

關於李達三博士滬港發展講座

滬港發展聯合研究所的滬港發展講座系列的成功舉辦，有賴李達三博士鼎力支持。香港中文大學為了感謝李博士的慷慨資助，特別將該講座命名為李達三博士滬港發展講座。李達三博士滬港發展講座由 2013年起每年舉辦，邀請國際知名學者或經濟、金融及政策研究專家主講當前滬港的熱門課題，為學界、商界、政界精英以及老師、同學分析香港與上海發展，推動滬港雙城合作、學術研究與交流，從而切實地貢獻社會。

李達三博士簡介

李達三博士生於浙江寧波，畢業於重慶復旦大學會計學系，畢業後來到香港經營電器銷售，在1955年成立樂聲電器有限公司，憑著勤奮和獨到的眼光，使業務蒸蒸日上，分店遍佈香港以及東南亞各地，迅即成為國際大型企業。不久更獲得聲寶牌（Sharp）電器產品在香港、新加坡和馬來西亞的地區總代理權。

李達三博士在商界成就卓越，同時不忘關懷社群、興學助教。李博士自1976年獲邀出任香港中文大學新亞書院校董至今，和中大已有將近四十年的情誼。李博士對中大愛護有加、關愛學生無微不至，歷年捐贈學生助學金，及工商管理學院及電子工程系多項獎學金，又在1980年捐資興建李達三樓，幫助工商管理學院擴展之用。為了表揚李博士對香港商業及本校工商管理教育的貢獻，中大於1984年頒發榮譽社會科學博士學位予李博士。李博士也大力支持醫學發展，除了資助醫學院外科學系成立「肝膽胰基金」及「李達三訪問教授計劃」，又資助消化疾病研究所的研究工作。

李博士時刻身體力行、回饋社會。2011年，在李博士的捐資和協助下，香港中文大學與寧波大學簽署李達三國際交流發展基金項目合作協議，共同推動雙方在學術和學生交流、科研以及人才培養方面的合作。2013年，中大再次得到李博士的鼎力支持，捐款協助滬港發展聯合研究所，推動滬港雙城發展及合作、學術研究與交流，包括舉辦講座，為表謝意，中大把講座命名為「李達三博士滬港發展講座」。香港特別行政區政府在2015年向李博士頒發大紫荊勳章，讚揚他長期參與社會及慈善服務，尤其對本港高等教育及人才培訓方面，不遺餘力，是一名備受尊崇的慈善家。



講者簡介

梁定邦先生為香港執業資深大律師及仲裁員，一直致力教學並同時研究法律金融史及當前的金融監管課題。他於1995年至1998年期間擔任香港證券及期貨事務監察委員會主席，其後應時任中國總理朱鎔基先生邀請，在1999年至2004年出任中國證券監督管理委員會首席顧問。梁先生是首位出任國際證監會組織技術委員會主席的亞洲人士，也曾於1997年至2008年期間擔任全國人民代表會常務委員會香港特別行政區基本法委員會委員。梁定邦先生目前為中國工商銀行獨立董事及該行董事會的風險委員會主席。



Comparing Shanghai and Hong Kong as Financial Centres: Past, Present and Future

Mr. Anthony Neoh

25 November, 2016

Distinguished guests, ladies and gentlemen,

It is my great pleasure to be here tonight, and it is nice to see so many young people. This is all about you, because the next 10 years is your 10 years. What I would like to talk about is what will happen in the next 10 years. Before doing that, I have to tell you what happened before, and what is happening now. Tonight, I am pleased to see my old friend, Professor Fanny Cheung, whom I have known for many years, and to see Professor Sung and Professor Shen.

The Past

I would like to show you the contrasts between Hong Kong and Shanghai by a photograph of the Shanghai Bund before the 2nd World War.

I chose the Bund in Shanghai mainly because it was at the center of the Far East in terms of Finance, from middle of the 19th century to Jan 5, 1942, the day the Japanese took over the Shanghai Municipal Council.

