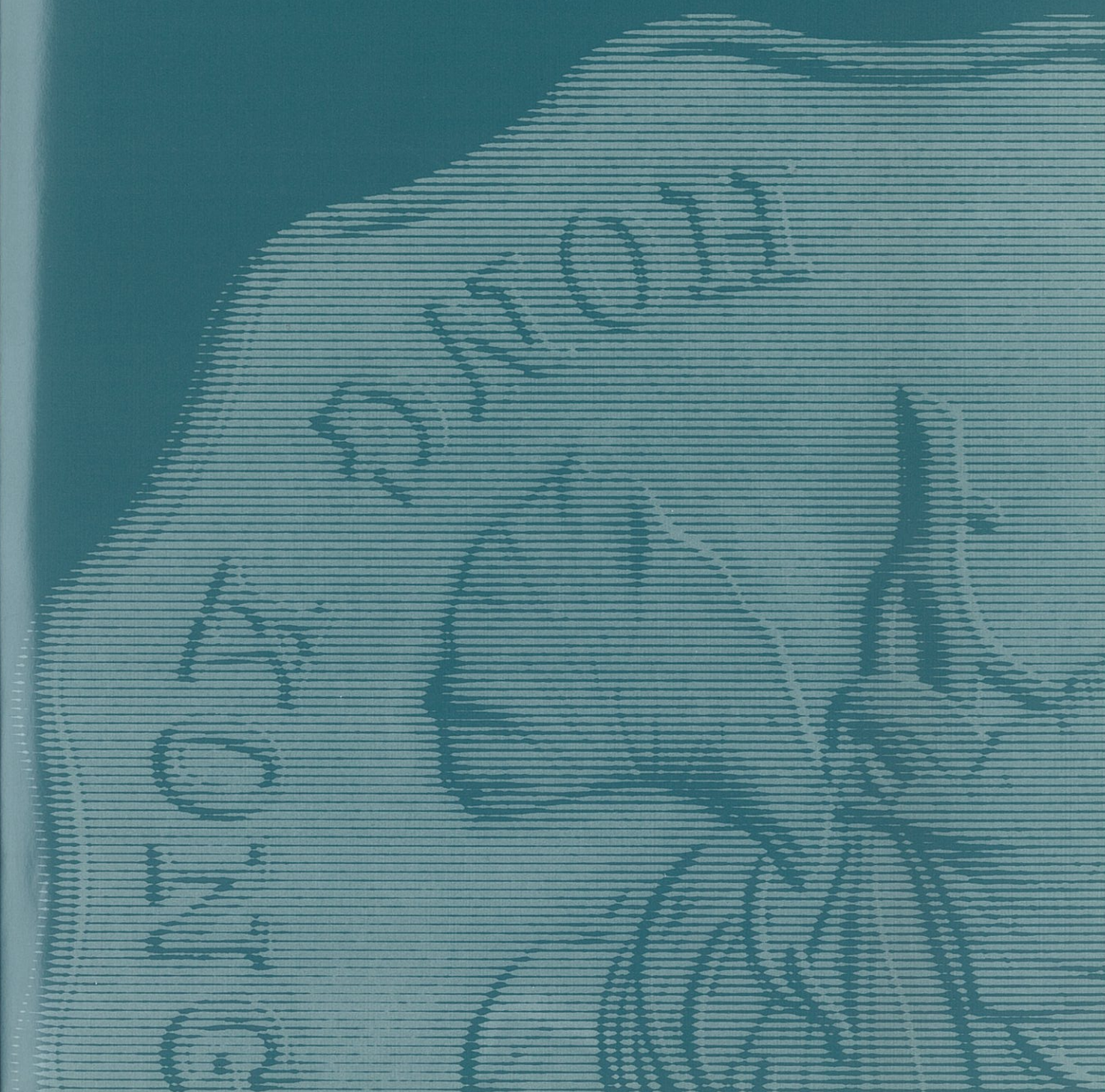


**The Monetary Authority's Operations
in 1993 and Review of the Year**





Hong Kong is undergoing economic and political transition. It is imperative for the stability and prosperity of Hong Kong that confidence in our monetary and financial systems be maintained. We need to ensure that our monetary system is robust and the mechanism for monetary management is effective. We need to ensure that our financial markets operate with integrity and our financial institutions are run prudently.

