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Futures guru upbeat on China

INTERVIEW

Leo Melamed, chairman emeritus of the Chicago Mercantile Exchange (CME), will go down in history as the founding father of the futures industry.

In 1972, he had a novel idea: if you could trade futures on pork bellies, wheat and beef, why not on Swiss francs, deutsche marks, or any other currency or financial instrument for that matter?

He went on to create the International Monetary Market (IMM) – the world's first futures market for financial instruments in 1972.

In 1987, Melamed spearheaded the introduction of Globex, the world's first futures electronic trading system.

*Today China is trying to develop its own financial futures market and is preparing to launch stock index futures and currency futures. Melamed shares his insights and views on the prospect of financial futures in China with China Daily reporter **Chen Jialu**.*

Q: What is the derivative market potential in China?

A: In the past 30 years, the derivative market has witnessed a rapid development in North America and Europe but Asian countries including China have lagged behind.

The derivative market is a very important mechanism in the development of the capital market. Without derivatives, I believe, the capital market cannot fully mature. China is still in the early stage of capital market development.

Q: As you know, China plans to launch an index futures and a currency futures market. How do you think they will make a difference to China's financial market?

A: The stock index futures market will make the stock market much more mature and much more liquid. The financial community will learn to better manage the risks of their stock portfolios.

China has recently suffered stock market turbulence. A stock index futures market could have softened that blow.

A foreign exchange currency futures market will also create liquidity, and liquidity means more participation and better use of cash flow.

Q: Do you think China is ready to launch stock index futures given that its stock market is still in its infancy?

A: The two should go hand-in-hand. Once you launch it, you will have a great deal of practical experience. That is not to say you should not study it before launching it. China is doing that now. I have urged Peking University to open a derivatives school.

Education is the key to learn how to use that market correctly because if you don't use it right, you will be hurt. China is ready to launch the stock index market this year.

The A-share market fell 30 percent without the stock index futures, so maybe it is the right time to launch it.

Q: There is quite a price gap between the shares of Chinese companies listed on the Shanghai Stock Exchange and the Hong Kong Stock Exchange. Do you think the index futures or stock-related derivative products could provide an arbitrage mechanism to narrow the gap?

A: Yes, it will. The stock index futures will adjust the value between the two markets.

Q: Derivatives in many Chinese people's eye represents high risk and betting on a derivative product dangerous. During the Asian financial crisis in 1997, some countries blamed hedge funds saying they were using derivative tools, destabilizing the local economies. Do you think it is possible for people to employ derivative products in a way that could negatively impact the health of the financial market in China?

A: You should never blame the hedge funds for taking advantage of a situation that was created by the government. The countries are creating conditions for people to take advantage of.

Q: In mature markets, derivative products are mostly used to hedge against risks and for maximizing returns. Is there any way for Chinese regulator to prevent investors from overly speculating on derivative products?

A: I believe nothing is wrong with speculation. Everybody speculates. But I believe there should be rules and efficient regulations. We have proved that a good market and a mature market have hedgers and speculators, commercial and speculative activities. The combination makes a market.

In the US, people misuse OTC derivatives ... not futures markets. Nobody misuses the futures market. The futures market works perfectly and continuously. That is the real distinction.

China's leaders are very smart and you cannot underestimate the ability of China's financial community to utilize the market sufficiently. I am a big believer in the people of China, and a big believer that they know what to do. The China Securities Regulatory Commission has done an excellent job and put a lot of rules in place.

Q: There has been too much hot money flowing into China. Do you think the launch of a futures market will bring more?

A: Without the futures market, hot money is flowing in anyway. I don't think it will increase it, but it will increase the ability to utilize the money better and efficiently.

Q: CME Globex launched renminbi futures last year. Will that make the yuan exchange rate more volatile? Will it accelerate yuan appreciation?

A: The futures market does the opposite since it creates more liquidity, which makes it less volatile.

The CME renminbi currency futures market has not fully worked. The yuan is not very actively traded on CME. It is very small compared to the yen or euro.

Because of the control of the currency exchange rate, yuan cannot fluctuate too much.

Q: Is China ready to launch a renminbi currency futures exchange?

A: Not until the currency is free floating. It will not be successful until the yuan is fully convertible.