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Hong Kong Guarantees Deposits, Sets Up Fund for Banks (Update3)

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(Adds review of measures in 2010 in the ninth paragraph.)

By Chia-Peck Wong and Theresa Tang

Oct. 14 (Bloomberg) -- The Hong Kong Monetary Authority will use its foreign exchange reserves to guarantee bank deposits, shoring up confidence in lenders after the first run on a bank in the city in more than a decade.

The government will also set up a fund from which banks can access additional capital if needed, John Tsang, Hong Kong's financial secretary, told reporters today. HKMA Chief Executive Joseph Yam said the city's banks have ``very low'' levels of bad loans and are unlikely to need assistance from the government.

``These two measures are precautionary and pre-emptive,'' Tsang said. ``They show our determination to safeguard our depositors and banking system.''

The collapse of Lehman Brothers Holdings Inc. last month deepened turmoil in credit markets that has forced European governments to take over some banks and prompted Indonesia, Australia and New Zealand to extend deposit guarantees. Hundreds of Hong Kong investors have protested at possible losses on Lehman-linked investments, while Bank of East Asia Ltd. last month suffered a brief run on deposits at branches in the city.

``It's likely to improve liquidity step-by-step,'' said Sebastien Barbe, a strategist at Calyon, the investment banking unit of France's Credit Agricole SA, in Hong Kong. ``It's doing the same thing as all the big central banks in the world.''

The run on Bank of East Asia, Hong Kong's third-biggest lender by assets, was sparked by rumors spread by text message questioning the institution's financial health. The bank and the monetary authority have said the lender is healthy, and police investigating the rumors arrested an 18-year-old man.

Capital Fund

Money market rates have risen as the deepening global financial crisis makes banks reluctant to lend to each other. Hong Kong's benchmark three-month interbank offered rate, or Hibor, was 4.4 percent today, almost double the rate a month ago. Some smaller banks are offering high interest rates to woo deposits.

The new capital facility will provide funds on a case-by-case basis if any bank needs it, Yam said today, declining to say how big the fund will be.

Both measures are effective immediately and will remain in force until the end of 2010, when Hong Kong will decide whether they need to be extended in light of international financial conditions at the time, Tsang said.

`Precautionary' Measures

``The measures are precautionary, and as such, they do not expect to have to inject capital,'' Glenn Maguire, chief Asia economist at Societe Generale SA in Hong Kong, wrote in a research note to clients. ``The move augments international initiatives and is aimed more at the consumer sector than the wholesale sector.''

Hong Kong had $160.6 billion foreign currency reserves as at end of September, according to the HKMA's Web site. Deposits in the city totaled HK$6 trillion ($773 billion), Yam said at the briefing.

``There is a very low possibility of local banks failing,'' Yam said. ``I hope the measures we roll out today can help strengthen our banking system.''

Hong Kong depositors managed to get back all their savings, plus interest, when the Bank of Credit and Commerce Hong Kong Ltd. went into liquidation in 1991, the last major failure, Yam said. The bank failed after its Luxembourg-based parent collapsed.

Today's measures come two weeks after the HKMA said it will provide more liquidity to banks by accepting more securities in repurchase transactions. The central bank is providing lenders with additional funds through the three-month repurchase window.

Unlikely Currency Attack

Yam also said the likelihood that today's measures will trigger an attack on the Hong Kong dollar by speculators isn't high, as the city has ``clearly'' demonstrated its determination to defend the currency's peg to the U.S. dollar.

The currency has been fixed at about HK$7.80 per U.S. dollar since 1983, a year before the U.K. signed an agreement to transfer Hong Kong to Chinese sovereignty in 1997, and is allowed to trade at 5 cents on either side of that level.

In 1998, Yam directed $15 billion of government stock purchases to defend the Hong Kong dollar, aiming to stop speculators by causing losses on their short positions on local shares and the currency. A short position profits from declines.

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