (HKMA) promptly took a number of precautionary steps to help preempt liquidity and solvency concerns. On October 14, 2008, the HKMA and the Financial Secretary John Tsang, having already enacted five liquidity measures, guaranteed all consumer bank deposits, and created the Contingent Bank Capital Facility (CBCF), a standby facility, to provide standby capital to banks should the need arise. (October 14 Press Release). The two programs (the full bank deposit guarantee and the CBCF) would be available until the end of 2010 to shore up depositor and investor confidence in Hong Kong's banking sector. (October 14 Press Release).

Program Description

On October 14, 2008, the Hong Kong Monetary Authority (HKMA) announced that it would use Hong Kong's Exchange Fund to set up a fund to provide standby capital to banks should the need arise. (October 14 Press Release). The so-called Contingent Bank Capital Facility (CBCF) would be available until the end of 2010 to shore up depositor and investor confidence in the local banking sector and was introduced in parallel with a broader set of announced measures including a consumer bank deposit guarantee and a number of liquidity initiatives.

Deposit-taking institutions in Hong Kong are classified into three tiers by the HKMA. "Deposit-taking Companies" engage in consumer finance and securitization and can accept deposits of HK$100,000 or more. "Restricted License Banks" are primarily merchant banking and capital market-focused ventures and may only accept deposits of HK$500,000 or more. Finally, "Licensed Banks" may only offer current and savings accounts but are permitted to accept deposits of any size and maturity from the public. Collectively, these companies are referred to as "Authorized Institutions" (AIs). (Three-tier Banking System). Of the 145 licensed banks that operated in Hong Kong at the end of 2008, only the 23 that were locally incorporated in Hong Kong were eligible to access CBCF capital should the need arise. (Annual Report 2008, 197; October 14 Press Release). (For the full list of locally incorporated licensed banks that were eligible to access the CBCF, please refer to KDD 6).

The Banking Ordinance of Hong Kong, a series of laws that govern most financial issues, lays out the authorization criteria that the HKMA uses to determine its list of authorized institutions. Only institutions that meet certain capital and liquidity thresholds and engage in accounting practices and other similar standards are authorized. (Banking Ordinance, Part XVIA, 97H). This preexisting list, which the HKMA regularly reviews and updates, was the basis for determining which institutions were eligible to receive CBCF capital.

The CBCF was, from its conception, precautionary in nature. On October 23, 2008, just over one week after announcing the CBCF, Joseph Yam, then the Chief Executive of the HKMA, wrote an expansive note that discussed aspects of the CBCF and candidly assessed the macroeconomic environment that spawned it. Writing specifically about the likelihood of banks drawing on the program, Yam wrote, "I believe it is unlikely that the capital cushions of the local banks will, in the next two years, be eroded to such an extent as to require drawing on the CBCF, although some erosion may be possible, either directly as a result of the impairment of financial assets induced by the financial crisis or indirectly as deteriorating economic conditions affect the repayment ability of borrowers. I expect such erosion, should it occur, to be small." (Viewpoint CBCF). This expectation would prove to be well-founded as the CBCF was never ultimately drawn upon.

In the unlikely event that a bank might face a capital crisis, Yam argued that it was preferable for a bank to first attempt to seek financing from private sources, both so that the government would not need to make a commitment, and so that the individual bank would not be beholden to the accompanying supervision and regulation. He wrote, "I obviously cannot exclude the possibility of individual banks finding themselves in a position of having to raise additional capital to replenish their cushions. I certainly hope that, should this happen, it will be when the worst of the financial crisis is over and the global financial system has started to function properly again, so that it will be easier to raise capital in the market. This would of course be preferable to using the CBCF considering the necessary supervisory conditions and restrictions attached to it." (Viewpoint CBCF).

Because the banking sector was not in need of urgent capitalization, the CBCF was, at its heart, much more about boosting confidence among skittish investors. Yam observed that even in the face of fundamental stability in the Hong Kong banking sector, market anxiety persisted. "Robust facts and figures might not be enough to sustain confidence in a situation of fear and uncertainty. There is therefore a need to ensure that the banking system is both well capitalised and seen to be so, hence the temporary Contingent Bank Capital Facility (CBCF)." (Viewpoint CBCF). Later, he added, "the existence of the CBCF provides comfort to all on the availability of additional capital. This comfort is particularly important now." (Viewpoint CBCF).

