Introductory remarks

Peter Pang[1]

Ladies and Gentlemen,

It is my pleasure to welcome you to Hong Kong and to the Hong Kong Monetary Authority.

First of all, for the benefit of those of you who are visiting us for the first time, let me briefly explain the relationship between the HKMA and the Hong Kong Institute of Monetary Research, the co-sponsor - together with the Asian Office of the BIS - of the conference. The HKIMR was established by the HKMA in 1999 to promote and conduct research in the fields of monetary policy, banking and finance with particular reference to Hong Kong and the Asian region. The Institute organises seminars and workshops for central banks in the region, and it has an active visiting-fellow programme that brings some 20 internationally respected scholars to Hong Kong each year to work on their research projects.

The HKIMR also organises regular international conferences such as this one. The theme this year, "Monetary policy approaches and implementation in Asia", is, I believe, both timely and important. Far from being a homogeneous dollar block as Ronald McKinnon has previously suggested, Asian central banks are becoming increasingly heterogeneous in their choice of monetary policy strategy. At one end of the spectrum there is Hong Kong, which has adopted a strategy based on an external anchor and hard exchange rate peg as its monetary policy. At the other end there is Japan, with a floating exchange rate and a policy strategy based on domestic economic considerations that currently dictate a zero interest rate and quantitative easing to guide the economy out of the deflation of the past.

The other countries in the region are located at various points between these two positions. Malaysia has an approach which, until recently, was similar to that of Hong Kong, whereas South Korea and Thailand are closer to Japan.

A new challenge for central banks in the region appeared in July this year when mainland China announced a new exchange rate regime, abandoning the fixed peg to the US dollar and adopting a managed floating system with reference to a basket of currencies. The main challenge, of course, is for the People's Bank of China, which over time will have to "design a framework for an independent monetary policy" - to paraphrase the title of the paper by Goodfriend and Prasad that will be presented tomorrow.

The change in the exchange rate regime of the mainland also has wider implications for other central banks in the region. The prospect of greater variability in the renminbi/US dollar exchange rate may lead to greater variability of cross-rates between Asian currencies. What is the appropriate monetary policy response to such increased variability? More generally, what should be the role of the exchange rate in the policy strategy of central banks that have opted to rely on a domestic anchor for monetary policy? These are important questions that I am sure you will debate during the coming two days, and I look forward to hearing the conclusions that you will reach.

Monetary policy is not only about setting a target for the exchange rate, the interest rate or some monetary aggregate. As recent analysis and experience have shown, communication with the public about policy goals and operational strategies is also an important element of a successful policy strategy, as it can influence the credibility of the central bank and hence the

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effectiveness of policy initiatives. I note that these aspects of monetary policy will also be discussed at the conference, and I am sure that there is a lot that we can learn from each other's experiences.

Monetary cooperation in the region is a topic that is close to the heart of us here at the HKMA, and such cooperation must always start with a thorough understanding of the challenges faced by each central bank and how it has chosen to deal with them. Conferences such as this one are a good way to improve such understanding, and I am pleased to see such a distinguished group of experts gathered here for this occasion.

Before concluding, allow me to take a few minutes to explain the institutional context in which the HKMA operates, and some aspects of our monetary policy strategy. In Hong Kong's case, the Financial Secretary is responsible for determining the government's monetary policy objective, but the Monetary Authority is, on its own, responsible for achieving this objective. In the current jargon of monetary theory, the HKMA has instrument independence but not goal independence.

The objective of monetary policy in Hong Kong was stated in a letter from the Financial Secretary to the Monetary Authority in 2003 as a stable exchange value of around 7.80 Hong Kong dollars to 1 US dollar. The letter also stated that the structure of the monetary system shall be characterised by currency board arrangements.

The Linked Exchange Rate system continues to evolve over time in response to market conditions. The latest round of refinements was introduced in May 2005 in response to the speculative pressures on the strong side of the link as the Hong Kong dollar came to be used as a proxy for speculation on a renminbi revaluation. In short, the refinements created a target zone for the Hong Kong dollar between 7.75 and 7.85, thus making our system symmetrical around the 7.80 value specified in the letter from the Financial Secretary to the Monetary Authority. The HKMA views transparency in its operations as essential for promoting confidence in the Linked Exchange Rate system among market participants and the general public. For this reason we make public all interventions in the foreign exchange market as they are carried out.

I believe that the current monetary system in Hong Kong has served our economy well. In part this is surely due to a well defined monetary policy objective that matches Hong Kong's particular circumstances. But I venture to say that the success is also in part due to the clear and transparent approach we have taken in carrying out our mandate. I will leave it to Stefan Gerlach, our former Executive Director for Research, to give you more detail about our exchange rate regime when he presents the paper on Hong Kong tomorrow.

So to conclude, it is a pleasure for me to welcome you to Hong Kong and to this conference, and I wish you success in your deliberations.

Thank you.