Mr Latter gives a tour d'horizon of the current situation on the world financial markets

Text of the opening address by Tony Latter, a Deputy Chief Executive of the Hong Kong Monetary Authority, to the Asia Pacific Issuers and Investors Forum, in Hong Kong on 7 December 1999.

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As we leave the twentieth century behind, the major regions of the world economy appear to be in quite good shape. North America is buoyant; Europe is positioned for more solid growth than of late, albeit only by its own rather modest standards; Japan may be moving forward, even if we have seen too many false dawns to be entirely confident; and the rest of Asia has recovered from the 1997 setback more strongly and quickly than most people expected.

Meanwhile, major stock markets look set to end the millennium at or near all-time highs, with the notable exception of Japan, where the Nikkei is still at only about half its peak of more than ten years ago.

It is also a confident end to the decade, century and millennium for "markets" in a broader sense. The 20th century has witnessed a considerable ebb and flow of fashions in economics, between allegiances to systems which afford primacy to market forces and those which yield varying degrees of control to the state. As it turns out, the former have held sway. We see this not just from the collapse of the Soviet Union and the extreme forms of socialism which it and its satellites practised, but also, in a subtler sense, from the fact that, among economies which have throughout been part of the free world, those which have been least burdened with high marginal taxation, state intervention in industry and commerce, massive social security programmes and so forth, appear to have come out on top in terms of growth and full employment. The USA, the UK, Hong Kong and some others in the Asia-Pacific region now exemplify this point. By contrast, Japan and much of continental Europe remain saddled with a greater number of structural and bureaucratic problems, which, arguably, have been a brake on growth.

But commitment to the market is far from sufficient to ensure a prosperous economy. The commitment must be accompanied by transparency, accountability and freedom from corruption, and by an infrastructure of laws which match the needs of the market economy, are respected and, when required, are enforceable. Absent those conditions, you end up with economic anarchy, which is perhaps what best describes the current situation in a number of countries which switched with much acclaim to the market paradigm during the past decade or so.

Another example of the ascendancy of market-based economics can, I would argue, be found in the realms of corporate governance. At times during the 1970s and 1980s, when the so-called anglo-saxon model of relatively unbridled financial markets was not delivering particularly good results in terms of economic growth, there was some envy of what one might depict as the institutional model of corporate ownership, as evident in Germany and Japan for example. In this model much of the equity of major businesses is closely held by friendly groups of long-term investors including one's bankers and associate companies.

It has been argued that this arrangement provides the best environment for long-term growth and stability, in contrast to the situation where businesses are exposed fully to the cut and thrust of the stock markets, which are characterised as being populated by people seeking only short-term profit and ever alert to opportunities for takeovers, asset stripping and the like. But experience of the 1990s does not support that view. Germany and Japan have been the laggards of the decade. The true cost to Japan of the longstanding cosy relationships between banks, industrial corporations and government ministries has become apparent. And we watch in some amazement the reaction among some sections of the political and business communities in Germany to the Vodafone/Mannesmann takeover battle - an almost unprecedented (for Germany) hostile bid, no more palatable for being from abroad - along with the government's efforts to save the Holzmann construction group, not to mention the authorities' stout defence of the largely state-owned domestic regional banking network there.

Thus, the more open and aggressive equity market environment of the anglo-saxon model seems to have delivered ultimately the fitter economy. But we should remember that the stock market doesn't serve everyone who is looking for equity finance. There is a large population of smaller and medium-sized businesses which cannot aspire to access the market. Nevertheless they are important contributors to the economy and need equity funding. Few, if any, economies have been able to match the USA when it comes to enterprise culture and the relatively abundant sources of funding available to SMEs. Even in Hong Kong, where we pride ourselves as being highly market-oriented and enterprising, we cannot claim that life is a bed of roses for SMEs. But I am encouraged by the launch of the Growth Enterprise Market - the stock exchange's second board – which fills a particular gap, albeit only one, in the needs of smaller or younger companies.

The final years of this century have also seen inflation largely conquered across much of the world economy. Low inflation should provide a propitious climate for the issuance of medium and long-term debt instruments. In Hong Kong the debt market has been growing, although more at the short end than the long, and the secondary market is not greatly active, except for Exchange Fund bills. There is of course nothing wrong in investors wanting to hold instruments to maturity; indeed, in one sense it may be interpreted as a sign of confidence. But the investor base for any particular issue will be that much larger if secondary market liquidity is assured.

