

Hong Kong: Currency Stability & Recovery Prospects

By

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Background

- Hong Kong dollar is linked to the US dollar at US\$1 = HK\$7.8 since October 1983. The issuance of all HK\$ bank notes have been supported by US\$ reserves.

Why the linked exchange rate regime is the best for Hong Kong:

- HK: small and open economy (total external trade value is 2 1/2 times that of its GDP and the daily capital inflow and outflow is again huge relative to the size of the economy)
- Link: equivalent to an anchor or monetary rule with an external indicator (i.e. US\$) which is easily understood by all walks of people.

**Essential attributes which make HK a
successful example of an economy
doing well under a linked exchange
rate system:**

- Flexible cost/price structure
- Strong banking sector to cope with interest rate volatility
- Ample and sufficient foreign exchange reserves
- Government observing strict fiscal discipline

Measures to strengthen Currency Board Arrangements in September 98

- Convertibility Undertaking
- Provision of day-end liquidity through Discount Window

Convertibility Undertaking

Objective

- Clear demonstration of Hong Kong's unwavering commitment to the linked exchange rate system

Provision of Liquidity through Discount Window

Objective

- Giving banks greater assurance of their access to day end liquidity through the use of Exchange Fund papers (which are fully backed by foreign exchange reserves) for repo with HKMA
- Dampen excessive interest rate volatility

HK economic outlook: Turning round the corner?

- Continuing and steady growth in China at high single digit will benefit Hong Kong's real sector.

HK economic outlook: Turning round the corner?

- Monetary sector link to the US because of our currency link to the US\$ - our recent measures of further strengthening and purifying the Currency Board Arrangements have further increased the confidence of the financial sector and the HK people in our monetary sector
- ⇒ more stable and lower interest rate environment

HK economic outlook: Turning round the corner?

- Interest rate outlook in the US - Monetary policy in the US has so far been accommodative.

HK economic outlook: Turning round the corner?

- Stock market - Hong Kong is a financial center with a high degree of affluence and very substantial savings among the people in Hong Kong.
- ⇒ Once the sentiment of the investors, both local and overseas, changed for the better, there has been very substantial rebound in the stock market as in the past few months.

HK economic outlook: Turning round the corner?

- Property market: land scarcity (limited supply) and HK, in the context of China, is like Manhattan in the context of US (strong potential demand).
- Property prices in Hong Kong command a premium over property prices elsewhere.