During the middle of the 19th century, after the signing of the Treaty of Nanking in 1865, Shanghai became a treaty port and thus, a place for international settlement. Back in the old days, the Bund and Pudong were undeveloped. When I first went to Pudong in 1985, it was just a swamp. Nowadays, Pudong is like Hong Kong, probably better than Hong Kong in many ways. I am showing you “The Bund” in Shanghai because all these historical buildings in “The Bund” represented part of the power of the West, not only the diplomatic power but also its economic and financial power as that power flourished on Chinese soil in the distant past. What started in Shanghai in 1860s was the Hong Kong



and Shanghai Bank, HSBC. If you move a little bit from the building with the clock, you can see HSBC which after 1949 became the Shanghai Municipal Office. The building with the clock is the Maritime Customs Building, built during the time of Sir Robert Hart, its longest serving Commissioner and the Chinese Maritime Customs Service was run by foreigners until the late 1940s. The buildings of the Shanghai Municipal Council, with its own police and courts, which ran the international settlement may be found at the end of the Bund. The original buildings of the Shanghai International Supreme Court, remains but today it is a six-star international hotel. For important cases, this Court brought judges from Colonial Hong Kong. This Court decided on important cases of conflict between Chinese law and customs and western law and customs, including commercial and family cases. These decisions are recorded in published law reports containing legal thought which is consulted even to this day, where cases involving clashes of legal systems and customs have to be decided.

On Jan 5, 1942, Mr. Katsuo Okazaki, who was the Consul General in Hong Kong before Hong Kong was occupied by the Japanese, became the Chairman of Shanghai Municipal Council. He held this post until 1945 when Japan surrendered. Before the Japanese occupation, Shanghai had the biggest Stock Exchange in the Far East, even larger than that in Tokyo. The Stock Exchange, which was launched in 1878, ceased operation on Jan 5, 1942 (but a stock exchange sponsored by the Wang Jingwei Government operated for three years during the Japanese occupation). We can see Shanghai was an international financial center of the Far East, including India, Pakistan, French Indochina and Australia. When World War II ended in 1945, the former Stock Exchange in Shanghai resumed operation in Jan 1946. However, the People's Republic of China was established in 1949. The new government believed private property was against communist ideology. In view of this, the Stock Exchange was closed at the beginning of 1950, and with it, the role of Shanghai as an international financial centre.

Hong Kong from the 1950's

As Shanghai became inward looking, Hong Kong began a new chapter of her history. It was because the Korean War started in 1951. Due to the international embargo of China at the time of the Korean War, Hong Kong became an important transshipment port.

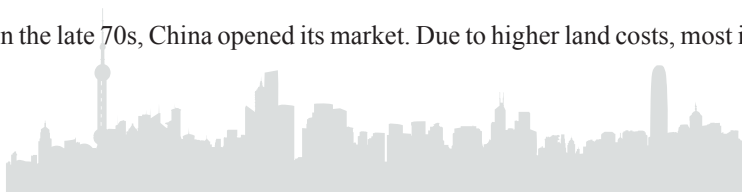
Most of the transshipments from Hong Kong contained strategic materials, were illegal by international law. Therefore, most of the transshipments indeed constituted smuggling. During the embargo period, Hong Kong was an important center for importing goods into China, as well as earning foreign exchange for China by exporting into and through Hong Kong. Thus, Hong Kong was the main channel for foreign exchange to China.

Hong Kong becoming an international financial centre

But Hong Kong did not become an international financial center until the 1970s. In 1971, the United States abandoned the gold standard. As a result, all currencies in the world began to float. Many countries in Asia had exchange controls, and China was one of them. Therefore, Hong Kong became an important center for foreign exchange and for people who want to keep their wealth away from their own government. For example, people who wanted to evade taxes in Southeast Asia keep their money in Hong Kong. Anyone who wanted to bribe the local government makes the payment through bank accounts in Hong Kong. In those days, there was no such thing like anti-money laundering laws. Gangsters and banking went together, mainly because there was not a lot of regulation. People feel if they don't want to let other people know of their financial affairs, they do it through the banking system because it had one important characteristic: banking is supposed to be secret between bankers and their clients. We still have bank secrecy laws nowadays because your relationship with your banker is always confidential. But nowadays, we have different laws for anti-money laundering and other crimes.

Hong Kong gradually became an international center under these somewhat shady circumstances and would not under present day values, be smelling quite so pleasantly if it had continued on this track. Most international centers tend to be like that when they first started, because people wanted to do business there without being conspicuous. Switzerland became a very big international financial center, as everyone wanted to hide their money in “secret” Swiss bank accounts. All of this have changed now.

