



Asia and Hong Kong Markets

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Asian crisis - growth slowed, but not as bad in USD terms

Real GDP Growth Rate (%)

	IN LOCAL CURRENCY			IN USD
	1997	1998	1999*	1999 over 1997
Hong Kong	5.0	-5.1	-0.5	-5.7
Singapore	8.0	1.5	5.0	-7.4
Taiwan	6.8	4.8	5.5	-2.6
S. Korea	5.5	-5.8	8.0	-20.5
Thailand	-1.3	-9.4	3.0	-24.8
Malaysia	7.5	-7.5	2.0	-31.4
Indonesia	4.9	-13.7	2.0	-70.2
Philippines	5.2	-0.5	3.0	-22.1

Remarks: * ADB September forecast; exchange rates for 1999 are the averages of Jan-Sep 1999

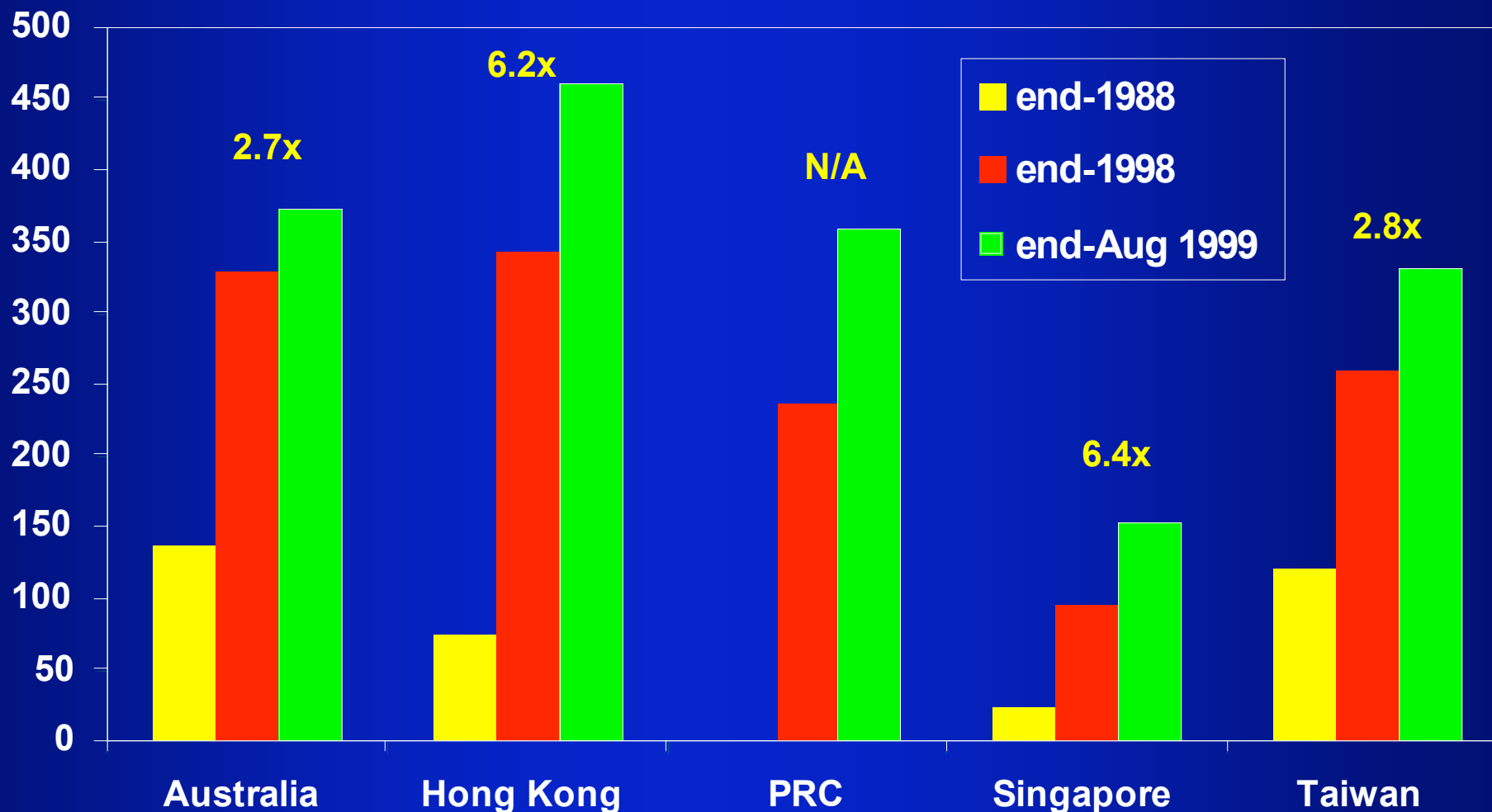


Current Account Position (US\$ billion)

