



HKIMR

A company incorporated
with limited liability.

www.hkimr.org

The HKIMR was established by the Hong Kong Monetary Authority (HKMA) in August 1999 to conduct and support research on issues in monetary policy, banking and finance that are of strategic importance to Hong Kong and the Asian region.

Highlights of this issue:

Third Annual International Conference on the Chinese Economy

New Chairman of the Council of Advisers

Conference on Monetary and Financial Stability in the Asia-Pacific amid an Uneven Global Recovery

The Ninth HKIMR Conference on the Mainland Economy

Joint Seminar on “Can Emerging East Asia Weather Another Global Economic Crisis?”

Visiting Fellow – Yue Ma

Visiting Fellow – Peter Tillmann

Hong Kong Institute for Monetary Research – *Newsletter*

Twenty-First Issue (February 2012)

Recent Activities

Third Annual International Conference on the Chinese Economy

The HKIMR held its Third Annual International Conference on the Chinese Economy in Hong Kong on 12 and 13 January 2012. The theme of this conference was “China’s Macroeconomic Performance in the Medium-Term: Deepening Reforms and Further Opening Up”.

This conference was the third of the HKIMR annual international conference series on the Chinese economy, which was intended to provide a forum for academics, policymakers and business economists to discuss important analytical and policy issues related to the Chinese economy. The conference featured speeches by Professor Chenggang Xu (The University of Hong Kong) on “Institutional Foundations of China’s Structural Problems”, Professor Shang-Jin Wei (Columbia University) on “New Housing Economics - An Application to China”, and Professor Leonardo Leiderman (Tel-Aviv University) on “Monetary Policy and Financial Sector Liberalisation in Latin America: Key Lessons



Dong He (Executive Director (Research) of the HKMA and Director of the HKIMR) delivering the opening remarks on “What are the Prospects of Continued Economic Reforms in China?”

for China”.

The conference was divided into four sessions and a total of eleven papers were presented. In the first session, Kunyu Tao (Peking University) presented her paper “Causes of and Remedies for China’s External Imbalances: The Role of Factor Market Distortion” and Zhenjie Qian (Tsinghua University) gave a presentation of her paper “Is Labor Income Share in China Too Low?”.

In the second session, Wenlang Zhang (HKMA) presented his paper “Productivity Growth of Non-Tradable Sectors in China”. It was followed by the presentation of Hao Shi (Shanghai Jiao Tong University) of his paper

Announcement



Professor Edward K. Y. Chen, Distinguished Fellow of Hong Kong Institute for Humanities and Social Sciences, The University of Hong Kong, has been appointed Chairman of the Council of Advisers of the HKIMR, as from 21 January 2012, to succeed Professor Richard Wong of The University of Hong Kong.

Third Annual International Conference on the Chinese Economy



Chenggang Xu (The University of Hong Kong) delivering a keynote speech on institutional foundations of China's structural problems.

External Impact of China's Exchange Rate Policy: Evidence from Firm Level Data" and "Challenges for the Future of Chinese Economic Growth" respectively.

Discussants from academia, the financial services industry, and policy institutions commented on each paper following the presentation. They included Guonan Ma of Bank for International Settlements (BIS), Dennis Tao Yang of The Chinese University of Hong Kong, Leon Berkemans of Reserve Bank of Australia, Chu Zhang of Hong Kong University of Science and Technology, Man-Keung Tang of HKMA, and Louis Kuijs of Fung Global Institute.

The conference was attended by over 100 participants which included representatives from ten central banks.

