Reconnecting China

Keynote speech at ASIFMA China Capital Markets Conference

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Good morning. It's my pleasure to be here today at ASIFMA's China Capital Markets Conference.

After years of COVID restrictions, I finally travelled to Beijing twice this year, in March and April. I saw a bustling metropolis home to 20 million people, with a unique blend of glistening modernity and profound history. I also met government officials eager to get the economy back on the growth track and financial executives brimming with ideas to expand overseas. All of them expressed a keenness to use Hong Kong's platform to connect with the rest of the world.

So today, let me talk to you about the strategy to reconnect with China.

Complex operating environment

As the nation re-opens its borders, many of us in Hong Kong are looking for a breath of fresh air in 2023. Indeed, our data for the first quarter show signs of hope. The licensed corporations under major investment banks saw their net profits before tax jump twofold over the previous quarter. Total income also rebounded by a high single-digit percentage.

However, we can only be cautiously optimistic for now. The pandemic may no longer make the headlines, but geopolitical tensions seem here to stay. Large economies continue to lock horns, and the war in Europe is ongoing. Global inflation once spiralled out of control, and to tame it, policies took a U-turn to quantitative tightening and rate hikes. Then came the US digital bank runs followed by the collapse of a major global bank. Through these turbulent times, our capital markets and licensed firms have shown remarkable resilience, thanks to their rigorous risk management measures.

Rethinking strategy for the new landscape

Of all the risks we face, many of you told me that geopolitical risk is the most difficult to navigate. There has been some talk in major Western economies about de-risking China, but one should not forget that China's capital markets have become too big to be ignored and too integrated with the rest of the world to be decoupled.

Globally, Shanghai and Shenzhen stock markets combined have raised the largest amount of funds from IPOs so far this year and also last year. China also accounted for 33% of international bond issuance in Asia last year. Foreign investors now hold more than RMB3 trillion in Mainland bonds and RMB3 trillion in A shares.

At the same time, the value of US Treasuries held by Mainland investors amounted to US$868.9 billion as of April this year. Mainland commercial and policy banks, which are among the world's largest, provide more than US$400 billion in loans to non-financial institutions overseas. And in the past three years, global leading financial institutions have set up more than 10 wholly-owned securities firms, mutual fund companies or futures companies onshore.

Undeniably, there have been temporary setbacks in recent years caused by multiple factors ranging from the pandemic to adjustments in industry-specific policies and geopolitics. But the direction of travel is clear – China will continue to integrate with global capital markets. Hong Kong has played a critical role in Mainland's capital market opening from the beginning, with northbound trading under Stock Connect now accounting for roughly 70% of capital inflows into the Mainland. This intermediary role will not change; it will only expand despite the current tough environment. And our strategy has proven to be agile enough to move with the times.

A uniquely positioned fundraising centre

The first part of our strategy to reconnect with China is about Hong Kong as a fundraising centre. In recent years, the SFC and the Hong Kong stock exchange adapted the listing rules to facilitate more listings of Mainland enterprises. New listing regimes such as the weighted voting rights (WVR) structure, the "homecoming" of China concept stocks and the biotech regime have helped finance China's booming new economy and deepen the pool of growth stocks in the Hong Kong market.

New-economy stocks now account for about 40% of our equity market capitalisation and 44% of market turnover, both doubling from 2017. Hong Kong has become Asia's largest fund-raising centre for biotech firms. In addition, about 80% of the overseas-listed China concept stocks have come here for either a dual primary or secondary listing.

We must therefore keep our regulatory approach agile to open the door to future opportunities. We believe our latest listing regime for specialist technology companies will help finance China's economic transformation and provide fertile ground for technology start-ups to fast-track their growth. In addition, we are working to diversify our sources of listings and attract enterprises from the Middle East, Southeast Asia and elsewhere in the region.

Connect schemes with Mainland markets

Second, we must further deepen our Connect schemes with Mainland markets. Since the launch of the first of the Connect schemes nine years ago, they have provided efficient channels for global investors to access Mainland markets. Hong Kong Exchanges and Clearing Limited provides international rules and practices which global investors are familiar with, giving them the comfort to strategically diversify allocation to different enterprises, economic sectors and investment products across the Mainland and Hong Kong markets; in other words, to comprehensively tap into China's growth story.

Stock Connect net inflows have been strong since its launch in 2014, and cumulatively they have now reached RMB2.3 trillion southbound and RMB1.9 trillion northbound. Eligible stocks now cover more than 80% of equity trading in Hong Kong and Mainland markets. Southbound trading daily turnover has averaged more than HK$27 billion, with investors favouring large-cap Mainland stocks in the communications, energy, financials, consumer and

IT sectors. So far this year, the biggest net buy sectors are communications, healthcare and energy.

