

Mr. Dai looks at the possibilities of strengthening financial co-operation between China and Hong Kong in order to promote economic prosperity and stability

Speech by the Governor of the People's Bank of China, Mr. Dai Xianglong, at the Hong Kong Association of Banks' Dinner on 13/11/96.

I would like to thank the Hong Kong Association of Banks for inviting me to Hong Kong to meet with you and to attend this dinner function. Although this is my first visit to Hong Kong since taking up my post in the central bank, we follow closely the economic developments of Hong Kong. All of you have contributed to the prosperity of Hong Kong. I greatly appreciate the wisdom and the spirit of the people of Hong Kong. They are industrious and always striving for the better. Hong Kong's success is partly attributable to the characteristics of its people. We have good reasons to believe that through our joint efforts, Hong Kong will have an even better future.

I would like to take this opportunity to give a brief description of the current situation of the economic and financial reforms in the mainland as well as the basic principles and policies towards the financial relationship between China and Hong Kong after 1997. In addition, I would also say something on co-operation and joint development between the financial sectors of China and Hong Kong.

I. Mainland China's economy is experiencing a stable development

First of all, I would like to talk about the financial and economic conditions of China which is a hot topic for discussion among professionals from the Hong Kong financial sector. This is because Hong Kong's future is closely linked with the economic and financial developments of China.

China's economy began to pick up in 1992 with a dynamic national economy. However, there was also hyper-inflation. During the latter half of 1993, the Chinese Government began to adopt an appropriately tight monetary policy. The adoption of this policy means firstly, price increases should be kept at a level lower than the rate of economic growth. Secondly, the growth of money supply should be slightly above the sum of the rate of economic growth and the target rate of the price increase. Thirdly, indirect monetary instruments should be used more frequently for relating money supply so that the economy will not be too volatile. Our efforts in the past three years are beginning to pay off. We have successfully curbed inflation by making macro-economic adjustments.

Firstly, the growth of the money supply has slowed down. It is expected that the total money supply at the end of this year will be 26% higher than the previous year. This growth rate is 3.7% lower than the average annual growth rate during the period under the "Eighth Five-Year Plan".

Secondly, price increases have slackened noticeably. During the period from January to October, retail prices have risen by 6.4% as compared to the same period last year. It is expected that the growth rate for the whole year will be around 6.5%.

Thirdly, the economy continues to grow at a relatively high rate. During the period from January to September, GDP rose by 9.6%. It is anticipated that the annual growth rate will exceed 9.5%.

Fourthly, our foreign reserves continue to grow. As at the end of October, our foreign reserves reached US\$ 98.8 billion. We are certain that our reserves will exceed US\$ 100 billion by the end of the year. The trade surplus is estimated to be over US\$ 100 billion this year. There is also US\$ 40 billion of foreign direct investment. The supply of foreign exchange exceeds demand and the exchange rate of the renminbi remains stable. Moreover, the renminbi has become fully convertible in the current account. Our experience proves that we are right in adopting an appropriately tight financial and economic policy. Our ability in performing macro-economic operations has improved greatly and our achievements are recognised internationally.

Despite the foregoing, several major problems remain to be solved. The percentage of financial revenues in GDP is still falling. The asset quality of banks still needs to be improved. The basic elements of the agricultural sector remain relatively weak and it is unlikely to have any improvement in the operational efficiency of state-owned enterprises in the short run.

In view of the current economic situation, the focus of economic and financial reforms in the coming year will be placed on promoting the reform of the economic system and changing the pattern of economic growth. We will continue to adopt an appropriately tight financial and monetary policy. Further efforts will be made to adjust the structure of the economy so as to foster new areas of economic growth. In order to ensure steady growth of the national economy, efforts will also be made to develop domestic as well as overseas markets. Based on the above considerations, it is desirable that next year's target annual GNP growth rate should be set at 8-9% while the retail price increase be contained at a level below 6%. In order to achieve these targets, the People's Bank of China is prepared to:

1. Control money supply. Our preliminary proposal is to contain the increase of next year's total money supply (M2) within the range of 23% to 25%.

2. Adjust the credit structure. The total amount of loans to the agricultural sector will be increased. Economic integration and the setting up of conglomerates will be encouraged. Efforts will also be made to promote the development and sale of residential property.

3. Conduct monetary operations. Employ more frequently monetary policy instruments such as interest rate policy, reserve requirements and open market operations to regulate the money supply.

4. Deepen financial reforms. Reforms of state banks should be stepped up. New commercial banks will be set up. The policy of transforming rural credit co-operatives into co-operative financial institutions will be maintained. Direct financing will be developed in a prudent way with better management. In addition, the financial sector will continue to open up.

