

Mr Yam presents the 1998 Hong Kong Monetary Authority's annual report

Speech by the Chief Executive of the Hong Kong Monetary Authority, Mr Joseph Yam, on the occasion of the presentation of the 1998 HKMA annual report before the Legislative Council Financial Affairs Panel in Hong Kong on 3 May 1999.

Introduction

Mr Chairman, Honourable Members,

I am most grateful to you for giving me this opportunity to speak to you on the occasion of the publication of the HKMA's Annual Report for 1998. The Report is tabled at this meeting of the Financial Affairs Panel; it is also being distributed to all Members of the Legislative Council this morning. This Report covers the full range of the HKMA's work for the calendar year 1998, in addition to giving an assessment of the economic and banking environment for the year.

I have no need to remind Members that 1998 was, to put it mildly, an eventful year. The Report sets out the many problems and challenges that the HKMA has had to grapple with during the course of the year, and explains what actions and initiatives the HKMA has been taking to address them. You are all familiar with these issues, and you have the details before you. So I do not wish to take up too much time with a long description. My main focus in this presentation will be on the challenges for the HKMA in the coming year, particularly in the light of current economic trends. Before I do that, however, I should like just to highlight the challenges and achievements of the past year, and to touch on an issue that I know is of concern to Members: the question of accountability and transparency.

The year in review

Nineteen-ninety-eight was an extremely tough year for Hong Kong. The Asian financial crisis, and eruptions in other parts of the world, brought continuing instability. The effects on Hong Kong's open and outward-looking economy were severe. GDP declined by 5.1%, the sharpest decline shown in GDP statistics dating back to 1961. The unemployment rate more than doubled, to 5.7% at the end of the year: it has, since then, increased still further. Property and share prices plummeted, though they have since regained some of their lost value. The strains and uncertainties of recession have penetrated into every home and every business. The distress has been all the more acutely felt because the recession appeared with dramatic suddenness after many years of vigorous and uninterrupted growth.

Hong Kong's banking system, quite naturally, came under severe pressure, though it has handled the downward adjustment in asset prices and the volatilities brought on by the financial crisis with remarkable success. A much more disturbing feature of the larger crisis has been the succession of opportunistic attacks on the Hong Kong dollar and on Hong Kong's financial markets. These attacks increased the pains of recession by pushing up interest rates and by corroding confidence in our financial system, both locally and overseas. They reached a climax in the sophisticated assault of early August, which mobilised massive resources in an attempt to play off the currency board system against the stock and futures markets. This attack was unprecedented in scale and organisation. It posed a grave threat to the stability and integrity of our whole financial system. Decisive, albeit controversial, action by the Hong Kong SAR Government ensured that this threat was averted. In combination with other factors, this action helped to ensure stability in our markets for the remainder of the year and beyond.

The HKMA's role in the August operation is well known to Members. For my part, I am fully convinced that what we did was necessary and right for Hong Kong, and that it delivered our financial system from the brink of a profound and very dangerous crisis. The portfolio of shares acquired by the

Government as a result of operations has been placed under the management of EFIL, which will draw up plans for disposing the majority of them in a gradual and orderly manner. But so much has been said about this subject that the impression is sometimes given that that is all that the HKMA did in 1998. This is a pity, because we have other solid achievements to place on record. Among the achievements worth singling out are:

- Effective supervision of the banking system to ensure stability and soundness during a period of intense regional financial crisis and domestic slowdown.
- A growth of 27.5% in the accumulated surplus of the Exchange Fund during the year, or 15% if the gains from the equity portfolio acquired in August are excluded.
- Continuing currency stability, within the framework of the linked exchange rate system, against unprecedented speculative attacks, and during a year of currency instability in much of the rest of the region.
- Substantial improvements to the currency board system, which have made it more resilient, more transparent, and less vulnerable to manipulation than it was before.
- Increased involvement in regional and global initiatives to promote Hong Kong as an international financial centre and to seek action to repair defects in the international financial architecture. Progress in this field has been slow, but not for lack of any advocacy on Hong Kong's part.

The three broad mandates of the Hong Kong Monetary Authority are to maintain currency stability, to promote the safety and stability of the banking system, and to enhance the efficiency, integrity and development of the financial system. I think that the HKMA can justifiably claim that it has successfully delivered on all of these mandates during 1998, and in the face of considerable difficulties.

Accountability and transparency

Monetary and banking stability is, of course, the result of efforts by the whole of the financial sector, and not just the work of the HKMA. It also depends on international faith in the integrity of our system, and, equally important, on the confidence of the community of Hong Kong. We believe that community support for our monetary and banking policies, and confidence in our financial system are strong. But we also know that confidence cannot be built on blind public faith in a remote monetary authority carrying out its esoteric policies in a quiet and mysterious way: it must be nurtured through explanation, through informed discussion, through a system that is both accountable and transparent. The safety of our banks and the stability of our currency are everybody's business, and the Asian financial crisis has brought this fact home to the people of Hong Kong. Economic hardship has prompted more people to ask more questions about the way Hong Kong manages its monetary and banking systems. Energetic policies, such as the operation in August, have also stimulated debate - some of it heated - over the rights and wrongs of what we are doing.