The conference programme and the papers can be found on: http://www.hkimr.org/conferences_detail.asp?id=62&callfrom=previous&page=1



More than 100 conference participants

... continued from last page

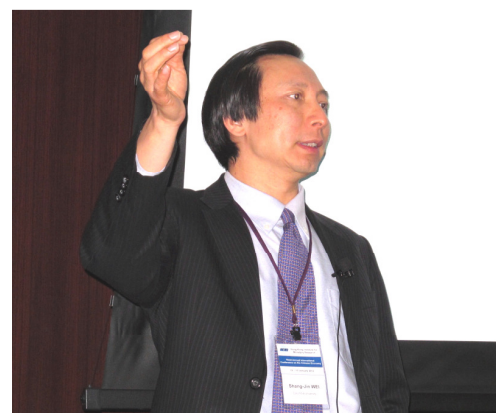
"A Reappraisal of Market Distortions and Manufacturing TFP Loss in China". Huiwen Lai (The Hong Kong Polytechnic University) also gave a presentation on his paper "Prices of Chinese Exports: Beyond Productivity". This session ended with a paper presented by Dan Lu (Princeton University and University of Rochester) entitled "Exceptional Exporter Performance? Evidence from Chinese Manufacturing Firms".

The third session on the second day included the presentations of "Dual-Track Interest Rates and the Conduct of Monetary Policy in China" given by Honglin Wang (HKIMR), "Understanding Chinese Bond Yields and their Role in Monetary Policy" by Nathan Porter (International Monetary Fund), and "Does Informal Finance Help Formal Finance? Evidence from Third Party Loan Guarantees in China" by Dragon Tang (The University of Hong Kong).

In the last session, Hui Tong (International Monetary Fund) and Jane Haltmaier (Board of Governors of the Federal Reserve System) presented their papers "The



Leonardo Leiderman (Tel-Aviv University) delivering the luncheon speech on "Monetary Policy and Financial Sector Liberalisation in Latin America: Key Lessons for China"



Shang-Jin Wei (Columbia University) delivering a keynote speech on "New Housing Economics - An Application to China"

Conference on Monetary and Financial Stability in the Asia-Pacific amid an Uneven Global Recovery

Together with the Asia and Pacific Department (APD) of the International Monetary Fund (IMF), the HKIMR co-organised a two-day conference entitled “Monetary and Financial Stability in the Asia-Pacific amid an Uneven Global Recovery” in Hong Kong on 10 and 11 October 2011.

The conference brought together policymakers, academics, and market participants, and aimed to generate constructive discussion on a wide range of empirical and policy issues related to the monetary and financial stability in the region. The conference commenced with Dong He (HKMA and HKIMR) and Vivek Arora (IMF) providing opening remarks. A total of nine papers were presented in three sessions. The papers presented in the conference covered topics including rapid credit growth and currency appreciation, impacts of Quantitative Easing (QE) policies of the US Fed on emerging Asian economies,



Vivek Arora (Assistant Director of APD, IMF)
delivering the welcome remarks



Joshua Felman (Assistant Director of
Research Department, IMF)

effects of capital controls, challenges to monetary operations in the face of large inflows, the real estate booms, and bond market development in the ASEAN-5.

The presenters of the papers were mainly from policy institutions and academia. The conference attracted over 70 participants and generated lively discussions.

The conference program can be found on:

http://www.hkimr.org/conferences_detail.asp?id=58&callfrom=previous&page=1



Peter Pang (centre) (Deputy Chief Executive of the HKMA and Deputy Chairman of the Board of Directors of the HKIMR) hosting the conference dinner. Vivek Arora (left) (Assistant Director of APD, IMF) and Roberto Cardarelli (right) (Division Chief of APD, IMF)



Conference speakers and session chairs

The Ninth HKIMR Conference on the Mainland Economy



Xiaohui Zhang (left) (Director General of Monetary Policy Department of The People's Bank of China (PBoC)) and Dong He (right) (Executive Director (Research) of the HKMA and Director of the HKIMR)



Conference participants

The HKIMR held its ninth conference on the Mainland economy in Putonghua on 17 November 2011. This year's conference was on "Money and Bond Market Developments in Mainland China".

