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# Hong Kong hits speculators, as China develops New Deal

by Mary Burdman

The myth that the speculators and their hedge funds are "invincible" has been smashed, by the decisive victory of the Hong Kong authorities on Aug. 28, the bloodiest day of the "battle of Hong Kong." The Hong Kong government mounted a highly sophisticated attack against some of the world's biggest hedge funds, including George Soros's Quantum Fund, which suffered serious losses. As the markets closed that day, Hong Kong officials announced that they would be enacting measures to drastically curb the speculators' ability to operate.

The Hong Kong authorities managed to maintain the level of the stock market on Aug. 28, a day dubbed "D-Day in Hong Kong" by the *Hong Kong Standard,* even as other markets were crashing, due to the financial disasters in Japan and Russia. After record trading of 79 billion Hong Kong dollars (almost $1 billion), the Hang Seng index closed at 7,829, down just 1.18% for the day, and up from 6,600 when the massive government interventions began on Aug. 14. The authorities have committed possibly as much as $10 billion of Hong Kong's $96 billion reserves so far to the financial battle against the speculators. Costly as this victory may have been, it certainly was a turning point in the current war between those nations willing, and able, to fight, and the monstrous financial bubble which has destroyed so many economies.

Of course, Hong Kong was not fighting alone. Although as a Special Administrative Region (S.A.R.) of China it is responsible for its own currency, markets, and foreign exchange reserves, Hong Kong had the full political backing of Beijing in its fight to defend the value of the Hong Kong dollar, which is pegged to the U.S. dollar, and to catch out the corrupt, destructive international speculators. In addition, Taiwan has also been taking steps toward protecting its economy from speculators, and on Aug. 29 barred all securities and investment trust companies from selling or buying hedge funds linked to George Soros.

More important, China, the world's most populous nation, is launching new initiatives, even before the floods which have devastated the Yangtze River valley and northeast China have subsided, to carry out its "New Deal" policy, which was presented at the beginning of this year. Beijing has just announced two measures to ensure that the "New Deal" is financed: Up to 1 trillion yuan (there are 8.3 yuan to the U.S. dollar) in new bank loans will be issued over the next four months, to rebuild industry and agriculture destroyed by the floods; and, 100 billion yuan in new government bonds will be issued for specific, crucial infrastructure development.

Hong Kong itself is not only a financial center; it is also the busiest port in the world, serving the vast developing economy of southern China's Pearl River delta. In addition to having the third largest reserves in the world, Hong Kong has no foreign debt. Taiwan, with reserves of $83.6 billion, the world's fourth highest, is increasingly focussing its investment, including in China, on infrastructure.

## Speculators at bay

As the dust of battle cleared on Aug. 28, the Hong Kong government announced that it will take measures to keep the speculators at bay. Hong Kong Chief Executive Tung Che-Hwa said that the government had "achieved its objective." He said, "When we entered the stock and futures market some two weeks ago, we did it because there was strong evidence of a linkage in the speculative activities between the stock and futures market, on the one hand, and the currency market on the other. Our efforts . . . have been specifically directed at this phenomenon, and we believe we have achieved our objective."

Financial Secretary Tsang Yam-kuen located Hong Kong's problems directly in the world crisis. "We have never seen a financial turmoil of this scale in history," he said on Aug. 28, focussing particularly on the biggest problem in the world economy: Japan. "Japan's economic and financial troubles seem to be intensifying. This is outside our control." The local economy is itself facing what could be as much as 4% shrinkage this year. Tsang announced that there would be "follow-through policy measures to enhance our resilience to speculative attacks," although the government stands ready to intervene again, as necessary. "After the episode in the past two weeks, we stand ready to operate in the stock and futures markets whenever speculators again engage in a similar double-play."

"We went into the market to restore order," Tsang said. "We are absolutely determined to use all the means available to us to protect the stability and integrity of our financial markets. . . . Speculators can no longer expect that they can manipulate at will our markets by attacking the currency. . . .



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They can no longer be sure of any profit from such manipulative play."

Tsang announced that the government would propose new regulations to restrict short-selling and stock borrowing, both means of "betting" against stock values. "We have a few specific ideas on the ways and means to tighten up on discipline in the areas of short-selling and stock borrowing, and to enhance the transparency in the trading of index futures. Some of these ideas, if agreed [to] by the Securities and Futures Commission and the exchanges concerned, can be put in place very quickly, while others may take a longer time. . . .

