Hong Kong monetary policy & the economy: Recovering from Asian financial crises

Joseph Yam

Joseph Yam is often described as the Alan Greenspan of Hong Kong. He is chief executive of the Hong Kong Monetary Authority (HKMA) and has served in this capacity since its establishment. In 1991, he was appointed Director of the Office of the Exchange Fund, and in 1985 was appointed Deputy Secretary for Monetary Affairs. Mr. Yam started his civil service career in Hong Kong as a statistician in 1971 and became an economist in 1976.

To stay strong, said Yam, Hong Kong’s economy must adhere to free market principles, be ruled by strict but flexible fiscal policies, and be facilitated by a small, disciplined government that can make rapid external adjustments and leverage imports. China’s SAR is adhering to these principles and the outlook for the economy is for a strong domestic recovery.

However, there is residual pain caused by the 1998 Asian Financial Crisis and a host of unknowns which could negatively impact Hong Kong’s economy depending on future developments.

- Oil prices
- U.S. hard/soft landing
- Asia and the Euro
- Japan’s economic recovery
- Vulnerability of emerging markets.

"We must remember that the geographic region is in different stages of development," said Yam. "Japan and China both want to be Hong Kong’s big brother. According to the philosophy of the Association of Southeast Asian Nations, the future lies in having a closer relationship. When Asia is profitable, Australia and New Zealand tend to be part of Asia; when Asia isn’t profitable, they tend to fade away. And the low Australian and New Zealand dollars could be contagious."

The role of the Hong Kong Monetary Authority

The primary monetary policy objective of the HKMA is to maintain exchange rate stability within the framework of the Linked Exchange Rate System and to adhere to the discipline of the currency board arrangements under that system.

The Hong Kong dollar is linked to the U.S. dollar at an exchange rate of HK$7.8 to US$1. Licensed banks must convert Hong Kong dollars in their clearing accounts into U.S. dollars at the fixed exchange rate.

The link was established in 1983 to encourage stability and investor confidence in the run-up to Hong Kong’s reversion to Chinese sovereignty in 1997. The PRC has supported the policy of maintaining the link.

The HKMA, together with the currency board and its subcommittees, works to keep the Hong Kong dollar on a sound footing and safeguard it from manipulation by speculators. The currency board arrangements are complex, with many benefits.
There are no foreign exchange controls of any kind under the system. The overall exchange value of the Hong Kong dollar is influenced predominantly by the movement of the U.S. dollar against other major currencies. The price competitiveness of Hong Kong exports is therefore affected by the value of the U.S. dollar in relation to third country currencies.

The linked exchange rate system, which in 1998 was beefed up, has proven to be the linchpin of financial stability in Hong Kong and is widely supported in the world’s financial community.

Volatility in international capital flows can be very destabilizing and present tremendous risks for the world economies. Properly managing these risks is critical to ensuring that capital flows are not disrupted. The HKMA has mechanisms in place to mitigate risks and stabilize the economy.

There have been times when large scale Hong Kong dollar transactions - such as in the case of large Initial Public Offerings - created extreme conditions in the inter bank market. Joseph Yam, chief executive of the HKMA, has made it clear that, in these circumstances, the HKMA may lend to or borrow from the inter bank market to dampen extreme conditions.