

# A less fervent apostle

Hongkong's new financial secretary continues 'positive non-interventionism' but admits to some worries

By Anthony Rowley

**Hongkong:** At a time when monetarism is becoming increasingly discredited as an economic panacea — British Prime Minister Margaret Thatcher's abrupt axing this week of cabinet colleagues who criticised her monetarism suggests she is on the defensive — Hongkong's liberal money policies ought in theory to be looking good.

But supply-siders can derive little comfort from the way the economy here is behaving. The continued liberal increase in the money supply is not bringing about the virtuous circle of increased production and productivity leading to falling inflation and rising international competitiveness which supply-siders look for.

The reason is that Hongkong's economy is as lopsided as that of its British "parent," if for different reasons. High interest rates are being used consciously (however unwisely) as a tool to screw down the money supply and inflation in Britain — though at great cost to the "real" economy. In Hongkong, the government does not believe in monetarism as such but has been forced to adopt equally damaging interest rate policies through the purported lack of any other means to control the money supply.

The fact that the government is becoming increasingly worried about its impotence on this score and its desire — willingness even — to do something about it were apparent from Financial Secretary John Bremridge's half-term speech on the state of the economy. Bremridge is an apostle of the "positive non-intervention" policies of his predecessor, Sir Philip Haddon-Cave. But he does not seem to have quite the same fervour as the master.

While repeating the conventional Haddon-Cave wisdom about interest rates being the only instrument of monetary policy available to the Hongkong Government (in the absence of public debt instruments) to mop up bank liquidity, Bremridge did make one concession to reform. "If we can contrive a simple and effective system of controlling credit creation in Hongkong which does not have undesirable and unavoidable side-effects, we will consider its introduction," he said.

Not that the money supply situation is quite as bad as it appears, he suggested. A new series of monetary statistics which separates out that part of the money supply which is in the form of Hongkong dollars from that in foreign currencies shows the broad M3 money measure to be rising this year at an annual rate of only 22%, he argued. If the foreign currency element — 16% of total M3 and mainly in the form of US dollars — is added, the latest annualised rate of increase rises to 28%, which is

still well down on last year's 39.9% and just about right to accommodate inflation plus growth in gross domestic product — expected to run out at 14% and 10% respectively this year, said Bremridge.

But all this is semantics. The foreign currency element could, as Bremridge acknowledged, at any moment be converted into Hongkong dollars, thus boosting the domestic money supply. The real crux of the matter, meanwhile, is that so much of the money supply increase, however defined, is going into non-productive property assets. As Bremridge himself put it: "Unfortunately, though present lending rates are high in real terms they are not so high or have not been so high until recently, in relation to the level of capital appreciation that has been available in the property market.

"This has meant that one major user of credit has not been deterred by high interest rates from borrowing at a time when other credit users, such as manufacturers

(HK\$ million)			
June 1981	Banks	DTCs	Total
Foreign trade finance	21,475	2,915	24,390
Other loans for use:			
In Hongkong	89,356	32,294	121,650
Outside Hongkong	26,422	27,701	54,123
Place of use unknown	11,900	16,013	27,913
Total	149,154	78,924	228,076

and traders, are finding that high interest rates threaten the viability of their businesses." These "painful consequences" made him loath to see any further increase in interest rates, though inflation might yet demand them, Bremridge added.

He gave no indication that the government is prepared to adopt the one positive (against largely negative interest rate policies) solution for controlling money supply which lies in its own hands. This is to reverse its own budgetary surpluses, which arise very largely from land sales at prices which themselves push up property prices and penalise industry, and run a deficit, at least for a time. The (non-inflationary) issue of government bonds or bills to finance such deficits would provide food for an eager money market in Hongkong and the instrument for open-market operations to control the money supply. Bremridge argues that under Hongkong's liberal exchange-control regime borrowers could easily turn offshore for funds if the local banks were constrained by any such operations. This is true, but they would probably not obtain new credit offshore with the same abandon that Hongkong banks create it.

As things are, the government's surpluses this year are likely to run out "well in excess" of the budget figure of HK\$7.8

billion (US\$1.3 billion). Land sales are a major factor, though interest tax and stamp duties, both of which have been heavily criticised by the financial community, are another. Buoyant revenues arising largely from record profits in property and banking are yet another.

A further undesirable side-effect of the increase in money and credit creation is the "high growth rate of imports of consumer goods in the first half of 1980." This, together with a sharp rise in Hongkong's re-exports, means that overall import growth will rise faster than expected.

The sharp rise in imports is not helping inflation and will inevitably mean a greater trade deficit than previously forecast. Despite the fact that re-exports have surged in the first half of this year largely on the back of China trade, helping to bale out stagnant domestic exports, the visible trade deficit in this period was HK\$10.5 billion against HK\$7.6 billion in 1980.

Bremridge, like his predecessor, attempted to put a brave face on this by arguing that the trade gap (that proportion of imports not covered by exports) has widened only slightly. But the real issue is that, with per capita tourist expenditure stagnating, one major component of the invisible exports Hongkong relies on to cover its trade deficit however defined is looking problematical.

This is hardly helping the Hongkong dollar which, like other trading currencies (only more so), is being buffeted by the high interest rates that are integral to United States President Ronald Reagan's monetarist policies. For the moment this effective devaluation of the Hongkong currency is helping exports. The export-weighted exchange rate index fell by 4.9% in the first eight months of 1981 against a fall of only 2.5% in the import-weighted index. But rising domestic inflation, fuelled in part by the rapid increase in consumer credit, could quickly erode this advantage, as Bremridge acknowledged.

His thinking on what the government should do to "prevent the benefits of a depreciation of the Hongkong dollar being depreciated" seems to be (like Haddon-Cave's) that the government should, if anything, reduce its spending to avoid overheating the economy. Unless land-sale policy and perhaps interest-tax policy are changed, this points to even bigger government surpluses in future rather than deficits. Any "anti-inflationary" benefits which Bremridge claims for such a fiscal stance are being more than offset by the lack of any effective means of controlling credit creation, such as through government debt instruments.

Overall, Hongkong's economic growth, though still strong by international standards, is highly unbalanced. As the financial secretary acknowledged: "The growth rate of the economy is being led more by domestic demand than by exports, a situation that cannot be sustained indefinitely." The growth in prices is also "undesirable" as is the widening trade deficit, he added. Property, the one side of the economy which has been benefiting from liberal supply of money, is showing serious signs of weakening, something which is rightly worrying some of the local and foreign banks which have invested heavily in this sector.