In the late 70s, China opened its market. Due to higher land costs, most industrial



enterprises in Hong Kong relocated to the Pearl River Delta or Shanghai initially and then to the Yangtze Delta. As a result, Hong Kong became the front office for manufacturing undertaken in China. Thus, in the 80s, Hong Kong became an international banking center, driven by manufacturing and exports from China.

Another change took place in the early 1990s. Prior to that, Hong Kong's stock market consisted of Hong Kong companies and the largest companies were HSBC, the original English Hongs (such as Jardines and Swire) and the emerging land development companies. But in the early 1990's, China started its stock market. I remember visiting the Shanghai Stock Exchange when it first started in a building at the end of the Bund, next to the old Supreme Court of the days of the International Settlement. In the early 90s, the building was nearly empty. It was a hotel called the "Moscow Hotel", opposite to the former Soviet Union Consulate General. The Moscow Hotel was a 19th century hotel, and an old building. When I walked upstairs to see the General Manager of the Shanghai Stock Exchange, the stairs made a big creaking noise as I went up. They had 100 odd PC computers for trading in the stock market. The stock market in Shanghai today is in Pudong. That was Shanghai beginning its financial market. By that time, Hong Kong had become an international financial center, based on international banking and essentially driven by exports. As an export-driven center, the stock market in Hong Kong in the late 1970s and 1980s was very small.

However, in the early 90s, when China began its own stock market, things began to change. I remember I was a member of the Stock Exchange Council in 1992. In June 1992, I was in a delegation of the Hong Kong Stock Exchange to Beijing. We were staying in the Diaoyutai Guo Bin Guan (the hotel for state guests). We were considered as VIPs those days. Nowadays, people in Hong Kong are considered as "trouble-makers" in Beijing! In those days, we were about to meet the Vice-Premier, Zhu Rongji. The proposal was "Can the Hong Kong Stock Exchange help China with capital raising for its state-owned enterprises?" We had a thick report from lots of consultancies in Hong Kong and elsewhere, which said that "China cannot have its stock market until it had securities laws, company laws, etc, and Hong Kong cannot list Chinese enterprises until that happened." I wondered when China could have its own stock market in the way

described by these consultants, when it had already started these markets in Shanghai and Shenzhen. Thus, I asked someone who just returned from the US. He told me he came back from the US with a letter from former US President, Richard Nixon, to Zhao Ziyang, introducing him. This person was Gao Xiqing (高西慶), who became the Vice-President of the China Securities Regulatory Commission (CSRC). I asked Gao, “You are the only lawyer from China that I know. When do you think these (the securities and company laws) will happen?” Gao rolled his eyes, and said “Well, maybe 20-30 years later?” He said that in 1992. I said, “perhaps Zhu Rongji would be quite angry if he hears this.” Next, I suggested “let’s forget this report. We can use whatever we have in China and construct a system which is acceptable to Hong Kong for the purpose of listings”. I thought it might be worthwhile to explore whether we might be able to build an equivalent system, but we need to work with people in the mainland. I therefore made a suggestion to the Chairman of the delegation, Chairman Charles Lee Yip Kwong (李業廣): “Propose to Zhu Rongji that we have a working party between Hong Kong and the mainland, so that we could work out the procedure for raising capital in Hong Kong for SOEs.” Chairman Lee accepted the suggestion and made the proposal to Vice Premier Zhu. A working party was formed. Chairman Lee and Professor Liu Hongru (劉鴻儒), who was then a Vice Governor of the Peoples’ Bank as well as Vice Minister of the State Council’s Economic System Reform Commission were co-heads of the Working Party. I was made Co-Head of the Hong Kong Legal Group under the Working Party and we succeeded in building a system for listing of Chinese shares in Hong Kong within 6 months. This system remains to this day. None of the people involved got paid for six months of full time work. My counterpart Co-Head on the Chinese Government side was Sun Shuyi (孫樹義), who eventually became the director of the office of the Leading Group for Financial and Economic Affairs (中財辦). He worked with Hu Jintao and Jiang Zemin before his retirement. The first listing of the shares of Chinese enterprises (called H Shares) was in March 1993.



