

Chief Executive's Statement



A year of recovery

In 1999 the recession that had afflicted Hong Kong for fifteen months lifted and the economy began to grow again. Against a background of market stability and renewed confidence, the recovery gathered momentum towards the end of the year. GDP growth moved from negative to positive in the second quarter, and registered 2.9% for the entire year. During the year unemployment, though still high, declined from a peak of 6.3% in the spring to 6.0% at the end of the year. The stock market recovered all the ground lost during the Asian financial crisis and ended the year at 16,962 – the highest point of the year.

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1998 – non-performing loans resulting from prolonged regional crisis and Mainland-related debt – began to recede, as provisioning for the former declined and constructive solutions were devised for the latter. Banks as a

whole saw improved results for the year, and some enjoyed remarkable growth in profits.



The assets of the Exchange Fund rose by 10% during the year and passed the trillion-dollar mark at the end of December. Much of the increase came from windfall gains on the Hong Kong equity portfolio acquired during the market operation of August 1998. The objective of that operation was to restore stability to Hong Kong's financial markets – a measure which, as is now generally acknowledged, was as effective as it was necessary. The further benefit of a substantial increase in the official reserves held for the people of Hong Kong has been a welcome by-product of this operation, though it should be recognised that a windfall of this kind is unlikely to be repeated in the future. The Hong Kong equity portfolio is under the management of Exchange Fund Investment Limited (EFIL), at arm's length from the HKMA. In

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November, EFIL successfully launched the Tracker Fund, which marked the first important stage in the gradual and orderly disposal of the larger part of the Hong Kong equity portfolio.

Building strength in times of calm

During this year of stability and recovery the HKMA focused its energies on reviewing and strengthening its policies, particularly in the light of the lessons learned during the financial crisis, and on preparing the ground for major reforms in the years ahead.

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The Sub-Committee on Currency Board Operations, under the Exchange Fund Advisory Committee, reviewed the whole range of currency board operations and monitored the progress of the strengthening measures introduced in September 1998 during their first full year of operation. The year saw a number of further reforms to the Currency Board system aimed at increasing transparency and further entrenching rule-based, non-discretionary principles. In August, the Hong Kong Institute for Monetary Research was established under the auspices of the HKMA with the objective of promoting the study of monetary, banking and financial issues of strategic importance to Hong Kong and the Asian region. In September, the official opening of our London Representative Office completed our arrangements to honour the unconditional Convertibility Undertaking – one of the most vital elements in our Linked Exchange Rate system – across the globe and around the clock.



The measures to improve the transparency and stability of our monetary arrangements within Hong Kong were echoed in the international sphere by our strong advocacy of greater disclosure and better risk management in the global financial market. On behalf of Hong Kong, the HKMA participated in a number of international forums, including the new Financial Stability Forum, to examine the causes of the volatility that has disrupted small, open markets, and to propose solutions. While considerable progress has been made towards achieving international consensus about the nature of the problem, and in drawing up preliminary proposals to tackle it, much work still remains to be done before concrete solutions can be put in place. It is important, in these unpredictable times, that we and our international counterparts do not slacken our efforts by assuming that the renewed stability currently being enjoyed by world markets can continue indefinitely. As we learned in 1997, financial storms strike quickly and without warning. Emergency responses after the event are no substitute for constructive and well planned prevention.

Preparing for a new millennium

Hong Kong – and the world at large – saw the benefits of solid preventive measures as the century turned at midnight on 31 December. A long period of extensive and near-exhaustive rectification work and contingency planning helped to bring our computer systems through the Year 2000 critical periods with the minimum of

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disruption. Throughout the financial community, and particularly in the banking sector, achieving Year 2000 compliance and maintaining public confidence in the measures taken to safeguard financial records were crucial objectives in the successful campaign against the millennium bug. The HKMA, in its supervisory initiatives and public communication strategy, played a central role in pursuing these objectives. The longer-term benefits of the exercise are an extensive upgrading of computer systems across the banking sector and valuable experience in contingency planning and crisis management.