"Another measure that we are considering, is how we can address the relative small size of the Aggregate Balance of the banking system compared with the large unregulated capital flows."

The government moved to buy up blue chip stocks—a step which one trader characterized as "the re-nationalization of Hong Kong," the *South China Morning Post* reported—to maintain the market level. Another financial analyst called this "the biggest equities defense of the century."

## The measures employed

Among the measures used by the Hong Kong Monetary Authority was to force a differential between the cash markets and the upcoming September-December contracts, making it very costly for speculators to roll over their expiring August contracts. Some managed to do so, which means the battle is far from over, but they will now have to face new regulations to restrict short-selling and stock borrowing. One well-informed City of London analyst also considers it a likely option, that Hong Kong will establish a two-tiered exchange rate: One, to be used for current accounts for trade, and so on, will be fixed, but a second rate could be used for capital markets, but will not be allowed to affect the real economy. Another measure reportedly under consideration, would be to prevent speculators from borrowing shares from banks as collateral for their speculative operations, which has been used recently with success by Malaysian Prime Minister Dr. Mahathir bin Mohamad on the Kuala Lumpur stock exchange.

On Aug. 29, Tung Che-Hwa confirmed that the fight will continue: "It is not something we particularly like to do, but we felt that we needed to have a very stable interest rate environment to go ahead with our recovery," he said. Speculators had pushed up interest rates and rendered recovery difficult. Also, he said, "the Asian financial turmoil, which indeed has become increasingly global, has given us an additional degree of instability. Nevertheless, we are determined to go on."

He said that Beijing had continued to show support for Hong Kong, but that the decision to enter the market was made by the local authorities alone.

The hyenas, of course, are seeking revenge. On Aug. 31, the financial "rating agency" Standard & Poor's, one of the most underhanded tools of the speculators, downgraded both Hong Kong's long- and short-term foreign currency sovereign credit ratings, including because of the government's stock market interventions. Such arbitrary downgrades are used repeatedly to undermine a nation's credit.

Local newspapers carried headlines invoking "war against the speculators," and at least two hedge funds, in addition to George Soros's Quantum Fund, which have been speculating against the Hong Kong markets, were named in the local press. These are Julian Robertson's Tiger Fund and Louis Bacon's Moore Capital.

There are unconfirmed rumors that Soros may visit Hong Kong, the *South China Morning Post* reported. Hong Kong Monetary Authority chief executive Yam Chi-kwong said of Soros: "I do not know whether he is in Hong Kong. I do not think I would have time to meet him. We do not have any plans to meet each other." Soros was a prominent speaker at the World Bank and International Monetary Fund yearly meeting in Hong Kong last September.

## The rules of the game must be changed

"Whatever the preference of individual governments, it has become clear to all that the rules of the game across Asia must be changed, in order to keep rapacious speculators at bay, and to maintain stability in economies," the *Hong Kong Standard* wrote in an Aug. 31 editorial. "Over the weekend, Hong Kong went forward some way to changing these rules. It will now be much more expensive for speculators to wreak havoc here. These are welcome changes, though how effective they will be in containing those destructive elements remains to be seen."

The *South China Morning Post,* which had printed several relatively negative commentaries on the government's sustained interventions in the markets, changed its tune on Aug. 29. "It may turn out that Donald Tsang has pulled off one of the great investment coups in history," the editorial stated. "Of more immediate concern, however, is what he will do now. . . . He spoke of new measures to keep speculators at bay. The love affair with derivative markets and big funds—which call themselves investors but have fangs protruding from the sheepskins they wear—is over. . . .

"For the past two trading days, the government was virtually the only buyer on the market. . . . Around the world investment funds scoured their vaults for Hong Kong stock to sell into this buying campaign on the reasoning that it cannot last and prices will drop when it ends."

But the government also took measures to "frustrate speculators seeking to recoup losses by rolling over into September the short positions they held in the August contract. Sending them off licking their wounds was the object of intervention," the paper said. If the government's buying

campaign is wound down, it will also have "hedged through the futures markets any paper losses on the stock it has bought. And let us call them paper losses at this stage. The government has the financial strength to hold these stocks, and, who knows, the timing may prove to have been extremely fortuitous."