The HKMA did not establish universal terms instead preferring to leave them up to the discretion of future HKMA staff. In an HKMA-authored paper presented at the October 17, 2008 meeting of the Legislative Council's Panel on Financial Affairs, it wrote, "The form and terms of any CBCF Capital will be decided on the basis of individual circumstances, and local banks receiving any such capital will be obliged to accept conditions or restrictions deemed appropriate by the HKMA to safeguard the financial commitment represented by the CBCF." (Two Measures, p3). Similarly, HKMA refrained from making a formal commitment to fund the CBCF. CBCF capital, should it be needed, would be drawn from the Exchange Fund on an as needed basis.

The primary objective of Hong Kong's Exchange Fund, as laid out in the Exchange Fund Ordinance, is to maintain the Hong Kong dollar's peg to the US dollar. Additionally, however, the Financial Secretary may, "with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and integrity of the monetary and financial systems of Hong Kong." (Exchange Fund Ordinance, 3(1A)). Historically, the government has displayed a willingness to creatively deploy the fund to promote financial stability and prevent capital flight including by buying up blue-chip equities in the late 1990s. (Blue-chip) From an operational standpoint, the Exchange Fund is a bit like a sovereign wealth fund, holding mostly US dollar denominated assets and generally investing conservatively. (This is a general statement, so not sure it needs to be cited, but here's an article that discusses the Exchange Fund's holdings https://www.scmp.com/business/banking-finance/article/3019923/hong-kongs-exchange-fund-earns-record-hk1708-billion-first) While it would have been unprecedented for a program like the CBCF to draw from the Exchange Fund, the stated purpose of shoring up the capitalization of the banking sector as a whole was consistent with the Exchange Fund's statutory mandate to "maintain the stability and integrity of Hong Kong's monetary and financial systems." (Exchange Fund Ordinance, 3(1A)).

While designating the Exchange Fund as responsible for funding the CBCF, the government didn't make a formal commitment in terms of scale of the program. That said, the HKMA did not expect to have to make any outlays, reporting to the Financial Affairs panel, "We therefore do not expect that the new measures would need to be triggered." (Two Measures, p4). At the end of 2008, the Exchange Fund had HK$1.4 trillion or approximately $180 billion in assets under management. (Annual Report 2008, 56) As a point of comparison, total bank deposits in Hong Kong at the time were estimated at around HK$6 trillion or approximately $771 billion. (Citation needed).

The HKMA did not expect to have to make any outlays, reporting to the Financial Affairs panel, "We therefore do not expect that the new measures would need to be triggered." (Two Measures, p4).

Outcomes

As HKMA originally anticipated, the CBCF was never accessed. The program was initially scheduled to expire at the end of 2010 and government kept to this commitment. (Expiry of CBCF).

II. Key Design Decisions

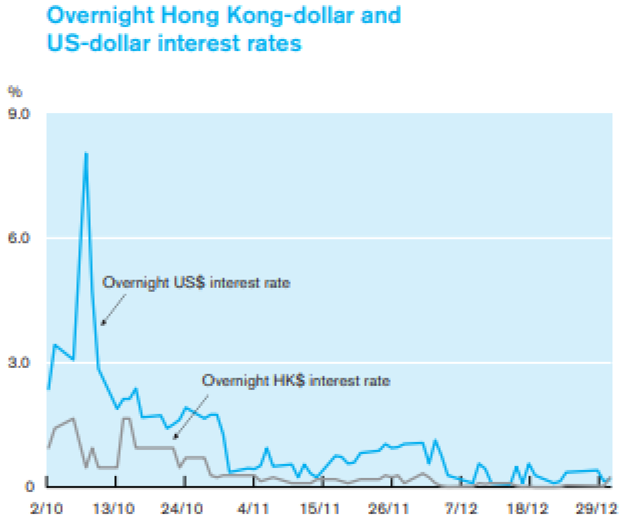
1. The CBCF was a component of a broader series of interventions.

