Speech by FS at London School of Economics
****

Following is the speech by the Financial Secretary, Mr John C Tsang, on "Hong Kong's Changing Financial Landscape" at the London School of Economics today (October 4, London time):

Sir Howard (Davies), Distinguished Guests, Students, Friends, Ladies and Gentlemen,

Good evening.

It is great pleasure for me to be here at LSE, the prestigious London School of Economics. I am also pleased to be part of your Asian Business and Finance Elite Series.

For decades, many of Hong Kong's brightest young minds have been attending LSE. I'm pleased to see that this trend is continuing today.

And how impressed I am with LSE's interest in Hong Kong and your knowledge of our city.

I am truly impressed, but I am not altogether surprised.

Over the years – roughly 150 years –, Hong Kong has evolved from what was once famously described by Lord Palmerston as a "barren rock" into an international business and financial centre. And we are still evolving at quite a pace.

Our unique and rapid development makes Hong Kong an interesting test case for economists around the world.

The late Milton Friedman was particularly enthusiastic about Hong Kong's philosophy of a free economy.

Mr Friedman once said, and I quote: "If you want to see capitalism in action, go to Hong Kong." End quote.

He had long argued that economic freedom is key to economic prosperity. Hong Kong, recognised as the world's freest economy by both the Heritage Foundation in the US and the Canada-based Fraser Institute, seemed to prove his point, rapidly transforming itself into a wealthy metropolis.

Some of the attributes that help define our economic freedom – in no particular order – are :

* Free flow of ideas and information including free speech and a free and unfettered media;
* Free flow of capital with a freely convertible currency;
* Free flow of talent through liberal immigration laws;

*Low and simple tax system with profits tax capped at 16.5 per cent and salaries tax at a top rate of 15 per cent. We have no VAT, no GST, no death duties, no capital gains tax and zero wine duty; and
* have a highly transparent regulatory environment.

Despite these economic freedoms, and perhaps because of our open and externally-oriented economy, Hong Kong has not been spared a direct hit from the global financial crisis over the past couple of years.

I am pleased to say that, today, our economy is back on its feet. Unemployment has returned to pre-crisis levels of just over 4 per cent, (4.2%), and we are forecasting robust GDP growth for this year of between 5 and 6 per cent.

Hong Kong remains third in the City of London's latest Global Financial Centres Index published last month. The Index also shows that Hong Kong has been gaining ground in this last round, but our competitors are pursuing us forcefully seeking to close the gap. And so there is no room for complacency.

So how has the global financial turmoil affected Hong Kong as an international financial centre, and what do these changes mean for the rest of the world?

I shall discuss this from four main perspectives.

First, the local perspective – what are the lessons learned during the financial crisis.

The second point is cross boundary collaboration how we should grasp new opportunities to strengthen financial ties with our neighbours in the Guangdong province and throughout our immediate hinterland – the dynamic Pearl River Delta.

As an extension, point three will discuss our closer financial integration within our nation China since the onset of the global financial tsunami.

The fourth and final area is our growing international connectivity – a key area for Hong Kong's small and outward looking economy.

First, the domestic front.

Financial services is one of the four pillar industries of our economy. The others are trade and logistics, tourism and professional services.

Our financial services sector learned valuable lessons during the Asian financial crisis more than a decade ago. Since then, we have enhanced our regulatory framework, making sure that our banks were well-capitalised and exercised prudent lending practices.

This work helped shield our economy from the global financial crisis, during which none of our banks failed and the financial services sector remains in relatively good shape.

However, new lessons need to be learned. In particular, the global financial crisis highlighted the vulnerability of investors to risky products, suspect sales tactics and unrealistic financial goals.

One thing we need to do is to provide better protection for investors. If he were alive today, "investor protection" is a term that Milton Friedman probably would not like to hear from Hong Kong, but it is a sign of the times – and Hong Kong is not alone. Not that we are leaving behind the "Caveat Emptor" plaque, we are actually seeking to empower our investors to make the right choices.

Britain has proposed establishing the Consumer Protection and Markets Authority and, in the US, there is the new Consumer Financial Protection Bureau.

