

# Hong Kong Financial Markets

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# The fundamental trend

- In March 1996 the House Banking Committee held a hearing where I was asked to testify regarding whether Hong Kong's shift to Chinese sovereignty might collapse the Hong Kong banking system and severely damage the U.S. financial system.
- In 1997 commentators still thought of the major global markets as New York, London and Tokyo.
- Prior to 1997 HSBC shifted its headquarters to London
- By January 17, 2008, Hong Kong had so clearly eclipsed Tokyo as an international market that Time magazine (January 17, 2008) initiated the phrase "Nylonkong" as a summary of the global financial marketplace.
- In 2010 HSBC is moving its headquarters back to Hong Kong



# Financial markets

- Equities
- Corporate control/M&A
- Bonds
- Deposits & loans
  - **Mortgages**
- Currency/foreign exchange
- Commodities
- Derivatives



# GLOBAL FINANCIAL CENTRES INDEX 2010

(Published by City of London)

- 1 London, UK, 772
- 1 New York City, U. S. 770
- 3 Hong Kong, 760
- 4 Singapore
- 5 Tokyo, Japan
- 6 Chicago, United States
- 7 Zurich, Switzerland
- 8 Geneva, Switzerland
- 9 Shenzhen, People's Republic of China
- 9 Sydney, Australia
- 11 Shanghai, People's Republic of China
- 12 Toronto, Canada
- 13 Frankfurt, Germany
- 14 Boston, United States
- 15 Beijing, People's Republic of China

# Market capitalization, Asian stock exchanges

End-2009

Tokyo SE	3,310
Osaka SE	245
<b>Hong Kong SE+GEM</b>	<b>2,304</b>
Shenzhen SE	1,053
Shanghai SE	2,400
India National	1,359
Korea Exchange	872
Taiwan SE	616
Singapore	551

US\$Billion

➤ Source: World Federation of Exchanges, online



# Equity issues, 2009, \$ billion

NASDAQ OMX	\$192,412.0
NYSE Euronext (US)	\$65,809.7
Hong Kong Exchanges	\$95,234.9
Shanghai SE	\$99,924.0
Shenzhen SE	\$71,499.8
India (National + Bombay)	\$53,546.3
London SE	\$24,437.1
Tokyo SE Group	\$18,061.9

Source: World Federation of Exchanges



# Booming IPO market

- **19 years 1986-2004: raised HK\$ 558 billion**
- **3 years 2005-2007: raised HK\$778 billion (HKMA)**
- **2009: raised HK\$741 billion (World Federation of Exchanges)**
- **Average over-subscription of 190 times (HKMA)**
- **Declining interest in secondary listings in US, UK, EU**

# Total funds raised by bonds (US\$ millions)

Bombay SE	14,624.1
Bursa Malaysia	206.1
Colombo SE	5.5
<b>Hong Kong Exchanges</b>	<b>6,112.8</b>
Indonesia SE	5,880.6
Korea Exchange	563,222.4
National Stock Exchange India	179,855.1
New Zealand Exchange	1,982.3
Osaka SE	5,583.1
Shanghai SE	237,072.9
Shenzhen SE	252,075.9
Singapore Exchange	185,632.3
Taiwan SE Corp.	8,670.5
Thailand SE	98,373.8
Tokyo SE Group	85,107.4





# Derivative markets

- Single stock options
- Single stock futures
- Stock index options
- Stock index futures
- ETF options
- Interest rate futures
- Currency futures
- Commodity futures
- Australia, **Hong Kong**
- India dominant
- Korea dominant
- Korea, Japan, **HKong**
- **Hong Kong** dominant
- Australia dominant
- Japan dominant
- China dominant



# Fundamentals

- Standards have remained high; perception of rising integrity
  - CFA Institute, *Financial Market Integrity Index: Hong Kong 2010*
  - *But see ACGA rankings*
- British law remains intact—sometimes with better judges
- Cosmopolitan
- Free-market
- Convertible currency
- Open market for corporate control