The CBCF was created as part of a series of different government initiatives to stabilize the banking sector. Indeed, the HKMA viewed the CBCF as part three of a "three-part strategy." (November 21 Testimony, p12). The first part consisted of shoring up depositor confidence through a deposit guarantee. On October 14, 2008, the same day as the creation of the CBCF, the Financial Secretary, hoping to calm consumers and preempt the possibility of a run on the banking system, announced a temporary guarantee of all consumer deposits with authorized institutions. (October 14 Press Release). This 100% deposit guarantee covered deposits at licensed banks up to HK$100,000 (a little under $13,000). While the so-called "Full Deposit Guarantee" was a temporary measure, upon its expiration at the end of 2010, a new and enhanced Deposit Protection Scheme took permanent effect on Janurary 1, 2011. (Expiry of CBCF).

The second part of the HKMA's three-pronged strategy comprised of measures to enhance banks' access to liquidity. On September 30, 2008, the HKMA introduced five temporary measures to provide liquidity to local authorized institutions that might need it. The HKMA loosened policies regarding discount-window borrowing by increasing the range of collateral accepted to include US-dollar assets and extending the maturity of discount-window borrowing from overnight to up to three months. The HKMA also directly injected large amounts of liquidity into the banking sector by purchasing US dollars against Hong Kong dollars and by offering foreign exchange swaps and Hong Kong dollar loans against collateral of an acceptable credit quality. As a result of the HKMA's efforts, the Aggregate Balance of the Convertability Zone increased dramatically from HK$10 billion to HK$158 billion. (March 2009 Quarterly Bulletin, 2).

In addition to the five temporary liquidity measures, the HKMA took an additional notable step that indirectly increased banking sector–wide liquidity. On October 8, 2008, the HKMA altered the way that the Base Rate, or the rate at which banks could borrow from the discount window, was calculated. By reducing the spread between the Base Rate and the US federal funds target rate, the HKMA effectively reduced the cost of discount-window borrowing. Immediately after the adjustment, the Base Rate was cut by 100 basis points from 150 to 50 basis points above the US federal funds target rate, and then subsequently, by a further 200 basis points in response to a parallel drop in the US federal funds target rate itself during the quarter. In response to the numerous liquidity initiatives, short-term interest rates declined and interbank lending stabilized. Chart 1 shows that during the 4th quarter, overnight interbank interest rates declined from 1.0% to .25%. (March 2009 Quarterly Bulletin, 2).

Chart 1



(March 2009 Quarterly Bulletin, 2).

And so, it was in this environment of broader and coordinated intervention that the CBCF was introduced ""To further enhance confidence in the local banking system and maintain banking stability" (November 21 Testimony, p21) by "making available additional capital to locally incorporated licensed banks, on request and subject to supervisory scrutiny should this become necessary." (October 14 Press Release). The simultaneity of a number of different initiatives reflects the seriousness with which the HKMA and the Hong Kong government took the financial crisis but it makes it challenging to disentangle the effects of any single one of the measures from the effects of other simultaneously-implemented programs.

2. Legal Authority

Section 7 of the Banking Ordinance grants the Monetary Authority with broad discretion to "promote the general stability and effective working of the banking system." (Banking Ordinance, 7.1). It was under this authority that the Financial Secretary initially established CBCF on October 14, 2008. (October 14 Press Release).

Funding for any CBCF Capital would come from the Exchange Fund. (Two Measures, p3). Section 3(1A) of the Exchange Fund Ordinance allowed the Financial Secretary, "in consultation with [the] Exchange Fund Advisory Committee" to "use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong" (Exchange Fund Ordinance, 3(1A)). As a paper delivered to the Legislative Council Panel on Financial Affairs on October 17, 2008 outlined, this consultation had occurred, "The Financial Secretary, after consultation with the Exchange Fund Advisory Committee, has given approval to the establishment of the CBCF." (Two Measures, p3).

3. Communication

From its conception, the CBCF was precautionary in nature. And while government officials determined that the CBCF was necessary in light of rapidly deteriorating conditions in the global financial system, they were highly motivated to emphasize in testimony before the Legislative Council Panel on Financial Affairs, and in other public statements, both the precautionary nature of the CBCF, and the remote likelihood that they perceived of the CBCF ever being drawn upon so as not to inspire concern within international markets about the adequacy of Hong Kong banks' capital positions. From the very first press release announcing the program on October 14, 2008, Financial Secretary John Tsang stressed that he "did not expect that the new measures would need to be triggered, since the Hong Kong banking sector was fundamentally sound. (October 14 Press Release).