Political pressure is mounting for legislation to cripple the speculators. One Legislative Council member, Bernand Chan, is proposing legislation which calls on the government to adopt "strategic and effective measures" to deter speculative attacks on the currency, including naming and exposing speculators.

Edgar Cheng, former chairman of the Hong Kong Stock Exchange, countered the complaints of those decrying the authorities' intervention in the markets, in a letter to the editor of the *South China Business Post* on Aug. 26. "If the world has not yet progressed to a stage where international rules can be made and enforced to prevent the exploitation of excessive market power by particular players, it seems perverse to criticize a government which attempts to achieve the same objective by much less authoritarian means, by merely participating in the free market to exercise a countervailing influence," Cheng wrote.

"Certainly," Cheng noted, "those who introduced anti-trust legislation in the United States and elsewhere considered that forceful intervention by the state was not only justified but necessary to protect markets from enslavement by a small number of powerful market players. . . .

"At the end of the day, whether the Hong Kong government's intervention in the stock market is considered 'right' or 'wrong' will be determined by whether it succeeds in achieving its objective. To condemn it on the grounds that it offends against the philosophy of free markets is humbug."

## The scale of the fight

Hong Kong's Chief Executive Tung Che-hwa confirmed on Aug. 29 that Beijing is continuing to support Hong Kong's measures. On Aug. 30, the official *China Daily* published a commentary by economist Li Guobin, of the State Council Information Center, stating that the "central government will answer any request of the Hong Kong government for a helping hand to defeat them [the speculators]." While "the Hong Kong government is fully capable of handling its own problem," at the same time, "Premier Zhu Rongji has made it clear that Beijing would help Hong Kong at the request of the Hong Kong government."

Li reiterated the commitment of Beijing to defend its own currency. "Rumors about the possible devaluation of the yuan are intentionally fostered by certain international fund companies seeking quick profits. Lies will be laid bare eventually. The fate of the yuan and the Hong Kong dollar are in the hands of the Chinese people, and will never be changed by any lie. . . . It is clear that the foundation for the stability of the renminbi now and in the future is quite solid."

"There should not be a problem of yuan devaluation before 2000," Li said. He also noted that if funds held by companies and individuals were added to China's official reserves of more than $140 billion, the supply of foreign exchange available is around $220 billion. Annual demand for dollars is $60 billion, of which $40 billion is for three months of imports and $20 billion is for debt repayment.

China itself has ordered a nationwide crackdown on all illegal foreign exchange speculation, after black market trading had begun to reemerge in the context of the financial crisis. Speculators have been spreading rumors that China would devalue the yuan next year, and have been selling yuan at black market rates of up to 9.5 to the dollar (the official rate is 8.29 to the dollar).

In addition, the *China Daily Business Weekly* reported on Aug. 30 that price controls are being imposed on grain and vegetables, especially in the regions hit by the floods, where food prices have doubled. In Wuhan, the local government has spent 2 billion yuan to keep food prices down. The city is now empowered to set price limits, to be capped at prices prevailing as of June 10, before the floods hit. "We have pre-formulated a price control regulation to prevent speculative price increases during the rebuilding period," a Wuhan official was quoted. Officials have ordered that some of China's record grain stockpiles be sold, to bring down prices.

Xinhua news agency reported on Aug. 31 that the People's Supreme Court has made several judicial interpretations of China's criminal code, to help stop illegal foreign exchange activities. Such practices as using fake documents to deceive banks in foreign exchange trades should be prosecuted, the court said, and joint-venture, non-state enterprises should avoid helping state firms conduct illegal foreign exchange deals, or face prosecution themselves. Foreign exchange trades above $200,000 should be conducted only through designated foreign exchange banks or institutions, the court directed, and customs, banks, and foreign exchange outlet officials were warned not to provide fake documents or approve any exchanges where the papers were problematic.

In another protective measure, Beijing will consolidate its 14 commodities futures exchanges into just three markets, in Shanghai, Zhengzhou, and Dalian, according to Western press accounts of a State Council document. After the merger, the number of contracts traded will be reduced from 35 to 12, which will be for copper, aluminum, steel, plywood, rubber, wheat, rice, and other agricultural products. Previously, there had been up to 50 commodities exchanges, but the number had already been reduced after the Chinese government began a crackdown against speculation in 1994.