Comparing Statistics

Let us now compare some statistics. Today, the GDP of Hong Kong is about 307 billion US dollar (USD). Shanghai has a population of 24 million, while Hong Kong has a population of 7 million, but the GDP of Shanghai is 2.5 trillion Yuan. I purposely gave it to you in Yuan because of the fluctuation of RMB these days. You can see the GDP composition is very different. Hong Kong's GDP now is 92.5% in services. The rest are little in manufacturing and primary production (7.5% in total). Out of the 92.5%, the import and export takes about 23%, financial services 18%, public services roughly the same. In Shanghai, they break down the GDP by agriculture (primary), manufacturing and services. 65% of GDP in Shanghai comes from service. Comparing to the national average (48%), Shanghai is well-advanced in services. One important factor is Shanghai's household expenditure as % of GDP. The national average is 58%. I believe the household expenditure in Shanghai is much bigger, and the figure in Hong Kong is roughly the same as that in Shanghai, i.e. Shanghai people spend as much as Hong Kong people.

The other thing about Shanghai is that we are also very close in terms of the attainment of our young people. The OECD does a test about young people in the 2nd last year in high school. They test them for reading, math and science. In 2012, Shanghai ranked No. 1 in the world, in terms of reading, math and science. Hong Kong ranked 3rd, while Singapore ranked 2nd. However, Shanghai spends more money, and receives more help from the central government. There are 10 "2-1-1" universities in Shanghai, which is the second largest (Beijing has the most "2-1-1" universities, since it is the capital of China). This excludes all major business schools, e.g. Harvard Business School campus in Shanghai. Hong Kong has 9 publicly funded universities, with no help from the central government. Although most of university funding in Hong Kong comes from the Hong Kong Government budget, we are fortunate in being able to benefit from private donations. All the nice seating that you have tonight, comes from Mr. Yasumoto, who donated funds for this building. Hong Kong raises a lot of money by private donations, while Shanghai gets money from the central government.

The next ten years: comparing GDP change

Still on comparisons, what would Shanghai and Hong Kong become in the next 10 years?

I would like to show you a few comparisons about GDP growth. Shanghai's GDP growth exceeds the national GDP growth, so it has grown very fast over the last 10 years. Shanghai is the first city in China that has a GDP of 2.5 trillion Yuan. In contrast, Hong Kong has a relatively mature economy. Hong Kong's GDP growth was 3% in 2011, and less than 2% recently. Its GDP growth rate now is roughly the same as the United States. One of the reasons is that Hong Kong dollar is pegged to the US dollar. Our monetary policy is the US monetary policy. Thus, our business cycle is pegged to the US business cycle while at the same time, we are affected by economic changes in China. With Mr. Trump (President-elect) of the United States, he wants to make the US GDP growth 4-5% (I am not sure he means the nominal or real GDP growth, his not very clear on this). If he can keep his promise, we might have 4-5% GDP growth as well, fuelled by continuing growth in China.

The next ten years: comparing banking systems

Let me compare the financial assets of the two places. Hong Kong's banking assets are very little (7.5 trillion HKD), less than 1 trillion USD or 7.5 trillion RMB. Meanwhile Shanghai has banking assets equivalent to the whole country. Banking assets in China (excluding the bond market and shadow banking) is over 120 Trillion RMB, or about 16 Trillion USD. Why is that? It is because all banking ends up in Shanghai. Shanghai is the place for all inter-bank payment systems. Indeed, the central payment system (CPS) is sited in Shanghai. Furthermore, the offshore RMB clearance system is placed in Shanghai, i.e. the China International Payment System (CIPS). Moreover, the China Foreign Exchange system, which deals RMB against 13 other currencies over the world, and the Interbank Bond market, is located at Shanghai. This explains why Shanghai represents the banking nerve center of China. This also explains why the People's Bank of China (PBOC) has an assistant governor in charge of PBOC in Shanghai, and only in Shanghai.



Hong Kong, to a certain extent, plays that same role (banking nerve center) for the whole country, essentially for its external dealings. Hong Kong has a currency board and no exchange control. Its payment systems are linked to the whole world, through its banking system. In fact, the Chinese payment systems' design is based on the Hong Kong system. A lot of engineers, IT specialists, consultants work with the Chinese payment system, after gaining experience from the Hong Kong payment system. The CIPS has a Hong Kong node, which goes through to the whole world. Therefore, Hong Kong is the main place for CNH. Renminbi in China is called "CNY" because it is the currency inside China. Renminbi outside China is called "CNH", irrespective where it is. It is because CNH starts from Hong Kong. This explains why Hong Kong is important as an interface between the nation and the world.