# Corporate governance (ACGA ratings 2010)

- Singapore (67)
- Hong Kong (65)
- Japan (57)
- Taiwan (55)
- Thailand (55)
- Malaysia (52)
- India (49)
- China (49)
- Korea (45)
- Indonesia (40)
- Philippines (37)



# Drivers

- **Chinese economic growth**
- **Regional economic growth**
- **Chinese corporate desire to operate under Hong Kong law**
- **Convenience of Hong Kong for Chinese who want to use “foreign” banks and buy foreign financial products**
- **Chinese government use of Hong Kong to experiment with liberalization**



# Chinese companies enthusiastically list in HK

- Chinese companies seek listings outside the mainland in order to operate under capitalist laws and regulations
  - To acquire experience for international operations
  - And to get HK equity analysts' reports
- Chinese pay a huge premium to list in Hong Kong as opposed to listing same shares in Shanghai or Shenzhen
  - Because HK P/E is lower
- The listing of Chinese companies in Hong Kong has added enormously to HK diversity, liquidity and market cap
- 9 of 10 largest listed companies on HKSE are from mainland



# Hong Kong-Shanghai I

- **China has been supportive**
  - **Despite view that Beijing would cripple Hong Kong to benefit Shanghai**
- **Historically HK has been most vibrant when Shanghai was (Reed; McCauley & Chan)**
- **Jao 2002: “All indicators show that Shanghai was dwarfed by Hong Kong” (reaffirmed by McCauley & Chan 2008)**
  - **International banking about three times Shanghai level (Jao, McC)**
  - **Gap in FX & derivatives much wider**



# Hong Kong-Shanghai II

- Finance, insurance, business services rose from 10% of Hong Kong GDP in 1990 to 17.5% in 2005—despite competition
- HK is world's most internationalized equity & bond market; Shanghai one of the most closed (c. \$42B QFII in 2007)
- Hong Kong will benefit disproportionately from removal of capital controls (McCauley & Chan)



# Banking market

- **Intense competition: large number of banks**
- **Supportive legal system**
- **Bank of China, HSBC, Standard Chartered all issue currency**





# Hong Kong expertise shapes mainland

- **HKMA executives seconded to Beijing**
- **Laura Cha & others served as Deputy CSRC Chair**
- **Joseph Yam a high level advisor**
- **Hong Kong officials & executives have influenced Chinese accounting, payment, clearing, custodial, risk management and corporate governance systems, as well as broader market regulation and monetary policy**
- **Liu Ming Kang came to Hong Kong to announce cleanup of BoC**



# RMB business expansion

- **Deposit taking in Hong Kong began in 2004**
- **RMB to HK\$ exchange 2004: 20,000 RMB/transaction for individuals**
  - **Unlimited business exchanges**
  - **As of 2009, RMB/HK\$ 80,000/day per individual**
- **HK banks do trade finance in RMB from 2009 on**
- **China debit & credit cards valid in Hong Kong**
- **HK banks can issue and cash RMB checks**
- **Mainland companies can issue RMB bonds in HK (2007)**
  - **Chinese government floats first offshore RMB bond in HK (2007)**



# Why others can't compete I

- **Technical: simultaneous trading of multiple currencies, multiple financial products**
- **Free capital flow (vs. Shanghai)**
- **Free market for corporate control (vs. Shanghai, Tokyo)**
- **Non-political listing criteria (vs. Shanghai)**
- **English language**
- **Free flow of information & communications (vs. Taipei)**



# Why others can't compete II

- Free flow of people
- Limited government control of economy
- Cosmopolitan culture
- International legal system
- Geographic convenience (vs. Sydney)
- Freedom from bureaucracy & corruption (Mumbai)
- Potential flight from onerous regulation in US, UK, EU



# Competition wins in key areas

- **Shanghai: basic China products**
- **Singapore: fund management**
- **Countries with governments that have run large deficits: bonds**

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