Meddling Mandarins

Who's afraid of Beijing? Hong Kong's most worrisome financial manipulators are right at home. BY SIN-MING SHAW

AUG. 14, 1998, WAS A MILESTONE IN THE ECONOMIC HIStory of Hong Kong. The government intervened heavily in the stock and futures markets, purchasing securities on a massive scale, not to make money but "to make sure currency manipulators lose money," in the words of Joseph Yam, head of the Hong Kong Monetary Authority. With that, the government launched a fateful war on speculators, and may have dug its own grave.

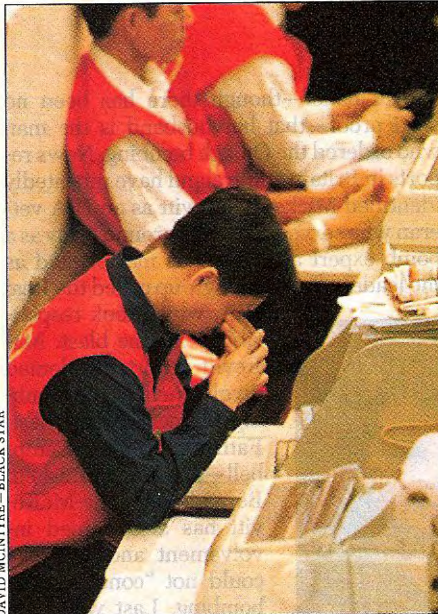
Markets usually make a mockery of such rescue operations. The government of Chief Executive Tung Chee-hwa has effectively set a moral floor for the stock market at 6500, the level at which the financial mandarins intervened. Now, if the market falls below that level, as most professional investors believe it will, the authorities will have a serious credibility problem.

Of course, Yam and his peers deny any intent to set a market floor. But if the 6500 level was worth defending last week, it's worth defending next week. Shouldn't they finish the war they started? In fact, for speculators to lose money the government would have to push the market to much higher levels, in order to hurt those who have sold the market short. If they abandon the battle, they will have misled individual investors who bought last week believing official claims that the market was too low. If they continue the battle, they court even worse trouble.

The government is unwilling to see rising interest rates, which are an inevitable consequence of Hong Kong's "peg," or fixed-exchange-rate system. That system forces the economy to adjust to an overvalued Hong Kong dollar and overblown stock and real-estate prices. By fighting this adjustment process, the government is close to admitting that it no longer wants to play by the rules of its own system. And if the monetary authority loses its battle against speculators, Hong Kong would suffer a substantial depletion of its reserves and destroy the peg. The cost to taxpayers and to confidence in the Hong Kong economy would be devastating.

In his defiant defense of intervention, Yam declared that governments could, in fact, be more correct than the market. He cited the ongoing collapse in the emerging-market stocks and currencies, which in his view could not be based on economic fundamentals. He believes massive G-7 intervention is inevitable for self-interest. But if in fact the "speculators" were wrong, why not do the smart thing and simply let them lose money for being wrong?

Global investors see the government's reasoning as inconsistent at best. After all, this is the same laissez-faire government that never objected when local speculators helped propel stock and property prices to extreme levels in years past. Through irresponsibility and hubris, Hong Kong officials, past and present, have allowed a real-estate bubble to grow to epic proportions.



DAVID MCINTYRE—BLACK STAR

War on speculators: *A weary stock trader*

With rare exceptions, all world-class bubbles fall between 80 and 90 percent from their peak. By that standard, Hong Kong's Hang Seng index should find a stable bottom at roughly 3200, about half of last week's close at 7200. Property prices have fallen 50 percent and should have another 50 percent to go.

The Hong Kong government can't fight gravity. Its currency is overvalued. Hong Kong dollars deliverable in the future are now valued well below 7.8 to the U.S. dollar, which tells us that either the currency must fall or that domestic prices in real estate, stocks and wages must drop more to compensate. If the exchange rate holds steady at 7.8, something else will have to give. These are the rules of our fixed-rate system. Once the adjustment in stock and real-estate markets is over, the future value of the Hong Kong dollar will be much closer to 7.8 to the greenback.

Hong Kong ought to understand the process of adjustment will be painful regardless of whether speculators are active. Often markets overshoot, but rarely do they need the heavy hand of the government to find their proper level. This government professes to hold free-market principles dear, but its action proves otherwise. Officials do not even understand that this villainous "speculator" is an integral part of any free market.

A lower future value of the Hong Kong dollar translates into higher interest rates, which is slowing the economy and increasing unemployment. The fear of rising joblessness is the real motivation behind the government's intervention. Unwilling to accept the political consequence of rising unemployment, Hong Kong's officials are echoing Prime Minister Mahathir Mohamad of Malaysia, blaming outsiders for problems of their own making. They have taken on the practice and spirit of the communist central planners of a bygone era, who thought they could mold an economy using blunt instruments of control. Before the handover a year ago, the prevailing wisdom was that Beijing's heavy hand would ruin Hong Kong's capitalist economy.

The irony is that local officials are doing all the damage so far. These public servants are not semi-educated or poorly paid colonial leftovers. Yam's salary of a million dollars is more than five times that of U.S. Federal Reserve Chairman Alan Greenspan. They consider themselves local mandarins. However, they have now set a troubling precedent. If history is any guide, this and future governments will intervene in markets with an ever more heavy hand. Hong Kong can prevent another misuse of executive power only by erecting more constitutional checks and balances. Alas, the Basic Law governing the handover to China has laid down a turtle-pace schedule for the establishment of democratic rule. Until then, Hong Kong can look forward to more financial volatility and damage inflicted by government, not foreign, manipulators. ■