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Hong Kong uses power of the state to hit speculators

by Mary Burdman

The clear commitment of China's leadership to the national economic security of their country, gave the government of China's Hong Kong Special Administrative Region the ability and opportunity to strike a forceful blow against the international speculators who have been torturing their economy. The S.A.R. authorities broke all precedent on Aug. 14, and, using some of their exchange reserves to intervene effectively in Hong Kong's currency, stock, and stock index futures markets simultaneously, they dealt international speculators a sharp, heavy blow. So far, the authorities have managed to both protect the peg of the Hong Kong dollar to the U.S. dollar, and keep the Hang Seng stock market index, which had collapsed almost 60% over the past year, from plunging further.

Of course, the speculators, with their vast financial bubble threatening to pop, have not surrendered. The City of London, embodied in the editorial views of the *Financial Times,* is outraged, and has vowed revenge. The Hong Kong government itself is preparing for further battle, and saying so every day.

At stake in this fight, is much more than the fate of Hong Kong, or even China. As Lyndon LaRouche observed in the wake of Russia's actions on Aug. 17, it is what comes next that really matters. Hong Kong, backed by China, used the power of the state against the speculators; the *Financial Times* response to this was very revealing. The question is, what will be the reaction in Malaysia, and elsewhere?

Malaysia has responded already. On Aug. 18, Prime Minister Dr. Mahathir bin Mohamad, speaking at a Workers' Day rally in Kuala Lumpur, said that speculative attacks on currencies in emerging markets had reached a dangerous level, and, pointing to the actions of the Hong Kong government, said that they are forcing countries to take extreme measures. Mahathir, according to the Singapore *Straits Times,* said that Malaysia is studying how Hong Kong bought up shares using its own funds, and how Taiwan had issued a moratorium to banks not to sell shares, even if undervalued. An indication of just how deep the disaster is in Russia, is that Mahathir warned that Russia could even be tempted to use its nuclear capability against those who had put the ruble under such pressure.

A New Bretton Woods

However useful all the moves toward re-regulation are—excepting so drastic a response by Russia—these actions remain nothing more than *crisis management,* and are utterly insufficient to deal with the enormity of the world financial and economic disaster. While the unique partnership of Hong Kong and the strength of the Chinese economy can take on the hedge funds much more effectively than the devastated economies of Southeast Asia or Russia, as long as their policy remains defensive, China and Hong Kong will be attacked again and again. What must be done, is to finally bury the stinking corpse of the current world financial system. This will only be done when a concert of nations adopts a "New Bretton Woods" agreement, proposed by Lyndon LaRouche.

The current financial system is dead; although its corpse may still be walking the earth, its soul has already plunged to the ninth circle of Dante's Inferno. Such actions as those of China and Hong Kong, and Russia, in cooperation with other nations, could germinate a new economic system; whether it is enabled to survive, and flourish, is the crucial question.

There have been some interesting discussion in Asia in recent days, where talk of some kind of an "Asian monetary union" is again under way, of what could be the germ of a new monetary system. Philippines Foreign Secretary Domingo Siazon said on Aug. 18 in Manila that, far from allowing the Association of Southeast Asian Nations to disintegrate under the pressure of the financial crisis, ASEAN member-states are promoting regional integration. One element of this process could be a future common currency, based either on the Japanese yen, or, much more interestingly, on the Chinese yuan. Siazon referred to European integration and the euro as examples of such an approach.

On the same day, Deutsche Bank chief economist Norbert Walter, speaking in Singapore, described an "Asian Monetary Union" as a future project for Asia. But, typically for him, he said that this is no project for tomorrow, but for the year 2025. The headquarters of the common central bank should be Hong Kong, Walter said, because China will then be the leading economy in the region. Already, 55% of trade by Asian countries is carried on inside Asia, and this will increase, making such a monetary union a good idea, he stated.

Minor as these indications are, they reflect tendencies, especially from China, to foster monetary as well as economic cooperation with other regions of Asia.

The upper echelons of the current financial system are also aware that "something is up," reflected in such actions as Hong Kong's. "Titanic struggles are being waged between speculators and the international financial order," read the London *Times*'s City Editor's commentary on Aug. 15. While shares sag in New York and London, and, in Russia, "a collapse of the Russian economy cannot be ruled out if speculators manage to impose either a new ruble devaluation or ruinous interest rates." But, in Hong Kong, something else was going on.

"In Hong Kong, self-help is being tried. The authorities detected a speculative plot by hedge funds, [and] Joseph Yam, sparky head of the Hong Kong Monetary Fund, was allowed to use exchange reserves to buy stocks and share index futures

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as well as the currency, putting a treble squeeze on hedge funds. More than 45 minutes ahead of a long weekend, this tactic was sensationally successful. Speculators are unlikely to take it lying down next week."