5. Foster risk management. Continue the rationalisation of financial order and prevent and eliminate financial risks.

It is envisaged that China's economy and society will continue to develop steadily in the coming years and objectives embodied in the "Ninth Five-Year Plan" can be achieved. China will enter the 21st century with a dynamic economy and society.

II. Basic principles and policies governing the financial relationship between mainland China and Hong Kong after 1997

As China and Hong Kong have different currencies and financial systems, people from Hong Kong as well as the international community are very much concerned with how the principle of "one country, two systems" can be implemented as regards financial issues. It is because the implementation of this principle has direct bearings on the prosperity and stability of Hong Kong as well as the status of Hong Kong as an international financial centre.

"The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China" lays down specific provisions relating to Hong Kong's status as an international financial centre, its monetary and financial policies, the status of the Hong Kong dollar and the issuing arrangements, capital flows and the role of the Exchange Fund. Our national leaders have reiterated on different occasions that the People's Bank of China, which is the central bank of the People's Republic of China, should insist on implementing the "Basic Law" and the principle of "one country, two systems". We should also protect the financial relationship between Hong Kong and the mainland which can be summarised as "one country, two currencies, two monetary systems and two monetary authorities" within a sovereign state and deal with issues relating to this relationship in an appropriate manner.

At the IMF/World Bank Annual Meeting which was held in late September this year, I stated in my speech our principles governing the financial relationship between the mainland and Hong Kong. Mr Chen Yuan, the Deputy Governor of the People's Bank of China, also presented these principles in a systematic manner at the Bank of England seminar which was held in September this year. Both the People's Bank of China and the Hong Kong Monetary Authority (HKMA) have been offered membership in the Bank for International Settlements. This is a clear demonstration of the above principles and shows that the mutually independent financial relationship between the mainland and Hong Kong are widely accepted by international financial organisations.

Now I am going to give an outline of the main issues relating to the financial relationship between the mainland and Hong Kong after 1997.

Hong Kong will continue to maintain its own system of currency issuance and management after 1997. The Hong Kong dollar and the renminbi will circulate as legal tender in Hong Kong and the mainland respectively. Hong Kong's existing note-issuing arrangements will remain unchanged. Moreover, China supports Hong Kong's commitment to the maintenance of the linked exchange rate system.

It follows from the two mutually independent monetary systems of the mainland and Hong Kong that the two monetary authorities, i.e. the People's Bank of China and the HKMA, will also be mutually independent. The HKMA will be accountable solely to the Hong Kong Government. The People's Bank of China will not take the place of the HKMA and will not set up any office in Hong Kong. The People's Bank of China will strengthen further its present sound co-operation with the HKMA. The HKMA has made great contributions to the stability of the local currency and the supervision of financial institutions. Such efforts by the HKMA help promote the prosperity and smooth transition of Hong Kong.

The Hong Kong Government will continue to supervise local financial institutions. The supervision will continue to be undertaken in accordance with Hong Kong's laws and international rules and practices. mainland financial institutions in Hong Kong shall not enjoy any privileges. They shall be regulated by the relevant supervisory authorities in Hong Kong.

The Exchange Fund of Hong Kong shall be managed and controlled by the Hong Kong Government. The financial revenues of the Hong Kong Special Administrative Region shall be used exclusively for its own purposes and the Chinese Government shall not levy taxes in Hong Kong. Moreover, China will not draw on or resort to Hong Kong's Exchange Fund or other assets in any way and for any reason.

All financial transactions between the mainland and Hong Kong will be conducted in accordance with the rules and practices of international financial activities. Claims and liabilities between institutions from the mainland and those from Hong Kong will continue to be regarded as external claims and liabilities. When participating in the Hong Kong market, Chinese entities will have equal treatment as other international and local market participants.

Apart from the above, it is also important for Hong Kong as an international financial centre to continue to develop its international monetary relations and participate in the activities of international and regional financial institutions. There are therefore provisions in the Joint Declaration and the Basic Law that Hong Kong may, on its own, maintain and develop financial relations with other countries, regions and relevant international organisations after 1997. The 1997 World Bank/IMF Annual Meeting will be held in Hong Kong just a few months after China resumes the exercise of sovereignty over Hong Kong. This is a magnificent financial event and I am confident that it will be successful.

III The strengthening of financial co-operation and the promotion of economic prosperity and stability between the mainland and Hong Kong

Mainland China and Hong Kong have close financial links with each other. Since the implementation of financial reforms and the open-door policy, such links have been strengthened further. It is necessary to further enhance such a mutually beneficial relationship between the two places.