The significance of developing domestic debt markets has been widely recognised elsewhere in this region too. It is perhaps something that is of special importance for countries where there is a clear advantage in expanding domestic financial intermediation in order to reduce dependence on external debt. Hong Kong has contributed to the APEC Compendium of Sound Practices for the development of debt markets, which covers such topics as regulation, transparency, risk control and so on. This will help guide the establishment of best-practice infrastructure for these markets, but that in itself is no guarantee that markets will actually mature. In general, however, the prospects for the further development of bond markets in the region in the new millennium look promising.

From the point of view of international investors, exchange rates may also, of course, be a crucial element of the investment equation. They are certainly so for the trader or short-term investor. For long-term investors, however, the swings and roundabouts may even out; it could be argued that much of the movement of exchange rates reflects nominal impulses, which should not unduly affect long-run real returns.

If one tries to predict exchange rates in pursuit of a winning investment strategy, one is likely to be as often disappointed as elated. In a rather arbitrary exercise I have looked at the return from investing in 7-10 year government bonds in different countries from mid-1986 (selected only because it was the starting point of the particular data set) to the present. The assumption is that the non-dollar currencies were purchased out of US dollars at the outset and changed back at the end, so that the comparison is on a US dollar basis. It emerges that the average annual return for the period was nearly 12% for Australia, 11% UK, 10.5% Japan, 10% Canada, 8% Germany and 6.5% Switzerland - with the US itself at 8%. How many of you would have got this right ex ante? I hesitate to try to draw any profound conclusions from this, other than that, with US inflation averaging about 3%, there was clearly a reasonable real return to be had everywhere. You did not have to be greedy to survive.

The argument of the monetarist school that - to put it in a slightly condensed form - monetary factors do not have a lasting effect on real developments, was especially fashionable during the 1970s when governments were criticised for conceding to inflation in the mistaken belief that they could thereby sustain or stimulate activity. Subsequent experience has proved, if anything, that the optimal monetary stance is, quite simply, a continuing steady one, and that variance on either side - whether too tight or too loose and after allowing for any real shocks - may incur lasting economic losses. Thus, today, the received wisdom is that central banks should follow clearly articulated policies aimed at a stable monetary environment. This in turn begs the question of how to define a stable monetary environment.

In Hong Kong, a highly open economy with no capital controls, we focus on stability of the exchange rate, but this regime itself requires a flexible economic structure and a sound banking sector. I believe that Hong Kong possesses those attributes, as demonstrated not least by the adjustment of the past two years, and that the peg remains the appropriate regime for us, but I would be the first to admit that it is may not suit others.

From the point of view of investors, it is the stability and credibility of macroeconomic policy as a whole which probably determines, or ought to determine, investment strategy. As experience tells us, it can be a costly mistake to pay attention only to particular parts of the policy regime, such as the exchange rate, without scrutinising the wider context in order to be satisfied that the overall design is credible.

And so it is my pleasure to help to launch this conference today, and to welcome those of you from outside Hong Kong. We pride ourselves in being a place which offers not only a wide choice of excellent conference facilities but also, more importantly, the critical mass of financial and ancillary services which issuers and investors require - and which many of you here today contribute to. Much has been written of late as to whether costs in Hong Kong are too high. Let me ask you to reflect on the following. Cities such as London and New York have a reputation for being expensive. So also do of a number of capital cities in former communist countries. In a very general sense one can say that London and New York are expensive as a consequence of success as business centres and because, presumably, people still feel that there is value for money there. I leave you to judge whether the others would fit that description; to my understanding, some of them have become expensive for rather different and less palatable reasons.

I strongly believe that Hong Kong fits the London-New York paradigm. Actually, our competitiveness (as measured by the real effective exchange rate) is now back where it was in mid-1997 before the onset of the Asian crisis, thanks to the sharp adjustment of property prices and reductions in labour costs, and with help from a strengthening of other currencies, notably the yen. Nevertheless, although costs may now be back closer to their norm, Hong Kong will never be a cheap place. But when you take account of what is on offer here and the high productivity of the labour force, I hope you will agree that you get value for money. Of course it is crucial for us all to pay continuing attention to raising efficiency and containing costs, but let’s not lose sight of the fact that emergence as a relatively high-salary, high-rent business centre is a symptom of success, not a reason for failure.

I wish you all an enjoyable and fruitful conference.