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HAS THE HKSAR GOVERNMENT MADE ANOTHER FAUX PAS ?

There is a Chinese maxim that states that it takes a certain kind of poison to kill a certain kind of snake (). It stands to reason, therefore, that the wrong kind of poison will have little to no affect on a certain kind of snake.

Applying this Chinese maxim to the economy of a country/territory of the world, a modification to an existing version of a monetary policy, introduced by a well-meaning governmental division of that country/territory, for one reason or another, will have either a beneficial or deleterious effect on that economy.

But any modification to an existing monetary policy, especially one that is newly introduced without its likely effects, having been considered in great detail, will have an effect, one way or another, almost immediately.

As for the not-too-distant future, such a modification, if it is not well-received or if it does not achieve a stated goal, could result in a catastrophic effect.

Which brings **TARGET** () to the subject of the new monetary measures, recently, introduced by the Government of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

On Friday, February 22, Mr John Tsang Chun Wah (), the Financial Secretary of the HKSAR, introduced what was termed as measures, aimed at reducing, immediately, the strong demand for residential and non-residential properties in the territory.

He said that, effective midnight of February 22, the ad valorem stamp duty (a tax, imposed by the Government, according to value) on residential and non-residential properties would be doubled and, for transactions, valued at $HK2 million or less, the ad valorem stamp duty would rise from $HK100 to 1.50 percent of the transaction.

He even went so far as to close any door that might be ajar by stating that, while the new ad valorem stamp duty would not apply to Permanent Residents of the HKSAR, who are not *'beneficial'* owners of other existing property(ies) in the territory at the time of the acquisition of a residential property.

Thus, in the case of a husband and wife, if the Sale and Purchase Agreement of the matrimonial home is in the name of the wife, the legal title of the property, being either in her maiden name or her married name, the husband, if he is desirous of purchasing a flat, for whatever reason, he would have to pay the new ad valorem stamp duty since it would be deemed that, as a Permanent Resident, he is, already, the beneficial owner of a residential property.

The HKSAR statistics indicate that the price of property in the territory rose about two percent in January and, since 2008, property prices have risen by about 120 percent.

The Affordability Rate for residential property, one is told, had fallen to about 52 percent in the fourth quarter of 2012.

The Chief Executive of the HKSAR, Mr Leung Chun Ying (), commenting on the statements of Financial Secretary, warned:

> *'If the* (property) *market continues to get overheated, we* (the Government) *will introduce further demand-side, management measures in a timely manner.'*

The resultant effects of the Friday, February 22, 2013, Government pronouncements were immediate.

By the following morning (Saturday, February 23), it was reported, widely, that the property market was feeling the brunt of the Government's new policy, with prospective buyers, backing off.

The immediate consequences of the Government's determination to try to cool down the property market, also, had a psychological effect on prospective investors, from the Mainland of the PRC and elsewhere.

The Hongkong Government must, today, be seen as veering away from its former economic philosophy of laissez faire – a doctrine, opposing governmental interference in economic affairs beyond the minimum necessary for the maintenance of peace and property rights.

Whether or not the HKSAR Government was correct in interfering with factors, associated with good governance, or of the concept of a free-market economy, only time will tell, but for certain, international investors must have taken note of what they must have viewed as the shock announcement of Friday, February 22, 2013.

The Monetary Authority

The Monetary Authority of the HKSAR, headed by its 54 year-old, Chief Executive, Mr Norman Chan Tak Lam (), announced on Friday, February 22, that all banks in the territory should assume a mortgage-rate increase of 300 basis points, instead of the then existing 200 basis points.

He said that the increases should take immediate effect in respect of all types of property.

He said, also, that the object of this exercise was, inter alia, to stress-test mortgage applicants' abilities to meet contractual obligations.

In addition, Mr Norman Chan Tak Lam said that the maximum, loan-to-value ratios in respect of mortgage loans for all commercial and industrial properties would be reduced by 10 percentage points from existing applicable levels.

He concluded by stating:

> *'I hope the public would understand that Hongkong is facing an extremely unusual macro-monetary environment. The ongoing quantitative easing by advanced economies is unprecedented in both scale and duration. Interest rates have been artificially maintained at extremely low levels, and we see huge volumes of liquidity flow into emerging markets like Hongkong. The current unusual circumstances are one of the main drivers for the prolonged boom in the local property sector. The risk of over-heating in the property sector to financial stability in Hongkong is no smaller than that seen in 1997. We should note in particular that while mortgage rates were generally over 10% in 1997, after the burst of the property bubble, US interest rates have fallen, and mortgage rates in Hongkong have spiralled down reaching about 2% in 2004. The situation we faced now is just the opposite. Mortgage rates are around 2%. And, even if the low interest rate environment were to remain until 2015 as anticipated by the US Federal Reserve, the US interest rates are bound to head back to more normal levels. Will mortgage borrowers in Hongkong then be able to withstand the impact of interest rate hikes and property price falls? For example, under a 30-year mortgage, even though the borrower will be able to enjoy a low interest rate in the first two years, the repayment burden could become much heavier as a result of interest rate hikes in the years that follow. This could have serious consequences for the well-being of those families in the coming years. Therefore, I*

hope that the public will be cautious and should not underestimate the risks that rising interest rate could have on repayment ability, asset prices and the overall economy in Hongkong.'