## Taiwan joins the fight

Taiwan is also joining the battle. Already last autumn, there were articles in the Taiwan press calling for the govern-

ment to investigate George Soros's operations. Since this spring, there have been calls for re-imposing controls on the markets.

On Aug. 30, the Taipei *China Times* quoted the Securities and Exchange Commission that the government has barred all securities and investment trust companies from selling or buying hedge funds linked to Soros. "Authorities have not approved sales of [Soros's] Quantum Group's funds in Taiwan, and anyone found illegally doing so will be severely punished," the paper reported.

The director of the Taiwan central bank's Foreign Exchange Department, George Chou, said that the bank was keeping a close watch on the domestic foreign exchange market and would deliver a hard blow to speculators, the official Central News Agency reported on Aug. 31. Taiwan has tightened controls on foreign exchange trading since May 25.

Hong Kong chief executive Tung Che-hwa has many connections in the Taiwan business community.

## China's New Deal

On Aug. 31, the People's Bank of China stated that up to 1 trillion yuan in bank loans would be issued to rebuild flood-hit areas, Xinhua reported. Commercial banks are to increase lending by 900 billion to 1 trillion yuan over the next four months, the state television quoted People's Bank of China Vice Governor Shang Fulin. Banks could "appropriately lower" interest rates on such loans to within limits set by the central bank, Shang said. The loans are to help people rebuild or repair their houses, help farmers resume planting and raising livestock, and help industries resume production.

"Banks and rural credit cooperatives should accelerate credit investigation and simplify procedures," Xinhua reported.

Damage from the floods is estimated at $20 billion at a minimum. The head of Jiujiang city's Economic Planning Commission was quoted in the *China Daily* saying (as the eighth flood peak was coming down the Yangtze) that that city alone needs at least 1 billion yuan to rebuild its infrastructure and to get farmers working again.

On Sept. 1, China's leading newspaper, the *People's Daily,* published an interview with a high-ranking official of the Ministry of Finance. The interview, entitled "With Great Effort, Vigorously Increase Infrastructure Investment," describes in detail the motivation behind the Chinese government issue of 100 billion yuan in new bonds, which were approved by the National People's Congress during the last week of August.

In recent days, China's leaders, including President Jiang Zemin and Prime Minister Zhu Rongji, have been reiterating that China can achieve its stated target of 8% national economic growth this year. Growth in the first half of the year had only reached 7%, due to the contraction of the world economy, especially in Asia, and there had been indications that the 8% target, set as the level necessary to ensure the reemployment of millions being laid off in the restructuring of China's state industries, might not be reached. But now, Beijing's determination to reach this goal is being reasserted.

Five highways, six airports in the western regions, low-cost housing, 62 rural power grids, and five canals are among the projects to be built, State Development Planning Commission Minister Zeng Peiyan said on Sept. 1.

With China facing a severe challenge, due to the Southeast Asian crisis, and a complicated domestic and international situation, the government has decided to take measures to increase domestic demand and stabilize the exchange rate of the renminbi, the Finance Ministry official told *People's Daily*. China must also fight the slowdown of its overall economic growth. With the increased savings levels and fall in prices due to this economic slowdown, it is a very good time to launch this kind of bond issue, he said. This would also have a positive effect on the crisis in Hong Kong, and guarantee economic growth.

The bonds will only be issued to the four national "policy" banks. What is most important, the official said, is to realize the national economic growth target, which will not only overcome China's economic problems and improve the trust of foreign investors, but will also have a stabilizing effect on Hong Kong. The policy will improve the entire nation's infrastructure, and improve the structure of production (a reference to the policy of installing higher-level technology in already existing industry, rather than building more, lower-technology industries). The targetted infrastructure construction will greatly stimulate demand and improve the structure of the economy, he said, and, in addition, the banks' capital base will be strengthened.

China's infrastructure base is not well developed; it needs water infrastructure for agriculture, railroads, communications, rural electrification, and urban infrastructure. The environment of the middle and upper reaches of the Yangtze and Yellow rivers must also be protected, he said.

There are certain principles for the use of the new bonds, the official stated. Funds derived from these bonds will be used *only* for selected infrastructure projects, not for industry. These bonds will work by exercising the well-known principle of the "multiplier effect" of public spending on an economy.