	1995	1996	1997	1998	1999f
5 Asian Crisis Economies	-41.0	-54.6	-26.3	58.5	43.2
Latin America	-31.2	-34.0	-58.1	-83.1	-69.5



Regional Market Capitalisation (US\$ billion)



Remark: x = increase from end-1988 to end-Aug 1999

Source : FIBV & IFC



Stock Market Performance

	Stock Market Indices		% change	
	end-Jun 97	end-Sep 99	end-Jun 97 to end-Sep 99 in local currency	end-Jun 97 to end-Sep 99 in USD
Hong Kong	15197	12733	-16.2	-16.4
Singapore	1921	2022	5.2	-11.4
Taiwan	9030	7599	-15.8	-26.4
S. Korea	745	836	12.2	-18.4
Thailand	527	389	-26.1	-55.2
Malaysia	1077	675	-37.3	-58.3
Indonesia	725	548	-24.4	-77.9
Philippines	2809	2096	-25.4	-51.9
Australia	2726	2881	5.7	-8.7



Global Financial Crisis

- ◆ **Greater frequency & intensity**
- ◆ **Bank NPLs 15-50% of GDP**
- ◆ **Private debt exceeds GDP and many borrowers cannot grow out of debt**
- ◆ **Global contagion real**
- ◆ **Fiscal & social costs huge**

Source: World Bank Financial Restructuring in East Asia? 1999



In 21st century, banking will be important, but not necessarily banks

- ◆ Free capital flows mean loss of monetary autonomy & danger of asset bubbles
- ◆ Loss of domestic franchise & competitive pressures threaten banking stability
- ◆ Domestic payment system channel of external shocks
- ◆ Asset funds larger than banks - HLIs and proprietary trading generate herding effects
- ◆ Risk management techniques inadequate



Asset Bubbles

- ◆ **Causes - excess liquidity, domestic supply constraints, demographics, bad credit management, distorted tax incentives**
- ◆ **Solution - Tinbergen Rule - Multiple targets require multiple tools - single tool of monetary policy cannot work**
- ◆ **Example - targeting stock market bubble through interest rate policy and securities enforcement against false accounting and reporting**
- ◆ **Need for constant vigilance**



Failure of Risk Management

- ◆ **Maturity mismatch**
- ◆ **Currency mismatch**
- ◆ **Credit risks grossly under-estimated**
- ◆ **Leverage under-reported**
- ◆ **Volatility of asset prices and capital flows grossly under-estimated**
- ◆ **Need for better VAR models**
- ◆ **Need for National Risk Management**



Risk Management

- ◆ Identify the risk - does left hand know what right hand is doing?
- ◆ Measure the risk
- ◆ Pricing the risk - do interest rates reflect true risks?
- ◆ Hedging the risk - dynamic hedging
- ◆ Stress tests - how much can the system take?



Need for National Risk Management

- ◆ Traditionally risks are managed separately
 - ✦ e.g. MoF in charge of external foreign debt
 - ✦ Central bank responsible for forex reserves
 - ✦ Need for external debt (including private debt) management policy
- ◆ Separate regulatory jurisdiction does not identify cross market risks
 - ✦ Financial markets are now seamless
 - ✦ But regulations still administered by markets, eg banking, insurance, securities, fund management
- ✦ Sectoral risk concentration can build up without one single agency being aware international crime and market misconduct, e.g. money laundering



Information & Markets

- ◆ **Markets need real time, reliable information to make correct decisions, especially for risk management in highly volatile environment**
- ◆ **High quality information need: -**
 - ✦ **Good accounting standards,**
 - ✦ **Reliable, timely statistical & reporting processes**
 - ✦ **Capacity to process, analyze and decide on information critical to competitive success**



Transparency & Accountability

- ◆ Gap in Disclosure
- ◆ Gap in Incentives to use information
- ◆ Gap in GAAP
- ◆ Gap in Capacity to understand information
 - ✦ **Urgent need to raise emerging market awareness of risks and full implications of globalization**



Getting incentive structure right

- ◆ Returns must match
 - ◆ Risks, reflecting
 - ◆ Rules that ensure level playing field
- = Making market work better

Example: Do lending rates in Asia reflect historical credit risks/NPL of 15-50%?