In Hong Kong, we have proposed setting up an Investor Education Council which we hope will begin operating soon after the legislative amendment to be introduced next year as well as a Financial Dispute Resolution Centre which is expected to come into operation by end of April 2012. The latter will help investors settle their disputes with financial institutions through a simple and quick resolution mechanism.

We have also proposed legislation that will require listed companies to make available more information for investors to make better-informed decisions. This will also enhance the transparency and quality of our equity market.

During the financial tsunami, we introduced a 100 per cent bank deposit guarantee to maintain confidence in our banks. This full deposit guarantee will expire at the end of this year. From next January, our regular deposit protection scheme will be enhanced, under which the protection limit will be increased five-fold to HK$500,000. The enhancement will facilitate a smooth exit from the full deposit guarantee, while continuing to give people peace of mind regarding their bank deposits.

For the insurance industry, we are considering establishing an Insurance Policyholders' Protection Fund. The aim is to improve insurance market stability and safeguard the interest of policyholders should an insurer default.

We are also consulting the public on the establishment of an Independent Insurance Authority. This would bring Hong Kong more in line with international practices and enhance the protection of policyholders.

All this will help to strengthen investor confidence and establish a warning system that would sound an alarm in a timely manner.

Now to my second point – cross boundary collaboration.

Hong Kong's relationship with neighbouring Guangdong province has been the lifeblood of our city from the early days of its development.

Our strategic location at the crossroads of global trade, in the heart of East Asia and on the southern tip of China has made us a special place for commerce.

Today, it is impossible to talk about post-financial crisis Hong Kong without mentioning the China factor.

In January 2009, the Central Government in Beijing unveiled plans to establish the Pearl River Delta, including Guangdong Province and the Special Administrative Regions of Hong Kong and Macao as one of the most competitive regions in the world.

In April this year, these ambitious plans took a giant leap forward in the form of the Framework Agreement on Hong Kong/Guangdong Co-operation. Signed in Beijing, this is the first agenda on Hong Kong/Guangdong co-operation to be endorsed by the State Council.

The key to this accord is that it breaks through the invisible barriers that stand in the way of the joint development of Hong Kong and Guangdong.

The Framework Agreement covers a range of specific policies and facilitates the free flow of people, goods, capital and information. Importantly for financial services, it supports the establishment of cross-boundary subsidiaries for financial institutions from Hong Kong.

Under the Agreement, Governments and financial regulators of both Hong Kong and Guangdong will also be able to explore certain specific work plans including exploring new arrangements for bank financing, and issue of Renminbi bonds in Hong Kong by Guangdong enterprises, and encouraging more Guangdong companies to list on the Hong Kong stock market.

Currently, Mainland Chinese companies make up about one third of the companies listed on our stock market, which is the third largest bourse in Asia and seventh largest in the world by market capitalisation.

Many of these initiatives will be for "early and pilot implementation" with a view to being expanded throughout our nation.

This leads to the third point – closer integration throughout Mainland China.

At a time when markets in Europe and the US are still feeling the pinch from the global financial turmoil, Asia, and in particular China, have been relatively resilient to the economic downturn.

Reflecting the emergence of a new global economic order, economists are discussing not whether but when the Mainland currency, the Renminbi, will become an international currency, and perhaps even in the longer run, a reserve currency.

As China's most important international financial centre, the internationalisation of the Renminbi is an area that will be vitally important to Hong Kong.

While the Central Government maintains a closed capital account and tight monetary controls in the Mainland, Hong Kong has a distinct advantage under the "One Country, Two Systems" principle. We maintain our own freely convertible currency and, at the same time, we have been able to establish a broad-ranging infrastructure for offshore Renminbi business.

Renminbi banking in Hong Kong began in 2004 and has been gathering momentum since then. Today, some 80 banks (77) offer Renminbi banking services including deposits, remittances, credit cards and checking accounts. In Hong Kong, total Renminbi deposits amount to over RMB130 billion.

A major recent development has been the expansion of Renminbi trade settlement scheme.

It was only in July last year that the Central Government began testing the water for currency liberalisation by introducing a Renminbi trade settlement scheme.

The scheme started with Hong Kong, Macao and the 10 ASEAN (Association of South East Asian Nations) economies being able to settle trade in Renminbi with five cities in the Mainland.