The funds will also be used to finance feasibility studies and planning of projects; badly planned projects must absolutely be ended. There will be very strict evaluation of projects, on how they fit into the overall plan for China's economy. There will be concentration on central and western China.

There will also be a big allocation for science education in China's budget. The *People's Daily* has been reporting that one of the main reasons for the economic crisis in Southeast Asia, was the lack of in-depth science and technology capabilities in those nations. Developing this capacity would be national insurance against financial crisis.

## Background on FDR's New Deal

Another public statement, of how China is determined to carry out its national development, was a commentary in the *People's Daily* on Aug. 31, on the "Background on Franklin Roosevelt's New Deal." While the term "New Deal" has appeared regularly in statements by government leaders and in the press since the past winter, referring to the government's large-scale infrastructure investment programs, there has, until now, been very little elaboration of what this policy would entail.

This commentary demonstrates under just how close scrutiny, the workings of Roosevelt's successful New Deal are being put in China.

The article gives a very detailed description of the U.S. situation in 1929-33, when Roosevelt became President and initiated his policies: the collapse of national income and of family income, deflation, the local crises in all parts of the United States; the collapse of 1,400 banks in 1932. The most important content of Roosevelt's New Deal, the *People's Daily* wrote, was the way the government applied macroeconomic measures to, especially, currency policy, credit, agriculture, industry, transport, electrification, and disaster relief.

Of course, all these economic issues are of great importance for China today.

The article describes the measures enacted. These included what the "emergency banking law" involved; agriculture policy, including raising prices to increase family income, and the setting up of a special purchasing company to buy what farmers themselves could not sell.

*People's Daily* detailed the provisions of the 1933 National Recovery Act, and the $3.3 billion assistance program for municipal projects to put people to work. The article also discussed measures for disaster relief, labor safety laws, unemployment insurance, the first U.S. public insurance for the elderly, and measures to improve the positions of unions. The 1935 industrial plan, *People's Daily* reported, created investment in construction of public housing, roads, airports, canals, and other infrastructure—where China is now itself investing.

*People's Daily* then described New Deal financial and monetary policy. At first, the policy had been to balance the budget, but it soon became clear to Roosevelt that it was necessary to apply the Keynesian policy of increasing government spending, through an expansive financial policy, to solve the problem of unemployment.

Through this policy, *People's Daily* said, Roosevelt was able to increase tax revenues; as the economy became more stable, the deficit was gradually reduced.

The most important thing about Roosevelt's New Deal, *People's Daily* concluded, was that it *established the concept of government intervention into the market economy,* in order to generate employment and economic recovery, and was able to demonstrate this method successfully.

China is learning fast. The huge, brutal hedge funds have, certainly, met an adversary far more formidable than they had thought. There are other nations also preparing to take them on.

## Documentation

# Malaysia asserts its monetary independence

*The Malaysian central bank released the following statement to the press on Sept. 1.*

1. Since the outbreak of the Asian financial crisis more than a year ago, the risk of further waves of instability of increasing proportions still very much remain on the horizon. Despite the measures and reforms that have been put in place by all the affected countries, there does not appear to be any sign of stability returning to the financial markets. On the contrary, the crisis has deepened and spread across other continents. In particular, significant risks remain in the region. A dramatic adjustment in any of the financial centres in the region can be expected to result in significant contagion effects, not only in the region but also in other global financial markets. The effects of these developments have been increasingly severe. The adverse developments in the foreign exchange markets, the equity markets and the depressing trends beginning to emerge from the external sector all reinforce each other to cause a severe contraction in real output of the economies of the region.

2. Given the global nature of the problems confronting the international financial markets, efforts to restore world financial stability require a concerted effort of the international community. Unfortunately, action on the part of the international community to deal effectively with the risks and challenges associated with the new environment of liberalised and globalised financial markets has not been forthcoming. The current escalation in the contagion effects has not provided the sense of urgency to the world financial leaders to act decisively to contain the global financial crisis. While arguments have been put forward for emerging economies to undertake economic and financial reforms, of greater urgency is the need to reform the international financial system to better cope with the changed international financial environment that we operate in. Unless this is recognised by the international community, there will not be a permanent solution to the current crisis.