Quite properly, the Legislative Council has been the focus of much of this debate, not just in its motion debates, but also in the many discussions organised by this panel on a variety of subjects. We have seen more interest in our work from Members during the past year than in any other year since the creation of the HKMA in 1993. I welcome this attention. It gives us the opportunity to enter into productive discussion with those who know and represent the community. It also shows that accountability is alive and well. We might choose to explain this accountability in narrow legal terms, by referring to laws, passed by the Legislative Council, that define and limit our powers and responsibilities, or by setting out the Monetary Authority's accountability, through the Financial Secretary and the SAR Government, to the Legislative Council under Article 64 of the Basic Law.

But we also recognise a broader responsibility to the community of Hong Kong, and a duty to promote an understanding of our role and objectives, and to keep ourselves informed of community concerns and open to public debate.

To this end, the HKMA pursues a policy of transparency and accessibility. This policy has two main objectives: to keep the financial industry and the general public as fully informed of the HKMA's work as possible; and to ensure that the HKMA is in touch with, and responsive to, the community that it serves. We have done a great deal over the past year to advance this policy. This applies not just to technical matters, such as the greatly increased transparency of the currency board system or the daily publication, since November, of the size and composition of the Monetary Base and the virtually real-time publication of the Aggregate Balance of the Banking System. It also applies to the information we issue for general public consumption, whether in print, through the press, on the Internet, or in our programmes of educational briefings and seminars.

Of course, considerations of market sensitivity, commercial confidentiality, and statutory restrictions on disclosure of confidential information place some limits on the amount of material we can make public. Given the increasing transparency and the extremely limited discretion over the currency board arrangements, which draws its credibility from a strict rule-based system, a certain constructive ambiguity is also necessary if we are to have the flexibility to deal decisively with sudden crises. Within these limits, we are committed to developing our policy of transparency, and to increasing the quality and comprehensibility, and not just the quantity, of the materials we put out for public consumption.

The challenges of this year

We see it as one of our challenges to seek to maintain public interest in our work, even though it is possible that some of the controversies and concerns that sustained that interest in 1998 will fade away as economic recovery moves closer. This brings me to the prospects for the remainder of this year and beyond. I leave the predictions and forecasts to others in the Government entrusted with this task. But I think it appropriate to say something here about the monetary environment.

Recent months have witnessed the return to a more stable monetary environment in Hong Kong. Speculative pressures on our currency have moderated sharply, allowing a significant decline in interest rates from the peaks last year. As you know, under the linked exchange rate system, our interest rates are closely tied to those in the United States in normal circumstances. In last year's exceptional environment, however, short-term interest rates, in the face of speculative attacks, rose at times to around double those for the US dollar. These spreads have virtually disappeared in recent months, testifying to the failure of those attacks to undermine the longer-term credibility of our exchange rate system. Combined with cuts in US interest rates last autumn, nominal interest rates in Hong Kong now stand at or below pre-crisis levels.

Of course, real interest rates remain high, as prices have come down along with the sharp downturn in economic activity. But I believe that this process of price adjustment, although painful in the short run, demonstrates the flexibility needed to restore our competitiveness in the region, setting the stage for renewed growth in the period ahead. Indeed, asset markets are already responding to signs that the worst of the downturn may be behind us, both here in Hong Kong and in the region as a whole.

Regarding the volume of financial activity in Hong Kong, domestic bank lending declined toward the end of last year, as corporate loan demand fell and banks reassessed risk factors. Yet growth in bank deposits and the money supply recovered at the same time, perhaps reflecting a rise in household savings in a period of uncertainty. Rising deposits and weak loan growth has left the banks well equipped to meet an expansion in loan demand during the recovery phase of the cycle, and market conditions overall seem now more conducive to corporate fund-raising. More generally, the sound

position of our financial system as we exit the crisis is virtually unique in the region, and will be a key pillar in ensuring a return to sustained growth.

A number of continuing issues, and new ones on the horizon, will provide the HKMA with a heavy workload in the remainder of this year. These include:

- The possibility of further attacks on the currency, despite the improved stability in local and world markets: we need to be constantly on our guard for signs of trouble.
- Further work to improve the currency board system, with the help of the EFAC Sub-Committee on Currency Board Operations: much progress has been made in the past nine months or so, but this is an on-going process, and a number of ideas for refining the system are in the pipeline.
- The rest of this year will continue to be somewhat difficult for the banking sector - but it remains as a whole in excellent shape to cope with the pressures ahead.
- One of these pressures is the Year 2000 problem. As this Panel heard a few weeks ago, Hong Kong's banks are internationally recognised as being among the best prepared in the region, if not the world, and work continues on contingency planning and other issues. This has been, and will continue to be in the months ahead, a priority task in the HKMA's supervisory programme.
- Decisions will also be taken later this year on the recommendations in the Banking Sector Consultancy Study, with the aim of enabling Hong Kong's banking system to make the best out of the opportunities and challenges of the next century, without sacrificing the stability that has seen it through these years of crisis. The views collected in the public consultation exercise will be announced in the next few days.
- Beyond Hong Kong itself, we shall continue to work with our counterparts overseas to reform the international financial system, so that it too is better able to cope with the kind of stresses and strains that have rocked the region in the past couple of years.

As I have said earlier, monetary and banking issues concern all of us, and stability in the international financial system and in our own are essential to Hong Kong's economic health. We intend to do our best to ensure that the community is kept informed of what we are doing and that the concerns of the community are taken into account. I feel sure that we can look to this Panel, and to the Legislative Council generally, to continue to work with us in this task, and my colleagues and I look forward to many further discussions with Members in the future.