

Announcement by the Monetary Authority
of Applicable Jurisdictional Countercyclical Capital Buffer Ratio for Hong Kong
9 July 2019

The Monetary Authority hereby announces, pursuant to section 3Q(3) of the Banking (Capital) Rules (Cap. 155L) (BCR), that the applicable jurisdictional countercyclical capital buffer (CCyB) ratio for Hong Kong will remain at 2.5%.

The considerations underlying this decision are set out in the Annex to this announcement.

Monetary Authority
9 July 2019

Decision

In reaching his decision to maintain the Hong Kong jurisdictional CCyB rate at 2.5%, the Monetary Authority reviewed a range of quantitative indicators and qualitative information. This included the “indicative buffer guide” produced by the Monetary Authority’s Initial Reference Calculator (IRC) which is a metric that takes into account conditions in local credit and property markets. By mapping (i) deviations (“gaps”) of the ratios of credit to GDP and of residential property prices to rentals from their respective long term trends to (ii) the Basel III CCyB range of 0% to 2.5%, the IRC produces a consistent starting point for further analysis. A gap has to be greater than 2% to be regarded as significant for the purposes of the IRC, and has to reach 10% to signal a 2.5% CCyB.

The latest IRC, calculated based on 2019Q1 data, signals a lower than current CCyB of 1.75% (after rounding down to the nearest 25bps) mostly due to the recent narrowing of the credit to GDP gap from more than 12% to about 9%, reflecting slower loan growth this year. The property price to rental gap, however, widened significantly to near 7% from 3% in the previous quarter.

The setting of the CCyB is however not a mechanical exercise. In considering whether there is a build-up of systemic risk, the Monetary Authority will consider a broad range of information in addition to the indicative buffer guide produced by the IRC. In particular, the Monetary Authority also reviewed a series of “Comprehensive Reference Indicators” designed to provide an aggregate view of local conditions including the build-up of systemic risk (such as measures of bank, household and corporate leverage; profitability and funding conditions within the banking sector; borrowers’ debt servicing ability; and macroeconomic indicators). These indicators suggested that system-wide risks in Hong Kong associated with a period of excessive credit growth have not subsided. Housing affordability remains highly stretched and household debt-to-GDP ratio has risen to a new high. Given these the Monetary Authority considered that it is appropriate to maintain the CCyB at 2.5% at this juncture.

The Monetary Authority will continue to monitor local credit conditions and potential systemic risk build-up in Hong Kong closely and the CCyB rate will be reviewed on a quarterly basis.

Background

The CCyB is part of the Basel III regulatory capital framework and is being implemented in parallel by Basel Committee member jurisdictions worldwide. The CCyB has been designed by the Basel Committee to increase the resilience of the banking sector in periods of excess credit growth. The banking sector can then act as a “shock absorber” in times of stress, rather than as an amplifier of risk to the broader economy.

The specific CCyB requirement applicable to a given AI is expressed as a percentage of its CET1 capital to its total risk-weighted assets (RWA). Each AI’s CCyB requirement may vary depending on the geographic mix of its private sector credit exposures and the CCyB rate applicable in each jurisdiction where it has such exposures.

The power to implement the CCyB in Hong Kong is provided by the Banking (Capital) Rules, which give the Monetary Authority the power to announce CCyB rates applicable to Hong Kong if the Monetary Authority considers that a period of excessive credit growth in Hong Kong is leading to a build-up of system-wide risks in the financial system of Hong Kong.

As an initial reference for the Monetary Authority to assess the extent of system-wide risks resulting from excessive credit growth and determine the corresponding level of the CCyB requirement, the Monetary Authority uses a methodology that synthesizes information from two main indicators, namely the size of the deviation of the credit/GDP ratio and the residential property price/rent ratios from their respective long-term trends, where the trends are estimated using historical data with a method (recommended by the Basel Committee and commonly used in macroeconomics to detect cyclical fluctuations) that gives a higher weight to more recent observations. A high credit/GDP gap signals significant leverage in the non-bank private sector (as the accumulated effect of above-trend credit growth over a period of time) and therefore vulnerability to such negative shocks as an increase in interest rates or a fall in income. A high residential property price/rent gap signals potentially unsustainably high property valuations (as a result of above-trend price increases over a period of time) and therefore vulnerability to a major market correction. However, the Monetary Authority also assesses a broader set of indicators and other relevant information before reaching a decision on the appropriate level of the CCyB.