Hong Kong and Shanghai play a complimentary role in the banking systems, as well as internationalization of Renminbi (RMB). Hong Kong also has the biggest RMB and foreign currency derivative market in the world, including RMB Forward, RMB-Euro swap and RMB-US dollar swap. Besides, Hong Kong is the primary place for capital rising for Chinese enterprises, which is one of the most important roles.

The next ten years: comparing legal systems

Hong Kong has a legal system that is accepted around the world. The legal system in China, however, is still developing and falls behind the world's commercial standards. For example, the bankruptcy laws in China are not well developed and enforced. Bankruptcy laws are very important for financial systems, mainly because they give people an idea about how expensive it is to go bankrupt. In Hong Kong and many developed legal systems, someone who goes bankrupt needs to expose all of his accounts and properties to a liquidator (or receiver), who is supervised by a court. This person has to report to the court what he has done over the last few years. All of his accounts will be audited. In China, if someone goes bankrupt, the Chinese court will simply declare "you are bankrupt". He does not get his accounts audited. In fact, the system in China favors the bankrupt person. This is the most important difference between China and Hong Kong.

In some cases, businesses do get audited. However, most business owner in China has multiple balance sheets. One of them is for the Internal Revenue Department, another one for the owner himself, and maybe another one for the owner's partner. There is rarely any enforcement to make people comply the laws. As a result, people take whatever actions need to maximize their revenue. This is a problem, but it is also common among all emerging markets, like Russia, Pakistan and India. This sets China apart from Hong Kong. It gives Hong Kong an opportunity to play a role in the development of China for the next decade.

The next ten years: comparing stock markets

Let us now compare the stock markets. These are names that you all know. Tencent incidentally is a Hong Kong company, though nearly all of its business is in China. It takes up a big part of the IT sector in the Hang Seng Index since it is a big company. Its stock started at \$4 in Hong Kong. Now the stock is over \$200. These companies, including China Life (中國人壽), have shares listed in Hong Kong, as well as in Shanghai. Shares in Hong Kong are called "H-shares", and shares in China are called "A-shares". I asked Liu Hongru, the former chairman of CSRC, the origin of the name of "A-shares". Liu said "A" is the first letter in alphabet, implying the superiority of the shares.

In Hong Kong, the Main board has 1693 companies, and GEM board has 248. That gives us close to 2000 companies in total. Shanghai, however, has only around 1100 companies. These major companies are also known as "Large Caps". Shenzhen has only 478 Large Caps, but it has a very active SME market (中小板), and a very active Chinext (創業板). We also have new third board (新三板) in China. The figure 9273 was updated in late October 2016. Now the figure has exceeded 10000, since there is not limit for going in 3rd board. This is an interesting board, where start-up companies get registered and go to the capital market. These companies do not raise lots of money, as each company can only have 35 new shareholders at any moment. However, companies are allowed to change shareholders with registration. As these companies grow, we can



foresee that they either become SME, Chinext, or come to Hong Kong, London or New York for listing. That is how markets shape up in China.

As of 15 September 2016, the Hong Kong market cap is 3301 billion USD, which ranks 7th in the world. However, in 2015, Hong Kong ranked the 1st in the world in IPO by raising 33.5 billion USD, despite the fact that it did not get Alibaba. Shanghai ranked the 4th in market cap, and the 3rd in IPO 2015. Shenzhen ranked the 8th in market cap, but the IPO in Shenzhen is negligible at this time.

Let me go to the Hang Seng Index. If you look at this representative index for Hong Kong, among 50 of the largest and most representative stocks in Hong Kong stock market, we have almost 50% of indexes taken up by financial stocks, and 12% of them by IT stocks. Yet, most of the IT stocks component in the Hang Seng Index are represented by Tencent. Properties and construction (like Cheung Kong and Sun Hung Kai) take up another 11%. The telecoms are next (mostly are taken up by Chinese Telecom, following by a small percentage represented by PCCW). We can see Hong Kong stock market is predominated by financial stocks, such as HSBC (10% of Hang Seng Index), AIA (8.4%), etc. Other than HSBC, AIA and Hang Seng Bank, the rest of the stocks are owned by Chinese companies. We can see Hong Kong stock market is basically a Chinese stock market, since 50% of the market share is taken up by Chinese companies. There was recent research showing that 80% of listed companies in Hong Kong derive their earnings from China. Hence, Hong Kong is a place for Chinese businesses to raise money internationally. If we look further at the composition of Hang Seng Index, China takes up 54% of the whole index.