On June 22 this year, the scheme was significantly expanded. The Central Government announced that businesses all around the world would be able to settle trade with the Mainland using Renminbi. At the same time, Mainland locations covered by the scheme were increased from just five cities to 20 provinces and cities.

In the first half of this year, the People's Bank of China estimated cross-border trade settlement in Renminbi at more than RMB 70 billion, which is more than 8 billion Euros. Hong Kong accounted for some RMB 53 billion, or about three quarters of the total.

This is a positive start and there is huge potential for further growth. Today's figures represent just a drop in the ocean, when you consider that the Mainland's total external trade topped RMB 15 trillion [Euros 1.7 trillion] last year.

Hong Kong has the full backing of the Central Government in developing an offshore Renminbi business.

Our freely convertible currency, deep pool of local and international financial talent and cluster of international banks makes Hong Kong an ideal conduit for the wider use of Renminbi outside the Mainland.

As demand for Renminbi inevitably grows, Hong Kong's attributes as a free and open economy and ability to handle overseas liquidity will help avoid causing undue shocks to the Mainland's evolving financial market.

A particularly dynamic growth area has been Hong Kong's Renminbi bond market. So far, there have been a total of 16 Renminbi bond issues in Hong Kong with a combined value of more than RMB 40 billion [4.6 billion Euros]. Also, last year, the Central Government issued its first sovereign bonds in Hong Kong worth RMB 6 billion [700 million Euros]. This was a big "Thumbs Up" for Hong Kong's financial sector.

Most of these Renminbi bond issues have been well over-subscribed, indicating strong demand from investors both locally and overseas.

This brings me to the fourth and final part of my talk. How can Hong Kong play a greater role in the international financial community?

I have already mentioned the expanding Renminbi bond market and its attractiveness to local and international investors. I have also talked about the Renminbi trade settlement scheme and Hong Kong's strength as a Renminbi trade settlement centre.

We will continue to encourage more overseas companies to use Hong Kong as a centre for settling their Mainland trade in Renminbi, instead of using a third currency.

Hong Kong was also the first place outside the Mainland to have an interbank market for Renminbi. In addition to this development, businesses anywhere in the world can now open an account in Hong Kong and freely exchange Renminbi.

All this activity is giving rise to a greater range of financial products in the marketplace.

Another area we are developing is Hong Kong's potential as a capital-raising centre for overseas businesses.

You need look no further than the "Golden Arches" of a familiar American fast food chain for a sign of our changing times.

In Hong Kong on August 19 this year, McDonalds Corporation, became the first non-financial foreign company to issue a Renminbi corporate bond. Even though the issue was a mere RMB 200 million, this represents the start of a whole new funding channel for overseas companies looking to raise capital for their China operations.

We also see great potential in encouraging more foreign companies, especially from emerging economies, to list in Hong Kong.

Russia is one such market. Not only is Russia a geographical neighbour of China, it is also a primary commodities exporter while China is a major consumer of commodities.

In January this year, the aluminium company UC Rusal became the first Russian firm to list on the Hong Kong stock market, raising US$2.2 billion [Euros 1.6 billion]. If you believe what you read in the newspapers, a number of other Russian firms are also considering listing in Hong Kong.

Not only are the Russians coming, many other companies have also expressed great interest. Indeed, we welcome firms from all over the world to tap Hong Kong's fund-raising potential, including British companies.

Ladies and Gentlemen, when our Chief Executive, Mr Donald Tsang, spoke here in this same lecture theatre in November 2008, he talked about the challenges and opportunities presented by the onset of the global financial crisis.

I am pleased to have had this chance to tell you about some of the ways we have been turning those challenges into opportunities over the past two years.

We have been learning new lessons from the financial crisis, building stronger links within our nation and reaching out to new markets around the world. I am confident that Hong Kong will continue to play a major role as a global financial centre alongside London and New York.

I wish you all every success with the Asian Business and Finance Elite Series. I also hope you will come visit Hong Kong soon to see for yourselves some of the remarkable opportunities in our part of the world. Seeing is believing, and if you should find it convincing enough to believe, you may be interested in staying on with us in Hong Kong and meeting these remarkable opportunities head on.

Thank you very much.

Ends/Tuesday, October 5, 2010
Issued at HKT 01:19