Mr Yam's statement on the listing of Exchange Fund Notes on the Hong Kong Stock Exchange

Speech by the Chief Executive of the Hong Kong Monetary Authority, Mr Joseph Yam, JP, at the listing of Exchange Fund Notes on the Hong Kong Stock Exchange on 19 July 1999.

Mr Lee, Mr Chan, Distinguished Guests, Ladies and Gentlemen,

Today's signing ceremony paves the way for the listing of Exchange Fund Notes on the Hong Kong Stock Exchange next month. In addition to offering retail investors an attractive and reliable investment opportunity, this listing will mark an important milestone in the development of Hong Kong's debt market.

Hong Kong, and indeed Asia as a whole, lacks an active debt market. What should in theory serve as an important pipeline of financial intermediation, through which the savings of the community flow into productive investment, has, in this region, always been constricted. At times, it has been quite clogged up. By the standards of developed market economies, our reliance on the banking and equity markets, the two other channels of financial intermediation, has been, and still is, disproportionately heavy. As a result, we cannot really say that financial intermediation in Hong Kong is entirely efficient. One consequence is that, in the event of a failure in one of those channels of systemic proportions, the pressure built up in the other channels could become unbearably great, and even explosive. A further consequence is disruption to the flow of money from savings to investment and disruption to the economic activities that are so important to the well being of our community.

By contrast, we saw in the case of LTCM how, in well developed financial markets, financial flows can be effectively redirected to the banking and equity sectors in response to the failure of the debt market. Indeed, the banks themselves were called upon to rescue LTCM and ensure that, even with dislocation in the debt market caused by excessive leveraging, the financial system could continue to function.

No matter whether we are responsible for the plumbing of the financial system or for making money work for the community, we in the financial community all have an interest in ensuring that money flows through these three channels freely, safely and efficiently. One important task for all of us has always been to develop a liquid debt market for Hong Kong.

As you are aware, the Exchange Fund debt programme, which started in March 1990, is part of that effort, although the development of the debt market was not the only objective of the programme. Since then, we have brought to the market a total supply of paper amounting to about $100 billion, with maturities ranging from three months to ten years. We have also developed a robust infrastructure for the debt market that is fully integrated with the real time payment system to achieve real time "Delivery versus payment" in the trading of Exchange Fund paper. But interest in this market at the retail level has been slow to develop. The paper is predominantly held by banks for liquidity purposes and a small part is held by institutional investors. There are a number of reasons behind this lack of retailer interest.

First, at least until recently, the real interest rate has been low and sometimes negative, and so the yield of Exchange Fund paper has not been attractive.

Second, as issuer, the Hong Kong Monetary Authority does not have the capacity to market the paper at the retail level. And, quite understandably, the banks who are recognised dealers and market makers are not keen to market the product for us in view of the possible impact on their deposit base.

Third, there is no convenient market infrastructure, in terms of both market information and mechanisms for participation, through which retail investors can access that market.

They may be other reasons. But to the extent that these three reasons are significant, our plan here to list the longer term paper, what we call the Exchange Fund Notes, on the Hong Kong Stock Exchange, and have trades settled through the established securities clearing system of CCASS, at a time when there is a significant positive real interest rate, should effectively address them.

According to this plan, Exchange Fund Notes will be listed on the Hong Kong Stock Exchange on 16 August 1999. On that day, all 57 outstanding issues of Exchange Fund Notes, with a total value of more than $34 billion, will be so listed. I very much hope that this joint effort by the Hong Kong Stock Exchange, the Hong Kong Securities Clearing Company and the HKMA will successfully stimulate retail interest in our Exchange Fund Notes and, more importantly, retail interest in debt instruments generally.

Let me now take this opportunity to do a bit of advertising. The Exchange Fund Notes are, of course, issued for the account of the Exchange Fund. Furthermore, all issues of Exchange Fund paper are fully backed by foreign reserves. For every HK$780 worth of Exchange Fund Notes there is US$100 held in the Exchange Fund. Investors therefore need have no concerns about the ability of the Exchange Fund to repay this debt. At this time, the Exchange Fund Notes also attract a yield higher than that for US dollar Treasury securities of corresponding maturity. Interest income from holding the Exchange Fund Notes will be exempt from profits tax and trading in the paper will be exempt from stamp duty. The Stock Exchange has also offered to lower the brokerage commission on these products. For a community that has always had a keen and very wide participation in the stock market, the convenience of being able to buy and sell the Notes on these terms, through the brokers on the Exchange, speaks for itself.

So much for the advertisement. May I conclude by extending my warmest congratulations to all of those involved in taking forward this important project. I hope that this project will prove to be a success and I look forward to further cooperation in the future with all who have an interest in developing the debt market in Hong Kong and in the region as a whole.