Now, let's talk about Shanghai. The Shanghai index is more evenly distributed. The financials account for 30% of the index, and industrials account for 20%. The interesting part is "Consumer Discretionary", which are the supermarkets, brand names in China, like "Li Ning". Consumer discretionary is a kind of goods which is highly elastic and resistant to economic fluctuation. Another part is health care, accounting for 4.2% of Shanghai index. These are the top financials in Shanghai, where ICBC has the largest market cap in Shanghai.



If we look at Shenzhen, it has an interesting weighting of its composite index. Shenzhen index has a small component in financial sector (only 8%), but it has a huge IT sector (around 22%) and health care sector (10%). It represents the component of businesses that companies in Shenzhen do. We can see businesses in IT, health care, and consumer discretionary are growing in Shenzhen. I believe these are the future businesses in China. If we look at the Chinext (創業版) in Shenzhen, 44% is in the IT sector, 18% in consumer discretionary, and 13% in health care. These are companies which are likely to grow very fast in the future. Then, we look at the Shenzhen SME index. Again, we found that the top three components are IT, health care and consumer discretionary. The structure for SME index is similar than that in Chinext.

What are the differences of investors between Hong Kong and China? In Hong Kong, more than half of the investments come from institutions. Interestingly, when institutional investors come to Hong Kong to buy or sell shares, they can register with the SFC (Securities and Futures Commission) as a collective investment. By doing this, they are exempted from capital gain tax, profit tax and dividend tax, but they have to pay transaction tax (印花稅). As a result, Hong Kong provides a huge tax advantage for investors. Hong Kong also provides an advantage for funds. Pension funds can register themselves as a fund, buy or sell stocks with no tax paid. Even more, they can withdraw their investments at any moment. In Hong Kong, institutional investors only compete with 27% retail investors. In China, investors need to compete with everyone else. Hence, Hong Kong is much more like a western market, very mature market in terms of investors. In comparison, in the Shanghai Stock Exchange, 85% of investments come from retail investors. Another 11% are institutional investors, which are also QFII (Qualified Foreign Institutional Investors). They also have lot of regulations when doing investments. Therefore, investors prefer buying and selling Chinese shares in Hong Kong.

Now, we have the linkages between two markets, such as Hong Kong-Shanghai Stock Connect, and the coming up of Hong Kong-Shenzhen Stock Connect, which will start at early December 2016. The two places have different market architecture. In terms of computer power, both places are doing great on it. Yet, markets are more



than just computer power. They also depend on architecture and how you trade, the kind of trading spreads (the difference between bidding and asking prices in the trading system) that you have. The trading spread in Shanghai is very large; the trading spread in Hong Kong is getting smaller. Thus, trading is more efficient in Hong Kong. The legal system and security laws are robust in Hong Kong. There are big differences on enforcements, laws, market architecture between the two places. We also have different market structures between the two places. Hong Kong has a more inclusive stock market, including derivative market. China used to have a big derivative market before 15 July, 2015. After that, the derivative market almost died out completely. Hong Kong has a rational derivative market, which is based on risk, international market share, and active transactions. Hong Kong's derivative market is well acknowledged around the world. In view of this, I believe Hong Kong still has an important role to play, until the Chinese market gets its act together.

The next ten years: comparing corporate governance

Let me go to the corporate governance. On paper, the corporate governance between Chinese companies and Hong Kong companies are 100% the same. However, the enforcement in China is different than that in Hong Kong. We still have big problems with Chinese companies listed in Hong Kong. This explains why the SFC has employed Dr. Gao Xiaozhen (高小真), who's worked in China and able to bring the Hong Kong enforcement and the Chinese enforcement authorities together.

The next ten years: comparing international perceptions

Let me compare between Hong Kong and Shanghai as international financial centers. This is an international assessment called GFCI (Global Financial Center Survey). GFCI is done at London every year. They asked a few thousand people about how they perceive various cities around the world. You can see that London is always ranked 1st, following by New York, Singapore and Hong Kong. Singapore and Hong Kong often interchange their rankings. Shanghai is ranked 16th, which is not bad. The top 5 financial centers vary over time: Tokyo, London, New York, Singapore and Hong Kong. Someone may ask about the top 20 centers in terms of reputational advantage.