Similarly, in a special meeting of the Legislative Council Panel on Financial Affairs held on October 17, 2008, in response to a legislator's concern that the Exchange Fund might be drawn upon for CBCF capital, the minutes reflect that the Chief Executive of the HKMA, Joseph Yam, "re-affirmed that the banking system of Hong Kong was strong and robust and the chance of the failure of locally incorporated licensed banks was relatively remote. Given that the capital position of locally incorporated licensed banks was among the strongest in the world, the Administration and HKMA did not expect that the new measures would need to be triggered." (October 17 Minutes, p11).

Mr. Yam had long written a public column "Viewpoint" published on the HKMA's website. The October 23, 2008 edition of Viewpoint was devoted exclusively to Mr. Yam's thoughts on CBCF. Though Yam argued vigorously that the capital position of Hong Kong banks was stable, he still argued that there was a need for the CBCF because, "robust facts and figures might not be enough to sustain confidence in a situation of fear and uncertainty." (Viewpoint CBCF). Ultimately, however, Yam concluded it to be, "unlikely that the capital cushions of the local banks will, in the next two years, be eroded to such an extent as to require drawing on the CBCF." (Viewpoint CBCF).

There were differing opinions on whether Yam's transparency and candor were productive. In the October 17, 2008 special meeting of the Legislative Council Panel on Financial Affairs, Deputy Chairman the Hon. Ronny Tong Ka-wah was critical of Yam's "Viewpoint" column because among other things, the column examined some of the possible downsides of the CBCF. According to the minutes of the meeting, Tong, "doubted whether this was the appropriate timing to issue the article as it might counteract the effects of the precautionary measures. He also questioned whether it would be more appropriate for other officials, instead of [Yam] himself, to highlight the possible downside of the new measures to the public." (October 17 Minutes, p12). Yam was defended by legislator James To who praised Yam's transparency. Yam, himself, also argued that it had long been his practice to communicate directly with the public and the banking system and that the article in question was in keeping with this tradition. (October 17 Minutes, p13).

4. The provisioning of CBCF capital was to be accompanied by oversight by the HKMA.

Section 7(2) of the Banking Ordinance tasks the HKMA with, among other responsibilities, "tak[ing] all reasonable steps to ensure that […] all authorized institutions and local representative offices are operated in a responsible, honest, and business-like manner;", "promot[ing] and encourage[ing] proper standards of conduct and sound and prudent business practices amongst authorized institutions and money brokers;", as well as "suppress[ing] or aid[ing] in suppressing illegal, dishonourable or improper practices in relation to the business practices of authorized institutions." (Banking Ordinance, 7.2 b-d).

On October 24, 2008, the HKMA published a guideline explaining its position and obligations after the implementation of the CBCF and Full Deposit Guarantee. In the guideline, the government specifically acknowledged that it was cognizant of the risk of moral hazard from the program (which under Section 7(2) of the Banking Ordinance, it was responsible for), "The MA is mindful of the potential 'moral hazard' that might be engendered by the availability of the Guarantee and the Facility, in the sense of their misuse to undertake activities without sufficient regard to the concomitant risks." (Guideline October 24, 1). The government continued, "The MA therefore has a strong interest in ensuring that AIs […] refrain from engaging in imprudent business activities or practices carrying significantly more risk than they would otherwise be inclined to undertake in the absence of the Guarantee and the Facility." (Guideline October 24, 1).

The government specifically mentioned six examples of business practices that would suggest the underlying emergence of moral hazard. These included "any unexpected increases in deposit base", "any solicitations of deposits by the offering of benefits or interest rates materially more generous, in relative terms by reference to industry benchmarks", "any unexpected material increases in the levels of the institution's financial exposures", "any unjustified relaxation of any of the institution's existing corporate governance, risk management or other control systems", "any material deviation from the institution's established business goals and strategies and risk appetite", and "any marked declines in the institution's capital adequacy ratio or supervisory ratios". (Guideline October 24, 2).