The Sino-British Joint Declaration specifies that after 1997 "the Hong Kong Special Administrative Region will retain the status of an international financial centre." We need therefore to provide the appropriate environment for the maintenance of this status.

To this end, important regulatory, supervisory and development roles need to be performed with a high degree of professionalism and continuity, and in a manner that commands the confidence of the people of Hong Kong and the international financial community.

This is why the Monetary Authority was established, within the framework of our executive-led Government, through the introduction of appropriate amendments to the Exchange Fund Ordinance. Serving *de facto* as the board of the Monetary Authority is the Exchange Fund Advisory Committee, chaired by the Financial Secretary.

In the discussion leading to the establishment of the Monetary Authority on 1 April 1993, it was clear that there was strong support from the people of Hong Kong and the international financial community. There was also strong support from both Britain and China.

In this, as in other developments of the monetary system of Hong Kong over the years, we have received valuable guidance from the Bank of England. Mr Eddie George, Governor of the Bank of England, paid a visit to Hong Kong in November 1993. Speaking to HKAB, he "very much welcomed the establishment of the Monetary

Authority" and confirmed that the Monetary Authority "can rely upon the continuing support of the Bank of England, and its active co-operation".

We have also over the years developed a close relationship with the People's Bank of China. The establishment of the Monetary Authority has enabled this important relationship to be intensified. Mr Chen Yuan, Deputy Governor of the People's Bank of China, was in Hong Kong in October 1993 as guest speaker at a seminar organised by the Monetary Authority. He welcomed the "further development of the good co-operative relationship between the two monetary authorities" and said that after 1997 the People's Bank of China "will not take the place of the Hong Kong Monetary Authority." This is a clear demonstration of the "one country, two systems" concept applying in the monetary field. After 1997, there will be two currencies, two monetary systems and two responsible monetary authorities.

The Monetary Authority received a very warm reception from the central banking fraternity; it is now actively participating in activities of central banking organisations. These are valuable opportunities for the Monetary Authority to keep in touch with, and contribute to, the development of central banking matters. This will enable the Monetary Authority effectively to promote Hong Kong's status as an international financial centre.

I am very honoured to have been appointed as the first Chief Executive of the Monetary Authority. The Monetary Authority has had a good start and the guidance from EFAC has been most valuable. The Monetary Authority has inherited very competent staff members from the former Office of the Exchange Fund and the Office of the Commissioner of Banking. We know that there are heavy responsibilities to carry, and that we have a duty to the people of Hong Kong to carry these responsibilities effectively. We know that in doing so, we will be contributing

significantly to the stability and prosperity of Hong Kong in this important and historical transitional period leading up to 1997 and beyond. We will do our best.

One important task of the Monetary Authority is the maintenance of currency stability. This is defined in Hong Kong as the maintenance of a stable external value for the HK dollar at HK\$7.80 against the US dollar, within the framework of the linked exchange rate system. I am happy to report that the exchange rate has remained stable at very close to HK\$7.80 to the US dollar throughout 1993. Furthermore, HK dollar interest rates have remained close to US dollar interest rates, as would be expected when currency stability is achieved.

There have, nevertheless, been some inflows into the HK dollar during the year, predominantly for the purpose of investment in the buoyant and increasingly internationalised stock market. These inflows, together with substantial over-subscription of new share issues, occasionally affected monetary conditions during the year. On these occasions, the Monetary Authority played a key role in maintaining monetary stability through money market operations and the Liquidity Adjustment Facility. The Monetary Authority also made recommendations to authorised institutions involved in new share issues, urging them properly to identify the associated risks and to manage them prudently.

The Monetary Authority manages the Exchange Fund, which is used primarily for affecting the exchange value of the currency of Hong Kong. At the end of 1993, the size of the Exchange Fund stood at HK\$348bn, representing an increase of 21% over the level of 1992. The bulk of the Exchange Fund was held in foreign currency assets, amounting to US\$43bn at the end of 1993 (US\$35bn at the end of 1992). This is about five times the amount of bank notes in circulation and more than eight months of retained imports. This puts Hong

Kong's foreign exchange reserves the sixth largest in the world, according to IMF statistics.