Singapore has very good reputation due to its enforcement and legal system. Interestingly, Qingdao is ranked 2nd. Why is that? It is because Qingdao did well on marketing herself as a center with reputational advantage. Someone may be interested about which 15 centers are likely to become more significant in the next few years. Indeed, Shanghai is ranked 1st. Everyone thinks Shanghai is more important, mainly because Shanghai has the largest foreign trade zone among all cities in China. It received a lot of registrations from foreign banks and institutions.

What are the factors that make up an international financial center? Here are 5 factors: Business environment (a good place to do business), financial development (financing transactions go through quickly and efficiently), good infrastructure (communication, good place to live) and human capital. Shanghai has the largest number of CFA holders in China. This explains why Shanghai has good human capital. Hong Kong also has a large number of CFA charter holders, in terms of percentage of CFA to population. CFA is just one of the metrics. There are other important metrics as well. We will go to those other metrics.

The next ten years: in conclusion

Now, I would like to discuss the changes in the next 10 years. What will happen in the next 10 years? First, RMB has become part of the Special Drawing Rights (SDR) Basket of the IMF. It becomes one of the world reserve currencies. It is the first step to make RMB recognizable internationally. According from the research by the IMF, RMB has 10% share among the five currencies in the SDR basket, putting RMB 3rd largest component in the SDR Basket. I think RMB will become more internationalized in the next 5-year cycle (in 2020). This is because the SDR gets reviewed every 5 years. With the internationalization of RMB, I believe RMB will increase its share in the SDR Basket, which will drive down YEN and Sterling. In the next 10 years, we will see RMB becoming bigger in the world stage. Currently, RMB ranks the 5th in terms of global payment currency, with a small percentage (1.8%). I expect it will grow within the next 10 years.



In terms of usage of RMB, interestingly, Asia-pacific has a high usage of RMB in China trade. I met Jia Qingguo (賈慶國), the Dean of the School of International Studies of Peking University, today during lunch time. He gave a talk about China's geopolitical position in the next decade. He said the most strategical regions of One Belt One Road (OBOR) are the Asia-pacific regions. These regions have robust economics and large population. Indeed, when trading with China, the Asia-pacific regions use 50% of their payment in RMB. In terms of financing the OBOR, there will be more RMB in those regions. As the CNH center, Hong Kong will play an important role in financing, as well as swap markets. A lot of the financing today are done with multiple currencies, including the local currency itself, the USD and the RMB. At this moment, there are 19 banks doing RMB clearing around the world. I expect them will grow like wildfire over the next 10 years. There are also 33 countries which sign RMB swap agreements with China. I expect the number of countries will go up.

The meaning of RMB joining SDR is important. It implies China becomes part of the international financial system. In this case, our banking system, monetary payment system, as well as monetary policy have to become more transparent. We note that RMB has been depreciated over the last 8 months. Interestingly, the purchasing pricing index is going up. This means that people who buy goods from our manufacturers pay more money. These tell us the fundamentals of RMB are still relatively good. Yet, the market considers RMB as a weak currency.

In the next 10 years, we need lots of reforms in China, including financial sector reforms, external sector reforms, less reliance on credit financing, etc. For the financial sector reforms, China developed its deposit insurance system. It has also fully liberalized interest rate. The Central bank has also launched Macro Prudential Assessment (MPA), which is professionally done. For the external sector reforms, we have the SFC Mutual Recognition of Funds in China, as well as the Forex dealing and QFII in China. The reliance of credit is high in China. Our debt to GDP ratio is around 2.3: 1. In other words, we use 2.3 dollars of credit to produce one unit of GDP. An ideal case would be one unit of credit producing one unit of GDP. As a result, we need to have a deeper capital market in China.

The banking credit in China is very high. The total banking assets in China are worth to 120 trillion RMB. Today, the banks in China have the following operating income structure: 74% of their incomes come from loans; 18% from fees and services, and 6% from Forex dealings. Within the next 10 years, the banks have to reinvent themselves. They need to reduce the proportion of their interest income, and increase their fee and commission income. If a bank keeps its interest income high, it has to maintain a lot of capital to sustain its loans. This is because international banking regulation standards require that there is a sufficient ratio between loans and capital. Hence, all banks in China need to enlarge the proportion of their fee-based income, which means there will be more cross-selling, wealth management among the banks.