Just a year ago, ETFs were added to the Connect family and this has been an instant success. In April, southbound trading has made up about 20% of the average daily turnover of eligible Hong Kong ETFs. Northbound global investors also stand to benefit from the many eligible A-share ETFs spanning divergent industries and themes.

And the story of Connect is just unfolding. The SFC is striving to reinforce Connect as a key long-term strategy to create value for investors. We are looking into block trading and other trading practices to improve efficacy. For many other schemes, including Wealth Management Connect, we are working to make enhancements and relax some requirements in the near term. On our own market, we are also set to add more derivatives contracts with Mainland assets underlying. Stay tuned.

Renminbi internationalisation

Third, Hong Kong has come a long way to evolve into the offshore renminbi hub that it is today. Investors now enjoy access to a range of renminbi investment products in Hong Kong, backed by our deep renminbi liquidity pool. The city must continue to enhance its pivotal role in the renminbi's road to internationalisation.

The last two decades of development can be divided into three phases. The first phase started in 2004 after the SARS epidemic, when personal renminbi business was launched in Hong Kong. The second stage took off in 2009, after the global financial crisis, as the Mainland allowed the use of renminbi to settle cross-border trade. The city's renminbi business then expanded to enterprises and renminbi flows became bilateral.

The golden era started in 2014. The launch of the Connect schemes catalysed the renminbi's increasing offshore adoption. This enabled its free circulation between Hong Kong and the Mainland in a closed loop, and fuelled the city's rise as an offshore renminbi hub.

We anticipate the renminbi will gain further traction as an international investment and reserve currency as US dollar funding costs go up and political alliances shift. The SFC is pulling its weight to enhance Hong Kong's role in this process. We are already seeing a much larger volume of RMB bond issuances.

Just a week ago, the Stock Exchange launched the Dual Counter Model to facilitate trading of Hong Kong stocks in renminbi, a choice that had been under-utilised. While the average daily turnover in the first week came in small at about RMB197 million, which was not unexpected, this is a meaningful start to build our ecosystem, prime our financial infrastructure and develop practices to expand listed renminbi products.

We have seen that market making for more liquid renminbi-denominated stocks is functioning as designed, with bid-ask spreads narrowed to around 1-2 ticks and the RMB prices tracking the HKD prices closely. Building up the ecosystem takes time, but we expect trading to be more active once southbound investors with surplus renminbi can access the renminbi counter through Stock Connect.

Sustainability and innovation

Fourth, Hong Kong has been at the forefront of sustainability and innovation for financial markets and we will continue to keep pace.

Just yesterday, the International Sustainability Standards Board (ISSB) under the IFRS Foundation launched its inaugural standards for corporate sustainability disclosures. When the standards are adopted globally, banks, fund managers and asset owners would have a set of comparable and consistent corporate information to help them allocate funding and price sustainability risks to meet their obligations to stakeholders and regulators. I understand the final standards and the accompanying adoption guidance have flexibilities to allow jurisdictions to scale and phase in the requirements. We welcome the ISSB standards and will study them closely with a view to proportionate implementation in Hong Kong.

The ISSB standards can serve as a common language between real economy corporates and the capital markets to communicate sustainability considerations. As Mainland firms account for about 80% of equity market capitalisation in Hong Kong, we urge companies to take advantage of this communication medium, especially if they do not want to be bypassed by international capital.

We also cannot underestimate the immense task for China to meet its commitments to achieve an emission peak by 2030 and net zero emissions by 2060. By aligning ourselves with the ISSB standards, Hong Kong plays a critical role in channelling global resources to companies on the Mainland and in the rest of Asia to fund the low-carbon transition. To this end, a whopping US$66 trillion in investments will be needed in Asia over the next 30 years, according to ASIFMA's recent report. Those of you from global intermediaries do not want to miss out on the huge transition finance opportunities.

On the innovation front, we see financial technology as essential to raise market efficiency and transparency and lower costs for operators. The SFC's new regime to regulate virtual asset trading platforms is part of our strategy to promote the responsible use of fintech. To extend these efforts, we aspire to use fintech to drive green finance and build Hong Kong into a hub for both green finance and fintech.

The next chapter

Ladies and gentlemen, our capital market journey to China is never short of setbacks. But from every challenge, Hong Kong bounces back with greater resilience. Coming out of SARS years back, the city staged a multi-year boom riding on China's economic miracle. Coming out of COVID, China may still face some headwinds, but it has re-opened and refocused on economic development. So, we must be patient and clear-headed about our strengths, stay agile in our strategy and gear up for a new chapter in our story of connecting with China.

I hope you all enjoy the conference. Thank you.