Goodbye laissez faire!

The Monetary Policy

With the appropriate monetary policy in place for an economy, it helps to oil the wheels of industry, thus beefing up the general economy by, inter alia, helping in the creation of jobs, increasing the value of exports, and, eventually, the obvious, knock-on effect is to increase the wealth of the general population of a country/territory.

Equilibrium in all economies is first and foremost in the minds of most economists, the world over.

Inappropriate monetary policy, eventually, has the ability to drive an economy away from equilibrium – and, then, everybody suffers.

All monetary policies have the ability to influence, directly, the levels of spending of households on the High Streets of the world.

Historically, one notes that high interest rates tend to encourage saving, but discourages borrowing, while low interest rates tend to reduce spending.

Tight monetary policies have been seen to have been the cause of prolonged retardation in an economy or to have prevented any material growth in an economy.

Alternatively, excessively loose monetary policies have been seen to have been the root cause of inflationary tendencies.

The object of the HKSAR's monetary policy, one might presume, should be aimed at equilibrium for the economy rather than punishment of that segment of the population that has, or would like to have, the ability to invest in bricks and mortar.

In a market economy, the best controller of the market is the market, itself.

Any monetary policy, however, is aimed not just at the present time, but somewhere down the line, say in two years or three years into the future.

The economy of the HKSAR is not driven by the market price of bricks and mortar, but by the ingenuity of a large proportion of the 7.30 million, resident population.

However, having said that, it is very clear that the market price of bricks and mortar is a gauge of the success, or otherwise, of an economy.

What the Administration of Chief Executive Leung Chun Ying is managing to do, probably out of sheer ignorance rather than by any well-considered design, is, slowly but surely, strangling those facets of the territory that caused it to become one of the last bastions of free enterprise as well as being the shining light for many economies of the world to view.

Without banking support for existing industries and entrepreneurs' visions for the future, these 416 square miles would cease to be and, like a vine, starved of water, it would wither and die.

What the Monetary Authority has managed to accomplish by the imposition of its directives on the banking industry is to hobble bankers to make decisions, based on their lending experiences and their intimate knowledge of their customers: This, certainly, is not in the best interests of the general economy.

Is one to assume that, if the Hang Seng Index rises too quickly to record-setting highs, with everybody and his cat, either thinking or, actually, buying stocks and shares on The Stock Exchange of Hongkong Ltd, that the HKSAR Government should impose measures to bring down the key index of the HKSAR's equity market to a level that it considers appropriate?

Today, many companies, listed on the Main Board of The Stock Exchange of Hongkong Ltd, are paying dividends, ranging from six percent to nine percent, per annum.

Meanwhile, banks are paying negative interest rates to depositors, de facto.

With interest rates at banks not being attractive, at all, it is only natural for those residents of the territory, those who are flush with cash, to look for ways to employ surplus funds in the best way that they know how: The property market and the equity market have, historically, been first on the list of areas of the economy in which to make investments.

If the Government should, some time in the future, determine to try to cool down the HKSAR equity market, it would be disastrous and, most likely, it would tend to kill the golden goose as far as international investors are concerned.

Therefore, it seems illogical even to consider that the HKSAR Government would consider such a move.

But, by cooling down the property market, as is the wont of the Government of today, it will have the almost immediate effect of driving up rental rates for those investors who were lucky enough to have purchased residential property in the past and, today, are about to benefit from elevated monthly incomes from their tenants.

In every determination, there are, always, plusses and minuses.

Which brings **TARGET** () to the questions:

a. *Has the HKSAR Government considered all of the minuses with regard to its determinations of February 22, 2013?*
b. *Is today a good time to loosen the purse strings of banks rather than tightening them, further?*
c. *Having determined to step in, in order to try to retard today's market price of residential property in the territory, has the stage been set to allow the Government to intervene, willy-nilly, in the event that the prices of any particular fresh produce, imported into the HKSAR, are considered too expensive to allow the poorer sector of the economy to purchase those foodstuffs that they enjoy?*
d. *In which direction is this Government taking the people of HKSAR?*

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