Finding opportunity in adversity

INTERVIEW WITH THE HON JOHN C TSANG, GBM, JP

FINANCIAL SECRETARY, GOVERNMENT OF THE HONG KONG SAR

JOHN C TSANG studied at La Salle College in Hong Kong and Stuyvesant High School in New York City. He pursued his interest in architecture at MIT, and went on to receive a Master Degree in Bilingual Education from Boston State College and a Master Degree in Public Administration from Harvard University's Kennedy School of Government. Mr Tsang joined the Hong Kong civil service in November 1982, and has served in a number of different capacities, including Director General of the HKETO in London. He was appointed Secretary for Commerce, Industry and Technology in August 2003, Director of the Chief Executive's Office in January 2006 and has been Financial Secretary since 1 July 2007.

This year's budget speech was set against a very different economic background to last year's, with GDP growth forecasts for 2014 cut to around 2.5 per cent. An over-arching theme of your speech was the need to enhance business competitiveness. What measures do you aim to introduce in order to achieve this goal?

First, let me point out that this year's reduced GDP growth forecast and the need to improve our business competitiveness are two different matters. In August we revised the GDP forecast for 2014 down to between 2 and 3 per cent because the global economy was not recovering as quickly as we would have liked, but that's a short-term matter. When I mentioned enhancing competitiveness in my budget speech, I was referring to something in the medium to long term. I believe that Hong Kong's economic success over the last decades owes a lot to our efforts to grasp the opportunities presented by our country's development, as well as to our steadfast commitment to free market principles, and also to our firm positioning as a world city; so we will continue to work hard on these fronts. That said; I believe that manpower and land, as well as an ageing population, are the major constraints to our future development. To overcome these constraints, we must endeavour to nurture a wealth of suitable talent for the future, increase land supply to expand the scale of the economy, and plan well ahead for an ageing society. Which is why we are investing heavily in education – from pre-school to vocational training: it takes up almost 22 per cent of our recurrent expenditure. We are also big investors in infrastructure, and are building more roads and railways to better connect the city and enhance usability of limited land; we are also building more tourism facilities so we can serve our guests better, along with more hospitals to prepare for an ageing population.

You have said that a structural deficit will be unavoidable within seven to 15 years. What corrective action do you intend to take to address this threat?

Like many other economies, our population is getting older. This will possibly slow down our economy, thereby reducing government revenue, while at the same time increasing public expenditure. It's obvious that this will pose serious risks to public finance in the long run. In response, I set up the Working Group on Long-Term Fiscal Planning in June 2013. The Working Group carried out a health check on the current state of Hong Kong's public finances and made projections on the SAR government's long-term fiscal position up to 2041-42, taking into account demographic trends, economic growth, and prevailing policies. The Working Group projects that the government's overall fiscal position in the short to medium term remains healthy. But if public expenditure continues to grow faster than revenue, we will be facing structural deficit in seven to 15 years, depending on the circumstances. There is no single solution to this, so we have to spend less, save more, and perhaps widen our revenue base so that expenditure growth matches revenue growth. I've also rolled out a series of expenditure-control measures, including a 2 per cent efficiency enhancement over the next three financial years. All government departments are now reviewing their policy priorities and streamlining their work processes, while at the same time ensuring effective and efficient delivery of public services. We are also looking into measures to stabilise our revenue base and how to enhance the return of government assets – which by the way have become an important source of revenue, contributing to around 10 per cent of government income. The Working Group is also developing proposals for setting up a savings programme.

The worry for Hong Kong's small, open economy is that it's been riding high on spending from tourists and foreign-money inflows, neither of which it can control. But a bigger threat comes from capital flows leaving the territory. It looks likely that fund inflows will continue to boost Hong Kong property and stock prices further. How concerned are you that investors could get burned in the property and stock markets if "hot money" flows reverse?

There is no denying that Hong Kong is susceptible to changing global economic and financial conditions: they cannot be avoided completely, so the key question is how to manage the potential risks they pose properly.