First of all, the mainland and Hong Kong should work together for the prosperity, stability and smooth transition of Hong Kong. China's commitment to the implementation of the "one country, two systems" principle is increasingly accepted and appreciated by the people of Hong Kong and the international community. Worries and doubts about the future of Hong Kong which emerged in the early 1980's have largely subsided. We are pleased to note that the financial situation in Hong Kong is heading towards a smooth transition. We are confident that Hong Kong will enjoy financial stability before and after 1997. Even though there may be some fluctuations in Hong Kong's financial market, we believe that the HKMA is fully capable of handling these situations satisfactorily. If necessary, the People's Bank of China will, at the request of the HKMA and in accordance with the Basic Law and market practices, offer support to the HKMA. Financial stability in Hong Kong before and after 1997 is not only essential to the prosperity of Hong Kong and China but also to financial stability in the Asia-Pacific Region. We are confident that the international financial community, including the central banks in the Asia-Pacific Region, will be actively involved in the efforts to maintain Hong Kong's financial stability.

Secondly, the two places should work closely together to maintain and enhance Hong Kong's status as an international financial centre. Hong Kong has some unique competitive advantages in being an international financial centre in a number of aspects such as opportunities, geographic location and people. I have made it clear to the international financial community on many occasions that after China's resumption of sovereignty over Hong Kong, the status of Hong Kong as an international financial centre will not be undermined but, rather, it will be further strengthened. This is because the many unique advantages which Hong Kong enjoys now will

continue to exist after 1997. There is also the Basic Law which guarantees that Hong Kong will remain unchanged. More importantly, with the sustained, rapid and healthy growth of the economy in China - the vast hinterland at the back of Hong Kong - numerous opportunities will be created for Hong Kong's financial sector. All these are favourable conditions for the maintenance and strengthening of Hong Kong's status as an international financial centre. Economic developments in the mainland have given rise to strong demand for funds and Hong Kong will continue to be our major funding centre. We will strengthen our coordination and co-operation with Hong Kong in areas such as the development of markets and infrastructures in response to the needs of financial developments in both places. I have met with many central bankers and major international bankers and they all agreed that Hong Kong should be able to maintain its status as an international financial centre as regards the future relationship between Hong Kong and Shanghai. I think as a national economic centre, Shanghai's financial status will become increasingly important. However, it will not be possible for Shanghai to become an international financial centre in the longer term and it will not replace Hong Kong.

Thirdly, the mainland and Hong Kong should co-operate fully with each other so as to promote prosperity and stability. Since the implementation of economic reforms and the open-door policy, financial co-operation between the two places has been strengthened which, in turn, helps to develop economic and trading ties. At present, China and Hong Kong are each other's major investment and trading partner. As at the end of 1995, Hong Kong's total cumulative investment in China reached US\$ 78.6 billion, accounting for 58% of total foreign investment in China. In 1995, 90% of the syndicated loans to China were arranged in Hong Kong and 90% of the Chinese companies listed on overseas stock markets have their primary listing in Hong Kong. The volume of import and export trade between the two places amounted to US\$ 44.6 billion last year, accounting for 15.9% of China's total external trade. If Hong Kong's entrepôt trade which came from China is also taken into account, the figure reached US\$ 124.1 billion, accounting for 34.1% of Hong Kong's total external trade in that year. The number of mainland financial institutions in Hong Kong is on the rise and vice versa. These institutions are going to provide a whole range of financial services which are conducive to the continuous and stable development of the economic relationship between the two places.

China will further open up its financial markets. This includes the opening up of more districts, the gradual relaxation of renminbi business and the gradual introduction of the investment banking mechanism. The Hong Kong financial sector will directly benefit from these moves since they will offer numerous business opportunities. In the course of stepping up our pace of financial reforms, we have to keep on learning from advanced international management experience and to provide training to outstanding personnel. We hope that the financial community in Hong Kong will provide us with assistance and support in these areas.

Before ending my speech, I would like to point out that the Hong Kong Association of Banks has contributed a lot in assisting the HKMA to ensure the financial stability of Hong Kong. I hope all of you will continue to give your support to the HKMA and play a more active role in promoting economic and financial developments in Hong Kong and its smooth transition. I would also like to announce that an association of mainland banks will be formed this year. I hope that the two banking associations will strengthen their exchanges and co-operation and work together for a more prosperous future.

A delegation from the Hong Kong Association of Banks will visit Beijing in a few days. I would like to welcome the delegation on behalf of the People's Bank of China. I will meet with some of you again on that occasion. We can further exchange views on the strengthening of co-operation between the banking sectors on the mainland and in Hong Kong.