To directly combat any emerging moral hazard that might develop from the provisioning of CBCF capital, The government wrote, "In view of the public interest in pre-empting or minimizing imprudent conduct in the circumstances described above, if an AI is found to have relied on, and so misused, the Guarantee and the Facility to engage in business activities or practices involving an imprudent degree of risk, the MA may […] impose directions under section 52(1)(A) of the Banking Ordinance to restrain any such conduct which comes to the MA's attention." (Guideline October 24, 3).

Section 52(1)(A) of the Banking Ordinance grants the HKMA broad latitude in certain situations to constrain the behavior of credit institutions. Among other things, it allows the HKMA, "to require the institution, by notice in writing served on it, forthwith to take any action or to do any act or thing whatsoever in relation to its affairs, business and property as he [the HKMA] may consider necessary (including any requirement imposing restrictions on the banking business, business of taking deposits as a deposit-taking company)." (Banking Ordinance, 52(1a)). Furthermore, the Monetary Authority would "appoint a person to be the

Advisor of [the] institution" to whom "the institution shall seek advice on the management of its affairs, business, and property"

The HKMA encouraged management of Authorized Institutions to "exercise adequate oversight" over their own business dealings so as to "guard against the emergence of any imprudent business activities or practices. (Guideline October 24, 2). In addition to calls for greater levels of self regulation, the HKMA directed institutions to "notify the MA in advance before embarking upon (i) any new line of business not previously conducted by them or (ii) any plan for expansion of an existing line of business by increasing the level or size of such business prevailing at the end of June 2008 at an annual rate of 10% or more."

5. Third element. CBCF capital, were it to be needed, would be drawn from the Exchange Fund on an as needed basis.

CBCF capital, should it be needed, would be drawn from the Exchange Fund on an as needed basis. (October 14 Press Release). While designating the Exchange Fund as responsible for funding the CBCF, the government didn't make a formal commitment in terms of scale of the program. This unbounded commitment would serve as a point of discussion in the October 17, 2008 special meeting of the Legislative Council Panel on Financial Affairs. Legislator Jeffrey Lam asked explicitly about, "whether there would be a ceiling on the amount drawn on the Exchange Fund for replenishing AIs' capital base. (October 17 Minutes, p11).

In response, Yam argued that, "the capital position of locally incorporated licensed banks was among the strongest in the world," making it less likely that "the new measures would need to be triggered." (October 17 Minutes, p11). Furthermore, "the capital base of the locally incorporated licensed banks was relatively small, and the need for capital from the Exchange Fund, if any, would be limited." (October 17 Minutes, p12).

6. Institutions eligible to receive CBCF capital were limited to locally incorporated authorized institutions.

The HKMA maintained a list of authorized institutions which retained their spot on the list provided that they continued to meet certain capital and liquidity thresholds, and engaged in sensible accounting practices and other similar standards. (Banking Ordinance, Part XVIA, 97H). From this list, the HKMA opened the CBCF only to Authorized Institutions that were locally incorporated in Hong Kong. (October 14 Press Release). In practice, this meant that Of the 145 licensed banks that operated in Hong Kong at the end of 2008, only the 23 that were locally incorporated in Hong Kong were eligible to access CBCF capital should the need arise. (Annual Report 2008, 197; October 14 Press Release). (A full list of locally incorporated licensed banks that were eligible to access the CBCF is included below).

LICENSED BANKS

Incorporated in Hong Kong

Bank of China (Hong Kong) Limited
Bank of East Asia, Limited (The)
China Construction Bank (Asia) Corporation Limited
Chiyu Banking Corporation Limited
Chong Hing Bank Limited
CITIBANK (HONG KONG) LIMITED
CITIC Ka Wah Bank Limited
Dah Sing Bank Limited
DBS BANK (HONG KONG) LIMITED
FUBON BANK (HONG KONG) LIMITED
Hang Seng Bank, Limited
Hongkong & Shanghai Banking Corporation Limited (The)
Industrial and Commercial Bank of China (Asia) Limited
MEVAS Bank Limited
Nanyang Commercial Bank, Limited
PUBLIC BANK (HONG KONG) LIMITED
Shanghai Commercial Bank Limited
Standard Bank Asia Limited
Standard Chartered Bank (Hong Kong) Limited
Tai Sang Bank Limited
Tai Yau Bank, Limited
WING HANG BANK, LIMITED
Wing Lung Bank Limited

(Annual Report 2008, 197)

7. Capital Characteristics

When it announced the creation of the CBCF, the Hong Kong government refrained from formalizing the structure or terms of any CBCF capital. In a Hong Kong Monetary Authority-authored paper presented at the October 17, 2008 meeting of the Legislative Council's Panel on Financial Affairs, the government wrote, "The form and terms of any CBCF Capital will be decided on the basis of individual circumstances, and local banks receiving any such capital will be obliged to accept conditions or restrictions deemed appropriate by the HKMA to safeguard the financial commitment represented by the CBCF." (Two Measures, p3).