As banks looked beyond the Year 2000 problem towards new technology-based initiatives and more sophisticated services, the HKMA initiated a programme of supervisory reforms aimed at supporting the development of Hong Kong's banking



sector into the twenty-first century. Following the publication of a major consultancy report on this subject in January 1999 and a public consultation in early 1999, the HKMA announced in July a package of banking reform measures to be implemented over the course of the next few years: the aim is to remove barriers to competition without compromising safety and soundness.

Implementation of the banking reform measures began in 1999 with a clarification of the HKMA's role as lender of last resort, a relaxation of the one-building condition for foreign banks, and the decision to allow access by restricted licence banks to the Real Time Gross Settlement system. The process of reform will continue in 2000 and 2001 with further deregulation of the interest rate rules, major studies on enhancing deposit protection and establishing a credit register, and reviews of the three-tier licensing system and market entry criteria. Further work is in progress to improve the financial disclosure framework, develop a more risk-based supervisory regime, and promote higher standards of corporate governance. Separately, the HKMA will be focusing on ensuring that supervisory policies and practices are able to address the needs and special challenges created by the proliferating and rapidly developing electronic banking industry.

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The role of the HKMA in all of these reforms is to facilitate – but not to direct – the development of Hong Kong's banking sector in a rapidly changing, increasingly competitive local and global environment. It is for the banks themselves to make the strategic decisions that will determine whether they are able to thrive in this new environment. What is clear, however, is that, in an age in which fierce competition and technological innovation play an ever increasing role in determining a bank's viability, the scale on which a bank conducts its business is vitally important. One solution to this challenge for the smaller banks lies in consolidation: Hong Kong's banks have generally been slow to accept this global trend, but they seem gradually to be recognising its advantages, for example, in the strategic alliances that some of them have formed to develop Mandatory Provident Fund products.



The HKMA's other responsibility as facilitator - in developing the larger infrastructure for Hong Kong's financial transactions and its overseas links – saw progress in a

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number of areas in 1999. Following the debt market linkages opened with Australia and New Zealand in 1998, a bilateral linkage was established in September 1999 between the Central Moneymarkets Unit in Hong Kong and the Korea Securities Depository. The HKMA implemented a number of

initiatives - most notably the listing of Exchange Fund Notes on the Stock Exchange – to promote the development of the debt market in Hong Kong and played a productive role in the APEC initiative aimed at fostering the development of bond markets throughout the region.

In 1999 the HKMA also sowed the seeds for a major infrastructural project that promises to mark an important stage in Hong Kong's development as a financial centre. In the second half of the year preparatory work was carried out for the introduction of an advanced US dollar clearing in Hong Kong. The project, which is expected to be brought to fruition in 2000, will enable rapid settlement of a wide range of US dollar transactions within the Hong Kong time zone, bringing with it the advantages of increased speed and efficiency, and reduced settlement risk.

Hong Kong in the new millennium

Measures to strengthen the currency board system, banking sector reforms, infrastructural development, and our wider efforts to promote changes to the international financial architecture all, to varying degrees, embrace the five main principles that guide the HKMA in its work: stability, transparency, safety, integrity and efficiency. We believe that these qualities are fully consistent with Hong Kong's needs as an international financial centre and with the expectations that the community has of its financial system. In 1999 we made special efforts to explain our work and increase our accessibility to the general public: we intend to take this process further in 2000 with a number of new initiatives, the highlight of which will be an exhibition on money and banking in Hong Kong.

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The new millennium, the advances in globalisation and technological innovation that come with it, and not least the expected accession of China to the World Trade Organisation bring new opportunities on a number of fronts for Hong Kong's further development as an international financial centre. The economic recovery now in progress enables us to focus on these opportunities with renewed energy and confidence. We should, however, be mindful of the risks and uncertainties that accompany these opportunities. The main uncertainty is whether the imbalances in industrial economies, particularly in the US, and the signs of overheating in the new economy of technological services will precipitate a further round of contagious financial turmoil. The main risk is that, in our enthusiasm for innovation or in our complacency with things as they are, we cease to see clearly the weaknesses in our global financial system and fail to take the measures to remedy them.



Joseph Yam
Chief Executive