Hong Kong's financial infrastructure is very sophisticated, and we have no problem handling massive capital inflows and outflows day in and day out. It's true that normalising monetary policy by the US Federal Reserve and other major central banks will make it difficult to predict interest rates and fund flows, but we can deal with it: to counter these potential problems, our regulatory bodies have implemented a range of prudential measures to keep the financial system sound and resilient. For example, our banks have maintained very healthy capital adequacy ratios, averaging just below 16 per cent, almost double the international minimum requirement. To protect the property market, we have put in place six rounds of counter-cyclical macro-prudential measures and three rounds of demand-side fiscal measures, which have yielded the intended effects. In short, we believe that our financial sector is well prepared for any coming problems, but of course individual investors must understand their exposure and take their own risk management measures.

Would you agree that under its three decades-old currency regime an undervalued Hong Kong dollar is attractive to overseas capital? You yourself have warned about the "perfect storm" produced in part by underlying social tension. Add to that distortions from inflation, and surely the government will have no choice but to let the currency break to the upside?

Some people have said that the Linked Exchange Rate System (LERS) has contributed to high levels of inflation in Hong Kong in recent years, but the fact of the matter is that our inflation rate has been comparable to other regional economies' with floating currency regimes. The LERS was introduced in Hong Kong in October 1983, and has been the anchor of Hong Kong's monetary and financial stability since then: it has helped Hong Kong survive even the worst global financial crises. What's more, it has maintained the stability of the Hong Kong dollar, virtually eliminating the foreign exchange rate against the US dollar, all of which has helped the development of our financial services and trade sectors. I can't see any reason why we would abandon the LERS.

One year on, how would you assess the impact of the Shanghai Free Trade Zone (FTZ) on Hong Kong? Can the city maintain its competitive edge, particularly if foreign and joint venture banks and privately funded financial institutions are attracted to the Mainland?

As one of the world's leading financial centres, Hong Kong has a unique role to play in contributing to our nation's financial reform. We're the laboratory for China's reforms; a firewall to shield its nascent financial markets from volatility in the international arena. These relationships are constantly being refined and need to be seen in the context of the Mainland's rapidly changing financial landscape. But let me say that we welcome rapid development in Shanghai. We believe that Hong Kong will be the first to benefit from the opening up of the Mainland's economy: Hong Kong's business community is the biggest external investor in every province in China, and we know the Chinese market better than anyone else.

You have backed calls for market consultation to possibly alter Hong Kong's listing rules to allow dual-class share structures. Many in the city's financial community would welcome such a change, despite resistance to the idea from the regulators. How likely is this to happen?

The Hong Kong stock exchange recently published a concept paper on the issue, so now we're waiting for the industry to tell us what it thinks. Any amendments to the listing rules would require the approval of the Securities and Futures Commission. That said, I'm open-minded about changes to the listing rules, provided that investors are well protected. But any changes must follow due process: we're not going to bend our rules in the middle of processing a listing application.

The Hong Kong government has increased the pace of land sales, reduced price-to-loan ratios, and lowered the applicable maximum loan-to-value ratio by 10 percentage points for borrowers whose principal income is from outside Hong Kong, which was widely seen as targeting Mainland buyers. How effective have these measures been in tempering Hong Kong's runaway property market, and what other cards does the government have to play in this respect?

Over the last few years Hong Kong has been subject to ultra-low interest rates, abundant liquidity, and tight supply. So the local private property market has continued to believe that property prices would continue to rise. The risk of an asset bubble was increasing rapidly. In response, we introduced six rounds of counter-cyclical macro-prudential measures and three rounds of demand-side fiscal measures between 2009 and 2013, which I think I can say have been effective in changing the market's expectations: people have been more cautious about buying and selling properties, putting more weight on the risk side of the equation. The measures we've introduced have helped contain the systematic risks to the financial sector, while at the same time reducing individual exposure. F

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