III. Evaluation

Perhaps in part because no CBCF capital was ever deployed, there has been no scholarly investigation into the effectiveness of the facility.

That said, there is some circumstantial evidence that the CBCF was a success. On October 13, 2008, one day before the formal announcement of the creation of the CBCF, markets responded positively in response to speculation of impending government efforts to support the banking sector. Equities, particularly those of banks, bounced back. Industrial & Commercial Bank of China Ltd., also known as ICBC, surged 13% in Hong Kong. The one-day move was particularly pronounced for ICBC, the world's largest bank by both market cap and assets under management, because it had suffered a 49% loss in the value of its stock in the preceding 12 months through October 10, 2008. Bank of East Asia Ltd., Hong Kong's third-largest bank by assets saw its stock price increase by 7.4% on October 13, 2008 as well. The performance of financial stocks boosted Asian markets more generally. The MSCI Asia Pacific (excluding Japan) Index increased 7.3% at 6:01 p.m. in Hong Kong with more than half of this gain attributable to the performance of financial stocks. Similarly, Hong Kong's Hang Seng Index grew by 10%. (Stocks Surge).

Similarly, HIBOR, the Hong Kong Interbank Offer Rate, which serves as a proxy for bank uncertainty, dropped on the announcement (see Chart 1). Several analysts welcomed these positive developments in the stock market and implied a connection to the announcement of the CBCF. “As long as the market gets a sense of assurance that the big banks are not going to fall, a credit deadlock would be mitigated,” said Nicole Sze, an analyst at Bank Julius Baer & Co., “Financial stability is kind of assured for the short term.” “At last we are seeing some light at the end of the tunnel,” added Steven Leung of UOB-Kay Hian Ltd. in Hong Kong, “We are finally seeing some buying in finance names. ” (Stocks Surge).

On the other hand, claims about the effectiveness of the CBCF should be scrutinized carefully. Given that the CBCF was never actually deployed, the relationship between its announcement and positive economic developments is naturally more tenuous than if it had actually been deployed. Furthermore, the announcement occurred in a broader environment of both local and global government actions and interventions. In addition to the previously discussed interventions that the Hong Kong government introduced at the same time (most notably the deposit guarantee), American and European authorities were making a number of aggressive monetary policy changes including slashing interest rates. Because the HKMA base rate was tied to the Federal Reserve’s Federal Funds Rate, American rate cuts also indirectly created an environment of looser monetary policy in Hong Kong in late 2008. This coupled with the more direct HKMA liquidity measures might reasonably explain the positive economic signs such as market optimism about the banking sector (as manifested by increases in equities) and the narrowing of HIBOR.

In an International Monetary Fund Staff Report on Hong Kong published on December 9, 2008, the IMF commended the Government’s broad response to the crisis. And while they warned of a potential slowdown in the Hong Kong economy, they noted that, “Hong Kong SAR’s banks have managed risk prudently and provisioned for losses, and are well positioned to handle such conditions.” (IMF Consultation, 3). Furthermore, “[IMF] Directors considered the introduction of a time-bound, blanket deposit guarantee and a contingent facility to provide capital to Hong Kong SAR’s banks [CBCF] as timely and warranted.” (IMF Consultation, 3).

Predictably, Hong Kong authorities were heartened by the IMF’s assessment of their performance. In a press release, Financial Secretary John Tsang stated that he was, “confident that Hong Kong’s strong fundamentals, sound regulatory framework and prudent risk management by financial institutions [would] stand us in good stead in tackling the global financial turmoil.” HKMA Chief Executive Joseph Yam added, “I am glad that the IMF supports the range of actions we have taken to sustain confidence in the banking system. We will keep a close eye on global market developments and are prepared to take any further necessary measures to safeguard the stability of the system.” (HK IMF response).

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