The banks in China today become financial institutions, unlike traditional commercial banks, which sell securities, wealth management products or insurance. The loans themselves have to be more automated, requiring resources from IT and big data. Automation will reduce the operation cost of the banks. In the next 10 years, the wealth management balance will grow in China. Currently, the wealth management balance is going down, since the banks are more careful about the wealth management products they sell. On the latest Macro Prudential Assessment, the central bank requires all banks to consider the risk of their respective wealth management products, even though such products are sold on an agency basis without directly impacting the banks' balance sheets.

The bond market is worth 47 trillion RMB, equivalent to 40% of China's GDP today. Bond markets in most countries are over 100% of the GDP, so we still have a relatively small bond market in China. As a result, we need to reform our regulatory structure. We have to let people understand the cost of not lifting up our honesty standards. Right now, there is almost no cost to be dishonest, which is a problem. Insolvency reforms will be very essential in the next 10 years. Another issue is the regulatory structure. Currently, the regulatory structure had built in isolation from one another, without much communication. This partly explains the stock market collapse last year. If China wants to advance, the government has to



change its regulatory structure, and ensure that regulation agencies talk to each other. Next stage would be fiscal reform and structural reform. Fiscal reforms mean improvements of budget law, tax systems. Structural reforms refer to the reduction of excessive production in China. Many of the procedures are in progress. As a result, the IMF believes China can still grow substantially within the next decade, both domestically and internationally.

There has been rising consumption and disposable income in China. This explains why household saving and national saving are falling. Rising consumption give business owners incentives to invest. In sometime next year, which I call “turning point”, business owners have to decide whether they will invest or not. At the same time, the saving rate is going up, but fertility rate is going down. Because of this, private consumption is stabilized. Private sector enterprises are awaiting the performance of consumption. When private sector investment increases, this will be the turning point in our economy.

Now, I would like to discuss the financial Development in the next decade. For China, I believe we will see improvements on systemic risk regulations, as well as improvement on functional regulation, picking up loop holes. Both Hong Kong and China will have big derivative markets. Also, banks will lift their fees and commission income. They will also lift their game in FinTech. If they don't, they will lose out to people like Ant-financial or Alibaba. I also expect social security, insurance, pension Funds and other public Asset Management entities to go global in their asset investment allocations.

For Hong Kong, it has the biggest CNH market out of China. So, it has an important role to play in OBOR. Hong Kong also has the largest IPO market in the world, with SOEs and 10,000 New 3rd board companies. All the PE (Private Equity) companies in China end up one way or another in Hong Kong either as a place for a holding company or a place where international deals are done. PEs inspect 3rd board companies, looking for those with the highest potential to succeed. The PE funds and adventure capital funds generally focus on small companies,

which are ample in China. There are tremendous amount of innovations among the younger generation in China. The owners of 3rd board companies are mostly in their late 20s or early 30s. At the same time, Hong Kong has a higher percentage of professionals, compared to the population. So, Hong Kong clearly has a role to play in the developing capital markets in China.

What are the disrupting forces in the next 10 years? One of them could be trade protectionism. Mr. Trump has already stated that he does not like the TPP (The Trans-Pacific Partnership). Hence, we could possibly go into a trade war. Next, we have geopolitical problems, e.g. issues with North Korea, is a complex problem with a big unknown. Besides, we have social issues. A survey from Renmin University shows that there were over 10,000 demonstrations in China in 2015. People feel the pressure, and thus they want to demonstrate. We have a big division between the rich and poor. Furthermore, health issues are substantial over the next 10 years. We will have people with shorter life span or cancer. The following chart shows that the Gini Coefficient in China is very high. It was over 50% three years ago, and it goes down to 46% at the moment. Meanwhile, the currently Gini Coefficient in Hong Kong is 53%. This explains why we have a lot of discontented people in Hong Kong.

In conclusion, I think Hong Kong's financial future will depend on China's development. Hong Kong will continue to play an important and indispensable role as China's window to the international markets. What should Hong Kong do? Simply, Hong Kong must develop its human resources, skills to navigate the markets in China, the region and globally. Hong Kong also needs to keep up its 5 factors that make up an international financial center.

This is my prognosis for Hong Kong, as well as my view of the financial developments in Hong Kong, Shanghai and the rest of China in the next decade. Thank you for listening.



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