- ◆ Returns on stocks reflect better risks
- ⇒ Must develop deep securities markets



Basic Functions of Financial Market

- ◆ Resources Allocation
- ◆ Price Discovery
- ◆ Risk Management
- ◆ Corporate Governance



Great development potential for bond market (% of GDP 1998)

	Bank Assets	Equity Market	Bond Market
Hong Kong	214	206	47
China	139	25	12
Singapore	220	112	20*
US	65	158	141
Japan	145	64	101
Germany	273	51	97
S. Korea	233	35	53
Thailand	176	30	21#

Remark: * figure for Singapore includes government bonds only; # 1997 figure
Sources: FIBV, IFC, World Bank and various central banks



Risk Management is therefore Knowledge Management

- ◆ Complexity of Global economy means we must shift risk management to self responsibility to everyone
 - ✦ **Consumer must know risks - buyer beware**
 - ✦ **Investor must have relevant price-sensitive information to assess risks**
- ◆ Must have clear principles, codes, standards, rules and regulations
- ◆ Need to educate: consumer, investor, intermediary and regulator of rights, responsibilities and risks



Financial Markets as Networks

- ◆ The wider the network, the more valuable it becomes as it draws on more resources and knowledge
- ◆ Networks have negative and positive externality
- ◆ Lessons of the Asian financial crisis



Application of Knowledge

- ◆ From technology revolution to management revolution
- ◆ Cheap and ready access of knowledge at all levels by the public
- ◆ Competition of economies becomes the competition of knowledge
- ◆ Value added by knowledge



Changes in Global Economic Structure

- ◆ Service prices have increased 3 times faster than industrial prices since 1960s
- ◆ 64% of world's wealth comprises human capital
- ◆ In US, General Electric derives 75% revenue from services and 25% from production (compared to 85% from production in 1961)



Alice Rivlin: Globalized domestic markets need

- ◆ **Flexibility and adaptability of businesses, workers and communities**
- ◆ **Willingness of workers to learn new skills, take risks and move to new jobs and places**
- ◆ **Nimbleness, flexibility and risk taking on part of businesses**
- ◆ **Communities to be adaptable, diversify economic bases, attract new jobs and residents**
- ◆ **Governments to be imaginative to design transition assistance for workers and communities to change and adapt**



Hong Kong as a Virtual Economy

- ◆ Skipped primary economic development rapidly into manufacturing
- ◆ Concentrated on supporting services in 1970s and 1980s
- ◆ Shifted to high value services such as investment banking, securities and derivatives in 1990s
- ◆ Largest service sector component in the world of 84% of GDP (76% in the US and 62% in Japan)



Hong Kong - Telecommunications

- ◆ Best technical telecom infrastructure, with 150,000 kilometres of fibre optic cables linked to 1,500 buildings
- ◆ Highest television, mobile and cellular phone penetration in Asia
- ◆ 150 Internet providers, with 150 users per 1,000 population
- ◆ Ranked 12th in the world's Information Technology-driven economies