The conference aimed to examine the development of the Mainland's money and bond markets, and their roles in Mainland's monetary policy transmission. Issues discussed included the dual-track interest rates, SHIBOR as the benchmark interest rate, liberalization of interest rates, major bond yield determinants, development of the secondary bond market, credit rating of bonds, and shadow banking in China. The discussion enhanced our knowledge of onshore RMB money and bond markets, which will be useful to the further development of the offshore RMB market in Hong Kong.



Yingli Huo (right) (Deputy Director General of Financial Market Department of PBoC) and Hongyi Chen (left) (Senior Manager of the HKIMR)

Joint Seminar on "Can Emerging East Asia Weather Another Global Economic Crisis?"

The Asian Development Bank (ADB) and the HKIMR co-organised a seminar entitled "Can Emerging East Asia Weather Another Global Economic Crisis?" in Hong Kong on 6 December 2011.

The seminar aimed to discuss the impacts of a potential global economic crisis on the Emerging East Asian economies, and to introduce the latest issue of the Asia Economic Monitor (AEM) of the ADB. The seminar featured a panel discussion session chaired by Andrew Filardo (Head of Economics for Asia and the Pacific, BIS). The panellists included Junkyu Lee (Head of Americas Team, Korea Institute for International Economic Policy), Yiping Huang (Chief Economist for Emerging Asia, Barclays Capital), R. Sean Craig (IMF Resident Representative in Hong Kong), Lillian Cheung (Head of Economic Research Division, HKMA), and Lei Lei Song (Senior Economist, ADB).



Iwan J. Azis (Head of Office of Regional Economic Integration, ADB) giving a presentation on AEM

Visiting Fellow – Yue Ma

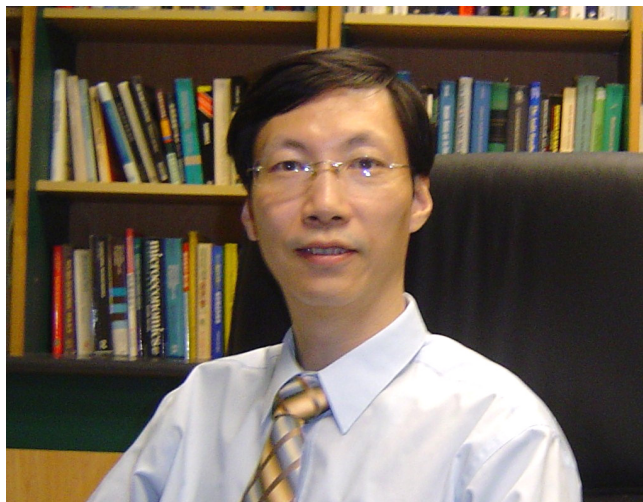
Yue Ma is a Professor and Head of the Economics Department, Lingnan University, Hong Kong. He earned a BSc in Optimal Control Theory from Computer Science Department at Xiamen University in 1985. His formal economics training started at the Sino-US Economics Training Centre, sponsored by the Ford Foundation, Renmin University, Beijing, 1985, where he was a postgraduate student of Nobel Prize laureates Professor Robert Engle and the late Professor Leonid Hurwicz. The Training Centre was organized by Professor Gregory Chow from Princeton University. Subsequently, Professor Ma earned his joint PhD degree in Economics and Econometrics from Manchester University, UK. He was then a tenured Reader at Stirling University in Scotland before he joined Lingnan in 1999.

It is my great pleasure to visit the IMR. In the early years of my academic career in the UK, I worked on policy research questions such as whether Europe should establish the euro and whether the British pound should join the eurozone, learning from the lessons of German reunification. Since I came to Hong Kong in 1998, I focused on the more interesting questions like whether the Hong Kong dollar should de-link with the US dollar and peg to the Chinese currency renminbi.