It should be noted that 1994 is likely to be a difficult year in the management of reserves, because of the impact of rising interest rates on bond prices and increasing volatility in foreign currency markets.

Managing such a large fund requires a continuous upgrading of our capability in reserves management, not least because its accumulated earnings have continued to grow substantially. The Exchange Fund therefore has to be managed with a prudent strategy, balancing liquidity, risk and return.

The Monetary Authority has been placing increasing emphasis on supervisory issues. It is the duty of the Monetary Authority, working with the banking community, in particular HKAB, objectively to identify the risks inherent in the circumstances we face and ensure that they are managed prudently, so as to safeguard the stability and integrity of the banking system. During the year, the Monetary Authority focused on a number of supervisory issues. These included the large over-subscription of new share issues, mortgage lending, liquidity requirements, netting, interest rate risk, market risk, disclosure and loan classification.

The Monetary Authority also considers it in the interest of Hong Kong's development as an international financial centre to promote the financial infrastructure. Central to this are the efficiency and integrity of the interbank payment and settlement arrangements in Hong Kong. For this purpose, a working party on payment and settlement system was formed in 1993. After intensive study, and with the help of consultants from the Bank of England, the working party concluded that Hong Kong's payment and settlement system should move on to a real time gross settlement basis. The working party will continue to explore, in close consultation with HKAB, how

this could be achieved. Meanwhile, a number of interim risk management measures have been identified for implementation in 1994.

In much the same vein, the Monetary Authority has developed a central clearing and custody system for the debt market in HK dollars. It is being run by the Central Moneymarkets Unit of the Monetary Authority on a cost recovery basis. Many market participants have expressed interest in becoming members of the CMU service. It is hoped that this will strengthen considerably the infrastructure of the debt market in Hong Kong, a market that has been developing rapidly since the introduction of the Exchange Fund Bills and Notes programme in early 1990.

The work in relation to the changing of the designs of our currency has progressed in 1993. Bank notes of new designs have been introduced by the two note issuing banks, The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank. Preparatory work for the third note issuing bank, the Bank of China, to start issuing bank notes has also gone smoothly. Coins of new designs have

also been introduced and the \$10 bi-metal bauhinia coin is expected to be issued in 1994.

This Annual Report is the first of the Monetary Authority since its establishment on 1 April 1993. As promised at the outset, the Monetary Authority has tried to be transparent, fair, effective and wholly accountable in its operations. The Annual Report provides, in considerable detail, an account of the Monetary Authority's aims and activities in 1993.

There are many other transitional matters, on both the monetary and supervisory fronts, mainly concerning the relevant legislation, that need to be addressed in the lead up to 1997. I am confident that these will be dealt with, as in the past, smoothly and expeditiously. All those concerned have a common interest in ensuring that there is an effective system for the maintenance of monetary and financial stability in Hong Kong and for developing Hong Kong as an international financial centre. My colleagues and I in the Monetary Authority are determined to play a full part in helping to achieve these objectives.



Joseph Yam
Chief Executive

Membership of the Chief Executive's Committee



Mr Stefan
Gannon

Mr Norman
Chan

Mr Andrew
Sheng

Mr Albert
Cheok

Mr Gordon
Leung

Mr Joseph
Yam

Mr James
Lau

Mr David
Carse

Mr John
Nugée

Membership:

Chief Executive
Mr Joseph YAM, JP

Deputy Chief Executive (Banking)
Mr David CARSE, JP

Deputy Chief Executive (Monetary)
Mr Andrew SHENG

General Counsel
Mr Stefan GANNON

Executive Director
(Monetary Management)
Mr Norman CHAN, JP

Executive Director
(Reserves Management)
Mr John NUGÉE

Executive Director (External)
Mr James LAU

Executive Director
(Banking Supervision)
Mr Albert CHEOK

Executive Director (Banking Policy)
Mr Gordon LEUNG