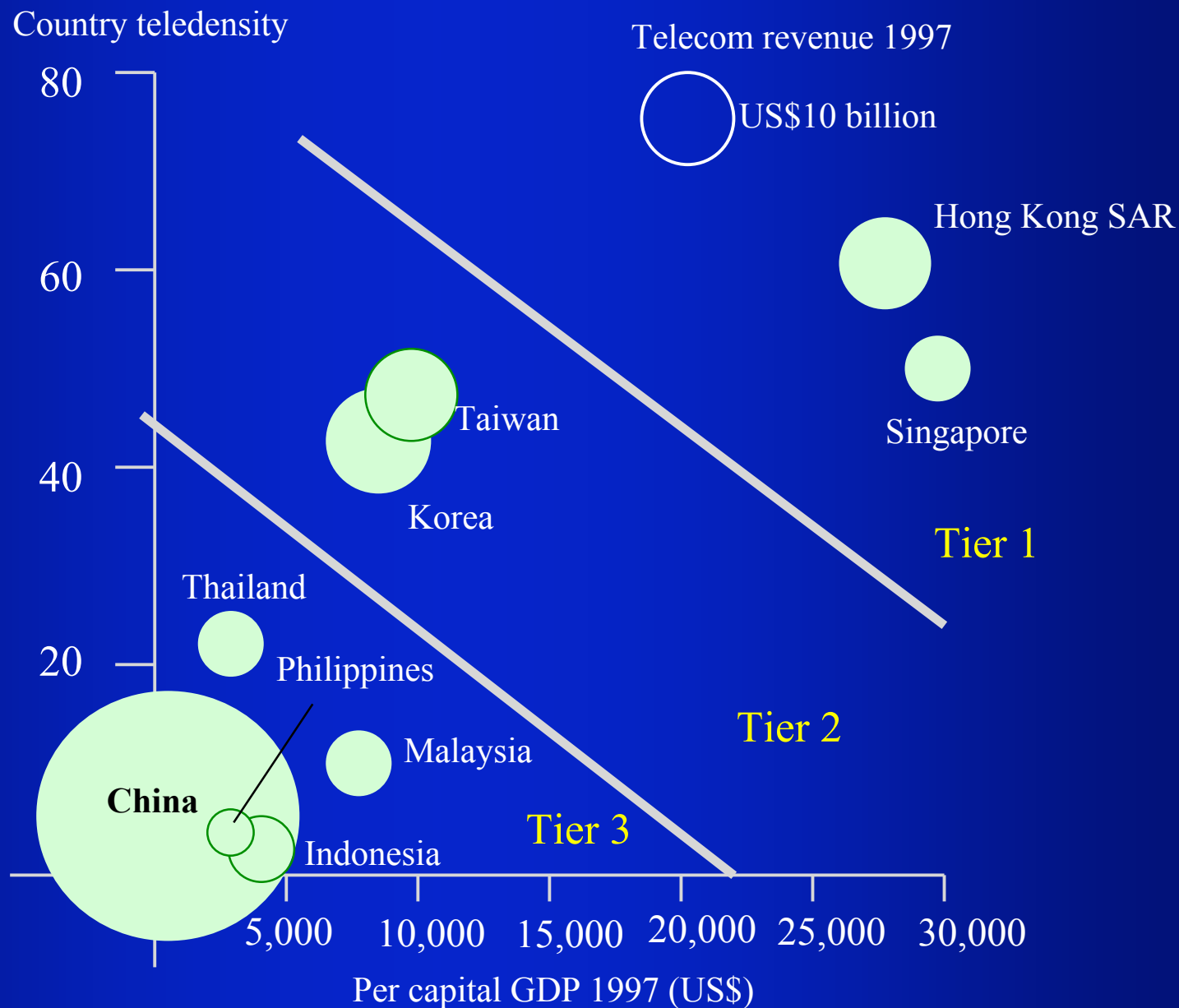


Challenges of the Digital Economy

- ◆ Fastest growth in high technology and knowledge based industries
- ◆ Even higher value added in knowledge-intensive industries (education, telecom, media and information, finance and risk management)
- ◆ Hong Kong's skills as an international financial centre combine with the technology skills of the Mainland to address the challenges