Recently, I visited the IMR to work with Shu-ki Tsang (HKBU), Matthew Yiu and Alex Ho from the Research Department of the Hong Kong Monetary Authority on the robustness of Hong Kong's Linked Exchange Rate System, which had undergone a mass inflow of hot money. This project extends the single-asset target-zone model pioneered by Paul Krugman in 1991 to include both bonds and equities. The new model provides a convenient framework for investigating a 'puzzle' recently noted in Hong Kong. While the economy has experienced persistently lower interest rates relative to the US, it has been able to maintain a stable peg between the Hong Kong dollar and the US counterpart under an environment of free capital flows. This is in apparent contradiction with the 'impossibility trinity' in the theory of the international finance.



In the aftermath of the subprime crisis, I worked at the IMR to complete a paper with Joel Houston and Chen Lin on "Regulatory Arbitrage and International Bank Flows", which is to appear in the *Journal of Finance*. This project studied whether cross-country differences in regulations have affected international bank flows. We found strong evidence that banks have transferred funds to markets with fewer regulations. This form of regulatory arbitrage suggests there may be a destructive "race to the bottom" in global regulations which restricts domestic regulators' ability to limit bank risk-taking. However, it was also found that the links between regulation differences and bank flows are significantly stronger if the recipient country is a developed country with strong property rights and creditor rights. This suggests that while differences in regulations have important influences, without a strong institutional environment, lax regulations are not enough to encourage massive capital flows.



"As investors in Hong Kong are compensated by a higher return from Hong Kong equities relative to US equities, there were capital inflows to Hong Kong even when the Hong Kong interest rate was below the US interest rate."

The trinity refers to the trilemma in which it would be impossible to achieve all of the three following targets for an authority at the same time: a fixed exchange rate, free capital movement, and an independent monetary policy. Since the Hong Kong dollar is pegged to the US dollar, and the Hong Kong government adopts no capital controls at all, one would expect that Hong Kong's interest rates should follow those in the US closely, albeit with occasional and temporary deviations due to short term liquidity shocks. However, the persistently lower interest rates observed in the Hong Kong monetary system posit a 'puzzle', or an apparent contradiction to the theory of the impossible trinity. By introducing the equity market into the model, our modified analytical structure presents a plausible route to a meaningful answer to the 'conundrum' and hopefully yields a certain degree of theoretical generality. As investors in Hong Kong are compensated by a higher return from Hong Kong equities relative to US equities, there were capital inflows to Hong Kong even when the Hong Kong interest rate was below the US interest rate.

Visiting Fellow – Peter Tillmann



Peter Tillmann is professor of monetary economics at the Justus-Liebig-University Giessen, Germany, and a visiting fellow at the Institute for Monetary and Financial Stability at the Goethe-University Frankfurt. Before arriving in Giessen he was assistant professor at the University of Bonn and worked as senior economist at the Swiss National Bank in Zurich. In his research he has focused on monetary policy, empirical macroeconomics and international finance with applications to both industrial and emerging countries.

I had the privilege to enjoy the generous hospitality of the HKIMR in September/October 2010 and again in October 2011. Being a tourist visiting Hong Kong is exciting. Being an economist visiting Hong Kong is more than that: it's a thrilling field trip to a dynamic small open economy. Hong Kong is a unique place to study macroeconomics meeting reality. A highly developed financial market, numerous banks on just a few square miles, a degree of openness rarely seen elsewhere, the streets crowded with people from all parts of Asia and the rest of the world. In short, a place where open economy macroeconomics and finance face reality.

For me this is the ideal backdrop against which to think about economic

research. Spending a few weeks in Hong Kong provides you with a fresh perspective on the dynamics of emerging Asia.

“The HKIMR provides the perfect environment for productive research. There you find a tremendous amount of expertise, an extremely friendly atmosphere, a marvelously helpful staff and the quiet desk you need.”

In September/October 2010 I worked on a project on the performance of inflation targeting in Asian economies. In recent years a number of Asian central banks have adopted monetary policy frameworks involving explicit inflation targeting. In a recent paper with Stefan Gerlach we explore how successful these policy choices have been, looking at data from economies with and without inflation targeting in Asia. This is an interesting issue since the literature to date has not drawn any clear-cut conclusions regarding how successful inflation targeting has been in emerging economies. As a metric of success we study how persistent shocks to inflation are. We find evidence that inflation persistence has declined in the economies using inflation targeting but not elsewhere.