The outcome of the battle shaping up, "is important," the *Times* stated. Asian stock markets have been falling further in recent weeks, "shrinking liquidity and deepening economic depression. Many Asian currencies, with the exception of China and Hong Kong, have also been driven too low by speculation and withdrawal of capital," putting a further squeeze on the banks. The IMF "response" is not working in Russia or Asia, "because it does not allow for speculative raids aimed purely at destabilizing markets. Hong Kong could offer a better second-stage response.

"If it works, it should provide a model for cost-effective international intervention in countries that lack the reserves to do it themselves. If the hedge funds win, world recession looks increasingly likely."

A senior financial analyst in Switzerland had a similar view. More important than what was done in Russia, was what took place in Hong Kong on Aug. 14, he told *EIR*. The actions there against the financial speculators will "increase international pressure to impose regulation on financial markets," he said. Despite expressing his own opposition, as a "follower of Immanuel Kant," to such moves, he acknowledged that "international deregulation has gone on for too long. We will now see a time, the next five to ten years, of re-regulation. It will be in the direction of what you people advocate."

The warnings by People's Bank of China Deputy Governor Liu Mingkang on Aug. 12—that "devaluation is not a good policy for China," and "I would like to tell speculators, that China is a big player, and they had best not miscalculate" (see *EIR,* Aug. 21)—were coordinated with the government of Hong Kong. On Aug. 13, Hong Kong Financial Secretary Tsang Yam-kuen announced that the S.A.R. had developed strategies to counter speculation, although he refused to divulge what the government would do. On Aug. 8, the official China News Agency of Hong Kong called the recent rumor that China's currency, the renminbi, will be devalued, "a trick of 'making noise in the east while attacking from the west,' by international speculators," whose real target was to generate panic in Hong Kong. However, not only was the Hong Kong government able to "successfully strike a counterblow to the attack of international speculators," but this policy was closely coordinated with Beijing.

Financial Secretary Tsang spoke directly with Dai Xianglong, governor of the People's Bank of China, who reiterated to Tsang that China will not devalue the renminbi. In addition, "at a recent economic forum in Hong Kong, Shi Guangsheng, minister of China's Ministry of Foreign Trade and Economic Cooperation, emphasized that the renminbi would not be devalued," China News Agency reported. Shi said that "China is capable of maintaining the value of the renminbi. . . . Shi Guangsheng pointed out that not devaluing the renminbi is a requirement for maintaining the sustained stability of China's economy, including the need to maintain the long-term prosperity and stability of Hong Kong. He said that it is also a manifestation of China's sense of responsibility for maintaining the economic and financial stability of Asia and even the world with a greatly responsible attitude."

China News Agency also cited the consensus view of Chinese economists, that a currency devaluation would harm rather than benefit China's economy in any way (see *EIR,* Aug. 21).

Even more interesting was the Aug. 2 report from the China News Agency, warning that the nations of Asia must take precautions against the continued collapse of the Japanese yen, which Tokyo has no intention of salvaging. Only weeks ago, before the mid-June U.S.-Japanese intervention to prop up the yen, China had demanded such measures, and that Japan play a responsible role to stop the Asian crisis; now, realizing that the Japanese will not act, China is warning its neighbors to defend themselves.

"As the excessive devaluation of the Japanese yen would trigger another round of currency turmoil in the Asia-Pacific region and even hurt U.S. interests, it would be better for countries concerned to adopt preventive measures and to continue to apply pressure on Japan to shoulder the responsibility of stabilizing the yen," China News Agency wrote. Warning that the yen could fall to 150-160 to the dollar this year, with resultant turmoil in the rest of Asia, CNA wrote that "countries in the region must be prepared for that eventuality and take precautionary measures." Japanese Finance Minister Kiichi Miyazawa's announcement of non-intervention "undoubtedly is a warning signal for countries in the Asia-Pacific region which are looking forward to an early rebound of the Japanese economy. China's Vice Premier Li Lanqing warned recently that 'the Asian economies are still in turmoil and developing.' This shows that China, in a spirit of seeking truth from facts, is watching closely external factors, and is ready to meet with new challenges." For the Southeast Asian nations and Hong Kong, "it would be an impractical illusion if they want to lift their economies by relying on the recovery of the Japanese economy."

The battle begins

On Aug. 14, a Friday before a three-day weekend, the Hong Kong authorities broke their long-standing policy of non-intervention in the stock and futures markets, and dealt a crushing blow to international speculators. Hong Kong chief executive Tung Chee-hwa said of the intervention, "We will do it time and time again, in order to ensure our point comes across." The government intervention was announced only *after* trading on the stock market had closed, taking speculators and traders totally by surprise.