Relative development of Asian telecom markets, 1997

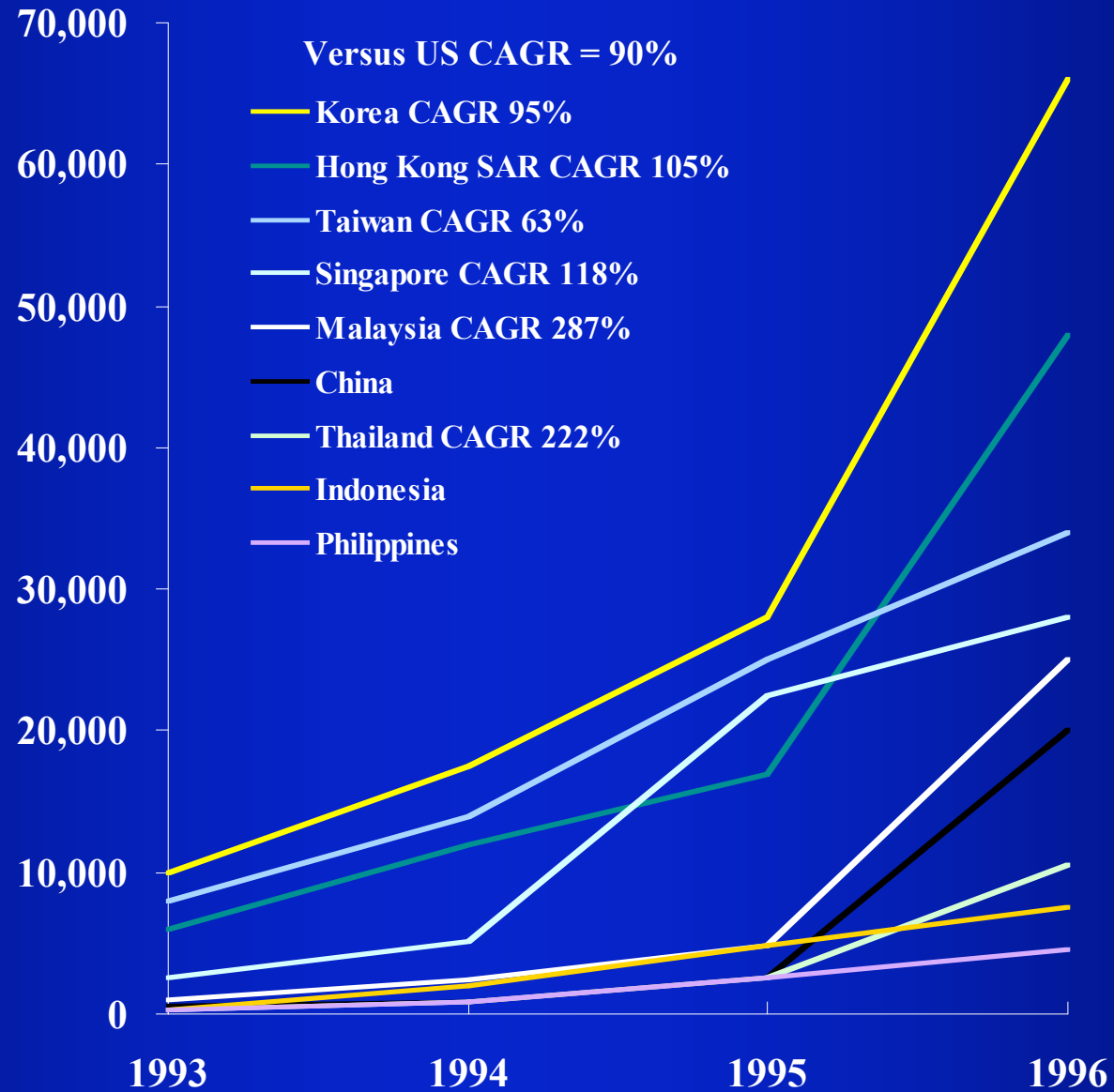


Source: EIU forecasts of 1997 GDP data; ITU teledensity data; industry sources



Growth in Internet capability, 1993-96

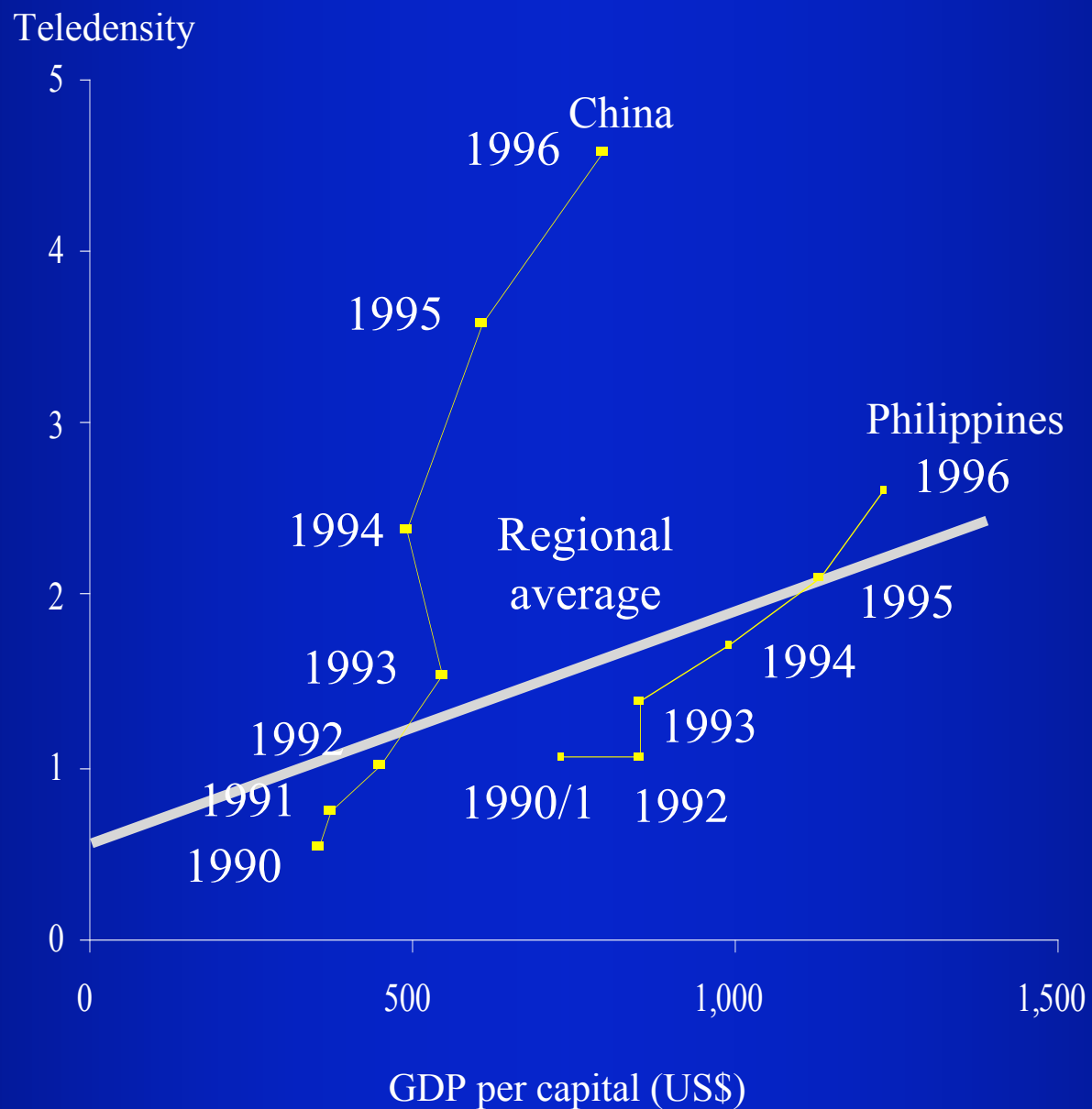
Internet host computers by region



Source: ITU



Growth in teledensity, China and Philippines



Source: ITU



China Teledensity

	Internet user base (<u>million</u>)	PC base (<u>million</u>)
1997	0.9	8.2
1998	2.1	11.1
1999	6.7	14.0
2000	12.0	17.7
2001	17.3	22.6
2002	25.5	28.9
2003	33.6	37.3

Source : IDC



China Teledensity (2)

- ◆ Internet user base will exceed 33m, growing at an annual rate of nearly 60% over the next five years
- ◆ Mobile phone usage grew by 2.34m subscribers in the first two months this year. By the end of June, total number of subscribers reached 33.1m
- ◆ Fixed-line phone subscribers jumped to 145m by the end of June, nearly triple the number three years ago
- ◆ IT market, worth US\$9.24bn in 1998, is expected to grow by 24.3% in 1999 and 31.3% in 2000



Liquid Pool of Risk Capital

- ◆ Most liquid pool of risk capital in Asia
- ◆ International financial regulatory standards
- ◆ Low tax base, absence of capital gains tax, high disclosure environment, deep professional and retail base of investors
- ◆ Growth Enterprise Market



Venture Capital in Hong Kong

- ◆ Highest concentration of venture capital professionals managing the largest pool of funds outside of Japan
- ◆ 107 venture capital funds in 1997
- ◆ More than US\$10.7 billion under management, nearly one-third of total venture capital funds in Asia



Strategy to improve competition through Privatization

- ◆ Telecom monopoly abolished and television/telecommunications open to competition
- ◆ Mass Transit Railway Corporation to be privatized
- ◆ Public housing management and water supply service being privatized
- ◆ Interest rate rules to be removed
- ◆ Utilities subject to market discipline and price competition



Hong Kong Advantages

- ◆ **Critical mass of institutional investors and efficient intermediaries**
- ◆ **High savings and deep risk appetite**
- ◆ **Low tax rate and simple tax system**
- ◆ **Hong Kong securities markets gearing up growth and development in China and global markets**
- ◆ **Best financial gateway to Asia**



Thank You