In a more recent project, which I will complete in February 2012, I aim at assessing the impact of capital inflows on property prices throughout Asian emerging market economies. For that purpose I estimate a panel VAR using sign restrictions to identify shocks to capital inflows. The results - though yet preliminary - suggest that capital inflow shocks have a significant effect on asset prices and contribute to an appreciation of property prices.

The HKIMR provides the perfect environment for productive research. There you find a tremendous amount of expertise, an extremely friendly atmosphere, a marvelously helpful staff and the quiet desk you need after a walk through the busy streets of Central. With the BIS's and IMF's regional offices next door, it's a perfect place to exchange ideas and views. It could happen that you meet leading scholars from Europe or the U.S. over a delicious dim sum lunch.

A visit to the HKIMR permits -literally- a bird's eye view of a small open economy: one of the most spectacular views of Hong Kong is possible from the HKIMR's offices on the 79th floor of the IFC tower. Having a coffee while overlooking Victoria Harbour among other things, is one of the many amenities Hong Kong offers to economists.

Application for Visiting Research Fellow

The HKIMR accepts applications for positions as Visiting Research Fellow on an ongoing and highly competitive basis. The Council of Advisers reviews proposals four times a year. The deadline for the next round of applications is 31 March 2012.

Applicants should note that papers produced, partly or wholly under this visiting programme, are required to acknowledge the financial support of the HKIMR if the papers are submitted to any journals.

Please visit our website (<http://www.hkimr.org>) if you are interested in this programme.

Upcoming Activities

Call for Papers: Conference on The Role of Financial System Reforms in Rebalancing the Chinese Economy

The HKIMR will hold its fourth Annual International Conference on the Chinese Economy in Hong Kong on 10-11 January 2013.

The conference is intended to provide a forum for academics, policymakers and business economists to discuss important analytical and policy issues related to the Chinese economy. Past conferences in this series attracted high-quality paper presentations and rigorous discussions, and were attended by researchers and China watchers from central banks and other institutions across the globe.

The theme of the forthcoming conference is “The Role of Financial System Reforms in Rebalancing the Chinese Economy”.

Possible topics include (but are not restricted to):

- Medium-term prospects of China’s external imbalances
- Underlying factors and distortions that contribute to imbalances
- Structure of factor and product markets and entry barriers
- Monetary, exchange rate, and fiscal policies
- Regulatory and supervisory structures and policies
- Efficiency and stability of the banking system and capital markets
- Interest rate liberalisation
- Capital account liberalisation and internationalisation of the renminbi
- Key issues in the housing market and housing finance
- Access to financing by small and medium-sized enterprises
- Informal finance and “shadow banking”
- Financial development and social inequality

Papers that do not fit into these categories, but that are related to the main theme of the conference, are also welcome.

Interested contributors should submit a draft paper (in a Word or PDF file) to the HKIMR by 3 October 2012 (e-mail to hkimr@hkma.gov.hk). Please use the contact author’s name as the name of the file. The HKIMR will select the papers based on originality, analytical rigor, and policy relevance and will contact the authors whose papers are selected by 9 November 2012.

Presenters will be reimbursed for reasonable travel expenses and accommodation. For further information, please email hkimr@hkma.gov.hk or visit the HKIMR website <http://www.hkimr.org>.

Conference on Financial Stability of the International Journal of Central Banking

The HKIMR will host the spring 2012 conference on financial stability of the International Journal of Central Banking on 17 and 18 May 2012 in Hong Kong. The International Journal of Central Banking is a world-renowned academic journal, with a particular focus on central banking issues. The Managing Director of the Journal is Mr. John Williams, President of the Federal Reserve Bank of San Francisco. Mr. Williams plans to attend this conference in Hong Kong.