Hong Kong Financial Secretary Tsang said that the government had made a "surgical correction to deal with a temporary attack. . . . We want to show that we mean business in the maintenance of the linked exchange rate. . . . We are prepared for the worst, and we are working 24 hours a day dealing with

the currency." Tsang said that the government had evidence that speculators were dealing in a complex "double play" across the currency, stock, and stock index futures markets. The S.A.R. authorities' intervention was a counterattack against speculators buying up both shares and dollars. "In order to achieve their objectives in undermining the Hong Kong dollar, speculators have deployed a whole host of improper measures which are clear to all. The measures include spreading vicious rumors on the delinking of the Hong Kong dollar with the U.S. dollar, devaluation of the renminbi, as well as instability of our banks, which led to bank runs." Tsang said that Hong Kong had sufficient reserves—which were $96.4 billion as of the last official report, the third-highest in the world, after Japan and China—to continue to deal with the problem. This action immediately pushed the Hang Seng index 8.5% higher, the biggest percentage rise in 23 years.

Then, battle was closed.

In its Aug. 17 coverage of events, the City of London's *Financial Times* issued an unmistakable warning with its headline: "Hong Kong Plays with Fire in Attempt to Hit Speculators." Hong Kong's "bold move was more a sign of weakness than of strength," the *Financial Times* asserted, announcing what it considers to be Hong Kong's vulnerabilities to speculators, and listing complaints, including from one "Citizens Party" leader who whined that the S.A.R.'s currency board had been "bastardized." "Critics," unnamed, of course, "warned that the move could backfire and damage the territory's free-market reputation," the newspaper wrote.

The *Financial Times* then dragged out "democracy" mouthpiece Martin Lee, now masquerading as a financial expert. "This is a huge cost to our reputation as a financial center," Lee was quoted. "The invisible hand of Adam Smith has been replaced by the invincible hand of the government." Finally, the *Financial Times* quoted an unnamed "fund manager," who threatened: "The administration is playing a dangerous game. Even if they win this battle, the war is far from over."

The Hong Kong goverment, as the *South China Morning Post* reported, then launched an "international campaign" to explain what it had done. Financial Services Secretary Hui Si-yan said that monetary authorities had immediately begun contacting international bodies, after the intervention on Aug. 14.

Hong Kong Monetary Authority Chief Executive Joseph Yam wrote a letter to the *Financial Times* editor, stating that the actions of the HKMA had been "misinterpreted, and there is a need for clarification." One such action, was "to tackle currency manipulation by those who have built up large short positions in the stock index futures. We are not against the taking of short positions in stock index futures by anybody, in accordance with our free-market philosophy. But we do object to people manipulating our currency to engineer extreme conditions in the interbank market and high interest rates to make profits in the short positions in stock index futures. We have reason to believe there has been such manipulation. This has nothing to do with our preparedness to bear the pain of economic adjustment under a currency board system. . . . But the currency manipulation, 'coinciding' with malicious rumors of all sorts, is disproportionately exacerbating that pain.

"To deter currency manipulation, we took action to tackle the matter at the source, and that meant making sure that those engaging in this activity lose money. We realize that this might be seen as a departure from our free-market philosophy. . . . But we feel that we have done the right thing. As soon as currency manipulation ceases, we will step back from the stock and futures markets and let them find their levels. But meanwhile we shall act to deter currency manipulation."

The government continued its intervention on the following days, to the annoyance of the speculators, who had been selling Hong Kong dollars in London and New York. One report on Aug. 19 said that the government had "disappeared" the supply of speculative blue-chip stocks.

More important, is the view of the situation in Hong Kong presented by Hong Kong Chief Secretary for Administration Anson Chan, in Singapore on Aug. 14. Published as a commentary in the *International Herald Tribune,* Anson Chan reasserted the policy to maintain the Hong Kong dollar link to the U.S. dollar, because "cutting it would set off another wave of currency instability in East Asia." The total value of Hong Kong's trade in goods and services is equal to well more than 250% of its GDP. "Businesses engaged in those export activities need certainty in exchange rates," she said.

Hong Kong has had "a bubble economy that needed to be corrected," especially in property prices. The Asian financial crisis has collapsed these prices, the stock markets, and sent unemployment soaring to a 15-year-high of 4.5%, Anson Chan stated. But while seeing these "painful" developments as a "free market at work," she also cited something of more real substance. "China, Hong Kong's hinterland, is continuing to grow, not at the 8% rate forecast at the start of 1998, but at a very healthy 7% for the first half. . . . We are embarking on a $30 billion infrastructure program to build for the future. The program includes investment in railways, roads, housing, education, training, and new technology. . . . As a Special Administrative Region of China since July 1997, Hong Kong has been handed unique opportunities to work with the mainland authorities and derive mutual advantages from cross-boundary development . . . particularly in the nearby Pearl River Delta. . . . We can further expand our role as a middleman for new venture capital in China."

There lies the problem. China, uniquely, has a *sane* economic policy, for development of its physical economy for the largest national population on earth. But, there will be no "new venture capital" of any use whatever for that vast project, from the dead financial system. China's real defense, as is Hong Kong's, must be revolutionary: to collaborate with other nations, to create a New Bretton Woods system.