Conference on “Currency Internationalization and International Monetary Reform”

The HKIMR plans to co-organise a conference on “Currency Internationalization and International Monetary Reform” with The Centre for International Governance Innovation (CIGI) on 12 and 13 December 2012. The conference will examine a range of views on the fundamental systemic issues that are pushing countries to seek international monetary reforms, and the views from the BRIC countries and regional considerations regarding Chinese and other currency internationalization.

Visiting Fellows and Seminars

20 February – 16 March 2012
Nelson C. Mark (University of Notre Dame)

July 2012
Shang-Jin Wei (Columbia University)

29 February 2012 *Global Economic Prospects 2012: Uncertainties and Vulnerabilities* – Hans Timmer (Director of the World Bank's Development Prospects Group)

Recent HKIMR Working Papers

- No.30/2011** “Sectoral Labor Adjustment and Monetary Policy in a Small Open Economy” by Kang Shi
- No.31/2011** “Give Credit where Credit is Due: Tracing Value Added in Global Production Chains” by Robert Koopman, William Powers, Zhi Wang and Shang-Jin Wei
- No.32/2011** “Geopolitics, Global Patterns of Oil Trade, and China's Oil Security Quest” by Sergey Mityakov, Heiwai Tang and Kevin K. Tsui
- No.33/2011** “Explaining Share Price Disparity with Parameter Uncertainty: Evidence from Chinese A- and H-Shares” by Tsz-Kin Chung, Ka-Fai Li and Cho-Hoi Hui
- No.34/2011** “The Cross-Section of Country News, Decoupling Expectations, and Global Business Cycles” by Mathias Hoffmann and Wei Liao
- No.35/2011** “Preference Relativity, Ambiguity and Social Welfare Evaluation” by Zhijun Zhao
- No.36/2011** “Exchange Rate Dynamics Under Alternative Optimal Interest Rate Rules” by Mahir Binici and Yin-Wong Cheung
- No.37/2011** “Love Thy Neighbor: Income Distribution and Housing Preferences” by Tin Cheuk Leung and Kwok Ping Tsang
- No.38/2011** “The Great Retrenchment: International Capital Flows During the Global Financial Crisis” by Gian-Maria Milesi-Ferretti and Cédric Tille
- No.39/2011** “Exchange Rates and the Margins of Trade: Evidence from Chinese Exporters” by Heiwai Tang and Yifan Zhang
- No.40/2011** “Information Flow between Sovereign CDS and Dollar-Yen Currency Option Markets in the Sovereign Debt Crisis of 2009-2011” by Cho-Hoi Hui and Tom Fong
- No.41/2011** “The Effect of Capital Flow Management Measures in Five Asian Economies on the Foreign Exchange Market” by Matthew S. Yiu
- No.01/2012** “Detecting Bubbles in the Hong Kong Residential Property Market: An Explosive-Pattern Approach” by Matthew S. Yiu and Lu Jin
- No.02/2012** “China's Financial Reforms: Why Dysfunctional Banking Survives” by Leo F. Goodstadt
- No.03/2012** “China's LGFV Crisis 2011: The Conflict between Local Autonomy, National Interest and Financial Reforms” by Leo F. Goodstadt

and more please visit our website.

Correspondence

ADDRESS:
 55/F Two International Finance Centre,
 8 Finance Street,
 Central, Hong Kong

PHONE:
 (852) 2878-1978

FAX:
 (852) 2878-7006

E-MAIL:
hkimr@hkma.gov.hk

We're on the Web!
 See us at:
www.hkimr.org

Chairman of the Board of Directors:
 Norman T. L. Chan

Chairman of the Council of Advisers:
 Edward K. Y. Chen

Director:
 Dong He

Staff:

Senior Manager:
 Hongyi Chen

Managers:
 Wei Liao
 Qianying Chen
 Honglin Wang

Research Analyst:
 Kenneth Chow

Assistant Officer:
 Selina Cheung

Administrative Assistant:
 Judy Kwan